

attorneys represent different sides of a legal issue to one where an attorney openly represents adverse interests.

### III. CONCLUSION

When a law firm recommends poison pill plans for one client then challenges the constitutionality of like poison pills for another client, the attorneys effectively question the constitutionality of their own advice. Consequently, to avoid any ethical dilemma, attorneys who provide planning or drafting services should abstain from challenging the constitutionality of antitakeover plans substantially similar to those they have previously recommended.

*Catherine R. Phillips*

## THE IMPACT OF THE SEC'S CASES AGAINST LEVINE AND BOESKY ON THE ACTIVITIES OF INVESTMENT BANKERS AND ARBITRAGEURS

The Securities and Exchange Commission's recent, highly publicized allegations of insider trading against Dennis Levine, Ivan Boesky, and others announced to Wall Street intensified SEC enforcement of insider trading sanctions against many professionals in the heart of the Wall Street community. Reactions to these cases form a wide spectrum of views. Some commentators applaud the crackdown on insider trading.<sup>1</sup> Others believe the SEC has gone too far.<sup>2</sup> Many investment bankers and

---

1. Glaberson, *The SEC's Message to the Market on Insider Trading*, BUS. WK., June 9, 1986, at 83 (commentary praising the SEC for finally attacking the heart of information abuse); Laderman, *The Epidemic of Insider Trading*, BUS. WK., April 29, 1985, at 79-92 (although an overzealous SEC could impair routine information gathering, vigorous enforcement effort against insider trading is needed).

2. See, e.g., Macey, *SEC Vigilant on Insider Trading—But Is It Within Law?*, WALL ST. J., May 28, 1986, at p. 34, col. 3; Seligman, *Is Dennis a Menace?*, FORTUNE, June 23, 1986, at 127 (criticizing the SEC for failing to show how the investing public was hurt); Steward, *SEC Insider Trading Case Could Clog Pipeline Between Bankers, Arbitrators*, WALL ST. J., May 19, 1986, at p.3, col. 2; *The SEC v. Wall Street*, WALL ST. J., May 28, 1986, at p. 32, col. 1 (criticizing the SEC's view that the purpose of regulating the security markets is to ensure an honest crap game and charging that Wall

arbitrageurs<sup>3</sup> fear they may become the next targets of the SEC's crack-down on insider trading.<sup>4</sup>

This Recent Development analyzes the SEC complaints against Levine and Boesky in light of *Chiarella v. United States*<sup>5</sup> and *Dirks v. SEC*,<sup>6</sup> two Supreme Court decisions limiting the scope of the insider trading laws. This comparison shows that, on the one hand, these initial fears may exaggerate the actions of the SEC. Although aspects of the complaints appear to ignore *Chiarella* and *Dirks*, the cases against Levine and Boesky ultimately fit squarely within these Supreme Court rulings.

On the other hand, the mere fact that the SEC has sought to enforce the insider trading sanctions against these Wall Street insiders has some independent significance. Coupled with the SEC's apparent attempt to extend the insider trading laws, these prosecutions will have a chilling effect on the activities of arbitrageurs and investment bankers.<sup>7</sup> Some evidence of this effect already has surfaced.<sup>8</sup> Thus, this Recent Development discusses the potential effect of the Levine and Boesky cases on these activities.

---

Street will not be able to discharge its economic function if no one of substance can buy or sell stock without consulting a lawyer).

3. Arbitrageurs, "arbs" in market jargon, are professional speculators. In part, arbs invest in the shares of companies that announce significant corporate transactions, such as tender offers, mergers, bankruptcies, liquidations, and restructurings. In doing so, they absorb risk that individual shareholders are unwilling to assume. For example, upon the announcement of a hostile tender offer arbs will often purchase large blocks of stock in the target company. Shareholders sell their shares to the arbs at a price somewhere between the pre-existing market price and the tender offer price to transfer the risk that the offer will fail to the arbs. These activities help to stabilize market prices in the face of substantial uncertainty. See generally Cole, *Arbitrageurs Face the Spotlight*, N.Y. Times, November 17, 1986, at p. Y21, col. 3; Laderman, *Are the 'Arbs' Too Cosy with Insiders?*, BUS. WK., June 16, 1986, at 33-34.

4. See, e.g., Bianco, *Wall Street's Frantic Push To Clean Up Its Act*, BUS. WK., June 9, 1986, at 82-83; Cole, *supra* note 3; Laderman, *supra* note 3; Monroe & Leefeldt, *Inside Trading Case Appears to Clamp Wall Street Gossip: Arbitrators Are Speculating Not on Takeover Plays, But on SEC's Next Move*, Wall St. J., May 21, 1986, at p. 2, col. 3.

5. 445 U.S. 222 (1980).

6. 463 U.S. 646 (1983).

7. See, e.g., Alpert, *Uneasy Street, Guilty Pleas to Spark New Insider Charges*, BARRONS, June 9, 1986, at 16; Bianco, *supra* note 4; Monroe & Leefeldt, *supra* note 4; *The SEC v. Wall Street*, *supra* note 2.

8. See Monroe & Leefeldt, *supra* note 4.

## I. THE PROHIBITION OF INSIDER TRADING UNDER THE SECURITIES EXCHANGE ACT OF 1934—*Chiarella* and *Dirks*

Courts have interpreted rule 10b-5,<sup>9</sup> promulgated by the SEC pursuant to statutory authority under section 10(b) of the Securities Exchange Act of 1934,<sup>10</sup> to embody an alternative duty to disclose material nonpublic information or refrain from trading until such information becomes public.<sup>11</sup> In the 1960's and 1970's, some courts greatly expanded the scope of rule 10b-5, imposing a duty to disclose or abstain upon any person possessing material nonpublic information.<sup>12</sup> In *Chiarella* and *Dirks*, however, the Supreme Court restricted the class of persons subject to liability for insider trading.

In *Chiarella v. United States*<sup>13</sup> the Court reversed the conviction of a printing firm's employee who, while printing takeover bid announcements, deciphered the secret identity of the target corporations and reaped great profits trading in their securities. The duty to disclose or abstain, the Court held, applies only to persons owing an independent duty to disclose to the selling shareholders.<sup>14</sup> Unlike corporate insiders who have a fiduciary duty to shareholders, *Chiarella* was a "complete stranger."<sup>15</sup> He owed no duty to selling shareholders.

*Dirks v. SEC*<sup>16</sup> further narrowed the scope of rule 10b-5. In *Dirks*, Secrest, a former officer of Equity Funding Corporation of America

---

9. 17 C.F.R. § 240.10b-5 (1986).

10. 15 U.S.C. § 10(b) (1982).

11. See SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968), cert. denied, 394 U.S. 976 (1969); Cady, Roberts & Co., 40 S.E.C. 907 (1961). For a brief description of the development of rule 10b-5 as applied to insider trading prior to *Chiarella* and *Dirks*, see Case Comment, *Tippee Liability Under Rule 10b-5 Predicated on Whether Tippee Tips to Secure Personal Benefit*, 62 WASH. U.L.Q. 165, 166-71 (1984).

In the tender offer context, rule 14e-3, 17 C.F.R. § 240.14e-3 (1986), promulgated by the SEC pursuant to statutory authority under section 14(e) of the 1934 Act, 15 U.S.C. § 14(e) (1982), purports to expand the insider trading prohibitions beyond those provided in rule 10b-5 as limited by *Chiarella* and *Dirks*. Rule 14e-3 prohibits trading by any person possessing material information relating to a tender offer, if that person "knows or has reason to know it has been acquired directly from" the offeror, the target corporation, or any "officer, director, partner or employer or any other person acting on behalf of the" offeror or target. 17 C.F.R. at § 240.14e-3(a) (1986). Although rule 14e-3 has yet to be challenged in the courts, in view of *Chiarella* and *Dirks* commentators question the authority of the SEC to promulgate the rule.

12. See, e.g., *Schapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 495 F.2d 228 (2d Cir. 1974); *Texas Gulf Sulphur*, 401 F.2d at 833.

13. 445 U.S. 222 (1980).

14. *Id.* at 231-35.

15. 445 U.S. at 232-33.

16. 463 U.S. 646 (1983).

tipped Dirks, an investment analyst, as to the fraudulent activities of the company. Dirks, in turn, exposed the fraud, but not before tipping his institutional clients who sold a substantial portion of their holdings of Equity Funding shares. The Court reversed the SEC's censure of Dirks, holding that a tippee's duty to disclose or abstain derives from the duty of a tipper to disclose or abstain.<sup>17</sup> A tippee acquires a duty to disclose or abstain only when he knew or should have known that the tipper breached his duty to the selling shareholders under *Chiarella*.<sup>18</sup> The Court further held that a tipper breaches this duty only when he benefits personally from the disclosure.<sup>19</sup> Because Secrest intended only to expose the fraud,<sup>20</sup> he breached no fiduciary duty. Dirks, consequently, derived no duty to disclose or abstain.

In footnote 14 of the opinion, however, the Court expanded the traditional definition of "insiders." When corporate officials reveal inside information legitimately to "professionals," the Court stated, these outsiders may become fiduciaries of the shareholders, "temporary insiders," subject to the rule 10b-5 duty to disclose or abstain.<sup>21</sup> The Court sought to limit this theory to situations in which the corporation expects, and the relationship implies, that the information is to be kept confidential.<sup>22</sup> But some lower federal courts have interpreted broadly the concept of a "temporary insider."<sup>23</sup>

---

17. *Id.* at 659.

18. *Id.* at 660-61.

19. *Id.* at 661-64.

20. *Id.* at 648-49.

21. *Id.* at 655 n.14.

22. The basis for recognizing this fiduciary duty is not simply that such persons acquired nonpublic corporate information, but rather that they have entered into a special confidential relationship in the conduct of the business of the enterprise and are given access to information solely for corporate purposes.

*Id.*; see also Note, *Dirks v. SEC's Footnote Fourteen: Horizontal and Vertical Reach*, 62 WASH. U.L.Q. 477 (1984) ("[Footnote fourteen] covers only those persons with preexisting duties to the issuer's shareholders and, derivatively, those persons who misappropriate inside information from corporate fiduciaries.").

23. See, e.g., *SEC v. Lund*, 570 F. Supp. 1397 (C.D. Cal. 1983). Lund was the Chief Executive Officer of Verit Industries. When Horowitz, the chief executive of P & F Industries, Inc., entered into negotiations with another company concerning a joint venture with P & F, he asked Lund if Verit would be interested in providing capital for the venture. Lund traded on this information before P & F disclosed the venture. The court held that Lund had become a temporary insider of P & F.

## II. THE SEC'S CASES AGAINST LEVINE AND BOESKY

Beginning in May 1986 the SEC filed a series of civil complaints against several Wall Street insiders in the United States District Court for the Southern District of New York. In addition to injunctive relief the SEC sought civil penalties under the Insider Trading Sanctions Act of 1984 in the amount of three times the profits made upon their insider trading.<sup>24</sup> The complaints also formed the basis for criminal charges against the same individuals. Taken together the complaints allege a network of investment bankers and lawyers who obtained, apparently in the course of their employment, information concerning extraordinary corporate transactions.<sup>25</sup> Those named in the complaints allegedly traded upon the information themselves or provided (and sometimes sold) the information to others who either traded upon or passed along the information to others.<sup>26</sup> The central figure in each case was Dennis Levine.

At the time the SEC filed its complaint against him, Levine was a managing director, and apparent co-head of the Merger and Acquisition Department, of Drexel Burnham Lambert, Inc.<sup>27</sup> The SEC complaint against Levine alleged that, over approximately five years, he reaped \$12.6 million in profits trading in the shares of 54 companies on the basis of nonpublic information concerning possible mergers, tender offers, leveraged buy-outs, recapitalizations, and other extraordinary corporate

---

24. 15 U.S.C. § 78u(d)(2)(a) (1982).

25. See Complaint for Injunctive and Other Equitable Relief at 5-6, *SEC v. Brown*, No. 86-7774 (S.D.N.Y. Oct. 9, 1986) [hereinafter cited as *Brown Complaint*]; Complaint for Injunctive and Other Equitable Relief at 6, *SEC v. Reich*, No. 86-7775 (S.D.N.Y. Oct. 9, 1986) [hereinafter cited as *Reich Complaint*]. The SEC alleged that David S. Brown, an investment banker with Goldman, Sachs & Co., and Ilan K. Reich, an attorney with Wachtell, Lipton, Rosen & Katz, traded upon information about certain corporate transactions obtained while employed in their respective capacities by one of the parties to the transaction.

26. See Complaint for Injunctive and Other Equitable Relief at 3-4, *SEC v. Boesky*, No. 86-8767 (S.D.N.Y. Nov. 14, 1986) [hereinafter cited as *Boesky Complaint*]; *Brown Complaint*, *supra* note 25, at 6-7; *Reich Complaint*, *supra* note 25, at 5-6. Brown disclosed information to Ira B. Sokolow, an investment banker for Lehman Brothers Kuhn Loeb Inc. and its successor Shearson/Lehman American Express, who allegedly sold this information to Levine. Reich disclosed the information he received directly to Levine. Levine allegedly then passed the information along to Robert M. Wilkis, an investment banker with Lazard Freres & Co. and E.F. Hutton & Co., who allegedly also provided Levine inside information, and to Boesky. Wilkis and Boesky then allegedly traded upon the information.

27. Complaint for Injunctive and Other Equitable Relief at 3, *SEC v. Levine*, No. 86-3726 (S.D.N.Y. May 12, 1986) [hereinafter cited as *Levine Complaint*]. Prior to joining Drexel, Levine was employed by Smith Barney Harris Upham & Co. and Lehman Brothers Kuhn Loeb Inc. and its successor Shearson/Lehman American Express.

transactions.<sup>28</sup> Levine often learned of these impending transactions as the investment banker representing one of the corporations involved.<sup>29</sup> Several of the transactions, however, involved companies having no direct relationship with Levine or his investment bank.<sup>30</sup> Levine learned of these transactions, the complaint alleged, "under circumstances in which he knew or should have known that he obtained the information through misappropriation or a breach of a fiduciary duty or other relationship of trust and confidence or other wrongful acts."<sup>31</sup> Levine settled with the SEC promising to surrender \$11.6 million in profits and to cooperate with further investigations.<sup>32</sup> A federal district court judge subsequently sentenced Levine on criminal charges to two years in prison.<sup>33</sup>

Levine's cooperation led to an even bigger case involving "the" arbitrageur on Wall Street, Ivan F. Boesky. The complaint against Boesky alleged that Boesky traded on the basis of information tipped to him by Levine.<sup>34</sup> Initially, the complaint alleged, Levine provided this information "to cultivate a relationship with" Boesky.<sup>35</sup> The complaint stated, however, that Boesky later agreed to compensate Levine. According to the SEC, Boesky agreed to pay Levine five percent of his trading profits when Levine provided information leading to Boesky's initial decision to purchase securities and one percent of his profits when Levine provided information prompting Boesky "to hold or increase his holdings of a spe-

---

28. See *id.* at 17-21. To hide his trading Levine allegedly traded through a foreign financial institution located in the Bahamas in an account in the names of two Panamanian corporations he created to advance the scheme. He also used the alias, Mr. Diamond. Moreover, after the SEC uncovered Levine's trading, Levine allegedly sought to cover up his trading by perjuring himself before the SEC, having documents at the Bahamian institution destroyed, transferring assets between accounts in the Bahamian institution, and further attempting to secret those assets to a bank in Cayman Islands. *Id.* at 22-25.

29. See *id.* at 6-7.

30. See Declaration of Leonard W. Wang in Support of Plaintiff's Application for a Temporary Restraining Order, Order to Show Cause, Order Freezing Assets, Order for an Accounting, Order to Transfer Assets, Order for Expedited Discovery, Order for Substituted Service and an Order Preventing Document Alteration or Destruction at 15-18, SEC v. Levine, No. 86-3726 (S.D.N.Y. May 11, 1986) [hereinafter cited as Declaration of Wang].

31. Levine Complaint, *supra* note 27, at 15. With respect to these transactions, the SEC relied simply on "statements Levine made and actions he initiated [that] evidence that he had knowledge of material nonpublic information." See Declaration of Wang, *supra* note 30, at 15. The SEC, in subsequent cases, alleged that Levine "purchased" at least some of this information from and through other investment bankers. See *supra* note 26 and accompanying text.

32. See Alpert, *supra* note 7.

33. See *Levine Sentenced*, Wall St. J., February 20, 1987, at p. 1, col. 6.

34. See *supra* note 25.

35. Boesky Complaint, *supra* note 26, at 4.

cific security.”<sup>36</sup> The SEC acknowledged that at no time, did Levine disclose, or Boesky ever learn of, Levine’s sources.<sup>37</sup> Nevertheless, citing the alleged agreement, the SEC asserted that Boesky “knew or had reason to know, or acted in reckless disregard of the fact, that the information was confidential and had been obtained through misappropriation or a breach of a fiduciary duty or other relationship of trust and confidence.”<sup>38</sup> Boesky, as Levine, settled with the SEC. He agreed to disgorge \$50 million in profits and to pay another \$50 million as a civil penalty.<sup>39</sup>

### III. ANALYSIS

Ultimately, the SEC’s cases against Levine and Boesky should raise few objections. To establish insider trading liability against Levine, the SEC could point to several instances of trading in securities of companies which had employed Levine himself, or his employer, as an investment banker in the underlying corporate transaction.<sup>40</sup> Indeed, all of the transactions detailed in the complaint involved such instances.<sup>41</sup> With respect to these transactions, Levine clearly became a “temporary insider.” Under the Supreme Court’s analysis in footnote 14 of *Dirks*, he thus acquired a duty to disclose or abstain.

The SEC also identified trading in securities of companies which had no relationship with either Levine or his employer. These transactions present conceptual difficulties not present in Levine’s trading of the shares of his clients. The complaint, for example, detailed Levine’s alleged transactions in shares of American Natural Resources Co. (ANR). At the time of these transactions, Levine was acting as an investment banker for Coastal Corp. in its takeover bid for ANR.<sup>42</sup> As an agent of the acquiring firm Levine was under no duty to the selling shareholders. He, therefore, acquired no duty to disclose or abstain under *Chiarella*.<sup>43</sup>

In attacking these transactions, the SEC apparently relied upon the

---

36. *Id.* at 4-5. The SEC alleged that Boesky agreed to pay Levine \$2.4 million under the arrangement, but that Levine’s arrest prevented payment. *Id.* at 5.

37. *Id.* at 4.

38. *Id.* at 3.

39. See Final Judgment of Permanent Injunction and Other Equitable Relief as to Ivan F. Boesky at 6-7, SEC v. Boesky, No. 86-8767 (S.D.N.Y. Nov. 14, 1986).

40. Levine Complaint, *supra* note 27, at 9-13.

41. See Levine Complaint, *supra* note 27, at 9-15.

42. See Levine Complaint, *supra* note 27, at 13-15.

43. Cf. *Chiarella*, 445 U.S. at 237-38 (Stevens, J., concurring).

“misappropriation” theory of insider trading liability.<sup>44</sup> Misappropriation theory contemplates liability for insider trading when persons improperly obtain nonpublic information and use it contrary to the interests of its owners.<sup>45</sup> If, for example, Levine traded in shares of ANR upon confidential information obtained from Coastal, misappropriation theory maintains that his actions operated to defraud Coastal’s shareholders, the owners of the information concerning Coastal’s takeover bid, in violation of rule 10b-5.<sup>46</sup> The full Supreme Court refused to consider the misappropriation theory in the *Chiarella* case.<sup>47</sup> The Second Circuit subsequently reaffirmed, and the Supreme Court has agreed to consider, the application of misappropriation theory in criminal cases.<sup>48</sup> Misappropriation theory seems equally applicable to civil actions brought by the SEC, at least, as in this case, when the civil action forms the basis for criminal charges.

From Levine’s alleged breach of confidence, the SEC alleged, Boesky derived a duty to disclose or abstain under the *Dirks* analysis. The complaint alleges that Boesky had reason to believe that Levine acquired the information in violation of a duty to his clients and/or employer. Under the profit-sharing arrangement between Levine and Boesky, Levine clearly would have benefitted personally from his breach of duty. Thus, at least with respect to trading upon information about transactions involving companies with a relationship to Levine or his investment bank,

---

44. See Memorandum in Support of Plaintiff’s Application for a Temporary Restraining Order, an Order to Show Cause Why a Preliminary Injunction Should Not Be Entered, an Order Freezing the Assets of the Defendants, an Order for Transfer of Assets, an Order for an Accounting, an Order for Substituted Service, an Order for Expedited Discovery and an Order Preventing Document Alteration or Destruction at 14-17, SEC v. Levine, No. 86-3726 (S.D.N.Y. May 11, 1986) [hereinafter cited as Levine Memorandum].

The SEC also relied upon rule 14e-3 which avoids the limitations of *Chiarella* and *Dirks*. See *supra* note 11. To the extent that rule 14e-3 is valid, then with respect to transactions involving shares of companies involved in a tender offer, the SEC would be relieved of relying on misappropriation theory.

45. See *Chiarella*, 463 U.S. at 239-43 (Burger, C.J., dissenting).

46. Cf. *id.* at 235-36.

47. The Court refused to address the Government’s arguments based upon the misappropriation theory because it failed to submit the issue to the jury. *Id.* at 236-37. Chief Justice Burger in dissent adopted this theory. *Id.* at 239-43; see also *id.* at 238 (Stevens, J., concurring) (noting that “[r]espectable arguments could be made in support of either position” with respect to the appropriateness of applying misappropriation theory).

48. See *United States v. Carpenter*, 791 F.2d 1024 (2d Cir.), cert. granted, 107 S. Ct. 666 (1986); see also SEC v. *Materia*, 745 F.2d 197 (2d Cir. 1984), cert. denied, 471 U.S. 1053 (1985). The Second Circuit, however, has refused to apply misappropriation theory in private actions. See *Moss v. Morgan Stanley*, 104 S. Ct. 1280 (1984).

the SEC's complaints against both Levine and Boesky sufficiently allege violations of rule 10b-5.

The allegations of insider trading with respect to transactions involving companies unrelated to either Levine or his employer, however, present more difficult issues. In contrast to the detailed account of Levine's transactions in the securities of companies represented by Levine or his employer,<sup>49</sup> the complaint discloses little of the SEC's theory with respect to trading in securities of these unrelated companies. It states only that Levine knew or should have known that he obtained the information through misappropriation or breach of fiduciary duty.<sup>50</sup> It fails to develop any facts upon which liability could be premised under *Dirks*.

The SEC, in subsequent cases, alleged that Levine obtained, and often purchased, this information from and through other investment bankers.<sup>51</sup> Yet even these facts would not necessarily establish Levine's liability under *Dirks*. Indeed, this criticism applies equally to the complaint against Boesky. To establish Boesky's knowledge of Levine's alleged breach of confidence, the SEC relied exclusively upon the existence of the profit-sharing agreement between Boesky and Levine.<sup>52</sup> From this factual allegation one could infer that Boesky knew Levine (or Levine's sources) misappropriated the information or otherwise breached a duty to the selling shareholders. Alternatively, based upon the inner workings of Wall Street,<sup>53</sup> one could infer that, despite his agreement to share profits, Boesky believed Levine obtained the information legitimately.

In the context of the Levine and Boesky cases, these shortcomings likely did little harm. As noted above, the allegations against Levine clearly are sufficient to establish insider trading liability. As to Boesky and the more troublesome aspects of the complaint against Levine, the SEC satisfied the requirements of a well-pleaded complaint.<sup>54</sup> The SEC might well have established the necessary factual premises at trial.

Evaluating the SEC's actions only in relation to the Levine and Boesky cases, however, ignores the effect the SEC's *complaints* could have upon activities of investment bankers and arbitrageurs. The SEC's actions

---

49. See Levine Complaint, *supra* note 27, at 9-15.

50. See *supra* text accompanying note 31.

51. See *supra* notes 24-25 and accompanying text.

52. See *supra* text accompanying note 36.

53. See *infra* notes 55-56 and accompanying text.

54. See FED. R. CIV. P. 12.

could seriously undermine the salubrious role of investment bankers and arbitrageurs in the capital markets.

By absorbing risk that inheres in the market, arbitrageurs and investment bankers help maintain orderly markets.<sup>55</sup> In order to fulfill this function, they participate in sophisticated information networks which often include lawyers, corporate executives and investment bankers.<sup>56</sup> This network, as the Levine and Boesky cases illustrate, provides access to, and potential abuse of, inside information. Much of the information that flows through this network, however, may be obtained through legitimate activities. Investment bankers and arbitrageurs routinely develop and decipher, utilize and share information about corporate transactions.<sup>57</sup> The line between legitimately obtained information and inside information may be quite fine.

The mere fact that the SEC has penetrated the Wall Street network undoubtedly will impair the flow of information between investment bankers and arbitrageurs.<sup>58</sup> But the SEC's willingness to prosecute Wall Street insiders without sufficient factual support ensure that the Levine and Boesky cases will have a much broader impact. Coupled with the SEC's ability to direct public attention, thereby extracting a high price—in terms of settlements<sup>59</sup> and damage to reputations—and perhaps forestalling resistance to its complaints, the complaints against Levine and Boesky create an unhealthy fear of SEC prosecution. This fear may unduly hinder the flow of information between investment bankers and arbitrageurs.

#### IV. CONCLUSION

Although the cases against Levine and Boesky purport to rest upon sound legal principles, the SEC should more clearly limit its enforcement actions than it has in the Levine and Boesky cases.<sup>60</sup> *Chiarella* and *Dirks* can serve to balance the need to regulate insider trading to preserve the

---

55. See *supra* note 3.

56. See Laderman, *supra* note 3, at 32.

57. Investment bankers and arbitrageurs specialize in identifying possible acquisition targets. Arbitrageurs use this information to speculate in stocks of target corporations. Investment bankers might use the same information to propose deals to potential clients.

58. Cf. *supra* note 8 and accompanying text.

59. See *supra* notes 31 & 38 and accompanying text.

60. See, e.g., Bluestein, *Disputes Arise Over Value of Laws on Insider Trading*, Wall St. J., November 17, 1986, at p. 14, col 5; Ingersoll, *Political Pressure Growing to Stem Trading Excesses*, Wall St. J., November 17, 1986, at p. 15, col. 5; Laderman, *supra* note 3.

integrity of the markets, on the one hand, and the useful function of Wall Street professionals, on the other. In the absence of a clear breach of confidence to an employer or client, the SEC should proceed cautiously. Moreover, the SEC should seek tippee liability only when it can clearly establish knowledge by a tippee of a breach of such confidence. An over-zealous enforcement policy can impede the free flow of information necessary to creating more efficient markets.<sup>61</sup>

*Christine M. Ramatowski*

## THE WILLIAMS ACT AND PREEMPTION OF SECOND GENERATION STATE TAKEOVER LEGISLATION

In 1982, in *Edgar v. MITE Corp.*,<sup>1</sup> the United States Supreme Court declared unconstitutional the Illinois Business Takeover Act.<sup>2</sup> A majority of the Court found that the statute impermissibly burdened interstate commerce.<sup>3</sup> Three justices argued further that the Williams Act,<sup>4</sup> the principal federal legislation regulating corporate takeovers, preempted the Illinois act.<sup>5</sup> Two justices disagreed, interpreting the Williams Act to leave some room for state regulation of corporate takeovers.<sup>6</sup>

---

61. See *The SEC v. Wall Street*, *supra* note 2; *but cf.* Laderman, *supra* note 1.

1. 457 U.S. 624 (1982).

2. ILL. REV. STAT. ch. 121½, § 137.51 *et seq.* (1979). See *infra* notes 19-22 and accompanying text.

3. 457 U.S. at 643-46.

4. Pub. L. No. 90-439, 82 Stat. 454 (1968) (codified as amended at 15 U.S.C. §§ 78m(d)-(f), 78n(d)-(e) (1982)).

5. 457 U.S. at 620-40. Article VI, clause 2 of the United States Constitution provides that "the Laws of the United States . . . shall be the supreme Law of the Land . . . , any Thing in the Constitution or Laws of any state to the contrary notwithstanding." The Supreme Court has held that the supremacy clause invalidates not only state laws that conflict directly with the operation of federal law, but also state laws that conflict with the purposes of the federal law. See, e.g., *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 229-30 (1947).

6. Justice Powell found nothing in the Williams Act to suggest "a congressional intent to prohibit state legislation designed to assure—at least in some circumstances—greater protection to interests that include but often are broader than those of incumbent management." 457 U.S. at 646, 647 (Powell, J., concurring). Justice Stevens discerned no "prohibition against state legislation