KING & SPALDING

Client Alert

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Timely Reminders to Avoid Inadvertent Tipping Liability

Just in time for the annual season of work holiday parties and family gatherings, the United States Supreme Court unanimously confirmed that leaking material non-public information to a close relative who then trades in securities can put both of you at risk, even if the relative does not repay you for the tip.[1] On December 6, 2016, in *Salman v. United States*, the Court held that a tipper's gift of confidential, inside information to his brother constituted a sufficient personal benefit to support an insider trading conviction of the brother's friend (who had also married the tipper's sister), without additional proof that the tipper received money, property, or something of tangible value in exchange for the tip. Although the opinion was narrowly decided, its reasoning is consistent with prior Supreme Court statements and seems likely to extend beyond relatives at least to include cases involving close friends.[2]

The *Salman* decision provides us an opportunity, once again, to remind well-meaning directors, executives, lawyers, consultants, and others privy to confidential business developments of just how important it is to talk about something else during the holidays.

Some people intend to violate the law, and this article is not aimed at those people (other than to say don't do it). Rather, as in our prior annual installments,[3] we highlight here some lessons from cases in the past year involving people who may have been caught up in circumstances they never intended. These "inadvertent tippers" undoubtedly wish they had never shared material non-public business information, that their friends or family members never traded, that government investigations had not ensued, and that no one had been charged. We hope that learning from their unfortunate experiences will help keep you and yours safe this holiday season.

Do Not Share Business Secrets or Answer Intrusive Questions About Your Work, Even from Parents or Other Family Members.

Sharing information with family members can seem natural in close families, particularly when family members trust each other. Parents of young professionals can be so proud of their son or daughter and may ask incessant questions about how work is going, what the young professional is working on, how she or he is being treated, and what's coming up in the schedule. Sons and daughters may offer up otherwise secret information to parents, knowing how curious the parents are and trusting that their parents would never put themselves

For more information, contact:

Dixie L. Johnson
+1 202 626 8984
djohnson@kslaw.com

Alana L. Griffin
+1 404 572 2450
agriffin@kslaw.com

Matthew B. Hanson
+1 202 626 2904
mhanson@kslaw.com

King & Spalding LLP

Washington, D.C.
1700 Pennsylvania Ave., NW
Washington, D.C. 20006-4707
Tel: +1 202 737 0500
Fax: +1 202 626 3737

Atlanta, GA
1180 Peachtree Street
Atlanta, GA 30309
Tel: +1 404 572 4600
Fax: +1 404 572 5100

www.kslaw.com

or their children at risk by taking advantage of the information for personal gain. But the primary lesson from 2016 is to talk about something else.

The allegory for this lesson comes to us from health care mergers-and-acquisitions banker Sean Stewart, whose father was charged with insider trading based on information that Mr. Stewart provided about six upcoming mergers.[4] Although some tippers are not themselves charged, particularly when the facts demonstrate that the trader misappropriated (or "stole") the information, in this instance Mr. Stewart was charged criminally with illegally tipping his father.

Taking the witness stand in his own defense, Mr. Stewart told the jury that his father had betrayed him by using information that came up casually during their conversations about Mr. Stewart's work.[5] Mr. Stewart testified that he had a close relationship with his parents and that he discussed the deals he worked on with his parents and with his now-former wife. Mr. Stewart said he confronted his father when he learned that his father had traded in securities of a company before a pending transaction was announced.[6] He added that he was "confused, ashamed and taken aback" to learn about his father's trades and that he "wanted to know why [his father] would do something so stupid."[7]

Of course, it would have been a better idea not to have shared information in the first place. But once Mr. Stewart made that first mistake, learning of his father's trading could have prompted him to stop confiding in his father about business secrets. It appears, however, that the young banker continued to discuss material non-public information about subsequent deals with his father. At his trial, the son said, "I know now the consequences have been severe, but at the time, it felt completely natural to have open discussions with my parents."[8] Indeed, the consequences were severe: Mr. Stewart's father pled guilty, and Mr. Stewart is expected to receive jail time for his conviction. It is clear that neither the government investigators nor the federal jury at his trial agreed with Mr. Stewart that these open discussions were "natural."

If You Share Information and Are Quizzed About It Later, Tell the Truth.

Yet another lesson from Mr. Stewart's circumstances is to tell the truth if your employer ever asks about possible trades by your friends or relatives. The government bolstered its case by alleging that Mr. Stewart lied by not flagging his father among a list of people who traded in advance of one of the transactions.

Self-regulatory organizations often raise questions if they observe aberrational trading in a company's stock. Following a merger announcement involving a NASDAQ company, for example, FINRA commonly sends letters to the listed companies, requesting a chronology of events leading to the announcement and a list of people at the company and within its service providers who knew about the planned merger before it was announced. After the company responds, FINRA may follow up with a second letter asking whether any of the listed people can identify persons or entities from another list provided by FINRA—presumably people and entities who traded in the issuer's securities before the announcement. Anyone who knew about the merger before the announcement and who also recognizes a person or entity on the trading list may become a witness in any subsequent government investigation about possible insider trading.

Mr. Stewart admitted during testimony that he lied when his investment bank employer confronted him about trades in one company. Based on the SEC's and U.S. Attorney's complaints, it appears that Mr. Stewart had been identified as a person who knew about the corporate transaction before it was announced, saw his father's name on a subsequent list, and did not tell his employer about the relationship or that he had shared information with his father. Mr. Stewart testified that he was not forthcoming to his employer because he wanted to protect his career and his father.[9] His efforts at protection backfired, though. His omissions made things worse.

Even if You Anticipate a Career-Changing Acquisition, Keep It Under Wraps Until the Deal Is Announced.

Executives of target companies often feel as if their lives have been thrown into turmoil, and people close to them may sense the change. Another reminder from the cases of 2016 is to avoid discussing potential career trauma until after the merger or other extraordinary corporate event has been announced. This lesson comes from SEC cases against two groups of traders who took advantage of separate, apparently unwitting leaks from insiders at GSI Commerce, Inc., a Pennsylvania-based company acquired by eBay.[10]

Do Not Tell Your Buddies. One GSI executive allegedly confided in a friend, Robert Munakash, at the 2011 Super Bowl and related GSI-sponsored events in Dallas, which Mr. Munakash attended as the executive's guest.[11] The executive and Mr. Munakash had been friends for many years, belonged to the same private club, vacationed together, and historically had shared with each other the challenges of their respective jobs, along with details about their families and personal lives. The SEC said the executive understood Mr. Munakash's disclosures were confidential and that he expected Mr. Munakash, in turn, to maintain the secrecy of any information that the executive shared.

But according to the SEC, instead of keeping his friend's secret, Mr. Munakash returned from the Super Bowl trip and immediately tipped the information to a friend and to his broker. All three purchased GSI shares that same morning. When the acquisition took a while to materialize, Mr. Munakash allegedly probed the executive for more information during the executive's own birthday dinner. Following the dinner, Mr. Munakash and his friend both purchased more GSI shares. The SEC charged Mr. Munakash, his friend, and his broker with securities law violations. While the defendants initially challenged the lawsuit, the SEC's complaint survived the motion to dismiss stage. All three defendants ultimately settled. [12]

The executive was not charged, but this was undoubtedly costly to him and to his employer. The emotional toll of a friend's betrayal would be bad enough, but based on the normal course of these investigations, the executive probably was personally investigated by his company and the government to determine whether his own conduct was a problem, ranging from violation of company policy to potential criminal tipping. His employer would have born the cost of its own internal investigation, as well as the costs of producing documents and information in the government's investigation. This is not the way to develop your reputation in a newly merged company.

If You Tell Your Spouse, Make It Abundantly Clear that the Secret Stops with Him or Her—Otherwise, It Might Not. It may be unrealistic to expect that insiders will never share confidential work information with their spouses. That, of course, would be the safest approach. But if anyone is going to ask about your extra work travel and long hours spent at the office, it is likely to be your husband or wife, who need to understand how crucial it is that they not spread this information around. The second group charged this year in connection with trading ahead of the eBay-GSI merger began with just such a conversation among spouses.[13]

According to the SEC, an insider at GSI told his wife about the possible deal. She then, unfortunately, allegedly shared that news with her close friend, Patricia Zajick Metzler. The SEC's charging documents explained, "Patricia understood as [the wife's] friend that the information she received from [the wife] was confidential." Ms. Metzler nevertheless tipped her husband, her father, and another friend about the deal. Although Ms. Metzler did not trade, the three people she tipped allegedly purchased GSI shares. Keep in mind that each of the traders heard the news second-hand—the GSI executive who initially divulged the news did not directly tip any of them. When tips are passed around second- or even third-hand, any trading done based on the tipped information has the potential to create headaches and liability for everyone involved in the chain.

Again, the GSI insider was not charged, and neither was his wife, presumably because they were credible in explaining that they shared the information fully expecting it to remain confidential. Even so, the traumas of the investigation undoubtedly were severe. Ultimately, Ms. Metzler, her husband, and Ms. Metzler's father agreed to pay disgorgement and fines to settle the allegations. The friend who traded on Ms. Metzler's tip—who was apparently a law student at the

time of the trading—agreed, in a separate settled administrative order, to disgorge $1,083, with $159 of prejudgment interest, and to pay a $1,083 civil penalty.[14] One might question whether it is a good use of government resources to bring a case for that small amount of money, but it certainly sends an important message: the government may charge anyone they determine has violated the law, even if the proceeds amounted to scarcely more than a semester's worth of textbooks.

Expect the Worst from People You Love.

Trusting family members and friends is important, but it's better not to test that trust by sharing business secrets. Financial troubles and other exigent circumstances can sometimes lead otherwise trustworthy people to trade on information they know should be kept secret.

In June, the SEC filed civil charges in federal court against Andrew Kerr, the brother of an executive at Florida-based AuthenTec, which Apple acquired in 2012.[15] The SEC alleged that the brothers had a close relationship with their mother, and that the executive confided in his mother about the upcoming acquisition. Although this was a risk, there is no allegation that the mother traded based on that information. However, the mother then allegedly told her other son, Andrew Kerr, about the upcoming merger. That did not go well, as Mr. Kerr allegedly amassed holdings in AuthenTec stock by trading on margin, draining his checking and savings accounts, and opening a brokerage account in another family member's name.

The SEC alleged that both the executive and the mother presumed the information they shared would remain confidential. As with most insider trading investigations, this one was intrusive, as evidenced by the SEC's allegations about Andrew Kerr's historical topics of conversation with his mother: "Among other things, they typically have discussed his children, his wife, his marital status, his house, his employment, his finances, his enrollment in graduate school in 2012, and other private family matters." The complaint also included details about Mr. Kerr's finances, noting that he supported his wife, three children, and his mother-in-law on his salary as a pharmacist. "After paying his monthly mortgage, credit card bills, and other living expenses, little was left over." The SEC charges in this case underscore that there is no "making-ends-meet exception" to insider trading liability.

Insider Trading is Not Just a Private Sector Risk; Government Employees Can Become Tippers, Too.

This is the first year we have included government officials among the list of our intended readers. It should come as no shock, however, that the SEC and criminal authorities see federal regulatory employees as "insiders." They often harbor knowledge regarding when drugs and other products are licensed for sale, when transactions are granted government approval, or how pending regulations might affect certain companies or industries.

In June, the Manhattan U.S. Attorney's Office charged portfolio managers, a political intelligence consultant, and others in a scheme where the consultant, Gordon Johnston, allegedly lured confidential information from employees at the U.S. Food and Drug Administration.[16] Mr. Johnston, whom the government styled as the initial misappropriator, was charged on June 13, 2016 and pled guilty.[17] According to the charging documents, the portfolio manager instructed Mr. Johnston—himself a former FDA official—to obtain confidential information from FDA employees about generic drug applications. If such applications are approved, they typically result in an increase in the generic drug company's stock price and a drop in the stock price of the company making the patented name-brand drug.

Mr. Johnston allegedly obtained confidential information from a long-time friend and former colleague at the FDA regarding progress with an application for a generic version of the drug Lovenox. The FDA employee remained anonymous in the charging documents, which stated that Mr. Johnston had worked with the FDA employee for 12 years and had cultivated a mentor-mentee relationship with the FDA employee. The two stayed in touch in part due to Mr. Johnston's continuing work together on a trade association. Based on that "relationship of trust and confidence," the government alleged that Mr. Johnston understood that the FDA employee expected Mr. Johnston to maintain the

confidentiality of the information. Instead, Mr. Johnston passed the information on to the portfolio manager, who ultimately made approximately $25 million by simultaneously betting for the generic drug-maker and against the company that sold name-brand Lovenox.

Mr. Johnston and others were also charged by the SEC in connection with the scheme.[18] In its complaint, the SEC stated that Mr. Johnston concealed from the FDA employee that he was seeking information on behalf of the portfolio manager. He was "careful not to ask questions that would reveal he was calling on [the portfolio manager's] behalf or on behalf of any investor."

The lesson from this case applies equally to former work colleagues from the government and from the private sector. Once colleagues exit, you should not update them on what happens after they leave the job. In addition to the prohibitions created by post-employment ethics rules and/or company policies, the SEC may view a conversation with your former colleague as a tip of potentially market-moving confidential information.

Document Non-Disclosure Agreements Before Sharing Non-Public Information.

Finally, along with cases involving family, friends, and former colleagues, government investigators sometimes plead tipping cases involving business counterparties, where one side believed information was being shared in confidence and the other side traded on the information anyway. If you want to make it clear that a conversation should remain confidential, it is helpful to get agreement on that fact in writing before having the discussion. Doing so increases the likelihood that all parties are on the same page, and the clarity of the written agreement may deter wrongdoing. It also may serve as evidence of a contractual duty, should the government ever scrutinize how the trading party learned about confidential news before it was disclosed to the broader market.

In September, the SEC filed charges against hedge fund manager Leon Cooperman and his firm Omega Advisors, after Omega traded in Atlas Pipeline Partners securities ahead of a natural gas processing facility sale. The government alleges Mr. Cooperman learned about the sale ahead of the market, during confidential discussions with Atlas management.[19] While Mr. Cooperman is challenging the lawsuit, the SEC claims he learned about the sale in one of several phone calls he had with an Atlas executive in January 2010. The complaint stated that Mr. Cooperman "explicitly agreed that he could not and would not use the confidential information" to trade Atlas securities but then "illegally capitalized" on the information by purchasing Atlas securities in advance of the public disclosure. The SEC does not, however, cite to any written non-disclosure agreement.

Atlas management has not been charged, but they undoubtedly have been caught up in the unpleasantness of the investigation, at a minimum. From a corporate insider's point of view, this case reflects the perils of sharing material non-public information, even with the company's largest shareholders, without first obtaining a written non-disclosure agreement.

Conclusion

In last year's installment, we predicted that, even during a period when insider trading law appeared to be in flux, the SEC would continue bringing and prevailing in cases where the tippers and tippees were immediate family members or close friends. This year's cases bear out that prediction. Notably, all of the cases discussed in this client alert were announced before the Supreme Court's unanimous *Salman* decision, which makes it easier for the government to meet its burden in tipping cases. Looking forward, given this vote of support for the government from the Supreme Court, we anticipate the number of insider trading and tipping cases will only continue to grow.

We hope this year's cases provide useful lessons from 2016 insider trading and tipping cases and serve as a useful reminder to talk, and laugh, about something other than confidential business information during this holiday season and beyond.

One last tip (pun intended): this is a great time for companies to consider updating their insider trading policies to reflect the *Salman* decision. Many corporate policies focus more on trading than they do on tipping. This year's cases, including *Salman*, are useful in reminding executives, employees, and directors once again of the dangers of talking shop outside of the office. Checking for a sufficiently broad definition of "tipping," providing examples to remind employees of the dangers of sharing corporate information, encouraging use of written non-disclosure agreements—all of these can deter information leaks and save everyone the pain of investigations in the future.

Happy Holidays!

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[1] *Salman v. United States*, No. 15-628, slip op. (Dec. 6, 2016).

[2] Alec Koch, Matthew Baughman, Dixie Johnson, Carmen Lawrence, and Erin East, *In Salman v. United States, Supreme Court Holds that the Government Need Not Prove that an Insider Received a Pecuniary Benefit in Exchange for Tipping Inside Information*, King & Spalding Client Alert (Dec. 7, 2016), http://www.kslaw.com/imageserver/KSPublic/library/publication/ca120716b.pdf.

[3] This Client Alert is part of a series of articles on the subject of inadvertent tipping. *See, e.g.*, Dixie L. Johnson & Matthew B. Hanson, *Post-Newman Reality: Investigations Involving Unwitting "Tips" to Close Friends and Relatives Will Continue*, King & Spalding LLP Client Alert (Oct. 8, 2015), http://www.kslaw.com/imageserver/KSPublic/library/publication/ca100815.pdf; Dixie L. Johnson & Matthew B. Hanson, *Friends and Family: Keeping Loved Ones Safe from Insider Trading Temptations*, King & Spalding LLP Client Alert (Dec. 8, 2014), http://www.kslaw.com/imageserver/KSPublic/library/publication/ca120814.pdf ; Dixie L. Johnson, *Maintaining Client Confidences During the Holidays: Avoiding Accidental Tipping*, Fried, Frank, Harris, Shriver & Jacobson LLP (Dec. 23, 2013), http://www.lexology.com/library/detail.aspx?g=2a508b8b-9a5d-416f-ba11-751bf9e39665; Dixie L. Johnson & Matthew B. Hanson, *Accidental Tipping: The Wrong Kind of Holiday Present for Family and Friend*s, Fried, Frank, Harris, Shriver & Jacobson LLP (Dec. 14, 2012), http://www.lexology.com/library/detail.aspx?g=4fc139d8-63bc-4662-8ef5-c257f9f14f51; Dixie L. Johnson & Robert Greffenius, *Topics to Avoid in Holiday Conversation: Religion? Politics? Work!*, Fried, Frank, Harris, Shriver & Jacobson LLP (Nov. 30, 2011), http://www.lexology.com/library/detail.aspx?g=7597e965-e49a-4e76-a1d0-6193196dab02; Dixie L. Johnson and Robert Greffenius, *Insider Trading by Friends and Family: When the SEC Alleges Tipping*, BUSINESS LAW TODAY (Aug. 2011), http://apps.americanbar.org/buslaw/blt/content/2011/08/article-johnson-greffenius.shtml.

[4] Steward Bishop, *Ex-JPMorgan Banker Convicted of Insider Trading*, LAW360 (Aug. 17, 2006), http://www.law360.com/articles/826574/ex-jpmorgan-banker-convicted-of-insider-trading.

[5] Stewart Bishop, *Ex-JPMorgan Banker Denies Insider Trading Claims At Trial*, LAW360 (Aug. 4, 2016), http://www.law360.com/articles/825236/ex-jpmorgan-banker-denies-insider-trading-claims-at-trial.

[6] *Id*.

[7] *Id*.

[8] *Id.*

[9] *Id.*

[10] The SEC had already charged another network of traders in connection with an intentional tipping scheme executed ahead of the eBay-GSI transaction. *See, e.g.*, *SEC Charges Six Individuals With Insider Trading in Stock of E-Commerce Company Prior to Acquisition by eBay*, SEC (Apr. 25, 2014), https://www.sec.gov/News/PressRelease/Detail/PressRelease/1370541642140.

[11] *SEC v. Robert M. Munakash et al.*, Case No. 2:16-cv-00833 (C.D. Cal. filed Feb. 5, 2016), https://www.sec.gov/litigation/complaints/2016/comp23460.pdf.

[12] Martin O'Sullivan, *Gas Station Owner Can't Ditch SEC EBay Insider Trading Suit*, LAW360 (May 17, 2016), http://www.law360.com/articles/797343/gas-station-owner-can-t-ditch-sec-ebay-insider-trading-suit; Cara Mannion, *Gas Station Owner Settles SEC's EBay Insider Trading Suit*, Law360 (Dec. 9, 2016), http://www.law360.com/articles/870884/gas-station-owner-settles-sec-s-ebay-insider-trading-suit; *In the Matter of Marc Winters*, Admin. Proc. No. 3-17706 (Dec. 2, 2016), https://www.sec.gov/litigation/admin/2016/34-79460.pdf.

[13] *In the Matter of Patricia Zajick Metzler et al.*, Admin Proc. No. 3-17141 (Mar. 1, 2016), https://www.sec.gov/litigation/admin/2016/34-77257.pdf.

[14] *In the Matter of Lawrence M. Gincel*, Admin. Proc. No. 3-17142 (Mar. 1, 2016), https://www.sec.gov/litigation/admin/2016/34-77258.pdf.

[15] *SEC v. Andrew F. Kerr*, Case No. 16-cv-03650 (N.D. Cal. filed June 29, 2016), https://www.sec.gov/litigation/complaints/2016/comp23586.pdf.

[16] *United States v. Gordon Johnston*, Case No. 16 Cr. 406 (S.D.N.Y filed June 13, 2016), https://www.justice.gov/usao-sdny/file/867221/download. Sanjay Valvani, the portfolio manager who was charged, tragically committed suicide the following week. Alexandra Stevenson and Matthew Goldstein, *Hedge Fund Manager Charged With Insider Trading Is Found Dead*, N.Y. TIMES DEALBOOK (June 21, 2016), http://www.nytimes.com/2016/06/22/business/hedge-fund-manager-charged-with-insider-trading-is-found-dead.html.

[17] *Hedge Fund Portfolio Manager Sanjay Valvani And Former Portfolio Manager Stefan Lumiere Charged In Manhattan Federal Court*, S.D.N.Y. (June 15, 2016), https://www.justice.gov/usao-sdny/pr/hedge-fund-portfolio-manager-sanjay-valvani-and-former-portfolio-manager-stefan-lumiere.

[18] *SEC v. Sanjay Valvani*, Case No. 16 Civ. 4512 (S.D.N.Y. filed June 15, 2016), https://www.sec.gov/litigation/complaints/2016/comp-pr2016-119-valvani-johnston.pdf.

[19] *SEC v. Cooperman*, Case No. 16-cv-5043, (E.D. Penn. filed Sept. 21, 2016), https://www.sec.gov/litigation/complaints/2016/comp-pr2016-189.pdf. Mr. Cooperman told his investors in a letter dated September 21, 2016 that the U.S. Attorney's Office for the District of New Jersey was also investigating and had decided not to pursue charges for the time being, pending the Supreme Court's pending *Salman* opinion. It remains to be seen whether prosecutors will renew their investigation of Mr. Cooperman's trades in light of the *Salman* opinion's generally favorable outcome for government investigators.