UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF TEXAS
(Dallas Division)

ANHEUSER-BUSCH COMPANIES, INC., Plaintiff, v. W. PAUL THAYER, BILLY BOB HARRIS, A. G. EDWARDS, INC., A. G. EDWARDS & SONS, INC., WILLIAM H. MATHIS, BEAR, STEARNS & CO., BEAR, STEARNS & COMPANY, BSC PARTNERS, GAYLE L. SCHRODER, MALCOLM B. DAVIS, PLUS, INC. and DOYLE L. SHARP, Defendants.	CA3-85-0794-R

MEMORANDUM OF THE SECURITIES AND EXCHANGE COMMISSION, AMICUS CURIAE

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MEMORANDUM OF THE SECURITIES AND EXCHANGE COMMISSION, AMICUS CURIAE

INTEREST OF THE SECURITIES AND EXCHANGE COMMISSION AND PRELIMINARY STATEMENT

In this action, an allegedly faithless corporate director and those to whom he illicitly transmitted highly sensitive and confidential corporate information seek to avoid liability under the federal securities laws to the injured corporation. Defendant W. Paul Thayer, then a director of plaintiff Anheuser-Busch Companies, Inc., ("Anheuser-Busch") secretly informed certain of the other defendants that Anhueser-Busch was involved in confidential merger plans and negotiations. Those defendants, and others to whom they in turn disclosed the information, traded in the merger partner's securities and thereby drove the price of the stock up significantly, reaping profits for themselves and allegedly causing Anheuser-Busch to pay far more to acquire the

company than it otherwise would have paid if the defendants had not traded on the information stolen from Anheuser-Busch. Certain of the defendants have now moved for summary judgment, arguing that the federal securities laws do not reach the lucrative fraud they perpetrated on Anheuser-Busch.

The Securities and Exchange Commission, the agency charged with primary responsibility for enforcing the federal securities laws -- including the Securities Exchange Act of 1934, 15 U.S.C. 78a et seq. -- submits this memorandum, amicus curiae, to address two important issues of first impression in the Fifth Circuit concerning the scope of the antifraud provisions of Section 10(b) of the Act, 15 U.S.C. 78j(b), and Commission Rule 10b-5 thereunder, 17 C.F.R. 240.10b-5. These issues are raised by defendants Thayer, A.G. Edwards & Sons, Inc., William H. Mathis and Bear Stearns & Co. on their motions for summary judgment. 1/

The first issue is whether, and under what circumstances, Section 10(b) and Rule 10b-5 are violated by a person who fraudulently misappropriates confidential information by using that information in connection with securities trading. The Commission is of the view, and every court to have reached the issue has held, that a person who, in breach of a duty of trust and confidence, fraudulently misappropriates confidential information violates Rule

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1/ The Bear Stearns and A.G. Edwards motions also include, as movants, in addition to Bear, Stearns & Co. and A.G. Edwards & Sons, Inc., several related entities that are also defendants. These are, respectively, Bear, Stearns & Company and BSC Partners, and A.G. Edwards, Inc.

10b-5 when he trades in securities on the information or discloses it to others who trade. In addition, those persons who receive the information from the misappropriator, directly or indirectly, with knowledge or with reason to know that it has been improperly disclosed to them in breach of a duty of trust and confidence, violate Rule 10b-5 by trading on the information or by disclosing it to others who trade. As this Court is aware, the Commission has pending in this Court its own action against two of the defendants in this private action, involving in large measure the same securities trading and based in large part (albeit not entirely) on the same theory of violations under Section 10(b) and Rule 10b-5. SEC v. Thayer, No. CA3-84-0471-R (N.D. Tex., filed Jan. 5, 1984).

The Commission will also address the issue of whether a person whom the misappropriator has defrauded by violating Rule 10b-5 can maintain a private action for damages against the misappropriator or against those who receive the information and use it in violation of Rule 10b-5. The Commission is of the view that a defrauded person who satisfies the established standing requirements for maintaining a private Rule 10b-5 action should be able to maintain a suit based on this type of securities fraud just as for any other type of securities fraud. The availability of private rights of action is important to the Commission because the private action serves as a necessary supplement to the Commission's own enforcement actions. 2/

2/ Defendants also contest Anheuser-Busch's allegations of causation and damages. The Commission is not addressing these issues in this amicus brief since they are primarily factual in nature.

STATEMENT OF THE CASE 3/

During the spring of 1982, plaintiff Anheuser-Busch began to explore the possibility of expanding its business through corporate acquisitions (Amd. Cmpt. ¶18). 4/ The company designated a policy committee of its board of directors, along with the company's corporate development department, to review possible target companies (id.). By June 1982, Anheuser-Busch had retained both an investment banker and a law firm to advise it on how best to proceed, and by June 23, 1982, management had narrowed its search to four potential merger partners, including Campbell Taggart, Inc. ("CTI")(id. ¶¶18-20).

On June 23, the Anheuser-Busch board met to discuss the company's acquisition plans (id. ¶21). As a member of the Anheuser-Busch board, defendant W. Paul Thayer attended the June 23 meeting and participated in the discussion of potential target companies (id.). During the next month, Thayer remained in contact with

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3/ The Commission will rely on the allegations in Anheuser-Busch's amended complaint for its statement of the underlying facts of this action. The moving defendants state that they do not dispute those allegations for the purposes of their present motions.

4/ The following abbreviations are used: "Amd. Cmpt. __" refers to the amended complaint of Anheuser-Busch; "Bear Stearns Br. __" refers to the Memorandum in Support of the Motion of Defendants Mathis and Bear, Stearns for Summary Judgment; "Edwards Br. __" refers to the Brief of A.G. Edwards & Sons, Inc. in Support of Its Motion for Summary Judgment.

Since defendant Thayer has, with respect to the violations discussed herein, only incorporated by reference the arguments in the Bear Stearns and Edwards briefs, no separate citations to the Thayer brief will be provided.

company officials to keep abreast of further developments in the acquisition plans (id. ¶22). When the board next met on July 28, 1982, it formally authorized management to approach CTI with a merger proposal (id. ¶23). On July 29, 1982, Anheuser-Busch's chairman called CTI's chairman with the proposal (id. ¶34). CTI was receptive, and the companies' top officers met on August 1 to begin to discuss a possible merger (id. ¶35). On August 9, following merger negotiations, the companies announced an agreement to merge (id. ¶37).

During the period when Anheuser-Busch was considering CTI as an acquisition target and discussing the merger with CTI, Thayer disclosed what he knew about the company's plans to, among others, defendant Billy Bob Harris, a stockbroker with the Dallas office of defendant A.G. Edwards & Co. ("A.G. Edwards") and Sandra Ryno, a personal friend of Thayer (id. ¶24). Between June 30, 1982, immediately after Thayer first disclosed Anheuser-Busch's plans to these persons, and August 2, 1982, Harris purchased over 73,000 shares of CTI stock for Ryno, for himself and for several other friends and associates (id. ¶25).

Harris in turn disclosed the information about Anheuser-Busch's acquisition plans to others who also purchased CTI stock (id. ¶26). Harris also recommended CTI stock to the A.G. Edwards research department, thus causing other A.G. Edwards salesmen to

trade in the stock and recommend it to customers (id. ¶29). 5/ Between June 30 and August 2, many of these persons collectively purchased more than 172,000 shares of CTI stock, much of it through A.G. Edwards (id. ¶¶27-29).

Among those persons to whom Harris disclosed the information was defendant William Mathis, a stockbroker with the Atlanta office of defendant Bear, Stearns & Co. ("Bear Stearns") (id. ¶30). Between July 7 and August 3, 1982, Mathis purchased in excess of 30,000 shares of CTI stock, and induced several of his customers to purchase over 100,000 more shares of CTI stock through Bear Stearns (id. ¶¶31-32).

The extensive trading on this information is alleged to have caused the price of CTI stock to rise from $24 per share on June 28 to $30 per share on August 3 (id. ¶¶27, 31, 48). In the wake of this trading, Anheuser-Busch and CTI announced publicly, on August 3, that they were negotiating towards a possible merger (id. ¶36). In the merger announced on August 9, 1982, Anheuser-Busch agreed to pay cash and issue securities in exchange for all outstanding CTI stock, at a price per share of approximately $37 (id. ¶37). Anheuser-Busch and CTI consummated the merger at that price on November 2, 1982 (id. ¶39).

5/ The complaint alleges that Harris also took steps to conceal the source of the information. At Harris' request, the research department at A.G. Edwards prepared a misleading research report that recommended the purchase of CTI stock, even though Thayer's tip formed the sole basis for recommending CTI. Harris, and later Mathis, used the report to justify their recommendations to customers to buy CTI (id. ¶¶41-43).

ARGUMENT

I. DEFENDANTS DEFRAUDED ANHEUSER-BUSCH IN VIOLATION OF SECTION 10(b) AND RULE 10b-5 WHEN THEY TRADED, OR TIPPED OTHERS WHO TRADED, IN SECURITIES ON NONPUBLIC INFORMATION FRAUDULENTLY MISAPPROPRIATED FROM ANHEUSER-BUSCH.

A. Thayer Violated Section 10(b) and Rule 10b-5 by Fraudulently Misappropriating Information from Anheuser-Busch in Connection with Securities Trading.

Anheuser-Busch alleges that Thayer and the other defendants violated Section 10(b) of the Securities Exchange Act and Rule 10b-5 when Thayer, in breach of a duty of trust and confidence owed to it, tipped other defendants about Anheuser-Busch's confidential plans to acquire CTI, and when the tippee defendants traded -- and tipped still other defendants who also traded -- in CTI stock on the information (Amd. Cmpt. ¶¶13-50). The effect of this trading, Anheuser-Busch alleges, was to fraudulently induce it to pay more to acquire CTI than it otherwise would have paid (id. ¶48).

Assuming the allegations of the complaint to be true, Thayer and the other defendants violated Rule 10b-5 by participating in a fraudulent misappropriation of confidential information from Anheuser-Busch in order to trade in CTI stock. Thayer himself did not trade but, as a director of Anheuser-Busch, he owed the company a duty not to misappropriate its confidential corporate information, and committed fraud on Anheuser-Busch by secretly and improperly tipping word of Anheuser-Busch's corporate plans, which the company had entrusted to him in confidence, to the trading defendants. The "tippee" defendants -- those who received the information from Thayer or from one of those "tipped" by him -- in turn acquired

derivative and co-extensive duties of confidence to Anheuser-Busch, when they received information about the company's plans that they knew or should have known had been improperly disclosed to them in breach of a duty of trust and confidence. 6/ The tippees defrauded Anheuser-Busch when they secretly traded on the information in breach of those acquired duties they owed to the company.

This misappropriation theory of a violation of Rule 10b-5 is well-established. Every court to have considered the issue has concluded that one who fraudulently misappropriates confidential information, in breach of a relationship of trust or confidence, by trading on that information -- or tipping others who trade -- violates Rule 10b-5. See, e.g., SEC v. Materia, 745 F.2d 197, 203 (2d Cir. 1984), cert. denied, 105 S. Ct. 2112 (1985); United States v. Newman, 664 F.2d 12, 18 (2d Cir. 1981), opinion after remand, 722 F.2d 729 (2d Cir.), cert. denied, 464 U.S. 863 (1983); Rothberg v. Rosenbloom, [Current] Fed. Sec. L. Rep. (CCH) ¶92,283, at 91,947 (3d Cir. 1985); United States v. Winans, 612 F. Supp. 827, 840-43 (S.D.N.Y. 1985), appeals pending, Nos. 85-1312, 85-1313, 85-1314 (2d Cir.); United States v. Reed, 601 F. Supp. 685, 720 (S.D.N.Y. 1985), reversed as to venue, No. 85-1031 (2d Cir., Sept. 30, 1985); SEC v. Musella, 578 F. Supp. 425, 438-39 (S.D.N.Y. 1984); SEC v. Gaspar, [1984-85] Fed. Sec. L. Rep. (CCH) ¶92,004 (S.D.N.Y. 1985).

6/ Proof that the recipients acted in reckless disregard of whether they had received the information improperly will suffice to show that they should have known they received it improperly.

There is ample basis for the principle that Rule 10b-5 is violated by defrauding a corporation or other person of information for use in securities trading. The antifraud provisions do not proscribe only those securities frauds aimed at investors. Rather, they aim "to achieve a high standard of business ethics * * * in every facet of the securities industry." United States v. Naftalin, 441 U.S. 768, 775 (1979) (emphasis omitted) (quoting SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 186-87 (1963)). In Naftalin, a unanimous Supreme Court rejected the contention that in order to violate the antifraud provisions of Section 17(a) of the Securities Act (on which Rule 10b-5 was modeled) the defendant must have defrauded an investor. Id. at 775-77. The Court disapproved the notion that Congress had intended only to advance the goal of investor protection (as important as that goal is) by enacting the securities laws, stating: "[F]rauds perpetrated upon either business or investors can redound to the detriment of the other or the economy as a whole." Id. at 776. 7/

This broad construction follows from the terms of Section 10(b), 15 U.S.C. 78j(b), which makes it "unlawful for any

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7/ In Naftalin, the defendant had argued that a fraudulent short-selling scheme did not violate the antifraud provision of Section 17(a) of the Securities Act, 15 U.S.C. 77q(a), because his scheme had not injured any shareholder or investor. Instead, his scheme had injured the broker who executed the short sales in reliance on Naftalin's representation that he would deliver the securities; the broker was ultimately compelled to "buy in" at higher prices to cover the sales. 441 U.S. at 770-71.

person * * * [t]o use or employ, in connection with the purchase or sale of any security * * *, any manipulative or deceptive device or contrivance" (emphasis added) in contravention of a Commission rule under Section 10(b), and of Rule 10b-5, which makes it a violation for "any person * * * to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit up on any person, in connection with the purchase or sale of securities." 17 C.F.R. 240.10b-5 (emphasis added). 8/ As the legislative history of Section 10(b) shows, it "was intended to be broad in scope, encompassing all 'manipulative and deceptive devices which have been demonstrated to fulfill no useful function.'" SEC v. Materia, 745 F.2d at 201 (quoting S. Rep. No. 792, 73d Cong., 2d Sess. 6 (1934)). Consistent with the broad purposes of these provisions, courts have construed them expansively, see, e.g., Herman & McLean v. Huddleston, 459 U.S. 375, 386-87 (1983), to prohibit any deceptive scheme whether it employs "a garden type variety of fraud" or "[n]ovel or atypical methods." Superintendent of Insurance v. Bankers Life & Casualty Co., 404 U.S. 6, 10-11 n.17 (1971)(quoting A.T. Brod & Co. v. Perlow, 375 F.2d 393, 397 (2d Cir. 1967)). So long as "what it catches is fraud," Chiarella v. United States, 445

8/ In construing a statute, the courts should appropriately begin with the language itself. See, e.g., International Brotherhood of Teamsters v. Daniel, 439 U.S. 551, 558 (1979) (citing Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 756 (1975); Santa Fe Industries, Inc. v. Green, 430 U.S. 462, 472 (1977).

U.S. 222, 235 (1980), Rule 10b-5 can encompass any fraudulent or deceptive practice touching the purchase or sale of securities. See Superintendent of Insurance, 404 U.S. at 12-13. 9/

There is no question that the violations alleged here constitute fraud. A corporate officer or director, such as Thayer, who misappropriates non-public corporate information, breaches a duty of confidentiality owed to the corporation. Where confidential information is given to a fiduciary he breaches his duty by using or communicating the information when the use or communication is likely to injure his beneficiary. See Restatement (Second) of Agency §395 and comments a and c (1958). Of course, a fully-disclosed breach of fiduciary duty does not constitute fraud in violation of Rule 10b-5. See Santa Fe Industries Inc. v. Green, 430 U.S. 462, 472 (1977). As the Fifth Circuit has made clear, however, Santa Fe "preclud[es] application of Rule 10b-5 only if the breach of fiduciary duty does not involve misrepresentations or nondisclosures." Brown v. Ivie, 661 F.2d 62, 66 (5th Cir.), cert. denied, 455 U.S. 990 (1982). Where a fiduciary misappropriates information deceitfully in connection with securities

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9/ See generally Affiliated Ute Citizens v. United States, 406 U.S. 128, 151 (1972) ("These proscriptions, by statute and rule, are broad and, by repeated use of the word 'any,' are obviously meant to be inclusive."); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 203 (1976)(Section 10(b) is a "'catch-all' clause to enable the Commission 'to deal with new manipulative [or cunning] devices.'")(brackets in original). See also United States v. Naftalin, 441 U.S. at 773, 775-77 (Section 17(a) of the Securities Act).

trading, without disclosing the breach to the beneficiary, he commits fraud on the beneficiary for purposes of Rule 10b-5. See United States v. Newman, 664 F.2d at 17-18.

This proposition is hardly exceptional. For example, under the federal mail and wire fraud statutes, a fiduciary who deceitfully breaches his duty, and thereby harms the beneficiary, has defrauded the beneficiary. Thus, the Fifth Circuit held, in United States v. Ballard, 663 F.2d 534, 540-41 (5th Cir. 1981), modified in part on other grounds, 680 F.2d 352 (1980), that the mail fraud statute is violated when an employee breaches his fiduciary duty to his company in circumstances involving "a violation of the employee's duty to disclose material information to the employer." Id. at 541 (footnote and citations omitted). As the Second Circuit stated in United States v. Barta, 635 F.2d 999, 1006 (2d Cir. 1980), cert. denied, 450 U.S. 998 (1981), a case cited with approval by the Ballard court, "[t]he additional element which frequently transforms a mere fiduciary breach into a criminal offense is a violation of the employee's duty to disclose material information to his employer." This principle has long been recognized in the Fifth Circuit. In Abbott v. United States, 239 F.2d 310 (5th Cir. 1956), Judge Brown explained why a scheme by outsiders to obtain confidential information -- in the form of geological maps -- from a corporate employee constituted fraud:

> This scheme had as its sole purpose to destroy the rightful exclusive enjoyment by [the corporation] of its property. [The outsider] was to acquire use of it without [the corporation's] consent by the stealthy, devious means of subverting the fidelity of its trusted servant. Comparatives seem to be of little

> significance here, but if they are, this was not simple theft. * * * The object was to filch from [the corporation] its valuable property by dishonest, devious, and reprehensible means. That is to "defraud," for "the law does not define fraud; it needs no definition; it is as old as falsehood and as versable as human ingenuity."

Id. at 314 (emphasis in original)(quoting Weiss v. United States, 122 F.2d 675, 681 (5th Cir.), cert. denied, 314 U.S. 687 (1941)).

In this case, Thayer misappropriated from Anheuser-Busch, to which he owed a fiduciary duty, confidential corporate information about Anheuser-Busch's acquisition plans. Thayer's faithless act deprived Anheuser-Busch of the full use of its secret information, because Thayer "disclos[ed] secret information which would cause others to buy [the target company's] stock, thereby making it more difficult for [the acquiring company] to consummate a merger on favorable terms." Rothberg v. Rosenbloom, [Current] Fed. Sec. L. Rep. (CCH) ¶92,283 at 91,947. See United States v. Newman, 664 F.2d at 17-18. Thayer defrauded the company when he not only improperly tipped others about the company's plans, but also failed to inform Anheuser-Busch that he had disclosed the information. Having undertaken through his tipping a course of conduct that conflicted with Anheuser-Busch's interests, Thayer owed an unqualified -- and continuing -- duty to disclose that fact to Anheuser-Busch so that it could take steps to protect itself. See generally Restatement (Second) of Agency § 395, comment c (1958); 1 F. Mechem, Law of Agency §§ 1207, 1353 (2d Ed. 1914); James & Gray, Misrepresentation -- Part II, 37 Md. L. Rev. 488,

524-25 (1978). By acting in secret, while under a duty to make full disclosure to Anheuser-Busch, Thayer defrauded it of valuable property.

Thayer's fraud violated Rule 10b-5 because it occurred in connection with the defendants' purchases of securities. A defendant commits a fraud in connection with a purchase or sale of securities if his conduct entails deceptive practices "touching" the transaction. Superintendent of Insurance, 404 U.S. at 12-13. In this case, Thayer's fraud against Anheuser-Busch comprised a "part and parcel of a larger design, the sole purpose of which was to reap instant no-risk profits in the stock market." SEC v. Materia, 745 F.2d at 203. As the Second Circuit aptly observed in United States v. Newman, 664 F.2d at 18: "[S]ince appellee's sole purpose in participating in the misappropriation of confidential takeover information was to purchase shares of the target companies, we find little merit in his disavowal of a connection between the fraud and the purchase.".

Defendants' fraud occurred not only in connection with their own trading, but also in connection with Anheuser-Busch's purchase of CTI stock at the time of its merger with that company. Thayer misappropriated the information specifically to allow his tippees to take advantage of Anheuser-Busch's impending merger offer. Indeed, only the planned purchase by Anheuser-Busch gave the stolen information -- and the traders' stock purchases -- its value. The fraud, moreover, had the forseeable effect of ultimately making Anheuser-Busch's acquisition of CTI through stock

transactions more difficult and costly to consummate. See Rothberg v. Rosenbloom, [Current] Fed. Sec. L. Rep. (CCH) ¶91,283 at 91,947; United States v. Newman, 664 F.2d at 17-18.

In spite of the foregoing extensive authority in support of the misappropriation theory of Rule 10b-5 violation, the moving defendants urge this Court to reject the theory. They contend that the Supreme Court's decisions in Chiarella v. United States, 445 U.S. 222 (1979), and Dirks v. SEC, 463 U.S. 646 (1983), limit Rule 10b-5 liability for trading on non-public information to frauds perpetrated on persons with whom one trades, and preclude a violation based on a fraud on the one from whom the information is obtained (Bear Stearns Br. 34-43; Edwards Br. 9-12, 17-18). Neither case supports defendants' position.

In Chiarella, an employee of a financial printer had traded on information about prospective tender offers to be made by his employer's tender offeror clients. Chiarella deciphered the identity of target companies from early drafts of documents entrusted to his employer by the offerors, and purchased stock in the target companies before the offers were announced. When the tender offers became public, the targets' stock prices rose, and Chiarella sold his shares at a substantial profit. Chiarella was criminally prosecuted for and convicted of defrauding those persons with whom he traded by making purchases without disclosure of the impending tender offers. The Supreme Court, in a 6-3 decision, reversed Chiarella's conviction, holding that he owed no duty of disclosure to the target companies' shareholders with

whom he traded, and thus did not defraud them. The Court reasoned that one defrauds the person with whom he trades by failing to disclose non-public information only when he has a duty to disclose the information. Concluding that a duty to disclose does not arise from "mere possession of nonpublic market information," the Court held that Chiarella owed no duty to disclose to his trading partners, and therefore did not defraud them by his non-disclosure. See 445 U.S. at 234-35.

In the Supreme Court, the government had argued that the Chiarella had nonetheless defrauded his employer -- and its tender offeror clients -- by secretly misappropriating the clients' confidential information for use in his securities trading -- the same theory presented in this case. Far from rejecting this misappropriation theory, the Court simply observed that the jury had not been instructed to consider whether Chiarella had defrauded anyone other than the persons with whom he traded. Accordingly, the Court declined to uphold the conviction on a theory that had not been submitted to the jury. Id. at 235-37. 10/

Rather than Chiarella signalling rejection of a misappropriation theory of fraud under Rule 10b-5, the concurring and dissenting opinions in the case suggest that a majority of the Court

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10/ The government also argued that the conviction should be sustained on the ground that Chiarella owed a disclosure duty to those with whom he traded by virtue of the fact that the information was stolen. Since the jury had not been instructed to consider whether there had been a misappropriation, the Court declined to consider this theory. See id.

might be inclined to accept a misappropriation theory. Four Justices expressly agreed that trading on misappropriated information would violate Rule 10b-5. Id. at 239 (Brennan, J., concurring); id. at 239-43 (Burger, C.J., dissenting); id. at 245-46 (Blackmun, J., dissenting, joined by Marshall, J.). While reserving judgment on the issue, since it had not been presented to the jury, Justice Stevens, concurring with the majority, observed: "[I]f we assume that [Chiarella] breached a duty to the acquiring companies that had entrusted confidential information to his employers, a legitimate argument could be made that his actions constituted 'a fraud or deceit' upon those companies 'in connection with the purchase or sale of any security,'" in violation of Rule 10b-5. Id. at 238.

Nor did the Supreme Court reject the misappropriation theory in Dirks v. SEC. To the contrary, it appears to have endorsed it. In Dirks, corporate insiders had transmitted nonpublic information -- that the insurance company for which they worked was engaging in fraudulent policy-writing -- to Dirks, a securities analyst. The Court held that Dirks did not violate Rule 10b-5 when he tipped the information to others who in turn sold the company's stock without disclosing the information to those with whom they traded. The Court concluded that the insiders who had disclosed the information to Dirks had breached no duty to the corporation's shareholders by passing the information to Dirks. 463 U.S. at 666-67. The Court held therefore that neither Dirks nor his

tippees had inherited any duty from the insiders to disclose the information to those with whom the tippees traded.

The Court in Dirks did not need to, and did not, consider any Rule 10b-5 violation that might have been committed by misappropriation of the information. Dirks' sources had lawfully divulged the information at issue in Dirks -- evidence of corporate crime. 11/ Nor had the sources expressly or impliedly limited the use to which Dirks might put the information; indeed, they plainly understood that Dirks would disclose the information to others. 463 U.S. at 648-49, 665. Thus, the Court took pains to note, Dirks had not "misappropriated or illegally obtained the information," suggesting that misappropriation could be a basis for a Rule 10b-5 violation. Id. at 665.

Indeed, the Supreme Court has recently expressly stated what was implicit in Dirks, and has indicated its acceptance of the misappropriation theory. In Bateman Eichler, Hill Richards, Inc. v. Berner, 105 S.Ct. 2622, 2630 n.22 (1985), a unanimous Court stated: "We have * * * noted that a tippee may be liable [under Rule 10b-5] if he otherwise 'misappropriate[s] or illegally obtain[s] the information,'" quoting Dirks v. SEC, 463 U.S. at 665.

11/ See generally Restatement (Second) of Agency § 395, comment f (1958).

B. Tippees to Whom the Information was Disclosed, Including Defendants Harris and Mathis, Who Knew or Should Have Known That They Received it Improperly in Breach of a Duty of Trust and Confidence, Violated Section 10(b) and Rule 10b-5 by Trading on the Information or Disclosing it to Others Who Traded.

Just as Thayer committed fraud on Anheuser-Busch by improperly and secretly disclosing the information to the trading defendants, his tippees likewise committed fraud on Anheuser-Busch. Those trading tippees who knew, or should have known, that Thayer had breached his duty to Anheuser-Busch by his disclosures, were participants after the fact in Thayer's breach. 12/ Stated differently, they also owed a duty, derivative of Thayer's duty, to Anheuser-Busch not to misappropriate the information by trading on it or making further improper disclosure.

In Dirks, the Supreme Court considered the circumstances under which one who otherwise owes no duty to a company's shareholders acquires a duty when he receives non-public information from corporate insiders who do owe such a duty. The Court held that a tippee acquires a duty to the shareholders "only when the insider has breached his fiduciary duty to the shareholders by disclosing the information to the tippee and the tippee knows or should have known that there has been a breach." 463 U.S. at 660. In explaining that conclusion, the Court observed that Professor Loss "has linked tippee liability to the concept in the law of restitution that '[w]here a fiduciary in violation of his duty to the

12/ As noted, reckless disregard of whether the information was improperly disclosed will suffice to show that defendants should have known of the breach.

beneficiary communicates confidential information to a third person, the third person, if he has notice of the violation of duty, holds upon a constructive trust for the beneficiary any profit which he makes through the use of such information.'" Id. at 660 n.20 (quoting 3 L. Loss, Securities Regulation 1451 (2d ed. 1961)). 13/

Thus, where a tippee knows or has reason to know that he has acquired secret information through the breach of a duty to a beneficiary, he acquires derivative duties to that beneficiary. To allow the recipient thereafter to use the information to the beneficiary's detriment would effectively permit him to continue the breach begun by the person from whom he acquired the information. As the Supreme Court has now twice made clear, such conduct would constitute participation after the fact in the tipper's breach of duty, and would render the tippee as liable under Rule 10b-5 for use of the information as the tipper. See Dirks, 463 U.S. at 659; Chiarella v. United States, 445 U.S. at 230 n.12.

Although the Dirks court was addressing an alleged breach of duty to trading shareholders, the principle is equally applicable when the person who discloses the information has breached a duty

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13/ Professor Loss was in turn quoting from The Restatement of the Law of Restitution §201(2) (1937). The principle that an improper recipient of confidential information becomes a trustee towards the true owner of the information is well established. See 5 A. Scott, Scott on Trusts §506, at 3569-70 (1967); Restatement (Second) of Agency §312, comment c (1958); Schein v. Chasen, 478 F.2d 817, 823-24 (2d Cir. 1973), vacated on other grounds sub nom. Lehman Bros. v. Schein, 416 U.S. 386 (1974); Ohio Oil Co. v. Sharp, 135 F.2d 303, 306 (10th Cir. 1943). See generally, G. Bogert, The Law of Trusts and Trustees §471, at 3 (Revised 2d ed. 1978).

not to misappropriate it from the rightful holder of the information. Under Dirks, a person who receives information while knowing or having reason to know that it was obtained through a breach of duty owed to the trading shareholders acquires a duty to those shareholders. In a misappropriation case, as alleged here, a person who receives information while knowing or having reason to know that it was obtained through breach of a duty not to misappropriate it, likewise acquires a duty to the rightful holder of the information not to misappropriate it further by trading or tipping. Applying this principle, courts have held that the tippees of a misappropriator violate Rule 10b-5 by trading on, or further tipping, the information. See SEC v. Gaspar, [1984-1985] Fed. Sec. L. Rep. ¶92,004 at 90,979; SEC v. Musella, 578 F. Supp. at 441-43.

Accordingly, when Thayer's tippees -- and their tippees in turn -- received the non-public information about Anheuser-Busch's plans, under circumstances where they knew or should have known that the information was disclosed in breach of a duty of confidence, they acquired a duty not to further that breach by trading on that information or disclosing it to others. Their secret misuse of the information defrauded Anheuser-Busch just as did Thayer's original misappropriation. 14/

14/ Thus, it cannot properly be argued that Mathis did "not have a confidential relationship with Busch" (Bear Stearns Br. 49). If, as alleged, Mathis knew or should have known that he had improperly acquired confidential information that belonged to Anheuser-Busch, he became, by virtue of the wrongful disclosure, a constructive trustee to Anheuser-Busch, holding the information exclusively for its benefit. He therefore was duty-bound not to misappropriate the information further.

The Dirks court suggested that at least with respect to the duty (to trading shareholders) at issue there, a tipper breaches his duty, and thereby transmits that duty to his tippees, only when he directly or indirectly receives a "benefit" as a result of his disclosure. As discussed below, we do not believe that a "benefit" test is necessary in a misappropriation case. But even if the benefit test is required here, Anheuser-Busch has alleged each of the elements of tippee liability outlined in Dirks as to Harris: The complaint charges that Thayer intended to disclose the information about Anheuser-Busch's plans to Harris; that Thayer received a benefit, in the broad sense that Dirks uses the term (463 U.S. at 663-64), as a result of his disclosure; and that Harris was aware of these facts. If those allegations can be proven at trial, Harris would be liable as a tippee, and Thayer, of course, would be liable for the illegal tipping to Harris in violation of Rule 10b-5.

Based on the complaint's allegations, Mathis likewise is liable as a tippee, since he is alleged to have received from Harris the information that Thayer improperly disclosed to Harris, and is alleged to have known or had reason to know that he received it improperly. Although Mathis and his employer, Bear Stearns, argue that Mathis could violate Rule 10b-5 by his trading on the information only if Thayer intended that the information be received by Mathis, and if both Thayer and Harris received a benefit from the disclosure of the information to Mathis (Bear Stearns Br. 43-44), that argument is based on a misapprehension of the basis for tippee liability.

As discussed above, a tippee or sub-tippee who improperly receives confidential information becomes a constructive trustee of that information, with duties to hold the information in trust for its rightful owner. So long as the tippee or sub-tippee knows or should have known that he has improperly received the information, the duty of a constructive trustee attaches.

The initial question is when is the tippee's or sub-tippee's receipt of the information improper for purposes of Rule 10b-5. As noted, the Dirks Court said that in the circumstances before it, a tipper violates Rule 10b-5 by his disclosure only when he obtains a benefit in return for the disclosure. Even if one assumes that the same benefit test applies in a misappropriation case, nothing in Dirks would suggest that the tipper must receive a benefit from each subsequent disclosure. Once the tipper has initially disclosed the non-public information for a personal benefit, he has breached his duty to the rightful owner. And once that duty has been breached, all persons who thereafter receive the information as a result of the breach, whether directly or indirectly, receive it improperly for Rule 10b-5 purposes. Nor is it necessary, for the sub-tippee's receipt to be improper, that the tipper intend that the sub-tippee receive the information. It is sufficient, as Dirks indicates, that the sub-tippee knows or should know that he has received it improperly, as a result of the tipper's original breach.

A sub-tippee, such as Mathis, satisfies these requirements by receiving the information with knowledge or reason to know of the

tipper's, Thayer's, original breach. By receiving the information improperly through that breach, Mathis became a participant after the fact in Thayer's breach of duty to Anheuser-Busch, and acquired duties toward Anheuser-Busch not to further misappropriate the information. Mathis' liability does not depend on whether Thayer committed an additional breach of duty by the disclosure of the information to him. Nor does Mathis' liability depend on whether Harris breached his acquired duties by making that disclosure. Mathis' own participation in Thayer's initial breach suffices to impose duties on him. 15/

In support of their arguments that the tipper must intend disclosure to the sub-tippee and receive a benefit from that disclosure, defendants rely principally on Schick v. Steiger, 583 F. Supp. 841 (E.D. Mich. 1984), which held that sub-tippee liability does not exist unless the tipper intends further disclosure to the sub-tippee and receives a benefit from it. We believe that Schick was decided wrongly. The decision rests on the erroneous view that a person who receives information wrongfully nonetheless

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15/ Mathis and Bear Stearns argue (Bear Stearns Br. 43) that "Dirks was not meant to apply to a trader like Mathis, who is * * * alleged to be only a remote tippee * * *. [I]ndeed, there was never a suggestion that the traders who obtained inside information from Dirks -- remote tippees like Mathis -- had engaged in securities fraud." That is incorrect. Dirks' tippees were, in fact, charged by the Commission with securities fraud for trading on the information he gave them, and were found by the Administrative Law Judge to have committed the violations and were censured. See Dirks v. SEC, 681 F.2d 824, 832-33 (D.C. Cir. 1982), rev'd, 463 U.S. 646 (1983). None of those tippees appealed the ALJ's decision (id. at 833), and thus the Supreme Court had no reason to address their culpability.

remains free to disseminate it, and that any recipient takes the information without responsibility to the rightful owner even though he knows or should know that the disclosure to him was improper.

To adopt this theory would be akin to to holding that one who unlawfully receives stolen property -- and this information was precisely that -- may lawfully give the property to another, and that person can freely use the property even though he knows it was stolen. Lest this analogy seem too strong, it should be remembered that the violations with which the defendants are charged have been prosecuted as criminal offenses. See United States v. Newman, 664 F.2d at 15-19; United States v. Winans, 612 F. Supp. at 840-43; United States v. Reed, 601 F. Supp. at 720. Defendants are alleged to have "misappropriated -- stole to put it bluntly -- valuable nonpublic information." SEC v. Materia, 745 F.2d at 201 (quoting Chiarella v. United States, 445 U.S. at 245 (Burger, C.J. dissenting)).

Finally, Mathis and Bear Stearns argue that in any event Mathis could not have violated Rule 10b-5 unless he had actual knowledge that Thayer had improperly disclosed the information in breach of a duty to Anheuser-Busch (Bear Stearns Br. 44). It is not necessary, however, for the sub-tippee -- or the tippee for that matter -- actually to know who the tipper is, what the tipper's breach was or whether the tipper received a benefit. As Dirks made clear, it suffices if the tippee or subtippee "should

have known" that the information was improperly disclosed to him. 16/ Thus, the fact that Mathis may not have known who the source of the information was, or precisely what duty was breached, or what benefit was obtained in the course of the breach is irrelevant. If, under all of the circumstances of Harris' tip, including the nature of the information, Mathis' past experience with Harris, as well as Mathis' own professional experience, Mathis should have known that he was receiving information improperly, and nonetheless traded on the information, his purported lack of specific actual knowledge of the details of breach does not bar liability. 17/

16/ Mathis and Bear Stearns cite State Teachers' Retirement Board v. Fluor Corp., 592 F. Supp. 592 (S.D.N.Y. 1984) in support of their argument that Mathis had to have actual knowledge of Thayer's identity, his breach of duty and the benefit he received (Bear Stearns Br. 46). Fluor, however, recognizes that tippee liability exists where "the tipper has breached his duty and * * * the tippee, in receiving the information knew or had reason to know of the tipper's breach." Id. at 594 (emphasis supplied). Thus, the court said, "unless the tippee knew or had reason to know that the tipper had satisfied the elements of tipper liability, the tippee cannot be said to be a knowing participant in the tipper's breach." Id. at 595 (emphasis supplied).

17/ We have assumed, for the purposes of the foregoing discussion, that the tipper in a misappropriation case must benefit from the initial disclosure in order for his misappropriation to be a breach of his duty. While defendants' motions can be denied even if that is so, since Thayer did receive a benefit from his disclosures, an alternative basis for decision is that receipt of a benefit is not necessary for tipping liability in a case based on misappropriation.

The Court in Dirks was dealing only with the question of when a corporate insider, through tipping, breaches what the court called the "Cady Roberts" duty -- a duty named after the

(footnote continued)

II. IN A PROPER CASE, THE MISAPPROPRIATION THEORY WILL SUPPORT A PRIVATE ACTION FOR DAMAGES UNDER SECTION 10(b) AND RULE 10b-5 BY THE PERSON WHOM THE MISAPPROPRIATOR HAS DEFRAUDED.

Defendants also argue that, even if Thayer and his tippees violated Rule 10b-5 by their misappropriation, that violation may only be asserted in a criminal prosecution or a Commmision enforcement action, and cannot support a private action for damages (Bear Stearns Br. 47-48; Edwards Br. 15-16). The availability of a private action for violations of Rule 10b-5, however, is "beyond peradventure." Herman & McLean v. Huddleston, 459 U.S. at 380. So long as the corporation defrauded by the misappropriator's scheme otherwise satisfies the standing requirements for a private action -- including the requirement that it be a purchaser

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17/ (Continued)

Commission's seminal decision in In re Cady, Roberts & Co., 40 S.E.C. 907 (1961). 463 U.S. at 653-64. The Dirks Court held that an insider violates that duty, which is owed to the corporation's shareholders, only by using the nonpublic information -- in connection with trading with the shareholders -- for personal advantage. 463 U.S. at 662. See Chiarella v. United States, 445 U.S. at 227-29. While a corporate insider must receive a benefit from tipping in order to breach his Cady Roberts duty (since the crux of the duty is not to use information for personal advantage), nothing in Dirks suggests that a fiduciary must obtain a benefit in order to breach, by his tipping, his very different duty not to misappropriate information, a duty that was not at issue in Dirks. See 463 U.S. at 653 n.10. In fact, a personal benefit is not required. A fiduciary breaches his duty not to misappropriate information whenever he discloses confidential information "in competition with or to the injury of his principal, on his own account or on behalf of another." Restatement (Second) of Agency §395 (emphasis supplied). The fiduciary "has a duty not to use information acquired by him as agent * * * for any purpose likely to cause his principal harm or to interfere with his business." Id. §395, comment a (emphasis supplied). See e.g., Ohio Oil Co. v. Sharp, 135 F.2d at 306.

or seller of securities defrauded in connection with a purchase or sale -- a private action for damages should be available. Anheuser-Busch contends that it is a defrauded purchaser of securities. 18/

A private right of action based on fraudulent misappropriation advances the Commission's enforcement of the securities laws' proscription against unlawful trading on nonpublic information. In a 1980 legislative report, Congress summarized the reasons why private enforcement is essential to the Commission's role:

> The Congress has long taken the view that private rights of action are a necessary adjunct to the Commission's enforcement efforts. With a relatively small staff charged with administrative responsibility for policing potentially unlawful securities related activities, the Commission cannot be expected to bring actions against even a large portion of those engaged in schemes, devices and activities that are prohibited by federal law. Therefore, private lawsuits serve an added deterrent to conduct made unlawful by Congress without the necessity of government involvement.

H.R. Rep No. 1341, 96th Cong., 2d Sess. 28 (1980). The Supreme Court has repeatedly "emphasized that implied private actions

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18/ Mathis and Bear Stearns argue that the courts in Ruskay v. Levin, 425 F. Supp. 1264 (S.D.N.Y. 1977) and Davidge v. White, 377 F. Supp. 1084 (S.D.N.Y. 1974), held that a corporation may not recover damages for trading on non-public information by its insiders (Bear Stearns Br. 42-43). But all that those courts held was that a company that is not defrauded as a purchaser or seller of securities by the insiders' trades lacks standing to sue the insider to recover his profits under Rule 10b-5. In Davidge the plaintiff company had not traded in securities at all, and thus lacked standing to sue. 377 F. Supp. at 1087-88. In Ruskay, the plaintiff company did later buy securities but, unlike Anheuser-Busch, did not claim it was defrauded when it made those purchases. Thus, the court held, it was not a defrauded purchaser or seller and therefore lacked standing to sue. 425 F. Supp. at 1268-70.

provide 'a most effective weapon in the enforcement' of the securities laws and are 'a necessary supplement to Commission action.'" Bateman Eichler, Hill Richards, Inc. v. Berner, 105 S. Ct. at 2628 (quoting J.I. Case Co. v. Borak, 377 U.S. 426, 432 (1964)).

In contending that the misappropriation theory will not support a private right of action, defendants make two incorrect arguments. First, defendants argue that Moss v. Morgan Stanley Inc., 719 F.2d 5 (2d Cir. 1983), cert. denied, 104 S.Ct. (1984), precludes assertion of a misappropriation theory in a private Rule 10b-5 case (Bear Stearns Br. 47-48; Edwards Br. 13-16). Moss stands for no such proposition. In Moss, the plaintiffs were shareholders of a target company in a tender offer, suing defendants who had misappropriated information not from the target company but from the tender offeror's investment banker, and then traded with plaintiffs in the target company's stock. The court held that the defendants owed no duty to the plaintiffs to disclose the impending offers when they traded with plaintiffs. Indeed, the plaintiffs were "complete stranger[s]" to the defendants, 719 F.2d at 15 (brackets in original)(quoting Chiarella, 445 U.S. at 232). Since, in the court's view, the defendants had not defrauded those plaintiffs, the plaintiffs could not sue. See 719 F.2d at 13.

The defendants in Moss had nevertheless defrauded their employer and its client -- the rightful holders of the information -- and thus violated Rule 10b-5. Id. Because the defrauded

persons did not sue, however, the Moss court did not have an opportunity to consider whether they could maintain a private action. Thus, even if Moss were to be followed in the Fifth Circuit, 19/ that case has no bearing here. The case corresponding to the Moss action under the present facts would be one brought by CTI shareholders who sold during the time that Thayer's tippees were trading. Under Moss, those plaintiffs would not have been defrauded and could not sue. But here the plaintiff is a corporation that the defendants did defraud. Nothing in Moss suggests that this corporation may not maintain a private action for damages resulting from that fraud. So long as the company defrauded by misappropriation was a purchaser or seller of securities, and otherwise meets the requirements for a Rule 10b-5 suit, it should

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19/ The Commission filed a brief amicus curiae in support of the plaintiffs in Moss. The Commission argued, and continues to believe, that one who trades on misappropriated information breaches not only a duty to the source of the information, but also to investors with whom he trades without disclosing the information. The duty to shareholders in those circumstances is premised on the obligation to disclose any information acquired by an illegal act. Keeton, Fraud -- Concealment and Non-Disclosure, 15 Tex. L. Rev. 1, 25-26 (1936); 1 F. Harper & F. James, The Law of Torts § 7.14 (1956); see Chiarella v. United States, 445 U.S. at 240 (Burger, C.J., dissenting); id. at 245-46 (Blackmun, J., concurring). Although this theory does not appear to be available to Anheuser-Busch in this case, since Anheuser-Busch did not trade with defendants, it would be available, and may be asserted by the Commission, in its own action.

be able to sue. As noted, Anheuser-Busch alleges it is a defrauded purchaser of securities. 20/

Defendants contend, however, that even if Anheuser-Busch is a defrauded purchaser or seller of securities, it lacks standing because its securities transactions were not contemporaneous with the trading by Thayers's tippees (Bear Stearns Br. 18-22; Edwards Br. 19-21). In making this argument, defendants are attempting to transfer to a misappropriation case a standing rule adopted by some courts in a very different context, which has no application in a misappropriation case.

The contemporaneous trader limitation evolved in cases where insiders and their tippees defraud those with whom they trade in impersonal securities markets either through making misrepresentations or failing to disclose material facts to them. Under a strict rule of privity, only those persons who actually traded with the defendants would be able to sue. In an impersonal market, however, the defrauded traders may be difficult to

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20/ The availability of a Commission enforcement action or criminal prosecution under the misappropriation theory, of course, does not require proof of all the elements needed for a private cause of action. See, e.g., Blue Chip Stamps v. Manor Drug Stores, 421 U.S. at 751 n.14 (requirement that the plaintiff be a defrauded purchaser or seller of securities does not apply in Commission enforcement action); Naftalin, 441 U.S. at 774 n.6 (same); Materia, 745 F.2d at 203 (no need for Commission to demonstrate "precise direction of the fraud"). The fortuity of whether the defrauded corporation suffered a harm compensable under the securities laws is irrelevant to a Commission action. "The Commission's duty is * * * to enforce the remedial and preventive terms of the statute in the public interest, and not merely to police those whose plain violations have already caused demonstrable loss or injury." Berko v. SEC, 316 F.2d 137, 143 (2d Cir. 1963); See also Naftalin, 441 U.S. at 776-77.

identify and, in any event, the traders are only matched through happenstance. Thus, the rule has developed in some circuits that liability extends "not only to the purchasers of the actual shares sold by defendants (in the unlikely event that they can be identified) but to all persons who during the same period purchased * * * in the open market without knowledge of the material inside information which was in possession of defendants." Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d 228, 237 (2d Cir. 1974). The rule allows all those who could have been defrauded by the defendants to sue, and cuts off potentially limitless liability:

> To extend the period of liability well beyond the time of the insider's trading simply because disclosure was never made could make the insider liable to all the world. Any duty of disclosure is owed only to those investors trading contemporaneously with the insider; non-contemporaneous traders do not require the protection of the 'disclose or abstain' rule because they do not suffer the disadvantage of trading with someone who has superior access to information.

Wilson v. Comtech Telecommunications Corp., 648 F.2d 88, 94-95 (2d Cir. 1981) (citations omitted).

The contemporaneous trading rule only applies when the defendant has defrauded his trading partner by failing to make full disclosure to that person. In such a case, the plaintiff can claim fraud only if he was at least in a position to be defrauded by the defendant, and he can only be in such a position if he traded contemporaneously. That rule does not apply in a misappropriation case where the defrauded party -- the person from whom the information was misappropriated -- was defrauded not by trading with the defendant, but by having information secretly

stolen and by having the subsequent trading on the information concealed. That type of fraud does not end when the defendant stops trading, but continues so long as the trading is concealed. If that fraud is causally connected with subsequent transactions by the defrauded party, even at a later date, that party should be able to sue under Rule 10b-5.

CONCLUSION

For the foregoing reasons, the Commission urges this Court to uphold (1) the misappropriation theory of violation of Section 10(b) and Rule 10b-5, and (2) the availability of a private right of action based on the misappropriation theory in favor of an otherwise appropriate plaintiff.

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