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ILLEGAL INSIDER TRADING: HOW WIDESPREAD IS THE PROBLEM AND IS THERE ADEQUATE CRIMINAL ENFORCEMENT?

HEARING

BEFORE THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

ONE HUNDRED NINTH CONGRESS

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ILLEGAL INSIDER TRADING: HOW WIDESPREAD IS THE PROBLEM AND IS THERE ADEQUATE CRIMINAL ENFORCEMENT?

TUESDAY, SEPTEMBER 26, 2006

U.S. SENATE,
COMMITTEE ON THE JUDICIARY,
Washington, D.C.

The Committee met, pursuant to notice, at 9:34 a.m., in room SD–226, Dirksen Senate Office Building, Hon. Arlen Specter, Chairman of the Committee, presiding.

Present: Senator Specter.

OPENING STATEMENT OF HON. ARLEN SPECTER, A U.S. SENATOR FROM THE STATE OF PENNSYLVANIA

Chairman SPECTER. Good morning, ladies and gentlemen. The Senate Judiciary Committee will now proceed with our hearing on oversight of the Department of Justice on the issue of the insider trading matters.

We have noted a comprehensive study made by Measuredmarkets, Incorporated, which found that 41 percent of the companies receiving buyout bids exhibited abnormal and suspicious trading in the days and weeks before those deals became public. And Measuredmarkets concluded that these unusual activities most likely involved illegal insider trading. These transactions involved very substantial sums of money, into the billions of dollars.

While the merger activity has increased in recent years, in the past 6 years the number of insider trading cases pursued by the SEC has remained steady. We have noted that the Department of Justice has had some problems in a couple of cases: *U.S.* v. *Scrushy*, where there was a motion to suppress prosecution testimony taken because the SEC civil investigation had been undertaken at the behest and with the instructions from the U.S. Attorney's Office; and in the case of *U.S.* v. *Stringer*, there was a dismissal because of misconduct on a conflict between witnesses and the attorney involving the Department of Justice and the Securities and Exchange Commission.

In wake of Sarbanes-Oxley, the Judiciary Committee authored a new Federal securities fraud statute in 18 U.S. Code, and we are pursuing this oversight hearing to make an evaluation as to what is being done to enforce that statute.

The Committee has undertaken some inquiries into the hedge funds, but in our society it is absolutely indispensable that the integrity of the markets be maintained. Americans invest very heav-

ily in the stock market, and that is really the backbone of our commercial system. And it is very, very important that the integrity be maintained.

We have a distinguished array of witnesses here today, and we will begin with the Associate Deputy Attorney General Ronald Tenpas, whose responsibilities include coordinating the work of the President's Corporate Fraud Task Force.

Welcome, Mr. Tenpas, and we look forward to your testimony. Before you begin, let me note for the record that Mr. Tenpas has an outstanding record, having clerked for Chief Justice Rehnquist after clerking for U.S. District Judge Louis Pollak. He had served as U.S. Attorney for the Southern District of Illinois and an Assistant U.S. Attorney for the Middle District of Florida and the District of Maryland; a bachelor's degree from Michigan State, a law degree from the University of Virginia, and a Rhodes scholar.

That is quite a pedigree, Mr. Tenpas. I expect a lot of success from a man with your record. Please proceed.

STATEMENT OF RONALD J. TENPAS, ASSOCIATE DEPUTY ATTORNEY GENERAL, DEPARTMENT OF JUSTICE, WASHINGTON, D.C.

Mr. TENPAS. Thank you, Mr. Chairman. You have set the bar for me.

Let me first begin by thanking you for inviting the Department of Justice to testify today concerning our efforts to prosecute insider trading, and at the outset let me assure you that the Department and the Corporate Fraud Task Force share your sentiment about the importance of ensuring that everyone can invest in our markets, trusting in their integrity and, in particular, without fear of being taken advantage of by insiders who improperly use information.

To understand the Department's approach and track record, it may be best to start with what we as prosecutors are concerned with proving when presented with allegations of insider trading. A criminal insider trading case requires us to prove multiple elements, including that there was, one, a willful and fraudulent buying or selling of a security; two, that the selling occurred in breach of a fiduciary duty or other relationship of trust and confidence; and, three, that the selling occurred while in possession of and in use of material nonpublic information about that security.

Given these requirements, proving criminal insider trading activity requires more than just market surveillance and the discovery of spikes in trading. Market anomalies may be indicative of a problem, but they are not enough to prove criminal activity.

Each of the elements I mentioned can present significant proof problems. Depending on their role in an inside scheme, potential defendants can suggest any number of defenses. For example, as I just mentioned, prosecutors must demonstrate that the defendant's conduct was a willful violation of the law, meaning that it must be proven that the defendant was aware at the time of the insider trade that he or she was doing something in violation of the law.

A tippee, therefore, may claim that he or she did not know that it was illegal to trade on the information he received, especially if

the tippee worked outside the corporation. Similarly, prosecutors must prove that the inside information at issue in the case was both material, meaning likely to be of interest to the reasonable investor, and nonpublic. Those who trade may often deny having known of the material information or, alternatively, claim that the information was broadly known and, thus, public.

Similarly, because we must show that the defendant used the information in making his or her trading decision, a defendant may claim that the reason for his trade was unrelated to the inside information and that the trade was prompted by a personal need for funds, the timing of options, tax considerations, a desire to lock in previous gains, or any number of other reasons. Still further, a corporate outsider, such as the tippee, can challenge the claim that he owed a fiduciary duty to others. Moreover, given the nature of these cases and what we have to prove, insider trading cases rarely have a smoking gun.

So, in sum, these cases almost universally turn on circumstantial evidence with inside traders frequently proffering a number of alternative explanations for their conduct, each of which must be discredited for the case to be successful.

The challenge of building a circumstantial case that discredits all plausible alternatives can be daunting, and, of course, we must do so beyond a reasonable doubt. Nevertheless, the Department of Justice is committed to bringing such prosecutions and has compiled a strong record in recent years. We typically use the antifraud provisions of the Securities and Exchange of 1934, which carries substantial penalties, including imprisonment of up to 20 years and fines of up to $5 million.

Our typical case can begin in a variety of ways, but often we will start with a referral from the SEC or from public reporting that casts attention on a particular transaction or transactions. We will then work with our prosecutors and agents, usually from the FBI, and often involving the Postal Inspection Service, to work cooperatively with the SEC to seek access to information that the SEC has secured, with each agency then conducting a parallel investigation—the SEC focusing on civil violations and remedies, and the Department prosecutors considering whether to bring criminal charges.

As outlined more fully in my written testimony, in recent years the Department has brought a wide variety of cases that have focused on the most egregious offenses that promise the greatest deterrence. We focus our efforts on those cases where the evidence is strongest and where the conduct is most serious, whether because the insider had an important leadership position or because the criminal ring was well organized or because it involved a sector of the market that is especially of concern. In doing so, we try to make our efforts part of an overall enforcement regime that includes the parallel and equally important role played by the SEC.

In sum, we are determined to use all tools at our disposal to attack insider trading, and we appreciate the opportunity to appear before you this morning to discuss this in more detail.

[The prepared statement of Mr. Tenpas appears as a submission for the record.]

Chairman SPECTER. Thank you very much, Mr. Tenpas.

We now turn to the Director of the Securities and Exchange Commission Division of Enforcement, Linda Thomsen, who has been with the SEC since 1995, was Assistant Director of the Department, then Associate Director, then Deputy Director—really right up the ladder, Ms. Thomsen.

She had been an Assistant U.S. Attorney for the District of Maryland, bachelor's degree from Smith, and a law degree from Harvard.

We appreciate your being here, and the floor is yours.

STATEMENT OF LINDA THOMSEN, DIRECTOR, DIVISION OF ENFORCEMENT, SECURITIES AND EXCHANGE COMMISSION, WASHINGTON, D.C.

Ms. THOMSEN. Thank you, Chairman Specter, and I appreciate being here. Thank you for inviting me to testify today about insider trading. Our laws against insider trading play an essential role in protecting our securities markets and in promoting investor confidence in the integrity of those markets. I appreciate the opportunity to explain the Commission's efforts to deal with insider trading and to answer any questions you may have.

I am especially pleased to testify together with Ron Tenpas of the United States Department of Justice. The respective histories of the SEC and the Department of Justice demonstrate our commitment to working with each other to prosecute insider trading, civilly and criminally.

Over the years, investigating and prosecuting insider trading violations has remained a steady component of the SEC's enforcement mission. Since 2001, the SEC has brought 300 actions against over 600 individuals and entities for insider trading violations and has frozen millions of dollars in illicit trading proceeds. Over that same period, insider trading cases have consistently made up about 7 to 12 percent of our filed caseload.

At the same time, our enforcement program is, by necessity, dynamic. Our priorities and resource allocations must change to meet trends in the market and developing misconduct. Even within the relatively narrow arena of insider trading, we must shift our resources to those areas where the greatest threats lie. Most recently, the focus of our insider trading investigations has been on globalization, merger activity, and hedge funds.

We have had some remarkable successes. Over the past year, we have charged a total of 17 defendants in the Reebok case, whom we allege participated in an international insider trading ring that netted at least $6.8 million in illicit gains by, among other things, stealing information from Merrill Lynch, from Business Week, and from a sitting New Jersey grand jury.

In recent years, the Commission has also brought several insider trading cases involving hedge funds or their managers. Over the past 2 years, the Commission has brought at least three cases involving insider trading by hedge funds and their managers in advance of more than two dozen stock offerings commonly referred to as PIPEs. The Commission has also recently brought cases against hedge funds or their managers involving insider trading ahead of mergers and acquisitions.

The Commission is particularly concerned about insider trading by registered broker-dealers and investment advisers. Earlier this year, the Commission filed a civil injunctive action against a former Merrill Lynch broker and ten former A.B. Watley day traders and their managers for participating in a scheme that allegedly involved trading ahead of large institutional orders broadcast over Merrill's in-house squawk boxes.

A few months ago, we instituted a settled administrative proceeding against Morgan Stanley for failure to maintain and enforce adequate policies and procedures to prevent the misuse of material nonpublic information by the firm or persons associated with the firm. Morgan Stanley agreed to pay a $10 million civil penalty and to engage an independent consultant to review its policies and procedures.

Let me step back for just a moment and make some general observations about our insider trading program.

Our Office of Market Surveillance is in daily contact with its counterparts in the various self-regulatory organizations, or SROs. The SROs perform primary surveillance, monitoring the markets for unusual trading, sudden changes in a security's price, or other unusual market activity. Our Office of Market Surveillance maintains an open line of communication with the SROs.

Insider trading leads also come to us from other sources, including the news media, our own inspections and investigations, and tips. When circumstances warrant, we can and will act swiftly, using asset freezes to preserve any alleged ill-gotten gains.

Identifying suspicious trading is an essential starting point, but it is only the first step in compiling a viable case. The challenge is not to establish facts that show suspicious trading. The surveillance records alone are often sufficient to establish that much. The real challenge is to establish that a particular individual was in possession of material nonpublic information and traded on it in breach of a duty and to establish those facts based on admissible evidence.

Piecing together an insider trading case can be a complex and painstaking process. Because insider trading involves secret information and communications, it is rare, as Mr. Tenpas said, to find a smoking gun proving that a trader was tipped and by whom. Virtually all insider trading cases hinge on circumstantial evidence, inferences to be drawn from the trading records, the timing of trades, the movement of funds, and other facts and circumstances. Building an insider trading case based on circumstantial evidence can be frustrating, risky, and time-consuming. But our staff has persevered and built hundreds of solid credible cases.

The Commission employs a broad range of remedies to address insider trading. The Commission generally seeks injunctive relief, disgorgement, and civil financial penalties, which may be up to 3 times the illegal profits made or the losses avoided.

In settling cases, we have typically sought and obtained an injunction, disgorgement, and a one-time penalty that is a penalty equal to the amount of the illegal profits realized or losses avoided.

Chairman SPECTER. Ms. Thomsen, how much more time would you like?

Ms. THOMSEN. I am happy to—I think about a minute.

Chairman SPECTER. OK.

Ms. THOMSEN. We believe that the remedies we have, along with the threat of incarceration in the event of criminal prosecution, give us an effective arsenal for enforcement and deterrence.

Insider trading undermines the integrity and credibility of our markets. We appreciate the fact that the markets are dynamic, and we understand the power of technology, and we will use it all to our advantage. We will continue to work very hard to protect the world's finest and fairest markets, and we would be happy to answer any of your questions. Thank you.

[The prepared statement of Ms. Thomsen appears as a submission for the record.]

Chairman SPECTER. Thank you very much, Ms. Thomsen.

Mr. Tenpas, as a result of the work of this Committee following Sarbanes-Oxley, we passed Section 1348 relating to securities fraud. Has that been helpful to the Department of Justice? And to what extent has it been used?

Mr. TENPAS. That has been very helpful to the Department. We have at this point successfully prosecuted somewhere slightly over 50 defendants.

Chairman SPECTER. Has anybody gone to jail under the prohibitions of 1348?

Mr. TENPAS. I believe so. Off the top of my head, I do not know the exact sentencing—

Chairman SPECTER. It is pretty important determinant as to how effective it is, wouldn't you say?

Mr. TENPAS. I believe it is, but as I say, I do not know the exact spread, but, yes, people have gone to jail.

Chairman SPECTER. Would you provide the Committee with a list of the prosecutions and the penalties which were obtained?

Ms. Thomsen, on that same subject, I note a $10 million fine that the SEC imposed in June of this year on Morgan Stanley for failing to conduct surveillance on hundreds of thousands of employees to determine insider trading. Is that really effective for a company the size of Morgan Stanley? Does $10 million really make much of an impact on a company like that?

Ms. THOMSEN. Well, I think the proof will be in the pudding, but I believe it was the largest penalty for that type of violation to date, which is a violation—

Chairman SPECTER. Well, that does not mean a whole lot, largest penalty and proof is in the pudding. The pudding has been made. Where is the proof?

Ms. THOMSEN. Well, I believe that to the extent Morgan Stanley is improving its procedures, to the extent we have consistently brought cases against broker-dealers and others for violations of 15(f), we do see better surveillance and better procedures. Our remedies are always civil, so our remedies are always limited to injunctive relief, to procedures relief, which we obtained in the Morgan Stanley case, as well as penalties. I think—

Chairman SPECTER. Your testimony says that the SEC has experienced recent successes in enforcing insider trading activities by hedge funds. We are very much concerned about hedge funds. We have had some investigation already, and some of it is ongoing. And I note in press reports the city of Philadelphia lost a lot of

money because of a hedge fund failure. And hedge funds, as we all know, are not regulated, and that is really the jurisdiction of another Committee.

Ms. THOMSEN. Yes, sir.

Chairman SPECTER. But this Committee has jurisdiction over criminal law enforcement. Have there been any criminal sanctions imposed on any of the hedge funds for violations?

Ms. THOMSEN. Well, I think I would defer to Mr. Tenpas, but I did read in the paper this morning that a hedge fund manager was indicted for insider trading by the Southern District of New York, and that was announced yesterday.

Chairman SPECTER. I am interested in indictments. I am even more interested in convictions and most interested in jail sentences. How about it? Any jail sentences?

Ms. Thomsen, that is directed to you.

Ms. THOMSEN. I am sorry.

Chairman SPECTER. You were talking about recent successes. I would like to know how successful you have been?

Ms. THOMSEN. Well, I am sorry, sir, but because we have no criminal jurisdiction, we do not prosecute criminally and we—

Chairman SPECTER. How many times have you gone for treble damages? You have statutory authority for that.

Ms. THOMSEN. We do have statutory authority for treble damages. We typically seek treble damages when we are litigating a matter. When we settle matters, as I mentioned, we typically seek a one-time—

Chairman SPECTER. Typically seek them when you have litigated the matter.

Ms. THOMSEN. Yes, sir.

Chairman SPECTER. How frequently have you obtained treble damages in the last 2 years?

Ms. THOMSEN. Infrequently.

Chairman SPECTER. Infrequently?

Ms. THOMSEN. Infrequently. Courts are—

Chairman SPECTER. Any?

Ms. THOMSEN. There is one case that I know of where we obtained treble damages, and I cannot remember—

Chairman SPECTER. Only one case that you know of, and you are the Director.

Ms. THOMSEN. Yes, sir. Courts are reluctant to impose up to 3 times.

Chairman SPECTER. Would you review those cases for the last 5 years and tell us what the—

Ms. THOMSEN. I believe it is one.

Chairman SPECTER. What the experience has been.

Ms. THOMSEN. Absolutely.

Chairman SPECTER. Mr. Tenpas, the *Scrushy* case raised the problem of collaboration between the SEC and the Department of Justice, and that case states, "To be parallel, by definition the separate investigation should be like side-by-side tracks that never intersect."

Would you like to see the statute amended to allow you to intersect those tracks?

Mr. TENPAS. Well, we certainly think it is important that we have the ability to intersect those tracks by consulting with one another—

Chairman SPECTER. Is that a yes, Mr. Tenpas?

Mr. TENPAS. We have not reached a judgment about whether the statute needs to be amended to allow us to accomplish that. In the *Scrushy* case, we were not able to take appeal. In the similar *Stringer* case, we have it under appeal. I think our feeling would be—

Chairman SPECTER. What are the reasons why you should not be able to collaborate with the SEC?

Mr. TENPAS. We do not think there are any reasons we should not be able to collaborate with them.

Chairman SPECTER. Well, would you review that matter and talk to others in the Department who have higher rank? Certainly nobody has a better record in the Department of Justice than you do.

How was it working for Judge Pollak?

Mr. TENPAS. It was terrific. He is a great man, a great judge. I owe him a great deal.

Chairman SPECTER. Would it be a fair question to ask you to compare working for Judge Pollak with Chief Justice Rehnquist?

Mr. TENPAS. Obviously they have—

Chairman SPECTER. I withdraw the question, unless you want to answer.

[Laughter.]

Mr. TENPAS. They were both great people to work for.

Chairman SPECTER. Very diplomatically stated. Thank you very much for appearing. I appreciate the work you have done, and I would like you to take a closer look at the effectiveness of your work with respect to criminal sanctions or treble damages. My own sense is that fines do not do a whole lot, but jail sentences do. And I have had a little experience in the field.

One of the ideas which this Committee is pursuing is to impose criminal liability on corporate officials who knowingly and maliciously put into interstate commerce instrumentalities which cause death or serious bodily injury. The Ford Firestone case is a good illustration where Congress did legislate to put criminal penalties into effect. But if you willfully and maliciously act in a way which results in someone's death, that states malice and grounds for prosecution for murder in the second degree. And typically that carries a jail sentence of 20 years.

And you have the Ford Pinto case, which is another good illustration. Internal corporate documents showed that they could save money by putting the gas tank in one spot as opposed to another spot, with an evaluation as to what they would have to pay by way of damages. And it seems to me that if it is knowing and willful—and that is a tough standard for a prosecutor to maintain. You are both former prosecutors. That does state malice, and consumers and people ought to be protected.

You are in a field where market integrity is really important for this country, and insider trading is insidious. And when you have this study as disclosed by the New York Times about 41 percent of the cases raise the probability of collusion and insider trading, it really ought not to be just up to the New York Times to conduct

the investigations. But if you have the benefit of their investigation—have you taken a look at that, Mr. Tenpas, Ms. Thomsen, as to what the Times has shown as to whether you ought to pursue that line?

Mr. TENPAS. We are aware of the study, Senator. We have looked at it, and we are addressing it in the way that we typically would, which is to work closely with the SEC and the SROs. They have—

Chairman SPECTER. Do you think that there is a valid basis for the conclusion of that study conducted by that outfit?

Mr. TENPAS. That is a little beyond my purview because it involves fairly sophisticated statistical analysis, and that is—

Chairman SPECTER. Sophisticated statistical analysis? Is that tough for a Rhodes scholar?

Mr. TENPAS. It is tough for me. I was not particularly in the math arena, and one of the—

Chairman SPECTER. Have you got some sophisticated statistical analysts in the Department of Justice? If not, we will get you some.

Mr. TENPAS. Well, we do, but we find that the SROs and the SEC have active enforcement entities that have those folks—

Chairman SPECTER. Well, OK. Ms. Thomsen, then you have looked at the study and you have analyzed it and you are sophisticated. What have you done?

Ms. THOMSEN. We have looked at it. We have not had an opportunity to study all the underlying data. We have also looked—

Chairman SPECTER. You have not had an opportunity to study all the underlying data? Why not?

Ms. THOMSEN. If I may explain, we also have the data that we are getting from the SROs, and I do not think anyone disagrees with the notion that there is an increase or there has been an increase in anomalous or suspicious trading in advance of merger or acquisition activity—

Chairman SPECTER. We have to move on, but let me ask each of you to give a report to the Committee on what you have done to date with respect to that study. I would hope that when you see that kind of an analytical study as prominently displayed as it was in a Sunday New York Times, you would take a look at it. And then I would like you to tell me what you think about it. And then the third aspect of the question is: What are you going to do in the future to pursue it?

Ms. THOMSEN. Sure.

Chairman SPECTER. Thank you both very much.

We will now turn to our second panel, and our first witness is Mr. Robert Marchman, Executive Vice President of the New York Stock Exchange Regulation, Inc., oversees the Market Surveillance Division, which investigates insider trading in securities listed on the New York Stock Exchange.

Regrettably, I am going to have to excuse myself for a few minutes at 10 minutes after 10 because we are having a news conference on the immigration question, and the immigration bill came out of this Committee, and I am searching to see if we can find someone who can replace me for a bit while I absent myself for a very brief period of time. But if we cannot, I am going to have to ask you to wait. I am sure you will understand that a big part of this job is juggling a lot of different issues, and right now we are

in very heavy duty as a result of being the last week we are in session before we break for October. And I do not like to ask anybody to wait, and especially as prominent, high-powered, and hourly rates as this prestigious group. But if I have to, I will have to.

Mr. Marchman, thank you for joining us. The floor is yours.

STATEMENT OF ROBERT A. MARCHMAN, EXECUTIVE VICE PRESIDENT, DIVISION OF MARKET SURVEILLANCE, NYSE REGULATION, INC., NEW YORK, NEW YORK

Mr. MARCHMAN. Good morning, Chairman Specter. Thank you for this opportunity to share my thoughts on insider trading, which is an area of serious regulatory concern for the New York Stock Exchange Regulation group.

The mission of NYSE Regulation is to protect the investing public and the integrity of our markets. We accomplish our mission by zealously monitoring trades in NYSE Group-listed securities by regular and ongoing onsite examinations of NYSE Group member firms and by proactive investigation and discipline of member firms and associated persons for violation of NYSE Regulation rules and applicable Federal securities laws.

The history of the securities markets teaches us that insider trading is a serious regulatory concern, particularly today, where the volume, complexity of trades, and products, as well as cross-border transactions are redefining capital markets on almost a daily basis.

The Division of Market Surveillance of NYSE Regulation continues to meet these challenges through the use of extensive and sophisticated surveillances, systems, and tools that allow us to timely review and aggressively investigate trading that may constitute illegal insider trading.

On an ongoing basis, Market Surveillance analysts conduct reviews of alerts and investigations. Real-time and exception-based alerts are mostly generated by advanced electronic surveillance systems within our Stock Watch unit. We have numerous electronic surveillances that surveill for activity that may constitute insider trading.

In a typical insider trading investigation, sophisticated systems complement analysts' requests for trading-related information from member organizations, listed companies, and other markets. Where, as is frequently the case, an investigation indicates possible insider trading by individuals or entities outside the jurisdiction of NYSE Regulation, for example, hedge funds, employees of listed companies, or customers of a member organization, the activity is referred to the SEC with whom we enjoy a strong and constructive working relationship.

In addition to our interaction with the SEC on specific insider trading investigations and referrals, we have ongoing discussions with the staff regarding practices and trends. In our view, in addition to our highly advanced technology and experienced and professional staff, a strong relationship with the SEC and other market regulators in the U.S. and internationally is critical to successful surveillance of activity that may constitute illegal insider trading.

To that effect, we continue to strengthen our proactive engagement with other market regulators. By way of example, this Au-

gust 18th there was a meeting convened amongst various regulators from the SEC, NYSE Regulation, NASD, and the Chicago Board of Options Exchange to talk about current developments and discuss investigative techniques in insider trading.

The last 2 years have seen a significant increase in the number and complexity of our insider trading referrals to the SEC. Referrals to the SEC increased from 68 in 2004 to 111 in 2005, a 63-percent increase. For 2006, at the current pace, we project 140 referrals to the SEC, an increase of 26 percent from 2005.

We have also seen during this period an increase in the number of insider trading matters related to hedge fund activity that had been referred to the SEC. Penalties and disgorgement from Market Surveillance referrals to the SEC have also increased. In 2004, penalties were approximately $2.5 million. In 2005, penalties were about $3.9 million. And for the first half of this year, penalties exceeded $3.2 million, and we are on our way to surpassing 2005 levels.

In conclusion, at NYSE Regulation we remain vigilant and cognizant of our responsibility to vigorously pursue the highest excellence in our regulation of the markets. We also remain committed to continue to work with the SEC and with our fellow regulators to improve and strengthen the system of self-regulation that has made the United States the financial center of the world.

I thank you again for this opportunity to discuss the efforts of NYSE Regulation in this important area of insider trading and invite you and your staff to experience firsthand our efforts by visiting us in the near future.

Thank you.

[The prepared statement of Mr. Marchman appears as a submission for the record.]

Chairman SPECTER. Thank you very much, Mr. Marchman.

I am going to have to take a short recess at this point and just a word of explanation as to where we stand and why it is important to do this.

The Senate has reported out an immigration bill, as you may know. The House has reported out an immigration bill. And we have been unable to go to conference. And they want border enforcement and employer verification. We do, too, but we want to handle guest workers and we want to handle the 11 million undocumented immigrants. And a good part of our work is informing the public as to what we are doing so they understand why the bill is not being finished and to try to induce the House Members to go to conference, which is going to have to be after we take the break.

So I gave you that little explanation because it is not something which is incidental to our work to be at a news conference, but really very directly tied into getting the job done. And everybody is just very, very busy right now. We are struggling the Supreme Court ruling in Hamdan and whether we are going to have habeas corpus. And we are struggling with the electronic surveillance issues. We are struggling with the fence and another matter. So that everybody is moving like molecules at a high speed in a lot of different directions.

So I hope you will pardon the brief recess, and I will return just as soon as I can.

[Recess 10:08 a.m. to 10:33 a.m.]

Chairman SPECTER. We will resume the Judiciary Committee hearing.

Again, I regret the interruption. This may not assuage you much, but this may be the shortest recess in the history of the Judiciary Committee to change buildings and have three Senators speak and come back.

We turn now to Mr. Christopher Thomas, President and Founder of Measuredmarkets Inc., an analytical research firm based in Toronto, Canada. Mr. Thomas had worked as an analyst, investment adviser, and broker prior to founding Measuredmarkets; bachelor's degree in economics from McGill University; studied at Loyola and Marlborough College in Marlborough, England.

Thank you for joining us here today, Mr. Thomas, and we are very interested in your study and look forward to your testimony.

STATEMENT OF CHRISTOPHER K. THOMAS, PRESIDENT, MEASUREDMARKETS INC., TORONTO, CANADA

Mr. THOMAS. Thank you, Senator. I am President of Measuredmarkets. The firm supplied the underlying data to the New York Times for its article of August the 27th on abnormal trading activity.

The analysis we did for the newspaper showed that for more than 40 percent of the scrutinized mergers with a value of $1 billion or more that were announced in the 12-month period, deviant trading behavior was evident before the deals became public. Therefore, we believe that with the data displaying such aberrant activity, it is more than reasonable to ask: What prompted this activity? Could it be insider trading?

The Financial Times of London recently reports: "Insider trading is endemic in the London stock market. The Financial Services Authority recently found that almost 30 percent of takeover announcements...were preceded by suspicious share price movements...." If 30 percent is considered endemic, what would one consider labeling a number greater than 40 percent?

Our company provides a service that statistically examines the trading behavior of individual stocks. We determine if today's activity conforms to the particular stock's historical patterns or deviates from them. When stocks do wander away from their usual pattern of behavior, our process issues alerts automatically. If there is no news publicly available that might explain this aberration, we deem such activity highly suspicious and irregular, going against historical norms.

Our factual data and experience has shown that very often such deviations occur several days before substantial changes in the prices of the identified stocks. We have numerous examples of such identification of unusual behavior preceding the release of material news. Some of these are cited in the New York Times article; others are on our website.

Amongst our clients are a governmental investigatory agency, news services, money managers, brokers, and individual investors.

So how does Measuredmarkets use the data? What determined abnormal trading? And what is considered suspicious trading?

We look at some 3,000 data points for each common stock each day on the four exchanges, and for some stocks as many as 5,000 data points. We examine a stock's history of trading using three measures: closing price, total volume, and the total trades or number of individual transactions. This last measure is distinct from volume, albeit related to it. A stock's normal behavior pattern for each measure is then calculated, covering nine different time periods. We thus have what can be 3-D pictures, covering each of the nine time periods, to compare against any day's activity. Each stock's history mathematically determines what its normal pattern of behavior is, automatically adjusting should it change from volatile to stable or vice versa.

Should a day's activity exceed the normal patterns, then it can be considered as exhibiting mathematically deviant behavior. It is aberrant, having wandered significantly away from its well-established normal path.

Each day, for the four markets that Measuredmarkets currently tracks, hundreds of stocks are flagged as showing newly deviant behavior. The majority of those so marked are actually reflecting news that is already in the public domain. The service our company provides becomes useful, important, and significant when stocks have deviated from their own norms and there is no news generally available that could explain the deviations. Such activity we suggest is suspicious. Referring to the New York Times articles: "The companies were not the subject of widely dispersed merger commentary during the periods of abnormal trading, nor did they make any announcements that would seem to explain the moves."

The Measuredmarkets service deals with real numbers from the real world—hard data that is in the public domain. From the immense amount of information that is generated by the stock markets, we sift the data so that ordinary investors and interested organizations gain valuable information.

I started this company to level the playing field for investors. "What is the use of living if it be not to strive for noble causes and to make this muddled world a better place for those who will live in it after we are gone?" That was Winston Churchill, and I have to point out that his mother was an American.

Thank you, Senator.

[The prepared statement of Mr. Thomas appears as a submission for the record.]

Chairman SPECTER. Thank you, Mr. Thomas.

Our next witness is Professor Jonathan Macey, Deputy Dean and Professor of Corporate Law, Corporate Finances and Security Law, at Yale University; was the Dupont Professor of Law at Cornell, and also served as an instructor at the University of Chicago, University of Tokyo, and University of Virginia; law clerk to Judge Friendly; bachelor's degree cum laude from Harvard, and law degree from Yale; editor of the Yale Law Journal.

A very distinguished record, Professor Macey. The floor is yours.

STATEMENT OF JONATHAN MACEY, SAM HARRIS PROFESSOR OF CORPORATE LAW, YALE UNIVERSITY, NEW HAVEN, CONNECTICUT

Mr. MACEY. Thank you very much, Mr. Chairman. It is a pleasure to be here, and thanks for inviting me. Insider trading has been a focus of my teaching and research. Illegal insider trading is the theft of valuable information about corporate plans that properly belongs to the corporation and its investors. Vigorous enforcement is important to protect intellectual property rights of investors and corporations.

However, not all trading by insiders is illegal, and not all trading on the basis of informational advantages is illegal. Rather, insider trading is illegal when securities are traded in breach of a relationship of trust and confidence, known as a "fiduciary duty." And it is also, of course, illegal to tip information in violation of a fiduciary duty or to misappropriate confidential information.

It is not the case that insider trading is a victimless crime. Insider trading is a crime that has victims because insider trading deprives people of what is rightfully theirs—the ability to profit on material nonpublic information about their companies or to avoid losses associated with such information, and in doing so deprives people of returns and undermines legitimate societal trust and expectations about market functions.

The problem with insider trading for personal benefits is that it reduces—another problem is that it reduces the incentives of legitimate market participants, like analysts, to allocate scarce resources to research. And the question that I want to turn to is: How much insider trading do we actually observe in the U.S., and can we and should we be doing more to stop it? And I want to make the following points.

No. 1, the available empirical research indicates that the U.S. has, by far, the most vigorous insider trading enforcement program in the world, as well as the strictest laws against insider trading. The U.S. is the country in which insider traders' profits are the lowest.

In the U.S., unlike many other countries, there is a private right of action for violation of the laws against insider trading, and from a causal perspective, the private plaintiff's bar generally piggybacks on the enforcement efforts of the Securities and Exchange Commission and also self-regulatory agencies. The evidence suggests that while coming up with a benchmark for what is vigorous enforcement is not an easy task, relative to any other countries the U.S. does a great deal more, and the SEC in particular. For example, over the last 5 years, the SEC has brought 260 insider trading enforcement actions. By contrast, in the U.K. there have only been 14 insider trading actions, and the largest fine, which was 25,000 pounds in the U.K., is lower than the average penalty in the U.S.

The enforcement program of the SEC has targeted not only corporate officers and directors and their friends, business associates, tippees, printing firm employees are common targets, also employees of investment banking firms, law firms, and accounting firms.

At the same time, I want to point out that trading that is not done on the basis of a violation of fiduciary duty and involves mak-

ing money from investments in legitimate research about corporate performance and governance is socially valuable and should be encouraged.

With respect to studies that we have been talking about today, studies that show increases in trading volume or share prices in advance of merger and acquisition activities must, if they are to be useful, do a couple of things that studies that have been discussed do not do. No. 1, they do not distinguish between legitimate and illegitimate trading activity. For example, purchases by a hedge fund or an LBO fund or an arbitrageur may actually put a company in play, increasing the chances of an outside acquisition attempt, which in turn can explain sudden increases in trading volume and share prices of target companies, thus suggesting that we need to think carefully about the causation that we observe in studies such as that reported in Gretchen Morgenson's August 27, 2006, New York Times article.

I also want to point out that, in terms of thinking about the allocation of resources in insider trading, there are other things on the SEC's plate that one can credibly argue should be the focus of sharp attention, such as options back-dating and accounting fraud. Thus, one can draw the conclusion, as I have done, that the SEC in its enforcement program does an excellent job of balancing the policy goal of detecting and punishing insider trading with the goal of conducting insider trading investigations in a careful way so that we maintain the important deterrent effect that we have associated with the social stigma that is carried with the act of illegal insider trading in the U.S. that one does not see as a matter of norms and social deterrent in other countries.

Thank you very much.

[The prepared statement of Mr. Macey appears as a submission for the record.]

Chairman SPECTER. Thank you, Professor Macey.

We turn now to Professor John Coffee, Columbia Law School; holds the distinguished Adolf Berle Chair; taught at Georgetown University Law Center, and was in private practice for 6 years with Cravath, Swaine & Moore; been a member of the NASD's Market Practices Committee and the Legal Advisory Committee of the New York Stock Exchange Board of Directors; bachelor's degree from Amherst, Phi Beta Kappa; law degree from Yale; master in law from New York University.

We may be overloaded with Yale law grads today— Professor Coffee, Professor Macey.

STATEMENT OF JOHN C. COFFEE, JR., ADOLF A. BERLE PROFESSOR OF LAW, COLUMBIA UNIVERSITY LAW SCHOOL, NEW YORK, NEW YORK

Mr. COFFEE. Thank you for inviting me, Senator. As a law professor, and uniquely for this panel, I teach both criminal law and securities law, so I look at insider trading from both sides, and I am going to focus my comments not on whether insider trading is bad—I assume we all agree on that—but on the criminal enforcement of it. And I am basically going to submit that criminal enforcement is the one force that will truly deter in this field. But

there are problems with criminal enforcement, and there are new problems looming on the horizon.

Now, I am going to ask a series of questions and give brief, incomplete answers.

Has insider trading increased? There is no universally recognized proxy, but there is pretty probative evidence that there has been an increase. The New York Stock Exchange data in Mr. Marchman's written submission shows that the number of referrals to their Market Surveillance Unit has made to the SEC over the last 2 years went up 60 percent in 2005 and 25 percent in 2006. That is consistent data because their computers are going to be objective and turn out the same criteria and the same warning bell each time.

Now, what is driving this increase that I think exists? Usually, it is related to merger and acquisition activity, but that is not the story today. I think it is more the intense competition among hedge funds where there is tough competition for the investor's dollar. They have to get very high rates of return to stay in business, and they may do anything to get material nonpublic information.

Second, there are new classes of transactions— management buyouts, PIPE transactions—that are particularly vulnerable because large numbers of people know in advance about these transactions, and the risk of insider trading goes up exponentially. So we have reasons for why it is increasing and evidence it is increasing. Is the SEC at fault? I cannot say that. I cannot make a case that the SEC has been inattentive. They have prosecuted between 7 and 12 percent of their enforcement cases, insider trading cases, for the last 10 years or so, and basically I cannot tell the SEC or this Committee that they should prosecute more insider trading and, thus, less accounting fraud or less market timing or less stock option back-dating. All of these things deserve the attention of the SEC.

Therefore, I would suggest the focus has to be on making enforcement more efficient, and here I want to give one basic message. If we look worldwide at what makes enforcement efficient, it is effective criminal enforcement, and effective criminal enforcement of insider trading is very difficult. It is easy enough to find out who traded, but it is very difficult to identify whether that trading was based on material nonpublic information that was misappropriated. That requires evidence that is hard to obtain.

Thus, many insider trading cases are actually prosecuted on other grounds. You will recall the Martha Stewart case where she was prosecuted for false statements and conspiracy and her co-conspirators for perjury, but none of them were prosecuted for insider trading.

The point I am making is that there needs to be cooperation between civil and criminal enforcers because often the actual charges brought will not be securities fraud but something else. However, it does deter.

Now, when we look worldwide at enforcement, I have to tell the Committee that in the legal systems closest to the United States, insider trading has not been successfully enforced through criminal law. In Great Britain and in Canada, there has been no success with criminal enforcement. I have just served on a Canadian com-

mission that has tried to examine why there has been little success, and basically we find that there are legal barriers between cooperation between the civil enforcer and the criminal enforcer, and the cases cannot be made.

Now, cooperation has never in the past been a problem in the United States, but within the last year, two Federal courts have dismissed criminal indictments brought by U.S. Attorneys because of cooperation between the SEC and the U.S. Attorney. The best known of these cases is the *Scrushy* case you referred to, the CEO of HealthSouth. In that case, the U.S. Attorney did call up the SEC attorney and suggest some questions they would like asked and some questions they would not like asked because it would tip off the deponent of the pending criminal investment. Also, the U.S. Attorney suggested they move the proceeding to Alabama from Atlanta so that they could indict the deponent if he committed perjury. Mr. Scrushy was indicted for perjury, and the case was dismissed by a court that says the Government had laid a perjury trap.

I think that is a very fallacious logic. I do not accept the perjury trap argument. The defendant was not induced to lie. The defendant was merely induced to lie in Alabama rather than in Georgia, and the defendant has no right to avoid prosecution because he was not told in advance that the Government was hiding in the bushes waiting to indict him if he lied. All defendants should know that they can be indicted if they lie before the SEC.

I suggest that Congress could fix this. This is not a constitutional problem. This is a simple problem of supervisory jurisdiction, and I think there is a quick fix that is possible. And I will leave it at that point.

[The prepared statement of Mr. Coffee appears as a submission for the record.]

Chairman SPECTER. Thank you very much, Professor Coffee.

We turn now to Professor James Cox, Duke Law School; appointed to the Currie Chair in 2000; previously taught at Boston University and the University of California at Stanford; a member of the NASD's Legal Advisory Committee and the ABA Committee on Criminal Law; bachelor's degree with high distinction from Arizona State University, law degree from the University of California, and a master's in law from Harvard.

We appreciate your being here, Mr. Cox.

STATEMENT OF JAMES D. COX, BRAINERD CURRIE PROFESSOR OF LAW, DUKE UNIVERSITY SCHOOL OF LAW, DURHAM, NORTH CAROLINA

Mr. COX. Thank you, Senator, for inviting me. My testimony prepared on a blustery Saturday morning reports a lot of studies that document everything that you have heard here this morning: that insider trading in our capital markets is pervasive and insidious, surrounding almost every event.

By way of illustration and replicating what Mr. Thomas found, you find that, on average, beginning about 12 days before takeovers or a merger, roughly 40 to 50 percent of the premium that is going to be ultimately paid in that unannounced event is already reflected in the stock's price; that the deals, earnings reports, list-

ings, delistings, bankruptcy, offering of new public securities are not well- kept secrets in our capital markets. So insider trading is a problem.

As Jack pointed out, we do not know whether the right number of referrals are the 140 cases anticipated this year by the Stock Watch group. Maybe it should be 300 cases or 400 cases. It is very hard to get a handle on that. What we do know is that the evidence of insider trading, as I repeated and as captured in my statement, is pervasive.

The suggestions I make are somewhat consistent with what both John and Jack have made, and that is that we need to think about enforcement. But enforcement really has two different components to it, and I focus in my testimony more on the first component, and that is, increasing the likelihood of detection. The other component of that is the sanction. In between there is the probability of successful prosecution. But let's talk a little bit about detection.

One of the relevant questions I have suggested in my written testimony would be an appropriate question for Mr. Marchman and his organization is whether they really believe that their data base has sufficient inputs as to who are the participants in the deal so that when you do find suspicious trading going on—and how do we know it is suspicious trading? Generally, a suspicious trade is determined just by the size of the trade. But maybe we ought to look at suspicious trading by who the trader is. Do they have in their data base sufficient knowledge about who the lawyers are, the investment bankers, the commercial bankers, the accountants that are likely involved with these transactions so that they are kicked out of the computers even though they may trade a very small amount?

For close to 20 years now I have studied how the Stock Watch group operated and how their data base is constructed, what names were in it, the heuristics that were used for identifying abnormal volume changes and price changes. And the question is: Has that data base kept apace with market developments? How transparent is the trading to the Stock Watch group of who the traders are vis-a-vis the Stock Watch group, not necessarily to the market? As we all know, being able to conceal your identity in the marketplace is an important attribute of capital markets. We do not want to have it necessarily totally transparent to other investors who is trading, but that is quite a separate question from whether we have a system that allows the self-regulatory organizations, the first line of defense for the integrity of our capital markets with respect to insider trading, to know who is trading and whether those data bases are adequate and sufficient.

I believe that we could have a method that would be designed to provide sufficient data bases in ways that are consistent with privacy notions and at the same time enhance greatly the surveillance of our capital markets, the detection of insider trading, and most likely the apprehension and successful prosecution of those who violate their trust by trading on material nonpublic information.

Thank you, Senator.

[The prepared statement of Mr. Cox appears as a submission for the record.]

Chairman SPECTER. Thank you, Professor Cox.

Well, there is certainly a broad divergence of views. That is an excellent panel from that perspective, and I compliment my staff on assembling them, more so than easel, if I might say.

Professor Cox, you are beating around the bush by calling insider trading only pervasive and insidious. Would you disagree with that, Professor Macey?

Mr. MACEY. Well, the available data suggests one of two things, Senator. One is we could say that insider trading is more pervasive in the U.S. than in other countries because the data that Jim Cox and Mr. Thomas are referring to suggests greater volume increases and bigger price spikes. But I do not think with a glancing familiarity with world capital markets would agree that insider trading is more pervasive.

Obviously, with respect to the question how much illegal insider trading should be—

Chairman SPECTER. He did not say it was more pervasive. He just said it was pervasive.

Mr. MACEY. Right. Well, the—

Chairman SPECTER. And you say it is less pervasive than other places, but—

Mr. MACEY. Fair enough.

Chairman SPECTER. Is it pervasive—well, I guess if you say it is less pervasive, it is pervasive. How about insidious?

Mr. MACEY. Well, I think by definition it is insidious because it is sneaky, to the extent that it is illegal. But, you know, I think again we have to look at causation. We have to look at the great efficiency of U.S. markets. And Mr. Thomas' company does suggest in its study that there is more—that they have more of this aberrant activity in the U.S. than, say, in London.

Chairman SPECTER. Well, I think that is a pretty comprehensive indictment to call it pervasive and insidious. I do not often ask the same question to other panelists, but is it pervasive and insidious, Mr. Marchman?

Mr. MARCHMAN. Chairman Specter, our numbers do indicate that in recent years, at least with regard to our referrals, activity which could be labeled as insider trading is on the upswing. Of course, I agree with all the panelists—

Chairman SPECTER. On the upswing. But is it pervasive?

Mr. MARCHMAN. It is an area of concern for our regulatory group given—

Chairman SPECTER. It is a matter of concern for your regulatory groups, but is it pervasive?

Mr. MARCHMAN. It is a conduct that we are attempting to ascertain the extent of the pervasiveness of the—

Chairman SPECTER. Conduct attempting to obtain an evaluation of the pervasiveness. OK. I am not going to ask it a fourth time.

Mr. Thomas, is it pervasive and insidious? Mr. Thomas, is illegal insider trading pervasive and insidious?

Mr. THOMAS. Well, certainly insidious if it is illegal. There is no doubt about that at all, and—

Chairman SPECTER. Well, it is illegal, so we now know it is insidious. But is it pervasive?

Mr. THOMAS. Certainly it seems to be pervasive based on our studies and the reports out of London and personal experience in the past.

Chairman SPECTER. Well, I do not have so much interest as to whether it is pervasive and insidious in London. How about in the United States?

Mr. THOMAS. According to our studies, it would certainly appear to be.

Chairman SPECTER. Professor Coffee, is it pervasive and insidious?

Mr. COFFEE. It is pervasive and insidious enough to need a stronger regulatory response.

Chairman SPECTER. OK. You have touched a core issue, Professor Coffee, on the parallel tracks matter, and what is the best rationale to be said in support of the Federal court decision striking an indictment because of cooperation? It seems to me a telephone call from—

Mr. COFFEE. There are two decisions—

Chairman SPECTER. Two cases. Well, one was the perjury trap and the other was the coordination—or were they both coordination?

Mr. COFFEE. Well, they both involved coordination, which created, in the view of one judge—

Chairman SPECTER. But was the rationale in both—

Mr. COFFEE. I think the underlying rationale—

Chairman SPECTER. The absence of parallel and disconnected tracks.

Mr. COFFEE. I think the underlying rationale is the defendant is somehow entitled to warning so that he could assert his Fifth Amendment rights if he knew that the U.S. Attorney was using the SEC proceeding as a way of gathering evidence for purposes of the criminal prosecution. However, in the past, Congress has written right into the Federal securities laws that the SEC can turn this information over. We just have a gap as to whether or not the two bodies can consult during the process of investigation, and that is where I think there could be a further fix, because right now there is considerable confusion in the law. And, frankly, any zealous defense counsel is almost duty bound to make a motion alleging that the Government has violated this perjury trap or somehow improperly cooperated between the civil and criminal sides.

Chairman SPECTER. I have not been in the prosecution business for a while. Is there an evolved doctrine of perjury trap? It is the first time I have heard of it.

Mr. COFFEE. *Scrushy* is the first time I heard it, and I think it is very surprising to most prosecutors. But as long as we have two decisions out there and no circuit court decisions, we are in a state of considerable uncertainty.

Chairman SPECTER. Entrapment is a well-accepted doctrine for a defense, but perjury—

Mr. COFFEE. Entrapment, as you are well aware, Senator—

Chairman SPECTER. Well, come back to the question which I have interrupted. What is the best rational for the conclusion that the SEC attorneys and the Department of Justice attorneys ought to be on totally separate tracks?

Mr. COFFEE. Well, I think the argument implicitly of the *Scrushy* court is that if you knew that the SEC was a stalking horse, was working hand in glove with the U.S. Attorney, you would have taken your Fifth Amendment rights, assert it at the SEC proceeding, and you would have had the case probably determined adversely against you because you can take inference—

Chairman SPECTER. That is the best rationale?

Mr. COFFEE. The rationale is that we should broadly protect—I do not agree with this rationale, but the rationale would be that we should give the defendant fair notice that the Government is going to use this evidence and permit him to assert his Fifth Amendment rights knowing the intended use of the evidence.

Chairman SPECTER. Well, a person ought to be on guard at all times for anything which is said which is incriminating, because it can be used in an evidentiary way, as we all know, by anybody who hears it as an admission, even on a hearsay basis, let alone if you have a governmental agency conducting an investigation.

Professor Macey, do you think that criminal sanctions ought not to be employed against illegal insider trading?

Mr. MACEY. No. I think criminal sanctions should be employed against illegal insider trading.

Chairman SPECTER. Professor Cox, Professor Macey has emphasized a view that the reputational penalties for insider trading are very high. Now, he does not think that they should be exclusive, as he just testified, but how meaningful do you think reputational penalties are for insider—to discourage illegal insider trading.

Mr. COX. My sense is not enough, and the reason for that is that we still see individuals who are engaged in professions which trade on reputation—lawyers, accountants, certain high-level investment bankers that still cross the line, and they must appreciate the fact ex ante that if they get caught, they will no longer be a lawyer or an accountant because nobody will ever retain them in their firm.

So I think individuals discount heavily the loss of reputation going into it. I think the loss of reputation is an important part of addressing—causing people to adhere to a norm. But it breaks down in lots of areas, and I suspect that the reputation loss for those that are business people, not professional people, is not nearly as great because the little bit of casual knowledge I know, individuals that have been involved in insider trading continue to be executives of firms; whereas, those who are lawyers or accountants find another profession other than being a lawyer or accountant. So it depends upon a little bit about where you came from, but also it depends a lot on who you are as well.

Chairman SPECTER. Reputational factors are not as important to business people as to lawyers or accountants because the penalties are not as high. They can keep their jobs.

Mr. COX. That is what my surmise would be, sir.

Chairman SPECTER. Mr. Thomas, Professor Cox has raised a question as to whether the data base is sufficient and wants to know if you cross-check lawyers and accountants and other professionals who are engaged in demonstrable illegal insider trading as a factor to be considered in your studies. Does your data base take into account what Professor Cox has asked about?

Mr. THOMAS. Senator, we have no idea who the particular parties are doing the trading. Something we do do is analyze the individual number of trades, and it usually happens that when tippees are involved, the number of individual trades or transactions increases significantly beyond the norms, independent of the absolute volume. And this is an important indicator that something funny may be going on.

Chairman SPECTER. Do you think it would be a better study if you tracked lawyers and accountants for the reasons Professor Cox articulates?

Mr. THOMAS. If someone paid us and gave us the mandate to do so, we would be happy to do it.

Chairman SPECTER. Well, this Committee is not in a position to pay you to do so.

Mr. THOMAS. I am just pointing out, Senator, with due respect, that is not the business we are in.

Chairman SPECTER. But you might propose it to the New York Times. Or they might have heard about it from what we are saying here.

It is a very interesting study that you have conducted, beyond any question.

Mr. THOMAS. Thank you.

Chairman SPECTER. And you have been commissioned to do so, according to the Times, by the New York Times itself. Correct?

Mr. THOMAS. Correct, yes.

Chairman SPECTER. Do you know the genesis as to why the Times decided to make these inquiries?

Mr. THOMAS. Our company and the New York Times have been talking for a while about exchanging—our providing some of our information. And then when the Financial Times of London reported on the FSA study the 30-percent number out of London, the New York Times said, Hey, could you do the same sort of study over here for the United States for, say, mergers and acquisitions—

Chairman SPECTER. So it was inspired by the London Times story as opposed to some preconception that there might be something rotten in Denmark.

Mr. THOMAS. There might have been that preconception. I have no idea. But the London Times, the Financial Times story was the trigger that got this investigation going.

Chairman SPECTER. Mr. Marchman, your statistics are very interesting about your referrals and the significant increase in referrals. Do you track what the SEC does with your referrals in terms of sanctions?

Mr. MARCHMAN. We do. We do, and the—

Chairman SPECTER. Are they doing a good job?

Mr. MARCHMAN. With the—

Chairman SPECTER. I withdraw that question. You probably should not be asked that question. What are they doing? I will not ask you a leading question. Professor Macey raised his eyebrows on that.

Mr. MARCHMAN. Well, what they do do, after we referred the matter, is that—and, Chairman Specter, I would note that before we do refer a matter to the SEC, there is an extensive process that is involved by my staff where we do, in fact, have an extensive data

base which contains information with regard to the identities of attorneys, accountants, individuals who may have been involved with—

Chairman SPECTER. So you pick up some of what Professor Cox suggested.

Mr. MARCHMAN. We pick up almost all of what Professor Cox has suggested.

Chairman SPECTER. And what has the SEC done with your referrals?

Mr. MARCHMAN. With our referrals, they have instituted a number of disciplinary actions, as noted in my written testimony, as a result of the referrals. We do keep track with regard to the numbers. We have discussions with regard to any additional information that they may need as they are going forward. And we also are mindful of the evidentiary burdens that do confront the SEC with regard to the referrals that we make.

The referrals that we do make, as I noted in my written testimony, are indications of potential violations of insider trading, not actual evidence.

Chairman SPECTER. Mr. Marchman, would you provide to the Committee your information as to what has happened on the referrals?

Mr. MARCHMAN. Sure.

Chairman SPECTER. And give us an evaluation, if you care to do so—I know this is sensitive—as to whether you think what the SEC has done is adequate. And we are going to track them on the other end with the SEC and with the Department of Justice to see what they are doing.

Mr. Coffee, you have raised the possibility of altering the mens rea test but think that that would be unwise to do. Would you expound upon that?

Mr. COFFEE. Well, right now, any criminal prosecution for securities fraud, which is how insider trading is classically prosecuted, requires you to show that the defendant has a mens rea of willfully violating the statute, and there are a series of decisions by eminent judges, like Henry Friendly, that say willfulness in this context requires proof of a conscious awareness of wrongdoing on your part.

That is a very high standard, and it is one of the problems. I do not think it is the principal problem. I think the principal problem is getting proof that you actually possessed material nonpublic information.

So it would be a move that would simplify the prosecution. I do not recommend it because I believe this is an extremely regulated and complex area, much like the tax law. And there are many people who trade believing that they are permitted to trade because they are not breaching a duty. And I think you should have some awareness that you are breaching a duty before you get criminally prosecuted for insider trading and face a penalty of up to 25 years.

Chairman SPECTER. You mentioned Judge Friendly and his test. What was it like, Professor Macey, clerking for Judge Friendly?

Mr. MACEY. He was a brilliant lawyer, particularly in the business law, white-collar crime, corporate and securities area, and a keen, keen intellect. It was a great honor and privilege.

Chairman SPECTER. Chief Justice Roberts clerked for Judge Friendly, too.

Mr. MACEY. That is correct.

Chairman SPECTER. Why didn't you then go ahead to clerk for Chief Justice Rehnquist and become Chief Justice?

[Laughter.]

Mr. MACEY. I like academic life, and one clerkship year was plenty for me. I guess Chief Justice Roberts had a bigger appetite for clerking than I did.

Chairman SPECTER. When you were on the Yale Law Journal, did you write a note or comment?

Mr. MACEY. Yes.

Chairman SPECTER. What were the subjects?

Mr. MACEY. The Banking Act of 1933, the Glass-Steagall Act.

Chairman SPECTER. Well, gentlemen, thank you very much for your participation here today. As a final question, I would like each of you to give an opinion, if you care to do so, on whether there is sufficient criminal law enforcement by the Department of Justice on insider trading or stock exchange manipulations generally on back-dating options or fraud in a variety of ways. Adequate or inadequate, Professor Cox? If you care to say.

Mr. COX. Well, I think I would like to see more prosecution just because I think that captures the attention of lots of people who need to have the message. And my sense is that we do not have a lot of prosecutions, and I will be very interested to see, with back-dating of stock options, whether there are criminal prosecutions there. I would certainly hope so.

Chairman SPECTER. What is your view, Professor Coffee?

Mr. COFFEE. It has only been in the last couple of years that U.S. Attorneys outside of New York have been willing to give priority to white-collar criminal prosecutions for securities fraud. This is still a developing transition. I think that there are many districts where you do not see the U.S. Attorney giving any attention to white-collar crime, and insider trading can occur anyplace.

So I think there is need for more enforcement, and there is an uneven pattern in the use of criminal sanctions across this country, as different U.S. Attorneys have different priorities.

Chairman SPECTER. Well, it is something the Department of Justice, Main Justice can handle. They certainly should weigh in. They have some control there.

Professor Macey?

Mr. MACEY. Just two quick points. One, I agree with Jack Coffee that there is strong evidence of regional asymmetries, biases. Some places are much more active—the Southern District of New York, for example—in criminal prosecutions.

But, two, before saying that the Department of Justice or the SEC should do more, I would really like to see a few factual stories and saying this person did the following, engaged in the following trading, and shouldn't that person have been prosecuted. Otherwise, I think it is too easy to say, gee, I am a good guy, we should be doing a lot more of this. And, you know, I think that to the extent that we can identify tangible examples of such misconduct, then I would look at those on a case-by-case basis.

Chairman SPECTER. Mr. Thomas, does the Crown bring enough prosecutions?

Mr. THOMAS. Does the Crown bring enough prosecutions?

Chairman SPECTER. Well, yes.

Mr. THOMAS. I doubt it. But Professor Laura Beny of the University of Michigan Law School has done a study insider trading law enforcements around the world, and her thesis is that the stronger the restrictions are and the more they are enforced, the more liquid and fair the markets become. I think that is a worthy goal.

Chairman SPECTER. And does Canada bring enough criminal prosecutions?

Mr. THOMAS. I doubt it.

Chairman SPECTER. Would you care to venture an opinion on the United States' criminal prosecutions adequacy?

Mr. THOMAS. I would prefer not to, Senator.

Chairman SPECTER. Well, you are not under subpoena so you do not have to.

[Laughter.]

Chairman SPECTER. Mr. Marchman, enough prosecutions under the criminal statutes in the United States?

Mr. MARCHMAN. Chairman Specter, I can only comment from the interaction that I have been fortunate to have with the U.S. Attorney's Office in the Southern District, and they have a very vigorous and active program. So from that vantage point, I do believe it is adequate.

Chairman SPECTER. Without objection, we will admit into the record a statement from Senator Grassley.

I am going to tell my colleagues what a good hearing they missed today, and I think next time I am not going to invite anybody. I like the current make-up of the panel.

[Laughter.]

Chairman SPECTER. I maintain a record of adhering strictly to time limits, and each questioner has 5 minutes, and I am now in excess of 20 minutes, 15 minutes over my time, which is a first for me. I am prompted to think about one-person grand juries, and we may adopt that policy for this Committee.

[Whereupon, at 11:15 a.m., the Committee was adjourned.]

Questions and answers and submissions for the record follow.]

QUESTIONS AND ANSWERS

Robert A. Marchman
Executive Vice President
Division of Market Surveillance

NYSE Regulation

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November 17, 2006

The Honorable Arlen Specter
Chairman
U.S. Senate Committee on the Judiciary
224 Dirksen Senate Office Building
Washington, DC 20510-6275

Dear Mr. Chairman:

Further to your request, please find below answers to your follow-up questions to your hearing entitled, "Illegal Insider Trading: How Widespread is the Problem and is There Adequate Criminal Enforcement" on September 26, 2006. I appreciate the opportunity to testify before your committee and I hope that you find the following answers to your questions responsive.

If I can be of any further assistance, please feel free to contact me.

Sincerely,

1. Please provide the Committee information concerning what the SEC does with New York Stock Exchange referrals.

The Market Trading Analysis ("MTA") Departments of the Market Surveillance Division of NYSE Regulation, Inc. ("NYSE Regulation") send electronic referral letters to the United States Securities and Exchange Commission ("SEC") via the SEC's Electronic SRO Referral System. As requested by the Office of Market Surveillance of the SEC, referral letters contain as much relevant information as possible, in addition to trading activity, in order to preliminarily inform staff at the Division of Enforcement of the SEC of the type of referral and size of trading and reason for the referral.

Electronic referrals are reviewed by Joe Cella, Mark Lineberry and Eric Ribelin – the assigned senior staff of the Office of Market Surveillance of the SEC -- and entered into an electronic tracking process.

After some processing, the Office of Market Surveillance circulates the referral to staff of the Division of Enforcement of the SEC in Washington, D.C. and to the SEC regional offices to determine whether there is interest in the referral. If the referral is assigned to staff in the Division of Enforcement of the SEC, the referral is given an MUI (Matter Under Investigation) number or its may be designated as a Formal Order of Investigation.

On occasion, and as appropriate, MTA staff may telephonically contact the Office of Market Surveillance of the SEC to inform them of an impending referral before the referral is entered through the electronic referral system. By way of example, MTA staff may contact the SEC by phone where time is of the essence, such as the referral of a foreign account where the SEC may want to seek a court order freezing foreign assets; where the chief executive officer or chief financial officer of the company is involved; or where the SEC has expressed a particular interest in the matter.

When SEC senior staff determines that a the referral should be forwarded to SEC staff for further investigation, MTA may be contacted by SEC staff for additional information, which may include an inquiry into what is in the files of the SRO such as account statements, chronology information, or other trade information. Also, staff from the Office of Market Surveillance will, at times, directly contact MTA staff about a referral.

Aside from the initial referral to the SEC, MTA staff may also make supplemental referrals related to the original referral. If the SEC has closed the initial referral with a decision of "no action," the SEC may nevertheless elect to pursue the supplemental referral or reopen the prior referral resulting from receiving additional information. If the SEC pursues the initial referral, then supplemental referrals are typically included within the SEC's review of the initial referral.

After a referral is made, MTA remains available to discuss the subject matter of the referral with the SEC and to provide additional information and assistance as requested.

2. Please provide the Committee with the NYSE's view of the adequacy of SEC and Department of Justice enforcement actions of insider trading cases based upon NYSE referrals.

NYSE Regulation works cooperatively with both the SEC and Department of Justice to ensure appropriate enforcement action is taken with respect to insider trading referrals made to each agency. While the number of referrals has increased, a referral itself is not dispositive of an insider trading case ripe for prosecution. We believe that both the SEC and Justice Department thoroughly review, evaluate and, when appropriate, prosecute the cases we refer to them.

U.S. Department of Justice

Office of Legislative Affairs

Office of the Assistant Attorney General

Washington, D.C. 20530

December 14, 2006

The Honorable Arlen Specter
Chairman
Committee on the Judiciary
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

Please find enclosed the Department of Justice's responses to questions directed to Ronald Tenpas, Associate Deputy Attorney General, following Mr. Tenpas's testimony at the Committee's September 26, 2006 hearing entitled "Illegal Insider Trading: How Widespread is the Problem and is there Adequate Criminal Enforcement?"

The Office of Management and Budget has advised us that from the perspective of the Administration's program, there is no objection to the submission of these responses. Please do not hesitate to call upon us if we may be of additional assistance.

Sincerely,

James H. Clinger

James H. Clinger
Acting Assistant Attorney General

Enclosure

cc: The Honorable Patrick J. Leahy
Ranking Minority Member

Follow-Up Questions Submitted by Senator Specter
Senate Judiciary Committee
"Illegal Insider Trading: How Widespread is the Problem and is there Adequate Criminal Enforcement?"

September 26, 2006

1. **Has anyone received a jail sentence under the prohibitions of 18 U.S.C. § 1348? If yes, please identify all individuals who have been convicted of violating § 1348 and their respective sentences.**

   Response:

   Yes. Please see attached list of cases that have been charged under § 1348, including but not limited to cases resulting in convictions.

2. **What is the Department's view as to the efficacy of the underlying data and analysis in the Measuredmarkets report?**

   Response:

   The Department has a copy of the report, which is publicly available. It does not have access to the underlying data and analysis that Measuredmarkets used to come to its conclusions. Accordingly, the Department cannot comment on the efficacy of the data and analysis in the report. It is, however, studying the report and its findings.

3. **Please report what, if anything, the Department of Justice has done with respect to the Measuredmarkets, Inc. Report on merger and acquisition activity suggestive of insider trading.**

Response:

The Department is studying the contents of the report and has disseminated it to the Financial Crimes Section at the Federal Bureau of Investigation. As previously stated, insider trading cases are difficult to prove. The government must establish that the violation is knowing and that the inside information is material and non-public. The government also must establish the insider's relationship with the corporation from which the information comes. When these cases involve outsiders -- those who receive tips from corporate insiders or agents -- it imposes an additional, significant burden. The Department will use the information in this report, as well as information gleaned in its own investigations, to identify, investigate, and prosecute insider trading.

4. **What, if anything, is the Department going to do in the future to stem the tide of unlawful insider trading in advance of mergers and acquisitions?**

   Response:

   The Department will continue to vigorously enforce insider trading laws through complete and thorough investigations and prosecutions of this activity.

5. **Would the DOJ support legislation to address the adverse rulings in the Scrushy and Stringer district court opinions raised at the hearing?**

   Response:

   The Department welcomes the legislative effort to make clear an area of the law which has been muddied by the recent court decisions in *United States v. Scrushy*, 366 F. Supp. 2d 1134 (N.D. Ala. 2005) and *United States v. Stringer*, 408 F. Supp. 2d 1083 (D. Or. 2006). The *Stringer* decision is currently on appeal to the Ninth Circuit. It may be preferable to wait until the Circuit issues a decision before proceeding to ensure that any proposed legislation would provide a comprehensive fix to the problem.

CRIMINAL CASELOAD STATISTICS
DETAIL RECORDS OF TITLE 18 USC 1348
ALL CHARGES AND NO APPEALS

DIST	DEFENDANT NAME	COURT	AUSA	FILED	CHARGE	DISP DT	RESULT	REASON	SNT DT	SENTENCE
ALN	Scrushy, Richard M.	DC	TDM	031104	15 :00078j(b)	050901	NG	JTRD		
ALN					15 :00078j(b)	050628	NG	JTRD		
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ALN					18 :01001	050628	NG	JTRD		
ALN					18 :01341	050628	NG	JTRD		
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ALN					18 :01512(b)(1)	050628	NG	DEMD		
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ALN					18 :01957	050628	NG	JTRD		
ARE	Smith, Gary Marcus	DC	GV	060508	15 :00078o					
ARE					15 :00078o					
ARE					18 :01348					
ARW	Zedlitz, Michael	DC	CES	060629	15 :00078	061031	GT	PLED		
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ARW					18 :01348	061031	GT	PLED		
CT	Ross, Robert R.	DC	MSM	050629	18 :01348	060530	GT	PLED		
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DIST DEFENDANT NAME COURT AUSA FILED CHARGE DISP DT RESULT REASON SNT DT SENTENCE

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FLS					18 :013481	050121	GT	PLED		
GAN	Moses, Timothy	DC	JBU	040929	18 :01348	051027	GT	JTRD	060217	78
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GAN					18 :01621	051027	GT	JTRD		
MA	Dinh, Van	DC	ADB	040929	15 :00078jb	040209	GT	PLED	040505	13
MA					15 :00078jb	040209	GT	PLED		
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NYE					15 :00078MA					
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NYE					18 :00666					
NYE					18 :00844H					
NYE					18 :00844I					
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NYE					18 :00982					
NYE					18 :01341					
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NYE					21 :00853P					
NYE					28 :02461C					
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DIST	DEFENDANT NAME	COURT	AUSA	FILED	CHARGE	DISP DT	RESULT	REASON	SNT DT	SENTENCE
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NYE					18 :01344					
NYE					18 :01346					
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NYE					18 :01349					
NYE					18 :01350					
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DIST	DEFENDANT NAME	COURT	AUSA	FILED	CHARGE	DISP DT	RESULT	REASON	SNT DT	SENTENCE
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DIST	DEFENDANT NAME	COURT	AUSA	FILED	CHARGE	DISP DT	RESULT	REASON	SNT DT	SENTENCE
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DIST	DEFENDANT NAME	COURT	AUSA	FILED	CHARGE	DISP DT	RESULT	REASON	SNT DT	SENTENCE
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NYE					18 :03551					
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NYE					28 :02461(c)					
NYE	Nourani, Daniel	DC	GSG	050803	18:00002					
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NYE					18 :03551					
NYE	Halperin, Scott	DC	GSG	050803	18:00002					
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DIST	DEFENDANT NAME	COURT	AUSA	FILED	CHARGE	DISP DT	RESULT	REASON	SNT DT	SENTENCE
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NYE					21 :00853(p)					
NYE					28 :02461(c)					
NYE	Hatfield, Sandra	DC	JHM	060824	18 00002					
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NYE					18 :01348					
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NYE					21 :00853(p)					
NYE					28 :02461(c)					
NYE	Vindman, Vladlen	DC	TRF	040120	18 :01348	041012	NG	JTRD		
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NYE	Saksa, Andrew	DC	GSG	040609	18 :01348					
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NYE					18:0371	050310	GT	PLEA		
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DIST	DEFENDANT NAME	COURT	AUSA	FILED	CHARGE	DISP DT	RESULT	REASON	SNT DT	SENTENCE
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NYE					18 :01956(h)	051228	DJ	PLED		
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NYE					18 :01956(h)					
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NYE					18 :01956(h)					
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NYE					18 :01001A3	060713	GT	PLED		
NYE					18 :01348	060713	DJ	PLOD		
NYE					18 :03551	060713	GT	PLED		

DIST	DEFENDANT NAME	COURT	AUSA	FILED	CHARGE	DISP DT	RESULT	REASON	SNT DT	SENTENCE
NYE	Zafar, Faisal	DC	MEC	060503	18:00002					
NYE					18:00002					
NYE					18 :01348					
NYE					18 :01349					
NYE					18 :03551					
NYE	O'Connell, Timothy	DC	MAA	050818	18:00002					
NYE					18:00002					
NYE					18 :00371					
NYE					18 :00981a1c					
NYE					18 :01001a1					
NYE					18 :01001a2					
NYE					18 :01348					
NYE					18 :01349					
NYE					18 :01512b1					
NYE					18 :01512b2a					
NYE					18 :01512b3					
NYE					18 :01512k					
NYE					18 :01952a3					
NYE					18 :03551					
NYE					21 :00853p					
NYE					28 :02461c					
NYE	Malin, Robert F.	DC	MAA	050818	18:00002					
NYE					18:00002					
NYE					18 :00371					
NYE					18 :00981a1c					
NYE					18 :01001a1					
NYE					18 :01001a2					
NYE					18 :01348					
NYE					18 :01349					
NYE					18 :01512b1					
NYE					18 :01512b2a					
NYE					18 :01512b3					
NYE					18 :01512k					
NYE					18 :01952a3					

DIST	DEFENDANT NAME	COURT	AUSA	FILED	CHARGE	DISP DT	RESULT	REASON	SNT DT	SENTENCE
NYE					18 :03551					
NYE					21 :00853p					
NYE					28 :02461c					
NYE	Casbarro, Ralph D.	DC	MAA	050818	18:00002					
NYE					18:00002					
NYE					18 :00371					
NYE					18 :01001A2					
NYE					18 :01348					
NYE					18 :01349					
NYE					18 :01512A3					
NYE					18 :01512B1					
NYE					18 :01512B2A					
NYE					18 :01512B3					
NYE					18 :01512K					
NYE					18 :03551					
NYE	Ghysels, Jr., David G.	DC	MAA	050818	18:00002					
NYE					18:00002					
NYE					18 :00371					
NYE					18 :00981a1c					
NYE					18 :01001a1					
NYE					18 :01001a2					
NYE					18 :01348					
NYE					18 :01349					
NYE					18 :01512b1					
NYE					18 :01512b2a					
NYE					18 :01512b3					
NYE					18 :01512k					
NYE					18 :01952a3					
NYE					18 :03551					
NYE					21 :00853p					
NYE					28 :02461c					
NYE	Nwaigwe, Linus	DC	MAA	050818	18:00002					
NYE					18:00002					
NYE					18 :00371					

DIST	DEFENDANT NAME	COURT	AUSA	FILED	CHARGE	DISP DT	RESULT	REASON	SNT DT	SENTENCE
NYE					18 :00981a1c					
NYE					18 :01001a1					
NYE					18 :01001a2					
NYE					18 :01348					
NYE					18 :01349					
NYE					18 :01512b1					
NYE					18 :01512b2a					
NYE					18 :01512b3					
NYE					18 :01512k					
NYE					18 :01952a3					
NYE					18 :03551					
NYE					21 :00853p					
NYE					28 :02461c					
NYE	Picone, Michael A.	DC	MAA	050818	18:00002					
NYE					18:00002					
NYE					18 :00371					
NYE					18 :00981a1c					
NYE					18 :01001a1					
NYE					18 :01001a2					
NYE					18 :01348					
NYE					18 :01349					
NYE					18 :01512b1					
NYE					18 :01512b2a					
NYE					18 :01512b3					
NYE					18 :01512k					
NYE					18 :01952a3					
NYE					18 :03551					
NYE					21 :00853p					
NYE					28 :02461c					
NYE	Leonard, Keevin H.	DC	MAA	050818	18:00002					
NYE					18:00002					
NYE					18 :00371					
NYE					18 :00981a1c					
NYE					18 :01001a1					

DIST	DEFENDANT NAME	COURT	AUSA	FILED	CHARGE	DISP.DT	RESULT	REASON	SNT DT	SENTENCE
NYE					18 :01001a2					
NYE					18 :01348					
NYE					18 :01349					
NYE					18 :01512b1					
NYE					18 :01512b2a					
NYE					18 :01512b3					
NYE					18 :01512k					
NYE					18 :01952a3					
NYE					18 :03551					
NYE					21 :00853p					
NYE					28 :02461c					
NYE	Coughlin, Paul F.	DC	MAA	050818	18:00002					
NYE					18:00002					
NYE					18 :00371					
NYE					18 :00981a1C					
NYE					18 :01001a1					
NYE					18 :01001a2					
NYE					18 :01348					
NYE					18 :01349					
NYE					18 :01512b1					
NYE					18 :01512b2A					
NYE					18 :01512b3					
NYE					18 :01512k					
NYE					18 :01952a3					
NYE					18 :03551					
NYE					21 :00853p					
NYE					28 :02461					
NYE	Deakins, William B.	DC	MAA	050818	18:00002					
NYE					18:00002					
NYE					18 :00371					
NYE					18 :00981a1C					
NYE					18 :01001a1					
NYE					18 :01001a2					
NYE					18 :01348					

DIST	DEFENDANT NAME	COURT	AUSA	FILED	CHARGE	DISP DT	RESULT	REASON	SNT DT	SENTENCE
NYE					18 :01349					
NYE					18 :01512b1					
NYE					18 :01512b2A					
NYE					18 :01512b3					
NYE					18 :01512k					
NYE					18 :01952a3					
NYE					18 :03551					
NYE					21 :00853p					
NYE					28 :02461					
NYE	Alexander, Jacob	DC	IJ	060928	15 :00078					
NYE					15 :00078					
NYE					18 00002					
NYE					18 :00371					
NYE					18 :00981					
NYE					18 :00982					
NYE					18 :01341					
NYE					18 :01343					
NYE					18 :01348					
NYE					18 :01956					
NYE					18 :01957					
NYE					18 :03551					
NYE					21 :00853					
NYE					28 :02461					
NYE	Mitchell, Brian Robert	DC	TYH	060424	18 :01348					
NYE					18 :01348					
NYS	Colon, Filiberto	DC	SM2	040109	18 :00371					
NYS					18 :00371					
NYS					18 :01341					
NYS					18 :01348					
NYS					18 :01349					
NYS	Colon, Luis	DC	SM2	040109	18 :01341					
NYS					18 :00371					
NYS					18 :01341					
NYS					18 :01348					

DIST	DEFENDANT NAME	COURT	AUSA	FILED	CHARGE	DISP DT	RESULT	REASON	SNT DT	SENTENCE
NYS					18 :01349					
NYS	Pianello, Adam	DC	SM2	040109	18 :01341					
NYS					18 :00371					
NYS					18 :01341					
NYS					18 :01348					
NYS					18 :01349					
OHN	Wilson, Peter	DC	JJR	041118	18 :01001					
OHN					18 :01001					
OHN					18 :01348					
OKW	Cooper, Adrian	DC	SW	051117	18 :01348	060327	GT	PLED	060920	75
OKW					18 :01341	060327	DM	GWOD	060920	
OKW					18 :01343	060327	DM	GWOD	060920	
OKW					18 :01348	060327	GT	PLED	060920	
OKW					18 :01956	060327	DM	GWOD	060920	
OKW					18 :01957	060327	GT	PLED	060920	
OKW					42 :00408	060327	DM	GWOD	060920	
PR	Soto-Cruz, Carlos H.	DC	JDN	040412	18 :01341	041008	GT	PLED	050818	
PR					18 :01341	041008	GT	PLED	050818	144
PR					18 :01343	041008	DM	GWOD	050818	
PR					18 :01348	041008	GT	PLED	050818	
SD	Byrd, Diane	DC	RAM	041216	18 :01348	050420	GT	PLED	050727	10
SD					18 :01344	050420	DM	GWOD	050727	
SD					18 :01348	050509	GT	PLED	050727	
TXN	Wannamaker, John	DC	LH	050720	18 :00371	050504	GT	PLED	061025	110
TXN					18 :00371	050504	GT	PLED	061025	
TXN					18 :01343	060919	GT	PLED	061025	
TXN					18 :01348	060919	GT	PLED	061025	
TXN					18 :01956	060919	GT	PLED	061025	
TXN					18 :01957	060919	GT	PLED	061025	
TXN	Price, Patrick	DC	LH	050720	18 :00371	060717	DM	GWOD	061108	
TXN					18 :00371	060717	DM	GWOD	061108	
TXN					18 :01343	060717	DM	GWOD	061108	
TXN					18 :01348	060717	GT	PLED	061108	36Probation
TXN	Saporta, Nancy	DC	LH	050720	18 :00371	060717	GT	PLED	061108	42Probation

TXN					18 :00371	060717	DM	GWOD		
TXN					18 :01343	060717	GT	PLED		
TXN					18 :01348	060717	GT	PLED		
UT	Weeks, Kenneth L.	DC	GCD	050415	18 :01348	051115	GT	PLED	60831	7
UT					18 :01348	051115	DM	GWOD		

* Caseload data extracted from the United States Attorneys' Case Management System
**Kenneth Weeks is listed twice as a defendant but counted only once. Mr. Weeks, a defendant in the Eastern District of New York, was transferred to the District of Utah

Disposition Codes:
DM: dismissed without prejudice
GT: guilty
NG: not guilty
TR: Transfer from district (Rule 20, 21)

Disposition Reason:
DEMD: by defense motion (district court)
GWDD: by government from district court with DOJ authorization
GWOD: by government from district court with no DOJ authorization
JTRD: jury trial verdict (district court)
PLED: Plea (district court)
RTWD: Rule 20 (district court)

Office of
Legislative Affairs

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

December 1, 2006

Mr. Barr Huefner
Hearings Clerk
Committee on the Judiciary
United States Senate
224 Dirksen Senate Office Building
Washington, DC 20510

Dear Mr. Huefner:

Enclosed, please find written responses to a series of questions from Chairman Specter in order to complete the record from the Committee on the Judiciary's hearing entitled "Illegal Insider Trading: How Widespread is the Problem and is there Adequate Criminal Enforcement?" held September 26, 2006. I am also sending you an electronic copy for your convenience.

I hope that the attached responses from Linda Thomsen are helpful to the Committee. As with other issues involving the Commission's responsibilities, we welcome the opportunity to share our views on these matters. If the Committee has additional questions or requires additional materials to complete its hearing record, please do not hesitate to contact me at (202) 551-2010.

Sincerely,

Jane Cobb
Director
Office of Legislative Affairs

Enclosures

United States Senate
Committee on the Judiciary
Questions Submitted for the Record

Linda Thomsen
Director, Division of Enforcement
U.S. Securities and Exchange Commission

"Illegal Insider Trading: How Widespread is the Problem and is there Adequate Criminal Enforcement?"

September 26, 2006

Responses to the follow-up questions posed in Chairman Specter's letter dated October 19, 2006 regarding Linda Thomsen's testimony about Insider Trading on September 26, 2006, are set forth below.

1. **How many times has the SEC sought treble damages in insider trading cases over the past 5 years?**

   The SEC generally seeks treble damages in all of its litigated cases alleging insider trading. Accordingly, over the past 5 years, the SEC has sought treble damages in litigated cases against a total of 63 defendants.

2. **Identify all cases in which the SEC has secured treble damages over the last 5 years?**

   The federal courts granted treble damages against 15 of the 63 defendants against whom the SEC sought treble damages. Thus, the courts imposed treble damages in 23.8% of the instances in which the SEC sought such damages. The 15 instances in which the courts granted the SEC's request for treble damages over the past 5 years are set forth in the chart attached hereto. However, only one of these cases, *David E. Lipson v. SEC*, Civ. Action No. 97 C.2661 (N. D. Ill. Jan. 11, 2001), was the result of a jury verdict. The other awards were made by courts in the context of default judgments, bench trials or on the Commission's motions for summary judgment before trial.

3. **Please report what, if anything, the Securities and Exchange Commission has done with respect to the Measuredmarkets, Inc. Report on merger and acquisition activity suggestive of insider trading?**

   Even before the publication of the New York Times article, the SEC's Division of Enforcement, through its ordinary processes, had independently commenced insider trading investigations into the majority of the transactions identified by

Measuredmarkets as "hits" on the basis of aberrant trading activity in advance of the public announcement of the transaction. The SEC's ongoing insider trading investigations were commenced primarily on the basis of referrals from various SROs through the Intermarket Surveillance Program previously described in my written testimony.

To date, the SEC has commenced investigations into approximately 65% of the hit transactions. An additional 25% of the hit transactions had been independently investigated by the SROs, but those investigations were closed without further action and did not result in referrals to the SEC. The remaining 10% of the hit transactions are still under investigation at the SRO level and may or may not result in additional referrals to the SEC.

Accordingly, 100% of the transactions identified as hits in the Measuredmarkets spreadsheet have been, or are being, investigated by the SEC and the SROs. In addition, the SEC and SROs independently commenced investigations into a substantial number of the transactions identified in the Measuredmarkets spreadsheet as "maybe" or "no" regarding potential insider trading.

As a point of information, the SEC's approximate percentage figures set forth above are based on all 46 transactions identified as hits by Measuredmarkets. The Times article stated that there were only 37 hits, and later stated there were 38, so the reporter apparently eliminated 8 or 9 of the hits (or about 20% of the total of 46) from further consideration for the article. The SEC has no information as to which transactions the Times reporter excluded and therefore used the total of 46. It should be noted, however, that the Times' exclusion of approximately 20% of the Measuredmarket hits is roughly consistent with the SROs' determination that their investigations into approximately 25% of the hit transactions should be closed without further action. The SEC's Office of Market Surveillance has reviewed and concurs in the SROs' determination that those transactions did not warrant further investigation or referral to the SEC.

4. What is the SEC's view as to the efficacy of the underlying data and analysis in the Measuredmarkets Report?

The SEC's Enforcement Division, Office of Economic Analysis and Office of Market Surveillance have reviewed the Measuredmarkets spreadsheet, but the SEC has only limited information regarding the underlying data and analysis, as Measuredmarkets considers its analytical methods to be proprietary. We understand the spreadsheet identifies transactions in which there was aberrational trading activity in advance of the public announcement of the transaction and an apparent absence of public information or events that might explain the aberration. Since all but one of the 46 transactions identified as hits by Measuredmarkets independently generated automated trading alerts at the respective SROs, the SEC has no reason to believe that the Measuredmarkets spreadsheet does not accurately identify aberrational trading activity.

The SEC takes issue, however, with the apparent conclusion that aberrational trading patterns necessarily suggest insider trading. The Measuredmarkets spreadsheet data, as interpreted by the New York Times reporter ("MM/NYT"), proceeds by process of elimination. Upon establishing an aberrational trading pattern, MM/NYT seeks to find publicly known information or events that might account for it. In the absence of such public announcements or events, MM/NYT suggests that the activity necessarily must have been the result of insider trading. But that conclusion may be inaccurate, as the aberrational trading pattern may result from any number of other factors. For example, traders often proceed on the basis of rumor, intuition or hunch. Some traders may have observed a specific industry for years and may simply view a particular company as ripe for acquisition. Others may notice a spike in trading volume in a stock and trade only because they see others doing so. These factors may provide legitimate alternative explanations for an aberrational trading pattern, but there may be no public record that these factors were at work. In such cases, based on the apparent lack of public information, the MM/NYT methodology could generate false hits.

Aberrational trading activity alone does not establish potential insider trading. Before any such conclusion can be drawn, the type of aggregate trading information relied on by Measuredmarkets must be broken down into specific trades by specific traders in order to identify which traders may have had access to, and traded on, material nonpublic information. To our knowledge, Measuredmarkets does not have access to the kind of detailed trading records that would enable it to establish a demonstrable link between aberrational aggregate trading patterns and any specific instances of insider trading.

Through the Intermarket Surveillance Program, the SEC and the SROs have full access to precisely the type of detailed trading records necessary to determine whether there is a credible link between aberrant trading patterns and potential insider trading. The SROs' trading records reveal the identities of the traders, the size and frequency of specific trades and the timing of specific trades in relation to the release of public information. Based on this information, the SROs also have the ability to conduct followup investigations. For example, in insider trading investigations, the SROs routinely request that companies survey their employees to identify any contacts the employees may have had with a list of persons identified as traders. Because of the availability of detailed trading records and related information, the SEC and SROs have the ability to conduct much more focused investigations of whether aberrational trading patterns were caused by possible insider trading, and the results of those investigations are likely to be far more reliable than conclusions based on the Measuredmarkets methodology.

5. **What, if anything, is the SEC going to do in the future to stem the tide of unlawful insider trading in advance of mergers and acquisitions?**

   The SEC will continue to use every tool available to it to combat insider trading, particularly the Intermarket Surveillance Program. Since 45 of the 46 hits identified by Measuredmarkets also generated automated trading alerts and followup investigations at the SROs, the Measuredmarkets spreadsheet itself confirms that the SROs' surveillance systems are highly effective in identifying aberrant trading patterns. Moreover, detailed trading records and other investigative tools available to the SROs ensure that they will continue to have the ability to make reliable insider trading referrals to the SEC. The SEC will support and coordinate with the SROs in their ongoing efforts to further improve the Intermarket Surveillance Program. Notably, the SEC is presently assisting the SROs in a effort to track potential flows of inside information in market transactions. In addition, the SEC is an active participant in the monthly meetings organized by the SROs to combat insider trading. The SEC also intends to study the referrals it has received from the SROs in recent years and the resulting SEC enforcement investigations in order to further improve the referral process and to ensure that referrals are consistent with SEC and SRO enforcement priorities.

6. **Would the SEC support legislation to address the adverse rulings in the Scrushy and Stringer district court opinions raised at the hearing?**

   We believe *Scrushy* and *Stringer* were wrongly decided and run counter to the substantial weight of federal case law endorsing cooperation between the Department of Justice and the SEC. Consistent with our view, most federal courts in subsequent cases have not followed the logic underlying *Scrushy* and *Stringer*, most recently in *United States v. Luce*, No. 05 CR 340, 2006 WL 2850478 (N.D. Ill. Sep. 29, 2006) (Manning, J.) and *United States v. Mahaffy*, 446 F.Supp.2d 115 (E.D.N.Y. 2006). Since *Stringer* is presently on appeal, we believe the optimal solution would be for the Ninth Circuit Court of Appeals to reverse the district court's opinion. If the Ninth Circuit does not reverse the lower court's opinion, however, the Enforcement Division would revisit the advisability of legislation.

SUBMISSIONS FOR THE RECORD

TESTIMONY OF

LAURA N. BENY
UNIVERSITY OF MICHIGAN LAW SCHOOL

ON UNLAWFUL INSIDER TRADING

BEFORE THE

SENATE JUDICIARY COMMITTEE
UNITED STATES SENATE

SEPTEMBER 26, 2006

Evidence on Insider Trading Laws and Stock Markets

Chairman Specter and Members of the Senate Judiciary Committee: Thank you for inviting me to submit written testimony to your hearing on unlawful insider trading. I am an Assistant Professor of Law at the University of Michigan Law School, where I teach courses on Corporate Law, Corporate Finance, International Finance, and Stock Market Development. Before joining Michigan Law School in 2003, I practiced corporate law at Debevoise and Plimpton LLP in New York City.

I have conducted several empirical research studies on insider trading laws and their enforcement across countries. In this testimony, I present a brief overview of the academic debate about insider trading and its regulation and a summary of some of my research findings. I conclude by discussing the implications of my research for the insider trading debate in the United States.

1. Overview of the Insider Trading Debate

The academic debate about the desirability of prohibiting insider trading is long-standing and as yet unresolved. Until Henry Manne's 1966 book, *Insider Trading and the Stock Market*,[1] the debate centered on whether insider trading is unfair to public investors who are not privy to private corporate information.[2] However, the fairness

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[1] HENRY G. MANNE, INSIDER TRADING AND THE STOCK MARKET (1966).

[2] *See, e.g.*, Roy A. Schotland, *Unsafe at Any Price: A Reply to Manne, Insider Trading and the Stock Market*, 53 Virginia Law Review, 1425 (1967). *See also* Victor Brudney, *Insiders, Outsiders and Informational Advantages Under the Federal Securities Laws*, 93 HARV. L. REV. 322, 334 (1979) ("the

approach is malleable and indeterminate and thus does not lend itself to clear-cut policy prescriptions.[3] Since Manne's book, the focus of the debate has been on the effect of insider trading on economic efficiency. Manne argued that, contrary to the prevailing legal and moral opinion of the time, insider trading is desirable because it is economically efficient and thus ought not to be regulated. In contrast, Manne's critics argue that insider trading is inefficient and thus ought to be regulated.

In brief, legal scholars who believe that insider trading is efficient and thus ought not to be prohibited maintain that insider trading increases managers' (and other insiders') incentives to behave in the interest of stockholders; makes stock prices more informationally efficient (that is, more accurate); and/or does not decrease the liquidity of the stock market. In contrast, legal scholars who believe that insider trading is inefficient and thus ought to be prohibited argue that insider trading reduces managers' (and other insiders') incentives to behave in the interest of stockholders; makes stock prices less informationally efficient (that is, less accurate); and/or decreases stock market liquidity.

The legal academic literature on insider trading suffers from a few significant shortcomings. One problem with this literature is that the scholarly debate fails to identify a specific efficiency locus. The academic inquiry varies from examinations of the narrow effects of insider trading on efficiency at the firm level (so-called agency theories of insider trading) to work studying the broader effects of insider trading on stock market efficiency (so-called market theories of insider trading). It is possible, however, that insider trading may enhance efficiency within the firm, but that markets in which insider trading is permitted are thereby less efficient in the aggregate. Researchers who focus their studies at different levels and report different results could be talking past each other. A second, major shortcoming of the law and economics literature on insider trading is that it is insufficiently grounded in empirical evidence.[4] Beginning with

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antifraud provisions [of U.S. securities laws] are said to serve principally a protective function – to prevent overreaching of public investors – and only peripherally an efficiency goal").

[3] U.S. insider trading law doctrine demonstrates this confusion and ambiguity. *See generally* Stephen M. Bainbridge, *Insider Trading, in* THE ENCYCLOPEDIA OF LAW & ECONOMICS 772 (Vol. III, Edward Elgar Publishing, 2000); Stephen M. Bainbridge, *The Insider Trading Prohibition: A Legal and Economic Enigma*, 38 U. Fla. L. Rev. 35 (1986); Frank H. Easterbrook, *Insider Trading, Secret Agents, Evidentiary Privileges, and the Production of Information*, 1981 Sup. Ct. Rev. 309, 309-339.

[4] Yet, as Professors Carlton and Fischel note, the "desirability of [regulating] insider trading is ultimately an empirical question." Dennis W. Carlton & Daniel Fischel, *The Regulation of Insider Trading*, 35 STAN. L. REV. 857, 866 (1983).

Manne's seminal argument, legal academic scholarship on insider trading has been largely speculative and theoretical. Moreover, few scholars sought to examine the impact of insider trading rules in a comparative context. However, without variation in insider trading rules and enforcement, one cannot test causal hypotheses about the effects of such rules and their enforcement.

2. Summary of Beny's Empirical Findings

In contrast to most of the existing legal scholarship on insider trading, my research is empirical and comparative.[5] In the study "*Insider Trading Laws and Stock Markets Around the World*," which I summarize in this brief written testimony, I investigate whether insider trading laws and enforcement are systematically related to stock market performance across countries.[6] I formulate three testable hypotheses, which are that countries with more stringent insider trading laws have (a) more widespread equity ownership; (b) more informative stock prices; and (c) more liquid stock markets, other things, including enforcement history and potential, equal. To test these hypotheses, I constructed an index of the stringency of insider trading laws for 33 countries as of the mid-1990s.

Using simple correlations and multivariable regression analysis, I find that countries with more stringent insider trading laws have more dispersed equity ownership; more liquid stock markets; and more informative stock prices, consistent with the

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[5] My empirical studies include: Laura N. Beny, *Insider Trading Laws and Stock Markets around the World: An Empirical Contribution to the Theoretical Law and Economics Debate*, J. CORP. L., Forthcoming 2007 [hereinafter Beny, *Insider Trading Laws and Stock Markets*]; *Do Investors Value Insider Trading Laws? International Evidence*, Michigan Law and Economics Research Paper No. 06-003 (2006); *Do Insider Trading Laws Matter? Some Preliminary Comparative Evidence*, American Law and Economics Review V7 N1 (2005) [hereinafter Beny, *Do Insider Trading Laws Matter?*]; and *The Political Economy of Insider Trading Legislation and Enforcement: International Evidence*, Harvard Law and Economics Discussion Paper No. 348 (2002) (2006 version on file with the author). My research contributes to the large and ever-expanding empirical law and finance literature. *See, e.g.*, Rafael La Porta, Florencio Lopes-de-Silanes, Andrei Shleifer, & Robert Vishny, *Legal Determinants of External Finance*, 52 J. FIN. 1131 (1997); Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer, & Robert Vishny, *Law and Finance*, 106 J. POL. ECON. 1113 (1998); Lucian Bebchuk & Mark Roe, *A Theory of Path Dependence in Corporate Governance and Ownership*, 52 STAN. L. REV.127 (1999); John Coffee, *The Future as History: The Prospects for Global Convergence in Corporate Governance and its Implications*, 93 NW. L. REV. 641 (1999); John C. Coffee, *The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control*, 111 YALE L.J. 3 (2001); Rafael La Porta, Florencio Lopez-de-Silanes, & Andrei Shleifer, *What Works in Securities Laws?*, 61 J. FIN. 1 (2006); Simeon Djankov, Rafael La Porta, Florencio Lopez-de-Silanes, & Andrei Shleifer, *The Law and Economics of Self-Dealing* (2006) (unpublished working paper, on file with the author).

[6] Beny, *Insider Trading Laws and Stock Markets*, *id.*

formulated hypotheses. The following three figures, excerpted from my study "*Insider Trading Laws and Stock Markets*," demonstrate these findings visually. Figure 1 shows that the countries in my sample that have more stringent insider trading laws tend to have lower average equity ownership concentration (that is, more dispersed share ownership) among their 10 largest non-financial firms.

Figure 1: Average Ownership Concentration Plotted Against Insider Trading Law Index

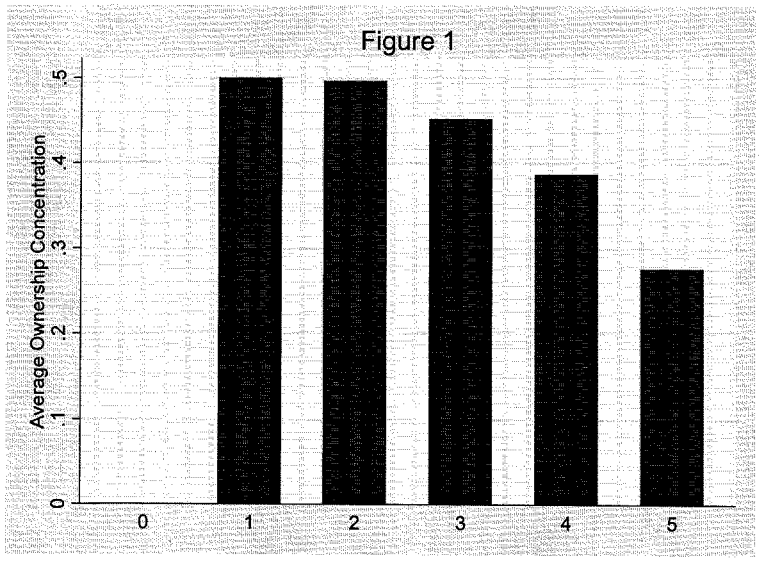
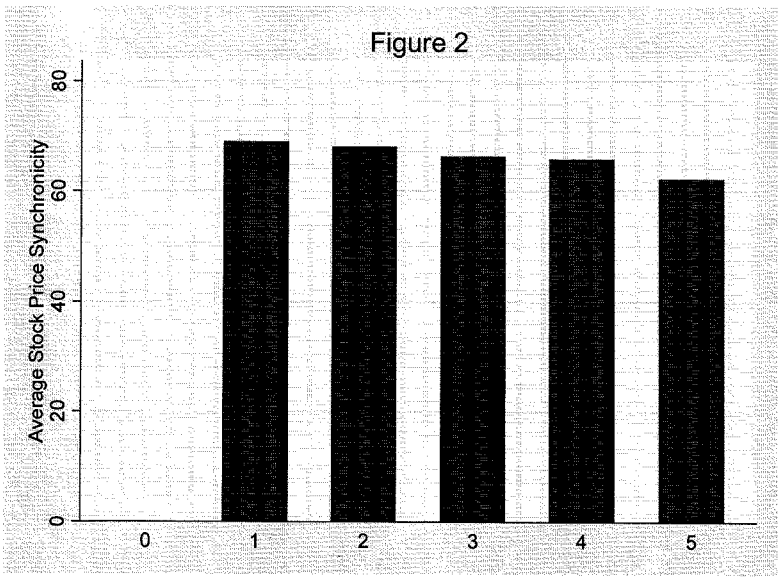


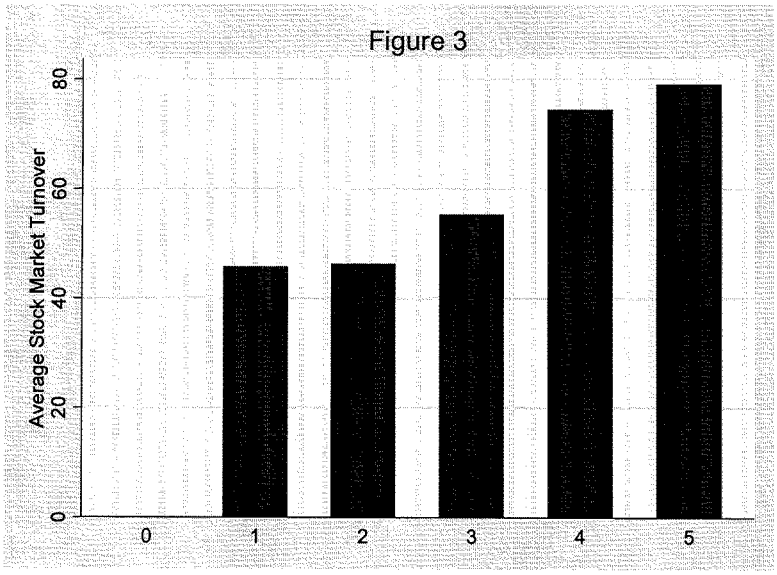
Figure 2 illustrates that the countries with more stringent insider trading laws also tend to have more informative stock prices, as measured by stock price synchronicity. (Stock price synchronicity is a measure of the degree to which the stock prices of different firms move together, with greater co-movement suggesting that stock prices are less informative about firm-specific information).

Figure 2: Average Stock Price Synchronicity Plotted Against Insider Trading Law Index



Finally, Figure 3 shows that the countries with more stringent insider trading laws tend to have greater average stock market turnover (a measure of liquidity) than countries with less stringent insider trading laws.

Figure 3: Average Stock Market Turnover/Liquidity (1991-1995) Plotted Against Insider Trading Law Index



I confirm these patterns when I conduct multivariable regression analysis to control for other factors, including past enforcement history and enforcement potential.[7] Furthermore, my regressions strongly suggest that *the possibility of stringent criminal or monetary sanctions, rather than the breadth of the insider trading prohibition, is the more salient feature of countries' insider trading laws.* Criminal and civil sanctions are more frequently significant than the scope of the insider trading prohibition in the

[7] Given the necessary brevity of my written testimony, I do not report my regressions here. For greater detail and discussion, please refer to Beny, *Insider Trading Laws and Stock Markets, id.*

regressions that I report in the article. Stringent public enforcement also seems to be more important than private enforcement mechanisms.[8]

3. Implications of Beny's Empirical Research for the U.S. Insider Trading Debate

My results are consistent with (but do not prove) the claim that insider trading laws have a positive impact on stock markets. More liquid stock markets and more accurate stock prices reduce the overall cost of equity capital and improve the efficiency of capital allocation, respectively. Private parties would be unlikely to give adequate consideration to these external benefits, if insider trading were left to private contracting (that is, if firms and shareholders were permitted to set the firm's insider trading policy in place of insider trading regulation). My findings thus support the case for public regulation and correspondingly weaken the case for deregulation of insider trading. Furthermore, to the extent that insider trading regulation encourages more accurate stock prices and greater stock market liquidity, regulation might indirectly ameliorate corporate agency problems, as more accurate stock prices and greater liquidity facilitate improved corporate governance and the market for corporate control. The United States has the most stringent insider trading rules and enforcement in the world and recent empirical evidence, including my own, suggests that this might be at least one reason why investor confidence is greater in our stock markets than in many other stock markets of the world. If insider trading laws are detrimental, as Professor Manne and others have posited, the patterns I find would have been unlikely.

It is premature, however, to claim that the debate between proponents and opponents of insider trading laws has now been empirically resolved. My results must be viewed cautiously for several reasons. One reason for caution is the crude nature of the available variables and the small sample of available countries. It is some consolation that these limitations might be expected to reduce the likelihood of finding significant relationships, but they nonetheless suggest a need for cautious interpretation. Finally, although my empirical results show a significant relationship between insider trading laws and various measures of stock market performance, they do not prove causality.

The appropriate conclusion to reach from this research is not that the arguments

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[8] *See* Beny, *Do Insider Trading Laws Matter?*, *supra* note 5.

of proponents of insider trading regulation have been shown to be sounder than the arguments of those who criticize such regulation, but rather that there is somewhat more reason to believe in their soundness than there was before this study was conducted. There is also need for further empirical research into these issues, including the assembly of more adequate cross-sectional data sets. My research is but a first step. It will help resolve the theoretical conflict (and perhaps contribute to the articulation of a more coherent insider trading doctrine in the United States) only if additional empirical work follows.

Testimony of Professor John C. Coffee, Jr.

Adolf A. Berle Professor of Law
Columbia University Law School

Before the Senate Judiciary Committee
On September 26, 2006

"INSIDER TRADING: CAUSES, ENFORCEMENT, AND PREVENTION"

Executive Summary

Professor Coffee's testimony addresses the following principal topics:

1. Has there been a recent increase in insider trading? No generally recognized measure exists, but the press report that the number of referrals to the SEC by the market surveillance unit of NYSE Regulation Inc. rose significantly in 2006 is certainly plausible evidence of some increase.

2. What could be causing any increase in suspicious trading? Insider trading is usually linked to merger and acquisition activity, but "M&A" levels are down in 2006 in terms of the number of deals (but up in terms of the dollar value). Other factors might loom larger in causing any increase, and these would include:

(1) the rise of the hedge funds;

(2) the increase in multi-player friendly buyouts (which make confidentiality restrictions hard to enforce); and

(3) the growth of global trading and the availability of foreign havens.

3. Who is injured by insider trading? Everyone. It is not just shareholders or the corporation (either the acquirer or the target). As informed traders increase their trading upon asymmetric information, bid/asked spreads are likely to widen on all stocks (thus increasing the cost to investors to trade). Ultimately, insider trading causes the cost of equity capital to rise, and this in turn has a macro-economic effect on GNP, employment, and the economy as a whole. As a result, it is not just investors who suffer, but all who are impacted by (marginally) reduced economic growth.

4. What works to curb insider trading? Worldwide, there is evidence that criminal prosecutions do deter insider trading (and reduce the cost of equity capital). The problem

for the United States is that it has reached the point of diminishing returns in its ability to deter by increasing authorized penalty levels. Since the time of Cesare Beccaria in the late 18th Century, most criminologists have agreed that the likelihood of apprehension is a more important variable than the severity of the sanction in the deterrence equation.

Other preventive measures could discourage insider trading at fairly low cost: (1) a pre-transaction public notification requirement requiring insiders to disclose an "intention to trade" in a specific amount prior to trading; (2) mandatory confidentiality restrictions that the corporation would be required to impose in certain transactions (most importantly, PIPE transactions – "Private Investment in Public Equity"); (3) advance scheduling of stock option awards, etc. These are not, however, within the jurisdiction of this committee, and so they will not be discussed in detail.

5. What, if any, current problems hobble the enforcement of the insider trading prohibition? Here, there is one new development. Enforcement of the insider prohibition in the United States has depended on close cooperation between the SEC, the NYSE, and the Department of Justice. In other jurisdictions, prosecutors have not been successful in prosecuting insider trading (Canada and Great Britain are relevant examples where despite strong regulatory agencies, criminal prosecutions are rare to non-existent). The inability to prosecute insider trading criminally in these jurisdictions seems attributable to restrictions on close cooperation between civil and criminal regulators. Today, close cooperation between civil and criminal enforcers in the United States is threatened by two recent federal district court decisions that chill their ability to cooperate: United States v. Scrushy, 366 F. Supp. 2d 1134 (N.D. Ala. 2005); United States v. Stringer, 408

F. Supp. 2d 1083 (D. Ore. 2006). Both decisions, particularly the former, seem ill-considered.

6. What could Congress do? To the extent that a Court bases its decision on due process or the Constitution generally, Congress is without power to overrule it, even prospectively. But the Scrushy decision was rested instead on the Court's claimed "supervisory authority over the manner in which Federal agents exercise their power." Id. at 1137. Congress can address that, and it can clarify that Federal agents may cooperate more fully than that the Scrushy Court would allow. Indeed, Congress had already authorized cooperation between the SEC and U.S. Attorneys in § 21(d)(1) of the Securities Exchange Act of 1934, but that provision can be read narrowly. In short, cooperation could easily be chilled by these recent decisions, and Congress therefore would be well advised to amend Section 21(d) to permit cooperation and to indicate that advance notice need not be given to a deponent in an SEC investigation that a U.S. Attorney may have an interest in his testimony or may have suggested specific questions.

TESTIMONY

I want to thank the Committee for inviting me to testify, and I will get directly to the point by breaking my testimony into subheadings.

1. Has there been an increase in insider trading? The "new" conventional wisdom is that insider trading has increased with a recent rise in the level of merger and acquisition activity. Such a correlation is far from new. Ivan Boesky achieved a still unequaled level of infamy for his insider trading on "M and A" transactions in the 1980s. Predictably, insider trading should rise and fall with the level of "M and A" activity, because no other category of information is as clearly material. But it is not clear that

"M&A" activity has actually risen, as the number of deals this year is down from the corresponding period last year, even if their dollar volume has increased.[1] Some have suggested that this increase is attributable to less active enforcement by the SEC in insider trading cases. I do not endorse the view (if anyone actually takes it) that the SEC is "soft" or "passive" about insider trading, but the SEC's enforcement staff has multiple priorities: accounting irregularities, market timing in mutual funds, backdating of stock options, unregistered sales of securities, etc. And its enforcement resources are necessarily limited. Even more importantly, the SEC can only enforce the law when it has evidence of a violation, and therein lies the rub. Although individuals tend to make poor inside traders, often leaving clumsy, messy footprints, institutions know how to leave a clueless trail.

The best evidence of an increase in insider trading lies in the higher number of referrals made this year to the SEC by the market surveillance unit of New York Stock Exchange Regulation Inc.[2] Still, an increase in regulatory referrals does not imply regulatory passivity. What then has changed that could explain the apparent increase in suspicious trading?

Three possibilities stand out:

a. The Rise of the Hedge Funds. For better or worse, hedge funds are the principal destabilizing force in corporate governance today. Hedge funds are different than mutual funds in two principal respects: (1) they need not diversify (and many do not), and (2) they can sell short. As a practical matter, mutual funds and pension funds do neither; the

[1] See Gretchen Morgenson, "Whispers of Mergers Set Off Bouts of Suspicious Trading," New York Times, August 27, 2006, Section 1, at p. 1.
[2] Id. (reporting that there were 76 such referrals for the first six months of this year, up from 60 for the same period in 2005. In turn, 2005 was up by 63% over 2004.)

former must diversify, and latter are largely indexed. Hence, neither is as prepared to make a large firm-specific investment as a hedge fund. That's part of the story, but there is another racier part: hedge funds are unregulated, and their managers are not monitored as closely by compliance officers and counsel. Hence, hedge fund behavior may often resemble the Wild West (remember Clint Eastwood in "The Good, The Bad, and The Ugly"?). But who leaks to a hedge fund? After all, they are not loved by the business community. Here, the answer may be that because they trade in larger increments than more diversified institutional investors, they will also pay more for useful tips. This point has a further implication: as usual, the most promising prosecutorial strategy is to "follow the money."

b. The increase in friendly, multi-player deals. Once, hostile deals dominated the scene, and then relatively few knew of an approaching hostile takeover (basically, only the bidder, its lawyers, investment bankers and the commercial bank financing it). More recently, "friendly" leveraged buy-outs have predominated. With this shift, the number who are aware of the transaction in advance of its announcement increases exponentially: target management, multiple private equity firms who are cooperating in the bid, creditors who must consent, plus the usual cadre of lawyers, investment bankers, etc. With each additional player, the risk that information will leak goes up significantly.

c. Global Markets. Off-shore trading is probably the one strategy for which the SEC does not have a ready response. If suspicious trading occurs though a U.S.-based brokerage account, the SEC can find out the identity of the trader from the U.S. broker quickly and easily. But if the trading originates from an overseas account with a non-U.S. broker, detection becomes more difficult.

What do these factors imply in combination? Although some insider trading will be the result of individuals tipping friends and co-conspirators, the lion's share should logically be the product of institutional activity, particularly in the case of short-selling and overseas trading. Institutions can trade in larger volume and can establish overseas havens for trading purposes.

2. What Steps Might Reduce the Incidence of Insider Trading? Sarbanes-Oxley has already elevated the penalty levels for securities fraud to 25 years and mail and wire fraud to 20 years. Thus, we have reached the point of diminishing returns on this front. Greater funds could be invested in enforcement, but the payoff is uncertain.

So what policy reforms make sense and are feasible? Basically, greater reliance needs to be placed on stronger internal controls. In the case of the corporate executive, the basic strategy should be to reduce the executive's discretion over the timing of corporate disclosures because the executive can manipulate timing in order to trade profitably. For example, if the executive can effectively pick the date of a stock option grant (as he often can today), the executive can exploit either favorable or unfavorable information (or both) to inflate the value of the grant – that is, by releasing negative information before the award to drive the price down, then releasing positive information afterwards (a practice already known as "springloading"). The result is that the stock option is awarded at the base of sharp, but manipulated, vortex in the stock's trading price. This practice may or may not constitute "insider trading,[3] but it is clearly manipulative and in violation of Rule 10b-5 and should be halted.

[3] This question depends largely on whether the board committee that awarded the options was aware of the material, nonpublic information that the executive knew. See SEC v. Texas Gulf Sulphur, 401 F.2d 833, 856-57 (2d Cir. 1968). At the time of the option grants in Texas Gulf Sulphur, neither the Texas Gulf Sulphur board nor its stock option committee was aware of the material information about TGS's ore

The simplest means to restrict such practices would be to require public corporations to issue options only on a scheduled basis – that is, on the same date each year or at least on a date announced several months in advance. Presumably, the date chosen in advance would be during a window period following the filing of the corporation's quarterly report on Form 10-Q. This is already the better corporate practice, but today most options are still awarded on an unscheduled basis, and the empirical evidence suggests that much more manipulation has surrounded the use of unscheduled than scheduled options.[4] The cost to the corporation of such a reform is low, and exceptions could be recognized, permitting the award of unscheduled options to non-insiders (for example, to an incoming employee who would not be one of the corporation's most highly compensated employees).

Similarly, reasonable controls could limit the insider's ability to exploit other forms of material nonpublic information. Executives can often exploit material nonpublic information by trading sufficiently in advance of the public release of that information as to make their trading appear unrelated to that release. Here, the better answer may not be thirty year criminal sentences or enormous SEC civil penalties, but a requirement that the executive disclose to the market and the SEC an "intent to trade" some short period of time before the executive (or his affiliates) buys or sells in any substantial quantity. Professor Jesse Fried was the first to advance such a pre-transaction notification

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discovery, but most of the option recipients were aware. 401 F.2d at 844. The Second Circuit indicated that it would enjoin those options that had not already been voluntarily cancelled. Id. at 856-57. Ultimately, the injunction of the one stock option award that had not been cancelled was vacated on other grounds. See SEC v. Texas Gulf Sulphur, 446 F.2d 1301, 1308-09 (2d Cir. 1971).

[4] See Randall Heron and Erik Lee, "What fraction of stock option grants to top executives have been backdated or manipulated?" (July 14, 2006) at Table 4.

requirement,[5] and it could realistically be limited to trading over some cut-off level (say 1,000 shares). Recently, the Canadian Task Force on Modernizing Securities Regulation (on which this author served) recommended that insiders be required to give the market at least seven days notice of their intention to sell. Although seven days may be somewhat longer than necessary, the impact of such a rule should be obvious: if the chief financial officer announces an intent to sell 25% of his holdings, the entire market could frontrun him. The negative price impact that large insider sales announced in advance would likely cause might render senior executives less liquid, in effect locking them into a longer-term holding. Depending on your perspective, this is not a cost, but an added benefit, because it more closely aligns their interests with those of long-term, "buy and hold" shareholders.

These reforms will not be as effective, however, in reducing insider trading by hedge funds and other actively trading institutions. One could imagine strict prophylactic rules so that a buyout or other private equity fund that participated in a buyout or LBO transaction had to surrender all profits made from trading in the subject corporation's stock for a specified period – say, six months – prior to the transaction. However, such a sweeping proposal may not be needed, because it seems unlikely that the buyout or private equity firms are, themselves, trading in anticipation of merger activity. Rather, the more likely scenario is that information is leaked by their staffs and by investment bankers to hedge funds and other active traders. These leaks are, however, not gratuitous; they are predictably in return for some likely quid pro quo. As hedge funds have come to dominate trading, they are often paying above market brokerage commissions, at least in

[5] See Jesse Fried, Reducing the Profitability of Corporate Insider Trading Through Pretrading Disclosure, 71 S. Calif. L. Rev. 303 (1998).

comparison to other institutional investors. The funds paying these above-market commissions expect many things in return: (1) priority in the allocation of hot IPOs, (2) the privileged access to sell-side security analyst research (i.e., the first look); and (3) hints about pending deals. The recent IPO "laddering" investigation shows how incestuously hedge funds and investment banks can cooperate in activities that were clearly over the line.

How then can we best discourage the tipping of inside information to them? Using our earlier proposed remedy for insiders, one obvious analogy would be pre-trading notification to the SEC. This would not require the same elaborate disclosure as does Schedule 13D under the Williams Act, because there would be no need to disclose the investment purpose or source of funds, but only the intent to make a large trade over a specified cutoff level. Nonetheless, I recognize that these proposals fall within the jurisdiction of other committees, and hence I will not elaborate on them further.

3. Can Congress make law enforcement more effective against insider trading? Congress can, of course, always appropriate more money for securities enforcement, or it could earmark funds specifically for the prosecution of insider trading – but this Committee does not need a law professor to tell it what it already knows. Nor is it always wise to limit funds to the enforcement of insider trading, as most forms of securities fraud have the same effect on investors, and different abuses flourish at different times.

Still, Congress can seek to make securities enforcement more efficient. Since at least the 1980s, the enforcement of insider trading has usually begun with warning signals from the market surveillance units of the NYSE and Nasdaq, which can effectively detect suspicious trading. The problem lies in moving from suspicion to proof.

a. Revising the Mens Rea Level. One possible approach to simplify enforcement (which I do not recommend) would be to lower the mens rea level that the Government must prove in a criminal prosecution. Under both Section 24 of the Securities Act of 1933 (15 U.S.C. § 77x) and Section 32(a) of the Securities Exchange Act of 1934 (15 U.S.C. § 78ff(a)), the Government must show that the defendant "willfully" violated an SEC rule or statutory provision (usually Rule 10b-5 or Rule 14e-3). The Second Circuit construed this willfulness requirement in United States v. Peltz, 433 F.2d 48, 54 (2d Cir. 1970), cert. denied, 401 U.S. 955 (1971), to require a showing of "a realization on the defendant's part that he was doing a wrongful act ... with the qualifications ... that the act be wrongful under the securities laws and that the knowingly wrongful act involve a significant risk of effecting the violation that has occurred."[6] Hence, good faith on the defendant's part is a viable defense to a securities fraud charge.[7] Subsequent cases have liberalized this test slightly by finding that the requisite willfulness can be found if the defendant deliberately closed his eyes to facts that he had a duty to see." United States v. Benjamin, 328 F.2d 854, 863 (2d Cir.), cert. denied, 377 U.S. 953 (1964). Modifying the mens rea level strikes me as fundamentally unfair given the ambiguity that often surrounds insider trading.

b. Preserve Parallel Proceedings. The SEC and the Department of Justice ("DOJ") frequently conduct parallel civil and criminal investigations, and the SEC often shares the fruits of its investigation with the DOJ. See United States v. Kordel, 397 U.S. 1 (1970); SEC v. Dresser Industries, 628 F.2d 1368 (D.C. Cir. 1980); United States v. Field, 592

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[6] For related decisions on the mens rea level, see United State v. Dixon, 536 F.2d 1388, 1397 (2d Cir. 1976); United States v. Schwartz, 464 F.2d 494, 509 (2d Cir. 1972).
[7] See Wall v. United States, 384 F.2d 758, 762 (10th Cir. 1967); see also Matthews, Criminal Prosecutions Under the Federal Securities Laws and Related Statutes, 39 Geo. Wash. L. Rev. 901 (1971).

F.2d 638, 696 (2d Cir. 1978); Bass v. United States, 409 F.2d 179, 180 (5th Cir. 1979). In fact, Section 21(d)(1) of the Securities Exchange Act of 1934 expressly authorizes the SEC to "transmit such evidence as may be available concerning such acts or practices as may constitute a violation of any provision of this title or the rules or regulations thereunder to the Attorney General, who may, in his discretion, institute the necessary criminal proceedings under this title." Congress was aware of and has approved this pattern of frequent information sharing. See Senate Committee Report on Foreign Corrupt Practices Act, S. Rep. No. 114, 95th Congress, 1st Session 12 (1977). In my experience, SEC Attorneys are often delegated to work with U.S. Attorneys on criminal cases, and they sometimes become Acting Assistant U.S. Attorneys for the duration of the criminal investigation.

In my judgment, this ability of the civil authorities to aid and assist the criminal enforcer is critical to effective law enforcement in securities fraud cases. I have spent the last two years as a member of a Canadian Task Force (the Task Force on Modernizing Securities Regulation) that has examined the need for changes in Canadian securities law. In particular, the Task Force focused on the inability of Canadian authorities to prosecute successfully criminal insider trading cases. We found that a major obstacle was that under Canadian law the civil regulators could not assist the criminal prosecutor. At least partially as a result of this problem, criminal insider trading cases are almost unknown in Canada, and much evidence suggests that insider trading is unchecked in the Canadian markets. Great Britain has had a similar experience and has largely abandoned criminal enforcement of insider trading. Unfortunately, nothing deters as well as the threat of jail.

Thus, the ability of the SEC to gather and provide information to the U.S. Attorney may be critical to effective enforcement. But that ability is today in jeopardy as a result of the decisions in United States v. Scrushy, 366 F. Supp. 2d 1134 (N.D. Ala. 2005) and United States v. Stringer, 408 F. Supp. 2d 1083 (D. Ore. 2006). In Scrushy, the SEC was investigating the defendant in a civil proceeding, and the U.S. Attorney's office in the Northern District of Alabama contacted the SEC's attorney and suggested both questions that might be asked by the SEC (and questions that should not be asked because it might warn Mr. Scrushy that a criminal investigation was underway). Also, the U.S. Attorney asked the SEC's attorney to move the deposition to a location within its jurisdiction. In so doing, the Scrushy Court found that the Government had set a "perjury trap" for the defendant and so suppressed, on the defendant's motion, the SEC deposition testimony given by Scrushy (which had resulted in a perjury indictment in the Northern District of Alabama). By forcing the Government to abandon its perjury count, the Court may have enabled Mr. Scrushy to escape conviction (in that case).

Why the Court should consider such cooperation to amount to a "perjury trap" is not clear to me. Presumably, the defendant must have known that if he lied at his sworn deposition before the SEC, he was subject to a criminal prosecution for perjury. No special warning should be necessary that you could be prosecuted if you lie. The potential impact of the Scrushy decision is that the defendant might have to be given a special warning if the U.S. Attorney has an advance interest in his testimony, and this might give some defendants a sense of relative immunity when they received no such warning. Put simply, there should be no "right to lie," and if the deponent must be told whenever the U.S. Attorney has an advance interest in the deponent's testimony, the deponent learns

that there is no such interest when there is no such warning. I see no reason to give the deponent such "peace of mind" and thereby increase the deponent's possible willingness to lie.

Other courts have disagreed with the Scrushy decision. See United States v. Moses, 2005 U.S. Dist. LEXIS 40187 (N.D. Ga. August 31, 2005). Nonetheless, it can be fairly anticipated that understandably zealous defense counsel will make motions to suppress in any future case where the SEC and the DOJ have discussed a possible line of questions in advance of the deposition or where the U.S. Attorney's interest in the SEC proceeding was not disclosed to the deponent. As a result, cooperation is chilled.

How might Congress respond to this problem? As noted above, Section 21(d)(1) of the Securities Exchange Act of 1934 already authorizes the SEC to pass information it gathers in discovery to the Attorney General. But it says nothing about advance cooperation between the two agencies; nor does it address the suggestion by the U.S. Attorney of lines of questions. Section 21(d)(1) might therefore be amended to add a sentence at the end of this section, stating:

> "The Commission may consult with other agencies, including the Department of Justice, at any stage of its investigations and shall be under no obligation to disclose these contacts to any person, except on the order of the Court for good cause shown."

The objection to such a provision will be that the deponent might have asserted its Fifth Amendment privilege if the defendant knew of the U.S. Attorney's interest. Or the defendant might seek a stay of civil discovery. In fact, few defendants take the Fifth Amendment before the SEC, because it can result in an adverse inference being taken and the loss of the SEC action. See Baxter v. Palmigiano, 425 U.S. 308 (1976) (permitting adverse inference to be drawn in a civil proceeding from the assertion of the privilege).

Still, an occasional deponent does assert the privilege (and Mr. Quattrone recently did). If the civil defendant believes his indictment is imminent (for example, if he has received a grand jury subpoena), he can also still seek a stay of civil discovery. But there seems little justification to force the U.S. Attorney to tip its hand at an early stage before any grand jury has begun its investigation and where the SEC investigation had its own legitimate concerns. This is not an area where the balance of advantage needs to be tipped even further in the criminal defendant's favor. Finally, in extreme circumstances, the proposed language would allow a defendant in an exceptional case to take his concerns to the Court (such as, for example, where the civil defendant believed that he could show that the SEC's action had no possible basis other than to gather information for the criminal investigation. But that is not how the SEC operates).

c. Civil Penalties. Section 21A of the Securities Exchange Act of 1934, 15 U.S.C. § 78u-1, authorizes the SEC to seek civil penalties for insider trading in an amount that "shall not exceed three times the profit gained or loss avoided as a result of the unlawful purchase, sale or communication." In practice, courts have been imposing far less than treble damages. One way to elevate the penalties in civil cases (where they are not high) would be to put a floor on these damages of not less than double the gain or loss (but still bounded by a ceiling equal to three times the gain or loss). Because far more cases are enforced civilly than criminally, this change could have real impact.

SOME CONCLUDING THOUGHTS

Today, the SEC is an effective enforcer of the insider trading laws against individuals, but less so against institutions. To give the SEC greater leverage, the focus needs to shift from simply increasing penalties (Sarbanes-Oxley already has inflated

criminal penalties to unconscionable levels) to mandating preventive controls. Pre-transaction disclosure of an intent to trade, transaction reporting, and a requirement that option grants be scheduled in advance of their award are examples of reasonable measures that could reduce the incidence of insider trading. In PIPE transactions, the SEC should similarly insist that an issuer obtain confidentiality agreements from every offeree solicited. All these proposals share the common perception that we have reached the point of diminishing returns from a policy based primarily on deterrent threats.

Finally, the recent Canadian and British experience is instructive: if civil and criminal regulators cannot cooperate, criminal enforcement will not succeed, and, without it, insider trading will not only persist, but flourish.

Testimony of

James D. Cox

Before

Committee on the Judiciary

United States Senate

September 26, 2006

on

Insider Trading

My name is James D. Cox. I am Brainerd Currie Professor of Law, School of Law, Duke University where my research and teaching focuses on securities and corporate law. Prior to coming to Duke in 1979, I taught at Boston University, University of San Francisco, University of California, Hastings College of the Law, and Stanford University School of Law. I have in the recent past been a member of the New York Stock Exchange Legal Advisory Committee and the National Association of Securities Dealers Legal Advisory Board. Among my publications are Securities Regulations: Cases and Materials (5th ed. Aspen 2006)(with Langevoort and Hillman) which has been adopted in approximately two-thirds of American law schools.

I submit this statement and appear before the Subcommittee on behalf of no organization and the costs incurred in connection with my appearing before this committee are being borne entirely by myself. I appreciate the research assistance in preparing this statement of Ms. Nicole

M. Guerroro who is a second-year student at the Duke University School of Law.

I. Big News Equates To Poorly Kept Secrets

The financial rewards of trading in securities markets on confidential material information are large. Unfortunately, not everyone resists the temptations of these large rewards so that there is ample empirical evidence that there is significant trading in securities markets on the basis of secret advance knowledge of material non public information bearing on such diverse topics as a merger, takeover, earnings announcement, or product development. The following paragraphs provide a brief summary of the leading empirical studies supporting these statements.

Initial studies of insider trading examined whether insiders (officers, directors and certain beneficial owners) who are required to report their trading pursuant to section 16(a) of the Securities Exchange Act abuse their informational advantage by trading on non public information. Jaffe, Special Information and Insider Trading 47 J. Bus. 410 (1974) and Finnerty, Insiders and Market Efficiency, 31 J. Fin. 1141 (1976), each find that insiders garner significant abnormal returns, an observation consistent with insiders deploying confidential corporate information to their personal advantage. Not captured by Jaffe and Finnerty is the extent, if any, that insiders share their good fortune with their friends and relatives through tipping so that the ill-gotten gains are more pervasive than those reaped by the director, officer or beneficial owner of a reporting company who file section 16(a) reports. If there is a silver lining is this cloud that hangs over our securities markets, it is that there is evidence that insider trading not only drives

securities prices in the direction of the post-announcement equilibrium level but appears also to be related to price-discovery efforts by "uniformed" traders who can be seen as jumping on the momentum provided by the informed trading by insiders. *See* Meulbroek, An Empirical Analysis of Illegal Trading, 47 J. Fin. 1661 (1992). This "positive"byproduct, however, should not detract from our condemnation of the substantial first mover advantage insiders enjoy. *See* Cox, Insider Trading and Contracting: A Critical Response to the "Chicago School," 1986 Duke L. J. 628 (claims of efficiency associated with insider trading are overstated as insider trading is slow and clumsy method to impart newsworthy information vis-a-vis a clarion corporate announcement).

Mergers and takeovers are particularly rife with insider trading abuses in the pre-announcement period. This is because they inherently involve significant market premiums to the acquired firm and because their planning and execution involve a large number of individuals each of whom faces the temptations of certain gains and uncertain detection should they decide to trade on their advance knowledge of the transaction. Each study of trading surrounding acquisitions consistently demonstrates that leakage and abuse of inside information is a pervasive problem in connection with mergers and takeovers. Among the earliest studies, using monthly stock price data, Halpern Empirical Estimates of the Amount and Distribution of Gains to Companies in Megers, 46 J. Bus. 554 (1976), found that as one moves closer to the first public announcement of the acquisition that excess (above market returns) returns garnered by owning shares of the target firms increases, an observation consistent with inside trading based on knowledge of the acquisition. *See also* Mandelker, Risk and Return: The Case of Merging Firms,

1 J. Fin. Econ. 303 (1974)(also using monthly data and reaching the same result). Using daily price data, Keown & Pinkerton, Merger Announcements and Insider Trading Activity: An Empirical Investigation, 36 J. Fin. 855 (1981), report that significant evidence of insider trading appeared on average 12 days prior to the first public announcement of a merger in 194 studied merger announcements. About 40-50 percent of the price gain experienced by the targets of takeovers occurs *before* the actual takeover announcement. Keown & Pinkerton, *supra*. Some might speculate, erroneously however, that the price run up in advance of takeover is due to lawful market trading by astute investors who "anticipate" mergers and takeovers. This hypothesis is rejected by the findings of Eyssell & Arshadi, Insiders, Outsiders, or Trend Chasers? An Investigation of Pre-Takeover Transactions in the Shares of Target Firms, 16 J. Fin. Res. 49 (1993). Indeed, trading based on public rumors were found not to generate any abnormal returns. Pound & Zechhauser, Clearly Heard on the Street: The Effect of Takeover Rumors on Stock Prices, 63 J. Bus. 291 (1990). The stock market is not the only venue where the insiders reap the rewards of their significant informational advantage; data confirms that put and call options are astutely used by insiders to reap gains in the pre-takeover period. *See* Arnold, Erwin, Nail & Bos, Speculation or Insider Trading: Informed Trading in Options Markets Preceding Tender Offer Announcements, Working Paper (May 2000) available at http://ssrn.com/paper-234797; Jayaraman, Frye & Sabherwal, Informed Trading Around Merger Announcements: An Empirical Test Using Transaction Volume and Open Interest in Options Market, _ Fin. Rev. __ (2001). Finally, it should be observed that climate appears not to dampen the frequency of inside trading in advance of takeover; a study of trading in advance of takeover announcements of 420 Canadian companies found significant price and volume changes in the subject companies in the

days preceding the first public announcement of a takeover. *See* King & Padalko, Pre-Bid Run-Ups Ahead of Canadian Takeovers: How Big is the Problem?, Bank of Canada Working Paper 2005-3. *See also*, Bris, Do Insider Trading Laws Work?, Working Paper Yale School of Management Oct. 2000 (study of 5,099 acquisitions in 56 countries finding significant profits garnered by insiders' trading prior to takeover announcement).

Earnings announcements have also been studied for possible insider trading. Park & Jang, Insider Trading Activity Surrounding Annual Earnings, 22 J. Bus. Fin. & Accounting 587 (1995), find that insider trading systematically occurs several weeks prior to earnings announcements but not immediately preceding the announcement; they speculate the absence of trading in close proximity to the earnings announcement reflects the insider's fear of being charged with insider trading. A similar pattern is supported by the findings of Ke, Huddart & Petroni, What Insiders Know About Future Earnings and How They Use It: Evidence of Insider Trades, 35 J. Accounting & Econ. 315 (2003)(insiders sales increase three to nine quarters prior to a break in earnings but there is little abnormal selling in two quarters immediately prior to a break in historic track of earnings increases). What emerges from this work is a pattern of officers and directors being averse to sell in close proximity to a break/unexpected decline in reported earnings while there is evidence that insider purchases peak much closer (within a month generally) to a large jump. *See* Marin & Olivier, The Dog That Did Not Bark: Insider Trading and Crashes, Working Paper Department of Econ. & Bus, Universitat Pompeu Frabra, (2006). *See also* Huddart, Ke & Shi, Jeopardy, Non-Public Information, and Insider Trading Around SEC 10-K and 10-Q Filings, _ J. Accounting & Econ. (Forthcoming 2006), available at http://ssrn.com/paper=756124 (Insiders avoid trading in close proximity to significant earning

announcements in documents filed with SEC). Finally, insiders appear to systematically exploit their information advantage regarding the firm's securities being listed or delisted on the NYSE or AMEX. *See* Lamba & Khan, Exchange Listings and Delistings: The Role of Insider Information and Insider Trading, _ J. Fin. Res. _ ( ).

II. Some Regulatory Choices

In broad overview, there are two well recognized routes policymakers can pursue to reduce the frequency and magnitude of misconduct: increase the probability that wrongdoers will be detected and successfully prosecuted, and policy makers can also enhance the sanctions to be imposed in such a successful prosecution. Over the past two decades, the Congress has moved aggressively on each of these two fronts. Certainly the enforcement budget of the SEC has grown significantly since 2001 and the pay-parity provision enacted by Congress has done much to retain senior leadership at all levels of the SEC. In 1988, Congress also externalized enforcement of insider trading prohibitions by imposing unique control person obligations upon broker-dealers and certain other market professionals so that vicarious liability could be imposed upon them unless they maintained a reasonable system of surveillance to discourage insider trading by employees. *See* Securities Exchange Act Sections 15(f) and 21A(b), 15 U.S.C. §§ 78o(f) & 78u-1(b). The legislation also introduced a novel "bounty hunter" mechanism to encourage third parties to identify individuals engaged in insider trading. Securities Exchange Act Section 21A(e), 15 U.S.C. § 78u-1(e). And, in 1988, Congress expressly authorized private actions for insider trading. Securities Exchange Act Section 20A, 15 U.S.C. § 78t-1. Penalties

for insider trading were significantly increased with the enactment of the Insider Trading Sanctions Act of 1984 which authorizes the SEC to recover up to treble the insider's profits. Securities Exchange Act Section 21A(a)(2), 15 U.S.C. § 78u-1(a)(2). Among the many contributions to enforcement by the Sarbanes-Oxley Act of 2002 are significant increases in criminal sanctions for several statutes commonly relied upon in criminal prosecutions of insider trading. *See e.g.,* Sarbanes Oxley Act Section 903 (increasing penalty for mail and wire fraud provisions). Sarbanes-Oxley also established a new criminal statute focused exclusively on securities fraud. *See* Sarbanes-Oxley Act Section 807 amending 18 U.S.C. § 1348. Against these developments it is fair to ask what more can be done? The following offers some areas the Senate Judiciary Committee may wish to pursue in answering this question.

A. Market Surveillance Efforts

As the members of this committee are aware, an important cornerstone of our regulation of securities markets is the commitment of self regulatory organizations to shoulder their fair share of the burden of policing our securities markets. There are multiple benefits of self regulation. True professionalism arises from a profession's understanding that their members have public obligations and as a group they have a responsibility to improve the standards of their members so as to fulfill society's expectations. After all, being a member of a profession, as Dean Roscoe Pound observed, is more than being a member of a group of grocery merchants. R. Pound, The Lawyer from Antiquity to Modern Times 7 (1953). Self regulation also places responsibility with those who likely have the greatest acuity to the operation of the enterprise to

be regulated. Thus, there are efficiency gains via self regulation. Not the least of these benefits are that it is the profession's resources and not the national government's resources that are placed into the regulatory breach. Nevertheless, we are well advised to heed the wise observation of the SEC's second chairman, William O. Douglas, who supported the view of "letting the exchanges take the leadership, with the Government playing a residual role." But he further cautioned, "[g]overnment would keep the shotgun, so to speak, behind the door, loaded, well-oiled, cleaned, ready for use but with the hope that it would never have to be used." W.O. Douglas, Democracy and Finance 64-65 (J. Allen ed. 1940).

Against the vivid image suggested by Justice Douglas, it is appropriate for this Committee to inquire whether the surveillance efforts of the self regulatory organizations have kept pace with market and regulatory developments. In an earlier and simpler time, the "Stock Watch" consortium of the trading markets such as Nasdaq and NYSE closely monitored listed companies to detect, among other matters, the likelihood of insider trading. In the last few years numerous changes have come to our securities markets that suggest the incentives for trading on inside information are greater than they were in earlier times and that self regulation may be more problematic today than in the past. These changes include decimalization, securities markets becoming dominated by institutional trading, the rising role of short-term trading strategies such as those engaged in by many hedge funds, and the demutualization of our major trading markets. Thus, we should inquire whether the SRO's market surveillance budgets, staffing levels, and computer technology are ahead or behind of the curve? More specifically, what is the present capability of the SROs ex post to, for example in the connection with takeover announcement, to reconstruct trading in the shares of the target company with sufficient

precision to identify traders with possible pre-announcement access to knowledge of the takeover? A related question is how electronic surveillance and data bases can be improved to better detect insider trading? Do the SRO's have the best available technology to ferret out possible insider trading? These lines of question are hopeful avenues of exploration toward the goal of increasing the probability that insider trading will be detected. With greater likelihood of detection there comes greater deterrence of insider trading. The focus of these questions should not be limited to self regulatory organizations that oversee our securities market but should also include those responsible for our derivative markets, since the before-referenced studies support the view that inside trading occurs frequently through financial derivatives.

B. Are More Sanctions Needed?

Increasing the severity of existing sanctions in theory should reduce the frequency and magnitude of insider trading. Because the sanctions that exist today for insider trading are substantial, my intuition is that further ratcheting up of the sanctions will yield at best only marginal benefits. Instead of changing the sanctions, we can benefit from some of the empirical insights set forth above as well as evidence coming to light in the wake of the backdating of stock options epidemic that continues to earn headlines in our national press. Several of the above studies suggest that officers and directors do not trade in close proximity to earning announcement dates. This finding likely reflects their belief that there is a greater risk of detection should they trade too close to the date of the announcement. Such probable detection is facilitated because the officers, directors and owners of more than ten percent of the equity of a

reporting company must promptly file with the SEC notice of any change in their holdings of their firm's shares. The Committee should be aware that studies of stock option backdating reveal that post-Sarbanes-Oxley, option backdating largely ceased. The infrequency of backdating of options post-Sarbanes-Oxley is because of a two-day window within which the option grant must now be reported. Thus, prompt disclosure of granting of options has achieved the desirable consequence of squelching the opportunity for option backdating. To be sure, individuals can always violate these requirements. For example, officers and directors could seek to avoid their section 16 reporting requirements by purposely failing to file the required information with the SEC. Thus, a fair question to ask is what is the level of compliance with these trading reporting requirements and how even greater compliance can be achieved.

The suggestion I offer here is that we consider imposing some greater transparency, at least to market regulators, of trading by professionals (such as investment bankers, attorneys, and bankers) of the type that regularly are involved with in acquisitions, takeovers, and other significant market activities for which evidence supports the view that there is massive insider trading. This transparency may involve no more tweaking of the system than to assure that the SRO's market surveillance data bases include information that could quickly match such a professional to a pre-announcement trade. It is my opinion that a reliable system that allows the SRO's to review trading in the pre-announcement period for evidence that individuals engaged in the "deal" would greatly enhance the deterrence capability of our existing insider trading laws. I also remain hopeful that such a regulatory structure could be devised that is consistent with our commitments to individual privacy.

In closing, I appreciate the opportunity you have provided me to share this information and ideas with you. I look forward to working with you and your staff as questions arise in your deliberations of this important matter.

UNITED STATES SENATOR • IOWA
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Prepared Statement of Senator Chuck Grassley of Iowa
Senate Committee on the Judiciary
"Illegal Insider Trading: How Widespread Is The Problem and Is There Adequate Criminal Enforcement?"
Tuesday, September 26, 2006

Chairman Specter, thank you for holding this oversight hearing on illegal insider trading. I share the Chairman's concerns about whether the laws on the books are tough enough to prevent and punish criminal conduct, as well as whether criminal enforcement in this area is adequate. Further, I have serious concerns as to whether current enforcement by the Securities and Exchange Commission (SEC) is adequate to protect against increasingly complex institutional trading. The current market oversight regime needs to be reviewed to ensure that individuals and organizations are not able to game the system. The Senate Judiciary Committee needs to exercise its oversight responsibilities to ensure that the laws are being enforced to deter corporate fraud and manipulation against our capital markets. So, I'm pleased that we are looking into these practices today.

In addition to today's hearing, Chairman Specter and I, in my capacity as Chairman of the Committee on Finance, have been investigating allegations from current and former SEC employees regarding, among other things, the adequacy of SEC enforcement against insider trading. While our joint investigation remains ongoing, today's hearing presents another opportunity to discuss SEC enforcement and to ensure that those who attempt to game the system for illegal gain are brought to justice.

There have been a number of recent reports suggesting increased trading activities in the days and weeks before major corporate mergers and buyouts become public. Are these trading activities legitimate? Some conclude that this high level of activity suggests illegal insider trading. The Judiciary Committee should look into whether that indeed is the case.

Moreover, are the Department of Justice and the SEC working together effectively to protect investors and the public from fraudulent activity? Are they taking the initiative to root out corporate fraud, and are they being as tough as they can when they settle their lawsuits? Some have suggested that there are impediments, both legal and institutional, that have hampered the government from enforcing the law and being as effective as they should be. Also, we need to ensure that our enforcement agencies have all the tools and resources they need to keep our capital markets clean. There is no

question that the Department of Justice and the SEC need to be aggressive when they investigate alleged wrongdoing. If they need additional tools and resources to do that, we need to look at crafting legislation to help them do their job.

So I'm looking forward to reviewing the testimony of the witnesses, and I thank Chairman Specter for his interest in this important topic and for holding this hearing today.

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September 25, 2006

BY OVERNIGHT MAIL & ELECTRONIC MAIL

Hon. Arlen Specter, Chairman
United States Senate
Committee on the Judiciary
224 Dirksen Senate Office Building
Washington, D.C. 20510
Attn: Hannibal G. Williams II Kemerer

RE: Hearing of the Senate Judiciary Committee on "Illegal Insider Trading: How Widespread is the Problem and is there Adequate Criminal Enforcement?"

Dear Chairman Specter:

I am writing to submit some brief remarks in connection with the Judiciary Committee's hearing examining illegal insider trading (the "Insider Trading hearing"). I submit these comments as counsel to the Alliance for Investment Transparency ("AIT"), on whose behalf I testified at the Judiciary Committee's June 28, 2006 hearing concerning "Hedge Funds and Independent Analysts: How Independent are Their Relationships?" (the "June 28th hearing"). The AIT is a group of concerned companies who have joined together in an effort to assist in bringing to light the lack of transparency and disclosure in certain areas of the financial markets.

There is an important theme that is common to both the Committee's June 28th hearing and its Insider Trading hearing: the improper and undisclosed influence that certain market participants wield in the financial markets. At the June 28th hearing, the Committee heard compelling testimony concerning wrongdoing and collusion by certain hedge funds and purportedly independent securities analysts. As the Committee recognized, the capital markets are seriously threatened by the reported activity of certain hedge funds colluding with securities analysts to attack publicly-traded companies, their employees

and shareholders, without any disclosure of the hedge funds' interest or involvement.

Similarly, the Committee's current focus on the improper use of non-public information by certain market participants, including some hedge funds, sheds light on another area in which market power and influence are abused. "Insider trading" is not a problem that is limited to improper trading in non-public information that is obtained from issuers or company personnel. There is, in fact, an equally serious and perhaps more insidious problem that has received far less attention, and that is the trading in material non-public information that is generated by market participants other than issuers -- specifically, by securities analysts, the investment banking and brokerage community, the financial press and traders themselves. Each of these groups of market participants necessarily has, at times, direct access to non-public information concerning market-moving events. This can include such non-public information as (i) the timing and substance of analyst reports; (ii) the timing and substance of investigative articles and publications; (iii) non-public stock, option and derivative market activity; (iv) advance knowledge of debt and equity offerings; and (v) knowledge of the fact and timing of governmental and regulatory inquiries and investigations.

In each instance, preferred access to such information can provide an enormous advantage to a market participant who abuses his or her access to this information. Such abuse -- even though the information in question is not necessarily received from an insider at an issuer -- is covered by existing insider trading law, but does not appear to be consistently and vigorously prosecuted. However, the cases that have been brought show the insidious nature of trading on such non-public information. Examples of prosecutions include one recent case in which conspirators were accused of infiltrating a printing plant in order to obtain advance copies of BusinessWeek magazine and, specifically, to trade on advance knowledge of market-moving articles that were set to appear.[1] In another prominent insider trading prosecution, Anthony Elgindy was convicted in January 2005 of racketeering, conspiracy and securities fraud for using confidential government information obtained from the Federal Bureau of Investigation to manipulate stock.

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[1] See U.S. Securities and Exchange Commission, Litigation Release No. 19696, May 11, 2006; SEC v. Sonja Anticevic et al., 05 Civ. 6991 (KMW) (S.D.N.Y.).

However, such schemes need not be as overt as these, and it is not at all clear that the more nuanced aspects of insider trading are consistently and vigorously investigated and prosecuted. For example, in many instances, certain hedge funds and other powerful market participants wield their influence over securities analysts to influence coverage and to gain advance knowledge of the timing and substance of forthcoming analyst reports. As the Economist has reported: "Some analysts admit that their hedge-fund clients press them to write reports in line with the funds' views. 'We have had hedge funds try to twist our arms to write reports a certain way. The pressure definitely exists,' says one." (The Economist, "Fair comment or foul? Hedge funds and equity research," April 1, 2006.) Similarly, The Wall Street Journal has reported that hedge funds "have become so large that increasingly, they are the marketplace. Their actions can cause enormous damage to other investors, not just their own" and that "hedge funds have become the life blood of the investment houses." "There is no denying the close relationship that now exists between the hedge funds and Wall Street, and the potential conflicts the connection raises." (Alan Murray, The Wall Street Journal, "Lawsuit shows how hedge funds need to open up for the markets," April 5, 2006.)[2] Ordinary investors and other less prominent customers of Wall Street banks are not provided with such privileged access to market-moving information.

Given this state of affairs, it is important that the appropriate bodies undertake a serious examination of the level of privileged access to market information and timing that broker-dealers give to their powerful hedge fund clients that they do not provide to regular investors. While we believe our current insider trading laws prevent these institutions from allowing their larger clients the benefit of advance knowledge about market-moving analyst reports and other expected

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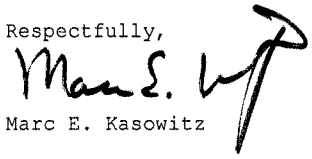
[2] The financial press has regularly reported on the privileged access that hedge funds, including Steven A. Cohen's S.A.C. Capital, have to market-moving information from Wall Street. See, e.g., Marcia Vickers, "The Most Powerful Trader on Wall Street You've Never Heard Of," BusinessWeek Online (Jul. 21, 2003) (describing S.A.C.'s "superpowerful information machine" and S.A.C. motto "'try to get the information before anyone else'"); Jenny Anderson, "True or False: A Hedge Fund Plotted to Hurt a Drug Maker?" New York Times (Mar. 26, 2006) ("Money means access on Wall Street, so Mr. Cohen is often first in line for the best information, which is the most valuable commodity in the trading world.").

developments, we are not aware of any widespread investigation into such practices even though they are widely understood to occur in the industry. Indeed, the recent controversy over the trading of hedge fund Pequot Capital echoes precisely what we believe you will find is not an uncommon practice in that industry, and demonstrates the need for vigorous investigations being targeted in that direction.[3]

We appreciate the Committee taking the time to look at these important issues relating to illegal trading on non-public information and hope that the Committee, together with regulators and law enforcement, continues to draw attention to these issues that are critical to the functioning of our capital markets. Illegal trading on non-public information threatens not only the companies who are targets of such improper trading, their investors and employees, but also strikes at the foundation of the financial system. If certain market participants are allowed privileged access to market-moving information -- and if they are permitted to profit from their access to that information -- public confidence in the financial markets will be greatly undermined and the markets in which so much of this country's wealth is concentrated will be at risk. We applaud the Committee's continuing efforts to address these issues.

Respectfully,



Marc E. Kasowitz

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[3] One area in which prosecutions have been focused is insider trading in connection with so-called "PIPE" transactions. In such instances, short-sellers have relied on non-public information concerning private equity offerings to trade ahead of public disclosure of those deals. See, e.g., U.S. Securities and Exchange Commission, Litigation Release No. 19199, April 21, 2005; SEC v. Pollet, No. 05-CV-1937 (SLT/RLM) (E.D.N.Y.).

Testimony of
Jonathan Macey

Before the Senate Committee on the Judiciary
226 Dirksen Senate Office Building, September 26, 2006

Illegal insider trading involves the theft of valuable information about corporate plans that properly belongs to the corporation and its investors. Vigorous enforcement of the laws against insider trading is important to protect the intellectual property rights of investors and corporations.

Trading by insiders is not always illegal. It is illegal when securities are traded in breach of a relationship of trust and confidence (a "fiduciary duty:), on the basis of material, nonpublic information that reasonably can be expected to affect the price of the securities being transacted. In addition to trading, it also is illegal to tip information in violation of a fiduciary duty and to misappropriate confidential information.

Properly understood, there is no serious argument that insider trading in breach of a fiduciary duty is a "victimless" crime. While the intuition that insider trading is "bad" and "wrong" is widely shared, the reasons why some, but not all, trading by insiders is and should be illegal is not well understood.

Insider trading is bad and wrong for the same reason that stealing is bad and wrong. It deprives people of what is rightfully theirs, and in doing so, undermines legitimate societal trust and expectations about how markets should operate. This property rights oriented approach to the law of insider trading is consistent with the case law as developed over time by the U.S. Supreme Court in the landmark cases of *U.S. v. Chiarella*, (1980), *Dirks v. Securities and Exchange Commission* (1983), and U.S. v. O'Hagen (1997).

Thus, for example, when an officer, or director, or a professional such as a lawyer, accountant or investment banker, trades for personal profit on the basis of confidential corporate information about a forthcoming earnings announcement, or merger, that person has taken (misappropriated) valuable information. The problem with doing this is that it reduces the incentives of legitimate market participants, like analysts, to allocate scarce resources to engaging in research because insiders will appropriate the trading profits associated with making discoveries of information before the analysts can get to it. And, of course, insider trading ultimately robs investors of many of the benefits of investing; by depriving them of the ability to avoid losses or to make gains from their own research or from the research they are buying directly and indirectly from institutions, professional advisers, portfolio managers and mutual funds. Finally, insider trading increases the transactions costs of investing; particularly by increasing the bid-asked spreads associated with buying and selling securities in public debt and equity markets. For these reasons, regulation of insider trading protects investors and, in doing so, encourages the development of high quality capital markets.

How much insider trading do we actually observe, and could we do more to stop it?

Here I wish to make the following points.

1) The available empirical evidence makes it clear that the U.S. has, by far, both the most vigorous insider trading enforcement program in the world, as well as the strictest laws against insider trading.
2) The USA is the country in which insiders' profits are lowest.[1]

[1] See Arturo Bris, "Do Insider Trading Laws Work?" . European Financial Management, Vol. 11, No. 3, pp. 267-312

3) In the U.S. there is a private right of action for violation of the laws against insider trading. The private plaintiffs bar generally "piggy backs" on the vigorous efforts of the Enforcement Division of the Securities and Exchange Commission. This, in turn, suggests that the vigorous public enforcement program of the SEC, which includes 250 insider-trading enforcement actions over the past five years, is highly effective. By contrast, in the UK there have been just 14 insider trading convictions since 1980, and the largest fine 25,000 pounds in 1987, is lower than the *average* penalty in the U.S. Community service is the most common penalty in the UK.

4) The enforcement program of the Securities and Exchange Commission is broad and wide-ranging. Cases brought by the SEC include actions against:

   a. Corporate officers, directors, and employees who traded the corporation's securities after learning of significant, confidential corporate developments;

   b. Friends, business associates, family members, and other "tippees" of such officers, directors, and employees, who traded the securities after receiving such information;

   c. Employees of law, banking, brokerage and printing firms who were given such information to provide services to the corporation whose securities they traded;

   d. Government employees who learned of such information because of their employment by the government; and

e. Other persons who misappropriated, and took advantage of, confidential information from their employers.[2]

5) As the Supreme Court made clear in Dirks, not all trading on the basis of information not reflected in share prices is, or should be, illegal. In particular, trading that is not done in violation of a fiduciary duty, and involves profit-taking from investments in legitimate research about corporate performance or governance is socially valuable and should be encouraged.

6) Studies that increases in trading volume or share prices in advance of merger and acquisition activity fail to distinguish between legitimate and illegitimate insider trading activity. For example, purchases by a hedge fund, LBO fund, arbitrageur or large equity investor may actually put a company "in play," increasing the chances of an outside acquisition attempt. These highly beneficial market activities will increase the trading volume and the share price of the target company, but are not always consistent with insider trading despite press reports the contrary (See Gretchen Morgenson, "Whispers of Mergers Set Off Bouts of Suspicious Trading," *The New York Times*, August 27, 2006.

7) Stock exchanges, despite their other self-regulatory problems, have strong incentives to monitor and control insider trading, at least by non-exchange officials.

8) In considering the question of whether more is needed, it is important to consider the fact that increased prosecutions may reduce so-called "type-one error" by reducing the amount of illegal insider trading that goes undetected and un-prosecuted; but it also inevitably will increase the amount of "type-two error" in

[2] http://www.sec.gov/answers/insider.htm

that it will increase the incidence of costly investigations of legal and legitimate trading activity.

9) One of the great inchoate assets of U.S. capital markets is the complex array of cultural norms that provides behavioral guidelines for professional market participants such as lawyers, accountants and investment bankers. An important aspect of this system of norms is the fact that, in U.S. trading markets, unlike many other markets, insider trading is not a professionally accepted market practice. People who engage in insider trading, and even people accused of insider trading, particularly those who work in the capital markets in a professional capacity, are viewed as pariahs. In other words, the reputational penalties for insider trading in the U.S. are very high. The SEC in its enforcement program does an excellent job of balancing the important public policy goal of detecting and punishing insider trading with the important public policy goal of conducting insider trading investigations in a careful and professional manner so as to not needlessly ruin the professional reputations of innocent people. In doing so, the SEC has been able to preserve the priceless deterrent effect of the social stigma associated with insider trading in U.S. capital markets.

Robert A. Marchman

Executive Vice President
Division of Market Surveillance
NYSE Regulation, Inc.

On

"Illegal Insider Trading: How Widespread is the Problem and is there Adequate Criminal Enforcement?"

Committee on the Judiciary
United States Senate
Washington, DC

September 26, 2006

Introduction

Chairman Specter, Ranking Member Leahy, distinguished Members of the Committee, my name is Robert A. Marchman, and I am the Executive Vice President of the Market Surveillance Division of NYSE Regulation, Inc.

I want to thank all the members of the Committee for providing me with this opportunity to address the important regulatory challenges raised by insider trading, an area of the highest priority for NYSE Regulation as our core mission is the protection of the investing public.

NYSE Regulation, Inc.

NYSE Regulation, Inc. is a not-for-profit subsidiary of the New York Stock Exchange Group, Inc. that performs self-regulatory functions for both the NYSE and NYSE Arca. NYSE Regulation is comprised of the following five divisions and a risk assessment unit: Member Firm Regulation, Market Surveillance, Enforcement, Listed Company Compliance, and the Office of the Hearing Board.

Market Surveillance

The Market Surveillance Division of NYSE Regulation plays the lead critical role of monitoring trades in NYSE-listed securities, options, bonds, exchange traded funds, closed-end funds, and other structured products. The Division is charged with monitoring the market for a variety of potentially violative conduct, including insider trading, and determining whether transactions are executed properly and fairly.

At the outset, it is important to underscore that NYSE Regulation has limited jurisdiction in the area of insider trading. We do not enforce insider trading for the general public. Rather, our jurisdiction is limited to NYSE Group, Inc. "members, member organizations, allied members, approved persons, and registered and non-registered employees of member and members" with respect to violations of the Securities Exchange Act of 1934 and our internal rules. By way of example, we do not have the jurisdiction or the ability to compel cooperation or bring disciplinary action against broker dealer customers, attorneys or accountants, nor do we have jurisdiction over hedge funds. Therefore, investigations at NYSE Regulation frequently result in referrals to the Division of Enforcement of the Securities and Exchange Commission, ("SEC") with whom we enjoy a strong working relationship in the investigation of potential insider trading. Our frequent and constructive interaction with the SEC allows us to discuss potentially troubling trading scenarios, trends, and referrals. Important outcomes of this constructive relationship are SEC enforcement actions resulting from Market Surveillance referrals.

The history of the securities markets teaches us that insider trading is a serious regulatory concern, particularly today, where the volume, complexity of trades and products, and cross-border transactions are re-defining capital markets almost on a daily basis. Market Surveillance continues to meet these challenges through the use of extensive and sophisticated surveillances, systems and tools that allow us to timely review and aggressively investigate trading that may constitute insider trading.

Market Surveillance: Surveillances and Alert Generation

On an ongoing basis, Market Surveillance analysts conduct reviews of alerts and investigations. Alerts are typically generated by automated electronic surveillance systems and real-time and exception-based surveillances, but can also be generated as a result of customer complaints. Electronic surveillances that relate to insider trading include, among others, Insider Trading, Frontrunning, Market Manipulation, Trading Ahead of Research, Earnings, Mergers and Acquisitions, and Trading Ahead of Publication. Insider trading is considered a high priority and we review related exceptions and alerts on an expedited basis.

Surveillances generate alerts that can contain one or more exceptions. Exceptions are defined as a particular type of suspicious activity or activity of potential interest because it meets or exceeds surveillance threshold criteria or parameters. Alerts are assigned to an analyst for tracking, management and conclusion. Investigations typically follow from a determination that an alert requires a more in-depth analysis and/or additional regulatory action.

A "Stock Watch" unit in Market Surveillance makes use of sophisticated computer and software systems to search and identify unusual trading patterns on a real-time basis in conjunction with support from the Massachusetts Institute of Technology (MIT). By way of example, Stock Watch uses a variety of services and information to augment its real-time surveillance capability including vendor services and information from sources such as Dow Jones, First Call, S&P Market Scope, real-time information from the consolidated tape, futures indices, major foreign indices, and selected stories from the Wall Street Journal and Barrons.

Stock Watch alerts Market Surveillance analysts on a real-time basis to aberrational price/volume activity in connection with news that may be suggestive of insider trading by generating exceptions that are further investigated by professionals and, where appropriate, by other analysts. On a daily basis, and throughout the day, the statistical outlier methodology used by Stock Watch electronically collects trading data for individual stocks in order to create a stock profile against which each trade on that stock is measured to determine deviations from the norm. An overall market volatility component is applied as an additional filter on a stock-by-stock basis. Stock Watch uses an additional alert system to monitor trading activity, which measures stock trades based on strict price and percentage movements, depending on the price level of the issue. Based on its review of trading activity, Stock Watch generates alerts that are further reviewed by analysts through the use of electronic surveillances.

Currently, Market Surveillance is designing the Inter-Case Analysis surveillance -- the next generation surveillance and data tools -- that will allow analysts, investigators and attorneys to delve deeper into trend analyses and pattern recognition of insider trading trends, allowing the analyst to retrieve information in an organized, drilled-down interface. These surveillance and data tools will allow our analysts to view accounts traded in previous investigations and view chronologically participants who were involved in more than one investigation.

Market Surveillance: Investigations and Referrals to the SEC

In a typical insider trading investigation, sophisticated systems compliment analyst requests for information from member organizations, listed companies and other

markets. Information used to ascertain facts surrounding trading under review include, among others (a) names and addresses of those involved in the deals; (b) trading chronologies; (c) firm trades for the period under review; (d) trading strategy descriptions; (e) written descriptions of meetings surrounding the event; and (f) summaries of what transpired at the meetings.

Systems and software tools compare results from our analytical and investigative surveillance systems with electronic bluesheets -- customer and proprietary trading information provided in electronic format by member organizations. This allows staff to run comprehensive surveillance analyses by individual, institution, customer and proprietary trading information, and broker/dealers. Systems have been designed to further assist the analysts in reviewing bluesheet data for volume activity, account open date and other characteristics that may be indicative of potential insider trading, including matching bluesheet data with investigation-specific chronological data, as well as other information culled from sources such as the Central Registration Depository. "Chronological data" refers to an electronic chronology of events in the given deal or event received from the member organizations. Such electronic data includes the names and addresses of individuals involved in the deal or the event and a narrative of the events leading up to the public announcement, such as dates of meetings, who participated in these meetings and the sum and substance of those meetings. Analysts also make use of our Internet Database or "IDB," which downloads on a daily basis all message traffic on NYSE-listed securities in Internet bulletin boards.

Upon opening an investigation on potential insider trading, Market Surveillance staff sends an electronic communication to the SEC via the Self Regulatory Organization

Investigation Referral System. Market Surveillance also notifies other SRO members of the Intermarket Surveillance Group that trade the security, or a derivative such as options, to coordinate investigative activities. At times, Market Surveillance will verbally notify the SEC of the opening of an insider trading investigation prior to sending an electronic notification. Circumstances warranting such immediate verbal notification include, by way of example, a foreign takeover or a surprise announcement where the price of the stock experiences a dramatic reaction. If options are traded on the stock and the options activity suggests possible insider trading, the SEC may contact staff by phone to advise of activity in the options market and to inquire about the underlying stock activity.

Where an investigation indicates possible insider trading by individuals or entities outside the jurisdiction of NYSE Regulation (for example, hedge funds; officers, directors, employees of a listed company; or customers of a member organization), the activity is referred to the SEC both in writing and via the SRO Investigation Referral System. In any given insider trading investigation, staff may make an initial referral, may supplement that referral as the investigation progresses, or may decide that a referral is not warranted. Trading by some accounts may not rise to the level of referral, but may yet merit notification to the SEC through an advisory.

Once a referral is made, the SEC may request from Market Surveillance staff documentation supporting the referral, such as account statements and chronologies. Market Surveillance staff works with staff from the SEC Division of Enforcement, providing background information related to the investigation and referral. Where appropriate, staff may also meet with relevant SEC staff regarding the investigation.

At times, the SEC may open an insider trading investigation related to a corporate

development also under review by NYSE Regulation. NYSE Regulation and SEC investigations may proceed in parallel and, as appropriate, documentation may be shared between the SEC and NYSE Regulation to avoid duplicative requests to the same parties. In that case, the SEC and NYSE Regulation maintain separate investigations, as the SEC is a government entity and NYSE Regulation is a self-regulatory organization.

Separate from an insider trading determination, NYSE Regulation may discipline those under its jurisdiction pursuant to NYSE Regulation Rule 476(a)(6), which prohibits "conduct inconsistent with just and equitable principles of trade" even where the elements of insider trading under SEC Rule 10b-5 may not be met. Occasionally, the SEC requests that NYSE Regulation refrain from pursuing a given insider trading investigation, or a particular individual or entity within that investigation, where our review may compromise a broader SEC investigation, or a related inquiry by the U.S. Attorney's Office.

In addition to our interaction with the SEC on specific insider trading investigations, NYSE Regulation has periodic meetings, normally three times a year, with the SEC staff regarding policies and practice issues, as well as discussions on trends.

Member Firm Regulation

Staff from our Market Surveillance Division often works closely with the staff of the Member Firm Regulation and Enforcement Divisions in conducting and referring insider-trading investigations to the SEC. Our Division of Member Firm Regulation ("MFR") is dedicated to investor protection by means of regular and for-cause on-site examinations of NYSE Group member firms and their branch offices.

The insider trading examination program at MFR is subdivided into several reviews focusing on member firms (institutions) and customers (traders). These reviews include the following examinations. The Written Policies and Procedures Review requires examiners to verify that the firm's written policies and procedures address elements such as safeguarding of confidential information, employee and proprietary trading, employee education and acknowledgement, and the role of Compliance in the monitoring and control of non-public information. The Research Department examination review ensures that firms that engage in research activities have controls to prevent non-public information from being utilized to prepare research reports used by proprietary traders, registered representatives and other employees. The Supervision of Interdepartmental Communication review allows examiners to verify that member organizations segregate departments that normally possess nonpublic information -- such as Investment Banking and Research -- from other departments that could potentially benefit from that information, including Sales and Trading.

MFR also requires production of the firm policies and procedures for the detection and prevention of misuse of material non-public information. Examiners review policies and procedures to ascertain whether they adequately call for (a) review of employee and proprietary trading, (b) supervision of inter-departmental communication by the firm's compliance department, and (c) review of proprietary trading when the firm is in possession of material, non-public information. In addition, examiners determine whether the firm has an adequate education process on the handling of non-public information. Typically, member organizations require employees to confirm in writing that Information Barrier/Insider Trading policies and procedures were reviewed by them

when they were initially hired, and annually thereafter. To that end, MFR examiners request a documentation sample to establish that employees have reviewed the firms' policies and procedures.

Enforcement

The Division of Enforcement investigates and disciplines for violations of NYSE Regulation rules and applicable federal securities laws and regulations. Enforcement cases stem from a variety of sources, including Market Surveillance, Member Firm Regulation, investor complaints made directly to NYSE Group companies, and referrals from the SEC.

Enforcement insider trading related cases originate primarily as referrals from the Division of Market Surveillance, but may also be received from the Division of Member Firm Regulation, the investing public, and filings made by member firms.

Interaction with Other Regulators and Market Participants

We are also continuing and strengthening our pro-active engagement with other market regulators. On August 18, 2006, officials of NYSE Regulation, NASD Regulation, the Chicago Board of Options Exchange, and SEC Enforcement met to discuss current developments in the insider trading area. Among other topics, participants discussed the use of spread-betting, Private Investment in Public Equities or "PIPES," IPOs, and secondary offerings. Participants also discussed the continued need for strengthening of cross-border information sharing, and training in cutting edge investigative trade techniques via the Inter-Market Surveillance Group. This follows on

the heels of our lead role and open discussion of these issues at the NYSE Regulation Second Annual Securities Conference on June 19 and 20, 2006; and our active participation at the Annual Securities Industry Association Compliance and Legal Division from March 19 through March 22, 2006.

Finally, NYSE Market Surveillance coordinates market surveillance efforts with other SROs and other regulatory bodies through our participation in various industry groups such as the Inter-Market Surveillance Group and the Securities and Commodities Fraud Working Group (a group comprised of various regulatory bodies including representatives from the U.S. Department of Justice). This coordination enables participations to identify trends and discuss best practices as to the effective and efficient utilization of resources devoted to protecting the public interest.

Insider Trading Surveillance Trends

The last two years have seen a significant increase in the number and complexity of our insider trading referrals to the SEC. Referrals to the SEC increased from 68 in 2004 to 111 in 2005, a 63% increase. For 2006, at the current pace, we project 140 referrals to the SEC, an increase of 26% increase from 2005. Combined, insider-trading referrals to the SEC have increased a cumulative 105% over the last two years. The projected 140 referrals in 2006 will handily surpass the 5-year high-water mark of 98 referrals in 2000. We have also seen an increase in the number of insider trading issues related to hedge fund activity referred to the SEC.

It must be underscored, however, that not all matters reviewed by NYSE Regulation result in a referral to the SEC. Only matters that Market Surveillance believes

warrant further review are the subject of a referral. Similarly, not all NYSE Regulation referrals to the SEC result in enforcement action by the SEC. We refer matters to the SEC where there is sufficient circumstantial evidence of insider trading. The evidentiary challenge associated with demonstrating that a person engaged in insider trading is substantial.

Penalties and disgorgement stemming from Market Surveillance referrals to the SEC have also increased. In 2004, penalties totaled more than $2.5 million. In 2005, penalties totaled more than $3.9 million. For the first half of 2006, total penalties exceeded $3.2 million, and are well on the way to surpassing 2005 levels.

Set forth below are summaries of significant actions taken by the SEC based on our referrals. These summaries will provide the Committee a better idea of the types of actions that we refer to the SEC.

- Prosecution of an international insider trading scheme orchestrated by a research analyst at the Fixed Income division of the Goldman Sachs Group and a former employee of Goldman Sachs in advance of the August 3, 2005 announcement by Reebok International Ltd. that it had agreed to be acquired by Adidas-Salomon AG. Defendants persuaded mergers and acquisitions analyst at Merrill Lynch to provide tips on upcoming mergers in return for a share of the profits. As part of its investigation of this referral, the SEC conducted additional investigations that led to the prosecution of Defendants for recruiting individuals to obtain jobs at a printing plant in Wisconsin in order to steal advance copies of Business Week and use information on the names of companies discussed favorably in the "Inside Wall Street" column before the information became public. Defendants used accounts in the United States and Europe to trade on the information in return for a share of their trading profits. Disgorgement in this action may exceed $6.7 million plus penalties, fines and prejudgment interest. SEC v. Sonja Anticevic, et. al., Civil Action 05-CIV-6991 (S.D.N.Y., May 11, 2006).

- Prosecution of an international scheme involving the fraudulent electronic theft of material non-public company information used in the trading ahead of market announcements, which may result in a disgorgement of $7.8 million and additional penalties, including fines and prejudgment interest. SEC v. Lohmus Haavel & Viisemann, Civil Action 05-CIV-9259 (S.D.N.Y.,

November 1, 2005); Litigation Release No. 19450 (November 1, 2005).

- Insider trading of stock and put options, and the shorting of stock, based on material nonpublic information involving a nationwide recall of human tissue due to possible contamination, resulting in disgorgement of $136,334, a penalty of $136,334, and prejudgment interest of $19,583. SEC v. Drinen, et. al., Civil Action No. 05-CV-8015 (S.D.N.Y., September 15, 2005); Litigation Release 19378 (September 15, 2005).

- Tipping by a benefits analyst to her husband of confidential information relating to acquisitions or tender offers for publicly traded corporations involving her employers' clients, resulting in disgorgement and penalties of $1,277,149. SEC v. Welt, et. al., Civil Action No. 05-CV-00783 (JR) (D.D.C., April 19, 2005); Litigation Release 19190 (April 19, 2005).

- Prosecution of managing director of J.P. Morgan Securities who used information obtained from a friend and business associate to purchase stock through his personal brokerage accounts after he was approached to help fund the acquisition of Unisource Energy Corporation. The action resulted in the disgorgement of $54, 693.25, payment of prejudgment interest in the amount of $7,280.38 and payment of $54,692 in civil penalties. SEC v. Huscher, Civil Action 06-CIV-3397 (N.D. IL., June 22, 2006) Litigation Release No. 10736 (June 22, 2006).

Recently, some analysts and commentators have stated their belief that the increase in insider trading cases coincides with an increase in merger and acquisitions activity. In fact, what can be fairly be said about M&A activity is that the number of M&A deals is down this year as compared to the same period last year, while the total dollar volume of M&A deals has increased. A year-to-year comparison of M&A deal activity by market analysts shows an increase in volume from $467 billion in 2002, to $871 billion in 2004, and $1.1 trillion in 2005. During the second half of 2006, global M&A increased to $1.95 trillion, up from the record level of $1.89 trillion in the first half of 2000, and up 36% from 2005 levels, topping the $2 trillion mark on July 10, 2006. During this period, European M&A activity climbed 73%, to $364.5 billion, while Asian Pacific activity, excluding Japan, followed in lockstep, with volume reaching $181

billion, exceeding levels reached in the second half 2005.

Cross-Border M&A represented a record volume of $705 billion or 36% of the total volume, exceeding by more than double last year's volume. Although the total number of deals has dropped to 685 from 763 for the first seven months of 2006, the dollar volume increased 36% during this period. "Merger arbitrage hedge funds" -- the term used to refer to hedge funds that purchase shares of target companies and sell the stock of acquiring firms – and investment banking firms are some of the top performers and revenue generators in the industry as a result of the increase in merger activity.

Conclusion

In sum, NYSE Regulation remains vigilant and cognizant of our responsibility to vigorously and pro-actively pursue the highest excellence in our regulation of the markets. In accomplishing that goal, we remain committed to continue to work with the SEC and with our fellow regulators to improve and strengthen the system of self-regulation that has made the United States the financial center of the world.

Again, I thank you for this opportunity to discuss the efforts of the NYSE Regulation in this important area and invite you, or your staff, to experience first hand our efforts by visiting us in the near future.

Department of Justice

STATEMENT

OF

RONALD J. TENPAS
ASSOCIATE DEPUTY ATTORNEY GENERAL
DEPARTMENT OF JUSTICE

BEFORE THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

CONCERNING

"ILLEGAL INSIDER TRADING: HOW WIDESPREAD IS THE PROBLEM AND IS THERE ADEQUATE CRIMINAL ENFORCEMENT?"

PRESENTED ON

SEPTEMBER 26, 2006
STATEMENT
OF
RONALD J. TENPAS
ASSOCIATE DEPUTY ATTORNEY GENERAL
SENATE JUDICIARY COMMITTEE
SEPTEMBER 26, 2006

Insider Trading: Another Front in the Battle Against Corporate Fraud

Good morning Chairman Specter, Ranking Member Leahy, and members of the Committee. Thank you for inviting the Department of Justice to testify today concerning its efforts to prosecute insider trading. At the outset, let me assure you and the other members of the Committee that the Department and the Corporate Fraud Task Force are committed to maintaining fairness and integrity in the marketplace by ensuring that individual investors are able to invest their hard-earned dollars without fear of being taken advantage of by those – whether they be corporate officers, members of the financial services industry or others – who improperly use inside information to enrich themselves at the expense of others.

The Nature of Insider Trading

The consequences of insider trading are profoundly harmful. Insider trading is a variation of corporate fraud that smacks of the secret backroom exchanges between insiders every small investor fears when he buys stock. Conceptually "insider trading" is relatively straightforward to explain, particularly when compared to other forms of corporate fraud involving complex transactions and complicated accounting schemes. By virtue of their positions within a corporation, corporate executives, managers, and employees obtain non-public "inside" information, such as information on a company's financial performance or its acquisition of another company, that will have a material effect on share prices. Similarly,

persons outside the corporation, such as the corporation's clients or those, like attorneys or accountants, who provide services to the corporation, may also become aware of such non-public information. This non-public information empowers the "holder" to get a jump on the market by buying or selling stock or options in advance of the public announcement of the information. By doing so, the "insider trader" either successfully avoids investment losses or reaps unfair investment gains - while the general investing public is unable to similarly protect or enrich itself because it does not have access to the same information. The end result is that the raw material – information – on which participants in the market for the affected security base their decisions is not generally and uniformly available to all, straining the confidence of the investing public and leaving investors at the mercy of insiders with an unfair advantage.

More technically, the crime of insider trading is defined as the following: Insider trading is the willful and fraudulent buying or selling of a security, in breach of a fiduciary duty or other relationship of trust and confidence, while in possession of material, non-public information about a security. It is also unlawful to pass material non-public information to any person who may be expected to trade on the basis of that information. That practice is known as "tipping." Insider trading violations may include "tipping" information, securities trading by the person "tipped" and securities trading by those who misappropriate such information. Most criminal insider trading cases are prosecuted as securities fraud under the Securities Exchange Act of 1934.

Criminal charges are filed alleging violations of the antifraud provisions of that Act, Title 15, United States Code , Section 78j(b), as well as Section 78ff and 17 C.F.R. § 240.10b-5. If fraud, including insider trading, is involved in a tender offer, charges may be filed under Title 15, United States Code, Section 78n(e). The punishment for willful

violations of these provisions is a fine up to $5 million and imprisonment up to 20 years. Cases alleging criminal insider trading also may involve conduct in violation of the mail fraud, wire fraud, conspiracy, obstruction of justice, or perjury statutes. The current criminal statutes used to prosecute insider trading case have proven effective to address insider trading. In addition to prosecutions brought by the Department, these abuses are addressed by the Securities and Exchange Commission ("SEC") through civil actions to obtain injunctive relief, disgorgement of "ill gotten gains," assessment of stiff administrative penalties and fines and other equitable relief. In each case of established wrongdoing, a determination is made whether to pursue criminal charges, administrative remedies, civil remedies, or some combination thereof.

The Challenges of Insider Trading Prosecutions

While the elements of criminal insider trading may be straightforward, successful investigation and prosecution of the crime presents significant challenges. For example, prosecutors charging a defendant with an insider trading violation must demonstrate that the defendant's conduct was a willful – as opposed to knowing – violation of the law, meaning that it must be proven beyond a reasonable doubt that the defendant was aware, at the time of the insider trade, that he or she was doing something in violation of the law. In addition, prosecutors must also prove that the inside information at issue in the case was both "material," meaning likely to be of interest to the reasonable investor, and "non-public," and that the defendant used the same information in making his or her trading decision. Prosecutors must also prove that the insider has a fiduciary relationship with the corporation from which the inside information comes. In cases involving corporate officers, directors or employees, this requirement is easily met, but in cases involving outsiders, and in particular those who receive tips from corporate insiders or agents, it can pose a significant burden.

Given these requirements, uncovering evidence of criminal insider trading activity requires more than just market surveillance and the discovery of spikes in trading. Anomalies such as these may be indicative of a problem, but they are simply the first step in an investigative inquiry. For example, there may be legitimate reasons for a spike in trading activity, such as expiration dates for option awards or other mechanics associated with the company's compensation program. Moreover, a spike in trading activity does not disclose to investors what information, if any, the individual involved in the trade used in making his or her trading decision, a key element in proving the crime of insider trading. Similarly, an assessment of the materiality of the inside information at issue is frequently not possible until the information itself is publicly disclosed. Only then can investigators determine if the information was something that would be of significance to a reasonable investor or if it had an impact on the company's stock price. Additionally, the identity of the traders and their "tippers" must be discovered, their possession of "insider information" must be documented, the relationship between all the subjects and targets must be understood, and the existence of any fiduciary relationships must be established. As the degrees of separation from the original source grow, proving the elements of a criminal prosecution becomes more difficult.

Insider trading cases are rarely proved with a "smoking gun." These cases almost universally turn on circumstantial evidence and insider traders frequently proffer a number of alternative explanations for their conduct. Furthermore, while it may be easier to tie the trading activity of known corporate executives to insider trading in their companies, the cases we have investigated and prosecuted demonstrate that insider trading can also be conducted by individuals with no readily apparent tie to the affected company or security – an outside accountant or an employee of a printing plant just as easily can be the recipient of "inside information" or can disclose inside information.

Our investigations must be conducted in a thorough and methodical manner to insure the evidence presented at trial is sufficient to prove beyond a reasonable doubt that the crime has been committed by the defendant. The prosecutive decision whether to file criminal charges is made by the United States Attorney or by Department prosecutors, based on an assessment of the evidence, the factual background of the particular case, and the applicable statutory provisions. These cases are difficult and risky, and the investigations are often protracted and complex.

How Are Insider Trading Cases Investigated?

Investigating and prosecuting insider trading is a collaborative effort. A majority of our insider trading cases emerge from our government enforcement partners or self-regulatory bodies, such as the SEC, the Commodity Futures Trading Commission ("CFTC"), the National Association of Securities Dealers ("NASD"), or the New York Stock Exchange ("NYSE"). In a typical case, the SEC begins an inquiry or formal investigation into activity that may indicate the presence of illegal insider trading. This investigation may be generated by suspicious securities trading activity immediately before announcement of a significant corporate event, which is detected by the SEC, CFTC, NASD or the NYSE. Such entities have sophisticated computer programs designed to track and match unusual trading patterns with merger announcements and have specialized expertise in detecting these anomalies.

But that is only the beginning of the process. After detecting an unusual pattern of trading activity, the SEC then may contact the United States Attorney's Office in its region, the Department of Justice, the Federal Bureau of Investigation ("FBI") or other law enforcement agencies, to inform these agencies of the results of its preliminary inquiry. The law enforcement agencies typically will then request access to the SEC investigative materials. Should the preliminary inquiry indicate there may have been trading by insiders,

the FBI, or another law enforcement agency, will often initiate a criminal investigation, in coordination with a United States Attorney's Office, while remaining in contact with the SEC, which will continue with its own investigation.

The prosecutors and the SEC maintain parallel and independent investigations, with the SEC pursuing its statutory responsibilities by ascertaining whether there has been a violation of the federal securities laws that warrants civil or administrative action to stop the illegal insider trading through injunctive or other relief, while the Department of Justice conducts its own criminal investigation. In this respect, I note that the Department respectfully disagrees with a recent district court decision in the District of Oregon, *United States v. Stringer*, in which the district court found that the criminal prosecutors were effectively using SEC attorneys as their agents to investigate the criminal case. That case is on appeal. The Department does not use the SEC to investigate its criminal cases. Rather, it properly coordinates with that agency to obtain documents and testimony properly obtained in the civil case for use in its criminal investigation. This coordination, which Congress has long authorized and encouraged, prevents a needless duplication of effort by the company under investigation and preserves scarce government resources. The Department and the SEC make completely independent charging decisions based on very different standards of proof and enforcement priorities.

The Department's Successful Track Record

Despite the significant hurdles to the successful criminal prosecution of insider trading cases, the Department has been very successful in prosecuting those who seek to exploit their access to information at the expense of the market. Our cases involve all types of defendants, from corporate officers, directors and employees who traded the company's securities after learning of significant confidential corporate developments, to friends, family

members, and other "tippees" who traded the securities after receiving inside information. While these cases are significant and troubling in their own right, perhaps the most egregious category of insider trading defendants consists of those who work in the financial services industry, including employees of law, banking, brokerage and printing firms who were given access to inside information to provide services to the corporation whose securities they traded and who – particularly in the case of brokers – sacrificed their duties to their clients to enrich themselves.

IMCLONE

Several of the cases we have prosecuted illustrate the wide range of insider trading activity. For example, Samuel Waksal was the former Chief Executive Officer of ImClone Systems, a medical research company which developed Erbitux, a well publicized cancer drug. In December 2001, Waksal learned the Food and Drug Administration (FDA) would not approve the license to distribute Erbitux. Before this information became public, Waksal contacted his stockbroker, Peter Bacanovic, and liquidated $10 million of family holdings in ImClone. After the FDA's decision was released, ImClone's stock price dropped significantly. Following his indictment, Waksal pleaded guilty to two counts of securities fraud for the insider trading scheme as well as charges of conspiracy, bank fraud, obstruction of justice and perjury. He was sentenced to seven years and three months and fined $3 million on June 10, 2003.

Bacanovic also was the stockbroker for Martha Stewart. In an interview with the FBI, Stewart lied about her sale of ImClone by claiming that she had a preexisting agreement with Bacanovic to sell the stock when it dropped below a specific price. Bacanovic provided a similar false explanation in an interview with investigators from the SEC. Stewart was convicted on four counts of obstructing justice for lying about her sale of ImClone stock.

Bacanovic was convicted on four counts of conspiracy and false statements. Each received a sentence of five months in custody and five months home detention.

PAJCIN/PLOTKIN

A case prosecuted recently in the Southern District of New York involved both insider trading associated with merger and acquisition activity and persons employed in the financial services industry. Earlier this year, Eugene Plotkin, an associate at Goldman Sachs, and Stanislav Shpigelman, an investment banking analyst at Merrill Lynch, were charged with participating in a $6.7 million insider trading scheme by obtaining confidential information relating to numerous pending mergers and acquisitions handled by Merrill Lynch. The confidential information was used by the defendants and others to purchase securities based on knowledge of the deals prior to the public announcement of the transactions and then sell the securities immediately after the public announcements. On July 14, 2006, Shpigelman pleaded guilty to the insider trading scheme and he is awaiting sentencing. Jason Smith, a grand juror on a federal grand jury in New Jersey who provided information to the group about the grand jury's investigation of accounting fraud at Bristol-Myers, also pleaded guilty to securities fraud, conspiracy and contempt on August 10, 2006, and he is awaiting sentencing.

In addition, according to the charges, Daniel Pajcin and Plotkin were at the center of schemes to trade on inside information not only from Shpigelman, but from pre-publication issues of Business Week. Pajcin allegedly directed defendant Renteria to get a job at the Business Week printing plant and Renteria then began giving Pajcin information about stocks from upcoming issues of Business Week prior to publication and dissemination to the public. Pajcin conducted stock trades on that information before the issues were distributed. Between May and August 2005, Pajcin directed trades from his aunt's account in Croatia,

making millions in profit. Plotkin, along with Juan Renteria and another employee of the printing plant, Nickolaus Shuster, were also charged in a separate scheme to gain advance information of favorable reviews of numerous stocks in the "Inside Wall Street" column of Business Week by bribing employees of that magazine and then trading in approximately 20 stocks one day before those stocks were reviewed in the magazine. Plotkin, Renteria and Shuster are scheduled to proceed to trial in April 2007.[1] Pajcin pleaded guilty and is cooperating.

MIN T. MA

Insider trading activity connected with mergers and acquisitions has not been limited solely to corporate insiders and financial analysts. For example, in the Northern District of California, an individual, Min T. Ma, was prosecuted for using his position as an employee of a company providing desktop publishing services to Merrill Lynch to profit illegally from insider trading. The case began when the FBI's San Francisco Division received a referral from the SEC and the NASD about suspicious purchases of a company's stock prior to the public announcement that the company had agreed to a merger. During the investigation, law enforcement officers learned that Ma had obtained material, non-public information related to potential mergers as a result of his position as an employee of a company that provided desktop publishing services to the Palo Alto and Menlo Park offices of Merrill Lynch. Ma used that material non-public information to buy stock in two companies. Following the public announcement of mergers involving these companies, Ma sold the stock for net profit of $197,258.62. In 2005, Ma pleaded guilty in the Northern District of California to two counts of insider trading. The district court sentenced Ma to 18 months' imprisonment and ordered him to pay restitution in the full amount of his improper gain.

[1] The defendants are presumed innocent of these allegations, unless and until proven guilty in a court of law.

ROGER D. BLACKWELL

The Department has also prosecuted cases involving corporate directors, the individuals who participate in a company's most significant and sensitive decisions. One of these cases involved Roger D. Blackwell, a member of the Board of Directors for Worthington Foods. Blackwell provided a tip to friends and associates about the Kellogg Company's pending purchase of Worthington. The subjects traded a total of 81,074 shares of Worthington stock and realized net profits of $882,065. The FBI's Cincinnati Division and its Columbus Resident Agency opened this investigation based on a criminal referral from the SEC. The investigation determined that Blackwell, while a member of Worthington's Board of Directors, obtained material, non-public information regarding Kellogg's intentions to purchase Worthington. After the acquisition became public knowledge, Worthington's share price rose 61% in value. Blackwell used this information to tip friends and associates so they could purchase Worthington stock prior to its increase in value. In addition to his position on Worthington's Board of Directors, Blackwell is a well known Marketing Professor at Ohio State University.

In the ensuing prosecution, a jury in the Southern District of Ohio convicted Blackwell and two other executives of conspiracy to commit securities fraud, false statements, and obstruction regarding their involvement in an insider trading case. Blackwell was sentenced to 72 months' imprisonment and fined one million dollars.

SCHOFIELD

On June 7, 2006, Brady M. Schofield, the owner and president of several companies in the food distribution business, pleaded guilty in the Southern District of New York to signing false audit confirmation letters and insider trading. The insider trading arose when an employee at U.S. Foodservice, Inc., a company that Schofield was doing business with, told

Schofield that Royal Ahold, a Dutch food conglomerate, intended to acquire the company. Knowing this, Schofield purchased U.S. Foodservice stock and sold it after the merger announcement, making $287,288.00 in illegal profits. This insider trading prosecution was also brought in conjunction with an accounting fraud to falsify earnings.

Insider Trading Statistics

The Department of Justice has maintained a consistent focus on insider trading criminal cases in partnership with the SEC, NASD, the FBI and the United States Postal Inspection Service. Statistics for the past six years available from the FBI illustrate this commitment. In FY01, the FBI statistics report 53 pending cases, 16 indictments and 14 convictions. In FY06 there were 56 pending cases, 24 indictments and 15 convictions. During this six year period, the number of pending cases, indictments, and convictions has remained relatively constant.

Table 1: FBI Insider Trading Statistics: FY01 through FY06 (to date)

	Pending Cases	**Indictments**	**Convictions**
FY01	53	16	14
FY02	52	16	12
FY03	51	14	15
FY04	53	21	13
FY05	67	19	19
FY06	56	24	15

The case load of the Postal Inspection Service similarly demonstrates law enforcement's commitment to combating insider trading activity. For the period from 2001-

2006, the Postal Inspection Service reports that the number of its cases nearly tripled, the number of indictments doubled, and total restitution soared from $25,000 to $70,402,388 in comparison to the previous five years. As stated, many of these cases were jointly investigated with the FBI.

Table 2: USPIS I Insider Trading Statistics (Comparing 1996-2000 with 2001-2006)

	1996 - 2000	2001 - 20062	
Cases	9	24	(9 joint with FBI)
Arrests	15	26	(18 joint with FBI)
Indictments	12	23	(18 joint with FBI)
Convictions	14	8	(4 joint with FBI)
Declinations	1	2	(2 joint with FBI)
Restitution	$25,000	$70,402,388	($1,110,877 joint with FBI)

But these statistics tell only part of the story. Many of the most sophisticated corporate and securities frauds, involving elaborate misrepresentations or accounting schemes, also involve insider trading activity. Defendants such as corporate officers or directors engage in such elaborate schemes with the aim of not only improving the appearance of the corporation to their outside investors – and thereby artificially enhancing the stock price – but also enriching themselves at investors' expense by selling shares at these inflated prices.

The Enron investigation provided an example of such activity. Enron CEO Jeffrey

2 These statistics are provided in the aggregate. The Department recognizes that the 1996-2000 data reflects a five year period, while the 2001-2006 reflects a six year period. However, five year statistics were not available at the time of this submission.

Skilling was convicted not only of misrepresentations involving the company's performance, but also of profiting from those misrepresentations by selling some of his Enron stock when the price was artificially high – based in no small measure on the lies he and his co-defendant Kenneth Lay told over and over during their stewardship of the company. Similarly, defendants Paula Rieker, an officer in Enron's investor relations unit, and David Delainey, CEO of Enron's retail energy division, pleaded guilty to insider trading charges for their part in the same effort to falsely portray Enron as a thriving business. Other executives, such as Ken Rice, CEO of Enron's Broadband Services division, pleaded guilty to securities fraud charges rather than insider trading yet admitted that their lies and misrepresentations were aimed at unjustly enriching themselves at investors' expense, the hallmark of insider trading, and agreed to disgorge the windfall profits they reaped from the sale of their own Enron stock and options while the company's securities traded at artificially high prices. This is an example of how statistics focused on insider trading alone risk underreporting the extent of the Department's efforts to address this crime.

Corporate Fraud Task Force

No matter what form corporate fraud takes, the American investing public demands that it be eradicated. Our efforts against insider trading do not stand alone, but are an integral component of our overall corporate fraud initiative. Our experience has been that insider trading is not conducted in a vacuum, but often in concert with other manifestations of fraud.

Whether the fraud involves insider trading, backdating of stock options, concealment of corporate losses through false financial reports, or the deliberate manipulation of fictitious business transactions, these abuses tilt the fair and even investment playing field in favor of those perpetrating the fraud, potentially placing the financial well-being of the investing public in serious jeopardy. These fraudulent activities are often conducted in concert as part

of an overall scheme to pillage the corporate entity. Repeated reports of multiple incarnations of fraud by corporate directors, managers and other insiders erode investor confidence and undermine the foundations of our capital markets. We are mindful that investors have suffered catastrophic losses as a consequence of successful schemes, whether hatched in a corporate boardroom or executed by a rogue executive trading on inside information.

You all are aware that a hallmark of the Department's commitment to prosecuting corporate and white collar crime is the President's Corporate Fraud Task Force, established just over four years ago. The Task Force's mandate is to clean up corruption in the boardroom; restore investor confidence in the fair operation of our markets; and send a strong message that corporate wrongdoing will not be tolerated. Since its formation, the Department has worked hard, together with its partners, to move aggressively against corporate fraud and other related white collar criminal activity.

That partnership is expansive. The Task Force, chaired by the Deputy Attorney General, includes members from the United States Attorney community, the heads of the Department's Criminal and Tax Divisions, and a broad range of law enforcement and regulatory agencies, including the FBI, the Postal Inspection Service, the SEC, the CFTC, and the Internal Revenue Service. The Task Force meets periodically in Washington, D.C., to map out strategy and identify best practices. At the working level, the agencies interact daily on individual matters. The Task Force has been a resounding success and remains an essential part of the Department's priority in fulfilling its ongoing mission.

The Task Force's record is impressive. From its inception in 2002 through this past December, the Task Force has obtained over 1,000 corporate fraud convictions, and has convicted 92 corporate presidents, 82 Chief Executive Officers, 40 Chief Financial Officers,

14 Chief Operating Officers, 98 Vice Presidents, and 17 corporate counsel or attorneys. The Enron Task Force alone has charged 34 individuals and obtained 25 convictions to date, which include the convictions of former Enron CEO Jeffrey K. Skilling and former Enron Chairman and CEO Kenneth L. Lay. During roughly the same period, FBI records show that more than 74 defendants were convicted of insider trading-related charges, including Enron's Jeff Skilling, Paula Rieker, and David Delaney.

Our successes are directly attributable to effective interagency coordination, which ensures focus and maximizes the combined efforts of the Department and other key law enforcement agencies. We all rely on these same techniques, resources and coordination in the fight against insider trading.

Conclusion

In closing, let me again thank the Committee for its continuing interest in our corporate fraud enforcement efforts, and its specific interest today in prosecuting insider trading. The story of the Department of Justice's efforts to prosecute corporate corruption has been one of success - our cases have been significant and we are committed to building on the advances we have made in developing more effective techniques to investigate and prosecute complex white collar fraud cases. We continue to leverage the impact of our resources by working closely with our law enforcement and regulatory partners. We also strive to maximize the effectiveness of these available resources by ensuring that our casework is accomplished in keeping with the real-time enforcement mandate of the Corporate Fraud Task Force. We remain committed to combating all threats to the integrity of our capital markets and to the welfare of the investing public. I look forward to your questions.

United States Senate Committee on the Judiciary

Testimony of Christopher K. Thomas,
President, **MEASUREDMARKETS INC.**

At a hearing on "Illegal Insider Trading: How Widespread is the Problem and is there Adequate Criminal Enforcement?"
Tuesday, September 26, 2006

Thank you Senator Specter and Committee Members for the invitation to appear here today.

I am the President of Measuredmarkets Inc., which firm supplied the underlying data to *The New York Times* for its article of August 27, 2006 on abnormal trading activity.[1]

The analysis we did for the newspaper showed that for more than 40% of the scrutinized mergers, with a value of $1 billion or more that were announced in the 12-month period ending in early July of this year, **deviant trading behaviour was evident before the deals became public. Therefore, we believe that with the data displaying such aberrant activity it is more than reasonable to ask: "What prompted this activity? Could it be insider trading?"**

The Financial Times recently reported: "Insider trading is endemic in the London stock market. The Financial Services

Authority recently found that almost 30 per cent of takeover announcements in 2004 were preceded by suspicious share price movements...."[2] If 30% is considered *endemic* what would one consider labelling a number greater than 40%?

Our company provides a Service that statistically examines the trading behavior of individual stocks. We determine if today's activity conforms to the particular stock's historical patterns, or deviates from them. When stocks do wander away from their usual pattern of behavior, as determined by our process, alerts are issued automatically. If there is no news publicly available that might explain this aberration, we deem such activity highly suspicious and irregular, going against historical norms. Our factual data and experience has shown that very often such deviations occur several days before substantial changes in the prices of the identified stocks. We have numerous examples of such identification of unusual behavior preceding the release of material news. Some of these are cited in The New York Times article and

many others are referenced on our web site at

www.measuredmarkets.com

Amongst our clients are a governmental investigatory agency, news services, money managers, brokers and individual investors.

So,

(A) How does Measuredmarkets Inc. use the data and

(B) What determines abnormal trading and

(C) What is considered suspicious trading behavior?

A. We look at some 3,000 [three thousand] data points for each common stock each trading day on the New York, NASDAQ (National Market), American and Toronto (TSX) Exchanges, and for some stocks as many as 5,000 data points. We examine a stock's history of trading using three measures: Closing Price, Total Volume and the Total Trades/transactions

count. This last measure is distinct from Volume, albeit related to it. A stock's normal behavior pattern for each measure is then calculated, covering nine different periods, establishing short, medium and longer term pictures of the trading history. We thus have what can be considered 3-D pictures, covering each of the nine time periods, to compare against any day's activity. Each stock's history mathematically determines what is its **normal** pattern of behavior, automatically adjusting should it change from volatile to stable or vice versa.

B. Should a day's activity exceed the normal patterns over any of the nine time series for one or more of the three measures [Price, Volume, Trades] then it can be considered as exhibiting mathematically deviant behavior. It is **aberrant**, having wandered significantly away from its well-established normal path.

C. Each day, for the four markets that Measuredmarkets currently tracks, hundred of stocks are flagged as showing newly-deviant behavior. The majority of those so marked are actually reflecting news that is already in the public domain. The Service our company provides becomes useful, important and significant when stocks have deviated from their own norms AND THERE IS NO NEWS GENERALLY AVAILABLE THAT COULD EXPLAIN THE DEVIATIONS. Such activity we suggest is suspicious. Referring to *The New York Times* article: *"The companies were not the subject of widely dispersed merger commentary during the periods of abnormal trading, nor did they make any announcements that would seem to explain the moves."*[13]

The Measuredmarkets Service deals with real numbers from the real world. Hard data, that is in the public domain.

From the immense amount of information that is generated by the stock markets, we sift the data so that ordinary investors and interested organizations gain valuable information.

I started this company to level the playing field for investors. **" What is the use of living if it be not to strive for noble causes and to make this muddled world a better place for those who will live in it after we are gone? "** [4] So said *Winston Churchill,* and let us not forget that his Mother was American.

Thank you for your time.

[1] **The New York Times, August 27, 2006, page 1: "Whispers of Mergers Set Off Suspicious Trading" by Gretchen Morgenson**

[2] ***Financial Times*** **July 2, 2006 – updated July 3, 2006 12:28.**

[3] **Op. Cit.**

[4] **Dundee, Scotland, on 10 October 1908**

Testimony Concerning Insider Trading

by Linda Chatman Thomsen
Director, Division of Enforcement
U.S. Securities and Exchange Commission

Before the U.S. Senate Committee on the Judiciary

September 26, 2006
*[As Amended October 5, 2006]**

Chairman Specter, Ranking Member Leahy, and Members of the Committee:

Thank you for inviting me to testify today about insider trading. Our laws against insider trading play an essential role in protecting our securities markets and in promoting investor confidence in the integrity of those markets. Rigorous enforcement of our current statutory and regulatory prohibitions on insider trading is an important part of the Commission's mission. I appreciate the opportunity to explain the Commission's efforts to deal with insider trading, and to answer any questions that the Committee may have.

I am especially pleased to testify together with Associate Deputy Attorney General Ronald Tenpas of the United States Department of Justice. The Commission, as you know, is a civil enforcement agency and we use civil sanctions to address insider trading. However, insider trading may also violate federal criminal law. The respective histories of the SEC and the Department of Justice demonstrate our commitment to prosecute insider trading, civilly and criminally. Our histories also demonstrate our collective commitment to working with each other.

Over the years, investigating and prosecuting insider trading violations has remained a steady component of our enforcement mission. Since 2001, this agency has brought 300 actions against over 600 individuals and entities for insider trading violations, and frozen millions of dollars in illicit trading proceeds.[1] In the aggregate, over the same period, insider trading cases have consistently made up about 7-12% of our filed caseload.[2]

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* Testimony amended on October 5, 2006 to delete the word "settled" from the text immediately preceding footnote 9 on page 4 of written testimony dated September 26, 2006, and to change the adjacent word "a" to "an".

[1] A list of the insider trading cases filed by the Commission in the past five years (FY2001 through the present, as of September 22, 2006) is attached hereto as Exhibit A.

[2] Each year, the Division of Enforcement brings a mix of cases in core program areas, including insider trading, as well as financial fraud, offering fraud, market manipulation and actions involving the conduct of registered investment advisers and broker-dealers. Our record shows that – despite shifting areas of concern that demand enforcement attention from year to year – insider trading has consistently been an important part of the program. In fiscal 2006 to date, the Division has initiated 44 actions against 77 individuals or entities that primarily involve insider trading allegations. In fiscal 2005, the Division initiated 49 such actions against 93 individuals or entities. In fiscal 2004, the Division initiated 42 such actions against 95 individuals or entities.

At the same time, our Enforcement program is, by necessity, dynamic—we constantly strive to respond to market, as well as legal and technological, developments. Our priorities and resource allocations must change to meet trends in the market and developing forms of fraud. Even within the relatively narrow arena of insider trading, we must shift our resources to those areas where the greatest threats lie. For example, in the mid-eighties, most of our insider trading cases arose out of the merger and acquisition boom. In the recession of the late eighties and early nineties, the Commission brought more "bad news" selling cases – insiders dumping shares before adverse corporate developments were disclosed. More recently, globalization, the technology boom, a renewal of merger activity, and our concern about insider trading by hedge funds have shifted our enforcement focus yet again.

Insider trading has remained an enforcement priority. As I mentioned a moment ago, the Commission has charged over 600 hundred insiders and tippees in recent years. Our investigative staff has pursued individuals who engage in insider trading in our markets all across the globe—from a corporate lawyer's office in New York City to a small town in Eastern Europe. By seeking immediate emergency relief, our staff has frozen and preserved millions of dollars in insider trading proceeds, often within only days of the illegal trading that created them.

We have had some remarkable successes. A few months ago, we brought an action against three hedge funds and two individuals for allegedly trading ahead of a merger announcement.[3] Over the past 18 months, we brought insider trading charges against another three hedge funds and three hedge fund managers for trading ahead of the public announcement of dozens of stock offerings by public companies.[4] And over the past year, we have charged a total of 17 defendants in the *Reebok* case—who we allege participated in an international insider trading ring that netted at least $6.8 million in illicit gains by, among other things, stealing information from Merrill Lynch, *BusinessWeek* and a sitting New Jersey grand jury.[5]

In fiscal 2003, the Division initiated 50 such actions against 104 individuals or entities. In fiscal 2002, the Division initiated 59 such actions against 144 individuals or entities. In fiscal 2001, the Division initiated 57 such actions against 115 individuals or entities.

[3] *SEC v. Nelson J. Obus, et al.*, Lit. Release No. 19667, Civ. Action No. 06-3150 (GBD) (S.D.N.Y. Apr. 25, 2006).

[4] *SEC v. Deephaven Capital Management, LLC and Bruce Lieberman*, Lit. Release No. 19683, Civ. Action No. 01:06CV00805 (D.D.C. May 2, 2006); *SEC v. Langley Partners, L.P., et al.*, Lit. Release No. 19607, Civ. Action No. 1:06CV00467 (JDB) (D.D.C. Mar. 14, 2006); *SEC v. Hilary Shane*, Lit. Release No. 19227, Civ. Action No. 05-civ-4772 (S.D.N.Y. May 18, 2005); *see also SEC v. Guillaume Pollet*, Lit. Release No. 19199, Civ. Action No. 05-CV-1937 (SLT/RLM) (E.D.N.Y. Apr. 21, 2005) (charging former managing director of investment bank, SG Cowen & Co., with insider trading ahead of stock offering).

[5] *SEC v. Sonja Anticevic, et al.*, Lit. Release No. 19775, Civ. Action No. 05 Civ. 6991 (KMW) (S.D.N.Y., fourth amended complaint filed July 26, 2006) ("*Reebok*").

Perhaps more than any other recent insider trading case we've filed, the *Reebok* case demonstrates the ingenuity and perseverance of our staff, and the lengths to which we will go in tracing a fraud. In *Reebok*, the Commission alleges that two individuals—one current and one former employee of Goldman, Sachs—engaged in a complex and wide-ranging scheme in which they illegally obtained inside information from the various sources I mentioned a moment ago (among others), and then forwarded the tips to multiple co-conspirators who traded on them throughout the United States and Europe.

We first focused on the Reebok trading in August 2005, when a retired Croatian seamstress made a series of sophisticated options trades that essentially amounted to a bet that the stock of Reebok International, Ltd. would rise quickly. In fact, just a day after her last trade, Reebok announced it had agreed to be acquired by Adidas-Salomon, AG, netting the seamstress a profit of over $2 million. Because of this extraordinary and fortuitous profit by an apparently inexperienced options trader, we filed an emergency action freezing the securities account in which these trades were made. Our New York office continued to investigate the matter, leading to additional actions alleging that the seamstress was in fact trading on instructions from her nephew, former Goldman, Sachs broker David Pajcin, and that Pajcin's co-principal in the scheme was Goldman, Sachs research analyst Eugene Plotkin.

Based on information discovered to date, the Commission's complaint charges Plotkin and Pajcin with orchestrating a scheme that involved a large group of unlikely co-conspirators who either illegally tipped inside information to others, or traded on the tips, and then shared in the trading profits. Chief among them was a mergers and acquisitions analyst at Merrill Lynch, who is alleged to have provided nonpublic information regarding pending corporate transactions. Two other individuals allegedly obtained jobs at a Wisconsin printing plant in order to steal information on *Business Week* articles before the magazine was circulated. Pajcin and Plotkin also allegedly obtained information from a letter carrier who was sitting on a federal grand jury in New Jersey regarding the grand jury's probe of a public company. Finally, to capitalize on the stolen information, Pajcin and Plotkin allegedly tipped a broad network of cooperating traders throughout the United States and Europe—including Pajcin's aunt, the retired Croatian seamstress, and a friend employed as an exotic dancer in New York. To date, the staff has charged 17 individuals in the scheme, which ultimately involved insider trading in the securities of not only Reebok, but a total of 26 different issuers. The staff's investigation—here and abroad—is continuing.

As I said before, even within a discussion of unlawful insider trading – a very specific type of violation – there are important areas of concentration we can consider. One such area involves insider trading by hedge funds—an area of significant concern to the Commission, the Enforcement Division, and I know, to this Committee. In fiscal year 2006 to date, the Commission has brought 44 insider trading cases. Of these, five involved hedge funds or their advisers.

The Commission has brought at least three cases in the past two years involving insider trading by hedge funds and their managers in advance of PIPEs offerings.[6] "PIPE" is an acronym for "private investment in public equities," a form of stock offering often used by distressed companies to raise capital when they are unable to obtain financing by other means. Hedge funds frequently invest in such offerings, but typically agree not to trade the stock before the PIPE offering is publicly announced. In the most recent of the PIPEs cases, the Commission charged that hedge fund adviser Deephaven Capital Management, LLC, a registered investment adviser, violated its agreements not to trade by selling stock short before PIPEs offerings were announced, and then covering with shares obtained in the offerings. In all, the Commission charged Deephaven and its former portfolio manager with insider trading prior to the public announcement of no fewer than 19 PIPEs offerings. In settling the case, the Commission obtained permanent anti-fraud injunctions and a total of $5.8 million in disgorgement, penalties, and interest from the adviser and portfolio manager, as well as an industry bar against the portfolio manager.[7] In a similar case, *Langley Partners*, three hedge funds and their portfolio manager paid nearly $16 million to settle an action involving insider trading in advance of the public announcement of 7 PIPE transactions.[8]

In addition to the PIPEs cases, the Commission has brought two cases against hedge funds involving insider trading ahead of mergers and acquisitions. In an insider trading action against a hedge fund I mentioned earlier today, the fund manager allegedly directed the purchase of shares in a merger target after receiving a tip from an insider through an intermediary, realizing illegal profits of over $1.3 million.[9] In yet another case brought within the past year, a Massachusetts-based hedge fund manager and his fund were charged with trading on material nonpublic information regarding Citizens Bank's planned takeover of Charter One Financial, making nearly three-quarters of a million dollars in illegal profits.[10] The latter case also illustrates the importance of criminal sanctions, as the fund manager recently pled guilty to five counts of criminal securities fraud.

The Commission has always viewed as particularly troubling malfeasance by the brokers, investment advisers and other professionals registered with us. Earlier this year, the Commission filed a civil injunctive action against a former Merrill Lynch broker and ten

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[6] *See supra* n.3.

[7] *Deephaven, supra* n. 3; *In the Matter of Bruce Lieberman*, Investment Advisers Act of 1940 Release No. 2517, Admin. Proc. File No. 3-12302 (May 28, 2006) (Lieberman subsequently barred from association with any investment adviser, with a right to reapply after three years).

[8] *Langley Partners, supra* n. 3

[9] *Obus, supra* n. 2.

[10] *SEC v. Michael K.C. Tom, et al.*, Lit. Release No. 19404, Civ. Action No. 05-CV-11966-NMG (D.Mass. Sept. 29, 2005). On June 8, three defendants who traded settled for fraud injunctions, disgorgement and civil money penalties. Defendant Michael Tom agreed to be barred from association with any investment adviser in March 2006, *In the Matter of Michael K.C. Tom*, Investment Advisers Act of 1940 Release No. 2494, Admin. Proc. File No. 3-12233 (Mar. 8, 2006).

former A.B. Watley day traders and their managers for participating in a scheme that involved allegedly trading ahead of large institutional orders broadcast over Merrill's in-house "squawk boxes."[11] The Commission alleged that the Merrill broker arranged to provide the A.B. Watley day traders with an open phone line to the Merrill trading floor throughout the workday, so they could hear the squawk box announcements of major orders and trade ahead of them. The Commission also sued A. B. Watley Group, A.B. Watley's publicly-traded holding company, in connection with this conduct. Earlier, in August 2005, the Commission charged five other individuals as part of this alleged scheme.[12]

Our concern extends beyond individual violations; indeed, it extends to the entities that shoulder the primary responsibility for supervising the professionals who work for them. A few months ago, we instituted a settled administrative proceeding against Morgan Stanley for its failure to maintain and enforce adequate written policies and procedures to prevent the misuse of material nonpublic information by the firm or persons associated with it.[13] There was no evidence that material nonpublic information was misused as a result of that failure. Morgan Stanley agreed to pay a $10 million civil penalty, as well as to engage an independent consultant to conduct a review of its policies, practices and procedures, and to recommend changes to those policies to prevent the future abuse of such nonpublic information. Morgan Stanley is the most recent in a line of cases in which the Commission has consistently made clear that broker-dealers and investment advisers are responsible for designing and enforcing policies to prevent the misuse of insider information.[14]

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[11] *SEC v. A. B. Watley Group, Inc., et al.*, Lit. Release No. 19335, Civ. Action No. CV-06-1274 (ILG) (E.D.N.Y. Mar. 21, 2006).

[12] *SEC v. John J. Amore, et al.*, Lit. Release No. 19335, Civ. Action No. CV-053885 (Glasser) (E.D.N.Y. Aug. 15, 2005).

[13] *In the Matter of Morgan Stanley & Co., Inc. and Morgan Stanley DW Inc.*, Securities Exchange Act of 1934 Release No. 54047, Admin. Proc. File No. 3-12342 (June 27, 2006).

[14] *See, e.g, In The Matter of Van D. Greenfield and Blue River Capital LLC,* Securities Exchange Act of 1934 Release No. 52744, Admin Proc. File No. 3-12098 (Nov. 7, 2005) (Blue River violated rules requiring policies governing handling of non-public information when it received such information about companies on whose bankruptcy and bondholder's committees Blue River principal Greenfield sat); *In re Goldman, Sachs & Co.*, Securities Exchange Act of 1934 Release No. 48436, Admin. Proc. File No. 3-11240 (Sept. 4, 2003) (Goldman, Sachs failed to have policies and procedures in place to prevent improper handling of embargoed information regarding Treasury Department's decision to abolish 30-year bond); *In re Gintel Asset Management, Inc., et al.*, Investment Advisers Act of 1940 Release No. 2079, Admin. Proc. File No. 3-10930 (Nov. 8, 2002) (firm violated provisions of the Investment Advisers Act of 1940 by failing to have policies in effect to prevent adviser from buying shares for client accounts before it releases favorable information regarding issuer); *In re DePrince, Race & Zollo, Inc., et al.,* Investment Advisers Act Release No. 2035, Admin. Proc.File No. 3-10798(June 12, 2002) (firm violated Advisers Act by failing to have procedures addressing possible conflicts of interest arising from transactions in stock of issuer on whose board firm principal sat); *In re Guy P. Wyser-Pratte et al.,* Securities Exchange Act of 1934 Release No. 44283, Admin. Proc. File No. 3-10479 (May 9, 2001) (firm violated Advisers Act and Exchange Act policy requirements by failing to have in place policies to prevent misuse of inside information gleaned by firm principal in course of advancing shareholder proposals); *In re Gabelli & Co., Inc. and Gamco Investors, Inc.,* Securities Exchange Act of 1934 Release No. 35057, Admin. Proc. File No. 3-8564 (Dec.

Let me step back and make some general observations about our insider trading program, in light of recent questions that have been raised in the press about its efficacy.

We have a lot of ground to cover. Our Enforcement Division's Office of Market Surveillance (OMS) is in daily contact with its counterparts in the various self-regulatory organizations, or SROs. After substantial study in the mid-1980s under the oversight of two Congressional Committees, an intermarket surveillance system was developed under which the SROs perform primary surveillance, as they are the entities closest to the market action.[15] The SROs monitor the markets for unusual peaks and valleys in trading, sudden changes in a security's price, or other unusual market activity. OMS maintains an open line of communication with the SROs, through which they continually pass on to us information concerning market events.

The surveillance departments at the SROs, such as the National Association of Securities Dealers (NASD), the New York Stock Exchange (NYSE), and the Options Regulatory Surveillance Authority, use cutting-edge software programs to isolate unusual trading activity that may indicate insider trading. These surveillance programs employ complex algorithms that alert analysts to anomalous trading activity. The SROs can rapidly identify the executing broker-dealer and the account for which a particular transaction was performed and investigate the basis for the trading. These programs are constantly being re-evaluated and updated as new trading mechanisms and strategies are introduced in the markets.

As demonstrated by cases like *Reebok*, we can and will move swiftly and decisively when conditions warrant. One of the principal tools we employ to prevent wrongdoers from benefiting from insider trading is the asset freeze. In *Reebok*, over $6 million in allegedly illicit trading proceeds have been frozen. Other recent cases have also used this remedy effectively. In recent action against drug company executive Alexander Yaroshinsky, alleging insider trading before the announcement of negative FDA findings on an experimental drug, the Commission took quick action ensure that Yaroshinky's assets were frozen before they could be dissipated.[16]

Insider trading leads come from a host of sources, not only market surveillance but also the news media, public tips, and information developed in our own inspections and

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8, 1994) (broker-dealer and affiliated adviser violate Exchange Act and Advisers Act by failing to implement policies to prevent misuse of nonpublic information despite role of firms' principal as CEO of issuer whose securities firms'accounts could have traded).

[15] *See* United States Securities and Exchange Commission, Final Report to the Senate Committee on Banking, Housing and Urban Affairs and the House Committee on Energy and Commerce Regarding the Market Oversight and Surveillance System at 2-3, 14-15 (Jan. 15, 1985).

[16] *SEC v. Alexander J. Yaroshinsky*, Lit. Release No. 19625, Civ. Action No. 06CV2401 (S.D.N.Y. Mar. 28, 2006).

investigations. Identifying suspicious trading is an essential starting point, but it is only the first step in compiling a viable case.

It is important to understand how difficult it is to build an insider trading case. They are unquestionably among the most difficult cases we are called upon to prove, and despite careful and time-consuming investigations, we may not be able to establish all of the facts necessary to support an insider trading charge. The challenge is not to establish facts that show suspicious trading—the surveillance records alone are often sufficient to establish that much. The real challenge is to establish that a particular individual was in possession of material non-public information and in fact traded on it in breach of a duty, and to establish those facts based on admissible evidence that can withstand challenge at trial.

Piecing together an insider trading case can be a complex and painstaking process. It is rare to find a "smoking gun;" virtually all insider trading cases hinge on circumstantial evidence. It is quite common for insider traders to come up with alternative rationales for their trading—rationales that the staff must refute with inferences drawn from the timing of trades, the movement of funds and other facts and circumstances. And because many insider trading cases involve secret communications between two people – the tipper and his tippee – assembling compelling circumstantial evidence is often difficult. In some cases, such as when a corporate insider trades on company information or when an outsider steals nonpublic information, there are no communications at all to use as evidence at trial, but only the facts of the wrongdoer's access and trading. Building an insider trading case based on circumstantial evidence can be frustrating, risky and time-consuming. Because of these challenges, we also have to accept that a number of the insider trading investigations we open may not result in a filed enforcement action—not for any lack of diligence on the part of the staff, but for lack of evidence.

Despite these challenges, our staff has become particularly adept at sifting through all available forms of evidence, including phone records, emails, instant messages, and the electronic footprints of internet protocol data.[17] Our staff culls through trading records, interviews and takes the testimony of witnesses, and reviews bank and brokerage statements. With these tools and resources, our staff has built solid, credible enforcement actions against hundreds of wrongdoers.

The Commission employs a broad range of remedies to address insider trading: injunctive relief, disgorgement of ill-gotten gains, penalties, industry bars and officer and director bars. And the Department of Justice, through its criminal prosecutions, can send insider traders to prison.

In the Commission's civil cases, the Commission generally seeks injunctive relief, disgorgement and civil financial penalties. Since 1984, the Commission has been

[17] *See SEC v. William A. Day*, Lit. Release No. 19553, Civ. Action No. 06-CV-10202-RWZ (D.Mass. Feb. 2, 2006) (coded message board posting alluding to nonpublic information); *SEC v. John Freeman, et al.*, Lit. Release No. 16469, Civ. Action No. 00 Civ. 1963 (VM) (S.D.N.Y. Mar. 14, 2000) (nonpublic information on 16 transactions passed through internet chat rooms).

authorized by statute to seek penalties in insider trading cases. Under the Insider Trading Sanctions Act of 1984 (ITSA) – and later expanded in the Insider Trading and Securities Fraud Enforcement Act of 1988 (ITSFEA) – Congress gave the Commission authority to bring civil actions in federal court seeking money penalties from insider traders of up to three times the illegal profits they made or losses they avoided.

In settling cases, we have typically sought and obtained a "one-time" penalty, or in other words, a penalty that is equal to the amount of illegal profits realized or losses avoided. This approach is particularly common when the Commission settles matters before proceeding to litigation. In some cases, where the conduct is particularly egregious, we have sought more than a one-time penalty. Among other circumstances, we believe additional penalties may be appropriate where the defendant lies to investigators, jeopardizing the integrity of our investigative process; where the defendant has taken extraordinary measures to conceal or disguise the trading activities; or where the defendant is a recidivist with a history of securities or other frauds. In other cases, where the equities dictated, we have agreed to less than a one-time penalty. In each of these instances, we made a determination that the penalty accurately reflected the seriousness of the wrongdoing, served as just punishment for the defendant's actions, and provided significant deterrent value.

We have also sought and obtained non-monetary sanctions. When appropriate, we have barred or suspended brokers, investment advisers and other professionals who have engaged in insider trading from their respective industries. Similarly, we have barred officers or directors who have insider traded from serving in that capacity for a limited time, or sometimes permanently.

We believe these remedies, along with the threat of incarceration by criminal authorities for large-scale or repeat offenders, those who go to great lengths to conceal their illicit activities, or those who lie or otherwise obstruct our investigations, give us an effective arsenal for enforcement and deterrence.

Insider trading undermines the integrity and credibility of our markets. We appreciate the fact that the market is dynamic. We understand the power of technology and we have and will use it to our advantage. We will continue to work hard to protect the world's finest and fairest markets.

I would be glad to answer any questions you might have.

EXHIBIT A
List of SEC Insider Trading Cases from FY2001 to Present
(as of September 22, 2006[18])

FY 2001

Name of Case	Release Number	Date Filed
SEC v. Marc B. Nogid	LR-16746	10/03/2000
SEC v. Robert D. Happ	LR-16755	10/05/2000
SEC v. Michael Andrew Petrescu-Comnene	LR-16765	10/13/2000
SEC v. Jerome Alpin, et al.	LR-16774	10/18/2000
In the Matter of Marc B. Nogid	34-43472	10/23/2000
SEC v. Jerome J. Nell, et al.	LR-16790	11/03/2000
SEC v. Richard A. Svoboda, et al.	LR-16791	11/07/2000
SEC v. Robert C. Schuster	LR-16806	11/20/2000
SEC v. Stephen J. Cowley	LR-16812	11/28/2000
SEC v. Leslye R. Schaefer, et al.	LR-16815	12/01/2000
In the Matter of Brett S. Henderson	34-43681	12/06/2000
SEC v. Harold W. Andrews, et al.	LR-16844	12/28/2000
SEC v. Colleen M. Millsap	LR-16850	01/03/2001
SEC v. Steven Eichenholz	LR-16853	01/03/2001
SEC v. Midpoint Trading Corp., et al.	LR-16862	01/17/2001
SEC v. Alan Myles Dornfeld	LR-16869	01/23/2001
SEC v. Keith J. Kim, et al.	LR-16872	01/29/2001
SEC v. David M. Bonrouhi	LR-16880	01/31/2001
In the Matter of Daniel M. Porush	34-43937	02/07/2001
In the Matter of Alan M. Stricoff	34-43936	02/07/2001
SEC v. David M. Brooks	LR-16893	02/08/2001
SEC v. Joanne M. Moore, et al.	LR-16899	02/14/2001
SEC v. Maria Iacovelli, et al.	LR-16901	02/15/2001
In the Matter of David M. Bonrouhi	34-43967	02/15/2001
SEC v. Daniel J. Lagermeier	LR-16903	02/21/2001
In the Matter of Allan G. Schaefer	34-43997	02/23/2001
SEC v. Aaron C. Finch	LR-16933	03/15/2001
SEC v. Robert P. Oliver, et al.	LR-16949	04/02/2001
SEC v. Melissa K. Quizenbeury	LR-16959	04/10/2001
SEC v. Matthew Joel Mesplou	LR-16956	04/10/2001
SEC v. Malcolm B. Wittenberg	LR-16970	04/18/2001
In the Matter of Cristan Kinnard Blackman, et al.	34-44204	04/19/2001
SEC v. J. Van Oliver	LR-16971	04/19/2001
SEC v. Robert K. Gasper, et al.	LR-16972	04/23/2001
SEC v. Daniel R. Dugan	LR-16987	05/02/2001
SEC v. Jorge Eduardo Ballesteros Franco, et al.	LR-16991	05/08/2001

[18] This list includes cases that we have classified as insider trading cases, although they may involve multiple allegations. This list does not include additional cases that may involve insider trading allegations, but that we have determined are more appropriately given another primary classification (for example, Broker-Dealer).

SEC v. Alejandro Duclaud Gonzalez de Castilla, et al.	LR-16997	05/11/2001
In the Matter of Michael Andrew Petrescu-Comnene	34-44310	05/16/2001
SEC v. W. Blake Brock, et al.	LR-17005	05/16/2001
SEC v. Steve Madden	LR-17015	05/23/2001
SEC v. Henry T. Pietraszek	LR-17022	05/31/2001
SEC v. Thomas Houck, et al.	LR-17029	06/06/2001
In the Matter of Ricardo Ballesteros Gutierrez	34-44420	06/13/2001
SEC v. George F. Brandt	LR-17161	07/02/2001
SEC v. Steven G. Thanhauser	LR-17077	07/23/2001
SEC v. James A. Anderson	LR-17103	07/26/2001
SEC v. Vincent Napolitano	LR-17107	08/21/2001
SEC v. Robert Breed	LR-17107	08/21/2001
SEC v. Shewak Vashdev Banchant	LR-17128	09/05/2001
SEC v. Harry Parker Daily, et al.	LR-17124	09/10/2001
SEC v. Patrick Joseph Danaher, et al.	LR-17125	09/10/2001
SEC v. Randall D. Martin, et al.	LR-17141	09/19/2001
SEC v. Dennis Ciccone	LR-17143	09/20/2001
SEC v. Devin A. Danehy	LR-17150	09/21/2001
SEC v. David Kenneth Tomney	LR-17153	09/27/2001
SEC v. Brendan J. Sterne, et al.	LR-17154	09/27/2001
In the Matter of Robert Bruce Lohmann	NONE	09/28/2001

FY 2002

Name of Case	Release Number	Date Filed
SEC v. Alan E. Wesa	LR-17168	10/01/01
SEC v. Sol Berg, et al.	LR-17170	10/04/01
In the Matter of Ryan Campbell Doersam	34-44939	10/16/01
SEC v. Rodolfo Luzardo, et al.	LR-17197	10/18/01
SEC v. William A. Rothrock, IV, et al.	LR-17213	10/31/01
SEC v. Joseph F. Doody IV, et al.	LR-17225	11/08/01
SEC v. Ken C. Chow, et al.	LR-17243	11/19/01
SEC v. Mark Apton, et al.	LR-17243	11/19/01
SEC v. Robert J. Prevette, et al.	LR-17243	11/19/01
SEC v. Geoffrey Chang, et al.	LR-17243	11/19/01
SEC v. David Chang, et al.	LR-17243	11/19/01
SEC v. Evan K. Lau, et al.	LR-17243	11/19/01
SEC v. Atul Bhagat, et al.	LR-17243	11/19/01
SEC v. George P. Matus, et al.	LR-17259	12/04/01
SEC v. Patricia A. Burgenhagen, et al.	LR-17278	12/18/01
SEC v. Sean R. Price, et al.	LR-17279	12/19/01
SEC v. Douglas M. Gloff	LR-17282	12/19/01
In the Matter of Benjamin J. Maldonado, III	34-45198	12/27/01
SEC v. Felix Litvinsky, et al.	LR-17306	01/14/02
SEC v. Robert C. Lowes	LR-17320	01/16/02

SEC v. Daniel J. Wooten III	LR-17330	01/22/02
SEC v. Ryan D. Evans, et al.	LR-17340	01/24/02
SEC v. Thomas T. Johnson, et al.	LR-17347	01/30/02
SEC v. Pablo Escandon Cusi, et al.	LR-17356	02/07/02
SEC v. John S. Kramer, et al.	LR-17391	02/19/02
SEC v. John Patrick Fitzgerald	LR-17370	02/21/02
SEC v. Robert Bartzoff	LR-17384	02/21/02
SEC v. John J. Cassese	LR-17378	02/25/02
SEC v. Hugo Salvador Villa Manzo, et al.	LR-17395	03/06/02
SEC v. Ronald K. Mahabir, et al.	LR-17401	03/07/02
SEC v. Andrew W. Sachs	LR-17402	03/07/02
SEC v. Anthony Chrysikos, et al.	LR-17404	03/07/02
SEC v. John Harbottle	LR-17424	03/20/02
SEC v. Geoffrey Etherington II, et al.	LR-17467	04/11/02
SEC v. George Kline, et al.	LR-17475	04/17/02
In the Matter of Hugo Salvador Villa Manzo	34-45806	04/24/02
SEC v. Eric Patton, et al.	LR-17495	04/30/02
SEC v. Edward Fruchtenbaum	LR-17499	05/02/02
In the Matter of Erich A. Kline	34-45878	05/03/02
SEC v. Steven S. Goldberg	LR-17505	05/07/02
In the Matter of Steven S. Goldberg	34-45888	05/07/02
SEC v. Josephine Anne Pagano	LR-17543	06/05/02
SEC v. Sitestar Corporation, et al.	LR-17541	06/05/02
SEC v. John Wesley Straub, et al.	LR-17549	06/10/02
SEC v. Jean-Jacques Degroof, et al.	LR-17554	06/11/02
SEC v. Samuel D. Waksal	LR-17559	06/12/02
SEC v. Janice A. Loef	LR-17599	06/28/02
SEC v. Jay S. Laveson	LR-17596	07/02/02
SEC v. Barry L. Saffer	LR-17597	07/02/02
In the Matter of Ronald K. Mahabir	34-46217	07/17/02
SEC v. Joseph Sidoryk, et al.	LR-17628	07/23/02
SEC v. Edward J. Smith, et al.	LR-17629	07/24/02
SEC v. Michael A. Ofstedahl, et al.	LR-17645	07/31/02
SEC v. Timothy P. Horne	LR-17680	08/15/02
SEC v. Genentech, Inc., et al.	LR-17684	08/15/02
SEC v. John Gomersall and Barry McGriff	LR-17699	08/22/02
SEC v. Michael W. Foti	LR-17700	08/27/02
SEC v. Harvey R. Dobrow, et al.	LR-17733	09/18/02

FY 2003

Name of Case	Release Number	Date Filed
SEC v. Thomas M. Gibson, et al.	LR-17767	10/03/2002
SEC v. Terry L. Kirch	LR-18314	10/07/2002
In the Matter of Michael Nicolaou	34-46608	10/07/2002
SEC v. Lionel P. Thotam	LR-17784	10/10/2002
SEC v. Lorene Ellen Turpin, et al.	LR-17786	10/15/2002

SEC v. William J. Pardue	LR-17806	10/24/2002
In the Matter of Rodolfo Luzardo	34-46854	11/12/2002
In the Matter of Sharad Kapoor	34-46871	11/21/2002
In the Matter of Arjun Sekhri	34-46873	11/21/2002
SEC v. Andrew S. Marks	LR-17871	12/03/2002
SEC v. Rand E. Shapiro, et al.	LR-17893	12/12/2002
SEC v. Robert Williams	LR-17932	01/15/2003
SEC v. Phong Nguyen, et al.	LR-17940	01/16/2003
SEC v. William D. Parker, et al.	LR-17944	01/21/2003
SEC v. Roger D. Blackwell, et al.	LR-17944	01/21/2003
SEC v. David W. Maxwell, et al.	LR-17944	01/21/2003
SEC v. Timothy J. Potter, et al.	LR-17958	01/30/2003
SEC v. Linda A. Watson, et al.	LR-17972	02/06/2003
SEC v. Kenneth W. Mellert, et al.	LR-17983	02/13/2003
In the Matter of Peter Matus	34-47487	03/12/2003
SEC v. James D. Logan	LR-18033	03/13/2003
SEC v. Wilmer Reid Funderburk, et al.	LR-18041	03/18/2003
SEC v. Geoffrey E. Fitts, et al.	LR-18080	04/10/2003
SEC v. Raymond S. Evans	LR-18133	05/12/2003
In the Matter of Gordon K. Allen, Jr.	34-47887	05/19/2003
In the Matter of Chad L. Conner	34-47886	05/19/2003
SEC v. David F. Carvajal	LR-18148	05/20/2003
SEC v. Michael T. Mulligan	LR-18156	05/23/2003
SEC v. Gregory D. Frazier, et al.	LR-18158	05/28/2003
SEC v. Gregory J. Misfeldt, et al.	LR-18160	05/28/2003
SEC v. Eric I. Tsao	LR-18164	06/02/2003
SEC v. Martha Stewart, et al.	LR-18169	06/04/2003
In the Matter of Jon Geibel	34-47989	06/05/2003
In the Matter of Seth J. Glaser	34-47987	06/05/2003
In the Matter of Peter L. Cohen	34-47988	06/05/2003
SEC v. Carl Stevens, et al.	LR-18238	07/18/2003
SEC v. Marvin W. Goldstein	LR-18246	07/23/2003
SEC v. Mark Fisch, et al.	LR-18264	07/30/2003
SEC v. Davi Thomas	LR-18298	08/20/2003
SEC v. Robert Arneson, et al.	LR-18321	09/03/2003
SEC v. Peter J. Davis, Jr., et al.	LR-18322	09/04/2003
In the Matter of Goldman, Sachs & Co.	34-48436	09/04/2003
In the Matter of Massachusetts Financial Services Company	IA-2165	09/04/2003
SEC v. Kris Klinger	LR-18333	09/09/2003
SEC v. Arthur K. Bartlett	LR-18361	09/24/2003
SEC v. Warren J. Soloski	LR-18368	09/25/2003
SEC v. John R. Felder, et al.	LR-18376	09/25/2003
In the Matter of Warren J. Soloski	33-8293	09/26/2003
SEC v. Frances J. Burkitt, et al.	LR-18384	09/29/2003
SEC v. DeWalt J. Willard, Jr., et al.	LR-18379	09/30/2003

FY 2004

Name of Case	Release Number	Date Filed
In the Matter of John Ray Rooney	34-49179	02/03/2004
SEC v. Kenneth S. Martin	LR-18564	02/04/2004
SEC v. Leon Levy, et al.	LR-18584	02/19/2004
SEC v. InVision Technologies, Inc.	LR-18657A	03/16/2004
SEC v. Sean S. Coghlan, et al.	LR-18633	03/23/2004
SEC v. E. Garrett Bewkes, Jr., et al.	LR-18658	04/07/2004
SEC v. Alfred S. Teo, Sr., et al.	LR-18673	04/22/2004
SEC v. Allen M. Glick, et al.	LR-18675	04/22/2004
SEC v. Barry Richard Kusatzky	AAER-1996	04/28/2004
In the Matter of Robert D. Bewkes	34-49645	05/03/2004
SEC v. Paula H. Rieker	AAER-2018	05/19/2004
In the Matter of Frank J. Zangara	34-49805	06/03/2004
SEC v. Frederick David Jones, et al.	LR-18742	06/10/2004
SEC v. Fiore J. Gallucci, et al.	LR-18873	06/16/2004
SEC v. J. Thomas Talbot	LR-18762	06/24/2004
SEC v. David M. Willey, et al.	LR-18794	07/26/2004
SEC v. Rick A. Marano, et al.	LR-18799	07/27/2004
SEC v. Kenneth F. Kryzda	LR-18806	07/28/2004
SEC v. Peter O. Marion	LR-18796	07/28/2004
SEC v. Michael J. McCloskey, et al.	LR-18819	08/02/2004
SEC v. Derrick S. McKinley	LR-18832	08/12/2004
In the Matter of Daniel Harris	34-50194	08/13/2004
SEC v. Gary M. Kornman	LR-18836	08/18/2004
SEC v. John Patrucco	LR-18846	08/24/2004
In the Matter of Fiore J. Gallucci	34-50334	09/09/2004
In the Matter of Andrew S. Marks	34-50432	09/23/2004
SEC v. Mark Kelly, et al.	LR-18906	09/28/2004
SEC v. Linda Ensor, et al.	LR-18902	09/28/2004
SEC v. James R. Jensen	LR-18912	09/29/2004
SEC v. Gerhard Andlinger, et al.	LR-18383	10/01/2003
SEC v. Stephen A. White, et al.	LR-18407	10/09/2003
In the Matter of Stephen A. White	34-48645	10/16/2003
In the Matter of Louis B. Lloyd	34-48661	10/20/2003
SEC v. Rodney R. Proto, et al.	AAER-1904	10/22/2003
SEC v. Bruce E. Snyder, Jr.	AAER-1904	10/22/2003
SEC v. Guillermo Garcia Simon, et al.	LR-18763	10/28/2003
SEC v. James M. Adelt, et al.	LR-18442	11/03/2003
SEC v. AmeriCredit Corp.	LR-18442	11/03/2003
In the Matter of Joseph F. Doody IV	34-48870	12/03/2003
SEC v. Richard Wilson	LR-18496	12/04/2003
In the Matter of John M. Youngdahl, Jr.	34-48900	12/10/2003
SEC v. Lianne and Stanley Gulkin	LR-18500	12/11/2003

FY 2005

Name of Case	Release Number	Date Filed
In the Matter of Joseph T. Falcone	34-50516	10/12/2004
In the Matter of Larry F. Smath	34-50515	10/12/2004
SEC v. Kevin J. Hobbs, et al.	LR-18977	11/16/2004
SEC v. Russell T. Bradlee, et al.	LR-18974	11/17/2004
SEC v. Peter J. Wilson	LR-18979	11/18/2004
SEC v. Michael J. Ricks, et al.	LR-18983	11/22/2004
SEC v. Evan S. Collins	LR-18986	11/30/2004
SEC v. Min T. Ma, et al.	LR-18998	12/14/2004
In the Matter of Dimitrios Kostopoulos	34-50933	12/27/2004
SEC v. Patricia B. Rocklage, et al.	LR-19032	01/12/2005
SEC v. Mark A. Bailin	AAER-2167	01/13/2005
SEC v. Charles E. Jannetti, et al.	LR-19037	01/13/2005
SEC v. Patrick S. Anderson, et al.	LR-19038	01/19/2005
SEC v. Jun Singo Liang	LR-19049	01/25/2005
SEC v. Frank R.V. Loomans, et al.	LR-19075	02/10/2005
SEC v. Patsy J. Aldredge, et al.	LR-19073	02/10/2005
SEC v. Richard Curtiss	LR-19082	02/16/2005
SEC v. John D. Hutchinson	LR-19106	02/28/2005
SEC v. Robert Goehring	LR-19105	03/02/2005
SEC v. Armund Ek	LR-19104	03/03/2005
SEC v. Zvi Fuks, et al.	LR-19128	03/09/2005
SEC v. Anthony C. Sudol III, et al.	LR-19162	03/31/2005
SEC v. Alina Welt, et al.	LR-19190	04/19/2005
SEC v. Nabil Hanna	LR-19194	04/20/2005
SEC v. Guillaume Pollet	LR-19199	04/21/2005
SEC v. John E. Martin	LR-19205	04/26/2005
SEC v. Ernesto Sibal, et al.	LR-19210	04/28/2005
In the Matter of Andrew M. Welt	IA-2382	05/11/2005
SEC v. Steven E. Nothern	LR-19223	05/12/2005
SEC v. Hilary L. Shane	LR-19227	05/18/2005
In the Matter of James J. McDermott, Jr.	34-51794	06/07/2005
SEC v. Gary D. Force	LR-19252	06/08/2005
SEC v. Zomax, Inc.	LR-19262	06/09/2005
In the Matter of Hilary L. Shane	34-51839	06/14/2005
SEC v. Barry Hertz	LR-19268	06/14/2005
SEC v. Jeffrey L. Matthews, et al.	LR-19304	07/18/2005
SEC v. Philip Evans, et al.	LR-19312	07/26/2005
SEC v. Sonja Anticevic, et al.	LR-19374	08/05/2005
In the Matter of Benjamin Y. Chiu	34-52222	08/08/2005
In the Matter of Ernesto V. Sibal, et al.	34-52223	08/08/2005
SEC v. David J. Shlansky	LR-19332	08/10/2005
SEC v. Raymond L. Burke	LR-19355	09/01/2005
SEC v. David L. Johnson	LR-19363	09/07/2005
SEC v. Jameson L. Thottam	LR-19364	09/07/2005
SEC v. James J. Farley, et al.	LR-19379	09/15/2005
SEC v. Rodney R. Drinen, et al.	LR-19378	09/15/2005
SEC v. Stanford Cohen	LR-19383	09/19/2005
SEC v. Jerry C. Moyes	LR-19389	09/21/2005
SEC v. Brian G. Paquette, et al.	LR-19393	09/26/2005

FY 2006 to date[19]

Name	Release Number	Date Filed
Petrosky, Robert B.	LR 19429	10/12/2005
Furino, Frank J.	34-52636	10/19/2005
Lohmus Haavel & Viisemann, et al.	LR 19450	11/01/2005
One Or More Unknown Purchasers Of Call Options for the Common Stock Of Placer Dome Inc.	LR 19457	11/02/2005
Casbarro, Ralph D.	34-52762	11/10/2005
Herwitz, Gary D., et al.	LR 19499	12/19/2005
Breed, Robert A.	34-53010	12/22/2005
Champe, Gregory N.	LR 19514	12/22/2005
Edelman, Lee	LR 19518	01/03/2006
Bucknum, Thomas J.	LR 19528	01/17/2006
Jeong, Deog Kyoon	LR 19531	01/17/2006
Kishel, Mark	LR 19539	01/19/2006
Joo, Robert Y.	34-53169	01/23/2006
Menezes, Victor J.	LR 19549	01/31/2006
Day, William A.	LR 19553	02/02/2006
Agarwala, Sanjiv S.	LR 19568	02/15/2006
Cao, Alan, et al.	LR 19586	03/01/2006
Drucker, Mitchell S., et al.	LR 19587	03/02/2006
Tom, Michael K. C.	IA 2494	03/08/2006
Langley Partners, L.P., et al	LR 19607	03/14/2006
A.B. Watley Group, Inc., et al.	LR 19616	03/21/2006
Singh, Sanjay	33-8673	03/21/2006
Yaroshinsky, Alexander J.	LR 19636	03/28/2006
Favilla, Terry F., et al.	LR 19628	03/29/2006
Feng, Xiangsha	LR 19648	04/06/2006
A Gerland, Kenneth M., et al.	LR 19649	04/10/2006
Garvey, Patrick I.	LR 19649	04/10/2006
Karaoulis, Diane	LR 19649	04/10/2006
Anthony, Garner	LR 19654	04/11/2006
Anderson, David N., et al.	LR 19665	04/24/2006
Obus, Nelson J., et al.	LR 19667	04/25/2006
Deakins, William B.	34-53719	04/25/2006
Deephaven Capital Management, LLC, et al.	LR 19683	05/02/2006
Leclerc, Leonard P., et al.	LR 19684	05/02/2006
Downs, Robert J., Jr., et al.	LR 19698	05/15/2006
Coughlin, Paul F.	34-53845	05/19/2006
Anton, Frederick W. III	LR 19712	05/31/2006
Roszak, Matthew, et al.	LR 19722	06/08/2006

[19] FY 2006 information is not finalized and is subject to change.

Cavallero et al.	LR 19731	06/15/2006
Huscher, Justin	LR 19736	06/22/2006
One Or More Unknown Purchasers Of Call Options for the Common Stock Of Petco Animal Supplies, Inc.	LR 19778	07/17/2006
Kahl, John, J., et al.	LR 19767	07/19/2006
Huscher, Justin	IA-2536	07/21/2006
Behl, Charan R., et al.	LR 19777	07/27/2006
Mitchell, Stewart P. "Tom"		