

SELECTIVE DISCLOSURE BY FEDERAL OFFICIALS AND THE CASE FOR AN FGD (FAIRER GOVERNMENT DISCLOSURE) REGIME

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This Article addresses a problem at the intersection of securities regulation and government ethics: the selective disclosure of market-moving information, by federal officials in the executive and legislative branches, to securities investors outside the government who use that information for trading. These privileged investors, often aided by political intelligence consultants, can profit substantially from their access to knowledgeable sources inside the government. In most instances, however, neither the disclosure nor the trading violates the antifraud provisions of the federal securities laws (under which the insider trading prohibitions arise). This legally protected favoritism undermines investor confidence in the fairness and integrity of securities markets—and in government itself. Congress considered these harms in the debates leading up to the Stop Trading on Congressional Knowledge (STOCK) Act of 2012. But it wisely opted to study the role of political intelligence in financial markets before legislating further.

To address securities trading on the basis of selectively disclosed government information, this Article examines an analogous situation in the private sector that plagued individual investors until relatively recently. Selective disclosure of issuer information by corporate executives to securities analysts and professional investors had been regarded as blatantly unfair yet, in most instances, not illegal. Regulation FD, which the Securities and Exchange Commission (SEC) adopted in 2000, addressed this unfairness by looking beyond the construct of fraudulent tipping and trading under Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder. The solution involved regulating the timing and manner of disclosures by corporate insiders, rather than the conduct of outsiders who gather and trade on the basis of those disclosures. Regulation FD embraced this approach for publicly traded companies and corporate executives have been adhering to it for more than a decade.

This Article proposes an analogous FGD regime—standing for Fairer Government Disclosure—that would prompt federal agencies, as well as members of Congress and their staffs, to deploy a variety of strategies that could substantially reduce the amount of selective disclosure of nonpublic government information to persons who are likely to use it in securities trading. The Article first gathers together press reports, agency and congressional correspondence,

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and other materials that demonstrate the ubiquity of selective disclosure in the federal government. It then analyzes insider trading law to show that most of these instances of selective disclosure are not illegal. The Article concludes that the problem can be solved—or at least curtailed—with more effective internal controls on the federal officials who selectively disclose government information. It thus begins a discussion as to how such controls could be developed without compromising the quality and timeliness of disclosures to persons, including voters, who must have information in order to make informed decisions.

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INTRODUCTION

Information is said to be “the lifeblood of our securities markets”¹ and “the currency of democracy.”² But when government officials selectively disclose market-moving information to certain privileged investors, leaks of this sort benefit neither markets nor democracy. Instead, ordinary investors and citizens lacking preferential access to the inside of government suffer a double blow: they lose out in the markets to securities traders with “unerodable informational advantages”³ and their playing field is skewed by government officials who should be serving the public at large rather than catering to the interests of a favored few.⁴ To be sure, government officials who use their positions to enhance the profit in their own investment portfolios undermine market confidence and the democratic process as well.⁵ But a government official’s own securities trading on the basis of material nonpublic government information falls squarely within the insider trading prohibitions arising under the antifraud provisions of the federal securities laws, namely, Section 10(b) of the Securities Exchange Act

1. Selective Disclosure and Insider Trading, Exchange Act Release No. 42,259, [1999–2000 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 86,228 (Dec. 20, 1999).

2. The quote is often attributed to President Thomas Jefferson. *E.g.*, National Information Infrastructure: Agenda for Action, 58 Fed. Reg. 49,025, 49,030 (Sept. 21, 1993).

3. *United States v. O’Hagan*, 521 U.S. 642, 658–59 (1997) (quoting Victor Brudney, *Insiders, Outsiders, and Informational Advantages under the Federal Securities Laws*, 93 HARV. L. REV. 322, 356 (1979)).

4. *See generally* RICHARD W. PAINTER, GETTING THE GOVERNMENT AMERICA DESERVES: HOW ETHICS REFORM CAN MAKE A DIFFERENCE (2009).

5. A recent series of investigative reports in the *Washington Post* has placed congressional officials and their investment practices into the public spotlight. *See, e.g.*, David S. Fallis et al., *Congressional Earmarks Sometimes Used to Find Projects near Lawmakers’ Properties*, WASH. POST, Feb. 7, 2012, at A1; Dan Keating et al., *Members of Congress Trade in Companies while Making Laws that Affect Those Same Firms*, WASH. POST, June 24, 2012, at A1; Kimberly Kindy et al., *Lawmakers Reworked Financial Portfolios after Talks with Fed, Treasury Officials*, WASH. POST, June 25, 2012, at A7. These investment practices have also been scrutinized in a controversial book. PETER SCHWEIZER, THROW THEM ALL OUT: HOW POLITICIANS AND THEIR FRIENDS GET RICH OFF INSIDER STOCK TIPS, LAND DEALS, AND CRONYISM THAT WOULD SEND THE REST OF US TO PRISON (2011).

of 1934 (Exchange Act)⁶ and Rule 10b-5.⁷ In contrast, for reasons we shall explain, the selective disclosure of material nonpublic government information, or securities trading on the basis of that information, seldom constitutes fraud under these provisions.⁸ As the Supreme Court recognized more than thirty years ago, “not every instance of financial unfairness constitutes fraudulent activity under Section 10(b).”⁹

Unfortunately, the selective disclosure of nonpublic market-moving information is a longstanding tradition in the federal government. In 1789, political allies and friends of the governing Federalists bought up federal and state Revolutionary War bonds that were trading at thirty-to-forty percent of face value.¹⁰ These extremely fortunate investors based their purchases on advance knowledge of then-United States Treasury Secretary Alexander Hamilton’s plan to pay the bonds at face value as a means of bolstering the United States’ credit rating.¹¹ Ironically, in the first few days of August 2011, history may have repeated when officials—perhaps at Standard and Poors (S&P), but conceivably at the United States Treasury Department—appeared to have selectively disclosed to some bond sellers the advance information that S&P would downgrade the credit rating of the federal

6. 15 U.S.C. § 78j(b) (2006) (authorizing the SEC to promulgate rules prohibiting “manipulative or deceptive device[s] or contrivance[s]” in connection with the purchase or sale of any security).

7. 17 C.F.R. § 240.10b-5 (2011) (“It shall be unlawful for any person . . . [t]o 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.”). Because Congress has not enacted a federal securities statute that explicitly prohibits securities trading on the basis of material nonpublic information, insider trading is generally illegal only insofar as it is fraudulent. For past Rule 10b-5 prosecutions against federal officials for their own securities trading, see, for example, Cheng Yi Liang et al., Litigation Release No. 22,171 (Nov. 30, 2011), <http://www.sec.gov/litigation/litreleases/2011/lr22171.htm> (announcing guilty plea and settlement of civil charges against former chemist with the United States Food and Drug Administration who garnered profits totaling more than \$3.7 million from trading in pharmaceutical stocks based on confidential drug approval information); Acree, Litigation Release No. 14,231, 57 SEC Docket 1579 (Sept. 13, 1994) (discussing a former employee of the Office of the Comptroller of the Currency who settled civil charges that he traded in securities of several bank holding companies while in possession of material nonpublic information); Saunders, Litigation Release No. 9744, 26 SEC Docket 75 (Sept. 2, 1992) (announcing guilty plea and the settlement of civil charges against civilian employed by Navy who had purchased shares in a company that was about to be awarded a government contract).

8. See *infra* Part I.B.3.

9. *Chiarella v. United States*, 445 U.S. 222, 232 (1980) (citing *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 474–77 (1977)).

10. See *infra* notes 48–49 and accompanying text.

11. See *infra* note 49 and accompanying text.

government from AAA to AA+.¹² Three years earlier, federal officials knew more than markets did about what the Treasury would do—or not do—in response to the financial crisis of 2008 and they met frequently with Wall Street executives in their attempts to resolve the crisis.¹³ It is unclear how much nonpublic government information was disclosed, when, and to whom. But, to take just one instance, then-Treasury Secretary Henry Paulson is said to have privately briefed a dozen or so hedge fund managers and investment bankers on July 21, 2008, apparently revealing advance plans for a partial government takeover of Fannie Mae and Freddie Mac.¹⁴

Over the past several years, financial journalists have catalogued a litany of other private briefings conducted by federal officials which very likely generated millions of dollars in trading profits for the privileged attendees or their clients.¹⁵ Notable briefings include those by executive branch officials at the Federal Reserve,¹⁶ the Pentagon,¹⁷ the Department of Education (DOE),¹⁸ and the Centers for Medicare and Medicaid Services (CMS).¹⁹ A *Wall Street Journal* front page article in December 2011 then focused the public eye on Congress, revealing “a growing, lucrative—and legal—practice” that employs a network of persons who work with hedge funds and other professional investors to arrange private meetings with members and legislative staffers from both political parties, with the meetings often convened in the Capitol Building itself.²⁰

There is little doubt that Congress regards securities trading on the basis of selectively disclosed government information as a national problem that undermines investor confidence in the fairness and integrity of our securities markets—and in government itself. But for much of 2012, concerns about selective disclosure to privileged investors were relegated to the sidelines while Congress sought to

12. See *infra* notes 110–113 and accompanying text.

13. See Kindy et al., *supra* note 5.

14. See *infra* notes 83–87 and accompanying text.

15. See Eamon Javers, *Washington Whispers to Wall Street: Low-Profile Firms Enjoy a Lucrative Business Selling ‘Political Intelligence.’* BUS. WK., Dec. 26, 2005/Jan. 2, 2006, at 42; Brody Mullins & Susan Pulliam, *Hedge Funds Pay Top Dollar for Washington Intelligence*, WALL ST. J., Oct. 4, 2011, at A1; Brody Mullins & Kara Scannell, *Hedge Funds Hire Lobbyists to Gather Tips in Washington*, WALL ST. J., Dec. 8, 2006, at A1; Jim Snyder, *K Street Phones Wall Street: Political Inside Info for Hedge Funds Moves Stock Prices*, HILL, Feb. 15, 2005, at 1.

16. See *infra* notes 88–92 and accompanying text.

17. See *infra* notes 95–100 and accompanying text.

18. See *infra* notes 103–106 and accompanying text.

19. See *infra* notes 107–109 and accompanying text.

20. Brody Mullins & Susan Pulliam, *Inside Capitol, Investor Access Yields Rich Tips*, WALL ST. J., Dec. 20, 2011, at A1.

clarify the law as it pertained to securities trading by its own members and their staffs. Fueled in large part by a claim in a *60 Minutes* broadcast that congressional insider trading was “perfectly legal,”²¹ momentum grew swiftly for congressional hearings²² and bipartisan legislation, which ultimately passed with landslide votes of 96-3 in the Senate and 417-2 in the House.²³ On April 4, 2012, President Barack Obama signed into law the Stop Trading on Congressional Knowledge Act (the STOCK Act).²⁴ The Act states explicitly that members of Congress and congressional employees, as well as all officers and employees in the executive and judicial branches of the federal government, “are not exempt from the insider trading prohibitions arising under the securities laws, including Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder.”²⁵ It furthers specifies that for purposes of these antifraud provisions, all federal officials owe “a duty arising from a relationship of trust and confidence” to the U.S. government and its citizens “with respect to material, nonpublic information derived from such person’s position . . . or gained from the performance of such person’s official

21. See *60 Minutes: Congress: Trading Stock on Inside Information?* (CBS television broadcast Nov. 13, 2011), available at http://www.cbsnews.com/8301-18560_162-57323527/congress-trading-stock-on-inside-information/ (stating in the episode summary: “For now, the practice is perfectly legal, but some say it’s time for the law to change”).

22. See *Insider Trading and Congressional Accountability: Hearing Before the S. Comm. on Homeland Sec. & Gov’t Affairs*, 112th Cong. (2011) (included witness testimony of Melanie Sloan, Donna M. Nagy, Donald C. Langevoort, John C. Coffee, Jr., and Robert L. Walker); *The Stop Trading on Congressional Knowledge Act: Hearing on H.R. 1148 Before the H. Comm. on Fin. Servs.*, 112th Cong. (2011) [hereinafter *House STOCK Act Hearing*] (included witness testimony of SEC Division of Enforcement Director Robert Khuzami, Jack Markell, Donna M. Nagy, and Robert L. Walker).

23. See Robert Pear, *Insider Trading Bill Clears Congress*, N.Y. TIMES, Mar. 23, 2012, at A13. Less than two months before, President Barack Obama had urged the Act’s passage. Address Before a Joint Session of Congress on the State of the Union, 2011 DAILY COMP. PRES. DOC. 47 (Jan. 25, 2011), available at <http://www.gpo.gov/fdsys/pkg/DCPD-201100047/pdf/DCPD-201100047.pdf> (“Send me a bill that bans insider trading by Members of Congress. I will sign it tomorrow.”).

24. STOCK Act, Pub. L. No. 112-105, 126 Stat. 291 (2012).

25. §§ 4(a), 9(b). Prior to the Act’s passage, securities law scholars had been engaged in a spirited debate as to the (il)legality of congressional insider trading. Compare Donna M. Nagy, *Insider Trading, Congressional Officials, and Duties of Entrustment*, 91 B.U. L. REV. 1105, 1111 (2011) (contending that members of Congress owe fiduciary-like duties to the federal government and concluding that congressional insider trading constitutes securities fraud under existing law), with Stephen M. Bainbridge, *Insider Trading inside the Beltway*, 36 J. CORP. L. 281, 285 (2011) (concluding that “the quirks of the relevant laws almost certainly would prevent members of Congress from being successfully prosecuted”).

responsibilities.”²⁶ The STOCK Act therefore affirms a duty of loyalty on the part of federal officials, which in turn provides the disclosure obligation that renders a federal official’s insider trading or tipping a fraudulent and deceptive act within the meaning of Section 10(b) and Rule 10b-5.

Although the STOCK Act eliminates any doubt that Section 10(b) and Rule 10b-5 prohibit federal officials from defrauding the federal government “in connection with the purchase or sale of any security,”²⁷ the new legislation does nothing to alter the existing judicial construction of these provisions. Thus, contrary to views expressed by some securities lawyers, the STOCK Act does not ban government insiders “from divulging market-moving information to individuals who could trade on it.”²⁸ Rather, the same doctrinal analysis that determines when tipping is fraudulent in the private sector now explicitly applies to the public sector.

Through the late 1990s, however, the selective disclosure of material nonpublic information by securities issuers had been an intractable problem. For years, corporate executives routinely provided securities analysts and professional investors with material nonpublic information pertaining to their companies, including advance notice of earnings announcements, product developments, and corporate reorganizations.²⁹ The privileged recipients of this information would use it in deciding whether to purchase or sell the issuer’s securities, or would pass the information along to hedge funds or other valued clients who were likely to trade.³⁰ While securities analysts often published favorable reviews of the corporate officials who had doled out the issuer’s material nonpublic information, quid pro quos between securities analysts and chief executive officers (CEOs) or other executives were almost always avoided.³¹

26. §§ 4(b), 9(b) (codified at 15 U.S.C. § 78u-1(g) to (h) (2012)). The STOCK Act further specifies that members of Congress and congressional employees owe a duty to Congress itself. § 4(b).

27. 15 U.S.C. § 78j(b).

28. Brody Mullins & Andrew Ackerman, *New Bill Clouds Legality of Tips*, WALL ST. J., Feb. 16, 2012, at C1.

29. See Selective Disclosure and Insider Trading, Exchange Act Release No. 43,154, [2000 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 86,319, at 83,677 (Aug. 15, 2000).

30. See *id.*

31. See generally Stephen J. Choi, *Selective Disclosures in the Public Capital Markets*, 35 U.C. DAVIS L. REV. 533, 551–52 (2002); Jill E. Fisch & Hillary A. Sale, *The Securities Analyst as Agent: Rethinking the Regulation of Analysts*, 88 IOWA L. REV. 1035, 1054–61 (2003); William K.S. Wang, *Selective Disclosure by Issuers, Its Legality and Ex Ante Harm: Some Observations in Response to Professor Fox*, 42 VA. J. INT’L L. 869, 873–75 (2002); *infra* notes 287–290 and accompanying text.

This routine practice of selective disclosure by securities issuers had been viewed by many as “wrong, plain and simple,” to quote former Securities and Exchange Commission (SEC) Chairman Arthur Levitt.³² But that practice typically did not trigger securities fraud liability because, according to the Supreme Court’s 1983 ruling in *Dirks v. SEC*,³³ selective disclosure by a corporate executive constitutes fraudulent tipping only when that insider breaches a duty of trust and confidence owed to the issuer and its shareholders by benefitting personally, directly or indirectly, from the disclosure.³⁴ Eschewing a broader construction of fraud that would reduce securities analysts’ incentives to conduct research, *Dirks* insisted that “the purpose of the disclosure” is key.³⁵ Thus, absent their receipt of a personal benefit which would evidence disloyalty to the corporation and its shareholders, corporate executives could legally dribble out valuable information to a favored few. Likewise, because *Dirks* instructs that a tippee’s liability for securities fraud is derivative from that of the tipper’s,³⁶ those fortunate analysts who received the selective disclosures could legally trade on that information or could advise their clients to trade. CEOs and other executives would almost always have legitimate corporate reasons for sharing material nonpublic information with analysts and other market professionals. And SEC officials were understandably reluctant to hang an illegal tipping or trading prosecution on the tenuous thread that positive coverage for securities issuers also inured to the personal benefit of their corporate insiders.³⁷

Regulation Fair Disclosure (FD),³⁸ which took effect in October 2000, eliminated the informational advantage traditionally possessed by securities analysts and their clients.³⁹ The SEC accomplished this feat by creating new disclosure obligations on the part of SEC reporting companies (often termed “publicly traded companies”) which operate separate and apart from the antifraud provisions. These obligations effectively require publicly traded companies to release material

32. ARTHUR LEVITT, TAKE ON THE STREET 87 (2002).

33. 463 U.S. 646 (1983).

34. *Id.* at 661–62.

35. *Id.* at 662.

36. *Id.* at 659 (regarding a tippee as “a participant after the fact in the insider’s breach of a fiduciary duty” (quoting *Chiarella v. United States*, 445 U.S. 222, 230 n.12 (1980))).

37. *But see infra* notes 295–305 and accompanying text (discussing the SEC’s settlement of a controversial enforcement action against Philip Stevens).

38. *See* 17 C.F.R. § 243.100 (2012).

39. Selective Disclosure and Insider Trading, Exchange Act Release No. 43,154, [2000 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 86,319, at 83,680–81 (Aug. 15, 2000).

nonpublic information to all investors at the same time. However, several exceptions, including a promise on the part of the recipient to maintain confidentiality, permit issuers to disclose information selectively. With Regulation FD on the books for more than a decade, *Dirks*' "personal benefit" hurdle no longer serves to insulate the practice of selective disclosure by corporate executives at publicly traded companies.

Regulation FD, however, hardly squelched the desire among professional investors for an informational edge in securities markets. When privileged access to material nonpublic information could no longer be provided legally by most securities issuers in the private sector, hedge funds and other institutional traders began to search out professionals who could gain access to other sources of market-moving information, including sources in the public sector. Although at one time these professionals with ties to the government were described in the traditional Washington vernacular as "lobbyists," that label soon gave way to the term "political intelligence consultant." Today, the political-intelligence industry is the booming \$100-million-a-year business that set the stage for the hedge fund briefings by federal officials that are referenced above.⁴⁰

But, just as in the private sector, the Court's decision in *Dirks* effectively insulates from securities fraud liability most instances of selective disclosure in the public sector. Indeed, federal officials typically can point to legitimate reasons for sharing nonpublic government information with outsiders, who often provide useful feedback and policy analysis. Thus, the SEC (or the Department of Justice (DOJ) in a criminal case) would rarely be able to demonstrate a federal official's misuse of information in breach of a duty of trust and confidence, even under the broad misappropriation theory of insider trading liability, which the Supreme Court endorsed in *United States v. O'Hagan*.⁴¹ Like the link between favorable analyst coverage and preferential access to nonpublic reports by a corporate CEO, enhanced reputation and the mere possibility of future political support or campaign contributions are unlikely to be regarded as quid pro quos that constitute a federal official's improper personal gain from the disclosure of material nonpublic government information.⁴²

40. See *supra* text accompanying notes 15-20. For an extensive analysis of the industry's escalating influence, 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 (2010).

41. 521 U.S. 642, 652-59 (1997); see also *infra* notes 138-141 and accompanying text.

42. See *infra* Part I.B.3.

Moreover, material nonpublic information pertaining to government and its operations implicates constitutional concerns because federal officials, particularly those in Congress, are obligated to discuss with constituents and other members of the public the important issues of the day. These discussions traditionally have received special protection under the First Amendment (and, for Congress, perhaps also under the Speech or Debate Clause⁴³). Thus, even if many selective disclosures by federal officials theoretically could be construed as fraudulent tipping under prior Court precedents interpreting Section 10(b) and Rule 10b-5, constitutional considerations would typically dictate a narrower construction of those antifraud provisions.

Because selective disclosure by securities issuers in the private sector and selective disclosure by federal officials in the public sector affect securities markets in a similar manner and escape insider trading regulation for much the same reason, a compelling case can be made for a comparable solution. Specifically, our Article proposes a new regime that would impose tighter internal controls on the ability of federal officials to advantage some investors over others in securities markets. We term this new regime FGD, which stands for “Fairer Government Disclosure.” An FGD regime would differ substantially from Regulation FD for publicly traded companies because it would reflect the vast size as well as the unique challenges and operational needs of the federal government. But like Regulation FD for publicly traded companies, an FGD regime for the federal government would focus on regulating “insiders and what they do . . . rather than on policing information *per se* and its possession.”⁴⁴

Our focus on selective disclosure by federal officials is particularly important and timely because, as a possible precursor to further legislative action, the STOCK Act requires the United States Government Accountability Office (GAO) to study and report to Congress on the role of political intelligence in financial markets.⁴⁵ Although each of us in prior writings has identified the need for a Regulation FD analogue in the public sector⁴⁶ and passing references to

43. See *infra* notes 217–218 and accompanying text.

44. *Dirks v. SEC*, 463 U.S. 646, 663 (1983) (quoting *In re Investors Mgmt. Co.*, 44 S.E.C. 633, 648 (July 29, 1971)).

45. See *infra* notes 231–233 and accompanying text.

46. See PAINTER, *supra* note 4, at 171 (suggesting the possibility of a “Regulation FD for government,” but acknowledging difficulties with its design and implementation); Nagy, *supra* note 25, at 1163 n.320 (observing the parallels between selective disclosure in the public and private sectors and stating that a “Regulation FD analogue for elected officials is an intriguing possibility that warrants further consideration”).

the possibility have been made by others,⁴⁷ this Article offers the first detailed analysis as to what an FGD regime for the federal government could look like. We proceed in three parts.

Part I explores the role of political intelligence in securities markets and highlights instances, both historical and contemporary, of selective disclosure to privileged investors. It then explains why most of these instances fail to constitute fraudulent tipping within the meaning of Section 10(b) and Rule 10b-5. We conclude by critiquing legislative efforts that go beyond the STOCK Act to require registration and reporting by political intelligence firms and to further amend the federal securities laws with a broad ban on securities trading on the basis of material nonpublic government information. Both types of proposals, though well intentioned, place unnecessary burdens on the private sector when the problem of selective disclosure calls out for more effective internal controls on federal officials.

Part II shifts the focus to selective disclosure by securities issuers in the private sector and analyzes Regulation FD's inventive solution to the problem. Part II also discusses important concerns that were raised by securities issuers, market professionals, and the media regarding the proposed regulation's possible chilling effect on the flow of corporate information to securities markets, and it explains how the SEC managed to ameliorate most of the concerns about chilling in its final regulation. It concludes with a discussion of Regulation FD's operations and effectiveness over the last decade.

Part III explores the complexity of government disclosure and suggests some ways in which the federal government can create a more level playing field for all securities investors. As a starting place, we propose seven FGD measures that federal officials can adopt either

47. For example, the Project on Government Oversight (POGO), a nonpartisan watchdog group, recently published an article that queried: "Wouldn't it be nice if the federal government and members of Congress also had to treat all investors equally, by adopting some public sector version of Reg FD?" Adam Zagorin, *Wall Street in Washington: Insider Access*, PROJECT ON GOVERNMENT OVERSIGHT (Dec. 8, 2011), <http://www.pogo.org/pogo-files/alerts/government-corruption/wall-street-in-washington-gc-ii-20111208.html>. Even critics of the SEC's decision to prohibit selective disclosure by securities issuers have questioned the public sector's lack of restraint. See, e.g., Stephen Bainbridge, *Why Isn't the Federal Reserve Subject to Regulation FD?*, PROFESSORBAINBRIDGE.COM (Nov. 23, 2011), <http://www.professorbainbridge.com/professorbainbridge.com/2011/11/why-isnt-the-federal-reserve-subject-to-regulation-fd.html> (pointing out that "[i]f the policy against selective disclosure makes any sense, it ought to apply to the Fed as much as to private issuers"); Larry Ribstein, *Congressmen as Securities Traders*, TRUTH ON THE MARKET (Mar. 13, 2011), <http://truthonthemarket.com/2011/03/13/congressmen-as-securities-traders/> (Congress can "[p]rotect against corruption by mandating disclosure not only of trades but also tips. In other words, as little as I like Regulation FD, there might be some benefit to imposing something like it on Congress.").

individually or through directives issued by agency heads and congressional committees. We also begin a discussion as to how fairer government disclosure can be implemented and enforced more comprehensibly, without compromising the quality and timeliness of disclosures to persons, including voters, who must have information in order to make informed decisions.

I. SECURITIES TRADING BASED ON SELECTIVELY DISCLOSED GOVERNMENT INFORMATION

Since the days of its founding, the federal government has served as a gold mine for material nonpublic information that could affect the stock price of publicly traded corporations. The recent growth of the political intelligence industry, however, leaves little doubt that this mine is being tapped with increasing fervor and regularity. Although selective disclosure by federal officials generally does not constitute fraudulent tipping under the federal securities laws, the practice can and should be curtailed. But each of the two types of proposals suggested thus far—registration and disclosure requirements for political intelligence consultants, and an explicit ban on securities trading on the basis of nonpublic government information—attacks the problem from the wrong direction.

A. *The Role of Political Intelligence in Securities Markets*

1. HISTORICAL BACKGROUND

While attention to the role of political intelligence in U.S. securities markets is relatively new, investment profits from the use of such intelligence can be traced back at least as far as 1789. At that point in history, the First Congress had been poised to approve Treasury Secretary Alexander Hamilton's plan to redeem at face value Revolutionary War bonds, which were issued by the Continental Congress and the states.⁴⁸ With advance notice of Hamilton's plan (an effort intended, in large part, to boost the new federal government's

48. See Richard W. Painter, *Ethics and Corruption in Business and Government: Lessons from the South Sea Bubble and the Bank of the United States* (U. Minn. L. Sch., Legal Studies Research Paper Series, Research Paper No. 06-32, 2006), available at <http://ssrn.com/abstract=920912> (published as the 2006 Fulton Lecture in Legal History by the University of Chicago Law School) (citing RON CHERNOW, ALEXANDER HAMILTON 225 (2004); STANLEY ELKINS & ERIC MCKITRICK, THE AGE OF FEDERALISM 112–21 (1993)). A recent newspaper article also recounted this incident. Kimberly Kindy, *Congressional Rules on Trading Had Their Start in 1789*, WASH. POST, June 23, 2012, at A14.

credit rating), political allies and friends of the governing Federalists bought large quantities of federal and state bonds, which had been trading at thirty-to-forty percent of their face value.⁴⁹ Senator William Maclay of Pennsylvania, a Democrat, opposed Hamilton's debt proposal and the insider trading that went along with it.⁵⁰ Most of his ire was directed at colleagues in Congress who themselves traded on the information that the Treasury had provided to them.⁵¹ But Maclay made it clear that many speculators on the outside were also trading on the informational advantage that other investors lacked. As Maclay wrote in his journal: "Mr. Hazard has followed buying [bond] certificates for some time past. He told me he had made a business of it; it is easy to guess for whom. I told him, 'You are, then, among the happy few who have been let into the secret.' He seemed abashed"⁵²

Maclay was recounting his conversation with Jonathan J. Hazard, Rhode Island's delegate to the Continental Congress in 1788, and Maclay had no doubt that "all commotion originated from the Treasury."⁵³ Maclay's journal further reveals that prior to their bond purchases, many of the speculators met with members of Congress in an attempt to influence the outcome of the vote on whether to approve Hamilton's plan.⁵⁴ Accordingly, in the words of a modern historian, "[t]he evidentiary record points toward the conclusion that the first market for government securities was created by interested parties with special information."⁵⁵

Congress, when it created the Department of the Treasury, responded to this bond trading scandal with a statute, apparently aimed at Hamilton. The statute, which is still in force today, provided that the Secretary of the Treasury and the Treasurer may not "be concerned in the purchase or disposal of any public securities of any State, or the United States" while in office, and that an officer who violates this provision shall be fined "three thousand dollars, and shall . . . be

49. See Painter, *supra* note 48.

50. See *id.*

51. See *id.*

52. JOURNAL OF WILLIAM MACLAY: UNITED STATES SENATOR FROM PENNSYLVANIA 1789-1791 at 174 (Frederick Ungar Publishing 1965) (1890).

53. *Id.* at 175.

54. *Id.* at 323 ("[T]he assumption [of the continental debt and of the states' debts] was forced on us to favor the views of speculation. . . . The whole town almost has been busy at it; and, of course, all engaged in influencing the measures of Congress.").

55. Howard M. Wachtel, Alexander Hamilton and the Origins of Wall Street 10 (1996) (unpublished manuscript), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=15091.

removed from office, and forever thereafter incapable of holding any office under the United States.”⁵⁶ The provision was intended to prevent these two Treasury officials from “speculating in the public funds.”⁵⁷ The use of the statutory language “concerned with” could be construed to cover tipping as well as trading by the Secretary and the Treasurer, although the reach of the statute has never been tested in court. The statute, however, said nothing about members of Congress speculating in Treasury securities or tipping others, nor did it directly address selective disclosure of Treasury Department information to securities investors.

Between 1789 and the present day, federal officials have been in possession of enormous amounts of material nonpublic information about government operations and decisions. On some occasions, market-moving information specifically designated as confidential has been clandestinely leaked in the course of schemes that amounted to bribery, such as in 1869, when famed speculators in gold apparently paid a Treasury official \$10,000 for inside tips as to the timing of gold sales from the federal government’s own stash.⁵⁸ Other notorious tipping scandals are discussed in the Section that follows,⁵⁹ including a 1905 incident at the United States Department of Agriculture (USDA) involving confidential cotton crop estimate reports that were leaked to commodities traders.⁶⁰ The USDA scandal even prompted specific

56. Act of Sept. 2, 1789, ch. 12, 1 Stat. 65, 67 (1789) (codified at 31 U.S.C. § 329 (2000)).

57. 1 ANNALS OF CONG. 635 (1789) (statement of the bill sponsor, Rep. Aedanus Burke).

58. See KENNETH D. ACKERMAN, *THE GOLD RING: JIM FISK, JAY GOULD, AND BLACK FRIDAY, 1869* (1988). As Ackerman explains, the famed speculators used President Ulysses Grant’s brother-in-law, Abel Corbin, to persuade the President to appoint a Civil War hero, General Daniel Butterfield, as Assistant Secretary of the Treasury. See *id.* at 75–76. Butterfield’s job was to sell the federal government’s gold into the trading markets. See *id.* at 93. Not only did the speculators pay Butterfield to provide them with advance information as to the government’s anticipated sales, but they also used Grant’s brother-in-law to persuade the Administration to delay the sale of its gold. See *id.* at 95. The speculators then started buying, driving up the price of gold, expecting to sell in advance of the government. See *id.* at 95–96. President Grant and his Treasury Secretary, however, got wind of the scheme and ordered an abrupt sale of \$4 million in gold into the market, with a contemporaneous press release. See *id.* at 186–87. The gold market plunged from \$160 to \$133 in a single day (now known as “Black Friday”), which precipitated a broad-based market panic, followed by a lengthy economic recession. *Id.* at 184–91. Congress subsequently investigated this gold conspiracy and Butterfield claimed that his \$10,000 payment had been an unsecured real estate loan. See *id.* at 77.

59. See *infra* Part I.B.1.

60. See *infra* notes 128–133 and accompanying text (discussing *Haas v. Henkel*, 216 U.S. 462 (1910)).

“lock-up” procedures at the agency designed to control the premature release of confidential crop estimate reports.⁶¹

But many parts of the federal government do not take lock-up or similar precautions to guard against the selective release of confidential information and, in any event, much nonpublic market-moving information has not been explicitly designated as “confidential.”⁶² Accordingly, toward the last two decades of the twentieth century, the gathering of “political intelligence” from the federal government for stock trading purposes was on its way to becoming a sophisticated industry. In the 1980s, for example, the stock arbitrageur Ivan Boesky is reported to have “hired a team of lobbyists in Washington to tell him if Congress would block Standard Oil Co.’s takeover of Gulf Corp.”⁶³ When Boesky was told that this merger would be approved, he purchased stock and profited mightily. Although he later pled guilty to a role in one of Wall Street’s biggest insider-trading scandals (embroiling a host of investment bankers and lawyers who were effectively selling their client’s confidential information to Boesky and other traders), neither Boesky nor his government sources were ever prosecuted for “tips received in Washington.”⁶⁴

2. THE POLITICAL INTELLIGENCE INDUSTRY

As the 1990s came to a close, those lobbyists who specialized in gathering information concerning legislative and regulatory developments began to be termed “political intelligence consultants.” These specialized consultants soon expanded into a thriving industry, in large part because of the growth of hedge funds, which are particularly aggressive in seeking out private meetings with federal officials for the purpose of gathering information for trading.⁶⁵ In addition, when Regulation FD brought the private sector’s routine practices of selective disclosure to a halt after 2000, hedge funds and other professional

61. See RICH ALLEN, U.S. DEP’T OF AGRIC., SAFEGUARDING AMERICA’S AGRICULTURAL STATISTICS: A CENTURY OF SUCCESSFUL AND SECURE PROCEDURES, 1905–2005 at 1–2 (2007); *infra* notes 403–405 and accompanying text (discussing steps taken by federal agencies to prevent premature release of market-sensitive data).

62. See PAINTER, *supra* note 4, at 63–65.

63. Mullins & Scannell, *supra* note 15.

64. *Id.*

65. See PAINTER, *supra* note 4, at 167–69 (discussing the proliferation of hedge funds with operations in and around Washington D.C., presumably set up for the purpose of acquiring and trading on nonpublic government information); Javers, *supra* note 15; Jerke, *supra* note 40, at 1471–74 (discussing the “[r]ise of [p]olitical [i]ntelligence [g]athering”); Mullins & Pulliam, *supra* note 15; Mullins & Scannell, *supra* note 15; Snyder, *supra* note 15.

investors began to focus more attention on market-moving nonpublic information from the public sector.

There is no doubt that the ability to deliver political intelligence commands big money. Less than a year ago, it was reported that “[t]housands of political insiders are being paid by hedge funds, private-equity firms and other big investors,” resulting in a “\$100-million a year business in Washington.”⁶⁶ Some clients pay Gerson Lehrman, often depicted as the largest so-called expert network firm, “up to \$240,000 a year for unlimited access to the Washington experts.”⁶⁷ The political insiders employed by these networks, lobbying firms, or law firms, as well as those consultants who work independently, are typically former officials in executive departments or agencies or former staffers on Capitol Hill, although many retired members of Congress also serve as political consultants.⁶⁸

Up until the *60 Minutes* episode that fueled the STOCK Act’s passage,⁶⁹ providers of political intelligence were not at all bashful about their services. For example, the law firm Sonnenschein Nath & Rosenthal once boasted on its web site: “While Congress negotiated significant pension reform legislation *behind closed doors*, our clients relied on our *political intelligence* gathering to inform them of the resolution of *key outstanding issues that could affect their investments*.”⁷⁰ This advertisement emphasized the value of the firm’s political intelligence gathering not for legal work or lobbying, but for investing. As the firm’s then-chairman underscored, “[t]here are a lot of savvy investors who have realized that there is a lot of money to be made from what Congress does.”⁷¹ Many other D.C. law firms and consulting firms have highlighted their political intelligence activities

66. Mullins & Pulliam, *supra* note 15.

67. *Id.*

68. See, e.g., Kristin Jensen et al., *Hedge Funds Hire Lobbyists for Inside Tips on U.S. Legislation*, BLOOMBERG (March 16, 2005), <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aYbb6sQ4HmGc&refer=us> (observing that former-Senator John Breaux, “a Louisiana Democrat, is one of a growing cadre of lobbyists being hired by U.S. hedge funds to provide instant tips on the progress of potentially market-moving legislation”); Brody Mullins, *Wall Street, Washington, and Gingrich*, WALL ST. J. (Jan. 13, 2012), <http://online.wsj.com/article/SB10001424052970203721704577156814083892408.html> (reporting that former-House Speaker Newt Gingrich arranged private meetings in May 2011 between analysts at Credit Suisse Group and senior Republican congressional health-care policy staffers).

69. See *60 Minutes*, *supra* note 21.

70. Jerke, *supra* note 40, at 1471 (internal citation omitted).

71. Mullins & Scannell, *supra* note 15 (quoting Elliot Portnoy who, according to the article, was elected as Sonnenschein’s chairman partly based on the performance of the firm’s political intelligence practice, which he founded).

and have spoken with the media about their clients.⁷² As one firm's principal candidly acknowledged, hedge funds "are not paying me to lobby," they are "paying me for information."⁷³ Foreign investors, including governments, also can get access to market-moving information from the federal government by buying a Washington D.C. political intelligence firm, as a government-run Chinese finance company apparently did in 2005.⁷⁴ Because they are not seeking to influence legislation, political intelligence firms and consultants currently do not have to register under the Lobbying Disclosure Act (LDA),⁷⁵ but that could change in a year's time once the GAO completes its report to Congress on the role of political intelligence in financial markets.⁷⁶

3. SELECTIVE DISCLOSURES PROFILED IN THE MEDIA

Several examples of selective disclosure that have been profiled in the media confirm the ubiquity of political intelligence activity. In 2005, for instance, the SEC launched an informal inquiry into possible selective disclosures pertaining to a speech made by then-Senate Majority Leader Bill Frist (R-Tenn.).⁷⁷ The speech announced his support for legislation that would have created a \$140 billion trust fund for asbestos liability claims.⁷⁸ The SEC's concerns were prompted by noticeable spikes in trading volume and stock prices—in the two days prior to the speech—for several companies with substantial exposure to asbestos lawsuits.⁷⁹ Press reports posited that hedge fund traders had obtained advanced information about the Majority Leader's speech

72. See Jerke, *supra* note 40, at 1473 (discussing examples of advertisements and media interviews involving "Patton Boggs LLP, Sonnenschein Nath & Rosenthal LLP, Washington Analysis, Podesta Mattoon, Cormac Group, Mehlman Vogel Castagnetti Inc., Bryan Cave Strategies LLC, DLA Piper, Williams & Jensen, and Akin Gump Strauss Hauer & Feld LLP").

73. Jensen et al., *supra* note 68 (quoting former legislative aide Jonathan Slade, a principal with the Washington-based Cormac Group).

74. See Javers, *supra* note 15, at 42 (reporting that Washington Analysis was sold in July 2005 "to China's Xinhua Finance, which is 6.5%-owned by the government-controlled Xinhua News Agency").

75. Lobbying Disclosure Act of 1995, 2 U.S.C. § 1601 (2006).

76. See *infra* Part I.C.1.

77. See Mullins & Scannell, *supra* note 15 (reporting that the SEC "is looking into whether laws are being broken somewhere in the transfer of information between Congress and Wall Street").

78. *Id.*

79. See Jerke, *supra* note 40, at 1453–55 (explaining that W.R. Grace, Crown Holdings, and USG Corporation "had used asbestos materials in manufacturing and that had been mired in litigation for years").

from political intelligence firms, who obtained that information from congressional insiders.⁸⁰ Although no one was ever charged with violating the insider trading or tipping prohibitions arising under Section 10(b) and Rule 10b-5, and many relevant facts remain unknown, much can be gained from exploring a counterfactual. The timing and the substance of Senator Frist's speech may not have been explicitly confidential pursuant to a formal rule, internal policy, or other mandate, but it almost certainly constituted material information (i.e., there was a substantial likelihood that a reasonable investor would consider it important in making an investment decision⁸¹) as well as nonpublic information (i.e., it had not been disclosed "to achieve a broad dissemination to the investing public generally"⁸²). Thus, even if an SEC inquiry had revealed the selective disclosure of material nonpublic information, the principal legal question for the agency would have been whether congressional insiders misappropriated this information from the federal government by sharing it with political intelligence consultants and their clients who traded securities. As we shall see, the answer to this misappropriation question turns on whether the congressional insiders can be said to have misused material nonpublic congressional information for an improper personal benefit.

Another much-publicized example of government selective disclosure occurred in July 2008, when Treasury Secretary Henry Paulson is reported to have met privately with several hedge fund managers and investment bankers and to have shared advance plans for a partial government takeover of Fannie Mae and Freddie Mac.⁸³ What

80. See Mullins & Scannell, *supra* note 15; Javers, *supra* note 15, at 42 (stating that "the news got to key Wall Street players a day early via . . . a small group of firms specializing in 'political intelligence' that mine the capital for information and translate Washington wonkspeak into trading tips").

81. *Basic, Inc. v. Levinson*, 485 U.S. 224, 231–32 (1988). Moreover, when information is "soft" or contingent, its materiality is to be judged by "a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event" in light of the totality of facts and circumstances. *Id.* at 238 (quoting *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 849 (2d Cir. 1968) (en banc)). For further discussion of materiality and its interplay with a so-called mosaic theory, see *infra* note 348 and accompanying text.

82. *Dirks v. SEC*, 463 U.S. 646, 653 n.12 (1983) (quoting *In re Faberge, Inc.*, 45 S.E.C. 249, 256 (May 25, 1973)). The Second Circuit has also recognized that information may be deemed public, even though it is known only by some in the market, if securities trading "has caused the information to be fully impounded into the price of the particular stock." *United States v. Libera*, 989 F.2d 596, 601 (2d Cir. 1993). For further discussion of when information is "nonpublic," see *infra* notes 339–344 and accompanying text.

83. Richard Teitelbaum, *How Paulson Gave Hedge Funds Advance Word of Fannie Mae Rescue*, BLOOMBERG MKTS. MAG., Nov. 29, 2011, available at <http://www.bloomberg.com/news/2011-11-29/how-henry-paulson-gave-hedge-funds->

he said at this meeting apparently differed in tone and substance from his public statements that these two companies would not be taken over.⁸⁴ It is not clear why Secretary Paulson had the meeting or believed it important to reveal the information. Nor is it clear whether any of the attendees did, in fact, trade securities on the basis of the information.⁸⁵ But it does not appear that anyone at the meeting had been instructed not to trade.⁸⁶ As the SEC did with the possible selective disclosures relating to Senator Frist's planned asbestos speech, it appears that the agency is now investigating securities transactions by the firms that were represented at the meeting with Secretary Paulson.⁸⁷

advance-word-of-2008-fannie-mae-rescue.html (reporting that “[a]round the conference room table were a dozen or so hedge-fund managers and other Wall Street executives—at least five of them alumni of Goldman Sachs”).

84. *See id.* (reporting that Paulson described “a possible scenario for placing Fannie and Freddie into ‘conservatorship’” and stating that one hedge fund attendee “was shocked that Paulson would furnish such specific information—to his mind, leaving little doubt that the Treasury Department would carry out the plan”).

85. *See id.* (explaining that it is not possible to track firm-specific short stock sales using public documents, although the SEC can track at least some short stock sales).

86. *See id.* (positing that those attending the meeting were “given a choice opportunity to trade on that information”).

87. *See* Juliet Chung & Jean Eaglesham, *Global Finance: Trades after 2008 Meeting Probed*, WALL ST. J., Sept. 14, 2012, at C3 (reporting that Taconic Capital Advisors “notified investors last week that it received a subpoena related to the meeting . . . [and that the firm] believe[d] that its conduct has been proper in all respects”). As *infra* Part I.B elaborates, in the absence of evidence of an agreement by the firms to retain the confidentiality of the information revealed at the meeting or a history, pattern, or practice of sharing such confidences with Secretary Paulson, Rule 10b-5 almost certainly would not have prohibited the firms from trading securities (assuming, of course, that Paulson did not personally derive an improper benefit from any of this selective disclosure to the firms). That said, if investment bank or hedge fund employees had used the alleged disclosures about Fannie Mae and Freddie Mac for personal gain in connection with their own securities trading (as opposed to trading for the benefit of the bank or hedge fund), those employees could possibly be subject to Rule 10b-5 liability under the misappropriation theory for defrauding their employer and its clients or investors. *See* Rosenberg, Litigation Release No. 12986, 49 SEC Docket 1373, 1991 WL 296668 (Sept. 24, 1991) (announcing settlement of Rule 10b-5 action against general partner and securities analyst at Cowen & Co., who allegedly sold his entire personal holding of nearly 11,000 shares of stock in an issuer after its CEO selectively disclosed negative material nonpublic information). The Rosenberg release states that the respondent “did not communicate the information that he learned” from the issuer’s CEO to Cowen & Co. or its clients prior to the issuer’s public announcement, and that Rosenberg’s personal gain from his stock sales breached “a duty arising out of a relationship of trust and confidence that he had with Cowen and Cowen’s clients.” *Id.* at *1. To be sure, nothing reported in the media suggests that the SEC is investigating personal securities transactions in connection with the Paulson meeting. But in any event, when material nonpublic government information is at issue, the SEC might well refrain from charging employees with a Rule 10b-5 violation

As the financial crisis dragged on, hedge funds and professional investors were also reported to be bullish on tips from the Federal Reserve (“the Fed”).⁸⁸ Although the Fed has specific rules that prohibit officials from disclosing confidential Fed actions that have not yet been made public, well-connected analysts and investors can often “glean[] clues about the thinking of Fed officials during private talks.”⁸⁹ For example, in the course of an August 15, 2011 meeting with Chairman Ben Bernanke in his office, one consultant apparently deduced that the Fed would be pushing down long-term interest rates by selling medium-term bonds and using the proceeds to buy long-term bonds (a 1960s-era strategy known as “Operation Twist”).⁹⁰ Selective disclosures may have been made to other consultants as well because there were sharp increases in the prices for long-term bonds in the five-week period before the official public announcement of Operation Twist on September 21.⁹¹ The stark contrast between Regulation FD’s prohibition of selective disclosure in the private sector and the lax standards applicable to the public sector prompted one securities law scholar to post on his blog: “[I]f private issuers shouldn’t be giving select investors an informational advantage, shouldn’t the same principle apply to the government?”⁹² Since then, however, both the Fed and the Federal Reserve Bank of New York have taken steps to increase transparency and reduce the likelihood of selective disclosure.⁹³

The Department of Defense (DOD) is yet another outlet for those seeking to mine political intelligence. To be sure, much information from the DOD is expressly classified as confidential and a federal official’s disclosure of such information to outsiders can often be prosecuted as a crime.⁹⁴ But privileged investors may sometimes gain

premised on the counterintuitive notion that an investment bank or hedge fund has an exclusive right to the use of a federal official’s selective disclosure.

88. Susan Pulliam, *Investors Bullish on Fed Tips*, WALL ST. J., Nov. 23, 2011, at A1.

89. *Id.*

90. *Id.* (reporting that after her meeting with Chairman Ben Bernanke, Nancy Lazar, an economist with International Strategies & Investment Group, Inc., “made a hasty call to investor clients”).

91. *Id.*

92. *See* Bainbridge, *supra* note 47.

93. *See infra* notes 393–396 and accompanying text (discussing the Fed’s recent decision to publicly disclose federal funds rate forecasts for its policy committee members and the Federal Reserve Bank of New York’s recent decision to post on its website the surveys it sends to major financial firms ahead of monetary-policy meetings).

94. *See* Scott Shane, *Inquiry of Leaks Is Casting Chill over Coverage*, N.Y. TIMES, Aug. 2, 2012, at A1 (discussing “the most sweeping” criminal investigation in

access to other types of nonpublic information that could affect the stock price of publicly traded companies, such as Lockheed-Martin, Boeing, Northrop-Grumman, or other military contractors of a smaller size. A *New York Times* columnist, for instance, has sharply critiqued what he claimed was the growing practice of officials at the Pentagon “sidling up to” institutional investors and securities analysts specializing in the military industry.⁹⁵ He recounted, in particular, a private meeting between the DOD’s Deputy Secretary and a dozen or so Wall Street analysts in October 2010, which “lay[ed] out the Pentagon’s cost-cutting plans in astonishing detail,”⁹⁶ and a breakfast speech delivered by the DOD’s Undersecretary for Acquisitions at a military industry investment conference in February 2011 with T. Rowe Price and other large institutional investors in attendance.⁹⁷ The episodes prompted the columnist to ask: “If you were an investor in the military industry, would you find this useful information? You bet—this is the stuff that can move markets.”⁹⁸ The DOD insists that “nothing new was divulged during the [analyst] session” in October 2010,⁹⁹ and the text of the February 2011 breakfast speech can be found on a DOD website.¹⁰⁰ But unless the information that was discussed with the analysts or shared in the breakfast speech had already been disclosed

years into intelligence disclosures made to the media, “which has reached into the White House, the Pentagon, the National Security Agency and the C.I.A.”); *infra* note 411 (citing the Supreme Court’s decision in *N.Y. Times Co. v. United States*, 403 U.S. 713 (1971) (the Pentagon Papers case)).

95. Joe Nocera, *From Pentagon, A Buy Rating on Contractors*, N.Y. TIMES, Feb. 12, 2011, at B1.

96. *Id.*

97. *Id.* According to Nocera, the attendees at the conference were told that “the Pentagon would frown on mergers among the five giant military contractors [but] . . . was going to encourage mergers among smaller military contractors. And, . . . ‘[it would] be attentive’ to innovative smaller companies that provide services (as opposed to weapons systems) to the Pentagon.” *Id.*

98. *Id.*

99. *Id.* As Nocera observes, Reuters “uncovered the meeting” and reported on it a few days after it occurred. *Id.* According to that Reuters report, the analysts at “Friday’s closed-door meeting in New York” were “sworn to secrecy, but sources familiar with the proceeding said [the Deputy Defense Secretary] faced tough questions about future profit margins and the Pentagon’s ability to maintain a choice of suppliers given decreased demand for weapons.” Andrea Shalal-Esa, *Pentagon Pitches Austerity Plan to Nervous Wall St.*, REUTERS NEWS (Oct. 5, 2010, 3:24 AM), <http://in.reuters.com/article/2010/10/05/arms-wallstreet-idINN0521646520101005>.

100. See Ashton B. Carter, Undersecretary of Def. for Acquisition, Tech., and Logistics, Remarks at Cowen Investment Conference: The Defense Industry Enters a New Era (Feb. 9, 2011), *available at* http://www.acq.osd.mil/docs/USD_AT&L_Cowen_Speech_020911.pdf.

“to achieve a broad dissemination to the investing public generally,”¹⁰¹ the DOD may well have accorded the analysts and institutional investors an investment edge.¹⁰²

Even agencies such as the DOE and CMS can be focal points for valuable political intelligence when their regulatory initiatives affect publicly traded companies. Last summer, prompted by concerns that DOE officials may have selectively disclosed nonpublic market-moving information that was used for securities trading, Senator Charles Grassley (R-Iowa) began an investigation into possible leaks.¹⁰³ Among other matters, the senator questioned whether a well-known hedge fund manager, who had been shorting stock in for-profit colleges, may have received nonpublic information from DOE officials pertaining to the imposition of new regulations—a so-called gainful employment rule aimed at for-profit colleges.¹⁰⁴ The senator set out eight questions in a letter to DOE Secretary Arne Duncan, including one that inquired: “[W]hat internal controls does the Department have to ensure that non-public information is not leaked to [investors in for-profit institutions] and that these investors do not influence the Department’s policies?”¹⁰⁵ As Senator Grassley’s letter reflects, the hedge fund manager may have been lobbying the DOE for a regulatory crackdown on for-profit colleges at the same time as he was shorting their stock, which would raise concerns about other possible market abuses.¹⁰⁶ Less

101. See *supra* note 82 and accompanying text (quoting the SEC’s test for when information can be deemed to be in the public realm).

102. Cf. *infra* notes 339–344 and accompanying text (discussing SEC guidance in Regulation FD’s adopting release as to how issuers can make “public disclosures” and subsequent SEC guidance as to whether postings on corporate websites can be deemed publicly disseminated for purposes of Regulation FD).

103. Ben Protess, *Grassley Questions Education Agency’s Ties to Hedge Funds*, N.Y. TIMES DEALBOOK (July 28, 2011, 10:02 AM), <http://dealbook.nytimes.com/2011/07/28/grassley-questions-education-agencys-ties-to-wall-street/>.

104. Letter from Sen. Charles Grassley to Arne Duncan, DOE Secretary (July 26, 2011) [hereinafter Grassley DOE Letter], available at <http://www.grassley.senate.gov/about/upload/DuncanLetter.pdf>. Senator Grassley’s letter quotes an e-mail from hedge fund manager Steve Eisman to DOE officials that was obtained by FOIA requests filed by public interest groups. *Id.*

105. *Id.*

106. *Id.* The nonprofit legal watchdog group, Citizens for Responsibility and Ethics in Washington (CREW), sent letters to the SEC and the DOJ raising questions about the fairness of DOE’s regulatory process as well as investors’ efforts to influence DOE regulations for their own personal gain. See Press Release, Citizens for Responsibility & Ethics in Washington, CREW Provides SEC New Information about Short-Sellers’ Efforts to Shape Education Regulations (Mar. 1, 2011), available at <http://www.citizensforethics.org/press/entry/crew-provides-sec-new-info-short-sellers-shaping-education-regulation>.

than six months later, in December 2011, Senator Grassley launched a second inquiry into possible incidents of selective disclosure, this time at the CMS.¹⁰⁷ In a letter to the CMS's Acting Administrator requesting responses to nineteen questions, the senator revealed that "[a] whistleblower within CMS has alleged that high level CMS employees attended lengthy information gathering briefings at the request of hedge funds and political intelligence brokers with no discernible benefit to CMS or the Federal government."¹⁰⁸ He was frank in expressing his concern about "a continuing pattern in which CMS officials . . . under the cover of reaching out and meeting with stakeholders, have disseminated information to well-connected lobbyists in non-public settings."¹⁰⁹

Also in 2011, the U.S. credit rating—established by Alexander Hamilton more than 220 years ago¹¹⁰—was placed at risk, and much material nonpublic information had been swirling around Washington as to whether and when the government would resolve the debt-ceiling crisis.¹¹¹ Although the media fueled speculation about possible repercussions from the ballooning national debt, specific details about a credit rating downgrade were not made public until August 5, 2011, when S&P announced its decision to reduce the federal government's rating from AAA to AA+.¹¹² The abnormally high volume of securities trading that preceded the announcement prompted an SEC investigation into whether officials—perhaps at S&P, but conceivably at the Treasury Department—may have selectively disclosed advance information about the downgrade.¹¹³

A final example of media-profiled selective disclosure returns full circle to Congress. In December 2011, in the wake of congressional hearings on the STOCK Act, the *Wall Street Journal* featured a front page report on the "network of brokers, lobbyists and political insiders who arrange private meetings" between hedge fund managers and

107. Letter from Sen. Charles Grassley to Marilyn Tavenner, CMS Acting Adm'r (Dec. 12, 2011) [hereinafter Grassley CMS Letter], available at http://online.wsj.com/public/resources/documents/GrassleyCMSLetter_Dec2011.pdf.

108. *Id.*

109. *Id.*

110. See *supra* text accompanying notes 48–49.

111. See Mullins & Pulliam, *supra* note 20 (reporting that political intelligence consultants arranged Capitol Hill meetings on topics including "whether political deadlock debate would lead to a U.S. default").

112. See Jean Eaglesham, *U.S. Probes Rating-Cut Trades; Regulators Subpoena Hedge Funds, Others over Actions ahead of S&P Downgrade*, WALL ST. J., Sept. 20, 2011, at A1; Kim Peterson, *Who Leaked the S&P Downgrade News?*, MSN MONEY (Aug. 12, 2011, 2:27 PM), <http://money.msn.com/exchange-traded-fund/article.aspx?post=77dc9185-ed4f-4b98-bdba-6b818b601f86>.

113. See Eaglesham, *supra* note 112; Peterson, *supra* note 112.

members of Congress or their legislative aides.¹¹⁴ The article depicted the hedge fund managers as “a select group who pay[s] for early, firsthand reports on Capitol Hill” and contended that “[s]eeking advance word of government decisions is part of a growing, lucrative—and legal—practice.”¹¹⁵ A number of specific incidents were recounted, including briefings arranged by the Wall Street firm of JNK Securities that occurred on December 8, 2009.¹¹⁶ The briefings took place in the Capitol Building, hours before the public announcement of the brokered compromise that eliminated the proposed government insurance option in the Senate bill that later became the Patient Protection and Affordable Care Act (often referred to as “Obamacare”).¹¹⁷ The *Wall Street Journal* acknowledged that none of the hedge funds who “were let in on the deal” would “publicly divulge how they used the information.”¹¹⁸ But it speculated that the “news was potentially worth millions of dollars” to the attendees at the briefings because the deal helped boost the share price of Aetna, Cigna, and other large national insurers that would have faced competition from a government-run insurance plan.¹¹⁹ It further reported that JNK Securities had organized “more than 200 similar sessions over the past three years” on a wide range of other topics.¹²⁰ The legislators who were interviewed defended the JNK sessions and other briefings and meetings as a means of gathering valuable feedback and analysis from the investment community.¹²¹

114. Mullins & Pulliam, *supra* note 20.

115. *Id.*

116. *Id.* (describing JNK Securities as “one of the most aggressive of the dozens of companies that escort clients around Capitol Hill”).

117. *Id.*

118. *Id.*

119. *Id.*

120. *Id.* (stating that meeting topics ranged from “how Congress would weigh in on the proposed merger between Express Scripts Inc. and Medco Health Solutions Inc.” to “whether political deadlock [during the debt-ceiling debate] would lead to a U.S. default”). Although hedge funds no longer pay fees to JNK Securities for arranging the meetings, “[i]f they use information gleaned at these face-to-face meetings they are expected to execute trades through the brokerage firm, which collects commissions.” *Id.*

121. *Id.* (“Republicans say they seek the view of hedge fund managers to help shape laws that spur investment. Democrats say the conversations lead to better public policy because investors tell them about loopholes, inefficiencies or unseen consequences of existing laws.”).

B. Fraudulent Tipping vs. Unfair Selective Disclosure

Notwithstanding the potentially valuable feedback and insights that can stem from meetings with political intelligence consultants, hedge fund managers, and other professional investors, the selective disclosure of market-moving government information places ordinary investors at a significant disadvantage in the securities markets. But as this Section will explain, most selective disclosures—including virtually all of the examples discussed in the prior Section—are unlikely to constitute fraudulent tipping under the federal securities laws. Moreover, because liability for fraudulent trading on tips is derivative, the privileged recipients of selectively disclosed government information are generally free to use it to trade securities. Although the recently enacted STOCK Act makes explicit that Section 10(b) and Rule 10b-5 apply to members of Congress and all other federal officials and employees, the Act does nothing to alter controlling judicial interpretations as to what constitutes fraud under these provisions. Thus, to distinguish between fraudulent tipping on the one hand and unfair selective disclosure on the other, we must turn to the case law.

1. PROSECUTIONS INVOLVING TIPS BY FEDERAL OFFICIALS

We have no doubt that the vast majority of federal officials who have shared material nonpublic information with securities investors did so for reasons consistent with their duties of trust and confidence to the federal government and its citizens. Yet, history reveals some rogue government officials who divulged market-moving information to outsiders for purposes that were undisputably disloyal. In the particular instances recounted below, the federal officials who tipped and/or their accomplices who traded were prosecuted for conduct that today would violate Section 10(b) and Rule 10b-5 (or the Commodity Exchange Act, when the trading involves commodities).¹²² Even before these laws were

122. Unlike the federal securities laws, under which insider trading is prosecuted as a species of fraud, the Commodity Exchange Act (CEA) expressly prohibits certain types of insider trading in commodities markets. In 2010, Congress amended Section 6c(a) of the CEA to explicitly ban commodities insider trading (and tipping) based on nonpublic information misappropriated from a government source. 7 U.S.C.S. § 6c(a) (LexisNexis 2010). This was done in response to a specific request by the Commodity Futures Trading Commission (CFTC). See *Hearing to Review Implementation of Changes to the Commodity Exchange Act Contained in the 2008 Farm Bill: Hearing Before the Subcomm. on Gen. Farm Commodities & Risk Mgmt. of the H. Comm. on Agric.*, 111th Cong. 2–6 (2010) (statement of Gary Gensler, CFTC Chairman). The new CEA provision has been described as the “Eddie Murphy” rule, an allusion to the actor’s starring role in *Trading Places*, a movie involving scheming brothers who are seeking to profit from trades in frozen concentrated orange

in place, however, federal officials who enabled outsiders to profit in financial markets could be prosecuted under criminal statutes proscribing fraudulent conspiracies against the United States.

The Second Circuit's relatively recent decision in *United States v. Royer*¹²³ describes one highly publicized prosecution for illegal tipping and trading under Section 10(b) and Rule 10b-5. Jeffrey Royer, a former FBI agent, had been convicted and sentenced to six years in prison for leaking confidential FBI information to Tony Elgindy.¹²⁴ Elgindy, who was also convicted and sentenced to prison, used the FBI's information to short the stock of publicly traded companies under investigation, effectively betting on a market price decline.¹²⁵ In denying their appeal, the Second Circuit pointed to the jury's finding that "the defendants unlawfully traded in various securities on the basis of material confidential information that Royer had misappropriated and then shared with Elgindy for the purpose of securities trading."¹²⁶ As an employee of the FBI, Royer stood in a relationship of trust and confidence with the agency and he breached this duty of loyalty when he disclosed its confidential data expecting to receive a share of the trading profits as well as a lucrative private sector job "making a million dollars a year" with Elgindy.¹²⁷

In 1905—nearly a century before *Royer* and three decades before Congress sought to regulate the financial markets—a tipping and trading scandal occurred at the USDA. The prosecution eventually reached the Supreme Court in *Haas v. Henkel*,¹²⁸ where the Justices reviewed an indictment charging the defendants with a conspiracy to obtain crop reports from a USDA statistician "in advance of general publicity and to use such information in speculating upon the cotton market."¹²⁹ The Court concluded that the conspiracy, if proven, would have defrauded "the United States by defeating, obstructing and impairing it in the exercise of its governmental function in the regular and official duty of

juice futures contracts using an illicitly obtained USDA orange crop report. *Id.* at 7; *see also infra* notes 128–133 and accompanying text (discussing the real life 1905 tipping scandal involving a misappropriated USDA cotton crop report). As part of the STOCK Act, Congress amended the CEA to make explicitly clear that Section 4(c)(a) extends to members of Congress and congressional employees, as well as to judicial officers and judicial employees, both with respect to tipping and trading. *See* STOCK Act, Pub. L. No. 112-105, § 5, 126 Stat. 291, 293 (to be codified at 7 U.S.C. § 6c(a) (2012)).

123. 549 F.3d 886 (2d Cir. 2008).

124. *Id.* at 890–91.

125. *Id.*

126. *Id.* at 897.

127. Brief for the United States at 150, *United States v. Royer*, 549 F.3d 886 (2d Cir. 2008) (No. 06-4081-CR), 2007 WL 6506774.

128. 216 U.S. 462 (1910).

129. *Id.* at 478.

publicly promulgating fair, impartial and accurate reports concerning the cotton crop.”¹³⁰ A USDA investigation of the scandal later revealed that a bureau chief had suspected that something was amiss, and had decreed that the statistician and two other employees were not to leave their work areas until the cotton report had been publicly disseminated.¹³¹ But the sly statistician and his commodities trading partner were hardly deterred. The investigation uncovered that they had “worked out a signal system using a particular window blind to indicate the level of the figure to be published.”¹³² The USDA statistician was ultimately sentenced to a fine of \$5000.¹³³

At least four other federal government insiders have been charged with unlawfully communicating material nonpublic government information to outsiders who traded securities based on that information. These include: a former FDA chemist and his son, who in 2011 were charged with trading stocks of drug companies based on unreleased drug approval determinations (though prosecutors subsequently dismissed the securities fraud charges involving the son);¹³⁴ a former director of the New York Federal Reserve Bank, who in 1989 admitted that he had regularly disclosed nonpublic information about the Fed’s discount rate to a securities brokerage firm;¹³⁵ a former

130. *Id.*

131. *See* ALLEN, *supra* note 61, at 1–2.

132. *Id.* at 2. The statistician, E.F. Holmes, and his trading partner “apparently estimated a probable level for the national figure and if the actual total was close to their estimate Holmes raised the window blind to the middle of the window. If the total was higher or lower, Holmes adjusted the blind based on the scale they had contrived.” *Id.*

133. *Id.*

134. *See* Cheng Yi Liang, Litigation Release No. 22,171 (Nov. 30, 2011), <http://www.sec.gov/litigation/litreleases/2011/lr22171.htm> (announcing that a former FDA chemist consented to the entry of an injunction and agreed to pay disgorgement of \$3,776,152, which was deemed satisfied by the forfeiture order entered as part of his guilty plea in the parallel criminal case); David S. Hilzenrath, *Former FDA Chemist Sentenced to 5 Years for Insider Trading*, WASH. POST, Mar. 6, 2012, at A13 (reporting that the chemist’s son “was arrested on accusations of securities fraud, his computer was seized, and he was later sentenced to just over a year in prison for possession of child pornography”).

135. Joseph F. Sullivan, *A Former Official of Federal Bank Indicted as Insider*, N.Y. TIMES, Dec. 9, 1988, at A1 (reporting allegations by then-United States Attorney Samuel Alito that Robert Rough’s tips “enabled the securities firm to ‘fraudulently make millions in profits and avoid millions of dollars in trading losses’” and that, in return, “the company gave Mr. Rough \$47,000 in interest-deferred loans, which were repaid”); *Shift by U.S. in Insider Case*, N.Y. TIMES, Aug. 30, 1989, at D12 (reporting that in exchange for Rough’s plea to one count of bank fraud, “[t]he Government agreed to drop six other counts, including insider trading, and . . . agreed to recommend a prison term of less than a year”); *Fed Ex-Official Gets 6 Months*, N.Y.

branch chief of the SEC's corporation finance division, who in 1966 communicated nonpublic information about a confidential investigation to a securities trader who had "procur[ed] female company" for the SEC staffer's benefit;¹³⁶ and a former law clerk to Supreme Court Justice Joseph McKenna, who was the subject of a dismissed prosecution in 1919 for allegedly tipping others who traded securities based on information pertaining to an unreleased Court decision.¹³⁷

Although the Supreme Court's decision in *United States v. O'Hagan* did not address directly the question of tipping, its misappropriation theory provides a clear roadmap for what prosecutors must now prove to establish Rule 10b-5 liability in cases against federal officials for illegally tipping. Under *O'Hagan*, "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

TIMES, Sept. 14, 1989, at D7 (reporting Rough's sentence of six months in prison and 200 hours of community service during two years of probation).

The Rough incident was not the only tipping scandal to beset the Federal Reserve. Over a three-year-period from 1964 through 1967, a manager of the Bond and Custody Department of the Federal Reserve Bank of Philadelphia allegedly disclosed confidential Treasury Department information about upcoming issuances of government securities to bond dealers at Blyth & Company Inc., who traded securities on the basis of that material nonpublic information. *See* Blyth & Co., 43 S.E.C. 1037 (Jan. 17, 1969). The SEC initiated and settled a Rule 10b-5 enforcement action against the brokerage firm and the bond traders based on their failure to abstain from trading while in possession of material information that they knew "was intended to be kept non-public until a predetermined time and then disseminated pursuant to established official procedures." *Id.* at 1039-40. The SEC Release, however, did not name the manager, but it did observe that he was suspended immediately after his tipping conduct came to light and that he died just over a week later. *Id.* at 1039 n.3.

136. *United States v. Peltz*, 433 F.2d 48, 49-51 (2d Cir. 1970) (affirming Philip Peltz's conviction for "conspir[ing] with others, including an employee of the SEC, to obtain confidential inside information about matters under consideration by the Commission and use such information for private profit"). The Second Circuit observed that Peltz had defended prostitutes in his legal practice and quotes witness testimony revealing that Peltz sometimes "would get the company of these girls for his friends in Washington." *Id.* at 50. The SEC staffer was indicted for and convicted of perjury on the basis of his grand jury testimony. *See United States v. Weiner*, 479 F.2d 923, 924 (2d Cir. 1973).

137. *See* John B. Owens, *The Clerk, the Thief, His Life as a Baker: Ashton Embry and the Supreme Court Leak Scandal of 1919*, 95 NW. U. L. REV. 271, 272 (2000). As Owens explains it, the case was dismissed even though an indictment against the law clerk had been upheld by the Court of Appeals of the District of Columbia and a writ of certiorari had been denied by the Supreme Court. *See id.* at 295-97 (citing *Embry v. United States*, 257 U.S. 655 (1921)). Owens maintains that the DOJ's "official files remain eerily quiet on the subject, containing no notes or memoranda explaining why the U.S. Attorney dismissed the case." *Id.* at 297.

the source of the information.”¹³⁸ And under the STOCK Act, all federal officials owe “a duty arising from a relationship of trust and confidence” to the U.S. Government and its citizens “with respect to material, nonpublic information derived from such person’s position . . . or gained from the performance of such person’s official responsibilities.”¹³⁹ Thus, in a prosecution against a federal official for illegal tipping, Section 10(b)’s deception element would be satisfied by proof of the official’s “undisclosed, self-serving use of [the government’s] information”¹⁴⁰ and Section 10(b)’s “in connection with” element would be satisfied by proof that the federal official knew or was reckless in not knowing that the information was to be used for securities trading purposes.¹⁴¹ Section 10(b) also requires prosecutors to prove that the information was both material and nonpublic,¹⁴² and that the federal official acted with scienter, “a mental state embracing intent to deceive, manipulate, or defraud.”¹⁴³ As the SEC Enforcement Director recently assured congressional officials in his testimony on the STOCK Act: “You have to be acting with corrupt intent, knowledge, or recklessness. If you act in good faith, you are not going to be guilty.”¹⁴⁴

O’Hagan’s misappropriation theory extends as well to certain tippees who trade securities on the basis of material nonpublic

138. *United States v. O’Hagan*, 521 U.S. 642, 652 (1997) (internal citation omitted).

139. STOCK Act, Pub. L. No. 112-105, §§ 4(b), 9(b), 126 Stat. 291, 292, 297-98 (2012) (to be codified at 15 U.S.C. § 78u-1(g) to (h) (2012)). The STOCK Act also specifies that members of Congress and congressional employees owe a duty to Congress itself. § 4(b).

140. *O’Hagan*, 521 U.S. at 652.

141. *Id.*; see also *United States v. Gansman*, 657 F.3d 85, 92 (2d Cir. 2011) (“In prosecuting a putative ‘tipper’ under the misappropriation theory of insider trading, the government must prove as an element of the offense that the tipper conveyed material nonpublic information to his ‘tippee’ with the understanding that it would be used for securities trading purposes.”). Nearly twenty years before *Gansman*, the Second Circuit held that Rule 10b-5 liability could be established even in the absence of proof that the defendant tippees knew their breach of fiduciary duty would lead to securities trading. See *United States v. Libera*, 989 F.2d 596, 602 (2d Cir. 1993). But the intervening ruling in *O’Hagan* likely prompted a re-evaluation of *Libera*. See Donna M. Nagy, *Reframing the Misappropriation Theory of Insider Trading Liability: A Post-O’Hagan Suggestion*, 59 OHIO ST. L.J. 1223, 1263 n.199 (1998) (“If the tippers [in *Libera*] did not have any knowledge that the information conveyed would be used by the tippees for securities trading purposes, it is difficult to see how the tippers’ breach of duty (in which the tippees were co-participants) can satisfy even the broadest interpretation of Section 10(b)’s ‘in connection with’ nexus.”).

142. See *supra* notes 81-82. Part II.B’s discussion of Regulation FD further elaborates on the question of when information is material and nonpublic.

143. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 194 n.12 (1976).

144. See *House STOCK Act Hearing*, *supra* note 22, at 32 (statement of Robert Khuzami, Director, SEC Division of Enforcement).

government information. As then-Second Circuit Judge Sonia Sotomayor recognized in *United States v. Falcone*,¹⁴⁵ to make a case against a tippee defendant, the SEC or DOJ is “simply required to prove a breach by . . . the tipper, of a duty owed to the owner of the misappropriated information, and defendant’s knowledge that the tipper had breached the duty.”¹⁴⁶ These prerequisites to tippee liability were present in the *Royer* case, where the short seller Elgindy was convicted and sentenced to prison for trading on tips conveyed to him by Royer, then an agent for the FBI.¹⁴⁷ In essence, Royer defrauded the federal government and its citizens through his secret, self-serving use of the FBI’s information for personal gain and Elgindy was a co-participant in that fraud.

2. SELF-SERVING USE OF INFORMATION BY TIPPING RATHER THAN TRADING

O’Hagan’s misappropriation theory constitutes one of the two theories under which insider trading violates Section 10(b) and Rule 10b-5. The Court’s alternative theory, the “traditional” or “classical theory,” holds that a violation occurs when a corporate insider, such as an officer, director, or employee “trades in the securities of his corporation on the basis of material, non-public information.”¹⁴⁸ As the Court recognized in *Chiarella v. United States*,¹⁴⁹ such classical insider trading violates Section 10(b) and Rule 10b-5 because “a relationship of trust and confidence [exists] between the shareholders of a corporation and those insiders who have obtained confidential information by reason of their position with that corporation,” and this relationship gives rise to a duty to disclose or abstain from trading.¹⁵⁰ The *Chiarella* decision was groundbreaking because it rejected the parity-of-information approach that had been developed by the SEC and lower courts, which required “anyone in possession of material inside information [to] either disclose it to the investing public, or . . . abstain

145. 257 F.3d 226 (2d Cir. 2001).

146. *Id.* at 234.

147. *See supra* notes 123–127 and accompanying text.

148. *United States v. O’Hagan*, 521 U.S. 642, 651–52 (1997).

149. 445 U.S. 222 (1980).

150. *Id.* at 228. Three years later in *Dirks*, the Court observed that this classical theory also extended to temporary agents or “constructive insiders” of the securities issuer, such as lawyers, accountants, or consultants, who “become fiduciaries” of the corporation’s shareholders because “they have entered into a special confidential relationship in the conduct of the business of the enterprise and are given access to information solely for corporate purposes.” *Dirks v. SEC*, 463 U.S. 646, 655 n.14 (1983).

from trading in or recommending the securities concerned while such inside information remains undisclosed.”¹⁵¹ In the Court’s view, this broad parity-of-information approach flouted a fundamental precept of common law fraud: that silence about material facts in a business transaction amounted to fraud only in the context of a fiduciary-like relationship of trust and confidence between the parties.¹⁵²

As the Court explained in *O’Hagan*, the classical theory and the misappropriation theory are complementary because “each address[es] efforts to capitalize on nonpublic information” in connection with securities trading, while adhering to the common law’s requirement of a disclosure duty arising from a relationship of trust and confidence.¹⁵³ Whereas 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 duty owed not to a trading party, but to the source of the information.”¹⁵⁴

Government insider trading cases fall squarely within the misappropriation theory. Although federal officials are “insiders” of the U.S. government, they are “outsiders” to the corporate issuer whose securities are traded. But the classical theory—as reaffirmed and expanded in *Dirks v. SEC*—is essential to understanding the misappropriation theory’s application to tipping. That is, *Dirks* illuminates how federal officials can be said to deceive and defraud the federal government and its citizens by self-servingly communicating information to others who trade securities.¹⁵⁵

Although *Dirks* was quick to echo *Chiarella*’s view that Rule 10b-5 liability turned on the “specific relationship between the shareholders and the individual trading on inside information,”¹⁵⁶ *Dirks* extended the duty to disclose or abstain beyond corporate insiders to certain tippees whose liability would be “derivative from that of the insider’s duty.”¹⁵⁷ As Justice Lewis Powell’s majority opinion explained, although a tippee of a corporate insider typically stands as a stranger to an issuer’s

151. *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 848 (2d Cir. 1968).

152. *Chiarella*, 445 U.S. at 228 (“[O]ne who fails to disclose material information prior to the consummation of a transaction commits fraud only when he is under a duty to do so.”).

153. *O’Hagan*, 521 U.S. at 652.

154. *Id.* at 652–53.

155. *See SEC v. Obus*, 693 F.3d 276 (2d Cir. 2012); *SEC v. Yun*, 327 F.3d 1263, 1270 n.15 (11th Cir. 2003).

156. *Dirks v. SEC*, 463 U.S. 646, 655 (1983).

157. *Id.* at 659 (explaining that “tippee’s obligation has been viewed as arising from his role as a participant after the fact in the insider’s breach of a fiduciary duty” (citing *Chiarella*, 445 U.S. at 230 n.12)).

shareholders, a tippee would nonetheless assume a fiduciary-like duty not to trade on material nonpublic information “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.”¹⁵⁸

Justice Powell, however, was explicit in holding that not all disclosures of material nonpublic information would violate an insider’s fiduciary duty. Instead, because “a purpose of the securities laws was to eliminate ‘use of inside information for personal advantage,’”¹⁵⁹ he held that Section 10(b) and Rule 10b-5 liability turned on the insider’s motivation for disclosing the information.¹⁶⁰ The requisite inquiry is therefore a contextual one that focuses on “objective criteria, *i.e.*, whether the insider receives a *direct or indirect personal benefit from the disclosure*, such as a pecuniary gain or a reputational benefit that will translate into future earnings.”¹⁶¹ That statement was immediately followed by a quote from a law review article authored years before by Professor Victor Brudney: “The theory . . . is that the insider, by giving the information out selectively, is in effect selling the information to its recipient for cash, reciprocal information, or other things of value for himself”¹⁶²

Elaborating on the particular facts and circumstances that could support the requisite finding of unjust enrichment (and thus disloyalty) on the part of an insider, Justice Powell stated:

For example, there may be a relationship between the insider and the recipient that suggests a *quid pro quo* from the latter, or an intention to benefit the particular recipient. The elements of fiduciary duty and exploitation of nonpublic information also exist when an insider makes a gift of confidential information to a trading relative or friend. The tip and trade resemble trading by the insider himself followed by a gift of the profits to the recipient.¹⁶³

Justice Powell acknowledged that such determinations of fact “will not always be easy for courts.”¹⁶⁴ But he concluded that this personal benefit test was nonetheless “essential . . . to have a guiding principle

158. *Id.* at 660.

159. *Id.* at 662 (quoting *In re Cady, Roberts & Co.*, 40 S.E.C. 907, 912 n.15 (1961)).

160. *Id.* at 662.

161. *Id.* at 663 (emphasis added).

162. *Id.* at 664 (quoting Brudney, *supra* note 3, at 348).

163. *Id.*

164. *Id.*

for those whose daily activities must be limited and instructed by the SEC's insider-trading rules."¹⁶⁵

As other securities law scholars have emphasized, *Dirks'* guiding principle recognizes that what Section 10(b) and Rule 10b-5 proscribe "is not merely a breach of confidentiality by the insider, but rather a breach of the duty of loyalty imposed on all fiduciaries to avoid personally profiting from information entrusted to them."¹⁶⁶ *Dirks'* guiding principle is likewise outcome determinative for the recipients of material nonpublic information as well: "Absent some personal gain, there has been no breach of duty And absent a breach by the insider, there is no derivative breach."¹⁶⁷

Although a few courts have questioned whether the classical theory's tipper-personal benefit requirement applies to cases predicated on the misappropriation theory,¹⁶⁸ the Eleventh Circuit drew no such distinction in *SEC v. Yun*.¹⁶⁹ After extensive analysis, *Yun* read *O'Hagan* to require a tipper's personal gain as a necessary element for tipper/tippee liability in misappropriation cases.¹⁷⁰ The Second Circuit likewise applied the personal benefit test in *SEC v. Obus*,¹⁷¹ a recent

165. *Id.*

166. Stephen M. Bainbridge, *Incorporating State Law Fiduciary Duties into the Federal Insider Trading Prohibition*, 52 WASH. & LEE L. REV. 1189, 1195 (1995); see also A.C. Pritchard, *Justice Lewis F. Powell, Jr., and the Counterrevolution in the Federal Securities Laws*, 52 DUKE L.J. 841, 942 (2003) (stating that under Powell's reasoning, "[g]arden variety breaches of the duty of care were clearly out; tipping required a breach of the duty of loyalty").

167. *Dirks*, 463 U.S. at 662. Despite *Dirks'* clear dictate that a tippee's liability under Rule 10b-5 derives entirely from a tipper's misuse of information for personal gain, in *United States v. Evans*, 486 F.3d 315 (7th Cir. 2007), the court affirmed the criminal conviction of a tippee who was retried after the friend who allegedly tipped him had been acquitted in the previous trial, *id.* at 325. It is exceedingly difficult to square this result with *Dirks*, and the court's effort to do so was not convincing. See Donna M. Nagy, *Insider Trading and the Gradual Demise of Fiduciary Principles*, 94 IOWA L. REV. 1315, 1347-48 (2009).

168. See, e.g., *SEC v. Rocklage*, 470 F.3d 1, 7 n.4 (1st Cir. 2006) (observing that the First Circuit has "left open" the question of personal benefit in misappropriation cases, but finding that the tipper's "gift of information" to her brother satisfied that the *Dirks* test, in any event); *SEC v. Sargent*, 229 F.3d 68, 77 (1st Cir. 2000) (addressing the SEC's argument and citing pre-*O'Hagan* cases for the view that there is no personal benefit requirement in misappropriation theory cases, but then finding that the *Dirks* test was satisfied because the tipper likely disclosed the information "to effect a reconciliation with his friend and to maintain a useful networking contact"). For a comment arguing against a personal benefit requirement in misappropriation theory cases, see David T. Cohen, Comment, *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 (2006).

169. 327 F.3d 1263 (11th Cir. 2003).

170. *Id.* at 1279-80.

171. 693 F.3d 276 (2d Cir. 2012).

decision stating explicitly that the tipping doctrine developed in *Dirks* also “governs in a misappropriation case.”¹⁷² Indeed, since *O’Hagan* was decided, no court has ever extended misappropriation theory liability to a putative tipper in the absence of evidence that he or she conveyed the material nonpublic information in exchange for a direct or indirect personal benefit.

The Eleventh Circuit’s analysis in *Yun* goes to the heart of the personal benefit issue. The facts involved the wife of a corporate executive who had been held liable under Section 10(b) and Rule 10b-5 for misappropriating material nonpublic information from her husband, who was the president of a Scholastic Corporation subsidiary.¹⁷³ The wife, however, did not trade securities herself. Rather, a jury found that she and a co-worker/friend had defrauded her husband when she secretly conveyed negative earnings information, with which she had been entrusted, to the co-worker/friend, who then used that information to trade put options on the husband’s company.¹⁷⁴ Although the SEC maintained that its evidence showed that the wife had personally benefitted from her disclosure, the SEC also argued that it did not have to prove that she “divulged the information for her own benefit; all it had to show was that [the wife] acted with ‘severe recklessness.’”¹⁷⁵ The *Yun* court emphatically rejected the SEC’s argument that “severe recklessness,” in the absence of a showing of a personal benefit to the tipper, is sufficient to sustain misappropriation theory liability.¹⁷⁶

The SEC conceded that *O’Hagan’s* misappropriation theory rests on an agent’s secret misuse of a principal’s information.¹⁷⁷ But it argued in its litigation brief that “personal benefit” to the agent (in this case, the executive’s wife) was merely one of two alternate vehicles for establishing the misappropriation theory’s requisite misuse.¹⁷⁸

172. *Id.* at 285–86. The court vacated the summary judgment order for defendants and ruled that the SEC had presented sufficient evidence that “if the tip occurred,” the alleged misappropriator “made the tip intentionally and received a personal benefit from it.” *Id.* at 291.

173. *Yun*, 327 F.3d at 1274.

174. *Id.* at 1267–70.

175. *Id.* at 1274. The *Yun* court observed that the SEC’s argument on appeal was “contrary to the position it assumed in its complaint,” which had plainly alleged that the wife had “deliberately communicated the confidential information [to her friend] ‘for her direct and/or indirect personal benefit because of her business relationship and friendship with’” him. *Id.* (quoting Complaint and Demand for Jury Trial Injunctive Relief Sought, *SEC v. Yun*, 327 F.3d 1263 (11th Cir. 2003) (No. 699CV00117), 1999 WL 34965842 at ¶ 21).

176. *Id.* at 1282.

177. See Brief of Securities and Exchange Commission, Appellee, *SEC v. Yun*, 327 F.3d 1263 (11th Cir. 2003) (No. 01-14490), 2001 WL 34455703, at *42–43.

178. *Id.* at *45.

According to the SEC, the other way by which an agent could breach her duty not to misuse information “is by making an unauthorized disclosure of confidential information in a way that is likely to harm the principal.”¹⁷⁹ The SEC drew support from section 395 of the Restatement (Second) of Agency, which was cited by the Court in *O’Hagan*.¹⁸⁰ The SEC thus sought to convince the court that regardless of whether the wife personally gained from her disclosure of the entrusted information, the wife had recklessly harmed her husband’s reputation and career, thereby warranting both tipper and tippee liability.¹⁸¹

The SEC’s “harm to the principal” argument, however, overlooked several key statements in *O’Hagan*, all of which make clear that the misappropriation theory always requires undisclosed personal gain on the part of the fiduciary-like person who is alleged to be a misappropriating tipper. The Court, for instance, framed the misappropriation theory as “a fiduciary’s undisclosed, *self-serving use* of a principal’s information to purchase or sell securities, [which] . . . defrauds the principal of the exclusive use of that information.”¹⁸² Later in the opinion, the Court emphasized that “misappropriators . . . deal in deception. A fiduciary who [pretends] loyalty to the principal while *secretly converting the principal’s information for personal gain* ‘dupes’ or defrauds the principal.”¹⁸³ And elsewhere, the Court observed that the “misappropriation theory bars only ‘trading on the basis of information that the wrongdoer *converted to his own use* in violation of some fiduciary, contractual, or similar obligation to the owner or rightful possessor of the information.’”¹⁸⁴

The *O’Hagan* Court’s repeated use of the term “conversion” is telling, as is the term “misappropriation” itself. An agent who recklessly disregards a likely harm to her principal may well be a wrongdoer under the law of agency because unauthorized communications of a principal’s secrets typically breach an agent’s

179. *Id.*

180. *Id.* at *42–43 (citing *United States v. O’Hagan*, 521 U.S. 642, 654–55 (1997)). The comments to section 395 of the Restatement (Second) of Agency provides that a fiduciary “has a duty not to use the information acquired by [the fiduciary] as agent . . . for *any* purpose likely to cause [the] principal harm or to interfere with [the principal’s] business.” *Id.* at *42–43 (quoting RESTATEMENT (SECOND) OF AGENCY § 395 cmt. a (1958)).

181. *Id.* at *45–46 (“David Yun was likely to suffer harm in his position as a senior corporate executive by his role in a chain of events that led to confidential corporate information entrusted to him being disclosed (by Donna Yun) to a person (Burch) who used that information to trade the company’s securities.”).

182. *O’Hagan*, 521 U.S. at 652 (emphasis added).

183. *Id.* at 653–54 (emphasis added) (internal citation omitted).

184. *Id.* at 663 (emphasis added).

duties of confidentiality and care.¹⁸⁵ But unless motivated by personal gain, an agent's disclosure to a third party would not breach her duties of trust and confidence. And without this secret breach of loyalty, the agent who disclosed that information would not be "feigning fidelity" to the information's source.¹⁸⁶ It is thus the disclosing agent's unjust enrichment from the use of material nonpublic information that transforms a mere breach of care and confidentiality into a deceptive misappropriation in connection with the purchase or sale of a security.

The court in *Yun* flatly rejected the SEC's "harm to the principal" argument because it recognized that undisclosed personal gain from the misuse of material nonpublic information constitutes the crux of *O'Hagan's* misappropriation theory. As the Eleventh Circuit emphasized, "*O'Hagan* explicitly states or implicitly assumes that a misappropriator must gain personally from his trading on the confidential information."¹⁸⁷ The *Yun* court continued:

If we were to hold that a misappropriator who tips—rather than trades—is liable even though he intends no personal benefit from his tip, then we would impose liability more readily for tipping than trading. Such a result would be absurd, and would undermine the Supreme Court's rationale for imposing the benefit requirement in the first place: the desire to ensure that a tip rises to the level of a trade. . . . The better approach, in our view, is to follow *Dirks* and ensure that an outsider who tips must have done so with the intent of benefitting from the tippee's trading.¹⁸⁸

The *Yun* court also reasoned that *Dirks* would be a "dead letter" if the SEC could avoid establishing the personal benefit element simply by proceeding under the misappropriation theory instead of the classical theory.¹⁸⁹ That is, *Yun* recognized what securities law scholars have long pointed out: "Virtually all cases that could be brought [under the classical theory] can also be styled as misappropriation cases."¹⁹⁰

185. See, e.g., RESTATEMENT (THIRD) OF AGENCY § 8.08 (2005) ("[A]n agent has a duty to the principal to act with the care, competence, and diligence normally exercised by agents in similar circumstances.").

186. *O'Hagan*, 521 U.S. at 655.

187. *SEC v. Yun*, 327 F.3d 1263, 1279 (11th Cir. 2003).

188. *Id.*

189. *Id.*

190. DONALD C. LANGEVOORT, INSIDER TRADING: REGULATION, ENFORCEMENT & PREVENTION § 6-2 (West vol. 18, 2012); see also WILLIAM K.S. WANG & MARC I. STEINBERG, INSIDER TRADING 492 (3rd ed. 2010) ("[I]n most instances, both the Commission and private plaintiffs could recast a classical special relationship cases as involving 'misappropriation.'").

In its final analysis, *Yun* concluded that the SEC's evidence was sufficient to support the jury's conclusion that the wife had expected to benefit from her tip to the codefendant "by maintaining a good relationship between a friend and frequent partner in real estate deals."¹⁹¹ Thus, the agency emerged victorious notwithstanding the Eleventh Circuit's clear dictate "that the SEC must prove that a misappropriator expected to benefit from the tip."¹⁹²

3. PROVING IMPROPER PERSONAL GAIN FROM SELECTIVE DISCLOSURE

Although misappropriation theory cases applying *Dirks*' personal benefit test are replete with instances of tips deemed illegal,¹⁹³ courts have yet to grapple with the test in the specific context of securities trading on the basis of material nonpublic government information. To be sure, in the few cases that have been brought against government insiders for illegal tipping, the defendants each appeared to have benefitted personally from his tip to the trading outsiders.¹⁹⁴ But these personal benefits all took the form of explicit quid pro quos (meaning "to take this for a that"). For example, the leaker in *Royer*, an FBI agent, was promised a share of the trading profits generated from the use of that information as well as lucrative future employment,¹⁹⁵ and the leaker in *Peltz*, a branch chief at the SEC, was enticed with the hiring of a prostitute.¹⁹⁶ In both cases, the federal official's exploitation of the government's information breached the duty of loyalty at the center of *Dirks* and *O'Hagan*, and the failure to disclose that breach (by "feigning fidelity") defrauded the agency and the federal government. *Dirks* also establishes that a federal official's "gift of confidential information to a trading relative or friend" would constitute an indirect personal benefit that would likewise trigger a Rule 10b-5 disclosure obligation.¹⁹⁷ Thus, the government insiders in 1789 who shared information with outsiders about Hamilton's bond redemption plan likely engaged in illegal tipping under the federal securities law that

191. *Yun*, 327 F.3d at 1280.

192. *Id.* at 1275.

193. In addition to *Yun*, see *SEC v. Rocklage*, 470 F.3d 1 (1st Cir. 2006), and *SEC v. Sargent*, 229 F.3d 68 (1st Cir. 2000). See also *United States v. Rajaratnam*, 802 F. Supp. 2d 491, 514 (S.D.N.Y. 2011) (holding that a reasonable jury could infer from a wiretapped call that the tipper and the tippee had a quid pro quo arrangement that satisfied the test for a personal benefit).

194. See, e.g., *Haas v. Henkel*, 216 U.S. 462 (1910); *United States v. Royer*, 549 F.3d 886 (2d Cir. 2008); *supra* notes 134–137 and accompanying text.

195. See *supra* notes 123–127 and accompanying text.

196. See *supra* note 136 and accompanying text.

197. *Dirks v. SEC*, 463 U.S. 646, 664 (1983).

exists today: the fact that many of the tippers also purchased bonds for themselves provides compelling evidence that they sought to “gift” the information to their Federalist friends. Absent such obvious gifts or explicit quid pro quos, how should *Dirks* apply to a federal official who conveys material nonpublic information to a government outsider who then trades?

In the wake of the STOCK Act, several commentators have suggested that prosecutors and courts are likely to construe *Dirks*' personal benefit test expansively in the context of tips involving government information. Professor Stephen Bainbridge, for instance, speculated that “[n]ow that Congress is covered by the insider-trading law, if a member of Congress gives a tip to a hedge fund manager, that is going to be illegal,”¹⁹⁸ provided that the SEC or DOJ can show “that the Member got a personal benefit from making the tip, such as a political contribution, log-rolling support for legislation, or enhanced reputation.”¹⁹⁹ John Berlau, a senior fellow at the Competitive Enterprise Institute, expressed the fear that congressional staffers could be prosecuted simply for facilitating the legislative agenda of the senator or representative who employs them:

Presumably, if a congressional staffer helps his or her boss win a major legislative battle, that staffer's reputation would rise—and, quite possibly, so would his or her future earnings. Thus, if a congressional staffer discloses, say, a nonpublic draft bill to a think-tanker or activist for the purpose of aiding the recipient's efforts to support or defeat the legislation, it is certainly plausible that a court might find that the disclosure was for personal benefit.²⁰⁰

Others have zeroed in on politicians and their continual need to raise campaign funds, with one attorney bemoaning that “[w]here the recipient of the information is a past or future campaign contributor, a fact finder might be asked to infer the requisite intent to benefit

198. Mullins & Ackerman, *supra* note 28.

199. Stephen Bainbridge, *Quoted re STOCK Act's Impact on Political Intelligence*, PROFESSORBAINBRIDGE.COM (Feb. 16, 2012, 11:18 AM), <http://www.professorbainbridge.com/professorbainbridgecom/2012/02/quoted-re-stock-acts-impact-on-political-intelligence.html>.

200. John Berlau, *The STOCK Act and the SEC*, NAT'L REV. ONLINE (Feb. 21, 2012, 2:00 PM), <http://www.nationalreview.com/articles/291570/stock-act-and-sec-john-berlau?pg=2>.

established by that fact alone, even without any direct evidence of a quid pro quo.”²⁰¹ He therefore warns that:

Given the very wide net potentially cast by insider trading law, one can expect prosecutors and the Securities and Exchange Commission to take the position that under the STOCK Act, if a member or staff person discloses to a member of the public material nonpublic information obtained during the course of the member or staff’s congressional duties, and the constituent trades on the information, both the member and the constituent have committed insider trading.²⁰²

Another attorney, referencing the difficulties that inhere in making determinations of materiality, went so far as to advise securities traders “to treat all non-public information learned from a member of Congress or their staff as material confidential information subject to the restrictions of the [STOCK Act].”²⁰³

We highly doubt, for several reasons, that securities law enforcers and courts will construe Section 10(b) and Rule 10b-5 in a manner that validates these predictions and cautionary warnings. Instead, we would expect to see SEC and DOJ prosecutions of federal officials (or securities traders who use government information) only in those rare instances involving either gifts of information to relatives or personal friends, or explicit quid pro quos involving identifiable personal benefits beyond enhanced reputations and the mere possibility of future political support or campaign contributions. We draw our analysis from three distinct areas: the SEC’s experience with selective disclosure in the private sector, the constitutional limitations that courts have placed on other statutes that implicate political speech and other interactions between government officials and members of the public, and the STOCK Act’s “Rule of Construction” provision.

a. An object lesson from the private sector

Although a full exploration of selective disclosure in the private sector is set forth in Part II, its object lesson can be encapsulated here.

201. Peter G. Neiman, *Is the STOCK Act Constitutional?*, N.Y. L.J. (Mar. 27, 2012), http://www.newyorklawjournal.com/PubArticleNY.jsp?id=1202546944492&Is_the_STOCK_Act_Unconstitutional&slreturn=20121016175848 (available at LexisNexis).

202. *Id.*

203. Joshua Horn, *The STOCK Act Presents Pitfalls for the Private Sector*, THOMSON REUTERS NEWS & INSIGHT (May 17, 2012), http://newsandinsight.thomsonreuters.com/Securities/Insight/2012/05_-_May/The_STOCK_Act_presents_pitfalls_for_the_private_sector/.

Until Regulation FD took effect in 2000, securities issuers and their corporate executives routinely put ordinary investors at a disadvantage by leaking material nonpublic information about corporate earnings and other developments to securities analysts who shared the information with professional investors who then traded. The SEC's struggle to end selective disclosure in the private sector demonstrates that communications, which arguably serve legitimate purposes, will effectively escape regulation under Section 10(b) and Rule 10b-5. As Part II elucidates, *Dirks* created an antifraud safe harbor that insulates most communications between corporate executives and securities analysts because its personal benefit test implicates only those disclosures that evidenced a breach of an insider's duty of loyalty. And corporate officials who have business-related reasons for sharing material nonpublic information with securities analysts are not acting disloyally (i.e., in breach of their duty of trust and confidence), even if their own professional reputations are enhanced along the way.

Dirks' safe harbor for selective disclosure in the public sector likely runs even wider and deeper than it does in the corporate world because goodwill, professional reputation, and fundraising are integral parts of American politics. The member of Congress, the legislative aide, the Cabinet official, or the agency staff member who briefs interested parties on the status of pending legislation or regulation is making the operations of government more transparent (albeit selectively and thus, oftentimes, unfairly vis-à-vis the rest of the public).²⁰⁴ Additionally, through the solicitation of feedback, the federal official may be making the government more effective.²⁰⁵ It is hardly surprising that goodwill, enhanced professional reputation, or future political support or campaign contributions typically result from those interchanges. But the relevant question under *Dirks* and *O'Hagan* is whether these results constitute *improper* personal benefits: do they evidence a breach of the federal official's duty of loyalty through his or her misuse of the government's information?²⁰⁶ In the context of a political system that turns on electoral campaigns financed largely through individual and corporate donations, these typical upshots of meetings and briefings are not likely to be construed as "exploitation of nonpublic information" for personal gain absent clear evidence of an

204. See *infra* Part III.A.

205. See *supra* note 121.

206. See *infra* note 283 and accompanying text (pointing to Justice Harry Blackmun's observation in *Dirks* that an enhanced reputation in the abstract was not sufficient to satisfy the majority's own test for fraudulent tipping).

explicit quid pro quo.²⁰⁷ Thus, as they do with communications between corporate executives and securities analysts, *Dirks* and *O'Hagan* set a standard that renders most selective disclosures of nonpublic government information—and most securities trading based on such disclosures—beyond the reach of the prohibitions in Section 10(b) and Rule 10b-5.

b. Constitutional considerations

Even if courts and securities law enforcers were otherwise inclined to view enhanced reputation and the possibility of future political support or campaign contributions as improper personal benefits within the meaning of *Dirks* and *O'Hagan*, constitutional considerations would, in many instances, preclude them from doing so. Indeed, the Constitution requires substantial “breathing space”²⁰⁸ for communications between federal officials and members of the public because “speech on public issues occupies ‘the highest rung of the hierarchy of First Amendment values,’ and is entitled to special protection.”²⁰⁹ This special protection for political speech takes the form of strict scrutiny and is warranted because “speech concerning public affairs is more than self-expression; it is the essence of self-government.”²¹⁰ Thus, in drawing the line between fraudulent tipping and unfair selective disclosure, “the First Amendment requires [courts] to err on the side of protecting political speech rather than suppressing it.”²¹¹

Interactions between federal officials and the media are yet another area in which First Amendment protections are likely to apply. The right to freedom of the press would make it exceedingly difficult for the SEC or DOJ to prosecute journalists for republishing nonpublic market-moving government information²¹² and this protection would likely extend to financial newsletters, including those having a narrow subscription base principally of hedge funds and other professional investors.²¹³ It is also highly unlikely that the SEC or DOJ would

207. See *supra* note 163 and accompanying text (quoting *Dirks v. SEC*, 463 U.S. 646, 664 (1983)).

208. *NAACP v. Button*, 371 U.S. 415, 433 (1963).

209. *Connick v. Myers*, 461 U.S. 138, 145 (1983) (quoting *Carey v. Brown*, 447 U.S. 455, 467 (1980)).

210. *Garrison v. Louisiana*, 379 U.S. 64, 74–75 (1964).

211. *FEC v. Wis. Right to Life*, 551 U.S. 449, 457 (2007). See generally Neiman, *supra* note 201.

212. See generally *infra* note 411 and accompanying text.

213. See Alfred C. Aman, Jr., *SEC v. Lowe: Professional Regulation and the First Amendment*, 1985 SUP. CT. REV. 93, 95–96.

pursue legal actions against federal officials for selective disclosure in circumstances where related actions against the media organizations or their subscribers for trading on the information would be unsuccessful.²¹⁴

In addition to the heightened constitutional scrutiny that is accorded to political speech and a free press, several other constitutional protections militate in favor of a narrow construction of Section 10(b) and Rule 10b-5 when the selective disclosure of government information is at issue. The First Amendment likewise protects “the right of the people . . . to petition the Government for a redress of grievances”²¹⁵ and, as constitutional scholars have observed, the Petitions Clause has been treated as a right “to participate fully in the political process, free from threats or reprisals.”²¹⁶ Communications with members of Congress or their staffs and members of the public may also draw special protection from the Speech or Debate Clause,²¹⁷ which extends not only to actual speech or debate by members of Congress, but also to those actions (including actions by staffers) “related to the due functioning of the legislative process.”²¹⁸ In addition, our representative democracy, which is reflected in the Constitution’s very structure, may warrant a narrow interpretation of Section 10(b) and Rule 10b-5 that avoids undue interference with interactions between federal officials and citizen-investors.

Although the Constitution’s interplay with *Dirks* and *O’Hagan* has yet to be explored in a government tipping case, personal benefit questions arise frequently in other political corruption cases and courts have taken great care to avoid construing federal statutes, such as those

214. However, as illustrated by the recent phone-hacking scandal in the United Kingdom involving the Murdoch press organization, there are limits to what the press can do to obtain government information: even the press cannot pay bribes to governmental officials in return for information. See Amy Chozick, *A Scandal Starts to Hem in Murdoch’s Empire*, N.Y. TIMES, Apr. 30, 2012, at A1.

215. U.S. CONST. amend. I.

216. James E. Pfander, *Sovereign Immunity and the Right to Petition: Toward a First Amendment Right to Pursue Judicial Claims against the Government*, 91 NW. U. L. REV. 899, 904 (1997).

217. U.S. CONST. art. I, § 6, cl. 1 (“[F]or any Speech or Debate in either House, [Senators and Representatives] shall not be questioned in any other Place.”).

218. *United States v. Johnson*, 383 U.S. 169, 172 (1966); see also *United States v. Brewster*, 408 U.S. 501, 512 (1972) (“A legislative act has consistently been defined as an act generally done in Congress in relation to the business before it.”); *Gravel v. United States*, 408 U.S. 606, 618 (1972) (“[T]he Speech or Debate Clause applies not only to a Member but also to his aides insofar as the conduct of the latter would be a protected legislative act if performed by the Member himself.”).

that prohibit bribery,²¹⁹ illegal gratuities,²²⁰ or extortion²²¹ in a manner that criminalizes ordinary politics.²²² Individuals and corporations, for example, have a First Amendment right to contribute to political campaigns and causes, and politicians have an ancillary right to solicit such contributions.²²³ The Supreme Court has therefore concluded that a connection between a campaign contribution and an official action can evidence a crime “only if the payments are made in return for an *explicit promise or undertaking* by the official to perform or not to perform an official act.”²²⁴ If federal statutes specifically designed to curtail political corruption cannot be construed in a way that unconstitutionally restricts or excessively chills the rights to free speech, expression, and political participation, surely the same is true for the antifraud provisions of the federal securities laws.

c. The STOCK Act’s rule of construction

The STOCK Act itself contains interpretative guidance when the communication of material nonpublic government information is at issue. Captioned a “Rule of Construction,” Section 10(2) provides that nothing in the Act shall be construed to “be in derogation of the obligations, duties, and functions of a Member of Congress, an

219. 18 U.S.C. § 201(b)(1)(a) (2006) (making it a crime for both the offeror and the public official to corruptly engage in a transfer of anything of value with the intent to influence any official act).

220. § 201(c) (making it a crime to provide (or accept) a gratuity “for or because of” the official’s performance of an official act “otherwise than as provided by law for the proper discharge of official duty”).

221. Hobbs Act, 18 U.S.C. § 1951(a)-(b) (2006) (making it a crime to obtain property with the consent of the victim “under color of official right”).

222. See PETER J. HENNING & LEE J. RADEK, *THE PROSECUTION AND DEFENSE OF PUBLIC CORRUPTION* 37–47, 107–121 (2011). Despite the care taken, many have urged the Supreme Court to better clarify what constitutes quid pro quo corruption. See, e.g., Brief of Richard F. Scruggs as Amicus Curiae in Support of Petitioner, *Siegelman v. United States*, No. 11-955 (U.S. Mar. 1, 2012), 2012 WL 707060 at *17–19. See generally Daniel H. Lowenstein, *When Is a Campaign Contribution a Bribe?*, in *PRIVATE AND PUBLIC CORRUPTION* 127 (William C. Heffernan & John Kleining eds., 2004).

223. See generally *Buckley v. Valeo*, 424 U.S. 1, 22 (1976) (“Making a contribution, like joining a political party, serves to affiliate a person with a candidate. In addition, it enables like-minded persons to pool their resources in furtherance of common political goals.”).

224. *McCormick v. United States*, 500 U.S. 257, 273 (1991) (emphasis added); see also *United States v. Allen*, 10 F.3d 405, 411 (7th Cir. 1993) (“[A]ccepting a campaign contribution does not equal taking a bribe unless the payment is made in exchange for an explicit promise to perform or not perform an official act. Vague expectations of some future benefit should not be sufficient to make a payment a bribe.”).

employee of Congress, an executive branch employee, a judicial officer, or a judicial employee, arising from such person's official position."²²⁵ A construction of the Act's "duty of trust and confidence" that renders enhanced reputation and the mere possibility of future political support or campaign contributions as improper personal benefits within the meaning of *Dirks* and *O'Hagan* could well impede federal officials from functioning effectively. Government functions could be impeded because federal officials would operate under the cloud of a possible fraud prosecution whenever they reveal nonpublic information in meetings or briefings with members of the public who could trade securities. As Part III explains, federal officials have a host of legitimate reasons for selectively sharing nonpublic information with broad ranges of individuals and entities.²²⁶

The legislative history concerning Section 10 of the STOCK Act is sparse. The little that exists consists primarily of a colloquy between Senators Harry Reid and Joseph Lieberman that occurred immediately before the Senate's final vote on the Act.²²⁷ Senator Reid began the exchange with the observation that "the STOCK Act should not be interpreted as limiting government transparency in any way. Discourse with the public, whether privately or publicly, is vital to maintaining a healthy democratic society."²²⁸ Senator Lieberman concurred, emphasizing his "agree[ment] that the STOCK Act is not intended to . . . hinder dissemination of information to interested parties regarding Congressional activities and deliberations."²²⁹ Both senators then sought to ameliorate concerns about "significant chilling effect[s]" by referencing conversations with the SEC that "explicitly clarified that it does not view the STOCK Act as creating new limitations on the disclosure of Congressional information in conversations with constituents."²³⁰

The STOCK Act's Rule of Construction, read in light of this legislative history, reflects an intention by Congress to insulate from Section 10(b) and Rule 10b-5 liability at least some communications that federal officials can be expected to make in the course of their official duties. It therefore obliges courts, as well as the SEC and the

225. STOCK Act, Pub. L. No. 112-105, § 10(2), 126 Stat. 291, 298 (2012) (to be codified at 5 U.S.C. § 101 (2012)).

226. See *infra* Part III.A.

227. See Robert L. Walker, *The STOCK Act: Insider Trading on Government Information; Corporate and Individual Compliance Concerns*, WILEY REIN LLP (Apr. 4, 2012), www.wileyrein.com/publications.cfm?sp=articles&id=7953.

228. 158 CONG. REC. S1980 (daily ed. Mar. 22, 2012) (statement of Sen. Harry Reid).

229. *Id.* (statement of Sen. Joseph Lieberman).

230. *Id.* (statement of Sen. Harry Reid).

DOJ, to proceed with extraordinary care in distinguishing between fraudulent tipping and lawful, though frequently unfair, selective disclosure.

C. Legislative Proposals beyond the STOCK Act

The STOCK Act includes an important provision requiring the Comptroller General, who heads the GAO, to perform a study and report to Congress within one year “on the role of political intelligence in the financial markets.”²³¹ The report must discuss, among other matters, the extent to which securities investors are buying and relying on political intelligence, and the “legal and practical issues that may be raised by the imposition of disclosure requirements on those who engage in political intelligence activities.”²³² The Act defines “political intelligence” as:

information that is—(1) derived by a person from direct communications with an executive branch employee, a Member of Congress, or an employee of Congress; and (2) provided in exchange for financial compensation to a client who intends, and who is known to intend, to use the information to inform investment decisions.²³³

This mandate for a GAO study replaced two related proposals for legislative action in earlier iterations of the STOCK Act, including the original version, which was introduced in the House in 2006 by United States Representatives Brian Baird (D-Wash.) and Louise M. Slaughter (D-N.Y.).²³⁴ One proposal would have applied the Lobbying Disclosure Act (LDA)²³⁵ to political intelligence consultants, requiring them to register and make public disclosures about their political intelligence activities.²³⁶ The other proposal would have amended the federal securities laws to include a broad ban on securities trading on the basis of material nonpublic government information.²³⁷ Although both proposals are well-intentioned attempts to go beyond the STOCK Act to curtail securities trading on selectively disclosed government

231. STOCK Act, Pub. L. No. 112-105, § 7(a)(1), 126 Stat. 291, 294 (2012). The Act requires the Comptroller General to work in consultation with the Congressional Research Service. *Id.*

232. § 7(a)(2)(F).

233. § 7(b).

234. STOCK Act, H.R. 5015, 109th Cong. (2006).

235. Lobbying and Disclosure Act of 1995, 2 U.S.C. § 1601 (2006).

236. H.R. 5015 § 4.

237. H.R. 5015 § 2(a).

information, each places the burden entirely on the private sector and neither tackles the problem at its root, which is the federal government's own lack of effective internal controls regarding its dissemination of material nonpublic information.

1. REGISTRATION AND DISCLOSURE REQUIREMENTS FOR POLITICAL INTELLIGENCE CONSULTANTS

Both the original Baird-Slaughter STOCK Act bill and the version of the bill that passed the Senate on February 2, 2012, contained a provision that would have regulated political intelligence gathering in a manner similar to lobbying activity.²³⁸ Specifically, the political intelligence provision in the Senate's bill of February 2, 2012 (which passed as an amendment sponsored by Senator Grassley²³⁹), would have amended the LDA to require registration of "political intelligence firm[s]" and public reporting of "political intelligence activities."²⁴⁰ Political intelligence activities included "political intelligence contacts" as well as "efforts in support of such contacts."²⁴¹ And the term "political intelligence contact" was broadly defined to include "any oral or written communication . . . to or from a covered executive branch official or a covered legislative branch official" that results in information "intended for use in analyzing securities or commodities markets, or in informing investment decisions, and which is made on behalf of a client" regarding: (1) "the formulation, modification, or adoption" of any federal legislation "including legislative proposals;" (2) any "Federal rule, regulation . . . policy, or position of the United

238. H.R. 5015; 158 CONG. REC. S310-15 (daily ed. Feb. 2, 2012). Representatives Baird and Slaughter reintroduced a similar bill in 2009. H.R. 682, 111th Cong. (2009). In 2011, the bill was again reintroduced with Representative Tim Walz (D-Minn.) joining Slaughter as its principal cosponsor after Representative Baird's retirement from office. H.R. 1148, 112th Cong. (2011); *see also* Nagy, *supra* note 25, at 1130-31 (recounting the STOCK Act's origins). The STOCK Act bill that passed the Senate on February 2, 2012, was brought to the floor by the Homeland Security and Governmental Affairs Committee, led by Chairman Joseph Lieberman (I-Conn.) and ranking member Susan Collins (R-Me.). 158 CONG. REC. S310 (daily ed. Feb. 2, 2012). Senators Kirsten Gillibrand (D-N.Y.) and Scott Brown (R-Mass.) were the lead Senate co-sponsors. *Id.* at S291.

239. 158 CONG. REC. S296-97 (daily ed. Feb. 2, 2012) (statement of Sen. Charles Grassley).

240. *Id.* at S313. The term "political intelligence firm" is defined to mean "a person or entity that has 1 or more employees who are political intelligence consultants to a client other than that person or entity" and the term "political intelligence consultant" is defined to mean "any individual who is employed or retained by a client for financial or other compensation for services that include *one or more* political intelligence contacts." *Id.* (emphasis added).

241. *Id.*

States Government;” or (3) “the administration or execution of a Federal program or policy,” including contracts, grants, loans, and licenses.²⁴² Communications made by or to media representatives, however, would not be deemed a political intelligence contact, “if the purpose of the communication is gathering and disseminating news and information to the public.”²⁴³

The Senate’s proposed political intelligence provision was then dropped from the STOCK Act bill that passed the House by a vote of 417-2 on February 9, 2012.²⁴⁴ Although many members in both chambers had urged the creation of a joint conference committee to reconcile the differences between the House and Senate versions,²⁴⁵ Senate leadership instead chose to vote on the bill that the House had passed without any further amendments.²⁴⁶ This House version—with the GAO study, but without the section regulating political intelligence—passed the Senate 96-3 on March 22, 2012,²⁴⁷ and the bill became law on April 4, 2012.²⁴⁸

Notwithstanding Congress’s decision in the STOCK Act to study political intelligence before attempting to regulate it, legislative efforts to require registration and reporting have continued. In the House, Congresswoman Slaughter, together with her colleagues Tim Walz (D-Minn.) and Mike Quigley (D-Ill.), are cosponsoring the Restore Public Trust Act, which includes a section that would apply the LDA to political intelligence firms;²⁴⁹ in the Senate, Charles Grassley and Kirsten Gillibrand (D-N.Y.) are expected to introduce their own bill.²⁵⁰ Describing the GAO study as a way to “kick[] the can down the road for another year,”²⁵¹ Senator Grassley is urging speedy action for a “straightforward” reason: “if trades are taking place based on ‘political

242. *Id.* (emphasis added).

243. *Id.*

244. 158 CONG. REC. H645–48, H657 (daily ed. Feb. 9, 2012); *see also* Rachel Bade, *Two Senators Blast Cantor over Dropped Provisions in Insider-Trading Bill*, CQ TODAY, Feb. 8, 2012, *available at* 2012 WLNR 308486.

245. *See* Richard E. Cohen, *Lawmakers Push for Conference Committee on Insider-Trading Measure*, CQ TODAY, Feb. 16, 2012, *available at* 2012 WLNR 3767180.

246. *See* Pear, *supra* note 23.

247. 158 CONG. REC. S1981 (daily ed. Mar. 22, 2012).

248. Remarks on Signing the Stop Trading on Congressional Knowledge Act of 2012, 2012 DAILY COMP. PRES. DOC. 247 (Apr. 4, 2012), *available at* <http://www.gpo.gov/fdsys/pkg/DCPD-201200247/pdf/DCPD-201200247.pdf>.

249. H.R. 4054, 112th Cong. § 101 (2012).

250. *See* Bridgette Blair, *STOCK Act Becomes Law*, PUBLIC CITIZEN NEWS, May/June 2012, at 1, 16.

251. 158 CONG. REC. S1966 (daily ed. Mar. 22, 2012) (statement of Sen. Charles Grassley).

intelligence’ . . . obtained from Congress or the executive branch, people in this country should know who is gathering such information.”²⁵²

At first blush, requiring public reporting of certain political intelligence activities seems sensible, because the information in those reports would put federal officials, the media, and the general public on notice as to the persons and entities seeking to profit from selective disclosure. But, as with most legislation, the devil is in the details and the details contained in the new Slaughter-Walz-Quigley bill—which mirrors the political intelligence section that was omitted from the STOCK Act—raise a host of concerns.

One concern involves the scope of the phrase “political intelligence contacts.”²⁵³ The definition is considerably overinclusive, extending well beyond the firms and persons performing the type of behind-closed-doors gathering and/or brokering of inside connections that has been profiled in the media.²⁵⁴ The proposed legislation’s sweeping registration requirement, coupled with its cumbersome reporting obligations, will likely burden a wide range of persons who are principally interested in gathering information as to what their government is doing. While these people may be engaged in securities or commodities trading, they may also be engaged in affecting change for the public interest.

Consider a private foundation, a university, a church, or some other organization that is interested in learning about how government activities will affect commercial or societal interests that are vital to the organization. Assume the organization also invests in the securities markets. If the organization hires a person to gather information about prospective government policies, does that person have to register and report? The proposed definition of “political intelligence activities” focuses on information gathered for the purpose of investment decisions and the person gathering the information may have been hired principally to help the organization form a strategy for responding to government actions. But the gatherer also may have no idea how the information will actually, or ultimately, be used. Accordingly, to be on the safe side, the gatherer may feel compelled to register as a political intelligence consultant simply because his or her client trades in securities markets. Then, whenever the registered consultant has a “political intelligence contact,” he or she will have to report both the nature of the contact and the client who is benefitting from that contact.

252. 158 CONG. REC. S487 (daily ed. Feb. 9, 2012) (statement of Sen. Charles Grassley).

253. See *supra* note 242 and accompanying text.

254. See *supra* Part I.A.2–3.

Moreover, the proposed definition of a “political intelligence consultant”—which extends to a person who simply makes a single contact requesting information from a federal official²⁵⁵—is far more expansive than the LDA’s definition of “lobbyist,” which excludes any “individual whose lobbying activities constitute less than 20 percent of the time engaged in the services provided by such individual to [a] client over a 3-month period.”²⁵⁶

Another concern involves the linkage of “political intelligence contacts” to any information informing an “investment decision,” even if that decision is not in any way related to securities trading. Consider a manufacturing corporation that hires a consultant to meet with senior officials at the EPA to garner insights about environmental compliance. Assume the corporation receives some guidance and then makes a capital investment decision based on what the consultant reports. Or consider a businessperson who retains someone to meet with her congressman to inquire about whether military base X is likely to be closed. Assume that the businessperson learns that the base is likely to remain open and then she uses that information to decide whether to invest in a new store in location A near base X. These are surely investment decisions, but posing those questions to a member of Congress and making investment decisions based on that information hardly undermines investor confidence in the securities markets or in government. Yet, the information gatherers may well be obliged to register and report under the Slaughter-Walz-Quigley bill as currently written.

On the other hand, people truly in the political intelligence business will have an incentive to avoid registration and reporting under the LDA and they will be eager to capitalize on statutory loopholes. The proposed blanket exemption for the media²⁵⁷ is one potential avenue of abuse because many news outlets serve a narrow subscription base of securities investors or give high-paying subscribers early notice of news developments.²⁵⁸ Differentiating among news organizations—and requiring some to register and allowing others to use the exemption—is not something any government official should be expected to do without bias and trepidation. News organizations often have an enormous influence over whether government officials get to keep their jobs.

It is possible, of course, that with the benefit of insight and guidance from the GAO study, these and other drafting issues can be

255. See *supra* note 240 and accompanying text.

256. Lobbying Disclosure Act of 1995, 2 U.S.C. § 1602(10) (2006).

257. See *supra* note 243 and accompanying text.

258. See *infra* Part III.B.6.

resolved in a manner that would focus more precisely on regulating the professional political intelligence consultants who comprise the industry generating more than a \$100 million annually.²⁵⁹ But no amount of targeted sunshine on the political intelligence industry will be an adequate substitute for better internal controls on the federal government's own dissemination of material nonpublic information.

2. AN OUTRIGHT BAN ON SECURITIES TRADING BASED ON MATERIAL NONPUBLIC GOVERNMENT INFORMATION

In addition to a section regulating political intelligence, prior versions of the STOCK Act also included a section that would have effectively banned any hedge fund, professional investor, or individual investor from trading securities on the basis of material nonpublic government information. For instance, the Slaughter-Walz bill,²⁶⁰ which garnered a remarkable 285 cosponsors in the House in the aftermath of the *60 Minutes* segment,²⁶¹ would have required the SEC to promulgate new rules under Section 10 of the Exchange Act prohibiting "any person from buying or selling the securities or security-based swaps of any issuer while such person is in possession of material nonpublic information" derived from Federal employment and relating to such information, if such person knew "that the information was so obtained" from a federal officer or employee.²⁶² Thus, under the broad statutory language in this proposed provision, liability for insider trading would not have turned on a showing that a federal officer or employee had breached a duty of trust and confidence in selectively disclosing the information to the person who traded. Instead, the proposed ban on securities trading would have extended even to

259. See *supra* note 40 and accompanying text.

260. H.R. 1148, 112th Cong. (2011).

261. See *supra* note 21; H.R. 1148 – STOCK bill ("STOCK Act"), OPENCONGRESS, <http://www.opencongress.org/bill/112-h1148/show> (last visited Nov. 10, 2012).

262. H.R. 1148 § 2(b). The bill proposed amending the Exchange Act with a new Section 10(d), captioned "Nonpublic Information Relating to Congress," and a new Section 10(e), captioned "Nonpublic Information Relating to Other Federal Employees." *Id.* However, as proposed, Section 10(d)'s application to Congress would have extended the trading prohibition only to material nonpublic information "relating to any pending or prospective legislation action relating to such issuer." *Id.*; see also Bainbridge, *supra* note 25, at 306 (pointing out that much market-moving congressional knowledge does not in any way pertain to legislative action); Nagy, *supra* note 25, at 1133–34.

material nonpublic government information that been disclosed to a recipient in good faith for an entirely legitimate reason.²⁶³

An outright ban on securities trading while a person is aware of material nonpublic information obtained from federal officials would have been a radical departure from existing federal securities law, to say the least. Had Congress adopted this ban, it would have essentially reinstated, for government information, the parity-of-information approach to securities fraud liability that the Court had rejected emphatically in *Chiarella*.²⁶⁴ The federal law governing insider trading in securities is confusing enough without dual tracks setting forth different prohibitions based on the identity of the source of the information.²⁶⁵

Beyond that, an outright ban on securities trading while a person is aware of material nonpublic information obtained from federal officials—which would be enforceable through SEC or DOJ actions—would undoubtedly discourage many citizens from using lawful means to gather political information. Many people could fear that federal officials would respond to their efforts by encouraging an SEC or DOJ investigation into their investment activities. The result would likely be a government that is far less transparent to its constituents and securities markets that are substantially less efficient.²⁶⁶ Our proposed

263. Just like in Rule 14e-3 insider trading cases involving tender offer-related information, the proposed ban could have extended even to material nonpublic government information that had been overheard in a Capitol Hill restaurant, provided that the lucky listener knew that his source was a federal officer or employee. *Cf. United States v. Chestman*, 947 F.2d 551, 557 (2d Cir. 1991) (en banc) (“Rule 14e-3 is a disclosure provision. It creates a duty in those traders who fall within its ambit to abstain or disclose, without regard to whether the trader owes a pre-existing fiduciary duty to respect the confidentiality of the information.”). The SEC Exchange Act Section 14(e)’s authority to regulate securities trading in the context of tender offers, however, is considerably broader than its authority to regulate fraudulent securities trading under Section 10(b). *See United States v. O’Hagan*, 521 U.S. 642, 673 (1997).

264. *See supra* notes 151–152 and accompanying text.

265. For critical assessments of existing jurisprudence, see, for example, Jill E. Fisch, *Start Making Sense: An Analysis and Proposal for Insider Trading Regulation*, 26 GA. L. REV. 179, 179 (1991) (“[T]he legal restrictions on trading securities while in possession of material nonpublic information are confused and confusing.”); Thomas Lee Hazen, *Identifying the Duty Prohibiting Outsider Trading on Material Nonpublic Information*, 61 HASTINGS L.J. 881, 883 (2010) (observing that there are “hundreds of decisions grappling” with insider trading’s fraud-based rubric and that “[m]any of these decisions are confusing and inconsistent with one another”); and Saikrishna Prakash, *Our Dysfunctional Insider Trading Regime*, 99 COLUM. L. REV. 1491, 1498 (1999) (“[T]he SEC’s dysfunctional regulatory strategy brings to mind unpleasant images of Cinderella’s stepsisters who each chopped off portions of a foot in order to stuff the foot into Cinderella’s shoe.”).

266. *See infra* notes 284–286 and accompanying text (discussing the Court’s concern in *Dirks* that an overly broad insider trading prohibition would deter analysts

FGD regime—which attends to the way in which government insiders disclose information, rather than what the way in which outsiders gather and use that information—provides a superior alternative.

II. SELECTIVE DISCLOSURE IN THE PRIVATE SECTOR

Our law has no tolerance for favoritism. It holds no place for privilege. Everyone deserves a fair shot at success in our nation's securities markets. Well-connected people don't deserve any greater chance for success than the average citizen. Nor do the friends and relatives of those well-placed people, who may reap unfair profits because they happen to know the news before it breaks. The process of capital formation is not an insider's game run for a select group of those "in the know." It's an expression of our democracy's faith in fundamental fairness. It's simply a question of integrity.

—SEC Chairman Arthur Levitt²⁶⁷

SEC Chairman Arthur Levitt's remarks could well have been directed at federal officials who facilitate securities trading on the basis of selectively disclosed government information. But when he was admonishing favoritism and privilege in February 1998, his appeal to integrity was targeted at corporate officials in the private sector and their lawyers. Securities analysts and professional investors had been reaping enormous profits from trading on the basis of nonpublic corporate information pertaining to earnings and other developments, which CEOs and other executives had been sharing routinely in advance of public announcements. The SEC considered such selective disclosure to be an unfair practice that undermined investor confidence in the securities markets. But it was struggling to prevent it because these executives were rarely misusing the issuer's information in violation of Section 10(b) and Rule 10b-5.

Regulation FD created new disclosure obligations on the part of publicly traded companies and thereby eliminated special trading

from gathering corporate information, which is an activity essential to the preservation of efficient securities markets); Donald C. Langevoort, *Investment Analysts and the Law of Insider Trading*, 76 VA. L. REV. 1023, 1024 (1990) (observing that *Dirks*, and much of the academic commentary that followed sought legal rules that would encourage searches for useful and accurate information, which would in turn be "reflected in the prevailing market price of the issuer's securities, to society's benefit").

267. Arthur Levitt, Chairman, SEC, A Question of Integrity: Promoting Investor Confidence by Fighting Insider Trading, SEC Speaks Conference (Feb. 27, 1998).

privileges for securities analysts and their clients. The result is that today, more than a decade later, investors operate on a playing field that is no longer as tilted toward those with special access to corporate executives. But this positive development did not result from the application of laws proscribing insider trading. Instead, securities markets became fairer only when the SEC turned its focus to regulating issuers and the means and manner by which they disclose material nonpublic information. Given the federal government's own problems with unfair selective disclosure, the private sector's experience is enormously instructive.

A. Corporate Executives and Securities Analysts

1. THE SAFE HARBOR IN *DIRKS*

Prior to the Supreme Court's decision in *Dirks v. SEC*, securities analysts enjoyed no particular privilege vis-à-vis the insider trading prohibitions arising under Section 10(b) and Rule 10b-5. Throughout the 1970s, lower courts and the SEC embraced the so-called parity-of-information approach to insider trading,²⁶⁸ and this broad interpretation of Rule 10b-5 liability essentially prohibited analysts and their clients from trading securities based on material nonpublic information that had been selectively disclosed by corporate officials. Even in this pre-classical theory period, courts had recognized that analysts performed "a needed service in culling and sifting available data, viewing it in light of their own knowledge of a particular industry and ultimately furnishing a distilled product in the form of reports."²⁶⁹ But those valuable contributions to market efficiency were not viewed as a reason for relaxing the parity-of-information rule. Thus, corporate executives who shared material nonpublic information with securities analysts incurred liability for illegal tipping and the securities analysts or clients who traded on the basis of selectively disclosed information incurred liability for illegal trading.²⁷⁰ As famously characterized by the

268. See *supra* note 151 and accompanying text (quoting the Second Circuit's holding in *SEC v. Texas Gulf Sulphur*, 401 F.2d 833 (2d Cir. 1968)).

269. *SEC v. Bausch & Lomb, Inc.*, 420 F. Supp. 1226, 1230 (S.D.N.Y. 1976), *aff'd*, 565 F.2d 8 (2d Cir. 1977).

270. See, e.g., *Elkind v. Liggett & Myers, Inc.*, 635 F.2d 156, 167-68 (2d Cir. 1980) (Chief Financial Officer violated Rule 10b-5 when he responded to an analyst's question with the material nonpublic information that earnings would be down); *Bausch*, 565 F.2d at 18-19 (corporate executive violated Rule 10b-5 by sharing material nonpublic information with analyst, but holding that the SEC's request for an injunction was not warranted); *SEC v. Geon Industries, Inc.*, 531 F.2d 39, 42-43 (2d Cir. 1976) (CEO violated Rule 10b-5 by disclosing merger-related information in

Second Circuit in *SEC v. Bausch & Lomb, Inc.*,²⁷¹ discussions were akin to “a fencing match conducted on a tightrope” where corporate executives were “compelled to parry often incisive questioning [by securities analysts] while teetering on the fine line between data properly conveyed and material inside information that may not be revealed without simultaneously disclosing it to the public.”²⁷²

When the Court decided *Dirks* in 1983, however, insider trading liability under Section 10(b) and Rule 10b-5 was grounded entirely in *Chiarella*'s classical theory,²⁷³ which focused on the breach of a disclosure duty arising from a relationship of trust and confidence “between the shareholders of a corporation and those insiders who have obtained confidential information by reason of their position with that corporation.”²⁷⁴ But *Dirks* then extended *Chiarella*'s holding to certain tippees of corporate insiders who could be viewed as coparticipants in an insider's breach of duty to shareholders.²⁷⁵ And, according to *Dirks*, disclosure by an insider to a person outside the corporation constituted a breach of duty only when the insider was acting for a direct or indirect personal benefit.²⁷⁶

The *Dirks* case had been a pivotal one for the securities industry because the petitioner, Raymond Dirks, was a securities analyst who had advised clients to sell securities based on highly negative information relayed to him by corporate executives.²⁷⁷ The SEC urged the Court to hold the analyst liable under Section 10(b) and Rule 10b-5 for “aiding and abetting” his clients' trading.²⁷⁸ But pursuant to its

response to “broker's questions” posed by a registered representative who then traded for himself and seventeen clients); *SEC v. Lum's, Inc.*, 365 F. Supp. 1046, 1058 (S.D.N.Y. 1973) (issuer and its President/Chief Operating Officer violated Rule 10b-5 when disclosures were made to an institutional salesman, who shared the material nonpublic information with trading clients); *Investors Mgmt. Co.*, 44 S.E.C. 633, 645-46 (1971) (investment advisers violated Rule 10b-5 when they traded securities on the basis of material nonpublic information obtained from broker-dealer retained by securities issuer); see also Langevoort, *supra* note 266, at 1027 (discussing selective disclosure in the early stages of Rule 10b-5's doctrinal development).

271. 565 F.2d 8 (2d Cir. 1977).

272. *Id.* at 9. Teetering was necessary because, even under a parity-of-information view of insider trading, analysts were allowed to obtain immaterial nonpublic information for purposes of “filling interstices in analysis.” *Investors Mgmt. Co.*, 44 S.E.C. at 646.

273. *Dirks v. SEC*, 463 U.S. 646, 659 (1983).

274. *Chiarella v. United States*, 445 U.S. 222, 228 (1980).

275. *Dirks*, 463 U.S. at 664.

276. See *supra* Part I.B.2.

277. *Dirks*, 463 U.S. at 648-51.

278. *Id.* at 651 (quoting the SEC's position that “[w]here ‘tippees’—regardless of their motivation or occupation—come into possession of material ‘corporate information that they know is confidential and know or should know came from a

personal benefit test for tipper/tippee liability, the Court found that the analyst had no duty to abstain from using the information.²⁷⁹ The information pertained to a widespread fraud that had been occurring at the Equity Funding Corporation, and the Court found that the current and former insiders who had revealed the fraud to the analyst had not acted improperly for a personal benefit.²⁸⁰ As the Court explained:

The tippers received no monetary or personal benefit for revealing Equity Funding's secrets, nor was their purpose to make a gift of valuable information to Dirks. As the facts of this case clearly indicate, the tippers were motivated by a desire to expose the fraud. In the absence of a breach of duty to shareholders by the insiders, there was no derivative breach by Dirks. Dirks therefore could not have been "a participant after the fact in [an] insider's breach of a fiduciary duty."²⁸¹

In so holding, the Court recognized that the analyst's clients possessed an informational advantage over all other traders who lacked knowledge about Equity Funding's likely demise. But the Court observed that "winner and losers" are inevitable in markets where investors act on incomplete or incorrect information, and it emphasized that "those who have 'lost' have not necessarily been defrauded."²⁸² Significantly, as Justice Blackmun observed in his dissent, the former officer of Equity Funding who revealed the ongoing fraud had also, in a sense, benefitted personally from "the good feeling of exposing a fraud and his enhanced reputation."²⁸³ Thus, in *Dirks* itself, an "enhanced reputation" in the abstract did not constitute an improper personal benefit triggering a disclose or abstain obligation under Section 10(b) and Rule 10b-5.

Underscoring much of the analysis in *Dirks* was the Court's twofold concern for market efficiency and predictable rules for Rule 10b-5 liability, particularly in the context of communications between corporate executives and securities analysts. In the Court's view:

Imposing a duty to disclose or abstain solely because a person knowingly receives material nonpublic information from an

corporate insider,' they must either publicly disclose that information or refrain from trading").

279. *Dirks*, 463 U.S. at 667.

280. *Id.* at 666-67.

281. *Id.* at 667 (internal citations omitted) (quoting *Chiarella v. United States*, 445 U.S. 222, 230 n.12 (1980)).

282. *Id.* at 667 n.27.

283. *Id.* at 676 n.13 (Blackmun, J., dissenting).

insider and trades on it could have an inhibiting influence on the role of market analysts, which the SEC itself recognizes is necessary to the preservation of a healthy market. It is commonplace for analysts to “ferret out and analyze information,” and this often is done by meeting with and questioning corporate officers and others who are insiders. And information that the analysts obtain normally may be the basis for judgments as to the market worth of a corporation’s securities.²⁸⁴

Rather than focusing on the analyst’s clients and the stock market losses they managed to avoid, the Court emphasized the central role that Dirks had “played in uncovering the fraud at Equity Funding, and that analysts in general can play in revealing information that corporations may have reason to withhold from the public.”²⁸⁵ The Court further observed that, in the absence of guidance “as to where the line is between permissible and impermissible disclosures and uses, neither corporate insiders nor analysts can be sure when the line is crossed.”²⁸⁶ Thus, while a broader interpretation of the insider trading prohibitions arising under Section 10(b) and Rule 10b-5 could have been reconciled with the common law, the Court eschewed that possibility and defined “illegal tipping” in a way that did not disincentivize securities analysts from gathering and analyzing nonpublic corporate information that contributed to pricing efficiency.

There is little doubt that *Dirks* achieved the Court’s desired effect: the decision provided corporate executives and securities analysts with a safety net for their tightrope. Corporate executives were routinely advised that the “‘personal benefit’ test provide[d] significant insulation against liability for selective disclosures of material nonpublic information to analysts.”²⁸⁷ And securities analysts were likewise counseled that they could trade on any material nonpublic information that they uncovered or could advise their clients to trade, “[u]nless the analyst is knowingly aiding an insider to benefit from the use of information about his company.”²⁸⁸ Of course, for corporate executives

284. *Id.* at 658–59 (internal citation omitted) (quoting Raymond L. Dirks, Exchange Act Release No. 17,480, 21 SEC Docket 1401, 1406 (Jan. 22, 1981)).

285. *Id.* at 658 n.18.

286. *Id.* at 658 n.17.

287. Richard M. Phillips & Gregory T. Nojeim, *Disclosures to Securities Analysts: The Drafty Exposure of the Open-Door Policy*, INSIGHTS, May 1990, at 3, 7.

288. Meyer Eisenberg, *Dirks v. S.E.C.: Implications for Financial Analysts*, in THE NEW FACE OF INSIDER TRADING: CHIARELLA, DIRKS, AND BEYOND X, X (ALI-ABA Course of Study 1983), quoted in John C. Coffee, Jr., *The SEC and the Securities Analyst*, N.Y. L.J., May 30, 1991, at 5 n.12.

as well as analysts, the harbor in *Dirks* would be safe only if there were legitimate reasons for relaying the material nonpublic information that had been used for securities trading. But, as many observed, disclosures to analysts served a variety of corporate ends, “such as to enhance the company’s standing with the investor community or to strengthen pre-existing lines of communication.”²⁸⁹ Accordingly, in the words of one distinguished scholar, the Court’s “language in *Dirks* once seemed a Magna Charta for securities analysis.”²⁹⁰

2. THE SEC’S PRE-REGULATION FD ATTEMPTS TO LEVEL THE PLAYING FIELD

In the immediate aftermath of *Dirks*, SEC officials floated trial balloons that questioned the comfort that corporate executives and securities analysts could draw from the decision. For example, one SEC official, then a branch chief in the Division of Enforcement, called attention to “the anomalous and undefined nature of a ‘personal benefit.’”²⁹¹ He then provided a cautionary example: if a securities analyst is employed by a financial publication, a corporate executive should “consider whether a personal benefit could be alleged based on a past article favorable to the insider’s reputation or the potential for such an article in the future.”²⁹² He also criticized *Dirks* for giving short shrift to the notions of fairness and market integrity that underlie the federal securities laws and for sacrificing small investors “in the interest of pricing efficiency.”²⁹³ He therefore argued for an expansive view of the personal benefit test, which, in his view, would better balance the competing policy interests at stake.²⁹⁴

In 1991, the SEC sought to create a more level playing field for all investors through a frontal attack on selective disclosure, with *Dirks*’ reference to a “reputational benefit” as the sword. Its target was a corporate executive who was charged with illegal tipping under Section 10(b) and Rule 10b-5.²⁹⁵ According to the SEC’s complaint, Philip Stevens, the CEO of Ultrasystems Corporation, made a series of unsolicited calls to certain securities analysts to inform them of lower than expected quarterly results prior to an official public

289. Langevoort, *supra* note 266, at 1024.

290. Coffee, *supra* note 288, at 6.

291. Bruce A. Hiler, *Dirks v. SEC—A Study in Cause and Effect*, 43 MD. L. REV. 292, 314 (1984).

292. *Id.* at 315–16.

293. *Id.* at 297–98, 341.

294. *Id.* at 317–23.

295. Phillip J. Stevens, Litigation Release No. 12,813, 48 SEC Docket 739, 739 (Mar. 19, 1991).

announcement.²⁹⁶ Two of the analysts shared these new quarterly figures with their clients and those clients sold their holdings in Ultrasonics, thereby avoiding substantial losses.²⁹⁷ The SEC argued that Stevens' motivation in making his disclosure was "to protect and enhance his reputation."²⁹⁸ The case was settled and thus the SEC's position was never tested in court.²⁹⁹

The reaction to the Stevens case was predictable. Advocates for individual investors hailed it as an important victory,³⁰⁰ but publicly traded companies, along with the securities industry, were startled by the defeat.³⁰¹ Corporate and securities lawyers were likewise surprised by the settlement, with many criticizing the SEC for "gutting" *Dirks*.³⁰² The scholarly consensus was that the theory in Stevens "trivialize[d] *Dirks*" and would extend to most communications between corporate executives and securities analysts.³⁰³ As Professor John Coffee saw it, "to the extent that any 'reputational benefit' resulted from Stevens'

296. *Id.*

297. *Id.* at 740.

298. *Id.* at 739.

299. Pursuant to the terms of the settlement, Stevens consented to the entry of a permanent injunction and agreed to pay approximately \$126,500 (the sum total of the monetary losses that had been avoided by the analyst's clients who sold their stock in Ultrasonics prior to the company's public announcement). *Id.* In Professor Coffee's view, the Stevens case "shows a defendant unwilling to fight even when it had a substantial prospect for a litigated victory." Coffee, *supra* note 288, at 6.

300. See, e.g., Dean Foust, Commentary, *The Do's and Don'ts of Feeding Wall Street Analysts*, BUS. WK., Apr. 8, 1991, at 27, 27 (critiquing the Stevens settlement and concluding that "[i]n an era in which small investors feel handicapped when competing against well-connected institutional traders, the SEC in this case is right on the money"), cited in Bruce A. Hiler, *The SEC and the Insider/Tipper*, N.Y. L.J., Aug. 29, 1991, at 5, 5.

301. See, e.g., Carl W. Schneider, *Fencing on the Electrified Tightrope: Shocking Executives Who Value Reputation*, INSIGHTS, July 1991, at 2, 14 (observing that a "simple desire by the executive to do his or her job effectively and well was not normally considered to [constitute] an improper purpose").

302. See Dennis J. Block & Jonathan M. Hoff, *Issuer Communications with Analysts*, N.Y. L.J., Aug. 22, 1991, at 5, 6 (bemoaning that the SEC's overly broad interpretation of the reputational benefit prong "could make that element of proof meaningless"); Harvey L. Pitt & Karl A. Groskaufmanis, *For the Issuer, It's Sometimes Tempting to Provide Analysts with Non-Public Information. But Selective Disclosures Can Be Perilous*, NAT'L L.J., Apr. 18, 1994, at B4, B6 (contending that the SEC's case "was built on a dubious theory," but speculating that the defendant likely settled rather than "wait for such vindication"); Schneider, *supra* note 301, at 14 (arguing that "by adroit pleading, the Commission, which lost *Dirks*, can proceed as though it had won, gutting the principle that the case generally was thought to have established").

303. Coffee, *supra* note 288, at 5; see also Merritt B. Fox, *Regulation FD and Foreign Issuers: Globalization's Strains and Opportunities*, 41 VA. J. INT'L L. 653, 662 (2001) (discussing reactions to the Stevens settlement).

conduct, it accrued to Ultrasystems and all of its shareholders proportionately, and thus should not amount to a ‘personal gain’ for purposes of *Dirks*.³⁰⁴ He and others further emphasized the substantial chilling effect that Stevens’ reputational benefit theory was likely to have on issuer communications with securities analysts.³⁰⁵

The SEC appeared to take these concerns to heart. Although after Stevens, SEC officials continued to warn corporate executives and securities analysts about the perils of selective disclosure, the agency did not initiate subsequent Rule 10b-5 litigation based on a reputational benefit theory.³⁰⁶ Nor did the SEC seek to redefine a corporate executive’s selective disclosure to a securities analyst as an illegal tip under the misappropriation theory. Such an attempt would have been futile because, as previously explained, the crux of the misappropriation theory is an agent’s undisclosed personal gain from the use of his principal’s information.³⁰⁷

The SEC did, however, continue to categorize selective disclosure as an “increasingly worrisome form of trading on the basis of non-public information.”³⁰⁸ In addition to its concerns about diminished investor confidence in securities markets, the SEC feared that corporate executives were withholding important information from the public so that they could curry favor with particular analysts or investors.³⁰⁹ As market volatility increased toward the end of the 1990s, the media began to highlight specific incidents of unfair selective disclosure and “[t]he problem took on increased urgency.”³¹⁰ In a series of town hall meetings across the country, Chairman Levitt vowed to make

304. Coffee, *supra* note 288, at 6.

305. See *id.*; Theodore A Levine & W. Hardy Callcott, *SEC Examines Relationship between Issuers and Analysts*, N.Y. L.J., Dec. 7, 1992, at 7, 8 (arguing that under the SEC’s rationale, “any corporate executive who ever reveals non-public information to an analyst risks insider trading liability . . . because the SEC will always be able to allege that the executive made the tip for the purpose of enhancing his or her reputation”).

306. See Fisch & Sale, *supra* note 31, at 1061 (observing that after the widely criticized Stevens settlement, “the SEC stopped bringing selective disclosure actions based on Section 10(b)"); Fox, *supra* note 303, at 662 (“Research does not reveal any subsequent case in which the SEC tried to utilize this theory again to pursue anyone either engaging in selective disclosure or acting on it.”).

307. See *supra* text accompanying notes 182–188. But see Wang, *supra* note 31, at 871–74 (acknowledging the “conventional wisdom” that selective disclosure is seldom illegal, but theorizing that the issuer itself could incur classical theory liability if the issuer, “as an entity, [obtains] reciprocal benefits by tipping analysts”).

308. Levitt, *supra* note 267.

309. See Selective Disclosure and Insider Trading, Exchange Act Release No. 42,259, [1999–2000 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 86,228, at 82,848 (Dec. 20, 1999).

310. Fisch & Sale, *supra* note 31, at 1061–62.

eradicating selective disclosure a top priority. His frustration was palpable: “Legally, you can split hairs all you want. But, ethically, it’s very clear: If analysts or their firms are trading—knowing this information, and prior to public release—it’s just as wrong as if corporate insiders did it.”³¹¹

Privileging certain investors with material nonpublic information may well have been “wrong, plain and simple.”³¹² But selectively disclosing that information, or trading on that information, was seldom illegal, “plain and simple.” Unwilling to risk litigation losses based on the nebulous theory of a reputational benefit and concerned about that strategy’s chilling effect even if were courts were to uphold it,³¹³ the SEC had to look beyond the federal insider trading prohibition in order to level the playing field for all securities investors.

B. Regulation FD

In December 1999, when the SEC proposed its initial version of Regulation FD, Chairman Levitt made good on his promise to end the routine practice of selective disclosure in the private sector.³¹⁴ Although predicated on the belief that “all investors should have access to an issuer’s material disclosures at the same time,”³¹⁵ the proposed regulation did not proscribe selective disclosure as a “deceptive device or contrivance” under Section 10(b).³¹⁶ Instead, it was made pursuant to the SEC’s authority under Exchange Act Section 13(a),³¹⁷ which empowers the agency to mandate ongoing disclosure by publicly traded

311. Levitt, *supra* note 267.

312. LEVITT, *supra* note 32, at 87.

313. See *Panel Discussion: The SEC’s Regulation FD*, 6 FORDHAM J. CORP. & FIN. L. 273, 279 (2001) (statement by former SEC Commissioner and General Counsel Harvey Goldschmid) (contending that the agency could have won “the extension-of-*Dirks* case at the Supreme Court . . . [but] there would or might be a heavy price to pay for doing so”).

314. Selective Disclosure and Insider Trading, Exchange Act Release No. 42,259, [1999–2000 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 86,228, at 82,846 (Dec. 20, 1999). Much of the background in this Section is based on the more extensive discussion in RALPH C. FERRARA, DONNA M. NAGY & HERBERT THOMAS, FERRARA ON INSIDER TRADING AND THE WALL § 7.08[3] (2012).

315. Selective Disclosure and Insider Trading, Exchange Act Release No. 42,259, [1999–2000 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 86,228, at 82,847 (Dec. 20, 1999). *But see* Choi, *supra* note 31, at 564 (observing that Regulation FD also acts “as a preventive device to protect against possible opportunistic uses of selective disclosures where determination of whether managers are acting opportunistically is difficult”).

316. 15 U.S.C. § 78j(b) (2006).

317. § 78m(a).

companies.³¹⁸ After a lengthy period of notice and comment, Regulation FD was revised and adopted in August 2000, with an effective date of October 15, 2000.³¹⁹ It reflects a clear policy decision to regulate issuers and their disclosures rather than securities investors and their trading.

Rule 100 of Regulation FD sets forth a “general rule regarding selective disclosure.”³²⁰ As summarized in the SEC’s adopting release, the rule requires that whenever:

- (1) an issuer, or person acting on its behalf,
- (2) discloses material nonpublic information,
- (3) to certain enumerated persons (in general, securities market professionals or holders of the issuer’s securities who may well trade on the basis of the information),
- (4) the issuer must make public disclosure of that same information
 - (a) simultaneously (for intentional disclosures), or
 - (b) promptly (for nonintentional disclosures).³²¹

Accordingly, although Regulation FD does not automatically require a publicly traded company to promptly disclose all material events as they occur, it does in fact require that when a company chooses to disclose material nonpublic information to a person covered by the regulation, “it must do so in a manner that provides general public disclosure, rather than through a selective disclosure” to a favored few.³²²

Regulation FD, as adopted, differs in at least two principal respects from the version originally proposed.³²³ First, in the final

318. In addition to issuers with a class of securities registered under Exchange Act Section 12, Regulation FD applies to issuers required to file reports under Exchange Act Section 15(d) and to closed-end investment companies, but it does not apply to any other investment companies or any foreign government or foreign private issuer. See 17 C.F.R. § 243.101(b) (2012).

319. Selective Disclosure and Insider Trading, Exchange Act Release No. 43,154, [2000 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 86,319, at 83,676 (Aug. 15, 2000).

320. § 243.100.

321. Selective Disclosure and Insider Trading, Exchange Act Release No. 43,154, [2000 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 86,319, at 83,680–81 (Aug. 15, 2000).

322. *Id.* at 83,681; see Robert B. Thompson & Ronald King, *Credibility and Information in Securities Markets after Regulation FD*, 79 WASH. U. L.Q. 615, 615 (2001) (emphasizing that under Regulation FD “companies now face an all or nothing choice: they are not required to disclose any more information than before, but if they tell someone, they must tell everyone”).

323. In its adopting release, the SEC highlighted the “outpouring of public comment” that was triggered in response to its proposal to add Regulation FD to the

version of the regulation, the SEC sought to narrow the scope by regulating only those communications from an issuer to one of four specifically enumerated categories of persons and associated persons: (1) broker-dealers, (2) investment advisers or institutional investment managers, (3) investment companies or hedge funds, and (4) holders of the issuer's securities, "under circumstances in which it is reasonably foreseeable that the person will purchase or sell the issuer's securities on the basis of the information."³²⁴ The initial proposal did not contain this limitation, applying instead to all communications with persons outside the issuer.³²⁵ In its adopting release, the SEC acknowledged that an application to all communications might "inappropriately interfere with ordinary-course business communications with parties such as customers, suppliers, strategic partners, and government regulators" and might also inhibit communications with the media.³²⁶ Second, to further ensure the free flow of ordinary-course business communications, the SEC restricted the types of issuer personnel who are covered by the regulation to only senior officials or other persons who "regularly communicate with securities market professionals or security holders."³²⁷

Regulation FD also explicitly exempts communications to "a person who owes a duty of trust or confidence to the issuer (such as an attorney, investment banker, or accountant),"³²⁸ as well as to other persons who "expressly agree[] to maintain the disclosed information in confidence."³²⁹ These exemptions thus recognize that issuers and their officials may continue to share material nonpublic information with outsiders for legitimate business reasons, but that any trading (or tipping) based on that information would subject the recipient to Rule

federal securities laws. *See* Selective Disclosure and Insider Trading, Exchange Act Release No. 43,154, [2000 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 86,319, at 83,677-78 (Aug. 15, 2000) (observing receipt of nearly 6000 comment letters, the vast majority of which were from individual investors urging adoption of the regulation).

324. § 243.100(b)(1)(i).

325. Selective Disclosure and Insider Trading, Exchange Act Release No. 43,154, [2000 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 86,319, at 83,680 (Aug. 15, 2000).

326. *Id.* at 83,681

327. *Id.* at 83,680.

328. § 243.100(a)(2)(i).

329. § 243.100(a)(2)(ii). The SEC has made clear that while an agreement to maintain confidentiality must be express, the agreement need not be a written one—"an express oral agreement will suffice." Selective Disclosure and Insider Trading, Exchange Act Release No. 43,154, [2000 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 86,319, at 83,682 n.28 (Aug. 15, 2000). Moreover, agreements entered into after the disclosure is made, but before the information's recipient discloses or trades on the basis of it, are sufficient as well. *Id.*

10b-5 liability as a “temporary insider” of the issuer under the classical theory of insider trading³³⁰ or pursuant to the misappropriation theory.³³¹ Here it is important to recognize that on the same day it adopted Regulation FD, the SEC also adopted SEC Rule 10b5-2, a new insider trading rule setting forth three nonexclusive circumstances under which a person can be deemed to have a duty of trust or confidence for purposes of the misappropriation theory.³³² One of those circumstances imposes a duty “[w]hensoever a person agrees to maintain information in confidence.”³³³ Yet, notwithstanding the plain text of Rule 10b5-2(b)(1), at least one court has held that mere confidentiality agreements, absent an explicit or implicit promise not to use confidential information in one’s own securities trading, cannot create a duty sufficient to support Section 10(b) and Rule 10b-5 liability under the misappropriation theory.³³⁴

The many definitional provisions set out in Regulation FD provide additional clarification with respect to the scope and effect of the general rule. For example, Rule 101(a) defines the selective disclosure of material nonpublic information as “intentional” when “the person making the disclosure either knows, or was reckless in not knowing, that the information he or she is communicating is both material and nonpublic.”³³⁵ When such intentional disclosures occur, the issuer is required to publicly disclose the same information “simultaneously.”³³⁶ The clear intent behind the SEC’s “simultaneous” disclosure requirement is to prohibit senior company officials from intentionally making selective disclosures to those persons who are most likely to trade on that information. Rule 101(d) then states that when a corporate official makes a “non-intentional disclosure” of material nonpublic

330. See *supra* note 150 (discussing *Dirks*’ extension of the classical theory to temporary insiders).

331. See *supra* text accompanying note 138.

332. See Selective Disclosure and Insider Trading, Exchange Act Release No. 43,154, [2000 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 86,319, at 83,696–97 (Aug. 15, 2000).

333. § 240.10b5-2(b)(1).

334. *SEC v. Cuban*, 634 F. Supp. 2d 713, 728 (N.D. Tex. 2009) (holding that the defendant’s alleged trading on information subject to a confidentiality agreement would not have been deceptive under Section 10(b) unless the SEC could also show that defendant “agreed, expressly or implicitly, to refrain from trading on or otherwise using for his own benefit the information the CEO was about to share”), *vacated and remanded on other grounds*, 620 F.3d 551 (5th Cir. 2010).

335. § 243.101(a).

336. § 243.100(a)(1).

information,³³⁷ the issuer must make public disclosure of that information “promptly.”³³⁸

Regulation FD also provides an issuer with a significant degree of choice as to how to make the requisite “public disclosures.” One option would be for the issuer to make the disclosure by filing a Form 8-K with the SEC.³³⁹ Alternatively, the issuer could “disseminate[] the information through another method (or combination of methods) of disclosure that is reasonably designed to provide broad, nonexclusionary distribution of the information to the public.”³⁴⁰ Thus, an issuer could accomplish the public disclosure through an announcement at a press conference or in a conference call, provided that the public is given “adequate notice” of the conference or call and the means for accessing it.³⁴¹ The adopting release further emphasized that “[t]he regulation does not require use of a particular method, or establish a ‘one size fits all’ standard for disclosure.”³⁴² Instead, the SEC opted to “leave[] the decision to the issuer to choose methods that are reasonably calculated to make effective, broad, and nonexclusionary public disclosure, given the particular circumstances of that issuer.”³⁴³ In 2008, the SEC issued a new release providing issuers with much needed guidance as to when information posted on a website could be deemed publicly available within the meaning of Regulation FD.³⁴⁴

337. For instance, a disclosure would be “non-intentional” if a corporate official were to disclose confidential information “inadvertently through an honest slip of the tongue” or if the official mistakenly (but not recklessly) believed that the information was not material or had already been made public. *See* Selective Disclosure and Insider Trading, Exchange Act Release No. 42,259, [1999–2000 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 86,228, at 82,853 (Dec. 20, 1999).

338. § 243.101(d). The term “promptly” is defined to mean:

[A]s soon as reasonably practicable (but in no event after the later of 24 hours or the commencement of the next day’s trading on the New York Stock Exchange) after a senior official of the issuer . . . learns that there has been a non-intentional disclosure by the issuer or person acting on behalf of the issuer of information that the senior official knows, or is reckless in not knowing, is both material and nonpublic.

Id.

339. *See* § 243.101(e)(1).

340. § 243.101(e)(2).

341. *See* Selective Disclosure and Insider Trading, Exchange Act Release No. 43,154, [2000 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 86,319, at 83,687 (Aug. 15, 2000).

342. *Id.*

343. *Id.*

344. *See* Commission Guidance on the Use of Company Web Sites, Exchange Act Release No. 34-58288, 2008 WL 4068202, at *9 (Aug. 1, 2008) [hereinafter SEC Guidance on Corporate Web Sites]. The release emphasized consideration of three factors: (1) whether a company’s website is “a recognized channel of distribution,” (2)

Absent from Regulation FD is any attempt to define “material” information. Rather, the SEC opted to rely on the existing definitions “established in the case law.”³⁴⁵ Although it recognized that “materiality judgments can be difficult,”³⁴⁶ the SEC decided against “set[ting] forth a bright-line test, or an exclusive list of ‘material’ items for purposes of Regulation FD.”³⁴⁷ The adopting release did, however, make clear that nothing in Regulation FD would prohibit an issuer from sharing “a non-material piece of information [with a securities] analyst, even if, unbeknownst to the issuer, that piece helps the analyst complete a ‘mosaic’ of information that, taken together, is material.”³⁴⁸ The SEC also emphasized that since materiality is an objective standard turning on the decision-making of a reasonable investor, “Regulation FD will not be implicated where an issuer discloses immaterial information whose significance is discerned by the analyst.”³⁴⁹

C. Evaluating Regulation FD a Decade Later

From the time Regulation FD was first considered, the possibility that it might chill corporate disclosures to analysts, investors, and the media was considered its principal cost. Indeed, commentators feared that it might cause issuers to speak less frequently and with a greater degree of abstraction, because corporate officials would fear a post hoc judicial or administrative determination that the disclosed information was material.³⁵⁰ And in the immediate aftermath of Regulation FD’s adoption, evaluations and feedback from both corporate issuers and securities analysts indicated that a chilling effect might have occurred.³⁵¹ Much of the commentary that followed a year or two later,

whether website posting disseminates information in a manner that makes it generally available to the securities market, and (3) whether there has been “a reasonable waiting period for investors and the market to react to the posted information.” *Id.* at *6.

345. Selective Disclosure and Insider Trading, Exchange Act Release No. 43,154, [2000 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 86,319, at 83,683 (Aug. 15, 2000).

346. *Id.* at 83,684.

347. *Id.*

348. *Id.* at 83,684–85.

349. *Id.* at 83,685.

350. *See id.* at 83,701 (citing comment letters from the Securities Industry Association, the Bond Market Association, and the American Bar Association).

351. *See, e.g., Industry Participants Want SEC to Issue Guidance on Regulation FD*, 33 Sec. Reg. & L. Rep. (BNA) No. 17, at 637 (Apr. 30, 2001) (“The analyst community has been particularly vocal in its opposition to the rule, claiming that issuers have clammed up, often unnecessarily, because of ambiguity surrounding Regulation FD.”); *Most Companies Seeking to Comply with Reg FD Disclosure Requirements*, 33 Sec. Reg. & L. Rep. (BNA) No. 16, at 586 (Apr. 23, 2001) (noting

however, “suggest[ed] that the purported negative effects of Regulation FD on information flow and volatility may be overstated.”³⁵² Instead, many issuers quickly adapted their disclosure practices in a manner that increased the general public’s access to corporate information.³⁵³ For example, in the year following Regulation FD’s adoption, issuer use of webcasts quadrupled, which provided the public with access to earnings conference calls and in-person meetings with analysts.³⁵⁴ Some issuers also argued that Regulation FD abridges commercial speech protected by the First Amendment.³⁵⁵ But the SEC has defended the regulation as an appropriate time, place, and manner regulation of commercial activity that mandates speech only when information has been previously or simultaneously disclosed to regulated professionals or holders of the issuer’s securities who are likely to trade.³⁵⁶

Today, more than a decade after Regulation FD’s adoption, SEC officials continue to laud the regulation as a tremendous success.³⁵⁷ While that self-evaluation is hardly surprising, even organizations that often function as the SEC’s nemesis have offered a positive evaluation.

that “[t]he regulation has been controversial in some circles, with groups contending it has hampered the release of information important to investors,” and that “[i]ssuers, in some cases, have complained that compliance with the regulation is too complex and uncertain”).

352. Fisch & Sale, *supra* note 31, at 1066–68 (discussing empirical research in the immediate aftermath of Regulation FD); *see also* Robert J. Conner, *Regulation FD: Its Creation, Its Authority, Its Possible Impact*, 28 SEC. REG. L.J. 233, 263 (2000) (contending that “issuers’ fears may not be as real as they appear”).

353. *See* Jill E. Fisch, *Regulation FD: An Alternative Approach to Addressing Information Asymmetry*, in RESEARCH HANDBOOK ON INSIDER TRADING (Stephen Bainbridge ed.) (forthcoming 2013), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2042696.

354. *See* Aaron J. VanGetson, Note, *Real-Time Disclosure of Securities Information via the Internet: Real Time or Not Right Now?*, 2003 U. ILL. J.L. TECH. & POL’Y 551, 565 (citing LAURA S. UNGER, SEC, SPECIAL STUDY: REGULATION FAIR DISCLOSURE REVISITED (2001), *available at* <http://www.sec.gov/news/studies/regfdstudy.htm>).

355. *See* Antony Page & Katy Yang, *Controlling Corporate Speech: Is Regulation Fair Disclosure Unconstitutional?*, 39 U.C. DAVIS L. REV. 1, 47–60 (2005).

356. The SEC has initiated a dozen or so enforcement actions charging securities issuers and/or their corporate executives with violations of Regulation FD. *See* FERRARA, NAGY & THOMAS, *supra* note 314, at § 7.08[3][b] (discussing Regulation FD proceedings). In the only Reg FD proceeding that was litigated rather than settled, the court held that the allegations in the SEC’s complaint did not support its claim that the defendants had privately disclosed material nonpublic information. *SEC v. Siebel Systems, Inc.*, 384 F. Supp. 2d 694, 710 (S.D.N.Y. 2005). Having granted the defendant’s motion to dismiss the complaint, the court “decline[d] to opine on the constitutional challenges raised.” *Id.* at 709 n.16.

357. *See, e.g.*, LEVITT, *supra* note 32, at 89 (“I now believe Reg FD has done more to restore investor confidence in the stock market than any other rule the SEC adopted during my tenure [as Chairman].”).

For instance, the Business Roundtable, which is comprised of the CEOs of 160 leading corporations,³⁵⁸ wrote to then-SEC Chairman William Donaldson in 2005: We “believe[] that Regulation FD has been successful in accomplishing the Commission’s goal of promoting full and fair disclosure. We also believe Regulation FD has had the important and beneficial effect of enhancing investor confidence in the marketplace. For these reasons . . . [we] continue[] to support Regulation FD.”³⁵⁹ Finance scholars have also been carefully tracking Regulation FD’s operations, though, as Professor Jill Fisch has recently summarized, the mixed results of the extensive empirical research make it difficult to reach definitive assessments.³⁶⁰ She observes, however, that “[t]here is substantial evidence that Regulation FD reduced selective disclosure and information asymmetries” and that these reductions in asymmetries have a beneficial effect to the market.³⁶¹ On the other hand, “[a]t least some studies have found reduced overall disclosure, especially by smaller firms.”³⁶² Yet she draws one conclusion that is equally relevant to the practice of selective disclosure by federal officials: “the disclosure-based structure of Regulation FD appears better suited to balancing competing policy considerations in this area than the blunt force of antifraud liability.”³⁶³

III. AN FGD REGIME FOR THE FEDERAL GOVERNMENT

In the private sector, the SEC was able to curtail unfair selective disclosure only when it shifted its attention away from securities analysts and what they did with the information they gathered, and focused instead on securities issuers and the ways in which corporate executives were disseminating material nonpublic information. Given the rare bipartisanship and rapid momentum that led to the passage of the STOCK Act,³⁶⁴ now is an opportune time to address the federal government’s own problem with selective disclosure.

358. Stephen M. Cutler, Dir. Div. of Enforcement, SEC, Remarks before the Directors’ Education Institute at Duke University: Staying the Course (Mar. 18, 2005), available at <http://www.sec.gov/news/speech/spch031805smc.htm>.

359. *Id.* (quoting a letter from Business Roundtable to William Donaldson, SEC Chairman).

360. Fisch, *supra* note 353, at 18–19.

361. *Id.* at 19 (citing sources including William J. Kross & Inho Suk, *Does Regulation FD Work? Evidence from Analysts’ Reliance on Public Disclosure*, 53 J. ACCT. & ECON. 225 (2012); and Praveen Sinha & Christopher Gadarowski, *The Efficacy of Regulation Fair Disclosure*, 45 FIN. REV. 331 (2010)).

362. *Id.* (citing Edward R. Lawrence et al., *Effect of Regulation FD on Disclosures of Information by Firms*, 21 APPLIED FIN. ECON. 979 (2011)).

363. *Id.* at 24.

364. *See supra* notes 23–24 and accompanying text.

This final Part of this Article sets out a framework designed to enhance the internal controls on federal officials who may interact with securities investors or consultants seeking to profit from political intelligence. We first discuss generally some of the challenges that likely will arise in designing an FGD regime. We then suggest seven possible measures for achieving fairer government disclosure. We intend to build on these FGD measures with more specific proposals in a subsequent article. Here, however, we begin the conversation by suggesting immediate steps that federal officials could take either individually or through directives issued by agency heads and congressional committees.

A. Challenges for Developing an FGD Regime

The development of an FGD regime for federal officials implicates several unique challenges that the SEC did not have to tackle in designing Regulation FD for publicly traded corporations and their executives. But these challenges should not impede a commitment to eliminating—or at least curtailing—the unfair selective disclosures that have been a tradition in the federal government for far too long.³⁶⁵

First, those working toward fairer government disclosure would have to recognize that a broad range of individuals and entities expect prompt disclosure of nonpublic government information that affects them directly. If the government does not wish to release such information to the general public (or wishes to delay the release),³⁶⁶ these affected persons expect, and in many instances deserve, selective disclosure. But individuals and entities lacking any intention to trade securities may inadvertently function as conduits for others who are seeking to gain an informational edge. For instance, a hedge fund trader deciding whether to short the stock of for-profit colleges could possibly gather nonpublic DOE information from community college officials who are eager to learn what the DOE is planning to do about alleged abuses by their for-profit competitors.³⁶⁷ The quest to deny an

365. *See supra* Part I.A. Although we have little doubt that selective disclosure of market-moving government information is a problem at the state and local level as well, our attention is focused on the federal government. Many of our ideas and suggestions, however, would be appropriate for state and local governments as well.

366. Professor Cass Sunstein identified five justifications often invoked by the government for suppressing, or delaying, its release of information: protecting military plans, facilitating negotiations, facilitating uninhibited deliberations within the government, avoiding interest-group pressures, and avoiding distrust and suspicion, encouraging communications from others. Cass R. Sunstein, *Government Control of Information*, 74 CALIF. L. REV. 889, 895–96 (1986).

367. *Cf. supra* notes 103–106 and accompanying text.

informational edge to some securities investors should not diminish the flow of government information to those individuals and entities that need nonpublic information to organize interests and activities that have nothing at all to do with investments in securities markets.

Moreover, as we have seen, securities investors will often acquire selectively disclosed government information while they are also seeking to influence government decision making.³⁶⁸ Whereas corporate managers generally are not expected to be in constant communication with persons trying to influence corporate conduct and decision making, federal officials—particularly elected officials—are expected to communicate with a host of different constituencies. Keeping their jobs may depend upon how well these officials communicate information, to whom, and how quickly. The right to petition the government for redress of grievances is not only constitutionally protected,³⁶⁹ it has become a multi-billion dollar business,³⁷⁰ and lobbying activity is often interwoven with political intelligence gathering.

An FGD regime would likewise have to address the very frequent communications that federal officials have with the media, which nowadays includes Internet sites, Twitter, subscription services, and other outlets in addition to traditional newspapers, radio, and television. Indeed, a political intelligence consultant may be able to attend a government press briefing as a journalist of sorts, and even some journalists from mainstream media organizations fall into a gray area because their newsletters offer specialized subscriptions to investment professionals.³⁷¹ With Regulation FD, however, the SEC did not have to contend with this challenge because the regulation restricts the disclosure of material nonpublic information only when certain corporate executives communicate with regulated market professionals or holders of the issuer's securities who are likely to trade.³⁷²

368. See *supra* notes 54–55 and accompanying text (discussing the lobbying that occurred in 1789 with respect to the payment of Revolutionary War debts); *supra* notes 103–106 and accompanying text (discussing a well-known hedge fund manager and his communications with the Department of Education).

369. Nicholas W. Allard, *Lobbying Is an Honorable Profession: The Right to*

369. See *supra* notes 54–55 and accompanying text (discussing the lobbying that occurred in 1789 with respect to the payment of Revolutionary War debts); *supra* notes 103–106 and accompanying text (discussing a well-known hedge fund manager and his communications with the Department of Education).

Petition and the Competition to Be Right, 19 STAN. L. & POL'Y REV. 23, 36–42 (2008) (discussing constitutional dimensions of public policy advocacy).

370. *Id.* at 49–50.

371. See *infra* Part III.B.6.

372. 17 C.F.R. § 243.100(b)(1)(i) to (iv) (2012); see also *supra* text accompanying note 324.

Finally, an FGD regime would have to recognize that federal officials often make selective disclosures of market-moving information to individuals and entities from whom the government is seeking cooperation, information, and guidance.³⁷³ Moreover, in crisis situations such as wartime, acts of terrorism, or economic collapse, such “necessary” selective disclosure must often be undertaken quickly, informally, and on a relatively broad scale. The Department of Homeland Security, for instance, might selectively disclose to airlines information about a major security threat that, unless resolved quickly, is likely to shut down air traffic for a prolonged period of time. Another example of necessary selective disclosure occurred in September 2008, when officials from the Treasury Department, the SEC, and the Federal Reserve met with Wall Street executives in an attempt to resolve the financial crisis.³⁷⁴ Indeed, market-moving information about the government’s decision to allow Lehman Brothers to fail was disclosed selectively to some on Wall Street in the days preceding the firm’s bankruptcy filing on Monday, September 15, 2008,³⁷⁵ and perhaps even in the months preceding Lehman’s failure. Yet some of this necessary selective disclosure may have occurred contemporaneously with other types of selective disclosure, such as the Secretary of the Treasury’s reported briefings to hedge funds and investment bankers about the government’s planned response to the situation at Fannie Mae and Freddie Mac.³⁷⁶

Although legitimate, good faith disclosures of material nonpublic government information to securities investors are frequently necessary and appropriate, federal officials often appear to make selective disclosures in the absence of any formal policy addressing, among other issues: (1) when federal officials may disclose market-moving information selectively and to whom, (2) when and how a public announcement of that information will be made, and (3) whether federal officials will procure an agreement from the information’s recipients to maintain confidentiality and not to use that information for securities trading purposes. An FGD regime could help sort out the necessary selective disclosures from the unnecessary and could establish better

373. See Mullins & Pulliam, *supra* note 15 (citing statements by lawmakers as to the value of feedback from hedge funds and other investors).

374. See *Public Policy Issues Raised by the Report of the Lehman Bankruptcy Examiner: Hearing Before the H. Comm. on Fin. Servs.*, 111th Cong. 179 (2010) (statement of Mary L. Schapiro, Chairman, SEC) (“Over the weekend of September 12th - 14th, representatives from the Treasury, the Federal Reserve Bank of New York and the Commission met with management from Lehman and other major financial firms in an effort to address the situation.”).

375. *Id.*

376. See *supra* notes 83–87 and accompanying text.

procedures and protocols for how necessary selective disclosure will be conducted. On the other hand, an FGD regime will have to give the government flexibility in many situations and even more flexibility in crisis situations.

B. Possible Measures for Fairer Government Disclosure

We sketch out below seven distinct measures that federal officials could adopt to create a more level playing field for all securities investors. None of these measures, even taken together, would amount to a Reg FD-like all-or-nothing prohibition of selective disclosure. Indeed, for a host of reasons including those set out above, an FGD regime obligating all federal officials in all three branches of the government to simultaneously disclose material nonpublic information to all securities investors simply could not be reconciled with the size and complexities of our federal government. Without a bevy of exceptions (which could perhaps swallow the general rule), the end result would be a triple whammy: a reduced flow of information out of the government, a less informed populace, and less efficient securities markets. In contrast, adherence to FGD measures along the lines we describe could go a long way toward increasing the flow of government information for everyone, while decreasing the investment edges that have long enabled privileged investors to beat out ordinary citizen-investors. Thus, an FGD regime could boost confidence not only in the integrity of securities markets but also in the integrity of the federal government itself.

1. PRESENT THE CASE FOR FGD TO THE PUBLIC

As an initial and important step, the President could announce fairer government disclosure as a major policy initiative. He could begin by acknowledging, in general terms, some of the unfair selective disclosures that have occurred in the past, and he could pledge to make more equal access to market-moving government information a top administrative priority.³⁷⁷ The President could then instruct all executive agencies and departments to review their internal controls for interactions with persons outside the government likely to be seeking information for personal profit in securities markets and he could

377. President Obama took a similar step when he endorsed the STOCK Act in his 2012 State of the Union Address and suggested new legislation that would prohibit “any elected official from owning stocks in industries they impact.” *See supra* note 23 and accompanying text.

encourage congressional officials to do the same.³⁷⁸ He could also call upon public interest groups, academics, and thinktanks—from both sides of the political spectrum—to weigh in on proposed measures for fairer government disclosure, much as organizations have already begun to do in the debate over whether and how to regulate political intelligence activity.³⁷⁹ Finally, the President could quote SEC Chairman Arthur Levitt as an effective reminder to all federal officials, including members of Congress, that our democracy “has no tolerance for favoritism,” that it “holds no place for privilege,” and that “[w]ell-connected people don’t deserve any greater chance for success [in securities markets] than the average citizen.”³⁸⁰ This appeal to integrity would produce a two-fold benefit: it would encourage federal officials to consider more thoughtfully the selective disclosures they make and it would engender the same type of populist support that the SEC drew at town hall meetings across the country prior to the adoption of Regulation FD.³⁸¹

378. As a more ambitious undertaking, the President could encourage Congress to begin to explore the possibility of legislation that would make real-time public disclosure of market-moving information more of a norm. *Cf.* OMB WATCH, MOVING TOWARD A 21ST CENTURY RIGHT-TO-KNOW AGENDA: RECOMMENDATIONS TO PRESIDENT-ELECT OBAMA AND CONGRESS 1-2 (2008), <http://www.ombwatch.org/node/11612> (advocating for “a government where . . . federal agencies proactively disseminate information to the public in timely, easy-to-find, and searchable formats” and calling upon President Obama and Congress to “act decisively to achieve this vision”). Existing statutes—such as the Freedom of Information Act, 5 U.S.C. § 552 (2006), which requires federal agencies to disclose their records upon request (subject to exceptions), § 552, and the Government in the Sunshine Act, § 552b, which requires every portion of every meeting of federal agencies to be open to the public (subject to exceptions), § 552b—would provide a rough model of what such an omnibus real-time disclosure statute could look like.

379. *Compare* Blair, *supra* note 250, at 16 (stating that “Public Citizen will push lawmakers to support . . . legislative efforts” to regulate political intelligence gathering and “will continue to fight to ensure that Wall Street can no longer secretly troll the halls of Congress for privileged information to prop up its profiteering schemes”), *with* John Berlau & David Bier, *The Problems with the STOCK Act*, NAT’L REV. ONLINE (Feb. 14, 2012, 4:00 AM), <http://www.nationalreview.com/articles/290847/problems-stock-act-john-berlau> (contending that proposed efforts to regulate political intelligence threaten First Amendment values and “would muzzle the communication necessary for sunlight and reform”).

380. *See supra* note 267 and accompanying text (quoting then-SEC Chairman Arthur Levitt).

381. *See id.*; *see also* text accompanying *supra* note 311. On his first day in office, President Obama ordered the Office of Management and Budget (OMB) to issue an open government directive requiring federal agencies to take specific steps toward greater transparency, participation, and collaboration. *See* Memorandum on Transparency and Open Government, 74 Fed. Reg. 4685, 4685 (Jan. 26, 2009). But neither that OMB directive, nor any of the open government initiatives that followed, have been tailored specifically toward preventing the type of informational edge that

2. ASSESS CURRENT PROCEDURES AND PROTOCOLS

The set of questions recently posed to the DOE³⁸² and CMS³⁸³ can serve as a useful template for self-studies that would assess procedures and protocols currently in place at executive agencies and congressional offices. These questions would prompt each executive agency as well as individual members of Congress to describe their policies “for all interactions with persons who are not government employees, contractors, or subcontractors and seek information for profit [in securities markets]” or to explain why the agency or congressional office has “not created a policy.”³⁸⁴ With the STOCK Act’s mandated GAO study of political intelligence gathering already underway,³⁸⁵ it is possible that some self-assessment may already be occurring.

These self-studies could then be used to inform possible rulemaking initiatives by executive agencies and congressional committees. Agency rulemaking could offer persons outside the government the opportunity to weigh in on an agency’s proposed FGD policies and procedures, some of which might allow too much selective disclosure, or, conversely, might reduce agency transparency by discouraging disclosure. The House and Senate Ethics Committees could likewise embody new policies and procedures in House and Senate rules binding on all members. FGD rules for agency and congressional officials, however, will be effective in altering longstanding traditions only insofar as they are enforced. Indeed, Regulation FD’s overall success in the private sector derives in large part from the SEC’s readiness to initiate enforcement action against issuers and corporate executives who violate the rules. But FGD compliance would likely be monitored and enforced internally, by the particular agency or committee that promulgated the rules.

Given the strict confidentiality norms observed by federal judges and their staffs, selective disclosure of market-moving information is not as likely to be a problem in the judicial branch as it is in the other

privilege investors routinely attain from their connections to the inside of government. *See generally Open Government Initiative*, WHITEHOUSE, <http://www.whitehouse.gov/open> (last visited Nov. 1, 2012). In contrast, an FGD Regime would be specifically aimed at the problem of selective disclosure and would be geared toward effective solutions.

382. *See* Grassley DOE Letter, *supra* note 104.

383. *See* Grassley CMS Letter, *supra* note 107.

384. *See* Grassley DOE Letter, *supra* note 104, at 2.

385. *See supra* notes 231–233 and accompanying text.

two branches.³⁸⁶ But the judiciary's policy-making body, the Judicial Conference of the United States, could use this occasion as an opportunity to review and refine its confidentiality rules as well as its procedures for announcing judicial decisions.

3. DESIGNATE ONE OR MORE FGD OVERSEERS

Progress toward fairer government disclosure would also be facilitated through the appointment of one or more FGD overseers. In the executive branch, for example, an official from the Office of Information and Regulatory Affairs (OIRA), a subdivision of the OMB, could coordinate with agency heads and disseminate information and best practices across agencies.³⁸⁷ In the legislative branch, one or more persons could be charged with similar responsibilities in connection with individual congressional offices. The Senate Select Committee on Ethics and the House Committee on Ethics could, for instance, each designate a particular staff counsel to perform this role.

4. GREATER USE OF THE INTERNET

Regulation FD prompted publicly traded companies to harness the power of the Internet, which now provides the public with routine access to earnings conference calls and in-person meetings between corporate executives and securities analysts.³⁸⁸ We would hardly support an FGD regime in which live webcasts were required for all meetings and briefings between federal officials and outside parties. But such webcasts might nonetheless be appropriate when senior agency officials, or members of Congress and their senior staffs, participate in briefings with political intelligence consultants, hedge funds, or other investors who are likely to use government information to profit in securities markets. An alternative to webcasts would be to post talking points memoranda on the executive agency or congressional office website, with the agency or office announcing that practice well in advance so that its website becomes a "recognized channel of

386. *But see supra* note 137 and accompanying text (discussing a leaking scandal in 1919 involving a law clerk to United States Supreme Court Justice Joseph McKenna).

387. OIRA already "oversees the implementation of government-wide policies in several areas, including information quality and statistical standards." *About OIRA*, OFF. OF MGMT. & BUDGET, http://www.whitehouse.gov/omb/inforeg_administrator (last visited Nov. 25, 2012).

388. *See supra* note 354 and accompanying text (noting that issuer use of webcasts quadrupled in the year following Regulation FD's adoption).

distribution” for new and important information.³⁸⁹ The principal exceptions to the webcast or talking points protocols would involve meetings and briefings with persons who have entered into confidentiality agreements that include a promise not to use material nonpublic information in securities trading,³⁹⁰ or meetings and briefings in which agency or congressional officials are confident that material nonpublic information will not be traded on or revealed.

Senior agency officials, as well as members of Congress and their senior staffs, could also adopt a general practice of posting on websites the time and place of their meetings and the names of attendees outside the government. Although the content of the discussion at these meetings would not need to be revealed, the disclosure of the meeting itself (e.g., “Treasury Secretary meeting with Ms. A from XYZ, Inc.” or “Congresswoman B meets with Mr. C”) would provide the public with some useful information and would discourage unfair selective disclosure of nonpublic information. This idea is hardly a new one: in 2006, the Sunlight Foundation launched a campaign (dubbed “Operation Punch Clock”) to encourage members of Congress to post their official daily schedules on the Internet.³⁹¹

Lastly, federal agencies and congressional offices could make greater use of the Internet by publicly posting material that could reveal leanings, deliberations, or decisions that otherwise would be known only by the well connected.³⁹² One example of a “best practice” is the

389. SEC Guidance on Corporate Web Sites, *supra* note 344, at *6.

390. See *infra* Part III.B.5. Discussion of nonpublic government information at certain broad categories of meetings, such as partisan political events and fundraisers, could perhaps be prohibited outright. The Hatch Act, 5 U.S.C. §§ 7321–26 (2006), already requires that executive branch officials attend such events only in their personal capacity. So it would be difficult to justify a legitimate, good faith reason for the disclosure of nonpublic government information at these events. On the other hand, a blanket ban that would prohibit federal officials from disclosing material nonpublic government information to certain categories of persons or entities (such as political intelligence consultants, hedge funds, or other professional investors) would likely trigger constitutional challenges under the Equal Protection Clause or First Amendment (and may also implicate protections under the Speech or Debate Clause for congressional officials). See *supra* Part I.B.3.b.

391. OpenCongress reports that five Senators and three Representatives currently post their schedules online: Senator Max Baucus (D-Mont.), Senator Mark Begich (D-Alaska), Senator Kirsten Gillibrand (D-N.Y.), Senator Bill Nelson (D-Fla.), Senator Jon Tester (D-Mont.), Representative Kathy Castor (D-Fla.), Representative Denny Rehberg (R-Mont.), and Representative John Yarmuth (D-Ky.). *Members of Congress Posting Schedules Online*, OPENCONGRESS, http://www.opencongress.org/wiki/Members_of_Congress_posting_schedules_online (last visited Nov. 1, 2012).

392. See Zagorin, *supra* note 47 (discussing a proposal from OpenTheGovernment.org, a coalition chaired by POGO, “under which federal departments would routinely and pro-actively post to the Internet non-exempt

Federal Reserve Bank of New York's recently announced decision to post on its website the surveys it sends to major financial firms ahead of monetary-policy meetings.³⁹³ Because those surveys contain queries that "can provide early clues to the Fed's thinking," same-day website accessibility creates a leveler playing field for ordinary investors who previously lacked access to these surveys.³⁹⁴ The following month, the Fed announced its own new policy for public disclosure of federal funds rate forecasts by its policy committee members.³⁹⁵ Although the Fed has reasons to publicly disclose such internal deliberations beyond avoiding unfair selective disclosure,³⁹⁶ the new Fed policy reduces that risk as well.

5. CONFIDENTIALITY AGREEMENTS WITH NON-USE COMPONENTS

Regulation FD permits a corporate executive to selectively disclose material nonpublic information to securities analysts, institutional investors, and other persons who expressly agree—either orally or in writing—to maintain the disclosed information in confidence.³⁹⁷ Although SEC Rule 10b5-2 provides that confidentiality agreements create a duty of trust or confidence for purposes of the misappropriation theory of insider trading,³⁹⁸ many securities issuers now include a non-use component that specifically obliges the recipient not to trade securities on the basis of that information.³⁹⁹

information about issues of clear public concern for all to see, rather than passively waiting for FOIA requests to open a window on their activities").

393. Susan Pulliam, *NY Fed Opens up Its Discussions with Banks*, WALL ST. J., Dec. 3, 2011, at A4.

394. *Id.*

395. See Jon Hilsenrath & Luca Di Leo, *Fed Will Detail Rate Plans, Easing Market Guesswork*, WALL ST. J. (Jan. 4, 2012), <http://online.wsj.com/article/SB10001424052970203462304577138850741089974.html> ("Under the plan, the Fed will publish a range of forecasts for interest rates among the central bank's 17 individual policy makers—including five board governors and 12 regional Fed bank presidents.").

396. See *id.* ("Mr. Bernanke wants to inject more clarity into how the Fed makes decisions about the direction of rates, believing such guidance will reduce public uncertainty about the Fed and give it more scope to manage the economy.").

397. See 17 C.F.R. § 243.100(b)(1)(iv) (2012).

398. See § 240.10b5-2(b)(1) (2012).

399. See JAMES T. ROTHWELL, *PIPES Enforcement Actions*, CORP. L. & PRACT. COURSE HANDBOOK SERIES (2012) ("[I]f you want the recipient not to trade, you had better be specific. The safest approach, of course, is to seek a written contractual standstill from recipients."); *supra* note 334 and accompanying text (discussing the district court's decision in *SEC v. Cuban*, 634 F. Supp. 2d 713 (N.D. Tex. 2009)).

Federal officials regularly employ confidentiality agreements with a non-use component in their interactions with individuals and entities outside the government who are serving as contractors. Specifically, government contractors typically sign agreements that prohibit the contractor and its affiliates from “[u]sing or releasing nonpublic information received under the contract except under limited conditions.”⁴⁰⁰ Moreover, to guard against organizational conflicts of interest that would arise if nonpublic information were used in competitive bidding situations, government contractors routinely set up firewalls “to ensure that the personnel preparing a contractor’s proposal do not have access to nonpublic information that the contractor obtained in the performance of a related contract.”⁴⁰¹

Using the model employed for federal contracting, other recipients of the government’s material nonpublic information could also be asked for assurances of confidentiality and non-use. If community college officials, for example, wish to discuss information that the DOE is not yet prepared to release publicly, the meeting could begin with a statement by a DOE official that the information is not to be used for securities trading, and that a confidentiality promise and nonuse agreement are preconditions for continuing. Once those assurances are given, DOE officials should then attempt to identify the nonpublic information they convey, so that the community college officials are put on notice as to what disclosures must be retained in confidence.

Senior agency officials and congressional officials should also make greater use of confidentiality agreements with nonuse components in the context of private meetings with political intelligence consultants, as well as hedge fund managers and other investors, whose insight and guidance are being sought on issues of policy. Then, if a hedge fund or other investor trades securities while the agreement is still in place, or if political consultants subject to an agreement share that information with traders, the SEC or DOJ could pursue that person under the misappropriation theory of insider trading: the nonuse and confidentiality agreement creates the relationship of trust and confidence that gives rise to a disclosure duty under Section 10(b) and Rule 10b-5.⁴⁰²

400. Keith R. Szeliga, *Conflict and Intrigue in Government Contracts: A Guide to Identifying and Mitigating Organizational Conflicts of Interest*, 35 PUB. CONT. L.J. 639, 647 (2006).

401. *Id.* at 665. See generally Kathleen Clark, *Ethics for an Outsourced Government* (Wash. Univ. in St. Louis Legal Studies Research Paper Series, Paper No. 11-05-0, 2011), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1840629.

402. See § 240.10b5-2(b)(1); *Cuban*, 634 F. Supp. at 728; *supra* text accompanying notes 333–334.

6. ADDITIONAL PRECAUTIONS FOR MARKET-SENSITIVE DATA

Several sectors of the government already go to great lengths to ensure that the release of market-sensitive data to the public is handled in a way that is fair to all investors. Some of these procedures were adopted in response to scandals involving leaks by executive agency employees. Recall that, to prevent a reoccurrence of a 1905 scandal, the USDA adopted strict security measures that protect crop data.⁴⁰³ More recently, in response to SEC and DOJ concerns in 2007 about possible leakages, the Department of Labor (DOL) and several other agencies reinforced their procedures to prevent the premature release of key market-sensitive statistics, such as the monthly Consumer Price Index (CPI), gas prices, home sales, and the unemployment rate.⁴⁰⁴ This data is kept inside a lock-up room with the explicit understanding that that the data will be embargoed until a designated time.⁴⁰⁵ As the DOL's Press Lock-ups Policy Statement explains, "lock-ups provide press the opportunity to read, review, ask questions about and compose coverage of the data."⁴⁰⁶

A recent dispute between the DOL and several news organizations over access to the lock-up room is instructive. Upon learning that certain little-known news organizations were effectively operating as conduits for hedge funds, the DOL took steps to revoke their press credentials.⁴⁰⁷ DOL officials were concerned because securities trades were being placed from inside the lock-up room immediately upon the embargo's expiration and thus before the market as a whole had an opportunity to access the information.⁴⁰⁸ Other organizations were asked to replace their computers in the lock-up room with new computers that could not be linked automatically to specialized trading models.⁴⁰⁹ The DOL took these steps to ensure that its data was released to "primarily journalistic" news organizations, which would

403. See *supra* note 61 and accompanying text.

404. See John H. Cushman, Jr., *Guarding the Numbers*, N.Y. TIMES, July 17, 2012, at B1 (reporting that the DOL guards the monthly CPI "with launch-code secrecy, a precaution against anyone who might try to take advantage of an accidental or a surreptitious leak to gain an insider's edge in the financial markets, turning milliseconds into millions").

405. U.S. DEP'T OF LABOR PRESS LOCK-UPS POLICY STATEMENT AND NEWS ORGANIZATION AGREEMENT (2012), available at www.dol.gov/opa/media/press/opa/OPA20120672.pdf.

406. *Id.*

407. Cushman, *supra* note 404.

408. *Id.*

409. *Id.* (observing that, because many hedge funds use computerized trading programs that are determined in advance, the very act of communicating information to a hedge fund computer may instantaneously result in a trade).

immediately share the unembargoed data with the general public or a broad base of subscribers.⁴¹⁰ Other agencies, however, may not be as willing as the DOL to venture down the politically perilous path of determining the bona fides of news organization seeking access to lock-up rooms or briefings.⁴¹¹

Although some executive agencies take extreme precautions in connection with the release of highly market-sensitive government data, it is often the case that public disclosure of government information need not be synchronized in so exact a manner, particularly if significant cost to taxpayers or impairment of government functions will result. For example, the Department of Transportation (DOT) probably does not need to take extraordinary measures to ban cell phones, Blackberries, and handheld computers from the press room when it announces a new policy initiative or the award of a significant government contract. On the other hand, agency staff should not talk about such developments in the hallways in the days or hours before a public announcement at a press conference.

Whenever market-moving government information is initially made public, there will always be some securities traders who are lucky

410. *Id.* The DOL identified “Need to Know News,” a small enterprise owned by the German exchange, as an example of an organization whose “data goes directly from the lock-ups to specialized trading programs.” *Id.* The DOL explained that Need to Know News was not “primarily journalistic” and did not “disseminate their information to a wide audience.” *Id.*

411. The Treasury Department is another agency that often embargoes certain market-sensitive information announced in press conferences. A 2001 incident reminds that the misuse of embargoed information may be prosecuted as securities fraud. The incident involved a political consultant who ultimately pled guilty to charges that he illegally tipped embargoed T-Bill information to bond traders at Goldman Sachs and other investment firms. *See* Davis, *Litigation Release No. 18,322, 80 SEC Docket 2952* (Sept. 4, 2003); *SEC v. Nothern*, 598 F. Supp. 2d 167, 177 (D. Mass. 2009) (holding that there was sufficient evidence for a jury to find that the consultant had illegally misappropriated the T-Bill information and that the tippee-defendant knew or shown have known that the consultant was breaching a duty of trust and confidence which he owed to the Treasury Department). Constitutional questions, however, might arise if a news reporter, as opposed to a consultant, were prosecuted for the premature publication of embargoed information. *Cf. Bartnicki v. Vopper*, 532 U.S. 514, 528 (2001) (observing that *New York Times Co. v. United States*, 403 U.S. 713 (1971) (per curiam), “raised, but did not resolve, the question whether, in cases where information has been acquired unlawfully by a newspaper or by a source, government may ever punish not only the unlawful acquisition, but the ensuing publication as well” (internal quotation marks omitted)); *New York Times Co.*, 403 U.S. at 714 (holding that the *New York Times* could publish portions of a classified Department of Defense study of United States-Vietnam relations and the conduct of the Vietnam War); Geoffrey R. Stone, *WikiLeaks and the First Amendment*, 64 *FED. COMM. L.J.* 477, 487–89 (2012) (discussing the circumstances under which the government can constitutionally punish the publication or public dissemination of classified information).

enough to act on it first, whether due to happenstance or because they had trading programs already in place.⁴¹² The most relevant consideration for an FGD regime, however, is whether any person's trading advantage results from favoritism on the part of an executive agency, congressional office, or its staff that could have been avoided without creating an unreasonable cost to taxpayers or undue interference with the agency or office's principal functions.

7. CONSULTATIONS WITH AND REFERRALS TO THE SEC

When Congress created the SEC in 1934, it empowered the agency to regulate the ongoing disclosure practices of SEC reporting companies.⁴¹³ Nothing in this charge, however, vests the SEC with the authority to regulate the ongoing disclosure practices at other executive agencies or in the legislative or judicial branches of the federal government. Of course, to the extent that officials in any of the three branches commit fraud "in connection with the purchase or sale of any security," Section 10(b) and Rule 10b-5 provide a basis for both civil and criminal liability.⁴¹⁴ And if the elected nature of their offices provided a reason to doubt that basis for members of Congress (or the President and Vice President), the STOCK Act expressly removes that doubt.⁴¹⁵

Although the SEC should not embroil itself in matters outside its regulatory mission, its expertise on disclosure issues is an important resource that could be tapped by other executive agencies or by officials in Congress and the courts. Executive, judicial, and congressional officials should be encouraged to consult with the SEC on issues relating to fairer government disclosure. Beyond that, if executive, congressional, or judicial officials have suspicions about the possibility of fraudulent tipping or trading in securities, a referral to the SEC should be made immediately.

412. See *Dirks v. SEC*, 463 U.S. 646, 666 n.27 (1983) ("[A]s market values fluctuate and investors act on inevitably incomplete or incorrect information, there always are winners and losers.").

413. See Securities Exchange Act of 1934, ch. 404, § 13(a), 73 Stat. 881 (codified at 15 U.S.C. § 78m(a) (2006)).

414. See § 10(b); 17 C.F.R. § 240.10(b) (2012).

415. See STOCK Act, Pub. L. No. 112-105, §§ 4(b), 9(b), 126 Stat. 291 (to be codified at 15 U.S.C. § 78u-1(g) to (h)). Section 4(b) refers expressly to members of Congress and Section 9(b)(2) specifies that the term "executive branch employee" includes the President and the Vice President. *Id.*

CONCLUSION

Securities trading on the basis of selectively disclosed material nonpublic information allows investors to profit from access to knowledgeable sources—whether the source is situated inside a publicly traded company or inside the federal government. The selective disclosure to outsiders, however, is unlikely to conflict with the duty of trust and confidence that is owed to the sources of the information because the insider usually has an apparently legitimate reason for communicating the information. Sharing the information, and trading securities based on that information, thus would not violate the insider trading prohibitions arising under the federal securities laws. The selective disclosure and trading nonetheless undermines confidence in the fairness and integrity of securities markets.

Curtailing the problem of selective disclosure in the private sector required looking beyond Section 10(b) and Rule 10b-5. The solution involved regulating the timing and manner of disclosures by corporate insiders, rather than the conduct of outsiders who gather and trade on the basis of those disclosures. The SEC embraced this approach in Regulation FD for publicly traded companies and corporate insiders have been adhering to it for more than a decade.

In the wake of the tremendous momentum and bipartisan efforts that led to the passage of the STOCK Act, attention can now turn to curtailing the problem of selective disclosure by federal officials in the public sector. A Fairer Government Disclosure (FGD) regime would boost investor confidence in securities markets and in the integrity of government itself. But the measures we propose are only a starting point. There is more study and work to be done—both by government officials and academics (including ourselves)—as to how an FGD regime can best be implemented and enforced.