SEC Files Insider Trading Charges Related to Medicare Reimbursement Rates

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By Jim Leahy

On May 24, 2017, the Securities Exchange Commission ("SEC") filed a civil complaint (the "Complaint") against four individuals in the United Stated District Court for the Southern District of New York for violations of Section 10b of the Securities Exchange Act of 1934, Rule 10b-5 thereunder and Section 17(a)(1) of the Securities Act of 1934.

The defendants are (i) Christopher Worrall, a federal government employee of the Centers for Medicare & Medicaid Services ("CMS") with confidential knowledge of changes to Medicare reimbursement rates for certain medical procedures and services; (ii) David Blaszczak, a close personal friend and former colleague of Mr. Worrall and a paid consultant to hedge funds, including Adviser A; (iii) Theodore Huber, an analyst at a registered investment adviser firm with nearly $10 billion under management that specializes in the healthcare sector ("Adviser A"); and (iv) Jordan Fogel, another analyst at Adviser A. Fogel and Huber frequently communicated with Blaszczak by text, email, phone and in person.

The SEC alleges that Worrall breached his duty of confidentiality to his employer by misappropriating material nonpublic information ("MNPI") from his employer (the federal government) and giving it to Blaszczak. Worrall tipped Blaszczak as a result of his "close personal friendship" and in exchange for "past and potential future pecuniary gain." Blaszczak boasted in emails to Huber and Fogel of his contacts inside CMS as he passed MNPI to them which served as the basis for profitable trades by Adviser A from May 2012 to November 2013, sometimes within minutes of contact from Blaszczak. For example, in an email from Blaszczak to Fogel, Blaszcak indicated that the quality and accuracy of his information was superior to one of his competitors because his competitor "doesn't know anyone at CMS. His guesses are just wild random guesses."

The Complaint appears designed to comply with the *Dirks*, *O'Hagan* and *Salman* line of Supreme Court insider trading cases. In *Salman*, Justice Alito, writing on behalf of the Court, indicated that: "The tippee acquires the tipper's duty to disclose or abstain from trading if the tippee knows the information was disclosed in breach of the tipper's duty, and the tippee may commit securities fraud by trading in disregard of that knowledge. In *Dirks v. SEC*, 463 U.S. 646 (1983), this Court explained that a tippee's liability for trading on inside information hinges on whether the tipper breached a fiduciary duty by disclosing the information. A tipper breaches such a fiduciary duty, we held, when the tipper discloses the information for a personal benefit. And, we went on to say, a jury can infer a personal benefit—and

thus a breach of the tipper's duty—where the tipper receives something of value in exchange for the tip or 'makes a gift of confidential information to a trading relative or friend.'"

The Complaint methodically outlines that Worrall, a federal employee, was under a duty of confidentiality from three separate sources: (i) the Stop Trading on Congressional Knowledge Act of 2012 (the "STOCK Act"); (ii) CMS's *Employee Nondisclosure Policy* and (iii) the *Standards of Ethical Conduct for Employees of the Executive Branch*. The emphasis on Worrall's duty is reminiscent of Dickens' emphasis on Jacob Marley's death in Stave One of A Christmas Carol: "Marley was dead to begin with. There is no doubt whatever about that…. There is no doubt that Marley was dead. This must be distinctly understood, or nothing wonderful can come of the story I am about to relate." Similarly, there must be no doubt that Mr. Worrall was under a duty not to disclose what he learned on the job at CMS.

In violation of his duty of confidentiality, Worrall passed the MNPI on to Blaszczak, his close personal friend. Blaszczak knew or should have known that Worrall's actions violated his duty of nondisclosure.

Blaszczak passed the MNPI on to Huber and Fogel at Adviser A and they traded and profited on this information. Huber and Fogel were both subject to Adviser A's Compliance Manual and Code of Ethics which prohibits trading while in possession of MNPI; they also attended firm training on this subject. Huber and Fogel both knew or should have known that Blaszczak's source was a government insider that tipped Blaszczak in exchange for a benefit.

The Complaint details the 15+ year close personal friendship between Worrall and Blaszczak: They were former colleagues. "[T]hey met regularly for lunch, golf, baseball games and drinks and also met frequently at CMS…." They also maintained regular and frequent correspondence by text message. In addition, the Complaint alleges that Worrall tipped Blaszczak in exchange for past and potential future pecuniary gain. For example, Blaszczak introduced Worrall to a health care policy firm that interviewed Worrall for a position in the private sector. Worrall leveraged the prospect of obtaining this private sector job for a promotion and raise at CMS. Worrall also received the benefit of giving valuable confidential information to a close friend. Based on these allegations and the existence of a "friendship," the SEC may be entitled to an inference that Worrall received a personal benefit.

The Complaint's detailed analysis appears designed to firmly establish the existence of a personal benefit necessary to establish the tipper's breach of a fiduciary duty. In *Dirks*, the Court stated: "…[T]he initial inquiry is whether there has been a breach of duty by the insider. This requires courts to focus on objective criteria, i.e., whether the insider receives a direct or indirect personal benefit from the disclosure, such as a pecuniary gain or a reputational benefit that will translate into future earnings…. There are objective facts and circumstances that often justify such an inference. For example, there may be a relationship between the insider and the recipient that suggests *quid pro quo* from the latter, or an intention to benefit the particular recipient. The elements of fiduciary duty and exploitation of nonpublic information also exist when an insider makes a gift of confidential information to a trading relative or friend…. Determining whether an insider personally benefits from a particular disclosure, a question of fact, will not always be easy for courts. But it is essential, we think, to have a

guiding principle for those whose daily activities must be limited and instructed by the SEC's inside-trading rules, and we believe that there must be a breach of insider's fiduciary duty before the tippee inherits the duty to disclose or abstain."

The alleged MNPI includes disclosures prior to public announcements by CMS affecting the value of securities issued by the following public companies: (i) DaVita Healthcare Partners, Inc. ("DVA"), which provides kidney dialysis and end-stage renal disease ("ESRD") treatments; (ii) Elekta AB ("EKTAB"), which develops and sells products and services related to cancer treatment; (iii) Fresenius Medical Care AG & Co. KGaA ("FMS") which also provides kidney dialysis and ESRD treatments; and (iv) Varian Medical systems ("VAR"), which builds devices and software to treat cancer.

The Center for Medicare ("CM") at CMS annually determines how much money a medical provider or supplier will receive from Medicare for a given procedure. CMS announcements often move the price of securities of the companies that provide the relevant device, service or procedure. For example, following the close of markets on July 6, 2012, CMS announced a preliminary reduction in the reimbursable treatment time for intensity modulated radiation therapy ("IMRT") from 60 to 30 minutes and for stereotactic body radiotherapy ("SBRT") from 90 to 60 minutes. Prospective earnings and stock prices of providers of these two radiation oncology procedures were negatively affected by this proposed change.

Details of this proposed change were documented at CMS in a confidential briefing paper dated April 18, 2012. The SEC alleges that Worrall and Blaszczak spoke by phone twice on May 8, 2012 and met in person at CMS soon after the second call and that Worrall conveyed MNPI concerning the proposed reduction in the reimbursement for IMRT and SBRT. Fogel spoke to Blaszczak for 12 minutes on May 9. Half an hour later Fogel emailed Huber and others at Adviser A about the proposed cuts for IMRT and SBRT. On May 10, Fogel emailed colleagues at Adviser A, including Huber, and recommended that Adviser A acquire a short position in VAR and EKTAB on behalf of its three fund clients. Adviser A did acquire this short position in the stock of both companies and added to this position based on additional subsequent meetings and communications with Blaszczak several times prior to the public announcement on July 6. The SEC alleges that between May 2012 and November 2013, Adviser A reaped more than $3.9 million in illicit gains and paid Blaszczak at least $193,000 for his information.

John Kim, Acting United State Attorney for the Southern District of New York also announced on May 24, 2017 the arrest of Blaszczak, Worrall, Huber and others on charges of, among other things, participating in a scheme to convert United States property, to defraud the United States, and to commit securities fraud and wire fraud for obtaining MNPI from CMS and using it to execute profitable trades at Adviser A. Mr. Kim also announced the unsealing of charges against Fogel who pled guilty and is cooperating with the Government.