> [T]he indictment fairly charges Chiarella violated Rule 10b-5 by converting offerors' confidential information to his own use. It not only alleged that appellant's activities "operated as a fraud and deceit upon the sellers of the aforementioned securities," it also charged a "scheme to defraud" in general terms. Clearly, violation of an agent's duty to respect client confidences, *Restatement (2d) Agency* § 395, transgresses Rule 10b-5, where, as here, the converted information both concerned securities and was used to purchase and sell securities.

The court also emphasized that petitioner's secret conversion and use of confidential information for market purchases threatened the offerors' interest in preventing an "anticipatory rise in the market price of the target company's stock" (*id.* at A3). As we demonstrate below, the district court and court of appeals correctly ruled that petitioner's conduct operated as a fraud on the acquiring corporations in violation of Section 10(b) and Rule 10b-5.

1. *Pre-announcement secrecy is essential to the success of tender offers*

As both of the courts below recognized, pre-announcement secrecy is essential to the success of a

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be victimized by a fraudulent scheme and reaches fraudulent practices aimed at businesses as well as individual investors. See *United States* v. *Naftalin, supra,* slip op. 6. Thus, the district court's charge permitted the jury to find that petitioner's conduct constituted a fraud upon both the acquiring companies and the investors who sold securities to petitioner.

tender offer or acquisition.[15] The corporations involved here used coded references in their draft prospectuses, or left the names of the target companies blank, to preserve strict confidentiality. Pandick Press recognized the importance of confidentiality by admonishing its employees that information contained in customer documents "is the private and personal property of the customer" and by prohibiting any disclosure or use of the information for private purposes (see pages 5-7, *supra*).

Members of the securities industry familiar with the mechanics of tender offers have frequently emphasized the need for pre-announcement secrecy. For example, during hearings before Congress prior to the enactment of the Williams Act, Pub. L. No. 90-439, 82 Stat. 454, witnesses pointed out that premature revelation of the acquiring company's plans can abort a tender offer. See, *e.g.*, testimony of Donald Calvin, Vice President of the New York Stock Exchange (*Full Disclosure of Corporate Equity Ownership and in Corporate Takeover Bids: Hearings on S. 510 Before the Subcomm. on Securities of the Senate Comm. on Banking and Currency*, 90th Cong., 1st Sess. 72 (1967)):

> Obviously, a company intending to make a tender offer strives to keep its plan secret. If

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[15] A tender offer consists of a bid by an individual or a group to buy shares of a corporation, usually at a price above the current market price. This premium has the effect of raising the market price of the target company's stock once the tender offer becomes publicly known.

> word of the impending offer becomes public, the price of the stock will rise toward the expected tender price. Thus, the primary inducement to stockholders—an offer to purchase their shares at an attractive price above the market—is lost, and the offeror may be forced to abandon its plans or to raise the offer to a still higher price. The cost of an offer to purchase hundreds of thousands of shares might prove prohibitive if the price had to be increased only a few dollars per share. * * * In spite of all precautions, there have been cases where tender offers have been preceded by leaks and rumors which caused abnormal market problems.

See also *id.* at 73-75. Other witnesses also mentioned the necessity to avoid rumors and leaks of information about imminent tender offers. See *id.* at 84, 87-89 (remarks of Philip West, Vice President, and Keith Funston, President of the New York Stock Exchange); 98, 105 (remarks of Ralph Saul, President of the American Stock Exchange); 151, 163 (remarks of Francis Schanck, Vice President of the Investment Bankers Association). See also Hayes. & Taussig, *Tactics of Cash Takeover Bids*, 45 Harv. Bus. Rev. 135, 139-140 (1967).

In addition to the potential effect on price, leaks and unusual trading patterns may alert the target company to the tender offeror's plans. See A. Fleischer, *Tender Offers: Defenses, Responses, and Planning* 4-6 (1978). A target company alerted to a possible tender offer by unusual trading volume or rumors can commence communications with its shareholders to deflect the offer, can prepare for litigation against

the offeror, and can attempt to find competing friendly bidders to defeat the offeror. See *id.* at 113-153. See also Hayes & Taussig, *supra*, 45 Harv. Bus. Rev. at 142-147; *Panel Discussion: Defending Target Companies*, 32 Bus. Law. 1349-1363 (special issue 1977). Of equally great importance, rumors, leaks and unusual trading patterns may alert the investment banking community and other potential tender offerors to the prospect of an attractive acquisition. This may trigger competing bids that result in expensive battles for control, if not total loss of the target company. See, *e.g.*, Troubh, *Purchased Affection: A Primer On Cash Tender Offers*, 54 Harv. Bus. Rev. 79, 83 (chart) (1976).

This "high drama of Wall Street," as the court of appeals observed, also has its "tedious aspects," particularly the vast amount of paper that must be generated before a tender offer is made (Pet. App. A2-A3). Therefore, to avoid unfavorable price behavior, defensive maneuvers by the target company, and competing bids, the tender offeror must select "[p]rinters * * * who are efficient as well as discreet * * *." Troubh, *supra*, 54 Harv. Bus. Rev. at 86. Far from being discreet, however, petitioner engaged in the very kind of behavior that was likely to frustrate the acquisition plans of Pandick's customers. As noted on pages 9-10, *supra*, petitioner's substantial trading in the stock of target companies represented one-half of the total volume of daily trading in two instances, and unexplained price rises in target shares were described by witnesses at trial. More-

over, petitioner's continuing communication with his broker and repeated purchases of large amounts of target company stock immediately prior to the announcement of the tender offers was the very kind of behavior that could serve as a tip to his broker and give rise to rumors of an offer.[16] This activity could easily have forewarned the target companies of the plans of the acquiring companies, to whom petitioner owed a duty of confidence.[17]

In sum, petitioner's secret conversion of confidential information and his use of that information for trading in the stock market placed him in a serious conflict of interest and posed a substantial threat to the interests of the customers of his printing firm.

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[16] Petitioner's broker was well aware that petitioner was employed in a financial printing firm (Tr. 70-74). The broker was also aware of petitioner's repeated success in picking tender offer targets immediately before the public announcement of the tender offers (Tr. 101-114). See generally *In re George Mayer*, Securities Exchange Act Release No. 84591 (1978) (customer trading alerts broker to non-public market information).

[17] See Fleischer, *supra*, at 4-5, pointing out that tender offer targets can protect themselves against take-over bids by "stock watch" programs focused on unusual trading activities and by alertness to information about possible tender offers available from brokerage houses. See also Reuben & Elden, *How To Be A Target Company*, 23 N.Y.L. Sch. L. Rev. 423, 429 (1978). Petitioner's use of confidential tender offer information was discovered by the New York Stock Exchange's stock watch personnel, who observed unusual trading patterns in the shares of one of the target companies. See *SEC* v. *Chiarella*, SEC Litigation Release No. 7935 (May 25, 1977).

2. *As an agent, petitioner was forbidden to engage in self-dealing affecting the subject matter of his agency without making full disclosure*

As a mark-up man at Pandick Press who received customer copy and who was aware of the need for confidentiality applicable to that copy, petitioner was subject to the rules of agency governing the preservation of confidences.[18] The rules of agency forbid an agent to place himself in a position of potential conflict with his principal, to earn secret profits through the agency, or to disclose or use for personal advantage any of the principal's confidential information. See II *Restatement of Agency* § 395 & Comments a and c, § 393 & Comment a, § 390 & Comment a, § 388, § 383 (1933). See also 1 F. Mechem, *Law of Agency* §§ 1189, 1191, 1209, 1224 (2d ed. 1914).

An agent contemplating a transaction that could infringe these rules has an unqualified duty to make prior disclosure to permit his principal to take steps to protect himself. See II *Restatement of Agency*, *supra*, at § 395 & Comment c, § 381 & Comment d, § 390 & Comment a, § 393 & Comment a. Accord, Mechem,

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[18] Because it assumed a fiduciary duty to use confidential information entrusted to it only for the purposes designated by its customers and acted under the control and for the benefit of those customers, Pandick Press occupied the position of an agent. See I *Restatement (Second) of Agency* § 14N (1958). Petitioner, an employee of Pandick Press with knowledge of the rule against using confidential information for personal benefit, was a sub-agent subject to identical fiduciary responsibilities. See Pet. App. A13 n.14; *id.* at A29 (Meskill, J., dissenting); II *Restatement of Agency* § 428 & Comment b; W. Seavey, *Agency* 10 (1964). See also Scott, *The Fiduciary Principle*, 37 Calif. L. Rev. 539, 540-541, 553-554 (1949); III J. Pomeroy, *Equity Jurisprudence* 793-796 (5th ed. 1941); 36A C.J.S. 382-389 (1961) (collecting cases).

supra, at §§ 1207, 1353. Nondisclosure by an agent or other fiduciary in such circumstances constitutes deceit. See, *e.g.*, III *Restatement of Torts* § 551(2)(a) & Comment e (1938); see also James & Gray, *Misrepresentation—Part II*, 37 Md. L. Rev. 488, 524-525 (1978); *Kerr on Fraud and Mistake* 185-186, 210-213 (7th ed. 1952); G. Bower, *The Law Relating to Actionable Non-Disclosure* 294-306 (1915).[19] Petitioner's contrivance to convert confidential information operated as a fraud on the companies that entrusted him with that information within these well-established principles.

3. *Petitioner's fraud occurred "in connection with" the purchase of securities and therefore violated the statute and the rule*

Because petitioner's scheme to defraud operated through his purchase of securities and also had a close

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[19] This Court has frequently held that an agent's failure to disclose self-dealing or conflicts of interest constitutes fraud. See, *e.g.*, *Sim* v. *Edenborn*, 242 U.S. 131 (1916); *Strong* v. *Repide*, 213 U.S. 419, 428-433 (1909); *United States* v. *Carter*, 217 U.S. 286, 305-310 (1910); *Wardell* v. *Railroad Company*, 103 U.S. 651, 654-659 (1880). The common law rule in the state courts is the same. See, *e.g.*, *Holland* v. *Moreton*, 10 Utah 2d 390, 396, 353 P.2d 989, 994 (1960); *Myers* v. *Linebarger*, 134 Ark. 231, 234, 203 S.W. 580, 581 (1918); *Allen* v. *Barhoff*, 90 Conn. 184, 187, 96 A. 928, 930 (1916); *Ericson* v. *Nebraska-Iowa Farm Inv. Co.*, 134 Neb. 391, 399, 278 N.W. 841, 845 (1938); *Doyen* v. *Bauer*, 211 Minn. 140, 145-148, 300 N.W. 451, 454-456 (1941). Moreover, as the district court noted (Pet. App. B2-B3), petitioner's secret conversion of the intangible property of the customers of Pandick Press bears the indicia of embezzlement, a crime that is inherently fraudulent. See, *e.g.*, *Grin* v. *Shine*, 187 U.S. 181, 189 (1902); W. LaFave & A. Scott, *Criminal Law* 644-645 (1972).

relationship with (and potentially injurious effect upon) the securities purchases of the acquiring companies, his fraud occurred "in connection with" securities transactions. It therefore violated Section 10(b) and Rule 10b-5.[20] As noted above, Section 10(b) and Rule 10b-5 apply to "any" deceptive device or contrivance used in connection with a purchase or sale of securities. When a defendant employs deceptive practices "touching" the purchase or sale of securities, Section 10(b) and Rule 10b-5 are violated, regardless of the means used to achieve the fraud. *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, 404 U.S. 6, 12-13 (1971). As the *Bankers Life* case illustrates, concealed embezzlement or conversion, achieved through the vehicle of a securities transaction, constitutes a variety of fraud prohibited by Section 10(b) and Rule 10b-5. See *id.* at 10-11 & n.7 ("misappropriation is a 'garden variety' type of fraud"); see also *Allico National Corp.* v. *Amalgamated Meat Cutters & Butcher Workmen of North America*, 397 F.2d 727, 728-730 (7th Cir. 1968); A. Jacobs, *The Impact of Rule 10b-5* § 67.02 (1978); cf. *A. T. Brod & Co.* v. *Perlow*, 375 F.2d 393, 397 (2d Cir. 1967).[21]

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[20] As noted above, petitioner's scheme would have been deemed fraudulent under common law principles. The securities laws impose even greater standards of candor, as this Court has often recognized. See, *e.g.*, *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194-195, 197-198, 201 (1963); *Affiliated Ute Citizens* v. *United States*, *supra*, 406 U.S. 128, 151 (1972). See also III L. Loss, *Securities Regulation* 1430-1436 (2d ed. 1961).

[21] See also *SEC* v. *Texas Gulf Sulphur Co.*, *supra*, 401 F.2d at 856 (self-dealing by agent officers of a corporation, who

Contrary to the assertion of the dissenting judge in the court below (Pet. App. A29), petitioner's secret conversion and use of confidential information was not merely a breach of fiduciary duty. Petitioner's conduct amounted to a breach of duty to be sure, but it also involved "some element of deception" (*Santa Fe Industries, Inc.* v. *Green, supra,* 430 U.S. at 475) —a material failure to disclose. And as this Court has noted, concealment, nondisclosure or deception in conjunction with a breach of fiduciary duty gives rise to a violation of Section 10(b) and Rule 10b-5. See *id.* at 474-476 & n.15. Finally, as the Court reaffirmed in *United States* v. *Naftalin, supra,* slip op. 6, the fact that this part of petitioner's fraudulent scheme was directed toward a business, rather than an investor, provides no immunity from prosecution, because the securities laws were intended to protect "honest business" as well as investors and thus to achieve " 'a high standard of business ethics . . . *in every facet of the securities industry*' " (emphasis in original).

C. Petitioner Defrauded Public Investors By Purchasing Securities From Them On The Basis Of Material Non-Public Information That He Converted From The Customers Of His Financial Printing Firm

Both courts below concluded that petitioner's purchase of securities based on material non-public information obtained by misappropriation constituted

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purchase stock options from the corporation without revealing material facts, violates the statute and the rule); *id.* at 865 (Friendly, J., concurring).

fraud on the sellers of those securities in violation of Section 10(b) and Rule 10b-5 (Pet. App. A2-A15, B3). Petitioner contends, however, that he did not commit fraud because he was subject to no duty to disclose or abstain from trading. He asserts that the duty to abstain from trading prior to public disclosure applies only to "insiders" of the corporations that have issued securities, "tippees" of such insiders, or persons having a "special trustee type of relationship" with other traders in the market (Br. 17, 19, 20, 22). Petitioner claims, in substance, the privilege of the ancient rule of *caveat emptor*. As we demonstrate below, petitioner's claim ignores established principles of the law of deceit, recognized both at common law and under the federal securities laws.

1. ***The rule of caveat emptor has never applied to transactions based on converted information that is inaccessible to other traders***

At common law, purchasers and sellers of goods were generally privileged to transact business with each other without disclosing their reasons for trading. See 2 T. Cooley, *Law of Torts* § 351, at 556 (4th ed. 1932): "*Caveat emptor* is the motto of commercial law, and in other dealings, as well as sales, every person is expected to look after his own interest, and is not at liberty to rely upon the other party to protect him against the consequences of his own blunders or heedlessness." [22] The rule of *caveat emptor* rewarded the astuteness of the informed trader and penalized

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[22] See also II J. Kent, *Commentaries on American Law* 618-623 (7th ed. 1851); 12 *Williston on Contracts* §§ 1497-1499 (3d ed. 1970).

the heedlessness of the uninformed. Thus, "where the means of intelligence are equally accessible to both parties," a buyer was free at common law to purchase goods while in possession of material information bearing on the market for those goods, even if that information was unknown to the seller. *Laidlaw* v. *Organ*, 15 U.S. (2 Wheat.) 177, 195 (1817). Any other rule would penalize the "superior diligence and alertness" of the buyer, conduct that society should encourage rather than deter. See *id.* at 193.

But the purpose served by the rule of *caveat emptor* placed distinct limits on its scope. Thus, where (unlike in *Laidlaw*) the "means of intelligence" were not "equally accessible" to both traders, the common law decisions in certain commercial contexts imposed a duty of full disclosure. See, *e.g.*, 1 F. Harper & F. James, *The Law of Torts* § 7.14 at 588 (1956), describing the "salutary rule" requiring disclosure of facts "peculiarly and exclusively within the knowledge of one party to the transaction." [23] A duty of full disclosure applied at common law to those categories of commercial transactions in which one party had access to material information that was hidden from the other and good faith required candid dealing, as in

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[23] See also, *Carter* v. *Boehm*, 3 Burr. 1905, 1910 (1766) (Mansfield, J.); *Hanson* v. *Edgerly*, 29 N. H. 343, 358-359 (1856); *Rothmiller* v. *Stein*, 143 N.Y. 581, 595, 38 N.E. 718, 722 (1894); *Jones* v. *Arnold*, 359 Mo. 161, 169, 221 S.W.2d 187, 193 (1940); *Simmons* v. *Evans*, 185 Tenn. 282, 285-287, 206 S.W.2d 295, 296-297 (1947); *Jenkins* v. *McCormack*, 184 Kan. 842, 844, 339 P.2d 8, 11 (1959); *Lingsch* v. *Savage*, 213 Cal.App.2d 729, 735-738, 29 Cal. Rptr. 201, 204-206, (1963); Cf. *Stewart* v. *Wyoming Ranche Co.*, 128 U.S. 383, 388 (1888).

certain insurance contracts, contracts of sale, suretyship contracts, and compositions. See G. Bower, *The Law Relating To Actionable Non-Disclosure, supra,* at 58-110; *Kerr on Fraud and Mistake, supra,* at 87.

A duty to disclose information inaccessible to the seller received unequivocal recognition when the buyer misappropriated or otherwise improperly came into possession of the information that formed the basis for the transaction. See, *e.g.*, G. Bower & A. Turner, *The Law of Actionable Misrepresentation* 107 (1974): "In other words, suppression by a purchaser of facts affecting the value of the property which are not merely within his own knowledge, but the issue of his own volition and wrongful action, is equivalent to a misrepresentation." This principle is illustrated by the English case of *Phillips* v. *Homfray*, L.R. 6 Ch. 770, 779-780 (1871), where the buyers converted coal from the sellers' property prior to purchasing the property: "the case is not merely that the purchasers, being more experienced men, knew the value of the coal better than the vendors, but that the vendors being unable to gain access to the coal, the purchasers took advantage of an unlawful access to it in order to test its value * * *." The court added that the buyer must employ a "legitimate mode of acquiring knowledge" if the rule of *caveat emptor* is to apply. *Ibid.* See also Keeton, *Fraud—Concealment and Non-Disclosure*, 15 Tex. L. Rev. 1, 25-26 (1936):

> [T]he way in which the buyer acquires the information which he conceals from the vendor should be a material circumstance. The infor-

> mation might have been acquired as the result of his bringing to bear a superior knowledge, intelligence, skill or technical judgment; it might have been acquired by chance; or it might have been acquired by means of some tortious action on his part. * * * Any time information is acquired by an illegal act it would seem that there should be a duty to disclose that information, irrespective of the nature of the remedy.

See also *id.* at 35; accord, 1 F. Harper & F. James, *supra*, § 7.14 at 590.[24]

Thus, the common law rule of *caveat emptor* affords no immunity to petitioner. The policy served by the rule—encouragement of diligence by sellers and buyers—has no application to conversion of information to secure an advantage over uninformed traders. Even under a strict view of the rule of *caveat emptor*, the law of fraud imposed a duty to speak when one party to a transaction had information inaccessible to the other, and that information was obtained through lawless means.

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[24] The economic basis for this rule of law is discussed at length in Kronman, *Mistake, Disclosure, Information, And The Law of Contracts*, 7 J. Legal Stud. 1, 9 (1978). As Prof. Kronman explains, the cases applying the rule of *caveat emptor* arise in a context where the party charged with nondisclosure has acquired information through legitimate research or other bona fide economic activity. The law permits nondisclosure in such contexts to encourage socially desirable economic behavior. See also *id.* at 34. But where a trading advantage is the result of exclusive access to important information, obtained and used in violation of an explicit legal duty, the rule of *caveat emptor* has no logical application.

2. *The federal securities laws were intended to replace the doctrine of caveat emptor with that of full disclosure and to forbid misuse of confidential business information for personal enrichment in the stock market*

If petitioner's claim of a right to trade without disclosure of misappropriated information finds little basis in common law precedent, it finds none under the federal securities laws. As this Court has repeatedly noted, "the 1934 Act and its companion legislative enactments embrace a 'fundamental purpose . . . to substitute a philosophy of full disclosure for the philosophy of *caveat emptor*' * * *." *Affiliated Ute Citizens* v. *United States*, *supra*, 406 U.S. at 151 (footnote omitted); accord, *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 186 (1963). Congress eliminated the rule of *caveat emptor* in securities transactions to restore investor confidence following the market crash of 1929.[25] Obtaining trading advantages over other investors through theft or

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[25] See, *e.g.*, H.R. Rep. No. 1383, 73d Cong., 2d Sess. 5 (1934) ("If investor confidence is to come back to the benefit of exchanges and corporations alike, the law must advance. * * * Unless constant extension of the legal conception of a fiduciary relationship—a guarantee of 'straight shooting'—supports the constant extension of mutual confidence * * * easy liquidity of the resources in which wealth is invested is a danger * * *. Just in proportion as it becomes more liquid and complicated, an economic system must become more moderate, more honest, and more justifiably self-trusting"); S. Rep. No. 792, 73d Cong., 2d Sess. 3 (1934) ("The unfair methods of speculation employed by large operators and those possessing inside information regarding corporate affairs * * * have also been contributing causes of losses to investors").

conversion of confidential information is wholly inconsistent with the objectives Congress sought to achieve in 1934.[26] Those objectives were reaffirmed by Congress in 1975 when it amended the Securities Exchange Act of 1934, Pub. L. No. 94-29, 89 Stat. 97. See H.R. Conf. Rep. No. 94-229, 94th Cong. 1st Sess. 91-92 (1975):

> The basic goals of the Exchange Act remain salutatory and unchallenged: To provide fair and honest mechanisms for the pricing of securities, to assure that dealing in securities is fair and without undue preferences or advantages among investors * * * and to provide, to the maximum degree practicable, markets that are open and orderly.

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[26] See remarks of Rep. Wolverton, 78 Cong. Rec. 7865-7866 (1934) ("It is my hope and expectation that a wise and judicious administration of the provisions of this act will create a new confidence in the integrity of the security markets. * * * 'If there were a justifiable belief that security markets actually were "free and open", that all buyers and sellers met on substantially equal terms * * * the response would be a greater investment interest in securities and a consequent improvement in all phases of the security business.' "). Rep. Rayburn expressed similar views prior to the enactment of the Securities Act of 1933, 77 Cong. Rec. 2918 (1933) ("The purpose of this bill is to place the owners of securities on a parity, so far as is possible, with the management of the corporations, and to place the buyer on the same plane so far as available information is concerned, with the seller"). See also remarks of Rep. Rayburn, 78 Cong. Rec. 7697 (1934) ("We should have a market place for the exchange of securities, but it should be a clean and honest market place.").

In light of these statutory purposes, the Securities and Exchange Commission and the courts have repeatedly held that Section 10(b) and Rule 10b-5 prohibit corporate employees, officers and directors from taking personal advantage of material non-public information entrusted to them for business purposes. Such information must be made public before trading; if it cannot be made public, the possessor must abstain from trading. The analytic basis for this rule was summarized by the Commission in *In re Cady, Roberts & Co.*, 40 S.E.C. 907, 912 (1961) (emphasis supplied; footnote omitted):

> We have already noted that the anti-fraud provisions are phrased in terms of "any person" and that a special obligation has been traditionally required of corporate insiders, e.g., officers, directors and controlling stockholders. These three groups, however, do not exhaust the classes of persons upon whom there is such an obligation. *Analytically, the obligation rests on two principal elements; first, the existence of a relationship giving access, directly or indirectly, to information intended to be available only for a corporate purpose and not for the personal benefit of anyone, and second, the inherent unfairness involved where a party takes advantage of such information knowing that it is unavailable to those with whom he is dealing.*

The Commission's analysis parallels that of the common law decisions limiting the doctrine of *caveat emptor*: it is a sharp practice to reap profits by misappropriating non-public information and trading

on the basis of that information with persons lacking access to it.

The rule of *Cady, Roberts* has received the sanction of every court that has considered it.[27] See, *e.g.*, *SEC* v. *Texas Gulf Sulphur Co.*, 401 F.2d 833, 848 (2d Cir. 1968) (en banc), cert. denied, 394 U.S. 976 (1969):

> [Section 10(b) and Rule 10b-5 are] based in policy on the justifiable expectation of the securities marketplace that all investors trading on impersonal exchanges have relatively equal access to material information * * *. The essence of the Rule is that anyone who, trading for his own account in the securities of a corporation has "access, directly or indirectly, to information intended to be available only for a corporate purpose and not for the personal benefit of anyone"

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[27] The courts of appeals are unanimous in holding that trading on the basis of material inside information violates the statute and the rule. See *Kohler* v. *Kohler Co.*, 319 F.2d 634, 637-638 (7th Cir. 1963); *Myzel* v. *Fields*, 386 F.2d 718, 733-734 (8th Cir. 1967), cert. denied, 390 U.S. 951 (1968); *Pennaluna & Co.* v. *SEC*, 410 F.2d 861, 869-870 (9th Cir. 1969), cert. denied, 396 U.S. 1007 (1970); *Stier* v. *Smith*, 473 F.2d 1205, 1208 (5th Cir. 1973). See also *Fridrich* v. *Bradford*, 542 F.2d 307, 318-322 & n.30, 323-327 & n.6 (6th Cir. 1976), emphasizing that criminal sanctions are available to enforce the prohibition. See generally III L. Loss, *Securities Regulation* 1445-1474 (2d ed. 1961); Schotland, *Unsafe At Any Price: A Reply To Manne, Insider Trading And The Stock Market*, 53 Va. L. Rev. 1425 (1967). The fact that other statutory provisions also extend to certain aspects of insider trading (see Section 16(b) of the Act, 15 U.S.C. 78p(b)) does not affect the coverage of Section 10(b). See *United States* v. *Naftalin*, *supra*, slip op. 9.

> may not take "advantage of such information knowing it is unavailable to those with whom he is dealing," i.e., the investing public. * * * Insiders, as directors or management officers, are, of course, by this Rule, precluded from so unfairly dealing, but the Rule is also applicable to one possessing the information who may not be strictly termed an "insider" * * *.

This Court has also recognized that Section 10(b) and Rule 10b-5 forbid trading on the basis of material inside information. See *Foremost-McKesson, Inc.* v. *Provident Securities Co.*, 423 U.S. 232, 255 (1976), noting that "Congress has passed general antifraud statutes that proscribe fraudulent practices by insiders. * * * Today an investor who can show harm from the misuse of material inside information may have recourse, in particular, to § 10(b) and Rule 10b-5 * * *."

As both courts below recognized (Pet. App. A6-A8, B2-B3), there is no difference in principle between petitioner's conduct and that of an officer of an issuer corporation who trades on the basis of material nonpublic information.[28] Petitioner had access to confi-

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[28] Contrary to petitioner's assertion (Br. 22), none of the foregoing cases limit the principles that they announce to a special category of persons. For example, tippees, with no special relationship with the issuing corporation and no "inside" status, are forbidden to utilize non-public information. See *In re Investors Management Co.*, 44 S.E.C. 633, 643 (1971) ("We reject the contentions advanced by respondents that no violation can be found unless it is shown that the recipient himself occupied a special relationship with the issuer or insider corporate source giving him access to non-

dential commercial information of great importance to investors, who could not have learned of it through any exercise of diligent research. He misappropriated that information for personal enrichment, in violation of his duty as an agent.[29] The conduct of a corporate officer, director or other agent of an issuer corporation, who misappropriates confidential information and exploits uninformed investors, is functionally identical. Although the source of the information is different, the elements are the same: (1) critical information is available to only one party to the transaction and (2) that information is converted rather than acquired through research or other bona fide economic activity.[30] Nor is the impact on the

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public information * * *."). See also *Shapiro* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 495 F.2d 228, 237-238 (2d Cir. 1974); *Kuehnert* v. *Texstar Corp.*, 412 F.2d 700, 702 (5th Cir. 1969). See generally A. Jacobs, *The Impact Of Rule 10b-5, supra*, § 66.02[a], at 3-273 to 3-278. As we discuss immediately below, these principles have been applied by the courts and the SEC in analogous cases involving market information frauds.

[29] Obtaining special trading advantages through misappropriation of confidential information is the very antithesis of obtaining a trading advantage through astute analysis of publicly available information, which the securities laws encourage. See *SEC* v. *Texas Gulf Sulphur Co., supra*, 401 F.2d at 848-849. See also *In re Investors Management Co., supra*, 44 S.E.C. at 641 n.18, distinguishing between information obtained by "general observation or analysis" and "industrial espionage."

[30] See *Diamond* v. *Oreamuno*, 24 N.Y.2d 494, 497-501, 248 N.E.2d 910, 912-914 (1969); *Brophy* v. *Cities Serv. Co.*, 31 Del. Ch. 241, 246, 70 A.2d 5, 8 (1949).

stock market different. As the court of appeals remarked (Pet. App. A15), "[i]t is difficult to imagine conduct less useful, or more destructive of public confidence in the integrity of our securities markets, than Chiarella's." [31] In short, the courts below correctly concluded that the mandate to "disclose or abstain" applied to petitioner. His trading on the basis of misappropriated information is a classic example of the kind of "deceptive practice[]" that can "fullfill no useful function." *Ernst & Ernst* v. *Hochfelder*, *supra*, 425 U.S. at 206.[32]

3. ***The fact that petitioner misappropriated non-public market information, rather than inside corporate information, does not immunize his conduct***

a. *Section 10(b) and Rule 10b-5 apply to petitioner's scheme even though the precise factual pattern involved here has not been presented in prior litigated cases*

Petitioner argues (Br. 20, 22) that the principles described above have no application to him because he was not an "insider" or a "tippee" of an insider,

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[31] If, as petitioner suggests, the securities laws are not available to restrain or punish conduct such as his own, then other members of tender offer team might be encouraged to exploit material non-public information for personal gain. These persons include lawyers, accountants, bankers, corporate employees and secretaries. Highly profitable trading on the basis of such undisclosed information would scarcely be an isolated occurrence.

[32] Petitioner was, of course, forbidden to disclose the confidential information here in question. It was therefore incumbent upon him to await disclosure by the acquiring companies before commencing to trade for his own account. See *SEC* v. *Texas Gulf Sulphur Co.*, *supra*, 401 F. 2d at 848.

as described in *Cady, Roberts* and *Texas Gulf Sulphur*. But such a limiting interpretation cannot be squared with the literal text of Section 10(b), which applies to "any" fraudulent scheme, or with the legislative history of the statute, which shows that it was intended to be a "catchall" extending to all "new cunning devices." See pages 25-28, *supra*. As this Court noted in *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, *supra*, 404 U.S. at 11 n.7 (quoting *A. T. Brod & Co.* v. *Perlow*, 375 F.2d 393, 397 (2d Cir. 1967) (emphasis in original)):

> "We believe that § 10(b) and Rule 10b-5 prohibit *all* fraudulent schemes in connection with the purchase or sale of securities, whether the artifices employed involve a garden type variety of fraud, or present a unique form of deception. Novel or atypical methods should not provide immunity from the securities laws."

Similarly, in *United States* v. *Naftalin*, *supra*, slip op. 3, this Court rejected the argument that the general antifraud provision in Section 17(a) of the Securities Act of 1933, 15 U.S.C. 77q(a), should be limited to frauds of the kind involved in prior litigated cases—*i.e.*, frauds aimed at investors. The Court noted that "[n]othing on the face of the statute supports this reading of it" (slip op. 3).[33]

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[33] Naftalin unsuccessfully argued in this Court that Section 17(a) should be limited to "investor" frauds in conformity with prior litigated cases: "in the entire history of Section 17(a) of the 1933 Act there existed 'no case in which [the statute] has been used to prosecute a defendant for fraud in the sale of securities perpetrated upon an agent-broker * * *' " (Br. 32).

In rejecting Naftalin's argument, the Court cited *United States* v. *Brown*, 555 F.2d 336 (2d Cir. 1977) (see slip op. 6), which held:

> The fact that there is no litigated fact pattern precisely in point may constitute a tribute to the cupidity and ingenuity of the malefactors but hardly provides an escape from the penal sanctions of the securities fraud provisions here involved.

Id. at 339-340. Nothing in Section 10(b) or Rule 10b-5 suggests that its prohibitions are confined to "insiders," "tippees" of insiders or "inside information." Frauds involving market information,[34] like any other frauds practiced in connection with a purchase or sale of securities, fall within the coverage of these broad antifraud provisions.[35]

Nor do economic considerations support petitioner's arguments about the scope of Section 10(b) and Rule 10b-5. The profits to be made from market information fraud, and the unfairness to investors, are at least as great as in inside information cases. Market information concerning forthcoming tender offers or acquisitions has tremendous importance to investors,

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[34] In this brief, the term "market information" refers to information about the demand in the market for a particular security, as opposed to the value of the assets or earning power of the corporation that issues the security. See Pet. App. A8 n.8.

[35] Moreover, as we demonstrate on pages 56-61, *infra*, prior decisions of this Court and the lower federal courts have applied the "disclose or abstain" principle in market information cases that are analogous to the present case.