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SAVE MARTHA STEWART? OBSERVATIONS ABOUT EQUAL JUSTICE IN U.S. INSIDER TRADING REGULATION

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I. Introduction

Martha Stewart[1] is the subject of a civil enforcement action alleging violations of U.S. securities laws and regulations governing insider trading.[2] This, in and of itself, is not remarkable. Many rich and powerful

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1. Although for many readers she may need no introduction, Martha Stewart is a director and the former Chief Executive Officer of Martha Stewart Omnimedia, Inc., a public company built around Stewart's ideas for home decorating, cooking, gardening, crafts, and other domestic pursuits. Termed "domestic diva" and the like by the media (*see* sources cited *infra* note 77), Stewart's company, among other things, publishes a magazine (*Martha Stewart Living*), conducts catalog (*Martha Stewart: The Catalog for Living*, formerly known as *Martha by Mail*) and web-based (marthastewart.com) retail businesses, distributes a syndicated newspaper column and radio program (*Ask Martha*), produces a cable television program (*Martha Stewart Living*), and designs and promotes a line of home and garden products (Martha Stewart Everyday) sold through K-mart stores. *See* Annual Report on Form 10-K of Martha Stewart Omnimedia, Inc. for the fiscal year ended December 31, 2002, filed March 31, 2003, 2-8, *at* http://www.sec.gov/Archives/edgar/data/1091801/000095012303003695/y84713e10vk.htm. (last visited Nov. 3, 2003). The author is a subscriber to *Martha Stewart Living* magazine, has purchased *Martha by Mail* and Martha Stewart Everyday retail items, and owns several *Martha Stewart Living* books.

2. *See* SEC v. Martha Stewart, No. 03 CV 4070 (NRB) (S.D.N.Y. filed June 4, 2003), *available at* http://www.sec.gov/litigation/complaints/comp18169.htm [hereinafter SEC Complaint]. In a separate action brought the same day as this enforcement action, the United States Attorney for the Southern District of New York obtained a criminal indictment against Stewart regarding alleged false statements in connection with the same securities trading transactions. *See* U.S. v. Martha Stewart, No. 03 Cr. (S.D.N.Y. filed June 4, 2003), *available at* http://news.findlaw.com/nytimes/docs/mstewart/usmspb60403ind.pdf. The indictment did not charge Stewart with criminal insider trading violations. *See also* Alex Beam, *Brand Names That Stand the Test of Time*, BOSTON GLOBE, June 12, 2003, at D1 ("She wasn't indicted on insider-trading charges, after all, but on several lesser counts."); Michael P. Malloy, *The Spin She's In*, L.A. TIMES, June 11, 2003, Part 2, at 13 ("The criminal indictment doesn't charge her with insider trading."); *Martha Stewart Reacts to Charges*, CORP. OFFICERS AND DIR. LIABILITY LITIG. REP., June 30, 2003, at 13 ("Although the indictment does not specifically accuse Stewart of insider trading, it says she violated the anti-fraud provisions of federal securities law by issuing false statements regarding her stock sale to prevent the stock price of her company, Martha Stewart Living Omnimedia, from dropping."); Tom Petruno, *Insider Trading, Tough to Prove, Isn't Part of Stewart Criminal Case*, L.A. TIMES, June 5, 2003, Part 3, at 1; William Safire, *Fight It, Martha*, N.Y. TIMES, June 12, 2003, at A35 ("The U.S. Attorney has not accused her of the crime of insider trading."); *Some Surprised by Martha Stewart Charges, at* http://asia.news.yahoo.com/030606/ap/d7rgclto2.html (June 7, 2003) ("Still, prosecutors did not actually indict Stewart on the charge of insider trading, an extremely difficult charge to prove in a criminal case."). Stewart is also the subject of a number of class actions and other private civil suits asserting (among other things) trading on nonpublic information, a number of which expressly allege violations of U.S. insider trading laws and regulations. *See, e.g.*, *Cauley Geller Bowman & Coates, LLP Announces Martha Stewart Living Omnimedia, Inc. Investors Have Until October 7 to File Lead Plaintiff Motion–MSO*, Sept. 26, 2002, *at* http://biz.yahoo.com/pz/020926/32125.html (last visited Sept. 8, 2003); *Martha Stewart Class Action Filed*, CNN MONEY, *at* http://money.cnn.com/2003/02/04/news/companies/stewart_lawsuit/ (Feb. 4, 2003); *Martha Stewart Sued Over Big Stock Sale*, ST.

people—and many others in less financially and socially advantaged situations—have been pursued and brought to account for trading securities while in possession of material, nonpublic information. In these post-Enron times,[3] much of the public has become numb to the pain of new revelations of possible securities fraud, including insider trading. In this landscape, the Martha Stewart insider trading investigation (including the related insider trading proceeding) is just one of many examples.

Yet, the Martha Stewart investigation somehow seems different—out of proportion to its apparent financial magnitude.[4] The human and

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PETERSBURG TIMES ONLINE, Aug. 23, 2002, *available at* http://www.sptimes.com/2002/08/23/Business/Martha_Stewart_sued_o.shtml; Greg B. Smith, *Martha Hit with Suit*, N.Y. DAILY NEWS, Aug. 21, 2002, *available at* http://www.nydailynews.com/news/story/12783p-12099c.html. For ease of reference, these laws and regulations, together with applicable decisional law, are collectively referred to as "U.S. insider trading regulation" or "insider trading regulation in the United States."

3. The reference to "post-Enron times" may conjure images and emotions of many kinds and may mean different things to different readers. In this context, the term is intended merely to create a temporal setting for the reader and refers to the corporate and financial environment in the United States following the revelation by Enron Corp. and federal regulators of possible significant misstatements and omissions in Enron's financial disclosures to the public. This revelation and the related investigation proved to be the first of a number of highly publicized allegations of corporate fraud in connection with the public disclosure of material information by high profile corporations with publicly traded securities.

4. The *New York Post* reported that Martha Stewart's profit from the sale of her ImClone shares totaled $42,000. Lauren Barack et al., *Experts: Fraud Case Could Cost*, N.Y. POST, Oct. 23, 2002, at 33. The *Chicago Tribune* published an article asserting that Stewart avoided a trading loss of $36,500. *See* David Greising, *Out of Spotlight Maybe, But Still in Hot Water*, CHI. TRIB., Sept. 15, 2002, at C1. The complaint filed by the U.S. Securities and Exchange Commission asserts that Stewart avoided losses of $45,673. *See* SEC Complaint, *supra* note 2, at ¶ 19; *see also* Melana Zyla Vickers, *Small-Time Enforcement Costs Taxpayers Big Time*, USA TODAY, June 10, 2003, at 13A (noting that "Stewart is accused of pocketing $45,673 in insider-trading profits—small change compared with as much as $11 billion in inflated earnings that telecom giant WorldCom hoodwinked its investors into believing it had").

The apparent intensity and magnitude of the Martha Stewart insider trading investigation is, in part, a creation of the highly public nature of the investigative process in her case and the resulting media attention. *See* Rachel Beck, *Is Martha Stewart Case All That? Stock-Sale Scandal Involving the Domestic Doyenne Makes Headlines, But Is She Really Corporate Culprit No. 1?*, Oct. 29, 2002, *available at* http://ww.sunspot.net/business/bal-martha1029,0,5788812.story?coll=bal-business-indepth; *Crossfire: Is Martha Stewart a Scapegoat?* (CNN television broadcast, Sept. 9, 2002), transcript *available at* http://www.cnn.com/2002/ALLPOLITICS/09/09/cf.crossfire/ ("[A]ll of us in the media are just going to go wild with this and cover it, cover every moment of it . . . .") [hereinafter *Crossfire-Scapegoat*]; Larry Kudlow, *Martha's a Good Thing*, NAT'L REV. ONLINE, June 20, 2002, *at* http://www.nationalreview.com/kudlow/kudlow062002.asp; Jeffrey Toobin, *Fact: Annals of Law: Lunch at Martha's, Problems with the Perfect Life*, NEW YORKER, Feb. 3, 2003, at 38 ("As unpleasant as the insider-trading investigation has been, the coverage by the press—a cascade of ridicule and abuse—may have been harder to take."). This aspect of the Martha Stewart investigation may invoke, for some readers, memories of the highly

monetary resources that have been (and continue to be) deployed by the U.S. Congress in connection with possible lawmaking, the U.S. Securities and Exchange Commission (SEC), and the U.S. Department of Justice (DOJ)[5] in pursuing Martha Stewart seem vast when compared to the gross profit she made from her December 27, 2001 sale of approximately 4,000 shares of ImClone Systems Incorporated ("ImClone") common stock.[6] The facts, as we now know them,[7] suggest that the considerable governmental

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publicized tax evasion case against Leona Helmsley in the late 1980s. *See* Ann Mumford, *Leona Helmsley: The Construction of a Woman Tax Evader*, *in* FEMINIST LEGAL STUDIES (1997); Christopher Byron, *Imagine No Martha*, N.Y. POST, July 8, 2002, at 31. Tellingly, the entertainment industry is also jumping on the Martha Stewart bandwagon with a made-for-television piece, starring Cybill Shepherd as Stewart, that aired on NBC on May 19, 2003. *See* Terry Kelleher & Amy Bonawitz, *Cybill Shepherd Sounds Off*, PEOPLE, May 26, 2003, at 26; Dalton Ross, et al., *What to Watch*, ENT. WEEKLY, May 23, 2003, at 67; Tom Shales, *Martha Stewart, Done to Perfection*, WASH. POST, May 19, 2003, at C01; Jon W. Sparks, *Cybill's Crits Assess Her Martha*, COM. APPEAL (Memphis, TN), May 20, 2003, at C1.

5. *See* Alison Beard & Julie Earle, *Celebrities May Be Tip of Insider Trading Iceberg: Experts Say Illegal Activity Is Rampant But Limited Resources Mean That Prosecutions Remain Rare*, FIN. TIMES (London), June 20, 2002, at 25; Andrew Pollack, *Martha Stewart Questions Widen, Punishing the Stock*, N.Y. TIMES, June 27, 2002 (late ed.), at C2.

6. *See* SEC Complaint, *supra* note 2, at ¶ 19; Barack et al., *supra* note 4; Beck, *supra* note 4; Bradley W. Skolnik, *Is Justice Served by Martha Stewart Circus?*, INDIANAPOLIS STAR, June 8, 2003, at 3E ("Stewart does the 'perp walk' for a relatively modest $229,000 insider-trading case while the likes of Enron's Ken Lay, WorldCom's Bernard Ebbers, and the whole gang of corrupt stock analysts and investment bankers and centimillionaire Wall Street CEOs seems to be getting off largely with fines and civil penalties.").

7. Certain publicized facts regarding Martha Stewart's sale of ImClone common stock in December 2001 are important to an analysis of the bases of potential insider trading enforcement bias. A brief restatement of those facts, summarized from media accounts, is here in order.

On December 27, 2001, Martha Stewart sold 3,928 shares of ImClone common stock for approximately $227,824, or an average price of over $58 per share. *See* SEC Complaint, *supra* note 2, at ¶ 19; Kudlow, *supra* note 4; Dan Harris, *Good Morning America: "Trading Downward": E-mails and Phone Calls May Shed Light on Stewart's Dumping of ImClone Shares* (ABC television broadcast, Aug. 9, 2002) transcript *at* http://abcnews.go.com/sections/GMA/GoodMorningAmerica/GMA020809Stewart_Emails.html; David Wilson, *The Whys of Martha Stewart Selling*, BLOOMBERG NEWS, June 21, 2002, *at* http://www.bloomberg.com/feature/feature1024667880.html. Stewart had desired to dispose of these shares in a tender offer made by Bristol-Myers Squib Co. in November 2001, but that tender offer was oversubscribed, and her tender was prorated to exclude these 3,928 shares from the offer. *See* Kudlow, *supra* note 4; Wilson, *supra*. In a June 2002 letter to the House Energy and Commerce Committee and in earlier government interviews, Stewart explained that the stock transaction had been prompted by a prior arrangement with her stock broker that he would sell her stock when the market price fell below $60 per share. *See* SEC Complaint, *supra* note 2, at ¶ 23. There are also allegations, however, that Stewart had a telephone conversation with her broker on that day. *See* SEC Complaint, *supra* note 2, at ¶¶ 18–19; Harris, *supra*. After the close of the market on December 28, 2001, an ImClone press release announced that the FDA had denied regulatory approval of Erbitux, a key ImClone cancer drug under testing. *Id.* According to the SEC, at the close of trading

resources spent pursuing Martha Stewart result from an express decision to single her out for potential criminal prosecution or civil enforcement based on some characteristic or characteristics personal to her or to one or more groups of which she is an actual or perceived member. For example, one may conclude that she has been singled out for investigation because she is (1) a woman, (2) a member and financial supporter of the Democratic party, (3) a public figure, or (4) a combination of some or all of the foregoing—that is, a very visible and controversial female public figure with political interests adverse to those of the Bush administration.[8]

The selective or targeted use of government resources in investigating and bringing civil enforcement proceedings or prosecuting criminal actions is an accepted part of civil and criminal enforcement.[9] Those charged with

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on December 31, 2001, ImClone's common stock was trading at $46.00 per share. *See* SEC Complaint, *supra* note 2, at ¶ 14. By January 3, 2002, the closing price of ImClone's common stock had fallen to $41.27, and by January 10, 2002, the closing price of ImClone's common stock had fallen to $34.22. *See* historical stock prices for ImClone (symbol IMCL) *at* http://www.finance.yahoo.com (last visited Jan. 25, 2003).

8. *See* Beard & Earle, *supra* note 5 (characterizing the Martha Stewart investigation as "celebrity scandal"); Paul Begala & Tucker Carlson, *Crossfire: McAuliffe Slams Bush; Should UNC Teach Koran to Freshmen?* (CNN television broadcast, Aug. 12, 2002), *available at* LEXIS, News & Business Library, News Group File (referencing Martha Stewart's status as a celebrity and a member of the Democratic party) [hereinafter *Crossfire-McAuliffe*]; Gloria Borger, *Why Hate Martha?*, U.S. NEWS & WORLD REP., July 8, 2002, at 17 (contending that Martha Stewart is being pursued because she is a "high-profile woman"); Pat Buchanan et al., *Buchanan & Press: Is GOP Exploiting 9/11?* (MSNBC Aug. 12, 2002), *available at* LEXIS, News & Business Library, News Group File; Byron, *supra* note 4 (noting that defenders of Martha Stewart argue she is being "scapegoated by people who want to drive women out of business and back into the kitchen"); Patrice Hill, *Stewart a Top Donor to Democratic Coffers; Mogul Focus of Republican Probe*, WASH. TIMES, Aug. 21, 2002, at A01; *Crossfire-Scapegoat*, *supra* note 4 (referencing Martha Stewart's status as a celebrity and a member of the Democratic party); Holman W. Jenkins Jr., *An Autumnal Resolution: Give Martha a Break*, THE WALL ST. J., Sept. 4, 2002, at A23 (asserting that Congress pursued Martha Stewart "solely because she's a celebrity"); Kudlow, *supra* note 4 (referencing Martha Stewart's status as a member of the Democratic party); *Martha Stewart Case Reveals Double Standard, Libertarians Say*, *at* http://www.lp.org/press/archive.php?function=view&record=628 [hereinafter *Martha Stewart Case Reveals Double Standard*] (referencing political and celebrity status as possible differentiators) (last viewed on Aug. 26, 2003) (on file with TX. J. WOMEN & L.); Alexandra Stanley & Constance L. Hays, *Martha Stewart's To-Do List May Include Image Polishing*, N.Y. TIMES, June 23, 2002 (highlighting Martha Stewart's status as a "rich, powerful, and fair-haired business woman"); Greta Van Susteren, *Fox on the Record with Greta Van Susteren: Interview with Geoffrey Fieger, Michael Musto, Mike Norman* (Fox News Network television broadcast, Aug. 22, 2002), *available at* LEXIS, News & Business Library, News Group File (referencing Martha Stewart as a "powerful, aggressive woman" and her status as a member of the Democratic party).

9. *See* CHARLES H. WHITEBREAD & CHRISTOPHER SLOBOGIN, CRIMINAL PROCEDURE, AN ANALYSIS OF CASES AND CONCEPTS 545 (4th ed. 2000); Jeffrey J. Pokorak, *Probing the Capital Prosecutor's Perspective: Race of the Discretionary Actors*, 83 CORNELL L. REV. 1811, 1813 (1998) (describing the breadth of criminal prosecutorial discretion).

enforcing our laws must have evidence of a possible violation of those laws before they may begin the inquiry and investigation process. This type of information may be more available with respect to some people or classes of people than for others. Moreover, federal investigators have only limited resources available for use in pursuing possible violators.[10] Accordingly, each prosecutor or enforcement agent must pick and choose those against whom the laws within its jurisdiction will be enforced.[11] This enforcement discretion,[12] while broad, is subject to statutory, regulatory, and constitutional limits in certain cases.[13] Even validly exercised enforcement discretion, however, may tilt the enforcement playing field in directions that do not well serve the intended purpose of and policies underlying the applicable legal or regulatory scheme. Enforcement bias[14]

10. *See* WHITEBREAD & SLOBOGIN, *supra* note 9, at 547 (referencing a lack of attorney time and investigative and other resources as factors in the exercise of prosecutorial discretion); Richard M. Phillips, et al., *SEC Investigations: The Heart of SEC Enforcement Practice, in* THE SECURITIES ENFORCEMENT MANUAL, TACTICS AND STRATEGIES 35 (Richard M. Phillips ed., 1997); Beard & Earle, *supra* note 5 (quoting Professor Stephen Bainbridge as saying that the SEC and the DOJ "devote their limited resources to areas that are high profile"); William Hicks, *Securities Regulation: Challenges in the Decades Ahead*, 68 IND. L.J. 791, 807 (1993) ("Limited resources prevent the government from detecting and prosecuting all violations of the federal securities laws."); Harvey L. Pitt & Karen L. Shapiro, *Securities Regulation By Enforcement: A Look Ahead At the Next Decade*, 7 YALE J. ON REG. 149, 171 (1990) (identifying the SEC's limited resources as a reason for the careful targeting of enforcement activities); Skolnik, *supra* note 6 (noting that "federal resources to fight white-collar crime are stretched . . . thin, due in part to the need to divert resources to the war on terrorism").

11. *See* Pokorak, *supra* note 9, at 1813 (noting that "[l]imited resources and crowded criminal dockets force prosecutors to make quasi-judicial decisions . . . ").

12. The term "enforcement discretion" is used in this paper to refer broadly to the judgment permitted to be exercised by enforcement officials to determine whether to initiate criminal or civil investigations or proceedings against suspected violators of U.S. insider trading regulation. The more commonly used term, "prosecutorial discretion," while often used to convey the same meaning, may be more narrowly interpreted to apply only to criminal enforcement. *See, e.g.*, WHITEBREAD & SLOBOGIN, *supra* note 9, at 545 (assuming an application of the term in the criminal enforcement context only).

13. As a general matter, constitutional limits on enforcement discretion are few and narrowly interpreted. *See id.* at 550–62; Richard Bloom, *Twenty-Eighth Annual Review of Criminal Procedure: II. Preliminary Proceedings: Prosecutorial Discretion*, 87 GEO. L.J. 1267 (1999) (summarizing constitutional and other constraints on criminal prosecutorial discretion); P.S. Kane, Comment, *Why Have You Singled Me Out? The Use of Prosecutorial Discretion for Selective Prosecution*, 67 TUL. L. REV. 2293, 2303–05 (1993) (describing Equal Protection Clause limits placed on criminal prosecutorial discretion). Scholars and litigants have argued, however, that the criminal enforcement of U.S. insider trading regulation raises due process concerns. *See* SEC v. Willis, 777 F. Supp. 1165, 1173–74 (S.D.N.Y. 1991); Daniel J. Bacastow, *Due Process and Criminal Penalties Under Rule 10b-5: The Unconstitutionality and Inefficiency of Criminal Prosecutions for Insider Trading*, 73 J. CRIM. L. & CRIMINOLOGY 96 (1982); Jill E. Fisch, *Start Making Sense: An Analysis and Proposal for Insider Trading Regulation*, 26 GA. L. REV. 179, 181 (1991).

14. As used in this paper, the term "enforcement bias" refers to the conscious or

that does not favorably serve the intended purpose of or policies underlying the laws or regulations being enforced should be identified and eradicated.

The recent Congressional, SEC, and DOJ emphasis on securities fraud investigations, prosecutions, and civil and administrative enforcement actions (many of which include facts supporting insider trading allegations) has put U.S. insider trading regulation in the spotlight.[15] In this environment, important questions about selective enforcement[16] of insider trading violations remain unanswered. Among these questions is the extent to which the nature of U.S. insider trading regulation allows for selective enforcement and the introduction of enforcement bias based on the nature and composition of the enforcement body or the personal background or characteristics of the individual enforcement agents.[17] This question can be

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unconscious discriminatory use of enforcement discretion to the detriment or benefit of a particular person or group based on identifying characteristics that are not related to insider trading regulation or to its underlying policies. *See generally* Todd Lochner & Bruce E. Cain, *Equity and Efficacy in the Enforcement of Campaign Finance Laws*, 77 TEX. L. REV. 1891, 1929–30 (1999) (using the term similarly to describe the relationship between comparative economic and other campaign resource deficiencies and Federal Election Commission audits); William J. Stuntz, *Race, Class, and Drugs*, 98 COLUM. L. REV. 1795, 1801, 1829 (1998) (using the term in a substantially similar manner with respect to the relationship between class and race, on the one hand, and drug enforcement); J. Hoult Verkerke, Note, *Compensating Victims of Preferential Employment Discrimination Remedies*, 98 YALE L.J. 1479, 1494 (1989) (using the term to describe disproportionate judicial enforcement of Title VII favoring unskilled and low-skilled workers).

15. *See, e.g.*, Mike France & Dan Carney, *Why Corporate Crooks are Tough to Nail*, BUS. WEEK, July 1, 2002, at 35, 37 (noting potential insider trading charges in connection with securities fraud allegations against Enron Corp. and Global Crossing Ltd.); Jonathan Peterson, *SEC's Get-Tough Attitude Tests the Limits of Its Power*, L.A. TIMES, Aug. 5, 2003, at 1 (noting that "scandals [have] swept corporate America" and that "corruption in the executive suite [is] a popular political issue"); Matt Richtel, *Finding Wrongs, Through the Prism of Silicon Valley*, N.Y. TIMES, Dec. 30, 2002, at C1 (reporting an increased focus on securities fraud and insider trading enforcement in Silicon Valley).

16. The term "selective enforcement" describes the exercise of enforcement discretion to pursue certain enforcement inquiries, investigations, or proceedings and to not pursue others. In the area of criminal law, this selectivity is frequently referred to as "selective prosecution," "discriminatory prosecution," or "arbitrary prosecution." *See* WHITEBREAD & SLOBOGIN, *supra* note 9, at 551–52; Bloom, *supra* note 13, at 1271–75; Kane, *supra* note 13, at 2301–05 (discussing claims of selective prosecution on racial grounds); Beard & Earle, *supra* note 5; *Martha Stewart Case Reveals Double Standard*, *supra* note 8. Prosecutors may, for instance, selectively enforce the law against one or more alleged violators to hold them out as public examples with the objective of deterring further violations of that law. *See* WHITBREAD & SLOBOGIN, *supra* note 9, at 552–53; Byron, *supra* note 4. The SEC has not been free from judicial scrutiny on the grounds of selective enforcement. *See, e.g.*, Arthur Lipper Corp. v. SEC, 547 F.2d 171, 182 (2d Cir. 1976), *cert. denied*, 434 U.S. 1009 (1978); Winkler v. SEC, 377 F.2d 517, 518 (2d Cir. 1967) (asserting bias in the relief awarded).

17. Specifically, enforcement bias in the insider trading context may allow for a discriminatory application of the law through which some classes of "insiders" and their "tippees" may escape investigation, trial or other proceedings, criminal guilt, or civil or

answered only by reference to the structure of the applicable system of regulation and by analysis of the impact of that structure on the effective enforcement of insider trading prohibitions. The structure of U.S. insider trading regulation consists of two components that create a unique opportunity for selective enforcement: (1) an unclear, imprecise set of substantive legal standards developed principally in decisional law (on the basis of specific facts and circumstances presented in individual cases)[18] and (2) an enforcement process characterized by a mosaic of governmental bodies (and agents within those bodies) that make decisions and take action in a relatively unconstrained procedural environment.[19]

This paper first describes the basic structure of insider trading regulation in the United States and then identifies potential structural sources of selective enforcement (both substantive and procedural) and certain easily recognizable bases for enforcement bias in the application of that regulation using the Martha Stewart insider trading investigation as an

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administrative liability for insider trading. At the same time, other classes may be investigated; pursued in the media, administrative proceedings, or the courts; or jailed, fined, censured, or found liable for monetary damages.

18. *See* Bacastow, *supra* note 13; William S. Feinstein, *Securities Fraud: Pleading Securities Fraud with Particularity—Federal Rule of Civil Procedure 9(b) in the Rule 10b-5 Context:* Kowal v. MCI Communications, 63 GEO. WASH. L. REV. 851, 854 (1996) (describing the provisions of both the statute and rule governing insider trading as "vague and open-ended"); Fisch, *supra* note 13; Kevin R. Johnson, *Liability for Reckless Misrepresentations and Omissions under Section 10(b) of the Securities Exchange Act of 1934*, 59 U. CIN. L. REV. 667, 674 (1991) (noting that "the courts have been less than precise in defining what exactly constitutes a reckless misrepresentation" under this insider trading regulation); Donald C. Langevoort, *Rule 10b-5 as an Adaptive Organism*, 61 FORDHAM L. REV. 7 (1993) (describing the applicable legal rule as having "a fluid character" and as "being sufficiently open ended," with contours that are "sufficiently indistinct"); Painter et al., *Don't Ask, Just Tell: Insider Trading After* United States v. O'Hagan, 84 VA. L. REV. 153, 188–91 (1998) (highlighting ambiguities in the misappropriation theory of insider trading); Lynda M. Ruiz, *European Community Directive on Insider Dealing: A Model for Effective Enforcement of Prohibitions on Insider Trading in International Securities Markets*, 33 COLUM. J. TRANSNAT'L L. 217, 229 (1995) ("A review of legislative, executive and judicial initiatives reveals ambiguity regarding the parameters of the U.S. prohibition on insider trading . . . ."). The observation that imprecise or vague laws raise the specter of selective and biased enforcement is not a new one. A number of scholars and courts, including the U.S. Supreme Court, have noted this relationship. *See, e.g.*, Grayned v. City of Rockford, 408 U.S. 104, 108–09 (1972) (noting the dangers of arbitrary and discriminatory enforcement in support of the "void for vagueness" doctrine); Brian C. Harms, *Redefining "Crimes of Moral Turpitude": A Proposal to Congress*, 15 GEO. IMMIGR. L.J. 259, 272–73 (2001) (mentioned in connection with a constitutional "void for vagueness" analysis); John F. Manning, *Textualism and the Equity of the Statute*, 101 COLUM. L. REV. 1, 66 n.263 (2001); Gregory L. Maxim, Comment, *The EPA's Title Bout—Remedying One Injustice with Another*, 30 MCGEORGE L. REV. 1091, 1125–26 (1999) (mentioned in connection with a constitutional "void for vagueness" analysis).

19. *See* Bacastow, *supra* note 13, at 132–33; Pitt & Shapiro, *supra* note 10, at 175–78 (describing the complex interactions between the SEC and the DOJ with respect to alleged insider trading violations).

example.[20] Finally, the paper recommends more rigorous investigation into possible sources of selectivity and bases for bias in the enforcement of alleged insider trading violations and offers preliminary suggestions for ways in which the identified potential for bias may be obviated or overcome in a manner that is consistent with the current federal regulatory and political environment.

II. The Structure of U.S. Insider Trading Regulation

A. Basic Statutory and Regulatory Content

Insider trading regulation in the United States involves all three branches of our federal government in multiple roles. Congress has enacted the basic statutory framework in the form of federal securities legislation. These statutes are interpreted by agency regulations promulgated by the Presidentially appointed SEC [21] under the authority of those statutes. Significant interpretation and gap-filling is undertaken by administrative law judges and the federal judiciary in connection with individual cases and controversies.

Insider trading typically is prosecuted, litigated, or otherwise enforced under Rule 10b-5,[22] a regulation adopted by the SEC under Section 10(b) of the Securities Exchange Act of 1934, as amended (the "1934 Act").[23] Section 10(b) is a statutory prohibition on the use or employment,

> in connection with the purchase or sale of any security . . . , [of] any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or

20. In choosing this example (and in entitling this paper), the author is not asking the reader to sympathize with Martha Stewart or to exonerate her from responsibility or liability for any violations of law she may have committed. Nor is the author asserting that actual bias exists in the Martha Stewart insider trading investigation. *See* Mumford, *supra* note 4, at 181–82. Rather, the Martha Stewart example represents both the genesis of the author's consideration of the issues discussed in this paper and a vehicle intended to draw the uninitiated into the baroque and motivationally complex world of U.S. insider trading regulation. The author is aware that the choice of this example may be uncomfortable for some, including certain feminist legal scholars, because the paper may be perceived as promoting the heroism of Martha Stewart—a biological woman who succeeded in a male-dominated corporate world and is alleged to have "engaged in abuses which were once the prerogative of the male." *Id.* at 192. Nevertheless, the example is, in the author's view, instructive.

21. *See infra* notes 94–95.

22. 17 C.F.R. § 240.10b-5 (2003).

23. 15 U.S.C. § 78j(b) (2003).

for the protection of investors.[24]

Promulgated by the SEC under Section 10(b) as one of the expressly authorized "rules and regulations necessary or appropriate in the public interest or for the protection of investors," Rule 10b-5 makes it

> unlawful for any person, . . . [t]o employ any device, scheme, or artifice to defraud . . . or . . . [t]o engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.[25]

B. Application of the Statute and Rule in the Insider Trading Context

The application of Section 10(b) and Rule 10b-5 to insider trading cases is not intuitive or obvious. The nature of the prohibited conduct (manipulation, deception, and fraud) is not clearly defined in Section 10(b) or Rule 10b-5, and neither "insider trading" nor "insider" is explicitly defined (or even mentioned) in these core operative provisions.[26] The inevitable result of this construction of the existing regulatory system is that neither Section 10(b) nor Rule 10b-5 provides clear interpretive or enforcement guidance. Accordingly, the SEC (through civil enforcement, administrative proceedings and rule making, and interpretive pronouncements) and the federal judiciary (in both civil and criminal adjudication) have stepped into the void to provide some guidance in the interpretation and development of U.S. insider trading regulation under Rule 10b-5. As a result, that body of regulation is largely an invention of

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24. *Id.*

25. 17 C.F.R. § 240.10b-5.

26. Numerous commentators have noted this deficiency. *See, e.g.*,. Ronald E. Bornstein & N. Elaine Dugger, *The Global Securities Market: International Regulation of Insider Trading*, 1987 COLUM. BUS. L. REV. 375, 385 (1987); Paula J. Dalley, *From Horse Trading To Insider Trading: The Historical Antecedents Of The Insider Trading Debate*, 39 WM. & MARY L. REV. 1289, 1351 (1998); Fred D'Amato, Comment, *Equitable Claims To Disgorged Insider Trading Profits*, 1989 WIS. L. REV. 1433, 1435 (1989); Elyse Diamond, Note, *Outside Investors: A New Breed Of Insider Traders?*, 60 FORDHAM L. REV. 319, 320 (1993); Michael P. Dooley, *Insider Trading: Comment from an Enforcement Perspective*, 50 CASE W. RES. 319, 320 (1999); Fisch, *supra* note 13, at 185–86; Dennis S. Karjala, *Federalism, Full Disclosure, and the National Markets in the Interpretation of Federal Securities Law*, 80 NW. U. L. REV. 1473, 1523 (1986); Roberta S. Karmel, *Outsider Trading on Confidential Information—A Breach in Search of a Duty*, 20 CARDOZO L. REV. 83, 86 (1998); Ronald F. Kidd, *Insider Trading: The Misappropriation Theory Versus An "Access To Information" Perspective*, 18 DEL. J. CORP. L. 101, 131–32 (1993); John I. McMahon, Jr., Note, *A Statutory Definition Of Insider Trading: The Need To Codify The Misappropriation Theory*, 13 DEL. J. CORP. L. 985, 985–87 (1988); Karen Schoen, Comment, *Insider Trading: The "Possession Versus Use" Debate*, 148 U. PA. L. REV. 239, 249 (1999).

the SEC and the federal judiciary. A number of key legal rules have emerged, resulting in three basic types of insider trading which may be actionable under Rule 10b-5: "classic," tipper/tippee, and misappropriation.

Under decisional law defining classic insider trading under Rule 10b-5, public issuers of securities and their insiders—those with "a relationship of trust and confidence" to the issuer's stockholders—cannot trade in the issuer's securities while in possession of material, nonpublic information.[27] Therefore, when a public issuer or one of its insiders is in possession of undisclosed material information, the issuer or insider must either disclose the information before trading or abstain from trading in the issuer's securities. This directive commonly is referred to as the "disclose or abstain" rule.[28]

The regulation of classic insider trading through the "disclose or abstain" rule leaves much to further interpretation. What facts constitute the requisite "relationship of trust and confidence" necessary to insider status? What does the rule mean by "possession"? What is "material" information? When is information "nonpublic"? To what type of nonpublic information does the duty apply? What measure of culpability or mental state is required for liability in a criminal action? What measure of culpability or mental state is required for liability in a civil action? Some of these questions have been answered, at least to some extent, by intervening SEC rulemaking, SEC interpretive guidance, or decisional law.[29] Much ambiguity and imprecision, however, remains.[30]

Trading by a tippee—one who obtains information directly or indirectly from a tipping insider for an inappropriate purpose, i.e., a purpose outside the scope of the business and operations of the issuer—also may be regulated as insider trading under Rule 10b-5.[31] A tippee "assumes

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27. *See* Chiarella v. United States, 445 U.S. 222, 228 (1980).

28. *Id.* at 226–27.

29. For an example, see the recently enacted Rule 10b5-1 under the 1934 Act (clarifying when a purchase or sale of securities "constitutes trading 'on the basis of' material, nonpublic information"). 17 C.F.R. § 240.10b5-1 (2003). Also, in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976), the Supreme Court found that scienter is a required element of a Rule 10b-5 action and indicated that the scienter requirement may be met by evidence of reckless conduct.

30. *See supra* note 18.

31. *See* Dirks v. SEC, 463 U.S. 646 (1983). Initially, many observers thought Martha Stewart was likely being pursued as a tippee under the rule of law established in the *Dirks* case. *See* Michael Freedman & Emily Lambert, *Will She Walk?*, FORBES, July 7, 2003, at 46, 47 ("Prosecutors first pursued an ironclad case: that Waksal tipped off Stewart, before the news broke, that the Food and Drug Administration had dealt a setback to an ImClone cancer drug, prompting her to dump 3,938 shares and avoid a $45,000 loss."); Greising, *supra* note 4, at C1 ("Stewart is in the same heap of trouble as anyone else who made a perfectly timed trade, after frequent phone communications with a close pal at the top of a company that was about to release some startlingly bad news."); Dan Haar, *Fair's Fair: Maybe It's Time for a Ranking of Rascals*, HARTFORD COURANT (Conn.), Oct. 1, 2002, at E1

a fiduciary duty to the shareholders of a corporation not to trade on material nonpublic information only when (1) the insider has breached his fiduciary duty to the shareholders by disclosing the information to the tippee and (2) the tippee knows or should know that there has been a breach."[32]

Because tippee liability derives from an effective transfer (from the

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(describing Stewart "as one who, if the accusations are true, profited from an insider tip"); *Hardball* (MSNBC television broadcast, June 3, 2003, *available at* LEXIS, News & Business library, News file) (comments of Adrian Michaels, indicating that Stewart may have received material nonpublic information directly from ImClone insider Waksal); *ImClone's Ex-CEO to Pay $800,000 for Insider Trading*, ANDREWS SEC. LITIG. & REG. REP., Mar. 26, 2003 (indicating Stewart allegedly was tipped by ImClone insider Waksal). *But see* Sean J. Griffith, *Being Martha Stewart: Will Her Celebrity Status End Up Doing Her In?*, CHI. TRIB., Nov. 19, 2002, at N25 (correctly analyzing the publicized facts regarding the asserted tip by Stewart's broker to Stewart).

According to publicized facts, any material, nonpublic information she may have had at the time she sold her ImClone shares may have come to her, directly or indirectly, from her friend, Samuel Waksal, then the Chief Executive Officer and a director of ImClone. *See supra* note 7 and accompanying text. According to the SEC, the material, nonpublic information that Stewart had was information about ImClone stock trades being made by Waksal and his daughter. *See* SEC Complaint, *supra* note 2, at ¶¶ 18 & 19. This information apparently came to Stewart through her stockbroker. *See id.* Stewart allegedly telephoned Waksal after requesting that her ImClone stock be sold. *See* Diane Brady et al., *Sorting Out the Martha Mess*, BUS. WK., July 1, 2002, at 44; Jenkins, *supra* note 8; Alex Kuczynski & Andrew Ross Sorkin, *For Well-Heeled, Stock Tips Are Served With the Canapés*, N.Y. TIMES, July 1, 2002 (Late Ed.), at A1; Pollack, *supra* note 5; Stanley & Hays, *supra* note 8.

Interestingly, the SEC's insider trading action against Stewart does not assert that Stewart received material, nonpublic information from Waksal in breach of his well known fiduciary duty to ImClone and its stockholders. Rather, the SEC's complaint against Stewart asserts (among other things) that Stewart received material, nonpublic information about Waksal family ImClone stock trading from her broker; that her broker breached his duty of client confidentiality (owed to his employer, Merrill Lynch); that Stewart knew or acted in reckless disregard of the broker's duty and of his breach of that duty; and that her sale of ImClone stock while in possession of the stock trading information about the Waksal family violates Rule 10b-5's insider trading "disclose or abstain" rule. *See* SEC Complaint, *supra* note 2, at ¶¶ 27–33. These allegations appear to suggest that the SEC desires to extend tippee liability to tippees of third-party brokers who misappropriate personal trading information from insiders. *See* Andrew Countryman, *Civil Suit Against Stewart May Break New Ground*, CHI. TRIB., June 10, 2003, at C1 (asserting that "[t]he underpinnings of the Stewart case lie in what's known as the 'misappropriation' theory"); Freedman & Lambert, *supra* note 31, at 47 (stating that, in the Stewart case, the SEC "must resort to the more tenuous theory of 'misappropriation'"). For information about misappropriation liability in U.S. insider trading regulation, see *infra* notes 36–44 and accompanying text.

The SEC's argument is not without a basis in the policies underlying the federal securities laws. Professors Strudler and Orts likely would term the broker's behavior a form of "frontrunning" (even though Stewart's broker tips, rather than trades on, nonpublic client information) and find that both the broker's conversion of the nonpublic information and the tippee's trade violate the policies underlying U.S. insider trading regulation. *See* Alan Strudler & Eric W. Orts, *Moral Principle in the Law of Insider Trading*, 78 TEX. L. REV. 375, 429–34 (1999).

32. *See Dirks*, 463 U.S. at 660.

insider to the tippee) of the duty imposed by the "disclose or abstain" rule,[33] the uncertainties surrounding application of that rule also exist in tippee liability cases. Tippee cases involve additional uncertainties, however. To find a tippee trader liable for insider trading, the court first must determine a breach by the insider of his or her fiduciary duty to the issuer in disclosing material, nonpublic information to the tippee.[34] The court then must find that the tippee either knew or should have known that the insider has committed that breach.[35] The court must make these determinations and findings in addition to resolving any ambiguities relating to the application of the "disclose or abstain" rule to the tippee's trade after receipt of nonpublic information from the insider.

The third type of insider trading liability cognizable under Rule 10b-5 is misappropriation.[36] Misappropriation liability arises out of a securities trading transaction conducted by a person in possession of material, nonpublic information obtained not from an insider, but from another source to which the trader owes a fiduciary duty—a duty that is breached by the trader's use of the nonpublic information in her securities trading transaction.[37] The insider trading liability in this context is based on the "fiduciary-turned-trader's deception of those who entrusted him with access to confidential information."[38]

Misappropriation liability is an insider trading theory of relatively recent vintage, only having been endorsed by the U.S. Supreme Court in 1997.[39] Accordingly, there is much room for interpretation of its various facets.[40] Of special importance in defining the misappropriation theory is the nature of the fiduciary duty to the information source that, if breached, results in potential insider trading liability.[41] Moreover, misappropriation

33. *Id.* at 659 ("the tippee's duty to disclose or abstain is derivative from that of the insider's duty").

34. *See id.* at 661–67; SEC v. Adler, 137 F.3d 1325, 1333 (11th Cir. 1998).

35. *See Dirks,* 463 U.S. at 660; SEC v. Lambert, 38 F. Supp. 2d 1348, 1351 (S.D. Fla. 1999). These ambiguities arise out of the same regulatory context as those applicable to classic insider trading. See authorities cited *supra* note 18.

36. *See* United States v. O'Hagan, 521 U.S. 642 (1997).

37. *See id.* at 652–53.

38. *Id.* at 652.

39. *See id.* at 642.

40. On this basis and other grounds, there has been significant criticism of the misappropriation theory of insider trading as endorsed by the Supreme Court in the *O'Hagan* case. *See, e.g.,* Karmel, *supra* note 26, at 109; Donna M. Nagy, *Reframing the Misappropriation Theory of Insider Trading Liability: A Post-O'Hagan Suggestion*, 59 OHIO ST. L.J. 1223 (1998); Richard W. Painter, *Insider Trading and the Stock Market Thirty Years Later*, 50 CASE W. RES. 305, 306–07, 310 (1999); Painter et al., *supra* note 18, at 188–91. To the extent that scholars and other observers construe the SEC's enforcement action against Stewart as an extension of the misappropriation theory, see *supra* note 31, additional criticism is likely to follow.

41. As a partial answer to the question, the SEC adopted Rule 10b5-2 in 2000. 17

liability (like the classic and tippee theories) is premised on the notion that a putative trader should abstain from market transactions unless and until all material information in possession of the trader has been disclosed.[42] Therefore, misappropriation liability is subject to the same criticisms, with regard to a lack of clarity and precision, to which the "disclose or abstain" rule is subject. While the U.S. Supreme Court finds the misappropriation theory definite enough to support findings of criminal liability,[43] the law governing misappropriation liability is far from clear.[44]

In all, the ambiguities surrounding application of Rule 10b-5 in the insider trading context are significant to the extent that they do not permit insiders and those receiving information from insiders and others to conduct their securities trading transactions with any degree of certainty that they will avoid insider trading liability. If a person is in possession of undisclosed information about an issuer of securities that is or may be material, the only clear choice for that person, should she want to avoid liability, is to abstain from trading in the issuer's securities.

Moreover, ambiguities in the substance of U.S. insider trading regulation present enforcement issues for the SEC and the DOJ and adjudicatory issues for the federal courts. Enforcement agents and judges alike must struggle with uncertainties similar to those that plague insiders and others who may be subject to insider trading restrictions. The complexities of the substance of U.S. insider trading regulation are matched only by the complexities of the related enforcement process.

C. The Enforcement Process

The various forms of actionable insider trading may be investigated and judicially enforced both civilly and criminally.[45] The SEC also has the

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C.F.R. § 240.10b5-2 (2003). By its terms, the Rule "provides a non-exclusive definition of circumstances in which a person has a duty of trust or confidence for purposes of the 'misappropriation' theory of insider trading under Section 10(b) of the Act and Rule 10b-5."

42. In fact, misappropriation could have been a possible alternate theory for imposing liability in the *Chiarella* case—the case in which the Supreme Court first blessed the "disclose or abstain" rule—if that matter had been put to the jury at trial. *See* Chiarella v. United States, 445 U.S. 222, 235–37 (1980).

43. *See* United States v. O'Hagan, 521 U.S. 642, 665–66 (1997).

44. *See* Judith G. Greenberg, *Insider Trading and Family Values*, 4 WM. & MARY J. WOMEN & L. 303, 305–06 (1998); Karmel, *supra* note 26, at 84; Painter et al., *supra* note 18, at 188–91.

45. The SEC is authorized to enforce the federal securities laws, including the 1934 Act. 15 U.S.C. §§ 78d, 78u, 78u-1, 78u-2, and 78u-3 (2003). This enforcement authority, however, does not extend to criminal prosecutions; criminal enforcement authority rests with the DOJ. 15 U.S.C. § 78u(d); 17 C.F.R. § 202.5(f) (2003). All actions to enforce Rule 10b-5's insider trading prohibitions must be brought in a federal court. 15 U.S.C. § 78aa (2003); *see* DONNA M. NAGY ET AL., SECURITIES LITIGATION AND ENFORCEMENT CASES AND

statutory authority to bring administrative actions against violators of the federal securities laws.[46] In addition, the U.S. Supreme Court has accepted the existence of implied private rights of action (including class actions) under Rule 10b-5 for insider trading and other forms of securities fraud.[47] Even with effective interagency coordination, this patchwork of available legal actions may result in parallel—and potentially inconsistent—investigation and enforcement of the same potential violation by the SEC, the DOJ, and private litigants.[48]

Insider trading enforcement activities begin with information about a possible violation. This information may be obtained from a variety of sources in a number of different contexts. These sources include: surveillance activities conducted by the SEC, the Federal Bureau of Investigation ("FBI"), or other governmental agencies; trading data gathered by the securities markets and other players within the securities industry; publicly available news reports; and independent informant reports.[49]

MATERIALS 833. For an excellent discussion of Section 10(b) and other hybrid statutes, together with issues involved in and suggestions for interpreting the same, see Margaret V. Sachs, *Harmonizing Civil and Criminal Enforcement of Federal Regulatory Statutes: The Case of the Securities Exchange Act of 1934*, 2001 ILL. L. REV. 1025 (2001).

46. 15 U.S.C. § 78u-3.

47. *See* Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 13 n.9 (1971). *See also* THOMAS LEE HAZEN, THE LAW OF SECURITIES REGULATION 571–73 (4th ed. 2002); Sachs, *supra* note 45, at 1040.

48. *See* HAZEN, *supra* note 47, at 879–81; NAGY ET AL., *supra* note 45, at 14. The U.S. Congress also has investigative powers in connection with its legislative function. *See* McGrain v. Daugherty, 273 U.S. 135, 174 (1927); Townsend v. United States, 95 F.2d 352, 355 (D.C. Cir. 1938), *cert. denied*, 303 U.S. 664 (1938); United States v. Seymour, 50 F.2d 930, 933–34 (D. Neb. 1931); Richard B. Zabel & James J. Benjamin Jr., *Congress' Role in Investigating Fraud: Are Legislators' Aggressive Approach in Hearings Helping or Hindering the Process?*, N.Y. L.J., Dec. 16, 2002, at 9. Congress has exercised these powers in connection with a number of recent insider trading allegations, including those involving Martha Stewart. *See* Kudlow, *supra* note 4; Jayne O'Donnell, *ImClone CEO denies tipping off brother*, USA TODAY, June 14, 2002, at 1B; Pollack, *supra* note 5; Edmund Sanders, *Senate Committee Chides Enron Board; Energy: Directors' failure to heed warnings about accounting practices underscored during hearing on the firm's collapse*, L.A. TIMES, May 8, 2002, Part 3, at 6; Byron York, *Joe's Fishing Trip*, NAT'L REV. ONLINE, May 24, 2002, *at* http://www.nationalreview.com/york/york052402.asp; Zabel & Benjamin Jr., *supra*.

49. *See* Phillips et al., *supra* note 10, at 34–35. The National Association of Securities Dealers, Inc. (NASD) or a stock exchange may conduct its own inquiry based on data available to it and also may supply information to the SEC. *See id.*; NAGY ET AL., *supra* note 45, at 723.

> Often, an investigation will be triggered when the SEC, NASD or NYSE identifies market activity that is suspicious in light of subsequent events (e.g., the price of a company's stock increases dramatically in advance of a positive announcement). The investigators (sometimes at the SEC, sometimes at the NASD or NYSE) will then ask each relevant company for a chronology of

Based on information about a possible violation, the SEC or the DOJ (through the FBI) then may commence an investigation to gather additional facts related to the matter to determine the existence of an actual violation and to develop its case.[50] Although there are some basic parameters for both preliminary inquiries and informal investigations, the manner in which the investigation proceeds is highly dependent upon the facts of each case and may vary between the two principal enforcement bodies and within each respective organization.[51] At this stage, the agencies typically will review available documentary evidence and interview cooperative

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> events leading to the announcement and a list of individuals (both company personnel and others) who knew the critical information before it was announced. The investigators will also ask broker dealers to identify the customers who made timely trades in the securities. Often, the investigators will ask if anyone with advance knowledge of the critical information knows any of the individuals who made timely trades. The SEC will then proceed by questioning witness [sic] (sometimes through telephone interviews, sometimes by taking testimony) and obtaining documents (including telephone and bank records). The SEC looks for circumstances that indicate that the timely trade was suspicious, evidence linking the trader to persons with advance knowledge, and evidence linking an individual who made timely trades to other individuals who made timely trades.

Kenneth B. Winer et al., *SEC Enforcement*, *at* http://www.realcorporatelawyer.com/faqs/enforcement.html (last visited Nov. 3, 2003).

50. *See* SEC v. Dresser Indus., Inc., 628 F.2d 1368 (D.C. Cir. 1980) (en banc). Although the DOJ can and does exercise independent investigative powers over insider trading matters (through the FBI), the SEC generally exercises primary investigative authority in potential insider trading cases. *See* 15 U.S.C. § 78u(d); 17 C.F.R. § 202.5(b) (2003); ALDEMAN, ET. AL., *Criminal Enforcement of the Securities Laws; A Primer for the Securities Practitioner*, in THE SECURITIES ENFORCEMENT MANUAL, TACTICS AND STRATEGIES, *supra* note 10, at 308; U.S. ATT'Y MANUAL 9-4.126, *available at* http://www.usdoj.gov/usao/eousa/foia_reading_room/usam (last visited Oct. 7, 2003); *The Investor's Advocate: How the SEC Protects Investors and Maintains Market Integrity, at* http://www.sec.gov/about/whatwedo.shtml#org; *About the Economic Crimes Unit: Securities/Commodities Fraud, at* http://www.fbi.gov/hq/cid/fc/ec/about/about_scf.htm (last visited Oct. 7, 2003) [hereinafter *The Investor's Advocate*]. This paper assumes initiation of an investigation by the SEC, unless otherwise noted. At the SEC, the preliminary investigative phases are referred to as preliminary or informal inquiries or investigations. 17 C.F.R. § 202.5(a) (2003 through Jan. 24); NAGY ET. AL., *supra* note 45, at 624–25; Ralph C. Ferrara & Philip S. Khinda, *SEC Enforcement Proceedings: Strategic Considerations When the Agency Comes Calling*, 51 ADMIN. L. REV. 1143, 1148–50 (1999); Phillips et al, *supra* note 10, at 35–40; *The Investor's Advocate, supra;* Winer et al., *supra* note 49. A formal SEC investigation order may ensue. *See* HAZEN, *supra* note 47, at 878; Ferrara & Khinda, *supra*, at 1150; Phillips et al., *supra* note 10, at 40–43. The term "investigation," as used in this paper with respect to the SEC, refers to either phase or both phases, and also may include the commencement of proceedings, as the context may require.

51. *See* 17 C.F.R. § 202.5(a); NAGY ET AL., *supra* note 45, at 623–24; Phillips et al., *supra* note 10, at 36–40; Winer et al., *supra* note 49.

witnesses while also pursuing and obtaining subpoenas to compel production of additional documents and testimony.[52]

If the enforcement body assembles information it believes to be sufficient to support a proceeding against an alleged violator, an appropriate proceeding may, but need not, be brought.[53] If the SEC determines to bring an insider trading proceeding, it also must decide what kind of proceeding—judicial or administrative—to bring. The SEC also may refer a matter that has been investigated internally to the DOJ for possible criminal enforcement.[54] The DOJ then may, but need not, prosecute the matter.[55]

III. Potential Sources of Enforcement Selectivity and Bias

A. Opportunities for Enforcement Selectivity and Bias

The relatively complex system of insider trading regulation in the United States provides many opportunities for selective—or targeted—enforcement.[56] These opportunities exist throughout the enforcement process. Specifically, possibilities for selective enforcement exist at the following critical junctures (among others) in the process of investigating and enforcing a potential insider trading violation:

- when information is received by the SEC, the DOJ, or a self-regulatory organization, like the NYSE (an "SRO") indicating a potential insider trading transaction;
- when a decision is made to pursue an investigation based on that

52. *See* 17 C.F.R. § 202.5(a); HAZEN, *supra* note 47, at 878–79; Ferrara & Khinda, *supra* note 50, at 1155–61; Phillips et al., *supra* note 10, at 34–43, 55–59.

53. *See* NAGY ET AL., *supra* note 45, at 641–42; William R. McLucas et al., *A Practitioner's Guide to the SEC's Investigative and Enforcement Process*, 70 TEMPLE L. REV. 53, 111 (1997) ("At the conclusion of an investigation, the staff may determine to take no action or to recommend that the Commission bring enforcement proceedings.").

54. 15 U.S.C. § 78u(d).

55. The DOJ has authority to either decline or pursue prosecution after an SEC referral. *See* U.S. ATT'Y MANUAL, *supra* note 50, at 9-2.020 ("The United States Attorney is authorized to decline prosecution in any case referred directly to him/her by an agency unless a statute provides otherwise."); *id.* at 9-2.030 ("The United States Attorney is authorized to initiate prosecution by filing a complaint, requesting an indictment from the grand jury, and when permitted by law, by filing an information in any case which, in his or her judgment, warrants such action.").

56. A number of commentators have noted the existence of some form of selective enforcement of U.S. insider trading regulation under Rule 10b-5. *See* Dooley, *supra* note 26, at 323; Karmel, *supra* note 26, at 84; James H. Lorie & Victor Niederhoffer, *Predictive and Statistical Properties of Insider Trading*, 11 J.L. & ECON. 35, 37 (1968); Henry G. Manne, *Insider Trading and the Law Professors*, 23 VAND. L. REV. 547, 554 (1970); Pitt & Shapiro, *supra* note 10, at 171–72.

information;
- during the investigation;
- when the decision is made to pursue enforcement through civil or criminal proceedings; and
- during the enforcement proceeding.

At each juncture, structural sources of selective enforcement may exist. These opportunities for selective enforcement relate to both the substance of U.S. insider trading regulation and the nature of the insider trading enforcement process. Opportunities for selectivity based on substance are created by gaps, ambiguities, and imprecision in the substantive regulatory framework. Opportunities for the exercise of selectivity in the enforcement process are created by many factors, notably (1) a lack of objective, institutionalized enforcement guidelines for use in enforcement decision making at various stages in the enforcement process and (2) the nature and composition of the enforcement body (or the personal background or characteristics of the individual enforcement agent) making decisions at these various stages of the enforcement process.

1. Receipt of Information Indicating a Possible Violation

The source or sources of information received by the SEC or the DOJ concerning a possible insider trading violation may be the first opportunity for the exercise of selectivity in the enforcement process. Certain information sources, especially the news media (which may tend to focus on specific types of transactions, corporations, and individuals) and private informants (who may have a narrow informational base or a personal vendetta or other agenda unrelated to enforcement of insider trading prohibitions) may result in the selective reporting of information regarding possible insider trading violations.[57]

The surveillance criteria used by the SEC and the FBI to identify potential insider trading transactions also may narrow the scope of information available to enforcement officials. In this regard, it is important to ask and answer a number of questions about the surveillance process. For example, what market and transaction data is routinely collected or reviewed by the SEC? Why? How broad-based are the data collected? If all available data are not reviewed, what is the basis for

57. *See* NAGY ET AL., *supra* note 45, at 624 (listing "disgruntled customers and whistleblowing employees" as likely sources of information leading to SEC inquiries); Phillips et al., *supra* note 10, at 35 (noting that informants may include "disappointed investors" and "disgruntled former employees"); *accord* Winer et al., *supra* note 49. Informants may be motivated to come forward with information about possible insider trading violations by bounty provisions added to the 1934 Act by the Insider Trading and Securities Fraud Enforcement Act of 1988. 15 U.S.C. § 78u-1 (2003).

selecting data for review? Are criteria for data retrieval and review strictly followed? It is possible that the SEC or the DOJ may, through its data collection or review criteria, screen out or include information that either forecloses or instigates the investigation of potential violators on a selective basis.

2. Decision to Pursue an Investigation

The criteria used by representatives of the SEC and the DOJ in determining whether to pursue an investigation of a possible insider trading violation may also introduce an element of selectivity into the investigation process.[58] Both the nature of these criteria and the extent to which these criteria are consistently and uniformly applied could affect whether a particular alleged violator is investigated based on the information then available to enforcement authorities. It would be important to identify, for instance, whether information received by the relevant enforcement body is discounted as unreliable, otherwise unworthy of further investment of resources, or required to be corroborated by other available information before the SEC or the DOJ makes a determination to proceed with the investigation process.[59]

The decision making methodology used by individual decision makers at the SEC and the DOJ (in closing an informal inquiry or in recommending or granting a formal investigative order) and other characteristics personal to those decision makers also may be a source of selectivity at this stage of the enforcement effort. Even if decisions as to further investigation are based on criteria that are uniformly applied on a consistent, institutionalized basis, an inquiry into the actual decision making process is appropriate. It is important to understand, in this context, whether there is a particular type of potential violator that enforcement decision makers are more likely to pursue or ignore at this stage in the enforcement process based on the manner in which individual decision makers consider and use the information at their disposal. This inquiry may reveal potential sources of bias.

58. Factors considered at the SEC may include "the priorities of the Commission at the time the information is received, the workload of the office receiving the information, the complexity of the issues, the magnitude of the investor harm resulting from the possible violation and whether the matter is appropriate for referral to an SRO, a state securities regulator, or another government agency." Phillips et al., *supra* note 10, at 35.

59. *See* Ferrara & Khinda, *supra* note 50, at 1153 (noting that the SEC Division of Enforcement need not prove to the Commissioners that a violation has occurred in order to obtain authorization for a formal investigation).

3. Conduct of the Investigation

The manner in which the investigation is conducted also presents an opportunity for selectivity.[60] Specifically, inquiries into both the guidelines for conducting insider trading investigations at the SEC and the DOJ and the ways in which investigators comply with these guidelines are appropriate. For example, the content of any existing investigatory guidelines at the SEC and the DOJ may not be neutral. The applicable guidelines may place certain alleged violators in different positions in the enforcement hierarchy, making it more or less likely that the SEC or the DOJ will recommend enforcement proceedings for those individuals.

Moreover, as in the pre-investigation stage, a lack of—or failure to consistently and uniformly apply—institutionalized guidelines for insider trading investigations allows the introduction of selectivity based on the nature of the investigative process employed by, and other personal characteristics of, the investigator. Characteristics unique to the investigator may impact the nature and extent of an investigation, resulting in the assembly of a higher volume or quality of information about some alleged violators and their transactions than is assembled about others.

4. Decision to Pursue Enforcement Proceedings

The process of determining whether to pursue legal proceedings against an insider presents another opportunity for selective enforcement. To seek enforcement through legal proceedings, the enforcement agent must first determine that she has sufficient information to present a case to the administrative law judge or to a federal court.[61] This determination is

60. The SEC's authority to conduct investigations is quite broad, allowing the SEC significant discretion. *See* 17 C.F.R. § 202.5(a); Phillips et al., *supra* note 10, at 32–33.

61. The procedure at the SEC at this stage is characterized by a somewhat complex set of chess moves. First, it is important to note that

> [t]he Staff does not have authority to institute an enforcement proceeding. If the Staff tentatively decides to recommend that the Commissioners authorize the institution of an enforcement proceeding, the Staff usually will notify counsel to the perspective [sic] defendant. This notification is referred to as a "Wells Call." Upon receiving a Wells Call, counsel should meet with the Staff to learn the basis for the Staff's tentative decision. Counsel can then prepare a document, referred to as a "Wells Submission," to persuade the Staff not to recommend the action or to recommend a less severe action. In addition, counsel can meet with the Staff and attempt to dissuade the Staff from proceeding with the proposed recommendation. If the Staff decides to proceed with the recommendation, the Staff submits to the Commission a memorandum setting forth its recommendation and the basis for its recommendation. Defense counsel does not have an opportunity to see this recommendation memorandum. At a meeting that is open to the Staff but closed to the public (including the

made by applying substantive U.S. insider trading regulations to the facts gathered during the investigation process. The process does not always result in a clear legal theory of the case. Incomplete or inconsistent facts, as well as the lack of clarity and precision in the substantive regulation of insider trading, allow enforcement agents to construe the law in novel ways to arrive at a legal theory that supports the initiation of enforcement proceedings against a specific alleged violator.

Assuming that the enforcement agents are able to construct a case supporting an insider trading violation based on the available facts, the relevant decision makers at the SEC or the DOJ then must determine whether to exercise their discretion to pursue enforcement in appropriate legal proceedings.[62] At the SEC, the exercise of enforcement discretion at this juncture may be impacted by many factors, including the nature and magnitude of the alleged violation, the desired remedy, and agency-based or externally focused strategic considerations.[63] These factors allow for the exercise of broad discretion, especially regarding the extent to which the SEC's own strategic considerations may be determinative of the decision to pursue enforcement.

At the DOJ, the U.S. Attorneys are bound to follow the Principles of Federal Prosecution, "a statement of sound prosecutorial policies and practices."[64] These Principles

> have been designed to assist in structuring the decision-making process of attorneys for the government. For the most part, they have been cast in general terms with a view to providing guidance rather than to mandating results. The intent is to assure regularity without regimentation—to prevent unwarranted disparity without sacrificing necessary flexibility.[65]

Specifically, the principles call for each U.S. Attorney to prosecute or

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proposed defendants and their counsel), the Commission decides whether to authorize the institution of the enforcement action based on the recommendation of the enforcement Staff, the Wells Submissions filed by proposed defendants, and input from other interested Divisions (e.g., the Office of the Chief Accountant, the Division of Corporation Finance, and the Office of General Counsel)."

Winer et al., *supra* note 49. *See* McLucas et al., *supra* note 53, at 111; Phillips et al., *supra* note 10, at 97–108. Of course, the SEC may decide not to recommend enforcement action after conclusion of an investigation. *See* 17 C.F.R. § 202.5(d); McLucas et al., *supra* note 53, at 111; Phillips et al., *supra* note 10, at 96–97. At the DOJ, the U.S. Attorney has broad discretion to prosecute "any case which, in his or her judgment, warrants such action," subject to certain constitutional, statutory, and other limits. U.S. ATT'Y MANUAL, *supra* note 50, at 9-2.030; *see also infra* notes 64–67 and accompanying text.

62. *See* 17 C.F.R. § 202.5(b); U.S. ATT'Y MANUAL, *supra* note 50, at 9-2.030.

63. *See The Investor's Advocate, supra* note 50.

64. U.S. ATT'Y MANUAL, *supra* note 50, at 9-27.001.

65. *Id.*

recommend prosecution when there is sufficient evidence of a federal crime unless (1) the prosecution would serve no substantial federal interest; (2) the matter is being effectively prosecuted in another jurisdiction; or (3) an alternative to criminal proceedings exists.[66] There are numerous definitional questions involved in interpreting the rule and its three exceptions.[67] These definitional questions are so numerous, in fact, that the principles arguably provide little meaningful guidance to federal prosecutors and, therefore, little protection against selective enforcement.[68]

Again, in the absence of effective, institutionalized statutory or regulatory guidelines regarding the exercise of enforcement discretion that are consistently and uniformly applied, few constitutional or other constraints on enforcement discretion exist.[69] Accordingly, the nature of the decision making process, together with other characteristics of the applicable decision makers, presents the opportunity for selective enforcement. As a general matter, the decision whether to pursue enforcement proceedings against an alleged violator is made at a high level in the hierarchy of an enforcement organization. At the SEC, the decision is made by the Commissioners—the members of the SEC—whereas decision making earlier in the process typically is made by SEC staff members in the Division of Enforcement.[70] At the DOJ, the U.S. Attorney with jurisdiction over the alleged violator generally decides whether to prosecute, whereas FBI personnel, in consultation with Assistant U.S.

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66. U.S. ATT'Y MANUAL, *supra* note 50, at 9-27.230, 9-27.240, 9-27.250.

67. *See* Michael A. Simons, *Prosecutorial Discretion and Prosecution Guidelines: A Case Study In Controlling Federalization*, 75 N.Y.U. L. REV. 893, 934–35 (2000).

68. "While the creation and publication of the Principles was an important step in bringing prosecutorial charging decisions into the sunshine, at bottom the Principles of Federal Prosecution are so vague as to be meaningless." Simons, *supra* note 67, at 934 (footnotes omitted).

69. *See supra* note 13 and accompanying text. In this connection, the Principles of Federal Prosecution note that

> [u]nder the Federal criminal justice system, the prosecutor has wide latitude in determining when, whom, how, and even whether to prosecute for apparent violations of Federal criminal law. The prosecutor's broad discretion in such areas as initiating or forgoing prosecutions, selecting or recommending specific charges, and terminating prosecutions by accepting guilty pleas has been recognized on numerous occasions by the courts. *See, e.g.*, Oyler v. Boles, 368 U.S. 448 (1962); Newman v. United States, 382 F.2d 479 (D.C. Cir. 1967); Powell v. Ratzenbach, 359 F.2d 234 (D.C. Cir. 1965), *cert. denied*, 384 U.S. 906 (1966). This discretion exists by virtue of his/her status as a member of the Executive Branch, which is charged under the Constitution with ensuring that the laws of the United States be 'faithfully executed.' U.S. Const. Art. § 3. *See* Nader v. Saxbe, 497 F.2d 676, 679 n. 18 (D.C. Cir. 1974).

U.S. ATT'Y MANUAL, *supra* note 50, at 9-27.110. There are also statutory and policy-oriented constraints on criminal enforcement discretion. *See id.* at 9-2.110–9-2.120.

70. *See The Investor's Advocate*, *supra* note 50; Winer et al., *supra* note 49.

Attorneys on staff, may make investigative decisions earlier in the enforcement process, to the extent that the investigation is being conducted at the DOJ.[71]

5. Conduct of Enforcement Proceedings

Another significant opportunity for selective enforcement exists in the substantive case actually presented by the SEC or the DOJ in the chosen enforcement proceeding. As earlier noted, enforcement authorities may selectively use the ambiguity in U.S. insider trading regulation in constructing their case against an alleged insider trader. More specifically, having determined to pursue enforcement proceedings against a potential violator under factual circumstances not clearly tested in earlier decisional law (or otherwise settled by SEC regulation or interpretation), the SEC or the DOJ may argue for an expansion of the law to cover these untested factual circumstances.[72] The unclear and imprecise legal standards in U.S. insider trading regulation form the basis for this argument.[73]

The success or failure of an SEC or DOJ argument to increase the scope of insider trading protections is determined by an administrative law judge (in an administrative enforcement proceeding) or the federal

71. U.S. ATT'Y MANUAL, *supra* note 50, at 9-2.001, 9-2.030.

72. This decision making process is the tradition in the development of insider trading regulation under Rule 10b-5. The *O'Hagan* misappropriation theory represents an extension of the duty-based decisional law regarding tippee liability evidenced in the *Dirks* case; the decisional law regarding tippee liability represents an extension of *Chiarella*'s duty-based "disclose or abstain" rule; and the "disclose or abstain" rule represents an expansive interpretation of the language in Rule 10b-5, founded on an earlier SEC administrative proceeding, *In re Cady, Roberts & Co.*, 40 S.E.C. 907 (1961). *See* Symposium, *Insider Trading: Law, Policy, and Theory After O'Hagan: Transcript Of The Roundtable On Insider Trading: Law, Policy, And Theory After O'Hagan*, 20 CARDOZO L. REV. 7, 13, 16 (1998) (comments of Daniel J. Kramer and Roberta S. Karmel, respectively); Benjamin D. Briggs, Notes & Comments: *United States v. O'Hagan: The Supreme Court Validates The Misappropriation Theory Of Insider Trading And Rule 14e-3(a), But Does The Court's Decision Help Or Hinder The Quest For Guiding Principles?*, 15 GA. ST. U. L. REV. 459, 464–67 (1998). The Martha Stewart case well may provide another example. *See supra* note 31; Mark J. Astarita, *The Story of Martha and the Telephone Call, at* http://www.seclaw.com/docs/marthastewartindictmentseccivil0603 (last visited Oct. 3, 2003) (asserting that the SEC's insider trading enforcement action against Stewart "is an attempt by the SEC to expand its powers and authority beyond all permissible bounds"); Countryman, *supra* note 31; Freedman & Lambert, *supra* note 31, at 46 (noting the views of securities lawyers that the Stewart civil and criminal cases "would extend securities laws further than ever before, in terms of who is an insider and what is insider information"); Raymond J. Keating, *Martha May Stand, and That's "A Good Thing,"* NEWSDAY, June 10, 2003, at A32 ("[M]any experts have commented in recent days that the SEC's insider trading charge pushes the bounds of case law."); Malloy, *supra* note 2 (intimating that the SEC insider trading case against Stewart is "at the edges of the law").

73. *See supra* Parts II.A and II.B.

judiciary (in a civil or criminal enforcement proceeding brought in federal court). Accordingly, once the SEC or the DOJ has presented its case, the opportunity for selective enforcement rests substantially on the shoulders of the judiciary. As with other aspects of the decision making process involved in investigating and enforcing alleged insider trading violations, the nature of the adjudicatory process used by, and characteristics personal to, individual members of the federal judiciary (including administrative law judges) may influence the judiciary to either accept or reject the law-expanding arguments of the SEC or the DOJ.[74]

B. Bases of Potential Enforcement Bias in the Martha Stewart Investigation

Thankfully, not every opportunity for selective application of the law or possibility of bias results in the exercise of actual bias against an alleged insider trader. Actual selective application of the law, when combined with a biased process or decision maker, however, may result in biased decision making. The actual experience of bias, in individual cases or in aggregated groupings of cases, may not best serve the purposes and underlying policies of insider trading regulation in the United States.

Selective application of U.S. insider trading regulation by biased decision makers may result in enforcement bias on the basis of any number of suspect classifications, too numerous to list in this paper, and an infinite number of factual scenarios. Accordingly, the possibility of enforcement bias in U.S. insider trading regulation is best explored by analysis of a specific set of facts. The Martha Stewart insider trading matter, about which much has been written in the press, provides an accessible example.[75]

There are a number of easily identifiable bases for the exercise of bias in the Martha Stewart insider trading investigation. In the case of each basis, the ambiguities of substantive U.S. insider trading regulation and the

74. For example, a judge's ideas about gender, party politics, or other matters may impact his or her interpretation of one or more of the various elements of a successful insider trading case. *See* Judith G. Greenberg, *Insider Trading and Family Values*, 4 WM. & MARY J. OF WOMEN & L. 303, 306 (1998) (contending that "the lines the courts have drawn, defining which types of relationships violate the insider trading rules, are influenced by the court's conception of gender roles, and the closely related realms of market and family"). *See generally* Theresa M. Beiner, *What Will Diversity on the Bench Mean for Justice?*, 6 MICH. J. GENDER & L. 113 (1999); Cynthia Grant Bowman, *Women and the Legal Profession*, 7 AM. U. J. GENDER SOC. POL'Y & L. 149 (1998/1999); Jeffrey M. Shaman, *The Impartial Judge: Detachment or Passion?*, 45 DEPAUL L. REV. 605, 626 (1996) ("The case law is . . . replete with instances where judges have expressed racial, ethnic, or gender bias . . . .").

75. *See supra* notes 4–8.

lack of objective, institutionalized enforcement guidelines that are consistently and uniformly applied together create the opportunity for selectivity. The random, individualized nature of the enforcement process, as well as attributes or characteristics personal to the enforcement agent, create the opportunity for enforcement bias.[76] This section focuses on three potential bases for enforcement bias that may have been, or may be, important or determinative in the conduct of the Martha Stewart insider trading investigation and sets forth certain publicly available information that may be relevant to each basis for bias.

1. Martha Stewart is a Woman

Like Leona Helmsley before her, Martha Stewart may be enduring a grueling and detailed investigation and may be facing the prospect of a protracted legal proceeding simply because she is a woman.[77] Martha Stewart is, of course, not the first woman to be subject to investigation for possible insider trading violations.[78] However, the Martha Stewart

76. The importance of the enforcement agent or body to the achievement of equal justice is expressly acknowledged in the U.S. Attorney Manual's Principles of Prosecution. "Important though these principles are to the proper operation of our Federal prosecutorial system, the success of that system must rely ultimately on the character, integrity, sensitivity, and competence of those men and women who are selected to represent the public interest in the Federal criminal justice process. It is with their help that these principles have been prepared, and it is with their efforts that the purposes of these principles will be achieved." U.S. ATT'Y MANUAL, *supra* note 50, at 9-27.001.

77. *See* Borger, *supra* note 8; Mumford, *supra* note 4, at 171–74. In 1991, Leona Helmsley was convicted of federal tax evasion (among other related charges) based on the fact that she signed a joint tax return prepared by accountants. *See* U.S. v. Helmsley, 985 F.2d 1202, 1204 (2d Cir. 1993); U.S. v. Helmsley, 941 F.2d 71 (2d Cir. 1991), *cert. denied*, 502 U.S. 1091 [hereinafter *Helmsley I*]. Harry Helmsley, her husband, was too ill to prosecute, and the DOJ therefore focused its enforcement efforts on Leona Helmsley. *See Helmsley I* at 78. The press has fueled the gender fire in the Martha Stewart case by referring to her using a series of feminine monikers. *See, e.g.*, Barack et al., *supra* note 4 ("Domestic Diva"); Beck, *supra* note 4 ("domestic doyenne"); *Love and Martha*, FIN. TIMES (LONDON), Feb. 5, 2003, at 14 ("dowager of domesticity"); Stanley & Hays, *supra* note 8 (using and defining the term "blondenfreude" and applying it to the Martha Stewart insider trading investigation); Paula Zahn, et al., *CNN People in the News: Profiles of Martha Stewart, Will Smith* (CNN television broadcast, July 6, 2002) *available at* LEXIS, News & Business Library, News Group File ("queen of domesticity"). These labels, among other media aspects of the Martha Stewart investigation, are reminiscent of the media's portrayal of Leona Helmsley. *See* Mumford, *supra* note 4, at 169–70 (noting the use by the media and commercial enterprise of Helmsley's self-constructed public persona as the "queen" of a hotel chain).

78. *See, e.g.*, Barry Flynn, *Deadline Looms in Insider Trading Case for Woman*, ORLANDO SENTINEL, Feb. 14, 2002, at B1; David Glovin, *Girlfriend Faces Charge of Insider Trading*, TORONTO STAR, Mar. 28, 2000, *available at* LEXIS, News Library, News Group File; *Insider-Trading Defendant Settles with SEC*, L. A. TIMES, Apr. 11, 2000, at C2; Timothy L. O'Brien, *He Said, She Said: When Insiders Share a Pillow*, N. Y. TIMES, Jan.

investigation represents a highly publicized attempt to enforce U.S. insider trading regulation against a woman.[79] Accordingly, the SEC may be pursuing its insider trading enforcement action against Martha Stewart to hold her out as an example to other women (presumably as a deterrent) that alleged violations of U.S. insider trading regulation committed by women will be vigorously pursued. As earlier noted, strategic enforcement action is common and is an accepted part of overall enforcement discretion.[80]

Other possible sources of gender bias in the Martha Stewart investigation include the nature, motivation, and agenda of the organizations and individuals that have offered information to the SEC and the DOJ, as well as the enforcement decision makers at the SEC and the DOJ. As a general matter, women not only lack majority status in many federal government bodies, but are also underrepresented in the "permanent Federal workforce" as compared to the civilian labor force.[81] The House Energy and Commerce Committee that investigated Martha Stewart and tendered evidence to the DOJ on her case (as part of its general investigation of trading activity involving ImClone's common stock) was comprised of eight women and forty-nine men.[82] Moreover, women are underrepresented at the SEC and the DOJ, as compared to the "Relevant Civilian Labor Force."[83] The numerical underrepresentation of women in these key enforcement structures, while lacking in formal equality, may not be, without more, a source of actual enforcement bias.[84] However, this

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19, 2003, at § 9, at 1; *SEC files trading charges*, DENV. POST, June 5, 1998, at C-02.

79. *See, e.g., supra* notes 4–8.

80. *See supra* note 16.

81. 2001 FEORP ANN. REP. 31, *available at* http://www.opm.gov/feorp01/ (last visited Oct. 3, 2003) [hereinafter ANNUAL REPORT]. In racial terms, Hispanic women and non-minority women are underrepresented in the permanent Federal workforce, as compared with the civilian labor force. *Id.* at 13.

82. *See* http://energycommerce.house.gov/107/members/members.htm (last visited Oct. 24, 2003) (on file with author). At the time Martha Stewart was investigated, there were 61 women and 374 men in the House overall. *See Women in the U.S. Congress*, *at* http://usgovinfo.about.com/library/weekly/aa121198.htm. Congress is a key legal structure, and the underrepresentation of women in important components of the Congress may be a cause for concern in legislation as well as enforcement. *See* Robin West, *The Aspirational Constitution*, 88 NW. U. L. REV. 241, 250 (1993) ("[W]e have good reason to believe that a Congress with a significant number of women will be more responsive to the needs of women . . . and hence will be a better Congress and enact better laws because of that fact . . . .").

83. ANNUAL REPORT, *supra* note 81, at 34, 35. Only one of the five current SEC Commissioners is a woman. *See Current SEC Commissioners*, *at* http://www.sec.gov/about/commissioner.shtml (last visited Mar. 17, 2003). There has never been more than one female Commissioner at any given time during the history of the SEC. *Concise Directory, Historical Summary*, *at* http://www.sec.gov/about/concise.shtml#history (last visited Feb. 18, 2003).

84. Neither the gender nor any other characteristic of an enforcement agent necessarily has bearing on the agent's ability to carry out her legal duties, especially in the context of a

underrepresentation, together with a lack of (1) feminine values and norms in enforcement and (2) decision making power and influence of women in constructing and implementing the enforcement process, represent potential sources of enforcement bias that may favor or disfavor Martha Stewart and other women.[85] Yet, without empirical evidence in the U.S. insider trading

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facially gender-neutral regulatory scheme. One does not need to accept the notion that enforcement is gendered, however, to acknowledge that gender hostility or affinity may exist in the enforcement context. Women's interests may, in fact, be underrepresented and underserved in U.S. insider trading regulation enforcement because of a lack of representation of women in the enforcement process. *See infra* note 85. For example, the possibility that enforcement authorities desire to make an example of women in the U.S. insider trading regulation context may cause one to question whether the exercise of enforcement discretion against women may be easier if women are not involved in the enforcement process. *See* sources cited *supra* note 16.

However, merely increasing the number of women in various enforcement bodies may not necessarily benefit women. The enforcement structure in U.S. insider trading regulation, as part of our entrenched governmental order, may be seen as inherently patriarchal. *See* Mary Becker, *Patriarchy and Inequality: Towards a Substantive Feminism*, 1999 U. CHI. LEGAL F. 21, 23–26 (1999). The effects of a patriarchal system are not necessarily countered by formal equality. For example, women in enforcement who have male-typical values may participate as coequals to men in proliferating an enforcement bias against women. As Professor Becker cogently summarizes:

> If all that happens in the next ten years is that more male-identified and male-centered women get more power in patriarchal institutions, most women are likely to be no better off than they are today.
>
> If we could jump into an ideal world without any transition, jump into a world in which women had as much power as men (for example, a world in which 50 percent of those in the Senate, the House of Representatives, the Supreme Court, and the Cabinet were suddenly women), [Catharine] MacKinnon's solution might work. All those women with power would then be able to reward qualities other than those associated with masculinity, and might well do so. But MacKinnon's approach is not a blueprint for getting to such a world because, in the short term, giving more power only to a few women—those who rise within patriarchal institutions—will not challenge patriarchy.

Id. at 39 (footnote omitted). *But see* Susan J. Carroll, *The Politics of Difference: Women Public Officials as Agents of Change*, 5 STAN. L. & POL'Y REV. 11 (1994) (arguing that women elected public officials may behave differently than men).

85. *See* Becker, *supra* note 84, at 39. Other scholars also have called for law enforcement reform focused on the nature and composition of the enforcement agents, frequently calling for greater numbers of women in enforcement roles. Professor Jenny Rivera notes:

> There is also the issue of patriarchy and the attitudes of those in the position of enforcing the laws, whether they be prosecutors, judges or court officers. . . . There is a need for extensive change in attitudes. Indeed, women and people of color must be brought into legislative and law enforcement positions in significant numbers to help facilitate such change.

Jenny Rivera, Symposium, *The Civil Rights Remedy of the Violence Against Women Act: Legislative History Policy Implications & Litigation Strategy, A Panel Discussion Sponsored by the Association of the Bar of the City of New York, September 14, 1995*, 4 J.L.

regulation context, it is impossible to determine the probability of enforcement bias resulting from the gender or gender bias of the participants in the enforcement process.

2. Martha Stewart is a Democrat

Some commentators have wondered why relatively early on in her investigation Martha Stewart received a Wells Call[86] regarding alleged insider trading and a Congressional "go ahead," as well as a trial in the public media, on related claims of perjury and obstruction of justice stemming from her testimony before the House Committee on Energy and Commerce. By contrast Kenneth Lay, the former Chief Executive Officer of Enron Corp. (who reportedly cashed out in excess of $70,000,000 of Enron Corp. stock before its market price fell following the public dissemination of facts regarding previously unreported off-balance sheet financing transactions[87]) is yet to have received a Wells Call or be made the subject of legal proceedings of any kind.[88] Many also ask why President

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& POL'Y 409, 417–18 (1994). Similarly, Professor Mary Jo White observes, after noting the significant number of female U.S. Attorneys:

> What we are seeking, of course, is the day that it is no longer news that a woman has been appointed or elected to any high position. The focus should be on the person and his or her qualifications, not on gender. This business of numbers and women firsts can be—and is—overblown sometimes. But we should also not kid ourselves—some numbers do matter .... The numbers and percentages do matter to how much clout and comfort we have in any given professional setting.

The 2002 Sandra Day O'Connor Medal of Honor Recipient—Mary Jo White, 26 SETON HALL LEGIS. J. 263, 266–68 (2002).

86. For an explanation of the Wells Call, see *supra* note 61. Martha Stewart is reported to have received a Wells Call in or about October 2002. *See* John Crudele, *ImClone-SAC Link—Hedge Fund Called Waksal Same Day as Martha*, N.Y. POST, Jan. 23, 2003, at 031; Greg Farrell, *SEC Close to Filing Charges on Stewart*, USA TODAY, Oct. 22, 2002, at 1A; Randi F. Marshall, *Stewart Case Lull Sparks Speculation*, NEWSDAY (New York), Nov. 26, 2002, at A58; Thomas S. Mulligan & Walter Hamilton, *SEC Likely to Charge Martha Stewart; The Staff Recommends Civil Action in the ImClone Insider Trading Case, a Source Says*, L.A. TIMES, Oct. 22, 2002, Pt. 1, at 1; Greg B. Smith, *Heat's on Martha Again; Feds To File Civil Suit, Criminal Probe Still On*, DAILY NEWS (New York), Jan. 18, 2003, at 7; Paul Tharp & John Lehmann, *Martha Scandal Heating Up*, N.Y. POST, Jan. 18, 2003, at 014.

87. *See* Mary Flood & Tom Fowler, *Grand Jurors Eye Lay; $70 Million in Stock Sales Focus of Probe*, HOUS. CHRON., Oct. 24, 2002; *Lay May Face Insider Trading Charges*, Aug. 29, 2002, *at* http://www.nysscpa.org/home/2002/802/4week/article40.htm (last visited Oct. 24, 2003); Jane Weaver, *Lay May Face Insider Trading Charges*, *at* http://www.msnbc.com/news/799703.asp#BODY (Aug. 28, 2002).

88. Many of these commentators fail to note that the facts regarding Lay's numerous securities transactions are significantly different from those regarding the single ImClone stock sale engaged in by Martha Stewart. For example, Lay's sales were made over time,

Bush's trading transactions in the common stock of Harken Energy Corp. have not received more investigative or enforcement attention.[89] Some of these commentators focus on political party affiliation and contributions as a principal distinguishing factor between Martha Stewart, on the one hand, and Ken Lay and President Bush, on the other.[90] Martha Stewart is a Democrat and a financial contributor to the Democratic Party; Kenneth Lay is a Republican and a financial contributor to the Republican Party, and President Bush is also a Republican.[91]

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starting in December 2000. *See* Flood & Fowler, *supra* note 87. Some of the sales were made to pay off loans. Some of Lay's sales were made on a programmed basis under a plan meeting the requirements of Rule 10b5-1(c), 17 C.F.R. § 240.10b5-1. *Id.* Lay sold his stock back to Enron Corp. (which presumably had at least the same amount of information that Lay individually had at the time of the sale), not to uninformed investors in the open market. *See* Kurt Eichenwald, *Enron Inquiry Is Now Examining Whether Company Inflated Assets*, N.Y. TIMES, Dec. 26, 2002, at A1. Also, Lay sold shares of a corporation of which he then was an insider, not publicly held shares of a third-party corporation. *Id.* Accordingly, he likely would be pursued for enforcement purposes under the classic insider trading theory, while Stewart, who traded in shares of a corporation as to which she is not apparently an insider, is being pursued under a variant of the tippee liability theory. *See supra* note 31. It should be noted here, however, that Stewart also is being pursued in private actions for insider trading in connection with certain sales by her of stock of Martha Stewart Omnimedia, Inc. at times when she allegedly knew that she would be investigated for insider trading violations in connection with her December 2001 sale of ImClone's stock. *See Class Action Filed Against Martha Stewart*, SRiMedia, *at* http://www.srimedia.com/artman/publish/printer_379.shtml (Feb. 5, 2003); *Martha Stewart Sued by Investor*, *at* http://news.bbc.co.uk/1/hi/business/2210598.stm (Aug. 22, 2002) ("The lawsuit alleges that Ms Stewart sold shares in her own company, Martha Stewart Living Omnimedia, because she knew she could be investigated on suspicion of insider trading in the ImClone case."); Joel Ryan, *Martha's Mess Gets Messier*, *at* http://www.eonline.com/News/Items/0,1,10430,00.html (Aug. 22, 2002) ("The class-action lawsuits further accuse Stewart of dumping 3 million shares of her own company in January when investigators began to circle ImClone (but while the Omnimedia stock price was still nice and healthy)."); Smith, *supra* note 2 ("Stewart dumped 3 million shares of Martha Stewart Living Omnimedia stock Jan. 8, the same day ImClone first learned it was the subject of an insider trading probe, according to the suit."). Accordingly, it may be misleading to directly compare possible claims against the two alleged insider traders.

89. *See* Buchanan et al., *supra* note 8; *Cooking with Martha: What's Good for the Goose*, *at* http://www.thedailyenron.com/documents/20020703081640-38022.asp (July 3, 2002); Paula Dwyer, *The Ghosts That Won't Go Away*, BUS. WEEK, July 22, 2002, at 34; Hill, *supra* note 8; *Martha Stewart Case Reveals Double Standard*, *supra* note 8; Paul Krugman, *Everyone Is Outraged*, N.Y. TIMES, July 2, 2002, at A21; Van Susteren, *supra* note 8. *But see* Byron York, *The Democrats' Latest Hit Job*, NAT'L REV. ONLINE, July 3, 2002, *at* http://www.nationalreview.com/york/york070302.asp (expressing the view that President Bush is being inappropriately targeted). Vice President Dick Cheney's trading transactions in the stock of Halliburton Co. raise similar questions. *See Martha Stewart Case Reveals Double Standard*, *supra* note 8.

90. *See* Hill, *supra* note 8; *Martha Stewart Case Reveals Double Standard*, *supra* note 8; Van Susteren, *supra* note 8.

91. *See* Jim Lehrer, *The NewsHour with Jim Lehrer: Building Walls; 401 (Chaos); Language Skills; Political Wrap* (television broadcast, Jan. 18, 2002), *available at* LEXIS,

Although information about enforcement bias based on political party affiliation and support may be limited and inconclusive, there is factual support for the premise that political party affiliation and support is a source of enforcement bias in the Martha Stewart investigation. The SEC or the DOJ may be using Martha Stewart's political party affiliation strategically. On one hand, Stewart's affiliation with and contributions to the Democratic Party, while public, are not key identifying factors. However, many are aware of her party affiliation, and this awareness provides a basis for the strategic use of enforcement discretion. By investigating Martha Stewart, the SEC and the DOJ can send a strong message that Democrats are not immune from insider trading enforcement.[92]

Another basis for this source of potential enforcement bias is a lack of majority status or other power and influence on the part of Democrats in key parts of the enforcement structure, including the organizations and individuals that have offered information to the SEC and the DOJ (e.g., the House Energy and Commerce Committee), as well as the enforcement decision makers at the SEC and the DOJ. For example, the House Energy and Commerce Committee that investigated Martha Stewart consisted of twenty-six Democrats and thirty-one Republicans.[93] In the SEC, at least at the important level of the Commissioners themselves, the basis for bias is less clear, however. Under statutory law, not more than three of the five Commissioners of the SEC may be members of the same political party, and the statute directs the President of the United States to appoint, "by and with the advice and consent of the Senate," members of different political parties to the SEC "alternately as nearly as may be practicable."[94] This statutory provision both creates and forecloses opportunities for the exercise of enforcement bias on the basis of political party affiliation.[95]

3. Martha Stewart is a Public Figure

Martha Stewart is an easily identifiable and visible social, cultural,

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News & Business Library, News Group File; Van Susteren, *supra* note 8.

92. *See* sources cited *supra* note 16.

93. *See* http://www.polisci.com/almanac/legis/comm/01060.htm (last visited Jan. 25, 2003) (list of members of the House Committee on Energy and Commerce). As a whole, the House of Representatives for the 107th Congress (during which time Martha Stewart's investigative hearings were conducted) consisted of 221 Republicans, 212 Democrats, and two others. *See* http://clerk.house.gov/histHigh/Congressional_History/partyDiv.php (last visited Oct. 3, 2003).

94. 15 U.S.C. § 78(d)(a) (2003).

95. *See* Pitt & Shapiro, *supra* note 10, at 169–70. Among other things, the President's political party affiliation and the political party composition of Congress may impact the extent to which politics influences SEC enforcement.

and media force in the United States. She leads a highly public life and has a well known personal and professional dossier. The visible nature of Martha Stewart's life and work also provides a basis for enforcement bias, even if the precise nature of the bias may be hard to gauge.[96] The SEC and the DOJ may be using the Martha Stewart investigation to send a message to the investing public that public figures are not immune from insider trading enforcement.[97]

The potential for bias based on Martha Stewart's status as a public figure derives not just from the extensive use of her name, image, and voice in the public media, but also (and perhaps more significantly) from the polarizing reactions to her highly public life and work.[98] Martha Stewart

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96. *See* Beard & Earle, *supra* note 5; Begala & Carlson, *supra* note 8; Borger, *supra* note 8; *Crossfire-McAuliffe*, *supra* note 8; *Crossfire-Scapegoat*, *supra* note 8; Jenkins, *supra* note 8. *But see* Greising, *supra* note 4 (discounting the impact of Stewart's "big name" on her possible liability for violation of insider trading prohibitions). The specter of public figure bias, which can benefit or detriment a putative defendant, has been noted by a number of commentators. *See* Dooley, *supra* note 26, at 323 ("publicity and other considerations that appear likely to advance the agency's interests often determine its choice of an enforcement target"); Beth A. Wilkinson & Steven H. Schulman, *When Talk is not Cheap: Communications with the Media, the Government and Other Parties in High Profile White Collar Criminal Cases*, 39 AM. CRIM. L. REV. 203, 210 (2002) ("In a close case, where the question of whether to indict is one of clear prosecutorial discretion, the prosecutor knows he is unlikely to be second-guessed for failing to indict a media darling."). Former SEC Chairman Harvey Pitt once wrote (referring to the SEC) that "[w]hen required to choose between proceeding against a relatively nondescript target and a highly visible one . . . an enforcement agency generally is apt to choose the highly visible target if it wants to achieve the greatest deterrent effect for its enforcement efforts. . . . A case of smaller dimensions (in terms of the magnitude or complexity of the illegal conduct alleged) with a more visible target may be deemed to be more appropriate than a larger case with a less visible target." Pitt & Shapiro, *supra* note 10, at 184.

97. *See* Jenkins, *supra* note 8. The choice to prosecute female public figures is also a common use of enforcement discretion. *See* sources cited *supra* note 16. In addition to the Leona Helmsley case earlier referenced, there have been many notable female celebrity prosecutions for alleged or actual criminal violations of various kinds. Among the more memorable modern female celebrity prosecutions are those of Zsa Zsa Gabor (driving without a license and related charges) and, more recently, Winona Ryder (shoplifting). *See* Nick Madigan, *Actress Sentenced to Probation for Shoplifting*, N.Y. TIMES, Dec. 7, 2002, at A12; *Meeting Again*, N.Y. TIMES, Mar. 4, 1990, Sec. 4, at 7. The notoriety of celebrity defendants in these and other cases effectively turns each defendant into a media-sponsored "poster child" for a public service campaign against the crime allegedly committed.

98. *See* Matthew Arnold, *Celebrity Clients—Shielding Your Client From Overexposure*, PR WEEK (US), Sept. 30, 2002, at 20; Borger, *supra* note 8; Kudlow, *supra* note 4; Stanley & Hays, *supra* note 8. A serious question exists as to whether the media may advantage or disadvantage a public figure criminal defendant at and prior to trial. *See* Mumford, *supra* note 4, at 171 n.12 (and accompanying text). More specifically, the question should be asked as to whether both Helmsley and Stewart have been prejudged in the media to such an extent that bias is the logical result. *Id.* at 175. Media coverage of the Martha Stewart investigation has been extraordinary and wide-ranging. *See* Toobin, *supra* note 4. Even cartoonists have gotten into the act, many of whom have featured Stewart in jail-related

can be seen as thoroughly modern and yet also as a traditionalist. She is both feminist and antifeminist—a substantial and powerful public company founder and director (having formerly worked, ironically enough, as a stock broker)[99] and a domestic diva,[100] touting conventional female roles in society and the family by purveying recipes, dispensing home decorating hints, and popularizing legions of craft projects.[101] Informants and decision makers involved at various junctures in the insider trading enforcement structure may come from either the "Save Martha" or "Surrender Martha" side of public opinion, and we do not know which.[102] If enforcement bias emanates from this source, it is hard to prove with reliable, objective data.

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cartoons that mock her public identity as a style maven. *See Martha Stewart Jokes*, *at* http://politicalhumor.about.com/cs/marthastewart/index.htm (last visited Jan. 25, 2003). Moreover, since the filing of the criminal indictment and civil enforcement action against her, Stewart has fought back in the news media. On June 5, 2003, Stewart purchased a full-page advertisement in *USA Today* stating her innocence and inviting the public to her "special Website," http://www.marthatalks.com. *See An Open Letter From Martha Stewart*, USA TODAY, June 5, 2003, at 7A. In its first 17 hours, the website received 1.7 million hits. *See* Bruce Horowitz, *Stewart uploads her cause to Web site*, USA TODAY, June 6, 2003, at 1B.

99. *See* Zahn, *supra* note 77.

100. *See supra* note 77.

101. In this area of inquiry, Martha Stewart's gender and public figure status fuse to form a unified, if somewhat contradictory, analytical whole. If Leona Helmsley is "the apotheosis of the punishment of the 1980s stereotype career woman," Mumford, *supra* note 4, at 176–79, then Martha Stewart is her parallel in the early 21st century. There exist in the public those who are delighted to see Stewart fall from grace. *See* Stanley & Hays, *supra* note 8. One journalist aptly notes:

> Let's face it: Martha can't catch a break. Not only is she a high-profile woman; she's also an easy target as an insider who broke into the boys club of finance. Now she's getting punished for her temerity. "How many men who have been accused of insider trading have been treated this way?" asks Betty Spence, President of the National Association for Female Executives. "The coverage is this big because she's a woman." Was Ken Lay ever accused, as Stewart was, of "clawing" his way to the top?
>
> Then again, it's not only the men who are making fun of Martha; we women are having at it, too. Some of us just don't like her, which is allowed. But why cheer for her failure? Maybe it's because there's a certain elite comfort that Martha's success comes from the celebration of the very kitchen that we baby boom women pledged to escape. Or maybe it's because there's no missing the obvious irony of perfect Martha Stewart making a mess. We love irony, not ironing.

Borger, *supra* note 8.

102. *See* http://www.savemartha.com (last visited Oct. 24, 2003) (a website apparently created and supported by Martha Stewart sympathizers that features and links to information regarding the Martha Stewart investigation and purveys related products); http://www.surrendermartha.com (last visited Oct. 24, 2003) (a website formerly featuring products unsympathetic to Martha Stewart that now purveys unrelated merchandise).

Moreover, if the media is a source of information used by enforcement agents at any stage of the insider trading enforcement process, there is another potential basis for enforcement bias in the Martha Stewart insider trading investigation. The press tends to focus its attention on large transactions, well capitalized issuers, and public figures.[103] Martha Stewart's status as a public figure and director of a NYSE-traded public company may put her at an advantage or disadvantage in the enforcement process. Information about Martha Stewart is widely available, and there are many investigative journalists in the field to assist the U.S. Congress, the SEC, and the DOJ in assembling information during the investigatory stages of the process.

Finally, because of Martha Stewart's status as a public figure, the SEC or the DOJ may have felt some pressure to investigate her stock trade and to initiate or refrain from commencing enforcement proceedings against her.[104] The media has covered the investigation of Martha Stewart's ImClone stock trade in great detail from the start. This extensive media coverage may create a public expectation that Martha Stewart will be held accountable for her actions, regardless of whether those actions violate U.S. insider trading regulation. Enforcement officials at the SEC or the DOJ may perceive that this expectation exists and may not want to frustrate it (and, in so doing, give the impression that public figures can violate or evade the law with impunity). Alternatively, the media attention paid to the Martha Stewart investigation may create some public sympathy for Stewart, making it less likely that the SEC or the DOJ will pursue enforcement proceedings against her. These public figure, media-related phenomena may create an actual insider trading enforcement bias against or for public figures.

103. *See* MARSHALL MCLUHAN, UNDERSTANDING MEDIA 215 (Seventh Printing 1998) ("[I]n its selection of the newsworthy, the press prefers those persons who have already been accorded some notoriety existence in movies, radio, TV, and drama."). Moreover, because the press views bad news as the only real news, *see id.* at 205, it desires to unmask and document deemed falls from grace. *See* Arnold, *supra* note 98; Borger, *supra* note 8; Stanley & Hays, *supra* note 8.

104. *See* Byron, *supra* note 4; Phillips et al., *supra* note 10, at 35 ("[I]nvestigations sometimes are undertaken into seemingly minor violations because they relate to activities that have received significant press coverage . . . .").

IV. Preliminary Recommendations and Suggestions for Further Inquiry and Change

A. Further Investigate Potential Sources of Enforcement Selectivity and Bias

The bases for bias in the Martha Stewart investigation described above are just that—*bases* for bias. One could argue whether—and, if so, how—these sources of potential bias have resulted in the exercise of actual bias in her case or in any similarly situated case.[105]

Rather than argue the point, it seems prudent to suggest more rigorous investigation of these and other identified bases for the exercise of actual bias in U.S. insider trading regulation.[106] With empirical evidence supporting or contradicting the existence of actual bias in U.S. insider trading regulation, those advocating change will be armed not only with better evidence of the need for reform but also with information that enables them to target reform efforts in a more meaningful way.[107] For example, evidence of the exercise of actual gender bias at any stage in the insider trading enforcement process may lead to reform efforts targeted to limiting or eradicating gender bias at that stage in the process, as opposed to broader reform initiatives.

Data regarding actual bias can be obtained from studies and anecdotal

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105. Interestingly, however, many members of the November 2002 audience for delivery of an earlier draft of this paper, *see supra* note *, were quick to comment that one or more of the identified bases for bias in the Martha Stewart matter, taken in the context of U.S. insider trading regulation and the then publicized facts regarding Stewart's December 2001 sale of ImClone stock, indicate actual bias, at least circumstantially. Although this paper acknowledges the potential validity of that viewpoint, the author recommends a more conservative approach to the determination of actual bias in the Martha Stewart matter, preferring instead to use the paper both as a vehicle for identification of the potential for the existence of actual bias in and outside the Martha Stewart case and as an impetus for further, more thorough, analysis.

106. Although this appears to be a safe and conservative approach, the retrieval and analysis of empirical data on actual bias has some risks. For one thing, the research design or implementation may be faulty. For another, results of the research, regardless of the integrity and accuracy of that research, erroneously may be considered conclusive for all purposes, for all time, thereby affecting legislative, regulatory, enforcement, and societal behavior in ways that ultimately prove to be inconsistent with the policy underpinnings of U.S. insider trading regulation or otherwise undesirable. *See* Theresa A Gabaldon, *Assumptions About Relationships Reflected in the Federal Securities Laws*, 17 WIS. WOMEN'S L.J. 215, 248–49 (2002).

107. *See* Kane, *supra* note 13, at 2306 (discussing reforms that would allow the use of statistical evidence of racial discrimination in making a case for discriminatory prosecution); Mumford, *supra* note 4, at 184 ("[U]ntil the experience of women at the hands of the tax collection authorities in both the UK and the U.S. is addressed, the foundations for understanding will remain incomplete.").

evidence.[108] Some studies can be conducted using publicly available information; some will require access to personnel and internal records at the SEC and the DOJ (which may or may not be forthcoming).[109] The details of any comprehensive study of bias in insider trading enforcement should be determined by a combined team of social scientists and legal scholars. However, any study ideally should have certain basic parameters. The researchers should gather data from investigations and enforcement decision making at both the SEC and the DOJ and from both administrative and court proceedings (civil and criminal). Independent data should be gathered at each stage of the enforcement process for each source of bias identified for study. In this way, data can be reported both individually and on various collective bases and can easily be compared, contrasted, and read with other data, both public and non-public, regarding the nature of the applicable enforcement agencies and their officials. The purpose of this suggested data retrieval structure is two-fold—to allow for highly informed decision making and to permit the use of the data in as many ways as possible.

Anecdotal evidence of actual bias may be obtained in interviews of officials and staff or found in internal SEC or DOJ meeting notes, memoranda, or electronic mail messages, some of which may be subject to disclosure under the Freedom of Information Act ("FOIA").[110] For the same reasons identified above with respect to study data, researchers seeking anecdotal data should seek information regarding both the SEC and the DOJ, all possible enforcement proceedings, and each stage in the enforcement process. Anecdotal data, together with available data from studies of the enforcement process, will best enable scholars, courts, legislators, and regulators to identify sources of actual bias and suggest or implement corrective substantive or procedural changes to the structure of insider trading regulation.

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108. Research of varying kinds already has been conducted to identify bias in a number of contexts. *See, e.g.*, Bowman, *supra* note 74, at 165–68 (gender bias in the courts); Kane, *supra* note 13, at 2295–300 (racial bias in criminal investigations and prosecutions).

109. The SEC has a web site (http://www.sec.gov) with significant amounts of information on charges and settlements, among other things. Regrettably, however, the site has only limited search capabilities. Accordingly, even if relevant information about the defendant (e.g., gender, political party affiliation, public-figure status, etc.) were available through the site, the site would not permit ready access to that information. The web site for the U.S. Department of Justice (http://www.usdoj.gov), while also a fine source of public information, is similarly unhelpful in regard to obtaining evidence of actual bias.

110. 5 U.S.C. § 552 (2003). Certain memoranda circulated internally within the executive branch may, however, be privileged and not subject to mandatory disclosure under the FOIA. *See* Kane, *supra* note 13, at 2308.

B. *Identify Ways in Which the Potential for Bias May be Obviated or Limited*

Even without empirical evidence of existing, actual bias in U.S. insider trading enforcement, reform may be desirable. The potential for selectivity and bias is both significant and pervasive, raising questions as to the efficacy of U.S. insider trading regulation. These questions are serious ones, in light of the purpose of U.S. insider trading regulation and the current low level of public confidence in the U.S. public securities markets.[111] United States insider trading regulation is intended to promote the integrity of U.S. securities trading markets by prohibiting the use of confidential information in trading transactions when that use constitutes or arises from a breach of fiduciary duty or another duty of trust or confidence.[112] Enforcement of the law against specific people or classes of people may or may not serve that policy objective. The exercise of actual or perceived enforcement bias may, in fact, give the investing public the impression that certain alleged violators are immune from enforcement, thereby undercutting the integrity of the market at a time when public confidence in the U.S. securities markets is at a low point.

Accordingly, means of obviating or limiting the potential for enforcement bias seem appropriate. These reforms may be instituted at any level in the regulatory structure, from the operative statutory law to related

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111. Dave Barry, *Crack Accounting*, WASH. POST, Aug. 4, 2002, at W32; Chris Bury & Dave Marash, *Nightline: A Matter of Trust: Has Main Street Lost Faith in Wall Street?* (ABC News television broadcast, June 13, 2002), *available at* LEXIS, News & Business Library, News Group File; Chris Reidy, *Seeking Calm for Roiled Markets*, B. GLOBE, July 12, 2002, at C1.

112. As one scholar cogently summarizes:

> Why is the insider's use of nonpublic information unfair? The answer can be explained, in part, by the importance of the capital markets to the large publicly held corporation. Absent a system in which corporations have ready access to capital markets, access which is facilitated by the availability of safe, liquid, regulated markets for secondary trading, the public corporation would be unlikely to attain the same size and dominance. This growth, in turn, provides management with unparalleled opportunities for wealth and status. Thus, in a sense, the corporate insider's superior access, due to his position, may be partially attributed to government and public participation in the markets. It is the fact that an insider has obtained his informational advantage because of his position, *and* the fact that this position is attributable to the presence of other less-privileged transactors in the market, that makes the insider's use of nonpublic information unfair.

Fisch, *supra* note 13, at 227–28. *See also* Nagy, *supra* note 40, at 1271–72 (referring to general insider trading policy underlying the misappropriation theory of liability). Said another way, U.S. insider trading regulation is designed to prevent insiders from benefiting personally from any information advantage they may have over other traders in the secondary markets.

SEC rules and regulations to internal agency guidelines applicable to investigations and the initiation and conduct of enforcement proceedings.[113] Substantive insider trading reform could, for example, add precision to the duty to "disclose or abstain" by more clearly identifying the classes of people who may violate U.S. insider trading principles. This reform may be accomplished by better defining, in law or regulation, both insiders and those outside of the issuer, whose use of material, nonpublic information triggers the imposition of insider trading liability.[114] Better clarity as to the definition of insider trading or the scope of information governed by U.S. insider trading information also could be beneficial.[115] For example, one might inquire whether it is enough (to trigger liability) that an insider has conveyed to someone outside the issuer the fact that she plans to sell some securities and, if that type of information is to be considered material, nonpublic information, under what circumstances liability should be imposed.[116] These and other substantive reforms should focus on clarifying the legal basis for U.S. insider trading regulation in an manner and with an effect that is consistent with established underlying legislative and regulatory policy objectives.

U.S. insider trading regulation also may benefit from procedural reform. Reform proposals of a procedural nature may be adopted in addition to or in lieu of any substantive reform and could include changes in the information retrieval and analysis systems used by the SEC and the FBI (as well as the exchanges and the NASD) in the decision to initiate, and (as applicable) conduct, inquiries and investigations. In this area, both sources and types of information could be regulated to limit or avoid selective enforcement or enforcement bias. Procedural reforms also could incorporate specific, institutionalized enforcement guidelines, consistently

113. It should be noted that the implementation of substantive or procedural changes in U.S. insider trading regulation might not correct observed decision making biases. The corrective capacity of law and regulation in addressing biases is unclear, at best. *See* Stephen M. Bainbridge, *Mandatory Disclosure: A Behavioral Analysis*, 68 U. CIN. L. REV. 1023, 1056–58 (2000).

114. For an intriguing set of proposals along these lines, see Theresa Gabaldon, *supra* note 106, at 248 (2002) (suggesting, among other things, mandatory reporting by those with whom insiders have privately discussed the issuer's business and the imposition of liability on any of those people if he, she, or it trades in the issuer's securities before the information becomes public).

115. Reform of this nature often has been suggested. *See generally,* Fisch, *supra* note 13. The SEC's promulgation of Rules 10b5-1, 17 C.F.R. § 240.10b5-1, and 10b5-2, 17 C.F.R. § 240.10b5-2, and its issuance of Staff Accounting Bulletin No. 99, *at* http://www.sec.gov/interps/account/sab99.htm (last modified Aug. 18, 1999), represent steps in the direction of enhanced clarity.

116. Based on the SEC Complaint and news accounts, it is possible that this is the only information that Martha Stewart had when she made her December 2001 trade in ImClone shares. *See supra* notes 2, 7.

and uniformly applied.[117] Examples of this type of reform could consist of parallel and meaningful investigatory guidelines for the SEC and the FBI or more specific, detailed criteria for use by the SEC and the U.S. Attorney in determining whether to initiate enforcement proceedings against an alleged insider trader. The specific nature of any procedural reforms should be based on a detailed review of current procedures and should be designed to serve the legislative and regulatory policies underlying U.S. insider trading regulation.

V. Conclusion

The system and enforcement of insider trading regulation in the United States present significant opportunities for selective enforcement and the exercise of enforcement bias. These prospects for selectivity and bias arise out of both the unclear and imprecise substance of U.S. insider trading regulation and the relatively unrestricted nature of the related multiple and overlapping enforcement processes. Although the opportunity for selectivity and bias may or may not result in the exercise of actual bias in any individual case or group of cases, the threat to the integrity of our securities markets is a clear and present danger.[118]

U.S. insider trading regulation can best deter unlawful activity and support and promote the integrity of the securities markets if it more clearly and precisely identifies and punishes those who undermine or challenge that market integrity by engaging in transactions based on their privileged access to significant, undisclosed information.[119] Otherwise, the potential for a veritable witch hunt exists, in which U.S. insider trading regulation could be used as a tool in a goal-oriented process to root out and punish market participants in accordance with a social, political, or economic agenda other than that for which U.S. insider trading regulation was intended.

Especially (but not exclusively) if evidence of actual insider trading

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117. *See* Susan E. Spangler, *Snatching Legislative Power: the Justice Department's Refusal to Enforce the Parental Kidnapping Prevention Act*, Comment, 73 J. CRIM. L. & CRIMINOLOGY 1176, 1200 n.113 (1982) ("Professor Davis . . . has argued that 'the assumptions on which prosecutors' uncontrolled discretion is founded are in need of reexamination . . . that a full study of the prosecuting power is likely to produce a movement in the direction of greater control of discretion, through more confinement, more structuring, more checks, and more procedural protections.'"). The benefits of clear, written, enforcement guidelines may extend beyond the alleged insider traders to the government agencies and the public at large. *See* Kane, *supra* note 13, at 2307.

118. This phrase is borrowed from the 1994 Paramount Pictures film of the same name, based on a novel by Tom Clancy and starring Harrison Ford, but also was earlier used by Justice Oliver Wendell Holmes in Schenck v. United States, 249 U.S. 47 (1919).

119. *See* Fisch, *supra* note 13.

enforcement bias can be shown, some reform in U.S. insider trading regulation is desirable, if not necessary, and can be achieved in a variety of ways. It makes sense both to assemble additional information regarding selectivity and bias in insider trading enforcement and to institute reform in the near term to restore market integrity.[120]

120. It should be noted that substantive or procedural reform in U.S. insider trading regulation also may ensure more efficient and effective resource utilization in the pursuit of alleged insider traders, although that matter is beyond the scope of this paper.