

ALERT

# The STOCK Act: Insider Trading on Government Information; Corporate and Individual Compliance Concerns

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The "Stop Trading on Congressional Knowledge Act of 2012" (STOCK Act) was signed into law today by President Obama. The President's remarks at the White House signing ceremony, like coverage of the STOCK Act in the media, focused on the Act's restrictive effects on securities trading by Members and employees of Congress. But enactment of the STOCK Act also confronts corporations and other organizations-and their lobbyists and other employees-with a clear compliance moment: If they have not done so already, they should now take steps to assure that investment decisions are not based on material, nonpublic information improperly "tipped" by a federal government official or employee. The Securities and Exchange Commission (SEC) and the Department of Justice (DOJ) will be watching to see what-and who-the insider trading enforcement spotlight generated by the STOCK Act exposes.

## What the STOCK Act Does

The STOCK Act "affirms" that Members, officers, and employees of Congress-and all other officials and employees of the executive and judicial branches of the federal government-"are not exempt from the insider trading prohibitions arising under the securities laws . . ." The central provisions of the Act provide that, in the insider trading context, Members and employees of Congress and all other federal officials and employees owe a "duty of trust and confidence" to the "United States Government" and to the "citizens of the United States" respecting "material, nonpublic information" derived from their official positions or gained through performance of their official responsibilities.

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## Practice Areas

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Election Law & Government Ethics

Other provisions of the Act:

- Make conforming changes to insider trading restrictions under the Commodity Exchange Act.
- Require all officials and employees of the Executive branch (from the President down) and all Members, officers and employees of Congress to publicly disclose each personal financial transaction within 30 to 45 days.
- Mandate electronic filing of, and internet access to, all public financial disclosure reports filed by federal government officials.

As passed, the STOCK Act does *not* contain the controversial provisions requiring registration and disclosure by "political intelligence" firms and consultants; this new regulatory scheme was shelved-at least temporarily-in favor of a 12 month study by the Comptroller General of the United States "on the role of political intelligence in the financial markets."

### **The STOCK Act and Insider Trading**

#### *The "misappropriation theory" of insider trading*

Insofar as a Member or employee of Congress-or any other federal government official or employee-is not engaged in trading securities as an actual corporate "insider" (e.g., as an officer or director of the company whose stock is being traded), an insider trading action against such an official would proceed under the "misappropriation theory." Under this theory-upheld by the Supreme Court in its 1997 decision in *U.S. v. O'Hagan*-a person may be prosecuted for insider trading if he or she trades on the basis of "material, nonpublic information" obtained from a source to which he or she owes a duty of trust and confidence.

*"Material, nonpublic information"; the "duty of trust and confidence" owed by government officials; and the scienter requirement*

As noted above, the STOCK Act statutorily defines the "duty of trust and confidence" for Members and employees of Congress "for purposes of the insider trading provisions arising under the securities laws":

[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 position as a Member of Congress or employee of Congress or gained from the performance of such person's official responsibilities.

The Act delineates a similar "duty of trust and confidence" for all officials and employees of the Executive and Judicial branches respecting use of material, nonpublic information.

There is debate over whether these "duty" provisions of the STOCK Act impose new, expanded insider trading restrictions on government officials or whether the STOCK Act simply clarifies already existing prohibitions. To address this uncertainty-and in the absence of any other instructive legislative history-prior to the Senate's final

vote on the Act, Senator Harry Reid and Senator Joseph Lieberman engaged in a scripted colloquy that will be central to interpretation and application of the Act. In this exchange, Senator Lieberman stated that "the STOCK Act is not intended to limit government transparency or hinder dissemination to interested parties regarding Congressional activities and deliberations." Senator Reid, to counter concerns that the Act "would have a significant chilling effect on government transparency," noted that the SEC "explicitly clarified" to Senate leadership staff "that it does not view the STOCK Act as creating new limitations on the disclosure of Congressional information in conversations with constituents"; he also cited the SEC's assurances "that any case brought under the insider trading prohibitions would still require the SEC to prove that a Member of Congress or their staff acted with *scienter*, which means acting corruptly, knowingly, recklessly, or in bad faith."

*Potential insider trading liability of lobbyists and other private citizens ("tippees") who receive governmental information: Questions remain*

The colloquy between Senators Reid and Lieberman arguably provides a safe harbor to Members and staff of Congress who communicate material, nonpublic information in the course of their official duties in "good faith," that is-in the context of the "misappropriation theory" of insider trading-if they communicate such information without expectation of some resulting personal benefit.

But for "tippees"-that is, for organizations or individuals who receive material, nonpublic congressional (or other governmental) information offered by an official in "good faith" and who engage in securities trading based on such information-the potential for being the target of an insider trading enforcement action depends on how one views the current state of the law on "tippee" liability in the absence of any enforceable liability by the "tipper." The weight of precedent and authority appears to support the view that-for "tippee" liability to be found-the "tipper" of the material, nonpublic information must have acted for some personal benefit in providing the tip, whether a financial benefit, reputational benefit, or otherwise. (See, e.g., *Securities and Exchange Commission v. Yun*, a 2003 case from the 11<sup>th</sup> Circuit.) But, as a legal matter, the issue of the scope of "tippee" liability still remains open, at least to some extent. And, as a practical matter, how certain can a "tippee" organization or individual be that a governmental source, in communicating information, is not acting at least for reputational or some other intangible benefit?

### **Related Ethics Guidance Mandated by the STOCK Act**

Some further sense of the scope of "safe" communications with Members and employees of Congress (and with officials and employees of the Executive and Judicial branches) under the STOCK Act may be provided when, as required by the Act, the House and Senate ethics committees (and the Office of Government Ethics and the Judicial Conference of the United States) issue "interpretive guidance" to "clarify" that under already applicable ethics rules Members, and other federal employees and officials, may not use nonpublic information derived from their official position or gained from the performance of official responsibilities "as a means for making a private profit." This ethics guidance could provide some content to the general "Rule of Construction" provision in the STOCK Act which states that nothing in the Act "shall be construed . . . to be in derogation of the obligations, duties, and functions" arising from a government official's or employee's official position. (Within hours after the President signed the STOCK Act, the House Committee on Ethics did issue an

advisory on "New Ethics Requirements Resulting from the STOCK Act." However, neither this new Committee advisory nor its November 29, 2011 advisory on "Rules Regarding Personal Financial Transactions" directly addresses the issue of what effect, if any, the STOCK Act's restrictions could have on the broad scope of necessary and appropriate communications by and with the Congress.)

Regardless of the scope of any ethics guidance issued under the STOCK Act's mandate, the extent to which such guidance will apply to potential liability by *recipients* of governmental information remains a significant and open question, as does the question of whether the SEC and DOJ would even view such ethics guidance as binding in connection with their insider trading enforcement activity.

### **STOCK Act Compliance**

What new organizational compliance concerns does the STOCK Act raise? Lobbyists, other employees who interact regularly with federal government officials, and all individuals involved in organizational investment decisions should receive training on the requirements of and potential pitfalls posed by the STOCK Act. Moreover, steps should be taken to assure that-if government-derived information is used in organizational (or even in individual employee) investment decisions-this information is already generally available to the trading public or has otherwise been disclosed in an open, publicly accessible forum.

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Robert L. Walker, Of Counsel in the Election Law & Government Ethics Practice Group testified on the STOCK Act before the Senate Homeland Security and Governmental Affairs Committee and the House Committee on Financial Services; he was called one of "the most knowledgeable expert witnesses" on questions and concerns raised by the STOCK Act. Prior to joining Wiley Rein in 2008, Mr. Walker served as Chief Counsel of the Senate Select Committee on Ethics, as well as Chief Counsel of the House Committee on Ethics. He was also a Trial Attorney in the Department of Justice, an Assistant U.S. Attorney and an attorney in the Division of Enforcement of the U.S. Securities and Exchange Commission investigating insider trading and other financial fraud matters.