

**Donna M. Nagy**  
**C. Ben Dutton Professor of Business Law**  
**Indiana University Maurer School of Law**  
**211 S. Indiana Ave.**  
**Bloomington, IN 47405**

**Richard W. Painter**  
**S. Walter Richey Professor of Corporate Law**  
**University of Minnesota Law School**  
**229 19<sup>th</sup> Avenue S.**  
**Minneapolis MN 55118**

December 11, 2020

The Honorable Nancy Pelosi  
Speaker of the U.S. House of  
Representatives  
1236 Longworth House Office Building  
Washington, DC 20515

The Honorable Mitch McConnell  
Majority Leader of the U.S. Senate  
317 Russell Senate Office Building  
Washington, DC 20510

The Honorable Kevin McCarthy  
Minority Leader of the U.S. House of  
Representatives  
2468 Rayburn House Office Building  
Washington, DC 20515

The Honorable Charles Schumer  
Minority Leader of the U.S. Senate  
322 Hart Senate Office Building  
Washington, D.C. 20510

Dear Speaker Pelosi, Minority Leader McCarthy, Majority Leader McConnell, and Minority Leader Schumer:

We write to urge the passage of a federal statute prohibiting members of Congress and their senior staff from owning securities of individual publicly traded companies as well as certain other interests in business enterprises that conflict with official duties. In 2012, in the lead up to the passage of the Stop Trading on Congressional Knowledge (STOCK) Act, the Senate considered the possibility of such a divestment requirement in the context of an amendment co-sponsored by Senators Sherrod Brown and Jeff Merkley. Their amendment was defeated in part because the requirement was viewed as unnecessary in light of the Act's mandate for more timely reporting of securities purchases and sales. But now, eight years and many securities trading scandals later, the need for additional legislative reform is abundantly clear, and a host of Senate and House members have recently introduced or co-sponsored bills that would require divestiture.

We discuss below two problems that arise when congressional officials own stocks in individual publicly traded companies—conflicts of interest and insider trading—and the reasons why divestment would minimize the risk of both.

*The conflict of interest problem*

18 U.S.C. § 208 criminalizes financial conflicts of interest for every federal executive branch official other than the president and vice president. More specifically, the statute makes it a crime for a federal official to participate personally and substantially in any particular matter that has a direct and predictable effect on the financial interest of the official or a spouse or minor child

as well as entities of which the official is a partner, director, or trustee. This includes a company in which the executive branch official or any of these persons or entities owns an equity interest above a de minimis amount. Some have argued that elected officials are constitutionally required to be exempt from conflict of interest statutes restricting their official duties,<sup>1</sup> but this position has gone unrefuted because the current statutory language in 18 U.S.C. § 208 does not extend to the president and vice president.

One of us previously proposed applying 18 U.S.C. § 208 or a similar conflict of interest prohibition to members of Congress.<sup>2</sup> The other proposed prohibiting members of Congress and their senior staff from holding individual stocks and other conflict creating investments to begin with.<sup>3</sup> The latter approach of requiring divestment is simpler and more likely to be effective. Instead of criminalizing certain official acts within the scope of federal elected officials' enumerated powers in Article I of the Constitution, a statute could require members of Congress to divest certain prohibited holdings before taking office and to refrain from acquiring additional prohibited holdings while in office. Senior staff of members of the House and Senate, as well as senior staff of House and Senate committees, also should be required to divest, although more flexibility could be given to staff members who choose to recuse from a particular matter as an alternative to divestment. Members of Congress should be available to vote on matters before Congress, but staff members can more easily recuse if divestment is burdensome for them or for a spouse.

Senate committee staff are currently prohibited from investing in companies if there is a conflict with official duties. Senate Rule 37(7), adopted in 1977, provides that: “[a]n employee on the staff of a committee. . . shall divest himself of any substantial holdings which may be directly affected by the actions of the committee for which he works, unless the Select Committee, after consultation with the employee's supervisor, grants permission in writing to retain such holdings or the employee makes other arrangements acceptable to the Select Committee and the employee's supervisor to avoid participation in committee actions where there is a conflict of interest, or the appearance thereof.”<sup>4</sup> Ironically—one also could say hypocritically—the same rule does not apply to the senators themselves. Our recommendation is to embody that same norm in a federal statute that would apply to senators, representatives, and their senior staff. Furthermore, the divestment requirement should cover all publicly traded securities in individual companies, not just securities that create immediate conflicts of interest with matters presently pending before Congress. This

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<sup>1</sup> See Memorandum to Richard T. Burrell, Office of the President, from Laurence H. Silberman, Deputy Attorney General, Re: Conflict of Interest Problems Arising out of the President's Nomination of Nelson A. Rockefeller to be Vice President under the Twenty-Fifth Amendment to the Constitution at 2, 5 (Aug. 28, 1974) (opining that Congress did not intend to apply the financial conflict of interest statute to the president and vice president and that doing so would raise “[s]ome doubt . . . as to the Constitutionality of the statute”).

<sup>2</sup> RICHARD W. PAINTER, *GETTING THE GOVERNMENT AMERICA DESERVES: HOW ETHICS REFORM CAN MAKE A DIFFERENCE* (Oxford U. Press 2009) at 148.

<sup>3</sup> Donna M. Nagy, *Owning Stock While Making Law: An Agency Problem and a Fiduciary Solution*, 48 WAKE FOREST L. REV. 567 (2013), available at SSRN: <https://ssrn.com/abstract=2373180>.

<sup>4</sup> Senate Code of Official Conduct, Committee on Ethics, Rule XXXVII(7) (applying to “[a]n employee on the staff of a committee who is compensated at a rate in excess of \$25,000 per annum and employed for more than ninety days in a calendar year”), available at <https://www.ethics.senate.gov/public/index.cfm/conflictsofinterest>.

requirement would help ensure that senators, representatives, and their senior staff will be conflict free when new matters arise.

Instead of requiring themselves to divest, senators have in place an extraordinarily weak ethics rule that requires a senator not to engage in certain actions the “*principal purpose* of which is to further *only* his pecuniary interest. . . .”<sup>5</sup> Other than a very few situations — perhaps inserting into a bill an earmark of a federal contract only for a company in which the senator has a controlling financial interest—it is difficult to imagine a situation where the prohibition in this rule would apply. In almost every situation there are some other purposes that senators can claim for legislation as well as other pecuniary interests, including those of other shareholders, that are furthered by the legislation. If the words “principal purpose” and “only” were to be inserted in this manner into the anti-conflict restraint in 18 U.S.C. § 208, the statute’s impact on the executive branch would be utterly meaningless. Applying a very different, almost nonexistent, financial conflict of interest rule to senators is a hollow gesture that significantly undermines public confidence in our government.

U.S. House ethics rules only require that representatives not use “the influence of [their] position . . . to make pecuniary gains.”<sup>6</sup> This language also is inadequate. It is extremely vague and far too dependent on a subjective showing of intent by House members to advance their own financial interests instead of to advance some other objective. Indeed, the language of the House rule is so open ended that defenses in ethics investigations can be absurd.<sup>7</sup>

Federal judges, in stark contrast, are bound by a strict conflict of interest provision, which is embodied in 28 U.S.C. § 455 and requires judges to recuse from cases involving companies in which they own stock.<sup>8</sup> Although federal judges are not required to divest themselves of individual

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<sup>5</sup> *Id.* at Rule XXXVII(4) (stating that “[n]o Member, officer, or employee shall knowingly use his official position to introduce or aid the progress or passage of legislation, a principal purpose of which is to further only his pecuniary interest, only the pecuniary interest of his immediate family, or only the pecuniary interest of a limited class of persons or enterprises, when he, or his immediate family, or enterprises controlled by them, are members of the affected class”).

<sup>6</sup> H. COMM. ON STANDARDS OF OFFICIAL CONDUCT, 110TH CONG., U.S. HOUSE ETHICS MANUAL at 186 (quoting 114 Cong. Rec. 8807 (Apr. 3, 1968)). House Code of Official Conduct Rule 23(3) provides that a Member, officer or employee “may not receive compensation and may not permit compensation to accrue to his beneficial interest from any source, the receipt of which would occur by virtue of influence improperly exerted from his position in Congress.” *Id.*

<sup>7</sup> See, e.g., *Congressman Offers Unusual Defense in Ethics Probe: Williams wasn’t helping himself, he was helping lobbyist*, Center for Public Integrity (September 13, 2016) (observing that the congressman, himself an auto dealer, introduced an amendment benefiting auto dealers, but claimed in his own defense in an ethics inquiry that he had introduced the bill not to help himself but instead to help a lobbyist, who was a campaign contributor and had drafted the proposed amendment), available at <https://publicintegrity.org/politics/congressman-offers-unusual-defense-in-ethics-probe/>.

<sup>8</sup> 28 U.S.C. § 455(a) provides that any U.S. justice, judge, or magistrate judge is required to disqualify himself or herself in any proceeding in which his or her “impartiality might be reasonably questioned.” Subsection (b) states that the judge “shall also disqualify himself in the following circumstances: . . . (4) He knows that he, individually or as a fiduciary, or his spouse or minor child residing in his household, has a financial interest in the subject matter in controversy or in a party to the proceeding, or any other interest that could be substantially affected by the outcome of the proceeding. . . .”

stocks, they are required to recuse from cases that may affect the value of their stocks. The preferred method for avoiding these conflicts is for judges to invest in diversified mutual funds and other conflict free assets.

In sum, financial conflicts of interest involving ownership of stock and other equity interests in businesses are strictly prohibited for most federal officials outside the legislative branch. This disparity is untenable and needs to be corrected. The preferable approach is a statute that requires divestment of most conflict creating financial interests for congressional officials and their senior staff. Recusal rules would then be more workable in addressing the financial conflicts of interest that remain.

The argument that disclosing financial conflicts of interest is an adequate remedy is wrong for several reasons. First, requiring disclosure only is not the standard that Congress applies to executive branch officials who are subject to 18 U.S.C. § 208's criminal financial conflict of interest prohibition *and* at a certain level of seniority also are required to disclose publicly their financial holdings. Second, financial conflicts of interest in Congress affect the entire country whereas only voters in a representative's district or a senator's state have a say in whether the conflict of interest warrants removal from office. Third, many incumbent representatives and senators have "safe" seats and know that they can do as they please with electoral impunity. It makes no sense for representatives and senators in swing districts and states to be held to a higher standard of ethics than their colleagues simply because, for unrelated political reasons, voters are more willing to remove them. A uniform standard of ethics for the House and Senate requiring divestiture of publicly traded securities and most other financial conflicts of interest is the only ethically acceptable answer.

We also emphasize how appearances can foster corrosive beliefs that personal financial interests are placed ahead of the public interest. Even if representatives or senators are not influenced by personal finances in sponsoring bills or casting votes, ownership of securities affected by legislation creates the appearance of corruption. Even if a representative or senator does not trade on nonpublic information, a problem we discuss in more detail below, the public may suspect otherwise. Such allegations may be magnified in election years when opponents feature them in attack ads. Instilling public confidence in Congress requires lawmakers to impose upon themselves certain rules of ethical behavior—and that includes a rule prohibiting ownership of publicly traded securities while in office.

### *The insider trading problem*

Another serious problem, insider trading, arises in connection with some of these financial interests. Most insider trading occurs in publicly traded securities, although use of misappropriated information in private securities transactions also can be illegal.

Illegal insider trading involves the use in securities trading of material nonpublic information that is misappropriated from the source of the information in violation of a relationship

of trust and confidence. The employer-employee relationship is the most common example, but other relationships of trust and confidence can create insider trading liability as well. Government officials, like employees of banks, law firms, and corporations, often are entrusted with nonpublic information and violate the law if they use this information for securities trading without first disclosing to their principals their intent to trade. Elected officials also are in a relationship of trust and confidence with the government and can incur insider trading liability with respect to nonpublic information they learn in the performance of official duties. This point already should have been clear from the fiduciary character of federal office and the federal case law interpreting Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder. But to remove any doubt, Congress enacted the STOCK Act, which amended the Exchange Act to provide that a member of Congress “owes a duty arising from a relationship of trust and confidence to Congress, the United States Government, and the citizens of the United States with respect to material, nonpublic information derived from such person’s position . . . or gained from the performance of such person’s official responsibilities.”

One of several problems with insider trading law is that trading on the basis of material nonpublic information is sometimes difficult to prove. Discerning whether a member of Congress was in possession of nonpublic information requires trained investigators, probably from the Securities and Exchange Commission or from the Department of Justice, to obtain copies of and review emails, phone logs, and testimony of witnesses who know what information was disclosed to the member and when. Such an investigation, among other problems, raises difficult questions under the Speech or Debate Clause of the Constitution,<sup>9</sup> and even if constitutionally permissible is likely to encounter strong pushback from Congressional leadership.

Another problem is that members of Congress who own securities in individual companies, when confronted with a conflict of interest, may not be able to sell the securities to resolve the conflict without risking liability under the insider trading laws. If material nonpublic information is disclosed to members at the time they become aware of a conflict of interest, it may be too late to sell the securities and recusal from a congressional investigation or legislation may be the only option that is both legal and ethical.<sup>10</sup> This problem would be avoided if the member did not own the stock to begin with. Given the wide range of matters that come before Congress, this is yet another reason for members to divest of individual company holdings upon entering Congress and to remain divested until they depart.

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<sup>9</sup> Article I, Section 6, Clause 1 of the Constitution provides that members of Congress “shall in all Cases, except Treason, Felony and Breach of the Peace be privileged from Arrest during their attendance at the Session of their Respective Houses, and in going to and from the same; and for any Speech or Debate in either House, they shall not be questioned in any other Place.” See *United States v. Rayburn House Office Building, Room 2113*, 497 F.3d 654 (D.C. Cir. 2007) (considering an appeal relating to an FBI search of a Congressman’s office in a corruption investigation and holding “that the compelled disclosure of privileged material to the Executive during execution of the search warrant for Rayburn House Office Building Room 2113 violated the Speech or Debate Clause and that the Congressman is entitled to the return of documents that the court determines to be privileged under the Clause”).

<sup>10</sup> See PAINTER, *GETTING THE GOVERNMENT AMERICA DESERVES*, *supra*, Chapter 9, *When Ethics Law and Other Law Intersect: Insider Trading, Taxes and Financial Conflicts of Interest*, at 176-77 (proposing that the SEC establish a safe harbor protecting a government official from insider trading liability when the official sells securities upon learning of a conflict of interest requiring divestment or recusal from a particular matter under applicable rules). To date, the SEC has not established such a safe harbor for “ethics” motivated securities sales, making it much preferable for the official not to own the securities to begin with.

### *Investments that should be prohibited*

The House Ethics Manual depicts the divestiture alternative to recusal as being “impractical” and “unreasonable” and even argues that members should not be “expected to strip themselves of all of their worldly goods.”<sup>11</sup> We take issue with each of these claims. As one of us has already pointed out in a law review article, this hyperbole ignores the wide range of conflict-free investments, including diversified mutual funds and index funds, that are available to members of Congress who divest from individual stocks.<sup>12</sup> Another argument made in the House Ethics Manual against divestiture is that it would insulate legislators from the personal and economic interests held by their constituents.<sup>13</sup> Once again, there are plenty of conflict-free assets, including mutual and index funds, that reflect the economic interests of a member’s constituents and probably better than ownership of shares in a particular company.<sup>14</sup> Even if the individual companies are major employers in the congressional district, ownership of stock in the employer does not necessarily align the member’s interests with the interests of its employees. Few if any members of Congress represent districts in which a large percentage of their constituents own considerable holdings in individual companies.

Publicly traded individual stocks should be prohibited investments as they pose both the risk of conflicts of interest and insider trading. There is no reason to own individual stocks; modern portfolio theory holds that most stocks are efficiently priced based on publicly available information—there being no obvious “bargains” to be had in publicly traded markets. To the extent there are such bargains to be found, it is also likely that professional portfolio managers at mutual funds are better stock pickers than elected officials who are complying with insider trading law and not trading on nonpublic information. Short selling of any stocks by elected officials should also be strictly prohibited—nothing is more unsavory and probably illegal than a member of Congress voting to regulate or tax a company or its industry after shorting its stock.

Private equity funds and hedge funds also should probably be prohibited investments, although conflict of interest concerns are mitigated if investors have minimal knowledge of the underlying assets, and insider trading concerns are mitigated if investors do not have control over trading decisions and do not move in and out of funds while holding public office. Still, the lack of transparency surrounding hedge funds and private equity funds undermines public confidence in the public officials who own shares in them. The fact that such funds are reported on an elected official’s public financial disclosure forms is of little help when there is no publicly available information about the underlying assets.

Equity interests in privately held businesses also can be highly problematic at least from a conflict of interest perspective. Most should be divested by the office holder if at all possible. Controlling interests in businesses that raise capital, borrow money or do considerable business

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<sup>11</sup> HOUSE ETHICS MANUAL at 250.

<sup>12</sup> Nagy, *Owning Stock While Making Law*, at 601.

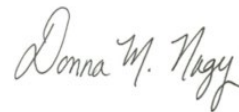
<sup>13</sup> HOUSE ETHICS MANUAL at 250.

<sup>14</sup> Nagy, *Owning Stock While Making Law*, at 601.

overseas must be divested to avoid violations of the foreign emoluments clause of the Constitution. Controlling interests in businesses highly likely to be affected by legislation in highly regulated sectors such as energy, health care, defense, and financial services should also be divested. Exceptions should be made to allow elected officials to own, through corporate entities or otherwise, family owned farms and some other local businesses that may help align the interests of elected officials with the interests of many of their constituents.

In sum we urge you to introduce a bill—or advance one of the many bills already introduced in both the House and Senate—that would ban senators, representatives, and their senior staff from owning securities in individual publicly traded companies and also would prohibit most other financial conflicts of interest for members of Congress.

Respectfully,



Donna M. Nagy



Richard W. Painter