We the People or We the Legislature? The STOCK Act's Compromise Between Politically-Motivated Accountability and Keeping Congress Above the Law

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NOTE

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I. INTRODUCTION

On January 24, 2012, President Barack Obama presented his annual State of the Union Address (“Address”) to Congress.¹ For the large majority of the Address, the President appeared to be speaking to the American people as a whole.² Toward the end of the Address, however, he spoke to the members of Congress directly with regard to the seeming disconnect between politicians and the rest of the country, specifically concerning their alleged trading behavior in financial markets.³ He stated: “Send me a bill that bans insider trading by members of Congress; I will sign it tomorrow.”⁴ That statement was met with great applause.⁵ Shortly thereafter, Congress appeared to have taken the President’s suggestion as a personal challenge.⁶ Two days after the Address was given, a measure relating to this very topic was addressed in the Senate.⁷ Members of Congress were lining up to give their approval of the bill before they even knew the details of its provisions.⁸

². See id. (telling anecdotes, emphasizing issues that were popular among the people, and using inclusive words and phrases).
³. Id.
⁴. Id.
⁵. See id.
⁶. See, e.g., 158 CONG. REC. S111 (daily ed. Jan. 26, 2012) (statement of Sen. Kirsten Gillibrand) (“President Obama said in his State of the Union Address, send this bill and he will sign it right away. We should not delay. It is time to act and take a step right now to begin restoring the trust that is broken in Congress.”).
⁷. See id. at S110 (describing the Senate version of the STOCK Act that was introduced that day).
Ten short weeks after the Address was given, President Obama signed the Stop Trading On Congressional Knowledge Act of 2012 ("STOCK Act" or "Act") into law.

President Obama is not the first government official to be concerned about insider trading by members of Congress. In fact, the issues of congressional corruption and conflicts of interest have a longstanding history of contention and dispute. The potential problem was brought to light as early as 1968, when journalists Drew Pearson and Jack Anderson published a book that shed light upon potential corruption within the halls of Congress. The book highlighted the numerous ways in which members of Congress have used their power and influence to financially benefit, in a personal capacity, from the information that crossed their desks daily. Concern over this issue has resurfaced with a vengeance in the wake of the worst economic crisis since the Great Depression. Congress has sought to distance itself as much as possible from Wall Street and the other groups credited for causing the recession.

Numerous individuals from all sides of the political and ideological spectrum have reported that members of Congress often use their privileged knowledge to reap large personal rewards in financial markets. There is little debate that congressional trading is

10. Id.
11. See Hulse, supra note 8.
12. See id.
14. Id.
15. See Hulse, supra note 8 (drawing the connection between a renewed interest in regulating legislators' trading behavior and an overall negative national economic climate).
16. See id.
17. See, e.g., PETER SCHWEIZER, THROW THEM ALL OUT: HOW POLITICIANS AND THEIR FRIENDS GET RICH OFF INSIDER STOCK TIPS, LAND DEALS, AND CRONYSM THAT WOULD SEND THE REST OF US TO PRISON 32 (2011) (tracing legislators' increasing wealth in office to certain investments they make in industries they influence); Daniel Indiviglio & Jeffrey Goldfarb, A CONGRESSIONAL CONFLICT OF INTEREST, N.Y. TIMES, Dec. 16, 2011, at B2 (noting that House Minority Leader Nancy Pelosi's financial interests and legislative influences hover around the same industries); Jane J. Kim, U.S. Senators' Stock Picks Outperform the Pros', WALL ST. J., Oct. 26, 2004, at D2 (observing that senators appear to know exactly when to sell their stock to make profits); 60 Minutes: Insiders, TASER, Freeman Hrabowski (CBS television broadcast Nov. 13, 2011), available at http://www.cbsnews.com/video/watch/?id=7388144n (highlighting that legislators have daily access to material non-public information and that their personal wealth has grown exponentially while in office).
undesirable. Most scholars agree that congressional trading should be regulated so as to eliminate a skewed incentive structure that encourages legislators to distort market efficiency for their own personal benefit.

For decades, scholars have debated whether existing insider trading law extends to forbid members of Congress from trading on information they learn in the course of fulfilling their legislative duties. Because the primary body of insider trading law is judge-made, and thus only develops piecemeal as new cases are brought before the court, the issue had never been completely resolved. Although several members of Congress have been called into question for their trading decisions (by the public, the media, and government ethics committees), the Securities and Exchange Commission ("SEC" or "Commission") has never attempted to bring formal insider trading charges against a member of Congress.


19. See id.

20. Joel Seligman, A Mature Synthesis: O'Hagan Resolves "Insider" Trading's Most Vexing Problems, 23 Del. J. Corp. L. 1, 2 (1998). It is important to note that there is no unified body of insider trading law. Id. The law that exists has been created piecemeal by the courts as cases come before it. Id.


22. Nagy, Congressional Officials, supra note 21, at 1110, 1137 (acknowledging that government officials, the media, and securities law scholars all have varying views as to the applicability of insider trading law to legislators because there is no concrete answer).

23. See, e.g., Scott Higham & Dan Keating, House Panel Chair Probed, Wash. Post, Feb. 10, 2012, at A1 (chronicling the insider trading investigation against Representative Spencer Bachus for trading securities in the industries regulated by the House Committee he chairs); Indiviglio & Goldfarb, supra note 17, at B2 (highlighting Nancy Pelosi's trading activities in industries she regulates).

The STOCK Act purports "[t]o prohibit Members of Congress and employees of Congress from using nonpublic information derived from their official positions for personal benefit, and for other purposes."

The Act clearly expresses that members of Congress have a duty to the American people not to trade on this information, and that members are subject to insider trading prohibitions. However, the Act creates different standards, requirements, and penalties for members of Congress than those that exist for corporate insiders under insider trading law.

This Note will argue that, although federal legislation is unquestionably necessary to clarify the law's position on insider trading by members of Congress and to provide guidance as to penalties that are appropriate for legislators that violate the prohibitions, the STOCK Act as passed is nowhere near sufficient to combat the growing problem. The Act not only fails to create sufficiently strict standards with regard to the areas that it attempts to regulate, but it also provides far too many loopholes and completely fails to regulate several of the leading causes of insider trading. Additionally, the specific wording of the final version of the Act has created additional problems that must be overcome in the future for the Act's purpose to be properly effectuated.

Part II will trace the evolution of insider trading regulations from their earliest developments to their state at the time of the Act's passage. It will then address the reasons why legislators' trading behavior is unfavorable and should be regulated, and examine the financial reporting requirements already in place for members of Congress prior to the passage of the STOCK Act. Finally, this Part will examine certain provisions of the STOCK Act in depth, with a particular focus on those that prohibit insider trading, require individual transactions to be reported, alter financial disclosure requirements, and govern initial public offering ("IPO") allocations.

25. Stop Trading on Congressional Knowledge Act of 2012, Pub. L. No. 112-105, 126 Stat. 291, 291. The Act also places restrictions on the trading behavior of legislative branch employees as well as members and employees of the executive and judicial branches. Id. § 9(a). However, an analysis of these provisions is outside the scope of this Note.

26. See id. § 4(a)-(b).


28. See infra Part III.A.

29. See infra Part III.B.

30. See infra Part III.

31. See infra Part II.

32. See infra Part II.

33. See infra Part II.
Part III will evaluate the STOCK Act’s overall effectiveness, both with regard to the extent to which it altered existing law and the additional problems it created in enforcing insider trading prohibitions against members of Congress. This Note will argue that the Act added very little substance to the existing body of law, but created several new problems that will present additional hurdles in effectively prohibiting members of Congress from trading on insider information. This logically leads to the conclusion that the Act is ineffective as passed because it caused many more problems than it fixed, and as a result, its stated purpose will be very difficult to achieve.

Part IV will suggest several amendments to the STOCK Act that will fix the previously mentioned problems and more effectively carry out its stated purpose. In particular, it will argue that the standards and requirements set forth for congressional insider trading should be identical to the standards and requirements imposed on corporate insiders. Additionally, it will argue that political intelligence, Congress’s primary method of tipping as a pay-off device, should be strictly regulated in a similar fashion to the way in which lobbying is currently regulated.

II. INSIDER TRADING AND THE STOCK ACT

In order to understand the overall effectiveness of the STOCK Act, one must understand the historical and political context in which it came to be. Part II, Subpart A examines the historical development of insider trading law, with a focus on the three theories of liability currently in force. Subpart B describes the prevalence of insider trading behavior currently exhibited on Capitol Hill and demonstrates why this behavior must be regulated. Subpart C details the financial disclosure requirements in place for legislators at the time that the STOCK Act was passed. Finally, Subpart D examines certain specific provisions of the STOCK Act and analyzes the extent to which these provisions alter preexisting law.

34. See infra Part III.
35. See infra Part III.
36. See infra Part III.
37. See infra Part IV.
38. See infra Part IV.
39. See infra Part IV.
40. See infra Part II.A (explaining why there are so many holes in insider trading regulation).
41. See infra Part II.A.
42. See infra Part II.B.
43. See infra Part II.C.
44. See infra Part II.D.
A. The Development of Insider Trading Law

Insider trading prohibitions of any type are a uniquely American development. The British, from whom Americans largely borrowed their laws, made no attempt to prohibit insider trading in the 17th and 18th centuries. British corporate insiders actively traded on the basis of their private information, including in foreign markets trading British securities. Even though insider trading was only formally recognized in the United States beginning in the 1960s, the behavior was primarily unregulated in most other countries around the world until the 1980s. It was not until 1989, when the European Community Directive Coordinating Regulations on Insider Trading went into effect, that any widely applicable regulation of insider trading was passed outside of the United States.

There are numerous reasons supporting the contention that insider trading should not be prohibited. The primary argument put forth, especially as applied to corporate insiders, is that allowing officers to trade in their own company's stock incentivizes their performance because they will personally benefit only when the company performs well. This argument is the most common one advanced for leaving this area unregulated. Other arguments put forth include: that insider trading regulations attempt to turn many shades of gray into black and white; that regulation inhibits the ability of securities analysts to thoroughly research companies in order to fully do their jobs; and that insider trading is a victimless crime, and thus enforcing it is a waste of valuable resources.

46. See Peter Koudijs, 'Those Who Know Most': Insider Trading in 18th Century Amsterdam 8 (June 1, 2012) (unpublished manuscript), available at https://wpweb2.tepper.cmu.edu/wfa/wfasecure/upload/2012_PA_272166_661442_382505.pdf. The logic follows that, if innovators were compensated proportionally to the future success of their work product, they would be willing to work harder. HENRY G. MANNE, INSIDER TRADING AND THE STOCK MARKET 138-40 (1966).
47. See Koudijs, supra note 46, at 8.
49. Newkirk & Robertson, supra note 45.
50. Id.
51. See id. (discussing numerous theories for allowing insider trading).
52. MANNE, supra note 46, at 139-40.
53. See id. at 138.
54. STEPHEN M. BAINBRIDGE, SECURITIES LAW: INSIDER TRADING 133-81 (2d ed. 2007) [hereinafter BAINBRIDGE, SECURITIES LAW]. However, it is important to note that these contentions are highly disputed. See Selective Disclosure and Insider Trading, 64 Fed. Reg. 72,590, 72,599 (proposed Dec. 28, 1999) (to be codified at 17 C.F.R. pts. 230, 240, 243, 249). For example, even the federal government recognizes that insider trading is not a victimless crime. See id. (recognizing
The American development of a body of formal insider trading law is relatively recent, and it has taken place primarily through the court system. Before insider trading was recognized as a separate offense, questions relating to the validity of a stock trade were rarely brought to court. In the rare instance that such a case was brought before the court, it was advanced under common law theories of fraud and misrepresentation. It was not easy to succeed on this legal theory, however, because certain elements of common law fraud were not intuitively present in the insider trading context. As more cases regarding securities trading disputes came before the SEC and federal courts, insider trading was formally recognized and three distinct theories for establishing liability were developed: the classical theory, the tipper-tippee theory, and the misappropriation theory.

1. Classical Theory

The first theory of insider trading liability to be formally recognized was the classical theory. The classical theory only applies to two categories of people: (1) corporate insiders who are agents of the company on whose information the individual is trading; and (2) certain individuals who obtain their information directly from such an insider, and thus to whom the agency relationship can be extended. The first
time that a corporate insider's trading behavior was adjudicated as a violation of the Securities Exchange Act\(^62\) was in *In re Cady, Roberts & Co.*\(^{63}\) Although this was only an administrative decision, not a federal court case, it was a landmark decision because it paved the way for federal courts to consider the issue a few years later.\(^{64}\)

In *Cady*, the SEC held both a company director and the person to whom he communicated his information (his broker) liable for insider trading when they traded on the director’s knowledge that the company was reducing its dividend.\(^{65}\) In convicting the director and broker, the Commission focused its analysis on the anti-fraud provisions of the Securities Exchange Act.\(^{66}\) These provisions bring certain trading behavior under the umbrella of fraud, manipulation, and deception in circumstances that, without the Securities Exchange Act, would not otherwise satisfy the common law requirements for such charges.\(^{67}\)

The Commission held that the director and broker breached their duty the moment they traded on the non-public information; trading on the information was an act of deception that harmed the people with whom they dealt in the financial market, including the corporation’s shareholders to whom they owed fiduciary duties.\(^{68}\) This held true regardless of whether the person trading on the basis of the knowledge was a company insider or merely someone who obtained their information from an insider.\(^{69}\) The director’s affirmative duty to abstain from trading on non-public information transferred to anyone who the director later offered the information to and who subsequently traded in reliance on it because the corporation’s shareholders were directly harmed by such action to the same extent as if the director traded on the information himself.\(^{70}\) To cure the harm caused here, the agent had the option of disclosing the non-public information before he traded on it.\(^{71}\) If he either could not or chose not to do so before the

\(^{64}\) See Cohen, *supra* note 60, at 553-54.
\(^{65}\) *Cady*, 40 S.E.C. at 907.
\(^{67}\) *Cady*, 40 S.E.C. at 910.
\(^{68}\) *Id.* at 911-12.
\(^{69}\) *Id.* at 911.
\(^{70}\) *Id.*
\(^{71}\) *Id.*
information went public, then he had the absolute duty to forgo the transaction altogether. 72

Only seven years after the SEC decided Cady, the Second Circuit applied its reasoning in deciding SEC v. Texas Gulf Sulphur Co. 73 The court held company employees liable for insider trading when they purchased company stock in advance of a public announcement of a geophysical study very favorable to the company and its stock price. 74 Again, the court narrowed in on the SEC’s Rule 10b-5 and its antifraud provisions. 75 In its reasoning, the court focused on the idea that there are expectations in securities markets “that all investors trading on impersonal exchanges have relatively equal access to material information.” 76 The court elaborated on the timing requirement of Cady’s abstain or disclose alternative. 77 It held that, “[b]efore insiders may act upon material information, such information must have been effectively disclosed in a manner sufficient to insure its availability to the investing public.” 78 The decision emphasized a policy of equal access to information. 79

The next landmark case in the development of the classical theory of insider trading law came twelve years after Texas Gulf Sulphur. 80 In Chiarella v. United States, 81 the Supreme Court relied on the classical theory of insider trading to reverse the lower court’s conviction of petitioner, an employee of a financial newspaper who obtained and subsequently traded on non-public information while setting up the newspaper layout. 82 Petitioner had no connection to the companies in whose stock he traded. 83 He did not obtain any information from the companies themselves or in any way other than from his employer. 84 Petitioner did not disclose any information before or during the time he

72. See id.
73. 401 F.2d 833, 854 (2d Cir. 1968).
74. See id. at 842, 857.
75. Id. at 847-48.
76. Id. at 848.
77. See id. at 854.
78. Id.
79. Id. at 848. Although the holding of this case largely stands today, the court’s policy arguments supporting the rule have varied. See Bainbridge, Inside the Beltway, supra note 18, at 287-88.
80. Chiarella v. United States, 445 U.S. 222 (1980); BAINBRIDGE, SECURITIES LAW, supra note 54, at 49 (explaining that Chiarella was the first case to significantly reduce the scope of the Texas Gulf Sulphur holding).
82. Id. at 228, 231, 236-37.
83. Id. at 224, 231.
84. Id.
traded on the information in the market. Continuing to rely on the anti-fraud provisions of the Securities Exchange Act, the Court reasoned that an individual who trades on non-public information cannot be penalized for failing to disclose this information if he had no affirmative duty to do so.

The Court specifically provided that the mere possession of non-public information does not give rise to a duty to disclose. Because petitioner was neither an agent nor any other type of fiduciary of the companies on whose information he traded, and thus had no duty to those corporations' shareholders, he did not violate the anti-fraud provisions of the Securities Exchange Act and could not be liable for insider trading. This case also briefly touched on the foundation of the third insider trading theory, the misappropriation theory, in dicta, but the Court did not conclusively address the theory because the issue was not raised in the lower court.

As the classical theory of insider trading developed and solidified, two distinct elements emerged that are required for a court to convict an individual of insider trading: (1) the existence of a relationship that provides access to non-public information intended only for corporate purposes; and (2) manipulation or deception derived from the possessor of such information trading on it without prior disclosure, thereby making "secret profits." The key requirement under this theory is the existence of a duty owed by the trader to the corporation of whose shares he traded (and, as an extension, to its shareholders). Under the classic theory, without the existence of such a duty, a person can trade on non-public information without any consequences under the Securities and Exchange Act.

2. Tipper-Tippee Liability

Tipper-tippee liability developed as an extension of the classical theory. This theory was created because the tippee was seen to inherit

85. Id. at 224.
87. Chiarella, 445 U.S. at 228.
88. Id. at 235.
89. Id. at 236-37.
90. See id. at 235-36.
92. See id.
93. See id. at 654. Note, however, that Chiarella would probably have been decided differently under the misappropriation theory. See Bainbridge, Inside the Beltway, supra note 18, at 290-92.
94. See Dirks, 463 U.S. at 657-58 (focusing analysis around whether there is a relationship of
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an obligation arising from his role in the tipper’s breach of fiduciary duty. The primary case through which the Court explained this extension is Dirks v. SEC. In this case, the Court held that a person who merely tells others of information he discovers about a company, without himself trading in that company’s stock, does not violate the prohibition on insider trading if he does not have any fiduciary relationship with the company. The Court created a tippee liability derivative of the tipper’s liability, largely because the information had been received by the tippee improperly. Therefore, the tippee can only have a duty not to trade on the information “when the insider has breached his fiduciary duty . . . by disclosing the information to the tippee and the tippee knows or should know that there has been a breach.” The test for a breach of duty is whether the insider will somehow “benefit, directly or indirectly, from his disclosure” of the information. However, subsequent courts have interpreted this benefit requirement very loosely. Therefore, if there was an initial breach by the corporate insider, courts will likely find that anyone else who the tipper told and who traded on that information is liable for insider trading.

3. Misappropriation Theory

Because the classical theory, and its extension through tipper-tippee liability, only applied to corporate insiders and others to whom their agency relationship extended, the SEC could not hold a non-fiduciary liable when he obtained non-public information and traded on it. This

trust between the trader and the provider of the material non-public information).

95. See Chiarella, 445 U.S. at 230.
96. 463 U.S. 646 (1983); BAINBRIDGE, SECURITIES LAW, supra note 54, at 55.
97. Dirks, 463 U.S. at 667.
98. Id. at 659. Dirks noted that it is “unlawful to do indirectly by means of any other person any act made unlawful by the federal securities laws.” Id. (internal quotation marks omitted) (citing Securities Exchange Act of 1934, 15 U.S.C. § 78t(b) (2006)).
100. Id.
101. Id. at 662.
102. See, e.g., SEC v. Yun, 327 F.3d 1263, 1275 (11th Cir. 2003) (“[T]he gain does not always have to be pecuniary. A reputational benefit that translates into future earnings, a quid pro quo, or a gift to a trading friend or relative all could suffice to show that the tipper personally benefitted.”); SEC v. Maio, 51 F.3d 623, 632-33 (7th Cir. 1995) (finding an inference of personal benefit when the tipper and tippee were close personal friends and had done each other several favors over the years).
103. See Bainbridge, Inside the Beltway, supra note 18, at 289-90 (identifying several scenarios in which a tippee can be held liable for insider trading).
gap in the law led to the development of the misappropriation theory of insider trading, which recognizes the existence of an agency relationship between the trader and the source of his information, regardless of where that source was employed or how he obtained his information. Lower courts began recognizing and applying the misappropriation theory as early as the 1980s.

The first Supreme Court case to hold an individual liable for insider trading under this theory was *United States v. O'Hagan*. In this case, the Supreme Court held the respondent attorney liable for insider trading when he traded in a company's stock on non-public information obtained in the scope of his employment. This was not a case of a constructive insider, because the company was not a client of respondent's law firm; instead, the firm's client, from which the information was obtained, was a company attempting to take over the company whose stock was traded. The Court reasoned that, even though the trader had no fiduciary duty to the company whose stock he traded, the trader's use of non-public information deprived the source (in this case, the firm's client) of its exclusive use of the information.

This extension of insider trading theory was consistent with established precedent, which held that a company's confidential information is the property of the company, and therefore the company has the right to its exclusive use. Misappropriation is a theory that punishes deception when one person, who need not be a fiduciary of the company in question, trusts another with confidential information, and the second party breaches that trust by using the information for personal gain.

When released, the *O'Hagan* decision was viewed by most scholars as a wide-sweeping expansion of insider trading law. In deciding the case, the Court went far beyond the bounds that anyone ever expected it,

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106. *See*, e.g., SEC v. Cherif, 933 F.2d 403, 408-11 (7th Cir. 1991); SEC v. Clark, 915 F.2d 439, 453 (9th Cir. 1990); Rothberg v. Rosenbloom, 771 F.2d 818, 824 (3d Cir. 1985); United States v. Newman, 664 F.2d 12, 18-19 (2d Cir. 1981). Other circuits courts have rejected the misappropriation theory. *See*, e.g., *United States v. O'Hagan*, 92 F.3d 612, 617 (8th Cir. 1996); United States v. Bryan, 58 F.3d 933, 944 (4th Cir. 1995).


108. *Id.* at 647.

109. *See id.*

110. *See id.* at 652-53.


because it could have sustained a ruling in favor of the government on much narrower grounds than it chose. The Court expressed "a willingness to embrace government arguments while displaying nearly complete disregard for countervailing viewpoints." The decision also left many gaps for future courts to interpret with very little guidance. Shortly after the decision was reached, scholars concluded that the full reach of insider trading under the misappropriation theory was anything but clear, and they expected the theory to expand and cover many more types of relationships. Overall, the O'Hagan decision seemed to give the SEC the Court's blessing to continue to prosecute all types of cases under insider trading law.

As financial markets have become more complex and insiders have become more financially tied to the corporations that employ them, the development of insider trading law has evolved to broaden the definition of an insider trading violator to encompass almost anyone who possesses and trades on material non-public information in breach of a duty. Nonetheless, there is still a fierce debate as to whether any of these theories would apply to members of Congress who have traded on information that they obtained in their scope of employment.

114. See id. at 56 & nn.239-40, 57 & n.241.
115. Id. at 56.
117. See, e.g., id. at 200, 208.
118. See Bebel, supra note 113, at 57 ("Due to the strength of the opinion, enforcement authorities will be emboldened in the never-ending quest to make new applications of Section 10(b), and anti-fraud provisions generally, while pursuing securities-related conduct characterized by deception and inherent unfairness.").
119. See Bruce Ian Carlin & Gustavo Manso, Obfuscation, Learning, and the Evolution of Investor Sophistication, 24 REV. FIN. STUD. 754, 778 (2010) (concluding that individual investors typically cannot keep up with market evolutions because markets develop at too brisk a pace for the average investor to learn of all changes).
120. See Brian J. Hall & Kevin J. Murphy, Stock Options for Undiversified Executives, 33 J. ACCT. & ECON. 3, 3-4 (2002) (acknowledging that a large portion of executive compensation comes from stock options).
121. See Adam R. Nelson, Note, Extending Outsider Trading Liability to Thieves, 80 FORDHAM L. REV. 2157, 2181-84, 2196-97 (2012) (arguing that, under current law, insider trading liability can even logically be extended to thieves who steal the information on which they subsequently trade); see also, e.g., SEC v. Dorozhko, 574 F.3d 42, 43-44 (2d Cir. 2009) (holding that a hacker who does not owe a fiduciary duty to the company can be liable for insider trading when he hacks into the company's computer system to obtain material non-public information).
122. Compare Nagy, Congressional Officials, supra note 21, at 1137 (arguing that the law as it stood before the STOCK Act clearly extended to members of Congress), with Barbabella et al., supra note 21, at 216-17 (articulating the need for clear legislation regulating congressional trading activities). Nagy believes that members of Congress can be prosecuted under the misappropriation theory without any additional legislative grant, and that any attempt to regulate members of Congress separately would narrow the discretion with which the SEC could otherwise act. Nagy,
Regardless of whether a successful argument can be made to extend insider trading laws to apply to members of Congress, the SEC has never pursued a single case of insider trading against a congressional official. Therefore, it is clear that the SEC needs further explicit guidance before it is willing to pursue a case of insider trading against a member of Congress.

B. The Current State of Insider Trading in Congress

Insider trading by members of Congress is a real problem. A 1995 study conducted by Professor Gregory Boller uncovered numerous conflicts of interest between the personal trading portfolios of particular members of Congress and the pieces of legislation those very same members of Congress were active in pushing to get passed. Although Professor Boller did not examine the financial returns of those legislators’ portfolios, he took note of the uncanny timing legislators seemed to have in executing their trades before both the rise and fall of a company’s stock price.

A 2004 financial study by several business and finance professors analyzed the financial returns of legislators’ personal portfolios over a six-year period, based on the information contained in legislators’ financial disclosure statements, and compared those returns with market returns and professional traders’ returns over the same time period.

Congressional Officials, supra note 21, at 1132, 1148. Barbabella and his colleagues, on the other hand, believe that the simple fact that there is even a debate concerning the applicability of current law to members of Congress justifies the need for further regulation. Barbabella et al., supra note 21, at 217.

123. Steinhauer, supra note 24.

124. See Bainbridge, Inside the Beltway, supra note 18, at 304; Devin Leonard, Outmanned, Outgunned, and on a Roll, BUS. WK., Apr. 29, 2012, at 62-63 (highlighting the restrictions that budgetary constraints place on the SEC’s enforcement capabilities). It is understandable why the SEC has failed to take action without explicit guidance. Bainbridge, Inside the Beltway, supra note 18, at 304. The SEC’s budget is granted by Congress, and the legislature could easily shrink the SEC’s budget if it acts in a way that is not in accordance with Congress’s desires. See id.

125. See Alan J. Ziobrowski et al., Abnormal Returns from the Common Stock Investments of the U.S. Senate, 39 J. FIN. & QUANTITATIVE ANALYSIS 667, 674 (2004) [hereinafter Ziobrowski et al., U.S. Senate] (analyzing the performance of legislators’ stock portfolios in comparison to portfolios of professional traders and fund managers, and concluding that there is a large and positive difference between legislators’ portfolio returns and market returns).


127. See Ward, supra note 126.

128. Ziobrowski et al., U.S. Senate, supra note 125, at 669.
The study concluded that, for all but two years of the time period examined, there was a consistent pattern of cumulative abnormal returns within legislators' portfolios. Senators with the least seniority attained the highest levels of returns in financial markets. This suggests that the enormous amount of new information available to legislators was primarily utilized in their first few years in office. Also of great importance in this context is the fact that securities held in legislators' portfolios greatly outperformed the market for the duration of time that they remained within the legislators' portfolios. However, once the legislators sold their holdings of these securities, their stock price almost immediately returned to average or below-average performance as compared to the market's performance as a whole and the stock's historic behavior.

The same group of business and finance professors recently completed a similar study using identical methods in relation to the personal trading portfolios of members of the House of Representatives. This study examined a longer time period, extending from 1985 to 2001. The study found that trading among members of the House of Representatives was not as widespread as among Senators, but that a small number of Representatives traded "disproportionately often." In a similar fashion to the findings regarding Senators, this study found that the Representatives who had the least seniority had portfolios with the highest returns. Overall, the findings of the House study closely mirror the findings in the Senate study.

Even scholars who disagree with the proposition that congressional trading should be banned or regulated acknowledge the conflict of interest problems that underlie legislators' trading in securities markets. Rather than disputing the existence of potential conflicts of

129. Id. at 674.
130. Id.
131. See id. at 674-75.
132. Id. at 674.
133. Id.; see also Kim, supra note 17 (observing that Senators appear to know exactly when to sell their stock).
136. See id. at 9.
137. Id. at 14.
138. See id. at 18.
139. See, e.g., Bruce H. Kobayashi & Larry E. Ribstein, Outsider Trading as an Incentive Device, 40 U.C. DAVIS L. REV. 21, 35, 37 (2006) (arguing that, as long as outsiders' trading does not interfere with property rights, it should be allowed; it could even encourage better investigation
interest between legislators’ official duties and their personal financial portfolios, these scholars typically focus their arguments on the questions of whether it is appropriate to regulate legislators’ trading behavior and whether market integrity is being hurt by allowing members of Congress to trade freely on non-public information.\footnote{140} Even the authors of the most critical study of the evidence supporting congressional trading have acknowledged that legislators’ portfolios are disproportionately invested in sectors of the economy over which they exert direct influence, and that these portions of their portfolios greatly outperform the rest of their portfolios.\footnote{141} Therefore, even if legislators’ portfolios as a whole do not beat average market returns, it is undisputed that legislators benefit in some way from their positions on Capitol Hill.\footnote{142} This is no small accession for scholars who sharply contest the need to regulate this type of behavior.\footnote{143}

In addition to directly trading in financial markets, legislators also take part in the political intelligence industry.\footnote{144} This industry is “discrete and virtually unknown” to the general public.\footnote{145} What little is known typically comes from media reports and lobbying firms’ promotional materials.\footnote{146} Political intelligence gatherers “mine the capital for information and translate Washington wonkspeak into trading tips” before the information becomes public.\footnote{147} They do not seek to influence Congress at all; they only seek to gather information from its members.\footnote{148} The industry began in the early 1970s, but has really taken off following the exponential growth in the hedge fund industry.\footnote{149} The

\footnote{140. See Ribstein, \textit{Congressmen as Security Traders}, supra note 139, at 273.}


\footnote{142. See id.}

\footnote{143. See Ribstein, \textit{Congressmen as Security Traders}, supra note 139, at 273-74 (urging strongly that the trading behavior of members of Congress should be let alone).}

\footnote{144. See Jerke, supra note 21, at 1461.}

\footnote{145. See id. at 1455.}

\footnote{146. Id. at 1471-72.}


\footnote{148. Jerke, supra note 21, at 1472.}

information gatherers are primarily employees of lobbying firms, especially those who work for financial companies. This is largely because the industry is not subject to regulation, even though lobbying firms are primary participants.

The Lobbying Disclosure Act, the primary piece of legislation governing lobbying firms, does not apply to the political intelligence industry; by the statute’s definition, a lobbyist is only subject to the law if he seeks to influence legislation. Political intelligence lobbyists do not seek to influence legislation; they only inquire as to the status of existing legislation. Because political intelligence firms are not subject to the law, they are not even required to disclose the identity of their political intelligence clients. Despite the little knowledge available about the inner workings of the industry, it is clear that legislators participate in it; members of Congress and their staff are the only people who know the political information in advance of its public release.

Legislators’ trading habits are particularly serious because Congress has gained direct control over so many aspects of the nation’s economy in the wake of the recent financial crisis. There is no question that legislators’ behavior needs to be regulated to prevent them from unfairly profiting from their insider knowledge, both for market efficiency and ethical reasons. The STOCK Act as written is nowhere near strong enough to regulate legislators’ behavior. With the addition

(observing that the hedge fund industry was valued at $2.13 trillion in April 2012 and continues to grow); Javers, supra note 147 (recognizing that hedge funds have sparked the recent growth in the political intelligence industry and are suspected to be the industry’s largest clients).

151. See Jerke, supra note 21, at 1472.
153. Id. §§ 1602(7)–(9); see also Jerke, supra note 21, at 1475.
154. Jerke, supra note 21, at 1472.
155. Id. at 1471–72.
156. See Javers, supra note 147 (documenting a 2005 instance in which the prominence of the political intelligence industry reared its head when a company’s stock price inexplicably doubled in a single day—a day before the public announcement of a bill in Congress that would greatly benefit the company); Mullins & Scannell, supra note 150, at A1 (describing a similar incident in which the shares of companies involved in asbestos litigation inexplicably rose before Congress announced the creation of a public trust fund for liability claims).
158. See infra Part II.B.
159. See infra Part III.
of several amendments to make it stronger, however, the STOCK Act has the potential to be a key piece of legislation in solving this widely recognized, but largely unaddressed, problem.\textsuperscript{160}

\textbf{C. Pre-STOCK Act Financial Reporting Requirements for Members of Congress}

Although it was unclear prior to the passage of the STOCK Act whether members of Congress could be held liable for insider trading under securities law, there were still numerous provisions in place in other laws that required legislators to report their financial holdings and transactions.\textsuperscript{161} For example, prior to the passage of the STOCK Act, members of Congress (as well as other senior government officials) were required to file annual reports disclosing their personal assets and investments, including outside income, securities transactions, real estate, and all types of bank accounts.\textsuperscript{162} These annual reports were made available to the public.\textsuperscript{163} Nevertheless, the purpose of these disclosure reports was not to catch violations of securities law.\textsuperscript{164} According to the U.S. Office of Government Ethics:

\begin{quote}
[T]he primary purpose of disclosure is to assist agencies in identifying potential conflicts of interest between a filer's official duties and the filer's private financial interests and affiliations. Once a reviewing official identifies a potential conflict of interest and consults with the filer's supervisor as necessary, several remedies are available to avoid an actual or apparent violation of Federal ethics laws and regulations.\textsuperscript{165}
\end{quote}

\textsuperscript{160. See infra Part IV.}

\textsuperscript{161. See, e.g., Ethics in Government Act of 1978, Pub. L. No. 95-521, §§ 101–102, 92 Stat. 1824, 1824-31. It is important to note, however, that the Ethics in Government Act was not passed primarily to regulate government employees' trading behavior but to prevent insider trading. See id. The stated purpose of the act was "[t]o establish certain Federal agencies, effect certain reforms in the operation of the Federal Government, to implement certain reforms in the operation of the Federal Government and to preserve and promote the integrity of public officials and institutions, and for other purposes." Id. pmbl. Thus, the financial disclosure requirement included in this Act was only one of numerous ways in which Congress sought to clean up government in the wake of the Watergate scandal. Benjamin R. Civiletti, U.S. Attorney Gen., Post-Watergate Legislation in Retrospect 3 (Oct. 31, 1980), available at https://www.ncjrs.gov/pdffiles1/Digitization/73468NCJRS.pdf.

\textsuperscript{162. Ethics in Government Act §§ 101–102.}

\textsuperscript{163. § 104.}


\textsuperscript{165. Id.}
This statement makes clear that, although these disclosure requirements were in place to serve a particular purpose, that purpose was not to penalize legislators for inappropriate trading behavior. Therefore, this statute's purpose is not similar to that served by the STOCK Act. Because these disclosure requirements were not intended to police legislators' trading activity, there was virtually no supervision of this activity and legislators were essentially free to behave as they wished without fear of penalty.

Despite the fact that some form of regulation was still in place, there were also subjects addressed by the STOCK Act that had either never before been addressed in such detailed form or had previously gone unregulated altogether. For example, the types of disclosures required under the Ethics in Government Act were not as detailed as the ones required under the STOCK Act. Additionally, there was no regulation of the participation of legislators in IPO allocations or of political intelligence activities before the passage of the STOCK Act.

D. The STOCK Act

The STOCK Act was signed into law on April 4, 2012. The bill was passed by an overwhelming majority in both houses of Congress; the House of Representatives voted 417 to 2 in support of the bill, and
the Senate voted 96 to 3 in favor of it. According to Senator Kirsten Gillibrand of New York, one of the Act’s authors and sponsors, the Act is intended to signify that “nobody is above the law” and that “members of Congress must play by the exact same set of rules as every other American.” Widespread congressional support for the bill, or at least the façade of widespread congressional support for a politically popular measure in the middle of an election year, was clearly present at the time of the Act’s passage.

The Act purports to regulate most financial behavior of members and employees of all three branches of the federal government. With respect to members of Congress, the primary behaviors regulated are financial market transactions, mortgage transactions, and IPO transactions. Other provisions of the Act provide enforcement mechanisms and rules of construction that simply aid in interpreting and carrying out the above provisions.

Before addressing any of the specific areas of regulation and reporting requirements already mentioned, the Act expressly clarifies that insider trading prohibitions, as they exist, extend to members of Congress and their employees. In order for this assertion to logically conform to the elements of existing insider trading law, the Act explicitly creates a duty owed by each member and employee of Congress. More specifically, the Act states:

[E]ach Member of Congress or employee of Congress owes a duty arising from a relationship of trust and confidence to the Congress, the United States Government, and the citizens of the United States with respect to material, nonpublic information derived from such person’s


176. See Hulse, supra note 8 (acknowledging that the bill was popular among constituents and that legislators were looking for ways to enhance their reputations in the wake of an upcoming election when their approval ratings were at an all-time low).

177. Stop Trading on Congressional Knowledge Act §§ 3–4, 6–9, 11–14. Although the Act imposes requirements on all branches of the federal government, the regulations imposed on the executive and judicial branches are beyond the scope of this Note.

178. Id. § 6.

179. Id. § 13.

180. Id. § 12.

181. See, e.g., id. § 5.

182. Id. § 4.

183. Id. § 4(b).
position as a Member of Congress or employee of Congress or gained from the performance of such person’s official responsibilities. 184

Based on this language, there can be no question that members of Congress now owe a duty similar to that required under insider trading theory as applied to corporate insiders. 185 Whether this duty conforms to the classical or misappropriation theory is irrelevant to the issue at hand; 186 since there is some type of explicit duty involved, members of Congress can be prosecuted under some form of insider trading. 187

The first new regulation regarding the financial behavior of members of Congress mentioned in the STOCK Act deals with the reporting of financial transactions. 188 The Act requires that legislators file a report of any financial transactions they participated in within thirty to forty-five days of the transaction’s occurrence, depending on which section of the Act the transaction falls under. 189 As compared to the previous reporting requirement mandating members of Congress to report their personal financial investments yearly, 190 this provision is intended to decrease the amount of time it takes for government ethics committees to uncover a legislator’s trades in the financial markets, and thus increase the likelihood that red flags will be raised and addressed. 191 However, it is unclear from the text of the Act who will be responsible

184. Id. § 4(b)(2).
185. Compare id., with Chiarella v. United States, 445 U.S. 222, 230 (1979) (holding that insider trading liability arises out of “a relationship of trust and confidence” between the trader and his counterparty in the transaction). However, note that some scholars believe this duty to be insufficient for insider trading purposes. See, e.g., Bainbridge, Inside the Beltway, supra note 18, at 295. Although not a widely-accepted theory, a few scholars have argued that a general duty to a group without a direct connection to the trading activity is insufficient to establish liability for insider trading. Id. This theory holds that a duty must apply either to the person with whom the insider trades or the source of the information traded on in order to establish liability. Id. Therefore, under this theory, a duty to the general public would not be adequate to hold an individual liable for insider trading. See id. Others counter this by pointing out that lower courts do not always follow Supreme Court precedent. See, e.g., Donna M. Nagy, Insider Trading and the Gradual Demise of Fiduciary Principles, 94 IOWA L. REV. 1315, 1340 (2009). Although precedent mandates a fiduciary relationship in order to establish liability, some lower courts have disregarded this in favor of a broader rule banning any wrongful use of material non-public information. Id.
186. The issue here is only whether members of Congress can be prosecuted for insider trading in general. Determining the theory under which they can be prosecuted is the next step in the analysis.
188. Id. § 6.
189. Id.
for reviewing these filings, and what exactly they will be charged with looking to uncover. 192 Although the Act prescribes penalties for breaches of legislators' duty in the form of insider trading, 193 it is unclear how strictly they will be enforced. 194

The second major provision of the Act requires federal employees to report their personal mortgage loans in their financial disclosure reports. 195 The Ethics in Government Act specifically exempted from disclosure requirements the reporting of mortgage loans by federal employees and their spouses. 196 Under the STOCK Act, however, only certain mid-level officials within the executive’s foreign affairs offices and the military are exempted from this reporting regulation. 197

The final major provision of the Act prohibits legislators from purchasing securities subject to an IPO in any way other than through the methods available to the general public. 198 This section of the Act is the shortest of the regulatory provisions at only a single sentence long. 199 It does not provide any details or guidance as to how the provision should be interpreted or applied. 200 It is somewhat of an anomaly compared to the remainder of the provisions, which at least offer some means of interpretation. 201

III. THE STOCK ACT’S SHORTCOMINGS

It is no secret that the STOCK Act has major shortcomings, especially compared with what it purports to accomplish. 202 Jonathan Macey, a Yale Law School professor and critic of the Act, has observed that “what Congress really wants is to keep making the big bucks that come from trading on inside information but to trick those outside of the Beltway into believing that they are doing something

193. Id. § 15(b).
194. See id. (lacking any enforcement mechanism).
195. Id. § 13.
198. Id. § 12.
199. Id. (“An individual . . . may not purchase securities that are the subject of an initial public offering . . . in any manner other than is available to members of the public generally.”).
200. Id.
201. Compare id. (offering no guidance as to how to apply the provision), with id. § 6 (providing details as to which government officials must report financial transactions under what circumstances), and id. § 13 (detailing which government officials must report details of their mortgage loans).
202. See infra Part III.A–B.
about this corruption." Numerous other commentators have voiced similar opinions.

There are two major flaws in the text of the Act as passed. The first is that the Act adds very little substance to the existing body of insider trading law. The second is that the Act adds an additional layer of complications in applying insider trading prohibitions to members of Congress. These two issues combine to lead to the natural conclusion that the Act has major shortcomings. These flaws need to be adequately addressed for the legislation to be considered effective regulation, rather than a politically-motivated guise to gain popularity before an important election.

A. The STOCK Act's Lack of Regulatory Substance

When examined as a whole, in comparison to existing legislation, the STOCK Act does not add much substance to the existing body of insider trading law as applied to members of Congress. In short, there is only one provision of the Act that may add anything of substance to existing law without including additional complications that outweigh the benefits. The Act attempts to end the fiduciary duty debate by clearly extending insider trading prohibitions and liability for insider trading violations to members of Congress. More specifically, the Act explicitly creates a duty that legislators owe to Congress as a collective whole, to the U.S. government, and to the citizens of the United States. This provision eliminates the decades-long scholarly

205. See infra Part III.A–B.
206. See infra Part III.A.
207. See infra Part III.B.
208. See infra Part III.A–B.
209. See infra Part IV.
210. Compare supra Part II.C, with supra Part II.D.
212. Id.
213. Id. § 4(b).
debate over whether insider trading prohibitions extend to members of Congress. 214

All other provisions of the Act that add substance to the existing body of law contain ambiguities or raise questions that further complicate the Act's execution. 215 For example, the Act requires legislators to report their financial transactions within a much shorter timeframe than was previously required. 216 However, as already mentioned, the Act does not provide for any mechanism to make this information useful for uncovering potential insider trading behavior. 217 Additionally, it is unclear what body is supposed to review the disclosure reports. 218 If the information is utilized in the same way in which financial disclosures were used under the Ethics in Government Act, 219 it will do little to further the stated purpose of the Act. 220 Regardless of how clear the language of the statute may be, technically extending insider trading prohibitions to members of Congress is toothless if there is no method of policing or enforcing such prohibitions. 221 The Act also requires legislators to update their asset and liability positions (including investment portfolios, all types of bank

214. See, e.g., Bainbridge, Inside the Beltway, supra note 18, at 293, 295 (concluding that insider trading liability does not extend to members of Congress); Barbabella et al., supra note 21, at 215-16 (finding that any restrictions on trading that members of Congress must follow are extremely vague and ambiguous); Andrew George, Public (Self)-Service: Illegal Trading on Confidential Congressional Information, 2 HARV. L. & POL’Y REV. 161, 170 (2008) (determining that existing insider trading law applies to members of Congress); Nagy, Congressional Officials, supra note 21, at 1137-59 (concluding that multiple theories of insider trading extend to members of Congress).

215. See infra Part III.B.

216. Compare Stop Trading on Congressional Knowledge § 6 (requiring reporting “[n]ot later than 30 days after receiving notification of any transaction required to be reported under section 102(a)(5)(B), but in no case later than 45 days after such transaction”), with Ethics in Government Act of 1978, Pub. L. No. 95-521, §§ 101-102, 92 Stat. 1824, 1824-31 (requiring reporting “on or before May 15 of the succeeding year”).

217. See Stop Trading on Congressional Knowledge Act § 6; see also supra Part II.D.

218. See Stop Trading on Congressional Knowledge Act § 6. Congress is presumed to have left the monitoring duty to laymen, in a continuance of the structure established in the Ethics in Government Act. See Insider Trading and Congressional Accountability: Hearing Before the S. Comm. on Homeland Sec. and Governmental Affairs, 112th Cong. 10 (2011) (statement of Melanie Sloan, Executive Director, Citizens for Responsibility and Ethics in Washington) (suggesting that public disclosure is essential to any successful piece of legislation). Congress’s presumption is that the public will have a personal interest in monitoring the filings, and thus will be a watchdog and will alert the proper authorities to any red flags that may arise. See id. at 153-54 (testimony of John C. Coffee, Jr., Adolf A. Berle Professor of Law, Columbia University Law School).

219. See Public Financial Disclosure, supra note 164 (“[A] reviewing official identifies a potential conflict of interest and consults with the filer’s supervisor as necessary . . . .”).


accounts, and personal mortgages) more frequently and in a much more thorough manner than was previously required.\textsuperscript{222} However, this provision is useless without a way to police and enforce trading behavior based on the information provided in the disclosure reports.\textsuperscript{223}

Finally, the Act technically imposes new restrictions on legislators with regard to IPO allocations.\textsuperscript{224} However, this provision is essentially meaningless because it incorrectly assumes that IPOs operate in a relatively uniform manner and that ordinary investors participate equally in this process.\textsuperscript{225} The legislative history on this topic is very sparse, and the little that can be found in the record is vague.\textsuperscript{226} It is thus relatively unclear why this provision even made it into the final version of the Act.\textsuperscript{227} This provision will be almost impossible to enforce because the restriction on legislators' participation in IPOs is vaguely written; enforcement will be especially problematic because the SEC—the enforcement mechanism best suited for the job—is hesitant to overstep its bounds and upset the government body that funds its operations.\textsuperscript{228}

\section*{B. Additional Problems Created by the STOCK Act}

In addition to failing to add much substance to the existing body of law, the STOCK Act creates additional problems that may have significant repercussions in the long run.\textsuperscript{229} For example, several scholars have acknowledged a potential conflict between the STOCK Act (or similar proposed regulations) and the Speech or Debate Clause

\textsuperscript{222} Compare Stop Trading on Congressional Knowledge Act § 6 (requiring reporting no later than forty-five days after a transaction takes place), with Ethics in Government Act of 1978, Pub. L. No. 95-521, §§ 101-102, 92 Stat. 1824, 1824-31 (requiring annual reporting, regardless of any transactions that occur throughout the year).

\textsuperscript{223} See Auble, supra note 221.

\textsuperscript{224} Stop Trading on Congressional Knowledge Act § 12.

\textsuperscript{225} See STEVEN E. BOCHNER & JON C. AVINA, GUIDE TO THE INITIAL PUBLIC OFFERING 11 (7th ed. 2010) (documenting the complexity of the IPO process).

\textsuperscript{226} See The Stop Trading on Congressional Knowledge Act: Hearing on H.R. 1148 Before the H. Comm. on Fin. Servs., 112th Cong. (2011) (failing to address the question of IPOs); see also Insider Trading and Congressional Accountability: Hearing Before the S. Comm. on Homeland Sec. and Governmental Affairs, 112th Cong. (2011) (failing to address the question of IPOs).

\textsuperscript{227} See supra notes 224-26 and accompanying text.

\textsuperscript{228} See Stop Trading on Congressional Knowledge Act § 12 (restricting legislators to participating in IPOs only in the "manner . . . available to members of the public generally"); BOCHNER & AVINA, supra note 225, at 11, 72 (explaining that "[a]n initial public offering is actually a series of related processes," and concluding that "[t]he laws and rules that govern the [IPO] process . . . are complex and constantly changing"). It is understandable why the SEC has failed to act up to this point without explicit guidance. George, supra note 214, at 172. The SEC’s budget is granted by Congress, and the legislature could easily shrink the SEC’s budget if it acts in a way that is not in accordance with Congress’s desires. Id.

\textsuperscript{229} See infra notes 230-63 and accompanying text.
in the Constitution. The Speech or Debate Clause prohibits inquiry into those things said or done in Congress by legislators "in the performance of official duties and into the motivation for such acts." The Speech or Debate Clause, however, does not extend to protect political matters that members of Congress engage in, and it does not protect any activity that has no relation to the "functioning of the legislative process." Courts have not created a general test to distinguish between what is and is not protected by the Speech or Debate Clause, and arguments can be made that legislators' trading behavior falls into the scope of the performance of official duties. Although most scholars have concluded that the Speech or Debate Clause would not conflict with legislators' trading on insider information, there has not yet been a firm governmental verdict on the issue.

An additional problem that the Act creates is a privacy risk to government officials who are required to disclose their financial position and those of their immediate families. The risk to individual legislators and their families created by the Act's requirement that members of Congress report all of their assets in fine detail, in an extremely public forum, outweighs the public interest in promoting fair and equitable markets. A federal court recently decided a case regarding employees of the executive department. The U.S. District Court for the District of Maryland issued a temporary preliminary injunction enjoining the government from implementing portions of the

230. U.S. CONST. art. I, § 6, cl. 1; see, e.g., Bainbridge, Inside the Beltway, supra note 18, at 302-03; Barbabella et al., supra note 21, at 217-19.
231. U.S. CONST. art. I, § 6, cl. 1; United States v. Brewster, 408 U.S. 501, 512 (1972). More specifically, the Speech or Debate Clause instructs that members of both houses of Congress:
shall in all Cases, except Treason, Felony and Breach of the Peace, be privileged from
Arrest during their attendance at the Session of their Respective Houses, and in going to
and from the same; and for any Speech or Debate in either House, they shall not be
questioned in any other Place.
U.S. CONST. art. I, § 6, cl. 1.
232. Brewster, 408 U.S. at 512.
234. Compare Bainbridge, Inside the Beltway, supra note 18, at 302, with Barbabella et al., supra note 21, at 217-18 (laying out different standards by which the applicability of the Speech or Debate Clause is analyzed).
236. See Barbabella et al., supra note 21, at 218-19.
237. See infra notes 238-45 and accompanying text.
239. Id. at 755-56.
STOCK Act related to these employees' financial disclosures.\textsuperscript{240} The court held that the information required by the disclosures is far too sensitive to be placed on the Internet with unrestricted access.\textsuperscript{241} Although the court partially focused on the fact that certain executive officials are faced with international security threats,\textsuperscript{242} many of the privacy arguments made relate to any government official whose information will be accessible to anyone with a computer and Internet access.\textsuperscript{243} Case law relating to the STOCK Act's violation of government officials' privacy quickly developed,\textsuperscript{244} and Congress wasted no time in taking action of its own.\textsuperscript{245}

The House and Senate Ethics Committees are also left with too much discretion in determining the definitions of the terms used in the Act.\textsuperscript{246} There are four provisions of the Act that call for government officials to issue "interpretive guidance" as to how the law will apply to certain groups of government employees.\textsuperscript{247} Each of these provisions grants the delegated authority the power to decide what does and does not fall under the category of prohibited activity.\textsuperscript{248} In each instance, the organization granted with this power is vested somewhere within the branch that the particular provision of the Act applies to.\textsuperscript{249} As noted by the distinguished Senator Charles Grassley, who was instrumental in passing the Congressional Accountability Act,\textsuperscript{250} after many failed attempts, it is very difficult to get Congress to subject itself to laws it

\begin{itemize}
  \item \textsuperscript{240} Id. at 756.
  \item \textsuperscript{241} Id. at 752.
  \item \textsuperscript{242} Id. at 753.
  \item \textsuperscript{243} See id.
  \item \textsuperscript{244} See id.
  \item \textsuperscript{245} Craig Holman, \textit{Congressional Insider Trading Revisited (But Don't Tell Anyone)}, ROLL CALL (May 9, 2013, 1:14 P.M.), http://www.rollcall.com/news/congressional_insider_trading_revisited_but_dont_tell_anyone_commentary-224674-1.html. On April 15, 2013, Congress passed an amendment to the STOCK Act that eliminated the reporting provisions as applied to executive employees and congressional staffers. Online Access of Financial Disclosure Statements and Forms, Pub. L. No. 113-7, § l(a)(I), 127 Stat. 438, 438 (2013). Although many think that this amendment removed all teeth from the Act, the Act was largely ineffective even before the amendment was passed. \textit{Compare} Holman, \textit{supra} (arguing that the Act could have been effective until the reporting requirements were removed), \textit{with supra} Part III.A (arguing that the Act was ineffective as passed, and thus, it is irrelevant whether reporting requirements are included).
  \item \textsuperscript{246} See Stop Trading on Congressional Knowledge Act of 2012, Pub. L. No. 112-105, § 3, 126 Stat. 291, 292 (delegating the role of interpreting how the relevant rules to each chamber shall apply to their members to Select Committee on Ethics of the Senate and the Committee on Ethics of the House of Representatives).
  \item \textsuperscript{247} See \textit{id. §§} 3, 9(a)(1)–(3).
  \item \textsuperscript{248} See \textit{id.}
  \item \textsuperscript{249} See \textit{id.}
  \item \textsuperscript{250} 2 U.S.C. § 1301 (2006).
\end{itemize}
passes for the private sector. Given this difficulty, it does not seem like any interpretive guidance will truly restrict legislators’ trading behavior much, if at all. As a result of this practically unfettered discretion, the two houses of the legislature have too much control over the extent to which the STOCK Act applies to their respective members.

Finally, rather than directly regulating political intelligence activities, the STOCK Act commissioned a report on the topic in order to determine the role that political intelligence has in financial markets. Congress is not ready to declare political intelligence a problem—probably because government ethics experts do not view it as a departure from or violation of existing ethics rules. However, as already articulated, political intelligence is a real problem in our government and our markets. The industry earns more than $400 million each year. Hedge funds have found that the information provided by politically-connected informants is very valuable in beating the market. If gathering political intelligence was not a useful practice, the practice would not continue to grow as significantly as it has in recent years. All types of insider trading—including political intelligence tips—harm the public, individual investors, and the markets as a whole. The fundamental unfairness of these practices undermines investor confidence in the integrity of the markets. The lack of investor confidence, in turn, undermines numerous characteristics that American capitalism and free markets embody.


252. Id. at 36 ("[S]elf-regulation, when not conducted by a disinterested and neutral third party, does not constitute credible regulation at all.").

253. Cf. id. (criticizing self-regulation in another piece of legislation purported to regulate the behavior of members of Congress).


255. See Javers, supra note 147 (summarizing ethics experts’ argument that members of Congress do not violate ethical standards because their decisions are made publicly and they are not receiving any personal benefit in exchange for the information that they provide).

256. See supra Part II.B.


258. Mullins & Scannell, supra note 150; see also Mullins & Pulliam, supra note 257, at A1 (noting an industry researcher’s observation that “the single largest source of gains for [hedge funds] has been what is going on in Washington”).

259. See Javers, supra note 147.


261. Id.

262. See Nelson Lichtenstein, Introduction, in AMERICAN CAPITALISM: SOCIAL THOUGHT AND
IV. A MORE EFFECTIVE ACT THAT EXTENDS BEYOND POLITICAL ACCOUNTABILITY TO EFFECTUATE REAL REGULATION

The STOCK Act fails to accomplish its stated goals, both philosophically and practically.\textsuperscript{263} On the philosophical level, the duty that the Act creates for members of Congress does not conform to the duty required by insider trading law.\textsuperscript{264} On the practical level, concrete regulation of political intelligence—arguably the most influential and controversial aspect of insider trading regarding members of Congress—was eliminated from the Act through the influence of powerful lobbyists.\textsuperscript{265} In order for the Act to truly accomplish its stated purpose, both of these problems must be remedied.\textsuperscript{266}

A. Lack of Consistency with Insider Trading Law

The philosophical problem with the STOCK Act relates to the duty that it created for members of Congress.\textsuperscript{267} As previously articulated, insider trading liability revolves around the existence of a duty between the trader and either the company whose stock is being traded or the source of the insider information used in trading.\textsuperscript{268} The duty that the STOCK Act imposes on members of Congress, however, is only “one arising from a relationship of trust and confidence to the Congress, the United States Government, and the citizens of the United States.”\textsuperscript{269} This legislatively created duty has no connection to the information being traded on or the company that has a property interest in its own information.\textsuperscript{270} A duty of confidentiality to someone with relation to the information must exist.\textsuperscript{271} A generalized duty to someone with no connection to the information is not sufficient for insider trading law to apply.\textsuperscript{272}
Corporate insiders have a stronger argument for being allowed to trade on insider information than do members of Congress. 273 As early as 1966, scholars have argued that insider trading can be an effective way of compensating top corporate executives. 274 However, there is no logically similar argument that applies to members of Congress. 275 Compensation arguments cannot apply to members of Congress because they do not create the information they subsequently trade on; they merely receive it. 276 It is important to recall here that, even though there are valid justifications for allowing corporate insider trading, these arguments have been strongly rejected in favor of an outright ban on the practice. 277 Because the argument in favor of allowing members of Congress to trade on inside information is even weaker and less supported than that which would allow corporate insiders to trade on the very same information, the regulations imposed upon legislators should be at least as strict as those imposed upon corporate insiders. 278

The problem of the creation of an adequate duty can be remedied by changing the duty-creating language in the Act. 279 More appropriate language would create a duty of confidentiality to the owner or possessor of the information. 280 The following language, or some variation thereof, would most effectively remedy this problem: "Each member of Congress owes a duty of confidentiality to any company whose information is given to, or presented in, Congress when such information is derived from the person’s position as a member of Congress or gained from the performance of such member’s official responsibilities." This would create a duty for members of Congress comparable to the duty applied to corporate insiders, and insider trading law would thus clearly apply to members of Congress for violation of this duty. 281

273. See MANNE, supra note 46, at 140 (arguing that insider trading can be an effective means of compensating top executives); see also Barbabella et al., supra note 21, at 224-27 (tracing the evolution of Manne’s argument).
274. See MANNE, supra note 46, at 138.
275. See id. at 179.
276. Id.
278. See Barbabella et al., supra note 21, at 234 (stating that insider trading by legislators does not reward them for productive behavior).
279. See supra notes 264-75 and accompanying text.
280. See supra notes 264-75 and accompanying text.
281. See, e.g., O’Hagan, 521 U.S. at 652.
B. Political Intelligence Was Lobbied Out of the Bill

Regardless of whether one is offended by the philosophical inconsistencies between established insider trading law and the STOCK Act, the practical problem of political intelligence is just as prevalent and causes just as many problems. Political intelligence is a primary form of insider trading within the halls of Congress. Not only are hedge funds benefitting from congressional information that has not yet been made public, but members of Congress are also indirectly benefitting by understanding how their political knowledge translates into market-moving information.

Investors lose confidence in market integrity when it becomes common knowledge that they are not operating freely. A large reason why corporate insiders are banned from trading on non-public information is to protect market integrity and to ensure that all market participants have equal access to information. If a corporate insider possesses material non-public information, he is either required to submit a full disclosure to the SEC before he trades in the company’s shares or refrain from trading altogether until the information has been made public. Members of Congress should be held to the same standard when they trade or disclose legislative information to political intelligence lobbyists.

282. See supra Part III.B.
283. See supra Part II.B.
284. See Zeiler, supra note 204.
288. See supra notes 282-87 and accompanying text.
Concrete regulation of the political intelligence industry was present in earlier versions of the STOCK Act. The Senate version of the 2012 Act also had a provision regulating political intelligence. The House, however, eliminated that provision in favor of the provision that made it in the final version of the Act. In its hurry to enact the bill into law, the Senate conceded to the change in this provision. Without this provision, however, a large chunk of actual regulation was lost from the legislation.

Political intelligence is a serious problem in Washington, D.C. Any solution that will restore public confidence in both the financial and political systems must address this problem. Political intelligence firms should be required to register in a similar fashion to the process that lobbying firms must follow. Political intelligence firms, and the individuals who work for them, should be required to disclose their asset trades, their clients, and the specific activities they perform for those clients. These firms and members of Congress should be held to the standards of corporate insiders and should face similar penalties for


290. O’Toole, supra note 289.

291. Id. The text of the final version of the Act reads:

Not later than 12 months after the date of enactment of this Act, the Comptroller General of the United States, in consultation with the Congressional Research Service, shall submit to the Committee on Homeland Security and Governmental Affairs of the Senate and the Committee on Oversight and Government Reform and the Committee on the Judiciary of the House of Representatives a report on the role of political intelligence in the financial markets.


293. See The Stop Trading on Congressional Knowledge Act: Hearing on H.R. 1148 Before the H. Comm. on Fin. Servs., 112th Cong. 5 (2011) (statement of Rep. Sean Duffy) (“[I]f we only take half a step, there will still be too much gray out there for members of the public to see that Members could skirt around the new rule.”).

294. See Jerke, supra note 21, at 1465-67 (reviewing the extent of Congress’s advantage in the information market).

295. See id. at 1510.


insider trading violations. This somewhat strict regulation is suggested because members of Congress are in a position to receive a significant amount of information that can have a great effect on financial markets. In order for any trading ban to be effective, it must outright prohibit legislators from trading in industries that they directly impact or influence, and from interacting with lobbyists and political intelligence gatherers in any way that would allow them to communicate this information.

This problem can be remedied by adding a specific provision regulating political intelligence to the Act. The definition of political intelligence found in the Act should remain untouched, as it adequately describes the activities observed. The following language, or some version thereof, would likely remedy this problem:

For purposes of the Lobbying Disclosure Act of 1995 and any amendments thereto, the definition of ‘lobbying’ is hereby extended to include political intelligence activities (as previously defined). Political intelligence firms are subject to any and all disclosure or reporting requirements that lobbying firms must follow. Any and all penalties applicable to lobbying firms for violation of the law are extended to political intelligence firms.

This would force political intelligence firms to operate outside of the shadows and subject them to much needed oversight and regulation.

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298. See id. at 5-6.
299. MANNE, supra note 46, at 179-80 (noting that information needed to legislate effectively is often similar to information needed to deal in the stock market).
300. See Eggers & Hainmueller, supra note 141, at 21.
301. See supra notes 282-300 and accompanying text.
302. See supra notes 144-56 and accompanying text. The definition in the Act reads:

[T]he term "political intelligence" shall mean information that is—

(1) derived by a person from direct communications with an executive branch employee, a Member of Congress, or an employee of Congress; and

(2) provided in exchange for financial compensation to a client who intends, and who is known to intend, to use the information to inform investment decisions.


V. CONCLUSION

Insider trading by members of Congress is a phenomenon that has existed for decades and has remained largely unexposed to the general public until recently. A legislature that is so quick to criticize this very behavior by corporate insiders should be held to the exact same standards of conduct. Allowing otherwise would permit the leaders of our government to put themselves above the law, an idea that even the Founders of the U.S. government could not fathom.

The problem has not only existed for quite some time, but it is also very pervasive. Quantitative evidence has demonstrated that trading on non-public information is a common occurrence within the halls of Congress. The American people are fully justified in demanding change because they are being betrayed by the very people they have trusted to run their government. Legislators are using their governmental positions to benefit themselves personally while, at the same time, the average American is struggling to recover from the recent financial crisis and its intrusions into other aspects of everyday life.

A system that allows America’s leaders to trade on valuable information that they learn in the course of their duties in the legislature does not conform to the idea that those who govern are not themselves above the law. The mere fact that insider trading law is considered ambiguous in its applicability to members of Congress flies in the face of the principles that our nation was founded upon. There must be some legislation enacted to resolve this problem. Although it attempted to do so, the STOCK Act is ineffective at adequately making these corrections.

The STOCK Act must either be amended or replaced so that the issues are fairly and effectively regulated. Specifically, there are two

304. See supra Part II.B.
306. See THE FEDERALIST No. 57 (James Madison) (articulating that laws passed by the national legislature will not be overly harsh to the nation’s citizens because the legislators themselves will be subject to the laws that they enact).
307. See supra Part II.B.
308. See supra Part II.B.
309. See supra Part II.B.
310. See supra Part II.B.
311. See THE FEDERALIST No. 57 (James Madison).
312. See id.
314. See supra Part III.
315. See supra Part IV.
problems that must be addressed. \textsuperscript{316} First, a duty of confidentiality must be established for members of Congress that relates to the companies whose securities are being traded by legislators. \textsuperscript{317} Second, the political intelligence industry must be brought out from the shadows and strictly regulated. \textsuperscript{318} If either problem is not addressed, the American people will continue to be placed at a disadvantage in comparison to, and at the hands of, their own government officials. \textsuperscript{319}

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\textsuperscript{316} See supra Part IV.
\textsuperscript{317} See supra Part IV.A.
\textsuperscript{318} See supra Part IV.B.
\textsuperscript{319} See supra Part II.B.

* J.D. candidate, 2014; Hofstra University School of Law. This Note is dedicated to my family—everything I have been able to accomplish is a result of the person you have helped me to become. I am forever indebted to Roberto Pomo and William Dillon, to whom I credit more of my success than they may be willing to accept. I would like to extend my sincerest gratitude to Professor J. Scott Colesanti, without whose time, effort, and thoughtful comments this Note would never have come to fruition. Finally, I must thank Brian Sullivan, Tyler Evans, and Sarah Freeman for their tireless efforts and for keeping me sane throughout this process.