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## The STOCK Act: More Questions Than Answers?

2012-03-28

On March 22, the United States Senate passed the "Stop Trading on Congressional Knowledge Act of 2012," or "STOCK Act." The bill passed by the Senate was identical to one passed by the House of Representatives on February 9. The Act's most prominent feature is an affirmation that the prohibition on insider trading in the U.S. securities laws applies to Members of Congress, employees of the executive branch, federal judges, and employees of the judicial branch. Although the Act does not include a much-discussed provision that would have required registration of "political intelligence" firms, its insider trading provisions still raise many interpretive questions, including ones that will directly affect private citizens speaking with Members of Congress and their staff members.<sup>1</sup>

### Prohibitions on Insider Trading

Section 4 of the Act provides that "Members of Congress and employees of Congress are not exempt from the insider trading prohibitions arising under the securities laws," specifically including section 10(b) of the Securities Exchange Act of 1934 (the "Securities Exchange Act") and Securities Exchange Act Rule 10b-5.<sup>2</sup> Similarly, Section 9 affirms that the insider trading prohibitions apply to executive branch employees, judicial officers, and judicial employees.<sup>3</sup> The Act amends Section 21A of the Securities Exchange Act to provide that Members and employees of Congress owe a duty 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 their position or gained from the performance of their official responsibilities.<sup>4</sup> A similar amendment to Section 21A states that executive branch employees, judicial officers, and judicial employees owe the same duty of trust and confidence to the United States government and the citizens of the United States.<sup>5</sup> Amendments to the Commodity Exchange Act add Members of Congress, employees of Congress, executive branch employees, judicial officers, and judicial branch employees to the list of persons covered by the prohibition on insider trading in the Commodity Exchange Act.<sup>6</sup>

The congressional ethics committees are directed to issue interpretive guidance clarifying that Members and employees of Congress are not permitted to use nonpublic information derived from their position or gained from the performance of their official responsibilities as a means for making

a personal profit.<sup>7</sup> The Act requires the Office of Government Ethics and the Judicial Conference of the United States to issue similar interpretive guidance with respect to executive branch employees, judicial officers, and judicial employees.<sup>8</sup> A rule of construction in the statute provides that the guidance shall not be construed to "impair or limit the construction of the anti-fraud provisions of the securities laws or the Commodity Exchange Act or the authority of the Securities and Exchange Commission or the Commodity Futures Trading Commission under those provisions."<sup>9</sup>

## **Report on Political Intelligence Activities**

The STOCK Act, as passed, does not include the controversial provision found in an earlier Senate draft that would have created a registration regime for so-called "political intelligence" firms, similar to the current regime for lobbyists. Instead, the Act requires the Comptroller General of the United States, in consultation with the Congressional Research Service, to issue a report on political intelligence activities within 12 months of the date of enactment.<sup>10</sup> The Act defines "political intelligence" as information:

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.<sup>11</sup>

The report required by the Act must include a discussion of:

- The prevalence of the sale of political intelligence and the extent to which investors rely on it;
- The effect of the sale of political intelligence on the financial markets;
- The extent to which the information being sold would be considered nonpublic information;
- The legal and ethical issues raised by the sale of political intelligence;
- The potential benefits of imposing disclosure requirements on people who engage in political intelligence activities; and
- Any legal and practical issues raised by such disclosure requirements.<sup>12</sup>

## **More Questions Than Answers?**

While the STOCK Act was intended to "clarify" or "affirm" the application of the prohibition against insider trading to Members of Congress and federal employees, it raises a number of interpretive questions that will need to be answered as the law is applied.

### *Confidential Information*

What government information is confidential and subject to the duty of confidence? The answer to that question is reasonably clear for most executive branch, agency, and judicial employees but is highly uncertain for the legislative branch. It is the most critical question raised by the Act because a Member or staff member will breach a duty only when he or she trades on or discloses information

that must be kept confidential.

What information acquired during the performance of his or her job must a Member of Congress keep confidential? Is information about the date or time of a floor vote or committee meeting confidential? Is information about the way a Member will vote on a particular matter confidential? Is information a staff member receives from a private citizen confidential? The ethics committees should address this important topic in their guidance.

### *Tipper-Tippee Liability*

The duties of trust and confidence created by the Act set up the possibility that Members of Congress or federal employees, and private citizens communicating with them, could be held liable for "tipping," i.e., improperly sharing information with another person for the purpose of trading. For this reason, clarity in identifying information subject to a duty of confidentiality is absolutely essential for all Americans communicating with legislative branch members and other officials of the federal government as well as for the government employees themselves. Without clear standards, employees of the federal government and private citizens could reduce and be wary about their communications with each other or otherwise face the possibility of damaging and costly enforcement investigations after securities or commodities trades. Legislative personnel will not always know when a private interlocutor will trade.

### *First Amendment Concerns*

As just mentioned, the potential liability created by the Act could chill communications between citizens and their elected representatives. The interpretive questions and vague standards in the Act and the consequent uncertainty could lead to a serious diminution in the free flow of information between legislators and voters about legislation, major public policy issues of the day, and other forms of the people's legislative business. Such a result, if it occurs, could raise important First Amendment issues or at a minimum be contrary to sound and effective governance. The First Amendment concerns raised by the Act are discussed in greater detail by WilmerHale partner Peter Neiman in a March 27, 2012 New York Law Journal article.<sup>13</sup>

### *Materiality*

The assessment of whether or not information is material can be a difficult and complicated question in the corporate context. Assessing whether or not information obtained in the course of government service is material is likely to be a much more difficult task. The Act does not even specify what information must be material to. Given the background of the legislation, the goal seems to be to cover information material to a securities or commodities transaction, but the statute does not say that. The ethics committees should address this topic in their guidance.

### *"Nonpublic" Information*

What information in the possession of, for example, a Member of Congress, will be deemed nonpublic? How broadly must information about legislative activity be disseminated to be considered public information? If a Member of Congress inadvertently discloses nonpublic information to a constituent that the Member later concludes could be material to a publicly traded security, will the Member need to quickly disseminate that information more broadly with, for example, a press release? Will behind-the-scenes negotiations among Members become more difficult as a result?

### *Speech and Debate Clause*

Depending on the circumstances of the relevant communications, an effort to enforce the Act could implicate the protections of the Speech or Debate clause of the Constitution.<sup>14</sup> That clause prevents the government from introducing evidence of a Member's legislative acts to prove an element of a charge and protects a Member's documents and records from being obtained in an investigation when the documents pertain to the Member's legislative activities. The clause does not protect documents that are not related, or only incidentally related, to the Member's legislative affairs. Thus, when the government needs evidence of a Member's legislative acts or records to prove or confirm a communication or breach of duty, the Speech or Debate clause would likely be an impediment to the enforcement proceeding.

**Conclusion:** While the compromise version of the STOCK Act passed by both houses eschewed the controversial registration regime for political intelligence firms, the application of the Act will still raise numerous difficult interpretive questions. These important questions relate to how liability will be established under the Act, how the Act will affect Member's interactions with each other, whether the Act will chill communications between the public and their elected representatives, and whether the insider trading provisions of the Act can be enforced without impinging on constitutional protections for the legislative branch of the federal government.

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<sup>1</sup> This Alert discusses only the provisions of the STOCK Act that relate to insider trading and political intelligence.

<sup>2</sup> Stock Act § 4(a).

<sup>3</sup> *Id.* § 9(b)(1).

<sup>4</sup> *Id.* § 4(b)(2).

<sup>5</sup> *Id.* § 9(b)(2)(B).

<sup>6</sup> *Id.* § 5.

<sup>7</sup> *Id.* § 3.

<sup>8</sup>*Id.* § 9(a).

<sup>9</sup>*Id.* § 10(1).

<sup>10</sup>*Id.* § 7(a)(1).

<sup>11</sup>*Id.* § 7(b).

<sup>12</sup>*Id.* § 7(a)(2).

<sup>13</sup> Peter G. Neiman, *Is the STOCK Act Unconstitutional?*, N.Y.L.J., Mar. 27, 2012, at 4.

<sup>14</sup> U.S. CONST. art. 1, §6, cl. 1.

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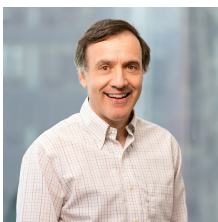
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