

Securities and Exchange Commission Historical Society
Interview with James Brigagliano
Conducted on July 15, 2014 by Kenneth Durr

KD: This is an interview with James Brigagliano for the SEC Historical Society's virtual museum and archive of the history of financial regulation. I am Kenneth Durr. Today is July 15, 2014, and we are at Sidley Austin in Washington, D.C. Mr. Brigagliano, thank you very much for taking some time to talk today. I want to start with the beginning, go back and touch on your education a bit. You went to Amherst, I guess. Are you a New England native, or did you just happen to get up there?

JB: No, I grew up in Long Island, in Valley Stream, specifically, in New York State. I went to college at Amherst and graduated in May, 1979, with a B.A. in American Studies.

KD: Did you know that you wanted to go into law?

JB: I had some interest in law from my youth. So yes, I expected to go into law.

KD: And you came to Washington, D.C.

JB: Yes, well I went to law school at Georgetown, so that brought me to Washington.

KD: Did you develop an interest in securities law at that point?

JB: Not specifically. I was more interested in litigation of some sort, but I then took a job in New York at a small corporate firm called Burke & Burke, where I did a range of corporate and securities transactional matters, and I became somewhat interested in securities regulation at that time.

KD: And how did you get an opportunity to come to the SEC?

JB: Well, after a couple years at the firm, like many young associates, I was looking for a government experience, whether at a U.S. attorney's office or the SEC. I had a friend from law school who was working at the SEC, Tom McGonigle, and he spoke highly of his SEC experience, so I sent a resume and came down and interviewed with a couple of divisions, both the Division of Enforcement and the Office of General Counsel. I had offers from both, and joined the General Counsel's Office in 1986.

KD: Why did you choose the General Counsel's Office?

JB: Because at that time, my interest was more in litigation and writing briefs and doing arguments than it was in investigating securities law violations, which I thought would be much more document-intensive versus legal research and writing.

KD: It sounds like you got to do some of the courtroom work, some of the litigation work.

JB: I did. There was quite a bit of discovery. In that office, we were kind of operating like a U.S. attorney's office for the civil division. I was a sort of assistant U.S. attorney with my client, one client, being the SEC. But instead of prosecuting, we were doing defensive work, some at the district court level and some at the appellate level, where the SEC or its staff would be challenged in particular activities.

For example, if someone took the position that their rights were being violated somehow in an investigation, or an investigation ruined their business, or they didn't want to produce records that the Commission wanted, or they wanted records from the Commission; they wanted information that the Commission viewed as privileged, we would represent the Commission. Also, at times, the investigative staff was sought to be deposed, so in a sense, the defense played offense, and they tried to get discovery from the SEC. And so, in that case, the Enforcement Division would represent the Commission in the underlying action, and we would represent the staff and the Commission in defending whatever the subject of the investigation threw at the Commission.

We were sort of the guard dog for the program divisions, and sometimes other divisions. Witnesses were sought in, for example, major civil trials relating to securities matters. Some of those matters might have been before the Commission in one way or another, and so the litigants might want information or testimony from staff in the Division of Corporation Finance, who may have reviewed a registration statement or may have views

about how the regulations work. Sometimes parties in private litigation wanted to take discovery on that material, and we would be that person's lawyer.

KD: Now, this is the mid to late 1980s.

JB: Correct.

KD: What kinds of issues are hot at this point? Was there mergers and takeover stuff?

JB: Well, there were some of the insider trading cases. I think *Boesky*, and then the *Milken* cases. Also, what was called microcap fraud. First Jersey was a prominent firm that was selling securities in lots of startup companies, heavily advertising to people. They did an ad with Robert Brennan, the president, in a helicopter, and got a lot of press. Some of the ad activity might be similar to what you would have seen in *The Wolf of Wall Street*, in these boiler room shops, selling dreams.

KD: Was that what Blinder, Robinson was, too?

JB: Blinder, Robinson was another firm. Stratton Oakmont was also, I guess, Jordan Belfort's firm, and Bob Brennan, First Jersey Securities. And so the Commission was conducting investigations into those firms, and so those firms were fighting back in a variety of ways. There was lots of discovery, so I got involved in some of those cases.

Really, you can think of it as protecting the Commission's flank while it brought an action, while it surged forward.

KD: So you're just kind of defending the fact that the SEC's ability to do these things is written into the securities laws.

JB: That's right, and the idea is that the program divisions would move forward as we defended them. We were escort fighters for the bombers.

KD: You sort of get them in the trenches, and then you move out.

JB: Yes, we were police escorts or whatever. And then I also did some appellate work, just various cases. We had an appellate section, but they didn't take all the appeals, and we may have been involved early on, so I got to argue in at least a half a dozen courts of appeals, and that was a lot of fun.

KD: These are district courts?

JB: Those were federal courts of appeal, one level below the Supreme Court. So those were good cases because you'd write a brief and then have an oral argument before three judges, typically, and it was a very scholarly exercise. Obviously, there'd be someone on the other side, and you'd make your argument and answer questions from the judges.

KD: Did any of those stand out in particular?

JB: Yes, there was a wiretap statute case which went en banc, which means it was not only heard by an appellate panel, but by the full court of appeals, which was twelve or thirteen judges. That was a case where the Commission was pursuing an insider trading investigation that started from a voicemail that was obtained privately by company employees. These employees suspected an affair between an executive and another employee, and so they intercepted phone calls, in a sense, and made tapes. When one of those tapes involved the executive saying (something to the effect of), “When we release the numbers next week, the stock’s really going to go down. I’ve shorted it; you should, too,” that was sort of a classic insider trading fact pattern, so one of the employees took it to the FBI. The FBI gave the tape to the SEC, and the SEC commenced an investigation.

The SEC took the executive’s testimony and played the tape, at which point the executive’s lawyer stopped proceedings and went and got an injunction to prevent the SEC from using the tape, then got another injunction to stop the Commission’s investigation. That was in the district court in Tennessee. So we appealed those up to the Sixth Circuit in Cincinnati and ultimately prevailed. But during all that litigation, the federal prosecutor in Los Angeles, who had jurisdiction, prosecuted criminally the executive and obtained a conviction without the tape. And actually, that was an example of had the defendant just settled, probably would not have been prosecuted. But that’s the most excitement and I would call, say, fun that I’ve ever had and gotten paid for.

KD: What was the name of that case?

JB: *SEC v. Smith*. It was under seal for a while, but then it was unsealed.

KD: Yes, that would be why it didn't show up when I was doing my research.

JB: So that was a good case, because again, arguing before twelve judges is a very stimulating exercise. They were all very well prepared, they have great law clerks, they're scholars, and they ask the hard questions, and so answering those is fun, is exciting.

KD: Much more difficult than a single judge, though?

JB: Yes, maybe. It depends on where the judge is coming from. But the district court argument can be more difficult because it's less cabined. In an appellate argument, the issues are more set out in the briefs, and you're less likely to be surprised, or you should be less likely to be surprised. In a district court, the judge can ask about all sorts of facts, or other cases, or other business of the Commission you may not even think is at issue. And it may not be at issue, but the judge might be interested.

KD: Things can come out of nowhere.

JB: Yes, I was once in an argument, a tougher moment, where the judge was asking about another case the SEC was handling before him, and he didn't like the way it was handling it. But of course, I was not involved in that case at all, yet he thought I should know it chapter and verse. So you know it's not always easy.

KD: So what do you do? You say, "I have no idea what you're talking about here"?

JB: You can offer to get facts and look into questions that the judge has, and then try to steer the judge back to the case at hand, which is what I did, but it's not a comfortable moment. So in a sense, the district court is much more of an uncertain environment than the court of appeals.

KD: Interesting. You talked about the idea of the shock troops and helping the SEC move the front forward a little bit. I saw that cases like First Jersey and Blinder, Robinson, they went on for years, I think, or at least almost a year or more. Is that an example of this kind of thing?

JB: Yes. Those cases, particularly First Jersey, went on. And then we would be involved sporadically, really, where the investigation would go on, and there would be events. The defendants would file a lawsuit, or there'd be a motion, or you'd get a subpoena, and we'd handle it.

KD: So the investigation would stop, you'd deal with it in court—

JB: Well, it would go on, and that was the point. And Enforcement would keep doing what it's doing, and then we would handle whatever came in, so we were tag teaming.

KD: I want to back up a little bit and talk about the people you trained with when you came in. Was Dan Goelzer the General Counsel?

JB: Dan Goelzer was the General Counsel at the time. Linda Fienberg was the Associate General Counsel. They're both extremely qualified people and very talented. I worked with Dan a little bit, but at that time he was obviously running the whole office. And I worked with Linda a little more, but she moved into another area. She moved into policy and off to be counsel for Richard Breeden, to do other things. So I didn't have a lot of time with Linda. She's very smart, one of the brightest people I've ever worked with. That's one of the reasons I wanted to take the job, because frankly, I sort of wanted to work for people like that. And then Richard Humes, with whom I worked most of the time, more than anyone there. Richard really taught me how to write a brief, and he was a good strategist. He's a terrific lawyer, and also a nice person to work for.

But there were a lot of people. You worked with other people in the office. Paul Gonson was the solicitor, and he's really one of the great appellate litigators, I think, in our time, and someone of consummate grace and professionalism and very, very ethical; insisted that the SEC lawyers always practiced to the highest standards. Nothing was said in a brief that wasn't accurate or well supported. Paul set that standard. Jake Stillman, who is

still there, who's brilliant, and he's the appellate lawyer extraordinaire. I didn't work with Jake a lot, but he was an icon and still is.

KD: So your title, at least at the beginning, was special trial counsel, right?

JB: Well, it started, it probably was just staff attorney, and then special trial counsel, and then assistant general counsel, staff attorney from '86 to '88, special trial counsel from '88 to '91, assistant general counsel from '91 to '98.

KD: And how did your job change as you moved up?

JB: I just started managing. Instead of writing the first draft of a brief, started supervising others, and editing, and having staff attorneys under me.

KD: How did the cases that you were dealing with change as you moved through the 1980s?

JB: I think it was the same kind of thing. There was the occasional interesting wiretap case, but a lot of what was called RFPA, Right to Financial Privacy Act cases, where when the SEC subpoenaed someone's bank records, they would have a right to challenge the bank or that subpoena, and the SEC had to demonstrate why it had a right to the records, why they were relevant, and we would write those briefs. Again, lots of discovery against the Commission, constitutional action saying we were violating someone's rights. That

smattering always existed. I'm not sure they changed fundamentally as a group. I just think it was occasionally there'd be an interesting issue or a more challenging case.

And then some of the senior Commission people in other divisions were witnesses for prosecutors in cases that the Commission had referred to federal prosecutors. So if the Commission did an investigation and it showed conduct that was viewed as criminal, more than just a civil violation—more serious—it might refer the matter to a U.S.

Attorney's office. They would initiate a prosecution, and then sometimes the prosecutors sought a Commission staffer as a witness to basically talk about the securities laws, and I would represent them. I represented some senior people in Corporation Finance and Trading and Markets, and that kind of thing. Or, it was then Market Reg. Mickey Beach, Bill Morley, both senior people in Corp Fin.

And in civil cases, sometimes former employees' testimony was sought, and we would represent them. I represented Chairman Breeden in a deposition. He had left. He had gone to Coopers & Lybrand, I believe, so we went up to New York. We couldn't stop his deposition, but I was there to assert privileges and work with him because the testimony related to his work. Actually, it was in the Salomon Brothers Treasury bid-rigging scandal. It had to do with some conversations he had had with John Gutfreund of Salomon Brothers, which was kind of a big deal. But we couldn't stop that, because it wasn't privileged. What a Commission person says to a civilian, an outsider, is not governmentally privileged, certainly not once the investigation's over. So plaintiffs in a class action against Salomon Brothers sought Breeden's testimony. They wanted to hear

about the phone call; they wanted to establish that basically, he had told Gutfreund that he had a problem, because that would be helpful to their case. So I'd do things like I'd go up and represent him in depositions, which I did. So those were interesting.

KD: *O'Hagan* went through when you were in the General Counsel's Office.

JB: It did. I know that case; I didn't work on it. That was done by the appellate section. *Bellzberg* was another big case then. There were a number of them.

KD: Any others that we should talk about?

JB: Well, there was the *Shearson* case, where the Commission took an amicus supporting the securities industry in enforcing arbitration clauses and account agreements. That was very significant, and a case which some of the staff disagreed with, because it basically took the position that if a securities firm required a customer to agree to arbitrate and not go to court for any disputes, that that was enforceable. And that was somewhat controversial in the office, but the Commission took that position.

KD: But that's just sort of staff opinions, I guess?

JB: Those were just staff. Some staff disagreed with that.

KD: Were these necessarily legal arguments, or just they felt—

JB: More of a policy argument, because it was whether that should be enforceable, because you could say the customers really don't have any bargaining power, so it's an adhesion contract, and the SEC should not be sanctioning forced arbitration. Of course, as a policy matter, you can argue the other side that arbitration is actually a better forum for consumers, because litigation court is too expensive for most of their cases. So in a sense, it's not clear. There are arguments on both sides, but it was controversial.

KD: It's interesting, this process you're talking about, sort of talking out the legal implications and arguments on both sides. Was this part of your job as you started to supervise people?

JB: Well, in our case you had to consider the program ramifications of what the litigation might bring. We had a case where a judge required a production of an action memorandum, which is the most sensitive commission document, an action memorandum recommending an enforcement action. The judge had a very narrow view of the attorney-client privilege, and so we debated whether to appeal that. Ultimately, we didn't appeal. The way the litigation evolved, it worked out okay. But the choice there would have been if we lost on appeal, you could have had a more difficult—so the Commission often had to decide, if it had a bad district court decision, it might be a bad decision, but it only had a limited impact because it was only governed in that small district. But of course, if you appeal, well, you might reverse that. But if you lose, now you've lost in a circuit. If you lose in a circuit, that's much more powerful and a concern for your program. So when you litigate, you always have to think about not just your

own view of the strength of your arguments or the law, but what are the ramifications of winning or losing, and what your client needs, and what the program requires.

KD: So the action memorandum in that case came out, but you managed not to set precedent on a broader scale.

JB: That's right. So yes, litigation, again, is a result-oriented process where you're trying to put your client in the best position. It's not really about just an argument over who's right.

KD: Any other highlights from the General Counsel days?

JB: No, that's about it.

KD: Well, you talked about this results-oriented process, and I guess it must have been kind of different going into Market Reg, in some respects. How did you make the transition from being the lawyer for the SEC to stepping into one of the divisions?

JB: Well, there were a couple assessments that were made. One, I started as I was representing witnesses from the program divisions, like Corporation Finance and Market Regulation. I became more interested in the underlying securities industry and the regulatory issues, so I started to just be more interested in working directly with that

rather than focusing on the litigation. I represented some really interesting experts, and that made me want to think about working for a program division.

KD: Like who?

JB: Well, Bill Morley and Mickey Beach in Corp Fin, and the late Jonathan Kallman in Market Regulation, Joe Furey in Market Regulation. Of course, Chairman Breeden. We represented Rich Lindsay, then Director of Market Regulation, but not in testimony, just in advising in a case. And then there were people in the Division of Enforcement, of course; that was a bit different. It also seemed like the focus of the SEC was on policy and regulatory policy, and not so much—the General Counsel’s job, particularly in our area, it was very important, but you weren’t on the front lines of recognition. Richard Humes used to say the only way a Commissioner will know your name is if you make a mistake. So the beef at the SEC, and the star power, was not in that office. You were support. You were the linemen, not the quarterback.

So anyway, at the time, as we evolved to the late nineties, the dotcom bubble markets were booming and law firms were hiring, and so they were hiring lots of people away from the program divisions, and that created some openings, so I applied for a couple. I think that it was also very hard to move into a management position from another division, because you were getting a job over staff that already worked there. It’s a difficult move to make. But the turnover was enough, so I think they were willing to take someone with management experience who might stay for a while.

KD: So you went into the Office of Trading Practices.

JB: Right, to work for Larry Bergmann, who was the Associate Director. Larry had a reputation as being very smart, very scholarly, and very nice, and he's all of those things. He was one of the hardest working people at the Commission, and the most thoughtful, and really was a great teacher.

KD: What was the agenda? What was happening?

JB: Well, the agenda early on was—the dotcom bubble burst. And so there was concern about abuses in initial public offerings and whether underwriters, in a sense, created extra froth in the market. These stocks, these companies that never made any money were offering their stock at about \$20, and demand was such that it would rise into the hundreds on the first day, which was an absurd valuation. Not all of that was because of bad behavior, but there were concerns that some firms were stimulating the market through their underwriting practices, and so I started to work on those issues.

Simultaneously with that, part of that dotcom bubble featured research analysts, who became stars on CNBC and they were talking about the next Microsoft and which dotcom was going to go through the roof, they became media stars as they would have price targets for these new companies that were stratospheric. And they became the stars of the investment banks. The investment banks would on occasion appear to be competing for

business by telling whatever dotcom that they would take their stock higher, that they would write a more glowing report.

Well, that kind of behavior led to some reports that were too glowing, and what concerned us was that there were conflicts of interest that were not disclosed, and a lot of the people who were watching CNBC didn't know that the dotcom company was an important investment banking client of the securities firm, that the analysts might have stock in the company that they were recommending, and so if the stock went up, the person writing the research report stood to make a lot of money when they sold their stock. And we thought disclosure of those conflicts was very important.

KD: Is this in the late nineties?

JB: This is in the late nineties, early 2000s.

KD: So this was before things really rose to—

JB: It culminated in what was called the global settlement, and frankly, sort of a research scandal. But we were trying, often with difficulty, to get people interested in having better disclosure for investors so that they would know the conflicts, and then they could choose to invest or not. And we were met with resistance. The industry didn't want to do it, some regulators didn't want to discourage the party, no one wanted to turn the music down, before it crashed.

KD: There was nobody who would logically have listened?

JB: Well, I think they should have listened, but, again, people don't want to burst the bubble. Times were good.

KD: How did you go about doing this? Did you just put out releases or talk to people?

JB: Well, we were trying to get releases out. We talked to industry, we talked to the SROs, the New York Stock Exchange and the NASD, to try to get them to enforce their rules and work with them, and ultimately developed a good working relationship, but it took a while. And frankly, it took certain e-mails that were found by New York Attorney General Eliot Spitzer, in which basically an analyst was viewed to have issued a very favorable report on a dotcom, meanwhile telling his clients that it really wasn't very good. And so that's not good behavior, when the public is told buy this stock, and the key clients are told it's a dog. And that really culminated, that was a high profile scandal, and Eliot Spitzer became an overnight star in some quarters.

KD: What did that mean for the SEC?

JB: Well, it meant for the SEC that they're in a position where it was their turf, and here was a state officer who seemed to be in the lead in ferreting out this scandal. So the SEC ramped up an investigation of all the securities firms, and more evidence was found that there should be concerns. Again, not everything was wrong, but there were concerns.

Anyway, it led to what was called the global settlement, where all the firms agreed to revise their procedures, and there were extensive rules imposed through that enforcement case. And Market Regulation was involved in helping create those rules. And at the same time, Congress passed Sarbanes-Oxley, which directed the Commission and the SROs to develop additional rules to address analyst conflicts of interest.

KD: I noticed in some case that there's an issue where Eliot Spitzer and his global settlement, some of the people involved are seeing a mismatch between the terms of the settlement and the SEC rules, and so there's this attempt to catch up, in some respects.

JB: Yes, there are some differences. The settlement governed firms that were found to have committed violations; they had one set of rules. And the SROs, with our assistance, developed rules for the entire industry. And the view was there might well be different rules, because certain firms were found to have violated the law and agreed to a settlement, and other firms hadn't done that, so their rules didn't need to be so strict, necessarily.

KD: Was this something that Enforcement was involved in?

JB: Very, very. Absolutely. The SEC brought a case against all these firms. That's the global settlement. So no, the SEC did a tremendous amount of work in the area, but really, the catalyst to ratchet it up were those e-mails that Spitzer found.

KD: How about your group in Market Reg, since you were involved in this a little early?

JB: Well, we were working with both the Division of Enforcement and also the SROs to craft rules, so it was a busy time. It was a very big project on a couple of fronts, and ultimately, I think extensive rules were imposed. But I actually think it's an example, to some extent, that had people accepted a more modest regulation earlier, they might not have gotten more extreme regulation later, which, to me, is a cautionary tale.

KD: Right. And it's similar to the one you told earlier about the defendant in that case. Crafting rules is something you wouldn't have done in the General Counsel's Office.

JB: No.

KD: So tell me a little bit about how you learned to do that and how that process works.

JB: Well, first you need to consider whether you have a regulatory concern, whether there is conduct that you think violates principles of the Exchange Act. Because the SEC is governed by the law, and the Exchange Act directs the SEC to address certain areas, to have a national market system, to have markets that are free of manipulation, that firms should have certain levels of capital. There are all sorts of principles, some fairly specific and some more general, to have information barriers so you don't have misuse of nonpublic information. And there the law is broad, and Congress gives the SEC authority to make more specific rules. So if you see conduct that is a concern—it may not be

illegal, but it may be a concern—then you try to do some fact-finding and consider whether there is a—and sometimes it’s a modification of an existing rule, not a whole new rule—whether a rule that governs the activity, let’s say short selling as a certain trading activity, is there a way that that might be changed? And if you think there is, and you think it’s a workable solution, you come up with rule text and draft a release and then put it out for comment.

And so you get comment from the public, which includes the industry, and often that comment really helps the process because there is information that the regulators don’t have. So you have credible comment, often from industry. Not all of it I think is very credible, but certainly some is. And you follow up comment letters with meetings and try to see if, after reading all the comments, you still think there should be a rule and whether it should be modified pursuant to the comments, and that’s often the case. And then you recommend that the Commission adopt the rule. It’s a very long process, it’s cumbersome, it can take years. But that’s how rulemaking is done.

KD: Is there a tendency to be conservative, to just figure out the minimum that you need to do in order not to push things too far?

JB: Well, I think at the proposing stage, there’s a tendency to be a little less conservative. And there should be, because the axiom is you can always cut back, but you can’t add at the adoption stage. You can pare back what you’ve proposed, but you can’t adopt something new, because people haven’t had a chance to comment on it. That’s an APA

principle, an Administrative Procedure Act principle. And there are lots of people involved in the rulemaking, so you have staff people that work on it, and rule text is discussed, and there's lots of input; it's a complete team effort.

And there's lots of review by the division, and then by the Commissioners and their counsels and the General Counsel's Office. So there were other divisions who are interested, so some part of the reason it takes so long is a good reason. I think in some cases it takes longer than it has to, but there is extensive input from many, many people. It's never a solo effort to make a rule.

KD: You started the discussion of what was happening in Market Reg early in your time, leading us up to the global settlement. I would think that the electronic exchanges, the real big changes that were happening in the markets themselves, would have been a big issue at that point.

JB: Well, there are lots of issues. Yes, there's the conversion to decimal trading was a significant issue, going from fractions to decimals, and we worked on rules in that regard. We worked on a sub-penny rule to prevent trading in sub-pennies.

KD: Was Market 2000 before your time?

JB: No, that was shortly after I arrived. I did not work on that specifically. The division had different units that worked on different things, so that was market supervision. Howard Kramer, another—

KD: But my sense was that was some kind of blueprint, sort of “this is where we think we’d like to go on these issues.”

JB: Yes, it was a staff report which kind of analyzed the status of the markets. There were order-handling rules passed near that time in response to another scandal about the inter-positioning of orders and how certain market makers may be taking advantage of their situation to intermediate in a way that was not good for investors. It cost them a lot of money. So there was extensive rulemaking, and that led into, then, Regulation NMS, which is a big deal. Again, that was by the Office of Market Supervision. .

KD: You were in Trading Practices.

JB: Yes, I was in Trading Practices.

KD: Outline for me what your purview is then.

JB: Well, again, IPOs and research were a big deal then. We also worked on anti-manipulation rules in connection with tender offers, the Rule 14e-5, and we worked with the Office of Mergers and Acquisitions. We did a lot of no-action letters in

connection with mostly cross-border tender offers. Another big facet was short selling. When the markets went down, particularly, then there became more of a focus on short selling, which some people view as a way that some people can drive a price of a security down. But there were a couple big issues going on in short selling, and one was whether to have a price test. Historically, you couldn't short below the last trade or the last sale price.

KD: Is that the tick test?

JB: Yes, the tick test. The idea was that short sellers should not lead the market down. If the price of a stock was going to fall, it should be owners of the stock that led that, not speculators. Now, it was from the thirties. But there came to be a view that the tick test was no longer necessary. There was good surveillance for manipulation, and it interfered with the smooth provision of liquidity. The Commission ultimately did a pilot program to test the tick test, and ultimately discarded it. You know, these were long rulemakings.

KD: Right.

JB: And then it brought back a circuit breaker sometime around the meltdown, when markets plunged again, and the circuit breaker imposed another price test. Instead of being based on the last sale, it was based on the bid, and so you couldn't be below the best bid and lead the market down that way. Same idea, but only if a stock had declined by 10 percent, so it's a test that's not in effect most of the time. But when Chairman

Schapiro came in, a lot of Congress apparently asked her to look at bringing back a short sale price test. Because during the meltdown, when stocks went from 14,000 to 7,000, there was concern about short sellers.

KD: Are you talking about the flash crash here?

JB: No, I'm talking about the meltdown in '07 and '08, the Lehman failure, and when stocks went down generally. This is over a couple years. And so a price test was brought back. The other thing that happened was that, actually even before that, the focus of short selling switched from price test to preventing naked short selling, and people shorting without borrowing stock, and failing on their trades because they would short stock and not deliver. So we passed rules to address that. Basically, we rewrote the short selling regime, and then that was a big deal. That's what I worked on.

KD: That's Reg SHO.

JB: That's Reg SHO.

KD: Tell me when short selling becomes a problem, and why. When did you first start noticing this?

JB: Well, short selling can be a problem if a stock is viewed as weak and short sellers can kind of pile on and exacerbate a decline in a way that may be in excess of what a

non-manipulated market would entail. There's a great deal of debate as to whether that happens, and I don't think it's been proven that that exists. It certainly can exist, but I don't know that that's very extensive. But there is a strong political view that's somewhat skeptical of short sellers, because after all, they're selling something they don't own. But short selling can have a great utility in liquidity, so if someone's a market maker and you want to buy stock, the market maker can short the stock for you and then cover in the market, and that way you can get the stock at the best price it's trading at right away. It happens very quickly, it's low cost, and the market maker covers, so short selling can be very useful for markets, as well.

How much it's abused, I think there are instances where a trader may spread rumors or basically badmouth a stock, and they have a short position, and it declines, and they make money. There's a discrete rule, its Rule 105, which is actively policed by the SEC today. That's where if a stock is trading and the company is going to do another offering, if you know you're going to get stock in the offering, you know that they're going to price the stock below market on whatever their pricing day is, so you short it on Tuesday and it prices on Friday. You know, you've helped drive the stock down. You cover, you buy the stock in the offering cheaper, you make your risk-free profit. And there's a rule, SEC Rule 105, that I spent a lot of time working on, that seeks to stop that, and that is heavily enforced by the SEC today.

KD: But in any case, in the early, mid-2000s there, 2003-4, you're getting corporations, they're saying people are shorting our stock on purpose. I think it was Martha Stewart and some others.

JB: Right, right. Short selling is an issue that resonates on Main Street. It's not so much a partisan issue; it's more of a Main Street versus Wall Street issue, where it just doesn't sound good to Main Street that people sell what they don't own.

KD: And you actually got a lot of press, I think, in the middle of one of those discussions about short selling.

JB: Well, there were a number of people who, when they lost money, they blamed short sellers, and then they blamed the SEC for not stopping short sellers. And I don't think that's most people, but certainly there were people who wrote letters and complained to their congressmen and that sort of thing. But in many cases, those people had invested, perhaps based on a chatroom, in a company that was untested, highly risky, and when the company had problems and the stock went down, they were looking for someone to blame. That was often the case. And sometimes, short sellers sniffed out a bad company before other people.

KD: But you did craft Reg SHO, and so there were some things that you could find that you did want to sort of—

JB: Yes, the fails. The idea that you should borrow and deliver stock if you're short selling. So it's basically creating rules so that you could sell short, but when you did that, you had to borrow and deliver stock. The idea is when people purchased stock, it would be there. I mean, stock is fungible, but that was something Chairman Cox felt strongly about at the time we worked on Reg SHO. In '04, he was there. In '08, as well; it was revised. But I think probably '08 that Chairman Cox was involved, and not '04.

KD: And you had a threshold list. What was the function of that?

JB: Well, the threshold list was one of the first iterations of Reg SHO. It focused on the idea that the regulation should police high levels of long-term fails. So are these companies, which seemed to be people weren't delivering stock, and that's where the rule should bite. And that was really the '04 version. In '08, Chairman Cox, in a sense, toughened that up to move from the threshold list to basically moving to where, if the stock wasn't delivered by the settlement cycle, which is trade plus three, T-3, then the firm had to close out and buy the stock on the morning of T-4. So that's what happened in '08.

KD: Was there pressure to make that happen?

JB: Sure.

KD: And we skipped right over Sarbanes-Oxley and the implementation of rules surrounding that. Were you involved in some of those?

JB: Only the research part. I mean, Sarbanes-Oxley also focused on accounting, right? Because it was post-Enron.

KD: Pretty heavily.

JB: Right, but there was a research component, and that's what I was involved in.

KD: And I came across something that I'd never heard of before that had your name attached somewhere, which was married puts.

JB: Married puts was another sort of short selling strategy where a trader would pair the purchase of stock with the purchase of a put, which was a right to sell the stock. It was basically a kind of a synthetic short selling strategy, and the Commission viewed it as potentially abusive, but not always. But there was a concern, again, that people could trigger a destabilizing movement in the stock through the use of married puts, that it was an effort to sort of get around short sale rules.

KD: So Reg SHO, the first iteration I guess came out in 2005, and Reg NMS at the same time. You mentioned earlier that a lot of these things that you were looking at led up to Reg NMS. Can you tell me a little bit about that process?

JB: Well, that was really more some of the order-handling issues led up to NMS. I did not craft NMS. I know something about it, but that was Bob Colby and Dan Gray and some other folks. Annette Nazareth.

KD: So you touched a little bit on the Great Recession and the stock market plunging there after Lehman Brothers. Any other fallout from that that your group in Market Reg had to deal with?

JB: Well, I think it was the beginning of the large trader rule that was adopted a couple years later, because during the first meltdown, we saw some volatility late in the day where the stocks would go down by 5 percent very quickly, and we wanted to know more about that, and it was hard to do a market reconstruction. And ultimately, some years later, after the flash crash when the markets dropped precipitously and it took three months for the Commission to do a reconstruction, finally the Commission adopted a large trader rule, which allowed it not only to identify large traders, but to be able to have a system of identification numbers that it could use to pull trading data quickly, so that when a market event happened, the Commission could do forensics much more quickly. So in a sense, that started with the meltdown.

KD: Is this related to the audit trail?

JB: Well, the consolidated audit trail will be a further way to track trading, and that's right, Large trader is more limited tool, but an important one which, again, will allow the Commission to learn more, more quickly.

KD: How did that tool work?

JB: Well, there's a threshold of trading to be a large trader, and if you are a large trader, you have to get an ID number. And broker-dealers have to have the capacity to track trading by ID numbers. So if the Commission decides it wants to investigate trading in IBM on October 10th by large traders, it can ask the brokers for all that trading material and get it within twenty-four hours. So that's how the rule works.

KD: So basically, you can just start the investigation all that much sooner.

JB: Right. So that was an important advancement, and I would jump to the 15c3-5, the market access rule, which basically requires broker-dealers who provide access to the markets for customers, usually institutional traders, and who access the markets themselves, to have both financial controls to make sure that the customers have credit and they can pay for what they're trading, and that the regulatory requirements are met before there are trades, and to prevent things like error trades and fat finger controls, which should help limit Flash Crash opportunities.

KD: And that came out of that?

JB: That came out of that. And then the other post-flash crash tools involved circuit breakers, limit up/limit down. The Commission has taken a number of steps to address potentially destabilizing activity and market glitches, which can drain confidence. Operational issues.

KD: So these were rules that were crafted, and somebody has to decide—like limit up/limit down, what were the specifics on that?

JB: Well, basically it's to prevent trades going off above, beyond a band where the market's trading, so it's to prevent, in a sense, if you think about it as an erroneous trade. If the market is 10 to 10.02, a trade should not be going off at \$50. So limit up/limit down prevents executions beyond the market band. And the market can move, naturally. But again, it's designed to prevent trades at absurd prices.

KD: It's not going to take great leaps.

JB: Well, yes, leaps that clearly are not a function of supply and demand; they're a function of some error.

KD: The market break in '87, there was a lot of talk about circuit breakers and things like that at that point. Was that just for the exchanges themselves? The SEC wasn't involved at that point?

JB: Well, I think the SEC was involved. I was in the General Counsel's Office still, then, and that was actually when Congress gave the Commission large trader authority, I believe. And the Commission proposed but did not adopt a rule, because everyone was so opposed to it.

KD: Alright, we're getting down to some of the issues of recent times. Dark pools. I know that you were involved in some respects with—

JB: Well, you know, one of the things that we wanted to determine was what ATS's, dark pools, disclosed to customers about how they handle their orders, and that's an important focus still today. That's pretty recent. Basically the idea is to make sure that when customers provide liquidity, send their orders to whatever trading platform, that they understand how those orders will be treated, where they'll be sent, who will get to see the orders. And that was an important goal, and I know when I was there, we were surveying firm practices on that issue, and that continues to be a focus at the SEC.

Also, in '09, the Commission proposed a release to require trade reporting by venue, so that when a trade was executed in a particular dark pool, it would be identified as such. That release was not adopted, but FINRA and the SROs just did a version of that concept at a lower level, not as specific as the Commission had proposed. But so that brings additional transparency to dark pool activity, which is important.

KD: Was this another one of those Wall Street versus Main Street issues?

JB: No, I think there's a fair amount of support for that. I don't really think there's a real split. Again, there was a rough consensus that there should be some additional transparency. I mean, it's really hard to argue with. I don't know that Wall Street was fungible, but they didn't want a trade-by-trade disclosure on the consolidated tape of which dark pool—that they would have been comfortable with end-of-day aggregated statistics. So no, I think there is probably some level of consensus that additional transparency was warranted there. There are a number of areas where the industry isn't just opposed to regulation, but there is kind of a middle ground that could be reached.

KD: What's another one? You say there's a number of areas like that.

JB: Oh, I think some of the rules that the Commission proposed—there's a display rule for orders, and the Commission proposed that these actionable indications of interest, which function like orders, ought to be displayed, and I think there was considerable support for that. It was not adopted. But things like after the flash crash, the circuit breakers, limit up/limit down, had a lot of industry support.

KD: So at this point, are you an associate director?

JB: Well, I became an associate director in 2006 to 2009, and then deputy from 2009 to 2011, and co-acting director from April to December of 2009.

KD: Did that work pretty well, having two acting directors?

JB: It did, because Dan Gallagher and I kind of split responsibilities, and because there were different units in the division, that was entirely smooth. We each kind of had our own domains, and then on management issues and so forth we worked together, and it went virtually seamlessly. Although, that said, we would have been happy to have Erik Sirri stick around for a while.

KD: How much can a director shape the agenda and the focus?

JB: Significantly. Of course, it all starts with the Chairman. The Chairman is the most important and influential person. The Chairman sets the agenda, but if you're a division director and if you've come to work for a Chairman, hopefully you have a good working relationship, and the Chairman has faith in you and listens to you. And the Chairman's got a lot to do, has lots of divisions to worry about, so I think there's a real opportunity for the director to not only make recommendations, but just really push a lot of things through. And then there's a lot of action at the staff level that should happen. Things like no-action letters and exemptions, staff legal bulletins, guidance. I think there's quite a bit of administration of rules that is done at the staff level, and should be, that the director can supervise.

KD: You emphasize the importance of no-action letters, which is sort of an inverse way of governing something. I mean, you're essentially telling people, "We've thought about it; go ahead and do that," right?

JB: That's right, because rules are very blunt instruments, and markets evolve, activities evolve. Rules are not written to fit all these specific activities. So you can have an activity that technically violates a rule, but doesn't cause the harm the rule was trying to prevent. So it often can be a very useful and legitimate activity, whether to conduct a transaction or a certain training activity, and a no-action letter can allow that useful market activity to get done, while at the same time, preserving the protections that the rule was designed for. So you can build in conditions, and you're giving relief based on certain representations, so it's a way to sort of further scope the rules and make the rules like a laser rather than a shotgun. So the process is a good one.

KD: But it's subtractive in a way, rather than additive.

JB: Well, Yes. I guess I would say it's more sculpting. And conditions, also, can be rigorous. So the conditions can limit the subtraction.

KD: Were there issues or ongoing challenges that kept coming back again throughout your time at Market Reg?

JB: Well, I think that one of the greatest challenges is getting business information. The Commission can have lots of smart lawyers, economists, accountants, and whomever else, and they can work hard, and they do work hard. But they don't have traders and bankers, by and large, and often, there's a real deficit in terms of knowing the activity that's going on, and that's the hardest thing for the Commission to get. Now, the Commission has recently been able to hire some fellows and other people who've worked in industry, and I think that's a good thing, and some people with quantitative expertise. I think the more of that, the better. That's smart.

KD: But that wasn't happening in the 2000s?

JB: It was somewhat, but it has geared up more lately, and I think it's a good trend.

KD: Any challenges, any problems that you worked on over and over again as far as rulemaking?

JB: Well, I think it's very challenging to get—there's an inertia principle, there's a limited number of meetings, the Commission has to hear other rules, go through the seriatim process where they go Commissioner to Commissioner. And basically, one Commissioner can hold something up, and the only remedy is for the Chairman to put it on the calendar, and that may be contentious or not. So in order to get a lot of rulemaking done, you need a Chairman who wants to get it done.

KD: Did any of the Chairmen that you served under particularly want to get it done?

JB: Well, I think they all had different priorities, and so there were things that were important to them. My view in general is that the Commission, the staff does the work, and more of it should be brought to fruition because too much gets held up. It's not just new rules. Sometimes it's deregulating.

KD: But this is held up by the Commission structure?

JB: Right. And sometimes it is even a guidance or a no-action process. I think the Commission and its staff should be very active in giving guidance, again, whether it's no-action, whether it's a new rule, whether it's answering FAQs, frequently asked questions. I think the Commission ought to be engaged, because if it doesn't do that, sometimes the vacuum is filled by enforcement, in a sense, and I don't mean just the Commission. SRO enforcement, examiners on the ground who can kind of impose conditions that may not be evident from the rules, so the industry can get surprised.

KD: Was there a time in your career when that was particularly a problem?

JB: I think later, the latter part of the career was harder, but it's always been challenging. And sometimes there can be different amounts of General Counsel review. General Counsels can be very conservative about doing anything, because to some extent, they may see action as creating risk, whatever the action is.

KD: One issue that we haven't spoken about is high frequency trading. We talked about the flash crash, and I believe you were involved in looking into high frequency trading toward the end there.

JB: Well, high frequency, the Commission has been for a while sensitive to and surveilling for trading that's abusive, whether you call it high frequency or not. I mean, trading shouldn't be manipulative, and it shouldn't be front-running, and it shouldn't be based on MNPI. It's not necessarily a problem if it's fast.

KD: What's MNPI?

JB: Material non-public information. So there are principles that a certain kind of trading can be problematic, but it's not simply because it's fast.

KD: I got that, but on the other hand, trading is getting faster.

JB: And the Commission is being sensitive to operational issues, so the market access rule is very important. That's key, and that's a big step to policing rogue high frequency traders, if they're out there. The other thing the Commission is considering, I believe, is making sure that—and Chair White has spoken of this—that any high frequency trader that's not registered ought to be registered so the SEC can examine it, or FINRA can. So I think there are steps that need to be taken. Any high frequency trader that's a significant one

should be registered. That would also create a level playing field if the brokers were all registered.

And Reg SCI that the Commission has proposed, to have more operational capability is a higher priority in the markets. It already is a high priority, but that's another step to protect the market's integrity. So it's not a matter of saying high frequency trading is bad or good. If there are manifestations of activity that need to be addressed, then they should be.

KD: Right. A useful sense of perspective, I guess. Did Dodd-Frank pretty much occupy your—

JB: I worked on some aspects. There were quite a few rules that it required, basically a scheme of regulation for security-based swaps, which were a kind of over-the-counter derivative. The CFTC has most authority over most swaps, and the SEC has a limited number, but important ones, like credit default swaps. So I worked on a couple of rules with people, and yes, they were rolling out slowly, and they're still largely unfinished.

KD: That's a huge job, implementing Dodd-Frank.

JB: Well, it is. But again, I think that the Commission needs to move at a certain pace.

KD: Your decision to come to Sidley, did you just feel like it was time to head out?

JB: Well, there was an early retirement opportunity, and yes, I thought it was—there are always a variety of factors that cause one to leave, and there were in this case.

KD: So you've been here for a few years now.

JB: Two years, eight months now.

KD: Has that changed your perspective on your time at the SEC? Have you come to look at it differently or appreciate things in a different way?

JB: Not fundamentally. I missed my colleagues the day I left, and working with teams of people in a way that was free of commercial imperatives, that you could just do the work you had to do with a team of people and not worry about billing it or whether a client would pay for it. It was a lot of work. We were working hard, but it's a little different. And getting to make policy is satisfying and fulfilling. There were frustrations because it was too slow.

And I think when I was—I truly believe there is a sensible center, and there are regulatory concerns that can be addressed with workable rules. Arthur Levitt put a logo on pads that said something like, "Important work, good people, workable rules." I'm not getting it quite right, but he really had it right. So there is a way to get it done, and

again, since I've been here, I am concerned that we're seeing too much regulation by enforcement and not enough by regulators.

KD: Anything else we should talk about before we call it quits for the day?

JB: No, I don't think so.

KD: Well that's a great place to stop. Thank you very much.

[End of Interview]