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The SEC and the Securities Industry Respond to September 11

MARC I. STEINBERG*

I. Introduction

In the aftermath of the terrorist attacks on September 11, 2001, the U.S. securities markets remain vibrant and strong. After a four-day market close, the longest since the Great Depression, the markets reopened on September 17.¹ With more than four billion shares traded that day on the New York Stock Exchange (NYSE), American Stock Exchange (Amex), and the NASDAQ, bordering on the most active day of trading in history,² the markets were relatively fair and orderly.³ Indeed, the more than 2.3 billion shares traded on the NYSE alone that day represented the heaviest day of trading in the “Big Board’s” more than 200-year history.⁴

That the Dow Jones Industrial Average (DJIA)⁵ fell by a record 684 points (or over 7

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1. See *Gloomy Return: U.S. Stocks Plummet As Trading Resumes Without Major Hitches*, WALL ST. J., Sept. 18, 2001, at A1; see also *Markets’ Reopening Seen as Victory, Despite Dow’s Tumble Through Week*, 33 SEC. REG. & L. REP. 1359 (2001).

2. See *Gloomy Return: U.S. Stocks Plummet As Trading Resumes Without Major Hitches*, *supra* note 1; *Markets’ Reopening Seen as Victory, Despite Dow’s Tumble Through Week*, *supra* note 1.

3. See *Pitt Outlines Expanded Power SEC Wants for Maintenance of Emergency Measures*, 33 SEC. REG. L. REP. 1393 (2001); see also *Gloomy Return: U.S. Stocks Plummet As Trading Resumes Without Major Hitches*, *supra* note 1; *Markets’ Reopening Seen as Victory, Despite Dow’s Tumble Through Week*, *supra* note 1.

4. See *Markets’ Reopening Seen as Victory, Despite Dow’s Tumble Through Week*, *supra* note 1, at 1359.

5. The DJIA is defined as:

[A]n index of 30 blue-chip U.S. stocks. At 100-plus years, it is the oldest continuing U.S. market index . . . The DJIA is the best-known market indicator in the world, partly because it is old enough that many generations of investors have become accustomed to quoting it, and partly because the U.S. stock market is the globe’s biggest.

Dow Jones Averages: Frequently Asked Questions, Dow Jones Indexes, at <http://www.djindexes.com/jsp/avgFaq.jsp> (last visited Mar. 11, 2002).

6. See E. S. Browning & Ken Brown, *Reasons to Cheer Despite Stock Sell Off*, WALL ST. J., Sept. 18, 2001, at C1; see also *Markets’ Reopening Seen as Victory, Despite Dow’s Tumble Through Week*, *supra* note 1, at 1359.

percent) on September 17⁶ and incurred additional losses later that week⁷ seemed de minimis when compared to the fact that the markets were operating efficiently and still retained the confidence of both individual and institutional investors.⁸ As Securities and Exchange Commission (SEC or Commission) Chairman Harvey L. Pitt perceptively reflected, the “key isn’t whether the market went up or down . . . but [that all investors] who wanted to trade shares could do so . . .”⁹. NYSE Chairman Richard Grasso declared on September 17: “America is strong, our economy is strong, the criminals have lost – that is what today is all about.”¹⁰

Indeed, subsequent to September 11, investors returned to the U.S. securities markets. In spite of the continued public anxiety regarding further terrorist attacks¹¹ and the presence of difficult economic times,¹² the DJIA closed the year 2001 above 10,000 points.¹³ Considering that the DJIA was approximately 9,600 points on September 10, 2001,¹⁴ this increase in the DJIA is astonishing. The markets’ resiliency is premised on an admirable partnership between the government and industry that accords to each a good deal of trust in particularly stressful times.¹⁵ This is not to suggest that alleged excessive government regulation, including SEC action, is not a constant concern to the private sector.¹⁶ None-

7. For example, on Wednesday, September 19, the DJIA fell over 144 points (amounting to a 1.6% loss). See Browning & Brown, *supra* note 6, at C1; see also *Markets’ Reopening Seen as Victory, Despite Dow’s Tumble Through Week*, *supra* note 1, at 1359.

8. See *Markets’ Reopening Seen as Victory, Despite Dow’s Tumble Through Week*, *supra* note 1, at 1359.

9. *Id.*

10. *Id.*; see also Emergency Order, Exchange Act Release No. 44,797, [2001 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 86,530, at 84,787 (Sept. 19, 2001):

The United States securities markets are the world’s strongest and most vibrant. The Commission has full confidence that the attacks of September 11, 2001, will have little lasting market impact. To that end, the Commission seeks to serve investors and the markets through all available means to facilitate the reopening of fair and orderly markets.

Id.

11. See, e.g., John Fialka et al., *Are We Prepared for the Unthinkable?* WALL ST. J., Sept. 18, 2001, at B1; Jodi Wilgoren & Laurene Zuckerman, *A Nation Challenged: The Pilots – Airline Pilots Adopt Their Own Security Measure*, N.Y. TIMES, Sept. 26, 2001, at B1; Lizette Alvarez, *A Nation Challenged: The Airports – Bush’s Approach on Plane Security Chosen By House*, N.Y. TIMES, Nov. 2, 2001, at A1; John Tagliabue, *A Nation Challenged: Atomic Anxiety – Threat of Nuclear Terror Has Increased, Official Said*, N.Y. TIMES, Nov. 2, 2001, at B4; Al Baker, *Security Tight for Start of United Nations Meeting in New York*, N.Y. TIMES, Nov. 10, 2001, at A6.

12. See Richard W. Stevenson, *Economists Make It Official: U.S. Is in Recession*, N.Y. TIMES, Nov. 27, 2001, at C1; see also Deborah Lagomarsino & Rebecca Christie, *Fed Survey Finds Further Slowing of the Economy*, WALL ST. J., Nov. 29, 2001, at A2; Edward Wyatt, *A Nation Challenged: Business – Ripples of Sept. 11 Widen in Retailing*, N.Y. TIMES, Dec. 10, 2001, at A1; *Another Rate Cut from the Fed*, N.Y. TIMES, Dec. 12, 2001, at A30; Suzanne Vranica, *Salary Cuts, Not Layoffs, Prevail As Hedge Against Market Slump*, WALL ST. J., Jan. 8, 2002, at B8.

13. See *Markets Diary*, WALL ST. J., Jan. 2, 2002, at C1 (stating that on December 31, the DJIA closed at 10021.50 points).

14. See *id.*

15. See *Pitt Tells Senate Panel of Possibility of SEC Seeking Extended Emergency Powers*, 33 SEC. REG. & L. REP. 1357, 1358 (2001) (quoting NASDAQ stock market’s chief executive officer statement that “the decision process to reopen the markets was a textbook example of effective cooperation among the government, markets, and private industry”).

16. See ROBERTA S. KARMEL, *REGULATION BY PROSECUTION – THE SECURITIES AND EXCHANGE COMMISSION VERSUS CORPORATE AMERICA* (1982); see also HOMER KRIPKE, *THE SEC AND CORPORATE DISCLOSURE: REGULATION IN SEARCH OF A PURPOSE* (1979). See generally Donald C. Langevoort, *The SEC as a Bureaucracy: Public Choice, Institutional Rhetoric, and the Process of Policy Formulation*, 47 WASH. & LEE L. REV. 527 (1990). But see Howard Fineman & Michael Isikoff, *Lights Out: Enron’s Failed Power Play*, NEWSWEEK, Jan. 21, 2002, at 14.

theless, in times of great stress, an understanding exists between the various “players”¹⁷ that government and industry must work together to help resolve the crisis, with the government (including the SEC) being an essential performer.¹⁸

II. SEC Actions

In the September 11th aftermath, it was abundantly clear that the liquidity, efficiency, and fairness of the securities markets were crucial determinants that must be addressed. The SEC responded under its emergency¹⁹ and exemptive²⁰ authority to facilitate the accomplishment of these objectives. Among the SEC actions taken are the following:

- (1) SEC Rule 10b-18²¹ permits companies to repurchase their own securities and pro-

17. This term refers to the SEC, the self-regulatory organizations (SRO), such as the stock exchanges as well as the National Association of Securities Dealers (NASD), and the private sector, encompassing, for example, broker-dealers, investment bankers, and publicly held companies.

18. Cf. Elizabeth Keller & Gregory A. Gehlmann, *A Historical Introduction to the Securities Act of 1933 and the Securities Exchange Act of 1934*, 49 OHIO ST. L.J. 329 (1988):

On October 19, 1987, now referred to as Black Monday, the Dow Jones Industrial Average dropped a previously unimaginable 508 points. On that Monday, \$500 billion of paper wealth evaporated. For many, it inevitably brought to mind the collapse of the stock market in 1929, which preceded the Great Depression. The reaction of businessmen to the recent crisis, however, points to one of the many differences between these two historical events. “Unlike their predecessors in the 1920’s, who did not think emergency Government measures could help, the businessmen of [today] are calling for Washington to intervene to stabilize the markets.” In addition, a Presidential task force studied the October crash and strongly recommended tougher governmental regulation of financial markets . . .

Id., quoting Andrew Feinberg, *Financiers React to the Plunge – Then and Now*, N.Y. TIMES, Oct. 25, 1987, at F6.

19. Securities Exchange Act § 12(k)(2), 15 U.S.C. § 78l(k)(2) (2001):

- (2)(A) The Commission, in an emergency, may by order summarily take such action to alter, supplement, suspend, or impose requirements or restrictions with respect to any matter or action subject to regulation by the Commission or a self-regulatory organization under this Act, as the Commission determines is necessary in the public interest and for the protection of investors –
- (i) to maintain or restore fair and orderly securities markets (other than markets in exempted securities); or
 - (ii) to ensure, prompt, accurate, and safe clearance and settlement of transactions in securities (other than exempted securities).
- (B) An order of the Commission under this paragraph (2) shall continue in effect for the period specified by the Commission, and may be extended, except that in no event shall the Commission’s action continue in effect for more than 10 business days, including extensions. In exercising its authority under this paragraph, the Commission shall not be required to comply with the provisions of section 553 of Title 5, United States Code, or with the provisions of section 19(c) of this Act.

Id. Note that the SEC’s emergency authority cannot exceed more than ten business days. A bill passed by the U.S. House of Representatives (H.R. 3060) allows the Commission to extend its emergency authority to thirty business days, and in certain situations, to ninety calendar days. See *House Passes Bill to Give More Powers, Leeway to SEC to Respond to Emergencies*, 33 SEC. REG. & L. REP. 1631, 1632 (2001).

20. See Securities Exchange Act § 36, 15 U.S.C. § 78mm (2001). Subsection (a) of section 36 states that, subject to certain exceptions, the SEC

may conditionally or unconditionally exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions, from any provision or provisions of this title or of any rule or regulation thereunder, to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors.

21. 17 C.F.R. § 240.10b-18 (2002).

vides a safe harbor from liability under Section 9(a)(2)²² and Section 10(b)²³ of the Securities Exchange Act (Exchange Act or 1934 Act) if the conditions set forth in the Rule are met.²⁴ To help effectuate market liquidity and orderly markets in a time of market volatility,²⁵ the SEC eased certain of Rule 10b-18's requirements, including the Rule's "time of day"²⁶ and volume restrictions.²⁷

(2) Generally, under Section 16(b) of the Exchange Act,²⁸ any profits derived from "short-swing" trading by directors, executive officers, or 10 percent shareholders of a subject issuer must be disgorged in a properly instituted shareholder action.²⁹ Hence, profits

22. 15 U.S.C. § 78i(a)(2) (2001) (prohibition against engaging in manipulative conduct on any national securities exchange).

23. 15 U.S.C. § 78j(b) (2001) (prohibition against deceptive or manipulative conduct in connection with any purchase or sale of any security). See SEC Rule 10b-5, 17 C.F.R. § 240.10b-5 (2002). See generally ALAN BROMBERG & LEWIS LOWENFELS, *SECURITIES FRAUD & COMMODITIES FRAUD* (2d ed. 2001).

24. 17 C.F.R. § 240.10b-18 (2002); see LEWIS LOSS & JOEL SELIGMAN, *SECURITIES REGULATION* 4063 (3d ed. 1992) (stating that Rule 10b-18 "is a non-mandatory, non-exclusive means of effecting issuer repurchases without violating the general anti-manipulative provisions of the federal securities laws, expressly including § 9(a)(2) and Rule 10b-5").

25. See Emergency Order, Exchange Act Release No. 44,791, [2001 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 86,529, at 84,785 (Sept. 19, 2001) (finding that "[u]ncertainty concerning the impact of the closure of the U.S. equities and options markets constitutes a major market disturbance characterized by sudden and excessive fluctuations of securities prices generally, or a substantial threat thereof, that threatens fair and orderly markets").

26. *Id.* at 84,786 (stating that:

[t]he timing condition in paragraph (b)(2) [of Rule 10b-18] may be satisfied if the issuer makes Rule 10b-18 purchases without regard to whether any such Rule 10b-18 purchase constitutes the opening transaction in a reported or exchange traded security or whether any such purchase would occur during the one-half hour before the scheduled close of trading on the primary market for such security).

27. *Id.* (setting forth that:

[t]he volume limitation in paragraph (b)(4) [of Rule 10b-18] may be satisfied if the issuer makes all Rule 10b-18 purchases other than block purchases of a reported or exchange traded security in an amount that, when added to the amount of all other Rule 10b-18 purchases, other than block purchases, from or through a broker or dealer effected by or for the issuer or an affiliated purchaser of the issuer on that day, does not exceed 100 percent of the trading volume (determined on the basis of the 4 calendar weeks preceding the week beginning on September 10, 2001) for the security . . .).

The SEC extended the relaxation of Rule 10b-18 requirements for an additional five business days pursuant to its emergency authority under section 12(k)(2) of the Exchange Act. Order Extending Emergency Order, Exchange Act Release No. 44,827, [2001 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 86,534, at 84,794 (Oct. 3, 2001). Pursuant to its exemptive authority under section 36 of the Exchange Act, the SEC subsequently extended certain accommodations to the Rule 10b-18 safe harbor from October 1 through October 12, 2001. Emergency Order, Exchange and Release No. 44,874, [2001 Transfer binder] Fed. Sec. L. Rep. (CCH) ¶ 86,547, at 84,867 (Sept. 28, 2001). See *supra* notes 19–20 and accompanying text.

28. 15 U.S.C. § 78p(a) (2001).

29. See DAVID RATNER, *SECURITIES REGULATION: MATERIALS FOR A BASIC COURSE* 363–64 (2d ed. 1980). Section 16:

- (1) imposes no disclosure requirements, other than the reporting of transactions to the SEC; (2) applies only to issuers which have securities registered under § 12 of the 1934 Act; (3) applies only to persons who fall within certain enumerated categories, regardless of whether they "control" the issuer; (4) applies only where there is a purchase and a sale [or a sale and a purchase] within a six-month period; (5) imposes liability based on the profit realized by the "insider," rather than the loss to those whom he deals; and (6) [subsection (b)] is enforceable only in actions brought on behalf of the issuer, rather than by the SEC or by purchasers [or sellers] of the securities involved.

Id. See also MARC I. STEINBERG, *SECURITIES REGULATION: LIABILITIES AND REMEDIES* § 4.01 (2001):

made in connection with any purchase followed by a sale or a sale followed by a purchase within a six-month period by a subject insider of a subject issuer is subject to strict liability.³⁰ Invoking its emergency authority,³¹ the SEC exempted purchases by subject insiders from Section 16(b) liability. In other words, purchases made during the time period covered by the SEC's emergency order are not matched against any sale within the preceding six-month period.³² This action was appropriate, according to the Commission, to facilitate market liquidity.³³ Significantly, the emergency order did not exempt any sale (rather than purchase) from Section 16(b) liability or the application of the 1934 Act's antifraud provisions, including Section 10(b) liability arising from illegal insider trading.³⁴

(3) To help comply with securities law proscriptions against trading on the basis of material nonpublic information, publicly-held companies have internal policies prohibiting purchases (or sales) of subject securities during specified time intervals (also called "black-out periods").³⁵ Recognizing the need for liquid and orderly markets in the aftermath of September 11, the SEC enunciated that noncompliance with a subject company's "insider trading" policy "will not by itself be considered as any indication that the [company] may have violated the antifraud provisions."³⁶ Importantly, however, the SEC's emergency order did not exempt the actual trading (or tipping of) material inside information.³⁷

(4) Recognizing that the airline and insurance industries were particularly damaged by the September 11th terrorist attacks, the SEC took administrative steps to facilitate companies in these industries to access capital.³⁸ For example, issuers in these industries that

Under Section 16(b), the profits gained by an 'insider' who engages in such short-swing transactions are recoverable by the issuer in a suit initiated by it, or if it declines to do so, in a properly instituted shareholders' suit expressly authorized by the statute. If the transactions fall within the statute's scope, intent to profit is unnecessary for recovery.

See generally PETER ROMEO & ALAN DYE, SECTION 16 TREATISE AND REPORTING GUIDE (2001).

30. See, e.g., *Foremost-McKesson, Inc. v. Provident Sec. Co.*, 423 U.S. 232 (1976); *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582 (1973); *Reliance Elec. Co. v. Emerson Elec. Co.*, 404 U.S. 418 (1972); Exchange Act Release No. 28,869, [1990-1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,709, at 81,248 (Feb. 20, 1991); see also RATNER, *supra* note 29; STEINBERG, *supra* note 29; ROMEO & DYE, *supra* note 29.

31. Securities Exchange Act § 12(k)(2), 15 U.S.C. § 78l(k)(2) (2001).

32. Emergency Order, Exchange Act Release No. 44,791, *supra* note 25, at 84,786 ("Notwithstanding the profit recovery provisions of Section 16(b) of the Exchange Act and the rules adopted under it, any purchase during the period covered by this Order by a person subject to Section 16 shall be exempt from the operation of that section with respect to any sale by that person during the preceding six months, and accordingly shall not be matched with such sale.") Pursuant to its emergency authority, the SEC extended this exemption from Section 16(b) liability through September 28, 2001. Order Extending Emergency Order, Exchange Act Release No. 44,827, *supra* note 27, at 84,794.

33. See Emergency Order, Exchange Act Release No. 44,791, *supra* note 25, at 84,785-86.

34. *Id.* In addition, any such purchase must be reported on Form 4 as required by Section 16(a). *Id.* at 84,786.

35. See Harvey L. Pitt & Karl A. Groskaufmanis, *Minimizing Corporate Civil and Criminal Liability: A Second Look at Corporate Codes of Conduct*, 78 GEO. L.J. 1559, 1633-53 (1990); Marc I. Steinberg & John Fletcher, *Compliance Programs for Insider Trading*, 47 SMU L. REV. 1783, 1828-35 (1994); Alan Weinberger, *Preventing Insider Trading Violations: A Survey of Corporate Compliance Programs*, 18 SEC. REG. L. J. 180 (1990).

36. Emergency Order, Exchange Act Release No. 44,791, *supra* note 25, at 84,786.

37. *Id.* See *infra* notes 53-64 and accompanying text.

38. SEC Press Release No. 2001-107, [2001 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 86,549 (Sept. 28, 2001), available at <http://www.sec.gov/news/press/2001-107.txt>.

39. Generally, the term "float" refers to "[t]he aggregate market value of an entity's voting securities held by nonaffiliates." MARC I. STEINBERG, *UNDERSTANDING SECURITIES LAW* 394 (3d ed. 2001).

met the \$75 million float test³⁹ for Form S-3⁴⁰ usage on September 10, 2001 were deemed eligible to use Form S-3 for the remainder of 2001, irrespective of their actual market float at the time of an offering.⁴¹ Moreover, the SEC's Division of Corporation Finance was directed to process registration statements by 1934 Act reporting companies in the airline and insurance industries within five business days of receipt.⁴²

(5) Other actions taken by the SEC encompassed: accommodations to brokerage firms with respect to calculating net capital under SEC rules;⁴³ pronouncements with respect to the availability of pooling-of-interests accounting;⁴⁴ relaxation of certain investment-company requirements;⁴⁵ relocation of certain Amex operations to the floor of the NYSE;⁴⁶ and an interpretive release setting forth that an auditor would not impair its independence under SEC rules by "providing bookkeeping services to those [client] entities that have been directly affected by the destruction of the World Trade Center . . ."⁴⁷

One significant emergency measure that the SEC declined to take, in spite of industry behest,⁴⁸ was a prohibition on short-selling.⁴⁹ SEC Chairman Pitt explained that short-

40. "Form S-3, in reliance on the efficient market theory, allows maximum use of incorporation by reference of Exchange Act reports and requires the least disclosure to be presented in the prospectus and delivered to investors." Securities Act Release No. 6383, 24 SEC Docket 1318, 1321 (1982).

41. See SEC Press Release No. 2001-107, *supra* note 38, at 84,901, available at <http://www.sec.gov/news/press/2001-107.txt>.

42. *Id.* Additional accommodations were made for issuers in the airline and insurance industries. See *id.* summarized in [2001 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 86,549; Michael Schroeder, *SEC Eases Process for Airlines, Insurers to Raise Capital*, WALL ST. J., Sept. 27, 2001, at C1.

43. Emergency Order, Exchange Act Release No. 44,791, *supra* note 25, at 84,786-87. The SEC subsequently exercised its exemptive authority under Section 36 of the Exchange Act with respect to certain net-capital computations impacting broker-dealers. See Order Regarding Government Securities Reconciliations, Exchange Act Release No. 44,916, [2001 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 86,550 (Oct. 10, 2001), available at <http://www.sec.gov/rules/exorders/34-44916.htm>.

44. Emergency Order, Exchange Act Release No. 44,791, *supra* note 25, at 84,786:

Notwithstanding the pooling-of-interests provisions in Accounting Principles Board Opinion No. 16, *Business Combinations*, and the related interpretations of the American Institute of Certified Public Accountants, consensuses of the Financial Accounting Standards Board's Emerging Issues Task Force, rules and regulations of the Commission and interpretations by its staff, and other authoritative accounting guidance, acquisitions by registrants of their own equity securities during the period covered by this Order will not affect the availability of pooling-of-interests accounting and, accordingly, a registrant's financial statements will not be misleading or inaccurate solely because the registrant has engaged in such purchases and has accounted for its business combination transactions as a pooling of interests.

45. Commission Notice, Investment Company Act Release No. 25,156 [2001 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 86,531 (Sept. 14, 2001), available at <http://www.sec.gov/rules/other/ic-25156.htm>.

46. Emergency Order, Exchange Act Release No. 44,797, *supra* note 10, at 84,787.

47. SEC Interpretation, Securities Act Release No. 33-8004, [2001 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 86,532 (Sept. 14, 2001). Accommodations also were made by other regulators. See, e.g., *Temporary Regulatory Aid Offered by CFTC in Wake of Terrorist Attacks*, 33 SEC. REG. & L. REP. 1397 (2001); see *NASDAQ Eases Listing Rules; Move Is to Help Companies Avoid Delisting*, 33 SEC. REG. & L. REP. 1397 (2001). Moreover, the USA PATRIOT Act, H.R. 3162, 107th Cong. (2001), enacted October 25, 2001, places new obligations on broker-dealers with respect to detecting and reporting money laundering, including the establishment of anti-money-laundering compliance programs. See *Anti-Terrorism Legislation Enacted Containing Money-Laundering Provisions*, 33 SEC. REG. & L. REP. 1532 (2001).

48. See Schroeder, *supra* note 42, at C14 (stating that SEC Chairman Harvey Pitt has not agreed to every request made by the securities industry, including "reject[ing] calls to curb short selling").

49. A short sale may be defined as:

[A] [p]ractice where an investor places an order to sell at the current market price a security which he/she does not then own. By so doing, he/she incurs an obligation to sell which is to be fulfilled by

selling has never been banned in the U.S. markets, even when Japan attacked Pearl Harbor. The Commission reasoned, according to Chairman Pitt that "short-selling has a legitimate place in market activities [and that] preventing short-selling would have interfered with a free and competitive market."⁵⁰ As will be discussed below, the SEC is devoting "substantial resources" to ascertain whether, prior to September 11, terrorists and their cohorts used short sales and put options⁵¹ to financially gain from post-September 11th decreases in airline, insurance, and related stocks.⁵²

III. The Gap in U.S. Regulation

The SEC and foreign authorities are examining suspected terrorist use of short sales and put options prior to September 11 as a strategy to profit from airline, insurance, and related stocks plummeting in price after the September 11th attacks.⁵³ Such financial efforts by terrorists and their cohorts to profit from their wrongdoing are despicable and should be severely punished. There is a major problem, however, that the SEC and others have failed to identify: namely, that this suspected trading (and tipping) by terrorists and their cohorts is not a violation of the U.S. securities laws.

Short-selling and put options are devices by which one can improperly trade (or tip) material⁵⁴ nonpublic⁵⁵ information. Their employment in connection with the September

purchasing the securities at a later date, hopefully for a lower price, and thereafter delivering such securities to the purchaser.

STEINBERG, *supra* note 39, at 406. For a U.S. Supreme Court decision addressing fraudulent short-selling, see *United States v. Naftalin*, 441 U.S. 768 (1979).

50. *Pitt Outlines Expanded Power SEC Wants for Maintenance of Emergency Measures*, *supra* note 3, at 1393. See generally Ralph Janvey, *Short Selling*, 20 SEC. REG. L.J. 270 (1992):

Short selling provides the market with two important benefits: market liquidity and pricing efficiency. Substantial market liquidity is provided through short selling by market professionals, such as market makers, block positioners, and specialists, who facilitate the operation of the markets by offsetting temporary imbalances in the supply and demand for securities. To the extent that securities professionals effect short sales in the market, such short sale activities add to the trading supply of stock available to purchasers and reduce the risk that the price paid by investors is artificially high because of a temporary contraction of supply.

Id. at 272.

51. Stated succinctly, a put option is an option to sell the underlying security. See *Laventhall v. Gen'l Dynamics Corp.*, 704 F.2d 407, 410-11 (8th Cir. 1983); GARY GASTINEAU, *THE OPTIONS MANUAL* (3d ed. 1988); see also Joel Seligman, *The Structure of the Options Market*, 10 J. CORP. L. 141 (1984).

52. See *infra* notes 53-64 and accompanying text.

53. See, e.g., Susanne Craig, *SEC Examines Trading in Firms Before Sept. 11*, WALL ST. J., Oct. 3, 2001, at C1; *French Regulator Probes Short Sales*, WALL ST. J., Sept. 21, 2001, at A16. The companies whose stock may have been subject to such short sales and put options include: Boeing Co., Lockheed Martin Corp., Raytheon Co., L-3 Communications, AMR Corp., Continental Airlines, Delta Air Lines, Northwest Airlines, Southwest Airlines, UAL Corp., U.S. Airways Group, General Motors Corp., Bank of America, Bank of New York, Bank One, Hercules Inc., W.R. Grace & Co., Carnival Corp., Royal Caribbean, American Express, Citigroup, Bear Stearns & Co., Lehman Brothers Holdings Inc., Morgan Stanley & Co., CNA Financial, Cigna Group, John Hancock Financial Services Inc., Progressive Corp., Royal & Sun Alliance, XL Capital Ltd., American International Group Inc., Axa-Spons ADR, MetLife Inc., Chubb Corp., Marsh & McLennan Cos., Vornado Realty Trust, Lone Star Technologies Inc., and LTV Corp. Craig, *supra*, at C11.

11th terrorist attacks exemplifies the use of nonpublic market information,⁵⁶ rather than internal corporate information,⁵⁷ to profit from the impact of “bad news” on the price of companies’ securities in the airline, insurance, and related sectors. As held by the U.S. Supreme Court, trading and/or tipping of such material information is illegal under Section 10(b) only if the insider or misappropriator breaches a fiduciary duty (or relationship of trust and confidence).⁵⁸ Although the SEC by rule has promulgated a parity-of-information rule in the tender offer setting,⁵⁹ in other contexts the scope of the insider-trading prohibitions is dictated by restrictive U.S. Supreme Court decisions.⁶⁰

As applied to the suspected September 11th scenario, the terrorists (including Osama bin Laden) in their short-selling and put-option trading clearly owed no fiduciary duty to the affected companies or to the shareholders of these companies. Being the source of the information (namely, the planned September 11th terrorist attacks), bin Laden and his co-terrorists did not misappropriate this information. By conveying this market information to their cronies/tippees, bin Laden and his cohorts gave their approbation to further trading by such tippees. Although the proceeds derived from this misconduct may be recovered under other federal statutes, clearly no violation of the federal securities laws occurred.⁶¹

Not surprisingly, a number of other countries with sophisticated markets proscribe this outrageous misconduct.⁶² Perhaps the SEC and the Department of Justice are simply too

and absorbed by the investment community, *see* SEC v. Mayhew, 121 F.3d 44, 50 (2nd Cir. 1997); or (2) relying on the efficient-market theory, the active investment community becomes privy to such information, *see* SEC v. Falbo, 14 F. Supp. 2d 508, 522 (S.D.N.Y. 1998).

56. Market information generally refers to information relating to the market for a particular company’s securities. For example, news of tender offer and merger transactions are classic examples of market information. *See* Chiarella v. United States, 445 U.S. 222 (1980).

57. Internal corporate information generally concerns information about the subject corporation or its business. *See, e.g.*, Dirks v. SEC, 463 U.S. 646 (1983).

58. *See* United States v. O’Hagan, 521 U.S. 642 (1997); *Dirks*, 463 U.S. at 646; *Chiarella*, 445 U.S. at 222; WILLIAM K.S. WANG & MARC I. STEINBERG, INSIDER TRADING §§ 5.1-5.4 (1996 & 2002 supp).

59. 17 C.F.R. § 240.14e-3 (2002). Under Rule 14e-3, a person who obtains material inside information regarding a tender offer directly or indirectly from the offeror (bidder), target corporation, or an intermediary neither can trade nor tip prior to adequate public disclosure (and absorption) of such information. In addition, a tippee of material confidential information relating to a tender offer who knows or should know that the subject information comes directly or indirectly from an offeror, target corporation or intermediary similarly cannot trade or tip prior to adequate public disclosure (and absorption) of this information. Rule 14e-3 provides an exception to this expansive disclose or abstain rule for multi-service financial institutions that adopt and implement sufficient screening mechanisms that effectively prevent the flow of confidential information to those who effect or recommend trades in the subject company’s securities. *See* WANG & STEINBERG, *supra* note 58, §§ 9.1-9.4.

60. *See* O’Hagan, 521 U.S. 642; *Dirks*, 463 U.S. 646; *Chiarella*, 445 U.S. 222.

61. Cases cited, *supra* note 60. *See* WANG & STEINBERG, *supra* note 58, §§ 5.1-5.4, 12.1-12.4. Note that the financial proceeds derived by bin Laden and his cohorts may be recovered by the U.S. government under other federal statutes, such as the Racketeer Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. §§ 1961-68 (1994) (with murder being the predicate offense and a pattern of racketeering activity being established). *See* MARC I. STEINBERG & RALPH C. FERRARA, SECURITIES PRACTICE: FEDERAL AND STATE ENFORCEMENT §§ 7:33-7:39 (2d ed. 2001).

62. *See* Australian Corporations Law § 1002. Under the insider-trading statutes of many countries, however, this misconduct is not prohibited. *See, e.g.*, Ontario (Canada) Securities Act §§ 76, 134; German Securities Act §§ 13, 14; United Kingdom Criminal Justice Act §§ 52, 56, 57, 62. For further discussion, *see* MARC I. STEINBERG, INTERNATIONAL SECURITIES LAW: A CONTEMPORARY AND COMPARATIVE PERSPECTIVE 114-148 (1999); *see also* Marc I. Steinberg, *Insider Trading, Selective Disclosure, and Prompt Disclosure: A Comparative Analysis*, 22 U. PA. J. INT’L. ECON. L. 635, 662-69 (2001).

reticent to recognize the reality that this financial wrongdoing goes unpunished under U.S. securities law. But the SEC is not to blame. The responsibility squarely rests on the U.S. Supreme Court for its unduly restrictive decisions in the insider trading context⁶³ and on Congress for neglecting to correct this situation.⁶⁴ Hopefully, this gap in insider trading will be remedied by Congress.

IV. Conclusion

The U. S. securities laws, with their effective enforcement and oversight by the SEC, are preeminent. The actions taken by the SEC in the aftermath of the September 11th terrorist attacks, supported by market participants and the securities industry, significantly minimized the enormous damage that otherwise would have been inflicted on the U.S. securities markets. Such a catastrophe would have redounded to the detriment of the U.S. economy, perhaps resulting in a more severe recession. By working as partners during this crisis period, the SEC and industry facilitated the return to normalcy and confidence in the U.S. securities markets.

63. See Alison Anderson, *Fraud, Fiduciaries, and Insider Trading*, 10 HOFSTRA L. REV. 341, 376-77 (1982) (referring to the U.S. Supreme Court's decision in *Chiarella v. United States*, 445 U.S. 222 (1980), Professor Anderson asserted that "[t]his is not a Supreme Court construing a complicated statutory scheme with wisdom, craft, and candor; this is a first-year torts class on a bad day.").

64. Statutory definitions of "insider trading" have been proposed but have not been enacted by Congress. See H.R. 559, S. 90, 98th Cong. (1984); H.R. 5133, 100th Cong. (1988); CONG. REC. S8912-8913 (1984) (remarks of Mr. D'Amato) ("In view of the complexity of the undertaking and the necessity for prompt action on the bill, the committee determined not to include a definition of insider trading in this legislation.").

