

**Statement to the Committee on Financial Services, United States House  
of Representatives, on “H.R. 1148, the Stop Trading on Congressional  
Knowledge Act”**

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Good morning Chairman Bachus, Ranking Member Frank, and Members of the Committee, and thank you for the opportunity to appear before you to discuss the important issues surrounding H.R. 1148, the Stop Trading on Congressional Knowledge (“STOCK”) Act.

In my testimony and prepared remarks I will address primarily the extent to which the congressional ethics rules and standards already in place address, or may be applied to address, potential instances of insider trading in securities by Members and staff of Congress. As an initial matter, however, I do want to state my view that the current prohibitions on insider trading under federal securities laws and rules, as worked out and applied by the courts through the “misappropriation theory” of insider trading, do apply fully to members and staff of Congress. In other words, in my view, Members and staff of the House and Senate do not enjoy any blanket immunity from enforcement actions, whether civil or criminal, for violations of the prohibitions on insider trading; an enforcement action may be brought where a Member or employee of Congress uses – in connection with a securities trade – material, nonpublic information, to the source of which the Member or employee owes a duty of trust or confidence.

Having said that Members and staff of Congress *could* be prosecuted for insider trading under the “misappropriation theory” as a matter of law, I do not say that any such prosecution or civil enforcement action against a congressional individual would be easy. Difficult matters of proof – difficult factual issues – could, and almost certainly would, arise. For example, there could well be proof problems as to the “materiality” of the information in question. Would a reasonable shareholder of the security traded by the congressional individual consider the information important in making an investment decision or – because congressional action on a matter often comes after extensive disclosures about a given company through other avenues – would such information more likely be seen as moot or cumulative? Given the flow of information in, around, and through the Capitol, was the information truly “nonpublic”? Or, to cite a point discussed by Professor Donna Nagy in her important article on the subject, was the information actually used in the securities trade in question or was the trade made on a separate and independent basis?

So there are practical difficulties to bringing an insider trading case against a congressional individual based on the “misappropriation theory.” To my understanding, however, there are inherent practical, proof difficulties to bringing a “misappropriation” insider case – or, to use another term, an “outsider” insider trading case -- regardless of

the arena or institution in which the questioned conduct occurs. On the other hand, not to minimize the potential practical difficulties of proving an insider case in Congress, proof in many such cases could be impeded by Speech or Debate Clause concerns; but such issues could arise as well in connection with enforcement actions brought under the STOCK Act, since no statute could trump a constitutional privilege.

I have not yet discussed the potential practical and factual problems that could arise in the congressional context in proving the final element of an insider trading allegation under the “misappropriation theory.” To sum up these potential problems in a question: Did the congressional individual under investigation for allegedly trading on the basis of material, nonpublic congressional information have the requisite duty of confidentiality with respect to that information? It is by way of addressing the question of what duty of confidentiality (or similar duty of trust) obtains on the part of Members and staff of Congress in connection with information before the Congress that I discuss those congressional ethics rules and standards already in place in the House and Senate that may – or may not – be used internally within each house of Congress to address alleged insider trading activity.

### **The Code of Ethics for Government Service and Congressional Obligations of Confidentiality**

The “Code of Ethics for Government Service” provides, at paragraph 8, that a person in government service should “Never use any information coming to him confidentially in the performance of governmental duties as a means for making private profit.”

The “Code” was passed by the House and Senate by Concurrent Resolution in July 1958. The Code is specifically listed in the Rules of the Senate Select Committee on Ethics as one source for the Committee’s investigative and disciplinary jurisdiction. The Committee on Ethics of the House states in its *Manual* that the Code not only states “aspirational goals for public officials, but violations of provisions contained therein may also provide the basis for disciplinary action . . .” Provisions of the Code have formed the basis for disciplinary and/or admonitory action against Members by each of the congressional ethics committees.

Quite clearly, paragraph 8 of the Code of Ethics for Government Service – with its prohibition on the use of confidential information as a means for making private profit – may be used by the House and the Senate, and their respective ethics committees, to capture and sanction the kind of conduct covered by the “misappropriation theory” of insider trading. What is less clear is the extent to which information before Congress, or before a committee or office of Congress, may be considered “confidential.”

There are no House or Senate rules, or policies, that impose a blanket duty of confidentiality on Members and employees in connection with information coming before them in the course of their official duties. The rules of some committees – for example, the rules of the ethics committees of both the House and the Senate and of the intelligence committees – explicitly impose obligations of confidentiality on committee

members and staff with respect to committee information. The rules of some other committees impose an obligation of confidentiality with respect to specific classes of information. The rules of many other committees of the House and Senate, however, do not impose any specific duties of confidentiality with respect to committee information.

Where does this uneven approach, among congressional committees and offices, to defining “confidentiality” leave use of paragraph 8 of the Code of Ethics for Government Service as a vehicle for addressing, within the congressional disciplinary process, allegations of insider trading, allegations that “confidential information” coming to a Member or employee “in the performance of governmental duties” was used “as a means for making private profit”? It ties congressional enforcement of paragraph 8 of the Code to a case-by-case, committee-by-committee, office-by-office analysis of whether a duty of confidentiality existed with respect to the information in question. If this is viewed as insufficiently systematic or insufficiently rigorous by some, doesn’t such a case-by-case approach largely characterize enforcement of insider trading prohibitions under the “misappropriation theory” in the world outside of Congress? Should Congress, by blanket rule or law, impose on itself stricter prohibitions against insider trading than apply to the general public? In my view, the STOCK Act would impose such stricter standards on congressional Members and employees.

One possible alternative to the blanket approach taken by the STOCK Act, would be for the House and Senate to require committees and offices to adopt more specific policies, procedures and rules regarding what information must be treated as confidential and what sanctions will apply if and when the duty of confidentiality is violated.

### **House and Senate Conflict of Interest Rules**

Apart from paragraph 8 of the Code of Ethics for Government Service, do any other House or Senate ethics rules or standards capture insider trading? It is arguable that the general conflict of interest provisions of House and Senate rules would cover instances of insider trading by Members and staff based on information coming to them in the course of their official duties. Consider, for example, paragraph 3 of House Rule XXIII states:

A Member, Delegate, Resident Commissioner, officer, or employee of the House may not receive compensation and may not permit compensation to accrue to the beneficial interest of such individual from any source, the receipt of which would occur by virtue of influence improperly exerted from the position of such individual in Congress.

Senate Rule XXXVII, paragraph 1, contains a similarly worded provision.

It is arguable that the operative phrase “by virtue of influence improperly exerted from his position” in Congress should and does include instances where a Member or employee, in effect, “improperly” influences the securities markets by trading on material, nonpublic information that has come to the Member or employee through his or her official position. This reading is implied by the House Ethics Committee in its

citation of the rule in its recent, and very timely, advisory memorandum on “Rules Regarding Personal Financial Transactions” (November 29, 2011).

However, in the Senate, at least, application of its parallel provision has been reserved for instances where an individual’s official power or position has been used to obtain some personal benefit “under color of official right” or office. For instance, the following examples from the legislative history to the Senate rule are provided in the *Senate Ethics Manual*, at page 66, to illustrate the meaning of this provision:

For example, if a Senator or Senate employee intervened with an executive agency for the purpose of influencing a decision which would result in measurable personal financial gain to him, the provisions of this paragraph would be violated. Similarly, if a Senator or Senate employee intervened with an agency on behalf of a constituent, and accepted compensation for it, the rule of this paragraph would also be violated.<sup>1</sup>

Similarly, the discussion in the *House Ethics Manual*, at page 186, of the House provision emphasizes that “[a]s noted in the debate preceding adoption of this rule, an individual violates this provision if he uses ‘his political influence, the influence of his position . . . to make pecuniary gain.’” (Citation omitted.)

A broader reading and application of this provision in the Senate – whereby the rule might be applied to allegations of insider trading – could be supported by other language from the legislative history of the rule, which, as stated in the *Senate Ethics Manual* at page 66, indicates that the provision was intended “as a broad prohibition against members, officers, or employees deriving financial benefit, directly or indirectly from the use of their official position.”<sup>2</sup> And as, the House Ethics Committee points out in its discussion of this provision in its *Manual*,

Members and staff, when considering the applicability of this provision to any activity that they are considering undertaking must also bear in mind that under a separate provision of the Code of Official Conduct . . . they are required to adhere to the spirit as well as the letter of the Rules of the House.

Notwithstanding such suggestions by the House and Senate ethics committee’s regarding the potential scope of Senate Rule XXXVII, paragraph 1, and House Rule XXIII, paragraph 3, it is my view that application of either of these provisions to instances of alleged insider trading by Members and staff of Congress would be an innovation going beyond the intent of these rules.<sup>3</sup>

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<sup>1</sup> S. Rep. No. 95-49, The “Nelson Report.”

<sup>2</sup> *Id.*

<sup>3</sup> I take this view notwithstanding the following language from The Senate Ethics Committee’s discussion of the “Basic Principles” of conflicts of interest at page 66 of the *Manual*: “The Senate’s commitment to avoiding conflicts of interest is embodied in Senate Rule 37. Paragraphs 1 through 4, 7, and 10 target the possibility or appearance that Members or staff are “cashing in” on their official positions . . .”

### **Conduct Reflecting Discredit**

I want to discuss one further current congressional ethics standard pursuant to which allegations of insider trading by Members and staff may be addressed. Paragraph 1 of House Rule XXIII provides that a “Member, Delegate, Resident, Commissioner, officer, or employee of the House shall behave at all times in a manner that shall reflect creditably on the House.” Although the Senate Code of Conduct does not explicitly contain a similar provision, the Senate Ethics Committee is obligated by its authorizing resolution “to investigate allegations of improper conduct which may reflect upon the Senate.” The Senate Ethics Committee and the Senate have admonished and disciplined Members for violations of this deliberately open-ended and flexible “catchall” provision.

In my view and experience, if credible allegations of insider trading by a Member or employee were to come before the House Ethics Committee, the Senate Ethics Committee, or the House Office of Congressional Ethics, and these allegations were supported by sufficient specific evidence -- that is, if the allegations were more than merely conclusory or based on more than mere coincidence -- even if it were determined that the specific provisions discussed above were applicable, these allegations would be diligently pursued and investigated as, potentially, constituting conduct reflecting discreditably on the institution.

### **The STOCK Act Disclosure Provisions**

The STOCK Act would amend the financial disclosure requirements applicable to Members and senior staff of Congress to require that the “purchase, sale, or exchange” of any “stocks, bonds, commodities futures, or other forms of securities” be reported publicly within 90 days. Current financial disclosure requirements mandate only annual public disclosure of securities transactions.

In the House and Senate, as a historical matter, public financial disclosure – rather than recusal or divestment – has been viewed as the principal means for policing potential conflicts of interest. The Senate Ethics Committee, in its *Manual*, has “made the case” for this reliance on disclosure:

Senators enter public service owning assets and having private investment interests like other citizens. Members should not “be expected to fully strip themselves of worldly goods” — even a selective divestiture of potentially conflicting assets is not required. Unlike many officials in the executive branch, who are concerned with administration and regulation in a narrow area, a Senator exercises judgment concerning legislation across the entire spectrum of business and economic endeavors. The wisdom of complete (unlike selective) divestiture may also be questioned as likely to insulate a legislator from the personal and economic interests that his or her constituency, or society in general, has in governmental decisions and policy.

Thus, public disclosure of assets, financial interests, and investments has been required and is generally regarded as the preferred method of monitoring possible conflicts of interest of Members of the Senate and certain Senate staff. Public disclosure is intended to provide the information necessary to allow Members' constituencies to judge official conduct in light of possible financial conflicts with private holdings.

*Senate Ethics Manual*, at pages 124-125, citations omitted.

Enactment of the STOCK Act provision requiring public reporting of securities transactions by Members and employees of Congress within 90 days of the transaction would undoubtedly be viewed as intrusive and burdensome by some Members and employees. I don't think anyone who is subject to the current annual disclosure requirements enjoys filling out the form; an annual disclosure filer once told me he found completing his income tax form to be more enjoyable. However, increasing the frequency of reporting on securities transactions would be more consistent with the current framework for addressing potential congressional conflicts of interest than an approach that would directly restrict trading itself or an approach that would create and impose new obligations of confidentiality, the unintended repercussions from which on the necessary and beneficial flow of information in and through Congress may be impossible to predict.

### **The "Political Intelligence" Provisions of the STOCK Act**

Finally, I have a few observations in connection with the provisions of the STOCK Act that would amend the Lobbying Disclosure Act (the "LDA") to impose registration and disclosure requirements on so-called "political intelligence consultants" and "political intelligence firms."

First, the Act defines "political intelligence contacts" to include "any oral or written communication . . . to or from a covered executive branch official or a covered legislative branch official, the information derived from which is intended for use in analyzing securities or commodities markets, or in informing investment decisions and which is made on behalf of a client . . . ." This seems very broadly worded. Is the language on "informing investment decisions" intended to cover potential capital investment decisions by, for example, a company in the oil services industry in connection with which a representative of the company has a purely informational, non-lobbying contact with an executive branch agency official about the administration or execution of a federal energy program in the Gulf?

Further, with respect to who would qualify as a "political intelligence consultant," the act takes a strict "one and done" approach; in other words, a "political intelligence consultant" means anyone "who is employed or retained by a client for financial or other compensation that include *one or more* political intelligence contacts." (Emphasis added.) This definition is not consistent with the manner in which "lobbyist" is defined under the LDA; the definition of "lobbyist" excludes any "individual whose lobbying activities constitute less than 20 percent of the time engaged in the services provided by

such individual to [a] client over a 3-month period.” Other than potentially deterring many individuals outright from becoming “political intelligence consultants,” what purpose is served by imposing the burdensome registration and disclosure requirements of the LDA on a person who simply makes one contact requesting information from a government official?

My final point concerns overburdening the LDA as a vehicle for regulating protected conduct. It is important for you to remember that the LDA creates an anomaly, that is, it creates a regulatory scheme that lives within the legislative branch. As such it is not subject to the legal tests and requirements to which other, executive branch regulatory schemes are subject pursuant to the Administrative Procedure Act. Violations of the LDA are potentially subject to civil and criminal enforcement, and yet no agency or office provides legally dispositive or authoritative guidance regarding the meaning of the terms or requirements of the LDA or regarding the application of the LDA in specific circumstances. The LDA requires the Secretary of the Senate and the Clerk of the House of Representatives to provide guidance and assistance on the registration and reporting requirements of the LDA and to develop common standards, rules and procedures for compliance with the LDA. But the LDA does not provide the Secretary or the Clerk with the authority to write substantive regulations about or issue definitive opinions on the interpretation of the LDA. It is problematic enough that a regulatory scheme for which no government office or agency is truly accountable – that is, the LDA – currently regulates the First Amendment protected activities of one class of persons, lobbyists. Extending the requirements and potential sanctions of the LDA to yet an entire new class of persons, “political intelligence consultants,” would compound this arguably constitutional concern.

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Thank you for considering my views on the STOCK Act and on other approaches to addressing allegations of insider trading within Congress. I would certainly welcome any questions you may have.

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United States House of Representatives  
Committee on Financial Services

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<b>3. Business Address and telephone number:</b> <div style="background-color: black; height: 40px; width: 100%;"></div>	
<b>4. Have <u>you</u> received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?</b>  <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	<b>5. Have any of the <u>organizations you are representing</u> received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?</b>  <input type="checkbox"/> Yes <input type="checkbox"/> No
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