No. 86-422

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

DAVID CARPENTER, KENNETH P. FELIS, and R. FOSTER WINANS,

Petitioners,

v.

UNITED STATES OF AMERICA,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR PETITIONERS

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QUESTIONS PRESENTED

1. Do section 10(b) and Rule 10b–5 impose criminal sanctions on a newspaper columnist for "misappropriating" his newspaper's publication schedule as part of a scheme to trade certain securities, where the newspaper is the only alleged victim of fraud and has no interest in the securities traded?

2. Should this Court reject the expansion of the mail and wire fraud statutes to cover breaches of purely private work-rules, intangible injuries, and incidental mailings and wirings?

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OPINIONS BELOW

The opinion (per Pierce, J., and Mansfield, J.) and dissenting opinion (per Miner, J.) of the United States Court of Appeals for the Second Circuit (Appendix to petition for writ of certiorari, 1a–29a)[1] is reported at 791 F.2d 1024 (2d Cir. 1986). The opinion of the United States District Court for the Southern District of New York (33a–73a) is reported as *United States v. Winans*, 612 F. Supp. 827 (S.D.N.Y. 1985) (Stewart, J.).

JURISDICTION

The judgment of the Second Circuit was entered on May 27, 1986. Petitions for rehearing with suggestions for rehearing *en banc* were denied on July 17, 1986 (30a–32a). The petition for writ of certiorari was filed on September 15, 1986 and was granted on December 15, 1986. 107 S. Ct. 666

1. Citations to the appendix to the petition for writ of certiorari are

(1986). The jurisdiction of the Court rests on 28 U.S.C. § 1254(1) (1982).

STATUTES INVOLVED

Petitioners were convicted of violating section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1982), Rule 10b–5 promulgated thereunder, 17 C.F.R. § 240.10b–5 (1986), and the mail and wire fraud statutes, 18 U.S.C. §§ 1341, 1343 (1982). Petitioners Felis and Winans were convicted of conspiring to violate the aforesaid statutes. 18 U.S.C. § 371 (1982). These provisions are set out verbatim on pages 2–4 of the petition for certiorari.

STATEMENT OF THE CASE

a. *"Heard on the Street"*

From August 1982 through March 1984, petitioner R. Foster Winans, a reporter for The Wall Street Journal (the "Journal"), was one of the writers of "Heard on the Street," a daily market gossip column which focused on the movements and prospects of various stocks. The Heard column did not purport to give investment advice, and the Journal did not view or present the column as giving such advice to readers.[2] The Journal's wide readership and the column's popularity, however, tended to give the column a short–term impact upon the market price of stocks it mentioned. 612 F. Supp. at 830; 35a–36a.

Winans chose stocks to mention in the column on the basis of unusual trading volume, significant price moves, recent Securities and Exchange Commission ("SEC" or "Commission") filings, and company announcements. He conducted interviews for the column with Wall Street sources who offered analyses of significant stock movements and predictions of future price direction. These sources — as well as their customers, friends and relatives — were free to trade at any time upon the information they gave Winans or the prospect of its publication in the Journal. Occasionally, they did so (T. 401, 1881).

Winans' columns never contained corporate "inside" information or "hold–for–release" information given to the Journal for dissemination at a specified time. 612 F. Supp. at 830 n.2; 35a n.2. As the district court expressly found, "Winans was not a temporary insider [of the corporations he wrote about], did not owe any duty to the corporations he wrote about, and was not a tippee of any corporate inside information. . . . [N]either Winans nor the Wall Street Journal owed any duties

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2. The Journal, a newspaper of general circulation, does not fall within the coverage of the Investment Advisors Act of 1940. *See* 15 U.S.C. § 80b–2(a)(11)(D) (1982). Even prior to this Court's opinion in *Lowe v. SEC*, 472 U.S. 181 (1985), which substantially limited the class of investment advisors, neither the SEC nor any other regulatory agency had ever suggested the contrary (T. 50, 396–97).

at all to the corporations that were the subject of Heard columns or to the shareholders of those corporations." 612 F. Supp. at 841; 56a.

b. Winans' Trading Arrangement

In mid–October 1983, Winans agreed to tell stockbroker Peter Brant the subject matter (name of stock), general tenor (positive or negative), and probable publication date of forthcoming Heard columns (T. 2078–79). According to the district court's findings of fact, Winans and Brant agreed that "the arrangement would not affect the journalistic purity of Winans' writing . . . [or] influence his choice of topic or the contents of any article; he would continue to write balanced pieces, containing both positive and negative information." 612 F. Supp. at 832; 40a. The trading decisions were left totally to Brant, who was told that any scheduled column might unexpectedly be cancelled. Net profits were to be split after Brant deducted fifty percent for taxes, and Winans would receive nothing if there were no profits. *Id.*; T. 2079–80.

Over the next four and one–half months, Brant bought and sold securities upon information supplied by Winans. Brant made all trading decisions, such as when to buy or sell securities, what types to trade (common stock or options, and which particular option series), and the amount of each transaction (T. 617, 2477). In executing the trades, Brant enlisted the assistance of a fellow stockbroker, petitioner Kenneth P. Felis, in whose accounts many of the trades were made.

Winans obtained the information furnished to Brant in the normal and lawful course of his employment. He did not engage in any thefts, break–ins, rifling of files, decoding of secrets or unauthorized entries into computer files (T. 2158–59, 2168, 2211). Though Winans believed that discovery of his arrangement with Brant would result in his dismissal (T. 2228; GX 343, at 253–54), neither Winans, Brant, nor Felis believed that they were acting illegally (T. 926, 955, 1295, 1889).[3]

3. Brant, who was the government's chief witness at trial, pleaded guilty to a separate information charging conspiracy and securities fraud. At the government's insistence, Brant's plea agreement contained an express pro-

During the four and one–half months that the trading arrangement lasted, Winans continued to write his articles conscientiously and accurately.[4] As anticipated, columns about which Winans had told Brant were occasionally delayed (T. 2108, 2206–07, 2279–80, 2304, 2308). Stock prices generally — but not always — moved in a direction consistent with the column's positive or negative tenor. Of the twenty–four transactions alleged in the securities fraud counts,[5] profits were made in twenty and losses were sustained in four (Exhs. W–E, W–F; App. 22, 23).

During this same period, unbeknownst to Brant and Felis, Winans also made six small pre–publication trades through an account opened in the name of petitioner David Carpenter, Winans' roommate. These trades resulted in total profits of $4,502.84 (Exh. W–D; App. 21).[6]

c. The Dow Jones "Conflicts of Interest Policy"

Winans' arrangement with Brant and Felis, as well as his separate trades in the Carpenter account, violated the private policy guidelines of the Journal's owner, Dow Jones & Co., Inc. ("Dow Jones"). Specifically, the written "Conflicts of Interest Policy" (GX 55; App.39) provided, along with much else, that knowledge of forthcoming Journal articles was "deemed" the "property" of Dow Jones, that an employee could not disclose

government's securities fraud theory (Exh. F–C).

4. Copies of the Journal articles which formed the basis for the substantive counts of petitioners' indictment (GXs 9–27, 29–36) will be lodged with the Court prior to argument.

5. The indictment upon which petitioners were tried contained 61 counts, consisting of a conspiracy count (Count 1), 24 securities fraud counts (Counts 2–25), 18 wire fraud counts (Counts 26–43) and 18 mail fraud counts (Counts 44–61). All of the mail and wire fraud counts, and most of the securities fraud counts, involved articles written by Winans. Seven of the 24 securities fraud counts (Counts 6, 7, 12, 14, 16, 17 and 21) involved articles written by others at the Journal about which Winans learned in the ordinary course of his work. The indictment is set forth at App. 1 - 20.

6. Six securities fraud counts (Counts 14, 17, 18, 21, 22 and 24) and six mail and wire fraud counts (Counts 38, 41, 42, 56, 59 and 60) were based on these trades. These were the only twelve counts on which petitioner Carpenter was found guilty (as an aider and abettor). Carpenter was

the subjects or schedules of forthcoming articles to persons outside the newspaper,[7] and that an employee could not buy or sell stocks if he was writing an article about the stock or knew such an article was to appear in the newspaper.[8]

These rules, contained in the back of a 44–page pamphlet distributed to Journal employees (GX 54),[9] were promulgated unilaterally by Dow Jones. They were not part of the agreement governing Winans' employment that was negotiated between Dow Jones and Winans' union (Exhs. WU–1, WU–2; T. 121).

Dow Jones, which has been in existence for over 100 years, had no such rules for its employees until the 1960's and never informed the public of its rules until after the events of this case (T. 115–16, 159). The Journal first informed its readers of the policy in a March 2, 1984 article entitled *Media Policies Vary on Preventing Employees and Others From Profiting On Knowledge of Future Business Stories*, which reported that most newspapers and broadcasters had no such policy (Exh. WSJ–9; App. 35).

At trial, the government expressly conceded that in the absence of Dow Jones' rules, petitioners' conduct would not have violated the securities laws (*see* Gov't Reply Memorandum of Law in Response to Defendants' Pretrial Memoranda, at 21; 612 F. Supp. at 842; 58a). Yet these rules, though warning that violations could result in termination of employment (GX 55; App. 43), were themselves expressly presented to Dow Jones' employees as intended to go well beyond the requirements of the law. They were explicitly designed to avoid even a "misperception" of impropriety, described by Journal officials as intended to make employees "squeaky clean," "above suspicion," and "as pure as Caesar's wife" (T. 135–36, 231, 319, 1523), and written in terms of "bending over backwards" to avoid even a "suspicion" of impropriety (GX 55; App. 40).[10]

d. The Aftermath of Winans' Conduct

When Winans' trading arrangement became known to the Journal, he was immediately fired. Dow Jones suffered no actual damage from Winans' conduct. The Journal broke the story of Winans' arrangement with Brant on March 29, 1984 (T. 106; GXs 38, 39). Yet its earnings, total revenues and advertising revenues for the second quarter of 1984 (ending June 30, 1984) all rose to record levels (T. 107, 252–57; Exh. W–A). *Fortune Magazine*'s January 7, 1985 issue rated Dow Jones as the most admired corporation in America for quality of products and services, as second only to IBM for quality of management and for long–term investment value, and as the number one publishing company in America (T. 107–10; Exh. W–K).

An SEC injunctive action filed on May 17, 1984 (*SEC v. Brant*, 84 Civ. 3470 (S.D.N.Y.)) was settled against petitioners with the entry of consent decrees and petitioners' disgorgement of all of their trading profits.[11] 17 Sec. Reg. & L. Rep. (BNA) No. 42, at 1884 (October 25, 1985) (Winans and Carpenter); 17 Sec. Reg. & L. Rep. (BNA) No. 32, at 1445 (August 9, 1985) (Felis).

e. Proceedings below

The indictment charged that the sole victim was Dow Jones and not any securities investor or reader of the Journal.[12]

7. This rule was referred to in the opinions below as a "confidentiality policy."

8. Dow Jones' 3–1/2 page, single–spaced written policy is set forth verbatim in the Joint Appendix (GX 55; App. 39). Under the policy, Winans was permitted to buy a stock even for the short term, or to sell a stock he already owned, provided he did not write an article about the stock and knew of no such forthcoming article by someone else at Dow Jones. Otherwise, he was required to wait two full trading days after the article first appeared before trading in the stock (GX 55; App. 41–42).

10. The Dow Jones internal policy has always been described to employees as going beyond the requirements of the law, rather than as a statement of the law. For example, the 1973 version of the written policy (Exh. W–M; App. 24), after quoting from the Second Circuit's decision in *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968) (*en banc*), *cert. denied sub nom. Coates v. SEC*, 394 U.S. 976 (1969), immediately went on to state "[b]ut we want to do more than just satisfy the regulations."

11. Felis disgorged a total of $159,813.93, representing his pre–tax profits in the trading scheme. Winans disgorged the $4,502.84 pre–tax profit from the trades in the Carpenter account.

12. The original indictment also contained a so–called "readership"

After a non-jury trial, the district court found that petitioners' conduct constituted securities, wire and mail fraud.[13] Rejecting petitioners' arguments that Winans' conduct did not constitute fraud upon Dow Jones and that the "misappropriation theory" should be limited to misappropriation from market participants, the Second Circuit affirmed the convictions (with certain minor exceptions),[14] over a vigorous dissent by Judge Miner as to the securities fraud counts.

Winans and Felis — the two petitioners who were sentenced to terms of imprisonment — remain at liberty pending the decision of this Court.[15]

theory in which the readers of the Journal were alleged to have been defrauded. The government dropped the "readership" theory and proceeded to trial on a superseding indictment which alleged fraud against the Journal only.

13. In addition to the conspiracy count with which all defendants were charged, Winans was charged with 60, Felis with 40, and Carpenter with 12 substantive counts. Two of the securities fraud counts against Winans and Felis (Counts 19 and 25) were dropped by the government at the close of its case. Aside from an acquittal of Carpenter on the conspiracy count, the three defendants were convicted of all remaining counts with which they were charged.

14. Winans' securities fraud convictions on Counts 15, 20, and 23 were reversed. These involved securities transactions by Felis' friend, Stephen Spratt, of which Winans had no knowledge and which were beyond the scope of his agreement with Brant and Felis. 791 F.2d at 1036; 26a.

15. Winans was sentenced to 18 months' imprisonment to be followed by five years of probation, during which he is to contribute 400 hours of community service. Winans was also fined $5,000.00. Felis was sentenced to six months' imprisonment to be served on weekends, to be followed by five years of probation and 500 hours of community service, and was fined $25,000.00. Carpenter was sentenced to three years of probation with 200 hours of commu-

SUMMARY OF ARGUMENT

1. Petitioners did not commit securities fraud

Statutory language, legislative history, precedents of the Court, and public policy do not permit the imposition of criminal sanctions against petitioners under section 10(b) and Rule 10b–5. The "misappropriation theory" cannot be used to punish conduct which does not involve manipulation of securities prices, deception of investors, use of "inside information," breach of duty to a market participant, or injury to a market participant. Breach of an employer's private workrules is not fraud, let alone securities fraud. Because the "misappropriation theory" is wholly undefined, and because its expansion by the courts below could not reasonably have been anticipated, the criminal prosecution of petitioners violated fundamental tenets of due process.

2. Petitioners did not commit mail or wire fraud

Petitioners'conduct was not mail or wire fraud because (a) there was no actual deception by petitioner Winans, but only a breach of his employer's workrules; (b) an unrealized potential for intangible injury to the Journal's reputation cannot satisfy the harm requirement of the statutes; and (c) the mailings and wirings underlying the convictions were not caused by petitioners, were not made for the purpose of executing the alleged scheme, and would have had the identical form and content in the absence of any scheme. The courts below erroneously substituted a judicially–created doctrine of fiduciary duty for the statutory requirement of fraud, erroneously permitted potential harm to intangibles such as reputation to satisfy the requirement of threatened economic harm, and erroneously allowed incidental mailings and wirings to satisfy the statutory requirement of mailings and wirings caused for the purpose of executing a fraudulent scheme. This expansion and distortion of the statutes improperly uses federal criminal sanctions to regulate private employment relationships. Such regulation should be left to the states.

ARGUMENT

POINT I
CRIMINAL SANCTIONS MAY NOT BE IMPOSED ON A NEWSPAPER COLUMNIST, UNDER SECTION 10(b), FOR "MISAPPROPRIATING" HIS NEWSPAPER'S PUBLICATION SCHEDULE AS PART OF A SCHEME TO TRADE CERTAIN SECURITIES, WHERE THE NEWSPAPER IS THE ONLY ALLEGED VICTIM OF FRAUD AND HAS NO INTEREST IN THE SECURITIES TRADED

Although convicted of securities fraud, petitioners were not insiders, temporary insiders or tippees. They did not manipulate the price of any security. They owed no duty — direct or indirect — to the shareholders of any company whose securities they traded. They did not trade upon any secrets of the companies whose securities they bought and sold. The only victim of fraud alleged by the government and found by the district court was the Journal, a financial newspaper which had absolutely no interest in the purchase, sale or value of any of the securities traded by petitioners. The sole basis for petitioners'securities fraud convictions was the violation of the Journal's internal workrules by petitioner Winans, who was then employed as a Journal columnist. The only alleged harm from the "securities fraud" was the potential injury to the Journal's reputation.

Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") "never was intended to protect the reputation, or enforce the ethical standards, of a financial newspaper." 791 F.2d at 1037; 29a (Miner, J., dissenting). Nevertheless, that is the singular result of the judgment below.

We show in Point II that Winans'breach of the Journal's workrules did not constitute a criminal fraud at all. In this section, we focus on the narrower question of whether an alleged fraud against a person who neither participates in, nor has any interest in, the purchase, sale or value of securities, can constitute a criminal violation of section 10(b). We submit that it cannot. To apply section 10(b) where there is no securities-related duty or injury, but only a breach of an employer's private workrules, perverts the purpose of the federal securities regulatory scheme, undercuts the predictability of law, provides no extra protection to investors, and leads to a host of inconsistent and irrational results which are neither supported by the language and legislative history of section 10(b) nor justified by public policy.

A review of what is *not* in dispute in this case shows how far afield the government has gone. First, the government did not claim that Winans' articles were altered, slanted, or falsified in any way in order to affect or manipulate the price of any security.[16] Nor were Winans' articles "planted" for the purpose of "touting" or "publicizing" any security.[17] The courts below specifically found that the subject matter and tenor of all articles on which the fraud counts were based had been chosen before petitioners decided to trade the securities mentioned in the articles; that the articles were not intended to influence the price of any security; and that the accuracy and quality of Winans' work were not affected by his trading arrangement. 791 F.2d at 1027; 7a; 612 F. Supp. at 834–35; 44a.

Second, the government did not allege, and the lower courts did not find, that the informational content of Winans' articles was "non–public." Nor was Winans, by virtue of some relationship of trust or confidence with the corporations about which he wrote, barred from trading in their securities. Winans' sources were not corporate "insiders." 612 F. Supp. at 841; 56a. The facts contained in Winans' articles were publicly available.

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16. Affirmatively false statements or half–truths deliberately made to inflate or depress the price of a security would be a "manipulative or deceptive device or contrivance" under section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b) (1982), and Rule 10b-5 promulgated thereunder by the Commission, 17 C.F.R. § 240.10b-5 (1986).

17. Section 17(b) of the Securities Act of 1933 (the "Securities Act"), 15 U.S.C. § 77q(b) (1982), prohibits accepting payment or other consideration in return for publicizing any security in a newspaper, unless such consideration is disclosed, irrespective of the truth or falsity of the article. Had Winans taken money to tout particular stocks, geared the content of his columns to his trading arrangement, or intended to influence the price of any security through his articles, that conduct would have violated section 17(b) of the Securities Act, section 10(b) of the Exchange Act, or both.

Knowledge of those facts, and anticipation of Winans'articles, provided a lawful basis *for trading* by Winans' sources (generally brokers, investors and securities analysts) and his sources' customers. *See, e.g.*, GX 23, Exhs. DJT–14, Q–1, Q–2.[18] Only the fact and date of publication and the general positive or negative tenor of the articles were "non–public." Had the Journal decided not to print an article submitted by Winans, he would have been free to trade upon the information he obtained about the company. Similarly, had Winans decided not to write an article after researching a company, he would have been free to buy or sell its securities.

Third, the government did not allege that any member of the investing public was defrauded or injured in any way. It is not claimed that any seller of securities received too little or any buyer of securities paid too much as a result of petitioners'trades; nor were petitioners charged with artificially affecting the market prices of the stocks involved.

Petitioners' securities fraud convictions turned wholly upon the existence of a particular Dow Jones internal policy which had never been revealed to Journal readers or the investing public, which did not exist at most other newspapers, which was presented to employees as going beyond the requirements of the law, and which Dow Jones itself was free to ignore. If the Journal had no policy or had a different policy,[19] if Winans had worked for one of the many newspapers without comparable workrules, or if Winans had been a "free–lancer" to whom the Journal policy did not apply, there would have been no violation of the securities laws.[20] Never has this Court permitted purely private rules to serve as the basis for criminal prosecution of otherwise lawful conduct. Never before have the federal securities laws been used to enforce an employer's internal policy where the employer had no interest – – direct or indirect – – in any of the securities involved. Because the Journal's interest in its confidential publication schedule is not within the zone of protection which Congress intended to create when it enacted the antifraud provision of the Exchange Act, petitioners'convictions should be reversed.

A. Under Section 10(b), Criminal Fraud Cannot Be Premised Upon The Breach of a Private Policy Where There is No Manipulation of Securities Prices or Deception of Market Participants

"The starting point in every case involving construction of a statute is the language [of the statute] itself." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 197 (1976) (quoting *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 756 (1975) (Powell, J., concurring)). Section 10(b) prohibits the use "in connection with the purchase or sale of any security . . . [of] any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe . . . in the public interest or for the protection of investors." Hence, Winans' breach of Dow Jones' internal corporate policy is violative of section 10(b) only if it constituted a "manipulative or deceptive device or contrivance" cognizable under that statute.

The legislative history of section 10(b) establishes that the statute's proscription of manipulative or deceptive devices or contrivances was enacted to protect public investors and not to protect the reputation of a financial newspaper or to enforce an employer's internal guidelines regulating employee conduct.[21]

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18. The government never disputed that Winans' sources were free to trade upon that information — and often did — legally and properly.

19. For example, a newspaper might simply require its reporters to provide periodic lists of their securities transactions.

20. As noted, the government conceded below that "without any [Dow Jones] policy, there could be no prosecution under the misappropriation

21. The Senate Report accompanying the Securities Act states that:

> *The purpose of this bill is to protect the investing public* and honest business . . . The aim is to prevent further exploitation of the public by the sale of unsound, fraudulent, and worthless securities through misrepresentation. . . .

S. Rep. No. 47, 73d Cong., 1st Sess. 1 (1933). The Exchange Act was enacted a year after the Securities Act as another "step in our broad purpose of protecting investors and depositors." H.R. Rep. No. 85, 73d Cong., 1st Sess. 2 (1933) (Letter, dated March 29, 1933, from President Roosevelt to Congress). The Exchange Act was aimed primarily at uncontrolled and exces-

Fifty years of jurisprudence since the enactment of section 10(b) further confirm that a "manipulative or deceptive device or contrivance" cognizable under the Exchange Act is one that artificially affects the price of securities or otherwise deceives investors or persons engaged in the process of buying or selling stock.[22] As stated by this Court, "a violation [of section 10(b)] may be found *only* where there is 'intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities.'" *Dirks v. SEC*, 463 U.S. 646, 663 n.23 (1983) (quoting *Hochfelder*, 425 U.S. at 199) (emphasis added). Consistent with the legislative purpose and language of the statute, this Court has never held section 10(b) applicable where the victim had no stake or role whatever in the underlying securities transaction.

To support the application of section 10(b) to Winans' breach of Dow Jones' private policy, the government and the courts below relied upon *Superintendent of Insurance v. Bankers Life & Casualty Co.*, 404 U.S. 6 (1971). In that case, the fraud involved the diversion of the proceeds of a sale of securities from the corporation that owned the securities. Rejecting defendants'argument that Rule 10b–5 did not apply because the sale itself was free of fraud, this Court held that the diversion of the proceeds caused the corporation "an injury as a result of deceptive practices" sufficiently "touching its sale of securities as an investor" to come within the protective zone of section 10(b). *Id.* at 12–13.

It is one thing to say that a deceptive device which deprives an investor "of any compensation for the sale of its valuable block of securities," *id.* at 10, sufficiently touches the investor's interest in the transaction to be within the scope of the securities laws; it is quite another to state that a fraud upon a person who is not a market participant violates section 10(b) so long as it is otherwise related in *any* manner — however remote or tangential — to the purchase or sale of a security. As then Circuit Judge Stevens recognized in *Eason v. General Motors Acceptance Corp.*:

> The emphasis on the injured party's status as an investor indicates that the protection of the rule extends to persons who, in their capacity as investors, suffer significant injury as a direct consequence of fraud in connection with a securities transaction, *even though their participation in the* transaction did not involve either the purchase or the sale of a security.[23]

In reaching this conclusion, Judge Stevens noted the Commission's own declaration that injury must be suffered in the victim's "capacity as an investor." *Id.* at 659 & n.23 (quoting Brief for the Securities and Exchange Commission, at 23).[24]

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sive speculation in the purchase and sale of securities and the manipulation of prices harmful to public investors. H.R. Rep. No. 1383, 73d Cong., 2d Sess. 2–3 (1934); S. Rep. No. 792, 73d Cong., 2d Sess. 3 (1934).

22. "Manipulation" is "virtually a term of art when used in connection with securities markets." *Hochfelder*, 425 U.S. at 199. As the legislative history of the Exchange Act makes clear, the term "manipulation" refers to various practices directed at investors. H.R. Rep. No. 1383, 73d Cong., 2d Sess. (1934). This Court, recognizing the legislative intent underlying section 10(b), has declared that "[t]he term [manipulation] refers generally to practices, such as wash sales, matched orders, or rigged prices, that are *intended to mislead investors* by artificially affecting market activity." *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 476 (1977) (emphasis added). *See Schreiber v. Burlington Northern, Inc.*, 472 U.S. 1, 6–8 (1985). In *Santa Fe Industries, Inc.*, this Court stated further that:

> Section 10(b)'s general prohibition of practices deemed by the SEC to be "manipulative" — in this technical sense of artificially affecting market activity in order to mislead investors — is fully consistent with the fundamental purpose of the 1934 Act "to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* . . . ."

430 U.S. at 476–77 (quoting *Affiliated Ute Citizens v. United States*, 406

23. 490 F.2d 654, 659 (7th Cir. 1973), *cert. denied*, 416 U.S. 960 (1974).

24. *United States v. Naftalin*, 441 U.S. 768 (1979), relied upon by the government below, is not to the contrary. In *Naftalin*, the victims injured directly by a fraudulent securities transaction were not investors but brokers who executed a short sale. Interpreting section 17(a) of the Securities Act, which covers "offers" to purchase or sell securities, this Court said the anti-

Accordingly, in determining what conduct violates section 10(b), courts have inquired not simply whether fraud by non-disclosure has occurred, but whether the undisclosed statement was "material" to the investment decision;[25] not simply whether there has been a deception, but whether the deception directly affected an investment decision;[26] not simply whether a misrepresentation has been made, but whether the misrepresentation pertained to the value either of the security or of the assets for which the security was purchased or sold.[27] Each of these inquiries is wholly irrelevant, however, if the purported "victim," such as Dow Jones in this case, has no interest or involvement in the purchase or sale of securities.

The prosecution here proceeded under the "fraud" language of Rule 10b-5, which is subject to the general limitations of section 10(b).[28] Trading securities on the basis of undisclosed information is fraud under section 10(b) and Rule 10b-5 only where the trader owes a duty of disclosure to a market participant. As stated by the principal draftsman of Rule 10b-5, the occasion for the adoption of the rule was an instance of a corporate insider trading unfairly on the basis of inside information. The rule was adopted because of a report that "the president of some company . . . is . . . buying up the stock from his own shareholders at $4.00 per share, and that he has been telling them that the company is doing very badly, whereas, in fact, the earnings are going to be quadrupled and will be $2.00 a share for the coming year." Freeman, *The Insider Trading Sanctions Bill — A Neglected Opportunity*, 4 Pace L. Rev. 221, 222 (1984) (quoting Freeman, *Administrative Procedures*, 22 Bus. Law. 891, 922 (1967)).[29] That situation involved not only direct misrepresentations to investors but a violation of a fiduciary obligation of the president to the shareholders in his own corporation, conduct plainly amounting to common law fraud.

The requirement of a duty to a market participant in insider trading cases was formulated by the Commission itself in *In re Cady, Roberts & Co.*, 40 S.E.C. 907 (1961). In that case, the Commission held that a broker/dealer and his firm had violated section 10(b) by selling securities on the basis of undisclosed information obtained from a corporate insider of the issuer, because "insiders must disclose material facts which are known to them by virtue of their position but which are not known to persons with whom they deal and which, if known,

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fraud provision is "expansive enough to encompass the entire selling process, including the seller/agent transaction." *Id.* at 773.

25. The requirement of "materiality," which has uniformly been defined in terms of a decision to participate in the purchase or sale process, makes little sense if the victim of the fraud need not have any interest whatsoever in the underlying securities transaction. Because the Journal was not contemplating any securities transaction, Winans' non-disclosure of his breach of the private workrules could not possibly be "material" as that term is defined in the case law. *See SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 860 (2d Cir. 1968) (*en banc*) (deceit must be "of a sort that would cause reasonable investors to rely thereon, and, in connection therewith, so relying, cause them to purchase or sell a corporation's securities"), *cert. denied sub nom. Coates v. SEC*, 394 U.S. 976 (1969).

26. Section 10(b) does not require the disclosure of material information by an employee to an employer (such as Dow Jones) *not* involved in an investment decision, even where the required disclosure would justify termination of the employment arrangement. *O'Brien v. Continental Illinois National Bank and Trust Co.*, 593 F.2d 54, 60 (7th Cir. 1979). *See also Congregation of the Passion, Holy Cross Province v. Kidder Peabody & Co.*, 800 F.2d 177, 181-82 (7th Cir. 1986) (nondisclosure by investment manager employed by religious community not within protection of Rule 10b-5); *Harris Trust and Savings Bank v. Ellis*, 609 F. Supp. 1118, 1120-21 (N.D. Ill. 1985) (transactions justifying termination of trustees for nondisclosure of conflicts of interest did not violate federal securities laws); *Hackford v. First Security Bank of Utah*, 521 F. Supp. 541, 552 (D. Utah 1981) (trustee's failure to disclose to beneficiaries information regarding investments not actionable under Rule 10b-5), *aff'd*, [1983-1984] Fed. Sec. L. Rep. (CCH) ¶ 99,402 (10th Cir.), *cert. denied*, 464 U.S. 827 (1983); *Blackmar v. Lichtenstein*, 438 F. Supp. 803, 807 (E.D. Mo. 1977) (nondisclosed self-dealing by trustee adverse to beneficiaries' interest does not constitute securities fraud), *rev'd on other grounds*, 578 F.2d 1273 (8th Cir. 1978).

27. *Eason*, 490 F.2d at 656 (Stevens, J.) (misstatements and material omissions may relate to value of assets acquired rather than value of security).

28. *Hochfelder*, 425 U.S. at 212-14.

29. *See also Hochfelder*, 425 U.S. at 213 n.32 (Marshall, J.); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 767 (1975) (Blackmun, J., dissenting).

would affect their investment judgment." *Id.* at 911. The Commission said its task in determining whether there was fraud was "to identify those persons who are in a special relationship with a company and privy to its internal affairs, and thereby suffer correlative duties in trading in its securities." *Id.* at 912.

Later, this Court in *Chiarella v. United States*, 445 U.S. 222 (1980), held that silence accompanied by trading cannot constitute a fraudulent non-disclosure under section 10(b) and Rule 10b-5 unless there exists "a duty to disclose arising from a relationship of trust and confidence between parties to a transaction." *Id.* at 230. This Court squarely rejected the notion that, in the absence of such a duty, an obligation to disclose material information to the investing public arises from mere possession of superior knowledge. *Id.* at 232-35. It made no difference that Chiarella's knowledge resulted from special access to information not legally accessible either to the shareholders of the corporation whose securities were traded or to the public at large. *Id.* at 235 n.20.

In *Dirks*, this Court emphasized that the obligation to "disclose or refrain" under Rule 10b-5 requires the existence of a specific relationship — direct or derivative[30] — between the company whose stock is traded and the individual who trades on material non-public information. 463 U.S. at 654-55.[31] Accordingly, the district court concluded that to "find *Dirks* controlling would be to find no securities violation" by petitioners. 612 F. Supp. at 841; 56a.

Dirks and *Chiarella* require reversal of petitioners'convictions under Rule 10b-5, unless this Court not only adopts the "misappropriation theory" on which it reserved decision in *Chiarella*, but extends that theory to facts — beyond anything contemplated in any previous case — involving neither a duty to a market participant nor a victim who is a market participant. Such an extension would be inconsistent with the history and purpose of section 10(b) and Rule 10b-5 and should not be effected absent a specific Congressional mandate.

B. Absent Any Duty or Injury To a Market Participant, "Misappropriation" Cannot Be a Violation of Section 10(b)

In the "insider trading" context, a "misappropriation theory" might arguably be applied without doing violence to the historic meaning of fraud[32] or to the intent of the federal securities laws where "misappropriated information" belongs to a market participant.[33] Such a theory makes best sense where the "misappropriated information" belongs to the corporation whose stock is traded. In these circumstances, the "misappropriation theory" comports with the limiting principles of *Dirks* and *Chiarella*. Like the tippee discussed in *Dirks*, one who misappropriates a corporation's information "inherits" the corporation's duty to its shareholders.

In the tender offer context, a "misappropriation theory" likewise makes best sense where an insider or temporary insider of, or misappropriator from, the *target* company buys *target* company stock with knowledge of a planned but yet unannounced takeover. The "misappropriation theory" would still apply, albeit more tenuously, where the purchaser of *target* company stock is an insider or temporary insider of, or misappropriator from, the *acquiring* company. Here, the

30. In *Dirks*, the Court noted that outsiders such as underwriters, accountants, lawyers or corporate consultants become temporary insiders because of their confidential relationship to the corporation and access to inside information. 463 U.S. at 655 n.14.

31. *Dirks* also held that a tippee inherits the insider's obligation to disclose or refrain from trading only where the tippee knows the tip was given in violation of the insider's fiduciary duty to the corporation. Only then does the tippee become an "accessory after the fact" to the insider's breach. 463 U.S.

32. Illustrative is the English case of *Phillips v. Homfray*, L. R. 6 Ch. 770, 779-80 (1871), where defendants first trespassed upon property, discovered and converted coal, and subsequently contracted to purchase the property from the owner without disclosure of the discovery.

33. *SEC v. Materia*, 745 F.2d 197 (2d Cir. 1984), *cert. denied*, 471 U.S. 1053 (1985); *United States v. Newman*, 664 F.2d 12, 17 (2d Cir. 1981), *aff'd after remand*, 722 F.2d 729 (2d Cir.), *cert. denied*, 464 U.S. 863 (1983); *SEC v. Musella*, 578 F. Supp. 425 (S.D. N.Y. 1984).

valuable non-public information emanates from the *acquiring* company rather than the target company whose shares are purchased. Because application of the theory in this instance is tenuous, the Commission in 1980 promulgated Rule 14e-3, which prohibits any person who possesses material non-public information relating to a tender offer, and which was acquired directly or indirectly from either the offeror or the target, from trading on the securities of either the offeror or the target.[34] 17 C.F.R. § 240.14e-3 (1986).

In this case, however, neither traditional duty analysis nor a "misappropriation theory" is applicable. The information used by Winans did not belong to the corporations whose securities he traded. Winans had no relationship — direct or derivative — with those companies. As Judge Miner, dissenting below, observed:

> No confidential securities information imparted by reason of any special relationship was purloined by these defendants. The "Heard" columns written by Winans consisted of high quality, accurate articles dealing with the strengths and weaknesses of various securities, and the research data upon which the columns were based were fully available to the public. To say that the 'publication schedule' of the Wall Street Journal was the non-public, confidential information stolen by the defendants is to extend the sweep of section 10(b) and rule 10b-5 beyond all reasonable bounds. Knowledge of publication dates simply is not the special securities-related knowledge [properly] implicated in the misappropriation theory.[35]

Nor was any duty owed to or injury inflicted upon any market participant.[36] By eliminating the need for a connection between "misappropriation" and a market duty or injury, the Second Circuit majority has transformed Rule 10b-5 into a law governing relationships outside the securities markets, in this case the relationship between a newspaper and its employee. Here, the duty breached involves no more than contractual, quasi-contractual, or so-called "fiduciary" obligations of an employee to his employer.[37] The opinion below thus represents a dramatic departure from past precedent, and, if affirmed, will require the development of a body of federal "fiduciary" law to be applied in any situation where securities are even tangentially involved.[38]

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34. Before Rule 14e-3, the Commission sought to proscribe the same conduct under Rule 10b-5. The Commission argued that purchases of the target corporation's securities based on knowledge of the acquiring corporation's secret plans would artificially inflate the price of the target's securities, thus jeopardizing the success of the tender offer. It was precisely on this basis that the Commission argued in *Chiarella* that the *acquiring* corporation, *itself* a market participant, had been defrauded. It was these issues — whether a duty to the *acquiring* corporation exists, whether it was breached, and whether such a breach constitutes a violation of section 10(b) — which this court left open in *Chiarella*. 445 U.S. at 236-37; *id.* at 238 (Stevens, J., concurring). Even if these issues (now mooted by Rule 14e-3) were to be answered affirmatively, they would not govern the situation here because Dow

35. 791 F.2d at 1037; 28a-29a (Miner, J., dissenting).

36. The "misappropriation theory," as previously applied by the Second Circuit in *Newman* and *Materia* (and as previously hypothesized in *Chiarella*), involved breaches of the fiduciary duties, owed by investment banks, financial printers and others similarly situated, and their respective employees, not to misappropriate confidential *client* information concerning proposed securities transactions such as tender offers. The victims of the misappropriations in *Newman* and *Materia* were market participants — corporations planning to engage in securities transactions in connection with contemplated tender offers.

37. As noted at page 32, *infra*, it is far from clear that all obligations of an employee to an employer are fiduciary in nature.

38. In *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462 (1977), this Court held that even breaches of duty directly affecting transactions in securities registered under the Exchange Act do not constitute violations of section 10(b) and Rule 10b-5 when neither manipulation of stock prices nor deception of investors is involved. The Court reasoned that to apply Rule 10b-5 in such a situation "would be to bring within the Rule a wide variety of corporate conduct traditionally left to state regulation," and that "the extension of the federal securities laws would overlap and quite possibly interfere with state corporate law." *Id.* at 478-79. This Court, "reluctant to federalize" state corporation law, refused to extend the scope of section 10(b) and Rule 10b-5 to cover breaches of duty traditionally governed by state law "absent a clear indication

C. The Extension of the "Misappropriation Theory" Below Leads to Irrational Results

The form of "misappropriation theory" applied by the courts below leads to the bizarre result that Dow Jones could have lawfully entered the trading arrangement with Brant, but Winans could not. It leads to the further bizarre result that a reporter for a newspaper without a policy such as the Dow Jones policy could have lawfully done exactly what Winans did. Yet, in both cases, the effect of the "lawful" and "unlawful" conduct on market participants is the same. Section 10(b), with its focus on protection of investors and the public, cannot logically permit such distinctions. The analysis adopted below causes an irrational incidence of criminal liability based on a happenstance unrelated to any interest of the investing public.

The facts of the *Dirks* case further demonstrate the incongruity of the government's expanded "misappropriation theory." Raymond Dirks had been told by Ronald Secrist, a former officer of Equity Funding, that Equity Funding's assets were fraudulently overstated. Dirks informed Wall Street Journal correspondent William Blundell of the fraud, but Blundell at first declined to write an article. Meanwhile, Dirks told his investor clients, and they sold $16 million of Equity Funding stock. Blundell then wrote the article.

This Court held that Dirks' conduct was lawful because Dirks had no duty arising from any special relationship with Equity Funding and because his source, Secrist, had not breached his fiduciary duty to Equity Funding in revealing the fraud to Dirks. But under the misappropriation theory adopted below, the reporter, Blundell, would be guilty of a federal crime if he had traded shares of Equity Funding before his story was published. Blundell would be subject to criminal prosecution for securities fraud, even though (as noted) his employer, Dow Jones, would itself be under no similar disability,[39] and even though (as *Dirks* holds) Secrist, Dirks and Dirks' clients had not violated the law.[40]

A still further anomaly arising from the "misappropriation theory" adopted below is that it permits the government to misuse a private company rule to resurrect — at the pain of criminal penalties — the "parity of information" and "equal access to information" theories that were explicitly rejected by this Court in *Chiarella*. 445 U.S. at 235 n.20. If an employer as a matter of policy declares that its employees should obey the "parity of information" rule even in situations where neither the employee nor employer have any independent duty of confidentiality to a company or its shareholders, then failure to obey the rule becomes, under the decisions below, a fraud against the employer and a criminal violation of Rule 10b–5. The results which flow from the decisions below are thus irrational and dubious as a matter of public policy.

D. The Securities Fraud Convictions Violate Due Process Because a Reasonable Employee Could Not Know that a Breach of The Journal's Workrule Is a Crime

The expansion of the "misappropriation theory" has created confusion as to what constitutes lawful conduct.[41] Congress has done nothing to date to eliminate the uncertainties that

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of congressional intent" to do so. *Id.* at 479. Here, the "duty" underlying this prosecution arises solely out of the employment relationship, which has long been governed by the common law and, in certain instances, state legislation. There is no federal common law governing employer–employee relationships, and there is no principled reason to rewrite section 10(b) to redress breaches of

39. *See Walton v. Morgan Stanley & Co.*, 623 F.2d 796 (2d Cir. 1980).

40. On the other hand, Blundell could lawfully have traded the stock under the decision below if he did not expose the fraud to the public and did *not* write an article; *it was only because of his forthcoming article that his* trading would violate the Journal's internal policy. This disincentive to reporting raises the very concern expressed by this Court in *Dirks* concerning the adverse impact of the Commission's position on the dissemination of information to the public. 463 U.S. at 661–63.

41. *See* Brief of the Securities Industries Association, Inc. as *amicus curiae in support of petitioners'petition for writ of certiorari in this matter*, stating that its members are now unable to know with any certainty whether transactions that they effect may constitute a breach of some non–securities related duty owed by a client to a third party, which breach may subject its [illegible] civil liability under the federal securities laws.

exist, although there has been ample opportunity to enact such legislation. During hearings on the Insider Trading Sanctions Act of 1984, Pub. L. 98–376, 98 Stat. 1264 (Aug. 10, 1984) (codified as amended at 15 U.S.C. §§ 78c, 78o, 78t, 78u, 78ff), Congress was urged to clarify what constitutes the illegal use of material non–public information,[42] but others preferred imprecision. The then SEC Enforcement Director gave to Congress six reasons for a definition of insider trading and six reasons against, before ultimately opposing any definition because it might not allow as broad an application of the securities laws as was possible under the current vague rule.[43] In passing the Insider Trading Sanctions Act, Congress did not enact a definition. More recently, because of the substantial confusion concerning Rule 10b–5, proposals have been submitted in Congress that define the contours of "insider trading."[44] The Commission, however, has expressed a preference to determine what constitutes "insider trading" on a case–by–case basis and to define "new" types of violations after the conduct in question has occurred. As stated by the Chairman of the Commission, "[w]e are judge, jury and prosecutor."[45]

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42. Freeman, *The Insider Trading Sanctions Bill – A Neglected Opportunity*, 4 Pace L. Rev. 221 (1984); Freeman, *Legislative Action Called "Desirable" for Resolution of Insider Trading Problems*, N.Y.L.J., Dec. 14, 1981.

43. The Insider Trading Sanctions Act of 1983: Hearings on H.R. 559 Before the Subcommittee On Banking, Housing and Urban Affairs, 98th Cong., 2d Sess. (1984) (statement of John Fedders, SEC Enforcement Director).

44. *See* S. 230, 100th Cong., 1st Sess. (1987). Senator D'Amato, recognizing this Court's criticism of the Commission's case–by–case approach to insider trading as "inherently imprecise" and thus preventing "parties from ordering their actions in accord with legal requirements," introduced legislation that would provide for a definition of insider trading. 133 Cong. Rec. S. 474 (daily ed. Jan. 6, 1987) (statement of Senator D'Amato, quoting *Dirks*, 463 U.S. at 652 n.17, 654 n.24). *See also* ABA Committee on Federal Regulation of Securities, Report of the Task Force on Regulation of Insider Trading – Part I: Regulation under the Antifraud Provisions of the Securities Exchange Act of 1934, 41 Bus. Law. 223, 235–37, 253–63, 270–71 (1985).

45. Williams, *What's Legal — And What's Not*, Fortune, Dec. 22,

A crucial and necessary function of criminal law is to advise citizens of what conduct is permissible and what conduct is not. "[B]ecause we assume that man is free to steer between lawful and unlawful conduct, we insist that laws give the person of ordinary intelligence a reasonable opportunity to know what is prohibited, so that he may act accordingly." *Grayned v. City of Rockford*, 408 U.S. 104, 108 (1972); *see also United States v. L. Cohen Grocery Co.*, 255 U.S. 81, 88–89 (1921).

This basic principle of our system of justice has sometimes been offended by a tendency in securities cases to expand the vague contours of Rule 10b–5 retroactively, in order to impose criminal sanctions on conduct never before proscribed. Dissenting from the Second Circuit's affirmance of the criminal conviction in *Chiarella*, Judge Meskill warned that the judicial "lawmaking function is severely restricted in the criminal area." 588 F.2d at 1376. This Court vindicated Judge Meskill's view, noting that "a judicial holding that certain undefined activities 'generally are prohibited' by section 10(b) would raise questions whether either criminal or civil defendants would be given fair notice that they have engaged in illegal activity." 445 U.S. at 235 n.20.

Here, the application of the undefined "misappropriation theory" to petitioners' conduct transgresses doctrines of fair notice, lenity and strict construction which are essential in the criminal law. *Rewis v. United States*, 401 U.S. 808, 812 (1971). Flexible interpretations of regulatory statutes consonant with the broad remedial purposes of such legislation, though proper in the context of civil enforcement, are impermissible in criminal prosecutions.

The offense to due process is egregious in this case because no one knows what constitutes a criminal "misappropriation" under Rule 10b–5. Is it sufficient that use of lawfully acquired information contravene an implied term of an employment contract? Does it require breach of a fiduciary duty? Do all employees owe such duties to their employers, or only certain kinds of employees, or only employees in certain kinds of professions, or only with respect to certain kinds of information?[46]

The courts below held that Winans "misappropriated" the Journal's publication schedule. But what does it mean to "misappropriate" knowledge? Winans did not deprive Dow Jones of the use or value of the information he obtained.[47] He learned of the information in the regular performance of his job, not by stealth or other dishonest means.[48] In contrast to all prior "misappropriation" cases, Winans did not use the information in a manner legally forbidden to his employer.[49] Finally, as we noted at pages 19–21, *supra*, in all prior "misappropriation" cases, a duty was owed, if only derivatively, to a market participant.

Once the requirement of "duty between the parties to a transaction" is eliminated from the jurisprudence of section 10(b), there are many places where the line between lawful and unlawful conduct may be drawn.[50] This plethora of possibilities, and the policy choices inherent in each, requires that the lines be drawn by Congress and not the courts.[51]

By using the federal securities laws to impose criminal penalties for breaches of internal corporate policy under a vague and undefined theory of "misappropriation", the Second Circuit has caused tremendous confusion as to what relationships and what types of information are covered by section 10(b) and Rule 10b–5.[52] This expansion of the securities laws to indefinite

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46. The Dow Jones conflicts of interest policy, both in its express language and as presented to employees, went "beyond the requirements of the law." *See* note 10, *supra*. Criminal prosecution of an employee for conduct violative of a company policy which has been presented to the employee as a *non–crime* offends the essence of fairness and is an "indefensible form of entrapment." *Cox v. Louisiana*, 379 U.S. 559, 571 (1965).

47. *Cf. Dowling v. United States*, 105 S. Ct. 3127, 3133–34 (1985), where the Court observed that unlawful use of copyrighted material

> does not easily equate with theft, conversion or fraud . . . . The infringer invades a statutorily defined province guaranteed to the copyright holder alone. But he does not assume physical control over the copyright; nor does he wholly deprive its owner of its use. While one may colloquially link infringement with some general notion of wrongful appropriation, infringement plainly implicates a more complex set of property interests than does run–of–the–mill theft, conversion, or fraud. As a result, it fits but awkwardly with the language Congress chose — "stolen, converted or taken by fraud" — to describe the sorts of goods whose interstate shipment § 2314 makes criminal.

48. Professor Keeton, summarizing the common law of fraud by nondisclosure just two years after the enactment of section 10(b), observed that unequal information in a business transaction does not amount to fraud where the information is lawfully (though unfairly) *acquired*. Keeton, *Fraud — Concealment and Non–Disclosure*, 15 Tex. L. Rev. 1, 35 (1936).

49. *See, e.g., Chiarella*, 445 U.S. 222; *Newman*, 664 F.2d 12;

50. This Court and the Commission itself have long recognized that not all unfairness in the markets violates a law which only "catches" fraud. *Chiarella*, 445 U.S. at 235. As this Court has stated:

> We do not suggest that knowingly trading on inside information is ever "socially desirable or even that it is devoid of moral considerations." [Citation omitted] . . . Depending on the circumstances, and even where permitted by law, one's trading on material non–public information is behavior that may fall below ethical standards of conduct. But in a statutory area of the law such as securities regulation, where legal principles of general application must be applied, there may be "significant distinctions between actual legal obligations and ethical ideals." SEC, Report of the Special Study of Securities Markets, H.R. Doc. No. 95, 88th Cong., 1st Sess., pt. 1 pp. 237–238 (1963).

Dirks, 463 U.S. at 661 n.21.

51. *See Dowling*, 105 S. Ct. at 3139. *See also* Note, *The Inadequacy of Rule 10b–5 to Address Outside Trading by Reporters*, 38 Stan. L. Rev. 1549, 1558–59 (1986).

52. *See, e.g.*, Arkin, *Insider Trading, Distinguishing Unequal Advantage from Fraud*, N.Y.L.J., June 19, 1986, at 1, cols. 3–4; Herzel & Katz, *Insider Trading Cases: Right Result, Wrong Rules*, Legal Times, June 23, 1986, at 15; *Insider Trading: Outside Which Law?*, Economist, June 14, 1986, at 76; Karmel, *Market Information: Insider Trading*, N.Y.L.J., June 19, 1986, at 1, col. 1; Klein, *Winans Decision Defies Doctrinal Shift*, Legal Times, June 23, 1986, at 15; Lewin, *Some Assert S.E.C. Pushes Too Far*, N.Y. Times, July 21, 1986, at D–1, col. 3; Marcus, *Murky Insider–Trading Rules Often Point to Outsiders*, Washington Post, June 1, 1986: Obermaier, *Who's an Insider? What's Inside?*, N.Y.L.J.,

boundaries in a criminal case creates the danger, realized here, that people will go to prison for conduct defined as criminal only in retrospect.

POINT II
THE MAIL AND WIRE FRAUD STATUTES DO NOT EXTEND TO SIMPLE BREACHES OF PRIVATE WORKRULES, INTANGIBLE INJURIES, AND INCIDENTAL MAILINGS AND WIRINGS

In summarily affirming petitioners' mail and wire fraud convictions, the Second Circuit took a further, and major, step in the "recent . . . extraordinary expansion of mail and wire fraud statutes"[53] to create, by judicial fiat, "a new crime – corporate improprieties – which entails neither fraud nor even a victim. . . ."[54] Because petitioners' conduct was not a fraud at all, or at least not a criminal fraud falling within the ambit of the mail fraud and wire fraud statutes, their convictions should be reversed.

The trend toward a "seemingly limitless"[55] expansion of the mail and wire fraud statutes has been severely criticized in dissenting opinions in the Second Circuit,[56] in majority, concurring and dissenting opinions in other circuits,[57] and by the near-unanimous weight of scholarly opinion.[58] It has never been

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July 1, 1986, at 1, col. 1; Williams, *What's Legal — And What's Not*, Fortune, Dec. 22, 1986, at 36–37 ("The SEC has a manhunt on for inside traders. But the rules are so vague that it's hard for arbitragers — and managers — to know if and when they have sinned."); Editorial, "SEC v. ?", Wall Street J., Nov. 20, 1986, at 34, col. 1 ("The problem with the SEC is that the crime it presumably is pursuing, 'insider trading', has for some time now lacked clear definition. No wonder the markets are uncertain . . see[ing] cases trying to further stretch the definition of 'insider' trading . . . since such an expansion would reduce, rather than expand, the amount of information available to the market").

53. *United States v. Weiss*, 752 F.2d 777, 791 (2d Cir.), *cert. denied*, 106 S. Ct. 308 (1985) (Newman, J., dissenting).

54. *United States v. Siegel*, 717 F.2d 9, 24 (2d Cir. 1983) (Winter, J., dissenting).

55. *Id.* at 14; *United States v. Margiotta*, 688 F.2d 108, 120 (2d Cir. 1982), *cert. denied*, 461 U.S. 913 (1983); *United States v. Von Barta*, 635 F.2d 999, 1001 (2d Cir. 1980), *cert. denied*, 450 U.S. 998 (1981).

Siegel, 717 F.2d at 23–24 (Winter, J., dissenting); *Margiotta*, 688 F.2d at 139–44 (Winter, J., dissenting); *United States v. Bronston*, 658 F.2d 920, 930–33 (2d Cir. 1981) (Van Graafeiland, J., dissenting), *cert. denied*, 456 U.S. 915 (1982). *See also United States v. Pisani*, 773 F.2d 397, 410–11 (2d Cir. 1985) (reversing mail fraud conviction based on fiduciary breach); *United States v. Dixon*, 536 F.2d 1388, 1398–1401 (2d Cir. 1976) (Friendly, J.) (reversing mail fraud conviction held to be "a considerable distance from the ordinary meaning of 'scheme or artifice to defraud'"). Many of the Second Circuit decisions extending the mail and wire fraud statutes reversed decisions by thoughtful district judges who, even within the confines of prior Second Circuit precedents, did not believe that the statutes could be further stretched. *See, e.g.*, *United States v. Courtois*, [1981] Fed. Sec. L. Rep. (CCH) ¶ 98,024 (S.D.N.Y.) (Haight, J.), *rev'd on other grounds sub nom. United States v. Newman*, 664 F.2d 12 (2d Cir. 1981), *aff'd after remand*, 722 F.2d 729 (2d Cir.), *cert. denied*, 464 U.S. 863 (1983); *Von Barta*, 635 F.2d at 999 (reversing dismissal of indictment by Brieant, J.).

57. *United States v. Hewes*, 729 F.2d 1302, 1322 (11th Cir. 1984), *cert. denied sub nom. Caldwell v. United States*, 469 U.S. 1110 (1985); *United States v. Lemire*, 720 F.2d 1327, 1335–36 (D.C. Cir. 1983) (majority opinion expressing "second thoughts" about expansion of mail fraud, and rejecting government's theory that "would criminalize any intentional undisclosed breach of duty to an employer"), *cert. denied*, 467 U.S. 1226 (1984); *United States v. Curry*, 681 F.2d 406, 418–25 (5th Cir. 1982) (Garwood, J., concurring) (expressing disagreement with "intangible rights" theory of mail fraud); *United States v. Ballard*, 663 F.2d 534 (5th Cir. 1981), *modified on reh'g*, 680 F.2d 352 (5th Cir. 1982) (requiring prosecution to prove actual financial loss to corporate employer where employee breached conflict of interest rules); *United States v. Rabbitt*, 583 F.2d 1014 (8th Cir. 1978), *cert. denied*, 439 U.S. 1116 (1979); *United States v. Craig*, 573 F.2d 455, 497–505 (7th Cir. 1977) (Swygert, J., dissenting) (describing the extension of the mail and wire fraud statutes as a "pernicious trend"), *cert. denied*, 439 U.S. 820 (1978); *United States v. Caldwell*, 544 F.2d 691, 697–98 (4th Cir. 1976) (Widener, J., concurring) (suggesting limitation of mail fraud prosecutions to tangible injuries); *United States v. McNeive*, 536 F.2d 1245 (8th Cir. 1976); *United States v. States*, 488 F.2d 761, 767 (8th Cir. 1973) (Ross, J., concurring), *cert. denied*, 417 U.S. 909 (1974); *United States v. Edwards*, 458 F.2d 875, 880 (5th Cir.), *cert. denied sub nom. Huie v. United States*, 409 U.S. 891 (1972); *United States v. Kelem*, 416 F.2d 346, 347 (9th Cir. 1969), *cert. denied*, 397 U.S. 952 (1970).

58. *See, e.g.*, Coffee, *From Tort to Crime: Some Reflections on the Criminalization of Fiduciary Breaches and the Problematic Line Between Law and Ethics*, 19 Am. Crim. L. Rev. 117 (1981) (hereinafter "*From Tort to Crime*") (criticizing the entire development of the mail and wire fraud stat-

reviewed by this Court. But, as we demonstrate below, the continuation of the trend in this case not only "eliminate[s] the need to show a substantial connection between the scheme to defraud and the use of the mails or wires . . . [but even] the need to show fraud" itself.[59] It flies in the face of the statutory language and contradicts this Court's earlier decisions construing these statutes.

On their face, the mail and wire fraud statutes simply prohibit a person from causing the use of the mails or interstate wires for the purpose of executing a scheme to defraud or for obtaining money or property by fraudulent means.[60] But where the statutes speak of a "scheme . . . to defraud," lower courts — and the courts here — have substituted a "breach of fiduciary duty."[61] Where the statutes speak of "obtaining money or property," lower courts — and the courts here — have substituted doing injury to "intangible rights" such as "honesty," "loyalty," "privacy," "reputation," "time," "effort," or "expectations."[62] And where the statutes speak of "causing" a use of the mails or wires for the "purpose of executing" the fraud, lower courts — and the courts here — have substituted any use (purposeful or otherwise) that is an incidental accompaniment of the events growing out of the "fraud."[63]

The Second Circuit's opinion in this case represents the culmination of each of these trends. The petitioners' mail and wire fraud convictions are based entirely on (A) simple breaches of private workrules and company conflict codes, (B) intangible injuries, and (C) incidental mailings and wirings. Because the proper scope of the mail and wire fraud statutes cannot be stretched so far, petitioners' convictions should be reversed.

A. Breaches of Private Workrules and Company Conflict Codes

Winans' misconduct was his breach of the Journal's "Conflicts of Interest Policy." From the outset, the "government concede[d] that without any [such] policy there could be no prosecution" here.[64] Of the various "guidelines" set out in the policy,[65] two were violated by Winans: guideline (i), a general prohibition against the prepublication disclosure ("leaking") to anyone outside the company of "any material gleaned by [the

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utes, especially as applied in *Bronston*); Jeffries, *Legality, Vagueness and the Construction of Penal Statutes*, 71 Va. L. Rev. 189, 190–201 (1985) (criticizing as "case-by-case criminalization" the extension of the mail fraud statute to fiduciary breaches as applied in *Margiotta*); Morano, *The Mail-Fraud Statute: A Procrustean Bed*, 14 J. Marshall L. Rev. 45 (1980); Tigar, *Mail Fraud, Morals and U.S. Attorneys*, 11 Litigation 22 (Fall 1984); Note, *Intra-Corporate Mail and Wire Fraud: Criminal Liability for Fiduciary Breach*, 94 Yale L.J. 1427 (1985) (criticizing as "untenable" the mail fraud fiduciary breach standard as applied in *Siegel* and *Weiss*); Comment, *Federal Prosecution of Elected State Officials for Mail Fraud: Creative Prosecution or An Affront to Federalism*, 28 Am. U.L. Rev. 63 (1978). *See also* Coffee, *The Metastasis of Mail Fraud: The Continuing Story of the "Evolution" of a White-Collar Crime*, 21 Am. Crim. L. Rev. 1 (1983) (hereinafter "*The Metastasis of Mail Fraud*"); Hurson, *Limiting the Federal Mail Fraud Statute — A Legislative Approach*, 20 Am. Crim. L. Rev. 423 (1983); Comment, *The Intangible-Rights Doctrine and Political-Corruption Prosecution Under the Mail Fraud Statute*, 47 U. Chi. L. Rev. 562, 578 (1980).

59. *Siegel*, 717 F.2d at 24 (Winter, J., dissenting).

60. 18 U.S.C. §§ 1341, 1343 (1982). Identical principles govern the construction and application of the two statutes. *See, e.g., Siegel*, 717 F.2d at 14 and cases there cited.

61. *See, e.g., Siegel*, 717 F.2d at 14; *Margiotta*, 688 F.2d at 120; *Newman*, 664 F.2d at 19; *Bronston*, 658 F.2d at 926; *United States v. Mandel*, 591 F.2d 1347 (4th Cir.), *aff'd on hearing en banc*, 602 F.2d 653, *cert. denied*, 445 U.S. 961 (1980); *United States v. Isaacs*, 493 F.2d 1124 (7th Cir.), *cert. denied*, 417 U.S. 976 (1974); *Post v. United States*, 407 F.2d

62. *See, e.g., Margiotta*, 688 F.2d at 120; *Newman*, 664 F.2d at 19; *Von Barta*, 635 F.2d at 1005–06; *United States v. Bohonus*, 628 F.2d 1167, 1172 (9th Cir.), *cert. denied*, 447 U.S. 928 (1980); *United States v. Condolon*, 600 F.2d 7, 9 (4th Cir. 1979); *United States v. Louderman*, 576 F.2d 1383, 1387 (9th Cir.), *cert. denied*, 439 U.S. 896 (1978); *United States v. Keane*, 522 F.2d 534, 544 (7th Cir. 1975), *cert. denied*, 424 U.S. 976 (1976).

63. *See, e.g., United States v. Green*, 786 F.2d 247 (7th Cir. 1986); *United States v. Muni*, 668 F.2d 87 (2d Cir. 1981).

64. 612 F. Supp. at 842; 58a.

65. The policy itself was set forth in the last few pages of a 44-page pamphlet entitled "The Inside Story," which was distributed to new employees of Dow Jones. GX 54; *see* 612 F. Supp. at 829; 35a.

employee] in the course of the employee's work," all of which material was "deemed to be strictly the Company's property";[66] and guideline (iii), a specific prohibition against prepublication trading in securities of any company that the employee knew was the subject of a forthcoming article.[67] Although only Winans was found to be specifically aware of both of these guidelines,[68] both Carpenter and Felis were held criminally accountable for having reaped benefits from Winans' breaches.[69]

Almost without any analysis or discussion, the Second Circuit held that Winans' breach of these internal guidelines and policy, *per se*, constituted a scheme to defraud cognizable under the mail and wire fraud statutes. Specifically, the court held that "the scheme to misappropriate material nonpublic information regarding the Journal's forthcoming publications in breach of the employee's [fiduciary] duty of confidentiality to the Journal in connection with securities transactions met the requirements" of these statutes.[70]

66. GX 55; App. 41–42. Of course, the Journal, like all newspapers, had no ethical compunction about soliciting "leaks" from the employees of other institutions, public or private, regardless of those institutions' internal rules.

67. GX 55; App. 42.

68. 612 F. Supp. at 831; 37a. Carpenter was found to be "generally aware" of the "policy of confidentiality" embodied in the first guideline. *Id.* at 831; 38a.

69. On appeal to the Second Circuit, Felis argued that in the absence of knowledge of the Journal's policies, he lacked the intent necessary to be found guilty of conspiring to defraud the Journal. Carpenter, who was acquitted of the conspiracy and found guilty of aiding and abetting Winans' personal trading in violation of guideline (iii), offered a similar argument based on the district court's finding that he only knew of guideline (i). The Second Circuit declined to address, other than summarily, either of these arguments.

70. 791 F.2d at 1035; 24a. At trial, the government initially suggested that mail and wire fraud liability could rest either on this "breach of fiduciary duty" theory or on a "misappropriation of information" theory. 612 F. Supp. at 844; 61a–62a. However, even assuming that the Journal's unilateral attempt to "deem" all information its property was controlling as a matter of law, *but see Dowling*, 105 S. Ct. at 3133, Winans' "misappropriation" of

Packed into this brief holding are a series of assumptions, each one less supportable than the next. First, at common law and in the law of the several states, "it is far from clear that an employee owes any fiduciary duty to his employer."[71] Yet, following earlier expansive mail and wire fraud decisions, the Second Circuit here posits that the duty owed by an employee to his employer is that of a fiduciary, thereby imposing, upon pain of criminal liability, a higher, federal standard upon employer–employee relations. Second, the court below here assumes that an employee's fiduciary duty extends to every private workrule — even if imposed unilaterally by the employer and without regard to the employment contract — and that a failure to adhere to such rules with a fiduciary's punctiliousness deprives the employer of the full faith and loyalty required of a fiduciary. In so holding, the Second Circuit applies to workrule breaches an intangible injury theory that, as suggested by Judge Friendly in *United States v. Dixon*,[72] was "developed to fit the situation [of] . . . public officials," whose fiduciary duties might at least be said to be imposed by the state.[73] Third and finally, the Second Circuit here assumes that every such breach of a workrule carries with it an intrinsic duty to report the breach to the employer, such that a failure to so report is inherently deceptive and fraudulent *per se*. By such legerdemain, the court removes from the concept of criminal fraud its most central feature — actual deception — and replaces it with a notion of constructive fraud, once held the mark of civil liability

unless it also constituted a fiduciary breach; hence, the government ultimately conceded that in the absence of a breach of the conflict of interest policy, there could be no conviction under the "misappropriation theory." *See supra* note 20. For similar reasons, both the district court (expressly) and the appellate court (implicitly) found that both the government's theories of mail and wire fraud liability merged into a single fiduciary breach theory. 791 F.2d at 1029; 24a; 612 F. Supp. at 844; 61a–62a.

71. *From Tort to Crime*, *supra* note 58, at 160.

72. 536 F.2d 1388 (2d Cir. 1976). *See also Courtois*, [1981] Fed. Sec. L. Rep. (CCH) ¶ 98,024, at 91,301.

73. *Dixon*, 536 F.2d at 1400. *See also Margiotta*, 688 F.2d at 121; *Bohonus*, 628 F.2d at 1171; *Keane*, 522 F.2d at 549. *Cf. United States v. Gray*, 790 F.2d 1290 (6th Cir.), *cert. granted*, 107 S. Ct. 642 (1986).

alone.[74]

Each of these assumptions carries the law of mail and wire fraud well beyond what is ordinarily recognized as fraud in the criminal law. The final assumption, moreover, goes further than any previous case. Prior to the instant case, most courts of appeals, however expansive a view they had taken of mail and wire fraud, had at least required that a breach of duty be linked with an independent material misrepresentation to the person to whom the duty was owed.[75] However, while the lower courts here paid lip-service to this requirement,[76] Winans in fact neither made any misrepresentations to the Journal nor failed to comply with any express duty to disclose his trading and leaks. Rather, he simply breached the conflicts of interest workrules themselves. By reading implicit deception into those workrule breaches, the Second Circuit silently adopts precisely the "bootstrap" approach to mail and wire fraud that it condemned in *Newman*, its prior precedent most closely in point,[77] and that is routinely condemned by federal courts in interpreting the securities laws.[78]

Under the principles announced by the lower courts' opinions and applied to petitioners in this case, disobedience of any internal workrule gives rise to a mail or wire fraud violation, no

74. *Cf. Von Barta*, 635 F.2d at 1005 n.14 ("Constructive frauds involve breaches of fiduciary or equitable duties where intent to deceive is lacking [citation omitted]. Only actual frauds are within the purview of the mail fraud statute.").

75. *See, e.g., Von Barta*, 635 F.2d at 1005 n.14, 1006–07; *United States v. Bush*, 522 F.2d 641, 648 (7th Cir. 1975), *cert. denied*, 424 U.S. 977 (1976); *Epstein v. United States*, 174 F.2d 754 (6th Cir. 1949). *See also The Metastasis of Mail Fraud, supra* note 58, at 14.

76. 791 F.2d at 1035; 24a; 612 F. Supp. at 844; 62a.

77. *Newman*, 664 F.2d at 19. The district court itself recognized that "it is a bit absurd to say that an element of Winans' crime was that he did not tell the Wall Street Journal that he was committing it." 612 F. Supp. at 844 n.13; 62a n.13.

78. *See, e.g., Atchley v. Qonaar Corp.*, 704 F.2d 355, 358 (7th Cir. 1983); *Staffin v. Greenberg*, 672 F.2d 1196, 1205 (3d Cir. 1982); *Biesenbach v. Guenther*, 588 F.2d 400, 402 (3d Cir. 1978); *Warner* [illegible] 581 F. Supp. 1482, 1490 (D. Del. 1984).

matter how technical the rule or trivial the conduct it prohibits, even where there is no discernible federal interest in regulating the employment relationship. It does not matter that the workrule has been, as here, imposed unilaterally by the employer,[79] and made known to the employee (if at all) only after employment has commenced. Nor does it matter that the rule has no specific correlative in criminal law[80] or even in common industry practices.[81] Violation of such rule now constitutes grounds not only for discharge but also for federal criminal prosecution. Indeed, even a former employee who has no better than a "general awareness" of the workrule (Carpenter)[82] or an outsider who has no awareness of the rule whatever (Felis)[83] can be criminally prosecuted if he assists the employee in the activities that violate the workrule.

79. The Journal's workrules were neither quoted nor referred to in the *collective bargaining agreement governing Winans' employment* (Exhs. WU-1, WU-2; T. 121).

80. Although the majority opinion, 791 F.2d at 1033 n.11; 21a n.11, refers to certain state criminal statutes prohibiting theft of trade secrets, these laws are carefully limited, in New York as elsewhere, to the narrowly defined category of "secret scientific material." N.Y. Penal Law § 165.07 (McKinney 1975 & Supp. 1986). *See also id.* § 155.00 [subd. 6]. The opinion also makes reference to *civil* liability for breach of confidentiality, 791 F.2d at 1028, 1033, 10a, 21a; but even accepting the questionable assumption that an employee would incur civil liability for disclosing a newspaper's publication schedule to a non–competitor, the relevant point is that the state legislature has chosen to protect criminally only a narrow area, not including the information here disclosed. Thus do the lower courts' decisions override the state legislature's determination.

81. According to the Journal, workrules restricting a reporter's trading of securities are the exception rather than the rule. *See Media Policies Vary on Preventing Employees and Others from Profiting on Knowledge of Future Business Stories*, Wall Street J., March 2, 1984 (Exh. WSJ-9; App. 35).

82. 612 F. Supp. at 831; 38a; *see United States v. Frade*, 709 F.2d 1387, 1392 (11th Cir. 1983) ("The finding that a defendant is aware that his conduct is generally unlawful is insufficient to sustain a finding of guilt under a statute requiring specific intent").

83. *See Ballard*, 663 F.2d at 543 (reversing conviction of mail fraud, conspiracy and aiding and abetting when there was no evidence that defendants knew of the duty owed by codefendant principal).

The decision below thus gives every employer the power to decide what acts are indictable as felonies and usurps a role heretofore reserved to the legislature.[84] Moreover, the practical effect of criminalizing every workrule breach is to give prosecutors almost total discretion in determining, after the fact, what conduct constitutes a crime and who should be criminally prosecuted.[85]

This Court has noted that the phrase "breach of fiduciary duty" "only begins an analysis" rather than provides guidance or certainty.[86] Yet, the decisions below and their immediate precedents effectively "read the [mail and] wire fraud statute[s] to embody a federal law of fiduciary obligations, including an undefined duty of yet further disclosure, enforceable by the sanctions of criminal law."[87] The Second Circuit's decision does not limit the power to criminalize private rules to breaches of employer workrules, but creates a federal felony wherever there may be said to be a "breach of fiduciary duty." This should no more be permitted under the mail and wire fraud statutes than under the comparable language of the securities fraud statutes.[88]

84. Under the Second Circuit's analysis, it is irrelevant that the "private policy" elevated to the status of criminal law purports to govern conduct involving the purchase and sale of securities, which is the subject of thorough Congressional scrutiny and a detailed statutory scheme, including the Securities Act, the Exchange Act, and the Investment Advisors Act. Even if the specific conduct proscribed by private company policy had been considered by Congress and deemed lawful, violation of the policy — if it involved the requisite wire or mailing — would be a federal wire or mail fraud. *Cf. United States v. Henderson*, 386 F. Supp. 1048, 1053–54 (S.D.N.Y. 1974) (Weinfeld, J.).

85. *See* Jeffries, *supra* note 58, at 190–201.

86. *SEC v. Chenery Corp.*, 318 U.S. 80, 85–86 (1943) (Frankfurter, J.) *See also Bronston*, 658 F.2d at 931 (Van Graafeiland, J., dissenting). The difficulties faced by the district courts in discerning the new criminal reach of "fiduciary duty" are made forcefully apparent in *United States v. Reed*, 601 F. Supp. 685 (S.D.N.Y.) (mail fraud indictment of son for alleged breach of fiduciary duty to father), *rev'd on other grounds*, 773 F.2d 477 (2d Cir. 1985).

87. *Siegel*, 717 F.2d at 24 (Winter, J., dissenting). *See also Margiotta*, 688 F.2d at 124 (dictum).

88. *See Chiarella*, 445 U.S. at 234–35.

By criminalizing every fiduciary breach, the lower courts' decisions work a vast interference with state laws defining the boundaries of employer–employee relations. As Professor Coffee has stated:

> [B]efore one accepts the equation that a knowing fiduciary breach equals a "scheme to defraud," some troubling consequences of this proposition need to be considered. [These include, among others, that]: . . . significant differences exist among state jurisdictions in terms of the duties that fiduciaries owe, thereby possibly creating significant disparities in the coverage of federal criminal law depending on the applicable state civil law; . . . if the result of the criminalization of fiduciary breaches is also their federalization, this conflicts with the principle of deference to state corporate law which recent Supreme Court decisions have established; . . . [and] the "internal affairs" rule of corporate law under which the law of the jurisdiction of incorporation controls as to all intra–corporate disputes seems irreconcilable with the policies underlying the traditional criminal law rule that one jurisdiction will not enforce the penal statutes of another.[89]

No clear mandate of Congress authorized this unbridled exercise of judicial discretion, overcriminalization of ordinary workrule breaches, and interference with state fiduciary requirements. Rather, they arose through a progression of expansive interpretations by courts bent on punishing not just those who have committed fraud in the traditional sense, but also those who simply "fail to match the reflection of moral uprightness, of fundamental honesty, fair play and right dealing in the general and business life of members of society."[90] Such

89. *From Tort to Crime*, *supra* note 58, at 150.

90. This is the standard of "fraud" under the mail and wire fraud statutes set forth in *Blachly v. United States*, 380 F.2d 665, 671 (5th Cir. 1967),

judicial overextension makes a mockery of this Court's recent reminder in *Dowling* that:

> Due respect for the prerogatives of Congress in defining federal crimes prompts restraint in this area, where we typically find a "narrow interpretation" appropriate. *See Williams v. United States*, 458 U.S. 279, 290 (1982). Chief Justice Marshall early observed: "The rule that penal laws are to be construed strictly, is perhaps not much less old than construction itself. It is founded on the tenderness of the law for the rights of individuals; and on the plain principle that the power of punishment is vested in the legislative, not in the judicial department. It is the legislature, not the Court, which is to define a crime, and ordain its punishment." *United States v. Wiltberger*, 5 Wheat. 76, 95, 5 L.Ed. 37 (1820).[91]

B. Intangible Injuries

Dowling also instructs that "when assessing the reach of a federal criminal statute, we must pay close heed to language, legislative history, and purpose in order strictly to determine the scope of the conduct the enactment forbids."[92] The language, history and purpose of the mail and wire fraud statutes strongly suggest that Congress intended that they extend only to those fraudulent schemes that inflict pecuniary or property injury.[93] When the mail fraud statute was enacted in 1872, it embodied a notion of fraud defined at common law to cover only the obtaining of money or property by affirmatively false statements of

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and subsequently adopted in numerous other mail and wire fraud cases. *E.g.*, *Bohonus*, 628 F.2d at 1171; *Keane*, 522 F.2d at 545; *United States v. States*, 488 F.2d at 764; *Gregory v. United States*, 253 F.2d 104, 109 (5th Cir. 1958).

91. *Dowling*, 105 S. Ct. at 3132.

92. *Id.* at 3131–32.

93. *See United States v. Regent Office Supply Co.*, 421 F.2d 1174,

existing facts.[94] Twice since then this Court has had occasion to caution against extending the statute beyond "pecuniary or property injury inflicted by a scheme to use the mails for the purpose."[95]

Nevertheless, a series of lower court decisions, as yet unreviewed by this Court, has permitted the substitution of intangible injuries for the tangible or economic injuries contemplated by the statute. Thus, as noted, the statutory requirement of a scheme to defraud has been held to be satisfied by a scheme to deprive a person of such intangibles as "time," "effort," and "expectations."[96] Likewise, the requirement of a specific intent to inflict harm[97] has been held to be satisfied by an intent to injure such intangible interests as "honesty," "loyalty," and "privacy."[98]

The instant decision extends this line of cases to new extremes by invoking no less than three different kinds of intangibles to satisfy various elements of the mail and wire fraud statutes. First, the courts below held that the statutory requirement of obtaining money and property was satisfied by Winans' obtaining of information, specifically the publication schedule of

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94. So narrow was the statute that it required a decision of this Court, *Durland v. United States*, 161 U.S. 306 (1896), and an amendment by Congress, Act of March 4, 1909, ch. 321, § 215, 35 Stat. 1130, to make clear that the statute also reached the obtaining of money or property by false pretenses, representations, or promises as to the future. *See Comment*, 47 U. Chi. L. Rev., *supra* note 58, at 578; Rakoff, *The Federal Mail Fraud Statute (Part I)*, 18 Duq. L. Rev. 771, 811, 816 (1980); Pearce, *Theft by False Promises*, 101 U. Pa. L. Rev. 967, 980 (1953). *See also United States v. Frankel*, 721 F.2d 917, 919–20 (3d Cir. 1983).

95. *Fasulo v. United States*, 272 U.S. 620, 628–29 (1926); *Hammerschmidt v. United States*, 265 U.S. 182, 189 (1924). *See also Ballard*, 663 F.2d at 534; *United States v. Curry*, 681 F.2d 406, 418 (5th Cir. 1982) (Garwood, J., concurring); *United States v. Caldwell*, 544 F.2d 691, 697 (4th Cir. 1976) (Widener, J., dissenting).

96. *Condolon*, 600 F.2d at 9.

97. *Regent Office Supply*, 421 F.2d at 1180–82; *Dixon*, 536 F.2d at 1399 n.11.

98. *Curry*, 681 F.2d at 410; *Bohonus*, 628 F.2d at 1172; *Keane*, 522

Heard columns. The courts below analogized this to the theft of commercially valuable information;[99] but the analogy is flawed. Here, unlike in other cases cited by the lower courts, use of the information in question did not detract from the economic value of the information to the person from whom it was supposedly being misappropriated, the Journal.

Second, as already noted, the lower courts held that the element of deception necessary to make the misappropriation of information a fraud was satisfied by Winans' breach of his duty of "honest and faithful service" to the Journal, in the form of his undisclosed breach of the confidentiality policy.[100] This, of course, is the necessary complement to the "fiduciary breach" theory of mail fraud: it is only because these courts have held an employer's "intangible right" to his employee's "full faith and loyalty" to be a protected interest under the mail and wire fraud statutes that an employee's breach of this "fiduciary" duty of loyalty can even arguably be said to state an injury, and the nondisclosure of the breach a deception, under these statutes. As summarized by Professor Coffee:

> Critical to this doctrine's significance is its assertion that the nondisclosure of a conflict of interest by a person characterizable as a fiduciary can amount to a deprivation of the "honest and faithful services" owed by the fiduciary to the beneficiary. As a practical matter, the operative effect of this disclosure requirement is to simplify the prosecutor's case by substituting proof of nondisclosure for proof of loss or illicit gain. At the same time, the protean character of the term "fiduciary" has enabled the prosecutor to reach areas that Congress never contemplated would be subject to federal criminal sanctions.[101]

99. 791 F.2d at 1034; 23a.

100. 612 F. Supp. at 844 n.13; 62a n.13.

Third and finally, while the prosecution was unable to firmly establish that Winans' breaches caused any harm, economic or otherwise, to the Journal,[102] the lower courts held that the requirement that the defendant contemplate actual harm to his victim[103] was satisfied here by the fact that Winans' leaks and trading placed the Journal's "reputation for professionalism" in potential jeopardy.[104] As one commentator has noted, "this is a strange sort of harm, for it occurs only if the scheme is discovered."[105] Nor is it easily squared with this Court's earlier rejection of blackmail as a basis for mail fraud prosecution and its insistence on tangible economic injury.[106] Moreover, it must be recalled that the Journal never even apprised its readers of the existence of its policy prior to the Winans incident[107] and, accordingly, had never invited readership reliance on any such policy or public expectation that such a policy was in place. It simply makes no sense to posit that the Journal might have suffered a lowering of public esteem for one reporter's failure to comply with a policy which the public did not know about and had no reason to believe existed, and which the law did not require the company itself to follow.

Aside from the total absence of any finding or evidence that petitioners intended reputational harm,[108] the simple truth is that if a concept as loose as "reputation for professionalism" can satisfy the harm requirement of the mail and wire fraud statutes, then the requirement has effectively been eliminated *sub silentio*. Such a doctrine sweeps within the ambit of the mail and wire fraud statutes entire areas of minor wrongs and peccadilloes that have never been held to warrant the invocation

102. 612 F. Supp. at 845; 63a–64a.

103. *See, e.g.*, ***Regent Office Supply***, 421 F.2d at 1180–82.

104. 791 F.2d at 1035; 24a.

105. Langevoort, *The Insider Trading Sanctions Act of 1984 and Its Effect on Existing Law*, 1985 Sec. L. Rev. 187, 210 n.113.

106. *Fasulo*, 272 U.S. at 628–29; ***Hammerschmidt***, 265 U.S. at 189.

107. T. 115–16, 159; Exh. WSJ-9; App. 35.

108. Instead of finding actual harm or intent to harm, the district court merely *presumed* harm from the alleged fiduciary breach itself. 612 F. Supp. at 845–46; 64a–65a.

of criminal sanctions in any jurisdiction, let alone classification as a federal felony. In fact, the sole interest protected by this prosecution — a newspaper's reputation[109] — is not the kind of interest that has historically been held to warrant the invocation of society's severest sanction, criminal penalties. Just as "[h]arm to reputation . . . never has been recognized as a proper subject for redress under section 10(b) or rule 10b–5,"[110] so too it has never before been recognized as a proper subject for redress under the mail or wire fraud statutes.[111]

In short, a view that certain kinds of corrupt schemes by public officials can defraud the public of "intangible" but publicly–defined rights[112] has now expanded, well beyond the limits of its logic,[113] to where the vaguest kinds of interests and injuries can satisfy both the objective and subjective elements of criminal fraud.[114] The result, in the words of one commentator, "has been both to extend the net of the federal criminal sanction over an extraordinarily vast terrain and to arm the federal prosecutor with a weapon substantially different in character from any previously known to the substantive criminal law."[115]

C. Incidental Mailings and Wirings

Not content with eliminating the last vestiges of the former mail fraud requirements of actual deception (see subsection A, *supra*) and economic injury (see subsection B, *supra*), the lower courts' decisions proceed to eliminate the requirement that the requisite mailings and wirings be in some sense caused by the defendants for the purpose of executing their fraudulent scheme. Indeed, the charged mailings and wirings — involving the printing of the Journal and its subsequent distribution — were entirely irrelevant to, and unaffected by, a "fraud" effected by pre–publication leaking and trading.

In holding that the mailings and wirings in this case were adequate because they were "important" to the success of the scheme and were "reasonably foreseeable" by the petitioners,[116] the lower courts' decisions ignored not only the relevant precedents of this Court[117] but also the statutory language itself, which requires that the petitioners "cause" the mailings or interstate wirings "for the purpose of executing" their fraudulent scheme. Winans' job was to write accurate columns for the Journal, which, along with the rest of the paper's text, were then conveyed by interstate wire communication (the predicate wirings) to the printing plant, from which the paper was distributed, partly by mail (the predicate mailings), to its

109. 612 F. Supp. at 845; 64a.

110. 791 F.2d at 1037; 29a (Miner, J., dissenting).

111. In so stating, the dissent necessarily discounted the "sullying of reputation" language in *Newman*, 664 F.2d at 17, as pure dictum; but, in any event, this aspect of the *Newman* decision suffers from many of the same infirmities as the decision here. *Cf. Langevoort*, *supra* note 105, at 210 (suggesting that *Newman* comes close to eliminating the "deception" element of fraud required by this Court in *Santa Fe*, and that Second Circuit cases following *Newman* eliminate this requirement altogether, almost without analysis).

112. *See, e.g.*, *Margiotta*, 688 F.2d at 121; *Isaacs*, 493 F.2d at 1150; *United States v. States*, 488 F.2d at 765; *Shushan v. United States*, 117 F.2d 110, 115 (5th Cir.), *cert. denied*, 313 U.S. 574 (1941). *Cf. Dixon*, 536 F.2d at 1400–01; *Aczel v. United States*, 232 F. 652 (7th Cir. 1916). The all-encompassing scope of "scheme to defraud" in cases involving corruption of state and municipal officials developed under the influence of the corresponding statute applicable to federal officials, now codified at 18 U.S.C. § 371 (1982), which proscribes conspiracy to defraud the United States. *See Haas v. Henkel*, 216 U.S. 462, 479 (1910), which provided "the most extreme expansion of the statute." Goldstein, *Conspiracy to Defraud the United States*, 68 Yale L.J. 405, 426 (1959).

113. *Cf. United States v. Borelli*, 336 F.2d 376, 380 (2d Cir. 1964) (Friendly, J.) ("the instant case . . . exemplifies, in Judge Cardozo's phrase, the 'tendency of a principle to expand itself to the limit of its logic' . . . and perhaps beyond"), *cert. denied sub nom. Cinquegrano v.*

114. Indeed, one major reason for the overexpansion of the mail and wire fraud statutes is that it has occurred piecemeal, with one panel building ever further on an earlier panel's decision without stepping back to examine the overall effect of the progression.

115. *The Metastasis of Mail Fraud*, *supra* note 58, at 1.

116. 791 F.2d at 1035; 24a–25a.

117. *United States v. Maze*, 414 U.S. 395, 400–05 (1974); *Parr v. United States*, 363 U.S. 370, 389–94 (1960); *Kann v. United States*, 323 U.S. 88, 94–95 (1944). *See also United States v. Lane*, 106 S. Ct. 725, 733–34 (1986)

subscribers. The alleged fraud did not change any of this one iota. Neither the timing nor the accuracy of the columns was affected; the wire transmission in form and content was exactly what it would have been in the absence of Winans' breach of the Journal's workrules. Nor were the mailings even directed to the alleged victim of fraud, the Wall Street Journal; indeed, on the theory of this prosecution, the "fraud" — consisting of Winans' unauthorized use of the Journal's publication schedule — was entirely completed before any relevant mailing or interstate wiring occurred.[118]

To be sure, the petitioners took advantage of the fact that Winans' columns would be printed and distributed to realize certain financial benefits from their arrangement.[119] But to equate this with the statutory requirement that they "cause" the mailings and wirings "for the purpose" of executing their scheme is to deprive the statutory words of their ordinary meaning, both individually, and, more importantly, in relation to one another. In no linguistically recognized or legal sense did the petitioners "cause" these mailings and wirings "for the purpose" of furthering their scheme. While the substitute terminology relied on by the lower courts, that the mailings and wirings were "important" and "reasonably foreseeable," may sometimes substitute for "cause" in the context of determining general proximate causality, they cannot reasonably substitute for "causing–for–a–purpose." In the words of the Eighth Circuit:

> "We reiterate that in order to obtain a conviction under § 1341, the government must prove beyond a reasonable doubt that the defendant intentionally devised a fraudulent scheme and caused the use of the mails *for the purpose of carrying out the scheme*. We trust that these requirements will serve as a restraint on whatever tendency the government might have to prosecute anyone who ever bounced a check."[120]

To be sure, the Second Circuit is not alone in watering down this statutory mandate of purposeful causality. But this Court has always stood fast by the statutory language. As Judge Posner, in dissent, recently stated:

> The distinction between mailing a letter to execute a fraud and merely taking advantage of a criminal opportunity created by a letter sent for a lawful purpose is at the heart of *Parr v. United States*, 363 U.S. 370 (1960) . . . .
>
> * * *
>
> Missing from both *Parr* and this case is a causal connection between the purpose and the mailings; the mailings would have occurred anyway. This point has been a ground of decision in other cases

118. This fact is evidenced most graphically by the government's contention that Winans' "fraud" occurred when he "leaked" information to Brant, and that an actual securities transaction was not required under its mail and wire fraud theory. Accordingly, Counts 43 and 61 of the indictment, involving Winans' prepublication disclosure of articles about Quotron (GX 30) and Chicago Milwaukee (GX 36), were upheld in the face of Fed. R. Crim. P. 29 motions to dismiss, notwithstanding the fact that no corresponding securities transactions were effected pursuant to the Winans/Brant/Felis arrangement (T. 1686–91; 1695–1703).

119. Almost every radio and television station in the country transmits interstate. Many, if not most, newspapers and magazines are mailed. Under the government's theory, if consistently applied, reporting of true, accurate and non–misleading information becomes a criminal fraud if assisted by a journalist or editor whose undisclosed self–interest (political, emotional, or economic) in the subject matter of the report — though it does not affect the accuracy of his reporting — could be a source of embarrassment to his employer. If such a rule is to become the law, this should be done only after the most careful and deliberate consideration by the Congress, and the adoption of specific guidelines and regulations which circumscribe and delimit the conduct sought to be proscribed in light of the chilling impact certain to emerge. It should not arise through a case–by–case development of federal

120. *United States v. Taylor*, 789 F.2d 618, 623 (8th Cir. 1986) (emphasis in original) (quoting *United States v. Freitag*, 768 F.2d 240, 244 (8th Cir. 1985)). *See also United States v. Castile*, 795 F.2d 1273 (6th Cir. 1986); *Curry*, 681 F.2d at 411–13; *United States v. Tarnopol*, 561 F.2d 466

> besides *Parr* — showing that *Parr* is not some legal sport that we are free to ignore because the other courts of appeals have ignored it. See *United States v. Curry*, 681 F.2d 406, 412 (5th Cir. 1982); *United States v. Boyd*, 606 F.2d 792, 794 (8th Cir. 1979) (alternative holding); *cf. United States v. Brown*, 540 F.2d 364, 377 (8th Cir. 1976).[121]

By permitting incidental mailings and wirings to substitute for the statutory requirements, the effect of the lower courts' opinions is not only to trivialize the sole basis for federal criminal jurisdiction over what is traditionally state-regulated activity, but also to trivialize the sole overt conduct required under the mail fraud and wire fraud schema. When coupled with the elimination of the other elements, as detailed above, the result is to make mail fraud and wire fraud inchoate crimes, in derogation of the fundamental principle that criminal law may not punish intent alone.[122]

On every score, then, this decision marks the furthest extension to date of the recent "limitless" expansion of the mail and wire fraud statutes. It is time for this Court to set reasonable limits by construing the statute as its own plain language, legislative history and manifest purpose dictate.

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121. *Green*, 786 F.2d at 256–58 (Posner, J., dissenting). The majority in *Green* similarly believed that *Parr* "may require proof that [the predicate] mailings were used with specific intent to defraud the recipients of the mail," but found that such proof had been adduced in *Green*. *Id.* at 250. No such proof was adduced here, however; nor could it be.

122. *The Metastasis of Mail Fraud*, *supra* note 58, at 10–13; *Rakoff*,

CONCLUSION

For the above reasons, the judgment of the Court of Appeals for the Second Circuit should be reversed with instructions to dismiss the indictment.

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Respectfully submitted,

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