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COMMENT

THE STOCK ACT IS INADEQUATE: U.S. INDEX FUNDS ARE THE SOLUTION TO POLITICAL INSIDER TRADING

Kevin W. Fritz[†]

I. INTRODUCTION

Members of Congress do not improve the public's poor perception of them¹ when their wealth increases during times of economic hardship,² especially when nearly a majority of them are already millionaires.³ A recent "60 Minutes" report on congressional insider trading⁴ intensified these negative sentiments and subjected Congress to increased public scrutiny.⁵ The report detailed several accounts of congressional insider trading, illustrating how—under current insider-trading laws—members of Congress are permitted to trade on insider information.⁶ With a focus on the House of Representatives, this Comment starts from the premise that congressional insider trading is legal under the present laws.⁷ Then, in addition to advocating that this state of the law is unacceptable, it also

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1. Marc Kilstein, *Gallup Poll: Public Trust in Legislative Branch at All-Time Low*, TPMDC (Sep. 24, 2010, 6:11 PM), <http://tpmdc.talkingpointsmemo.com/2010/09/american-trust-in-legislative-branch-at-all-time-low-in-new-gallup-poll.php>.

2. Michael Brush, *In Congress, Nearly Half the Members Are Millionaires*, MSN MONEY (Jan. 5, 2012, 4:56 PM), <http://money.msn.com/investing/latest.aspx?post=70cc8f98-07b4-4e4e-923e-5569bd82627d>.

3. *Id.*

4. This is also commonly referred to as political insider trading, and it consists of politicians trading in the stock market on nonpublic information, such as upcoming market changing information, gained from their position. Babatunde Onabajo, *Ban on Political Insider trading*, THE DAILY ORGAN, <http://www.dailyorgan.com/2011/12/ban-political-insider-trading/> (Last visited Feb. 4, 2012).

5. Steve Kroft, *Congress: Trading Stock on Inside Information?* 60 MINUTES (Nov. 13, 2011, 7:06 PM), available at http://www.cbsnews.com/8301-18560_162-57323527/congress-trading-stock-on-inside-information/?tag=contentMain;contentBody.

6. *Id.*

7. See *infra* Part V.B.

provides a strict remedy to solve the problem. Implementing such a solution would not only help our political system take one step closer to justice, it would also improve America's trust in its politicians and give members of Congress an incentive to improve the economy.⁸

To fully appreciate why the strict remedy proposed in this Comment is necessary, it is first essential to understand the history and pervasiveness of the problem. Part II describes how American politics have been plagued by insider trading since this nation's founding and it further develops the facts about how current politicians are trading on nonpublic information for personal gain without any legal consequence.⁹ To aid the reader in understating the scope of current insider-trading laws, this Comment explains state insider-trading laws in Part III,¹⁰ and then, in Part IV, details federal insider-trading laws.¹¹

In Part V, this Comment examines the Congressional Ethics Rules, and then it applies current insider-trading laws to situations where members of Congress engage in political insider trading.¹² This will help the reader appreciate how current insider-trading laws do not apply to members of Congress trading on nonpublic information regarding congressional activity. After seeing that members of Congress commit insider trading while being immune from insider-trading laws, Part VI discusses the underlying moral and ethical questions of whether it *should* be prohibited under two different perspectives: (1) law and economics; and (2) the biblical worldview.¹³ Finally, in Part VII, after discovering that the practice is not only inefficient but also immoral, this Comment addresses different ways to solve the problem and advocates that the best solution is to require members of Congress to only invest proportionally in the Dow Jones Industrial Average (hereinafter "DJIA"), Standard and Poor's 500 (hereinafter "S&P 500"), and Nasdaq index funds. This solution would help solve the problem and give members of Congress incentive to improve the U.S. economy.¹⁴

8. See *infra* Part VII.

9. See *infra* Part II.

10. See *infra* Part III.

11. See *infra* Part IV.

12. See *infra* Part V.

13. See *infra* Part VI.

14. See *infra* Part VII.

II. A DESCRIPTION OF THE PROBLEM OF INSIDER TRADING

A. *An American Problem from the Beginning*

Congressional use of nonpublic information for the purpose of individual financial gain has plagued this nation since the founding of the Republic.¹⁵ As Secretary of the United States Treasury, Alexander Hamilton advocated for Congress to purchase, and thus give value to, the states' Revolutionary War debt, as well as the debt created by the Continental Congress.¹⁶ Hamilton met intense resistance to this proposal—particularly from fiscally responsible states like Virginia, which had already paid most of its debt.¹⁷

During the struggle to pass the legislation that would give value to the Revolutionary War debt, some insiders to the negotiations purchased devalued certificates and, in the process, tipped off some of their wealthy supporters to this financial opportunity.¹⁸ Connecticut congressman Jeremiah Wadsworth, one of Hamilton's associates, allegedly made an \$18 million profit from purchasing depreciated paper from southerners.¹⁹ Senator Robert Morris made an even larger profit of \$20 million.²⁰ Many Americans were outraged when they learned that these government officials had taken advantage of them by using such nonpublic information for personal profit.²¹ As evidenced by Hamilton, Wadsworth, and others, our nation's birth was accompanied by an unfortunate defect: representatives entrusted with leading the nation immediately began abusing their positions of leadership for private financial gain.²²

15. 1 JERRY W. MARKHAM, *A FINANCIAL HISTORY OF THE UNITED STATES*, 78–80 (2002).

16. *Id.* at 78.

17. *Id.*

18. *Id.* at 80.

19. *Id.*

20. *Id.*

21. *Id.*

22. *Id.* at 78–80.

B. *The Problem Remains*

1. Examples of Current Politicians Who Commit Political Insider Trading

America continues to elect corrupt politicians who practice insider trading for personal gain, and federal law continues to allow these politicians to operate without legal hindrance.²³ Representative Brian Baird, an advocate for the Stop Trading on Congressional Knowledge Act (hereinafter “STOCK Act”),²⁴ is one of the few politicians in this nation to recognize this as a problem.²⁵ Discussing the issue of political insider trading, Representative Baird stated, “There are some members who seem to think the rules just shouldn’t apply to us.”²⁶ Unfortunately, those members of Congress who “think the rules just shouldn’t apply”²⁷ are correct under the current insider-trading laws.²⁸

The television broadcast “60 Minutes” recently released a report on political insider trading, uncovering several underhanded congressional financial transactions.²⁹ For example, in 2005, the House Speaker Dennis Hastert purchased land near his home.³⁰ He then earmarked a bill to build a highway near the land, and months later, after the earmark was approved, he sold the land for \$2 million, earning—to use the word loosely—a sizable profit.³¹ In 2008, when Nancy Pelosi was Speaker of the House of Representatives and the economy was on the brink of financial collapse, Speaker Pelosi and her husband purchased 5,000 IPO shares of Visa at \$44 per share.³² At the same time, Speaker Pelosi was involved in advancing legislation through the House that would negatively affect Visa.³³ Two days

23. Erika Lovley, *New Push to Ban Hill Insider Trading*, POLITICO (Oct. 11, 2010 11:34 AM), http://www.politico.com/news/stories/1010/43400_Page2.html.

24. Stop Trading on Congressional Knowledge Act, H.R. 1148, 112th Cong. §§ 1–7 (2011), available at <http://www.opencongress.org/bill/112-h1148/text>.

25. See Lovley, *supra* note 23.

26. *Id.*

27. *Id.*

28. See *infra* Part V.B.

29. Kroft, *supra* note 5, at 1–5.

30. *Id.* at 2.

31. *Id.*

32. *Id.* at 3.

33. *Id.*

after her purchase, the Visa shares were trading at \$64 a share; the legislation mysteriously failed to reach the House floor for a vote.³⁴

In September of 2008, also just before a stock market collapse, Treasury Secretary Hank Paulson and Federal Reserve Chairman Benjamin Bernanke held secret meetings with members of Congress about the upcoming financial collapse.³⁵ Representative Spencer Bachus was present at the meetings and made several stock transactions shortly after the meetings, particularly in General Electric, which yielded significant profits for him.³⁶ Some members of Congress also made stock transactions while the recent healthcare legislation³⁷ advanced through Congress.³⁸ John Boehner, who was the House Minority Leader at the time, fought against the public option provision in the bill, which would have competed with health insurance companies, while purchasing shares in various health insurance companies.³⁹ The public option was defeated shortly thereafter, and the value of his purchased shares skyrocketed.⁴⁰

Recent instances of politicians committing political insider trading are not confined to the few situations described in the “60 Minutes” report. Other examples include Senator John Kerry, who made a large profit trading during the recent health care reform debates.⁴¹ During that time, he purchased \$750,000 worth of stock in the company, Teva Pharmaceuticals.⁴² Before the health care reform bill passed, he purchased the stock around \$50.⁴³ The value of the stock jumped to \$62 after the bill was passed.⁴⁴ Also, Senator Dick Durbin attended meetings with Paulson and Bernanke similar to those attended by Representative Bachus.⁴⁵ After one meeting, Durbin sold \$73,715 the next day to avoid losses that the general public would soon

34. *Id.*

35. *Id.* at 1–2.

36. *Id.*

37. Patient Protection and Affordable Care Act, Pub. L. No. 111-148, 124 Stat. 119 (2010).

38. Kroft, *supra* note 5, at 2.

39. *Id.*

40. *Id.*

41. PETER SCHWEIZER, THROW THEM ALL OUT 5–6 (2011).

42. *Id.* at 5.

43. *Id.*

44. *Id.* at 5–6.

45. *Id.* at 34.

experience.⁴⁶ Senator Durbin, however, also made profitable purchases of stock during this time.⁴⁷ Additionally, in 2003, Rahm Emanuel, who sat on the House Financial Services Committee's Subcommittee on Capital Markets, Insurance, and Government-Sponsored Enterprises, provided direct oversight for Freddie Mac and Fannie Mae.⁴⁸ Days after he sold all of his Freddie Mac stock that was valued at \$250,000, the price dropped 10%.⁴⁹ Sadly, the few examples listed here are only a small portion of the list of politicians, on both ends of the political spectrum, who take advantage of their positions of leadership and the information that those positions provide.⁵⁰

2. Statistics on Political Insider Trading

After conducting a study on the stock market transactions of members of the United States House and Senate, researchers found that members "trade with a substantial information advantage."⁵¹ According to a study done in 2004, United States Senators outperformed the market by approximately ten percent each year.⁵² A follow up study in 2011 found that Representatives, on average, outperformed the market by six percent each year.⁵³ The study also found that Democrats did seven percent better than Republicans in the market, and those with less seniority substantially outperformed their senior members.⁵⁴ The researchers believed this was because the newer members have the strongest incentive to raise money, while the senior members, who have had more time to establish themselves, have little problem raising money at large campaign events.⁵⁵ The study was based on Congress's required annual Financial Disclosure Report, which

46. *Id.*

47. *Id.*

48. *Id.* 36.

49. *Id.*

50. *Id.* at 6–8, 60–61, 65–69. Additional politicians who commit political insider trading include, but are not limited to, the following: Senator Jim Webb, Senator Tom Carper, Senator Judd Gregg, Representative Jerry Lewis, and Senator Harry Reid. *Id.* Schweizer provides a detailed account of the shady transactions that occurred behind closed doors during the recent healthcare debates and bank bailouts. *See generally id.*

51. Alan J. Ziobrowski et al., *Abnormal Returns from the Common Stock Investments of Members of the U.S. House of Representatives*, 13 BUS. & POL. 1, 5 (2011).

52. *Id.* at 3.

53. *Id.* at 5.

54. *Id.* at 14.

55. *Id.* at 15.

reveals information regarding the stock trades of each elected official and his immediate family.⁵⁶ The researchers stated, however, that they were unable to validate the exactness of the study's results because no independent, private entity or government agency has examined the Financial Disclosure Report.⁵⁷

3. "It's Not *What* You Know . . ."

Congressional aides also greatly benefit from access to information their positions provide.⁵⁸ In 2008, one of Senator Harry Reid's advisors made approximately 100% profit on an investment in a firm that directly benefitted from legislation passed by Senator Harry Reid.⁵⁹ Howard Wolfson worked for Hillary Clinton's presidential campaign in 2008, and he was able to make exceptionally profitable trades that year.⁶⁰ He purchased thousands of dollars in Fannie Mae and Freddie Mac just a few days before both of the institutions were approved to receive federal aid.⁶¹ Based on a Wall Street Journal study, at least seventy-two aides across both political parties invested in companies subject to their superiors's oversight.⁶² Thus, when it comes to trading on nonpublic information regarding Congressional activities, the age-old colloquialism rings true: it's not always what you know, it's who you know.

III. STATES: THE STARTING POINT OF INSIDER-TRADING LAWS

A. *The Minority Rule*

Before the 1960s, insider trading was regulated exclusively by state law.⁶³ One of the first developments in insider-trading law occurred in the

56. *Id.* at 2–6.

57. *Id.* at 6. Due to this lack of accountability and man's sinful human nature, it is not unreasonable to conclude that many members of Congress failed to disclose some of their more controversial and highly lucrative trades, which would make these statistics of outperforming the market even higher.

58. Brody Mullins et al., *Congressional Staffers Gain From Trading in Stocks*, WALL ST. J. (Oct. 10, 2010), <http://online.wsj.com/article/SB10001424052748703431604575522434188603198.html>.

59. *Id.*

60. *Id.*

61. *Id.*

62. *Id.*

63. STEPHEN M. BAINBRIDGE, *SECURITIES LAW: INSIDER TRADING* 7 (2d ed. 2007). The classic definition of insider trading is as follows: "The use of material, nonpublic information

Georgia Supreme Court case *Oliver v. Oliver*.⁶⁴ In *Oliver*, the court held that a director of a corporation, who by nature of his position is privy to secret information, must disclose any information that affects the value of the stock before transacting with a stockholder.⁶⁵ This holding became known as the duty-to-disclose rule (hereinafter “the minority rule”).⁶⁶

B. *The Majority Rule*

Before *Oliver*, directors did not have this obligation under the no-duty rule (hereinafter “the majority rule”).⁶⁷ Under the majority rule, directors were only liable to stockholders for actual fraud—where the director concealed or misrepresented a material fact during a face-to-face transaction.⁶⁸ In the seminal Massachusetts Supreme Court case of *Goodwin v. Agassiz*,⁶⁹ the court stated that a director with material inside information does not have a duty to disclose that information in an impersonal stock exchange because it would be too burdensome on the director.⁷⁰ The court noted, however, that the director might owe a duty to disclose under special circumstances.⁷¹

In *Goodwin*, Rodolphe Agassiz, the director of a mining company, knew of a geologist’s theory that valuable minerals were on the company’s property, information of which Homer Goodwin, the plaintiff-stockholder, was unaware at the time.⁷² After reading a newspaper article asserting that the company had concluded its exploratory ventures on that property, Goodwin sold his shares of the stock.⁷³ The company, however, was not responsible for the inaccurate article.⁷⁴ Agassiz bought Goodwin’s stock,

in trading the shares of a company by a corporate insider or other person who owes a fiduciary duty to the company.” BLACK’S LAW DICTIONARY 866 (9th ed. 2009).

64. *Oliver v. Oliver*, 45 S.E. 232 (Ga. 1903); BAINBRIDGE, *supra* note 63, at 9.

65. *Oliver*, 45 S.E. at 234.

66. The duty-to-disclose rule is the minority approach, which holds that a director has a duty to disclose material information to a shareholder before conducting the trade. *Id.*; BAINBRIDGE, *supra* note 63, at 9.

67. BAINBRIDGE, *supra* note 63, at 8. The “no duty rule” is the majority approach. *Id.*

68. *Id.*

69. *Goodwin v. Agassiz*, 186 N.E. 659 (Mass. 1933).

70. *Id.* at 661.

71. *Id.*; *see infra* note 86.

72. *Goodwin*, 186 N.E. at 659.

73. *Id.* at 660.

74. *Id.*

and the stock value increased because the geologist's theory proved accurate.⁷⁵ The court noted that Goodwin, a member of the stock exchange, was not a novice and had failed to make any inquiries into the company.⁷⁶ Furthermore, the court stated that Agassiz's belief in the geologist's theory was just a hope,⁷⁷ and it would have been detrimental to the company to disclose the information at that time.⁷⁸ Thus, under these circumstances, the court held that no injustice had been committed and dismissed Goodwin's claim.⁷⁹

C. Summary of State Insider-Trading Laws

The majority of the states, in their common law, follow the *Goodwin* approach, purporting that there is no duty to disclose inside information.⁸⁰ A few states, however, follow the approach in *Oliver*, and have held that a director has an affirmative duty to disclose material, nonpublic information.⁸¹ Although finding their origin in state law, these state-created insider-trading rules were significantly changed with the involvement of the federal government.⁸² The federal government has essentially taken over insider-trading regulation, relegating state common law relevance to rare circumstances when federal regulations do not cover the transaction.⁸³

IV. THE FEDERAL GOVERNMENT'S INVOLVEMENT

A. Granting Cert: The United States Supreme Court's First Insider Trading Case

The Supreme Court first addressed the issue of insider trading in *Strong v. Repide*.⁸⁴ In *Strong*, the Court held that a director does not have a general

75. *Id.*

76. *Id.* at 661–62.

77. *Id.* at 661.

78. *Id.*

79. *Id.* at 662.

80. BAINBRIDGE, *supra* note 63, at 8.

81. *Id.* at 9.

82. *Id.* at 15.

83. *Id.*

84. *Strong v. Repide*, 213 U.S. 419 (1909); *Insider Trading by Congress: Historical Timeline*, PRO CON, <http://insidertrading.procon.org/view.resource.php?resourceID=002391> (last updated Apr. 4, 2012, 1:50:43 PM).

duty to disclose information to stockholders; however, under the particular facts of this case, the director was found to have a duty to disclose the material information and, thus, was found guilty of illegal insider trading.⁸⁵ This holding became known as the special circumstances rule⁸⁶ and provides an exception to the majority rule.⁸⁷

The director of the company in *Strong* was involved in negotiations with the United States government for the sale of land owned by the company.⁸⁸ Because the sale would greatly affect the value of the company's stock, the director sent out an agent to purchase shares of the company from Eleanor Strong, a shareholder.⁸⁹ The Court emphasized two important things about the transaction that proved unacceptable: (1) the defendant concealed his identity from the shareholder/plaintiff; and (2) the information regarding the negotiations substantially affected the value of the stock.⁹⁰ Much like *Goodwin*, *Strong* provided a possible exception to the majority rule for special circumstances.⁹¹ Excepting this notable case, the regulations on insider trading developed without substantial contribution from the United States Supreme Court for the next seventy years.⁹²

B. Securities Exchange Commission Rule 10b-5

After the stock market crash of 1929, the federal government passed the 1934 Securities Exchange Act—which created the SEC—to restore investor confidence in the market.⁹³ The general rule regarding securities fraud is located in Section 10(b)⁹⁴ of the 1934 Act.⁹⁵ Approximately eight years later,

85. *Strong*, 213 U.S. at 433–34.

86. The special circumstances rule provides that under certain circumstances, a director has a duty to disclose nonpublic material information. *Id.*; BAINBRIDGE, *supra* note 63, at 9.

87. The majority rule is that a director does not have a duty to, or a fiduciary relationship with, the shareholder. *Strong*, 213 U.S. at 431; BAINBRIDGE, *supra* note 63, at 8–9.

88. *Strong*, 213 U.S. at 423–24.

89. *Id.* at 425.

90. *Id.* at 432–33.

91. Special circumstances may include a defendant hiding his true identity and material information. *See id.* at 433–34; *Goodwin v. Agassiz*, 186 N.E. 659, 661 (Mass. 1933); BAINBRIDGE, *supra* note 60, at 8–14.

92. BAINBRIDGE, *supra* note 63, at 50.

93. *Insider Trading by Congress: Historical Timeline*, *supra* note 84.

94. 15 U.S.C. § 78j(b) (2010).

in 1942, the SEC passed Rule 10b-5,⁹⁶ which was crafted to resemble, yet also to improve upon, Section 17(a)⁹⁷ of the Securities Act of 1933.⁹⁸ Rule 10b-5 addressed misstatements and omissions in the previous Act.⁹⁹ For example, Section 17(a) of the 1933 Act only applied to the sale of securities, while Rule 10b-5 applies to both sales and purchases.¹⁰⁰ Under Rule 10b-5, there are five main elements that a plaintiff must prove: “(1) fraud or deceit (2) by any person (3) in connection with (4) the purchase or sale (5) of any security.”¹⁰¹ Additionally, since either fraud or deceit is a necessary element, the common law elements of fraud must also be established in any Rule 10b-5 action—elements such as: “materiality, reliance, causation, and damages.”¹⁰²

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Id.

95. THOMAS LEE HAZEN, *THE LAW OF SECURITIES REGULATION* 442 (6th ed. 2009).

96. 17 C.F.R. § 240.10b-5 (2012).

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Id. The reader must be careful not to confuse Section 10(b) of the 1934 Act with Rule 10b-5.

97. 15 U.S.C. § 77q(a) (2012).

98. HAZEN, *supra* note 95, at 442.

99. *Id.*

100. *Id.*

101. *Id.* at 445.

102. *Id.*

The Commission, however, was ignorant of the importance that the newly formed rule would have in future litigation.¹⁰³ The modern regulations regarding SEC Rule 10b-5 are “a creature of SEC administrative actions and judicial opinions, only loosely tied to the statutory language and its legislative history.”¹⁰⁴ Chief Justice William Rehnquist later opined, “When we deal with private actions under Rule 10b-5, we deal with a judicial oak which has grown from little more than a legislative acorn.”¹⁰⁵

C. *Judicial Contribution to Rule 10b-5*

1. Disclose or Abstain Rule

In the seminal SEC decision *In re Cady, Roberts & Co.*,¹⁰⁶ the SEC rejected the standard rule that an insider’s duty runs only to stockholders and expanded the duty of the insider to either (1) disclose nonpublic, material information or (2) abstain from trading (hereinafter “Duty to Disclose or Abstain”) to non-stockholders in the open stock market.¹⁰⁷ In *Cady*, Robert Gintel, a broker, tipped his clients to sell stocks on information that he received from an insider before the information became public.¹⁰⁸ J. Cheever Cowdin, the tipper, was present in an important company meeting, and after agreeing on a major decision that would affect the value of company shares, the meeting took a recess.¹⁰⁹ While on recess, Cowdin telephoned Gintel, who then informed his clients.¹¹⁰

The court held that the Duty to Disclose or Abstain consists of two elements: (1) a relationship, which by its nature allows direct or indirect access to information intended only for corporate purpose and benefit, and (2) the inherent unfairness of one party using such information to its advantage in a transaction against another party without such information.¹¹¹ Furthermore, the court added that a broker’s client cannot expect to benefit from inside information that the broker possesses when trading on such information would be to the detriment of the general

103. *Id.* at 442.

104. BAINBRIDGE, *supra* note 63, at 29.

105. *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975).

106. *In re Cady, Roberts & Co.*, 40 S.E.C. 907 (1961).

107. *Id.* at 911, 913.

108. *Id.* at 908–10.

109. *Id.* at 909.

110. *Id.*

111. *Id.* at 912.

public.¹¹² Therefore, to protect public investors, Gintel was held to be in violation of Rule 10b-5, and he was suspended from the stock exchange.¹¹³

2. Material Information

Another major judicial decision regarding Rule 10b-5 is the 1968 case *SEC v. Texas Gulf Sulphur Co.*¹¹⁴ In *Texas Gulf*, the court held that an insider or anyone else with material inside information has a Duty to Disclose or Abstain.¹¹⁵ Through this decision, the court broadened the scope of Rule 10b-5 to include anyone trading on nonpublic, material information.¹¹⁶ The court further noted that information is material only if a reasonable investor would consider it material.¹¹⁷

The facts of *Texas Gulf* are fairly straightforward. The Texas Gulf Sulphur Company (hereinafter "TGSC") conducted a geographical survey¹¹⁸ and discovered an area of land that appeared to be rich in minerals.¹¹⁹ TGSC covered up the drill site and told the group working on the drill site to keep the discovery confidential, even from other TGSC employees.¹²⁰ Several of the individuals involved with the discovery purchased stock in TGSC and made tips to others.¹²¹ Despite their best efforts, however, news of the discovery began to leak out.¹²² In response to the rumors, TGSC publicly announced that it was uncertain whether the land was rich in minerals, and it needed to continue testing the land.¹²³ Shortly after that announcement, TGSC publicly announced the discovery, and then Francis Coates, a TGSC director, purchased several shares of stock.¹²⁴ The court held that the TGSC employees who traded on the nonpublic information violated Rule 10b-5 for purchasing stock on nonpublic information.¹²⁵ It also found Coates in

112. *Id.* at 916.

113. *Id.* at 917–18.

114. *SEC v. Tex. Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968).

115. *Id.* at 848.

116. *Id.*

117. *Id.* at 848, 862–63.

118. *Id.* at 843.

119. *Id.*

120. *Id.* at 844.

121. *Id.* at 843–44.

122. *Id.* at 844–45.

123. *Id.*

124. *Id.* at 847.

125. *Id.* at 856.

violation of Rule 10b-5 because he purchased the stock before the public had a reasonable amount of time to learn about the information.¹²⁶ Thus, by expanding the duty to anyone with material, nonpublic information, the court attempted to provide more security for the general public in the stock market and place investors in an equal position with corporate insiders.¹²⁷

3. Purchaser or Seller

In the 1975 case *Blue Chip Stamps v. Manor Drug Stores*,¹²⁸ the Supreme Court addressed the issue of standing in insider trading actions.¹²⁹ The Court held that standing to assert a Rule 10b-5 action requires a plaintiff to be either a purchaser or seller of the security that is the subject of the suit.¹³⁰ Under a reorganization plan, Blue Chip Stamps (hereinafter "Blue Chip") was required to offer shares to retailers that used its service in the past.¹³¹ The plaintiffs claimed that Blue Chip made intentionally misleading statements about Blue Chip's status and future earnings estimates.¹³² The Court, however, held that the plaintiffs, who had not purchased the stock, did not have standing because it would be impossible to refute reliance without an actual purchase of the stock, and the amount of potential plaintiffs in Rule 10b-5 actions could be endless without such a requirement.¹³³

4. Requirement of Deception

Two years after *Blue Chip*, the Supreme Court heard *Santa Fe Industries, Inc. v. Green*.¹³⁴ Santa Fe Industries (hereinafter "SFI") owned 95% of the stock in Kirby Lumber Company and wanted to procure the rest of the stock to attain complete ownership.¹³⁵ Delaware law contained a statute that allowed a parent corporation with at least 90% ownership to merge with its subsidiary, provided that the directors of both corporations agreed, the parent corporation gave a ten-day notice, and the parent corporation paid

126. *Id.*

127. *Id.* at 851–52.

128. *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975).

129. *Id.*

130. *Id.* at 754–55.

131. *Id.* at 725–26.

132. *Id.* at 726.

133. *Id.* at 761.

134. *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462 (1977).

135. *Id.* at 465.

cash to the minority of the stockholders for their stocks.¹³⁶ SFI assessed the value of the corporation at \$125 per share and offered \$150 per share to the stockholders.¹³⁷ Despite SFI's compliance with the Delaware statute,¹³⁸ the plaintiffs claimed: (1) there was no business purpose for the merger other than more control, and (2) the offered price for the shares was too low, which constituted fraud under Rule 10b-5.¹³⁹

The Court held that the statutory language of Section 10(b) of the Securities Exchange Act fails to demonstrate congressional intent to prevent any actions not amounting to manipulation or deception.¹⁴⁰ The Court held that SFI did not act in a manipulative or deceptive manner as alleged in the complaint because the plaintiffs were fairly informed of the relevant information and options.¹⁴¹ Therefore, SFI did not violate Section 10(b) or Rule 10b-5.¹⁴²

5. Tippee's Duty to Disclose or Abstain

The Supreme Court made a significant change regarding the application of Rule 10b-5 in the 1980s with its holding in *Dirks v. SEC*.¹⁴³ Raymond Dirks worked as an analyst for a New York broker-dealer firm.¹⁴⁴ He received a tip from a former officer of Equity Funding of America (hereinafter "Equity Funding") that Equity Funding was overstating its assets and committing fraud.¹⁴⁵ The tipper wanted Dirks to verify the information and expose the fraud.¹⁴⁶ During his investigation of the tip, Dirks discussed the information with the clients and people he interviewed.¹⁴⁷ Although Dirks did not own any shares in Equity Funding, some of the people he shared information with did, and they sold their shares based on their discussions with Dirks.¹⁴⁸ Dirks contacted *The Wall*

136. *Id.*

137. *Id.* at 466.

138. *Id.*

139. *Id.* at 468.

140. *Id.* at 473.

141. *Id.* at 473-74.

142. *Id.*

143. *Dirks v. SEC*, 463 U.S. 646 (1983); BAINBRIDGE, *supra* note 63, at 50.

144. *Dirks*, 463 U.S. at 648.

145. *Id.* at 649.

146. *Id.*

147. *Id.*

148. *Id.*

Street Journal to expose the fraud, but *The Wall Street Journal* declined to run the story.¹⁴⁹ Later, the fraud was exposed and the price of shares plummeted.¹⁵⁰ The SEC claimed that Dirks violated Rule 10b-5.¹⁵¹ The Court held that:

[A] tippee assumes a fiduciary duty to the shareholders of a corporation not to trade on material nonpublic information only when the insider has breached his fiduciary duty to the shareholders by disclosing the information to the tippee and the tippee knows or should know that there has been a breach.¹⁵²

The Court further opined that the test for determining whether a tippee is under a Duty to Disclose or Abstain hinges on whether the tip was a breach of the insider's fiduciary duty.¹⁵³ To determine if the disclosure is a breach, courts will mainly consider whether the insider personally benefited from the disclosure.¹⁵⁴ If an improper purpose is absent, the duty to the stockholders has not been breached.¹⁵⁵ If there is no breach by the insider, then there is no derivative breach by the tippee.¹⁵⁶ Accordingly, Dirks and the insider did not violate any duty to the shareholder because there was no improper purpose.¹⁵⁷ They wanted to expose the fraud.¹⁵⁸ The changes in insider trading law that occurred in both *Dirks* and *Chiarella v. United States*¹⁵⁹ limited the scope of the Duty to Disclose or Abstain holding of *Texas Gulf*.¹⁶⁰

149. *Id.* at 649–50.

150. *Id.* at 650.

151. *Id.* at 650–51.

152. *Id.* at 660.

153. *Id.* at 661.

154. *Id.* at 662. Personal benefit can be financial, reputational, information, or anything else that the person values. *Id.* at 663–64.

155. *Id.* at 662.

156. *Id.*

157. *Id.* at 665–66.

158. *Id.* at 649.

159. *Chiarella v. United States*, 445 U.S. 222 (1980); see *infra* Part IV.C.6.a.

160. BAINBRIDGE, *supra* note 63, at 50.

6. The Misappropriation Theory¹⁶¹

a. The classical theory versus the misappropriation theory

In *Chiarella*, the defendant, Vincent Chiarella, worked for a printing firm.¹⁶² He obtained inside information while he worked on documents for a client of the printing firm.¹⁶³ He learned the names of companies involved in a corporate takeover from the information that was not redacted in the documents.¹⁶⁴ He bought shares in those companies and made a significant profit in a short time.¹⁶⁵ The SEC investigated and indicted him for violating Rule 10b-5.¹⁶⁶

The Supreme Court reversed the conviction of Chiaralla under Rule 10b-5, concluding that he did not have a duty to the shareholders of the companies targeted for the takeover.¹⁶⁷ Upholding the classical theory, the Court—limiting the holding from *Texas Gulf*—held that Chiarella did not have a relationship of confidence and trust with the shareholders because he was a mere stranger trading through the impersonal stock market.¹⁶⁸ The Court distinguished the facts from those of *Cady* where a relationship of trust and confidence existed between shareholders and insiders.¹⁶⁹ The Court stated that the formation of such a broad Duty to Disclose or Abstain for everyone who participates in the stock market would break with the current requirement of a special relationship; accordingly, it refused to adopt it in the absence of evidence of congressional intent.¹⁷⁰ The majority did not address the misappropriation theory because it was not presented to the jury.¹⁷¹

161. The misappropriation theory is a broader than classical insider trading. It is defined as “the deceitful acquisition and misuse of information that properly belongs to persons to whom one owes a duty.” BLACK’S LAW DICTIONARY 866 (9th ed. 2009).

162. *Chiarella*, 445 U.S. at 224.

163. *Id.*

164. *Id.*

165. *Id.*

166. *Id.* at 225.

167. *Id.* at 232–34.

168. *Id.* at 232–33; SEC v. Tex. Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968) (holding that anyone with nonpublic material information has a duty to abstain from trading or disclose the information).

169. *Chiarella*, 445 U.S. at 228.

170. *Id.* at 233.

171. *Id.* at 236.

The foundation of the misappropriation theory, however, can be found in Chief Justice Burger's dissent in *Chiarella*.¹⁷² He would have upheld Chiarella's Rule 10b-5 convictions based on the misappropriation theory.¹⁷³ Chief Justice Burger interpreted Rule 10b-5 "to mean that a person who has misappropriated nonpublic information has an absolute duty to disclose that information or to refrain from trading."¹⁷⁴ He noted that Chiarella knew the information was secret and entrusted to his employer.¹⁷⁵

b. Rule 14e-3: SEC's response to *Chiarella*

In response to the Supreme Court's decision in *Chiarella*, the SEC passed Rule 14e-3 to prevent people who commit acts similar to those in *Chiarella* from escaping punishment under insider-trading laws.¹⁷⁶ Rule 14e-3 expanded insider-trading laws to "prohibit anyone other than the tender offeror from trading on the basis of advance information pertaining to a not-yet-announced tender offer."¹⁷⁷ The validity of Rule 14e-3 was disputed for exceeding the scope of the SEC's authority, an issue that will be taken up later in this Comment.¹⁷⁸

c. Adoption of the misappropriation theory and Rule 14e-3

When the issue of the misappropriation theory came before the Supreme Court again, the Court was split.¹⁷⁹ According to the misappropriation theory, the Duty to Disclose or Abstain does not require a relationship with the company or a direct party to the stock transaction.¹⁸⁰ Also, under Rule 10b-5, there was a problem with adopting the misappropriation theory. Supreme Court precedent established that for a plaintiff to have standing, he must be a purchaser or seller of the securities in dispute.¹⁸¹ The issue

172. BAINBRIDGE, *supra* note 63, at 99.

173. See *Chiarella*, 445 U.S. at 239-45 (Burger, C.J., dissenting).

174. *Id.* at 240.

175. *Id.* at 244.

176. *Insider Trading by Congress: Historical Timeline*, *supra* note 84; 17 C.F.R. § 240.14e-3.

177. HAZEN, *supra* note 95, at 505.

178. See *United States v. O'Hagan*, 521 U.S. 642, 647 (1997); see also *infra* Part IV.C.6.c.

179. *Carpenter v. United States*, 484 U.S. 19, 24 (1987) (holding also that a company's confidential information is its property).

180. HAZEN, *supra* note 95, at 499.

181. *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 754-55 (holding that a plaintiff must be a purchaser or seller to have standing); HAZEN, *supra* note 95, at 500.

remained unresolved until *United States v. O'Hagan*,¹⁸² where the Supreme Court decided to adopt the misappropriation theory.¹⁸³

In *O'Hagan*, James O'Hagan was a partner at a law firm.¹⁸⁴ Grand Metropolitan PLC (hereinafter "Grand Met") hired O'Hagan's firm to represent it in a potential tender offer for stock in the Pillsbury Company.¹⁸⁵ O'Hagan did not work on the transaction, and both the firm and Grand Met took precautions to keep the information confidential.¹⁸⁶ Despite these precautions, O'Hagan acquired the information, which he used to make several purchases of Pillsbury stock.¹⁸⁷ After Grand Met announced its offer, Pillsbury's stock value skyrocketed.¹⁸⁸ O'Hagan sold his stock and made a profit of \$4.3 million.¹⁸⁹ He later argued trading on the stock was not for personal gain because he needed the profits to repay money he embezzled from the firm.¹⁹⁰

The *O'Hagan* Court discussed the classical theory of insider liability where a corporate insider trades on corporate, nonpublic information.¹⁹¹ It stated that trading on the information qualifies as a deceptive device under Rule 10(b)¹⁹² because of the relationship of trust and confidence between shareholders and the insiders of the corporation.¹⁹³ Moreover, the Court added that the misappropriation theory complements the classical theory because:

The classical theory targets a corporate insider's breach of duty to shareholders with whom the insider transacts; the misappropriation theory outlaws trading on the basis of nonpublic information by a corporate "outsider" in breach of a

182. *O'Hagan*, 521 U.S. at 651.

183. *Id.* at 666.

184. *Id.* at 647.

185. *Id.*

186. *Id.*

187. *Id.*

188. *Id.* at 648.

189. *Id.*

190. *Id.* at 683-84 (Thomas, J., dissenting).

191. *Id.* at 651-52.

192. 15 U.S.C. § 78j(b) (2010).

193. *O'Hagan*, 521 U.S. at 652.

duty owed not to a trading party, but to the source of the information.¹⁹⁴

According to the misappropriation theory, a person commits fraud “in connection with” a securities transaction, and thereby violates § 10(b) and Rule 10b-5, “when he misappropriates confidential information for securities trading purposes, in breach of a duty owed to the source of the information.”¹⁹⁵ The Court also added that the misappropriation theory seeks to protect the principal from fraudulent misuse of his information by his fiduciary.¹⁹⁶ The Court noted, however, that an outsider might escape liability by fully disclosing his plans to trade on the nonpublic information to the information’s source because the element of deception no longer exists.¹⁹⁷

The *O’Hagan* Court held that the secret information was the property of Grand Met, which it entrusted to O’Hagan’s firm.¹⁹⁸ Thus, the Court agreed with the government’s contention that O’Hagan breached the duty of trust and confidence that he owed to the firm and its client.¹⁹⁹ Furthermore, the *O’Hagan* Court held that the prohibition against deception in Rule 10b-5 is not confined to persons who buy or sell the securities, which broadened the scope of standing.²⁰⁰

The second issue the Court dealt with in *O’Hagan* was whether the SEC exceeded its rule-making authority by passing Rule 14e-3.²⁰¹ The Supreme Court reversed the decision of the Eighth Circuit Court of Appeals and approved the validity of Rule 14e-3.²⁰² O’Hagan challenged the validity of Rule 14e-3 because it did not contain a requirement for a breach of fiduciary duty.²⁰³ The Court held that Rule 14e-3 constitutes a “disclose or abstain”²⁰⁴ regulation, which authorized the SEC to create reasonably

194. *Id.* at 652–53.

195. *Id.* at 652; see 15 U.S.C. § 78j(b) (2010); 17 C.F.R. § 240.10b-5 (2005).

196. *O’Hagan*, 521 U.S. at 652.

197. *Id.* at 655.

198. *Id.* at 653.

199. *Id.*

200. *Id.* at 651.

201. *Id.* at 649.

202. *Id.* at 647.

203. *Id.* at 649.

204. *Id.* at 669.

designed rules to prevent fraud.²⁰⁵ Thus, the Court upheld Rule 14e-3²⁰⁶ and reversed the Eighth Circuit's ruling regarding O'Hagan's Rule 14e-3 violations.²⁰⁷

D. *The Sarbanes-Oxley Act*

In 2002, Congress passed the Sarbanes-Oxley Act²⁰⁸ (hereinafter "Sarbanes-Oxley") in response to a series of corporate scandals—including scandals in well-known corporations like Enron, Xerox, Tyco, WorldCom, and Adelphia—all of which involved several billions of dollars in corporate fraud.²⁰⁹ The Sarbanes-Oxley reforms made important changes to regulations regarding public companies.²¹⁰ The purpose of Sarbanes-Oxley was to ensure more accountability for insiders and improve the communication of a corporation's financial status to its shareholders.²¹¹ Sarbanes-Oxley emphasized that a corporation must rapidly disclose any material changes regarding its financial condition.²¹² Sarbanes-Oxley also requires an insider to electronically disclose his trades of the corporation's stock within two days after they are made.²¹³

V. CONGRESSIONAL RULES ON INSIDER TRADING

A. *Congressional Ethics Rules*

The rules governing political insider trading are much different than those governing corporate insiders. For instance, members of the House of Representatives can be punished for insider trading because it is a violation of the House Code of Official Conduct.²¹⁴ According to the House Code of Official Conduct, a member or employee of the House of Representatives

205. *Id.* at 673.

206. *Id.* at 676.

207. *Id.* at 678.

208. Sarbanes-Oxley Act, Pub. L. No. 107-204, 116 Stat. 745 (2002).

209. *Insider Trading by Congress: Historical Timeline*, *supra* note 84.

210. HAZEN, *supra* note 95, at 745.

211. *Insider Trading by Congress: Historical Timeline*, *supra* note 84.

212. *Id.*

213. *Id.*

214. H. ETHICS MANUAL, 110TH CONG., COMM. ON STANDARDS OF OFFICIAL CONDUCT 3 (Comm. Print 2008), available at http://ethics.house.gov/sites/ethics.house.gov/files/documents/2008_House_Ethics_Manual.pdf.

“may not receive compensation and may not permit compensation to accrue to his beneficial interest from any source, the receipt of which would occur by virtue of influence improperly exerted from his position in Congress.”²¹⁵

The House Ethics Manual, which provides guidance on how to abide by the Code of Official Conduct, adds that a member or employee of the House of Representatives is prohibited from using his position for personal gain.²¹⁶ The Manual further states that House members and staff should avoid situations that might cause a reasonable person to draw an inference of any impropriety.²¹⁷

On its face, this standard appears to be very high. Nevertheless, a deeper reading shows that the standard is not really as strict as it purports to be. A confusing tension exists between the several regulations and exceptions. When discussing the Financial Disclosure Reports, the Manual states, “No federal statute, regulation, or rule of the House absolutely prohibits a Member or House employee from holding assets that might conflict with or influence the performance of official duties.”²¹⁸ Unlike corporate insiders,²¹⁹ members of Congress are only required to make a financial disclosure once per year.²²⁰ These financial disclosures must include “investments, income, and liabilities.”²²¹ Investments under \$1,000 simply do not need to be disclosed at all.²²² Also, in a “rare instance” when a member of Congress has a direct personal conflict with the subject matter to be voted on, that member is required to abstain from voting.²²³ Direct personal conflicts are determined by the House Standards Committee on a case-by-case basis.²²⁴

The Manual also provides that members are not required to report everything, and they are also not “expected to fully strip themselves of

215. CODE OF OFFICIAL CONDUCT, 112TH CONG., H. COMM. ON ETHICS RULE XXIII (Comm. Print 2011), available at <http://ethics.house.gov/publication/code-official-conduct>.

216. H. ETHICS MANUAL, *supra* note 214, at 186.

217. *Id.*

218. *Id.* at 248.

219. *Insider Trading by Congress: Historical Timeline*, *supra* note 84. Corporate insiders must disclose within two days. *Id.*

220. *Id.*; Ethics in Government Act of 1978, Pub. L. No. 95-521, 92 Stat. 1824 (1978).

221. H. ETHICS MANUAL, *supra* note 214, at 249.

222. *Id.* at 257.

223. *Id.* at 250.

224. *Id.* at 249, 251.

worldly goods.”²²⁵ The financial disclosure policy only requires the reporting of what is relevant to a “potential conflict of interest.”²²⁶ If the financial information is too private or burdensome to be retrieved, then members are not required to disclose it.²²⁷ Generally, the financial information belonging to spouses and dependents of members of Congress must also be disclosed—there is an exception, however, to this general provision.²²⁸ The House Standards Committee then reviews the financial information that the members of Congress provide.²²⁹ Also, members of Congress always have the option to transfer their assets to a blind trust and take advantage of the fact that assets placed in blind trusts do not have to be reported.²³⁰ The strict remedy recommended by this Comment would eliminate the confusion created by the series of regulations and exceptions in the House Code of Official Conduct, and it would no longer allow the House to self-discipline itself by granting that power to the SEC.

B. *Why Insider-Trading Laws Do Not Apply to Congress*

As mentioned previously, insider-trading laws currently do not apply to members of Congress.²³¹ In fact, insider-trading laws have never been applied to members of Congress.²³² Members of Congress can, and do,

225. *Id.* at 250.

226. *Id.*

227. *Id.*

228. *Id.* at 253. The exception to the spouse and dependent disclosure policy is only applicable:

when the financial interest of a spouse or dependent child meets all three standards listed below, may a filer omit disclosure of an asset:

- (1) The item is the sole interest or responsibility of the spouse or dependent child, and the reporting individual has no knowledge of the item;
- (2) The item was not in any way, past or present, derived from the income, assets, or activities of the reporting individual; and
- (3) The reporting individual neither derives, nor expects to derive, any financial or economic benefit from the item.

Id.

229. *Id.* at 252.

230. Ethics in Government Act Act of 1978, Pub. L. No. 95-521, § 102(e), 92 Stat. 1824 (1978); SCHWEIZER *supra* note 41, at 169.

231. *See supra* Part I.

232. Aruna Viswanatha, *SEC Warns on Congressional Insider Trading Ban*, REUTERS (Dec. 6, 2011), <http://www.reuters.com/article/2011/12/06/us-sec-insider-trading-idUSTRE7B520320111206>.

freely trade on “nonpublic current or upcoming congressional activity.”²³³ To understand how current insider-trading laws do not apply to members of Congress, it is helpful to consider instances of political insider trading as applied to the classical theory,²³⁴ tipper/tippee liability,²³⁵ and the misappropriation theory.²³⁶

1. Political Insider Trading Applied to the Classical Theory

To fully analyze this issue, a review of the classical theory is essential.²³⁷ Once again, under the classical theory, a Rule 10b-5 conviction requires a corporate insider, who obtained confidential information solely by reason of his position, to trade on that nonpublic information while having an existing relationship of trust and confidence with a corporation’s shareholders.²³⁸ Thus, the relationship creates the Duty to Disclose or Abstain.²³⁹ Furthermore, this theory “applies not only to officers, directors, and other permanent insiders of a corporation, but also to attorneys, accountants, consultants, and others who temporarily become fiduciaries of a corporation.”²⁴⁰

In Representative Bachus’s situation,²⁴¹ he made several stock transactions based upon nonpublic information that he learned of immediately prior to the stock market collapse during his meeting with Treasury Secretary Hank Paulson and Federal Reserve Chairman Benjamin Bernanke.²⁴² Here, Representative Bachus does not have the requisite relationship of trust and confidence with the shareholders of the corporations in which he traded because he did not gain that information by nature of being a corporate insider or fiduciary of those corporations. Like the situation in *Chiarella*, Representative Bachus is a corporate

233. David Callahan, *Myths and Facts on Congressional Insider Trading*, CHEATING CULTURE (Dec. 17, 2011, 12:09 PM), <http://www.cheatingculture.com/insider-trading/2011/12/17/myths-and-facts-on-congressional-insider-trading.html>.

234. See *infra* Part V.B.1.

235. See *infra* Part V.B.2.

236. See *infra* Part V.B.3.

237. See *supra* Part IV.C.6.a. (defining the classical theory).

238. *United States v. O’Hagan*, 521 U.S. 641, 651 (1997); *Chiarella v. United States*, 445 U.S. 222, 228 (1980).

239. *O’Hagan*, 521 U.S. at 651; *Chiarella*, 445 U.S. at 228–29.

240. *O’Hagan*, 521 U.S. at 651; *Dirks v. SEC*, 463 U.S. 646, 655 n.14 (1983).

241. See *supra* Part II.B.1 (presenting the Representative Bachus scenario).

242. Kroft, *supra* note 5, at 2.

outsider²⁴³ who gained the nonpublic information through a government meeting on market intelligence.²⁴⁴ Moreover, unlike *Chiarella*, Representative Bachus is not an employee of a corporation that serves the client who owns the nonpublic information.²⁴⁵ Thus, just as the classical theory did not apply to *Chiarella*, it will not apply to Representative Bachus's situation.

In former Speaker of the House Nancy Pelosi's scenario,²⁴⁶ she bought shares of stock in a company that would be negatively affected by legislation being proposed in the House—of which she was the leader and member of the controlling party.²⁴⁷ Coincidentally, the legislation failed shortly after her purchases.²⁴⁸ Here, the nonpublic information was gained by her position as Speaker of the House, not as a corporate insider. As Speaker of the House, she was in the position to know whether the legislation would be successful because the House polls members of Congress to determine the outcome of legislation.²⁴⁹ Furthermore, it is very possible that even the corporate insiders of the company with which she traded were unaware that the legislation would not pass. Thus, under the classical theory, it would be impossible to convict former House Speaker Pelosi because she did not gain the nonpublic information that she traded on by virtue of being a corporate insider or fiduciary; therefore, no relationship of trust or confidence between shareholders and corporate insiders would be breached. This would be true, even if she was not the Speaker of the House but simply knew the status of the legislation by virtue of her position as a member of the House. The breach of trust and confidence that occurs between a member of Congress and an American citizen during such instances of political insider-trading *should* be a violation of insider-trading laws, but, as displayed under the classical theory, it is not.

243. *Id.*

244. *Id.*

245. *Chiarella*, 45 U.S. at 224.

246. *See supra* Part II.B.1 (presenting the Speaker of the House Nancy Pelosi's scenario).

247. *Id.* at 2–3.

248. *Id.* at 3.

249. Christopher Beam, *Cool Whip: What Does a Congressional "Whip" Actually Do?*, SLATE (Mar. 3, 2010, 5:18 PM), http://www.slate.com/articles/news_and_politics/explainer/2010/03/cool_whip.html.

2. Political Insider Trading Applied to Tipper/Tippee Liability

According to tipper/tippee liability, the tippee takes on a fiduciary duty to the shareholders of the corporation.²⁵⁰ That duty is to refrain from trading on material, nonpublic information.²⁵¹ The duty is required only when the corporate insider has breached his fiduciary duty to the shareholders by disclosing such information to the tippee, and the tippee knows or should know that the tipper breached that duty.²⁵² Again, the test for whether there has been a breach is whether the tipper personally benefits from the disclosure.²⁵³

In a tipper/tippee analysis, the first thing to consider is whether a corporate insider has breached his fiduciary duties.²⁵⁴ Representative Bachus received his information from Treasury Secretary Hank Paulson and Federal Reserve Chairman Benjamin Bernanke, neither of which were corporate insiders.²⁵⁵ Thus, Paulson and Bernanke did not breach any duty to any shareholders by disclosing the information. Furthermore, they did not achieve any personal benefit from the financial disclosure. They were merely doing their respective jobs to warn Congress about the upcoming financial collapse.²⁵⁶ So, here, Representative Bachus will escape tipper/tippee liability because he had no fiduciary duty to refrain from disclosing any information to any shareholders. There was also no improper purpose for the tipper's disclosure, and thus, there is no breach.

The same is true for former House Speaker Nancy Pelosi. No corporate insider personally benefited or breached any fiduciary duty to corporate shareholders by informing her of the information affecting Visa's stock.²⁵⁷ She knew this information because of her position as House Speaker.²⁵⁸ The elements of tipper/tippee liability are once again not present because there was no duty to corporate shareholders owed by the corporate insider—the tipper. Thus, another set of current insider-trading laws has failed to capture the circumstances that are involved in political insider trading.

250. *Dirks v. SEC*, 463 U.S. 646, 647 (1983).

251. *Id.*

252. *Id.*

253. *Id.* at 662. See *supra* Part IV.C.5 (stating that a personal benefit can be financial, reputational, informational, or anything else that a person values).

254. *Id.* at 659–65.

255. Kroft, *supra* note 5, at 2.

256. *Id.*

257. *Id.* at 2–3.

258. *Id.*

3. Political Insider Trading Applied to the Misappropriation Theory

Because members of Congress can escape punishment under the classical theory and under tipper/tippee liability, an examination of the misappropriation theory, which is broader, applies to the previous situations. As discussed earlier, a Rule 10b-5 conviction under the misappropriation theory requires a corporate outsider to trade on nonpublic information in breach of the Duty to Disclose or Abstain owed to the source of information.²⁵⁹ The misappropriation theory protects the principal against his fiduciary's fraudulent misuse of his information.²⁶⁰ If, however, the outsider fully discloses to the source of the information that he intends to trade on that information, there is no breach of the Duty to Disclose or Abstain. In this situation, the outsider escapes liability because the requisite element of deception no longer exists.²⁶¹

In Representative Bachus's situation, Treasury Secretary Hank Paulson and Federal Reserve Chairman Benjamin Bernanke were the sources of Representative Bachus's nonpublic information.²⁶² They gained the nonpublic information through their government positions by researching the nation's economy and being privy to information only accessible to those in their positions, or other similar ones.²⁶³ These facts are unlike the facts in *O'Hagan* where the source of the information was O'Hagan's employer, which owed the Duty to Disclose or Abstain to its client—the corporation that owned the nonpublic information.²⁶⁴ Thus, in Representative Bachus's situation, there was no corporate "owner" of property rights in information. Rather, information was gathered through government research to which Representative Bachus was granted access via his position. Additionally, unlike *O'Hagan*, Treasury Secretary Paulson and Federal Reserve Chairman Bernanke were not Representative Bachus's principals, and as a member of Congress, Representative Bachus was not

259. *United States v. O'Hagan*, 521 U.S. 642, 652–53 (1997).

260. *Id.* at 652.

261. *Id.* at 655.

262. Kroft, *supra* note 5.

263. *History & Society: Federal Reserve System*, ENCYCLOPEDIA BRITANNICA, <http://www.britannica.com/EBchecked/topic/203437/Federal-Reserve-System> (last visited Apr. 18, 2013); *History & Society: United States Department of the Treasury (United States Government)*, ENCYCLOPEDIA BRITANNICA, <http://www.britannica.com/EBchecked/topic/603749/US-Department-of-the-Treasury> (last visited Apr. 18, 2013).

264. *O'Hagan*, 521 U.S. at 653.

their fiduciary.²⁶⁵ They did not employ Representative Bachus, and he did not owe them a duty of loyalty. Members of Congress do have general fiduciary duties to the people that they represent; however, the misappropriation theory requires a fiduciary duty to the specific source of the information.²⁶⁶ Thus, this general fiduciary duty that a representative owes to the general public, which was not the specific source of information, is too vague, derivative, and broad to properly capture the intent required by the misappropriation.²⁶⁷

The misappropriation theory would also allow former House Speaker Nancy Pelosi to escape liability for similar reasons. As Speaker of the House, her position was her source of information regarding the status of the proposed legislation that negatively affected a company in which she owned stock. Thus, she is not violating any duty to the source of information. Like Representative Bachus, her only fiduciary duty is a general duty to the electorate,²⁶⁸ and the electorate was not the source of the information on which she traded.

Furthermore, hypothetically, under the misappropriation theory, a member of Congress could receive information by a corporate insider who wants to gain legislative favor and legally trade on that information, as long as that member disclosed their plans to trade on that information to the insider. As a former SEC official declared, members of Congress are “not breaching a duty of confidentiality to anybody and therefore [they] would not be liable for insider trading.”²⁶⁹ Though some in the legal community may claim that the current laws are sufficient,²⁷⁰ the language of Supreme Court precedents coupled with the fact that insider-trading laws have not been applied to members of Congress—despite its practice being committed since the founding of America—strongly reinforces the assertion that the

265. *Id.* at 647–54.

266. Stephen M. Bainbridge, *Insider Trading Inside the Beltway*, 36 J. CORP. L. 281, 295 (2011).

267. *Id.*

268. *Id.*

269. *Id.* at 296; Peter Lattman, *Bill Looks to Ban Insider Trading for Lawmakers and Their Aides*, WSJ BLOG (Mar. 28, 2006, 8:58 AM), <http://blogs.wsj.com/law/2006/03/28/bill-looks-to-ban-insider-trading-for-lawmakers-and-their-aides/>.

270. Andrew George, Comment, *Public (Self)-Service: Illegal Trading on Confidential Congressional Information*, 2 HARV. L. & POL'Y REV. 161, 170 (2008); Donna M. Nagy, *Insider Trading, Congressional Officials, and Duties of Entrustment*, 91 B.U. L. REV. 1105, 1163 (2011).

current insider-trading laws do not apply to them. Thus, a clear statute addressing the issue is required.

C. *The STOCK Act*²⁷¹

The STOCK Act prohibits members of Congress from trading on nonpublic information obtained by reason of their position.²⁷² Also, instead of disclosing trades every year, the STOCK Act provides that members of Congress must disclose trades of stock within ninety days of the trade.²⁷³ The STOCK Act applies not only to Congress, but also to all federal employees and all people receiving nonpublic information while knowing that the tipper obtained such information by reason of his position in the federal government.²⁷⁴

The largest section of the STOCK Act, however, includes regulations that require disclosure of political intelligence activities under the Lobbying Disclosure Act.²⁷⁵ The government does not presently regulate political intelligence activities.²⁷⁶ Political intelligence is a \$100 million per year industry that uses members of Congress and former staff members to obtain valuable, nonpublic information to sell to investors.²⁷⁷ Currently, the STOCK Act's future approval appears uncertain. Nevertheless, as discussed later in this Comment, even if the Act is approved, it still does not adequately address the problem of political insider trading.²⁷⁸

In past years, a handful of representatives have unsuccessfully attempted to pass the STOCK Act on multiple occasions.²⁷⁹ The STOCK Act has been introduced three times but has never made it out of a committee.²⁸⁰ A recent "60 Minutes" report, however, brought significant attention to the problem of political insider trading, causing the STOCK Act to be reintroduced.²⁸¹

271. Stop Trading on Congressional Knowledge Act, *supra* note 24.

272. *Id.* § 2(d).

273. *Id.* § 5(a).

274. *Id.* § 2(e).

275. *Id.* § 6.

276. Kroft, *supra* note 5, at 7.

277. *Id.*

278. See *infra* Part VII.B.

279. *What is the Stop Trading on Congressional Knowledge Act*, PRO CON, <http://insidertrading.procon.org/view.resource.php?resourceID=004520> (last updated Dec. 15, 2011, 2:13 PM).

280. *Id.*

281. *Id.*

Currently, support for the Act seems to be substantially increasing in response to the “60 Minutes” report.²⁸² House Majority Leader Eric Cantor, however, stopped progress of the STOCK Act in 2011, which had 237 co-sponsors, and promised instead to expand and build upon it in the spring.²⁸³

VI. WHY IS POLITICAL INSIDER TRADING WRONG?

Before the American people can demand that a statute be written to prohibit insider-trading, it is important to wrestle with the question of whether insider trading is wrong, and if so, why it is wrong. First, law and economics arguments regarding political insider trading must be considered because it is a popular view among many American legal scholars, especially those in the area of securities. Next, in discussing the morality of political insider trading, it is also extremely relevant to reflect on what Christianity, a predominant religion,²⁸⁴ says about the practice.

A. *Law and Economics Perspective*

Law and economics presupposes that the market is more efficient at regulating society than the government.²⁸⁵ Man is considered a rational maximizer, working to increase his own satisfactions, and the government’s role in the economy is to offer man incentives to achieve outcomes that it

282. *Id.*

283. Seung Min Kim, *Eric Cantor Pledges to Expand the STOCK Act*, POLITICO (Dec. 16, 2011, 7:47 PM), <http://www.politico.com/news/stories/1211/70581.html>. At the time this Comment was submitted, the United States Senate approved the STOCK Act by a vote of 96–3, which then sent it to Congress for review, debate, and approval. Abby Ohlheiser, *STOCK Act Sails Through the Senate*, SLATE (Feb. 3, 2012), http://slatest.slate.com/posts/2012/02/03/stock_act_aims_to_ban_insider_trading_in_congress.html. Congress passed the STOCK Act, but as this Comment recommended, it voted to drop the political intelligence disclosure requirements. Associated Press, *House Passes Insider-Trading Bill*, FOX NEWS (Feb. 9, 2012), <http://www.foxnews.com/politics/2012/02/09/housepasses-insider-trading-bill/>. The changes will require a Senate and House conference for a debate and vote. *Id.*

284. Richard Allen Greene, *Christianity Goes Global As World’s Largest Religion*, ABC NEWS (Dec. 19, 2011), <http://www.abc2news.com/dpp/news/national/christianity-goes-global-as-worlds-largest-religion>.

285. *History & Society: Law and Economics*, ENCYCLOPEDIA BRITANNICA, <http://www.britannica.com/EBchecked/topic/178548/economics/236779/Law-and-economics> (last visited Dec. 21, 2011).

deems proper.²⁸⁶ Judge Richard Posner of the Seventh Circuit Court of Appeals,²⁸⁷ largely responsible for bringing a law and economics analysis to American jurisprudence, advocates that laws are—or should be—efficient.²⁸⁸

There is a split, however, in the law and economics community about whether insider-trading is actually economically efficient.²⁸⁹ Some law and economics advocates argue that insider trading is a good thing because it is an efficient way to disclose the actual price of a stock sooner.²⁹⁰ These advocates claim that it also decreases the need for whistle blowers because if a corporation is committing fraud, then all one needs to do is watch for insiders selling their personal stocks in the corporation.²⁹¹ Another argument against a prohibition on insider trading is that abstention from trading can be a form of insider trading, which is impossible to catch.²⁹² Furthermore, insider trading is an efficient way to compensate employees for their work and new ideas.²⁹³

Some economic theories, however, dispute the efficiency of allowing insider trading and advocate that insider trading should be regulated.²⁹⁴ Others hold that trading at the wrong price harms the investor.²⁹⁵ Another economic argument against insider trading focuses on the harms it places on the corporation by creating an incentive for corporate employees to delay sharing information with their bosses.²⁹⁶ Additionally, in merger transactions, insiders could harm the corporation by increasing the price of

286. RICHARD POSNER, *ECONOMIC ANALYSIS OF LAW 2-4* (Erwin Chemerinsky et al. eds., 6th ed. 2003).

287. *Contact Information*, UNITED STATES COURT OF APPEALS: SEVENTH CIRCUIT, <http://www.ca7.uscourts.gov/contact.htm#posner> (last updated Oct. 17, 2011).

288. *The Economic Analysis of Law*, STANFORD ENCYCLOPEDIA OF PHILOSOPHY (Aug. 12, 2011), <http://plato.stanford.edu/entries/legal-econanalysis/>.

289. Alan Strudler & Eric W. Orts, *Moral Principle in the Law of Insider Trading*, 78 TEX. L. REV. 375, 382-83 (1999).

290. Donald J. Boudreaux, *Insider Trading Prohibitions Should go out of Style*, THE FUTURE OF FREEDOM FOUNDATION (Jun. 6, 2003), <http://www.fff.org/comment/com0306f.asp>.

291. *Id.*

292. *Id.*

293. BAINBRIDGE, *supra* note 63, at 144-47.

294. *Id.* at 159-81.

295. *Id.* at 158-66.

296. *Id.* at 166-68.

the target corporation by purchasing stock in that corporation before the merger.²⁹⁷

When questioning whether political insider trading is harmful, the law and economics analysis changes because members of Congress do not create profit-making information, but rather, are simply in a position to receive it.²⁹⁸ Thus, the incentive to allow insider trading to increase efficiency in the market is nonexistent.²⁹⁹ Furthermore, allowing politicians to trade on material, nonpublic information could give them additional reasons to attack certain businesses,³⁰⁰ manipulate the legislative process, and engage in a form of bribery.³⁰¹ Thus, economically, it does not make sense to allow members of Congress to commit insider trading.

B. Biblical Perspective

Trading on nonpublic information in the stock market is, of course, not mentioned in the Bible because the stock market did not exist in antiquity.³⁰² One can, however, deduce from Scriptures that the practice of insider trading is morally wrong and should be prohibited, especially for a person in a position of leadership.

The main theme of the Bible is to love God and to love others.³⁰³ Jesus Christ teaches that one should treat others the way he wishes to be treated.³⁰⁴ Most people do not want to be intentionally misled in a financial transaction by insiders with nonpublic information. Thus, according to Christ's teachings, insiders should not purposefully take advantage of those in an inferior position. Continuing the theme of not taking advantage of others in business transactions, the Bible states, "unequal weights are an abomination to the Lord."³⁰⁵ God also curses the man who leads a blind

297. *Id.* at 168–72.

298. Bainbridge, *supra* note 266, at 299.

299. *Id.*

300. Larry E. Ribstein, *Congressmen As Securities Traders*, 14 GREEN BAG 2d 269, 270 (2011).

301. Bainbridge, *supra* note 266, at 299–300.

302. *The Birth of Stock Exchanges*, INVESTOPEDIA (Oct. 25, 2007), <http://www.investopedia.com/articles/07/stock-exchange-history.asp#axzz1hHfssqMn>.

303. *Matthew* 22:36–40 (English Standard Version) (all subsequent citations to Scripture are to the ESV).

304. *Matthew* 7:12.

305. *Proverbs* 20:23.

man astray.³⁰⁶ In the situation of insider trading, one party is blind to the material nonpublic information, while the other deceptively acts as if the price is fair. It can also be deduced that financial disclosure is a biblical practice because the Bible teaches that one should act in the light, and that one's sins will be revealed.³⁰⁷ Furthermore, the Bible also teaches that sin and corruption grow in the darkness.³⁰⁸

Regarding leaders, the Bible teaches that they should administer justice and not show partiality, exact gifts, or accept bribes.³⁰⁹ When leaders forsake such instructions, ruin will inevitably follow.³¹⁰ Furthermore, the Bible teaches that leaders should be above reproach, and thus, be held to a higher standard than the people the leader oversees.³¹¹ Consequently, according to a biblical perspective, it logically flows that members of Congress should be held to an even higher standard than mere businessmen.

VII. WHAT NEEDS TO BE DONE TO STOP IT?

A. *Why Can't the States Pass Laws to Address the Issue?*

While states would be the most financially independent overseer of Congress, state oversight currently is not a viable option for regulating members of Congress trading on nonpublic information. As mentioned previously, the federal government has largely taken over regulation of insider trading.³¹² Additionally, America's Founders did not want states to have the power to determine the qualifications of members of the House of Representatives because they wanted uniformity in those qualifications.³¹³ The Founders feared that the federal government would be at the mercy of the states if the states had the power to include or exclude who could hold office in the House of Representatives.³¹⁴ The federal power to determine the qualifications for House members was balanced against the states's

306. *Deuteronomy* 27:18.

307. 1 *Corinthians* 4:5; 2 *Corinthians* 4:2–6; *Job* 12:22; *Proverbs* 28:13; 1 *Thessalonians* 5:5–8.

308. *Isaiah* 29:15–16; *Job* 24:13–17.

309. *Deuteronomy* 16:19; *Isaiah* 1:23; *Proverbs* 29:4.

310. *Proverbs* 29:4.

311. 1 *Timothy* 3:2; *Titus* 1:7–14.

312. *See supra* Part IV.

313. THE FEDERALIST NO. 52, at 273 (James Madison) (The Gideon ed., 2001).

314. THE FEDERALIST NO. 59, at 307 (Alexander Hamilton) (The Gideon ed., 2001).

interest in that they were vested with the authority to appoint members in the Senate.³¹⁵

Touching on this issue specifically, the Supreme Court held in *U.S. Term Limits v. Thornton*³¹⁶ that states could not require additional qualifications for members of the House of Representatives or Senate.³¹⁷ The Court reasoned that the reserved state powers protected by the Tenth Amendment did not include the power to add requirements to membership in the House and Senate.³¹⁸ The Court added that any state provision adding qualifications or restrictions beyond those enumerated in the Constitution is unconstitutional.³¹⁹ Thus, it is highly unlikely that the Court would allow states to enact provisions requiring their representatives to disclose financial transactions or abstain from trading on nonpublic information. It should be noted, however, that in the dissent in *Thornton*, four Justices supported the notion that nothing in the Constitution prevented the states from adding such qualifications.³²⁰ Consequently, if the issue comes before the Court again, the result might be different depending on the current Court's willingness to distinguish or adhere to *Thornton*.³²¹

B. *Why Not Adopt the STOCK Act?*

As discussed previously, there is currently no law addressing members of Congress trading on nonpublic information regarding market changing legislation.³²² By default, the STOCK Act is a step in the right direction, however, as currently drafted, the Act is anemic. Like many congressional actions, passing the Act is similar to placing a small bandage on a bullet wound. The Act is too watered down to adequately remedy such a corrupt and widespread practice that has plagued our government for over 200 years.

315. *Id.* at 307–10; U.S. CONST. art. 1, § 3, cl. 1, amended by U.S. CONST. amend. XVII.

316. *U.S. Term Limits, Inc. v. Thornton*, 514 U.S. 779 (1995).

317. *Id.* at 783.

318. *Id.* at 802.

319. *Id.* at 836.

320. *Id.* at 845.

321. See generally Benjamin S. Walton, Note, *U.S. Term Limits, Inc. v. Thornton: Who Are the People and Why Does It Matter?*, 4 LIBERTY U. L. REV. 173 (2009). This Note further discusses whether states have reserved powers to limit the federal government according to the founders. *Id.*

322. See *supra* Part V.

1. Why so Long a Period Before Disclosing?

One major problem with the Act is that it grants members of Congress ninety days before they are required to disclose a stock transaction.³²³ Why are members of Congress, our nation's leaders, granted ninety days, while corporate insiders must report within two days?³²⁴ A two-day disclosure period for corporate insiders is both reasonable and necessary, and if any group is to be held to a higher standard, it should be Congress. When major legislation is being proposed and voted on, the American people want to know that their leaders are acting in the best interest of the country, not lining their own pockets. Trust in Congress is at an all-time low; the people of America are sick of the behavior of those in Congress,³²⁵ and requiring a much shorter financial disclosure period might be one step toward a remedy. Furthermore, the electorate is being robbed of the chance to voice its concern to its representatives about legislation that it thinks is being passed for corrupt purposes. After three months, the passage of the legislation is ancient history with our fast-paced and short-attention-spanned society,³²⁶ and all of the underhanded transactions that occurred during that time are nowhere near as meaningful because little can be done about it so long afterwards.

If there is going to be a disclosure period, why not require members of Congress to disclose new transactions instantaneously? In a world of iPhones, Blackberries, and email, members of Congress can simply disclose the transaction minutes after it has been completed. A 24-hour disclosure requirement would be better because the nation would be updated on possible conflicts on important legislation immediately. It would also allow them time to gather their information and fill out forms during a demanding schedule.

323. Stop Trading on Congressional Knowledge Act, *supra* note 24, § 5(a).

324. 15 U.S.C. § 78p(a)(2)(C) (2010).

325. Kilstein, *supra* note 1.

326. David Marcovitz, *Point/Counterpoint is Educational Technology Shortening Student Attention Spans?*, INTERNATIONAL SOCIETY FOR TECHNOLOGY IN EDUCATION (Aug. 8, 2012, 13:36 PM), <http://www.iste.org/learn/publications/learning-leading/issues/august-2008/point-counterpoint-is-educational-technology-shortening-student-attention-spans->.

2. *What Makes \$1,000 a Magical Number?*

Another problem with the Act is that members of Congress do not have to report any financial transactions under \$1,000.³²⁷ As evidenced by Senator Clinton, a savvy and well-connected politician can turn a small investment of \$1,000 into a \$100,000 in a matter of months.³²⁸ Under the Act, she would have been able to purchase \$999.99 in stock and have a similar profit within the same short time frame without having to make the initial ninety-day disclosure. In effect, this \$1,000 limitation serves no purpose, and must be eliminated.

3. Put the Political Intelligence Section in a Separate Bill to Gain Support

Also, while the political intelligence section in the Act is adequate, it may be more effective to address that issue in a separate piece of legislation to gather more support to address the issue of political insider trading. As discussed earlier, political intelligence is another corrupt form of political insider trading because it consists of former members of Congress or their staff using their connections to gain nonpublic information to sell to investors.³²⁹ The Act would properly require political intelligence firms and consultants to register with Congress just as lobbyists are required to register.³³⁰ Undoubtedly, this additional step toward increased disclosure on the practices in Congress would be beneficial, but an incremental approach regarding this effort may prove more effective, particularly considering the resistance this Act has already received.³³¹ Sometimes, taking one small step forward by addressing one issue at a time is more successful than attempting to address several issues at once. Thus, advocates for the Act should also strongly consider an alternative strategy to pass the Act by separating Section 6, regarding political intelligence, into a different Act. By

327. Stop Trading on Congressional Knowledge Act, *supra* note 24, at § 5(a).

328. Mark Hosenball & Eleanor Clift, *Hillary's Adventures in Cattle Futures Land*, THE DAILY BEAST (Apr. 10, 1994, 8:00 PM), <http://www.thedailybeast.com/newsweek/1994/04/10/hillary-s-adventures-in-cattle-futures-land.html>. Before Senator Hillary Clinton took office, she turned an investment of \$1,000 into \$100,000 in nine months during the time President Bill Clinton was governor of Arkansas. *Id.* She traded on the advice of brokers who were later found to have violated unrelated trading rules. *Id.*

329. See *supra* Part V.C.; see also Kroft, *supra* note 5, at 5.

330. Stop Trading on Congressional Knowledge Act, *supra* note 24, § 6.

331. *What is the Stop Trading on Congressional Knowledge Act*, *supra* note 279.

doing this, advocates for the Act may be able to pick up more votes and more media attention, which could lead to a better chance of success.

4. *Why Allow a Bias toward Certain Companies?*

Finally, the Act still allows too much freedom for members of Congress to make investments in individual companies while they consider market-changing legislation. The STOCK Act generally states that members are prohibited from trading on nonpublic information, and all transactions over \$1,000 need to be disclosed.³³² Members can own stock in a company like IBM, before drafting market-changing legislation, and later vote on legislation that benefits individual companies like IBM—or whatever company they own stock in. This allows too much of a conflict of interest and is a form of insider trading because members of Congress may abstain from selling while they are aware of the effects of market-changing legislation on individual companies. The purposeful act of favoring certain companies and industries over others just to benefit a personal stock portfolio is an extremely corrupt practice and has the potential to negatively affect millions. To prevent this, additional safeguards are necessary. A more strict and comprehensive approach is needed to adequately tackle this corrupt motivation.

C. *Other Insufficient Proposed Solutions*

Some in the legal community have advocated for blind trusts to solve this problem.³³³ A blind trust exists when a trustee handles the investments and the owner does not know what stocks he holds.³³⁴ The problem, however, with blind trusts is that the investments do not need to be disclosed³³⁵ and by their nature are secret. As mentioned earlier, shining light on people's conduct is a great deterrent of corrupt practices.³³⁶ It is also hard to enforce a prohibition against communicating with the trustee of the trust, especially

332. Stop Trading on Congressional Knowledge Act, *supra* note 24, §§ 1–7.

333. Bud W. Jerke, Comment, *Cashing in on Capitol Hill: Insider Trading and the Use of Political Intelligence For Profit*, 158 U. PA. L. REV. 1451, 1513–17 (2010).

334. *Blind Trust*, INVESTOPEDIA, <http://www.investopedia.com/terms/b/blindtrust.asp#axzz1iVQXEbgb> (last visited Jan. 5, 2012).

335. Ethics in Government Act of 1978, Pub. L. No. 95-521, 92 Stat. 1824, § 102(e) (1978).

336. See *supra* Part VI.B.

because the settlor chooses the trustee.³³⁷ These flaws prevent the blind trust from stepping in as a viable solution to the political insider trading problem.

Others advocate that the insider-trading laws are sufficient as they are—the problem lying only in their enforcement.³³⁸ This assertion has already been addressed in this Comment and is simply not true; the laws, as they currently stand, do not apply in political insider trading.³³⁹ The fact that there has never been a conviction of a member of Congress for trading on nonpublic information regarding congressional activity³⁴⁰ supports the notion that those advocating the sufficiency in the current laws are in error.

Some in the legal community advocate for the passage of the STOCK Act with some modifications, such as shortening the disclosure requirements.³⁴¹ Under the STOCK Act, members would still be able to invest in individual companies and be aware of those individual holdings, which could easily influence their legislative policies. While passing the STOCK Act is at least a step in the right direction, a more stringent bright-line requirement is necessary to ensure that this type of fraud committed by our nation's leaders ends.

D. Provisions That Should Be Adopted to Adequately Address The Problem

1. Mandatory Investment in U.S. Index Funds

A statute that adequately addresses political insider trading would require members of Congress to invest only in index funds based on the United States economy, which would provide a clear bright-line standard to enforce. This rule would apply to the following types of investments: stocks, grantor trusts, blind trusts, bonds, hedge funds, options, IPOs, and mutual

337. SCHWEIZER, *supra* note 41, at 168–69 (evidencing how politicians put their money in blind trusts and still get away with political insider trading because they communicate the nonpublic information to their trustee).

338. George, *supra* note 270, at 170; Nagy, *supra* note 270, at 1149–51.

339. *See supra* Part V.B.

340. Viswanatha, *supra* note 232. At the time of this Comment's submission, an investigation began regarding Representative Bachus's trades during the financial collapse in 2008, and if he is convicted, it will be interesting to see what laws the government uses to convict him. Scott Higham & Dan Keating, *Rep. Spencer Bachus Faces Insider-Trading Investigation*, WASH. POST (Feb. 9, 2012), http://www.washingtonpost.com/politics/rep-bachus-faces-insider-trading-investigation/2012/02/09/gIQA21Ui2Q_print.html.

341. Bainbridge, *supra* note 266, at 307; Matthew Barbabella et al., *Insider Trading in Congress: The Need For Regulation*, 9 J. BUS. & SEC. L. 199, 235–37 (2009).

funds.³⁴² Thus, if a member of Congress owns one of the covered investments, he or she will be required to transfer that amount in the authorized index funds that are based on the U.S. economy. An index fund is a category of mutual funds³⁴³ that complements or follows a market index.³⁴⁴ The DJIA, S&P 500, and Nasdaq are all common U.S. indices in which one can invest.³⁴⁵ The DJIA consists of thirty of the largest companies located in the United States.³⁴⁶ The S&P 500 represents 500 large companies throughout important sections of the U.S. economy,³⁴⁷ and the Nasdaq Composite Index consists of the 100 largest nonfinancial companies such as internet and technological stocks.³⁴⁸ To adequately address the problem of insider trading, all members of Congress should have to proportionally transfer all of the covered investments evenly into these three indexes two weeks before being sworn into office and be required to only invest proportionally in these index funds while serving in office. Thus, two weeks before being sworn into office, each member's total covered investments should be divided by three, and placed proportionately into the DJIA index fund, the S&P 500 index fund, and the Nasdaq index fund. Two years after leaving office, the former member of Congress should be allowed to transfer their funds freely into their choice of stock.

A statute such as this would make it extremely difficult for members of Congress to favor one industry or company over another for personal financial gain. Also, their investments would be so dependent on the well being of all sectors of the United States economy that favoritism for

342. Investments in land, commodities, and personal or family businesses will be excluded from this rule. The SEC, however, will monitor these investments to ensure that there is not a conflict of interest.

343. *Mutual Funds: What Are They?*, INVESTOPEDIA, <http://www.investopedia.com/university/mutualfunds/mutualfunds.asp#axzz1iVQXEBgb> (last visited Jan. 4, 2012).

344. *Index Investing: Index Funds*, INVESTOPEDIA, <http://www.investopedia.com/university/indexes/index8.asp#axzz1iVQXEBgb> (last visited Jan. 5, 2012).

345. *Index Investing: Introduction*, INVESTOPEDIA, <http://www.investopedia.com/university/indexes/default.asp#axzz1iVQXEBgb> (last visited Jan. 5, 2012).

346. *Index Investing: The Dow Jones Industrial Average*, INVESTOPEDIA, <http://www.investopedia.com/university/indexes/index2.asp#axzz1iVQXEBgb> (last visited Jan. 4, 2012).

347. *Index Investing: The Standard & Poor's 500 Index*, INVESTOPEDIA, <http://www.investopedia.com/university/indexes/index3.asp#axzz1iVQXEBgb> (last visited Jan. 4, 2012).

348. *Index Investing: The Nasdaq Composite Index*, INVESTOPEDIA, <http://www.investopedia.com/university/indexes/index4.asp#axzz1iVQXEBgb> (last visited Jan. 4, 2012).

personal gain would be significantly decreased. Furthermore, this would give congressmen incentive to help improve every sector of the U.S. economy while in office. The requirement forcing them to transfer their stocks within two weeks of being sworn into office will ensure that members of Congress do not have the ability to invest in individual companies while concurrently possessing the power to financially affect certain companies through legislation. Also, the requirement prohibiting them from transferring their money out of the index funds until two years after leaving office prevents them from being privy to nonpublic information regarding potential future legislation or other nonpublic information. After two years, there will also be several different members of Congress, and the information will not be as relevant.

Because they would not be allowed to invest in individual companies, political insider trading would no longer be a problem, and current insider-trading laws pertaining to the private citizen would not be affected by this requirement. Some may advocate that such a strict requirement is unfair, but this heightened standard is appropriate for the leaders of our country. Members of Congress are elected by their constituents to serve their country through leadership—good leadership requires personal sacrifices.³⁴⁹ This nation needs honest and impartial men and women in office, and a provision such as this helps ensure such desperately needed honesty and impartiality. This type of provision would radically diminish the problem of political insider trading. It would also restore America's trust and confidence in Congress because members of Congress would not be able to directly invest in companies with the unfair advantage of possessing nonpublic information regarding legislation affecting the market.

2. Entirely Enforced by the SEC

If a provision such as this is adopted, the SEC is the proper organization that should be responsible for providing oversight and ensuring that members of Congress follow it. Committees consisting of their colleagues rarely ever hold members accountable³⁵⁰ and the SEC has more experience

349. ROD GRAGG, *A COMMITMENT TO VALOR: A CHARACTER PORTRAIT OF ROBERT E. LEE* 30, 36–37 (2001); JOHN C. MAXWELL, *THE 21 IRREFUTABLE LAWS OF LEADERSHIP* 133–40 (2007).

350. Kristen Byrne, *Ethics Committee (Finally) Staffs Up Amid Trial Delays*, NATIONAL LEGAL AND POLICY CENTER (Jul. 7, 2011), <http://nlpc.org/stories/2011/07/06/ethics-committee-finally-staffs-amid-trial-delays>.

and skill to provide oversight in securities regulations;³⁵¹ therefore, oversight should not be entrusted to a committee. Granted, the SEC receives its funding from Congress, and thus, there may be some tension not to enforce the provision. There is, however, no financially independent federal organization to provide such oversight because Congress funds all branches of the government, except at the state level. Thus, for now at least, the SEC is in the best position to enforce this proposed provision.

Members of Congress, after elected, should disclose all of their investments to the SEC, and when they transfer those investments into index funds, those index fund accounts should also be disclosed to the SEC. The SEC will also have authority and discretion to regulate and monitor the types of investments to which this rule does not apply. Investments not covered by the rule include investments in land, commodities, and personal or family businesses. For example, the SEC could require members of Congress to abstain from voting on legislation that directly benefits their family business. Unlike the STOCK Act, this statute would prove more beneficial because it would alleviate some monitoring responsibilities for the SEC, an organization of questionable efficiency at times,³⁵² by decreasing the various possible stock transactions and providing a bright-line rule. Thus, oversight responsibility would be delegated to an independent outside agency, and those responsibilities of oversight would be minimal due to the clear and unambiguous standards set forth.

VIII. CONCLUSION

For corruption in Washington to end, political insider trading must be addressed. Members of Congress will be much less likely to play favorites with certain corporations and industries if they are unable to invest in them

351. *Insider Trading by Congress: Historical Timeline*, *supra* note 84. Congress created the SEC for the purpose of specializing in securities oversight and regulation. *Id.*

352. See Ed O'Keefe, *SEC Porn Investigation Nets Dozens*, WASH. POST (Apr. 23, 2010, 6:35 AM), http://voices.washingtonpost.com/federal-eye/2010/04/eye_opener_porn_and_federal_wo.html (discussing how more SEC time may be spent viewing pornography than regulating securities transactions); see also Sarah N. Lynch & Matthew Goldstein, *Exclusive: SEC Builds New Tips Machine to Catch the Next Madoff*, REUTERS (Jul. 27, 2011, 3:41 PM), <http://www.reuters.com/article/2011/07/27/us-sec-investigations-idUSTRE76Q2NY20110727> (addressing the SEC's embarrassing failures in stopping Bernie Madoff's ponzi scheme); Thor Valdmanis, *Senate Report Blasts SEC's Enron Oversight*, USA TODAY MONEY, http://www.usatoday.com/money/industries/banking/2002-10-06-sec_x.htm (last visited Jan. 4, 2011) (reporting on SEC's failures to address warnings signs of Enron's corruption, and the SEC's incompetence in handling Enron's fraudulent activities).

personally. Under current insider-trading laws, members of Congress are able to legally escape punishment for trading on nonpublic, material information regarding market-changing legislation. This needs to change. The STOCK Act will help this to a small extent, but it is not enough. There is even the real risk that if the STOCK Act is passed, Congress and the American people will feel like the issue has been sufficiently addressed, and this insufficient attempt to reign in an incredibly destructive practice might be the last attempt that we see in a very long time. Therefore, while there is so much media attention and popular pressure on the issue,³⁵³ a stricter requirement needs to be implemented to ensure that the problem is adequately addressed and resolved. That solution is to mandate that members of Congress transfer their investments proportionately into DJIA, S&P 500, and Nasdaq index funds. This would not only solve the problem of political insider trading, but it would give them incentive to fix and improve the U.S. economy, especially during this economic downturn.³⁵⁴

353. SCHWEIZER, *supra* note 41; Becket Adams, 'Legalized Bribery': How Bad is Congressional Insider Trading? You Might Be Shocked at Some of The Details Revealed by Glenn Beck and Peter Schweizer, THE BLAZE (Dec. 6, 2011, 6:15 AM), <http://www.theblaze.com/stories/legalized-bribery-how-bad-is-congressional-insider-trading-you-might-be-shocked-at-some-of-the-details-revealed-by-glenn-beck-and-peter-schweizer-ready-as-promised/>; BLOOMBERG NEWS, *Congress Discusses Enacting Stricter Insider-Trading Laws*, N. Y. TIMES (Dec. 6, 2011), <http://www.nytimes.com/2011/12/07/business/congress-considers-new-limits-on-insider-trading.html>; Kroft, *supra* note 5; MJ Lee, *Rick Perry: End Congress Insider Trading*, POLITICO (Jan. 6, 2012, 6:29 AM), <http://www.politico.com/news/stories/0112/71142.html>; Seung Min Kim, *supra* note 283; Kimberly Kindy, *Bill to Ban Insider Trading in Congress is Suddenly Popular*, WASH. POST (Nov. 30, 2011), http://www.washingtonpost.com/politics/bill-to-ban-insider-trading-in-congress-is-suddenly-popular/2011/11/30/gIQAn193DO_story.html; Chad Pergram, *House Ethics Committee Warns Lawmakers About Insider Trading*, FOX NEWS (Nov. 29, 2011), <http://www.foxnews.com/politics/2011/11/29/house-ethics-committee-warns-lawmakers-about-insider-trading/>; Dave Clarke, *House Hearing Scheduled for Insider Trading Bill*, REUTERS (Nov. 17, 2011), <http://www.reuters.com/article/2011/11/17/us-financial-regulation-stock-idUSTRE7AG2M820111117>.

354. Catherine Rampell, *Second Recession in U.S. Could Be Worse Than First*, N.Y. TIMES (Aug. 7, 2011), <http://www.nytimes.com/2011/08/08/business/a-second-recession-could-be-much-worse-than-the-first.html>.