tion a consequent breach of a fiduciary obligation. *See generally,* 3 L. Loss, Securities Regulation 1450-56 (2d ed. 1961); 6 L. Loss, Securities Regulation 3556-76 (2d ed. supp. 1969). From the landmark opinion in *Cady, Roberts & Co.,* 40 S.E.C. 907 (1961), where Chairman Cary defined persons covered by the broad language of the antifraud provisions as those "who are in a special relationship with a company and privy to its internal affairs . . ." (*id.* at 912) to *SEC* v. *Texas Gulf Sulphur,* 401 F.2d 833 (2d Cir. 1968), where Judge Waterman held the duty to disclose information or the duty to abstain from buying or selling securities was limited to persons (or those in privity with them) "dealing in *his* company's securities" (*id.* at 848) (emphasis supplied), access to inside information of the issuer has been the *sine qua non* for 10b-5 nondisclosure liability.

This necessity of a fiduciary nexus in situations the same as the instant one was pointedly set forth by Judge Friendly in *General Time Corp.* v. *Talley Industries,* 403 F.2d 159, 164 (2d Cir. 1969):

> "We know of no rule of law . . . that a purchaser of stock, who was not an 'insider' and 'had no fiduciary relation to a prospective seller, had any obligation to reveal circumstances that might raise a seller's demands and thus abort the sale. . . ."

And *see Radiation Dynamics, Inc.* v. *Goldmuntz, supra,* 464 F.2d 876, 890 (2d Cir. 1972) (". . . purpose of Rule . . . as we have stated time and time again, is to prevent corporate insiders and their tippees from taking unfair advantage . . ").

Commentators, too, have stated that the practice of a prospective offeror making open market purchases of shares

of a target without disclosing an impending tender offer is not violative of the Rule. *See, e.g.*, A. Bromberg, Securities Law: Fraud §6.3 (1969).

It was a fair and rational extension of the concept of non-liability of prospective offerors for Chiarella or any attorney he might have consulted to conclude that tippees of the offerors similarly were not liable. Indeed, Chiarella testified he believed that since an offeror corporation was not guilty of wrongdoing by open market purchases previous to a tender offer, a common practice of which he was aware, he was also acting in a lawful manner because he derived his information from that source (R.492). The same determination logically flows from the Williams Act (15 U.S.C. §78m [d][1]) which excuses disclosure of intention by the prospective offeror until it has accumulated a sufficient block of stock in the target to constitute it a major shareholder, and thus, a fiduciary.

In assessing the state of the law and Chiarella's actual or potential notice of it at the time of his conduct, it would be remiss to overlook Judge Meskill's vigorous dissent from the majority decision which in his view, "expands Section 10(b) drastically" and is indisputably "a departure from prior law" (588 F.2d at 1373).

Chiarella's acts at the time committed could hardly have been said to "plainly and unmistakably" fall within Section 10(b) and Rule 10b-5 where such disparate opinions even now address the issue.

Nor were the omens and portents of the policy underlying the securities laws so apparent that Chiarella might

be charged with having gleaned from them a clear and definite understanding that his future acts would be deemed criminal in nature. Aside from the wide divergence in theory as evidenced by the majority and dissenting opinions, the majority explicitly rejected the trial court's policy justification for distinguishing Chiarella from the prospective offerors (*i.e.*, the Pandick Press clients from whom he obtained his information). Thus, the trial court explained away the anomalous situation where at the same time Chiarella was liable his "tipper" was not by reference to a "presumptively legitimate business purpose" of the offeror which the trial court perceived as absent in Chiarella (450 F.Supp. at 97). The Appeals Court specifically disavowed the policy justification of the trial court and agreed with Chiarella that ". . . 'business purpose' cannot be dispositive of liability under Rule 10b-5" (588 F.2d at 1368 n.15) and justified its decision on other policy grounds.

Almost two years after Chiarella's acts upon which the indictment is predicated, the American Law Institute, in a thorough study of federal securities law, concluded that there was no "justification" in the present law "for imposing a fiduciary's duty of affirmative disclosure on an outsider who is not a tippee" such as Chiarella. American Law Institute, Proposed Official Draft of the Federal Securities Code, 538-39 (March 15, 1978). As the council and staff wrote in its submission to the Institute's members (*id.*):

> ". . . [I]t is hard to find justification today for imposing a fiduciary's duty of affirmative disclosure on an outsider who is not a 'tippee.' It would be convenient to have a new category of 'quasi-insider' that

> would cover people like judges' clerks who trade on information in unpublished opinions, Federal Reserve Bank employees who trade with knowledge of an imminent change in the margin rate [citations omitted], and perhaps persons who are about to give profitable supply contracts to corporations with which they are not otherwise connected, while excluding persons who have merely decided to go into the market in a big way. But all this does not lend itself to definition. It is difficult in the abstract to opine even on illustrative cases. Where, for example, would one place the outsider who is about to make a tender offer—or his depository bank?''[19]

The question of liability under Rule 10b-5 for the tippee of an "outsider" tender offeror is specifically noted by the ALI as a "question . . . left to further judicial development . . . as not ripe for codification." American Law Institute, Proposed Official Draft of the Federal Securities Code, §1603, comment 3(d), at 539 (March 15, 1978).

Criminally Prosecuting Chiarella's Conduct Violated the Fair Notice Requirement of Due Process.

Recognizing the necessary elastic quality of the Rule and its occasional rightful application to original sets of facts, still it is bluntly a violation of due process to apply it to conduct which could not have been discerned to be within the Rule. This constitutional infirmity in Chiarella's conviction is made manifest when considered in light

19. Doubtlessly, Federal Reserve employees and judges' clerks who trade on information received in the course of their employment would run afoul of Chief Judge Kaufman's formulation of the rule which would impose liability on *"Anyone*—corporate insider or not —who regularly receives material nonpublic information . . ." 588 F.2d at 1365.

of the policies underlying the Rule, its history, judicial interpretation which previously adjudicated identical conduct legal, and scholarly comment with respect to it. All these authorities support the conclusion that the Rule did not cover Chiarella's conduct. Neither may Chief Judge Kaufman's *ex post facto* interpretation add the requisite definiteness to cure the constitutional insufficiency.

A fundamental precept of our system of justice is the constitutional requirement of definiteness, that is, a criminal statute must "give a person of ordinary intelligence fair notice that his contemplated conduct is forbidden. . . ." *United States* v. *Harriss,* 347 U.S. 612, 617 (1954). And *see, Dunn* v. *United States,* —— U.S. ——, 47 U.S.L.W. 4607, 4611 (June 4, 1979); *Rewis* v. *United States,* 401 U.S. 808, 812 (1971); *Bouie* v. *City of Columbia,* 378 U.S. 347 (1964); *Lanzetta* v. *New Jersey,* 306 U.S. 451, 453 (1939); *compare United States* v. *Naftalin,* —— U.S. ——, 47 U.S.L.W. 4574, 4577 (May 21, 1979).[20]

Bouie v. *City of Columbia, supra,* is apposite. In that case defendants were convicted under a South Carolina statute prohibiting trespass—the entry on the premises

20. In *United States* v. *Naftalin, supra,* Naftalin conceded that his conduct amounted to a "scheme to defraud" within the meaning of Section 17(a)(1) of the 1933 Securities Act and quarreled only with whether his victims—stockbrokers—were within the protected class. Since the language of the statute plainly makes fraud in connection with the offer or sale of securities unlawful without requiring that the victim be a member of any particular class, there was no genuine notice problem. In the case at bar, where the whole question is whether Chiarella's conduct amounts to fraud within the statute or rule, unlike *Naftalin,* "the words of the statute" do not "plainly impose" liability nor has "congress . . . conveyed its purpose clearly" so that real "ambiguity . . . exists" (*id.* at 4577).

of another after receiving notice not to enter. The South Carolina Supreme Court affirmed the convictions by interpreting the trespass statute to cover the act of remaining on the premises of another after receiving notice to leave. This Court reversed the convictions and held that the retroactive application of a new and expansive judicial interpretation of a criminal statute violated due process. Mr. Justice Brennan wrote (*id.* at 352-54):

> "There can be no doubt that a deprivation of the right of fair warning can result not only from vague statutory language but also from an unforeseeable and retroactive judicial expansion of narrow and precise statutory language . . . . [A]n unforeseeable judicial enlargement of a criminal statute, applied retroactively, operates precisely like an *ex post facto* law, such as Art. I, §10, of the Constitution forbids . . . . If a state legislature is barred by the *Ex post Facto* Clause from passing such a law, it must follow that *a State Supreme Court is barred by the Due Process Clause from achieving precisely the same result by judicial construction.*" (Emphasis supplied.)

The vice in the Second Circuit's opinion is precisely that of the South Carolina Supreme Court in *Bouie,* and indeed, is an even more egregious form of it. The Circuit here retroactively expanded the coverage of Rule 10b-5 to "*Anyone*—a corporate insider or not—who regularly receives market information." Yet, to construe remaining on the premises of another after receiving notice to leave as a criminal trespass is far more predictable as a common sense protection of property rights than is importing an essentially fiduciary obligation into an area where none previously existed.

The constitutional injustice to Chiarella is powerfully evidenced by the Circuit's articulation of the "test" of "regular access to market information" and its use of that circumstance to affirm his conviction. The Second Circuit's holding that "regular access to market information" is what justifies the criminal application of Rule 10b-5 is of a piece with the government argument in *Rewis* v. *United States, supra,* 401 U.S. at 814, which this Court bluntly rejected. In *Rewis,* a Travel Act prosecution, this Court held that conducting a gambling operation frequented by out-of-state bettors was not within the Act's proscription against interstate travel with the intent to promote gambling. The government urged that the conviction should be affirmed because the Act could be construed to include the operator of a gambling operation who actively attracts business from another state. Although this Court believed that there was some support for the government's argument, it refused to uphold the conviction on the basis of the government's interpretation of the Act "because it is not the interpretation of [the Act] under which petitioners were convicted." (*Id.*)

With language of especial application to this case, this Court wrote as follows in *Rewis*:

> "The jury was not charged that it must find that petitioners actively sought interstate patronage. . . . As a result, the Government's proposed interpretation of the Travel Act cannot be employed to uphold these convictions." (*Id.*)

Similarly, the jury here was not charged that it must find that Chiarella had "regular access to market information." Simply put, the factual merits of a defense argu-

ment to the jury on that issue aside, Chiarella had an absolute right to have the jury determine "every fact necessary to constitute the crime," not an appeals court after the fact. *In re Winship,* 397 U.S. 358, 364 (1970).

Nor does the Court of Appeals' reliance on signs posted by Chiarella's employer warning against the use of confidential information and the possibility of criminal liability and several civil consent decrees settling SEC lawsuits justify its finding that petitioner "manifestly had adequate notice that his trading in target stock could subject him to criminal liability" (588 F.2d at 1369). Any notice obtained from the employer's signs or from the commencement of civil lawsuits by the SEC "manifestly" does not provide the notice and predictability due process requires.

In *Bouie, supra,* this Court rejected the contention that defendants had adequate notice of the trespass violation because a chain with a "no trespassing" sign attached had been placed on the premises by an employee of the owner (378 U.S. at 355 n.5):

> "The determination whether a criminal statute provides fair warning of its prohibitions must be made on the basis of that statute itself and the other pertinent law, rather than on the basis of an *ad hoc* appraisal of the subjective expectations of particular defendants."

That the sign and the SEC's lawsuits are not "the statute itself and the other pertinent law" sufficient to provide notice is best illustrated by the Second Circuit majority's own language (588 F.2d at 1370 n.18):

"The sign merely informed appellant of the SEC's view of the law—*a view we today hold was correct.*" (Emphasis supplied.)

And with respect to the SEC's view of the law, this Court has on a number of recent occasions rejected the SEC's interpretation of various provisions of the Securities Acts. *See, International Brotherhood of Teamsters* v. *Daniel,* —— U.S. ——, 99 S.Ct. 790, 800 n.20 (1979), and cases cited therein. Further, "less formalized custom and usage" (*Parker* v. *Levy,* 417 U.S. 733, 754 [1974]) must fairly be considered to have indicated to Chiarella the legality of his conduct. As noted above, he was keenly aware of the common and accepted practice of a prospective offeror purchasing shares of the prospective target in the open market.[21]

In sum, Section 10(b) and Rule 10b-5 as applied in this case failed to meet the constitutionally requisite standards of definiteness, whether perceived "through the eyes [of Chiarella, or] . . . his lawyer" had he consulted one. *See* Note, *Due Process Requirements of Definiteness in Statutes,* 62 Harv. L. Rev. 77, 82 (1948).

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21. Chiarella's knowledge that the prospective tender offerors from whom he obtained his information were trading in the target company stocks understandably engendered his belief that what he was doing was legal. Since, as in GX31F, this conduct by the prospective offerors was disclosed in the prospectuses and thus, necessarily approved by the regulatory authorities, Chiarella was entitled to believe that it had been deemed lawful by the SEC. Such a justifiable belief on his part negates his criminal intent, and his reliance on this authoritative guidance renders his prosecution violative of due process. *Cf. United States* v. *Pennsylvania Industrial Chemical Corp.,* 411 U.S. 655 (1973); *Cox* v. *Louisiana,* 379 U.S. 559 (1965); *Raley* v. *Ohio,* 360 U.S. 423 (1959).

POINT III

The trial court failed to instruct the jury on an essential element of the crime charged, namely specific intent to defraud or deceive.

Chiarella's sole defense on the merits was that he denied having an intent to defraud. Despite consistent urgings by the defense that the jury be charged that a finding beyond a reasonable doubt of intent to defraud was a predicate to conviction and despite defense requests to charge embodying that principle,[22] the court flatly refused to charge the jury that specific intent to defraud was a requisite element of the crime.

It is fundamental that a defendant is entitled to jury instructions regarding every essential element of the crime charged. In *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185 (1976), this Court held that in a *civil* action for damages for violation of Section 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. §78j[b]) and Rule 10b-5 it is necessary to plead and prove " 'scienter'—intent to deceive, manipulate, or defraud." *Id.* at 193. The Court concluded that by the use of the words "manipulative or deceptive device," in Section 10(b) congress intended to prohibit only "intentional or willful conduct *designed to deceive or defraud* investors." (Emphasis supplied.) *Id.* at 198-99.

In this *criminal* case, in an *a fortiori* violation of the rule announced in *Hochfelder,* the trial court never in-

22. *See* Chiarella's Requests to Charge Nos. 14, 18, 20, 21, 24-26; Supplemental Request to Charge No. 2(a).

structed that specific intent to defraud was an essential element. Rather, the state of mind the jury was instructed conviction could be premised on was "a realization on the defendant's part that he was doing a wrongful act" (R.688).

But a defendant's "realization . . . that he was doing a wrongful act" is functionally and theoretically remote from having a specific intent to defraud. The essential distinction between the two concepts is the element of purpose embraced in the specific intent concept. Thus, a person who "realiz[es]" he commits a "wrongful act" cannot necessarily be said to have acted with a specific purpose to defraud or deceive.

The difference is crucial in Chiarella's case. Because there was evidence that his employer had posted signs warning that use of "any information learned from customer's copy . . . will result in . . . being fired immediately . . . [and could result in] criminal penalties" (GX14A), the jury could easily have found that Chiarella "realiz[ed] . . . he was doing a wrongful act." He testified that he knew his conduct was in contravention of company policy and that he could have been fired for it (R.495). But Chiarella denied that he intended to defraud or cheat anyone (R.483-84) and the fact that his security transactions were all conducted anonymously over the open market was argued as circumstantial proof that he lacked the required specific intent to defraud the target company stockholders he never met and never dealt with (R.625-29).

Moreover, where the gravamen of Chiarella's "crime" was silence, the element of specific intent to defraud takes

on added significance. What distinguishes mere negligence based on silence or omission from the commission of a civil Rule 10b-5 violation predicated on similar conduct is the element of specific intent to defraud. *Ernst & Ernst* v. *Hochfelder, supra,* 425 U.S. at 198-99. In a *criminal* Rule 10b-5 prosecution which obviously can never be based on negligence, it was particularly important for the jury to have been instructed to acquit unless they found that behind Chiarella's silence was a specific purpose to defraud or deceive.

The Second Circuit panel majority held that the trial court "correctly refused to charge the jury that the Government must prove specific intent to defraud" because the trial court charged the jury not to convict unless it found that Chiarella acted "knowingly" and "willfully" and defined those terms to mean "a realization on the defendant's part that he was doing a wrongful act . . ." (588 F.2d at 1370-71). Citing *United States* v. *Peltz,* 433 F.2d 48, 54-55 (2d Cir. 1970), *cert. denied,* 401 U.S. 955 (1971) and *United States* v. *Dixon,* 536 F.2d 1388, 1395-97 (2d Cir. 1976), the Court of Appeals reasoned that the language of the charge had been specifically approved for prosecutions, as was the instant one, brought under Section 32(a) of the 1934 Act (15 U.S.C. §78ff[a]).

In neither *Peltz* nor *Dixon* did the court deal at all with the intent requirement in a Rule 10b-5 case.[23] Both *Peltz* and *Dixon* (which in any event are pre-*Hochfelder*) deal

23. *Peltz* and *Dixon* simply cannot be read as having any bearing on the mental element required for there to be a Section 10(b) and Rule 10b-5 violation. Indeed, in *Peltz* the court was dealing with a Section 10(a) and Rule 10a-1(a) violation and in *Dixon* at issue were Section 14(a), Rule 10a-3 and Section 13.

exclusively with Section 32(a)—the general penalty provision of the 1934 Act which makes criminal any *willful violation* of any section of the Act or any rule or regulation thereunder "the violation of which is made unlawful."[24] Once another section of the Act or rule or regulation thereunder makes conduct "unlawful," Section 32(a) punishes such conduct as criminal where there is a "willful violation" of that other section or rule or regulation. Thus, a purely civil violation of a section, rule or regulation is transformed into a criminal one by proof beyond a reasonable doubt of all the essential elements required by the particular section, rule or regulation *including the requisite mental element, and in addition* establishing under Section 32(a) that the violation was "willful."

This Court in *Hochfelder* made clear that the requisite mental element for a Rule 10b-5 violation is the specific "intent to defraud." The trial court's error in charging the jury was that while it permitted the jury to find "willfulness" under Section 32(a) and the *Peltz* and *Dixon* formulation of "a realization of a wrongful conduct," it never charged the jury that a violation of Section 10(b) and Rule 10b-5 required proof of a specific "intent to defraud."

The trial court's *Peltz* and *Dixon* charge on willfulness did not and could not replace a *Hochfelder* charge on intent to defraud. A properly instructed jury should have been told *both* that intent to defraud was required before a

24. Thus, Section 32(a) provides:

"Any person who willfully violates any provision of this chapter . . . or any rule or regulation thereunder the violation of which is made unlawful . . . shall [be punished for a crime]."

Section 10(b) and Rule 10b-5 violation could be found and that if found, such violation was a crime if determined to be a willful violation, *i.e.*, that the defendant committed the violation with a realization that he was engaged in wrongful conduct.[25]

POINT IV

Chiarella's statement to the New York Department of Labor was inadmissible under Rule 501 of the Federal Rules of Evidence since the federal legislative, judicial and constitutional interests clearly favor and support the statutory privilege accorded the statement by the State of New York.

In an effort to alleviate pressing financial burdens, Chiarella sought unemployment compensation from the State of New York. During the course of processing his claim he was told to supply a statement setting forth the reasons he was discharged by his last employer and he complied with a complete and accurate account of how he came to lose his job:

> "I was discharged for violations of the company rules re: disclosure of client information. The allegation is true. It was a matter of printing of stock tender offers and I utilized the information for myself. This hap-

25. To be sure, "intent to defraud" may embrace "willfulness" thereby obviating the necessity of charging the latter separately. But the converse is not true—willfulness does not include "intent to defraud." In any event, since intent to defraud was not charged, the issue of whether intent to defraud embraces willfulness and therefore whether both need to be charged is not before the Court. Insofar as *United States* v. *Charnay*, 537 F.2d 341 (9th Cir.), *cert. denied*, 429 U.S. 1000 (1976) can be read for the proposition that "awareness of wrongdoing" satisfies the *scienter* requirement of Section 10(b) and Rule 10b-5, the case is in direct conflict with *Hochfelder*.

> pened last year and through investigation by the SEC, the matter came to light and I was discharged" (transcript of proceedings, April 3, 1978, pp. 1-24–1-28).

This statement was, under the express terms of a state statute, privileged and inadmissible in "any" court proceeding. These unequivocal legislative assurances, however, proved impotent, for within a few months a federal prosecutor subpoenaed Chiarella's signed statement and at his ensuing federal trial, over objection, paraded it before the jury as Chiarella's guilty plea (R.275).

A statement procured in this manner has no place in a federal criminal trial and should have been excluded. While Rule 501 of the Federal Rules of Evidence vests the federal criminal courts with power to formulate their own law on privileges, it also requires the courts to exercise that power after a review of federal and state interests involved in the particular claim of privilege before it. Both federal and state interests strongly favor preserving the confidentiality of the statement made by Chiarella. The admission of that statement was therefore error and given the pervasive prejudicial effect of its admission, one of sufficient magnitude to require reversal.

The State of New York mandates, in no uncertain terms, confidentiality of information provided in connection with a claim for unemployment insurance. New York Labor Law, §537 provides, as it has for over 40 years, that "information" acquired from employers or employees pursuant to the law shall be for the "exclusive use" of the commissioner "and shall not be open to the public."[26] The legis-

26. The statute at the time Chiarella made his statement is set out at p. 4, *ante*.

lature, reaffirming the confidential and privileged nature of these communications, specified that the information so acquired shall not "be used in any court in any action or proceeding pending therein" except those actions or proceedings in which the Commissioner of the Department of Labor was a party. The legislature's commitment to this policy is underscored by its decision to punish any unauthorized disclosure of the information as a misdemeanor. The plain and explicit wording of the statute which, despite frequent legislative attention[27] has remained intact, demonstrates New York's resolve to keep the information it acquires under the law confidential and to bar its admission into evidence.

In recognition of the purposes sought to be accomplished by this explicit legislative command, the executive and judicial branches of the state have uniformly enforced the privilege created by §537. The statute, as one court put it, provided "for a positive nondisclosure of the communication . . . in court or out of court," a provision described as embodying either a "common-law variety of absolute privilege" or "a statutory privilege" with respect to the communications covered by the statute. *Coyne* v. *O'Connor*, 204 Misc. 465, 466, 121 N.Y.S. 2d 100, 101 (Sup. Ct. Nassau Co. 1953). And the underlying objective of the privilege was ably stated by the State's Attorney General. Appear-

27. The nondisclosure and penalty provisions have remained the same since 1935 when the statute (then §524 of the N.Y. Labor Law) was originally enacted (L. 1935, chap. 468, §1). Subsequent amendments to that law did not affect this language. See L. 1936, chap. 117, §9; L. 1938, chap. 266, §9; L. 1939, chap. 662, §21. In 1944, the legislature reenacted the nondisclosure provisions as Section 537 of the Labor Law (L. 1944, chap. 705, §1) and thereafter amended that section three times, each time without any change in the confidentiality provisions. See L. 1947, chap. 115, §2; L. 1948, chap. 346, §1; L. 1978, chap. 545, §5.