

1988

Regulation of Manipulation Under Section 10(b): Security Prices and the Text of the Securities Exchange Act of 1934

Steve Thel

Fordham University School of Law, sthel@law.fordham.edu

Follow this and additional works at: http://ir.lawnet.fordham.edu/faculty_scholarship



Part of the [Securities Law Commons](#)

Recommended Citation

Steve Thel, *Regulation of Manipulation Under Section 10(b): Security Prices and the Text of the Securities Exchange Act of 1934*, 1988
Colum. Bus. L. Rev. 359 (1988)

Available at: http://ir.lawnet.fordham.edu/faculty_scholarship/677

This Article is brought to you for free and open access by FLASH: The Fordham Law Archive of Scholarship and History. It has been accepted for inclusion in Faculty Scholarship by an authorized administrator of FLASH: The Fordham Law Archive of Scholarship and History. For more information, please contact tmelnick@law.fordham.edu.

REGULATION OF MANIPULATION UNDER SECTION 10(b): SECURITY PRICES AND THE TEXT OF THE SECURITIES EXCHANGE ACT OF 1934

STEVE THEL†

INTRODUCTION	359
I. THE EXCHANGE ACT AND THE SCOPE OF SECTION 10(b)	362
A. The Justification for the Exchange Act — The Importance of Prices	364
B. Protecting the Public Interest in Security Prices and the Meaning of Manipulation	374
II. THE SUPREME COURT AND THE SCOPE OF SECTION 10(b)	382
III. PRICES AND THE CONTROL OF MANIPULATION	389
A. Income and Price — The Control of Issuer Behavior	389
B. Information and Price — Required Disclosure and Honesty	396
C. Speculation and Price — Investment Value and Prohibited Communications	405
D. Trading and Price — The Control of Disruptive Trading	415
CONCLUSION	438

INTRODUCTION

The United States Supreme Court (the “Court”) changed the role of federal law in regulating securities transactions in a series of recent cases limiting the reach of Rule 10b-5.¹ In 1985 the Court ex-

† Associate Professor, Fordham University School of Law. B.A., 1976, North Texas State; J.D., 1979, Harvard. The author is grateful to Larry Bush and Marc Steinberg for reading and commenting upon a preliminary draft of this article and to Greg Aleshire and Harold Hudson for research assistance.

¹ 17 C.F.R. § 240.10b-5 (1988).

tended the reasoning of these cases to its logical conclusion, holding that conduct is not manipulative within the meaning of the Securities Exchange Act of 1934² (the "Act") unless it is deceptive.³ These decisions substantially constrain the authority of the Securities and Exchange Commission (SEC) to regulate conduct under section 10(b) of the Act.⁴ The Court did not examine the structure of the Act or the history of federal regulation of manipulative practices in any of its Rule 10b-5 cases. Instead it grounded its decisions on the "fundamental purpose of the . . . Act 'to substitute a philosophy of full disclosure for the philosophy of *caveat emptor*.'"⁵

This article is about the meaning of the word "manipulative" in section 10(b). It concludes that the term must be given independent interpretive significance as part of a broader re-discovery of the original and most logical agenda for the statute

— that of ensuring that securities are in a certain sense appropriately priced. This is a more far-reaching goal than the one the Court ascribes to the Act, which is essentially only the institution of a system of disclosure of corporate earnings and profits. If the statute is correctly understood in this way, the authority granted to the SEC by section 10(b) is seen as extending to contemporary practices as diverse as program trading, arbitrage, poison pills, stock-parking, and corporate abuses of control over dividend policy. This article begins by discussing the importance of market prices to the framers of the Act and to the market system and all participants in it. There

² 15 U.S.C. §§ 78a - 78kk (1982 & Supp. III 1985) [hereinafter the Act].

³ *Schreiber v. Burlington Northern, Inc.*, 472 U.S. 1 (1985).

⁴ As the Act explains:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange . . . [t]o use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the SEC may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. § 78j.

⁵ *Schreiber*, 472 U.S. at 6-7 (quoting *Santa Fe Indus. v. Green*, 430 U.S. 462, 476-77 (1977), quoting *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 151 (1972), quoting *SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 186 (1963)). In most recent cases interpreting the federal securities statutes the Court has been guided by this supposed congressional concern with disclosure. The inadequacy of the philosophy of full disclosure as a guiding principle for interpreting various provisions of the federal securities statutes is suggested by Karjala, *Federalism, Full Disclosure, and the National Markets in the Interpretation of Federal Securities Law*, 80 Nw. U.L. Rev. 1473 (1986), and Chang, *Meaning, Reference, and Reification in the Definition of a Security*, 19 U.C. DAVIS L. REV. 403 (1986).

follows a discussion of the process by which the Court came to the conclusion that section 10(b) reaches only deceptive conduct. The article then examines section 10(b) in the light of both the substantive provisions of the Act and of the "express recital of evils"⁶ found in section 2 of the Act,⁷ concluding that much of the Act, including section 10, cannot be explained in terms of disclosure. The article suggests that what ties the Act together is a concern with the public interest in security prices.

It is hard to define the word manipulative concisely for the purpose of the Act.⁸ It is not simply "a general term comprising a range of misleading practices."⁹ The substantive provisions of the Act and the public policy forcefully enunciated in section 2 indicate that manipulative practices are those that undermine the proper functioning of the securities markets. Section 10(b) gives the SEC the authority to regulate almost any conduct toward the end of restraining practices that influence security prices. It authorizes the SEC to do whatever it concludes is necessary to prevent speculation from undermining the proper functioning of the securities markets. Section 10(b) is a broad mandate to the SEC to implement the basic anti-speculative policy behind the Act. Congress itself required some disclosure in the Act, and presumably the SEC can also do so. However, the Act does much more than merely require disclosure, and the SEC should be permitted to do more as well.¹⁰ Most limits on

⁶ *American Power & Light Co. v. SEC*, 329 U.S. 90, 105 (1946).

⁷ 15 U.S.C. § 78b.

⁸ Professor Loss, after an extensive analysis of the regulation of market manipulation, concluded that the word manipulative has no precise meaning in § 10(b). 3 L. LOSS, *SECURITIES REGULATION* 1573 (3d ed. 1988); see also L. LOSS, *FUNDAMENTALS OF SECURITIES REGULATION* 998 n.75 (1983) [hereinafter *FUNDAMENTALS*].

In both treatises Professor Loss said the matter of market manipulation is "[r]elated to the field of fraud — but not altogether a part of it." *SECURITIES REGULATION*, *supra*, at 1529; *FUNDAMENTALS OF SECURITIES REGULATION*, *supra*, at 982; see also Loomis, *The Securities Exchange Act of 1934 and the Investment Advisers Act of 1940*, 28 GEO. WASH. L. REV. 214, 241 (1959) ("Manipulation, like fraud, . . . takes a variety of forms and cannot be exactly defined."). The judicial and administrative regulation of manipulation under the Act is thoroughly covered in Professor Loss' treatises and in A. BROMBERG & L. LOWENFELS, *SECURITIES FRAUD & COMMODITIES FRAUD* (1986).

⁹ *Schreiber*, 472 U.S. at 6.

¹⁰ An elaborate discussion of the nature of manipulative conduct under § 10(b) is contained in Norman Poser's article on the application of the anti-manipulative provisions of the Act to corporate control transactions. Poser, *Stock Market Manipulation and Corporate Control Transactions*, 40 U. MIAMI L. REV. 671 (1986); see also *Hundahl v. United Benefit Life Ins. Co.*, 465 F. Supp. 1349 (N.D. Tex. 1979). Poser concludes that the Court is correct in holding that deception is an essential element

the SEC's authority are to be found outside section 10(b).

I. THE EXCHANGE ACT AND THE SCOPE OF SECTION 10(b)

The Act was a response to the general public perception that stock market activities and the prices prevailing on the market profoundly affected the welfare of the country. By 1934 there was a broad consensus that stock market speculation had contributed to the stock market crash of 1929 and to the Great Depression that followed.¹¹ While almost everyone agreed that this warranted government intervention, or at least that such government intervention was inevitable, there was no consensus on what was to be done.

In 1934 the public was concerned with the exchange market, par-

of manipulation under § 10(b). *See also* Loomis, *supra* note 8, at 241 ("The principal element . . . of manipulation in general . . . is deception."). Poser's argument is based on both the statutory scheme and his understanding of the meaning the word manipulation had in financial circles in 1934. This article reaches a different conclusion on the statutory scheme but does not attempt to reconstruct the meaning of manipulative conduct except by reference to the statute.

Although he might not agree with the article's conclusions on the SEC's role in market regulation, in his book on insider trading Henry Manne used the word manipulation in the way it is defined in this article. H. MANNE, *INSIDER TRADING AND THE STOCK MARKET* 147-58 (1966); *see also* Manne, *Insider Trading and the Administrative Process*, 35 GEO. WASH. L. REV. 473, 492 (1967) ("It should be noted that there is no suggestion in this interpretation [i.e. one focused upon the statute] that section 10(b) was in any way concerned . . . with the general philosophy of disclosure."); *cf.* Ruder, *Civil Liability Under Rule 10b-5: Judicial Revision of Legislative Intent?* 57 NW. U.L. REV. 627, 658 (1963) ("[S]ection 10(b) was not to provide an all-inclusive private weapon against fraud . . . , but to allow the Commission to prevent market manipulations and speculations by persons seeking to take advantage of loop-holes in the statutes.").

¹¹ "The New Deal was born of the Great Depression and, to the naked eye of the ruined investor and the unemployed apple-seller, the depression had been touched off by the stock market panic of October, 1929." T. TAYLOR, *GRAND INQUEST* 65 (1953); *see also* *First Inaugural Address of Franklin D. Roosevelt* (Mar. 4, 1933), *reprinted in* 2 DOCUMENTS OF AMERICAN HISTORY 239, 240 (H. Commager 9th ed. 1973); *Letter from Franklin D. Roosevelt to Sam Rayburn* (Mar. 26, 1934), *reprinted in* 5 LEGISLATIVE HISTORY OF THE SECURITIES ACT OF 1933 AND SECURITIES EXCHANGE ACT OF 1934, item 18 (J. Ellenberger & E. Mahar eds. 1973) [hereinafter LEGISLATIVE HISTORY] ("The people of this country are, in overwhelming majority, fully aware of the fact that unregulated speculation in securities and in commodities was one of the most important contributing factors in the artificial and unwarranted 'boom' which had so much to do with the terrible conditions of the years following 1929."); *cf.* T. McCRAW, *PROPHETS OF REGULATION* 180 n.49 (1984) ("This connection between the crash and the depression, though valid in the minds of New Dealers, has been challenged by modern scholars."); M. PARRISH, *SECURITIES REGULATION AND THE NEW DEAL* 109 (1970).

ticularly the New York Stock Exchange (the "NYSE").¹² The exchanges were powerful institutions, however, and proposals to regulate them encountered intense opposition. In the end, the Act regulated stock exchange credit and trading practices and the affairs of issuers that sought to have their securities traded on exchanges.¹³ The Act was the product of extremely involved compromise. Many controversies were resolved by giving the SEC the authority to decide how to proceed,¹⁴ or by ordering it to study the matter further.¹⁵ In addition to its specific prohibitions and delegations, the Act included two sections that subjected broad areas of activity to SEC rules. One was section 15, which forbade unlawful participation by any broker or dealer in any securities market other than an exchange whose internal rules provide investors protection equal to or exceeding that provided by the Act and by regulations prescribed by the SEC.¹⁶ The other was section 10(b).

The Act was "a tremendous experiment in governmental regulation of business."¹⁷ Congress itself did not require many changes in the way that the securities business worked, but it empowered administrators to insist upon fundamental change.¹⁸ Although the language of section 10(b) does not itself make clear what problems the

¹² The exchanges were thought to account for most equity trading and the New York Stock Exchange [hereinafter the NYSE] for most exchange trading. R. DEBETS, *THE NEW DEAL'S SEC 20* (1964); TWENTIETH CENTURY FUND, INC., *THE SECURITY MARKETS*, ch. 7 (1935).

¹³ The Act has been amended extensively. The Act as originally enacted is described in Tracy & MacChesney, *The Securities Exchange Act of 1934*, 32 MICH. L. REV. 1025 (1934).

¹⁴ See, e.g., Securities Exchange Act of 1934, Pub. L. No. 73-291, § 11, 48 Stat. 881, 891 (for the current version, see 15 U.S.C. § 78k) (segregation and limitation of functions of exchange members, brokers and dealers); § 13, 48 Stat. at 894 (for the current version, see 15 U.S.C. § 78m) (form and timing of reports); § 14, 48 Stat. at 895 (for the current version, see 15 U.S.C. § 78n) (proxy solicitation); cf. §§ 7 and 8, 48 Stat. at 886, 888 (for the current versions, see 15 U.S.C. §§ 78g, 78h) (credit regulation).

¹⁵ Securities Exchange Act of 1934, Pub. L. No. 73-291, § 11(e), 48 Stat. 881, 891 (repealed 1975)(study of segregation of broker and dealer functions); § 12(f), 48 Stat. at 894 (repealed 1936)(study of unlisted trading); § 19(c), 48 Stat. at 899 (repealed 1975)(study of exchange governance); § 211, 48 Stat. at 909 (15 U.S.C. § 78jj (omitted from U.S.C.)) (study of protective and reorganization committees).

¹⁶ Pub. L. No. 73-291, § 15, 48 Stat. 881, 895. Section 15 has been repeatedly and substantially amended. For the current version, see 15 U.S.C. § 78o.

¹⁷ Tracy & MacChesney, *supra* note 13, at 1037.

¹⁸ On the expanded role played by administrators in New Deal legislation, see generally J. LANDIS, *THE ADMINISTRATIVE PROCESS* (1938); R. PIERCE, S. SHAPIRO & P. VERKUIL, *ADMINISTRATIVE LAW AND PROCESS* 32-34 (1985); Stewart, *The Reformation of American Administrative Law*, 88 HARV. L. REV. 1667 (1975).

administrators are supposed to solve or what they may do to solve them, the rest of the Act does.

A. The Justification for the Exchange Act — The Importance of Prices

Congress itself explained why it regulated securities-market transactions and related practices in the Act. Section 2 of the Act lists reasons that transactions in the securities markets are affected with a public interest necessitating federal intervention. The section focuses almost exclusively on the importance of market prices. Section 2 emphasizes the role of the market as an appraiser of value, the importance of market prices (to investors, creditors and the public treasury), and the widespread quotation of the prices established in market transactions.¹⁹ Market prices "are susceptible to manipulation and control, and the dissemination of such prices gives rise to excessive speculation, resulting in sudden and unreasonable fluctuations in the prices of securities," undermining the credit, tax and banking systems and precipitating, intensifying and prolonging national emergencies, like the Depression. Significantly, section 2 fails to mention full and honest disclosure or the importance of information about issuers.

It is perhaps possible to overemphasize the importance of section 2. It was included primarily to establish that Congress had the power to regulate stock exchange practices and institutions that had been carefully designed so as not to operate across state lines.²⁰ The constitutional basis for federal regulation of security transactions was uncertain in 1934, and section 2 was included in the Act because the Court had earlier indicated it would respect the judgment of Congress, expressed in a statute, that intrastate transactions bur-

¹⁹ The Securities Acts Amendments of 1975 directed the SEC to facilitate the establishment of a national market system for securities. As part of this initiative, the Act was amended to reflect further congressional findings on the public interest in the securities markets. Pub. L. No. 94-29, §§ 2, 7, 84 Stat. 97, 97, 111-17 (codified as amended in §§ 2, 11A, 15 U.S.C. §§ 78a, 78k-1). Section 11A(a)(1) expresses the finding that there is a public interest in assuring broad dissemination of information about securities quotations and transactions.

²⁰ *Stock Exchange Regulation: Hearing Before the Comm. on Interstate and Foreign Commerce, House of Representatives, 73d Cong., 2d Sess. (1934), reprinted in 8 LEGISLATIVE HISTORY, supra note 11, at 16-20 and 28-34 (testimony of James Landis). See generally Hanna, The Federal Regulation of Stock Exchanges, 5 S. CAL. L. REV. 9, 18-24 (1931); Hanna & Turlington, Protection of the Public Under the Securities Exchange Act, 21 VA. L. REV. 251, 282 n.27 (1935).*

dened interstate commerce.²¹ Nonetheless, the section fairly summarizes contemporary public sentiment and the problems said to justify federal intervention in the debate over the Act. It is therefore remarkable that the Court ascribes a fundamental purpose to the Act that Congress failed to mention in this preamble.²²

Congress appropriately expressed its concern about the securities markets in terms of securities prices. The value of a security lies largely in the income stream that its owner is entitled to receive from its issuer.²³ Most investors buy securities in hopes of making money. They do not need or use them for anything else. An owner who sells her or his security simply trades her or his right to future payments for a current payment. The income a security produces for its owner thus consists of distributions from the issuer while she or he owns it and of proceeds from the buyer when she or he sells it. Since a security is essentially the right to a stream of issuer payments, and since the price of a security is the amount others will pay for that income stream, for many purposes a security is nothing more than its price.²⁴

²¹ Board of Trade of Chicago v. Olsen, 262 U.S. 1, 37-38 (1923).

²² Section 16(b) of the Act, 15 U.S.C. § 78p, gives "preventing the unfair use of information" as the reason for allowing issuers to recover short-swing trading profits of control persons. Even this limited reference to information does not directly address disclosure.

²³ R. BREALEY & S. MYERS, PRINCIPLES OF CORPORATE FINANCE 3 (2d ed. 1984); J. LORIE, P. DODD & M. KIMPTON, THE STOCK MARKET — THEORIES AND EVIDENCE 88 (2d ed. 1985). See generally V. BRUDNEY & M. CHIRELSTEIN, CASES AND MATERIALS ON CORPORATE FINANCE 133-372 (3d ed. 1987) (rights of security holders); K. GARBADÉ, SECURITIES MARKETS 1 (1982). Owners of debt securities receive payments in the form of periodic interest payments and reimbursement of the principal at maturity. The owner of common stock is entitled to periodic distributions such as dividends and a portion of the residual value of the issuer upon liquidation of the issuer.

Some people value securities for reasons beyond the passive income they receive. The most important alternative source of value is the right to participate in the control of the issuer accorded to the owners of most securities. Investors who value voting rights will presumably pay for them, and accordingly the right to control carried with a security probably affects its price. See generally Bhagat & Brickley, *Cumulative Voting: The Value of Minority Shareholder Voting Rights*, 27 J.L. & ECON. 339 (1984); Easterbrook & Fischel, *Voting in Corporate Law*, 26 J.L. & ECON. 395 (1983); Fischel, *Organized Exchanges and the Regulation of Dual Class Common Stock*, 54 U. CHI. L. REV. 119, 144-46 (1987); Seligman, *The Historical Need for a Mandatory Corporate Disclosure System*, 9 J. CORP. L. 1, 710-12 (1983).

²⁴ Cf. *Marine Bank v. Weaver*, 455 U.S. 551, 559-60 (1982) (unique agreement to share profit not designed to be traded publicly not security); FitzGibbon, *What is a Security? A Redefinition Based on Eligibility to Participate in the Financial Markets*, 64 MINN. L. REV. 893 (1980); Karjala, *supra* note 5, at 1508-15.

Morton Horwitz argues that the modern law of contracts evolved in response to

Investors who value securities because of the income they produce make trading decisions by comparing the cost of a security with the present value of the income that they expect it to produce. An investor will buy a security if he or she values the income which he or she expects it to produce more than the amount that he or she will have to pay for the security, and will sell the security if he or she values the expected income from the security at less than what he or she can sell the security for. When one person's estimate of the present value of the income that a security will produce is less than a second person's, then the two may trade the security at a price between their estimates.²⁶ The range of prices at which trades occur narrows as the number of potential buyers and sellers of a security who know about each other increases, since the buyer bidding the most will trade with the seller offering to accept the least.²⁶

Section 2 and the rest of the Act reflect a concern less with prices per se than with prices on organized markets. The price at which a security trades in a particular transaction is obviously important to the buyer and to the seller, but it is not obvious why that price should interest anyone else. The prices reported from securities exchanges are essentially different from the prices posted by merchants. Exchange prices are the records of completed transactions; no one necessarily stands ready to trade at those prices. Nonetheless, information about trades on the securities exchanges, including prices and volume, is promptly and widely disseminated.²⁷ The fact that there is sufficient demand for such information to jus-

this unique attribute of securities. M. HORWITZ, *THE TRANSFORMATION OF AMERICAN LAW 173-74* (1977). *Contra* Simpson, *The Horwitz Thesis and the History of Contracts*, 46 U. CHI. L. REV. 533, 547-61 (1979) (stock cases refined existing rule); *cf.* RESTATEMENT (SECOND) OF CONTRACTS § 360 comment b (1979) (specific performance of contract to sell control shares).

²⁵ A buyer will not pay a price higher than the value of the income that he or she thinks that the security will produce. Conversely, a seller will not accept less than the amount that he or she believes necessary to acquire an alternative investment that will yield an equally attractive income.

²⁶ See generally K. GARBADE, *supra* note 23, at 417-66; Lipton, *Best Execution — The National Market System's Missing Ingredient*, 57 NOTRE DAME L. REV. 449 (1982); Niederhoffer & Osborne, *Market Making and Reversal on the Stock Exchange*, 61 J. AM. STATISTICAL A. 897 (1966).

²⁷ See K. GARBADE, *supra* note 23, at 449; Gilson & Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549, 609 (1984). Transactions in many securities that are frequently traded "over the counter" [hereinafter OTC] are also widely reported, as are bid and asked quotations for even more OTC securities. See generally Schedule D to NASD By-Laws, NASD Manual (CCH) ¶ 1754; K. GARBADE, *supra* note 23, at 438-42; SEC, Report of Special Study of Securities Markets, H.R. Doc. No. 95, 88th Cong., 1st Sess., pt. 2, at 42-45, 355-56, 595-610, 630-45 (1963) [hereinafter Special Study].

tify its publication is itself probably the best evidence of the importance of the prices at which trades occur on securities exchanges.

On developed markets, including American stock exchanges, trades occur at prices that reflect the collective judgment of market participants of the value of the traded securities, with each participant's judgment carrying the weight of the money that she or he is willing to commit to the market. The price at which a security trades is idealized as:

an appraisal of the value of that stock due to a series of actual sales between various persons dealing at arm's length . . . and so . . . a true chancering of the market value of that stock thereon under the process of attrition due to supply operating against demand.²⁸

Inasmuch as market prices are the products of the prices at which investors have been willing to buy and sell, anyone interested in knowing what investors will pay or accept for securities can find valuable information in market prices. Owners of securities and individuals who are obligated to buy securities are obviously interested. Their wealth is a function of the prices at which they can sell or buy,²⁹ and these prices are in turn a function of the prices which others are willing to pay for the securities, or which others are willing to accept in exchange for the securities. The prices at which the securities have recently traded are extremely useful sources of information. Potential traders have presumably been in the market, and in a large market it is likely that a substantial number of traders value any security at approximately the price at which it is trading. Thus, prices at which trades have recently occurred are good indicators of the prices that will obtain in the next trades, and security owners can use recent prices to calculate the market values of their holdings and so too their wealth.

Reported prices may also interest people who are trying to decide whether or not to trade a security. Most participants in exchange markets are price-takers. Instead of deciding what price to ask for or

²⁸ *United States v. Brown*, 5 F. Supp. 81, 85 (S.D.N.Y. 1933), *aff'd*, 79 F.2d 321 (2d Cir.), *cert. denied*, 296 U.S. 650 (1935). The appraisal of value was often cited in the 1930's as an important and valuable function of exchanges. *See* S. REP. NO. 1455, 73d Cong., 2d Sess. (1934), *reprinted in* 5 LEGISLATIVE HISTORY, *supra* note 11, item 21, at 30; TWENTIETH CENTURY FUND, INC., *supra* note 12, at 26-32; J. KEYNES, *THE GENERAL THEORY OF EMPLOYMENT, INTEREST AND MONEY* 152 (1936) (characterizing conventional view); Berle, *Liability for Stock Market Manipulation*, 31 COLUM. L. REV. 264, 267 (1931); Moore & Wiseman, *Market Manipulation and the Exchange Act*, 2 U. CHI. L. REV. 46, 51 n.26 (1934); *Legislation*, 21 VA. L. REV. 103, 108 (1934).

²⁹ K. GARBAGE, *supra* note 23, at 449.

to pay, they decide whether they will buy, sell or simply hold their positions at the market price.³⁰ Leaving aside temporarily the possibility that a trade may reveal information relevant to value, no individual's trades will affect the market price of a security unless these transactions constitute a substantial part of total market activity for the security. This will seldom be the case, and thus usually a substantial amount of an exchange-traded security can be bought or sold at or very near the price at which it last traded.³¹ Therefore most investors can make their decisions knowing that they will be able to trade at or very near recent prices.³²

Reported prices are not independently significant to people who are deciding whether or not to trade. Potential traders are interested in reported prices simply because they reveal something about the state of the market. On the other hand, investors sometimes "borrow" reported prices and use them in their own transactions. Investors may borrow reported prices because they reflect relevant information, but when reported prices are used derivatively, they are given independent significance, and thus become important in and of themselves, apart from any information that they are thought to contain. Section 2(2) of the Act recognizes that the prices at which exchange transactions occur are used by outsiders as prices for their transactions. For example, securities are sometimes traded in negotiated transactions at prices based on those reported from exchanges.³³ Regional stock exchanges serve largely as alternative markets for securities traded on the NYSE, and securities trade on

³⁰ See generally *id.* at ch. 11.

³¹ In 1986, 90.2% of all trades on the NYSE were within one-eighth of one point of the previous trade's price. NYSE FACT BOOK 1987 at 15. See generally K. GARBADE, *supra* note 23, at 449; *cf.* the Act, § 2(2) (reported transactions set prices); Levmore, *Efficient Markets and Puzzling Intermediaries*, 70 VA. L. REV. 645, 647 (1984) (market clearing price is best indicator of future price). *But cf.* R. BREALEY & S. MYERS, *supra* note 23, at 278-79 (substantial sellers believe they must cut price); Carney, *Signalling and Causation in Insider Trading*, 36 CATH. U.L. REV. 863, 884-85 (1987) ("conventional . . . wisdom"); Scholes, *The Market for Securities: Substitution versus Price Pressure and the Effects of Information on Share Prices*, 45 J. BUS. 179, 179-81 (1972) (characterizing one view). See generally *infra* notes 243-45 and accompanying text.

³² People trying to decide whether to sell can condition their orders on receiving a certain price, but investors who assume market prices fairly reflect supply and demand may be willing to trade at whatever price they can get in the market. Many investors are willing to accept market prices and accordingly order their brokers to trade at the best price available rather than at a set price. Current data are not available, but in 1966 about sixty percent of executed orders on the NYSE were market orders. Niederhoffer & Osborne, *supra* note 26, at 904. These investors rely on the market to fairly price securities, not on its having done so in previous trades.

³³ See, e.g., Scholes, *supra* note 31, at 185 (secondary distributions).

regional exchanges at prices derived from the NYSE.³⁴ During the boom market of the 1920s, several issuers took advantage of the willingness of some investors to buy securities at reported prices.³⁵

People who have an interest in a security often base investment decisions upon its value, and much important business turns on the value of securities. As section 2(2) of the Act notes, when market prices are available, they are often used as governors of conduct. People sometimes agree to trade securities at prices based on their market prices at later dates. A corporation trading its own stock for a business or other asset may agree to deliver more stock if its market price drops.³⁶ In a public offering of securities without an existing market the seller might guarantee that a market will develop and that the market price will remain above the sale price.³⁷ Employee compensation may be tied to the price of the employer's common stock or to the market value of a portfolio of securities that the employee manages.³⁸ If the market value of securities serving as collateral for a loan declines, the lender may require the borrower to provide further security.³⁹ Finally, the market price of securities is also used in calculating a variety of taxes.⁴⁰

³⁴ Special Study, *supra* note 27, pt. 2, at 12, 932 and 949-50; Poser, *Restructuring the Stock Markets: A Critical Look at the SEC's National Market System*, 56 N.Y.U. L. Rev. 883, 892-93 (1981).

³⁵ One of the great outrages disclosed during the debate over the Act involved an oil company's sale of over one billion dollars of its stock by means of widespread personal solicitations. The stock was sold at a price one-eighth of one point higher than its closing price on the New York Curb Exchange the previous day. During the distribution, the company bought back most of its stock sold on the Curb, and used most of the money from its stock sales to support the market price of the stock. 8 LEGISLATIVE HISTORY, *supra* note 11, at 833-35 (testimony of Robert Healy).

³⁶ See *infra* notes 269-72 and accompanying text. Price changes affect parties to transactions in securities even if they do not trigger contractual obligations. Thus someone planning to acquire assets with securities would like the price of the securities to rise. See, e.g., Putka, *Overseas Scandal: Guinness Affair Makes British Likely to Curb Corporate Acquisitions — Unusual Stock Buying Aided Firm in Its Bitter Battle To Take Over Distillers*, Wall St. J., Jan. 19, 1987, at 1, col. 1.

³⁷ Cf. *Dlugash v. SEC*, 373 F.2d 107 (2d Cir. 1967) (organizer would repurchase from broker at profit); *In re Associated Investors Secs., Inc.*, 41 S.E.C. 160, 167-69 (1962) (promise to maintain successively higher market price).

³⁸ E.g., Rustin & Putka, *Merrill Lynch Unit Fires Two Executives In Risk Arbitrage for Violations of Policy*, Wall St. J., Jan. 21, 1982, at 4, col. 2.

³⁹ E.g., *SEC v. Guild Films Co., Inc.*, 279 F.2d 485 (2d Cir.), *cert. denied*, 364 U.S. 819 (1960); see also sources cited *infra* note 257.

⁴⁰ See, e.g., I.R.C. § 2031 (1982) (estate tax); Treas. Reg. § 20.2031-2 (1986); see 11B BUSINESS ORGANIZATIONS — FEDERAL TAXATION OF SECURITIES TRANSACTIONS §§ 1.04-.05 (1987). Securities must be valued in order to determine wealth-transfer and property taxes, income from exchanges and the basis of property acquired in ex-

Presumably, drafters of contracts and statutes use market price as a standard of value because they think that market price reflects value, or at least that it cannot be controlled by someone trying to avoid his or her obligations.⁴¹ If, as stated in section 2(3) of the Act, market prices are susceptible to manipulation and control, or if they fluctuate suddenly and unreasonably, then they will be unsuitable for use in governing conduct or in computing value.⁴² If in fact reported prices do not reflect value or can be controlled, then those who persist in defining contractual obligations by reference to market prices and those subject to statutes or to regulatory schemes that contemplate market efficiency and integrity will find that their rights and obligations fluctuate in response to irrelevant influences.⁴³

These contracts use future prices in order to set the precise terms of obligations currently undertaken. Reported prices, and especially changes in reported prices, may also induce people to act. As mentioned above, some investors search for and trade securities that trade at a market price that they think does not correspond to its true value. Investors who think that the market is wrong are almost

change for securities.

Security prices probably had a greater relevance to tax collections in 1934 than they do now. James Bonbright wrote that "Federal income-tax cases . . . along with those arising under the state and Federal death taxes, furnish the greatest mass of legal precedents on the appraisal" of corporate stock. 2 J. BONBRIGHT, *THE VALUATION OF PROPERTY* 1019 (1937). There was a federal tax on the capital stock of corporations from 1916 until 1926, and market price was an important factor in valuing the capital stock of corporations with actively traded common stock under the capital stock tax. *Id.* at 577-95.

⁴¹ Many states deny shareholders appraisal rights in connection with fundamental corporate changes if there is a public market for their stock, "apparently . . . based on the premise that [publicly traded stocks] are traded in an efficient market that systematically values the stock in an accurate manner . . ." Steinberg, *Stock Exchange Exception to Appraisal and Its Ramifications for the Constitutionality of State Takeover Statutes*, 15 SEC. REG. L.J. 105, 105 (1987).

⁴² When no market is available or when the security is too thinly traded to adequately indicate value, judicial, administrative or private valuation, formula valuation or consensus mechanisms are substituted as measures of value. See generally J. BISHOP & A. ROSENBLUM, *FEDERAL TAX VALUATION DIGEST* (cum. ed. 1981); J. BONBRIGHT, *supra* note 40; F. H. O'NEAL, *CLOSE CORPORATIONS* ch. 7 (1986). The imperfections of non-market methods of valuing securities have been widely noted. *E.g.* V. BRUDNEY & M. CHIRELSTEIN, *supra* note 23, at 1-132; Levmore, *supra* note 31, at 656 ("[V]aluation techniques that do not rely on market prices are notoriously arbitrary."); Roe, *Bankruptcy and Debt: A New Model for Corporate Reorganization*, 83 COLUM. L. REV. 527 (1982).

⁴³ See Hanna, *supra* note 20, at 15 ("The manipulated quotations . . . are the basis for bank loans, they are a guide to the appraisal of estates for tax and distributive purposes.").

always wrong themselves,⁴⁴ and accordingly the fact that so many investors persist in trying to outguess the market is a matter of some interest.⁴⁵ Perhaps even more interesting are investors who trade in response to changes in market prices, sometimes in studied disregard of value. Some investors attempt to predict future prices from past price changes.⁴⁶ For example, when market prices are rising, some people buy simply because they think that prices will continue to rise.⁴⁷ “[S]ecurities markets are unusual in that price rises often attract buyers, while price declines attract sellers.”⁴⁸

Finally, security prices may affect people who do not own or trade securities at all. Substantial market-wide price declines are often blamed for declines in the levels of employment and economic activity.⁴⁹ Although changes in security prices are now usually seen as results rather than as causes of changes in underlying business activity,⁵⁰ many people still regard declining stock prices as a cause of business contractions. When stock prices fell precipitously on exchanges and on over-the-counter markets on October 19, 1987, there was widespread concern that the decline would result in a contraction of overall productive activity.⁵¹ Many still attribute the depression of the 1930s at least in part to the collapse of prices on the

⁴⁴ See generally J. LORIE, P. DODD & M. KIMPTON, *supra* note 23, at 73-76 (mutual fund performance).

⁴⁵ Gilson & Kraakman, *supra* note 27, at 622-26.

⁴⁶ It appears that in fact prices move randomly and thus that the pattern of price changes in the past cannot predict future changes. See generally J. LORIE, P. DODD & M. KIMPTON, *supra* note 23, at 55-65.

⁴⁷ S. LEE & P. PASSELL, A NEW ECONOMIC VIEW OF AMERICAN HISTORY 365-67 (1979); see P. SAMUELSON, *ECONOMICS* 74 (10th ed. 1976).

⁴⁸ Poser, *supra* note 10, at 696 n.140; see also Friend, *The SEC and the Economic Performance of Securities Markets* in *ECONOMIC POLICY AND THE REGULATION OF CORPORATE SECURITIES* 185, 201 (H. Manne ed. 1969) [hereinafter *ECONOMIC POLICY*] (reason for most trades during price movements is to trade with trend); Kryzanowski, *Misinformation and Security Markets*, 24 *MCGILL L.J.* 123, 125 (1978).

⁴⁹ Cf. Hanna, *supra* note 20, at 10 (“The hostile feeling toward stock markets is always translated during depression into a demand for some kind of governmental action.”).

⁵⁰ E.g., P. SAMUELSON, *supra* note 47, at 75 (“It is reasonably clear that business activity, national income, and corporate earnings determine stock prices and not vice versa . . .”). But see Galbraith, *The 1929 Parallel*, *THE ATLANTIC*, Jan. 1987, at 62.

⁵¹ E.g., Bennett, *Who Gets Hurt?*, *N.Y. Times*, Oct. 20, 1987, at 1, col. 2; Gelman, *Does 1987 Equal 1929?*, *N.Y. Times*, Oct. 20, 1987, at 1, col. 2 (“Yesterday, after a plunge reminiscent of the worst days of 1929, the most pressing question was whether the aftershocks would be as devastating to individuals and the nation at large.”); *N.Y. Times*, Oct. 20, 1987, at 1, col. 6 (headline: “Stocks Plunge 508 Points, A Drop of 22.6% . . . Frenzied Trading Raises Fears of Recession”).

NYSE that began in 1929.⁵² During the 1930s, the market's crash and whoever was responsible for it were even more widely blamed for the Depression. In justifying federal control of the market with the Depression, Section 2 of the Act merely repeats the popular wisdom.

National emergencies, which produce widespread unemployment and the dislocation of trade, transportation, and industry, and which burden interstate commerce and adversely affect the general welfare, are precipitated, intensified, and prolonged by manipulation and sudden and unreasonable fluctuations of security prices and by excessive speculation on such exchanges and markets⁵³

The Act should be read in the light of the terrible times in which it was written. There is no doubt that the Act was enacted because most people blamed the Depression on the speculative excesses of the 1920s.

Even if stock market activity does not directly affect the amounts of goods and services produced, security prices may influence the types of goods and services produced, by virtue of their effect on the allocation of capital.⁵⁴ It is often said that the most important thing about securities markets is their influence in moving money from savers to users.⁵⁵ If security prices affect the cost of capital or other-

⁵² J. GALBRAITH, *THE GREAT CRASH* 191 (3d ed. 1972) ("The role of the stock market crash in the great tragedy of the thirties . . . is one of respectable importance.") S. LEE & P. PASSELL, *supra* note 47, at 372-83 (1979) (decline in consumption resulting from decline in wealth resulting from decline in stock prices may have contributed to the Depression); Galbraith, *supra* note 50, at 64.

⁵³ The Act, § 2(4). *See also id.* at § 2(3) (price fluctuations cause unreasonable expansion and contraction of the volume of credit available for trade, transportation and industry).

⁵⁴ *See generally* J. VAN HORNE, *FINANCIAL MANAGEMENT AND POLICY* 560-65 (7th ed. 1986).

⁵⁵ *See, e.g.,* W. BAUMOL, *THE STOCK MARKET AND ECONOMIC EFFICIENCY* vii (1965); Friend, *supra* note 48, at 190 ("Traditionally, allocational efficiency has been regarded as the most important economic function performed by the securities markets"); *cf. Note, The Efficient Capital Market Hypothesis, Economic Theory and the Regulation of the Securities Industry*, 29 *STAN. L. REV.* 1031, 1034 (1977) ("[S]ecurities regulation may harm the primary and socially useful economic function of capital markets, which is the allocation of capital to its most productive uses."). *But see* Stout, *The Unimportance of Being Efficient: An Economic Analysis of Stock Market Pricing and Securities Regulation*, 87 *MICH. L. REV.* 613 (1988).

Although the protection of the pricing mechanism was the central goal of those who enacted the Act, the allocation of capital is not mentioned in § 2. During the debate over the Act little was made of the need to protect the capital-allocating function of the stock market. *But see* J. KEYNES, *supra* note 28, at ch. 12; TWENTIETH CENTURY FUND, *supra* note 12, at 13-16, 21-25. References to allocational efficiency may have

wise influence the investment decisions of security issuers, then anything that influences security prices will also affect the allocation of capital to the production of goods and services.

The availability of a trading market itself reduces the cost of capital to issuers selling securities to the public, since investors value the liquidity that the market gives to their investments.⁵⁶ The level of public confidence in the integrity of the market influences the cost of capital to businesses that raise capital in the market. Investors will demand a premium for participating in volatile markets⁵⁷ or in markets in which they believe that others are better able to predict future prices.⁵⁸ Thus, the cost of raising money by selling securities will increase with investor unease about price volatility and investor suspicion that the market is a rigged game. Reducing this unease will reduce the cost of raising money in the market. Reformers made a great deal of the need to restore investor confidence in the markets in the wake of the 1929 crash,⁵⁹ and the restoration of confidence was an important goal of the Act.⁶⁰ Although section 2 of the Act does not mention investor confidence specifically, it characterizes the Act as a measure "to insure the maintenance of fair and honest markets" and it repeats the popular belief that stock prices are susceptible to manipulation, control, and unreasonable fluctuation.⁶¹

The price at which a security trades may affect the business practices of its issuer. To the extent that firms raise capital by selling securities, capital will flow to firms with relatively high security prices. This direct impact may be relatively unimportant since most businesses seldom issue new securities,⁶² but the market price of a

been infrequent because few issuers were raising capital in 1934 or because the terminology was not then in wide use. See Clark, *The Four Stages of Capitalism: Reflections on Investment Management Treatises*, 94 HARV. L. REV. 561, 571 n.28 (1981) ("Perhaps the typical legislator voting for the securities laws would have formulated his objective as that of promoting 'honest' securities markets, rather than in today's jargon, 'efficient capital markets.' But I think that my revision is more terminological than substantive.").

⁵⁶ Cf. K. GARBADÉ, *supra* note 23, at 1; Berle, *supra* note 28, at 266-67 ("[T]he function of the market is to supply . . . liquidity.").

⁵⁷ Donnelly, *Efficient-Market Theorists Are Puzzled by Recent gyrations in Stock Market*, Wall St. J., Oct. 23, 1987, at 7, col. 1 (comments of Fischer Black). See generally R. BREALEY & S. MYERS, *supra* note 23, at ch. 8.

⁵⁸ K. GARBADÉ, *supra* note 23, at 476-78 (bid-ask spread in block trades).

⁵⁹ Seligman, *supra* note 23, at 51-52.

⁶⁰ Cf. *Marine Bank v. Weaver*, 455 U.S. 551, 555 (1982) ("The [Exchange] Act was adopted to restore investors' confidence in the financial markets . . .").

⁶¹ The Act, § 2(3).

⁶² See V. BRUDNEY & M. CHIRELSTEIN, *supra* note 23, at 516 n."d;" R. JENNINGS &

security may influence the investment decisions of its issuer's managers even if they do not intend to issue more securities. Although the extent to which managers are concerned with shareholder interest is a much debated question, managers may cancel or avoid projects that will reduce the market price of the firm's securities.⁶³ And if holders feel that a security's price is low relative to its potential earnings, they may force management to change investment practices in order to realize those earnings.⁶⁴

If security prices do, as discussed above, influence issuer investment decisions, and if security prices accurately reflect the profitability of their issuers, then capital will flow to profitable issuers and profitable issuers will expand operations. Assuming that profitable issuers are efficient producers, this will be for the greater good of society. Capital will flow to those who will use it best and the cost of production will be minimized. On the other hand, if price does not accurately reflect issuer profitability, then capital will be allocated poorly and production will be accomplished inefficiently.⁶⁵

B. Protecting the Public Interest in Security Prices and the Meaning of Manipulation

Reported security prices may well be viewed as nothing more than the record of transactions undertaken on the market by self-interested traders. Even if market prices affect employment levels, the

H. MARSH, *SECURITIES REGULATION 1-2* (6th ed. 1987); Meltzer, *On Efficiency and Regulation of the Securities Industry* in *ECONOMIC POLICY*, *supra* note 48, at 217, 219-20.

⁶³ See generally J. VAN HORNE, *supra* note 54, at chs. 7 & 8; Rappaport, *Stock Market Signals to Managers*, *HARV. BUS. REV.*, Nov.-Dec. 1987, at 57.

⁶⁴ V. BRUDNEY & M. CHIRELSTEIN, *supra* note 23, at 592, 830-43 (tender offers to displace management); R. GILSON, *THE LAW AND FINANCE OF CORPORATE ACQUISITIONS* 371-86 (1986).

⁶⁵ Regulation of the markets rests on stronger ground if securities markets do not serve to allocate capital well. If security transactions produce wealth or lead to the efficient allocation of resources then the suffering of those who make bad deals serves a good end, and any effort to ameliorate their suffering risks harming society by rendering ineffective a valuable institution that allocates capital perfectly. See Hieronymous, *Manipulation in Commodity Trading: Toward a Definition*, 6 *HOFSTRA L. REV.* 40, 52-53 (1977) (exchange-imposed settlement prices in congested commodity markets are manipulative); cf. R. POSNER, *ECONOMIC ANALYSIS OF LAW* 65-69 (2d ed. 1977). If the efficient allocation of capital is not a by-product of an unregulated market in securities, then society has little to lose from interfering with the market in response to the pleas of those who have lost money. One might conclude that a securities market that does not benefit society should be closed. See J. KEYNES, *supra* note 28, at 159 ("It is usually agreed that casinos should, in the public interest, be inaccessible and expensive.").

allocation of capital or the investment decisions of managers, it is not at all clear that the SEC would be able to protect jobs or improve the quality of investment by intervention in the market. Nonetheless, the Act reflects a congressional judgment that federal intervention is necessary and appropriate. The wisdom of such intervention is thus not a question open to courts reviewing SEC actions under section 10(b) of the Act. The way in which the SEC intervenes is another matter. Courts appropriately ask whether in intervening, the SEC is acting within the authority that Congress gave it, and that question is not easily answered by reference to section 10(b) or to the statement of purpose in section 2.

Congress could have addressed the public concern about the securities markets and market prices in the 1930s by closing the exchanges or by regulating them. There was talk of shutting down the stock market in the early 1930s, but all of the influential participants in the debate over the Act preferred that the country continue to rely on the market to set security prices. However, although security prices were to be set on the market, it was to be a regulated market.

The Court has concluded that the Act is basically nothing more than a complicated scheme to require issuers to disclose relevant information. This is in keeping with most contemporary discussions of securities regulation, which begin from the assumption that security prices are a function of information and focus on some problem in the regulation of the flow of information.⁶⁶ These discussions are usually informed by the substantial evidence which indicates that it is impossible to profit by trading on the basis of publicly available information, and thus that market prices reflect all publicly available information that is relevant to price.⁶⁷ The Act cannot be explained fully in terms of information or disclosure, however, and the insistence on doing so has resulted in an inappropriately narrow reading of the scope of section 10(b).

Most of the substantive provisions of the Act have nothing to do with full disclosure. It would be surprising if they did. After the debacle of 1929 there was little confidence in stock market institutions. People trying to correct market failures that they saw as the cause of the depression would hardly have been satisfied with nothing more than a prescription of full disclosure. Few suggested that the crash would have been avoided had investors been better in-

⁶⁶ Gilson & Kraakman, *supra* note 27, at 549-53; Levmore, *supra* note 31, at 645 n.1.

⁶⁷ See generally P. LORIE, S. DODD & M. KIMPTON, *supra* note 23, at 55-87.

formed.⁶⁸ Influential commentators criticized the Securities Act of 1933, which is a disclosure statute, as soon as it was adopted, on the ground that full disclosure was not enough to protect the interests of investors and the public in the proper functioning of the stock market.⁶⁹

The Act was addressed to the problem of speculation and the dislocation thought to attend stock market cycles.⁷⁰ All of the provisions enacted in 1934 are directed at conduct that was at the time thought to influence security prices. The Act deals with almost everything that affects the prices at which securities trade on exchanges, including the development of public opinion, the translation of public opinion into trading decisions, the matching of trading decisions in completed transactions and the publication of the prices at which these transactions occur.

Several provisions of the Act, including the reporting provisions of section 13, regulate the pricing process by regulating the flow of information that will affect investors' expectations about the income that securities will produce. These provisions do not require full disclosure, however. They do not require disclosure of all material information, they do not all require disclosure of the information with which they are concerned, and they even make it illegal to tell the truth about some things. More to the point, other provisions of the Act do not have anything to do with information. They reflect a concern with the effect that trading itself has on price.

If section 10(b) shares with the rest of the Act the purpose of curbing excessive speculation, then the Court has given it an unduly narrow reading. Redefining or rediscovering the purpose of the Act is not a real solution to the problem of defining the SEC's authority to intervene in the market, though. In the end, any construction of section 10(b) grounded on a statutory philosophy or on a fundamental purpose will depend on the philosophy and purpose of the person construing the statute.

In hard cases, the end that a statute is intended to accomplish

⁶⁸ There is an ongoing debate about whether issuers had to be compelled to disclose information or whether by 1933 they were now willing to do so voluntarily, but even those who conclude compulsion was necessary do not argue its earlier adoption would have prevented the depression. See generally Seligman, *supra* note 23.

⁶⁹ 15 U.S.C. §§ 77a-77aa (1982). Douglas, *Protecting the Investor*, 23 YALE REV. (n.s.) 521 (1934); Douglas & Bates, *The Federal Securities Act of 1933*, 43 YALE L.J. 171 (1933); Jennings, *Mr. Justice Douglas: His Influence on Corporate and Securities Regulation*, 73 YALE L.J. 920, 928-31 (1964); cf. Berle, *High Finance: Master or Servant*, 23 YALE REV. (n.s.) 20 (1933) (speculative markets).

⁷⁰ H.R. REP. NO. 1383, 73d Cong., 2d Sess., reprinted in 5 LEGISLATIVE HISTORY, *supra* note 11, item 18, at 6.

may be a good interpretive guide. This is surely so in the case of a statutory provision as vague as section 10(b).⁷¹ The SEC should consider the reasons for the Act's enactment in deciding whether to bring an action or promulgate a rule under the section. Nonetheless, identifying the problems that Congress wanted solved when it enacted section 10(b) only shows what the SEC is supposed to use its power for. It cannot show what that power is. Section 10(b) itself states its end — the SEC is to protect investors and the public. Honest people disagree about what is in the public interest of course, and this statutory goal hardly limits the range of protective actions that the SEC can use. Almost any rule can be justified as insuring full disclosure or protecting the public from excessive speculation.⁷²

However well it is known, the purpose of a grant of administrative discretion cannot alone define the scope of that discretion. The key to understanding the SEC's role under section 10(b) is to identify both the task that Congress gave to the SEC and what Congress authorized the SEC to do in order to accomplish its task. Once again, the language of the section is not very helpful. The SEC is to accomplish the section's ends by regulating the use of "manipulative or deceptive devices and contrivances." A great deal of conduct can be said to qualify as a deceptive device or contrivance. No one seems to doubt that a lie is a deceptive device or contrivance, and before the Court spoke to the issue several lower courts had acted as though a negligent misrepresentation was also one.⁷³ The word "manipulative" presumably brings even more practices under the SEC's authority.⁷⁴

The Court has responded to the almost limitless potential of the

⁷¹ See Bork, *Legislative Intent and the Policy of the Sherman Act*, 9 J.L. & Econ. 7, 7 (1966); Easterbrook, *The Supreme Court, 1983 Term — Foreword: The Court and the Economic System*, 98 HARV. L. REV. 4, 15 (1984); Fuller & Perdue, *The Reliance Interest in Contract Damages*, 46 YALE L.J. 52, 52 (1936); see also Macey, *Promoting Public-Regarding Legislation Through Statutory Interpretation: An Interest Group Model*, 86 COLUM. L. REV. 223 (1986).

⁷² Cf. NAACP v. FPC, 425 U.S. 662, 669 (1976) ("public interest" takes meaning from purposes of statute).

⁷³ See, e.g., SEC v. Aaron, 605 F.2d 612 (2d Cir. 1979), *rev'd*, 446 U.S. 680 (1980); SEC v. World Radio Mission, Inc., 544 F.2d 535 (1st Cir. 1976); Hochfelder v. Ernst & Ernst, 503 F.2d 1100, 1104 (7th Cir. 1974), *rev'd*, 425 U.S. 185 (1976); White v. Abrams, 495 F.2d 724, 730 (9th Cir. 1974).

⁷⁴ The Court itself has noted that the word does not always carry the connotation of deception. *Schreiber*, 472 U.S. at 7 n.4; see Fiflis, *Of Lollipops and Law — A Proposal for a National Policy Concerning Tender Offer Defenses*, 19 U.C. DAVIS L. REV. 303, 321 (1986) ("stultifying *faux pas*"); Poser, *supra* note 10, at 683 n.68.

language of section 10(b) by delineating the SEC's role in terms of candor. It has defined both the purpose and the method of the Act as full disclosure. The Court has not examined the substantive provisions of the Act in determining the tools available to the SEC under section 10(b), any more than it examined section 2 in defining the purpose of the Act. In fact, the Court has defined the method of the Act by reference to disclosure, which it takes to be the Act's purpose. This is unfortunate, for the substantive provisions of the Act make it clear that Congress intended to authorize the SEC to do much more than perfect a regime of full disclosure.

Section 10(b) was the only original provision of the Act that made conduct illegal on the basis of its being manipulative. It is impossible to determine what the word manipulative means by reading section 10(b) alone. Since 1934, the federal securities statutes have been amended to proscribe manipulation in a variety of contexts,⁷⁶

⁷⁶ Section 15(c) was added to the Act in 1936. Act of May 27, 1936, ch. 462, § 3, 49 Stat. 1375, 1377 (current version at § 15(c)(1), 15 U.S.C. § 78o(c)(1)). It forbade brokers and dealers to effect or induce OTC transactions "by means of any manipulative, deceptive, or other fraudulent device or contrivance," and directed the SEC to "define such devices or contrivances as are manipulative, deceptive, or otherwise fraudulent."

Section 15(c) was amended in 1938 as part of the Maloney Act, which provided the framework under which the NASD operates. The amendment forbade brokers and dealers to engage "in any fraudulent, deceptive, or manipulative act or practice, or make any fictitious quotation" in connection with an OTC transaction. The SEC was directed to "define, and prescribe means reasonably designed to prevent, such acts and practices as are fraudulent, deceptive, or manipulative." Act of June 25, 1938, ch. 677, § 2, 52 Stat. 1070, 1075 (current version at § 15(c)(2), 15 U.S.C. § 78o(c)(2)).

In 1960, § 206(4) was added to the Investment Advisers Act. Act of Sept. 13, 1960, Pub. L. No. 86-750, § 9, 74 Stat. 885, 887 (codified in the Act, 15 U.S.C. § 80b-6(4)). The amendment applied substantially the language of the 1938 Amendment to § 15 of the Act to investment advisers.

In 1968 the Williams Act added § 14(e) to the Act. Pub. L. No. 90-439, § 3, 82 Stat. 454, 457 (for the current version, see 15 U.S.C. § 78n(e)). Section 14(e) makes it unlawful to engage in any fraudulent, deceptive, or manipulative acts or practice in connection with a tender offer. The Williams Act also made it illegal for issuers with equity securities registered under the Act to repurchase their equity securities in contravention of such rules as the SEC might adopt to define or to prescribe means reasonably designed to prevent acts and practices which are fraudulent, deceptive or manipulative. § 2, 82 Stat. at 454-55 (codified in § 13(e)(1), 15 U.S.C. § 78m(e)(1)).

In 1970, § 14(e) was amended to direct the SEC to define and prescribe means reasonably designed to prevent such acts and practices. Pub. L. No. 91-567, § 5, 84 Stat. 1497, 1497-98 (codified in § 14(e), 15 U.S.C. § 78n(e)). The same year § 17(j) was added to the Investment Company Act. Investment Company Amendments Act of 1970, Pub. L. No. 91-547, § 9(c), 84 Stat. 1413, 1421 (codified in § 17(j), 15 U.S.C. §§ 80a-17(j)). Section 17(j) makes it illegal for an affiliate of an investment company to engage in any act, practice or course of business in connection with his or her trades in securities held or proposed to be acquired by the investment company in contra-

but these amendments do not shed much light on section 10(b). The word may not even mean the same thing in every place that it appears in these statutes.⁷⁶ For example, it seems particularly inappropriate to give the word the same meaning in section 14(e), which makes manipulative conduct illegal, as one would give to it in section 10(b), under which nothing is illegal unless it contravenes an SEC rule. Presumably only unmanageable misconduct is contemplated by the term "manipulative" in section 14(e), or Congress would not have outlawed it. However, it seems that a broader range of conduct, including some innocent — if not innocuous — conduct, is contemplated by the term in section 10(b), or Congress would have outlawed the use of all manipulative devices itself rather than leaving it to the SEC to decide which ones to regulate and how to do so. Moreover, the rule-dependence of section 10(b) serves to insure that an expert agency will define the section's effective scope, whereas the scope of section 14(e) will be determined primarily by the decisions of private litigants and the courts,⁷⁷ which are beyond

vention of such rules as the SEC adopts to define and prescribe means reasonably necessary to prevent acts, practices or courses of business that are fraudulent, deceptive or manipulative.

The 1975 amendments to the Act added § 6(b)(5), which provides that an exchange shall not be registered unless the SEC determines that its regulations are designed to prevent fraudulent and manipulative acts and practices. Securities Acts Amendments of 1975, Pub. L. No. 94-29, § 4, 89 Stat. 97, 104-05 (codified in § 6(b)(5), 15 U.S.C. § 78f(b)(5)). The 1975 amendments also added § 11A(c)(1)(A), which forbids regulated persons to transmit information about securities transactions in contravention of such regulations as the SEC shall prescribe to prevent the distribution of fraudulent, deceptive or manipulative information with respect to transactions. § 7, 89 Stat. at 114-15 (codified in § 11A(c)(1)(A), 15 U.S.C. § 78k-1(c)(1)(A)). They also required the SEC to establish a Municipal Securities Rulemaking Board with rules designed to prevent fraudulent and manipulative acts and practices, § 13, 89 Stat. at 131-37 (codified in § 15B(b)(2)(C), 15 U.S.C. § 78o-4(b)(2)(C)), and extended the proscriptions of §§ 15(c)(1) and (2) to municipal security dealers, § 11, 89 Stat. at 125-26 (codified in the Act, 15 U.S.C. § 78o(c)(1),(2)).

⁷⁶ The language enacted in these amendments and the record of their adoption provides evidence to support almost any reading of the word manipulative. For example the language of § 15(c)(1) of the Act, first adopted in 1936, suggests that manipulative devices are a subgroup of fraudulent devices. The language of § 15(c)(2) of the Act, first adopted in 1938, is closer to that of §§ 10(b) and 14(e) of the Act, and suggests that manipulation and fraud are distinct problems. *See generally* J. SELIGMAN, *THE TRANSFORMATION OF WALL STREET* 138-44, 183-89 (1982) (1936 and 1938 amendments). The 1975 amendments employed the language of both sections to regulate municipal securities dealers. *See infra* note 114.

⁷⁷ *See Schreiber*, 472 U.S. at 12 ("Inviting judges to read the term 'manipulative' with their own sense of what constitutes 'unfair' or 'artificial' conduct would inject uncertainty into the tender offer process.").

the controls of Congress and the SEC.⁷⁸ In any case, the considerations of fair notice that indicate a narrow reading of open-ended terms in section 14(e) and perhaps in SEC rules are not so compelling when interpreting an enabling provision like section 10(b).⁷⁹

A good guide to the meaning of the word manipulative in section 10(b) is available from sections 9 and 10(a) of the Act, which were enacted in 1934 along with section 10(b).⁸⁰ Sections 9 and 10 are entitled "Prohibition against manipulation of security prices" and "Regulation of the use of manipulative and deceptive devices," respectively. Congress labeled the practices that it addressed in these sections as manipulative, and taken together the two sections give the word meaning for the purpose of construing section 10(b).⁸¹

⁷⁸ The requirement of administrative action in § 10(b) of the Act made it unnecessary for the Court to focus on the meaning of manipulative in its Rule 10b-5 cases, in which manipulation was never thought to be in issue. Those who feel that the Rule 10b-5 cases should not govern the interpretation of § 14(e) have emphasized the off-hand treatment of manipulation in those cases. Fifis, *supra* note 74, at 312-22; Note, *Target Defensive Tactics as Manipulative Under Section 14(e)*, 84 COLUM. L. REV. 228, 246 (1984). The lack of administrative guidance in the development of § 14(e) was underscored by the SEC's failure to participate as *amicus curiae* in *Schreiber*.

⁷⁹ See *Schreiber*, 472 U.S. at 8 ("the term 'manipulative' provides . . . guidance to those who must determine which types of acts are reached by the statute"); *cf.* § 32(a), 15 U.S.C. § 78ff ("no person shall be subject to imprisonment under this section for the violation of any rule or regulation if he proves that he had no knowledge of such rule or regulation.").

⁸⁰ Section 9(f) of the Act, was amended and § 9(g) of the Act, *id.*, was added as part of the 1982 SEC-CFTC jurisdictional accord. Securities-Commodities Accord Amendments of 1982, Pub. L. No. 97-303, § 3, 96 Stat. 1409. This part of the accord expanded the SEC's authority over options.

⁸¹ The Court has looked to § 9 of the Act, to define manipulation. *E.g.* *Santa Fe*, 430 U.S. at 476; *Hochfelder*, 425 U.S. at 201-07; see also Poser, *supra* note 10, at 700-11 (§ 9(a)(1)-(5) as source of meaning). The legislative history of the Act and § 10(b) is beyond the scope of this article, but it is fair to say that §§ 9 and 10 were usually treated as related in the debate over the Act. *But see* 5 A. JACOBS, LITIGATION AND PRACTICE UNDER RULE 10B-5 § 5.01, at 1-176 n.14 (2d ed. 1987) (legislative history uninformative on relationship between §§ 9 and 10). An index listing most references to §§ 9 and 10 in the hearings on the Act is contained in 4 LEGISLATIVE HISTORY, *supra* note 11, at xv and xvii.

It seems settled that conduct with respect to OTC securities that would violate § 9(a) if it involved exchange-registered securities violates Rule 10b-5 and § 15(c)(1). The reasoning is usually that manipulated prices are somehow misleading, but there seems to be a sense that § 15(c)(1) and Rule 10b-5 incorporate the proscriptions of § 9(a). See *SEC v. Resch-Cassin & Co., Inc.*, 362 F. Supp. 964, 975 (S.D.N.Y. 1973) ("It is well settled that the manipulative activities expressly prohibited by § 9(a)(2) with respect to a listed security are also violations of § 17(a) of the Securities Act and § 10(b) of the Act when the same activities are conducted with respect to an over-the-counter security."); *In re Barrett & Co.*, 9 SEC 319, 328-30 (1941); *cf.* *Crane Co. v. Westinghouse Air Brake Co.*, 419 F.2d 787, 792-99 (2d Cir. 1969) (manipulation and

Sections 9 and 10, like the rest of the Act, contemplate extensive regulation of the market toward the end of protecting the public from speculative and manipulative conduct. Section 9 starts by declaring a variety of trading practices and communications unlawful if they are motivated by certain purposes or have certain consequences.⁸² The rest of sections 9 and 10 make it unlawful to do a variety of things in contravention of SEC rules.⁸³ Section 9 gives the SEC the authority to regulate stabilizing transactions and the use of exchange facilities in connection with options.⁸⁴ Section 10(a) gives the SEC the authority to regulate short sales of exchange-registered securities and the use of stop-loss orders on such securities. Finally, there is section 10(b).

Part III of this article discusses section 10(b) and related provisions of the Act in the context of four broad categories of activity that may influence security prices in ways that damage the public: the business activities of security issuers, the dissemination of information, speculative trading, and disruptive trading. Before proceed-

failure to disclose it), *cert. denied*, 400 U.S. 822 (1970). See generally 3 L. Loss, SECURITIES REGULATION, *supra* note 8, at 1563-68; Bloomenthal, *The Case of the Subtle Motive and the Delicate Art — Control and Domination in Over-the-Counter Securities Markets*, 1960 DUKE L.J. 196 (1960); Jacobs, *Regulation of Manipulation by SEC Rule 10b-5*, 18 N.Y.L.F. 511 (1973); Hirshowitz, *Proof of a Manipulation of the Market of a Security Traded Over-the-Counter* (April 1, 1965) (memorandum available in SEC library). It might be argued that Congress intended the SEC to have power under § 10(b) to extend the proscriptions of § 9 of the Act to OTC securities, regardless of whether those proscriptions related to manipulative or deceptive devices or contrivances. Cf. *Hundahl v. United Benefit Life Ins. Co.*, 465 F. Supp. 1349, 1361-62 (N.D. Tex. 1979); L. Loss, FUNDAMENTALS, *supra* note 8, at 998 n.75; Karjala, *supra* note 5, at 1483-84; Poser, *supra* note 10, at 706-07. However, there is no indication of this in the legislative history, and as originally enacted, § 15 gave the SEC more than ample authority to accomplish regulation of the OTC market.

⁸² Each of the subparts of § 9(a) is limited by its terms to exchange-registered securities. Section 9 was not amended in 1964 when § 12 of the Act was amended to require issuers to register most publicly traded securities with the SEC. Securities Act Amendments of 1964, Pub. L. No. 88-467, § 3(c), 78 Stat. 565, 566-68 (codified in § 12(g), at § 78 (1982)). When the Act was first enacted, § 9(f) provided that § 9 did not apply to exempt securities, but now exempt securities are subject to all of § 9 except § 9(a).

⁸³ Section 9(e), provides that any person who willfully participates in any act or transaction in violation of §§ 9(a)-(c) is liable to any person who traded any security at a price affected by the violation for "the damages sustained as a result of . . . such act or transaction."

⁸⁴ Sections 9 (b)-(d), which give the SEC the authority to regulate the guaranteeing of options by exchange members and the use of exchange facilities to effect options transactions. Section 9(g), added in 1982, expands the SEC's authority to regulate option trading. See *supra* note 81.

ing to that discussion, it may be useful to examine in some detail the way in which the Court has defined the word manipulative in section 10(b).

II. THE SUPREME COURT AND THE SCOPE OF SECTION 10(b)

Rule 10b-5 has become the most important provision of the securities laws.⁸⁵ Although it is entitled "Employment of Manipulative and Deceptive Devices," the rule speaks in terms of fraud.⁸⁶ The word manipulative does not appear in the rule except in its title, and the closest that the rule comes to reaching conduct that might not be deceptive is to make it unlawful to engage in any act, practice or course of business that operates as a fraud. Most discussion about the reach of the rule have been framed in terms of the law of fraud, and controversies over the rule's scope have centered on the question of whether to free the rule from various constraints of traditional fraud doctrine.

Rule 10b-5 was not enacted by Congress. It was prescribed by the SEC and has the force of law only because the Act authorized the SEC to promulgate it. Although recently the SEC has tried to obscure the source of its authority to promulgate rules, the sanction of section 10(b) is the foundation for the tremendous body of law that has grown up around Rule 10b-5. The sanction of section 10(b) may be critical to any effective SEC regulation of the market.⁸⁷ Most discussion of section 10(b) has been in connection with Rule 10b-5,⁸⁸

⁸⁵ 11A Pt. 1 BUSINESS ORGANIZATIONS — FEDERAL SECURITIES EXCHANGE ACT v (A.A. Sommer, gen. ed. 1987) (Rule 10b-5 "has been the basis for more litigation than all other sections of the federal securities laws taken together."). See generally A. BROMBERG & L. LOWENFELS, *supra* note 8; A. JACOBS, *supra* note 81.

⁸⁶ The rule is modeled on § 17 of the Securities Act of 1933, 15 U.S.C. § 77q (1982), which is entitled "Fraudulent Interstate Transactions."

⁸⁷ See, e.g., Short Sales in Connection with a Public Offering, Exchange Act Release No. 26,028, [Current] Fed. Sec. L. Rep. (CCH) ¶ 84,315 at 89,385 (Aug. 25, 1988); Proposed Rule 10b-21 on Short Sales in Connection with a Public Offering, Exchange Act Release No. 24,485, [1987] Fed. Sec. L. Rep. (CCH) ¶ 84,127 at 88,683 n. 19 (May 20, 1987); Adoption of Amendments to Rule 10b-6, Exchange Act Release No. 24,003, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,055 at 88,415-16 (Jan. 16, 1987); cf. Piper v. Chris-Craft Industries, Inc., 430 U.S. 1, 45-46 (1977) (SEC suggests that it promulgated Rule 10b-6 under § 9(a)(6), as well as under § 10(b)). Compare Seligman, *Equal Protection in Shareholder Voting Rights: The One Common Share, One Vote Controversy*, 54 GEO. WASH. L. REV. 687, 714-19 (1986) with Dent, *Dual Class Capitalization: A Reply to Professor Seligman*, 54 GEO. WASH. L. REV. 725, 726-37 (1986) (power to forbid trading in common stock with unequal voting rights).

⁸⁸ There was a great deal of discussion of stock market manipulation and its treatment in the Act around the time of the Act's adoption, but very little was said about

and perhaps because the rule principally addresses deception, section 10(b) has usually been discussed in terms of deception.⁸⁹

The Court has explored the scope of section 10(b) in a series of important opinions involving alleged violations of Rule 10b-5. In each of these cases the Court concluded that section 10(b) did not authorize the SEC to regulate the challenged conduct. The Court assumed in each case that if the challenged conduct fell within the scope of section 10(b), it was because it was deceptive. The Court did not ignore manipulation, though. It repeatedly supported its narrow construction of the section by citing the sinister connotation that it found implicit in the word manipulative. The language that the Court used in doing so suggested that the word has no independent significance in section 10(b).

The plaintiffs in *Ernst & Ernst v. Hochfelder*⁹⁰ contended that an accounting firm was liable to them under Rule 10b-5 for aiding and abetting a fraudulent securities scheme perpetrated by the president

§ 10(b), beyond an occasional mention of its vague and potentially broad language. See generally J. FLYNN, *SECURITY SPECULATION* (1934); TWENTIETH CENTURY FUND, INC., *supra* note 12; (1935); Berle, *supra* note 28; Berle, *Stock Market Manipulation*, 38 COLUM. L. REV. 393 (1938); Hanna, *supra* note 20; Hanna & Turlington, *supra* note 20; Herlands, *Criminal Law Aspects of the Securities Exchange Act of 1934*, 21 VA. L. REV. 139, 153-64, 177-80 (1934); Mathias, *Manipulative Practices and the Securities Exchange Act* (pts. 1 & 2), 2 U. PITT. L. REV. 7, 104 (1936); Moore & Wiseman, *supra* note 28; Seligman, *supra* note 23, at 25-31; Tracy & MacChesney, *supra* note 13; Note, *Illegality of Stock Market Manipulation*, 34 COLUM. L. REV. 500 (1934); Comment, *Market Manipulation and the Securities Exchange Act*, 46 YALE L.J. 624 [hereinafter Comment] (1937); see also Note, *Manipulation of the Stock Markets Under the Securities Laws*, 99 U. PA. L. REV. 651 (1951); Comment, *Regulation of Stock Market Manipulation*, 56 YALE L.J. 509 (1947).

Until recently there has been very little discussion of the SEC's authority to regulate manipulation under § 10(b) of the Act. Cf. *supra* note 10. Several commentators have described manipulative practices in the over-the-counter market and their regulation under Rule 10b-5 and § 15(c), but most of this commentary was written when Rule 10b-5 was being accorded wide scope and the problem of authority was not so pressing. See *infra* note 120. There has been a great deal of discussion of the meaning of manipulation in the context of statutory provisions that of themselves forbid manipulation of commodities markets, see *infra* notes 311-19 and accompanying text, and in connection with tender offers, see *infra* note 40.

⁸⁹ Section 10(b) does not explicitly authorize the SEC to promulgate rules. It simply makes it unlawful to employ any manipulative or deceptive device or contrivance in contravention of such rules as the SEC may prescribe. While 15 U.S.C. § 78w authorizes the SEC to make rules necessary to execute the functions vested in it by the Act, it is conventional to treat § 10(b) as conferring authority on the SEC to regulate manipulative and deceptive devices and contrivances. *E.g.*, *Aaron v. SEC*, 446 U.S. 680, 687-88 (1980).

⁹⁰ 425 U.S. 185 (1976).

of a brokerage firm that it audited. The plaintiffs alleged that if the accountants had conducted their audits properly, they would have reported certain irregularities to the SEC and to the Midwest Stock Exchange, which would have investigated and discovered the scheme.⁹¹ The Court held that "a private cause of action for damages will [not] lie under § 10(b) and Rule 10b-5 in the absence of any allegation of 'scienter' — intent to deceive, manipulate, or defraud."⁹² Writing for the Court, Justice Powell consciously focused on section 10(b) rather than on Rule 10b-5. He explained that the SEC does not have the power to make law but has only the power to effectuate the will of Congress as expressed in the statute. He reasoned that if Congress had intended the SEC's authority to extend beyond such misconduct, then the statute would not speak "so specifically in terms of manipulation and deception, and of implementing devices and contrivances — the commonly understood terminology of intentional wrongdoing."⁹³

This much of the Court's opinion might have had little impact on the regulation of manipulation under section 10(b). Most of the non-deceptive conduct that the SEC has undertaken to regulate under section 10(b) probably qualifies as intentional misconduct.⁹⁴ However, in response to the argument of the SEC *amicus curiae* brief, that the language of section 10(b) should be read broadly since Congress was concerned with ends and not means, Justice Powell wrote

⁹¹ 425 U.S. at 190. The principal irregularity was the rule that only the president of the brokerage firm could open mail addressed to his or her attention.

⁹² *Id.* at 193.

⁹³ *Id.* at 212-14; *see also id.* at 197. Justice Powell had emphasized the controlling importance of the language of § 10(b) earlier in his concurring opinion in *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975), where the Court, explicitly relying upon policy considerations, limited standing to sue for violations of Rule 10b-5 to buyers and sellers. Justice Powell felt the result was compelled by the language of § 10(b) of the Act, 421 U.S. at 756-57. *See generally* 1 A. BROMBERG & L. LOWENFELS, *supra* note 8, § 2.1, at 2:11 to :12.

The dissenting opinion in *Blue Chip Stamps* treated false statements as a type of manipulation, characterizing the conduct alleged of the defendants, an overly conservative prospectus designed to discourage offerees from buying, as "a deceptive and manipulative scheme designed . . . to enhance the value of [the defendants'] own shares in the subsequent offering." 421 U.S. at 762; *see also id.* at 770 ("no reason for denying standing to sue to plaintiffs . . . injured by novel forms of manipulation").

⁹⁴ However, in some instances it may not. For example, the SEC has relied at least in part on its § 10(b) power in promulgating Rules 10b-4, 10b-7 and 10b-18, which regulate short tendering, stabilizing transactions and issuer repurchases respectively. These practices are not necessarily wrongful. *See infra* notes 266-82, 296-304 and accompanying text; *cf.* the Act, §§ 13(e)(1) and 14(e), 15 U.S.C. §§ 78m(e)(1) and 78n(e) (authority to prescribe means reasonably designed to prevent manipulative practices); *Schreiber v. Burlington Northern, Inc.*, 472 U.S. at 11 n.11 (1985) (discussing § 14(e)).

that Congress'

[u]se of the word 'manipulative' is especially significant. It is and was virtually a term of art when used in connection with securities markets. It connotes intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities.⁹⁵

By this narrow definition, made on the authority of the dictionary, the Court deprived the word manipulative of any independent significance. Manipulative is a term of art now, but it encompasses only a few trading practices that are independently prohibited by other provisions of the Act and by stock exchange rules and that the SEC could forbid as deceptive devices even if it had no power over manipulative ones.⁹⁶

The Court focused on the statute again in *Santa Fe Industries, Inc. v. Green*,⁹⁷ when in the context of a challenge by minority shareholders to a short-form merger it held that more than a breach of fiduciary duty must be shown in order to establish a violation of Rule 10b-5 and section 10(b).⁹⁸ It was "readily apparent" to the Court that a short-form merger that treats cashed-out shareholders unfairly is not manipulative within the meaning of section 10(b).⁹⁹ The Court volunteered that interpreting the term "manipulative" in section 10(b) "in this technical sense of artificially affecting market activity in order to mislead investors — is fully consistent with the fundamental purpose of the 1934 Act 'to substitute a philosophy of full disclosure for the philosophy of *caveat emptor*.'"¹⁰⁰

By 1980, through force of repetition, deception had been made into an element of manipulation. In *Chiarella v. United States*,¹⁰¹ the Court reversed a printer's conviction for violating section 10(b) and Rule 10b-5. The printer deciphered the identity of several take-

⁹⁵ 425 U.S. at 199.

⁹⁶ See, e.g., *Pin v. Texaco, Inc.*, 793 F.2d 1448 (5th Cir. 1986) (sanctions imposed under Fed. R. Civ. P. 11 for alleging manipulation without alleging misrepresentation). Cf. *Levine, Mathews & Callcott, The Carpenter-Winans Case*, 21 REV. SEC. & COMMODITIES REG. 55, 61-62 (1988).

⁹⁷ 430 U.S. 462, 472 (1977) ("the language of the statute must control the interpretation of the Rule").

⁹⁸ The Court accepted the district court's finding that all relevant information had been disclosed to the minority shareholders, 430 U.S. at 474.

⁹⁹ 430 U.S. at 476.

¹⁰⁰ 430 U.S. at 477, quoting *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 151 (1972), quoting *SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 186 (1963).

¹⁰¹ 445 U.S. 222 (1980).

over targets from documents that he had handled, bought stock in the target companies, and then sold the stock after the takeover attempts were announced and the stock price had risen. Holding that silence is not actionable under section 10(b) absent a duty to speak,¹⁰² the Court reversed the conviction because the jury had been instructed that it could find the defendant guilty even if he did no more than trade without first disclosing material non-public information in his possession.¹⁰³ The decision could have rested on the language of Rule 10b-5, which by its terms deals with actual and constructive fraud, but of course the Court did not limit itself to the rule. *Chiarella* followed *Hochfelder* in emphasizing the statute,¹⁰⁴ but unlike *Hochfelder* it did not focus on the statute's language. Manipulation disappeared from the statute. "Section 10(b) is described as a catchall provision, but what it catches must be fraud."¹⁰⁵

The Court extended *Hochfelder's* scienter requirement to actions brought by the SEC in another important 1980 opinion, *Aaron v. SEC*.¹⁰⁶ The majority recognized that the reasoning of *Hochfelder* compelled this result, and its opinion does not belabor the point.¹⁰⁷ Nonetheless, three Justices dissented from "the Court's technical linguistic analysis."¹⁰⁸ It was "quite unclear" to them that the words "manipulative or deceptive device or contrivance" in section 10(b) connote knowing or intentional misconduct.¹⁰⁹

The Rule 10b-5 opinions played an important role in defining the SEC's power to regulate manipulation, but they did not confront the issue directly. The first securities cases in which courts recognized that the meaning of the term manipulative was of controlling significance arose under section 14(e) of the Act.¹¹⁰ Section 14(e) forbids

¹⁰² *Id.* at 235.

¹⁰³ *Id.* at 236.

¹⁰⁴ *Id.* at 226.

¹⁰⁵ *Id.* at 234-35; see also *id.* at 226 ("Section 10(b) was designed as a catchall clause to prevent fraudulent practices."). But see *id.* at 246 (Blackmun, J., dissenting) ("I think [Chiarella's] brand of manipulative trading . . . lies close to the heart of what the securities laws are intended to prohibit.").

¹⁰⁶ *Aaron v. SEC*, 446 U.S. 680 (1980).

¹⁰⁷ *Id.* at 689-91, 694. Most of rest of the opinion deals with other matters presented by the case, including the scienter requirement for actions under § 17(a) of the Securities Act of 1933, 15 U.S.C. § 77q(a) (1982), and the argument that *Hochfelder* should not apply to requests for equitable relief.

¹⁰⁸ 446 U.S. at 715.

¹⁰⁹ *Id.* at 705. The dissenting opinion focused on the meaning of the word device, which figured prominently in the majority's analysis of § 17(a) of the Act. *Id.* at 695-96 (majority), 707-08 (dissent).

¹¹⁰ 15 U.S.C. § 78n(e). The meaning of manipulation has long been acknowledged

the employment of manipulative devices in connection with tender offers. While nothing violates section 10(b) unless it contravenes an SEC rule, any manipulative conduct in connection with a tender offer violates section 14(e). In *Mobil Corp. v. Marathon Oil Co.*¹¹¹ a tender offeror challenged the propriety of options on valuable corporate assets that the target had granted to a friendly suitor in order to defeat the tender offer. The Sixth Circuit concluded that exercise of the options should have been enjoined, reasoning that the options were manipulative, and thus that they violated section 14(e), because they effectively set a ceiling on the price of the target's stock.¹¹²

Mobil attracted a great deal of attention.¹¹³ It did not attract a following in other courts however,¹¹⁴ and the Court finally repudiated its reasoning in *Schreiber v. Burlington Northern, Inc.*¹¹⁵ In *Schreiber* the Court held that rescinding a hostile tender offer and replacing it with a negotiated offer was not a manipulative act even though target shareholders who tendered in response to the original offer would have received more had it not been rescinded. The Court refused to read "the phrase 'fraudulent, deceptive, or manipulative acts or practices' to include acts which, although fully dis-

as a problem in commodities law. See *infra* notes 311-19 and accompanying text.

¹¹¹ 669 F.2d 366 (6th Cir. 1981), cert. denied, 455 U.S. 982 (1982).

¹¹² 669 F.2d at 374-75.

¹¹³ E.g., Nelson, *Mobil Corp. v. Marathon Oil Co. — The Decision and Its Implications for Future Tender Offers*, 7 CORP. L. REV. 233 (1984); Prentice, *Target Board Abuse of Defensive Tactics: Can Federal Law Be Mobilized to Overcome the Business Judgment Rule?*, 8 J. CORP. L. 337 (1983); Profusek, *Tender Offer Manipulation: Tactics and Strategies After Marathon*, 36 SW. L.J. 975 (1982); Rosenzweig, *The Legality of "Lock-Ups" and Other Responses of Directors to Hostile Takeover Bids or Stock Aggregations*, 10 SEC. REG. L.J. 291 (1983); Weiss, *Defensive Responses to Tender Offers and the Williams Act's Prohibition Against Manipulation*, 35 VAND. L. REV. 1087 (1982); Note, *Target Defensive Tactics*, *supra* note 78; Note, *Tender Offer Defensive Tactics — Federal Regulation of Management's Prerogative*, 10 FORDHAM URB. L.J. 633 (1981); Note, *Lock-Up Options: Toward a State Law Standard*, 96 HARV. L. REV. 1068 (1983); Note, *Section 14(e) of the Williams Act: Can There Be Manipulation with Full Disclosure or Was the Mobil Court Running on Empty?*, 12 HOFSTRA L. REV. 159 (1983); Note, *Tender Offer Defenses: The Need for National Guidelines in Light of Mobil*, 21 SAN DIEGO L. REV. 159 (1984); Note, *Swallowing the Key to Lock-Up Options: Mobil Corp. v. Marathon Oil Co.*, 14 U. TOL. L. REV. 1055 (1983); Note, *Hostile Tender Offers and Injunctive Relief for 14(e) Manipulation Claims: Developments After Mobil Corp. v. Marathon Oil Co.*, 40 WASH. & LEE L.J. 1175 (1983).

¹¹⁴ See *Feldbaum v. Avon Prods., Inc.*, 741 F.2d 234 (8th Cir. 1984); *Buffalo Forge Co. v. Ogden Co.*, 717 F.2d 757 (2d Cir.), cert. denied, 464 U.S. 1018 (1983).

¹¹⁵ 472 U.S. 1 (1985).

closed, 'artificially' affect the price of the takeover target's stock."¹¹⁶ The Court cited *Hochfelder* and *Santa Fe* as cases reflecting the use of the word manipulative "as a general term comprising a range of misleading practices"¹¹⁷ and quoted from them extensively in explaining its "conclusion that 'manipulative' acts under § 14(e) require misrepresentation or nondisclosure."¹¹⁸

In light of the Court's heavy reliance on its Rule 10b-5 decisions, *Schreiber* unquestionably defines the term "manipulative" for the purposes of section 10(b).¹¹⁹ Indeed *Schreiber* will probably limit the reach of every provision of the federal securities statutes that proscribes manipulative conduct or provides for its regulation. If nothing is manipulative unless it is deceptive, then the SEC cannot regulate non-deceptive conduct under section 10(b). If this is so, some of the SEC's most important rules are unauthorized or irrelevant and the SEC may be powerless to address new problems, including novel trading practices that many people believe have a detrimental impact on the public.¹²⁰ Instead of being a broad mandate to the SEC to ensure a regime of appropriate pricing, the Act is reduced to an enabling statute for a system of disclosure.

¹¹⁶ *Id.* at 6.

¹¹⁷ *Id.*

¹¹⁸ *Id.* at 6-8. See also *id.* at 8 (congressional concern with disclosure is core of Act), 12 (disclosure is core mechanism of the Act). The Court also relied on the "familiar principle of statutory construction that words grouped in a list should be given related meaning." *Id.* at 8 (quoting *Securities Indus. Ass'n v. Board of Governors*, 468 U.S. 207, 218 (1984)).

¹¹⁹ The Court said it had "interpreted 'manipulative' in [§ 10(b)] to require misrepresentation" in *Santa Fe*, *Piper* and *Hochfelder*. 472 U.S. at 7-8. *Schreiber* has been read to remove any doubt that misrepresentation or nondisclosure is an element of manipulation under § 10(b) of the Act. Poser, *supra* note 10, at 682; see also T. HAZEN, *THE LAW OF SECURITIES REGULATION* § 12.1, at 84 (1987 Supp.).

¹²⁰ See T. HAZEN, *supra* note 119, at § 12.1 (1987 Supp.) (listing rules that would be invalidated by extending *Schreiber* to § 10(b)). Sections 13(e)(1) and 14(e) of the Act, 15 U.S.C. §§ 78m(e)(1), 78n(e), give the SEC authority to prescribe rules reasonably designed to prevent manipulative acts. In *Schreiber*, the Court said that under this provision of § 14(e) the SEC has the power to "regulate non-deceptive activities as a 'reasonably designed' means of preventing manipulative acts." 472 U.S. at 11 n.11. Nonetheless, several commentators have read the opinion to limit the SEC's § 14(e) rulemaking authority to requiring disclosure. T. HAZEN, *supra*, at 119; Pitt & Chernov, *Williams Act Rejected as Tool to Ensure Fairness*, *Legal Times*, June 17, 1985, at 27. See also Note, *The Impact of Schreiber on the SEC Tender Offer Timing Rules*, 57 GEO. WASH. L. REV. 77 (1988).

III. PRICES AND THE CONTROL OF MANIPULATION

A. Income and Price — The Control of Issuer Behavior

Since the primary value of a security is the income that it will produce for its holder, the price that people are willing to pay or to accept for a security is likely to change when the income that it is expected to produce changes. Issuer distributions are an important source of income to security holders,¹²¹ and so perhaps the surest way to change a security's price is to change the issuer distributions that it will in fact produce.

Recently, a former brokerage-house clerk undertook a pernicious scheme to injure a security issuer's earning capacity so that he could profit from the drop in the price of its securities that he thought would follow. After buying options to sell a substantial amount of the common stock of a corporation that manufactured pharmaceuticals, he put rat poison in capsules of medicine produced by the company, put the capsules on store shelves, and called television stations and the manufacturer and told them what he had done. The company recalled the capsules, at substantial expense, and as the clerk had hoped, the price of its stock fell, although not enough for him to profit by exercising his options.¹²²

The clerk was trying to tamper with the stock market,¹²³ and he succeeded in compromising the public interest in the integrity of the market. In doing so he perpetrated a wrong independent of the wrong he did to the owners and employees of the manufacturer and independent of the wrong he would have done to any consumer who used the poisoned capsules. The language of section 10(b) plainly gives the SEC power to regulate schemes like this one. The clerk intended to manipulate the price of the manufacturer's securities and of the derivative securities that he owned, and the various acts that he undertook in furtherance of his scheme were surely "manipulative." Had he acted in contravention of an SEC rule, he would have violated section 10(b).

Strangers to corporations do not often destroy assets in order to

¹²¹ The other source of income is the price a holder will receive on resale, which may be the consensus view of the present value of all expected future issuer distributions.

¹²² N.Y. Times, Aug. 27, 1986, at A9, col. 1; *id.*, June 21, 1986, at 32, col. 1; *id.*, June 8, 1986, at 28, col. 1; *id.*, May 31, 1986, at 1, col. 2.

¹²³ The *New York Times* reported that he was "accused of poisoning over-the-counter drugs in an attempt to make a killing in the stock market." *Id.*, June 28, 1986, at 28, col. 1.

depress corporate security prices, and when they do so they are perhaps best made to account for their actions under rules against destroying assets.¹²⁴ The managers of security issuers have much more regular opportunities to manipulate corporate assets toward the end of influencing security prices. One of the reasons that managers of publicly held corporations undertake and publicize profitable activities is that they recognize that they will thereby increase the price of their employers' securities. While profitable projects should be encouraged, presumably managers should not undertake losing projects with a view to profiting personally from the publication of their losses.¹²⁵

Section 16 of the Act makes it difficult for people who control publicly held companies to profit by manipulating the firm's affairs toward their own ends.¹²⁶ Section 16(b) provides that any profits that the officers, directors or substantial shareholders of a publicly held company realize from short-swing trading in the company's equity securities shall inure to the company. Section 16(c) forbids such officers, directors and shareholders from selling short the company's equity securities.

Section 16(b) recites "preventing the unfair use of information" as its purpose, but the provisions of section 16 do not function well as disclosure rules. They are under-inclusive in several respects. They do not cover everyone who has access to inside information, or who is likely to have access to such information, but only those persons who control issuers. Moreover, section 16(b) leaves officers and directors free to profit from the price appreciation that will result when the good work that they are paid to do is publicized.¹²⁷ Section 16(b) is of no consequence to a controlling person who buys while in possession of good, non-public information, but who is prepared to hold for the long haul; nor to one selling securities that he or she has owned for six months or more on the basis of bad news, so long as he or she does not intend to repurchase as soon as the bad news is released. Section 16 is also over-inclusive for a disclosure rule, primarily because it covers short-swing trading and short sales regardless of the trader's knowledge or motivation.

¹²⁴ The clerk pleaded guilty to product tampering, wire fraud and giving false information about the tampering and was sentenced to prison. Com. Appeal (Memphis), Oct. 31, 1986, at 1, col. 1.

¹²⁵ Cf. H. MANNE, *supra* note 10, at 154-56 (insider trading on bad news).

¹²⁶ 15 U.S.C. § 78p.

¹²⁷ Section 16(b) of the Act, *supra* note 2, does not even forbid the trading that it covers, and the SEC cannot bring an action under it. It merely provides that any trading profits shall inure to the issuer. The person on the other side of the affiliate's trade is not protected by this section.

These frequently made criticisms are on the mark if section 16 is directed toward achieving informational parity. They may, however, simply show that section 16 "is not a disclosure rule at all."¹²⁸ Section 16 is well tailored to altering the behavior of corporate managers.¹²⁹ It only applies to people likely to control corporations, and it removes much of their incentive to mismanage corporate affairs for the purpose of producing personally profitable trading opportunities. Section 16(c) makes it unlawful for managers to sell short, on the theory that management should not be able to profit from its own mistakes.¹³⁰ Section 16(b) may have been intended to discourage managers from trading on inside information, but it was also intended to discourage them from profiting by manipulating corporate affairs in order to create short-swing price changes or unfair distributions of corporate assets.¹³¹ By forbidding key insiders from selling short and by denying them any profits from short-swing trades, section 16 makes it impossible for them to profit by trading the issuer's stock except by buying and holding for long-term appreciation, which they can presumably best insure by managing the issuer's business well.

The Court recognized the public interest in keeping managers from manipulating corporate affairs for the purpose of influencing security prices when it upheld the SEC's refusal to approve a plan of reorganization for a holding company under the Public Utility Holding Company Act¹³² in its celebrated second decision of *SEC v. Che-*

¹²⁸ Easterbrook, *Insider Trading, Secret Agents, Evidentiary Privileges, and the Production of Information*, 1981 S. CT. REV. 309, 319; cf. Yourd, *Trading in Securities by Directors, Officers and Stockholders: Section 16 of the Securities Exchange Act*, 38 MICH. L. REV. 133, 143-44, 147-48 (1939).

¹²⁹ ABA Comm. on Fed. Reg. of Secs., *Report of the Task Force on Regulation of Insider Trading — Part II: Reform of Section 16*, 42 BUS. LAW. 1087, 1092 (1987) ("[S]ection 16 remains a useful tool for preventing speculative abuses by insiders and for focusing their attention on their fiduciary duty and on long-term corporate health, rather than on short-term trading profits."); see also *id.* at 1093 (§ 16 of the Act was response to revelations of businessmen profiting "by means of short-swing trading and manipulation of corporate events to enhance their trading profits.").

¹³⁰ *Id.* at 1097-99; see also H. MANNE, *supra* note 10, at 153 n.13; Easterbrook, *supra* note 128, at 319 n.50.

¹³¹ S. REP. NO. 792, 73d Cong., 2d Sess. (1934), reprinted in 5 LEGISLATIVE HISTORY, *supra* note 11, item 17, at 9 (manipulation of dividend policy); H. MANNE, *supra* note 10, at 8-10; A.B.A. Comm. on Fed. Reg. of Secs., *supra* note 129, at 1093-94 ("[S]ection 16(b) was designed to eliminate the temptation for insiders to manipulate corporate events so as to maximize their own short-term trading profits."); Yourd, *supra* note 128, at 133; D. VAGTS, *BASIC CORPORATION LAW* 551 (3d ed. 1989).

¹³² 15 U.S.C. §§ 79 to 79z-6 (1982).

tery Corp.¹³³ The SEC had refused to approve the plan because it gave members of management common stock in the reorganized company on the basis of the preferred stock that the managers had purchased in the market while the SEC was considering the firm's various proposed reorganization plans.¹³⁴ As the SEC saw it, by virtue of its control of the holding company's business, management could affect the market price of outstanding securities and had "a formidable battery of devices that would enable it, if it should choose to use them selfishly . . . to influence the market for its own gain" ¹³⁵ The SEC concluded that it would be unfair and detrimental to the public interest or the interest of investors within the meaning of the statute to allow the managers to receive common stock in the reorganized company on the basis of securities that they had bought at prices they might have influenced, by the way they managed the business of the company or by the way they shaped the reorganization process.¹³⁶ The Court sustained the decision as consistent with the authority that Congress had granted to the SEC, even though it was "plain that there was no fraud or lack of disclosure in" the managers' purchases.¹³⁷

The Public Utility Holding Company Act and section 16 of the Act cannot stop managers from destroying their own firms for personal ends. The drafters of the Act were sensitive to the likelihood that they would be accused of trying to socialize business, and by and large they avoided matters of corporate governance in their drafting.¹³⁸ State law remedies for breaches of fiduciary duties of care and loyalty may be the best protection that the law affords

¹³³ 332 U.S. 194 (1947); see also *SEC v. Chenery Corp.*, 318 U.S. 80 (1943). The Court's two opinions focus on the role of adjudication in administrative decision making and the scope of judicial review of administrative orders.

¹³⁴ 332 U.S. at 197-99; see also 318 U.S. at 81-85.

¹³⁵ 332 U.S. at 205 (quoting SEC order, Holding Company Act Release No. 5584).

¹³⁶ *Id.* at 204.

¹³⁷ *Id.* at 197; see also 318 U.S. at 91-92 (1943) (short-swing trading proscription of Public Utilities Holding Company Act is not a limit of SEC power over conduct of holding company management).

¹³⁸ Kripke, *The SEC, Corporate Governance, and the Real Issues*, 36 *BUS. LAW.* 173, 173-74 (1981). Compare Anderson, *The Meaning of Federalism: Interpreting the Securities Exchange Act of 1934*, 70 *VA. L. REV.* 813 (1984) with Kitch, *A Federal Vision of the Securities Laws*, 70 *VA. L. REV.* 857 (1984). This is not to say that the Act was not intended to regulate management behavior. Critics of self-interested management of public corporations had long called for the disclosure of information about compensation, see L. BRANDEIS, *OTHER PEOPLE'S MONEY* ch. 5 (1914), and the regulation of proxy solicitation in § 14 of the Act was directed at controlling management.

against mismanagement.¹³⁹ Nonetheless, while the Act was not promoted as a way to regulate managements' business decisions, revelations of abusive management practices were a driving force behind its enactment.¹⁴⁰ A manager who mismanages a corporation for the purpose of causing the price of its securities to drop has employed a manipulative device,¹⁴¹ and it seems that a manager who contravenes an SEC rule in doing so has also violated section 10(b).¹⁴²

Dividend policy is one area of management that the drafters of the Act may have contemplated that the SEC might regulate under section 10(b). Managers are often accused of coordinating their trading and changes in corporate dividend policy in order to take advantage of the changes in share prices that are likely to follow announced changes in dividends, or in order to secure corporate distributions for themselves.¹⁴³ Instances of prominent executives abusing their controls over dividend policies were well known by 1934, and abusive dividend policy was one of the problems that the Act was intended to address. The Senate Banking and Currency Committee's report on the bill that became the Act cited several ex-

¹³⁹ Cf. *CTS Corp. v. Dynamics Corp. of America*, 107 S. Ct. 1637, 1647 n.9 (1987) ("In the unlikely event that management were to take actions [in response to a hostile tender offer] designed to diminish the value of the corporation's shares, it may incur liability under state law Neither the [Williams] Act nor any other federal statute can assure that shareholders do not suffer from . . . mismanagement").

¹⁴⁰ See Brudney, *Insiders, Outsiders, and Informational Advantages Under the Federal Securities Laws*, 93 HARV. L. REV. 322, 335 n.50 (1979) ("Evidence of the connection of insider trading with such manipulation of corporate affairs was frequently alluded to in congressional hearings.").

¹⁴¹ See H. MANNE, *supra* note 10, at 147 ("The first form of manipulation is the publication of untrue good or bad news with the intention the others in the stock market rely upon the statement. The second form of manipulation is the intentional production of bad news"); *id.* at 150-51, 153-54; Kryzanowski, *supra* note 48, at 124 ("Some effective manipulative techniques include . . . manipulation of the generation and release of information on company activity.").

¹⁴² Cf. *Atchley v. Qonaar Corp.*, 704 F.2d 355, 356-59 (7th Cir. 1983) (financial statements misleading in light of management scheme to depress earnings). Existing rules may adequately deal with mismanagement. On the other hand the interests of those charged with the care of corporate assets may diverge from those of others with an interest in the assets, and the sanctions likely to be applied when a manager wrongly acts in his self interest may not be sufficient to protect security owners or the public.

¹⁴³ *E.g.*, *Pittsburgh Terminal Corp. v. Baltimore & O.R.R.*, 680 F.2d 933 (3d Cir.), *cert. denied*, 459 U.S. 1056 (1982) (withholding notice of common stock dividend so as not to prompt conversion of debentures into stock); *Mutual Shares Corp. v. Genesco, Inc.*, 384 F.2d 540 (2d Cir. 1967); *Hundahl v. United Benefit Life Ins. Co.*, 465 F. Supp. 1349, 1354, 1355 (N.D. Tex. 1979). See generally *Jacobs, supra* note 81, at 549-50; *Poser, supra* note 10, at 725-26 (discussing cases).

amples of dividend-related trading by management in support of section 16.¹⁴⁴

Dividend policy could be regulated as a disclosure issue. Changes in dividend policy may affect prices because of the information that they convey, and management might be required to explain its reasons for changing its policy clearly and completely.¹⁴⁵ Trading by a corporation's managers in the firm's securities immediately prior to a dividend announcement might be labeled deceptive on the basis of a fiduciary duty to disclose before trading. However, full and prompt disclosure might not be enough to eliminate the potential for abuse of dividend policy. There is some question about why and to what extent dividend policy affects security prices.¹⁴⁶ If dividend policy influences share prices for some reason other than the information that it conveys, then management can use a change in dividend policy to manipulate the price of stock for its own ends, even if it publicly, honestly and convincingly explains its new policy immediately upon adopting it. Dividend policy was seen as independently significant in 1934; the abuse was the improper dividend policy itself, not lying about it.¹⁴⁷ While a fully disclosed policy intended to change share prices so that management could trade profitably would not be deceptive, it might fairly be characterized as manipulative conduct of corporate affairs in connection with a securities transaction, and thus within the literal scope of section 10(b).¹⁴⁸ The Senate Committee at least intended section 10(b) to be a supplement to section 16 in discouraging such conduct. It described sections 9, 10 and 16 together and placed them all under the heading of

¹⁴⁴ S. REP. NO. 792, *supra* note 131, at 7-9.

¹⁴⁵ See Brudney, *Dividends, Discretion, and Disclosure*, 66 VA. L. REV. 85 (1980).

¹⁴⁶ See generally V. BRUDNEY & M. CHIRELSTEIN, *supra* note 23, at 479-521; R. CLARK, *CORPORATE LAW* 594-602 (1986).

¹⁴⁷ The Senate Report emphasized "instances . . . [of trading] profits derived from the use of information not procurable by the investing public," but its discussion of a "particularly glaring instance" illuminates the congressional concern with mismanagement aimed at creating trading opportunities.

[T]he chairman of the executive committee and another director participated in a pool organized in [sic] trade in the stock of their company when the stock was paying no dividends. During the operation of the pool, which continued for a period of 2 years, they caused the company to resume the payment of dividends, more than 25 percent of which were received by the pool participants.

S. REP. NO. 792, *supra* note 131, at 9.

¹⁴⁸ *Marsh v. Armada Corp.*, 533 F.2d 978, 982 (6th Cir. 1976), *cert. denied*, 430 U.S. 954 (1977). *But see* Poser, *supra* note 10, at 726 n.329 (*Marsh* does not survive *Schreiber*).

“Manipulative Practices.”¹⁴⁹

The SEC has not tried to regulate management conduct by calling it manipulative within the meaning of section 10(b).¹⁵⁰ Nor has anyone spent much time trying to decide whether the SEC has the power to promulgate a rule against what the clerk did.¹⁵¹ The only sustained interest in the meaning of the word “manipulative” in the Act has, however, focused on the not dissimilar efforts of management to defeat hostile tender offers.¹⁵²

Corporate managers who want to discourage or defeat hostile takeovers have a wide variety of defensive techniques to choose from, some of which work by insuring that if a party that is unacceptable to management or to shareholders gains control of the corporation, the value of the corporation will automatically decline substantially.¹⁵³ Potential targets often try to discourage hostile takeovers by issuing to their shareholders securities which make it difficult for outsiders to acquire control of the firm. These securities, which are sometimes (and ironically, given what the clerk did) known as “poison pills,” may also reduce the market value of the issuer’s outstanding securities and thus injure the current owners of the issuer.¹⁵⁴

It was in the context of the charge that a management response to a tender offer was manipulative that the Court finally held that manipulation entails deception. Perhaps it was appropriate for the

¹⁴⁹ S. REP. No. 792, *supra* note 131, at 7-9; *see also* Special Study, *supra* note 27, pt. 3, at 5 (§ 16(c) of the Act directed at manipulative techniques); Mathias, *supra* note 88, at 106-14 (§ 16 eliminates insider manipulation).

¹⁵⁰ Most disputes over the SEC’s power to regulate management conduct of business have arisen in the context of tender offers. Section 14(e) of the Act, *supra* note 2, gives the SEC independent authority to regulate manipulative practices in tender offers. *See* Loewenstein, *Section 14(e) of the Williams Act and the Rule 10b-5 Comparisons*, 71 GEO. L.J. 1311 (1983); *See also supra* notes 80-84 and accompanying text.

¹⁵¹ *See supra* text accompanying note 122.

¹⁵² *See supra* text accompanying notes 37-45.

¹⁵³ *See generally* A. FLEISCHER, *TENDER OFFERS: DEFENSES, RESPONSES, AND PLANNING* (Supp. 1985).

¹⁵⁴ *See generally*, Concept Release on Takeovers, Exchange Act Release No. 23,486, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,018, at 88,203-206 (July 11, 1986); V. BRUDNEY & M. CHIRELSTEIN, *supra* note 23, at 847-49; A. FLEISCHER, *supra* note 153, at 44.5-44.22; Office of the Chief Economist, SEC, *The Effects of Poison Pills on the Wealth of Target Shareholders* (Oct. 12, 1986); Office of the Chief Economist, SEC, *A Study on the Economics of Poison Pills*, [1985-1986 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,971 (Mar. 5, 1986); Note, *Protecting Shareholders Against Partial and Two-Tiered Takeovers: The “Poison Pill” Preferred*, 97 HARV. L. REV. 1964 (1984).

Court in *Schreiber* to reject a construction of section 14(e) that would have allowed private litigants to strike down most defensive tactics.¹⁵⁵ However, the Court's rationale in *Schreiber* leads inescapably to the conclusion that the SEC cannot regulate managerial or clerical poison pills, manipulative dividend policies or any other non-deceptive conduct under section 10(b), even if it is undertaken for no purpose other than influencing security prices.¹⁵⁶ This conclusion is as unfortunate as it is inescapable. Section 10(b) easily permits the regulation of such practices, if the word manipulative is accorded independent interpretive significance. The SEC must have the authority to regulate such practices if the statute's expressed purpose of protecting the public's interest in stock prices is to be achieved.

B. Information and Price — Required Disclosure and Honesty

Poison pills and dividend policy will not affect market prices unless the public knows about them. In a market in which investors buy and sell the income-producing potential of securities, prices will reflect market participants' judgments of the present value of the income that they expect each traded security to produce. The collective prediction of market participants of the income that a security will produce may be better than that of any one participant,¹⁵⁷ but there is no reason to think that even as a group, market participants can accurately predict the future. The most that their collective forecast can do is to reflect the best analysis of all available information which may have a bearing on what actually happens.

Various forces work toward the development of a consensus view that incorporates all information that is worth producing or discovering. The managers of successful security issuers have an incentive to release information, and market participants have an incentive to

¹⁵⁵ See Karjala, *supra* note 5, at 1504-06. *Schreiber* did not involve any SEC rule defining manipulative acts or prescribing means reasonably designed to prevent them. See *supra* text accompanying notes 75-81.

¹⁵⁶ Even if the Court had to base its decision in *Schreiber* on the meaning of the word manipulative, it could have held that issuer conduct is not manipulative unless its purpose is to influence market price. Management's purpose in employing defensive tactics is to lower the value of the issuer's stock only to the bidder, and any reduction in market value is inadvertent. See Poser, *supra* note 10, at 688-89. The ideal defensive tactic would discourage unattractive suitors or coercive offers without reducing the value of the corporation to current shareholders. Cf. V. BRUDNEY & M. CHIRELSTEIN, *supra* note 23, at 846-49 (3d ed. 1987) (collecting sources).

¹⁵⁷ See generally Gilson & Kraakman, *supra* note 27, at 580-85.

search out and analyze information.¹⁵⁸ Nonetheless, private initiative is not sufficient to insure that all relevant information is publicized¹⁵⁹, and thus security prices may not reflect all of the information that is available to some traders, or the best possible analysis of all information.¹⁶⁰

Since security values depend on future events that cannot be predicted with certainty, and since market prices will not necessarily reflect even the best possible prediction of the future, market prices will change as events come to pass and are disclosed to market participants or as market participants come to see the information which they already possess in a new way.¹⁶¹

Participants in the market presumably focus on news they think to be relevant to issuer profits, since profits are the source of distributions and distributions are the ultimate source of income — and

¹⁵⁸ The profit available to those who discover new information is a key to market efficiency. Someone who discovers new information relevant to the value of a security or a better way to make sense of outstanding information may well be able to profit by the discovery. Someone who discovers an issuer will be more profitable than anyone expects can buy the issuer's common stock and wait for the issuer to distribute its income or sell after publication of the discovery when market price will presumably reflect the good news. If on the other hand he or she discovers an issuer will be less profitable than expected, then he or she can sell its securities and buy them back at a lower price after the information is disclosed.

¹⁵⁹ Some valuable investigation and analysis will not be undertaken since the discoverer of new information relevant to a publicly traded security or the best analyst of public information cannot always appropriate the full value of the discovery or analysis. Compare Easterbrook & Fischel, *Mandatory Disclosure and the Protection of Investors*, 70 VA. L. REV. 669, 680-90 (1984) with Coffee, *Market Failure and the Economic Case for a Mandatory Disclosure System*, 70 VA. L. REV. 717 (1984) (information as public good).

¹⁶⁰ J. LORIE, P. DODD & M. KIMPTON, *supra* note 23, at 73-77; cf. Merton, *A Simple Model of Capital Market Equilibrium with Incomplete Information*, 42 J. FIN. 483, 485-86 (1987) (evaluation). For example, an investor who buys a novel form of debenture that he or she figures out is more likely to produce income than anyone expects, will realize his or her profit only after others share in his or her discovery. See *id.* at 486; J. BONBRIGHT, *supra* note 40, at 25; Gilson & Kraakman, *supra* note 27, at 613-16.

¹⁶¹ It seems clear that prices prevailing on larger security markets reflect all generally available information market participants feel is indicative of the income a security holder will receive from his or her security. See J. LORIE, P. DODD & J. KIMPTON, *supra* note 23, at 55-79 (collecting evidence). But see Wang, *Some Arguments that the Stock Market Is Not Efficient*, 19 U.C. DAVIS L. REV. 341, 349-59 (1986) (collecting contrary evidence). However, market prices may change with the disclosure of new developments or previously unknown facts that indicate the income from a security will be different from that expected. The more difficult it is to acquire and analyze information, the further market price will be from the price that would prevail if there were no secrets. Gilson & Kraakman, *supra* note 27, at 609-13.

thus value — for security holders.¹⁶² The most familiar provisions of the federal securities laws are directed at insuring that information about issuer profits is made available to investors. The Securities Act conditions the sale of securities on the issuer disclosing specific information, most of it relating to the issuer's operations. The Act effectively compels the issuers of most publicly traded securities to disclose similar information on an ongoing basis.¹⁶³

Prices may change in response to false or misleading communications since security prices reflect what investors believe, even if those beliefs are wrong. People may make false statements by mistake,¹⁶⁴ or they may make them knowingly. Corporate agents may postpone disclosure or may even lie in order to protect a valuable corporate opportunity,¹⁶⁵ to hide criminal activity,¹⁶⁶ or simply to buy time in which to trade securities issued by the corporation before the truth is published.¹⁶⁷

¹⁶² It is difficult to determine what information investors feel is important. The failure of a statement to affect price does not mean the information discussed is not material; it may mean that the information was already available to the market. See R. GILSON, *supra* note 64, at 235-38; Fischel, *Use of Modern Finance Theory in Securities Fraud Cases*, 38 BUS. LAW. 1 (1982); Givoly & Palmon, *Insider Trading and the Exploitation of Inside Information: Some Empirical Evidence*, 58 J. BUS. 69, 72 (1985).

¹⁶³ See § 12(g), the Act, 15 U.S.C. § 78l(g) (registration of widely held equity securities); § 13, *id.* at § 78m (reports on § 12 securities); § 15(d), *id.* at § 78l(d) (reports on securities registered under Securities Act); *cf.* §§ 14(a) and (c), *id.* at §§ 78l(a) and (c) (proxy and information statements). Section 12(a), *id.* at § 78l(a), and Rule 15c2-11, 17 C.F.R. § 240.15c2-11 (1988), effectively forbid brokers and dealers from participating in the market for a security unless information about the issuer is available to investors. *Cf.* § 12(b), 15 U.S.C. § 78l(b) (registration of exchange-traded securities). See generally L. LOSS, *FUNDAMENTALS*, *supra* note 8, at 459-567 (history of Act issuer-reporting requirements).

It is sometimes suggested that the federal securities laws require issuers to disclose all important information. The exchanges encourage issuers of listed securities to disclose material developments as soon as practicable, and given the possibility of a court assuming there is such a duty and the likelihood that material developments will render recent issuer statements misleading it is certainly wise to do so. See generally *Affirmative Disclosure Obligations Under the Securities Laws*, 46 MD. L. REV. 907 (1987); Block, Barton & Garfield, *Affirmative Duty to Disclose Material Information Concerning Issuer's Financial Condition and Business Plans*, 40 BUS. LAW. 1243 (1985). Nonetheless, neither the statutes nor the rules require the disclosure of all material information. Indeed there would be no need for the detailed disclosure requirements of the statutes and rules if there were such a requirement.

¹⁶⁴ *E.g.*, *Aaron v. SEC*, 446 U. S. 680 (1980); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976).

¹⁶⁵ *E.g.*, *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969).

¹⁶⁶ *E.g.*, *Dirks v. SEC*, 463 U.S. 646 (1983).

¹⁶⁷ *Cf.* *GAF Corp. v. Milstein*, 453 F.2d 709 (2d Cir. 1971) (outsiders alleged to have

Several provisions of the federal securities statutes forbid the making of false or misleading statements that may influence investors. Section 17(a) of the Securities Act¹⁶⁸ declares it unlawful for anyone in the offer or sale of a security to obtain money by means of any untrue statement of a material fact, and sections 11¹⁶⁹ and 12¹⁷⁰ provide for private actions against the makers of false statements. Section 9(a)(4) of the Act makes it unlawful for a broker or a dealer or a person trading a security to make a statement for the purpose of inducing a trade if he or she knows or has reason to know that the statement is false with respect to a material fact.¹⁷¹ Section 14(e) of the Act forbids the making of any untrue statement of a material fact in connection with a tender offer.¹⁷² The Court interprets section 10(b) to be an adjunct to these provisions, and whether or not it is, Rule 10b-5 is one of several SEC rules forbidding false or misleading statements.¹⁷³

Information can be conveyed by acts as well as by words, and the Act would not be a complete full-and-honest-disclosure statute if it did not deal with the communicative element of acts.¹⁷⁴ The act of trading communicates important information.¹⁷⁵ For example, every bid conveys information about the demand for a security. Thus, significant information about supply and demand is contained in specialists' order books and in the record of completed trades.¹⁷⁶

disparaged management to depress price to facilitate stock acquisition).

¹⁶⁸ The Securities Act of 1933, 15 U.S.C. § 77q(a) (1982).

¹⁶⁹ *Id.* at § 77k (1982).

¹⁷⁰ *Id.* at § 77l (1982).

¹⁷¹ 15 U.S.C. § 78i(a)(4).

¹⁷² *Id.* at § 78n(e).

¹⁷³ See also 17 C.F.R. § 240.12b-20 (1988) (reports); 17 C.F.R. § 240.14a-9 (1988) (proxy statements); 17 C.F.R. § 240.14c-6 (1988) (information statements); 17 C.F.R. § 240.15c1-2 (1988) (brokers and dealers).

A good argument that section 10(b) of the Act, *supra* note 2, does not authorize the SEC to regulate false statements is that Congress had already done so itself in the Securities Act of 1933 and in § 9(a)(4) of the Act. See Manne, *supra* note 10; Ruder, *supra* note 10. Interestingly, § 9(a)(4) of the Act is left out of the Federal Securities Code as redundant. 2 ALI FED. SEC. CODE § 1609(c) comment 5 (1978).

¹⁷⁴ Cf. *Schreiber v. Burlington Northern, Inc.*, 472 U.S. 1, 7 n.4 (1985) ("I can see no substantial distinction between false rumors and false and fictitious acts." (quoting Lord Lopes in *Scott v. Brown, Doering, McNab & Co.*, [1892] 2 Q.B. 724, 730 (C.A.))).

¹⁷⁵ Cf. Note, *The Inadequacy of Rule 10b-5 to Address Outsider Trading by Reporters*, 38 STAN. L. REV. 1549, 1565 (1986) ("The underlying principle of the [efficient capital market hypothesis] is that investors transmit information to the market by trading.").

¹⁷⁶ See generally K. GARBADE, *supra* note 23, at 469-79; Niederhoffer & Osborne,

As noted above, the prices and sizes of most trades occurring on securities exchanges are routinely and quickly reported.¹⁷⁷ In 1975, Congress explicitly recognized the public interest in accessible trading information, and directed the SEC to facilitate the dissemination of such information as part of its program of establishing a national market system for securities.¹⁷⁸ However, as originally enacted, the Act did not require exchanges to publish trading information.¹⁷⁹ This does not mean that Congress overlooked the communicative aspect of trading or that it was unconcerned with it. As section 2 states, by 1934 trading information was already widely reported,¹⁸⁰ and it probably did not occur to anyone that the government had to compel the publication of such information.¹⁸¹ In fact, the efficacy of the Act rested on the interest of market professionals in continued reporting. The cornerstone of the regulatory system envisioned by the Act was the registration of exchanges with the SEC, but the Act did not require exchanges to register. It effectively forced the exchanges to register, however, by making it unlawful for brokers, dealers, or exchanges, directly or indirectly, to report transactions taking place on unregistered exchanges.¹⁸²

Unexecuted orders to buy or to sell will influence future prices,

supra note 26, at 904-08.

¹⁷⁷ Cf. K. GARBADE, *supra* note 23, at 480-91 (price dispersion in markets in which prices are not costlessly available); Merton, *supra* note 160, at 486 (price information may not have been accessible).

¹⁷⁸ Securities Act Amendments of 1975, Pub. L. No. 94-29, 89 Stat. 97 (1975) (codified in 15 U.S.C. § 78k-1). See generally J. SELIGMAN, *THE SEC AND THE FUTURE OF FINANCE* 1-80 (1985); Calvin, *The National Market System: A Successful Adventure in Industry Self-Improvement*, 70 VA. L. REV. 785 (1984); Poser, *supra* note 10; Simon & Colby, *The National Market System for Over-the-Counter Stocks*, 55 GEO. WASH. L. REV. 17 (1986); Werner, *The SEC as a Market Regulator*, 70 VA. L. REV. 755 (1984).

¹⁷⁹ Section 19(b)(8) of the Act, *supra* note 2, did authorize the SEC to supplement the rules of an exchange "in respect of such matters as . . . the reporting of transactions on the exchange and upon tickers maintained by or with the consent of the exchange, including the method of reporting short sales, stopped sales [etc.]."

¹⁸⁰ Section 2(2) of the Act, 15 U.S.C. § 78b(2). See generally TWENTIETH CENTURY FUND, INC., *supra* note 12, at 251-52.

¹⁸¹ Indeed the New York Stock Exchange [hereinafter the NYSE] had trouble controlling the dissemination of quotations. See N. GRAS & H. LARSON, *CASEBOOK IN AMERICAN BUSINESS HISTORY* 338-39 (1939). But see W. DOUGLAS, *DEMOCRACY AND FINANCE* 70-72 (1940) (exclusion of odd-lot trades from market and tape).

¹⁸² The Act, § 5. Section 5 also made it illegal to use the mails or any means or instrumentality of interstate commerce to effect exchange transactions, but exchanges were carefully structured so that all their business was conducted in one state. 8 LEGISLATIVE HISTORY, *supra* note 11, at 16 (testimony of James Landis), 562-71 (brief of NYSE).

and those who know about such orders may be able to use their knowledge to trade profitably. Investors who want to trade an exchange-traded security at a particular price can give limit orders to that effect to their brokers, who in turn convey the orders to specialists in the security. By virtue of their positions, specialists know more about trading interest in their securities than anyone else, and they are able to trade profitably by taking advantage of their unique knowledge.¹⁸³ Operators of manipulative pools depended on access to specialists' books to find securities with easily dominated supply and demand.¹⁸⁴ Congress was aware of this situation, but it did not require specialists to publish their books.¹⁸⁵ Although the scheme of the Act contemplated that information on completed trades would be available, it did not contemplate full disclosure of information about unexecuted orders. Instead, it adopted a parity of information rule. Specialists may not disclose information in their books to anyone other than a regulator, unless the information is available to all exchange members.¹⁸⁶

Trades convey information other than the state of the market; most importantly, they convey the predictions of the traders. The predictions of people with access to non-public information are valuable. Even if such people do not announce their views, their trading decisions may reveal them. For example, if investors learn that a corporate officer has sold his or her employer's stock, they may conclude that the officer knows about something which is detrimental to the corporation's prospects, and may then lower their estimates of the stock's value. The trading of informed traders and of others who emulate them may move the market price to one reflecting the non-public information, without the information ever being made pub-

¹⁸³ R. BREALEY & S. MYERS, *supra* note 23, at 270; Niederhoffer & Osborne, *supra* note 26, at 908. See generally Special Study, *supra* note 27, pt. 2, at 72-78.

¹⁸⁴ W. HICKERNELL, WHAT MAKES STOCK MARKET PRICES 62-66 (1932).

¹⁸⁵ The related question of specialists' trading for their own accounts was one of the most difficult that had to be resolved before the Act could be approved. As first introduced the Act would have forbidden specialists to trade for their own accounts. H.R. 7852 § 10, 73d Cong., 2d Sess., reprinted in 10 LEGISLATIVE HISTORY, *supra* note 11, item 24 § 10 (1934). In the end the question was referred to the SEC for further study. Pub. L. No. 73-291, § 11(e), 48 Stat. 881, 891 (repealed 1975). See generally Special Study, *supra* note 27, pt. 2, at 57-170; J. FLYNN, *supra* note 88, at 228-43; K. GARBADE, *supra* note 23, at 448 n.10; TWENTIETH CENTURY FUND, INC., *supra* note 12, at 402-42.

¹⁸⁶ The Act, § 11(b). The SEC has residual power to require disclosure. NYSE rules forbid specialists to disclose order information. NYSE Rule 115, 2 N.Y.S.E. Guide (CCH) ¶ 2115.

lic.¹⁸⁷ Traders do not typically volunteer their identities, but the Act requires some classes of investors to report their trades. Section 16(a) requires control persons to report their trades monthly,¹⁸⁸ and sections 13 and 14 now require persons engaged in substantial acquisition programs to identify themselves. Trading reports relating to the Act are widely circulated and analyzed.¹⁸⁹

Like all statements, trading reports can create erroneous impressions.¹⁹⁰ For example, a report that a substantial amount of a security has changed hands in a substantial number of trades at the same price may create the impression that the market for the security at that price is very deep. If the report is wrong or if the trades are the product of a peculiar situation, this impression may be wrong.

The Act addresses misleading trading reports. In addition to forbidding misleading statements, section 9(a) makes it illegal to employ certain trading tactics for the purpose of misleading the investing public about the state of supply and demand. Section 9(a)(1) deals with the entry of offsetting purchase and sale orders, and transactions that do not result in a change in beneficial ownership. Such transactions had been widely criticized before 1934,¹⁹¹ as their report in a medium purporting to report only real trades is inherently misleading. Section 9(a)(1) forbids such transactions if effected "[f]or the purpose of creating a false or misleading appearance of active trading in [the traded security] or a false or misleading appearance with respect to [its] market."

¹⁸⁷ The trades of those in possession of non-public material information may exert pressure on the price of the security, but this pressure, which is a function of the size of the trades and not their information content, is likely to be inconsequential. See *infra* text accompanying notes 242-46.

¹⁸⁸ Although the reporting helps private parties enforce § 16(b)'s forfeiture provisions, Congress viewed the information reported as independently valuable for discouraging inappropriate management behavior. ABA Comm. on Fed. Reg. of Secs., *supra* note 129, at 1099. The version of the Act the House sent to conference required control persons to report their trades and forbade them to sell short but did not restrict their short-term trading. H.R. 9323 § 15, 73d Cong., 2d Sess. (1934), *reprinted in* 10 LEGISLATIVE HISTORY, *supra* note 11, item 30.

¹⁸⁹ See ABA Comm. on Fed. Reg. of Secs., *supra* note 129, at 1100-01 (§ 16 reports); *cf.* Carney, *supra* note 31, at 879-80 (unlikely outsiders can profit from emulating insiders); Givoly & Palmon, *supra* note 162, at 70.

¹⁹⁰ Section 15(c)(2), which was added in 1938, Act of June 25, 1938, ch. 677, § 2, 52 Stat. 1070, 1075 (current version in 15 U.S.C. § 78o(c)(2)), forbids brokers and dealers from making fictitious quotations; *cf.* Special Study, *supra* note 27, pt. 2, at 605-09 (fictitious quotations).

¹⁹¹ See, e.g., Report of the Governor's Committee on Speculation in Securities and Commodities (June 7, 1909); Documents of the Senate of the State of New York, 133d Sess. (1910), *reprinted in* W. VAN ANTWERP, THE STOCK EXCHANGE FROM WITHIN 421-23 app. (1913).

Even true reports of actual trades can convey misleading impressions, especially about the information that traders possess. Although some people likely to possess valuable information are required to report their trades, many are not. Some investors study the information available about the prices and sizes of trades recently concluded in the market, in the hope of determining whether such people have recently been trading.¹⁹² Large trades are often seen as particularly instructive. Insiders with valuable information profit from their information in proportion to the size of their trades, so large trades are sometimes considered particularly worthy of further examination for signs that they have been affected by insiders.¹⁹³ Even if the large traders are not insiders, they may, by virtue of their wealth, have access to valuable information or to sophisticated analytic techniques capable of producing valuable insights.¹⁹⁴ Thus, investors who learn of large sales may conclude that the sellers are probably in possession of bad news, and will discount the value of the traded securities accordingly.¹⁹⁵ Conversely, investors who believe that no one will buy a large amount of a stock without good news, will read good news into any large trade that is not made at a discount from the prevailing price.¹⁹⁶

While investors are trying to determine whether or not those parties with better information are trading, the latter can profit by their trading only so long as they do not reveal that they possess information, and thus lose its value. Accordingly, traders who be-

¹⁹² Carney, *supra* note 31, at 876-91; Gilson & Kraakman, *supra* note 27, at 572-79; see, e.g., Rotbart, *Market Mover: Arbitrager Mulheren Generates Controversy as His Fortunes Rise*, Wall St. J., July 28, 1986, at 1, col. 6; Stewart, *Tracing a Scandal: Insider-Trading Plot Unraveled as Profits Lured Copycat Buyers*, Wall St. J., July 15, 1987, at 1, col. 6. Givoly & Palmon, *supra* note 162, conclude that insiders earn an abnormal return on their trading not because they trade on the basis of non-public information about their companies but rather because their trades themselves cause others to reevaluate the companies and thus the values of the securities the insiders have traded.

¹⁹³ See K. GARBADÉ, *supra* note 23, at 476-78; Scholes, *supra* note 31, at 183. But see Givoly & Palmon, *supra* note 162, at 79-85 (large insider trades not more profitable than small).

¹⁹⁴ See sources cited *supra* note 194; cf. § 16(a) of the Act (over 10% shareholders).

¹⁹⁵ Market participants may try to figure out the information or just assume it is there. Disclosed sales by persons in positions with regular access to information do depress stock prices. K. GARBADÉ, *supra* note 23, at 256-64, 454-60; J. LORIE, P. DOND, & M. KIMPRON, *supra* note 23, at 68-70; Scholes, *supra* note 31.

¹⁹⁶ For example, in examining the non-informational effect of large trades on price, Scholes focused on block sales rather than purchases in part because "large block purchases of securities often reflect attempts to acquire control." Scholes, *supra* note 31, at 184 n.12.

lieve that revealing their trading will necessarily reveal information that they possess, including their own trading plans, may try to hide their identities.¹⁹⁷ Given investors' interest in who is trading and why, and traders' interest in keeping this information secret, transaction information is particularly likely to create misleading impressions about the knowledge of traders. The trades of unimportant traders may be reported in ways that make them appear to be those of important traders, while genuinely important traders may try to disguise their trading, for example by having undisclosed agents trade as though for their own accounts.¹⁹⁸ Inasmuch as information about the knowledge and motivations of traders is potentially much more valuable than information about aggregate supply and demand, mistakes about who is trading and why they are trading may have a much greater impact on market price than mistakes about the mere fact that a trade has taken place.

The Act also forbids at least one practice that might mislead investors about important traders' sentiments. Section 16 of the Act makes it illegal for corporate managers to use one tool that could help them to hide their sales. Congress was concerned that if insiders could sell their holdings but deliver borrowed securities, investors might incorrectly believe that the insiders were confident about the future.¹⁹⁹ Accordingly section 16(c) makes it illegal for insiders to sell securities and deliver borrowed securities to their buyers.²⁰⁰

Sections 9(a)(1) and 16(c) only begin to cover misleading trading techniques. Since trading conveys information and often creates misleading impressions, the Act can hardly be characterized as a full disclosure statute unless it requires traders to identify themselves, or at least makes it illegal for them to mislead others about their identities. However, there is good reason to allow some traders to conceal their identities. Requiring traders to identify themselves might make it impossible for the discoverers of new information to

¹⁹⁷ See Wall St. J., Mar. 20, 1987, at 3; Smith, *Street Hazard: Big-Block Trading Pits Institutions, Dealers In a Fast, Tough Game*, Wall St. J., Feb. 20, 1985, at 1, col. 6; cf. Carney, *supra* note 31, at 886-87 (several reasons to conceal identity).

¹⁹⁸ *E.g.*, Strong v. Repide, 213 U.S. 419, 432-33 (1909) (concealing buyer's identity); cf. Hertzberg, *Stock 'Parking' Becomes Big Factor in Insider Scandal*, Wall St. J., July 9, 1987, at 6, col. 1 (" 'Parking' of stock among securities firms is emerging as a major factor in Wall Street's widening insider-trading scandal Parking occurs when one investor buys stock, usually a large position, for another who doesn't want to be identified as the owner. ").

¹⁹⁹ Letter from the Counsel for the Committee on Banking and Currency, 73d Cong., 1st Sess. 7-8 (Feb. 18, 1933) (Comm. Print), *reprinted in* 5 LEGISLATIVE HISTORY, *supra* note 11, item 15.

²⁰⁰ 15 U.S.C. § 78p(c).

profit from their discoveries, and might thereby undercut the production of new information. Any policy between the extremes of requiring full disclosure and of leaving disclosure to private initiative necessarily involves a sensitive balancing of the incentive to produce information against the value of a fully informed market. If balancing is to be done, it should be done by an agency better suited than Congress or the courts to the study and regulation of the wide variety of circumstances in which persons with information trade. Moreover, the agency should be able to modify unwise or outdated rules promptly in response to experience and to new situations. The SEC would seem a natural choice for this role, and section 10(b) gives it the power and responsibility to supplement sections 9 and 16.²⁰¹

The Court focused on the value of information and on the problem of incentive in *Chiarella*,²⁰² and held that section 10(b) does not give the SEC the power to require all traders to disclose what they know before they trade. If the SEC cannot require traders to disclose what they know, then presumably it cannot require them to reveal their identities either. However, even if section 10(b) only reaches deception, it reaches deceptive devices and contrivances, not just misrepresentations. Thus the SEC might require traders to identify themselves if their trading practices would otherwise likely be misinterpreted by investors.²⁰³ Nevertheless, the Court has foreclosed even this approach by beginning from the premise that trading is noncommunicative.²⁰⁴

C. Speculation and Price — Investment Value and Prohibited Communications

Issuers are required by various provisions of the Act and of the Securities Act to disclose information relating to their income, assets and management. Presumably Congress and the SEC have con-

²⁰¹ See *supra* note 152 and accompanying text.

²⁰² 445 U.S. at 230-35.

²⁰³ *But cf.* *Carney*, *supra* note 31 (insider trading seldom influences others).

²⁰⁴ 445 U.S. 222, 226 ("This case concerns the legal effect of the petitioner's silence."). The fiction that a purchaser's identity and reason for purchasing are immaterial and so may be misrepresented accomplishes a similar result under common law. See, e.g., *Finley v. Dalton*, 251 S.C. 586, 164 S.E.2d 763 (1968); see 2 F. HARPER, F. JAMES & O. GRAY, *THE LAW OF TORTS* § 7.9, at 439 (2d ed. 1986); *cf.* *List v. Fashion Park*, 340 F.2d 457, 462-64 (2d Cir.) (reliance: 10b-5 plaintiff would not have been influenced had he known buyer was insider), *cert. denied*, 382 U.S. 811 (1965). *But see* *Strong v. Repide*, 213 U.S. 419 (1909). See generally *Keeton, Fraud — Concealment and Non-Disclosure*, 15 TEX. L. REV. 1, 21-27, 35-36 (1936).

cluded that the information which they require issuers to disclose is of interest to investors who are trying to predict the income that issuers are likely to earn.²⁰⁵ The narrow reading that the Court has given to section 10(b) is premised on the assumption that these provisions are at the heart of what Congress sought to accomplish in enacting the federal securities laws. To assume that Congress was primarily concerned with insuring that investors received information is to assume that Congress thought that investors evaluated securities on the basis of their predictions of issuer income, and were being denied the information they needed to make their predictions.²⁰⁶ Investors may in fact evaluate securities on the basis of the distributions which they expect issuers to make, but the structure of the Act reflects a view of the stock market in which investors have at most only a secondary interest in issuer distributions or the income from which they are derived.

The price that an owner will realize upon the sale of a security is a significant part of the total income that it will yield. Thus, in deciding whether to trade, investors will try to predict future prices. Investors can take at least two approaches to predicting the future price of a security. They can try to predict what distributions the security's holder will receive from the issuer (and thus focus directly on the issuer's likely income). Alternatively, recognizing that prices are determined by the activities of market participants, investors can try to predict the views of market participants.

Investors trying to predict a future consensus may come to conclusions about a security's value that differ substantially from the conclusions of investors trying to predict issuer earnings. Predicting change in consensus may be more difficult than predicting issuer earnings, especially if accurate information about the issuer is available.²⁰⁷ More important, the inquiries may be fundamentally differ-

²⁰⁵ Criticism of the disclosure provisions and their administration by the SEC usually centers on the charges that they require disclosure of the wrong information and require issuers to disclose even that in the wrong way. *See, e.g.*, H. KRIPKE, *THE SEC AND CORPORATE DISCLOSURE: REGULATION IN SEARCH OF A PURPOSE* (1979).

²⁰⁶ *But compare* Easterbrook & Fischel, *supra* note 23, *with* Coffee, *supra* note 159 (debating utility of disclosure rules for informing investment decisions but explicitly rejecting informed investment decisions as sole end of statutes).

²⁰⁷ The predictor of public opinion must bear in mind that other investors are also trying to predict future consensus valuations, so he or she must predict not what others will think the value of the security is but what others will think that everyone else will think, with those others mindful that everyone else will be doing the same thing and so on. J. KEYNES, *supra* note 28, at 154-56.

The ability to predict the future price of a security is obviously a valuable skill. Many people devote a great deal of effort to developing this skill, but very few are successful. The current price of a publicly traded security is as good an estimate of its

ent. Even if investors believe that the ultimate source of value is issuer distributions, if they believe that other market participants are irrational or are unable to predict distributions correctly, they will ignore their best estimates of distributions in constructing their predictions of consensus value.²⁰⁸ To the extent that investors evaluate and trade securities on the basis of their conclusions about future prices, prices will move toward their conclusions. Securities markets that include a significant number of such investors may perform many of the functions usually credited to the stock market, especially those relating to capital allocation.²⁰⁹ In addition to incorrectly pricing capital and sending the wrong signals, markets in which investors evaluated securities on the basis of expected changes in public opinion may produce more volatile prices than markets in which investors look only to expected issuer profits and to the time value of money.²¹⁰ This volatility would increase the cost of raising capital.

There are certainly forces at work which tend to keep market prices in line with predicted issuer distributions. Some investors

future price as most people are able to make and very few people can predict price changes consistently enough to make money. *See supra* notes 41-48 and accompanying text. This is to be expected so long as it is difficult to predict better than everyone else whatever matters, whether that is issuer income or collective whim.

²⁰⁸ *See* V. BRUDNEY & M. CHIRELSTEIN, *supra*, note 23, at 123-30; J. WILLIAMS, *THE THEORY OF INVESTMENT VALUE* 33-34 (1938) (“[S]ome old traders think it a handicap . . . to let themselves reach any conclusion whatsoever as to the true worth of the stocks they speculate in.”); Gordon & Kornhauser, *Efficient Markets, Costly Information, and Securities Research*, 60 N.Y.U. L. REV. 761, 824-30 (1985); Wang, *supra* note 161, at 344-45; *cf.* Berle, *supra* note 69, at 31 (“If you expect to be repaid, you look to your debtor, and constantly wonder what he is doing toward that end. But if you expect to resell, you look to the market, and wonder how other people feel about buying. Once in a great while, and that usually is an emergency, you take account of stock of your debtor and check up on his financial policies.”).

Investment decisions based on expected changes in investor opinion may be the same as those based on expected issuer earnings. For example the effort to identify likely tender offer targets reflects a concern with what someone will pay for a company's securities rather than with what they will yield from the company. But if tender offerors buy securities that are underpriced in view of the income the issuer can produce, the successful search for likely targets, even if made without conscious attention to earnings, will move prices toward the collective estimate of yield.

²⁰⁹ J. KEYNES, *supra* note 28, at 159 (“When the capital development of a country becomes a by-product of the activities of a casino, the job is likely to be ill-done.”). *But see* Stout, *supra* note 55, at 706 (concluding that “trading market prices are only remotely connected to the socially optimal allocation of real resources”).

²¹⁰ *See* KEYNES, *supra* note 28, at 154; DeBondt & Thaler, *Does the Stock Market Overreact?*, 40 J. FIN. 793 (1985); Law, *A Corporation is More than Its Stock*, HARV. BUS. REV., May-June 1986, at 80; Bishop, *Wall St. J.*, Nov. 17, 1987, at 31, col. 4.

search for and buy securities that trade for less than the present value of the distributions to which the securities will entitle their owners.²¹¹ They realize that they can profit by holding such securities until the market recognizes the mistake, or, failing that, by holding until the issuer distributes its earnings.²¹² These investors will bid on the basis of their best estimates of issuer profits, and prices will reflect the collective best estimate of issuer profitability to the extent that such "serious" investors commit their capital to the market.²¹³

However, it is not necessary to decide whether market prices in fact reflect market participants' best estimates of prospective issuer distributions in order to interpret the Act.²¹⁴ It is only necessary to remember that the Act was written by people who thought that market prices did not do so. Substantial price swings that cannot be explained by any substantial change in business conditions undermine faith in the market's fidelity to underlying value,²¹⁵ and after the 1929 crash many people thought that speculators and manipulators had so dominated the stock market that stock prices had lost any connection to a rational valuation of the claim on issuer earnings that the securities represented.²¹⁶

²¹¹ J. KEYNES, *supra* note 28, at 156-57; J. WILLIAMS, *supra* note 208, at 33-36.

²¹² Conversely, investors who own a broad inventory of securities or can sell short, sell call options or buy put options will search for and sell those securities the market "overvalues."

²¹³ Keynes suggested a number of factors mitigating against the preponderance of such investors in the market. J. KEYNES, *supra* note 28, at 156-58. Two of them — the lack of reliable information and the pressure on investment managers to produce profits in the short-run — figure prominently in recent criticism of the market.

²¹⁴ The random movement of security prices is often interpreted to mean they quickly and correctly reflect new information about issuer profitability. Note, *Broker Investment Recommendations and the Efficient Capital Market Hypothesis: A Proposed Cautionary Legend*, 29 STAN. L. REV. 1077, 1089-92 (1977); cf. J. LORIE, P. DODD, & M. KIMPRON, *supra* note 23, at 5 ("The value of a corporation's stock is determined by expectations regarding future earnings of the corporation and by the rate at which those earnings are discounted."). However, random movement is consistent with prices that are not influenced by issuer earnings at all. Friend, *supra* note 48, at 201; Meltzer, *supra* note 62 at 217, 222-23; Levmore, *supra* note 31, at 647-48; cf. Law, *supra* note 210, at 81; Wang, *supra* note 161, at 344-49, and 359-62 (evidence stock prices do not reflect issuer earnings).

²¹⁵ See Donnelly, *supra* note 57.

²¹⁶ See, e.g., W. HICKERNELL, *supra* note 184, at ix. A recent example of the burst of a speculative bubble was the collapse a few years ago of the unofficial stock market in Kuwait after rampant speculation and easy credit pushed prices to spectacular heights. *Cleaning up the Debris of a Stock Market Crash*, BUS. WK., Feb. 28, 1983, at 44; Epstein, *Embassy Cables*, ATLANTIC MONTHLY, May, 1983, at 16; Surya, *Illicit Securities Market Adds to Financial Crisis*, 3 COMPANY LAW. 285 (1983); Surya, *Long Term Effects of the Stock Market Collapse*, 5 COMPANY LAW. 197 (1985).

The Act was in large part designed to insure that securities trade on the stock market at prices equal to the present value of the issuer income to which they entitle their owners, that is, to trade at what is sometimes called "investment value."²¹⁷ Investors cannot trade with a view to investment value if they cannot get information about issuers, and presumably more investors will trade with a view to yield if accurate information is readily available. Congress recognized this, and required issuers of publicly traded securities to disseminate information about their operations and forbade at least some false statements. But requiring disclosure was only one of several steps that Congress took toward the larger overall end of curbing the excessive speculation that moved prices away from investment value.

The response to ruinous speculation centered on discouraging people who were looking for price changes from participating in the market. For example, sections 7 and 10(a) authorize administrative agencies to keep borrowed resources out of the market,²¹⁸ and the short-swing trading and short-sale provisions of section 16 eliminate the incentive and wherewithal for people in critical positions to speculate or participate in price manipulation.²¹⁹ Section 9 is designed to keep market operators from exciting the speculative impulses of investors.²²⁰

In 1934, "the notorious market pools" were frequently blamed for moving price away from investment value.²²¹ Congress, along with

²¹⁷ See J. WILLIAMS, *supra* note 208; TWENTIETH CENTURY FUND, INC., *supra* note 12, at 27-32 (1935); Note, *Illegality of Stock Market Manipulation*, *supra* note 88, at 500 n.3. See generally S. COTTLE, R. MURRAY & F. BLOCK, *GRAHAM AND DODD'S SECURITY ANALYSIS* (5th ed. 1988).

²¹⁸ The margin provisions of § 7 were intended to limit price fluctuations and reduce the diversion of credit from commerce into stock market speculation. See Special Study, *supra* note 27, pt. 4, at 2-3, 9-11; 2 L. LOSS, *SECURITIES REGULATION*, *supra* note 8, at 1239-43; Staff of the Board of Governors of the F.R.S., *A Review and Evaluation of Federal Margin Regulations 44-47, 135-67* (1984). Section 10(a), which authorizes the SEC to regulate short sales, is discussed below in the text accompanying notes 321-31.

²¹⁹ Special Study, *supra* note 27, pt. 2 at 36 (§§ 7, 9, 10(a) and 16 were aimed at curbing speculative excesses); see also § 11(a) (current version in 15 U.S.C. 78k(a)) (SEC regulation of excessive trading by floor members); Special Study, *supra*, note 27, pt. 2 at 48-57 (member's trading may unduly influence price or excite excessive speculation).

²²⁰ The element of inducement in the second through fifth clauses of § 9(a) evidences a concern for the communicative element of the prohibited conduct. Cf. RESTATEMENT OF CONTRACTS §§ 476, 479 (1932); RESTATEMENT OF TORTS §§ 525, 531 (1938) (fraudulent misrepresentation).

²²¹ 3 L. LOSS, *SECURITIES REGULATION*, *supra* note 8, at 1529. For discussion and criticism of pool techniques see also Hanna, *supra* note 20, at 15 n.7 and sources cited

everyone else, found the pools to be terribly destructive. The pools identified a thinly-traded security in which their trading might move price. They sometimes accentuated the effects of their trades by obtaining large holders' promises not to sell while they were in the market.²²² They then acquired a position in the security, often in the form of an option to buy at a price substantially above current market price, and set about moving the price up.²²³ The pools used a variety of devices to move price from where they found it — a level that under the conventional view represents the conjunction of investment supply and demand, and thus the best judgment of value — to another level at which they could close out their positions at a profit. Every one of these devices that had been identified was outlawed or subjected to regulation in the Act.

Part of the solution to the pool problem consisted of denying pool operators the tools that they had used to control supply and demand, including options and the order information that specialists possessed.²²⁴ Another part of the solution was to regulate the practices the pools used to induce others to trade. The Act's treatments of publicity and of acts designed to induce trading are particularly instructive in the context of the supposed centrality of disclosure to the Act.

Trading by outsiders was crucial to the success of the manipulative pools. For example, bull pools encouraged buying by outsiders in order to inflate the price of the manipulated security. Outside buyers were also the market for the pools' previous positions once their prices reached satisfactory levels. The pools employed a variety of tools to excite outsiders into trading. It is this inducement of trading that is sometimes said to be the essence of manipulation.²²⁵

Investors who suspected the existence of substantial buying interest in a security could be expected to buy. One way in which the pools induced outsiders to trade was to convince them that substan-

in 3 L. LOSS, *SECURITIES REGULATION*, *supra* note 8, at 1530 n.5.

²²² 3 L. LOSS, *SECURITIES REGULATION*, *supra* note 8, at 1529-30 (quoting Comment, *supra* note 88, at 626-27); Hanna, *supra* note 20, at 15 n.7.

²²³ Bear pools might sell short and then set out to depress price so that they could cover at a profit.

²²⁴ See §§ 9(b)-(d) of the Act, 15 U.S.C. §§ 78i(b)-(d) (options), § 11(b), *id.* at § 78k(b) (specialists' books); *supra* notes 183-86 and accompanying text.

²²⁵ Clark, *supra* note 55, at 348 ("Manipulation is behavior aimed at creating trading, or the appearance of active trading, in a security for the purpose of inducing others to buy or sell the security."); Comment, *Regulation of Stock Market Manipulation*, *supra* note 88, at 512 ("Market manipulation refers to widely varying types of devices used to stimulate or to discourage the buying and selling of securities.").

tial interests were trading.²²⁶ The cheapest way for operators to convince the public that substantial traders were in the market for a security was to engage in risk-free trades, such as wash sales. Section 9(a)(1) made it illegal to effect such transactions for the purpose of creating a misleading appearance with respect to the market in exchange-registered securities. These trades were publicized in a way that suggested that they involved a change of ownership, and as such they are fairly characterized as deceptive.²²⁷ However, section 9 goes beyond forbidding misrepresentations and acts likely to be misinterpreted; it treats some information as an improper subject of discourse and declares that such information may not be communicated. A variety of actors are forbidden to disseminate even correct information about market activity if they are acting for the purpose of inducing others to trade.

The pools used actual trades as well as fictitious ones to create the market activity and the nascent price movements that excited public trading. It will be recalled that for many investors rising prices are a signal to begin buying.²²⁸ Pool operators took advantage of this in creating a trading record that would induce others to buy. Bull pools traded vigorously or bid up the price of a security by a small amount in order to convince outsiders that the security was undervalued, and to bring in other buyers who would push the security's price up to a point at which the pool could profitably unload its holdings. Section 9(a)(2) outlaws these practices.²²⁹ It makes it illegal to use trading that creates actual or apparent active trading or price changes for the purpose of inducing others to trade.²³⁰ Section

²²⁶ "One sure method of pulling traders into a pool is to show a rising market on heavy volume." 8 LEGISLATIVE HISTORY, *supra* note 11, at 110 (testimony of T. Corcoran); TWENTIETH CENTURY FUND, INC., *supra* note 12, at 471.

²²⁷ Because of their deceptive nature such trades may have been illegal even before enactment of the Act. *United States v. Brown*, 5 F. Supp. 81 (S.D.N.Y. 1933), *aff'd*, 79 F.2d 321 (2d Cir.), *cert. denied*, 296 U.S. 650 (1935); Berle, *supra* note 28.

²²⁸ See *supra* notes 206-212 and accompanying text.

²²⁹ It shall be unlawful for any person . . . [t]o effect, alone or with one or more other persons, a series of transactions in any security registered on a national securities exchange creating actual or apparent active trading in such security or raising or depressing the price of such security, for the purpose of inducing the purchase or sale of such security by others.

Section 9(a)(2) of the Act, 15 U.S.C. § 78i(a)(2).

²³⁰ The SEC insisted on rewriting the codification of § 9(a)(2) in the proposed Federal Securities Code [hereinafter the Code] "to eliminate the troublesome requirement . . . of showing a purpose to induce others to buy or sell." 2 ALI FED. SEC. CODE § 1609(c) comment (2d Supp. 1981); see R. JENNINGS & H. MARSH, *supra* note 62, at 624. The rewritten Code would forbid anyone to effect transactions or to create active

9(a)(2) is concerned with the use of trading to communicate generally, not just with the use of trading to deceive. It forbids the creation of apparent trading activity, but it also forbids the creation of real price changes and of actual activity.²³¹

Investors responded to active trading and to price increases for a variety of reasons. Some may have suspected that the buyers had valuable information. Many simply suspected the existence of bull pools and hoped to profit along with the operators by selling before

trading in a security for the purpose of raising or depressing its price or that of a related security:

Manipulation by Trading. — It is unlawful for any person to effect (alone or with one or more other persons) a series of transactions in a security, or to create active trading (actual or apparent) in a security, for the purpose of raising or depressing the price of (1) the same security, (2) a security of a different class of the same issuer, or (3) a security of a controlling, controlled, or commonly controlled company.

2 ALI FED. SEC. CODE § 1609(c) (2d Supp. 1981).

This codification would simply forbid by statute what the SEC already has power under § 9(a)(6) of the Act to forbid by rule. *See generally infra* notes 294-307 and accompanying text. Section 9(a)(6) is codified at § 1610 of the Code. *See also* 2 ALI FED. SEC. CODE § 1609(d) (codification of Rule 10b-6) (2d Supp. 1981). It leaves unaddressed the problem of excited trading that is at the heart of § 9(a)(2). In this the revised Code reflects the error of viewing the manipulation provisions as directed at nothing more than arcane deceptive acts; it treats manipulation as nothing more than interference with the market.

The Code would not forbid all the conduct forbidden by the section either. One can violate § 9(a)(2) by trading to change price or to create active trading, in either case for the forbidden purpose of inducing trading. A trader who uses trades to create price changes to induce trading violates § 9(a)(2) and would also violate the Code, since such a person by hypothesis intends his trades to cause price changes and presumably has a purpose of changing price. Someone who creates active trading by trading in order to induce others to trade would violate § 9(a)(2) but not the Code. The Code would instead make it unlawful to create active trading for the purpose of changing price, so under the Code in an active trading case the Commission would have to prove that the trader acted for the purpose of causing a price change. The Commission might argue that a person with the purpose of changing price created active trading to induce others to trade and change price, but this would require proof of § 9(a)(2) purpose (inducing trades) and more (changing price).

²³¹ *Cf. Stock Exchange Practices: Hearings Before the Senate Comm. on Banking and Currency*, 73d Cong., 2d Sess. 7558-59, 7580 (1934), reprinted in 7 LEGISLATIVE HISTORY, *supra* note 11, item 22 (NYSE proposals to limit section to transactions creating misleading appearance of trading volume or prices not reflecting market value). Poser insists that § 9(a)(2) of the Act is also directed at deceptive trading practices, on the theory that a purpose to mislead investors about investment supply and demand is an element of a § 9(a)(2) violation. Poser, *supra* note 10, at 703-05; *cf. H. MANNE, supra* note 10, at 152-53 (pools allegedly attempted to mislead technical traders). However, § 9(a)(2) forbids the wrongful creation of actual price changes or actual or apparent activity, in contrast to § 9(a)(1), which reaches only misleading appearances. *See also infra* notes 228-31, 294-98 and accompanying text.

the stocks collapsed.²³² Pool operations and other manipulations were well known during the bull market that led up to the 1929 crash.²³³ Outsiders who treated the market like a chain letter were the natural allies of the pool operators who were trying to move prices. Regular reporting of the operations of a pool could greatly aid in its success,²³⁴ and some operators, in hopes of exciting public interest and trading, employed agents to inform brokerage firms of when a pool was about to create a price move.²³⁵

Verbal communications that induce trading or that are intended to do so are the subject of sections 9(a)(3) through (5). In addition to making it unlawful to lie in section 9(a)(4), the Act makes it illegal for some people to circulate information about market operations undertaken for the purpose of influencing price. Section 9(a)(3) makes it illegal for brokers, dealers, or traders to induce trades of exchange-registered securities by "the circulation or dissemination in the ordinary course of business of information to the effect that the price of any such security will or is likely to rise or fall because of market operations of any one or more persons conducted for the purpose of raising or depressing the prices of such security." Section 9(a)(5) makes it unlawful for anyone else to induce a trade by circulating or disseminating such information in exchange for a payment from a broker, dealer, or trader.

Sections 9(a)(3) and (5) then make it illegal for many market participants to make true statements about price-directed market operations if they thereby induce trading,²³⁶ and section 9(a)(4) makes it

²³² W. HICKERNELL, *supra* note 184, at 67 ("One reason for buying [during price climb] is the belief that a pool is actually at work . . ."); R. SOBEL, *THE BIG BOARD — A HISTORY OF THE NEW YORK STOCK EXCHANGE* 247-48, 251-52 (1965) ("The public thought that it could not make money without the aid of manipulators."); TWENTIETH CENTURY FUND, INC., *supra* note 12, at 444; Comment, *Regulation of Stock Market Manipulation*, *supra* note 88, at 512; see also B. GRAHAM, *THE INTELLIGENT INVESTOR* 43 (1965).

²³³ F. PECORA, *WALL STREET UNDER OATH* 171 (1939) (1968 reprint); R. SOBEL, *supra* note 231, at 251-52, 267, 269, 272 (publication of reports of pools); cf. *Scott v. Brown, Doering, McNab & Co.*, (1892) 2 Q.B. 724, 729, 61 L.J. (N.S.) 738, 741, *quoted in* 3 L. Loss, *supra* note 8, at 1529 n.1. There was even a maxim: "Stocks never go up; they are put up." Hanna, *supra* note 20, at 14.

²³⁴ *In re Michael J. Meehan*, 2 S.E.C. 588, 598 (1937); TWENTIETH CENTURY FUND, INC., *supra* note 12, at 477-81.

²³⁵ W. HICKERNELL, *supra* note 184, at 58; TWENTIETH CENTURY FUND, INC., *supra* note 12, at 466-71; Herlands, *supra* note 88, at 159, 164.

²³⁶ It seems clear that the proscription of true statements in the subsections was intended and was not the result of poor drafting. Early commentaries noted that § 9 forbade the making of true statements. See J. FLYNN, *supra* note 88, at 284; C. MEYER, *THE SECURITIES EXCHANGE ACT OF 1934 ANALYZED AND EXPLAINED* 73-74 (1934) (§

illegal for traders to make false statements about material market operations for the purpose of inducing trading.²³⁷ It is particularly difficult to square sections 9(a)(3) and (5) with the notion that the fundamental purpose of the Act is the achievement of full disclosure.²³⁸

Full and honest disclosure cannot explain even the provisions of the Act that deal with the dissemination of information. The Act was intended to do much more than to "substitute a philosophy of full disclosure for the philosophy of *caveat emptor*."²³⁹ The provisions of the Act dealing with communication reflect a profound awareness of the potential effect of information on security prices — and through prices on the public welfare. Toward the end of creating a market in which security prices would reflect information relating to issuer profitability, Congress required issuers to disclose information about their operations. Congress went beyond requiring those with information to disclose it. Even with accurate information available, Congress was apparently unwilling to trust the public welfare to markets dominated by investors who had just shown themselves prone to fantastically destructive speculation. The Act discourages the trafficking in information that Congress did not want reflected in price. Part (2) of section 9(a) forbids market operators to employ certain trading signals, and parts (3) and (5) forbid

9(a)(3) "is in part directed at the practices . . . [of] recommending the purchase of a stock on the ground pool is operating in it. *Such statements may no longer be made even if they are true.*"; Comment, *supra* note 88, at 630; Cf. Legislation, *Federal Regulation of Securities: Some Problems of Civil Liability*, 48 HARV. L. REV. 107, 112 n.36 (1934) ("Subdivision (3) [of § 9(a)] is a purely punitive regulation which does not involve fraud at all."). *But see* marginal index notation to § 9(a)(3), 48 Stat. 881, 889 ("Circulate false information concerning market operations . . ."). False statements about market operations may not even violate subsections (3) and (5). Section 9(a)(4) of the Act independently proscribes false rumors, and the use of the words "information to the effect" in clauses (3) and (5) — as opposed to "statement . . . false or misleading with respect to any material fact" in clause (4) — suggest that statements must be true to be within clauses (3) and (5).

²³⁷ Section 9 of the Act, *supra* note 2, does not forbid making a true statement about market operations, even for the purpose of inducing trading, unless the statement does in fact induce others to trade.

²³⁸ Norman Poser suggests that deception is an element of subsections (3) and (5) because "these two subsections are in a sense derivative as they can be violated by truthful statements only if there is a manipulation." Poser, *supra* note 10, at 702 n.187. But deception is by derivation an element of the subsections only if "market operations . . . conducted for the purpose of raising or depressing the prices of such security" are deceptive. Such operations are not inherently deceptive, and they can be so characterized only if investors are entitled to believe no one undertakes such operations, in which case their deceptive aspect is of little consequence.

²³⁹ See *supra* text accompanying note 100.

them to announce their operations. Whether the meaning of manipulation is to be found in the Act's fundamental purpose of discouraging speculation or in the specific provisions of section 9, section 10(b) seems to empower the SEC to regulate the discussion of security market operations that cause price changes.

D. Trading and Price — The Control of Disruptive Trading

To the extent that security prices are determined by information, the pricing mechanism can be regulated by regulating the flow of information. Prices on any market reflect the value judgments of its participants, and presumably those judgments will always be a function of the information that is available to the participants. Thus, prices will reflect whatever information makes a difference to those investors who are willing and able to trade. Although it may well be said that prices should reflect the analysis of whomever is prepared to participate in the market, Congress in 1934 did not want the analysis of some investors who could afford to trade to be reflected in the market. To this end, parts (1) through (5) of section 9(a) forbid the use of certain devices in order to execute misinformed or poorly motivated trades.

Although the reporting provisions of the Act and the parts of section 9(a) noted above cannot all be characterized as requiring full disclosure, they all regulate the flow of information. They require the disclosure of some items, forbid the communication of information about other things, and prohibit communications that may create incorrect impressions. If these were the only important provisions of the Act, then it would be difficult to argue, as this article does, that the residual authority granted to the SEC in section 10(b) should permit it to regulate more than the flow of information, no matter how the authority is stated.²⁴⁰ However, other provisions of the Act, including some that were seen as quite central by those who pressed for the Act's adoption, have nothing to do with information or with full disclosure.

Information does not translate itself into price. Prices are determined by the decisions of market participants. Information is reflected in price only after it influences the behavior of market participants, and information influences market participants only after

²⁴⁰ This is not to say that authority to regulate deception would be adequate to the task of creating a fully informed market. Regulation of deception would not allow for required disclosure or, as the Court has construed deception, the regulation of innocent misrepresentations.

they learn and analyze it.²⁴¹ Ultimately it is trading that sets price.²⁴²

Prices on ideal markets are the product of the views of all market participants on the values of the securities traded in the market, with each view carrying the weight of the resources its holder commits to it. Thus, prices reflect all of the available information that market participants consider to be relevant to value. A trade on such a market changes price only if it leads other participants to change their views or if it is so large a trade that it exceeds the amount of the security that other market participants are willing to buy or to sell at the prevailing price.²⁴³ In a market made up of investors who draw the same conclusions from the available information, trades that are not understood to disclose information will not affect price. If investors do not agree on the conclusions to be drawn from the available information, then a trade that exceeds the supply or demand that is available at the prevailing price may not be possible at that price, even if it is non-informative. The trade will thus produce a pressure-induced price change, which is entirely appropriate. The price at which the trade occurs will reflect the judgment of investors who are willing to risk their own money in the market, with the change in price simply being the result of the addition of the new investors' judgment to the mix.

If many investors, each with a great deal of money, are assembled together, it is extremely unlikely that the trading of any one investor will affect market clearing prices, unless such trading changes other investors' views on the values of the securities in question. Although investors may not all feel the same way about all securities, there are still many investors who are willing to trade most publicly traded securities at or very near market prices. Even if an investor buys or sells a great amount of a security for any one person, for most publicly traded securities the trade is unlikely to be significant relative to the total supply and demand available at the prevailing price.

To the extent that the commodity traded on the stock market is an income stream, the potential supply or demand for a particular

²⁴¹ Prices will change as investors reevaluate securities in response to new information, but until the reevaluation is complete trades may occur at prices different from the one that will ultimately prevail. At any given time trades will occur at a price at which buying and selling interest offset each other.

²⁴² Prices may change in response to new information without anyone trading, but the price change does depend on a change in the price at which investors would be willing to trade. Cf. Carney, *supra* note 31, at 880 (reservation prices).

²⁴³ See J. WILLIAMS, *supra* note 208, at 10-41; Levmore, *supra* note 31, at 651-57.

security at the market price is, for most purposes, infinite. Investors who are interested in securities only because they produce income, will, after all, view two securities they expect to produce the same income stream as basically identical, even if the issuers are in very different businesses.²⁴⁴

Although many people are able and willing to trade most widely traded securities at market price, they are not always in the market. A trade may change the price of a security simply because it is so large that the market cannot instantaneously mobilize supply or demand. The securities markets can handle most trades without such disruption,²⁴⁵ but a large trade can dislocate prices, especially if relatively few investors are interested in trading the security.²⁴⁶ The price at which such disruptive trades occur reflects the appraisal not of all investors willing to trade, but only of those who are present in the market when the trade is made. This "incorrect" price will last

²⁴⁴ Investors will seldom believe that the distribution of probable returns from two securities are identical. Although many issuers will be affected the same way by most events that may affect the return on their securities, few will be affected the same way by all events. However by diversifying her portfolio an investor can substantially reduce the impact of events that affect the income of only one or a few securities without sacrificing return. With relatively little diversification an investor can eliminate most such firm-specific risk. No one security will be particularly helpful in achieving this diversification. R. BREALEY & S. MYERS, *supra* note 23, at 119-54; J. LORIE, P. DODD, & M. KIMPTON, *supra* note 23, at 108-31; J. VAN HORNE, *supra* note 54, at 55-76. Thus any given security and many others will be almost perfect substitutes for each other for the purpose of constructing an appropriate portfolio. See R. BREALEY & S. MYERS, *supra* note 23, at 278-79; cf. Scholes, *supra* note 31, at 179.

²⁴⁵ Even large transactions have at most only a negligible pressure effect on price so long as other investors are convinced that the transaction is not triggered by private information. R. BREALEY & S. MYERS, *supra* note 23, at 278-79; J. LORIE, P. DODD & M. KIMPTON, *supra* note 23, at 68-73; Carney, *supra* note 31, at 887; Scholes, *supra* note 31, at 211.

²⁴⁶ See Special Study, *supra* note 27, pt. 2, at 15-18; K. GARBADE, *supra* note 23, at 419-28 (market depth, breadth and resiliency). Trading by stock exchange specialists was a "pet target" of stock exchange critics during the debate over the Act. J. FLYNN, *supra* note 88, at 228; see also S. REP. NO. 1455, 73d Cong., 2d Sess., reprinted in 5 LEGISLATIVE HISTORY, *supra* note 11, item 21, at 23-28; see also *supra* notes 183-186. The reason usually given for allowing specialists to trade for their own accounts is that they can thereby maintain orderly markets with price continuity in thinly traded securities. S. REP. NO. 1455, *supra*, at 26. The SEC permits exchanges to use specialists to assist in the maintenance of fair and orderly markets. 17 C.F.R. § 240.11b-1(a)(2) (1988); see Special Study, *supra* note 27, at 88-121; see also Cole, *Specialists Man the Ramparts*, N.Y. Times, Oct. 22, 1987, at D14, col. 1; cf. N.Y.S.E. Guide (CCH) ¶ 2104.10 (functions of specialist include maintenance of a fair and orderly market which implies minimizing effects of temporary disparity between supply and demand).

only until other investors come to the market,²⁴⁷ but until this occurs, the new trade price may cause problems for those who rely on market prices.

People interested in changing the price of a security (for purposes such as triggering a right or avoiding a liability) need not create or disclose any information to the market, and need not change other investors' minds about the value of the security. Even if appropriate resources are devoted to the market by well-informed and well-motivated investors, if market mechanisms are less than perfect, prices will not precisely correspond to the consensus judgment of value — and even perfecting the consensus will not produce appropriate prices. Those who stand to benefit from changes in reported prices can simply trade in a way that takes advantage of the market's inability to mobilize all investors instantaneously.²⁴⁸ One way that they can do this is to use carefully timed trades to control prices temporarily. People with obligations or rights measured in terms of market prices may be able to profit from a temporary change in reported prices resulting from such trading. Since their profits depend only on a price being reported and not on their being able to trade at that price, they can benefit from the pressure effect of their trades even if they do not inspire others to trade.²⁴⁹ Given the speed

²⁴⁷ See Scholes, *supra* note 31, at 182. Traders who realize that the new price is the result of a market defect will not trade until price rebounds. If some traders are willing to trade in the mistaken belief the new price represents an equilibrium market-clearing price, bargain hunters will eagerly trade with them.

²⁴⁸ The pricing of securities traded on the organized exchanges is affected by the forces of simple competition only after they have been refracted through the machinery of the exchanges, a point at which artificial stimuli can have great immediate effects upon security quotations. Manipulation is the generic term used to identify the employment of such stimuli for the primary purpose of controlling the prices or the volume of transactions of securities traded on the exchanges.

Comment, *supra* note 88, at 624.

²⁴⁹ Those who change prices by their trading pressure will not be able to trade at the prices produced by their trading. The pressure effect of their trading will last only so long as they trade. It does not reflect the supply or demand of those with whom they would trade. Thus a person can bid up the price of a security by buying but cannot sell at that price unless other traders hold it up.

Trading that presses price up may lead others to conclude the security is worth the new price. These others may then be willing to buy from the trader at the inflated price. The trader succeeds in raising the price at which he or she can sell the security because his or her trades lead others to reevaluate the security, not because its trades absorb the supply available at the prevailing price. The ploy only works if the public is fooled, while contractual rights can be triggered even if the trading public ignores closing prices. Nonetheless, there have been spectacular instances of such support. See Genesco, Inc., Prospectus 19-23 (May 10, 1966), reprinted in [1964-66 Transfer

with which supply and demand will be brought to bear, the prices that they create may not prevail for long, but they may accomplish their purposes if they can control the reported prices, even momentarily.

Often such interested people trade heavily just before the close of the market in order to control closing prices and thus manipulate their contractual rights or obligations.²⁵⁰ In one scheme, traders working for a large brokerage firm used concerted trading to inflate the nominal value of the portfolio that they managed. The traders ordered large amounts of securities on several exchanges at prices above market price during the final minutes of trading on Christmas Eve, resulting in a substantial increase in the closing price value of the portfolio.²⁵¹ This trading did not change the price that the brokerage firm could have realized on the sale of the portfolio, but the firm planned to base bonuses on closing prices, so, had they not been caught, the traders would have received substantially larger bonuses as a result of the temporary price inflation that their trading produced.

It is not clear how such a scheme violates the securities laws.²⁵² The traders did not violate section 9(a)(2) unless they intended the record of their trades to induce others to trade. There was no evidence that they intended to induce others to trade, and in fact they traded so late in the day that others would not have had time to act in response to the publication of their trades.²⁵³ The SEC charged some of the traders with violating section 10(b) and Rule 10b-5, in that the trades moved prices away from those that normal supply and demand would have produced. The traders consented to an injunction against violating these provisions. The SEC overreached if section 10(b) only reaches deceptive devices and contrivances. The traders purposefully distorted market prices, but even if that is rep-

Binder] Fed. Sec. L. Rep. ¶ 77,354 (issuer-controlled entities accounted for up to seventy-five percent of monthly trading in issuer stock during period of substantial issuer distributions); See also *supra* note 36 and accompanying text.

²⁵⁰ The last prices at which trades occur on stock exchanges are clearly defined and widely published and thus are well suited for use as contractual references.

²⁵¹ SEC v. Choset, SEC Litigation Release No. 10,036 (June 15, 1983) (S.D.N.Y. June 14, 1983) (LEXIS, Fedsec library, Rels file) (injunction entered by consent); Rustin & Putka, *supra* note 38.

²⁵² As employees of a brokerage firm the traders were subject to sanctions by self-regulatory organizations that would not have been available against unregulated persons. The exchanges imposed heavy fines on the traders for violations of § 10(b), Rule 10b-5 and exchange rules. Litigation Release No. 10,036, *supra* note 251.

²⁵³ Cf. *In re J.A.B. Securities Co., Inc.*, Exchange Act Release No. 15,948, 17 SEC Docket 1086 (June 25, 1979) (presumption of purpose).

rehearsable, it is not deceptive.²⁵⁴ They did not represent that in trading they were motivated by normal supply and demand. Nor were people reading the reports of the trades entitled to assume that the traders were so motivated, inasmuch as the law neither requires traders to disclose their motivations nor makes it illegal to trade for the purpose of changing prices.²⁵⁵

The point of this scheme may have been novel, but people often trade to support or to depress the prices of securities in order to trigger rights tied to market price or to prevent the triggering of duties tied to prices.²⁵⁶ Schemes like this are troubling for several reasons. Their publication may lead people to believe that the stock market is a rigged game, thereby increasing the cost of capital to security issuers who will have to compensate investors for playing. Moreover, people who would like to base conduct on the price at which a particular security can be traded cannot use reported prices as a proxy for available prices without making expensive and imprecise adjustments for price aberrations.²⁵⁷ If one party to a contract trades in order to influence security prices to the detriment of another party, then the other party may be entitled to redress on the theory that the first party has interfered with the occurrence of a condition.²⁵⁸ But even this theory offers no relief to parties prejudiced by price aberrations resulting from the concerted trading

²⁵⁴ If the brokerage firm's bonuses were fixed by contract it is hard to see who might have complained of being misled other than investors who thought the value of their portfolios had appreciated when they read the paper Christmas morning but were later disappointed to find they had not. See Rustin & Putka, *supra* note 38, at 4, col. 4 (prices receded after holiday weekend).

²⁵⁵ See Berle, *supra* note 28, at 272 (no common law obligation to refrain from arranging trades to unduly influence price).

²⁵⁶ Typical schemes have involved rights to purchase or obligations to sell securities at market price and attempts to support the price of securities pledged as collateral, see Proposed Amendment of Rule X-10B-7, Exchange Act Release No. 6127, [1957-1961 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,675, at 80,538 (Nov. 30, 1959). See generally Ricks, *SEC Believes Short-Term Manipulation of Stock Prices Occurred, Official Says*, Wall St. J., Nov. 23, 1987, at 4, col. 2 (short-term manipulation of prices in connection with secondary offerings and acquisitions and to avoid margin calls).

²⁵⁷ Such persons might protect themselves by defining their rights or obligations by reference to an average price over a longer trading period, over which it would seem aberrational prices would be less important. This may be difficult to accomplish however, and in any event will increase the cost of using market prices as contractual triggers. See also Levmore, *supra* note 31 (superiority of market prices to appraised prices for purposes of governing behavior).

²⁵⁸ See RESTATEMENT (SECOND) OF CONTRACTS §§ 225, 245 (1981); McDermott, *Defining Manipulation in Commodity Futures Trading: The Futures Squeeze*, 74 Nw. U.L. REV. 202, 215-25 (1979).

of wholly unrelated third parties.

Concerted trading is sometimes used to influence the price at which a future securities trade will occur. Substantial sales of securities are sometimes announced in advance, with the price to be based on the reported price at some future date. It is often possible for someone to profit by influencing that price through concerted trading. The SEC has addressed such concerted trading in two recent rule-making initiatives.

One trading scheme that takes advantage of a proposed sale at a price to be based on a price reported at a certain time in the future is called shorting a public offering.²⁵⁹ It can be used whenever an issuer or an owner proposes the future public sale of a security that is already publicly traded, with the price to be that prevailing just before the sale.²⁶⁰ The schemers sell short a substantial amount of the security on the market just before the sale price is to be set, thereby driving down the market price and with it the price at which the distribution will be made.²⁶¹ They then cover their short sales by buying in the public sale at the reduced price that they have produced. If they sell enough to force the price down, then the schemers are sure of a profit, unless the seller calls off the transaction at the last moment. The scheme works not by misleading the seller about market interest, but by taking advantage of the undertaking to sell at the future reported price. If the seller goes through with the transaction, it may sell for less than the price that the market would bear, and thus pay an inappropriately high cost for capital.²⁶²

The SEC has expressed concern about shorting public offerings on several occasions, and it recently adopted a rule, on a temporary basis, that regulates the practice.²⁶³ However, as the SEC seems to recognize, it may not have the authority to adopt such a rule.²⁶⁴ The

²⁵⁹ See J.A.B., *supra* note 253; Exchange Act Release No. 26,028, *supra* note 87 (adopting temporary Rule 10b-21 (T)); Exchange Act Release No. 24,485, *supra* note 87 (proposing Rule 10b-21).

²⁶⁰ The seller may announce this or the issuer may reveal it in a registration statement filed under the Securities Act. See, e.g., J.A.B., *supra* note 253, at n.11.

²⁶¹ The respondents in J.A.B., *supra* note 253, did this with three securities that were traded on the American Stock Exchange, and their sales, which accounted for about half or more of the trading in the last twenty minutes of the day, drove down the closing prices and accordingly the prices at which the securities were distributed.

²⁶² Exchange Act Release No. 26,028, *supra* note 87, at 89,386 (first-hand experience of commentators).

²⁶³ Rule 10b-21 (T), 3 Fed. Sec. L. Rep. (CCH) ¶ 22,741; Exchange Act Release No. 26,028, *supra* note 87 (adopting release).

²⁶⁴ See Exchange Act Release No. 26,028, *supra* note 87, at 89,383; Exchange Act

SEC might regulate short-selling campaigns in exchange-registered securities under sections 9(a)(6) and 10(a),²⁶⁵ but the problem may be more severe in distributions of over-the-counter securities that are outside the scope of these sections.²⁶⁶ The SEC can regulate over the counter campaigns under section 10(b) even though they are not deceptive if, as suggested in this article, the term manipulative has independent significance. (Of course, the SEC can argue that short sales that depress prices mislead the public,²⁶⁷ but given that the shorters are not concerned with what the public thinks, this argument once again begs the question of the public's right to believe that prices reflect only investment supply and demand.)

The converse of shorting into a public offering may be used when an issuer proposes to trade its stock for assets. If the number of shares to be delivered is based on their price on a future date, then the issuer has an incentive to bid up the price of the security before that date. The SEC's current position on such trading began to take form in litigation it initiated in 1966.

In the early 1960s, the Georgia-Pacific Corporation ("GP") bought several businesses and agreed to pay for them with its common stock. The exact number of shares to be paid in each case was to be based on NYSE prices at certain times after the date of the acquisition agreement. In 1966, the SEC charged GP with bidding up the price of its stock in connection with the acquisition program, claiming that GP thereby violated section 10(b), Rule 10b-5, and in addition, Rule 10b-6,²⁶⁸ which declares it unlawful for persons participating in the distribution of a security to purchase it.²⁶⁹ The SEC

Release No. 24,485, *supra* note 87, at 88,681.

²⁶⁵ If a shorted security is registered on an exchange, the SEC may be able to proceed against the shorters under § 9(a)(2) of the Act. The difficulty with a § 9(a)(2) charge in this situation, as always, is proving purpose to induce others to trade. The shorters' purpose is to depress price, not to get others to sell. However, their purpose will be furthered if others join in and depress the price further. The respondents in *J.A.B.*, *supra* note 253, argued that their trading late in the day was inconsistent with a purpose of inducing others to trade. The SEC rejected the argument, noting that some of the respondents' trades "were early enough to permit others to react," and finding "the inference compelling that [the respondents' sales that were intended to depress market price] were also calculated to entice others to effect transactions which would further lower those prices." *Id.* at 1091. The SEC underscored the weakness of this inference when it emphasized that it would have imposed the same sanctions even if it had not found a § 9(a)(2) violation. *Id.* at n.17.

²⁶⁶ Exchange Act Release No. 24,485, *supra* note 87, at 88,681.

²⁶⁷ *J.A.B.*, *supra* note 253, at n.13.

²⁶⁸ 17 C.F.R. § 240.10b-6 (1988).

²⁶⁹ *SEC v. Georgia-Pacific Corp.*, [1964-66 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 91,680 (S.D.N.Y. April 27, 1966).

alleged that GP and entities that it controlled intentionally purchased GP stock "in a manner which would and did . . . cause the last sale price of GP common stock on the NYSE to rise in order that GP's obligation to issue additional shares" under the agreements would be avoided or at least reduced.²⁷⁰ GP subsequently consented to the entry of an injunction against, among other things, "[b]idding for or purchasing any security of GP for the purpose of creating actual or apparent active trading in or raising the price of any security of GP."²⁷¹ Since GP consented to the injunction, the SEC was never forced to explain how these purchases violated section 10(b).²⁷²

In 1970, the SEC proposed to require all issuers of publicly traded securities effecting repurchases to comply with most of the terms to which Georgia-Pacific had consented.²⁷³ The SEC did not explain its authority to regulate the manner in which issuers accomplish repurchases, but it proposed to regulate repurchases under section 13(e) of the Act, under which it may have greater authority than it has under section 10(b).²⁷⁴ The SEC never adopted the proposal, but it specifically addressed issuer repurchases in 1982 when it adopted Rule 10b-18.²⁷⁵ Instead of forbidding non-conforming repurchases,

²⁷⁰ *Id.* at 95,489. The purchases "were caused to be concentrated near the close of the market" *Id.* at 95,488.

²⁷¹ SEC v. Georgia-Pacific Corp., [1964-66 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 91,692 at 95,525 (S.D.N.Y. May 24, 1966). Georgia-Pacific also agreed not to buy its securities during a distribution except as permitted by Rule 10b-6, nor to buy its securities within ten days prior to any date the market price of any Georgia-Pacific security is to be used to determine the amount of such security to be issued as consideration for assets acquired by it, nor to buy more than a specified part of the average daily and weekly trading volume of its securities on the NYSE. Bids and purchases were not to be made at the opening of the NYSE and orders were to be executed before the close of the Exchange. *Id.* at 95,525-26.

²⁷² *But see* Loomis, *Purchase by a Corporation of its Own Securities*, 22 Rec. N.Y.C.B.A. 275 (1967) (address by SEC general counsel). *See generally* R. JENNINGS & H. MARSH, *supra* note 62, at 820-22; Note, *Corporate Stock Repurchases Under the Federal Securities Laws*, 66 COLUM. L. REV. 1292, 1298-1300 (1966).

²⁷³ Notice of Proposal to Adopt Rule 13e-2 and to Amend Rule 10b-6 Under the Securities Exchange Act of 1934, Exchange Act Release No. 8930, [1969-1970 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,837 (July 13, 1970) (proposing Rule 13e-2); *see also* Revision of Proposed Rule 13e-2 and Amendment to Rule 10b-6 Under the Exchange Act, Exchange Act Release No. 10,539 [1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,600 (Dec. 6, 1973); Purchases of Certain Equity Securities by the Issuer and Others, Exchange Act Release No. 17,222 [1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 82,669 (Oct. 17, 1980).

²⁷⁴ *See supra* note 120 and accompanying text.

²⁷⁵ 17 C.F.R. § 240.10b-18 (1988).

Rule 10b-18 establishes a safe harbor from sections 9(a)(2) and 10(b) and from Rule 10b-5, for issuer repurchases conducted within the terms set forth in the rule.²⁷⁶ The conditions of the safe harbor, which are designed to limit the effect of repurchases on price, are basically that the issuer and related parties may purchase only a relatively small amount of the security, and that they must accomplish all purchases at or below market price.²⁷⁷

The SEC again failed to explain how issuer repurchases violate section 10(b) and Rule 10b-5; apparently, the SEC simply assumed that issuers need a safe harbor.²⁷⁸ The SEC said that it was concerned with issuer repurchases because "investors and particularly the issuer's shareholders should be able to rely on a market that is set by independent market forces and not influenced in any manipulative manner by the issuer."²⁷⁹ This sounds good, and perhaps the SEC should have found a way to protect investor reliance instead of creating a safe harbor for repurchasers that may undermine it. But if deception is an element of a section 10(b) violation, as the Court has repeatedly suggested, then there is no need for a safe harbor, unless issuer repurchases are deceptive in and of themselves or, if investors are entitled to assume that issuers have not influenced the

²⁷⁶ The rule provides that the purchaser shall not be deemed to have violated the provisions solely by reason of the timing, price or magnitude of the complying purchases, leaving open the possibility that the purchaser might violate them for some other reason, such as a purpose to influence price or induce trading. The adopting release repeatedly says the rule is a safe harbor, however. The "solely by reason" language was intended to make clear that the whole transaction was not immunized from § 10(b) and Rule 10b-5. Securities Act Release No. 6434, [1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,276, at 85,478 n.5 (Nov. 17, 1982).

²⁷⁷ Rule 10b-18(b). One condition is that repurchases may not constitute the opening transaction and must be made before the last half hour of the trading day. Rule 10b-18(b)(2). The SEC informally waived this condition for issuers that initiated repurchase programs the day after the NYSE's record October 19, 1987, price break. Wurczinger, *Confusion Follows SEC Reaction to Stock Crash*, Nat'l L.J., Nov. 9, 1987, at 20, col. 1; Dorfman, *SEC Clarifies Position on Buy-Backs In Potentially Manipulative Late Trades*, Wall St. J., Nov. 16, 1987, at 6, col. 1.

²⁷⁸ "[S]ince the general language of the anti-manipulative provisions of the federal securities laws offers little guidance with respect to the scope of permissible issuer market behavior, certainty with respect to the potential liabilities for issuers engaged in repurchase programs has seemed desirable." Securities Act Release 6434, *supra* note 276, at 85,477.

The SEC also failed to explain the source of its authority to exempt transactions from § 9(a)(2) of the Act for violations of which the statute provides a private remedy, § 9(e). The adopting release listed the Act §§ 2, 3, 9(a)(6), 10(b), 13(e), 15(c) and 23(a) as authority for the rule, but it did not specify which of these authorizes the SEC to exempt transactions from § 9(a)(2).

²⁷⁹ Securities Act Release No. 6434, *supra* note 276, at 85,477.

prices of their securities with their trading. Issuer repurchases are subject to criticism on several fronts,²⁸⁰ not the least of which is that they are sometimes used to distort market prices,²⁸¹ but they are not inherently deceptive. Nor is it clear why investors are entitled to assume that issuers have not tampered with market prices. While it might be argued that it is an improper use of corporate resources to repurchase stock for the purpose of influencing price, neither common experience nor any law against trading justifies the assumption that all reported trades are motivated by investment interest.²⁸²

The question of whether trades can disrupt the market and affect prices more than is justified by their information content is also raised by the debate over program trading. During the last several years, NYSE daily trading-volume and price-change records have been approached and broken frequently, and even before the collapse of prices on October 19, 1987, the magnitude of the price swings had attracted a great deal of attention and concern.²⁸³ Many critics complained even before the crash that program trading, especially computerized arbitrage trading, had increased market volatility.²⁸⁴ Criticism grew after the crash, and if there is not an official explanation of the crash at least some of the official reports put a substantial part of the blame on program trading.²⁸⁵ Whether or not

²⁸⁰ See generally, V. BRUDNEY & M. CHIRELSTEIN, *supra* note 23, at 533-83.

²⁸¹ See, e.g., Putka, *supra* note 36 (issuer caused third party to buy its shares to raise price to make stock-for-stock takeover bid more attractive).

²⁸² But see Berle, *supra* note 28, at 274-79.

²⁸³ *Stocks Plunge 508 Amid Panicky Selling*, Wall St. J., Oct. 20, 1987, at 1, col. 6.

²⁸⁴ See, e.g., Division of Market Reg., SEC, *Role of Index-Related Trading in the Market Decline on September 11 and 12, 1986* (March 1987); Lee, *What's with the Casino Society?* FORBES, Sept. 22, 1986, at 150; Seligman, *Don't Fret About Program Trading*, FORTUNE, Oct. 13, 1986, at 87; Wurzinger, *supra* note 277; Williams, *The Big Board's Battle to Contain the Damage*, N.Y. Times, Oct. 25, 1987, § 3, at 8, col. 1; Cowan, *Bitter Lessons During Plunge*, N.Y. Times, Oct. 22, 1987, at D1, col. 3, and at D15, col. 6 (Donald Regan); McMurray, *Stock-Index Markets Are Hurt by Rout*, Wall St. J., Oct. 22, 1987, at 6, col. 1; Sanger, *Traders Expect Regulatory Action on Program Trading*, N.Y. Times, Oct. 22, 1987, at 36, col. 1; N.Y. Times, Oct. 22, 1987, at 35, col. 1; Anders, *Stock Price Swings Raise Question: Is Character of Market Changing?* Wall St. J., Oct. 1, 1986, at 35, col. 4; *Interest-Rate Worries and Program Trading Send Stocks Plunging*, Wall St. J., Sept. 12, 1986, at 1, col. 6. David Ruder focused on program trading in his first public address after becoming chairman of the SEC. Wall St. J., Oct. 7, 1987, at 30, col. 1.

²⁸⁵ See Solomon & Dickler, *The Crash of 1987: A Legal and Public Policy Analysis*, 57 FORDHAM L. REV. 191 (1988). For a critical summary and review of the reports and the failure of responsible authorities to respond to the crash in a meaningful way, see Karmel, *The Rashomon Effect in the After-The-Crash Studies*, 21 REV. SEC. & COMM. REG. 101 (1988).

there actually is a problem, there continues to be pressure to respond to what is seen as a problem, perhaps by discouraging computerized trading or by changing the markets in order to minimize the effects.

If a security trades for different prices on different markets, then arbitrageurs can profit by buying on the low-priced market and simultaneously selling on the high-priced market. They will continue to do so until prices on the two markets come together.²⁸⁶ It is also possible to arbitrage discrepancies between the prices of futures or options, and the prices of the securities underlying them. For example, if a stock index future sells at a premium to the price of the stocks that make up the index, after adjusting for the costs and benefits of owning the stocks or the future, an arbitrageur can profit by simultaneously selling the future and buying the stocks. The arbitrageur can realize his or her profit by buying back the future and selling the stocks when the future expires, or earlier if changes in relative prices make it advantageous to do so.²⁸⁷ By using computers to calculate premiums and to order trades quickly, arbitrageurs can realize significant profits by trading large amounts of securities which trade at only a small premium to each other.

Program arbitrage trading is simply large-scale trading in response to price discrepancies between markets. Although program trading does not differ in quality from other arbitrage trading, some observers are concerned about it because of the effects that they believe to follow from the enormous scale on which it is done. However, even though the dislocations accompanying the rapid adjustment of market prices to their correct levels may be troubling,²⁸⁸ interference with the trading practices that cause such adjustments runs the risk of leaving prices for related securities out of line with each other.²⁸⁹ There is clearly a problem though, if arbitrage trading

²⁸⁶ Their trades may eliminate the price differential either by disclosing the price imbalance to participants in the two markets — who will then reevaluate and change their behavior — or by absorbing the supply available below the final price or the demand above.

²⁸⁷ This is a simplified example of one of many techniques. See generally Division of Market Reg., *supra* note 284.

²⁸⁸ After the market dropped precipitously in October 1987, Alvin Toffler suggested that computer-driven trading programs now allow the financial system to respond to change instantaneously, with instantaneous response itself amplifying changes and accelerating the pace of change. He saw increasing stock market volatility as evidence that instability has reached a level that threatens the structural integrity of the financial system. Toffler, *A Post-Panic System*, N.Y. Times, Oct. 25, 1987, § 3, at 8, col. 4.

²⁸⁹ Solomon & Dicker, *supra* note 285 (summarizing criticism of suggested reforms); Gilpin, *Portfolio Insurance is Growing*, N.Y. Times, Oct. 23, 1987, at D6, col. 6; Flynn, *Program Trading Is Defended*, N.Y. Times, Oct. 22, 1987, at 37, col. 1.

overwhelms the market, pushing prices further than is necessary to synchronize markets.

The exchanges and their regulators are responding to this possibility by modifying trading practices and by defining futures and options in a way that has now made trading less disruptive. For example, on October 21, 1987, the NYSE limited the use of computers to execute trades in the wake of the collapse of prices on October 19. The Exchange said that it acted to protect its facilities, but it may also have intended to reduce volatility and to restore confidence.²⁹⁰ Some market structures have also been modified. Some futures and options are now settled at opening prices rather than at closing prices, on the theory that supply or demand to offset any imbalance can be mobilized more easily during the morning (before the market opens) than during the hectic minutes before closing.²⁹¹ After the crash, the Exchange required market-on-close orders on expiration dates to be entered thirty minutes before the market closed, so that it could disclose order imbalances.²⁹²

The SEC has paid attention to the disruptions caused by temporary imbalances of supply and demand. It has used Rule 10b-5 to challenge the purposeful creation of temporary price changes, and it has considered regulating the trading patterns that are used to produce temporary price changes. It has sought, through informal arrangements with the exchanges and through various rules, to minimize the disruption thought likely to result from program trading. It is likely to come under increasing pressure to regulate or even to forbid such trading.

There remains the question of the SEC's authority over such trading practices that disrupt prices by creating or exacerbating these temporary imbalances. The SEC often tries to sidestep this authority problem. Sometimes it ignores the issue and sometimes it obscures it by summarily listing a variety of potential sources of authority without explaining any. Nonetheless, the SEC's authority

²⁹⁰ Sanger, *Limits Set on Program Trades*, N.Y. Times, Oct. 21, 1987, at D17, col. 4.

²⁹¹ Garcia, *Triple Witching Day Doesn't Roil Stocks As New Trading Procedures Curb Volume*, Wall St. J., June 22, 1987, at 32 col. 1; cf. Amihud & Mendelson, *Trading Mechanisms and Stock Returns: An Empirical Investigation*, 42 J. FIN. 533, 538-39 (1987) (NYSE opening prices).

²⁹² *Annual Review of Securities Regulation, Significant 1986 Regulatory and Legislative Developments*, 42 BUS. LAW. 827, 865-66 (1987); Karr and Grisdela, *SEC Asks Big Board to Test Proposal Aimed at Curbing Sharp Price Swings*, Wall St. J., Sept. 11, 1986, at 45, col. 1.

often comes down to section 10(b).²⁹³ In this area, as in others, the Court's suggestion that the word manipulation is not independently significant in section 10(b) may have important ramifications. If section 10(b) reaches only deceptive conduct, the SEC cannot regulate disruptive practices unless they can successfully be characterized as deceptive.

Inasmuch as disruptive traders seldom make any affirmative statements, whether true or false, it is hard to say that they are doing anything deceptive. The SEC has occasionally characterized disruptive practices as deceptive on the familiar ground that investors should be able to count on prices' reflecting normal supply and demand, or at least on prices' not reflecting supply and demand that is created solely for the purpose of influencing prices. But the SEC cannot explain why investors' reliance is binding on traders. It is by no means clear that investors believe that all traders trade for investment, nor is it clear that they believe that prices are a function of investment-motivated trades. In any case, even if investors do believe that they participate in a model market, that would only show that investors are mistaken, not that anomalous traders have misled (or deceived) them. Both at common law and under section 10(b) the misinformed can prove fraud only by showing that the deceiver has done something wrong. Aside from the relatively few traders who affirmatively misrepresent themselves, traders who trade for non-investment reasons or who affect prices by the way that they trade are not using a deceptive device or contrivance, unless they either are trying to mislead other investors or are trading in violation of some independent rule against their trading.

Program traders and people who move prices in order to avoid their obligations or to trigger those of others are not intent on misleading anyone. The problem then lies in finding an independent duty that requires traders who will move prices to forego trading or to explain themselves. Common law fiduciary principles and sections 13, 14 and 16 of the Act govern trading by issuers, insiders and persons engaged in substantial acquisition campaigns, but otherwise state law and the federal securities statutes leave most people free to trade for their own reasons and without telling anyone about it.

The best answer to the SEC's authority problem is to reconsider section 10(b)'s manipulation language and to give it the independent interpretive significance that it deserves. The practices discussed

²⁹³ The SEC might regulate program trading under § 10(a) of the Act when it involves the use of short sales or as the functional equivalent of a set of stop-loss orders. The NYSE can effectively regulate the practice by controlling access to its facilities.

above are considered inappropriate for reasons that have nothing to do with deception. In fact, they are objectionable precisely because they move market prices even though they do not disclose information. Program traders and short schemers move prices by selling (or buying) more of a security than other market participants are prepared to buy (or sell) at the prevailing price, or at least more than those in the market at the time are prepared to trade. Their conduct is essentially the same as that prohibited or subjected to regulation under the heading of "manipulation" in sections 9(a)(2), 9(a)(6), 9(b), 9(c) and 10(a) of the Act, and as that conduct labeled "manipulative" in the field of commodities law. Regardless of whether concerted trading is deceptive, it is fairly characterized as manipulative, and accordingly section 10(b) should be understood to forbid its use or employment in connection with the purchase or sale of a security in contravention of a rule prescribed by the SEC as necessary or appropriate in the public interest or for the protection of investors.

Three years before the Act was adopted, Adolph Berle wrote that of all of the objectionable manifestations of stock market manipulation, the freedom to arrange trades so as to unduly influence prices "arouses public condemnation more than any other single legal element in the situation."²⁹⁴ Section 9(a)(2), which is at the heart of the Act,²⁹⁵ is the response to this abusive practice. It is true that section 9(a)(2) does not forbid trades that change prices unless they are undertaken for the purpose of inducing others to trade, but the purpose clause was included in section 9(a)(2) only to protect traders who are not motivated by a desire to affect price, but who know that their trades will do so.²⁹⁶ In any case, the point is not that the Act forbids trading that changes prices,²⁹⁷ but that it calls the intentional use of trading to influence price "manipulation."²⁹⁸

²⁹⁴ Berle, *supra* note 28, at 272. See also Berle (1938), *supra* note 88.

²⁹⁵ 3 L. Loss, *SECURITIES REGULATION*, *supra* note 8, at 1549.

²⁹⁶ Poser, *supra* note 10, at 703-05. Those concerted traders who trade for the purpose of changing price are the unintended beneficiaries of this clause. As noted above the SEC insisted that the proposed Federal Securities Code should make it illegal to trade for the purpose of changing price. See *supra* note 230.

²⁹⁷ The pools could not profit merely by creating price changes with their trading pressure. Under § 9(a)(2) of the Act the pressure effect of their purchases would merely reflect the money that the pool had spent, and since it would disappear as soon as the pool stopped buying, the pool would not be able to sell at the inflated price. Wash sales and matched orders have no pressure effect, being fictitious transactions. A pool's trading profits depended on others trading at the new price, and toward this end pool operators used fictitious trades, price-changing trades and paid publicity to get others to rethink their conclusions about the value of the security.

²⁹⁸ The predecessor of § 9(a)(2) of the Act in the version of the bill that the Senate

The last trading practice addressed in section 9(a) is price stabilization. Stabilizing the market in connection with the distribution of securities is thought to be a necessary and legitimate technique because of the possibility that a distribution puts pressure on price. Indeed, section 9(a)(6) seems to be concerned solely with the direct influence of trading on price.

The sale of a substantial block of a security is often thought to depress the prices of the security by overwhelming the market.²⁹⁹ The idea that sales depress price is intuitively attractive, but sales will have a pressure effect only when they are so large that they exceed demand at the prevailing price. As discussed above, in large, well-developed markets, few sales will be so large, and in fact even the largest distributions have at most only very small pressure effects on prices.³⁰⁰ Nonetheless, the idea that large sales necessarily depress price seems to have intuitive appeal, and it is considered legitimate for those involved in large distributions to support — that is, to stabilize — the market for the security. This stabilization entails being prepared to buy the distributed security on the market during the course of the distribution if the new supply appears to be depressing the security's price. The theory is that while it is wrong to push the price of a security up before a large sale, it is acceptable to offset the downward pressure of the sale with carefully orchestrated purchases.³⁰¹

Congress gave the SEC responsibility for regulating stabilization. Section 9(a)(6) makes it unlawful to effect any series of transactions in an exchange-registered security for the purpose of "pegging, fixing, or stabilizing" its price, in contravention of the rules prescribed by the SEC. The potential for the abuse of stabilizing purchases that was recognized in this grant of authority exists in the over-the-counter market as well as on the exchanges, and the SEC has regulated stabilization in both markets. It has done so by declaring it a manipulative or deceptive device or contrivance within the meaning

passed and sent to conference declared it unlawful "[t]o manipulate . . . the price of any security registered on a national securities exchange by means of any series of transactions in such security effected with the specific intent of raising or depressing such price." H.R. 9323 (as passed with Senate amendments), 73d Cong., 2d Sess. § 9(a)(3) (1934), reprinted in 10 LEGISLATIVE HISTORY, *supra* note 11, item 32 at 80; see also S. 3420, 73d Cong., 2d Sess. § 9(a)(3) (1934), reprinted in 11 LEGISLATIVE HISTORY, *id.* at item 37.

²⁹⁹ R. BREALEY & S. MYERS, *supra* note 23, at 307-08, 439; J. LORIE, P. DODD & M. KIMPTON, *supra* note 23, at 60-70; Scholes, *supra* note 31, at 180-81.

³⁰⁰ See *supra* notes 243-51 and accompanying text.

³⁰¹ See Halleran & Calderwood, *Effect of Federal Regulation on Distribution of and Trading in Securities*, 28 GEO. WASH. L. REV. 86, 90-91 and 101-03 (1959).

of section 10(b), to buy or bid for a security for the purpose of pegging, fixing, or stabilizing its price, except in compliance with its rules.³⁰²

The SEC thus clearly has the power under section 9(a)(6) to regulate the stabilization of exchange-registered securities, but the power to regulate the stabilization of unregistered securities must be found elsewhere. Stabilization can with some justification be called inherently deceptive,³⁰³ but the fact that it is permitted is evidence that Congress did not regard it in that way in 1934 and, presumably, that

³⁰² Broadly speaking, Rule 10b-7, 17 C.F.R. § 240.10b-7 (1988), permits persons making a fixed price offering to keep the market price of the security from falling and Rule 10b-6 forbids all other purchases intended to peg, fix or stabilize the price of any security. Rule 10b-6, 17 C.F.R. § 240.10b-6 (1988), declares it a "manipulative or deceptive device or contrivance" for anyone involved in a distribution of a security to purchase it. Stabilizing transactions are excepted from Rule 10b-6 if they do not violate Rule 10b-7. Rule 10b-6(a)(4)(viii). See also 17 C.F.R. § 240.10b-8 (1988) (rights offering); 3 L. LOSS, *SECURITIES REGULATION*, *supra* note 8, at 1571-1614; Foshay, *Market Activities of Participants in Securities Distributions*, 45 VA. L. REV. 907 (1959); Parlin & Everett, *The Stabilization of Security Prices*, 49 COLUM. L. REV. 607 (1949); Wolfson, *Rule 10b-6: The Illusory Search for Certainty*, 25 STAN. L. REV. 809 (1973).

³⁰³ As noted above, the demand for most securities is extremely broad, and so the expansions of supply represented by most distributions should not depress prices. Market institutions are capable of mobilizing demand quickly, so that even if a distribution is large enough to overwhelm the ready demand, price will quickly recover. (Advance notice of the distribution would take care of the problem, Scholes, *supra* note 31, at 186, but advance announcement will itself depress price if it is interpreted to mean that the seller knows bad news. *But cf.* Wall St. J., Oct. 27, 1986, at 36, col. 3 (advance notice of large futures orders).)

A distribution may result in a price decline even if it does not overwhelm the market. Market participants may interpret the offering to mean that the seller knows that something is wrong, and may reduce their estimates of the security's value accordingly. The change in price occasioned by this change in expectations will not be a transitory problem of a disorderly market, and the pressure effect of supporting purchases will be of no avail to a seller. The distributors can keep the price up if they are prepared to buy back everything that anyone sells at the offering price, but they will not be able to sell at the supported price, since the price will fall back to consensus value as soon as the distributors stop buying. Distributors cannot simply by their purchases provide the demand for what they propose to sell.

Stabilizing transactions may work because of their information content. So long as the distributors stand ready to buy, the value of the distributed stock is the price that they are prepared to pay. If the distributors can convince market participants that they are prepared to buy, then the market price will not fall. Thus stabilization will work if the distributors can complete their sales but then withdraw their support before market participants expect them to. To this extent stabilization depends on misleading market participants for its effectiveness. See Exchange Act Release No. 2446, 11 Fed. Reg. at 10,976 (March 18, 1940) (separate statement of Comm'r Healy); cf. J. FLYNN, *SECURITY SPECULATION*, *supra* note 88, at chs. 5 & 6 (1934).

the SEC does not see it that way now.³⁰⁴ Although the SEC requires sellers who are stabilizing the market to disclose that they may be doing so,³⁰⁵ the rules do more than require disclosure. If section 10(b) reaches only deception, then trading in contravention of the SEC's stabilization rules does not violate section 10(b). Yet stabilization seems to be another practice that is manipulative even if not deceptive. It seems clear that stabilization in contravention of the SEC's rules does violate section 10(b). The SEC can regulate manipulative devices and contrivances under section 10(b), and stabilization is manipulative wholly apart from any deceptive character that it may have.³⁰⁶ Congress subjected stabilization techniques to regulation because it was concerned about the misuse of the pressure effect of purchases. Section 9(a)(6) simply is not concerned with deception, and the treatment of the problem of stabilization under the rubric of manipulation is evidence that when Congress gave the SEC the power to regulate manipulation in section 10(b), it contemplated more than the regulation of communication, that is, more than the limited scope of authority now conceded to the term by the Court.³⁰⁷

A substantial body of law on manipulation has grown up in the related and analogous area of commodity trading regulation. To the extent that securities are nothing more than income producing assets, all securities are potentially substitutes for each other. If securities were fungible, then the amount that investors would supply and demand at prevailing prices would dwarf anyone's trading, especially if investors could trade on credit — that is, if they could buy with borrowed money and sell borrowed securities. Of course, securities are more than the income that they produce, and so for some purposes they are not fungible. Investors are entitled by virtue of their ownership of securities to participate in controlling the issuer, and a buyer is entitled to the delivery of the purchased security, and not merely to the income from it. When the unique aspects of a security come into demand, for example in a contest for corporate control or when a short seller has to replace borrowed stock, the limits on the supply of the stock may manifest themselves in price

³⁰⁴ See Exchange Act Release No. 2446, 3 Fed. Sec. L. Rep. (CCH) ¶ 22,541 (Mar. 18, 1940).

³⁰⁵ See 17 C.F.R. § 240.10b-7(k) (1988).

³⁰⁶ Cf. Exchange Act Release No. 2446, *supra* notes 303-04, at 16,555-3 ("The Commission is unanimous in recognizing that stabilizing is a form of manipulation. The statute itself so recognizes."); L. LOSS, FUNDAMENTALS, *supra* note 8, at 999.

³⁰⁷ The Court has never tried to fit most of § 9(a) of the Act into its reading of the word manipulative. Norman Poser, who treats § 9 more fully, simply omits § 9(a)(6) (and § 10(a)) from consideration. See Poser, *supra* note 10, at 691, 701-11.

increases.³⁰⁸

A person who controls the available supply of a security and who has the right to demand the delivery of more of the security is said to have cornered the market. Yet corners are not deceptive.³⁰⁹ Stock market corners are not often reported on now and they are not specifically addressed in the Act.³¹⁰ However, corners are thought to be a significant problem in the commodity markets.

The prevention of manipulation is one of the primary purposes of the federal regulation of commodity trading.³¹¹ The Commodity Exchange Act makes it illegal to manipulate or to attempt to manipu-

³⁰⁸ Cf. Comment, *supra* note 88, at 627 n.13 ("A security provides an admirable vehicle for the monopolistic control which is the essence of manipulative operations since its supply is limited to the outstanding capitalization.").

³⁰⁹ Cf. 5 A. JACOBS, *supra* note 81, § 2.02 at 1-16 ("An agreement to buy up, or corner, the entire supply . . . of a security is another blatant type of manipulation."). See generally *United States v. Patten*, 226 U.S. 525, 538-43 (1913) (cotton corner); W. HICKERNELL, *supra* note 184, at 136-41; HIGH FINANCE IN THE SIXTIES (F. Hicks ed. 1929). But see Poser, *supra* note 10, at 692-93 (deceit was an "essential element" of pre-Act manipulative operations, including corners); cf. Easterbrook, *Monopoly, Manipulation, and the Regulation of Futures Markets*, 59 J. Bus. S103, S106 (1986). Judge Easterbrook reasons that since no one voluntarily subjects himself or herself to monopoly, would-be futures-market manipulators (he treats monopoly and manipulation as virtual synonyms, see *infra* note 71) need secrecy to assemble unpredictably large positions. "Monopoly [that is, manipulation] in a futures market therefore turns out to be a species of fraud." *Id.* As the word is used here, fraud does not seem to contemplate misrepresentation or silence in the face of a duty to speak. Fraud is nothing more than taking advantage of secrecy to do something other market participants do not expect.

³¹⁰ The predecessor to § 9 in the bill that was eventually enacted as the Act would have forbidden corners. H.R. 7852, 73d Cong., 2d Sess. § 8(a)(8), reprinted in 10 LEGISLATIVE HISTORY, *supra* note 11, item 24; cf. Hanna, *supra* note 20, at 16 n.15 ("Technical corners are unknown today, partly because pools have learned to make more money without corners, and partly because the stock exchange is likely to suspend a stock from trading if its sponsors permit a corner."). But see Norris, *The Case of the Curious "Corner"*, N.Y. Times, Jan. 22, 1989, § 3, at 1, col. 2 (rare modern example of corner, perhaps inadvertent).

³¹¹ *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353, 361-62 (1982); 2 P. JOHNSON, *COMMODITIES REGULATION*, 231 (1982); Bianco, *The Mechanics of Futures Trading: Speculation and Manipulation*, 6 HOFSTRA L. REV. 27, 35-39 (1977); Davidson, *Squeezes and Corners: A Structural Approach*, 40 BUS. LAW. 1283 (1985); Harrington, *The Manipulation of Commodity Futures Prices*, 55 ST. JOHN'S L. REV. 240 (1981); Hieronymous, *supra* note 65; McDermott, *supra* note 258. The legislative findings of § 2 of the Act, including its emphasis on the evils of speculation and manipulation, were modeled on those of § 3 of the Grain Futures Act, which is now called the Commodity Exchange Act, 7 U.S.C. §§ 1-26 (1982). See generally *supra* notes 19-22 and accompanying text; Stassen, *Propaganda as Positive Law: Section 3 of the Commodity Exchange Act*, 58 CHI. KENT L. REV. 635 (1982).

late the price of a commodity,³¹² but it does not define manipulation. The failure of courts and administrators to explain this proscription has been widely noted,³¹³ and it is impossible to explain precisely what constitutes commodities manipulation. However this may be, abuse of market dominance figures prominently in all definitions of commodity manipulation.³¹⁴

Participants in commodity futures markets trade standardized contracts for the purchase and sale of a defined commodity at a future date.³¹⁵ The vast majority of participants intend to satisfy their obligations by acquiring offsetting contracts before the delivery date. The problem is that speculators cannot be sure how much of the market is made up of other speculators who are planning to offset, and how much of it is made up of hedgers who are looking toward delivery. Accordingly, traders intent on making offsetting trades may not balance at expiration. If speculators cannot acquire offsetting contracts, then they must perform their contractual obligations. For example, if long traders — that is, traders who have agreed to buy commodities — want delivery of substantially more of a commodity than the short traders as a group had intended to deliver, then some short traders will have to buy deliverable commodities or offsetting long contracts at whatever price those who are willing to sell can demand.³¹⁶ If the deliverable supply is scarce, then the premium for offsetting contracts may be substantial.³¹⁷

³¹² Section 9(b), 7 U.S.C. § 13(b) (1982); see also 7 U.S.C. §§ 7(d), 9, 13b, 9a, 21(b)(7) (1982). See generally 2 P. JOHNSON, *supra* note 311, at § 5.01.

³¹³ See, e.g., Bianco, *supra* note 311; Davidson, *supra* note 311; Harrington, *supra* note 311; Hieronymous, *supra* note 65; McDermott, *supra* note 258; Perdue, *Manipulation of Futures Markets: Redefining the Offense*, 56 *FORDHAM L. REV.* 345 (1987).

³¹⁴ See, e.g., *Cargill, Inc. v. Hardin*, 452 F.2d 1154 (8th Cir. 1971), *cert. denied*, 406 U.S. 932 (1972); *Volkart Bros. v. Freeman*, 311 F.2d 52 (5th Cir. 1962); *Great Western Food Distributors, Inc. v. Brannan*, 201 F.2d 476 (7th Cir.), *cert. denied*, 345 U.S. 997 (1953); 2 P. JOHNSON, *supra* note 311, at § 5.03 ("Price manipulation is kindred to the exercise of monopoly power to dictate prices that would be not achievable in a truly competitive environment."); Easterbrook, *supra* note 309, at S107; *cf.* *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 222-24 (1940) (Douglas, J.) (combination to "stabilize" market by buying distress gas offered below market price is manipulation and per se violation of Sherman Act); *Board of Trade of Chicago v. Olsen*, 262 U.S. 1, 12 (1923) (quoting Herbert Hoover's congressional testimony on manipulating commodity prices by buying or selling).

³¹⁵ See generally *Merrill Lynch*, 456 U.S. at 357-67; *Cargill*, 452 F.2d at 1156-58; P. JOHNSON, *supra* note 311.

³¹⁶ If, on the other hand, speculative long interest is excessive, traders who are long will have to accept delivery of a commodity that they do not want or will have to buy an offsetting short contract from someone who had planned to deliver.

³¹⁷ See generally *Cargill*, 452 F.2d at 1156-58; Davidson, *supra* note 311, at 1285-87.

It is neither manipulative nor illegal to try to predict and profit from an imbalance between buying and selling interests; that is the point of commodity speculation.³¹⁸ What is illegal is to gain control of deliverable supplies on the long or the short side of the futures market for the purpose of creating this situation, or to use such control to extract "artificial" prices from speculators. This may be an unsatisfactorily ambiguous rule, but it is clear that the illegitimate acquisition or use of market power is the essence of commodity manipulation. In fact, those who would give manipulation a more precise meaning in commodities law often propose greater focus on power and less on motivation.³¹⁹ Simply put, commodities manipulation is the use of a dominant position in the market for a particular futures contract and/or for the deliverable commodity, to change market price or to extract a premium price from traders forced to turn to the manipulator to cover.³²⁰

The most telling flaw in the Court's view of section 10(b) is its failure to account for section 10(a). Short sales are another non-deceptive trading practice that Congress has labeled manipulative. Section 10(a) of the Act authorizes the SEC to regulate short sales of exchange-registered securities and the employment of stop-loss orders in connection with trades in such securities. Short selling has always aroused a great deal of suspicion,³²¹ and public hostility toward it was probably the most powerful impetus for the Act.³²²

³¹⁸ Easterbrook, *supra* note 309, at S117.

³¹⁹ See, e.g., Davidson, *supra* note 311, at 1296-98; Hieronymous, *supra* note 65, at 52-56; McDermott, *supra* note 258, at 213-25.

³²⁰ See, e.g., Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran, 456 U.S. at 369-71; Board of Trade v. Olsen, 262 U.S. at 10-15, 37-40.

³²¹ "The prime instrument of perdition on the Stock Exchange [was] supposed to be short selling." J. FLYNN, *supra* note 88, at 216; see also 2 L. LOSS, SECURITIES REGULATION, *supra* note 8, at 1224 ("short selling has been a favorite whipping boy"); TWENTIETH CENTURY FUND, INC., *supra* note 12, at 95 (volume and intensity of criticism and defense of short selling varies inversely with business cycle); Hanna, *supra* note 20, at 11 ("Some persons, concluding that the stock market is evil only when it registers declines, seek to isolate the cause of the declines and propose to abolish the short seller or bear.").

³²² After the 1929 crash, much of the public concluded that speculators and profiteers had pushed the market to unreasonable highs and then caused its collapse with their short sales. R. DEBEDTS, *supra* note 12, at 12, 17-18; 2 L. LOSS, SECURITIES REGULATION, *supra* note 8, at 1166 (quoting J. FLYNN, *supra* note 88, at 216); M. PARRISH, *supra* note 11, at 109-11; cf. W. DOUGLAS, *supra* note 181, at ch. VI (short sales contributed to market collapse in 1937); H. HOOVER, MEMOIRS — THE GREAT DEPRESSION, 1929-1941, at 125-30 (1952) (short sales by bear raiders retarded recovery). Not all critics of stock market practices condemned short-selling. See, e.g., TWENTIETH CENTURY FUND, INC., *supra* note 12, at ch. 11; Hanna, *supra* note 20, at 13 (no evi-

Short selling may not have deserved its notoriety, but it was clear that any exchange regulation statute enacted as part of the New Deal would at the very least regulate short sales. The centrality of the controversy over short selling in the Act's legislative and political history shows that many of the proponents of the Act were concerned with much more than full disclosure. Even if sections 2 and 9 and the other provisions of the Act can be ignored or explained in construing section 10(b), section 10(a) cannot. Any construction of section 10(b) must accommodate section 10(a), and section 10(a) is not accommodated by a construction that sees section 10 as directed at problems of deception or disclosure.

Short-selling and sales triggered by stop-loss orders can affect security prices by conveying information or by overwhelming demand. Short sales convey information, as do all sales. In 1929, investors probably read the tremendous volume of trades at declining prices to mean that sellers had revised their yield predictions for securities. Those who were selling short might not have been heard had short selling been impossible.³²³

Short sales may also depress prices by absorbing demand at prevailing prices. If short sales have this effect, then they will have it even if they are not publicized. Short selling permits investors to participate in the supply side of a security that they do not own, so prices on a market that permits short selling reflect the pessimistic judgments of short sellers. These judgments might not be reflected were short selling impossible.³²⁴

Those agitating for the elimination of short selling did not prove their case, but Congress did authorize the SEC to deal with the issue. The SEC has regulated short selling as a practice that can of its own weight depress prices, rather than as one that is misleading.³²⁵ The SEC's main rule simply forbids short sales at a price below the price of the last trade or at the price of the last trade unless the last

dence short sales depress price). *See generally* Special Study, *supra* note 27, pt. 2, at 246-94.

³²³ A pessimist can also register his or her opinions by trading stock options and futures, but these instruments were not available for trading in 1934.

³²⁴ During the 1930s, apologists for short selling argued that short sellers must cover at some point and that their covering tends to support the market. TWENTIETH CENTURY FUND, INC., *supra* note 12, at 360-61. The point is still made today. *See, e.g.*, Wall St. J., July 27, 1987, at 24, col. 1 ("[A] big rally in the market can't occur until there is heavy short-selling. The stock sold short eventually has to be bought back.").

³²⁵ Special Study, *supra* note 27, pt. 2, at 251-54; L. LOSS, FUNDAMENTALS, *supra* note 8, at 711-17; *see* Exchange Act Release No. 11,276, [1974-1975 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,129, at 85,153-54 (March 5, 1975) (criticism of regulation).

different price was lower.³²⁶ "The primary purpose of [the rule] is to prevent manipulative sales of a security for the purpose of accelerating a decline in the price of such security."³²⁷ Thus it distinguishes among short sales not on the basis of their information content but on the basis of their likely pressure effects on prices.

It may be possible to characterize short sales, corners and concerted trading as deceptive. Despite the restrictive reading that the Court has given to the word deceptive in its Rule 10b-5 cases, it is fair to say that the federal securities laws generally, and section 10(b) in particular, have expanded the scope of the law of fraud.³²⁸ Perhaps the word deceptive is now broad enough to encompass any interference with the market.³²⁹ Since *Santa Fe*, many courts have characterized mismanagement, breaches of fiduciary duty and other misconduct as deceptive for the purposes of section 10(b).³³⁰ Concerted trading certainly deceives the public if there is some rule against it and if the public is entitled to assume that all trading is undertaken for legitimate reasons. But if the word deceptive is construed to include disruptive trading, it is being given a much broader construction than the Court, or for that matter almost anyone else, has given it.³³¹ To extend the word deceptive to encompass disruptive trading would seem to deprive it of any connotation of intentional wrongdoing.

Even if it is possible to characterize disruptive trading as deceptive, little is accomplished by doing so. Labeling trading that affects market prices as deceptive incorrectly characterizes the nature of

³²⁶ 17 C.F.R. § 240.10a-1; see also *supra* note 258 (proposed Rule 10b-21); cf. 17 C.F.R. § 240.10b-4 (short tendering).

³²⁷ Exchange Act Release No. 20,715 [1983-1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,504, at 86,663 (March 6, 1984).

³²⁸ Ruder, *supra* note 10, at 651.

³²⁹ See 6 L. LOSS, SECURITIES REGULATION, *supra* note 8, at 3757 (Supp. 1969) (London Stock Exchange rule forbidding members to promote a false market and defining a false market as one in which prices are moved to a level not justified by assets, earnings or prospects); Legislation, *supra* note 236, at 121 (The Act adopts "the view that transactions to the public."); see Berle (1938), *supra* note 88.

³³⁰ *E.g.* United States v. Carpenter, 791 F.2d 1024 (2d Cir. 1986), *aff'd*, 108 S.Ct. 316 (1987) (securities law aspect of the Second Circuit decision affirmed by equally divided court without discussion); Goldberg v. Meridor, 567 F.2d 209 (2d Cir. 1977), *cert. denied*, 434 U.S. 1069 (1978). See R. JENNINGS & H. MARSH, *supra* note 62, at 1087-92.

³³¹ There has been substantial resistance to extending the law or morality of honesty to people taking advantage of others' mistakes or ignorance, see C. FRIED, CONTRACT AS PROMISE 77-88 (1981), and there seems little predicate for requiring traders to concern themselves with the reactions of unrelated strangers with whom they do not propose to deal.

the problem, which is that prices are out of line with those that prevailed immediately before the trades and with those that may prevail again immediately after the trades. If program trading is objectionable it is not because it deceives anybody, but because it produces damaging dislocations. Supporting the price of a security in order to trigger a contractual right is wrong because it takes advantage of a rule, not because it misleads anyone about the market value of a security. The injured party is affected by the price change, but it does not act in reliance upon the price created by the trader; it is already obligated to act.

The real problem with concerted trading that influences prices is that regardless of the trader's motivation, it may undermine the proper functioning of the market and injure people who are not even trading and who have no reason to look at security prices at all. Concerted trading is inappropriate because it manipulates market prices away from the prices that would prevail if the market worked perfectly or if all market participants traded for reasons and in manners considered appropriate.

CONCLUSION

Section 2 of the Act states that the public interest makes it necessary to provide complete and effective regulation and control of the transactions conducted on securities markets and related matters. The specific provisions of the Act regulate communications, corporate managers and trading practices, toward the end of protecting the public interest in these markets. Section 10(b) is the provision that insures that federal regulation and control of the securities markets is complete.

The SEC's authority to regulate the use of manipulative devices and contrivances under section 10(b) extends to all practices that contribute to disorder in the market or that give voice to speculative sentiment there. This may not be a satisfactory statement of administrative authority, but it is one indicated by the scheme of the statute.³³² It is also the one indicated by a fair reading of the language

³³² One of the first attempts to explore the purposes of federal stock exchange regulation and to give meaning to the SEC's rule-making authority under the Act reached much the same conclusion.

The problems with which stock market regulation has had to cope were [in 1934] too new and too little understood. But there appear to be a few . . . principles permeating Federal legislation and regulation of the security markets which if clearly recognized and consistently applied may do much to lend a certain clarity and directness to the course of stock market regulation

of section 10(b), for in common usage, manipulation clearly encompasses more than deception.³³³

Rule 10b-5 has gotten out of hand. Surely Congress did not intend a rule to eclipse the statute. Denying private parties the right to challenge violations of the rule in court would help restore balance to the statutory scheme, but that avenue is no longer open. Perhaps the SEC has been so irresponsible in its rule-making that Congress or the courts should step in. There are limits on the SEC's authority under section 10(b). A rule does not even bring section 10(b) into play unless the SEC has prescribed it as "necessary or appropriate in the public interest or for the protection of investors." Presumably the SEC cannot regulate manipulative practices under section 10(b) if Congress has itself regulated them in other parts of the Act. Perhaps Congress simply delegated too much power to the SEC.

These limitations do not depend on the meaning of the phrase "manipulative or deceptive device or contrivance." They are of the general nature of limits under which any administrative agency operates when it promulgates rules.³³⁴ The Court has not even considered these administrative law grounds as a basis for limiting the scope of Rule 10(b)-5. It has never said that the SEC has misused the power Congress granted it in section 10(b), nor has it said that Congress acted improperly in delegating that power. Instead, it has said that Congress only authorized the SEC to regulate deception. In this the Court has overreached. The language and statutory context of section 10(b) indicate that the SEC may regulate almost any conduct that influences security prices. The Court has found other-

Woven persistently through the whole fabric of Federal regulation are the two basic aims of Congress, namely that stock markets should be "fair" and that they should be "orderly."

.....

What Congress had in mind in its references to an orderly market is not entirely obvious. Clearly, it was intended in some way to represent a market which was free from "excessive speculation"

R. VERNON, *THE REGULATION OF STOCK EXCHANGE MEMBERS* 132-34 (1941) (footnote omitted); see also *TWENTIETH CENTURY FUND, INC.*, *supra* note 12, at 444 (defining manipulation for purposes of its discussion).

³³³ Fiftis, *supra* note 74, at 314-15. Manipulation seems to mean any skillful treatment of the environment toward some end. Even when it has a negative connotation it encompasses the use of force in addition to the use of deception. See, e.g., F. HAYEK, *THE CONSTITUTION OF LIBERTY* 143-44 (1960), quoted in Poser, *supra* note 10, at 686 n.85 ("Deception, like coercion, is a form of manipulating the data on which a person counts, in order to make him do what the deceiver wants him to do. Where it is successful, the deceived becomes in the same manner the unwilling tool.").

³³⁴ Manne, *supra* note 10, criticizes Rule 10b-5 in terms of administrative law.

wise on the basis of nothing more than a flawed vision of the fundamental purpose of the Act.