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The Poli-Intel Industry: Considering the Common Law's Application in Insider Trading under the Stock Act

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NOTE

THE POLI-INTEL INDUSTRY: CONSIDERING THE COMMON LAW'S APPLICATION IN INSIDER TRADING UNDER THE STOCK ACT

ERNIE C. JOLLY*

President Barack Obama signed the Stop Trading on Congressional Knowledge Act ("STOCK Act") into law on April 4, 2012. Congressional silence on the STOCK Act's purview over the political intelligence industry and the lack of guidance from the Securities Exchange Commission ("SEC") have led practitioners and scholars to speculate on the STOCK Act's reach. Due to uncertainty, Congress should clarify its intent behind the STOCK Act, and the SEC should provide further guidance on the proper application of its securities laws while considering fundamental principles of fraud established through common law. Applying common law principles to political intelligence activity would weed out fraudulent behavior without having an overbroad impact, a risk enforcement officials run when applying vague insider trading principles to political intelligence activity. Ultimately, without further guidance, the STOCK Act's applicability to political intelligence activities will remain speculative,

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discouraging legitimate interactions with the government that may prove conducive to efficient capital markets.

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INTRODUCTION

On June 6, 2012, Washington insiders convened for breakfast at Charlie Palmer Steak Restaurant, only a few blocks from the Capitol Building.¹ The morning’s discussion, titled “Defining Political Intelligence,”² examined the future of an opaque industry.³ At the event, panelists defined political intelligence as the “process for collecting industry policy research” and “the deliverables of collected information (reports and analysis) sold to

1. See *Political Intelligence Panel Discussion Concludes With Recognized Need for Increased Disclosure of Non-Public Material Collection and Use*, BUS. WIRE (June 12, 2012, 8:00 AM), [http://www.businesswire.com/news/home/20120612005322/en/Political-Intelligence-Panel-Discussion-Concludes-Recognized-Increased](http://www.businesswire.com/news/home/20120612005322/en/Political-Intelligence-Panel-Discussion-Concludes-Recognized-Increased-Increased) [hereinafter *Political Intelligence Panel*] (summarizing the details of a panel discussion organized by Washington lobbyists, attorneys, and policy analysts interested in the political intelligence industry).

2. *Id.*

3. See generally Press Release, Sen. Chuck Grassley, Grassley Seeks Same Transparency from Political Intelligence Professionals as Lobbyists (Feb. 2, 2012), available at http://www.grassley.senate.gov/news/Article.cfm?customel_dataPageID_1502=38833 (discussing the need for transparency around an obscure industry).

customers.”⁴

The panel convened approximately two months after President Barack Obama signed into public law the Stop Trading on Congressional Knowledge Act (“STOCK Act”).⁵ The STOCK Act reinforces the duty of trust and confidence owed by congressional members and staffers to Congress and the American people⁶ and declares a similar duty within the other branches of government.⁷ The law explicitly subjects individuals employed by the government to liability for trading securities on the basis of material, nonpublic information obtained through their positions.⁸

Regarding the political intelligence industry, Section 7 of the STOCK Act merely instructs the Comptroller General of the United States to release a report on the role political intelligence plays in the financial markets.⁹ Despite the STOCK Act’s silence on selling policy analysis based on political intelligence (some of which may be considered “material” and “nonpublic”), Washington attorneys have speculated that the STOCK Act, in conjunction with traditional insider trading principles, may already expose political intelligence professionals to liability.¹⁰

4. *Political Intelligence Panel*, *supra* note 1.

5. See Press Release, White House, FACT SHEET: The STOCK Act: Bans Members of Congress from Insider Trading (Apr. 4, 2012), *available at* <http://www.whitehouse.gov/the-press-office/2012/04/04/fact-sheet-stock-act-bans-members-congress-insider-trading> (announcing the enactment of the STOCK Act and detailing its provisions).

6. See Stop Trading on Congressional Knowledge Act of 2012 (STOCK Act), Pub. L. No. 112-105, 126 Stat. 291 (2012).

7. See *id.* § 9 (incorporating employees and officers within the Executive and Judicial branches under the purview of the STOCK Act by simply compelling the Judicial Conference of the United States and the Office of Government Ethics to provide interpretive guidance on standing ethics statutes and regulations).

8. See *generally* JACK MASKELL, CONG. RESEARCH SERV., R 42495, THE STOCK ACT, INSIDER TRADING, AND PUBLIC FINANCIAL REPORTING BY FEDERAL OFFICIALS (2012) (breaking the STOCK Act into four major features, including its clarification of a public official’s duty of trust and confidence to the American people, a provision that opens public officials to insider trading liability).

9. STOCK Act § 7. See *generally* U.S. GOV’T ACCOUNTABILITY OFFICE, GAO-13-389, POLITICAL INTELLIGENCE: FINANCIAL MARKET VALUE OF GOVERNMENT INFORMATION HINGES ON MATERIALITY AND TIMING (2013) (considering the extent to which investors rely on political information, whether such practices implicate established securities laws, yet providing no recommendations for legislatures beyond balancing the costs and benefits of a disclosure regime).

10. See ARNOLD & PORTER LLP, ADVISORY: STOCK ACT EXPANDS INSIDER TRADING LIABILITY: COMMUNICATING WITH GOVERNMENT OFFICIALS CARRIES NEW RISKS 1-4 (2012), http://www.arnoldporter.com/resources/documents/Advisory%20STOCK_Act_Expands_Insider_Trading_Liability_Communicating_with_Government_Officials_Carries_New_Risks.pdf (advising clients to be more cautious when using information obtained from federal employees and officials); DAVIS POLK & WARDWELL LLP, CLIENT MEMORANDUM: THE STOCK ACT: IMPLICATIONS FOR TRADING ON POLITICAL INTELLIGENCE 1 (2012), <http://www.davispolk.com/files/Publication/4af2e74c-700d-4f4e-970f->

This Note examines the impracticality of applying traditional insider trading principles to political intelligence activity. Furthermore, it considers an alternative interpretation of our securities laws' purview over the political intelligence industry, based on common law understandings of fraud, while acknowledging the realities of information sharing in Washington. Finally, it concludes that interpreting the STOCK Act based on fundamental principles of fraud would provide practical standards for political intelligence professionals, many of whom engage in legitimate policy research and analysis that is conducive to efficient capital markets.

I. FROM THE STOCK MARKET'S CRASH TO THE STOCK ACT: AN EVOLUTION OF SECURITIES LAWS

The Securities Exchange Act of 1934 ("SEA") was a political byproduct of the stock market's failure during the Great Depression.¹¹ Concerned with "ineptitude and/or chicanery" among stockbrokers and investment bankers, policymakers passed sweeping legislation to restore confidence within the market.¹²

Pursuant to the SEA,¹³ the Securities and Exchange Commission ("SEC") promulgated Rule 10b-5, which prohibits individuals from engaging in deceptive practices in connection with the purchase or sale of any security.¹⁴ Although the term "insider trading" is not statutorily defined, the SEC and courts construe Rule 10b-5 to prohibit "insider trading"—a phenomenon not limited to corporate insiders, which is something the term may suggest.¹⁵ Generally, insider trading includes all

8c3f00d63e6c/Presentation/PublicationAttachment/6edb24cd-f22d-4c36-a4bb-8d0e9e3f5373/033012_STOCK_Act.pdf (advising market participants who engage public officials to access relationships with such officials before trading in order "to ensure that there is not a relationship of trust and confidence that could give rise to insider trading liability based on a misappropriation theory"); Robert L. Walker, *The STOCK Act: Insider Trading on Government Information; Corporate and Individual Compliance Concerns*, WILEY REIN LLP (Apr. 4, 2012), <http://www.wileyrein.com/publications.cfm?sp=articles&id=7953> (suggesting training on the likely pitfalls the STOCK Act could pose to professionals who obtain market sensitive information from federal employees).

11. See George J. Benston, *Required Disclosure and the Stock Market: An Evaluation of the Securities Exchange Act of 1934*, in 2 THE SELECTED WORKS OF GEORGE J. BENSTON 66, 66 (James Rosenfeld ed., 2010) (describing how the Depression-era Congress wanted federal approval of all securities sales and how President Roosevelt preferred disclosure by corporations who sold their securities).

12. See *id.* (highlighting the stock market crash of 1929 and the subsequent Great Depression as the basis for the subsequent financial reform laws).

13. Securities Exchange Act § 901, 15 U.S.C. § 78a (2006).

14. 17 C.F.R. § 240.10b-5 (2012).

15. See Robert J. Kuker, Comment, *Insider Trading Liability of Tippees and Quasi-Insiders: Crime Shouldn't Pay*, 22 J. MARSHALL L. REV. 295, 295 n.1 (1988) (analyzing the nonobvious legal interpretation of the phrase "insider trading").

unlawful trading based on material, nonpublic information, regardless of whether the trader is a corporate insider.¹⁶

Notwithstanding the broad applicability of the SEA, the STOCK Act represented an expansion beyond our securities laws' original foundation in fiduciary duty principles.¹⁷ Consequently, legal scholars and practitioners have sought ways to best fit political intelligence activity within our established securities law regime. It has been argued that political intelligence activity is most susceptible to insider trading liability under the misappropriation theory as it applies to "tippers" (those who divulge nonpublic, material information) and "tippees" (those who receive nonpublic, material information).¹⁸ The misappropriation theory, described in *United States v. O'Hagan*,¹⁹ considers trading on material, nonpublic information unlawful when one owes a duty of trust and confidence to the source of the information, but not necessarily to the company as a whole. Courts have held tippers and tippees liable for trading on misappropriated information when certain requirements are met.²⁰ Under the tipper/tippee model, liability is imposed on a tippee when the tipper has breached a fiduciary duty by divulging material, nonpublic information, and the tippee knows or has reason to know that the breach has occurred.²¹ When it is difficult to determine the extent to which information is material or nonpublic, however, the otherwise straightforward tippee/tipper liability rule may be difficult to apply, a difficulty that arises when applying this rule to the emerging political intelligence industry.

16. *See id.*

17. *See Preventing Unfair Trading by Government Officials: Hearing Before the Subcomm. on Oversight and Investigations of the H. Comm. on Fin. Servs.*, 111th Cong. 49 (2009) [hereinafter *Preventing Unfair Trading by Government Officials*] (statement of J.W. Verret, Assistant Professor, George Mason Univ. Sch. of Law) (providing concerns about the STOCK Act's potential unintended consequences since it expands insider trading beyond the theory's foundational principles).

18. *See The Stop Trading on Congressional Knowledge Act: Hearing Before the H. Comm. on Fin. Servs.*, 112th Cong. 81 (2011) (statement of Robert Khuzami, Director of the Div. of Enforcement, U.S. Sec. & Exch. Comm'n) (analyzing the applicability of insider trading laws to congressional members, staffers, and others who may receive and trade on material, nonpublic political intelligence).

19. 521 U.S. 642, 652 (1997) (defining the misappropriation theory of insider trading).

20. David T. Cohen, Note, *Old Rule, New Theory: Revising the Personal Benefit Requirement for Tipper/Tippee Liability Under the Misappropriation Theory of Insider Trading*, 47 B.C. L. REV. 547, 561–62 (2006) (noting that tipper/tippee liability applies in the context of the misappropriation theory, although courts are divided on whether a personal benefit is a necessary element similar to tipper/tippee liability under the classical theory).

21. *See id.* (providing the uncontested elements of tipper/tippee liability as it applies under the misappropriation theory, yet acknowledging elements of the theory that are still contested in the courts).

II. THE MOST VEXING ISSUES POSED BY THE STOCK ACT AND THE IMPRACTICALITY OF APPLYING TRADITIONAL INSIDER TRADING PRINCIPLES

Congressional silence on the STOCK Act's purview over the political intelligence industry and no indication of guidance from the SEC led practitioners to speculate on the STOCK Act's reach.²² Some of the most vexing issues for practitioners include applying the (1) material and (2) nonpublic elements of the misappropriation theory to political intelligence activity.²³ This Section will examine the application of these elements in turn.

A. *The Material Element*

Depending on the facts, courts approach the materiality element of insider trading in two different ways. Normally, courts consider whether it is likely that the inside information "would have assumed actual significance in the deliberations of a reasonable investor."²⁴ Contrarily, when dealing with speculative and/or contingent material information, courts apply a probability/magnitude test that considers the likelihood of an anticipated event and its potential financial impact.²⁵ Scholars anticipate that the probability/magnitude test is most applicable to political intelligence activity given the speculative nature of the legislative process.²⁶

22. See ARNOLD & PORTER LLP, *supra* note 10, at 1–2, 4 (speculating that the STOCK Act's language may already impose liability on political intelligence professionals); DAVIS POLK & WARDWELL LLP, *supra* note 10, at 2–3 (cautioning that due to the STOCK Act's language in conjunction with the misappropriation theory, one should consider the nature of the information obtained on Capitol Hill before selling that information, or trading upon it). See generally Walker, *supra* note 10.

23. See Kenneth A. Gross, *Unique Issues Facing Companies Under the STOCK Act*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (May 3, 2012, 9:24 AM), <http://blogs.law.harvard.edu/corpgov/2012/05/03/unique-issues-facing-companies-under-the-stock-act/> (discussing the difficulties of applying insider trading principles under the STOCK Act to political intelligence activities given a public official's unique access to information and the official's duty to interact with constituents).

24. See Bradley J. Bondi & Steven D. Lofchie, *The Law of Insider Trading: Legal Theories, Common Defenses, and Best Practices for Ensuring Compliance*, 8 N.Y.U. J. L. & BUS. 151, 179 (2011) (considering that the materiality element of the misappropriation theory is a high standard established by courts in order to protect shareholders from useless information that is not conducive to informed decision-making).

25. See *id.* at 180 (examining an alternative approach to determining the materiality of market-sensitive information when material, nonpublic information pertains to speculative matters similar to mergers, acquisitions, and bankruptcies).

26. See *Preventing Unfair Trading by Government Officials*, *supra* note 17, at 33–35 (statement of Peter J. Henning, Professor of Law, Wayne State Univ. Law Sch.) (hinting at the notion that the legislative process's unpredictable nature would best fit the probability/magnitude materiality test).

Applying the probability/magnitude test to legislative action in a meaningful way, however, is problematic given the general uncertainty that introduced legislation would eventually be enacted by Congress.²⁷ Take the 111th Congress' legislative record. Between 2009 and 2010, members of Congress introduced 10,629 bills for consideration.²⁸ Only ten percent of those bills underwent some form of legislative activity beyond simply being referred to a committee.²⁹ Furthermore, only 366 laws were passed in the 111th Congress, a mere thirty-six percent of bills that underwent legislative activity beyond the committee level; ultimately, only three percent of bills introduced in the 111th Congress became public law.³⁰

These statistics may reflect the numerous obstacles within the legislative process, including necessary voting on the committee level and on each chamber's floor,³¹ reconciliatory proceedings between both chambers,³² and a necessary signature or veto from the President.³³ Furthermore, a host of non-legislative factors may impact the legislative process,³⁴ making it difficult to consider truly any one piece of political intelligence material on its own.³⁵ These realities of the legislative process would likely trigger the "mosaic defense" against insider trading allegations,³⁶ a shield based on the legal rule that "an investor [who] assembles multiple pieces of non-material information to reach a material conclusion has not violated insider trading

27. See Josh Tauberer, *Kill Bill: How Many Bills Are There? How Many Are Enacted?*, GOVTRACK.US (Aug. 4, 2011), <http://www.govtrack.us/blog/2011/08/04/kill-bill-how-many-bills-are-there-how-many-are-enacted/> (noting that the 111th Congress enacted only three percent of legislation introduced).

28. *Id.*

29. *Id.*

30. *Id.*

31. See JOHN V. SULLIVAN, HOW OUR LAWS ARE MADE, H.R. Doc. No. 110-49, at 37 (2007) (stating that after the House of Representatives has considered a bill the "Senate committees give the bill the same detailed consideration as it received in the House and may report it with or without amendment").

32. See *id.* at 41-48 (detailing the conference process to reconcile conflicting bills between the Senate and the House).

33. See generally *id.* at 50-51 (detailing the veto process within the larger legislative process).

34. Benjamin I. Page & Robert Y. Shapiro, *Effects of Public Opinion on Policy*, 77 AM. POL. SCI. REV. 175, 186 (1983) (arguing that public opinion influences policy, while acknowledging that there may very well be other influences, including world events, interest group campaigns, and other exogenous factors).

35. See *E-Alert: STOCK ACT Spotlights Trading on Government Information*, COVINGTON & BURLING LLP 1, 5 (2012), http://www.cov.com/files/Publication/7f2980b7-4773-4b5b-b7bc-3b2e10aedb1a/Presentation/PublicationAttachment/fcfc6963-f48f-4320-a19e-416fba589ac3/STOCK_Act_Spotlights_Trading_on_Government_Information.pdf (noting that groups that engage Members of Congress and their staff would likely acknowledge that information they obtained is not material individually, although such an argument would not prevent prosecutorial action by the SEC).

36. See *id.*

laws, regardless of whether the information obtained was nonpublic.³⁷ Considering the varying factors that affect the legislative process, and the rarity that any political intelligence would be considered material individually, applying the probability/magnitude standard to a piece of political information may be an issue that would take years to resolve.³⁸

B. *The Nonpublic Element*

Information is considered public when it has been dispersed widely among investors with no special regard to any particular person or class.³⁹ Even after such information has been disclosed, it is considered nonpublic until it has been communicated so widely that stock prices reflect the availability of such information.⁴⁰ Furthermore, factors considered when determining if information is nonpublic includes the following: (1) whether the information is public through the Dow Jones business information service; (2) whether the information has been disseminated through “wire services, such as AP or Reuters, radio, television, or the Internet”; (3) whether the information has been circulated through a general news service (such as *The Wall Street Journal* or *Business Week*); and (4) whether the information has been disclosed through public documents filed with the SEC.⁴¹

Given the unique nature of information sharing that is encouraged within the halls of Congress, the applicability of the nonpublic element will remain a cumbersome legal issue for a number of reasons.⁴² Congressional committee meetings and hearings are an example of how Capitol Hill’s unique nature complicates the applicability of insider trading laws. Clause 2(g)(1) of Rule XI of the Rules of House of Representatives provides that “[e]ach meeting for the transaction of business, including the mark up of legislation, by a standing committee or subcommittee thereof (other than the Committee on Ethics or its subcommittees) shall be open to the public,

37. Bondi & Lofchie, *supra* note 24, at 154 (emphasis removed).

38. See COVINGTON & BURLING LLP, *supra* note 35, at 6.

39. See SEC v. Suman, 684 F. Supp. 2d 378, 388 (S.D.N.Y. 2010) (synthesizing case law in order to determine when information should be considered material, nonpublic information).

40. See *United States v. Royer*, 549 F.3d 886, 898 (2d Cir. 2008) (affirming a district court’s jury instruction that information is considered public after stock prices have “an opportunity to ‘absorb’ the disclosed information . . .”).

41. See CORPORATE COUNSEL GUIDE TO INSIDER TRADING & REPRESENTATION § 18:4 (2012 ed.) (noting that tangible evidence that information has been disseminated to investors serves as the best indicator of whether information should be considered public).

42. Gross, *supra* note 23 (analyzing the difficulties of determining when congressional information should be considered “public” or “nonpublic” given the nature of communication on Capitol Hill).

including to radio, television, and still photography coverage.”⁴³ With a few exceptions, mostly all official congressional committee meetings are public, and many can be viewed live on television or the Internet.⁴⁴

Although most congressional proceedings are accessible to the public, it is unclear to what extent information obtained from such meetings is considered “public” under our insider trading laws.⁴⁵ Consider the following real-life scenario. During the mid-2000’s, Congress considered legislative remedies for Americans who suffered from asbestos-related injuries, which included establishing a \$140 billion government-backed trust fund for claims against manufacturers who used asbestos.⁴⁶ During those proceedings, hedge funds employed “line sitters” and other political intelligence operatives to hold seats at committee hearings.⁴⁷ Given the legislation’s potential impact on the stock prices of companies with asbestos-illness liability, political intelligence operatives were able to profit from the information they obtained.⁴⁸

Notwithstanding the theoretic public nature of congressional hearings, attendees fortunate to reserve a space are privy to potentially market-sensitive information before the larger American public. Therefore, in practice, the larger American public would have to wait to obtain such information through television access (if aired), news articles (if covered), or word of mouth (if fortunate). Such information has the potential of becoming worthless by the time it is well-known because of the ever-changing nature of the market.⁴⁹ Investors and political intelligence operatives are left to wonder exactly when congressional information is “public.”⁵⁰ Such a lack of clarity would leave market researchers with

43. KAREN L. HAAS, CLERK, H.R., 112TH CONG., RULES ON THE HOUSE OF REPRESENTATIVES, R. XI, at 17–18 (2011).

44. See *id.* (providing official protocol that encourages public access to congressional meetings and hearings).

45. Cf. Gross, *supra* note 23 (pointing out that while televised congressional proceedings would certainly be considered “public,” an insider trading analysis of political intelligence would be more difficult where proceedings are open to a smaller number of persons, are not televised, or are conducted in private).

46. See 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, 1453–54 (2010) (noting the relevancy of mesothelioma cases to the political intelligence industry and market participants).

47. See *Political Intelligence Panel*, *supra* note 1.

48. See Jerke, *supra* note 46, at 1453 (indicating that after asbestos legislation narrowly passed the Senate Judiciary Committee in 2003, shares of USG Corporation, a construction materials manufacturer, rose by 8.3% because the company had asbestos-related tort liabilities).

49. See Sisira Kanti Mishra, *Capital Market Efficiency* 1 (2011), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1942820 (describing the nature of efficient capital markets that adjust to new information).

50. See ARNOLD & PORTER LLP, *supra* note 10, at 3 (speculating about the STOCK

fewer incentives to seek out political intelligence.⁵¹

III. CONSIDERING AN ALTERNATIVE APPROACH TO POLITICAL INTELLIGENCE ACTIVITY BASED ON COMMON LAW PRINCIPLES OF FRAUD

In his dissent in *Chiarella v. United States*, Chief Justice Burger offered an alternative approach to insider trading that holds liable those who benefit from information “unlawfully converted for personal gain.”⁵² According to Chief Justice Burger, whether trading on material, nonpublic information is illegal should turn on whether an investor exploits an “ill-gotten informational advantage.”⁵³ Consequently, this reading of Rule 10b-5 allows a safe harbor for professionals who benefit from material information that is not generally known, but was still acquired lawfully.⁵⁴

Burger’s reasoning in *Chiarella* has its roots in common law principles.⁵⁵ Under the common law, whether a party has a duty to disclose information during a business transaction should be determined, in part, by considering: (1) whether the information is extrinsic or intrinsic to the transaction; (2) whether there is an unusual difference in intelligence among transacting parties; and (3) whether material, nonpublic information was obtained illegally instead of through legitimate diligence.⁵⁶

An early example of how these principles may apply to political intelligence activity can be found in the landmark Supreme Court case *Laidlaw v. Organ*.⁵⁷ In *Laidlaw*, two parties contracted for the sale of tobacco.⁵⁸ The buyer possessed what amounted to valuable political

Act’s potential scope).

51. See Jerke, *supra* note 46, at 1518 (addressing the potential chilling effect on congressional engagement if insider trading is expanded to regulate political intelligence activities).

52. See *Chiarella v. United States*, 445 U.S. 222, 243 (1980) (5–4 decision) (Burger, C.J., dissenting) (providing an alternative interpretation of insider trading precedent and statutory language to provide legal room for market specialists to perform their everyday functions).

53. See *id.* at 245.

54. See *id.* at 242–43 (“[M]arket specialist would not be subject to a disclose-or-refrain requirement in the performance of their everyday market functions. [In this instance], trading is accomplished on the basis of material, nonpublic information, but the information has not been unlawfully converted for personal gain.”).

55. See Donald C. Langevoort, *Words From On High About Rule 10b-5: Chiarella’s History, Central Bank’s Future*, 20 DEL. J. CORP. L. 865, 883 (1995) (explaining how the reasoning in Burger’s dissent in *Chiarella* has its roots in principles established through common law).

56. See W. Page Keeton, *Fraud—Concealment and Non-Disclosure*, 15 TEX. L. REV. 1, 34–35 (1936) (providing a number of factors that should be considered when determining whether nondisclosure amounts to fraud).

57. 15 U.S. (2 Wheat.) 178 (1817).

58. See *id.*

intelligence—information that indicated the War of 1812 had ended by way of a treaty between the United States and England.⁵⁹ Consequently, an embargo was lifted, substantially raising the price of tobacco.⁶⁰ The Court held that a party in a similar situation does not have a duty to disclose when the information at question pertains to extrinsic circumstances, is equally accessible, and has been obtained lawfully.⁶¹

The remainder of this Section will examine how these principles may be applied to contemporary scenarios that are common in Washington.

A. Is the Political Intelligence Extrinsic or Intrinsic?

Under common law, whether information is material depends on the extent to which the information is considered intrinsic.⁶² Intrinsic information pertains to “the very ingredients” of a transaction; contrarily, extrinsic information forms “no part of” the transaction, notwithstanding the possibility that such information may very well induce a party into a transaction.⁶³

For an illustration of how this principle may apply to political intelligence, compare the Emergency Economic Stabilization Act with Title X of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”). Both pieces of legislation pertained to the financial markets.⁶⁴ While the Emergency Economic Stabilization Act authorized the Department of Treasury to purchase \$700 billion in failed assets,⁶⁵ including mortgage-backed securities,⁶⁶ Title X of Dodd-Frank established the Bureau of Consumer Financial Protection, which has broader authority.⁶⁷ Possessing inside knowledge from the Hill or from the

59. *See id.* at 183.

60. *See id.* (noting the price of tobacco increased thirty to fifty percent).

61. *See id.* at 194.

62. *See Keeton, supra* note 56, at 20 (discussing fundamental common law principles of fraud, including the general idea that intrinsic facts, more so than extrinsic facts, should be disclosed during a transaction).

63. *See id.* (distinguishing circumstances that are extrinsic to a transaction from those that are intrinsic).

64. Compare Emergency Economic Stabilization Act of 2008 § 115, 12 U.S.C. §§ 5201–02 (Supp. IV 2011) (seeking “to restore liquidity and stability to the financial system of the United States . . .”), with Dodd-Frank Act § 1011, 12 U.S.C. § 5491 (Supp. IV 2010) (creating an independent agency with oversight of consumer financial products and services).

65. 12 U.S.C. § 5225.

66. *See* BAIRD WEBEL, CONG. RESEARCH SERV., R41427, TROUBLED ASSET RELIEF PROGRAM (TARP): IMPLEMENTATION AND STATUS 2–3 (2012) (describing the Public-Private Investment Program of the 2008 bailout program and its status at relieving banks from failed mortgage-backed securities).

67. *See* DAVID H. CARPENTER, CONG. RESEARCH SERV., R42572, THE CONSUMER FINANCIAL PROTECTION BUREAU 1 (2012) (explaining that the newly established Bureau of Consumer Financial Protection has rulemaking power over “many consumer

Treasury Department regarding which banks would be injected with bailout money would certainly amount to intrinsic information under common law.⁶⁸ However, Title X's oversight of mortgage servicing pertained to countless financial institutions, making inside knowledge of its broad provisions extrinsic to the markets they affected.⁶⁹

B. *Is There an Unusual Advantage?*

The common law also disfavors unusual advantages in information.⁷⁰ Consider private meetings where official legislative and executive business is conducted. In the midst of the 2008 financial crisis, President George W. Bush and congressional leaders negotiated on how \$700 billion in federal aid to the financial markets would be distributed.⁷¹ The meeting's attendees included the House Speaker, the Senate Majority Leader, chairmen of powerful committees, and the two presidential hopefuls, future President Barack Obama and Arizona Senator John McCain.⁷² The meeting was mostly a closed session, opening only for photographic documentary and brief remarks from the President.⁷³ In the event that an insider with permission to attend became aware of the negotiated agreements on the allocation of bailout funds, that insider would have an unusual advantage in information.⁷⁴ Under the common law, the hypothetical insider may trigger a duty to disclose due to his unusual access into closed White House proceedings.⁷⁵

financial products and services, as well as the entities that sell them").

68. Cf. Keeton, *supra* note 56, at 20 (providing insight on what information should be disclosed depending on the information's intrinsic nature).

69. Cf. *id.* (defining extrinsic information as facts that are "accidentally connected with" the essence of a transaction, rather than "bear[ing] upon it," even though that information may very well affect pricing during a transaction).

70. *See id.* at 34.

71. *See* Elisabeth Bumiller & Jeff Zeleny, *With Debate Uncertain, Candidates Meet with Bush*, N.Y. TIMES (Sept. 25, 2008), <http://www.nytimes.com/2008/09/26/us/politics/26debatecd.html?pagewanted=all&r=0> (summarizing the proceedings during the 2008 bailout meeting at the White House, a negotiation session that led to no consensus).

72. *See* Mark Silva & Naftali Bendavid, *The bailout parley: How it went down; Tracing McCain and Obama's capital steps*, CHI. TRIB. (Sept. 26, 2008), http://articles.chicagotribune.com/2008-09-26/news/0809251043_1_john-mccain-obama-campaign-john-boehner (describing the closed-door bailout meeting which lasted for approximately fifty-seven minutes, ending with a lawmaker simply stating, "[a]ll I can say is, we had an interesting meeting with the president and vice president, Sen. Obama and Sen. McCain").

73. *Id.*

74. Cf. Keeton, *supra* note 56, at 34 (explaining why using unusual advantages in information suggests that a party has a greater duty to disclose his extraordinary knowledge prior to a business transaction "simply because our sense of justice demands it" to avoid fraud).

75. Cf. *id.* (acknowledging that where information is equally accessible, and where

C. Was the Information Obtained Through an Affirmative Deceitful Act, or Is It a Product of Diligence?

Common law disfavors investors who benefit from information obtained illegally or deceptively.⁷⁶ Consider congressional meetings, hearings, and markups that are closed to the public.⁷⁷ Some meetings regarding national defense are conducted in private, and such legislative activity may also have an impact on certain markets.⁷⁸ If an investor intentionally misrepresented herself as a congressional staff member to gain access to a defense budget hearing, under the common law, that information should be disclosed prior to a business transaction due to its illegal and deceptive acquisition.⁷⁹

Furthermore, under common law, an investor would be compelled to prevent another's reliance on misrepresented material information that investor learns to be false.⁸⁰ Take the Supreme Court's recent ruling on the Affordable Care Act ("ACA"). After the ruling was released and confirmed, stock prices in hospital companies increased, while those in insurance companies fell immediately.⁸¹ While the ruling was being announced, however, there were conflicting reports by news media on how the Court ruled on the ACA's individual mandate.⁸² Although there were reports stating that the Court overturned the individual mandate, those

diligent effort would make it attainable to anyone, an unfair advantage does not exist, regardless of the number of people with such knowledge).

76. *See id.* at 35 (explaining that the manner in which information is acquired may determine whether disclosure is legally required).

77. *See* HAAS, *supra* note 43.

78. *See, e.g.,* Jeremy Herb, *Defense Contractors Hesitate Over Issuing Layoff Notices Before Election*, THE HILL (Sept. 9, 2012, 5:00 AM), <http://thehill.com/blogs/defcon-hill/industry/248313-defense-contractors-hesitate-over-layoff-notices-before-election> (noting that major defense contractors have threatened layoffs in fear of automatic budget cuts looming at the end of the 112th Congress if a budget deal is not met).

79. *Cf. Keeton, supra* note 56, at 35 (suggesting that information that affects the value of the subject-matter of a transaction should be disclosed when obtained by an illegal act).

80. *Cf. id.* at 6 (elaborating on how the common law disfavors a party continuing misrepresentations when they are aware of the falsehood and have an opportunity to prevent reliance thereon).

81. *See Supreme Court's Health Care Ruling Touches Stock Market, Political Campaigns*, ASSOCIATED PRESS, June 28, 2012, available at http://www.pennlive.com/midstate/index.ssf/2012/06/supreme_courts_health_care_rul_1.html (discussing the financial impact of the Supreme Court's 2012 health care ruling).

82. *See* Brian Stelter, *CNN and Fox Trip Up in Rush to Get the News on the Air*, N.Y. TIMES (June 28, 2012), <http://www.nytimes.com/2012/06/29/us/cnn-and-foxs-supreme-court-mistake.html> (describing how some media outlets incorrectly reported the Supreme Court's 2012 health care ruling).

reports were false.⁸³ Consistent with common law principles of fraud, once media officials realized they reported inaccurate information on the ACA's ruling, they assumed a duty to disclose accurate information or abstain from trading, if they were involved in trading impacted by the ruling.⁸⁴ Such active concealment during a business transaction is fraudulent as a matter of law.⁸⁵

IV. MOVING FORWARD: HOW THE STOCK ACT CAN BE MADE MORE FUNCTIONAL BY APPLYING COMMON LAW PRINCIPLES TO POLITICAL INTELLIGENCE ACTIVITY

While the STOCK Act directs Congress's ethics committees, the U.S. Office of Government Ethics, and the Judicial Conference of the United States to provide interpretive guidance to individuals working within the three branches of government,⁸⁶ the Act has little to say about outsiders who engage government officers and employees daily.⁸⁷ Accordingly, political intelligence professionals have been left to speculate on how their profession fits under the STOCK Act's authority.⁸⁸

Moving forward, Congress, the SEC, or both should take action. While Congress should clarify its intent in enacting the STOCK Act, the SEC should provide interpretive guidance on how its securities laws apply to political intelligence activity. Either way, both Congress and the SEC should consider fundamental principles of fraud established under common law and alluded to in Chief Justice Burger's *Chiarella* dissent.⁸⁹ While political intelligence obtained through affirmative misrepresentations or illegal acts should have no place in the financial markets, political intelligence acquired through "exceptional knowledge, skill, or effort" should be permissible.⁹⁰ Such permission would incentivize the exploration of political information, which may in turn encourage a more efficient market place.⁹¹

83. See *id.* (detailing the confusion surrounding the Supreme Court's decision on the health care ruling).

84. Cf. Keeton, *supra* note 56, at 36 (considering the question of whether an affirmative action prevented a party from discovering information as a factor used to determine fraud).

85. Cf. *id.* at 37 ("The active concealment of anything that might prevent the purchaser from buying at the price agreed on, is, and should be, as a matter of law fraudulent.").

86. STOCK Act §§ 3, 9.

87. See *id.*

88. See generally ARNOLD & PORTER LLP, *supra* note 10, at 4–5.

89. See *Chiarella v. United States*, 445 U.S. 222, 243–44 (1980); Langevoort, *supra* note 55, at 883.

90. See Keeton, *supra* note 56, at 26.

91. See Jerke, *supra* note 46, at 1520 ("Mining nonpublic information does not simply help the direct recipient of the information, but encourages accuracy of prices,

CONCLUSION

Professor W. Page Keeton once noted that “a decision on a particular state of facts may be desirable today, whereas the same decision a hundred years from now might be undesirable as not sub-serving the best interests of society.”⁹² The legal community is in a similar situation today as it attempts to apply traditional insider trading principles to a relatively new phenomenon—the commodification of political intelligence. Accordingly, Congress and the SEC should approach the political intelligence industry cautiously, considering the practicality of applying traditional insider principles to a profession that furthers favorable market research. As this Note suggests, there may be value in considering fundamental principles of fraud established under common law, hinted to by Chief Justice Burger in his *Chiarella* dissent. Nonetheless, this very debate may be an indicator that lawmakers should consider overhauling our insider-trading regime altogether. Indeed, the expansion of traditional insider trading principles to cover political activity signals a clear policy shift from 1934 to the present. Comprehensive reform and a clear indication of legislative intent may be needed to avoid the risk of uncertainty among participants within our capital markets.

efficiency of markets, and protection of all investors.”).

92. Cf. Keeton, *supra* note 56, at 34.