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NOTE

INSIDER TRADING, SEC DECISION-MAKING, AND THE CALCULUS OF INVESTOR CONFIDENCE

[T]he Commission and staff have long been proud of their work in carrying out Commission responsibilities. They know, more than anyone else, that disclosure to investors, detecting fraud and preventing it where possible, promoting fairness in the marketplace, ensuring that those who handle other people's money adhere to proper standards and give accurate and adequate accounts of their stewardship, and encouraging high standards of business conduct all combine to build public confidence in the nation’s securities markets.

Being able to provide continued confidence is the bulwark of the SEC's charter.¹

Securities and Exchange Commission Orientation Handbook

Many falls from grace must be ignored by the legal system in an imperfect world.²

Professor Michael P. Dooley

The Securities and Exchange Commission (SEC) has been entrusted with an overarching statutory mandate to maintain public confidence in the fairness and integrity of the nation’s securities markets.³ The Commission has in part attempted to fulfill this objective through a vigorous insider trading enforcement program,⁴ an effort which has grown in prominence in recent years.⁵ Reliance upon the

³ See D. LANGEVOORT, INSIDER TRADING REGULATION 13 (1988); supra text accompanying note 1; infra text accompanying notes 8-9.
⁴ See infra text accompanying notes 10-42.
⁵ See infra text accompanying notes 25-42.
assumed nexus between insider trading prosecutions and investor confidence may be largely misplaced, however, since investor confidence is the function not of any single input, but rather of a number of potentially incongruent variables. By utilizing the factual setting of the Commission's case against Ivan Boesky as a starting point, this Note exposes the implications of the complex calculus of investor confidence for SEC enforcement strategy, and outlines a decision-making framework for resolving these complications and maximizing investor confidence.

I. THE CALCULUS OF INVESTOR CONFIDENCE

The events surrounding the Great Crash of 1929, and the concomitant disintegration of investor confidence in the integrity of the securities markets, provided the primary impetus for federal regulation of securities transactions. Identifying widespread insider trad-

8. Investor confidence is crucial to the health of the capital markets. See B. RIDEH & H. FRENCH, THE REGULATION OF INSIDER TRADING 6-7 (1979) (noting the importance of investor confidence in attracting capital from international investors in addition to domestic investors); DIVISION OF MARKET REGULATION, SECURITIES AND EXCHANGE COMMISSION, THE OCTOBER 1987 MARKET BREAK xiv (1988) [hereinafter SEC REPORT] (stating that the participation of individual investors is important both for the additional liquidity it provides and the consensus support it demonstrates for the national economic system); SECURITIES AND EXCHANGE COMMISSION, REPORT OF THE ADVISORY COMMITTEE ON ENFORCEMENT RULES AND PRACTICES 5 (1972) [hereinafter SEC ADVISORY COMMITTEE REPORT] (stating that the maintenance of investor confidence is necessary to enable the free enterprise system to generate and allocate capital resources needed to sustain economic growth and vitality); Laderman, The Epidemic of Insider Trading, Bus. Wk., Apr. 29, 1985, at 78, 79 (stating that the participation of individual investors is necessary to the maintenance of a bull market); Phelan, In Pursuit of Insider Traders, BANKERS MAG., Nov.-Dec. 1986, at 51, 52 (asserting that "[s]hareholders' participation is an act of faith in the system . . . . If that faith is lost or badly shaken, then the system is at risk."); Wu, An Economist Looks at Section 16 of the Securities Exchange Act of 1934, 68 COLUM. L. REV. 260, 264 (1968) (noting that "[a] liquid stock market presupposes public confidence which creates willingness to purchase shares. Much of the difficulty in organizing capital markets in the less developed countries arises from public distrust and reluctance to invest funds in such markets.").

Significantly, individual households own about 60% of all U.S. publicly-held common stock. REPORT OF THE PRESIDENTIAL TASK FORCE ON MARKET MECHANISMS 1 (1988) [hereinafter BRADY COMMISSION REPORT]. The New York Stock Exchange estimated that 47 million individuals owned shares of publicly traded corporations in mid-1985, NEW YORK STOCK EXCHANGE, FACT BOOK 1988, at 61 (1988), representing about one in every five Americans. In addition, as many as 133 million Americans have an interest in the market through pension plans, life insurance policies, and other intermediaries. Id. at 63.
ing as a central ingredient in the lack of investor con-

ing Before the Subcomm. on Oversight and Investigations of the House Comm. on Energy and Commerce, 99th Cong., 2d Sess. 1 (1986) [hereinafter House Hearings] (opening statement of subcommittee chairman John Dingell); S. Phillips & J. Zecker, The SEC and the Public Interest 8 (1981); Gadsby, Historical Development of the S.E.C. — The Government View, 28 Geo. Wash. L. Rev. 6, 9, 16 (1959); Warren, A Foreword on Insider Trading Regulation, 39 Ala. L. Rev. 337, 340 (1988); see Securities Indus. Ass'n v. Board of Governors of the Fed. Reserve Sys., 468 U.S. 137, 150 (1984) (stating that the Securities Act of 1933 and the Securities Exchange Act of 1934 were among "several pieces of legislation collectively designed to restore public confidence in financial markets," along with the Glass-Steagall Act of 1933 and the Public Utility Holding Co. Act of 1935); Ferrara, SEC Division of Trading and Markets: Detection, Investigation and Enforcement of Selected Practices that Impair Investor Confidence in the Capital Markets, 16 How. L.J. 950, 951-53 (1971) (discussing the public's lack of confidence in the securities markets in the early 1930s); Morton & Booker, The Paradoxical Nature of Federal Securities Regulations, 44 Den. L.J. 479, 480-82 (1967) (theorizing that Congress' purpose in passing the Securities Act was to restore public confidence in order to get the markets working to finance business, although the Act was sold to the public under the more politically attractive guise of protecting the individual investor by preventing fraud); see also C. Meyer, The Securities Exchange Act of 1934: Analyzed and Explained 25 (1934) (predicting that stockbrokers' business would benefit from the increased public confidence expected to accompany the Exchange Act); Brokers See Gain In Federal Plan, N.Y. Times, Jan. 30, 1934, at 27, col. 6 (observing that "[j]ust as the Hughes investigation into the insurance business twenty-five years ago was followed by a return of public confidence in life insurance, the enactment of a bill establishing an agency to supervise the stock market might cause a similar revival in the securities markets."). See generally Legislative History of the Securities Act of 1933 and Securities Exchange Act of 1934 (J. Ellenberger & E. Mahar eds. 1973) [hereinafter Legislative History]. Professors Morton and Booker argue that the SEC lost sight of the true purpose of the statutes, Morton & Booker, supra, at 485, and, beginning to believe its own publicity, seduced itself into thinking that investor protection is its primary function. Id. at 491. As a result, it developed a scheme of disclosure requirements that is inconsistent with the purpose of the original statutes. Id. at 491-96.

10. "Insider trading" is a term used to refer to trading in the securities markets while in possession of "material" information that is not available to the general public. For discussion of the "definition" of insider trading developed by the SEC and the courts, see D. Langevoort, supra note 3, at 37-242; L. Loss, Fundamentals of Securities Regulation 726-810 (2d ed. 1988); Bagby, The Evolving Controversy Over Insider Trading, 24 Am. Bus. L.J. 571 (1986); cf. Symposium: Defining "Insider Trading", 39 Ala. L. Rev. 337 (1988) (discussing the present definition of insider trading and the proposals for legislative reform); infra text accompanying notes 141-46 (analyzing the SEC's proposed statutory definition).

11. The 1934 report of the Senate Banking and Currency Committee stated:

Among the most vicious practices unearthed at the hearings before the subcommittee was the flagrant betrayal of their fiduciary duties by directors and officers of corporations who used their positions of trust and the confidential information which came to them in such positions, to aid them in their market activities.

Stock Exchange Practices: Report of Comm. on Banking and Currency, S. Rep. No. 1455, 73d Cong., 2d Sess. 55 (1934), reprinted in 5 Legislative History, supra note 9, at item 21. In one case described by the Committee, the president of a corporation and his brothers, owners of over 10% of the corporation's stock, turned a profit of approximately $9 million when they disposed of their holdings of $16 million shortly before the corporation announced it would skip a dividend, and later repurchased the shares for $7 million. S. Rep. No. 792, 73d Cong., 2d Sess. 9 (1934), reprinted in 5 Legislative History, supra note 9, at item 17. For
dence,\textsuperscript{12} Congress enacted the Securities Exchange Act of 1934\textsuperscript{13} with various mechanisms to deter such "inequitable and unfair" transactions\textsuperscript{14} and ensure full disclosure of material information.\textsuperscript{15}

additional illustrations of trading abuses by insiders uncovered at the committee hearings, see S. REP. NO. 1455, supra, at 55-68; F. PECORA, WALL STREET UNDER OATH: THE STORY OF OUR MODERN MONEY CHANGERS 268-69 (1939).


\begin{quote}
In our society, we traditionally abhor those who refuse to play by the rules, that is, the cheaters and the sneak. A spitball pitcher, or a card shark with an ace up his sleeve, may win the game but not our respect. And if we know such a person is in the game, chances are we won't play.
\end{quote}

\textit{ABA TASK FORCE REPORT, \textit{supra}}, at 227. \textit{But see} Carlton & Fischel, \textit{The Regulation of Insider Trading}, 35 STAN. L. REV. 857, 879-80 (1983) (stating that the economic theory of market exchanges is still in its infancy, but that "no obvious logic indicates that insider trading has any substantial effect on liquidity."); Manne, \textit{supra} note 11, at 577 (noting that the percentage of public participation in the stock market was quite high in the 1920s despite notoriously widespread insider trading); Wang, \textit{supra}, at 1227 (noting that "investors already disregard a large body of evidence indicating that it is difficult for even the most sophisticated institutions to outperform the stock market averages.").


15. \textit{See} H.R. REP. NO. 1383, 73d Cong., 2d Sess. 11-13 (1934), \textit{reprinted in 5 LEGISLATIVE HISTORY, \textit{supra} note 9, at item 18; see also} C. MEYER, \textit{supra} note 9, at 11 (stating that the Act was intended to maintain orderly markets by eliminating excessive speculation, prohibiting unfair practices, and requiring full disclosure of all material facts regarding shares...
The provision most directly aimed at the prevention of insider trading was section 16(b),\footnote{16} which provides that profits earned by those classes of investors presumed to have access to nonpublic corporate information\footnote{17} in certain short-term purchases and sales “shall inure to and be recoverable by the issuer . . . .”\footnote{18} Congress also included section 10(b)\footnote{19} in the Act as a general “catchall clause to prevent fraudulent practices,”\footnote{20} and a considerable body of insider trading jurisprudence has developed around this provision.\footnote{21} In addition, Congress established the Securities and Exchange Commission\footnote{22} and provided it with “an arsenal of flexible enforcement powers”\footnote{23} aimed at the prohibition of insider trading and enforcement of the securities laws’ disclosure requirements as well as the regulation of the traded).

17. Specifically, § 16(b) is applicable to directors and officers of the issuer of any equity security registered pursuant to § 12(g) of the Act, 15 U.S.C. § 78l(g) (1982 & Supp. IV 1986), and to the beneficial owners of more than 10% of any class of any such security. Id. § 78p(a) (1982).
18. Id. § 78p(b); see also Exchange Act § 16(c), 15 U.S.C. § 78p(c) (1982) (prohibiting short sales by corporate insiders).
21. For discussion of the development of the insider trading restriction under § 10(b) and SEC Rule 10b-5, see D. Langevoort, supra note 3, at 37-218; L. Loss, supra note 10, at 726-810; Bagby, supra note 10, at 574-79.
22. Ch. 404, § 4, 48 Stat. 885 (codified as amended at 15 U.S.C. § 78d (1982)); see R. DeBeds, The New Deal’s SEC: The Formative Years 205 (1964) (stating that the SEC became the most important element of the New Deal “in restoring confidence for the continued use of the tools of investment finance as a needed part of the capitalist system.”); Ferrara, supra note 9, at 953 (stating that the Commission was entrusted with the authority to prohibit certain acts and practices which impair investor confidence as well as the authority to define and prohibit such other abuses as the Commission might encounter); see also SEC Advisory Committee Report, supra note 8, at 5:

The Commission is regarded by the Congress and the public not merely as an agency to administer a series of statutes but as the federal instrumentality for protecting the public interest and the interest of investors in its oversight of the processes of capital formation and trading in securities . . . . Hence, the efficacy of the Commission’s work is an important element in maintaining the confidence of the public in the processes of capital formation and securities trading.
nation's securities markets.24

Notwithstanding increasing academic controversy over the propriety of prohibiting insider trading,25 Congress and the SEC have persistently adhered to the fundamental values of the original statutes,26 and recently reaffirmed the central importance of a vigorous

24. See Ferrara, supra note 9, at 953-54 (stating that the Commission pursues both enforcement and regulation programs). Criticism of this combination of responsibilities is plentiful. See, e.g., Werner, The SEC As a Market Regulator, 70 VA. L. Rev. 755, 755-56 (1984) (arguing that these functions have led to a split personality in SEC administration of the securities laws — one personality, the "sunlight" SEC, is the highly visible, efficient SEC that administers the laws' disclosure and anti-fraud provisions; the other is the regulatory SEC, which has largely disregarded its role); see also R. KARMEL, supra note 1, at 92 (former Commissioner Roberta Karmel arguing that the SEC's prosecutorial zeal has upset its balance as a regulator). Karmel also finds the mix of prosecutorial and adjudicative functions in the SEC disturbing in that it evokes at least the appearance of unfairness. Id.

25. The literature on this topic is voluminous. The seminal work identifying the major issues in the debate was Professor Henry G. Manne's book Insider Trading and the Stock Market, which suggested that insider trading is an efficient way to compensate managers and enhances market efficiency without demonstrable harm to individual investors. See H. MANNE, INSIDER TRADING AND THE STOCK MARKET (1966). For discussion and elaboration of Manne's work, see Carlton & Fischel, supra note 12, at 880 (arguing that any loss in confidence affects only the issuer whose shares are traded and not the markets generally); Dye, Inside Trading and Incentives, 57 J. Bus. 295 (1984) (finding that shareholders benefit by allowing managers to trade on inside information when the managers' compensation is earnings-contingent); Dooley, supra note 2; Easterbrook, Insider Trading, Secret Agents, Evidence Privileges, and the Production of Information, 1981 Sup. Ct. Rev. 309; Haddock & Macey, A Coasian Model of Insider Trading, 80 NW. U.L. Rev. 1449 (1986) (arguing that corporations should be able to opt out of the securities laws' per se prohibitions on insider trading since insider trading is only undesirable to shareholders where insiders are risk averse and the shareholder group contains a large number of investors particularly knowledgeable about the company); Manne, supra note 11, at 546. According to its critics, the grievous defect in Manne's thesis is that it is important for the markets not merely to do equity but to appear to do equity. 5 L. Loss, SECURITIES REGULATION 2999 (1969) (supplement to 2 L. Loss, SECURITIES REGULATION (2d ed. 1961)); see also Laderman, supra note 8, at 81 (former SEC Commissioner A.A. Sommer, Jr. arguing that "[t]here are issues that go beyond economics . . . . There are moral, political, and ethical dimensions to this."). Since Congress and the SEC have impliedly assumed that an effective insider trading prohibition is necessary to the maintenance of investor confidence, see supra text accompanying notes 10-42, that assumption also underlies this Note. However, it is interesting to observe that, although utilizing opposing analytical assumptions, the pro-Manne school and this Note both reach critical conclusions regarding the utility of SEC insider trading enforcement.

For criticism of the Manne position, see B. RIDER & H. FRENCH, supra note 8, at 5-6; Ferber, The Case Against Insider Trading: A Response to Professor Manne, 23 VAND. L. Rev. 621 (1970); Hetherington, supra note 12; Schotland, supra note 12, at 1425; Sture, Illegal Insider Trading: Crisis of Confidence in Financial Markets, VITAL SPEECHES OF THE DAY, Apr. 15, 1987, at 404, 407-09; Wang, supra note 12, at 1217; see also Longstreth, Halting Insider Trading, N.Y. Times, Apr. 12, 1984, at A27, col. 3 (former SEC Commissioner Bevis Longstreth, currently a partner at New York's Debevoise & Plimpton, stating that "arguments in favor of insider trading are, in short, rubbish.").

26. R. KARMEL, supra note 1, at 44. Karmel states that:
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insider trading enforcement program to the maintenance of investor confidence. In 1984, Congress enacted the Insider Trading Sanctions Act\textsuperscript{27} without a single dissenting vote in either house,\textsuperscript{28} amending the Exchange Act\textsuperscript{29} to provide a more effective deterrent of insider trading violations than that contained in the original statute.\textsuperscript{30} The basic assumptions expressed in the report accompanying the bill out of committee mirrored those of the Seventy-third Congress: “Capital formation and our nation’s economic growth and stability depend on investor confidence in the fairness and integrity of our capital markets. Insider trading threatens these markets by undermining the public’s expectations of honest and fair securities markets where all participants play by the same rules.”\textsuperscript{31} The memorandum of the
SEC in support of the bill echoed the Congressional commitment to insider trading enforcement: "Insider trading in publicly traded securities undermines the expectations of fairness and honesty that underlie public confidence in our nation's securities markets."  

Insider trading enforcement has in fact become the most visible of the SEC's programs, enjoying bipartisan political support within the Commission. The Commission brought seventy-seven enforcement actions involving insider trading violations from fiscal 1982 through fiscal 1985, the same number as it had brought in the preceding forty-eight years of its existence. The Commission brought another thirty insider trading cases during fiscal 1986, resulting in disgorgements of approximately $29.7 million, a thirteen-fold increase over fiscal 1985. The proportion of SEC resources devoted to enforcement reflects this prosecutorial emphasis. Thirty-two percent of the Commission's fiscal 1987 appropriation and thirty-three public's expectations of fair and honest securities markets where all participants play by the same rules.


33. Langevoort, supra note 30, at 1275; see also D. LANGEVOORT, supra note 3, at 10-11 (stating that "[f]or much of the early 1980's, the fight against insider trading has been the SEC's highest enforcement priority.").

34. Langevoort, supra note 30, at 1275. Significant in this regard is the Exchange Act's requirement that no more than three of the Commission's five members be from the same political party. 15 U.S.C. § 78d(a) (1982). Apart from such structural explanations, Professor Kripke has suggested that this phenomenon can be explained by the Commission's hubris in "thinking that what you were doing was the most important thing in the world and that some more of the same would be still better." See Kripke, Wrap-up, 29 BUS. LAW. 185, 185 (Spec. Issue 1974) (reprinting Address by Professor Homer Kripke, Proceedings of ABA National Institute: Revolution in Securities Regulation, Washington, D.C. (Oct. 13, 1973)); cf. Stigler, Public Regulation of the Securities Markets, 37 J. BUS. 117, 117 (1964) (stating that the Commission has enjoyed the friendship of both political parties).

35. See House Hearings, supra note 9, at 54 (statement of then-SEC Chairman Shad).

36. Id.

37. Id.

38. Id.

39. Id. $2.1 million was disgorged in fiscal 1985. Id.

percent of its program staffing were directed to the prevention and suppression of fraud, including insider trading.

Unfortunately, investor confidence is not simply a function of the ability to enforce the securities laws’ prohibition of insider trading. On the contrary, the factors that impact upon investor confidence are numerous and interrelated. It is clear, for example, that macroeconomic trends exogenous to the operation of the markets significantly affect the willingness of investors to participate.

For the SEC, the OMB’s estimate included $34.8 million for prevention and suppression of fraud (31.6%). An additional $28.5 million (25.9%) was appropriated for enforcement of the disclosure requirements. The remainder of the SEC budget included: $13.3 million for supervision and regulation of securities markets (12.1%); $11.4 million for investment management regulation (10.4%); $7.0 million for legal services (6.4%); $2.3 million for economic and statistical analysis (2.1%); and $12.7 million for program direction (11.5%).

See House Hearings, supra note 9, at 93 (memorandum of SEC). Of the 1930 “staff years” estimated for fiscal 1987, 629 were allocated to prevention and suppression of fraud (32.6%). An additional 452 were allocated for enforcement of the disclosure requirements (23.4%). The remainder of staffing allocations included: 242 staff years for regulation and supervision of securities markets (12.5%); 208 staff years for investment management regulation (10.8%); 113 staff years for legal services (5.9%); 40 staff years for economic and statistical analysis (2.1%); and 246 staff years for program direction (12.7%).

But cf. infra text accompanying notes 195-200 (arguing that the SEC’s budget may be insufficient to enable it to effectively perform all of its duties).

In fact, the announcement of a successful insider trading enforcement action may actually undermine investor confidence, at least in the short term. See infra text accompanying notes 71-76.

Professor Brudney points out that although the antifraud and disclosure provisions place their primary emphasis on different goals, both goals were considered fundamental to restoring trust in the securities markets, id. at 334-35.

The Brady Commission found that the market crash of October 1987, discussed infra text accompanying notes 101-13, was triggered by specific macroeconomic events, including an unexpectedly high merchandise trade deficit and a concomitant increase in interest rates, and proposed tax legislation which depressed the stock prices of a number of likely takeover targets. BRADY COMMISSION REPORT,
over, the market’s resistance to price volatility\(^{46}\) and its ability to accurately value securities\(^{47}\) play important roles in the maintenance of public confidence, as do the general notions of investor protection embodied in the securities laws’ disclosure requirements.\(^{48}\)

To be successful, the SEC’s enforcement program must consequently reflect a sensitivity to these other factors.\(^{49}\) Accordingly, in its brief to the Supreme Court in the landmark case \textit{Dirks v. SEC},\(^{50}\) the Commission acknowledged that it had considered whether its administrative decision would impair the efficiency of the securities

\(\textit{supra} \text{ note 8, at } v.\)

\(^{46}\) See A. Basch & M. Kybal, \textit{supra} note 45, at 77 (stating that “[f]requent short-range fluctuations [in market value] tend to create mistrust among the public,” and that an unusual increase in prices may cause as much damage to public confidence as a major drop); \textit{Brady Commission Report, supra} note 8, at 53 (noting that the violence of price movements, both up and down, during the October 1987 market break, discussed \textit{infra} text accompanying notes 101-13, “threatened to undermine the integrity of the markets and may have substantially inhibited buyers’ participation.”); \textit{SEC Report, supra} note 8, at xi-xii, xiv (stating that the increased volatility experienced on and after Black Monday can have serious long-term effects on the participation of small investors); \textit{cf. General Accounting Office, Financial Markets: Preliminary Observations on the October 1987 Crash, GAO/GGD-88-38, at 5 (1988) [hereinafter \textit{GAO Study}] (discussing the need to restore investor confidence following the market crash of October 1987).}

\(^{47}\) See Sporkin, \textit{A Call for a New Special Study of the Securities and Financial Markets,} 46 Md. L. Rev. 915, 916-17 (1987) (stating that the securities markets could not continue to command investor confidence without “financial and disclosure integrity”); \textit{see also} S. Keane, \textit{Stock Market Efficiency: Theory, Evidence and Implications} 2-3 (1983), stating: The creation of wealth depends on the optimal allocation of investment capital, and it is through the securities market that this allocation is most likely to be achieved. . . . Lack of confidence in the pricing efficiency of the market tends to focus the attention of both investors and raisers of capital on potentially wasteful techniques of exploiting perceived inefficiencies, and away from a more positive recognition of the messages contained in the market’s prices. \textit{Id.; accord} Brudney, \textit{supra} note 12, at 334; \textit{cf. infra} text accompanying notes 50-53 (discussing the Commission’s sensitivity to market efficiency concerns).

\(^{48}\) See Fleischer, Mundheim & Murphy, \textit{An Initial Inquiry Into the Responsibility to Disclose Market Information,} 121 U. Pa. L. Rev. 798, 816 (1973) (stating that the “[e]limination of disparities in information available to participants in the trading markets has been an important part of the program to maintain investor confidence.”); Herman, \textit{supra} note 44, at 3 & n.7 (stating that former chairmen of both the New York Stock Exchange and the SEC had expressed concern “that publicity suggestive of a privileged position for institutional investors in obtaining corporate information conveys an adverse image that might discourage small investors.”).


\(^{50}\) 463 U.S. 646 (1983), discussed further \textit{infra} note 140.
markets. The Commission noted that “market efficiency is an important statutory goal that is significantly enhanced by the activities of professional analysts in ferreting out and analyzing information relating to the value of securities.” To accommodate its dual responsibilities of promoting market efficiency and protecting investors from the unfairness of insider trading, the Commission recognized that “a line must be drawn.”

As the Commission's enforcement action against Ivan Boesky pointed out, however, drawing such a line is not always a simple task. During the course of its investigation, the Commission recognized that the public announcement of its prosecution was likely to have a negative impact on securities prices. To avert the possibility that this downturn would spiral into a market crisis, Boesky was permitted to liquidate a substantial portion of his investment fund's portfolio prior to the announcement. In light of the negative public reaction and disclosure problems occasioned by this decision, the remainder of this Note examines whether the decision-making process employed by the Commission reasonably comported with the calculus of investor confidence as developed above, and if not, how that process can be amended to better serve the Commission's objectives.

II. SEC v. Boesky

A. Background of the Boesky case

After the close of trading on Friday, November 14, 1986, the Securities and Exchange Commission announced that its ongoing investigation into insider trading had resulted in the commencement of an enforcement action against arbitrageur Ivan F. Boesky. The

52. Id. at 15.
53. Id.
54. See infra text accompanying notes 59-69 (discussing the background of the Boesky case).
55. See infra text accompanying notes 85-88.
56. See infra text accompanying notes 89-98.
57. See infra notes 77-78.
58. See infra text accompanying notes 116-46.
59. “Risk arbitrage” is defined as “[t]hat branch of investment banking involved in taking risks associated with anticipated [short-term] growths in securities values arising from corporate takeover situations.” D. BROWNSTONE & I. FRANCK, THE VNR INVESTOR'S DICTIONARY 272 (1981). Normally, risk arbitrage involves the purchase of shares of the company expected to become an acquisition target and the short sale of shares of the acquiring company, on the speculation that shares of the target will go up and shares of the acquiring com-
SEC alleged that Boesky had caused securities to be purchased for
certain affiliated entities while in possession of material nonpublic information provided him by Dennis Levine, formerly an investment banker with Drexel Burnham Lambert, Inc. and a central figure in the SEC's investigation. Without admitting or denying the allegations in the Commission's Complaint, Boesky consented to the entry of a Final Judgment of Permanent Injunction and Other Equitable Relief, permanently enjoining him from future violations of Exchange Act sections 10(b) and 14(e). The Judgment also provided that Boesky disgorge the sum of $50 million and transfer assets with an aggregate value of $50 million to the U.S. Treasury as a civil penalty under the Insider Trading Sanctions Act, a total payment of $100 million. In addition, the Commission entered an ad-


62. See supra note 60 (describing Levine's role in the investigation).


65. Id. The Commission has available a wide variety of enforcement remedies in addition to disgorgement of ill-gotten profits and the imposition of a civil penalty under ITSA. See infra note 203 (listing the various enforcement remedies available in insider trading cases). See generally D. Langevoort, supra note 3, at 243-80; 1 M. Steinberg & R. Ferrara, Securities Practice: Federal and State Enforcement §§ 3:29-:40 (1985); Rowe, Settlement of an SEC Enforcement Action, in Practising Law Institute, Handling an SEC Investigation 1980, at 925, 931-34 (1980).

The $50 million disgorged, representing the profits allegedly obtained by Boesky as a result of his illegal trading, was to be paid to an escrow agent and utilized to satisfy valid claims against Boesky or his affiliated entities arising out of the transactions referred to in the Complaint. SEC v. Boesky, No. 86 Civ. 8767, slip op. (S.D.N.Y. Nov. 14, 1986); see infra note 173 (discussing a number of the suits filed against Boesky). The $50 million payment to the Treasury under the Insider Trading Sanctions Act, see supra note 30, was deemed satisfied by the transfer of 5,786,712 ordinary shares and 8,482,371 capital shares of Cambrian & General Securities, p.l.c., and 193,827 shares of Northview Corp. common stock. SEC v. Boesky, No. 86 Civ. 8767, slip op. (S.D.N.Y. Nov. 14, 1986).

ministrative order barring Boesky from association with any broker or dealer.\textsuperscript{67} and Boesky agreed to plead guilty to one unspecified securities fraud violation.\textsuperscript{68} Also significant was Boesky’s agreement to cooperate with the Commission in its continuing investigation.\textsuperscript{69}

Although initial public reaction to the SEC’s effort was generally positive,\textsuperscript{70} a number of investment professionals expressed concern that the disclosure of widespread insider trading abuses might undermine rather than bolster investor confidence in the markets’ integrity.\textsuperscript{71} Salomon Brothers’ chairman John H. Gutfreund stated, 

\begin{itemize}
  \item \textit{In re} Boesky, Exchange Act Release No. 34-23802 (Nov. 14, 1986). The Order provided that the bar be stayed until April 1, 1988, or such earlier time as the Commission would deem sufficient, for the purpose of preserving the assets of Boesky’s businesses and avoiding a default on any instrument or security relating thereto. \textit{Id.} The stay was subsequently lifted on May 20, 1987. \textit{In re} Boesky, Exchange Act Release No. 34-24488 (May 20, 1987).
  \item \textit{See} Litigation Release No. 11288, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) $\times$ 92,991 (Nov. 14, 1986)). In addition to providing information regarding his trading activities and his relationships with others in the investment community, Boesky reportedly agreed to have his conversations with such figures electronically recorded in the weeks preceding the SEC announcement. Sterngold, \textit{Boesky Said to Aid Inquiry by Taping of Wall St. Talks}, N.Y. Times, Nov. 18, 1986, at A1, col. 6.
  \item \textit{SEC Now is on Target} (editorial), Wall St. J., Mar. 26, 1987, at 39, col. 1; Vise & Schrage, \textit{Wall Street Lambastes SEC Action}, Wash. Post, Nov. 21, 1986, at A1, col. 1; \textit{see}, e.g., Vartan, \textit{Street Awaits Boesky Impact} (Market Place column), N.Y. Times, Nov. 17, 1986, at D8, col. 5 (quoting Richard S. Strong, chairman of Strong/Cornellison Capital Management, Inc. as stating, “[w]hen people think it through, it should bolster their confidence that the SEC is on the job.”). One industry executive observed:
    
    I see the SEC’s action in this case as a positive sign of improvement in the integrity of the marketplace. The enforcement mechanism that the SEC has put into place appears to be working, and the $100 million penalty sends a large message as to the kind of activity that is not going to be tolerated.

\textit{Id.} (statement of Robert S. Salomon, Jr., director of equity research at Salomon Brothers); \textit{see also infra} text accompanying note 76 (discussing longer-term positive effects on investor confidence); \textit{cf.} Heston, \textit{‘Mania’ Out of Merger Mania?}, \textit{FUTURES}, Jan. 1987, at 80, 81 (Alfred Goldman, corporate vice president at A.G. Edwards & Sons, arguing that the \textit{Boesky} case will be a long-term positive for the stock market by inducing investors to return to investment “fundamentals”).
  \item \textit{See}, e.g., Rowen, \textit{White Knuckles on Wall Street}, Wash. Post, Nov. 20, 1986, at A27, col. 6 (stating that the Boesky scandal gave small investors one more reason to lose faith in the system, and quoting Lazard Freres senior partner Felix Rohatyn who warned of the confluence of a number of events “eroding the climate of confidence required of our institu-
"My first reaction is that this will prove all the suspicions that the public might have that Wall Street is just full of a bunch of insiders taking advantage of them." Furthermore, uncertainty such as that created by the SEC's November 14 announcement is anathema to Wall Street, as the Commission apparently recognized when it felt compelled to take actions to stabilize the market. Nevertheless, such short-term ills have been viewed as tolerable in light of the expectation that in the longer term, insider trading prosecutions will increase investor confidence by producing fairer markets.

However, such long-term benefits will likely prove elusive after the subsequent disclosure that Boesky had liquidated up to $1.4 billion of his investment fund's assets, with the imprimatur of the


73. See infra text accompanying note 88.

74. Sterngold, California Broker Becoming a Focus of Insider Inquiry, N.Y. Times, Nov. 20, 1986, at A1, col. 4, D18, col. 6 (quoting a stock trader as stating "the way to disrupt a market is to create uncertainty, and what the S.E.C. did was to create unbelievable amounts of uncertainty about who is next and if Drexel is going to be hurt."); Vartan, Cloud Over Takeover Stocks, N.Y. Times, Nov. 20, 1986, at D1, col. 3, D18, col. 1 (stating the classic maxim on Wall Street that "the stock market abhors uncertainty."); Behr & Hinden, Jitters on Wall Street Send Stocks Plunging: Insider Scandal Fuels Rumors, Uncertainty, Wash. Post, Nov. 19, 1986, at A1, col. 6, A14, col. 2 (quoting John Wolf, senior vice president and manager of stock index futures for Donaldson, Lufkin & Jenrette, as attributing the markets' post-announcement decline to "the unknown — fear — the environment you have now because of the events of the weekend.").

75. See infra text accompanying notes 85-115 (discussing the circumstances compelling market-stabilizing action by the SEC).

76. See Silk, Boesky Fallout: Some Benefits, N.Y. Times, Nov. 21, 1986, at D2, col. 1; see also Is Boesky Bullish? A Contrary View of the Scandal (interview with Robert Wilson), BARRON'S, Nov. 24, 1986, at 17, 57 (predicting that to the extent the Boesky case will have any impact on the market, the impact will be positive, by increasing investor confidence in the longer term); Anders, Boesky Insider Trading Case May Hurt Confidence In Markets, Spur Regulation, Wall St. J., Nov. 17, 1986, at 29, col. 3 (statement of Robert Birnbaum, president of the New York Stock Exchange, acknowledging that initial investor reaction was likely to be negative, but predicting that "long-term the markets will be better off.").

77. Initially, the amount of the sell-off was thought to be approximately $440 million.
Commission, in the weeks prior to the November 14 announcement. While the SEC maintains that its action was necessary to prevent a potential market crisis, critics protested that the SEC's acquiescence allowed Boesky to sell sensitive takeover-related stocks at their peak prices to investors who were unaware of the impending SEC announcement, thereby avoiding the losses in which his partnership would have shared when the prices of such stocks fell precipitously subsequent to the announcement. Early estimates placed the amount of this potential loss between $40 and $50 million; subsequent estimates, however, updated this amount to approximately $100 million. The resulting perception that the SEC had given Bo-


Information as to precisely when Boesky reached a settlement with the SEC and began liquidating his assets is sketchy since Boesky's plea agreement has been withheld by the government pending conclusion of its investigation. Coll & Vise, 3 Plea Bargain Agreements Released in Insider Scandal, Wash. Post, June 11, 1987, at E1, col. 1. However, evidence seems to indicate an agreement date of September 18, 1986, id., almost two months before it was made public.

79. See infra text accompanying notes 85-98.

80. Critics of the SEC action included journalists, see, e.g., Mr. Shad's Disclosure Problem (editorial), Wall St. J., Dec. 5, 1986, at 30, col. 1; legislators, see infra note 84; academicians, see infra note 84; and market professionals, see infra note 84, text accompanying notes 118-22, including other arbitrageurs, see infra text accompanying notes 121-22.


82. See, e.g., Nash, Boesky was Allowed to Sell Stock to Avoid any Panic, S.E.C. Says, N.Y. Times, Nov. 22, 1986, at 1, col. 3, 43, col. 3 (“as much as $40 million”); Nash, S.E.C. Is Under Fire In Letting Boesky Sell Off Holdings, N.Y. Times, Nov. 21, 1986, at A1, col. 1, D6, col. 3 (up to $50 million).

83. See, e.g., Nash, S.E.C. Let Boesky Pare $1.4 Billion From Fund's Debts, N.Y. Times, Dec. 12, 1986, at A1, col. 1, D4, col. 4 (at least $100 million, and “perhaps several times that amount,” based on a $1.32 billion liquidation rather than a $440 million liquidation). But see House Hearings, supra note 9, at 112 (testimony of then-Chairman Shad) (arguing that by the end of the week following the announcement, the market had gone on to new all-time highs, and therefore Boesky's fund actually lost money by selling early). However, Chairman Shad's argument ignores the fact that takeover securities, which comprised the bulk of the fund's portfolio, see supra note 77, did not rebound as quickly as the overall market, see
esky one last chance to avail himself of inside information at the expense of the investing public was inevitable.84

B. Complexities Motivating the Commission's Decision-Making

The determination of whether the SEC acted in furtherance of its mandate to stimulate public confidence in deciding to permit Boesky's pre-announcement trading first requires an analysis of the factors which motivated that decision. The SEC anticipated that the November 14 announcement of its investigation and settlement with Boesky, coupled with the ongoing investigation into possible illegal activities elsewhere on Wall Street in which he had agreed to participate,85 would have a substantial short-term negative impact on the market.86 This effect was expected to be especially pronounced in the

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84. See, e.g., Manne & Ribstein, supra note 60, at 26 (George Mason Law School Dean Henry G. Manne and Professor Larry E. Ribstein asserting that "[a]pparently the SEC is not disturbed by all forms of insider trading." (emphasis added)); Ingersoll, Shad Defends SEC Move to Allow Boesky to Sell Holdings Before Probe Disclosure, Wall St. J., Nov. 24, 1986, at 2, col. 2, 24, col. 3 (Senator Howard Metzenbaum, member of Senate Committee on the Judiciary, calling the sell-off "the ultimate insider deal" and admonishing the commissioners for an "absolute abandonment of their responsibilities."); Nash, S.E.C. Is Under Fire in Letting Boesky Sell Off Holdings, N.Y. Times, Nov. 21, 1986, at A1, col. 1 (Representative Charles Schumer, member of House Committee on Housing, Banking, and Urban Affairs, charging that "[t]he S.E.C. has permitted the reenactment of the crime"); Vise & Schrage, supra note 70, at A1, col. 1 (David Nolan, a chief stock trader for Spear Leeds & Kellogg, arguing that "[t]he SEC has unwittingly aided one of the largest insider trading scams in history").

85. See supra text accompanying note 69.

86. SEC concern in this regard is evidenced by the violation of its own rule against announcing breaks in cases on Friday afternoon. Wise, Boesky's Deals Before Scandal Viewed by Experts as Legal, N.Y.L.J., Nov. 31, 1986, at 1, col. 3, 3, col. 1 (statement of Pamela R. Chepiga, presently with N.Y.'s Cadwalader, Wickersham & Taft and former head of securities fraud unit at U.S. Attorney's office, S.D.N.Y.); see also Kilborn, U.S. Said to Issue Subpoenas Linked to Boesky Trading, N.Y. Times, Nov. 17, 1986, at A1, col. 1, D4, col. 3; Vartan, supra note 70, at D8, col. 5 (quoting Strong/Corneliuson Capital Management's chairman Richard S. Strong). The rule against Friday announcements "is designed to maximize the deterrent effect of the [Commission's] actions by insuring that they don't get downplayed by the press over a weekend." Wise, supra, at 3, col. 2 (quoting Ms. Chepiga). In spite of this precaution, the Dow Jones Industrial Average (DJIA) dropped the following Monday to 1860.52 from a Friday close of 1873.59, a loss of 13.07 points. STANDARD & POOR'S, DAILY STOCK PRICE RECORD: NEW YORK STOCK EXCHANGE, OCT.-DEC. 1986, at xi (1987). The DJIA dropped 43.31 points further on Tuesday to 1817.21, id., at that time the fourth largest drop in history. Crudele, 43.31 Drop Puts Dow At 1,817.21, N.Y. Times, Nov. 19, 1986, at D1, col. 6, and an average loss per share on the Big Board of 93 cents, id. at D12, col. 6. An early morning downturn in takeover stocks, see infra note 87, developed into a sell-off of blue chip stocks, which in turn triggered a selling spree by the index arbitrageurs. Behr & Hinden, Jitters on Wall Street Send Stocks Plunging: Insider Scandal Fuels Rumors, Uncertainty, Wash. Post, Nov. 19, 1986, at A1, col. 6. On the significance of index arbitrage/pro-
market for sensitive, takeover-related securities, since the announcement was accompanied by the issuance of a number of subpoenas seeking information about trading in a dozen takeover situations and the role in those transactions of, among others, corporate raiders Carl Icahn and Victor Posner, and Michael Milken, the head of "junk bond" financing at Drexel Burnham Lambert, Inc.

gram trading as a factor in market volatility, see infra text accompanying notes 101-13 (discussing the "Black Monday" market break of October 19, 1987).

87. In retrospect, this prediction appears to have been accurate. Almost every stock involved in takeover activities or rumors fell in the two days of trading following the announcement. Even stocks of formal acquisition targets fell below the prices offered for them. For example, Gillette closed on Tuesday at 60, down from 67 3/4 on Friday and $5 a share below what Revlon Group had offered for the company; Lear Siegler dropped 2 3/4 to 89 3/4, 3 3/4 below Wickes' proposal; Collins & Aikman fell from 52 1/4 to 51, $2 a share lower than the $53 offered by Wickes. Miller, Doubts Over Financing by Drexel Put Takeover Stocks Into Tailspin, Wall St. J., Nov. 19, 1986, at 3, col. 1. Other takeover situations hit hard on Monday and Tuesday included American Brands, down 2% to 41 1/4 (-6.2%); Borg-Warnner, 4% to 38 3/4 (-9.6%); CPC Int'l., 4% to 71 3/4 (-6.4%); GTE, 4% to 58 7/8 (-7.0%); Goodyear, 2% to 44 1/2 (-5.0%); Holiday Corp., 3% to 70 3/4 (-4.6%); E.F. Hutton, 4% to 40 (-9.9%); Lockheed, 3% to 50 (-6.1%); Time, Inc., 5% to 71 3/4 (-6.8%); and Transworld Corp., 1% to 38 3/4 (-4.7%).

88. Stewart & Hertzberg, Spreading Scandal: Fall of Ivan F. Boesky Leads to Broader Probe of Insider Information, Wall St. J., Nov. 17, 1986, at 1, col. 6. "Junk bonds" are high-yield high-risk debt securities rated BB or lower by Standard & Poor's. C. CURRIER, THE INVESTOR'S ENCYCLOPEDIA 23-24 (1987). In recent years, Drexel Burnham Lambert pioneered the use of junk bonds to finance corporate takeovers; as a result, junk bonds have been called "the solar plexus of the bull market." Smith & Monroe, supra note 87, at 20, col. 1 (quoting James Grant, editor of Grant's Interest Rate Observer); see also Weiss & Farrell, supra note 87, at 35 (discussing the evolution of junk bond financing). At the end of 1986,
Faced with this possibility, the SEC was forced to evaluate the potential effect on the market if Boesky was prohibited from trading on behalf of his investment fund, Ivan F. Boesky & Co., L.P., prior to the announcement. Since the fund’s holdings were largely debt-financed and concentrated primarily in stocks of takeover-target companies, the SEC believed it likely that the anticipated post-announcement decline in prices of such securities would have triggered margin calls on Boesky’s accounts. Unable to meet these margin requirements, the margin lenders would have been forced to liquidate Boesky’s considerable positions into the market. Due to the size of the fund, the Commission was concerned that such liquida-

junk bonds accounted for more than 21% of the corporate bond market, and Drexel controlled nearly 50% of both the new-issue and secondary markets. Id. In fact, Drexel had been primarily responsible for arranging $120 billion in junk-bond financing. Behr & Hinden, supra note 86, at A14, col. 2. Since Drexel has remained the dominant force in the junk bond market, news that it was the subject of investigation could reasonably be expected to cast doubts on its ability to arrange financing for future takeovers and to have an impact throughout the securities business. See Smith & Monroe, supra note 87, at 1, col. 6; Miller, supra note 87, at 3, col. 1; Sterngold, Nervous Markets Plunge on Fears of Wider Scandal, N.Y. Times, Nov. 19, 1986, at A1, col. 3; see also Carrington, Shock Waves of the Boesky Affair Could Bring Shrinkage in Drexel’s Merger, Investment Lines, Wall St. J., Nov. 21, 1986, at 2, col. 2 (questioning whether the activity in corporate takeovers could be sustained in light of doubts regarding Drexel’s ability to arrange financing); Scott, Boesky-Case Broom is Big, Christian Sci. Monitor, Nov. 19, 1986, at 1, col. 2, back page (suggesting that if Milken was implicated, a financial crisis could develop). As it turned out, the SEC did not bring charges against Drexel and Milken until September 1988. See supra note 60.

89. Liabilities totalled approximately $2.36 billion, including margin debt of $1.1 billion, stock loans of $600 million, and a $660 million debenture issue used to finance the partnership. House Hearings, supra note 9, at 112, 124 (testimony of then-Chairman Shad and Director of Market Regulation Richard Ketchum).

90. See supra note 77.

91. A "margin call" is a formal request from a lender to a borrowing investor or broker calling for additional payments of cash or securities into a margin account. D. Brownstone & I. Franck, supra note 59, at 193; see 12 C.F.R. § 220.2(l) (1988). Such a situation usually arises when the value of a stock purchased "on margin," that is, by a combination of cash and credit, D. Brownstone & I. Franck, supra note 59, at 192, has lost market value, making the proportion of loan to borrower’s equity too large to conform with legal requirements or lender policy. Id. at 193. This minimum percentage of equity required to purchase stock is called the "margin requirement," id. at 194, and is determined by Regulation T of the Federal Reserve System, 12 C.F.R. §§ 220.1-18 (1988), which governs the conduct of margin accounts. A. Pessin & J. Ross, Words of Wall Street: 2000 Investment Terms Defined 130 (1983). The various organized stock exchanges and individual lenders may, however, specify higher margin requirements. See D. Brownstone & I. Franck, supra note 59, at 194.

92. See 12 C.F.R. § 220.4(d) (1988) (requiring the lender to liquidate securities sufficient to meet the margin call or eliminate the margin deficiency when a margin call is not met within the required time, usually seven days under 12 C.F.R. § 220.4(c)(3) (1988)); see also New York Stock Exchange, Fact Book 1988, at 57 (1988).

93. Ivan F. Boesky & Co., L.P. had positions in the area of $2.2 billion at the time. House Hearings, supra note 9, at 112 (testimony of then-Chairman Shad).
tions in a declining market would have precipitated far more substantial price decreases than those actually experienced, which would then trigger additional program trading\(^{94}\) and widespread margin calls and liquidations throughout the market.\(^{95}\) Furthermore, the Commission believed that due to the concentration of the partnership's holdings in takeover-target companies and the relative size of those stakes, the adverse effect of such liquidations would be greatly exaggerated over the effect of the liquidation of a broad portfolio.\(^{96}\) Thus, the SEC contends that its decision to allow the liquidations pre-announcement averted a potential post-announcement market crisis\(^{97}\) and converted the following week into a "non-event."\(^{98}\)

On the other hand, a number of market professionals disputed the SEC's concerns as overly pessimistic. At the center of the disagreement was their contention that the market contained enough li-

\(^{94}\) "Program trading" is a generic term used to describe the trading of organized "baskets" of securities. *Division of Economic Analysis & Division of Trading and Markets, Commodity Futures Trading Commission, Final Report on Stock Index Futures and Cash Market Activity During October 1987 to the U.S. Commodity Futures Trading Commission 22 (1988) [hereinafter CFTC Report]; GAO Study, supra note 46, at 26. "Stock-index arbitrage" and "portfolio insurance" are two portfolio management strategies included in the category of "program trading." CFTC Report, supra, at 22. Underlying these strategies is the ability to use stock index futures to trade the entire market as if it were a single commodity. *Brady Commission Report, supra note 8, at 7. "Index arbitrage" involves taking advantage of the price differential between prices of stock-index futures contracts and the value of the underlying securities comprising the index. C. Currier, supra note 88, at 406. See generally GAO Study, supra note 46, at 29-30; Brady Commission Report, supra note 8, at 6-7. "Portfolio insurance," also known as "dynamic hedging," GAO Study, supra note 46, at 32, is a hedging strategy used to protect stock holdings from declining prices by selling stock-index futures as stock prices fall. Brady Commission Report, supra note 8, at 7; Stewart & Hertzberg, *Market Medicine: Brady Panel Proposals Underscore Worries '87 Crash Could Recur*, Wall St. J., Jan. 11, 1988, at A1, col. 6, A20, col. 1.

\(^{95}\) *House Hearings*, supra note 9, at 120-21 (testimony of Director Ketchum); cf. infra text accompanying notes 101-13 (demonstrating the viability of this concern in light of the "Black Monday" market break of Oct. 19, 1987). Market officials were apparently cognizant of this possibility before Black Monday as well. *See, e.g., Phelan Calls Speculation Real Danger*, Wash. Post, Dec. 12, 1986, at D10, col. 2 (New York Stock Exchange Chairman John J. Phelan warning that the advent of computerized trading programs had added new risk to the market).

\(^{96}\) *House Hearings*, supra note 9, at 121 (testimony of Director Ketchum).

\(^{97}\) *Id. at 113* (then-Chairman Shad testifying that "[i]t would have been uncontrolled selling on a down market that would have had a snowball effect."); accord Strodes, *Beyond Boesky*, *Fin. World*, Mar. 10, 1987, at 12 (arguing that criticism of the Division of Enforcement is misplaced because it would have been faced with a stock market catastrophe had there been premature disclosure); *see also Vise & Schrage, supra* note 70, at A8, col. 3 (statement of Gerald F. Rath, attorney with Boston's Bingham, Dana & Gould, appointed by SEC to monitor Boesky's trading after the settlement).

\(^{98}\) *House Hearings*, supra note 9, at 112 (testimony of then-Chairman Shad).
quidity to withstand potential margin calls and avert the downward spiral feared by the SEC.\textsuperscript{99} As one trader argued, "Margin calls can be contained a lot more quickly than before. The margin issue has to be viewed a lot differently from the 1920s.\textsuperscript{100}

However, the lessons learned from Black Monday\textsuperscript{101} may belie this claim. Amidst unprecedented volume\textsuperscript{102} and price volatility,\textsuperscript{103} the Dow Jones Industrial Average (DJIA) dropped 508 points,\textsuperscript{104} a

\textsuperscript{99} See Glaberson, Did the SEC Give Boesky Too Sweet a Deal?, Bus. Wk., Dec. 8, 1986, at 37.

\textsuperscript{100} Anders, Some Question Move to Allow Sales by Boesky, Wall. St. J., Dec. 15, 1986, at 4, col. 1; see also id. (William Priest, vice-president of BEA Associates, Inc., a N.Y. money management firm, stating that "[t]he market has withstood far more serious shocks than the Boesky case without serious problems . . . . Prices might have dropped in the first 48 hours, but in the end it would have been all right."); Jarrell & Pound, supra note 70, at 39, col. 3 ("[S]uch concerns are unwarranted given the breadth and depth of modern American capital markets, which have been demonstrated to be remarkably stable with respect to fast-breaking, major news.").

Further, one may plausibly argue that had the SEC been genuinely concerned about such a downward spiral, it would have employed any of a number of techniques available to mitigate this potentiality which would have avoided the problems discussed infra text accompanying notes 116-46. For a full discussion of these alternatives, see infra text accompanying notes 147-90.

\textsuperscript{101} See generally CFTC REPORT, supra note 94; GAO STUDY, supra note 46; KATZENBACH, AN OVERVIEW OF PROGRAM TRADING AND ITS IMPACT ON CURRENT MARKET PRACTICES (1987) [hereinafter KATZENBACH REPORT]; BRADY COMMISSION REPORT, supra note 8; SEC REPORT, supra note 8.

\textsuperscript{102} See GAO STUDY, supra note 46, at 4; BRADY COMMISSION REPORT, supra note 8, at 1. Approximately 604.3 million shares were traded on the New York Stock Exchange. STANDARD & POOR'S CORP., DAILY STOCK PRICE RECORD: NEW YORK STOCK EXCHANGE, OCT.-DEC. 1987, at xii (1987).

\textsuperscript{103} See GAO STUDY, supra note 46, at 4; see also infra note 112 (discussing price swings on Tuesday, Oct. 20).

\textsuperscript{104} See STANDARD & POOR'S CORP., supra note 102, at xi. According to the President's Task Force, October 19, 1987, was perhaps the worst day in the history of U.S. equity markets. BRADY COMMISSION REPORT, supra note 8, at 36. On that day, the financial markets in the United States and abroad experienced almost unprecedented turmoil as the value of equity markets fell dramatically amidst record trading volumes. GAO STUDY, supra note 46, at 14. Monday's debacle was actually a continuation of the previous week's downturn. GAO STUDY, supra note 46, at 41-42. See generally BRADY COMMISSION REPORT, supra note 8, at 15-30. At the close of trading on Friday, October 16, the Standard & Poor's 500 futures contract was trading at a 21 point discount to the underlying Standard & Poor's index. GAO STUDY, supra note 46, at 42. The order imbalance resulting from this selling pressure, coupled with the sell-off of stock index futures by a few portfolio insurers, drove the price of futures contracts to deep discounts to the underlying stocks on Monday morning. BRADY COMMISSION REPORT, supra note 8, at 30. In response to this discount, index arbitrageurs began to buy futures and sell stocks. GAO STUDY, supra note 46, at 42. Futures prices subsequently rebounded, id. at 43, and eventually reached a premium to stock prices. BRADY COMMISSION REPORT, supra note 8, at 30. The Dow began to rally. Id. In the early afternoon, however, the volume of sales overwhelmed the New York Stock Exchange's computerized execution system. Id. at 34. The resulting delays made index arbitrageurs unwilling to execute their program
twenty-three percent decline. Volume during the last hour of trading alone totalled 109.5 million shares. The following day, the DJIA gained 102 points, the largest gain on record, on a trading volume of 608.1 million shares. At about noon that day, "the securities markets and the financial system approached breakdown" as the stock markets and the stock index futures market "disconnected" and a free fall developed in both markets. Although investigators may disagree as to the causes of this market break and the means of preventing its recurrence, the crash made

trading strategies. GAO Study, supra note 46, at 43. With no mechanism to force convergence between the two markets, id., the futures and stock markets became "disconnected." Brady Commission Report, supra note 8, at 34-36. The remainder of the day "was disastrous." Id. at 36. In the last hour of trading, the DJIA dropped approximately 250 points on trading of 109.5 million shares. GAO Study, supra note 46, at 43.

105. GAO Study, supra note 46, at 4. A decline of this magnitude is comparable only to the 24.5% drop in the Dow experienced on October 28 and 29, 1929, which together constituted the Great Crash of 1929. Brady Commission Report, supra note 8, at 1; see also GAO Study, supra note 46, at 4.

106. GAO Study, supra note 46, at 43. In comparison, the average daily trading volume on the New York Stock Exchange in 1986 was 141 million shares. Brady Commission Report, supra note 8, at VI-32.

107. Standard & Poor's Corp., supra note 102, at xi.


109. Standard & Poor's Corp., supra note 102, at xii.


111. Id. at 42.

112. Id. At the close of trading on Monday, the discount between the Standard & Poor's 500 futures contract and the underlying index was about 25 points. GAO Study, supra note 46, at 43. Exchange officials asked their members to refrain from using the computerized execution system for program trading. Id. at 44. When the market opened on Tuesday, the DJIA rallied 200 points above the open. Id. Stock prices began a precipitous decline, however, and the morning's gains were erased by about noon. Id. With trading in many stocks closed, price information difficult to get, and speculation that the NYSE was about to close, the Chicago Board Options Exchange and the Chicago Mercantile Exchange suspended trading in options and futures. Id.; Brady Commission Report, supra note 8, at 40. It was at this point that the markets again disengaged. Brady Commission Report, supra note 8, at 40-41; see also supra note 101 (discussing a similar event the previous day). According to the Brady Commission, the financial system was on the brink of collapse, and "the ability of securities markets to price equities was in question." Brady Commission Report, supra note 8, at 41. After futures trading resumed, stock prices began to rebound, with the DJIA gaining over 160 points between 2:15 and 3:30 p.m. GAO Study, supra note 46, at 44. In the last half hour of trading, however, stock prices again began to drop, losing 75 points. Id.

113. See, e.g., CFTC Report, supra note 94 (suggesting better coordination between the exchanges); GAO Study, supra note 46 (suggesting upgrading of NYSE's computerized order system, contingency planning, and coordinated intermarket regulation); Katzennbach Report, supra note 101 (suggesting restraints on stock index arbitrage, improvement in the exchanges' electronic trading systems, contingency planning for closing exchanges in emergencies, and regulation of stock index futures by the SEC rather than by the CFTC); Brady Commission Report, supra note 8 (suggesting unified stock and futures margin requirements,
clear that the type of instability feared by the SEC was indeed possible.

Accordingly, faced at the very least with the possibility of extreme market volatility induced by its enforcement proceeding, the SEC was in a very difficult position — if it had not taken action to avert potentially uncontrolled selling and such a crisis did ensue, investor confidence in the markets and in its stabilizing mechanisms may have been destroyed.\(^\text{114}\) Under such awkward circumstances,\(^\text{115}\) the Commission's good faith decision to take some prophylactic action deserves due deference.

C. Shortcomings of the Commission's Response

This is not to say, however, that the method chosen by the Commission to limit the announcement's anticipated adverse effects was without fault. On the contrary, it appears that the Commission failed to adequately weigh the possibility that its acquiescence in Boesky's early trading would have a substantial negative impact on investor confidence,\(^\text{116}\) and thereby undermine the purpose of its prosecution.\(^\text{117}\) Initially, market professionals were dismayed by the apparent inequity in permitting Boesky's partnership to escape potential losses\(^\text{118}\) by reducing its positions prior to the announce-

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\(^\text{114}\) See supra text accompanying note 46 (discussing the importance of market stability to investor confidence).

\(^\text{115}\) See Anders, Some Question Move to Allow Sales by Boesky, Wall St. J., Dec. 15, 1986, at 4, col. 1 (quoting Stephen Canter, head of Chase Manhattan Corp.'s money management subsidiary, who called the Commission's predicament a "damned if you do, damned if you don't" situation).

\(^\text{116}\) See This Week With David Brinkley, supra note 71 (Sen. Alfonse D'Amato of the Senate Banking Committee noting that the SEC's acquiescence in the early sales "shakes the confidence of the public in the marketplace . . . ."); cf. Glaberson, supra note 99, at 37 (charging that the SEC wasn't "sophisticated enough about the devastating public relations impact of a big sell-off just before the settlement."); Nash, They Who 'Delivered' Boesky Are Perplexed, N.Y. Times, Jan. 2, 1987, at B6, col. 6 (stating that some experts on SEC operations have speculated that the Commission may not have anticipated the public scrutiny the Boesky case would engender).

\(^\text{117}\) See supra text accompanying notes 1, 8-9 (discussing the maintenance of investor confidence as the SEC's underlying objective).

\(^\text{118}\) See supra text accompanying notes 81-83 (discussing the amount of losses avoided).
while unknowing investors who stayed in the market were hit hard in the immediate post-announcement period.\textsuperscript{120} As one arbitrageur put it, “Why should his investors get the benefit of his knowledge [about the impending announcement] and not mine?”\textsuperscript{121} Another investment professional noted, “It’s the irony of all ironies. The biggest inside information is that Boesky is being put out of business, and he gets to trade on it first.”\textsuperscript{122}

Such a perception should not be downplayed, since Rule 10b-5 itself has been said to be based in policy on the justifiable expectation that all investors have relatively equal access to material information.\textsuperscript{123} Consistent with this approach, the SEC ruled in \textit{In re Cady, Roberts & Co.}\textsuperscript{124} that corporate insiders must abstain from trading in the shares of their corporations unless they have first disclosed all material inside information known to them.\textsuperscript{125} Further-

\textsuperscript{119} See supra text accompanying notes 77-78.

\textsuperscript{120} See supra notes 86-87. \textit{But cf.} Sperber v. Boesky, 672 F. Supp. 754 (S.D.N.Y. 1987), aff'd, 849 F.2d 60 (2d Cir. 1988). The putative class action plaintiff in \textit{Sperber} asserted a claim under the Racketeer Influenced and Corrupt Organizations Act (RICO), alleging damages resulting from the SEC announcement’s adverse effect on the price of class securities. The court noted that the alleged injury arose not from the alleged RICO violation but rather from its disclosure. 672 F. Supp. at 757-58. As a result, plaintiff’s claim could be viewed as based not on any RICO violation but rather on the fact that the alleged violation was not successful. \textit{Id.} at 758. In addition, the court ruled that the RICO violation alleged was not the proximate cause of plaintiffs’ injuries. \textit{Id.} at 758-59. Significantly, however, the court expressly declined to comment on the sufficiency of any insider trading claim based on the pre-announcement sales. \textit{Id.} at 756.


\textsuperscript{122} Anders, \textit{Boesky Fund Sold Big Blocks of Securities}, Wall St. J., Nov. 20, 1986, at 3, col. 1 (quoting the head of stock trading at an unnamed Wall Street firm); \textit{see also} Scott, \textit{Wall Street Recovers Some Aplomb After the Boesky Bomb}, Christian Sci. Monitor, Nov. 24, 1986, at 25, col. 1 (quoting a New York Stock Exchange specialist as complaining that “Boesky’s the only one making money these days . . . . ”); Sterngold, \textit{California Broker Becoming a Focus of Insider Inquiry}, N.Y. Times, Nov. 20, 1986, at A1, col. 4, A18, col. 5 (quoting another arbitrageur as stating, “It’s the ultimate arbitrage. You take advantage of advance knowledge of your own legal problems . . . . The irony is that the guy protected the most was Boesky himself.”).


\textsuperscript{124} 40 S.E.C. 907 (1961).

\textsuperscript{125} \textit{Id.} at 911. Only “material facts” which have not yet been disseminated to the public are subject to the duty to disclose or abstain. \textit{See Texas Gulf Sulphur}, 401 F.2d at 848-50; List v. Fashion Park, Inc., 340 F.2d 457, 462 (2d Cir.), \textit{cert. denied}, 382 U.S. 811 (1965). The issue of materiality is governed by the test enunciated in TSC Indus. v. Northway, Inc., 426 U.S. 438 (1976), specifically made applicable to the 10b-5 context in Basic, Inc. v. Levinson, 108 S. Ct. 978 (1988). Under \textit{Northway}, a fact is deemed material if there is a substan-
more, the duty to "disclose or abstain" may be applied to establish a 10b-5 violation by individuals other than traditional corporate insiders.\(^{128}\)

In *Chiarella v. United States*,\(^{127}\) however, the Supreme Court held that such a duty does not arise from the mere possession of nonpublic market information,\(^{128}\) but rather requires the existence of a fiduciary relationship.\(^{129}\) As a result, an employee of a financial printer was found not to have committed a 10b-5 violation since "[h]e was not [the corporation's] agent, . . . was not a fiduciary, [and] was not a person in whom the sellers [of the securities] had placed their trust and confidence."\(^{130}\) Accordingly, in the absence of some novel theory establishing such a relationship,\(^{131}\) or in the alternative some evidence of a misappropriation of confidential information,\(^{132}\) Boesky's pre-announcement sales would not fall within the

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\(^{126}\) Klein: Insider Trading, SEC Decision-Making, and the Calculus of Investo

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128. Id. at 235.
129. See id. at 227-35.
130. Id. at 232.
131. See, e.g., Wise, supra note 86, at 3, col. 2 (Stanley M. Grossman, specialist in class action lawsuits for injured investors with Pomerantz, Levy, Haudek, Block & Grossman, P.C., suggesting a possible viable theory might emerge if Boesky had agreed to a secrecy pact with the Government, since such an agreement might carry with it an obligation not to take advantage of the information).
traditional definition of insider trading despite any apparent similarity between the two. 133

It is worthwhile to note, however, the similarity between the Boesky transactions and the broader definition of insider trading which the SEC has historically sought. 134 In the Dirks case, 135 for exam-
ple, the SEC asserted that a tippee "inherits" the Cady, Roberts duty to shareholders whenever he or she knowingly receives material nonpublic information from an insider. According to the Commission, the defendant's use of nonpublic "market" information, analogous to that in Boesky's possession, constituted a 10b-5 violation. The Supreme Court reversed, holding this view to be inconsistent with its decision in Chiarella.

A brief analysis of the Commission's recently proposed statutory definition further illustrates the analogy. The bill would prohibit...
any person from buying or selling securities while in possession of material nonpublic information if the information was "wrongfully" obtained or its use would be wrongful. Information is "wrongful" if it was "obtained by, or its communication would constitute,... (A) theft, bribery, misrepresentation, espionage... or (B) conversion, misappropriation, or any other breach of a fiduciary duty, breach of any personal or other relationship of trust and confidence, or breach of any contractual or employment relationship." While the Commission maintains that this definition does not fundamentally alter the scope of prohibited conduct under present law, former Commissioner Richard B. Smith has noted that the bill could plausibly be read to establish a violation for any trading while in possession of material nonpublic information because that fact alone could be construed to constitute a misrepresentation to the counterparty. No fiduciary relationship or misappropriation of information would be required to establish a violation. Clearly under this relaxed standard Boesky's pre-announcement sales would fall within the scope of prohibited conduct.

D. Possible Alternative Responses


142. SEC Proposed Bill, supra note 141, sec. 2, ¶ 16A(b)(1).
143. Id.
146. Id.
confidence. Although a number of alternative responses would appear to have been suitable, closer scrutiny reveals that this may not have been the case.

1. **Option A.**— The most obvious “solution” to the Commission’s dilemma would have been a complete ban on all trading by Boesky and his affiliated companies until after the announcement, in accordance with the *Cady, Roberts* duty to disclose or abstain. As Ira L. Sorkin, former head of the SEC’s New York office, noted, “You can make anything a condition of a settlement. I would have said ‘Don’t you dare trade one share of stock. You are frozen. Do not pass go. Do not collect $200.’”

At first glance this approach would appear to remedy the appearance of unfairness in allowing Boesky’s early trading. Unfortunately, it is wholly inadequate in addressing the Commission’s concerns over post-announcement market instability. First, in order to effectively avoid the danger of uncontrolled selling in a falling market, the trading ban would have to be in effect until after the market’s short-term reaction to the announcement subsided. Even then, the market’s knowledge that Boesky was yet to liquidate his substantial holdings would likely negate the utility of this option, since post-announcement prices would correct downward in anticipation of the impending sell-off. Such a correction would result in price drops approaching those that would have resulted had the SEC taken no market-stabilizing action at all.

Second, the SEC may not possess the legal authority to implement such a plan, since a no-trading provision in its settlement with Boesky would not be binding on the margin lenders holding the fund’s securities. As a result, the lenders would have been able to liquidate the holdings in response to the fund’s failure to meet the anticipated margin calls in the interim period, regardless of the

149. *See supra* text accompanying notes 80-84, 116-46.
150. *See supra* text accompanying notes 85-96.
151. It is a well-settled principle of contract law that a consent judgment binds only those parties who have consented to it. *See Centron Corp. v. United States*, 585 F.2d 982, 987 (Ct. Cl. 1978); 49 C.J.S. Judgments § 174b (1947); *see also* United States v. Northern Colo. Water Conservancy Dist., 608 F.2d 422, 430-31 (10th Cir. 1979) (stating that “a consent decree . . . is to be construed for enforcement purposes basically as a contract.”) (citing United States v. ITT Continental Baking Co., 420 U.S. 223 (1975)).
152. *See supra* text accompanying notes 89-92.
ban on trading by Boesky.  

Furthermore, this proposal is unsatisfactory because a shutdown of Boesky's operations would have been impossible to conceal. Because of the size of his fund and his unparalleled success, Boesky's traders on the floor of the exchange were carefully monitored by other arbitrageurs. Consequently, the investment community would have been tipped off as to his legal troubles and his pre-announcement cooperation in the SEC's investigation would have been suspected and rendered useless.

2. Option B.—Alternatively, the Commission could have coupled a trading ban akin to that suggested in Option "A" with a requirement that Boesky reduce his margin debt through a limited pre-announcement liquidation of a representative sample of stocks in the fund's portfolio, rather than just the more sensitive takeover-related securities.

This proposal also appears on its face to successfully reconcile the Commission's objectives, since it would provide Boesky with sufficient liquidity to meet the initial wave of margin calls and avert a mass liquidation by the margin lenders without permitting him to sell off those securities which were expected to react with the greatest volatility to the SEC announcement. However, this remedy provides at best only a partial remedy to the fairness issue. This result obtains from the fact that stock prices dropped across the board.

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153. Moreover, even if the Commission did possess such power, its application in this circumstance would be highly imprudent in light of the vulnerability to which this would subject the banking community. See Nash, S.E.C. Let Boesky Pare $1.4 Billion from Fund's Debts, N.Y. Times, Dec. 12, 1986, at D4, col. 4 (stating that the SEC had privately said that it feared the effects of a downward spiral on the banking system).


156. See supra note 69.

157. This Week With David Brinkley, supra note 71 (interview with then-Chairman Shad).

158. Supra text accompanying notes 147-57.

159. This would include the sale of whatever blue-chip stocks and other nontakeover-related equities held by the partnership, as well as investment grade debt securities, i.e. bonds rated AAA, AA, A, or BBB by Standard & Poor's, see C. Currier, supra note 88, at 18, since such bonds are less susceptible to extreme price volatility than junk bonds.

160. A senior executive at a major Wall Street firm asserted that "[i]f the SEC was really worried about pressure from margin debt, that would have been the way to handle it." Nash, Boesky Was Allowed to Sell Stock to Avoid Any Panic, S.E.C. Says, N.Y. Times, Nov. 22, 1986, at A43, col. 3.
following the announcement;\textsuperscript{161} takeover stocks as a group were the hardest hit,\textsuperscript{162} and remained depressed for a longer period,\textsuperscript{163} but the damage was not limited to this sector of the market. Consequently, any pre-announcement sales by Boesky's fund would have resulted in avoidance of loss, albeit to a lesser degree than that which may have actually resulted,\textsuperscript{164} and would have evoked the same issues of non-disclosure discussed earlier in this Note.\textsuperscript{165}

In addition, the high concentration of takeover-target stocks in the partnership's portfolio\textsuperscript{166} casts doubt on whether the sale of the remainder of its holdings alone could have generated enough liquidity to satisfy potential margin calls.

This option also fails to address a major stumbling block for Option "A,"\textsuperscript{167} that is, the need to protect the integrity of the SEC's ongoing investigation.\textsuperscript{168} Due to its deviance from Boesky's normal trading pattern, the trading required by this option would certainly have been detected by those investment professionals who regularly monitored Boesky's activities.\textsuperscript{169} Consequently, this option also proves to be unsatisfactory.

3. Option C.— A third alternative would have been to permit Boesky to trade prior to the Commission's announcement under the stipulation that the losses his partnership thereby avoided\textsuperscript{170} would be paid over to either (1) the disgorgement pool established pursuant to the consent decree in addition to the $50 million in previously disgorged profits\textsuperscript{171} or (2) the U.S. Treasury as a civil penalty in addition to the $50 million previously received.\textsuperscript{172}

\begin{footnotes}
\item[161.] See supra note 86.
\item[162.] See supra note 87.
\item[163.] See supra note 87.
\item[164.] See supra text accompanying notes 81-83 (discussing the amount of losses actually avoided).
\item[165.] See supra text accompanying notes 116-46.
\item[166.] See supra note 77.
\item[167.] Supra text accompanying notes 147-57.
\item[168.] See supra text accompanying notes 155-57.
\item[169.] See supra text accompanying note 155.
\item[170.] See supra text accompanying notes 81-83. The difficulty in calculating this amount is a principal shortcoming in the application of this option. See infra text accompanying notes 182-90.
\item[171.] See supra note 65.
\item[172.] See supra note 65. Both the $50 million civil penalty and the $50 million representing disgorged profits paid in the Boesky case were to come from Boesky's personal holdings. House Hearings, supra note 9, at 88 (testimony of Gary Lynch, SEC Director of Enforcement). The additional amount proposed here would be the responsibility of Ivan F. Boesky & Co., L.P., since the losses avoided by the pre-announcement sales would accrue to it rather
\end{footnotes}
This option presents the most promise for resolving the SEC's
decision-making dilemma. Under such a stipulation, the substantial
holdings of Boesky's investment fund would be removed from the
anticipated post-announcement sell-off without any profits from the
early sales accruing to Boesky or his limited partners. Such a result
would not, of course, mitigate the actual losses sustained by inves-
tors following the announcement. It would, however, effectively elim-
inate the ramifications of the informational advantage available to
Boesky's partnership and place it at the same risk of loss as the rest
of the market. Moreover, the first sub-option would generate addi-
tional funds for the satisfaction of civil judgments obtained against
Boesky. Since the total damages sought by plaintiffs in such suits
greatly exceeds the $50 million available in the disgorgement pool,
even moderate success would render the pool insufficient to satisfy
judgment creditors. Consequently, it seems equitable to bestow the
windfall of Boesky's early trading on those who are able to prove
injury resulting from his illegal trading rather than on his limited
partners who presumably benefited from such behavior in the past.

173. A number of civil suits have been commenced naming Boesky as a defendant. See,
e.g., FMC Corp. v. Boesky, 852 F.2d 981 (7th Cir. 1988) (corporation alleging that Boesky's
insider trading increased the cost of its recapitalization by $235 million); Arden Way Assoc.
$338 million investment, alleging that information provided to them in connection with the
offering of limited partnership interests was false and fraudulent and therefore violative of
federal securities laws and the common law); Guinness Enters. v. Boesky, 669 F. Supp. 659
1494 (S.D.N.Y. 1987) (same allegations); see also Sperber v. Boesky, 849 F.2d 60 (2d Cir.
1988) (affirming dismissal of RICO claim based on injury to investors resulting from the SEC
announcement's depressing effect on stock prices), discussed supra note 120. The Arden Way,
Guinness, and Farnsworth and Hastings suits have been consolidated with various others
before U.S. District Senior Judge Milton Pollack. In re Ivan F. Boesky Securities Litigation,

174. See supra note 173 (discussing some of the cases naming Boesky as a defendant).

175. See Sontag, Many Eye Millions in SEC Pool, Nat'l L.J., May 30, 1988, at 1, col. 1. More than 100 claims to disgorged funds have reportedly been filed with the SEC. Id. at 28,
col. 1. Since the standards for determining who is entitled to priority are unclear, see id., "it is
unlikely [the SEC] will be able to formulate a plan [for the distribution of the $50 million]
that will make everybody happy." Id. at 28, col. 4 (quoting Thomas C. Newkirk, chief litigation
counsel for the SEC's Division of Enforcement).

cussed supra note 173; Guinness Enters. v. Boesky, 669 F. Supp. 659 (S.D.N.Y. 1987); Farns-
worth and Hastings, Ltd. v. Boesky, 660 F. Supp. 1494 (S.D.N.Y. 1987); Boesky Investors
Agree to Distribute Payout, N.Y. Times, Feb. 10, 1987, at D29, col. 5 (reporting that the
limited partners were expected to lose approximately $90 million, or 26% of their capital
investment, on the investment fund's dissolution).
From a practical standpoint, however, this remedy is only partially satisfactory, and may have in fact been unavailable to the Commission in the Boesky case. Assuming that the SEC's settlement with Boesky represented the best deal it could reach, the demand that Boesky give up the opportunity to cut his partners' losses would necessarily result in a trade-off in some other area of the settlement. This is especially true if Boesky had anticipated that the investors in his partnership would attempt to recover from him the amount of losses they allegedly incurred as a result of the partnership's early dissolution, since the amount he could save via the early liquidation would reduce his potential liability to them. Because the proposed change in settlement terms would thus be neutral vis-à-vis Boesky as well as the average investor, the appearance of unfairness occasioned by the early liquidation would not change. Additionally, this proposal fails to account for the debilitating effect of Boesky's changed trading status. The incentive for Boesky to trade in a profit-maximizing manner would be minimized if he knew he was trading for the benefit of the United States Treasury or those plaintiffs successful in obtaining judgments against him rather than for himself and his limited partners.

177. On the facts of the Boesky case, this may in fact be a big assumption. See Glaberson, supra note 99 (questioning whether the settlement was too lenient, thereby minimizing its deterrent effect).

178. See This Week With David Brinkley, supra note 71 (former SEC regional director Ira L. Sorkin, stating "You do make deals. You do enter into arrangements with people who are willing to cooperate, and you do trade off."). Evidence of such trade-offs in the Boesky settlement may be found in the fact that Boesky's guilty plea, see supra note 68, was apparently crafted so as to lessen his vulnerability to civil lawsuits. See Cole, Guilty Plea Entered by Boesky, N.Y. Times, Apr. 24, 1987, at D1, col. 6, D2, col. 5. Since the plea involved trading in the shares of only a single company, shareholders of other companies are not able to build claims against Boesky on the guilty plea, id. at D1, col. 6, and Boesky is "free to contest all other civil litigation based on any other transaction," id. at D2, col. 6 (quoting Michael S. Feldberg, former federal prosecutor and presently with the law firm Shea & Gould). Moreover, the offense is not one which serves as a "predicate offense" under the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §§ 1961-1968 (1982 & Supp. IV 1986), and plaintiffs alleging claims under RICO must therefore bear the burden of proving that Boesky engaged in a pattern of racketeering behavior. See Insider Suits Face Struggle (Business and the Law column), N.Y. Times, Apr. 27, 1987, at D2, col. 1.

179. See sources cited supra note 176.

180. See supra text accompanying notes 80-84, 116-46.

avoid the public relations problems associated with the pre-announcement sell-off and to produce additional funds for the satisfaction of prospective judgments should therefore not be overstated.

Moreover, calculation of the amount of losses avoided further complicates the practical utility of this option. As in the case of the civil penalty calculation under the Insider Trading Sanctions Act of 1984, the amount of losses avoided would be the difference between the price at which Boesky sold various securities and the trading price of such securities “a reasonable period after public dissemination of the nonpublic information.” Since the length of the “reasonable period,” that is, the amount of time necessary for the market to “internalize” the information, is contingent upon a number of factors, including the liquidity of the market for the issuer’s shares, the nature of the information, and the extent of the information’s publicity, its determination is necessarily somewhat arbitrary. In the ordinary litigation, this arbitrariness may be remedied by ascertaining the time at which the market price “levelled off” after disclosure, an approach adopted by the First Circuit in SEC v. MacDonald. Furthermore, in the context of ITSA, the

religious studies at New York’s Jewish Theological Seminary). If Boesky is truly as repentant as these reports would indicate, perhaps he would have acted so as to maximize the benefit to those he allegedly defrauded.


184. D. Langevoort, supra note 3, at 169.

185. Bagby, supra note 10, at 585; Langevoort, supra note 30, at 1280. Where a company is widely followed by professional investors and the information is of a type that is susceptible of rapid evaluation, studies indicate that the information can be reflected within hours of disclosure. See, e.g., Patell & Wolfson, The Intraday Speed of Adjustment of Stock Prices to Earnings and Dividend Announcements, 13 J. Fin. Econ. 223 (1984). For more thinly traded shares, or subjective information which takes more time to evaluate, the information will be assimilated by the market more slowly. D. Langevoort, supra note 3, at 170; see also 5A A. Jacobs, Litigation and Practice Under Rule 10b-5, § 66.02[g], at 3-580 to -583 & n.48 (2d ed. rev. 1988) (stating that “[t]he public’s evaluation will take longer if the announcement is complicated, its contents cannot be analyzed instantaneously, or the topic is less spectacular,” and listing suggestions for fixed time spans).

186. See D. Langevoort, supra note 3, at 170.

187. 699 F.2d 47 (1st Cir. 1983) (en banc). In reversing an order requiring disgorgement and remanding for recalculation, the MacDonald court held that:

[T]he market itself may be the best indicator of how long it took for the investing public to learn of, and react to, the disclosed facts. The natural effect of public disclosure would be to increase the demand for, and correspondingly, the price of, [the company’s] stock, and once investors stopped reacting to the good news, the price could be expected temporarily to level off. Therefore, upon remand, in deter-
trebling mechanism\textsuperscript{188} insures that this arbitrariness poses no danger that the insider will benefit from too short a “reasonable period.”\textsuperscript{189} Neither safeguard would be present, however, in calculating Boesky’s loss avoidance. First, the “reasonable period” fixed would result from an antecedent contractual negotiation between Boesky and the Commission rather than from a retrospective judicial analysis as in MacDonald. Second, the trebling mechanism of ITSA would not be implicated in the application of this alternative. Compounding this calculation problem is the fact that announcement of Boesky’s insider trading settlement was relevant to the price of all securities traded in the market,\textsuperscript{190} in contrast to the ordinary insider trading case where the information in question is relevant to the securities of only a single issuer.

III. A PROPOSED DECISION-MAKING FRAMEWORK

The Boesky case therefore confronted the SEC with a decision-making quandary. Once its enforcement proceeding had passed “the point of no return,” the Commission was compelled to take some action to mitigate its expected destabilizing effect.\textsuperscript{191} This process unfortunately caused the Commission to lose sight of its ultimate objective.\textsuperscript{192} As a result, the Commission permitted Boesky to trade prior to the public announcement of its enforcement action, a decision which arguably sanctioned the type of transaction which the SEC itself has classified as injurious to investor confidence.\textsuperscript{193} In fairness to the Commission, however, alternatives which adequately addressed its concerns appear to be lacking.\textsuperscript{194}

If a solution to this dilemma exists, it may therefore lie not in a search for post hoc remedies, but rather in a reevaluation of the Commission’s case selection process and an expanded use of alternative enforcement methods. Presently, the SEC’s budgetary con-

\textsuperscript{188} See supra note 30.
\textsuperscript{189} Langevoort, supra note 30, at 1279 n.36.
\textsuperscript{190} See supra text accompanying notes 85-88.
\textsuperscript{191} See supra text accompanying notes 85-115.
\textsuperscript{192} See supra text accompanying notes 1, 8-9 (arguing that the Commission’s ultimate objective is to maximize investor confidence in the capital markets).
\textsuperscript{193} See supra text accompanying notes 134-46.
\textsuperscript{194} See supra text accompanying notes 147-90.
straints\textsuperscript{185} dictate a selective enforcement program intended to achieve maximum impact.\textsuperscript{186} This means that the Commission will give highest priority to cases promising a particularly high "payoff" or a relatively low cost.\textsuperscript{187} Accordingly, considerable weight is given to investigations that will be widely reported\textsuperscript{188} and to those that involve broker-dealers, professional money managers, and other points of access to the securities markets.\textsuperscript{189} The Boesky investigation appeared to fit perfectly into this model.\textsuperscript{200}

195. Professor Dooley points out that "the SEC is a relatively small agency charged with the enforcement of a number of complex laws. Much of its resources are consumed by routine regulation such as reviewing registrations and reports, overseeing the markets, and rulemaking."\textsuperscript{36} Dooley, supra note 2, at 18. As a result, the adequacy of SEC enforcement resources has repeatedly been questioned. See, e.g., \textit{House Panel Told SEC is Not Keeping up with Epidemic Securities Fraud Activity}, \textit{18 Sec. Reg. & L. Rep. (BNA) 309 (Mar. 7, 1986)} (discussing Congressional debate over the adequacy of SEC enforcement resources); \textit{Report of the Task Force on SEC Rules Relating to Investigations, 42 Bus. Law. 789, 791 n.3 (1987)} (expressing concern that the Division of Enforcement's staffing is inadequate for the Commission to discharge its responsibilities); Laderman, supra note 8, at 88 (discussing whether the SEC should be given the manpower to increase enforcement efforts); Scott, \textit{Boesky-Case Broom is Big}, \textit{Christian Sci. Monitor, Nov. 19, 1986, at 1, col. 2, back page} (Richard M. Phillips, former chairman of American Bar Association's task force on federal securities regulation, stating "[t]hey [SEC] don't have the resources to deal with the burgeoning marketplace"); \textit{This Week With David Brinkley, supra note 1} (Senator D'Amato arguing that Congress should give the SEC additional resources in order to create a more effective deterrent); cf. supra note 66 (comparing the size of the SEC's budget with the $100 million penalty paid by Boesky).


197. Dooley, supra note 2, at 19. In order to conserve enforcement resources, the Commission tends to select "those cases in which the defendant is likely to settle before trial or extensive pretrial proceedings." See id.; see also Herlihy & Ferrigno, supra note 196, at 156 (stating that "[t]he Commission attempts to settle as many of its cases as possible in order to conserve its limited resources."); cf. Rowe, supra note 65, at 930 (stating that "SEC Administrative Law Judges generally encourage settlements."). In fact, as many as 90\% of enforcement actions are settled rather than litigated. 1 M. Steinberg & R. Ferrara, supra note 65, at § 3:59.


199. 1 M. Steinberg & R. Ferrara, supra note 65, at § 2:03; Herlihy & Ferrigno, supra note 196, at 154-55.

200. On the other hand, it is now apparent that the Boesky case and its offspring will prove to be very expensive for the SEC. In statements before a House Appropriations subcommittee, SEC Chairman David Ruder said that the Government was getting less cooperation.
Unfortunately, as the Boesky case aptly demonstrates, the Commission may be misdirected in its reliance on such deterrence-related selection criteria.\textsuperscript{201} If the Commission had instead focused at the outset of its investigation on the calculus of investor confidence,\textsuperscript{202} perhaps it could have anticipated the exigencies of its enforcement action and tailored its enforcement response accordingly.

In particular, the Commission has available various seldom-used forms of remedial action which can be flexibly employed in particular cases to further the Commission's underlying policy mandate.\textsuperscript{203} In cases such as Boesky, for instance, the Commission should consider whether the maintenance of investor confidence would be better served by opting for a more modest remedy than the kind of highly publicized, full-scale enforcement action utilized in the Boesky case and elsewhere.\textsuperscript{204} The use of a "desk undertaking"\textsuperscript{205} or "cautionary letter,"\textsuperscript{206} for example, would remedy both the short-term adverse effects of the announcement of an SEC enforcement action\textsuperscript{207} and the longer-term detriment which can predictably result from the exigencies of particular investigations.\textsuperscript{208} The Commission should also

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\item from witnesses than it had hoped. \textit{S.E.C. Hints at Big Cases}, N.Y. Times, Mar. 25, 1988, at D14, col. 3. As a result, the SEC was likely to be involved in large-case litigation, to which approximately 20\% of the Enforcement Division's resources would need to be devoted. \textit{Id.}
\item See \textit{Herlihy & Ferrigno}, supra note 196, at 158-59 (stating that the case selection process focuses on "the deterrent effect that a potential case will have on the industry.").
\item See supra text accompanying notes 10-53.
\item The various forms of proceedings available to the SEC include: (1) no further proceedings; (2) cautionary letters, warning releases, and "desk undertakings;" (3) civil and criminal referral to other law enforcement agencies; (4) referral to self-regulatory organizations; (5) § 21(a) statements; (6) administrative proceedings against broker-dealers and other associated persons, and Rule 2(e) proceedings against attorneys, accountants, and other professionals practicing before the Commission; and (7) injunctive actions, which may seek ancillary relief such as disgorgement of ill-gotten profits. See generally 1 M. \textit{Steinberg} & R. \textit{Ferrara}, supra note 65, at §§ 3:29-:40; Rowe, supra note 65, at 931-34.
\item The Commission has apparently recognized this principle in other contexts. See, e.g., \textit{Herlihy & Ferrigno}, supra note 196, at 155-56 (stating that in enforcement proceedings involving viable businesses, the Commission has sought the appointment of an independent board of directors and/or special counsel rather than the appointment of a receiver in order to minimize the disruptive effect of such a request).
\item A "desk undertaking" is a stipulation from the subject of an investigation that he or she will commit no further violations of the securities laws or will adopt procedures to prevent future violations. See Rowe, supra note 65, at 932. Such an undertaking is normally not disclosed to the public. See \textit{id}. The remedy is infrequently used today. See \textit{id}.
\item A "cautionary letter" is a letter in which the SEC advises a party of perceived violations of securities laws, or of conditions which make future violations likely. See 1 M. \textit{Steinberg} & R. \textit{Ferrara}, supra note 65, at § 3:32. This remedy is seldom used, and is generally not disclosed to the public. \textit{Id.}
\item See supra text accompanying notes 71-75.
\item See, e.g., supra text accompanying notes 116-46 (discussing the adverse impact of
\end{itemize}
not overlook the possibility that in some more extreme cases, the pursuit of any enforcement action might be harmful to investor confidence and therefore to the health of the securities markets.\textsuperscript{209}

Admittedly, adoption of such a "flexible response" approach to insider trading enforcement would allow some violators to escape with little more than a slap on the wrist. This criticism should be mitigated, however, by the recognition that due to both budgetary constraints\textsuperscript{210} and the difficulty of detection\textsuperscript{211} and prosecution,\textsuperscript{212} the SEC is presently able to successfully detect and prosecute only a fraction of the cases where violations have likely occurred.\textsuperscript{213} This has become especially apparent in recent years with regard to foreign

the Boesky liquidation on investor confidence).

\textsuperscript{209} See supra note 12 (discussing the relationship between insider trading and investor confidence). Although attempts to convince the SEC that no action should be taken in a particular case have usually proved futile, Rowe, supra note 65, at 931, the exercise of such discretion by the SEC is not without precedent. In 1976, for example, the Commission instituted a voluntary program for disclosure of questionable or illegal corporate payments and practices, in which corporations conducted their own internal investigations, publicly disclosed the results, allowed the SEC staff access to their investigation files, and terminated questionable or illegal practices. See id. at 931-32 (describing the "Voluntary Program"). In its report to the Senate Committee on Banking, Housing and Urban Affairs, the Commission stated that "[a]lthough participation in the voluntary program does not insulate a corporation from Commission enforcement action, it does diminish the possibility that the Commission will, in its discretion, institute action." Report of the Securities and Exchange Commission on Questionable and Illegal Corporate Payments and Practices 8 n.7 (May 12, 1976), quoted in Rowe, supra note 65, at 931-32.

\textsuperscript{210} See D. Langevoort, supra note 3, at 243 (stating that "resource limitations have . . . made it impracticable for the [SEC] staff to investigate or proceed in more than a small fraction of cases in which unlawful trading has likely occurred.").

\textsuperscript{211} See Copeland, Wall Street's Paper Tiger, NEWSWEEK, Dec. 22, 1986, at 44; Dooley, supra note 2, at 19-20; Laderman, supra note 8, at 81. The Boesky investigation itself is illustrative of the SEC's difficulty in detecting unlawful insider trading. Between 1983 and 1986, the New York Stock Exchange's Stockwatch surveillance system reportedly flagged 47 "trading anomalies" in which Boesky appeared to have been involved. House Hearings, supra note 9, at 25-27 (statement of William J. Anderson, Assistant Comptroller General, General Accounting Office). Nevertheless, the case against Boesky resulted from Dennis Levine's cooperation rather than these warnings. See supra note 60.

\textsuperscript{212} See Ingrassia, For SEC, Developing Insider-Trading Cases is Frustrating Work, Wall St. J., July 2, 1986, at 1, col. 6 (unnamed SEC enforcement official estimating that only 15-20\% of investigations succeed in establishing the necessary link on which to base a circumstantial case); see also Dooley, supra note 2, at 18-19 (arguing that since the line between legal and illegal trading is often unclear, "proving that given behavior should be characterized as a violation is seen as a difficult, complex undertaking of uncertain success.").

\textsuperscript{213} Dooley, supra note 2, at 19; see, e.g., Ingrassia, supra note 212, at 1, col. 6 (detailing the SEC's unsuccessful efforts over a three-year period in building a case against a Midwestern financial planner who had engaged in two suspicious trades in options for Digital Equipment Corp. stock); see also D. Langevoort, supra note 3, at 23 (stating that "[t]he typical insider trader is never caught or prosecuted.").
insider trading, where uncooperative foreign authorities and jurisdictional limitations further impair SEC enforcement efforts.

Moreover, such an approach would have little or no adverse impact on the insider trading prohibition’s deterrent effect, to the extent such a deterrent exists. Certainly, at the time a prospective inside trader is contemplating a violation, he or she would be hard-pressed to predict the exigencies of a future enforcement action or the SEC’s response to such exigencies. As a result, a proposal which on its face may seem to invite the prohibited conduct may in fact be the most effective means of fulfilling the prohibition’s underlying...
function.

CONCLUSION

Public confidence in the nation's securities markets is the function of a number of interrelated variables.\textsuperscript{218} Although Congress and the SEC have recently placed great weight on a vigorous insider trading enforcement program,\textsuperscript{219} factors such as market stability are also important elements in the calculus of investor confidence and must therefore be considered by the Commission not only in its regulatory capacity but in the formulation of enforcement strategy as well.\textsuperscript{220} As illustrated by the \textit{Boesky} case, the exigencies of particular enforcement actions can make this calculation especially problematic.\textsuperscript{221} What is required is a careful weighing of all options available to address these exigencies with an eye toward the Commission's ultimate mandate of maximizing investor confidence.\textsuperscript{222} And one option which the Commission has needlessly overlooked, which may be the most effective method of maximizing investor confidence in many cases, is for the SEC to tailor its enforcement response to the exigencies of the particular investigation and to the calculus of investor confidence.\textsuperscript{223}

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\textsuperscript{218} See supra text accompanying notes 8-48.
\textsuperscript{219} See supra text accompanying notes 26-42.
\textsuperscript{220} See supra text accompanying notes 43-53.
\textsuperscript{221} See supra text accompanying notes 70-190.
\textsuperscript{222} See supra text accompanying notes 147-90.
\textsuperscript{223} See supra text accompanying notes 195-217.
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