Securities and Exchange Commission Historical Society
Interview with Theodore A. Levine
Conducted on July 25, 2006 by Kenneth Durr

KD: This is an interview with Ted Levine at Wachtell Lipton Rosen & Katz in New York City on July 25, 2006 by Kenneth Durr. Thanks for agreeing to talk to me. I want to chat a little bit about your background and how you came to the Securities and Exchange Commission.

TL: It's actually relevant to insider trading because at George Washington University Law School, Henry Manne was my professor and I was taking a Corporation course. He recommended me to Stan Sporkin, the then Associate Director of Trading and Markets at the SEC. I was a summer intern at the SEC after my second year of law school in 1968 working in the Division of Trading and Markets. In 1969, when I graduated from law school, I thought I was going to be drafted; it turned out I wasn't, so I obtained a full-time position with the Commission. I ended up staying at the SEC from 1969 until I left in 1984, when I became a partner with Wilmer, Cutler & Pickering.

KD: Tell me about that class with Henry Manne. He must have talked a lot about insider trading.

TL: It was a Corporation class, so we spent a little time on it; he was a young professor. He had his theory in defense of insider trading and written a book arguing that insider trading was basically a way to reward the entrepreneurial efforts of executives. Remember, it was right after Texas Gulf Sulphur had been decided by the 2nd Circuit; I think that was 1968. I did very well in the Corporation class but truthfully it was almost 40 years ago so I don't really remember much about the class. I do remember the fact that he had recommended me to Stanley and he had taken an extreme position on insider trading. I was probably too young to appreciate what was right and what was wrong in that respect but it nonetheless that's how I got started at the Commission.

KD: Tell me about working for Stanley Sporkin in Enforcement. These must have been pretty exciting times.

TL: It was really Irv Pollack and Stanley Sporkin at that time. Thereafter Irv became a Commissioner and they reconstituted what was called Trading and Markets into the

Division of Enforcement. They also established a Division of Market Regulation. The Division of Enforcement, until Stanley left in 1981 when John Shad became Chairman, was really the center of not only the enforcement work but the development of mostly all the regulatory proposals at the Commission. Basically, all rule proposals or regulatory initiatives and even briefs that were being filed in the General Counsel's Office passed through Enforcement. Enforcement lawyers, including myself, had a role--at least I did--that was greater than simply doing Enforcement cases and supervising others. It was really having input into the regulatory structure.

I remember there was a "gestalt" approach utilized by the Commission – not only to use Enforcement actions but also develop rules and regulations around those actions. The Foreign Corrupt Practices Act developed that way; the perks rules and disclosure of compensation; the beneficial ownership rules, and the tender offer rules all developed first through Enforcement actions and then the development of rules and regulations based on those actions. It was a very exciting time and we were involved in everything going on at the Commission. Stanley had a very important role in influencing the Commission's direction. It's also interesting that before the Foreign Corrupt Practices Act, the SEC was a rather sleepy organization. The Foreign Corrupt Practices Act, particularly the voluntary disclosure program, really put the Commission on the map because it got huge visibility. That was in 1976, that whole post-Watergate era—the Commission became much better known and therefore much more controversial as a result of its higher profile.

KD: The Commission got into some controversy as you mentioned with Texas Gulf Sulphur in the '60s. I'm interested in the legacy of that.

TL: I recall two or three themes my Enforcement days. First, we set up different units within the Enforcement Division and one of the things we focused on was insider trading cases with us. The approach we used was not to have an ad hoc program but to have a programmatic approach to insider trading cases. We tried to concentrate the insider trading cases in one or more units in order to have the expertise to deal with them. Second, with Cady, Roberts, Texas Gulf Sulphur and the Investment Management decisions, there wasn't that much thought whether the legal theory used was parity of information or basically that insiders couldn't trade. You didn't have the duty analysis and all the stuff that followed the Chiarella decision. The law was not really the issue. The issue was -- could you make the factual case? Moreover, there wasn't a civil penalty remedy at the time, so the remedy the

Commission sought was injunction and disgorgement. The theory of the Enforcement efforts at that time was really not to punish but to bring the case and have a deterrent effect and to improve business standards. The philosophy of Enforcement has shifted. Actually it shifted with John Shad. During the Sporkin era, there was tough enforcement, it was a broad program and an innovative program. So basically the Enforcement cases were used to remedy the problem and put in constructive fixes. It wasn't designed to punish. The theory was to bring the enforcement case and get it out publicly so people could see it and the publicity would have the deterrent effect. In addition, you would get an injunction and disgorgement to deprive the violator of ill-gotten gains.

KD: This is under Shad?

TL: No, this was under Sporkin. Under Shad with his "he's going to stomp on you with hobnailed boots"--all that stuff; it was a much different, much narrower program and it became punitive. And then in 1984 with the Insider Trading Sanctions Act the Commission got civil penalties for the first time, in my view under a mistaken theory that you had to be tougher in order to deter people from engaging in insider trading. I don't think it actually was the case and even with the tougher penalties, it hasn't deterred insider trading.

KD: Now because of that approach, did you pick and choose cases and say "let's go after those people who are very visible?"

TL: No, I wish it was that simple. Most of the cases that were brought were a result of market surveillance and more reactive because --just like today-- news was matched against trading. It was more rudimentary then because you didn't have the surveillance technology that the Commission has today.

KD: Was this the SEC's market surveillance?

TL: Yes, market surveillance was a separate unit within the Enforcement Division. There wer also some referrals, because of jurisdictional issues, from the NASD or the Exchange. In the days when I started at the Commission, we had in the market surveillance room the broad tape, which was literally a roll of white paper that news was printed on. So if you wanted to reconstruct events, you'd go in and cut the item out of the broad tape and then scotch tape the broad tape back together. The ticker was also right there in the room so you could watch every print on the New York Stock Exchange. In fact I think the ticker probably still sits in the Director of Enforcement's office. But if the broad tape ran out of paper and someone wasn't there to change it you would miss some of the news. That's how rudimentary the Commission surveillance was when I was there. Things have obviously changed a lot since then.

KD: Tell me a little bit about how you and Ed Herlihy did business; who you had working with you; how you divided the labor.

TL: It changed over time. I remember when I started-- --it would have been '72 when I became a branch chief and then maybe '75 or '76 when I became an Assistant Director and then an Associate Director before I left. Ed who was one level below me, being the Branch Chief and moving up to Assistant Director. Gary Lynch worked with us at one time down there as did Bill McLucas. I know we had two branches when I was an Assistant Director and when I was an Associate Director I had more branches under my supervision. A branch had a Branch Chief and a number of attorneys in it and we concentrated the insider trading cases in a branch. I don't recall if I had market surveillance reporting to me, but I may have at one point in time. Later on in the '80s, particularly when the takeovers became more prevalent, you had a lot of M&A related stuff but in the early times it could have been the selling in advance of bad corporate news or buying in advance of good news. The focus involved corporate insiders and not Wall Street. I think the Wall Street phenomenon developed mostly when investment banks became advisors in M&A transactions.

So it was pretty simple looking back now. You'd look at the event and you'd get the blue sheet information which took a while because it was manually supplied either to the SROs or the SEC. Then you'd go back to the brokerage firm and get the information about who was identified as the trader and then you would start either through a formal or informal process getting in touch with that person and also probably get a chronology from the company and also try to identify who may have known about the non-public information--if it was an insider you'd try to establish whether the person had access to the information. If it wasn't clear who the person was then you would try to identify where there was a relationship between the person who knew the non-public information and the person who traded. And if you could establish that, you'd take testimony and then bring an enforcement case. A lot of those cases were settled. There were relatively few litigations of insider trading cases.

KD: Why is that?

TL: There was rarely ever a criminal case; Chiarella was the first criminal case except for a short-selling case involving a guy named Pelz. In addition, there was no civil penalty at the time so the remedy being sought was either administrative or injunctive relief and disgorgement of ill-gotten gain. The cases were relatively easy to settle.

KD: So you'd get that through the settlement and then you wouldn't have to worry about it?

TL: Yes, right. And most of the times these cases were settled without admitting and denying the allegations. As I said, the philosophy was to bring the case, have the public airing of it and hopefully influence conduct and improve standards. The SEC was viewed as having the premier enforcement program and it was emulated around the world.

KD: So these were classic insiders, members of Boards of Directors?

TL: Officers, right, or employees, yes.

KD: Did you ever get these more orchestrated groups that I know turned out up in the '80s where you've got people sharing information in brokerages?

TL: I don't think so—but it's hard for me to remember. The cases that I recall in the '70s were, I think, more plain vanilla cases. I think the events that changed everything--three things happened -- actually maybe more than three things happened. First, you had the shift in the Supreme Court. The high water mark of the Supreme Court from the SEC standard was probably in the early '70s with the Affiliated Ute case and also the Superintendent of Insurance v. Bankers Life cases where there was an expansive reading of Rule 10b-5. And then as you recall, Powell joined the Court and Douglas left. There was this shift; Burger became the Chief Justice and then you had a whole spate of cases: Aaron, Hochfelder, Transamerica v. Lewis, and the Blue Chip Stamp; you had a narrowing of the interpretation of the securities laws. You also had up to this point a very favorable Court of Appeals in the 2nd Circuit. Besides being a very sophisticated court, one of the 2nd Circuit Judges was Timbers who was a former General Counsel of the SEC. Douglas having been the former Chairman of the SEC carried a lot of the weight on the Supreme Court. You also had a very favorable DC Circuit. So you had this shift in the make up of the courts and the narrowing of the expansive reading of securities laws. Second, you had takeovers -- they started in the '70s into the'80s—and that led to a much different approach. Third, you had the involvement of investment banks. Fourth, you had the change in the Chairman in 1981 because Shad became Chairman when Reagan became President. Stanley left and Fedders became the head of Enforcement. Those were all dramatic changes which impacted insider trading. The Chiarella decision had a huge impact on how the Commission approached those cases. But it was a combination of all these things that changed the program substantially in my view.

The insider trading cases were much more visible; they had much more prominence. Chairman Shad focused on insider trading cases in order to basically cut back the Enforcement program. Basically it was a very expansive program under Sporkin; it was like having a cop on every corner. Shad was against the Commission suing broker/dealers. He wanted to only name individuals. He also wanted to cut back on the expansive nature of the enforcement program. So what he did is focus very strongly on insider trading cases and he signaled that the SEC was really going to be tough on those cases.

At the same time there was one other event which I should have mentioned in the '80s – the development of the unknown purchaser case --Santa Fe. That was really an unprecedented case where basically the Commission authorized the suing of people who they couldn't identify simply based on the fact that the individuals traded "out of the money" options shortly before the announcement of a material event. The Commission actually was very successful in bringing that case and getting the Court to lock up the profits from the trading. This really involved foreign governments, particularly Switzerland, and there was the Banca Della Svizzera case before that, where Judge Pollack in the Southern District of New York threatened to seize the assets of the bank if it did not cooperate. This was a very expansive and controversial action. I was at the Commission at the time of the Santa Fe case and I was involved in it. We went to the Commission and said we don't know who traded, but the individuals must have had inside information, because why else would they purchase out of the money call options right before expiration?

KD: Whose idea was it to do that?

TL: I don't recall, but the evolution of the idea was that people believed that the individuals had to know of the insider trading because they were buying large amounts of "out of the money" options shortly for expiration and they were bought through foreign entities. The theory was if you can convince a judge that that's enough circumstantial evidence to tie up the profits, you'll force the individuals to come to the Court, and basically that's what happened.

KD: How do you do that?

TL: You had to file a complaint alleging the unknown purchaser had to have insider information. And basically you sought a TRO or a temporary relief to tie up the assets so they wouldn't leave the account because if we were correct and the assets left, they would be gone. At the same time, the Commission developed a Memorandum of Understanding with Switzerland to get access to the underlying foreign records. That was a challenge because of Swiss secrecy, and the fact that insider trading was not a crime in Switzerland, although they later amended the criminal statute. Under Swiss law, unless you could demonstrate a crime, there was no access to the confidential information. Ultimately the MOU was negotiated which allowed, under certain standards, the SEC to get access to these foreign records.

KD: Did that grow out of the Santa Fe case?

TL: I think it probably did. That probably was finished in '84 or '83--you may know better than I do the timing. But if it didn't grow out of it exactly, it was related.

KD: So was the idea that you lock up the assets and wait for the person whose assets they were to come and try to get them?

TL: Right; forced to come in, because you're essentially tying up all the capital. It was pretty successful. One footnote, there was a huge amount of litigation over how you divide up the disgorged profits. I think you will find—and I'm not as familiar with the details—but there was litigation in the 2nd Circuit over who was entitled to the disgorged assets. It was very complicated litigation because disgorgement normally means you give the assets to the person who was defrauded on the other side of the transaction. And by the way I recall that there was a lot of controversy over how you deal with who was entitled to the assets. There was no Fair Funds provision. The Court, if it got jurisdiction in an injunction case, could use its equitable powers to deprive the violator of ill-gotten gains. That's the theory of disgorgement; it's an equitable remedy. The Commission always took the position that its purpose was not to provide restitution to the defrauded party. They left it to the private parties. Today, the philosophy has changed. The Fair Funds program is the latest example of that.

KD: What was behind that philosophy?

TL: The philosophy was it wasn't a collection agency. It certainly worked to help investors and disgorgement would do it but it adhered to the principle that it isn't a collection agency.

KD: Which makes sense.

TL: Yes; but now as these principles have merged, the SEC has taken more of a restitution approach in its Enforcement program. Currently, the Commission believes that when it gets hundreds of millions of dollars of disgorgement, it should not put it in the Treasury while investors get nothing. That is the theory underlying Sarbanes-Oxley and the Fair Funds program.

KD: Was that partly due to when the amounts got so much larger in the '80s ?

TL: Yes, in part, but the '80s is much different you had option trading and you had the Insider Trading Sanctions Act. Even though the statute provided for a civil penalty up to three times the gain or the loss avoided, the Commission adopted as a philosophy in all settled cases of seeking a one-time penalty. They also insisted on prejudgment interest so you could have on a million dollar profit disgorgement plus a million dollar penalty, which was not going to investors at the time. It was going to the Treasury. Plus the Commission would get prejudgment interest maybe so it became much more expensive to settle insider trading cases. Also, the insider trading law become more complicated.

KD: The Insider Trading Sanctions Act you mean?

TL: No, the law of insider trading became really screwed up in the '80s, post-Chiarella. Chiarella, with its majority and concurring opinions, basically said you have to find a duty, so the duty analysis took over. What developed in the '80s was everyone doing this duty analysis and then you had the Dirks case, which was a big shock to the Commission. I believe it was Judge Skelly Wright in the DC Circuit who wrote a very strong decision in support of the Commission's position in that case, and then he got overturned at the Supreme Court. The Court introduced the personal benefit test. So you had a duty analysis, you had a personal benefit test, and then you had an anomaly which resulted from the US v Newman and Moss v Morgan Stanley cases. US v Newman was a case where Morgan Stanley and Lehman employees tipped individuals who then traded and they were prosecuted criminally under the theory that if you have a breach of duty—sullying the reputation of the investment bank as a repository of confidential information in connection with the purchase or sale of assets, that constitutes a violation of Rule 10b-5. But in Moss v. Morgan Stanley, the 2nd Circuit decision threw out the related private litigation on the theory that the person who was defrauded was the investment bank, not the shareholders on the other side of the trade. The fraud was misappropriating the information from the investment banks. The investment banks were the defrauded party, but they weren't a purchaser or seller, so they didn't have any private right of action. So you had this anomalous situation where you could prosecute someone criminally but you didn't have a private cause of action on the same facts because the person on the other side of the trade wasn't defrauded. That generated a big controversy in the bar. I did a lot of speaking at PLI and other programs at that time and spent many hours discussing what that all meant.

I also remember there was a case Gary Lynch and I brought involving Tom Reed, who was the Deputy Secretary of Defense. I don't know if you spoke to Gary yet if he mentioned that to you.

KD: Yes, he did.

TL: And we got chastised on the Hill because we settled the case civilly with an order and a disgorgement of profits. Al D'Amato was a Senator and we got called up there and criticized for being so weak on insider trading.

KD: But you got another shot at another Administration official.

TL: Yes, it was Tom Reed. His father was at SoCal I think and the allegation was his father mentioned something about a takeover and he went out and traded and that also is really misappropriating it from a parent relationship. The Chestman case in the 2nd Circuit also raised the same issue. When is it that you actually violate in the family relationship? Does a level of trust and confidence exist in a family?

KD: The Thayer case was similar to that too - a real cast of characters.

TL: Yes, Thayer was the other case. The other big event in the '80s, partly because of Rule 14e-3, was the development of what was then known as Chinese walls and restricted watch lists -- now known as informational barriers. It became imperative that every broker/dealer adopt Chinese wall procedures. This movement actually started in the '70s with Slade v. Shearson Hamill, a 2nd Circuit decision. The issue identified was what can a multi-faceted investment bank do where you have one group of individuals who have non-public information and yet there is firm trading and customer activity in other areas of the firm. I represented Merrill Lynch in Cotton v. Merrill Lynch which was in Oklahoma District Court where that issue was prevalent. There was a case where an insider, a Director who was on the outs with the Board of the target company, wasn't aware that the Board was considering essentially a merger. He went to Merrill Lynch who was the investment banker on one side and, unsolicited, sold his stock for X and then the merger was announced and the stock went to Y; he sued Merrill Lynch and others saying you had a duty to tell me about the merger. Merrill Lynch's defense, we argued successfully, was no, the law precludes disclosure. The Chinese wall prevented the sharing of information.

And then there's the emergence of Creditors Committees, during the bankruptcies in the late '80s, which also raised the Chinese wall issue. Investment banks set up Chinese walls, restricted and watch lists, and procedures in order to let them do a variety of business activities in a multi-disciplined firm. In 1988, Section 15(f) was enacted codifying the requirement that firms have policies and procedures in place to prevent the passing of information within a firm.

The concept of Chinese walls in part came out of the M&A area, particularly where you had the private side of the wall, basically the investment banking side, and then you had the trading and customer activity on the other, public, side. Investors also tried to anticipate deals before the merger announcement and firms used watch lists to monitor that activity.

KD: Are these the run-ups that people were always seeing in the early '80s?

TL: Yes.

KD: And I've heard that credited largely to insider trading.

TL: Part of it. When I was in private practice, I represented Ivan Boesky in 1986, and part of that whole Dennis Levine, Marty Siegel, Milken and Boesky cases was the issue of leakage of information about deals, pre-announcement. That practice has continued today. I just saw in today's paper an article about the HCA buyout-- the SEC is investigating option trading prior to the public announcement of the buyout. So the practice continues and this is now 30 years later. Normally, the run up just prior to an announcement suggests someone was buying, but the combination of changes in the law, the narrowing of the interpretation of the insider trading laws, the prevalence of option trading and the M&A activity which provides a lot of opportunity for profit, all has created this rebirth and is probably why the government tried to move to tougher standards. There were other factors as well but those were the main factors.

KD: This setting an example that people can be prosecuted--clearly it wasn't doing anything to stem this activity.

TL: Yes, that's right. Well, there's a phenomenon of law enforcement: look at murder and robbery. Those laws are vigorously enforced – and yet murders and robberies still happen. I found among most business people that the public opprobrium in the community of someone being charged with insider trading is the worst thing, and reputationally you don't ever get over that. It has never been viewed as a badge of honor to be sued by the SEC. Look at Chiarella; that was an SEC settlement, and the Department of Justice – not the SEC – wanted to pursue him criminally.

KD: That's right.

TL: It turned out to be a mistake--the SEC had $30,000 settlement, disgorgement of profit and would have moved on. I assume Paul Gonson will, if you haven't spoken to him, set the stage for that decision. It was coming anyway, I think, because there was a narrowing of the interpretation of the securities laws. Some of the other cases also operate under the theory that if you prosecute criminally, you will scare people and you'll deter violations. It works to some extent but I think it was overblown and I might say a consequence is that the SEC loses a fair amount of cases when they litigated. Once you have a criminal prosecution or you have a higher cost of settlement through insisting on a civil penalty, it becomes much more demanding to settle –particularly with respect to the closer cases where the SEC looks to circumstantial evidence to pursue the case.

In those circumstances, the SEC loses some cases and their program suffers. As the SEC insider program expanded, SEC offices all over the country and prosecutors in different jurisdictions started handling the cases. You didn't have all the cases focused in the 2nd Circuit--a sophisticated Circuit in these types of cases. You had several Circuits handling the cases and you'd have crazy decisions which hurt the SEC's program. If the SEC goes to court and say all I'm asking you to do is give me an injunction to obey the law and don't violate it again, plus the person that violated gives up all ill-gotten gain, the government gets the benefit of the doubt, and preponderance of the evidence is the standard of proof in those cases. I think once you start putting in a civil penalty and the consequence of criminal prosecution, subconsciously judges put a greater burden on the government in proving its case. It becomes more like a clear and convincing standard and so the result of all that toughening up was that it became harder for the SEC to prevail.

KD: What's an example of that? Is there a case that sticks out?

TL: There was the Teicher case in the 2nd Circuit which led to Rule 10b5-1, this whole debate about "possession or use" of insider information--did the SEC have to show the person had it or did it have to show the person actually used it? An example was at tax time and the individual said I have to sell because I have to pay my taxes. I need money; I need liquidity. At the same time the company was doing badly and the person was selling in advance of the announcement of bad earnings. So the person had a reason to trade, but on the other hand he possessed the information. I can't give you the number of SEC losses in litigated cases but there were losses along the way. Generally speaking, the Enforcement Program, because of toughening up changed from being prophylactic and remedial to punitive. If the insider trading case is perceived by a court to be punitive, it will be tougher to get the relief sought because the court is going to hold the prosecutor to a higher standard.

KD: Now it would seem this was particularly difficult since there was no definition of insider trading.

TL: Yes, well it's very interesting. There was a committee formed by Harvey Pitt, which I was on, and we came up with a definition of insider trading. Actually there was a bill introduced--Senate Bill 1380.

KD: Now your committee was working with D'Amato?

TL: Yes, and actually the Committee codified everything the Commission needed, and basically it was a very broad bill. And then I think the SEC put out their own proposal in 1987--I forget exactly when--

KD: It was '87?

TL: It didn't go anywhere because the SEC was deathly afraid of the fact that somehow by codifying insider trading, it would lose the ability to pursue a case even though in retrospect they think it was a mistake not supporting a definition. This was an attempt to basically give certainty but "expansive" certainty. There was a lot of resistance to the SEC; let's see, '87 -- I don't remember who the Chairman was at that time.

KD: Ruder?

TL: It may have been Ruder at the time, I forget exactly, but there was a lot of resistance. Charles Cox was the Chairman when this came out; he had moved up as Acting Chairman. The bill went nowhere, so there isn't a definition of insider trading. Are you aware of the bounty provision?

KD: No, I'm not.

TL: There's a provision in the statute that provides that the Commission can pay up to 10-percent of the civil penalty to someone who essentially gives them a tip of insider trading. It's Section 21(a) E.

KD: Now why didn't the Senate initiative go?

TL: It was very hard to get something through Congress if the Commission did not support the bill. Congress would defer to the agency; if the Commission wasn't supporting it, they wouldn't do it.

KD: Was your group trying to get the agency moving or anything?

TL: Yes, I'm sure. The idea was "look at this turmoil, post-Chiarella, post-Dirks--so let's get a definition so people know what the boundaries are about insider trading." One thing I also recall that I should have mentioned earlier was the Switzer case, which exemplified the problems post-Chiarella. Barry Switzer was the coach of the Oklahoma football team. We dealt with this when I was at the Commission. Switzer was sitting in the stands and an executive of a company was talking about a deal with someone else--this is the allegation--Switzer overhears the conversation, goes out and trades, and the SEC sues him for insider trading. The court threw it out ultimately and the theory was it was not non-public because Switzer overheard the executive in the stands at a football game. If in fact Switzer had stuck his head into the conversation, he would have violated, but if he overheard it and he was sitting there, he wasn't, because then it wasn't deemed to be in confidence and non-public. I think it was a "hometown" decision.

KD: How does the personal benefit fit into that?

TL: The personal benefit wouldn't fit in. The theory here was misappropriation, and personal benefit comes up where the motive of the tipper looms large, post-Dirks. The Court in Dirks basically said if you're trying to get a pecuniary benefit or a reputational benefit or convey a gift to a friend, those are improper motives. In Equity Funding, Secrist had a proper motive; he was trying to reveal a fraud and so there was no improper motive. Of course what the decision did provide is that Dirks could selectively reveal the information to clients and so it does defraud some people – those who don't know the information. The court said look at the tipper, you have to find a personal benefit to the tipper.

KD: In the '70s, you said that you really did begin to worry about legal theories and how you were going to adhere to legal theories and just wanted to show that somebody was trading with inside information. Tell me a little bit about how that changed and when that changed. Obviously Chiarella is a turning point. But how did that affect day-to-day --how you and the people you worked with did business?

TL: I left the SEC in '84, the end of '83; Chiarella was '80; Dirks was '84. On the routine cases it didn't change because Texas Gulf Sulphur was still good law.

KD: The classic insider trading?

TL: The classic insider who was trading or tipping; those cases didn't change in that sense. You remember that didn't have the personal benefit analysis so basically the insider had the information and either traded or tipped -- that was pretty actionable. Where it became more challenging, particularly post-Chiarella, was the circumstance where you had either a temporary insider or you had others that were not insiders who had access to information and that really was major league important when you had the M&A area because that's where you involved all these other persons.

KD: So do you remember instances in which you sat down and said "okay we've got this case, this is going to be a difficult one. Let's approach it differently."

TL: I don't think I have that recollection, but as I said, the Santa Fe case I do recall because that was very different. That wasn't necessarily on the theory case but it was a new approach to deal with this phenomenon of offshore trading and not be able to get access to who the underlying owner of the securities were. Two things happened: I think there was a migration in the M&A area to use Rule 14e-3. It required a negligence standard rather than a scienter standard under Rule 10b-5. Two things come to mind about the attitude generally in Enforcement. One was that the cases factually were so compelling that you'd find a theory; that was always the case. Even in the circumstances of an M&A transaction, this was true because there were these huge profits. You didn't worry about the 100-share trade but you had either the large option trade or the large stock trade. Second, you would conjure up duties. An investment bank was easy because of Footnote 14 in Dirks -- the accountants, lawyers, underwriters—were "temporary insiders;" and then you had the misappropriation theory -- if you steal it or if you get it for one purpose and use it for another -- so what evolved was you took what was out there and started using it. So while you worried about it a little bit, you didn't worry about it that much because you had compelling facts and then you had alternative theories.

KD: You got out of the SEC about the time that the insider trading cases were really just about to become headline news.

TL: Yes.

KD: Did you have knowledge that these kinds of things were in the pipeline?

TL: No. I left at the end of '83. The Boesky case, in which I was involved, was in November '86. Dirks was in '84, so yes, there was a lot emanating; there were a lot of cases and a lot of insider trading. Chairman Shad made it a high-priority program. However, I didn't have a sense of the pipeline. The run of the mill insider trading case, even in M&A context, took on a whole different meaning when you're talking about people meeting on the street corners of New York with bags full of cash and you had hidden accounts and you had notable people involved in what looked like horrendous conduct. That's really what happened with the Dennis Levine, Boesky, and Marty Siegel cases. It opened up Wall Street to this big time and there was a flurry of enforcement activity from, let's say, '85 to '90.

KD: Right. I guess my question would have been, did you have a sense that that might be out there?

TL: No. I didn't have any sense of that.

KD: So everybody in the SEC was a little surprised?

TL: Yes, the cases were hand delivered to them. Gary Lynch took over as head of Enforcement when Fedders had to leave the Commission. Basically, the Boesky case was walked into the SEC and the U.S. Attorney's Office. I mean the SEC was nowhere in its investigation. There was trading and they were frustrated because they couldn't get behind it because it was taking place offshore. And they couldn't trace it.

KD: Is there anything that we haven't talked about that we should touch on?

TL: I don't think so. I don't know if this has been helpful or not.

KD: Terrific--I appreciate it; thanks for talking to me.

TL: Very good.