ORIGINAL

In the

Supreme Court of the United States

VINCENT F. CHIARELIA,

PETITIONER

V.

UNITED STATES,

RESPONDENT.

No. 78-1202

Washington, D. C.
November 5, 1979

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IN THE SUPREME COURT OF THE UNITED STATES

VINCENT F. CHIARELLA, Petitioner, v. UNITED STATES, Respondent.	No. 78-1202

Washington, D. C.,

Monday, November 5, 1979.

The above-entitled matter came on for oral argument at 1:58 o'clock p.m.

BEFORE:

WARREN E. BURGER, Chief Justice of the United States
WILLIAM J. BRENNAN, JR., Associate Justice
POTTER STEWART, Associate Justice
BYRON R. WHITE, Associate Justice
THURGOOD MARSHALL, Associate Justice
HARRY A. BLACKMUN, Associate Justice
LEWIS F. POWELL, JR., Associate Justice
WILLIAM H. REHNQUIST, Associate Justice
JOHN PAUL STEVENS, Associate Justice

APPEARANCES:

STANLEY S. ARKIN, ESQ., Arking & Arisohn, 600 Third Avenue, New York, New York 10016; on behalf of the Petitioner

STEPHEN M. SHAPIRO, ESQ., Office of the Solicitor General, Department of Washington, D. C.; on behalf of the Respondent

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C O N T E N T S

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P R O C E E D I N G S

MR. CHIEF JUSTICE BURGER: We will hear arguments next in 78-1202, Chiarella v. United States.

Mr. Arkin, I think you may proceed whenever you are ready.

ORAL ARGUMENT OF STANLEY S. ARKIN, ESQ.,

ON BEHALF OF THE PETITIONER

MR. ARKIN: Mr. Chief Justice, and may it please the Court:

This matter is on certiorari to the Second Circuit. It concerns the scope of section 10(b) of the 1934 Securities Exchange Act and, more particularly, whether it is a violation, a criminal violation of that statute for a purchaser of stock who is not an "insider" and had no fiduciary relation to a prospective seller to purchase that stock without revealing that he had obtained information from a source thoroughly outside the issuer corporation, that is, not inside information but outside information created by the outside source.

Mr. Chiarella, the petitioner, was employed in 1975 and 1976 as a mark-up man in Pandick Press, which is a financial printing house in downtown New York, and while there he came upon and in possession of information from customers of Pandick with respect to their intention to tender through other corporations, and using that information which he obtained from the customers in his capacity as a mark-up man, he

went into the open market and he purchased shares of stock in the target corporations. He didn't tell anyone he was doing that; he just did it.

The issue in this case is whether he had any relationship with the seller of the shares, which would have mandated that he make a disclosure, or whether pure nondisclosure where there is no fiduciary or other special relationship amounts to a violation of 10(b).

QUESTION: Well, you said no special relationship. What if an author has written a book and he takes it to a printer to have it printed, and at this stage there's no problem about copyright. Do you think there is a special relationship between the printer and the author to take no step that would jeopardize his copyright standing?

MR. ARKIN: I would agree that there is a relationship between the author and the printer, who is an agent of his principal, the printer, but there the remedy would not be something which is analagous to section 10(b). It would be a state remedy which I think would be most appropriate here.

QUESTION: By this statute, but you said no special relationship. My question was directed at only your statement that there is no special relationship between the customer and the printer.

MR. ARKIN: No special relationship between the seller of the stock in the open market and the printer. There

is a relationship of sorts, special, between Mr. Chiarella here, the printer, and the customers of Pandick. But that is not at issue, I say, here, though I will deal with that in a moment, because the Solicitor General seems to suggest it may have some point.

The statute prohibits the employment of any deceptive or manipulative device or contrivance in violation of particular rules which are promulgated by the SEC. Simply put, there has been no deception, no manipulation here within that statute. This is a case of no more than a breach, if you will, of some kind of state fiduciary duty which Mr. Chiarella may have owed the customers of Pandick.

If you look at the history of this particular litigation, you will see a remarkable effort on the part of the District Court and then the Circuit Court and now the Solicitor General to formulate an entirely new theory of relationship in order to impose 10(b) liability on Mr. Chiarella. In the District Court you had a simple, straightforward classic insider analysis used.

QUESTION: Incidentally, where does the concept "insider" come from? Is there a specific rule under 10(b) dealing with insiders?

MR. ARKIN: No, the only rule that Congress has ever enacted, Justice Rehnquist, which deals with insiders, insofar as trading, is Rule 16(b), which mandates that an insider,

which is defined in the statute as an officer or director or majority -- not majority, but control shareholder -- of a corporation is proscribed from trading, purchasing or selling, or selling or purchasing --

QUESTION: Was your client charged with a violation of the rule under 16?

MR. ARKIN: No, he was not. He was charged with a violation of Section 10(b).

QUESTION: Well then, it really doesn't make much difference whether he's an insider or not, does it?

MR. ARKIN: Well, as I think --

QUESTION: The case law.

MR. ARKIN: The case law also --

QUESTION: From the Second Circuit.

MR. ARKIN: From the Second Circuit, yes. I would say that in this particular case, assuming that Texas Gulf Sulphur and its progeny, or Cady, Roberts and its progeny are correct, that it would make all the difference in the world, because my client did not have any statutory or common law fiduciary duty to any of the shareholders in the corporation the stock of which he purchased. So it does make a difference for that reason.

QUESTION: And Texas Gulf Sulphur is a Second Circuit case?

MR. ARKIN: Yes, Your Honor, it is indeed a Second

Circuit case. It was the landmark case as of that time when insider trade --

QUESTION: In the Second Circuit?

MR. ARKIN: In the Second Circuit, in that circuit alone. But if you look at what took place in the trial court, the imposition of the classic insider duty and it was sorely inappropriate and it was imposed on the theory that he had no legitimate business purpose in his trade, that is, Chiarella didn't, whereas the tender offer corporations whom he sought to identify himself with had some legitimate economic purpose. Interestingly, this theory was rejected at the circuit level and an entirely new effort to push this conduct into 10(b) was formulated which has been referred to as the market insider rule, that is, the Second Circuit rule that since Mr. Chiarella was employed in a printing house which had access to financial information on a regular basis, that that regular receipt of information somehow put him into a particular category of status requiring him to disclose or abstain, as the case may be, and of course somebody in that position would really, if the Court of Appeals were correct, have a duty to abstain, and disclosure would not be something which would be relevant or work at all.

That particular test formulated by the Second Circuit was entirely new, expansive, novel approach to section 10(b), was rejected in a footnote by the Solicitor General on the

ground that it was insufficiently discreet, that is, that rule would encompass the activities of market professionals and others who perform a worthy market function and that accordingly that rule wouldn't obtain, and an entirely new rule or rules, again an effort to push this conduct into a particular box, was formulated.

The theory which the Solicitor General now advances in its effort to demonstrate some relationship Chiarella had is that by somehow reaching a duty, committing some kind of tort, vis-a-vis the tender offeror, the customer of Pandick, that that, as if it were a contageous disease, was carried over into the transaction between Mr. Chiarella and the purchaser on the open market; and then, secondly, on the other hand that somehow Mr. Chiarella by virtue of having this superior information which he obtained in a -- and I am quoting the Solicitor General -- "a torteous manner," that that itself created a direct duty by Mr. Chiarella to the purchaser.

Neither one of those theories wash. Neither one of them should stand up to analysis. They simply totally obviate prior law under section 10(b) and the common law.

With respect to whether or not there is any relevance as to whether Mr. Chiarella did anything to the tender offeror, the customer, of course that wasn't charged in this case. The case was not indicted that way, it wasn't tried on that theory,

it wasn't charged to the jury on that theory, so that is an entirely novel and new approach. But aside from the fact that it is not in the case except at the appellate level, really, there would have been no duty of Chiarella here because it is a tender -- not the tender offeror, it is the customer, the seller of the stock which 10(b) is directed at, aimed at, and there was no relationship of Chiarella to that person. And so what happened vis-a-vis the tender offeror we say is not relevant at all. Moreover, there was really no fraud there. At most, I think you could say there was an unauthorized use of information and I would suggest that not all fiducial breaches, not all unauthorized conduct --

QUESTION: Well, his conduct certainly wasn't very appealing to a person of ordinary moral standards. That doesn't necessarily mean it is criminal.

MR. ARKIN: Well, not very appealing but that is most respectfully, Mr. Justice Rehnquist, hardly a standard to bring within a statute enacted by Congress. No, it was not but it was a kind of conduct which should appropriately be dealt with by the state with a vast body of state law. He could have been sued in conversion, he could have been fired, as it was, sued for breach of contract, or possibly sued under a theory of unlawful acquisition of a corporate opportunity. But it certainly wasn't within 10(b) and, of course, not all unappealing conduct or undesirable conduct is within the

common law or statutory meanings of fraud or manipulation.

QUESTION: In your opinion, was it criminal under state law?

MR. ARKIN: Mr. Justice Blackmun, under New York state law I don't believe it was, but there are statutes in other states in this country which would seem to proscribe what is called industrial espionage, that is taking a secret of an employer and using it for your own benefit, and so possibly in some states it might be deemed criminal, but not in New York to my knowledge.

QUESTION: You feel fairly certain about that in New York?

MR. ARKIN: I don't know, but I believe so. We have checked the statutes on that and could find no statute which would make his conduct criminal. I suppose that one might attempt to fashion some kind of unlawful taking from what Mr. Chiarella did, but our analysis of the statutes is such that that couldn't be done, but to be fair we thought about that.

Insofar as Mr. Chiarella's relationship to the seller himself, of course there was no privity between the two of them. Mr. Chiarella classically made no misrepresentation. He didn't say a half truth. He had no duty to that seller. He had no reason, if you will, to have made a disclosure. There is no rule of law that says he must.

Now, the Solicitor General does cite an ancient -- perhaps not so ancient, but 1870 English case, the Omphrey case, which is a sport among the vast body of common law and a needle in a haystack type case, but a proposition that somehow the superior information was tortiously acquired, it is unfair for a seller to deal with the buyer without making that disclosure.

Aside fom its sporting nature, the Omphrey case is hardly applicable here in that the tort was afflicted upon the seller in that case, which dealt with a sale of land and the fact that there was coal under the land, unknown to the seller, and there was a trespass committed onto the land affecting the seller by the buyer, not at all apposite.

The background of section 10(b) and its administrative and judicial history --

QUESTION: Mr. Arkin, why isn't the case apposite? You just said it wasn't, but I didn't quite understand your reasoning why the case wasn't apposite. Why isn't that case like this?

MR. ARKIN: Well, because there there was conduct which was directed at the seller, Mr. Justice Stevens. There the buyerhad gone onto the land and he had --

QUESTION: You mean the trespass itself was a tort against the seller?

MR. ARKIN: The trespass itself, and I suspect what

would happen there in the English court is that in those days when trespass meant somewhat more than it may today, it felt that that was something which was a fundamental wrong to the buyer and so they imported or created for that particular case that kind of duty. To our knowledge, the case, aside from perhaps a Law Review article or two, has not been used since. I thought it was fair to bring it up. It was in the Solicitor General's brief.

But if you look at the history of this statute, how it originated and administratively and judicially how it has been administered by the SEC, I think you find little or no basis -- I shouldn't say little or no, it is giving away too much -- you find no basis at all for suggestint that the conduct at issue here is within the statute. To the contrary, I would say that what we have to show, it shows it is very far outside the ambit of the statute.

QUESTION: Suppose a judge trying a case in the trial court knows that economic consequences are going to have a great impact on the market. Assume (a) he has some stock in the company and the impact is going to be to push the market down, so he sells and then alternatively assume it is going to go up as a result of his holding and he goes out to the bank and borrows some money and buys a lot of the stock, just the way this fellow did here.

MR. ARKIN: No, I would suggest, Your Honor, it is

not what this fellow did because --

QUESTION: No, I don't mean --

MR. ARKIN: No, no, not even abstracting, not even in principle because the individual in the hypothetical Your Honor gives, is somebody who in effect does something to the sellers or buyers of shares in the market. What he does, having, as a judge does, I would say a fiduciary obligation to the public as a whole --

QUESTION: Well, I am assuming for the purposes of my question that what he does is the correct, not a corrupt decision but a correct decision, but he just takes advantage of the knowledge that he has acquired about the economic consequences.

MR. ARKIN: I would say a judge is a special person having a special relationship to the public as a whole not to make use of his judicial knowledge or decisions from his own --

QUESTION: How about his secretary?

MR. ARKIN: I would say his secretary would stand in his shoes, but --

QUESTION: The bailiff of the court?

MR. ARKIN: It becomes more difficult, the more remote you become. But I would suggest that much is in the typical or standard insider case, if you follow the source of the information. In this particular case, with the judge, I

would say he had some kind of an obligation overall to the community at-large not to self-deal.

Now, let me suggest to you that there is still in my mind some difficulty in applying section 10(b). I don't know whether the kind of duty which the judge has which may flow from common law notions of what a judge should do and shouldn't do, and up to the present time when we have specific rules regulating judicial conduct while on the bench in terms of what kind of stock you can own and not own and how you sell and buy, I don't know whether that would fit within section 10(b).

The fact that it is something which may not, to get to the point of your hypothetical, appear entirely cricket is not what we are talking about here. We are talking about whether or not conduct falls within a statutory mandate of is it manipulative or deceptive, is it a manipulative or deceptive device. Now, I say that you don't have anything like that here. The hypothetical Your Honor suggests is one which has certain equities in it and the question is whether it was in the statute, but I don't suggest that that is the same at all as our case because there is a different status between Chiarella and a judge. Chiarella has no general duty to the public. At most, his duty here would be directed toward his employer and possibly through that to the -- well, not possibly but most certainly through that to the employer's

customer.

QUESTION: What did the government rely on, Mr. Arkin, to show that an instrumentality of interstate commerce had been used in this transaction?

MR. ARKIN: The mail.

QUESTION: That the offer was made by mail?

MR. ARKIN: Well, no, the fact that the confirmation slips of the particular -- the indictment lists 17 counts in the common ways of U.S. Attorneys in the Southern District, the number of counts was 17 based upon five interceptions of information and each one was a separate mailing.

QUESTION: From Mr. Chiarella? I --

MR. ARKIN: Well, from the broker to Chiarella, that is the confirmation slip on the purchase of stock. Those were the means.

Legislatively this statute, section 10(b), was originally introduced as part of 9(c) of the '34 act, and the idea there was -- if you look at the statute as originally constituted before it was lifted out of 9(c) and passed in and of itself by Congress, was to stop manipulation, that is something which artificially affected the price of stocks. It had nothing to do with the kind of fact pattern of a situation we have here because certainly whatever Mr. Chiarella did did not artificially affect the price of stock on the market.

The only inside trading, the only trading on confidential information which Congress dealt with was 16(b) which we mentioned a moment ago.

QUESTION: Well, hypothetically if he had been able to borrow enough money and borrowed a million dollars and bought a million dollars worth of stock, it might have an affect on the market, wouldn't it?

MR. ARKIN: Not artificially, Your Honor. At most it would have shoved the price of stock in the right direction because the real value of the stock -- and that is the point of the case -- was the price at which a tender offeror was willing to tender, how much it was willing to pay. And when you talk about artificial prices, you are talking about pegging, rigging, scalping, and that kind of thing, where you go out and you put some phony information into the market and hope it goes down or goes up, as the case may be. Nothing like that occurred here. If anything, it moved in the right direction.

Administratively, too, this particular section has always been considered, almost always been considered by the SEC to deal with, in the category of inside information, special information, if somebody who had a fiduciary relationship to the seller of stock or some special relationship, fiduciary relationship to the issuer of stocks --

QUESTION: Mr. Arkin, supposing the tender offeror here had been the issuer, you could have an issuer wanting to

buy up a block of its own stock, would your case be different?

MR. ARKIN: That would be a Texas Gulf case. In Texas Gulf --

QUESTION: No, no. I am saying he is still a printer. He is still a printer, not an insider.

MR. ARKIN: He would be a tipee. He would be a tipee for the issuer corporation and as such, assuming that he knew that the information came --

QUESTION: The tipees there got it directly, didn't they, from the directors or officers?

MR. ARKIN: Yes, they got it from the issuing corporation.

QUESTION: And this man got it through his job at the print shop.

MR. ARKIN: But he got it from a source not the issuer. There is a fundamental distinction here. You see, the Texas Gulf case --

QUESTION: In other words, are you conceding -- let me be sure I don't lose this -- are you conceding that he would be liable if the client of the print shop had been the issuer?

MR. ARKIN: And he had purchased the issuer's share, I am conceding that under Texas Gulf Sulfur he would fit, yes, assuming he knew that the information came from the issuer.

QUESTION: But does the wrongfulness of his conduct

or the language of the statute draw any distinction at all between the kind of customer of the print shop? It is kind of a strange distinction.

MR. ARKIN: No, the statute itself is a very broad and generic one.

QUESTION: I understand.

MR. ARKIN: It is much like the mail fraud statute, and it doesn't even say that he would be guilty in the hypothetical which Your Honor tenders, but that was engrafted on the law in Texas Gulf -- actually before, in Katy Roberts --

QUESTION: Well, are you conceding that Texas Gulf Sulfur wasn't in all respects properly decided?

MR. ARKIN: Oh, no, I'm going to deal with that right now. I don't think that it would be appropriate for me to say it wasn't in all repsects proper. At least it is arguable in that Texas Gulf went back to funda ental common law fiduciary relationship between a corporate officer, director or control shareholder and shareholders, which has grown up in this country in the last forty or fifty years, perhaps most recently or more recently with the Transamerica case, or, said Texas Gulf Sulfur, you might have special circumstances, that is a special relationship between the seller of the shares and between the buyer of the shares, is a strong opinion which was a decision of this Court in 1907.

But the Court in Texas Gulf in the Second Circuit clearly adopted what is referred to in the common law as have been realready ruled, imposing some kind of fiduciary obligation upon a corporate personage, somebody who has some fiduciary relationship to the corporation and taken that particular minority rule and relationship and carried it into section 10(b). But with our case --

QUESTION: Who is the beneficiary of that, the entire investing public?

MR. ARKIN: The beneficiary of that, Your Honor, depending on what you are --

QUESTION: I am talking about the Texas Gulf Sulfur rule.

MR. ARKIN: In Texas Gulf Sulfur, the beneficiaries there directly, the parties protected -- the parties protected are the selling shareholders who have the right to expect, have a confidence in the officers, directors of their corporation.

QUESTION: So it is only the shareholders of the corporation of which the defendants are the insiders, is that it?

MR. ARKIN: YEs. In a broad sense you might say the public interest is protected because the public has an interest in seeing to it that things are done properly and according to law and that faithful allegiances are maintained. But the

protected category here under section 10(b) quite clearly would be the injured seller or in an appropriate case the injured buyer.

QUESTION: Suppose one of the officers of the corporation seeking to make the tender offer individually for his own account went and bought up some of the stock ahead of time.

MR. ARKIN: He would --

QUESTION: If he made a profit, perhaps his own company could recover it.

MR. ARKIN: Yes.

QUESTION: But how about the selling stockholder?

MR. ARKIN: I would think that the selling --

QUESTION: And he fails to disclose to them that there is about to be a tender offer.

MR. ARKIN: I would think the selling shareholder could recover on the ground that the selling shareholder could claim to be an injured party and that the officer of the issuing corporation --

QUESTION: And this would be true even though the tendering company itself may buy a limited amount of stock without disclosing anything?

MR. ARKIN: I think I missed your question, Your Honor. I don't think that the shareholders or the tender offeror would be able to --

QUESTION: The what?

MR. ARKIN: Or the offeree. You are talking about the offeree corporation?

QUESTION: I am talking about an officer of the company that is making the tender offer, the offeror.

MR. ARKIN: The offeror.

QUESTION: He knows about this pending offer --

MR. ARKIN: Yes.

QUESTION: -- and he goes to some of the stockholders of the target company and he buys it up for his own account. Has he defrauded those sellers?

MR. ARKIN: He has indeed. They are his shareholders under the --

QUESTION: Oh, no, they aren't his shareholders.

MR. ARKIN: The tender offeror -- excuse me, I am sorry, I was off on something else. The point is no, he would not have a duty to the offeree shareholders. He would not have any duty at all under section 10(b) --

QUESTION: Well, he wouldn't have any duty to disclose to them --

MR. ARKIN: No. He would have a duty only to his company, the tender offeror.

QUESTION: Yes, that is what I am asking.

MR. ARKIN: He woudln't --

QUESTION: He wouldn't have a duty to the tender

offerees' shareholders?

MR. ARKIN: No, he would not.

QUESTION: Now, if he would not, I suppose you would argue a fortiori that this printer's employee wouldn't?

MR. ARKIN: Yes, I would argue that, certainly so. He is a remote tipee.

QUESTION: Well, have there been some cases like that on an officer of the offeror trading in the shares for his own account?

MR. ARKIN: Not to my knowledge, not in the shares of the offeree corporation.

QUESTION: And I suppose under the law the offering corporation itself may acquire some of the shares?

MR. ARKIN: Under the law, under the Williams Act, and before the tender offeror -- under the Williams Act, the tender offeror can now acquire up to five percent without making a disclosure under the Williams Act.

QUESTION: And that is not thought to be a fraud on anybody?

MR. ARKIN: No. Indeed --

QUESTION: And how about before the Williams Act?

MR. ARKIN: In 1968, Judge Friendly, prior to the Williams Act being enacted, said that we know of no rule of law applicable at the time -- referring to prior to the Williams Act, which was about to be enacted -- that a purchaser

of stock, who was not an insider or had no fiduciary relationship to a prospective seller, had any obligation to reveal circumstances that might raise a seller's demand. So that as of 1968, it was very clear that there was no such obligation.

QUESTION: Yes, but under my brother White's question he is an insider of the offeror corporation, and he uses that inside information based on that inside information, i.e., of a forthcoming takeover attempt by his corporation, he goes to shareholders of the target corporation and buys their shares, and because of his inside information he has every reason to believe that the price of the shares is going to go up.

MR. ARKIN: That would undoubtedly be something which the offeror, tender offeror could claim against him in a suit for --

QUESTION: Well, assume he could, but could the selling stockholders of the offeree also get to him?

MR. ARKIN: No, no way. No way. There is no --

QUESTION: He is using inside information.

MR. ARKIN: Inside, not to the target corporation, not to the issuer. It is very different. He owes no duty, if you will, to the selling shareholder. Now, what you are doing is taking the category insider, which itself may not be the most accurate term or label, insider in one place and importing it to another place. We say --

QUESTION: Your insider is my outsider, in other words.

MR. ARKIN: Exactly right.

QUESTION: I suppose if the printer had breached his contract and just decided to publish, he is printing but he decides he is just going to -- it would be a hot item to announce to the press, so he just announces it. He probably might be liable in damages to the offeror, but he probably wouldn't have violated 10(b), would he?

MR. ARKIN: I think that is exactly right and I think a very fine hypothetical to test is what we are presenting to this Court here, and the point is that had Vincent Chiarella, for example, say, gone to the target company and said let me sell you some information you would like to have, why, that would not have the violation clearly of section 10(c), it would have been some kind of contractual or perhaps conversion breach.

QUESTION: The reason, of course, I suppose was it had not been in connection with the purchase or sale of a security, that would be -- but the thing that puzzles me a little bit, we seem to be coming to the conclusion that your client may have defrauded the customer of the printer, the tender offeror but not the person that he bought the stock from. But even if that conclusion is correct, why isn't it still true that he committed a fraud in connection with the

purchase or sale of a security?

MR. ARKIN: Because --

QUESTION: Even though the defrauded party is a different party than the person from whom he bought the security.

MR. ARKIN: Well, that is one of the themes of the Solicitor General and I suggest to you that in connection which means a fraud directed at the transaction, something which intended to visit injury upon the seller or purchaser of shares. That didn't take place here.

QUESTION: Do you think all -- it may be that blue ship and all the rest, but in essence does it hold that the wrongdoer must defraud the other party to a transaction? There are a lot of 10(b) cases that don't fit that mold, aren't there? Maybe I'm wrong. I just --

MR. ARKIN: There are 10(b) cases which may, depending on the standing issue, come up with somewhat different way, but basically all of the cases involved have to do with imposing a sanction upon somebody who is directing his fraud, his misconduct toward the purchase or buyer of shares.

QUESTION: What about (c), subparagraph (c), which reads "to engage in any act, practice which operates or would operate as a fraud or deceit upon any person." It doesn't limit it to any particular person, but in connection with the purchase or sale of any security. Now, he has engaged in the purchase or sale of a security, hasn't he?

MR. ARKIN: Yes, but his conduct was not directed at the seller in this particular case.

QUESTION: Is there anything in that langauge that says it must be directed at the seller?

MR. ARKIN: Well, this Court, if you will, in Blue Chips seemed to suggest that very strongly, adopting the Burnbaum rule out of the Second Circuit.

Moreover, I should say to Your Honor -- I know my time is up -- that this was not the theory on which this case was tried, it wasn't indicted that way, and that if for some reason this Court were to find that any conducted directed to the tender offeror fitted into a category of 10(b) violation, that would run afoul, I would suggest, of Lewis and Bouie and those cases which called for fair notice.

QUESTION: But isn't that argument you just made applicable to the arguments that the Solicitor General has made that are different from those made below?

MR. ARKIN: Yes, I think that the fact that different arguments have been made and rejected by the government at various levels certainly does go to that point, yes. The fact is there was a deprivation of due process here. If through some new novel interpretation of section 10(b) it is found that Mr. Chiarella had some liability under that statute, it would have to be prospective.

QUESTION: Their evidence -- I hate to go over your

time this way, but their evidence on this point was confined to the people who had bought the -- rather, who had sold the stock to Chiarella. They all got on the stand and said I wouldn't have sold if I had been told, isn't that what they said?

MR. ARKIN: Yes, they did. The court instructed the case out that way and the summation of the prosecutor, except for one line, was all towards the vast injury suffered by these sellers.

QUESTION: Very well. Thank you, Mr. Arkin.

Mr. Shapiro.

ORAL ARGUMENT OF STEPHEN M. SHAPIRO, ESQ.,

ON BEHALF OF THE RESPONDENTS

MR. SHAPIRO: Mr. Chief Justice, and may it please the Court:

Section 10(b) and rule 10(b)(5) forbid the use of deceptive devices in connection with the purchase of securities. The central question presented in this case is whether petitioner used such a deceptive device.

We contend that his use of converted non-public market information to enrich himself in the stock market without disclosure to anyone was a deceptive device within the prohibition of the statute and the rule. In establishing this proposition, we look first to the duties which petitioner owed to the tender offerors whose information he converted.

We then consider the duties which petitioner owed to public investors. We begin with the fact which was admitted on the witness stand that the petitioner misappropriated confidential information belonging to the tender offerors and used that information to purchase securities at a large personal profit. Because he was --

QUESTION: Mr. Solicitor General, may I just throw one question at you that you could handle before you get -- suppose that -- one can argue that it was the seller who was defrauded or one can argue that it was the tender offeror who was defrauded, either way. Assume you had an action in which the defendant came in and said I know I cheated somebody, I will pay the money into the court and you two fight it out as to who is entitled to this money. Who would get it, that is, as between the tender offeror and the people who sold to him?

MR. SHAPIRO: The SEC's dissent decrees in this area have made the restitution first to the public investors and if they can't be identified then to the tender offerors whose information has been converted. The priority has been given to the investors.

QUESTION: But assuming there has got to be a choice, you say the investor would get it even though the tender offerors could have made precisely the same transaction with the investor?

MR. SHAPIRO: Well, the tender offeror is --

QUESTION: He could have separately -- say he doesn't have up to 5 percent, he could have gone to the sellers and said I will buy this amount of stock at this very same price that this person does.

MR. SHAPIRO: That case is not only a distinguishable one, it is antithetical in our view. The tender offeror makes an investment decision on the basis of publicly available information. He doesn't steal. He doesn't convert or he doesn't embezzle.

QUESTION: The information he is about to make a tender offer isn't publicly available.

MR. SHAPIRO: That is internally generated information, gotten through bona fide business activity. It is not stolen information.

QUESTION: It is the epitomy of inside information.

MR. SHAPIRO: But inside information in the cases that have come up thus far can't be misused in situations where it has been misappropriated, where there is conversion or theft or misappropriation. This is the triggering circumstance that gives rise to the duty of disclosure, and that is how we distinguish that case from the present case.

QUESTION: Well, inside information has to be fitted in with some portion of rule 10(b)(5), doesn' it, which doesn't say anything about inside information?

MR. SHAPIRO: That's correct. We rely on subjsection

(a) and subsection (c) which deal with devices, schemes or artifists to defraud or practices which operate as frauds. This Court held in the Affiliated Ute case that total silence when there is a duty to disclose can be a device to defraud. It held the same thing in the Capital Gains case, and that was the rule of common law when there was a duty to speak, total silence was a device to defraud.

QUESTION: Well, the issue here I suppose ultimately is was there a duty to disclose.

MR. SHAPIRO: There was a duty to disclose here --

QUESTION: That is the issue, isn't it?

MR. SHAPIRO: It is indeed -- to the tender offerors and to the public investors. I would like to begin with the tender offerors and explain why there was a duty to disclose to them.

QUESTION: Wasn't there also a duty to disclose to the tender offeror? Didn't Chiarella owe a duty to his principal?

MR. SHAPIRO: Precisely. Precisely.

QUESTION: Yes.

MR. SHAPIRO: It was a double failure to disclose in connection with a securities transaction. An agent or other fiduciary who plans to make personal use of confidential information that is entrusted to him has an unqualified duty to make prior disclosure to his principal before using that

information. At common law, failure to make disclosure to the principal was a form of deceit. To be sure, it was a breach of fiduciary duty, but was something more because there was a failure to disclose and a duty to disclose. Secret misappropriation is different from unfairness or negligence in the discharge of a fiduciary duty.

Under black letter legal principles, it is a garden variety type of fraud or deception. Petitioner schemed to enrich himself by using this confidential information, was carried on through stock transactions. In this case, as in the Bankers Life case, a stock transaction was the vehicle for a fraudulent misappropriation. In Bankers Life, the defendant engaged in securities transaction and afterwards converted the proceeds of the sale. Because that conversion was in connection with the securities transaction, this Court held that it violated section 10(b) and rule 10(b)(5).

Section 10(b), we would point out, is not limited to frauds that injure investors. As this Court held last term in the Naftalin case, in construing the parallel anti-fraud rule in the '33 Act, the anti-fraud provisions that are phrased in general terms reach frauds practiced on any person.

QUESTION: Now to whom was this duty to disclose owed as you are now positing it? To the person he bought the stock from?

MR. SHAPIRO: The first duty that we deal with is

the duty owed to the tender offerors. There was a duty to disclose to them prior to his misappropriation of their confidential information.

QUESTION: Disclose what?

MR. SHAPIRO: Disclose that he was about to deal on his own behalf or in his own interest with their confidential property.

QUESTION: That he was about to misappropriate this information?

MR. SHAPIRO: That he was about to misappropriate it. That is a black letter rule of agency and it is a black letter rule of the common law fraud, and we rely on that in connection with the tender offerors.

QUESTION: Not that he was about to purchase shares on the New York Stock Exchange?

MR. SHAPIRO: He had to disclose that he was about to use their information to purchase shares on the New York Stock Exchange.

QUESTION: That is all.

MR. SHAPIRO: That is the omission and it is conceded that he made no such disclosure to these tender offerors before converting their information --

QUESTION: He made no disclosure of any kind, did he?

MR. SHAPIRO: No disclosure of any kind.

QUESTION: Just so I may be clear, your submission is

he should have disclosed what?

MR. SHAPIRO: He should have disclosed to the tender offerors that we are dealing with first that he was about to misappropriate confidential information entrusted to them to purchase stock on the New York Stock Exchange.

QUESTION: And that -- there were two separate disclosures then -- and that he was going to use this confidential information --

MR. SHAPIRO: Both things had to be disclosed as a matter of agency law and as a matter of common law fraud.

QUESTION: So then your basic submission is that the criminal provisions of the SEC make any violation of an agency principal relationship into a crime?

MR. SHAPIRO: Not at all. Only when there is a failure to disclose or misrepresentation in connection with a breach of fiduciary duty is there a 10(b)(5) violation. That is the holding in the Green case and we think that is a correct analysis. In this case, there was a failure to disclose where there was a duty to disclose, and under the Green case that can be a violation of section 10(b). That is the analysis we rely on here.

It doesn't matter that the victims of this scheme, when we look at the tender offerors, weren't purchasers or investors. The Blue Chips Stamp rule is a rule of standing in private damage action. It isn't applicable in a government

enforcement proceeding. In a government proceeding, all that the government needs to show is that a deceptive device was used in connection with the purchase of securities. The identity of the victim is simply irrelevant. That was the holding in Naftalin and it is equally applicable here.

QUESTION: You think that criminal statutes should be more broadly construed than civil statutes?

MR. SHAPIRO: The statute should be given its literal interpretation, that is all we are contending for, that it reaches any fraudulent device used in connection with a securities transaction, not limited to particular kinds, not limited to transactions that injure particular categories of victims. It covers any fraudulent scheme.

QUESTION: How about the officer of the tender offeror who uses his inside information to go out and trade on his own account, just like this printer did?

MR. SHAPIRO: He violates section 10(b). The case of SEC v. Shapiro, from the Second Circuit, held that persons who misappropriate information from the acquiring company and use that information to buy the target stock violate the rule.

QUESTION: Do you think in that case the seller of the stock from whom he buys could recover damages from him under 10(b)?

MR. SHAPIRO: Well, the question of who can recover in a private action is an unsettled area. There is divergence

among the courts on that.

QUESTION: I am not asking you how much. I would just like to ask you whether a legal duty to the seller of the stock has been breached.

MR. SHAPIRO: There has been a breach of legal duty to that seller. If that seller can be identified --

QUESTION: Under 10(b)?

MR. SHAPIRO: Yes, that is correct. That was the holding --

QUESTION: Because there is a duty to disclose?

MR. SHAPIRO: There is a duty to disclose --

QUESTION: Where do you get that out of 10(b)?

MR. SHAPIRO: Whenever misappropriated information is used in the stock market and it is material and non-public, there is a duty to disclose. This has been the SEC's position in --

QUESTION: Why does it have to be misappropriated?

MR. SHAPIRO: Well --

QUESTION: What if it is just confidential?

MR. SHAPIRO: If it is information, non-public market information generated through bona fide business activity, with no element of misappropriation, none of the case law yet has held that that brings you into the area of fraud. The element of --

QUESTION: WHat if this printer had gone out and just

told everybody what he knew, he didn't go out and misappropriate it in the sense that he profited by it, he just went out and blabbed it all over town and a lot of other people started buying shares.

MR. SHAPIRO: Well, telling the truth is not a violation of section 10(b) because it is not deceptive, it is not fraud --

QUESTION: But he did spread around confidential information. That is not enough?

MR. SHAPIRO: No. If he --

QUESTION: Even though he breached his contract and breached his fiduciary duty to his principal --

MR. SHAPIRO: That's correct. You need deception or non-disclosure to come within the scope of section 10(b). That is why Your Honor's hypothetical is not a 10(b) violation, although it is a wrong to the tender offerors.

QUESTION: Does he need to profit by it himself?

MR. SHAPIRO: No, he doesn't. The element of profit is irrelevant. If he uses a deceptive device in connection with a stock transaction and he does so willfully and the mails are used, the government's case is complete. Personal profit is not an element of the crime.

QUESTION: Mr. Shapiro, may I ask this question: Do you read the opinion of the Second Circuit Court of Appeals as requiring some special relationship, fiduciary relationship?

It seems to me it says -- and here I quote from it -- "a test of regular access to market information appears to us to provide a workable rule."

MR. SHAPIRO: The court does appear to adopt a rule of regular access to non-public information.

QUESTION: But you don't go that far?

MR. SHAPIRO: We don't go that far, for the reasons that are discussed in the amicus curiae brief of the Securities Industry Association. Many legitimate businesses obtain non-public market information in the course of their business activities. The specialist on the New York Stock Exchange floor does this, and because there is no element of misappropriation or conversion, the cases have not interpreted this kind of activity as a violation of the statute.

QUESTION: What about the investment analyst that pays a visit to a corporation and obtains more current estimates of earnings for the year than are available generally, then that analyst advises his clients to buy, has he violated 10(b)(5)?

MR. SHAPIRO: Yes, the theory that has been applied in these cases is that the leaking of the confidential information to this individual is a misappropriation or a misuse of confidential corporate information that shouldn't be available for the personal use of anyone and that is a wrong to the company. And if he thereafter uses it for personal profit,

that is a violation of section 10(b).

QUESTION: You are saying that if a corporate executive gives any information to an analyst who visits him that isn't public, and it may arguably affect the influence of the stock and that information subsequently is used, that both the executive -- I guess he is a tipper and the investment adviser is a tipee, is that the --

MR. SHAPIRO: That is essentially correct, if the information is material, confidential information that hasn't been disclosed to the rest of the analysts and the rest of the investors in the market --

QUESTION: Well, where do you get that out of either the statute or the rule?

MR. SHAPIRO: That has been the consistent interpretation of the SEC since the Katy Roberts case and every court that has considered it, every court of appeals --

QUESTION: We are talking about the Second Circuit now.

MR. SHAPIRO: This Court approved that rule in the case of Foremost v. McKesson. It said that misuse of inside information by insiders is a violation of section 10(b). It said that in the course of its analysis of section 16(b) of the act, but this Court has approved that analysis.

QUESTION: It sounds like misuse, misappropriation -- they seem to me to be quite loosely used by the government

here.

MR. SHAPIRO: It is a violation of legal duty, that is what we mean by misuse. If this information is taken for the personal benefit of an employee of the company and used in the stock market, that is a wrong against the company, of course.

QUESTION: How do you decide whether there is a legal duty or not? Is this a state law or a federal law?

MR. SHAPIRO: It is ultimately a question of federal law of whether there is a violation, but you look to state law to determine if there is a duty to make this -- to keep this information confidential.

QUESTION: Are you saying, in response to Mr. Justice Powell's question, therefore that whether there was a duty on the part of the corporate president not to disclose to the analyst would depend on the law of the fifty states?

MR. SHAPIRO: Well, the law in the fifty states is consistent on this point. An agent that has confidential information of its principal, in your hypothetical the company, can't misuse that and can't leak it to other persons. That is a violation of his duty under black letter agency rules. It isn't a matter of various rules under different state jurisdictions. It is a settled principle of agency law.

QUESTION: But the difficulty is that as a practical matter corporate executives wouldn't know whether information

was material or not in a sense that a jury might perhaps decide. You talk about your company. You talk about it all the time. The country is full of analysts and investment advisers who try to understand what is going on in corporations.

MR. SHAPIRO: The courts have wrestled with this difficulty, and one of the safeguards against improper prosecution or improper civil damage judgments is the scienta requirement. This has to be done with an element of mens rea or scienta. It can't be done innocently or even negligently.

QUESTION: I think the point made in this case by your colleague is that there is no proof of intent in this case to defraud.

MR. SHAPIRO: The District Court charged the jury that it couldn't convict unless it found engagement in a device to defraud knowingly, intentionally and willfully with realization that it was wrongful, with an understanding that this was wrongful conduct.

QUESTION: What was the device in this case?

MR. SHAPIRO: It was failure to disclose to the tender offerors (a), and (b) failure to disclose to public investors that stolen information was being used in transactions with them.

QUESTION: I understand, of course, that there was a failure to disclose. The question in my mind is whether the man on the street would construe that as a device or

scheme or an artifice. They are the statutory words and we have a criminal case which is what concerns me.

MR. SHAPIRO: I have no doubt that the man --

QUESTION: I don't defend what this fellow did, but I --

MR. SHAPIRO: I have no doubt that the man on the street would say that someone that steals information that is non-public and uses that to exploit a seller in the stock market is guilty of a cunning device, but this is not a new cunning device.

QUESTION: Haven't you got new independent grounds for this?

MR. SHAPIRO: We do.

QUESTION: Even if he didn't have legal duty to the seller --

MR. SHAPIRO: He had a duty to those tender offerors and that is a ground --

QUESTION: And even if he breached no duty to the sellers, he did breach a duty to the offerors in connection with his purchase of the securities.

MR. SHAPIRO: That's quite correct.

QUESTION: And that is as far as you need to go?

MR. SHAPIRO: Well, we agree that the Court could affirm on that narrow ground, that is correct, but we also think that --

QUESTION: Don't they usually try to affirm on the narrowest ground possible?

MR. SHAPIRO: Well, that is a possibility but we think that both of these theories are integrally related and that they both have a clear basis in prior law and we would --

QUESTION: I know, but if you include the latter and say -- if you say you had to have a breach of duty to the seller, you have some -- it seems to me you have some problem about permitting the corporation itself to purchase shares without disclosure of the facts. I know you don't think so, but it seems to me that certainly before the Williams Act it had been held that the offeror could go out and purchase shares without disclosing.

MR. SHAPIRO: That's quite true. Information --

QUESTION: And there was no breach of duty.

MR. SHAPIRO: That is because there was no embezzlement or conversion in obtaining that information.

QUESTION: That is just restating your conclusion.

MR. SHAPIRO: Well, the information is generated within the corporation through honest methods. There is no way to characterize that as dishonest.

QUESTION: I know, but there is no -- I am talking about the duty to the seller. There is no disclosure whatsoever, although the corporation knows it is going to make a tender offer.

MR. SHAPIRO: That's correct, and at common law there wasn't a duty to disclose when information was gotten honestly and that is the principle we rely on here, and that has been the principle that the SEC and the courts have used under section 10(b). As early as 1943, the SEC concluded that misappropriated non-public market information couldn't be used in the stock market to take advantage of uninformed investors. That is one of the earliest cases under section 10(b). The Second Circuit in the Shapiro case held that you couldn't convert information from the acquiring company and use that information to buy the shares from the target company shareholders. This principle --

QUESTION: Mr. Shapiro, excuse me for interrupting but all of these cases are civil cases, how many criminal prosecutions have there been under 10(b)(5)?

MR. SHAPIRO: We have collected some of them in a footnote.

QUESTION: How many prior to this case?

MR. SHAPIRO: Criminal cases, I would say the number is between 20 and 30. They are collected in Professor Loss' treatise and we cite some of them.

QUESTION: Have they been prosecuted to a conclusion?

MR. SHAPIRO: A number of them have which we have cited in our brief.

QUESTION: With convictions?

MR. SHAPIRO: With convictions, with Appellate Court opinions.

QUESTION: Under 10(b)(5)?

MR. SHAPIRO: That's correct.

QUESTION: Do you remember where they are cited? It is in a footnote?

MR. SHAPIRO: It is indeed a footnote in our brief.

QUESTION: I was under the impression that a dissenting judge on the Court of Appeals said that there never had been a criminal prosecution under 10(b)(5). Did he say that?

MR. SHAPIRO: What he had in mind is that there has never been a criminal prosecution for misuse of inside information. He didn't mean to suggest that there has never been a criminal prosecution for various other kinds of misconduct in connection with a stock transaction because there have been dozens of those.

QUESTION: But never a criminal case like this?

MR. SHAPIRO: Well, there is one case that has some similarity to this that we have cited. It is the Hancock case, where non-public information about an acquisition of a mutual fund was misappropriated by an employee and that information was used to purchase up the stock and this was the subject of an indictment and a guilty plea in New York, that is the only case that fits this exact factual pattern that came up in a

criminal context.

QUESTION: Judge Meskill said we have been cited no case in which criminal liability that 10(b) nondisclosure has been imposed on any purchaser of stock either inside or outside.

MR. SHAPIRO: Well, that case was not cited in the Second Circuit. We have included it in our brief in this Court.

I would like to speak directly to the point of fraud on the sellers of these securities.

QUESTION: Just before you leave your point of fraud of the customer --

MR. SHAPIRO: Yes, Your Honor.

QUESTION: One can agree readily with you that it was a breach of some sort of a fiduciary duty for him not to disclose to the customer corporation that he had acquired this information as an employee of the printers but how freely translatable is a breach of a fiduciary duty into something that is fraud or deception or misrepresentation?

MR. SHAPIRO: That is an important question after this Court's Green decision because it has to be non-disclosure as opposed to simply unfairness --

QUESTION: There has to be reliance to the detriment --

MR. SHAPIRO: No reliance --

QUESTION: -- of the non-disclosee.

MR. SHAPIRO: If I may say, in a government enforcement proceeding, there is no requirement of proof of injury to a private person, simply --

QUESTION: But fraud means misrepresentation upon which there is reliance to the detriment of the person to whom the misrepresentation has been made.

MR. SHAPIRO: The definition is suppression of the truth to take advantage of another person. That is the definition that was used in the charge to the jury, and here the suppression of truth was in failing to disclose to the tender offerors that this self-dealing was occurring, where there was a duty under established black letter principles to make that disclosure.

QUESTION: Fiduciary duty, a fiduciary duty.

MR. SHAPIRO: A fiduciary duty.

QUESTION: And how is breach of a fiduciary duty so freely translatable into a misrepresentation or deception or fraud?

MR. SHAPIRO: Well, as the Court in the Green case pointed out, if there is a duty to disclose and a failure to disclose, that is a fraud. It is a form of misrepresentation. That is what this Court held in the Affiliated Ute case.

QUESTION: That could follow as between strangers, but it might not carry over where you are talking about a

breach of a fiduciary duty, which is a stricter standard.

MR. SHAPIRO: Well, if the fiduciary duty requires disclosure and there is non-disclosure and it is in connection with a securities transaction, that is 10(b)(5) fraud.

QUESTION: But I don't see that follows necessarily. It could follow but it need not necessarily follow.

MR. SHAPIRO: That is what this Court held in the Capital Gains case and it held that in Affiliated Ute, when there is a fiduciary duty to make disclosure and there was a failure, a complete silence on the part of the defendant, that was a deceptive device.

QUESTION: Now, Mr. Shapiro, what if the fiduciary duty had been obeyed here and there had been a disclosure?

MR. SHAPIRO: To the tender offerors.

QUESTION: To the tender offerors. The sellers on the stock market wouldn't have known anything about that, would they?

MR. SHAPIRO: Well, in that case you would have to address the question of whether failure to disclose is on the sellers.

QUESTION: Presumably it wouldn't thereby be public knowledge, would it?

MR. SHAPIRO: That's correct. It could well be a fraud on the sellers of the securities, even though it wasn't a fraud on the tender offerors.

QUESTION: Why would it have been a fraud? Where would it have been their loss?

MR. SHAPIRO: Well, in a government enforcement proceeding it isn't necessary to show that there is a private loss, but the --

QUESTION: Well, that is the definition of fraud though, common law definition, it has to be detriment, doesn't it?

MR. SHAPIRO: Well, this Court held in Capital Gains that there doesn't have to be proof of private loss in the government enforcement proceeding, and the lower courts have all held that under section 10(b). That is not an element under section 10(b). The crime is complete when there is proof of a deceptive device in connection with a stock transaction, use of the mails and mens rea. That is the entire case.

QUESTION: But somebody else has got to be involved. People don't write letters and just drop them in the dead letter box.

MR. SHAPIRO: Well, there have been prosecutions in cases very similar to that where a false prospective may be misdelivered and that it causes no harm to anyone, but the convictions are sustained uniformally because there has been deceptive conduct in connection with a stock transaction. It doesn't have to be effective. It doesn't have to be completed

and cause injury to a private party. That is not an element of the offense.

QUESTION: Mr. Shapiro, I have not read the instructions to the jury. To what extent in those instructions was there emphasis placed on the tender offeror as the party to whom the duty of disclosure was owed? I thought the case was tried on the other theory.

MR. SHAPIRO: It was tried throughout on two theories. In the indictment it was charged that the petitioner's scheme was a fraud on the sellers and then, secondly and independently it was a device, scheme or artifice to defraud without limitation on the victims. And in the court's pretrial decision --

QUESTION: Without limitation. Do they specifically say that the tender offeror was defrauded?

MR. SHAPIRO: Well, the defendant moved for dismissal of the indictment and the District Court held that both kinds of fraud were encompassed by this language in the indictment and that it could be a fraud both on the tender offerors and a fraud on the sellers, and that is how the case was argued to the jury. It was argued as a fraud on the tender offerors and on the sellers. Both theories were presented and there was no question of surprise to the defendant because the District Court held as its first ground for sustaining the indictment that this conduct was a fraud on the tender offerors. Both of these elements have been in the case

throughout the litigation.

QUESTION: The Second Circuit certainly didn't rely on that theory at all.

MR. SHAPIRO: The Second Circuit relied principally on fraud on the sellers, although it affirmed on this alternative ground as well. It didn't give the same play to it that the District Court had.

QUESTION: Could the jury have decided it on either ground or was the jury required to find that there was fraud on both the offerors --

MR. SHAPIRO: The jury could find on either ground, that's correct, that is how the case was argued.

I would emphasize to the Court that as early as 1943, the SEC had held that it is a violation of section 10(b) to convert confidential marketing information and use that information to exploit uninformed investors. That is the Honohan case cited in our brief at page 59. The commission has also held that inside corporate information can't be misused in the stock market, but none of the commission's decisions or the decisions of any court suggests that section 10(b) is limited to inside information frauds.

QUESTION: Mr. Shapiro, let me ask you just one more. Would you concede that under Blue Chip the tender offeror could not have recovered damages from the defendant?

MR. SHAPIRO: Well, I wouldn't concede that because

the tender offerors did purchase securities, and if in fact they could prove injury in connection with those securities in their capacity as purchasers, they would have standing to sue under Blue Chip --

QUESTION: Say they had engaged in no purchase transactions just because there was a breach of duty to them, they could not recover damages just out of these five transactions.

MR. SHAPIRO: That's correct, if they were not purchasers, defrauded as purchasers they wouldn't have standing to sue under Blue Chip.

This Court's decision in the Affiliated Ute case in 1972 held that use of undisclosed market information to exploit uninformed investors can violate the statute. That wasn't a case involving insiders, that was a case involving outsiders with market information. And the Second Circuit in the Shapiro case that I have referred to held that the same principle applies to an acquiring company officer or consultant who misappropriates confidential information and uses that information to take advantage of the sellers in the stock market.

QUESTION: Mr. Shapiro, I am going to have to go back a minute. I gather that before there is a breach of duty here to the sellers, there has to be a misappropriation of information?

MR. SHAPIRO: That's correct.

QUESTION: So you do have to find both elements? You have to find some wrong to the tender offeror --

MR. SHAPIRO: That's correct.

QUESTION: So there really aren't two independent grounds.

MR. SHAPIRO: There is --

QUESTION: You wouldn't say a fellow who is eavesdropping at lunch one day and heard some inside information and he wasn't connected with anybody, he just heard it and he went out and purchased on the market and made the same profit as this man did, he would not have violated 10(b).

MR. SHAPIRO: Without some element of misappropriation of wrongfulness in receiving the information, that tippee isn't liable. He has to realize that it is non-public and he has to realize that it has gotten through some improper means before a tippee is responsible.

QUESTION: So just a wrong to the sellers alone would not violate 10(b)?

MR. SHAPIRO: Just using information without some --

QUESTION: Just non-disclosure to the sellers wouldn't violate 10(b)?

MR. SHAPIRO: That's quite correct. That's quite correct.

QUESTION: Unless you went on and showed that the

information was wrongfully obtained and being wrongfully used.

MR. SHAPIRO: That's correct. That is correct.

QUESTION: Mr. Shapiro, your argument as I understand it turns on there being a relationship, however one might describe it. In Ute, as I understand it, there was what would normally be regarded as a relationship of trust, there was a bank involved, a transfer agent or trustee. In this case, you had a man who had access to information, he would not normally be viewed as a trustee. You used the word fiduciary. He may have been sort of a sub-agent, Pandick was perhaps an agent for a purpose, but you carry that thought along, you have office boys in law firms, for example, you have the cleaner who comes into an office firm at night and who is smart enough to do what this gentleman did, you go all the way down the line to anybody who sort of picks up information, regardless of how tenuous the relationship may be.

MR. SHAPIRO: Well, our position is that stolen, embezzled or converted information can't be used in the stock market under any circumstances. Under the situations that you pose, if someone picked up a piece of paper without realizing what it was in a ramdom way, that certainly would not be a violation. But if a secretary or a para-legal working on a tender offer prospectus were to take this information and knowingly use it and realizing that this was wrongful conduct, that would be a violation. It would indeed. These

people are entrusted with confidential information and they have a fiduciary duty to tender offerors. That principle is a principle of an agency. Where they have been trusting and a violation of that trust, there is a duty to disclose to the tender offerors before misappropriating their information.

QUESTION: But the cleaning woman who was smart enough to understand the situation, who didn't work for the law firm but who did pick up not just one piece of paper but who picked up drafts of prospectuses of tender offers, what category would she fall in?

MR. SHAPIRO: I would say that that situation, you would have theft rather than embezzlement. There hasn't been an entrusting of information to the cleaning woman, but if she realizes that she is stealing something that belongs to someone else, that can't be used in the stock market. The commission discussed this at some length in the Investors Management decision, where it held that getting information through burglary or commercial espionage is an improper way to get information to exploit investors in the stock market.

Thank you.

MR. CHIEF JUSTICE BURGER: Thank you, gentlemen. The case is submitted.

(Whereupon, at 3:00 o'clock p.m., the case in the above-entitled matter was submitted.)

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