Testimony of

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on behalf of

The Sunshine in Government Initiative

Before the
Committee on Financial Services
U.S. House of Representatives

Regarding

Legislative Proposals to Address Concerns Over
the SEC's New Confidentiality Provision

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Chairman Frank, Ranking Member Bachus, and Members of the Committee,

I am grateful for the opportunity to testify today. I especially want to thank you, Mr. Chairman, for taking the time to hold this hearing to air concerns about Section 929I of the Dodd-Frank Wall Street Reform and Consumer Protection Act (PL 111-203, 124 Stat. 1376, hereafter ("Dodd-Frank").

Simply put, our concern is that under Sec. 929I as it is currently written in the law, journalists and the public will have an even harder time knowing how well (or poorly) the Securities and Exchange Commission (SEC) is doing its job.

About the Sunshine in Government Initiative

I testify today on behalf of the **Sunshine in Government Initiative (SGI)**, a coalition of media associations promoting policies and practices of transparency in the federal government. Members include the **American Society of News Editors**, **Associated Press**, **Association of Alternative Newsweeklies**, **National Association of Broadcasters**, **National Newspaper Association**, **Radio-Television Digital News Association**, **Reporters Committee for Freedom of the Press**, and **Society of Professional Journalists**.

Our members work tirelessly to strengthen the federal Freedom of Information Act (FOIA). From disaster response to food safety to federal spending, democracy lives on the free flow of information. As part of our open government promotion, SGI hosts an online database of news and other stories that relied on FOIA to inform the public. We have over 500 stories in our files which demonstrate FOIA's contribution to democracy, with more coming weekly.

We recognize there are reasons for keeping some information confidential, to protect national security, legitimate trade secrets and law enforcement investigations to name a few. We simply believe that the exemptions to FOIA must be narrow in scope and enacted only after careful consideration. To that end, a significant aspect of our work involves finding and deterring overbroad or unnecessary exemptions written elsewhere into federal law. One of the biggest violators, in terms of overbroad FOIA exemptions, are the laws known as Exemption 3, or "(b)(3)" statutes for the subsection of FOIA that acknowledges them. We have counted over 250 of these, many of which are entirely unnecessary in nature. Sec. 929I of the Dodd-Frank Wall Street Reform and Consumer Protection Act is *just one* of these (b)(3) exemptions.

Before I continue, however, let me be clear: We do not believe this Committee or the SEC was actively concealing the existence of this provision. We understand the SEC wants to protect its ability to gather information and effectively oversee the banks, hedge funds, private equity firms and other financial firms that operate under its authority. Journalists also need to observe and report how effectively the SEC is doing its job, especially when the answer is "not very well at all."

I would like to use my time to highlight four points.

First, the statute as written is facially broad and subject to interpretation.

Second, Sec. 929I's flaws can be remedied only by an act of Congress that clarifies and narrows the statute's scope.

Third, the approaches taken by legislation pending before Congress to fix Section 929I would be better than additional study while Sec. 929I stands.

Fourth, Congress, with the leadership of this and other committees, can help strengthen review of proposed statutory exemptions from FOIA disclosure.

Section 929I is overbroad and should be rewritten

To begin, Sec. 929I is overbroad and should be rewritten.

Chairman Shapiro has noted that Sec. 929I is meant to let the SEC "quickly obtain important information from entities registered with the SEC when performing examinations."

As you are well aware, at its broadest Sec. 929I allows the SEC to withhold records or information provided to the Commission, or information *"based upon or derived from"* such information, in furtherance of the SEC's "regulatory or oversight activities" which may or may not involve risk assessments and surveillance activities.[1]

That is a far broader exemption than the SEC describes in its explanatory letter to this committee.

First, "other regulatory and oversight activities" arguably includes all the Commission's official business, including its approach to oversight, number of open and closed investigations, and other information revealing little about specific trades, trading algorithms, or other information held by hedge funds or investment companies.

Second, Sec. 929I notes examples of the types of information the Commission may withhold but does not clarify the limits of the exemption with examples of what the SEC must still disclose.

Third, the statute gives too much discretion to the SEC to decide what should be disclosed or withheld. This is a key factor the courts look at in determining whether a particular statute qualifies as an Exemption 3 statute under the tests provided in Subsection (b)(3)(A) of FOIA.[2]

Fourth, a narrower provision would provide greater clarity and help avoid unnecessary litigation. One court has already ruled the statute upon which Section 929I is based to be too vague to qualify as a (b)(3) statute.[3] In that case the SEC chose to disclose some documents but withhold similar information. Section 929I is similar: It is a broadly worded statute and it would be subject to the interpretation and discretion of the SEC to decide what to withhold. Further, one news story strongly indicates further litigation on Sec. 929I is likely.[4]

Fifth, while the SEC indicates cooperation is the goal, the result may be quite the opposite. Noting that the law is vague and SEC's implementation is unclear, one firm already recommends that companies stamp "confidential" on documents they previously would have turned over freely.[5]

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[1] Sec. 929I(a), Sec. 929(b) and Sec. 929(c), which refer to the Securities and Exchange Act of 1934 (15 U.S.C. 78x), Investment Company Act of 1940 (14 U.S.C. 80a- 30) and Section 204 of the Investment Advisers Act of 1940, respectively. The phrasing is identical in each subsection.

[2] Long v. IRS 742 F. 2d 1173, 1179 (9th Cir. 1984).

[3] Aguirre v. SEC, 551 F. Supp. 2d 33 - (Dist Court. 2008) (ruling "[b]ecause the Investment Advisers Act gives the SEC unfettered discretion … as to what it can withhold, it cannot qualify as an Exemption 3 statute").

[4] Dunstan Prial, "SEC Says New Financial Regulation Law Exempts it from Public Disclosure," Fox Business, July 28, 2010. Available at: http://www.foxbusiness.com/markets/2010/07/28/sec-says-new-finreg-law-exempts-public-disclosure/. Accessed September 14, 2010.

[5] Kevin J. Harnisch, Paul H. Pashkoff, Michael A. Umayam and Brian T. Sumner, Fried Frank Harris, Schriver & Jacobson LLP, "Deciphering the Dodd-Frank FOIA Flap," August 18, 2010. Available at http://www.lexology.com/library/detail.aspx?g=db9436ba-6cb3-46c6-8b3a-70fcbaa2dbba; accessed August 19, 2010. They write:

> As a matter of practice, regulated entities should expressly identify document productions made pursuant to Section 17(b) of the Exchange Act, Section 204 of the Advisers Act, or Section 31 of the Investment Company Act. As noted above, the protection from public disclosure offered by

Previous efforts to carve out a FOIA exemption to induce cooperation and information sharing with the private sector have not worked. In the wake of 9/11 Congress passed a sweeping exemption from FOIA disclosure for information about the nation's critical infrastructure to encourage the government and private sector to share information and collaborate. It turns out the exemption for Critical Infrastructure Information was seldom invoked.[6] Earlier this year, the Government Accountability Office concluded that to this day, the private sector remains reluctant to share information with the government, hampering security efforts.[7]

Further, the courts are unlikely to help close the gap between narrow intent and broad implementation. Of 140 lawsuits involving Exemption 3, courts ruled for the agency 80 percent of the time, according to one analysis.[8]

For these reasons, we believe Sec. 929I is overbroad and should be rewritten. Let me turn to my second point to note why Congress should act.

Only Congress can remedy Section 929I's flaws.

Only an act of Congress can remedy Sec. 929I's flaws.

Before creating new legislation granting exemptions to disclosure, Congress and the SEC should carefully consider alternatives to secrecy to achieve the Commission's purpose. The SEC could use existing authorities more aggressively to ensure it has the information it needs, but the opportunity for abuse still exists.

Despite assurances from Chairman Shapiro that the law will be applied sparingly, we remain deeply skeptical that the SEC's plan to issue guidance to staff can fix this problem. [9] Even the most disclosure-friendly guidance is not sufficient to address this problem. We have seen agencies interpret statutory exemptions to FOIA as broadly as they see fit when they have discretion.

> Section 929I applies to documents provided to the Commission pursuant to the Examination and Surveillance Statutes. *In practice, however, the specific statutory justification underlying the Commission's request for documents or an entity's production of documents is not always clear. Unless and until Commission guidance dictates a specific procedure, regulated entities producing documents to the Commission should identify all situations where Section 929I appears to apply and submit a written cover letter, together with the documents, expressly referencing the relevant statute and claiming confidential treatment.* (emphasis added)

[6] " DHS Should Take Steps to Encourage More Widespread Use of Its Program to Protect and Share Critical Infrastructure Information," *Government Accountability Office,* GAO-06-383 (April 17, 2006).
[7] "Key Private and Public Cyber Expectations Need to be Consistently Addressed," *Government Accountability Office*, GAO-10-628 (July 2010).
[8] Catherine J. Cameron. 2009. "Fixing FOIA: Pushing Congress to Amend FOIA Section b(3) to Require Congress to Explicitly Indicate an Intent to Exempt Records from FOIA in New Legislation" ExpressO Available at: http://works.bepress.com/catherine_cameron/1; accessed September 10, 2010.
[9] Letter from Mary Shapiro, Chairman, U.S. Securities and Exchange Commission to Chairman Barney Frank, Committee on Financial Services, U.S. House of Representatives, July 30, 2010.

- After the widely publicized landing of a passenger jet in the Hudson River in January 2009, the Federal Aviation Administration argued that its database showing bird strikes on airplanes should be withheld under an exemption that allows the FAA administrator to deny a FOIA request if disclosure would harm aviation safety and security.[10] But disclosing that data set would not increase the likelihood that birds would fly into airplanes, but it might help pilots avoid flying into flocks of birds. Eventually, the Secretary of Transportation intervened and the data were released.

- One statute (41 USC 253b(m)) exempts losing contract bids from disclosure. Access to losing bids would help the public know if the winning contracts were the best possible deals for taxpayers. When first added to the National Defense Authorization Act in 1997, it only applied to the Department of Defense but through the legislative process it was broadened to apply to all agencies.[11] By 2009, 14 cabinet departments and 7 independent agencies reported using this exemption to deny 267 FOIA requests.[12]

I could go on, but the lesson is clear: When Congress writes broad exemptions, the government broadly uses them. The time to ensure that the government makes only narrow exceptions to disclosure is when Congress creates the exceptions.

I'll reiterate: <u>it is not too late to fix this problem</u>. I'd like to turn now to what this Committee and others in Congress can do to help prevent this problem from growing worse than it already is.

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[10] The FAA proposed that information in the Wildlife Hazard Database be exempt from disclosure under FOIA (*Federal Register*, Vol. 74, No. 52, Mar. 19, 2009). The Wildlife Hazard Database includes information regarding encounters between aircraft and birds and other wildlife in the air and on the ground. The FAA proposed that this database be protected under the authority of 49 U.S.C. § 40123, which allows the FAA to withhold voluntarily provided information if the FAA Administrator determines that

> (1) the disclosure of the information would inhibit the voluntary provision of that type of information and that the receipt of that type of information aids in fulfilling the Administrator's safety and security responsibilities; and
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> (2) withholding such information from disclosure would be consistent with the Administrator's safety and security responsibilities. (49 U.S.C. § 40123)

[11] See Kirsten B. Mitchell, "Open Records Audit: Agencies find a path around data disclosure," Sarasota Herald-Tribune, March 16, 2008. Available at http://www.heraldtribune.com/article/20080316/NEWS/803160786; accessed September 3, 2010.

[12] The year 2009 refers to the federal fiscal year 2009, which began October 1, 2008. This information was compiled from agency annual FOIA reports. The fourteen departments are Agriculture, Commerce, Defense, Energy, Education, Health and Human Services, Homeland Security, Housing and Urban Development, Interior, Justice, State, Transportation, Treasury and Veterans Affairs. The seven independent agencies are the Agency for International Development, Environmental Protection Agency, General Services Administration, National Science Foundation, Nuclear Regulatory Commission, Securities and Exchange Commission, and Tennessee Valley Authority.

Legislative Solutions

Dodd-Frank expanded the SEC's authority to include many new entities. It is unclear how the SEC will approach its new responsibilities and how well the Commission will do its job. Reporters want to ask these questions and provide answers.

We suggest that any statute exempting information from disclosure under FOIA include certain elements. Once a specific, articulable need for an exemption has been expressed, any statute under Exemption 3 of FOIA should include the following elements:

- **A time limit after which disclosure is appropriate.**
- **A sunset**. There should be a fixed ending period.
- **Limited scope.** Limits on what information is disclosed should be clear.
- **An assessment.** An independent entity such as the inspector general should examine the impact on transparency and the SEC's ability to obtain cooperation from regulated entities,
- **Clear criteria or no discretion to decide what to withhold.** Congress should determine what information is exempt, not the Commission.
- **Protections for whistleblowers.**

Legislation currently pending before Congress to resolve this dispute either would repeal Sec. 929I and revert to previous law, or would allow the SEC and the firms it regulates to use FOIA's categorical exemption for "financial institutions" (Exemption 8).

Simple repeal of Sec. 929I would be welcome. I suspect we would only see renewed efforts to shield this information, either through the courts or Congress. The SEC could more publicly identify specific information it seeks to keep confidential, and the specific reasons and context (such as court decisions) preventing it from protecting that information.

Congress could apply FOIA's Exemption 8 to the financial firms now subject to SEC oversight. FOIA's Exemption 8 protects matters

> contained in or related to examination, operating, or condition reports prepared by, on behalf of, or for the use of an agency responsible for the regulation or supervision of financial institutions. 5 U.S.C. 552(b)(8)

A central purpose of this exemption is to promote the economic stability of banks given taxpayer dollars are at stake and to preserve the relationship between the government and banks to encourage information sharing.[13]

Exemption 8 has its flaws. Chiefly, it is broad.[14] But at least we have a history of using this exemption, and this approach avoids enacting broad ad hoc exemptions allowing the SEC to withhold unknown types of information.

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[13] Consumers Union of the United States v. Heimann, 589 F .2d (D.C. Cir. 1978) at 534, as quoted in *Guide to the Freedom of Information Act*, Office of Information Policy, U.S. Department of Justice (2009), p. 661.

Credit unions may be a model for limiting Exemption 8. Congress mandated full disclosure of inspector general reports whenever credit unions fail. Whenever a credit union failure triggers a payout from the federal depository insurance fund, the inspector general of the National Credit Union Administration writes a report, makes that report public, and may not use Exemption 8 to justify withhold any of the report.[15]

The Commission has also sought to avoid responding to third-party subpoenas. This issue is bound with other concerns and interests having little to do with public disclosure under FOIA, and should not be conflated with the FOIA issue.

Third party subpoenas may yield important information to help parties in a lawsuit, or help disclose wrongdoing. Yet the courts and judicial mandates for disclosure should not be abused to gain intelligence about competitors or potential business partners for private advantage. Given their complexities and differences, the FOIA and third-party subpoenas issues should be dealt with separately.

Congress should strengthen the review of Exemption 3 statutes.

I want to use my remaining testimony to note one reason this hearing is being held today. This controversy arose because the process that Congress uses for proposing statutory exemptions to FOIA is flawed, leading to imprecise, overbroad, redundant, and ill-considered federal legislation. The plain fact is, there is no process. Some of these proposals become laws that trim FOIA with a butcher knife rather than a scalpel. This committee fell victim, in a sense, to this weakness.

As I mentioned earlier, we have identified over 250 different Exemption 3 statutes to deny FOIA requests. Sometimes the purpose of these exemptions is clear, such as to protect sources and methods of intelligence gathering (50 U.S.C. § 402). Other times the purpose seems to be special interest, not public interest. Federal statutes protect the identities of honeybee handlers (7 U.S.C. § 4608(g)), watermelon growers (7 U.S.C. § 4908(c)), and the National Death Index. (42 U.S.C. § 242m(d))

Often these proposals become public when it is too late for users of the information to have a seat at the discussion table. For instance, during the conference committee debate over the 2008 "farm bill" reauthorization, a provision was "airdropped" into the final text that exempted from disclosure certain geographic descriptions of farmlands that USDA required farmers to submit to participate in USDA programs.[16] The provision appeared in neither version of the bill that passed the House and Senate, and no one mentioned this

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[14] Given we are operating under a new era of financial reform, it may be worth examining changes to Exemption 8, but only after careful study and long after fixing Section 929I.
[15] 12 U.S.C. 1790 (Section 216(j)) of the National Federal Credit Union Act as amended by Sec. 988 of Dodd-Frank).
[16] Section 1619 of H.R. 6124, the Food, Conservation, and Energy Act of 2008

change to the users who depend on bulk access to the data.[17] They are now urging changes when Congress reauthorizes the farm bill in 2013.

Congress and the executive branch can take modest but vital steps to reduce these overbroad and often unnecessary exemptions. Specifically, Congress could:

- Enforce the OPEN FOIA Act of 2009. All exemptions from disclosure of government records must cite to FOIA section (b)(3). Sec. 929I did, in fact, specifically mention FOIA's section (b)(3).

- Promote early disclosure. Require disclosure of Exemption 3 proposals in searchable form online at the time of *introduction* of any bill or amendment creating an exemption to FOIA, similar to the practices of earmark disclosures.

- Routinely use committee referrals. Any proposed (b)(3) exemption should be referred to the committee with jurisdiction over FOIA (Oversight and Government Reform, Subcommittee on Information Policy, Census & National Archives) and to the committee with subject matter jurisdiction (e.g., transportation records/transportation committee).

- Conduct a "need assessment" for all proposed (b)(3) exemptions.

- Closely scrutinize *every* proposed exemption from disclosure. Notwithstanding the OPEN FOIA Act of 2009, some bill previsions requiring confidentiality of records or information may not specifically be *labeled* as (b)(3) exemptions.

We are confident these steps are feasible and can avoid needless litigation and congressional controversy while reinforcing our democracy's promise that the public should be able to know what the government is up to.

Conclusion

Journalists tell us they are chiefly concerned that the language in Sec. 929I is broader than the SEC says it needs. Experience shows us that once granted, the power to withhold information will be used. Only an act of Congress to rewrite the law will fix this problem.

Congress can also take several modest steps to ensure that the public is appropriately notified any time these statutory exemptions from FOIA are proposed. When they are

[17] AgriData, Inc., "Changes needed in Section 1619 of the 1008 Farm Bill," August 28, 2008. Available at http://www.agridatainc.com/farmbill08/AgridataIncPositionPaper.pdf, accessed September 3, 2010 ("Restrictions upon the release of USDA geospatial data that were included in Section 1619 of the 2008 Farm Bill have resulted in a negative impact upon agricultural professionals, producers, landowners and others who utilize Common Land Unit (CLU) data (field borders) in their professions on a regular basis. A technical corrections bill or an amendment is needed to change Section 1619 to restore public access to CLU data.")

proposed, Congress can ensure they receive proper review for their impact on transparency.

We appreciate the opportunity to testify today on this important matter and would be happy to take your questions.

Thank you.