(Slip Opinion)

NOTE: Where it is feasible, a syllabus (headnote) will be released, as is being done in connection with this case, at the time the opinion is issued. The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States* v. *Detroit Lumber Co.*, 200 U.S. 321, 337.

SUPREME COURT OF THE UNITED STATES

Syllabus

CHIARELLA *v.* UNITED STATES

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

No. 78-1202. Argued November 5, 1979—Decided March 18, 1980

Section 10 (b) of the Securities Exchange Act of 1934 (Act) 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 [Securities and Exchange] Commission may prescribe." Rule 10b-5 of the Securities and Exchange Commission (SEC), promulgated thereunder, makes it unlawful for any person to "employ any device, scheme, or artifice to defraud," or to "engage in any act, practice, or course of business which operates or would operate as a fraud or a deceit upon any person, in connection with the purchase or sale of any security." Petitioner, who was employed by a financial printer that had been engaged by certain corporations to print corporate takeover bids, deduced the names of the target companies from information contained in documents delivered to the printer by the acquiring companies and, without disclosing his knowledge, purchased stock in the target companies and sold the shares immediately after the takeover attempts were made public. After the SEC began an investigation of his trading activities, petitioner entered into a consent decree with the SEC in which he agreed to return his profits to the sellers of the shares. Thereafter, petitioner was indicted and convicted for violating § 10 (b) of the Act and SEC Rule 10b-5. The District Court's charge permitted the jury to convict the petitioner if it found that he willfully failed to inform sellers of target company securities that he knew of a forthcoming takeover bid that would make their shares more valuable. Petitioner's conviction was affirmed by the Court of Appeals.

Held: Petitioner's conduct did not constitute a violation of § 10 (b), and hence his conviction was improper. Pp. 2-12.

(a) Administrative and judicial interpretations have established that silence in connection with the purchase or sale of securities may operate

Syllabus

as a fraud actionable under § 10 (b) despite the absence of statutory language or legislative history specifically addressing the legality of nondisclosure. However, such liability is premised upon a duty to disclose (such as that of a corporate insider to shareholders of his corporation) arising from a relationship of trust and confidence between parties to a transaction. Pp. 2–7.

(b) Here, petitioner had no affirmative duty to disclose the information as to the plans of the acquiring companies. He was not a corporate insider, and he received no confidential information from the target companies. Nor could any duty arise from petitioner's relationship with the sellers of the target companies' securities, for he had no prior dealings with them, was not their agent, was not a fiduciary, and was not a person in whom the sellers had placed their trust and confidence. A duty to disclose under § 10 (b) does not arise from the mere possession of nonpublic market information. Pp. 8–12.

(c) This Court need not decide whether petitioner's conviction can be supported on the alternative theory that he breached a duty to the acquiring corporation, since such theory was not submitted to the jury. The jury instructions demonstrate that petitioner was convicted merely because of his failure to disclose material, nonpublic information to sellers from whom he bought the stock of target corporations. The conviction cannot be affirmed on the basis of a theory not presented to the jury. Pp. 12–14.

588 F. 2d 1358, reversed.

POWELL, J., delivered the opinion of the Court, in which STEWART, WHITE, REHNQUIST, and STEVENS, JJ., joined. STEVENS, J., filed a concurring opinion. BRENNAN, J., filed an opinion concurring in the judgment. BURGER, C. J., filed a dissenting opinion. BLACKMUN, J., filed a dissenting opinion, in which MARSHALL, J., joined.

NOTICE: This opinion is subject to formal revision before publication in the preliminary print of the United States Reports. Readers are requested to notify the Reporter of Decisions, Supreme Court of the United States, Washington, D.C. 20543, of any typographical or other formal errors, in order that corrections may be made before the preliminary print goes to press.

SUPREME COURT OF THE UNITED STATES

No. 78-1202

Vincent F. Chiarella, Petitioner, *v.* United States.	On Writ of Certiorari to the United States Court of Appeals for the Second Circuit.

[March 18, 1980]

MR. JUSTICE POWELL delivered the opinion of the Court.

The question in this case is whether a person who learns from the confidential documents of one corporation that it is planning an attempt to secure control of a second corporation violates § 10 (b) of the Securities Exchange Act of 1934 if he fails to disclose the impending takeover before trading in the target company's securities.

I

Petitioner is a printer by trade. In 1975 and 1976, he worked as a "markup man" in the New York composing room of Pandick Press, a financial printer. Among documents that petitioner handled were five announcements of corporate takeover bids. When these documents were delivered to the printer, the identities of the acquiring and target corporations were concealed by blank spaces or false names. The true names were sent to the printer on the night of the final printing.

The petitioner, however, was able to deduce the names of the target companies before the final printing from other information contained in the documents. Without disclosing his knowledge, petitioner purchased stock in the target companies and sold the shares immediately after the takeover attempts were made public.[1] By this method, petitioner realized a gain of slightly more than $30,000 in the course of 14 months. Subsequently, the Securities and Exchange Commission (Commission or SEC) began an investigation of his trading activities. In May 1977, petitioner entered into a consent decree with the Commission in which he agreed to return his profits to the sellers of the shares.[2] On the same day, he was discharged by Pandick Press.

In January 1978, petitioner was indicted on 17 counts of violating § 10 (b) of the Securities Exchange Act of 1934 (1934 Act) and SEC Rule 10b–5.[3] After petitioner unsuccessfully moved to dismiss the indictment,[4] he was brought to trial and convicted on all counts.

The Court of Appeals for the Second Circuit affirmed petitioner's conviction. 588 F. 2d 1358 (1978). We granted certiorari, 441 U. S. 942 (1979), and we now reverse.

II

Section 10 (b) of the 1934 Act, 15 U. S. C. § 78j, 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." Pursuant to this section, the SEC promulgated Rule 10b–5 which provides in pertinent part[5] that

"It shall be unlawful for any person, directly or indi-

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[1] Of the five transactions, four involved tender offers and one concerned a merger. *United States* v. *Chiarella,* 588 F. 2d 1358, 1363, n. 2 (CA2 1978).

[2] *SEC* v. *Chiarella,* No. 77 Civ. 2534 (GLG) (SDNY May 24, 1977).

[3] Section 32 (a) of the 1934 Act sanctions criminal penalties against any person who willfully violates the Act. 15 U. S. C. A. § 78ff (a) (1972–1978 Supp.). Petitioner was charged with 17 counts of violating the Act because he had received 17 letters confirming purchase of shares.

[4] *United States* v. *Chiarella,* 450 F. Supp. 95 (SDNY 1978).

[5] Only Rules 10b–5 (a) and (c) are at issue here. Rule 10b–5 (b)

rectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

"(a) To employ any device, scheme, or artifice to defraud, [or]

. . . . .

"(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or a deceit upon any person, in connection with the purchase or sale of any security." 17 CFR § 240.10b–5 (1979).

This case concerns the legal effect of the petitioner's silence. The District Court's charge permitted the jury to convict the petitioner if it found that he willfully failed to inform sellers of target company securities that he knew of a forthcoming takeover bid that would make their shares more valuable.[6] In order to decide whether silence in such circumstances violates § 10 (b), it is necessary to review the language and legislative history of that statute as well as its interpretation by the Commission and the federal courts.

Although the starting point of our inquiry is the language of the statute, *Ernst & Ernst* v. *Hochfelder*, 425 U. S. 185, 197 (1976), § 10 (b) does not state whether silence may constitute a manipulative or deceptive device. Section 10 (b) was designed as a catch-all clause to prevent fraudulent practices. *Id.*, at 202, 206. But neither the legislative history nor the statute itself affords specific guidance for the resolution of this case. When Rule 10b–5 was promulgated in 1942, the

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provides that it shall be unlawful "[t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading." 17 CFR § 240.10b–5 (b) (1979). The portion of the indictment based on this provision was dismissed because the petitioner made no statements at all in connection with the purchase of stock.

[6] Record, at 682–683, 686.

SEC did not discuss the possibility that failure to provide information might run afoul of § 10 (b).[7]

The SEC took an important step in the development of § 10 (b) when it held that a broker-dealer and his firm violated that section by selling securities on the basis of undisclosed information obtained from a director of the issuer corporation who was also a registered representative of the brokerage firm. In *Cady, Roberts & Co.*, 40 S. E. C. 907 (1961), the Commission decided that a corporate insider must abstain from trading in the shares of his corporation unless he has first disclosed all material inside information known to him. The obligation to disclose or abstain derives from

> "[a]n affirmative duty to disclose material information[,] [which] has been traditionally imposed on corporate 'insiders,' particularly officers, directors, or controlling stockholders. We, and the courts have consistently held that 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, would affect their investment judgment." *Id.*, at 911.

The Commission emphasized that the duty arose from (i) The existence of a relationship affording access to inside information intended to be available only for a corporate purpose, and (ii) the unfairness of allowing a corporate insider to take advantage of that information by trading without disclosure. *Id.*, at 912, and n. 15.[8]

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[7] See SEC Release No. 3230 (May 21, 1942).

[8] In *Cady, Roberts,* the broker-dealer was liable under § 10 (b) because it received nonpublic information from a corporate insider of the issuer. Since the insider could not use the information, neither could the partners in the brokerage firm with which he was associated. *Cady, Roberts & Co.*, 40 S. E. C. 907 (1961). The transaction in *Cady, Roberts* involved sale of stock to persons who previously may not have been shareholders in the corporation. *Id.*, at 913, and n. 21. The Commission embraced the reasoning of Judge Learned Hand that "the director or officer assumed

That the relationship between a corporate insider and the stockholders of his corporation gives rise to a disclosure obligation is not a novel twist of the law. At common law, misrepresentation made for the purpose of inducing reliance upon the false statement is fraudulent. But one who fails to disclose material information prior to the consummation of a transaction commits fraud only when he is under a duty to do so. And the duty to disclose arises when one party has information "that the other [party] is entitled to know because of a fiduciary or similar relation of trust and confidence between them." [9] In its *Cady, Roberts* decision, the Commission recognized a relationship of trust and confidence between the shareholders of a corporation and those insiders who have obtained confidential information by reason of their position with that corporation.[10] This relationship gives rise

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a fiduciary relation to the buyer by the very sale; for it would be a sorry distinction to allow him to use the advantage of his position to induce the buyer into the position of a beneficiary although he was forbidden to do so once the buyer had become one." *Id.*, at 914, n. 23, quoting *Gratz* v. *Claughton*, 187 F. 2d 46, 49 (CA2 1951), cert. denied, 341 U. S. 920 (1951).

[9] Restatement of the Law 2d, Torts § 551 (2)(a) (1976). See James & Gray, Misrepresentation—Part II, 37 Md. L. Rev. 488, 523–527 (1978). As regards securities transactions, the American Law Institute recognizes that "silence when there is a duty to speak may be a fraudulent act." ALI, Federal Securities Code § 262 (b) (Proposed Official Draft 1978).

[10] See 3 W. Fletcher, Cyclopedia of the Law of Private Corporations § 838 (1975) (hereinafter Fletcher); 3A Fletcher, §§ 1168.2, 1171, 1174; 3 L. Loss, Securities Regulation 1446–1448 (2d ed. 1961); 6 L. Loss, at 3557–3558 (1969 Supp.). See also *Brophy* v. *Cities Service Co.*, 31 Del. Ch. 241, 70 A. 2d 5 (1949). See generally Note, Rule 10b-5: Elements of a Private Right of Action, 42 NYU L. Rev. 541, 552–553, and n. 71 (1968); 75 Harv. L. Rev. 1449, 1450 (1962); Daum & Phillips, The Implication of *Cady, Roberts*, 17 Bus. Law, 939, 945 (1962).

The dissent of Mr. Justice Blackmun suggests that the "special facts" doctrine may be applied to find that silence constitutes fraud where one party has superior information to another. *Post*, at 3. This Court has never so held. In *Strong* v. *Repide*, 213 U. S. 419, 431–434 (1909), this Court applied the special facts doctrine to conclude that a corporate to a duty to disclose because of the "necessity of preventing a corporate insider from tak[ing] advantage of the uninformed minority stockholders." *Speed* v. *Transamerica Corp.*, 99 F. Supp. 808, 829 (Del. 1951).

The Federal courts have found violations of § 10 (b) where corporate insiders used undisclosed information for their own benefit. *E. g., SEC* v. *Texas Gulf Sulphur Co.*, 401 F. 2d 833 (CA2 1968), cert. denied, 404 U. S. 1005 (1972). The cases also have emphasized, in accordance with the common-law rule, that "[t]he party charged with failing to disclose market information must be under a duty to disclose it." *Frigitemp Corp.* v. *Financial Dynamics Fund, Inc.*, 524 F. 2d 275, 282 (CA2 1975). Accordingly, a purchaser of stock who has no duty to a prospective seller because he is neither an insider nor a fiduciary has been held to have no obligation to reveal material facts. See *General Time Corp.* v. *Talley Industries, Inc.*, 403 F. 2d 159, 164 (CA2 1968), cert. denied, 393 U. S. 1026 (1969).[11]

This Court followed the same approach in *Affiliated Ute Citizens* v. *United States*, 406 U. S. 128 (1972). A group of American Indians formed a corporation to manage joint assets derived from tribal holdings. The corporation issued stock to its Indian shareholders and designated a local bank as its

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insider had a duty to disclose to a shareholder. In that case, the majority shareholder of a corporation secretly purchased the stock of another shareholder without revealing that the corporation, under the insider's direction, was about to sell corporate assets at a price that would greatly enhance the value of the stock. The decision in *Strong* v. *Repide* was premised upon the fiduciary duty between the corporate insider and the shareholder. See *Pepper* v. *Litton*, 308 U. S. 295, 307, n. 15 (1939).

[11] See also *SEC* v. *Great American Indus., Inc.*, 407 F. 2d 453, 460 (CA2 1968), cert. denied, 395 U. S. 920 (1969); *Kohler* v. *Kohler Co.*, 319 F. 2d 634, 637–638 (CA7 1963); Note, *supra* n. 10, 42 NYU L. Rev. at 554; Note, The Regulation of Corporate Tender Offer Under Federal Securities Law: A New Challenge for Rule 10b-5 359, 373–374 (1966). See generally Note, Civil Liability under Rule X-10b-5, 42 Va. L. Rev. 537, 554–561 (1956).

transfer agent. Because of the speculative nature of the corporate assets and the difficulty of ascertaining the true value of a share, the corporation requested the bank to stress to its stockholders the importance of retaining the stock. *Id.*, at 146. Two of the bank's assistant managers aided the shareholders in disposing of stock which the managers knew was traded in two separate markets—a primary market of Indians selling to non-Indians through the bank and a resale market consisting entirely of non-Indians. Indian sellers charged that the assistant managers had violated § 10 (b) and Rule 10b–5 by failing to inform them of the higher prices prevailing in the resale market. The Court recognized that no duty of disclosure would exist if the bank merely had acted as a transfer agent. But the bank also had assumed a duty to act on behalf of the shareholders, and the Indian sellers had relied upon its personnel when they sold their stock. *Id.*, at 152. Because these officers of the bank were charged with a responsibility to the shareholders, they could not act as market makers inducing the Indians to sell their stock without disclosing the existence of the more favorable non-Indian market. *Id.*, at 152–153.

Thus, administrative and judicial interpretations have established that silence in connection with the purchase or sale of securities may operate as a fraud actionable under § 10 (b) despite the absence of statutory language or legislative history specifically addressing the legality of nondisclosure. But such liability is premised upon a duty to disclose arising from a relationship of trust and confidence between parties to a transaction. Application of a duty to disclose prior to trading guarantees that corporate insiders, who have an obligation to place the shareholder's welfare before their own, will not benefit personally through fraudulent use of material nonpublic information.[12]

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[12] "Tippees" of corporate insiders have been held liable under § 10 (b) because they have a duty not to profit from the use of inside information