Securities and Exchange Commission Historical Society
Interview with Henry Manne
Conducted on August 6, 2012 by James Stocker

JS: This is an interview with Henry Manne for the SEC Historical Society's virtual museum and archive on the history of financial regulation. I'm James Stocker. Today is August 6, 2012. We're talking at Professor's Manne's home in Naples, Florida. Professor Manne, thanks for having me here today.

HM: It's a pleasure to be with you, James.

JS: To start off, where were you born and where did you grow up?

HM: I was born in New Orleans and grew up from the age of four in Memphis. I went through public schools in Memphis. I went to college in Tennessee, at Vanderbilt, and after college, I left the South. I went to the University of Chicago Law School and then Yale Law School for an SJD.

JS: Just to go back a little bit, was either of your parents a lawyer?

HM: No. My father was a merchant, and my mother worked with him.

JS: As a young man, did you plan on having a career in law?

HM: No. As a matter of fact, like many people, even today I think, it was sort of all that was left. After I had excluded doing everything else, I went to law school.

JS: Were you an avid reader when you were young?

HM: I wouldn't say avid, but I was a good student, and that meant reading. Memphis in the thirties and forties had a superb public education system for the white population. I can't attest to what it was for the poor blacks. It was totally segregated, of course, which was one of the reasons I was anxious to leave the South. But the education was very good. I don't think that quality of public school exists anywhere today.

JS: Would you say that you had any early influences, literary or philosophical, that strike you as important?

HM: In the family background were merchants. My great-grandfather had been a peddler, as was not uncommon with Jewish immigrants, and had founded a store in a small country town, New Madrid, Missouri, and I rather grew up in a commercial environment. I understood what retailing was about, what marketing was about. As I once said jokingly, "In law school, I was perhaps the only person in my class the first year who had ever seen a bill of lading." So that there was a little bit of that in my background, but nothing very specific that I can point to.

JS: Would you have described at the time as either conservative or libertarian?

HM: No, I think you would have described me by the standards then as a radical leftist. I went to law school at the University of Chicago, thinking I would become a labor lawyer. I was certainly not by modern standards a radical at all, but Henry Wallace's campaign appealed to me very much in those days.

JS: At Vanderbilt, you majored in economics. Why?

HM: That's a very interesting question and would have a surprising answer for you. When I went to Vanderbilt, I started in the summer of 1946, with the gigantic push into universities of veterans on the GI Bill. Vanderbilt at that time had double its prewar enrollment and half its prewar faculty. It was, to put it mildly, a mess. The departments weren't organized; courses weren't available. Nothing was straight.

By my last year there – I completed the four years in three years with summer work – they had managed to get one department working again, and that was economics. It was clear that they had acquired some very good faculty and organized the program and so forth. That was one of the reasons I majored in economics. So it was an accident. On the other hand, it was an economics professor with a Ph.D. from the University of Chicago who strongly suggested that I go to the law school at the University of Chicago.

JS: You said you attended college on the GI Bill?

HM: I didn't.

JS: You didn't personally.

HM: I was not a veteran at that time.

JS: You were too young probably for military service.

HM: That's right. I missed it by one year. But I did start college with all the World War II veterans – that was the peak of the GI Bill population in colleges.

JS: When did you decide to go to law school?

HM: I guess in my last year of college. Again, as I said, because I really couldn't think of anything else to do. I really wanted to at that point to get a Ph.D in economics, and I was terribly insecure about the education that I'd gotten. I really thought you had to be advanced to enter that Ph.D program. It wasn't true, but I didn't know it, and went to law school.

JS: Did you expect to practice law after graduating?

HM: I already at that time had some aspirations for teaching. I knew enough to know that law teaching was a possibility a short time after finishing law school.

JS: So why the University of Chicago?

HM: I mentioned that a professor who was a considerable influence on me, Roland McKean, later a very distinguished professor at the University of Virginia and UCLA, had recently gotten his Ph.D at Chicago. He knew Aaron Director, who was the economist in the law school who was so influential in the development of the field of Law and Economics. I was very attracted to the work in economic theory that I was doing with him. I became friendly with him, and he was a mentor. He suggested that I would like Chicago, and he was right.

JS: Did you realize at the time that the University of Chicago Law School was a relatively unique place?

HM: No. Almost no one realized it, because it wasn't even a jelled fact at that time. Aaron Director had gone there only one or two years before. He went there, I believe, in '47. I went there in '49. In two years, an enormous influence had occurred in the law school from economics through Aaron Director, but this was not widely known outside the school. Certainly, Professor McKean – to whom I was referring – had no sense that there was anything developing like a comprehensive economic analysis of law. No one had any full idea of how you would integrate law and economics. It was just that new.

JS: Would you tell me about some of the courses that you took at the University of Chicago Law School?

HM: Interestingly, a first-year required course was Price Theory. That was an accident, a hangover from an old Hutchins program that gave an accelerated BA and JD, and included some non-law courses in the law school. A very distinguished economist, Henry Simons, had taught that course in the law school. He died, I believe, in 1946, and that was when Director went there to take it over. The Price Theory course was, of course, completely unusual.

It was the same course that Frank Knight taught in the college at the University of Chicago. It was a comprehensive course that really plumbed the philosophic depths of economics more than many price theory courses do. You go to law school as a naïve student, not knowing what is given. I assumed that the course in economics was not a totally unusual thing to have in law school.

JS: To your knowledge, was there any other law school in the country that offered a similar course?

HM: Nothing similar. There were known to be a couple of efforts to use economists in law schools, both of which were unsuccessful. One was an economist named Hale at Columbia. He apparently influenced no one – nothing ever came of that, though I think he was a rather distinguished economist. The other was at Yale Law School. One of the

founding partners of Arnold, Fortas & Porter, Walter Hamilton, was an economist who was what they called an institutionalist. The institutionalists were much closer to sociology in those than to economics. While he taught some economics at the Yale Law School, it had no influence. It didn't catch on. It was a one-time thing.

What happened at Chicago was ad hoc and unique. There was nothing prior to it in any sense, and it was accidental. After all, Aaron Director's being there was the result of the death of Henry Simons and the peculiar program that Hutchins had introduced at Chicago.

A strange story about Aaron Director – well-known. Aaron Director was Milton Friedman's brother-in-law. He was Rose Friedman's brother and was a student of Frank Knight, along with Milton and Rose and George Stigler. But he had a serious problem. He had a writer's block. It's an unusual thing for a man as famous as he is in his field today, but he just could not produce substantial written material. That is why he never received a Ph.D. That's why they wouldn't hire him in the economics department at the University of Chicago, even though many people said, "that's the most brilliant man ever, you should hire him." They wouldn't do it, because he didn't have a Ph.D. It was a rigged deal to get him to the University of Chicago to put him in the law school. It was, again, an accident that a space had opened with Simons' death.

JS: At this time, were law professors expected to publish before they started teaching?

HM: No, they were not. I think I had had one book review published before I started teaching. A good record in law school was the sina qua non and almost sufficient. Clerkships for judges were not terribly significant either. They were often desirable, but they were seen more as a way of getting in with the local bar and introducing yourself to law practice than academia.

JS: Now, did law schools offer courses on financial regulation or securities at this time?

HM: Almost never. This is the late forties, early fifties. My guess – I've never looked at historical material – is that Yale and Harvard and maybe Michigan would have had courses taught by an adjunct professor who was a practitioner in securities regulation, but I don't even know that that was true.

At Chicago, they offered a course called Securities Regulation. It was very odd. It was a course in antitrust law. It was a seminar on one case and one case alone. That was the *U.S. v. J.P. Morgan and Company*, which had been brought before World War II, suspended during the war, and resumed afterwards. The professor was Roscoe Steffen, who had been at Yale and moved to Chicago about that time. He had been one of the government prosecutors in that famous antitrust case.

A large part of that case was amassing detail about the operation of investment banking industry, and that is basically what we studied there. I would not say I learned much law or economics, and, indeed, nothing about securities regulation. Now I went to Yale the

following year and was intrigued with the course there in securities regulation. There was a very distinguished practitioner, Homer Kripke, who was also a very prolific author in the securities field and certainly one of the more thoughtful people in the field. He was teaching the course at Yale. I took it, but it was strictly a bread-and-butter course. I mean, he taught it just as any good bureaucrat would teach the rules of the particular laws that he was enforcing. There was no theory to it; there was no questioning.

Homer Kripke had come up in law at a time when that sort of analysis was unknown in law schools. Now, it was already being done at Yale and at Chicago, more so than at Yale then. But not in Kripke's course. It was my introduction to the difference between the '33 and the '34 Acts and various periodic statements and so forth. Rule 10b-5 was never mentioned.

JS: I'd like to ask you more about your time at Yale, but first let me ask you one more thing about the University of Chicago Law School. Do you recall if the professors there had a particular perspective on either financial regulation or the Securities and Exchange Commission? In other words, were they exceptionally critical of the agency?

HM: Oh, no. If anything, if you had to characterize the political or ideological slant of the faculty at Chicago, it was very liberal.

JS: Did that extend to people like Aaron Director?

HM: Not Aaron Director. Aaron Director was a steel-minded devotee of free markets. I don't know whether he had gotten that from Frank Knight or got it on his own. He was also more than just acquainted with Frederick Hayek and Ludwig Von Mises, who were the extremes, you might say, among free market advocates. But Aaron's influence was not ideological; it much more had to do with technique and approach.

Certainly one of the most famous pieces that came out while I was a student at Chicago was one by Walter Blum and Harry Kalven, called *The Uneasy Case for Progressive Taxation.* This is a classic work of theoretical appraisal of an income tax. You can see a great deal of the influence of Aaron Director in that, and yet Kalven and Blum certainly were not advocating repeal of the income tax. But it was an uneasy case. I think for Aaron it might have been an easy case. I came out of Chicago certainly influenced by Director. I even sat occasionally in the seminar that Frederick Hayek gave there. I was already becoming aware of the idea, though it was not well formed by any means, of free markets and private property as the basis for an ideology. I didn't have it yet then by any means.

JS: One question that I wanted to ask you a little bit earlier and skipped over, today one of the major influences for libertarians is Ayn Rand and her works. Had you read anything by her at this time?

HM: No. I knew who she was. I had not read them then, though subsequently I did. Her role in the development of the whole modern libertarian movement is very interesting. It is

one dimension of that movement. It had almost no effect on me. I came at libertarian thought almost exclusively through ideas of economics and economic theory and principles. I think stronger libertarians today have that kind of background, not the first principle idea of Ayn Rand, where freedom of individuals is a starting point, not the point you reach in your reasoning.

JS: So tell me a little bit about this graduate fellowship you had at Yale Law School. How did you get this fellowship?

HM: Actually, it wasn't what I wanted. What I wanted was the Bigelow Fellowship at the University of Chicago, which was awarded to me. There was only one problem. It was not a degree program, and I would have been drafted immediately. Somehow I was really caught up in ideas and schooling at that point. I'd been very enthused about my time at Chicago, unlike my undergraduate work. So I wanted to continue.

I knew that eventually I was going to have to go in the service, but I wasn't sure when. So I had to turn down the Bigelow Fellowship and applied for a fellowship at Yale, and that came through and gave me the deferment. I went off to Yale. Before I went, I corresponded with Eugene Rostow, later the dean there, and probably at that point, the best-known name in academic law in the field of antitrust, which is all I was interested in then. Corporations was a secondary, but interesting, area to me. I wrote to Rostow, told him what I would like to do and that I would like to do some more economics. He wrote

back, "Well, that's the Yale Law School. You can do all the courses in economics you want as a graduate law student."

That was very much to my taste, so I went there and discovered a man named Myres McDougal, who was one of the more famous law professors of the era. He and Harold Lasswell, the famous political scientist, had devised a schemata for using the social sciences to approach law. It was called *Law, Science, and Policy.* All graduate students were required to immerse themselves in this, if you'll pardon me, garbage. I say "garbage" because I think there's only one rigorous social science and that's economics, and *Law, Science, and Policy* had no economics in it whatsoever. What they thought they were doing, I don't know. Today there are no remnants of it around. In those days, it was a "big idea" in legal education, and Lasswell and McDougal were demigods in that era.

I hated it. From the beginning, it wasn't what I was interested in. McDougal was in charge of graduate students and wouldn't let me take the full list of economics courses that Rostow had already approved. Apparently, he and Rostow had a bitter fight in the Yale faculty meeting about me, and McDougal won. I was allowed to take one course each semester in economics, and the rest I had to do in the law school.

JS: But you did take a full load of classes while you were there?

HM: Yes, you had to go through the master's degree program first and if you did well in that, you were admitted to candidacy for the SJD. I took the course in securities regulation. I

took a course from Boris Bittker in taxation. I can't remember what all. I think I took a course in arbitration. It was uninteresting to me, but Yale was not nearly as intellectually stimulating as Chicago, even though its reputation far exceeded that of Chicago in those days.

JS: Homer Kripke later became more of a critic of the SEC than he perhaps was at this time, but you said that during his course he was not very critical.

HM: Not only that, when I first started writing in securities and corporate field, he was a critic of mine. But we were very friendly. I used to see Homer anytime I went to New York, and I honestly believe that I influenced him. In his very late writings, after he retired and was teaching at the University of San Diego Law School, you can see this reflected. He was an open-minded guy. As I said, he hadn't been imbued with ideology through law school, because no law school in his era did that.

JS: Do you think you stood out as a student in your classes for perhaps being critical?

HM: No, I don't think so. Not at Yale; I may have at Chicago.

JS: So outside of your course work, did you do any independent study while you were there?

HM: Because of my dissatisfaction with what developed as my program at Yale, I began doing considerable reading in areas mainly I'd learned from Aaron Director, works of Hayek,

whom I had met at Chicago, and Mises. I always used to joke that I was one of the few people in the world who probably sat down and read the whole of *Human Action*, Mises' great work on philosophy and economics, which later on, you'll see, played a role in my intellectual development. I hadn't put all the pieces together by any means, but I was obviously very attracted to that writing, even then. So in some ways I give Yale some credit that they probably would reject. It was a valuable year, but not for reasons that the Yale law faculty had anything to do with.

JS: After graduating from Yale or finishing at Yale, you practiced law briefly. Would you mind telling me what you did?

HM: You left out an episode in my life. I applied for and got a direct commission in the Air Force JAG, and when the commission came through, it came in a letter that said it would probably be six months before I would be called to active duty. I went back to Chicago. Aaron Director and Ed Levy, who was then the dean, had gotten a big grant from the Ford Foundation for something called the *Antitrust Study*. It became monumentally important, because it ultimately changed all of antitrust law.

I got back there at the right time, with a letter from the Air Force saying I had at least six months, and I was hired as the first research associate on that project. One week later, I got a telegram from the Air Force to report for active duty in twenty-four hours. That was the end of my Chicago employment. Incidentally, the person who took my place on

that project was Bob Bork, who later came to great fame by writing the book that summarized the *Antitrust Study* at Chicago.

JS: Fascinating. So where did you serve in the Air Force?

HM: Well, I didn't serve for long. I went in on this rush order, and was in for thirty-five days when the Air Force came out with the regulation that said if you were in a term enlistment – mine was three years – you either had to get out or go indefinite, which was a minimum of five years. I checked with my Selective Service board and found I couldn't be drafted because I'd had one day of more active duty during the Korean War, and so I got out. I then started practice in Chicago in a firm that did some securities work.

A month after I was there, would you believe it, Selective Service amended their regulations to require sixty days active duty, which I didn't have. I got a 1-A card. After a lot of arguing in Washington about that, I was called back to active duty for two years.

JS: Where did you serve then?

HM: That was at McGuire Air Force Base in New Jersey. It was in some ways two of the most valuable years of my life, because I was in court, in trial, almost every day of that period, which was a wonderful experience. Now, intellectually, criminal justice wasn't the area I was particularly interested in. But it was a fascinating experience, and I think it always

stood me in good stead, too. At least, I could tell students I had tried several hundred cases, so it was good for that.

JS: What did you do after leaving the Air Force?

HM: At that point, I was invited back to the firm I'd gone with in Chicago, but I wanted to start teaching and, frankly, with all this interruption – Yale, the in and out of the Air Force, a year of practice, then back two years in the Air Force – I decided the hell with it, I would see if I could get a teaching job. And I did.

JS: Where did you end up teaching?

HM: At St. Louis University. Now, I had a more impressive offer. I had an offer that I accepted at the University of Virginia, and it was later withdrawn when they discovered that I was Jewish. They made no bones about it. That was the reason the offer was withdrawn. The dean was slightly apologetic. He said it wasn't the faculty; it was the Board of Visitors. I was never completely sure of that, but they did withdraw the offer.

I had an invitation from Boston University after I had the offer from St. Louis University, and I talked to Ed Levy about that. "Henry," he said, "Maybe you'd better take the St. Louis offer." He said, "At Boston, they may already be at the point where they have too many Jews on the faculty." They had four. (Laughter.) This was the beginning of the era of tremendous increase of the number of Jews in teaching and higher education generally,

but law was almost the last holdout. I didn't realize that, probably because it was not true at Yale or Chicago.

There was no school I talked to at that time in which religion was not an issue. I got terrified when Levy told me that about BU, so I accepted the offer at St. Louis University and I loved it. It was a real university, in the sense that they took education seriously. The president was a Ph.D from Chicago, a Jesuit, but he was much imbued with the Chicago style of things. I had four very good years there.

JS: You also taught at the University of Wisconsin for a few years in the fifties.

HM: That was a visiting appointment, but never resulted in a full appointment. It was a way station. I did teach antitrust, and that was always useful to me. I wasn't teaching corporation law then, because the dean was well-known in that field.

JS: What year was it that you moved to George Washington University?

HM: Nineteen sixty-two. That was a critical year, because I think the article that really first brought me to the law school world's attention I wrote mostly at St. Louis, but it was published after I moved to George Washington.

JS: This was the *Higher Criticism of the Modern Corporation*?

HM: That's right, in 1962, in the Columbia Law Review.

JS: What was the argument of that article?

HM: It wasn't so much an argument as an effort to do a comprehensive analysis from an economics perspective of the various theories of what we now call corporate governance. Some of it predated the New Deal, but a lot of it came out then. There were various theories around corporate democracy – that large corporations should be run like democratic states. This was one idea. The notion that we now call corporate social responsibility then had a number of terms for it – corporate altruism, corporate statesmanship.

At any rate, I went into the literature of these various fields, plus the main paradigm of the day – the Berle and Means thesis of the separation of ownership and control – and their somewhat ambiguous suggestion for how to cure it. They never were very clear about that. At any rate, no one had ever done anything like that in the corporate area. No economist had. The business schools at the time were totally dead letters as far as economics or anything intellectual was concerned. This is exactly what I thought I should be doing. I think I thought that it would bring me fame and fortune and instead it brought me calumny and hostility.

JS: Berle himself responded to your article in the same issue of the journal in which it was published, which was the Columbia Law Review.

HM: Thereby I think said to the world, "This is important, even though I don't agree with any of it." I don't think he understood one word of it. I met him several times. In fact, we had a kind of nice relationship. He tried to get me on the faculty at Columbia. He was that broad-minded a person.

JS: Do you know what happened that kept that from happening?

HM: Yes. Bill Cary, later chairman of the SEC, was on the faculty, and he absolutely stormed, and would not allow it. The phrase I began to hear around that time was "conservative kook." Now, you also have to understand that at about this time, the phrase "Chicago economics" was beginning to appear. Milton Friedman had made some popular inroads, and Chicago as a bastion of free market economics began to emerge, and it emerged not as something that people said, "Oh, this is important. This is going to change the history of the world." Rather it was seen in the more intellectual community as evil conservative ideology.

That's what was meant by the phrase Chicago economics, and that got attached to me. I would not say inaccurately, except that the characterization of the economics was all wrong. So, as I say, instead of being met with success for writing something totally new and opening a whole new area of intellectual investigation, it was just the opposite.

JS: Did you respond directly to this line of criticism?

HM: I couldn't do much. I was a young professor. I was not that confident in my economics at that point, either, although I got moral support from economists, including Milton Friedman, less so from Aaron Director, who was always sort of cold and standoffish. He wouldn't enter the fray. He, at that point, I believe, had already retired to Stanford.

Just before the '62 article, probably the seminal intellectual event in my life occurred. I was invited to a small conference for young professors at Claremont College, in which three very distinguished people held seminars for these young professors. One was John Jukes from Oxford, who had taken a very strong position against British socialism, then the Labour government. Another was Felix Morley, who was a political opponent of Roosevelt during the New Deal, a distinguished journalist and political theorist.

The third was a then somewhat young economist from UCLA by the name of Armen Alchian. I mentioned before that the Mises I read at Yale in 1952 or 1953 came back in the early sixties, because Alchian began his seminar by reading a paragraph. It was a paragraph about property, and he asked if anyone in the group could identify it. I was the only one; I recognized immediately that that was from Mises' *Human Action.* As he developed that first lecture – which became I think one of the most important economic articles of the twentieth century, *Economics of Property Rights* – it was like a light bulb went off in my head, it was incredible. All of a sudden, everything that I had done intellectually for thirteen years came together, with this one idea of Alchian's about the real nature of property rights and the Misesian notion of people making choices, with

every choice being a tradeoff, meaning that there is a cost – what you give away is the cost of what you get. Alchian put that into terms of behavior explaining how people reacted in economic settings.

But it was clearly applicable beyond what he was talking about. I told him that I was teaching corporation law – I think I had taught it one year then – and was very interested in this sort of thing because no one had done anything like this. Incidentally, after that first lecture, in 1957 or thereabout, began a fifty-five year friendship that is one of the defining relationships of my life. Alchian is still alive, though at 98, he's long past lucidity.

At the break during his first lecture, I told Alchian, "This is really what the lawyers have been looking for. Something that would explain why a given rule affects behavior in a certain way." I said, "Only one thing, please don't call it property rights, because if you do, you'll confuse the lawyers." He wasn't concerned about that. He did call it property rights, and it's a subfield of economics today, the economics of property rights, that he invented and should have gotten the Nobel Prize for it.

JS: Was this in 1962?

HM: No, it was in 1957.

JS: 1957, this seminar, so this was before you started publishing some of your later works?

HM: Yes. I mentioned that I was teaching corporation law and Armen put me onto another very important book that is less known that it ought to be, called *An Economic Theory of Democracy* by a man named Anthony Downs. Downs did a doctoral dissertation under Ken Arrow at Stanford. It is actually the beginnings of the modern field of public choice theory. The credit is usually given to Jim Buchanan and Gordon Tullock, for the *Calculus of Consent.* In terms of addressing it as a new field, I think it is correct that they get the credit, but the sort of thing that Downs was doing was more helpful to me. He talked about a market for votes in the political arena. It was that very concept, which is also close to Alchian's concept that you can have property rights in anything you make decisions about, that gave me the idea that, "Well, we have votes in corporations, what's going on here?", and eventually led me to realize that we actually had a market in votes in corporations, unlike the way we do it in politics, where we have a barter system. We exchange the vote for whatever the politician will give us; in corporations, we had a much more efficient system in which you could buy the share with the vote.

JS: So this line of argumentation influenced your article *Theoretical Aspects of Share Voting*?

HM: That's a little later. Actually, in the '62 article, you will find all the subsequent arguments that I made in later writing. Some of it is buried in footnotes, some of it is alluded to, but it's all there. It all comes out of the intellectual experience of that period.

JS: After the article *The Higher Criticism,* perhaps the next important article that we could talk about was *Mergers and the Market for Corporate Control*, which was published in 1964 in *The Journal of Political Economy.* Would you characterize this as your most influential article?

HM: Easily. As I said, the ideas existed in the '62 article, but the law profession, including academia, simply couldn't understand that article. Berle really didn't understand it. He's responding to something I didn't write. I've read it a hundred times; I can never quite grasp what it is he has in mind. But you have to realize how much alone I was in all of this. There was literally zero analysis of this type on the law side, no one in any way sympathetic with what I was writing or how I approached it.

JS: What was the argument of *Mergers in the Market for Corporate Control*?

HM: The simple argument was that the Berle and Means' hypothesis of the separation of ownership and control – which was well documented. We use different terminology today – we talk about agency cost – but it was basically the idea that in large publicly-held corporations, management was free of any real control by the so-called owners, the shareholders.

Berle suggested that as a result, they misbehave, or at least can. That's part of the confusion, because at the end of the book he says that the only thing that's the saving grace of the corporate system is that these managers act right. They produce what they

are supposed to produce, they don't take exorbitant salaries, the margins are cheap, but by and large, the system is saved by the good faith of corporate directors. That's why he never had an enemy in the corporate sector in the United States – because he said nice things about them.

The conclusion was fundamentally inconsistent with the rest of the work, but at any rate, the idea caught on that there was something all wrong with these large corporations because there was no way of controlling the people who really controlled the companies. I said, "That can't be true," I said, "There simply wouldn't be a gigantic stock market with people investing hundreds of billions" – I don't think we had the word trillions then – "of dollars if the thing is going to be nothing but a scam, cheating them over and over," which is what Berle suggested.

This little piece, *The Market for Corporate Control,* explained the mechanism whereby the market provides the protection against the possibility that Berle had raised, and it was through having votes attached to shares with an open market for shares, so that you could go out and actually amass enough votes to take over control.

JS: Did you see this line of argument as a complete substitute for the Berle-Means model, or was it something that could also exist alongside it?

HM: At the time, I saw it as almost exclusive. I've come to think that there are other devices. I mentioned some of the others in that article. Competition in the market for managers

will help control them, and competitive markets in commodities will control managers, because they can't control the prices of their input. Capital markets will control them. The one I missed – and I'm really sorry – the bond holders have considerable influence on corporations that aren't being well run. I missed that one, but I had the others. It was just that this was so new and, frankly, it was so exciting to have discovered this that I may have overstated it. I'm not sure.

At any rate, I stated it clearly enough that the law professors understood it. It was the first thing I had written that didn't get a hostile reaction at all. As a matter of fact, I would say the reaction was very good, and I think I know why. As today, the enemy is corporate management. I don't know why they are villainized and demonized as they are. They aren't angels, but nonetheless they certainly aren't any worse than any other group. Nonetheless my idea was seen as an attack on managers by the left-leaning professoriate. I was saying that, "Oh, we've got this device to show these guys they'd better behave," and so they liked it. It fitted their ideology about corporations. That was all right with me; I didn't care.

JS: Your article offers a certain view of investors. It basically says that investors will have an economic incentive to exercise control over the management of a corporation.

HM: No, they will not. For the most part, they won't even know anything about actual management. One of the great insights about markets – this comes out of Hayek and Mises – nobody has to know anything for markets to function absolutely perfectly. That

was true of the shareholders. They didn't have to know whether managers were doing well or not. All they had to know was whether the price of their shares was as much as they wanted. If it was going up, they were happy. If it was going down, they were unhappy.

If you're unhappy, what do you do? You sell your shares and put further pressure on the price, until eventually someone says, "Oh, I can buy all these shares very cheaply, take over the company, run it well or put it in the hands of good managers, and make a potful of money." There would be a big payoff from this.

JS: Some people have also suggested that your article foreshadowed what is called the efficient capital market hypothesis.

HM: Yes, it did. That's funny, because a couple of people I guess at the edges of that have gotten Nobel Prizes. Eugene Fama, who named the efficient market hypothesis and is a major proponent of it – I predated his work. To me, it just came out of theory; his work was entirely empirical, testing to see whether markets effectively responded to extraneous events. I said they had to. There was no other theory possible to explain market pricing other than something like this.

I even offered in a footnote the basis of much of later theory on this, in which I said that all decisions in the stock market tend to be of a binomial type, a one or a zero, a yes or a no, and that error therefore cancels itself out, because if it's random error, it'll be error on

the plus side as well as on the minus side, and what's left will be correct. That's a theory of the efficient market, and it was in that article. Occasionally some academics have noticed that I made that point before anyone else.

I have great pride in the fact that even earlier, in the '62 article, I had a footnote in which I talked about votes having market value. In the footnote, there was one case that was just so easy that someone with no mathematics background at all could still do it. You could show the before and after price of stocks and show that the difference could only be accounted by the value of the vote in a control fight. That was the first empirical work anyone had ever done, an event study of the thing.

In neither of those can I take credit for the great amount of work that is gone on since, but at least I anticipated it. I think they were simply consistent with a fully integrated theory of markets.

JS: So your next major work was in 1965, *Insider Trading in the Stock Market*. Tell me a little bit about writing this work. How long did it take you?

HM: I guess, maybe a year and a half. It started in class. Class was always a great stimulant to get new ideas. We were talking about compensation, and remembering some of Alchian's lessons, I realized that anything of value would be part of the total compensation that people would react to, not merely the part that was in cash. It could be

longer vacations. It could be less hard work. It could be thicker carpets. Or it could be valuable information.

As I thought about that, I said that made perfectly good sense, and now it has been empirically established beyond a question that the value of the information is part of the compensation package, or at least was when it was legal. I simply developed the notion from there. But the class was very resistant to it. I realized very early that there was a psychological response to the idea that was strange.

There was a woman who sat in the front row in the corporations class, who, after I gave a lecture one time on why insider trading might be a useful device, banged her fist on the desk and said, "I don't care what you say, it's just not fair." That became the "It's just not fair" theory of insider trading. To this day, I've never fully worked out the basis for the degree of hostility we see to insider trading, but I know that it's not economics. The economic arguments? Almost nonexistent. I could go into that later if you want, but the thing that fuels the laws against insider trading, as I said, has almost nothing to do with economics and a great deal to do with human psychology. Why it is as strong as it is in that particular area, I'm not sure.

JS: Do you think that your argument applied to all forms of insider trading or just the actual trading by those inside the company?

HM: No, clearly, the economics applies to everyone with valuable information. Incidentally, I was always at great pains to point out that my argument didn't apply in the case where contractually a person was obliged not to engage in insider trading, and didn't apply to cases of fraud or manipulation or anything of the sort. I was only talking about cases in which someone at that point legally came by the information and used it in the stock market, but quite clearly this has been terribly misunderstood, and even today the SEC or its apologists regularly confound insider trading with fraud and manipulation.

My opponents made another error. They thought I was talking only about the upper echelons of executives in the corporation. That was not what I was talking about, although I can understand how someone not reading my work carefully would come to the conclusion that I was advocating this form of compensation for only high-ranking corporate officials. I was talking about what the role of information is in an efficient stock market and how it relates to what we now call corporate governance. I have moved in my own thinking somewhat, not totally, but somewhat, away from the idea of this is an incentivizing device for specific individuals.

One of the illustrations I used in the book was the team of scientists in the labs of pharmaceutical companies, who we know, every morning before they got to work on their laboratory benches, first dealt with their current findings for group investment in the stock market. They were not alone in that, but it was well known that they were doing that. I think that kind of example is what misled me that it was possible to have a direct one-on-one incentive-result nexus.

I think now there is a much more general effect, and in this last paper, I suggested that allowing anyone to engage in insider trading will create a culture of innovation within a company. One of the great problems in theoretical writing about the economics of a corporation is how to incentivize people to be innovative in a giant bureaucracy? Many people, including Joseph Schumpeter, one of the greatest economists ever, thought that it was impossible. He predicted that the large corporation would disappear, because we couldn't properly incentivize people to be entrepreneurial in large companies. Today I think that is perhaps a more important role for insider trading that what I originally identified.

JS: Now in this work, you seem to directly criticize several SEC officials, or at least you bring up a position of William Cary, who was SEC Chairman in the early 1960s. As far as I could tell, this is the first time that you addressed the SEC directly in one of your works.

HM: The word "directly" makes that correct, but if you go back to the '62 article, you pointed out that I really sort of invented the efficient market thesis. If there's an efficient stock market, you don't need securities regulation. If the market works as efficiently as Fama and others have proven it does, what in the world is all this regulation about? You search in vain in the legal history of the securities laws to find any explanation of that, that is a theory of market failure that would justify regulation. This goes back to that other point that I was making, and why I'm perhaps kinder to the SEC today than I was forty years

ago. That is that they just didn't have any conception that something like economic theory had any application to this area. It was a totally foreign world to them.

Now part of the problem, I will say, relates to the field of economics. We just did not have the economics in 1933 that would allow us to understand securities markets as we do today. It hadn't been invented. Property rights theory hadn't been invented. Efficient markets hadn't been identified. The Coase Theorem and the idea of agency or transaction costs hadn't been invented. There was no way that people simply looking at this very complex mechanism of capitalism in 1933 could understand it without these tools. I wish they had taken a more hands-off, a more humble point of view, but humility was not what characterized the New Deal. They all thought they had truth and that they could regulate to perfection.

JS: How did they react to your book, the SEC?

HM: Terribly. Really bad. A colleague at the time at George Washington University Law School was Manny Cohen, an adjunct professor who about that time became Chairman of the SEC. He knew what I was writing about. We had even talked about it some; I can't remember the conversations, but he had agreed that when the book came out that he would review it. Well, the book came out, and the next thing I knew, no one at the SEC would review the book, including Manny Cohen. I was subsequently told that at that time, there were meetings held at the SEC at which the decision was made that nobody

on the staff could review by book or cite any work by me. I always called this one of my proudest accomplishments in life, my own pseudo-bill of attainder.

JS: If you don't mind me asking, where did you hear about this from? How did you find out that the SEC had done this?

HM: Well, you live in Washington. Washington is a sieve. I used to have people from the SEC come lecture to my class in securities regulation. I'd hear it from them. They were a very talky lot, I remember that. Over the years, several former SEC staff members told me of this informal rule about citing my work. I was invited once to the Commission to debate Roy Schotland, a professor at Georgetown Law School who authored the first response to my book on insider trading, a review in some sense commissioned by the SEC, where he was a regular consultant. The review was fairly uninformed, but it was a decent work of criticism. Like most of the critics, it didn't rely, other than superficially, on economics; it relied on morality and fairness arguments more than anything else. He and I were invited to debate this at the SEC. My recollection is very dim about it. People were very hostile to me at that time. They were not friendly at all. There was no collegial atmosphere, as far as I was concerned.

JS: In 1967, you wrote two other articles that continued your line of argument on the modern firm and the financial regulation. The first was *Our Two Corporation Systems*, which seemed to offer a more comprehensive theory of the firm.

HM: It was intended as an overview of a book that I planned to do, which later Dan Fishel and Frank Easterbrook in Chicago wrote. They give me credit for all the basic ideas, but they wrote the book on the economics of corporations and I didn't. That article allowed me to catalog all the ideas about the economics of corporate governance that I'd been accumulating for quite some time. It was a very important article. It was also, oddly enough, somewhat well received by the academic community. Things were beginning to change at that point.

JS: What do you mean?

HM: I remember one episode – you have to remember, I'd been teaching for eleven years in 1967, most of it with a feeling that somehow I was not part of the in group. At a meeting of the Association of American Law Schools, however, I remember I was starting up an escalator in a hotel and there were two young professors I didn't know in front of me, except that I overheard that they were talking about me. One of them said to the other one, "Aw, no, he's not a conservative kook; he's like Milton Friedman." At that point, I knew that the world had changed. If it had reached the level where Milton's popularity and influence was now resurrecting my reputation, it was of big importance.

So when the Virginia article came out on *Our Two Corporation Systems*, it was quite well received. I think it became standard for reading in courses in corporation law. At about that point, I was really exasperated with law schools. As you can well imagine, even my own colleagues with whom I always got along very well had sort of the attitude, "Let's

go twit Henry about economics." Economics was still a joke at most law schools. At that point, I was offered a chair in political science and economics at the University of Rochester.

JS: This was in 1968?

HM: It came in '67; I went in '68. I was not very hesitant about accepting. I was ready to leave law schools; I was just so disgusted with them. I shouldn't have been; I was perhaps too impatient. But I'd been doing the stuff for twelve years, and there was still no one in the law school world with whom I could talk intelligently about any of this. Not one person, not one.

JS: Before you talk about your time at Rochester, let me ask you about one other article that you published around this time. It was entitled *Cash Tender Offers for Shares – A Reply to Chairman Cohen.* That was also an attempt to enter into a political debate, as far as I can see.

HM: Not exactly. The Williams Act had been presented in an extreme form as an antidote to these terrible hostile takeovers that were displacing these fine gentlemen who were running corporations with financial pirates who liquidated the company and did all kinds of terrible things. That was the argument and the intellectual level of argument.

At any rate, Harrison Williams was a known crook. He later went to jail for accepting a bribe in a sting by the FBI, but the worse crime he ever committed was drafting the Williams Act. That's probably cost the world's shareholders more trillions of dollars than we can count, because it allows corporations to be more wasteful than they would otherwise be. I can't measure that, but I know it's huge.

At any rate, when I saw the first version of that act, I could hardly believe it. Every line of it had something that contradicted intelligent economics. That was the article that I wrote. Now Manny Cohen was already on board defending this, because it was obviously being pushed by the Johnson administration. Johnson had close friends who were hurt by some hostile takeovers and those guys played hard ball. They weren't easygoing at all.

When I saw the first version of that act, I could hardly believe it. Every line of it had something that contradicted intelligent economics. That was the article that I wrote. Now Manny Cohen was already on board defending this, because it was obviously being pushed by the Johnson administration. Johnson had close friends who were hurt by some hostile takeovers and those guys played hard ball. They weren't easygoing at all.

At any rate, that's the call for the title. It was in response to Chairman Cohen. I wanted to embarrass him, too. I think it did, but then the hard politics continued. When the bill was revised considerably – I don't know to what extent because of my article – there were some parts of the original bill that were just so embarrassing that they had to get rid

of them. As the bill came through in final form, Williams scheduled hearings in I think it was 1967, and I expected to be called to testify.

I was then in fairly frequent contact with a man named Stanley Reed, who published a journal of mergers and acquisitions. In fact, I think that journal is what gave the name to the field, M&A. He was a great fan of my writing and had summarized it in his own work in that magazine. He testified on the bill and invited me to come, but I wasn't invited to testify. I was right there in Washington. I was a professor at GW then.

After the testimony and the hearings, Reed went up to Senator Williams and said, "Look, why in the world wasn't Professor Manne invited to testify on this?" He said, "He's the only one who said anything interesting in this field." Williams said, "Manne, Manne? I never heard of him." He turned to Manny Cohen and said, "Manny, I asked the SEC to give me the names of people who've been writing in the field." Manny Cohen, who knew me very well, said, "I don't know how we…" It was sort of double-talk.

Reed let them have it. He really got furious, and as we went down on the elevator together, Reed and I and Williams and Manny Cohen, I don't know who else, Reed really let them have it. He told them, he said, "Look, there have been three articles written on this subject, and two of them were written by Manne, and you said you didn't know it?" But it didn't make any difference. They didn't really care. You couldn't embarrass those guys – they were playing for very big stakes.

JS: So you were convinced that they left you off intentionally?

HM: Absolutely. No question about it. They didn't want any more publicity than they could possibly get.

JS: In 1968, you started teaching at the University of Rochester in the political science department. One of the first articles you published after this time, though, was *Insider Trading and the Law Professors* in 1969. Was this sort of a parting shot against the legal profession?

HM: It was. It was perhaps the only time I ever really let my vituperation get into the articles.

JS: For the record, can you just summarize what the article said?

HM: It was a point-by-point refutation from an economics perspective of what people like Mr. Ferber, who was the long-time solicitor of the SEC, and Roy Schotland –

JS: Who wrote a review of your book in 1967.

HM: Yes, and there was another famous article in the *Harvard Law Review* by a corporation law professor and I can't remember his name now. I took them on and simply showed they didn't know what they were talking about.

JS: Was there any response to this particular article or did it manage to sort of fade away then?

HM: It never faded away; it hadn't faded away to this day. It was a fight I knew I was in for the long haul. I got sick of it at some point. When insider trading was then becoming a very big topic, there were all kinds of conferences, and inevitably I'd be invited and sit there and hear this nonsense and have an audience of people who didn't have a clue of what I was talking about. I quit accepting invitations to those conferences. I just got fed up with it, and I was sort of tired of insider trading, too. I thought I could leave the topic. I was never able to. As you know, up to last year, I've been writing articles about insider trading.

JS: To switch gears here just a little bit, by the late 1960s and early 1970s, you were starting to become more of a public intellectual, you might say.

HM: That's right.

JS: You were publishing –

HM: See, this is about the period when I heard that famous statement, "He's not a conservative kook; he's like Milton Friedman."

JS: Right.

HM: Chicago economics, that phrase ceased to be as pejorative for most people as it had been earlier. It was recognized that Chicago economics was an important advance in economic theory and was very serious scholarship, and I got the benefits of that. Now, in that period, I had invitations to visit at Stanford and Yale, things that I would have died for years before, but when the call came from now-Judge Ralph Leonard at Yale Law School, he said, "Henry, we've finally beaten back the Philistines, and we've decided to make you an offer."

I said, "Ralph, you're two weeks and five years too late." He said, "What do you mean?" I said, "Well, two weeks ago, I agreed that I would start this new center on law and economics." He said, "And five years?" I said, "And you're five years too late for me to give a damn." That was exactly how I felt about it. In my early career, I knew I was writing the most important stuff in the field, and I couldn't get anywhere. Now that I was recognized, I had a new agenda.

JS: Now, as part of this increased public attention, during this period you became a critic and an occasional debating partner of Ralph Nader. Would you mind telling me how that came about?

HM: It originated with his campaign GM and his total mischaracterization of large corporations and corporate governance, and I had written pieces in *Barron's*. I wrote quite a bit for *Barron's* in those days. I'd be invited to debate with him on corporate

governance, which was fine, but that mushroomed into broader matters. I didn't object to this.

Business Week, I think, had an article on me as the country's leading critic of Ralph Nader. That made my speaking fees go way up to levels I should have been at years before. Ralph was a formidable debater, no question about that. The first debate we had, I didn't know what to expect. He mopped up the floor with me, because I couldn't make any single argument. He had such a scatter-gun approach. Everything was wrong, and everything raised all sorts of different economic issues. I'd try and address it and my argument would fall apart. I learned you had to zero in on one thing and hold him to it. Then I became a much more effective debater. I once had occasion to counsel Ronald Reagan on that point. He was debating with Nader at the American Enterprise Institute.

JS: Do you remember what year this was?

HM: It must have been '68 or '69. I knew the people at AEI then. I'd done a book for them, incidentally, a very important book, called *Economics of Securities Regulations*. It was the first time anyone ever publicly announced that economics had anything to do with securities regulation. At any rate, I simply told Reagan what I'd just recounted to you. He was very good. He had no trouble dealing with Nader in debate.

But I continued to have association with Nader for years after that. I remember students, when I was dean at George Mason, came in, very hesitantly, because they wanted a big

name for some conference or debate. They knew that I had had some connection with Ralph Nader, and I said, "Sure, I'll get him for you." I picked up the phone and promised him a microbiotic lunch, and he came and all the students were very impressed by that.

JS: So in the 1970s you also began a series of summer workshops. One of the series was on economics for lawyers. Would you tell me briefly where this idea came from?

HM: I'd gone to the University of Rochester with two titles – one an academic title and one an administrative one, to be director of planning for a new law school. The University of Rochester never got a law school, but that law school plan eventually became the blueprint for the George Mason Law School. I had previously been a consultant to the Rochester president and had written a monograph on what I thought legal education should look like. He was very impressed with it, and that was part of why he invited me to Rochester.

It was clear from the get-go there was going to be financial problems with getting the money for a new law school, but as part of the preparation, I advanced the idea that it would be good for Rochester to have some contact with the law school world. I wanted to do this program for personal reasons. As I told you several times, for years I'd been out there with no one in the law school world who had a clue of what I was talking or writing about. I could talk to Armen Alchian, Milton Friedman, Aaron Director, Ronald Coase, and other economists, but not the lawyers.

I got the idea that perhaps I could train people be able to read what I had written. That was part of my idea in doing this and part of it was to establish a law school connection to the University of Rochester, but it developed a life of its own. It was so successful that eventually out of that grew the Law of Economics Center and the development of the whole field of law and economics. So I give the SEC some credit for that. Their failure to understand any economics goaded me into economics education and ultimately helped develop the enormous modern field of Law and Economics.

JS: You also later started a series of summer workshops on economics for federal judges. Did you ever think about starting a series for people from the SEC?

HM: Yes, we did actually address the issue of economic illiteracy in government, though not specifically the SEC. We actually had three programs. The first one we did was for staff members of members of Congress.

JS: Do you remember what year this was?

HM: It probably would have been about 1977, maybe '78. At any rate, they didn't take it seriously. The people were playing, and they just were not serious and the program was not a success. But we still had the idea of educating government people, so we said maybe if we took a particular area and got people from all over the government – not just the congressional staff people – that it would go better. For whatever reason, we decided not to do securities regulation; we did health economics. For two years, we were ran this

program in economics for government healthcare officials, and it was enormously successful.

Then we couldn't get money for it. The pharmaceutical companies wouldn't touch it. They were terrified. They live a political life, and this is scary, so they don't do things like that. The big health foundations wouldn't give us money, and so we dropped it. I later had an undersecretary of Health, Education, and Welfare tell me that something he learned in that program changed one provision of the federal health bill that he estimated saved the taxpayers a half a billion dollars. I said, "Boy, if markets worked, I'd get some of that for more programs." But that wasn't an area that markets worked in.

JS: Creating the GMU law school – this is something that you have written an article about. Perhaps we won't go into too much detail about it, but would you tell me briefly about that process?

HM: It really began with Rochester. At Rochester, I had proposed an overly ambitious program of having intellectual tracks in law schools, so that a law student would major in economics, psychology, history, technology – those are the main four, I think. Maybe finance was another one. Eventually, I realized you could not do more than one of those in a startup law school. Maybe a very rich law school could do them all.

I had this book on what a modern law school should look like that I'd been carrying around with me for twelve years at that point, when I was first called about the deanship

at Mason. Now they had recently bought a very bad law school; it had just barely become accredited, but it shouldn't have been.

My friends Jim Buchanan and Gordon Tullock were at Mason then, and I said, "Look, I have no reason to think that I could do anything with an existing law school. If I could start a new one, it'd be fine." They asked me if I would come up and talk to the president about law schools, because he wanted a law school. So I did, and he was a very good salesman. He liked the proposal I had. He was not a profound man, but he had a very good sense of public relations. He sensed that this would be something different and he wanted that in his law school.

He sold me. He committed enough money that I could buy out a lot of the existing faculty and fire those that didn't have tenure, and I did. I got rid of fourteen people in one year and hired eleven new people, twenty-five personnel actions without a single faculty meeting. Nothing like that has ever happened in the history of higher education. By the second year, we were already an important law school, and embarked on implementing the Rochester program at Mason.

JS: What would you say has been the contribution of this law school, either to the field of law and economics or to the study of financial regulation more broadly?

HM: Enormous. First of all, it has had a big influence on legal education, because other schools began to see that they would have to broaden legal education beyond the black

letter of the law stuff that most people were doing, and serious intellectualism of the Mason type was probably the best antidote to what was becoming a serious problem in law schools, ideological radicalism.

As another measure of Mason's influence, one could count the number of Law and Economics people that William and Mary, Georgetown, American University, and George Washington hired after I started this program at George Mason. The idea of professional specialization in law school certainly got kick-started at Mason. It's a very expensive thing to implement with the existing accreditation system in legal education, but more and more schools are doing it.

My moves at Mason also caught the coattails of the rising influence of Law and Economics. The Law and Economics Center that started at Miami had been successful in establishing this as very serious intellectual work. Not many people before that realized that it was. But by 1986, everyone throughout the academic world knew that Law and Economics was big, important and not to be ignored.

I think the judges' program you mentioned had something to do with this; certainly, the law professors' program had a lot to do with it. Then the existence of a whole law school built around that paradigm had a lot to do with it. I think it was mutual, that was part of the reason for the success of George Mason, and George Mason in turn had influence on the growth of Law and Economics. Today the school is a powerhouse.

JS: Do you know whether many graduates from that law school have gone on to serve in the SEC?

HM: Yes, quite a few have, including two Commissioners. More importantly, some of the staff people in Congress who oversee the SEC recently invited me to testify on the use of cost-benefit analysis in securities regulation. I learned subsequently that the staff director was a graduate of George Mason Law School, and he had learned the lessons that I wanted him to learn. The school is having a considerable influence in Washington.

Now, it is not alone. There've been a number of factors – the development of the Mercatus Center at George Mason has I think been very important. The think tanks like Cato, AEI, Heritage, have all become a lot more legitimate and a lot more intellectual than they used to be because of George Mason University and its law school.

I once wrote a piece for *Forbes* as to why conservatives shouldn't fear Obama as much as they did Roosevelt. One of the differences was that in 1932, there was no intellectual opposition. It didn't exist. There was ideological opposition, but not intellectual. No university specialized in microeconomics and price theory. The idea of economics of property rights was unknown. Economics was really quite primitive then. I pointed out that now we have a large intellectual force. You have these think tanks, you have journals, you have books, and you have whole schools. It's a different intellectual world today than it was back then.

JS: Just to go back a little bit, in 1981, the Reagan administration took office, which meant that for the first time in many years, you had an administration with a limited government philosophy that had come into power. Now, did you see this manifested in regards to financial regulation?

HM: I didn't. I was not paying close attention to it, either. In '81, I had moved the Law and Economics Center to Emory. If you recall, the economy was taking its corrective recession then. Money was very hard to raise, unlike what it had been when I first started the Law and Economics Center. I was working hard to keep it going then. I wasn't teaching, so I was not paying a lot of attention to the securities field at all in those years.

JS: Hostile takeovers and insider trading were both very hot issues during this period. Were you invited to testify before the Congress?

HM: No, I don't think I ever was, on either subject. I don't know that there were ever any hearings on insider trading. Before the '87 Act, there may have been hearings, but I was not invited. They would have been highly technical; they didn't go to the fundamentals of it anyway. The history of the whole insider trading thing is weird. From the beginning it was weird. It never went through normal law-making regulation, rule-making procedures.

The jurisprudence of it is just bizarre – how the law emerged in a funny way without any of the usual procedures and safeguards built into our system for law making, and the

courts, I think accidentally, stumbling into accepting it as law. The Supreme Court getting the Texas Gulf Sulphur case, which they decided on a technicality and never addressed the central issue at all. But people took that as acceptance of the law. The subject has never really had its proper day in court.

JS: During this time in the 1980s, you also publically defended some who had been convicted of insider trading, such as Michael Milken?

HM: That was a replay of a gross miscarriage of justice that happened early in the history of hostile takeovers. The guy who invented hostile takeovers was a man named Louis Wolfson, who, as a young man, was a rather crude professional boxer. I think he sort of stumbled into this takeover business. I later met him, and he never had any understanding of the economic implications of takeovers, but he understood how to make money. He pioneered the thing. He worked out a lot of the different angles of the early hostile takeovers.

In the course of this, quite naturally, Wolfson made some big, powerful enemies, including – I believe – people in the Johnson administration. He was tried in about as bad a trumped-up Soviet-style criminal case as we ever had. They even were able to select the judge who had been the man who wrote all the mythology about securities regulations – Pecora and the famous Pecora hearings – who was now a district judge in New York. He tried the case, and they sent Wolfson to jail for an incredibly minor technical violation under the Securities Act of 1933.

Again, it never should have been tried as a criminal case, because the rule had not even developed on the civil side yet. At any rate, they convicted him; he went to jail. When he got out of jail, he sold all his financial interests completely. He said he never wanted to have to deal with the SEC again. He got into thoroughbred horseracing and had two Kentucky Derby winners and owned Affirmed, the last Triple Crown winner. He was a rough-and-tumble guy.

That was reprised, not with all the same bells and whistles, with Michael Milken, in what was called an insider trading scandal. Nothing that Milken was alleged to have done involved insider trading. The only thing I could ever see that he ever did that was wrong was a kind of payoff to a mutual fund manager to buy some shares, but that was a common practice. The other stuff was all sham, but if you can remember, the world was in one of its states of hysteria about finance then, and it was clear that some heads had to roll.

Now, you had Boesky, who was a clear crook. He was paying cash money to young lawyers to get information out of law firms. I never condoned that. He was engaged in insider trading, the so-called parking of shares and things of that sort. Milken also played hardball, I'm sure, but I don't think he did anything very wrong and certainly nothing deserving of prison.

At that time I debated Rudolph Guliani, who sent Milken to jail and was the star of the day at sending these guys to jail and handcuffing brokers.

JS: Tell me about that debate.

HM: It was astounding. I left it and I shook my head. I said, "I didn't know there were still people around who were so totally ignorant of this field." This man knew nothing, absolutely nothing. He wasn't even profound about the law, but as for any understanding of what he was involved with, it was 100 percent missing. It was not friendly.

I was always suspicious of him later. I must say I came around to thinking that politically he got himself on the right track, but I was always very uneasy about this guy. I like people who understand what they're talking about, and he did not. The debate was in a securities law group in New York, and I would say that a considerable part of that audience, I won. Things were beginning to be different in those years, very unlike the early years when total ignorance of economics was not merely tolerated; it was ignored.

JS: Perhaps another side of that was in 1987, when *The Wall Street Journal*, in an op-ed, mentioned your name as a possible candidate for the SEC Chairmanship. Do you think there was any serious consideration of this?

HM: I don't think so. I think it was tongue-in-cheek from *The Wall Street Journal*. I have good friends there, and they knew that that was about as impossible as landing a man on Mars next year.

JS: So a leitmotif of your work is the role of economics and securities legislation. From your perspective, how has the SEC dealt with this issue?

HM: From the beginning, when I really first began my writing, it was almost disbelief. There is a strong community of securities lawyers, based on their work with and in the Securities and Exchange Commission. They have their own culture. They have their own set of beliefs. I was so far outside of that. This was so strange to them, that it was almost like, not a foreign language, but a hostile foreign culture, attempting to invade.

I was talking about their area, but in a way they didn't understand. Certainly, the intellectual leader of that crowd in those years was Louis Loss, a professor at Harvard Law School and the author of a six-volume treatise on securities regulation, of which I must repeat one of my most famous *bon mots* – "Louis Loss did one of the great tour de forces of all times. He wrote a six-volume treatise without a single thought in it." That is perhaps unfair, but perhaps not. How can you write six volumes about securities regulations and not once ask anything about the economics of markets, finance, exchange, price, any of those things? He just assumed that he knew all the answers to those questions, if they entered his mind at all. That was the mindset of the SEC.

That's why, when a book came out on the economics of insider trading, they were hostile, but it was mainly because they thought it was a joke. They didn't take it seriously. They couldn't. There was nothing in their background that would allow them to take it seriously. That's why I say I'm kinder in my thinking about them today than I used to be. Now there's been a big change. Part of it is the change I'd mentioned with the role of Milton Friedman in modern thought. Part of it has been the success of the Law and Economics movement.

After all, none of the young lawyers going into the SEC today come out of law schools where they haven't heard of or had a course in law and economics. Forty years ago, that would have been unheard of, completely. So they are a little bit more susceptible to it. In the recent hearings on cost-benefit analysis and securities regulation –

JS: This was in April of this year?

HM: April of this year, 2012. The SEC came out with a surprise statement by their General Counsel and – I forget which division – requiring that they always have used and will certainly continue to use cost-benefit analysis in rule-making. The first sentence says they have always done that. Well, they have never done that. Again, I don't know whether that sentence signified that they were just being disingenuous or that they still don't know what cost-benefit analysis really is. But it's a big advance. Big step forward.

JS: Your testimony to Congress was actually relatively positive about the SEC?

HM: When I saw that, I was in a state of disbelief. I later learned that they didn't want to publish it. They didn't want to publicize that they had written it, and the House Committee in effect pressured them so that it is published now. I don't know whether it will have any effect on law – I think it might, because of some recent opinions in the D.C. Court of Appeals on the use of cost-benefit analysis in rule-making. I think this may be absorbed into the rules the SEC has to live by, and if it is, it really is a revolutionary change.

JS: You followed up your testimony with an article in *Regulation Magazine* that argued that the requirement that the new regulations come with a cost-benefit analysis is salutary. In your view, has the SEC turned the corner?

HM: I don't know the answer to that. If they have turned the corner, it's a very slight turn. It's nothing that they think of as revolutionary. It's nothing that has entered their day-to-day discourse any different than it was five years ago. But it is there, and I'm optimistic. It may make a difference.

JS: That's a great note to end on. Professor Henry Manne, thank you very much for talking with me today.

HM: Thank you.

– [End of Interview]