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 BLACKMUN, with whom MR. JUSTICE MARSHALL joins, dissenting.

Although I agree with much of what is said in Part I of the dissenting opinion of THE CHIEF JUSTICE, *ante*, I write separately because, in my view, it is unnecessary to rest petitioner's conviction on a "misappropriation" theory. The fact that petitioner Chiarella purloined, or, to use THE CHIEF JUSTICE's word, *ante*, p. 7, "stole," information concerning pending tender offers certainly is the most dramatic evidence that petitioner was guilty of fraud. He has conceded that he knew it was wrong, and he and his co-workers in the print shop were specifically warned by their employer that actions of this kind were improper and forbidden. But I also would find petitioner's conduct fraudulent within the meaning of § 10 (b) of the Securities Exchange Act of 1934, 15 U. S. C. § 78j (b), and the Securities and Exchange Commission's Rule 10b–5, 17 CFR § 240.10b–5 (1979), even if he had obtained the blessing of his employer's principals before embarking on his profiteering scheme. Indeed, I think petitioner's brand of manipulative trading, with or without such approval, lies close to the heart of what the securities laws are intended to prohibit.

The Court continues to pursue a course, charted in certain recent decisions, designed to transform § 10 (b) from an intentionally elastic "catchall" provision to one that catches relatively little of the misbehavior that all too often makes investment in securities a needlessly risky business for the

uninitiated investor. See, *e. g.*, *Ernst & Ernst* v. *Hochfelder*, 425 U. S. 185 (1976); *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U. S. 723 (1975). Such confinement in this case is now achieved by imposition of a requirement of a "special relationship" akin to fiduciary duty before the statute gives rise to a duty to disclose or to abstain from trading upon material nonpublic information.[1] The Court admits that this conclusion finds no mandate in the language of the statute or its legislative history. *Ante*, at 3. Yet the Court fails even to attempt a justification of its ruling in terms of the purposes of the securities laws, or to square that ruling with the long-standing but now much-abused principle that the federal securities laws are to be construed flexibly rather than with narrow technicality. See *Affiliated Ute Citizens* v. *United States*, 406 U. S. 128, 151 (1972); *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, 404 U. S. 6, 12 (1971); *SEC* v. *Capital Gains Research Bureau*, 375 U. S. 180, 186 (1963).

I, of course, agree with the Court that a relationship of trust can establish a duty to disclose under § 10 (b) and Rule 10b–5. But I do not agree that a failure to disclose violates the Rule only when the responsibilities of a relationship of that kind have been breached. As applied to this case, the Court's approach unduly minimizes the importance of petitioner's *access* to confidential information that the honest investor, no matter how diligently he tried, could not legally obtain. In doing so, it further advances an interpretation of § 10 (b) and Rule 10b–5 that stops short of their full implications. Although the Court draws support for its position from certain precedent, I find its decision neither fully consistent with developments in the common law of fraud, nor fully

[1] The Court fails to specify whether the obligations of a special relationship must fall directly upon the person engaging in an allegedly fraudulent transaction, or whether the derivative obligations of "tippees," that lower courts long have recognized, are encompassed by its rule. See *ante*, at 7, n. 12; cf. *Foremost-McKesson, Inc.* v. *Provident Securities Co.*, 423 U. S. 232, 255, n. 29 (1976).

in step with administrative and judicial application of Rule 10b–5 to "insider" trading.

The common law of actionable misrepresentation long has treated the possession of "special facts" as a key ingredient in the duty to disclose. See *Strong* v. *Repide*, 213 U. S. 419, 431–433 (1909); 1 F. Harper & F. James, The Law of Torts § 7.14 (1956). Traditionally, this factor has been prominent in cases involving confidential or fiduciary relations, where one party's inferiority of knowlege and dependence upon fair treatment is a matter of legal definition, as well as in cases where one party is on notice that the other is "acting under a mistaken belief with respect to a material fact." *Frigitemp Corp.* v. *Financial Dynamics Fund, Inc.*, 524 F. 2d 275, 283 (CA2 1975); see also Restatement (First) of Torts § 551. Even at common law, however, there has been a trend away from strict adherence to the harsh maxim *caveat emptor* and toward a more flexible, less formalistic understanding of the duty to disclose. See, *e. g.*, Keeton, Fraud—Concealment and Nondisclosure, 15 Tex. L. Rev. 1, 31 (1938). Steps have been taken toward application of the "special facts" doctrine in a broader array of contexts where one party's superior knowledge of essential facts renders a transaction without disclosure inherently unfair. See James & Gray, Misrepresentation—Part II, 37 Md. L. Rev. 488, 526–527 (1978); 3 Restatement (Second) of Torts § 551 (e), Comment *l* (1977); *id.*, Tent. Draft No. 10, at 166–167 (1964). See also *Lingsch* v. *Savage*, 213 Cal. App. 2d 729, 735–737, 29 Cal. Rptr. 201, 204–206 (1963); *Jenkins* v. *McCormick*, 184 Kan. 842, 844–845, 339 P. 2d 8, 11 (1959); *Jones* v. *Arnold*, 359 Mo. 161, 169–170, 221 S. W. 2d 187, 193–194 (1949); *Simmons* v. *Evans*, 185 Tenn. 282, 285–287, 206 S. W. 2d 295, 296–297 (1947).

By its narrow construction of § 10 (b) and Rule 10b–5, the Court places the federal securities laws in the rear guard of this movement, a position opposite to the expectations of

Congress at the time the securities laws were enacted. Cf. H. R. Rep. No. 1383, 73d Cong., 2d Sess., 5 (1934). I cannot agree that the statute and Rule are so limited. The Court has observed that the securities laws were not intended to replicate the law of fiduciary relations. *Santa Fe Industries, Inc.* v. *Green,* 430 U. S. 462, 474–476 (1977). Rather, their purpose is to ensure the fair and honest functioning of impersonal national securities markets where common-law protections have proved inadequate. Cf. *United States* v. *Naftalin,* 441 U. S. 768, 775 (1979). As Congress itself has recognized, it is integral to this purpose "to assure that dealing in securities is fair and without undue preferences or advantages among investors." H. R. Conf. Rep. No. 94–229, p. 91 (1975).

Indeed, the importance of access to "special facts" has been a recurrent theme in administrative and judicial application of Rule 10b–5 to insider trading. Both the SEC and the courts have stressed the insider's misuse of secret knowledge as the gravamen of illegal conduct. The Court, I think, unduly minimizes this aspect of prior decisions.

Cady, Roberts & Co., 40 S. E. C. 907 (1961), which the Court discusses at some length, provides an illustration. In that case, the Commission defined the category of "insiders" subject to a disclose-or-abstain obligation according to two factors:

> "[F]irst, the existence of a relationship giving access, directly or indirectly, to information intended to be available only for a corporate purpose and not for the personal benefit of anyone, and second, the inherent unfairness involved where a party takes advantage of such information knowing it is unavailable to those with whom he is dealing." *Id.,* at 912 (footnote omitted).

The Commission, thus, regarded the insider "relationship" primarily in terms of *access* to nonpublic information, and not merely in terms of the presence of a common-law fiduciary

duty or the like. This approach was deemed to be in keeping with the principle that "the broad language of the anti-fraud provisions" should not be "circumscribed by fine distinctions and rigid classifications," such as those that prevailed under the common law. *Ibid.* The duty to abstain or disclose arose, not merely as an incident of fiduciary responsibility, but as a result of the "inherent unfairness" of turning secret information to account for personal profit. This understanding of Rule 10b–5 was reinforced when *Investors Management Co.*, 44 S. E. C. 633, 643 (1971), specifically rejected the contention that a "special relationship" between the alleged violator and an "insider" source was a necessary requirement for liability.

A similar approach has been followed by the courts. In *SEC* v. *Texas Gulf Sulphur Co.*, 401 F. 2d 833, 848 (CA2 1968) (en banc), cert. denied, 394 U. S. 976 (1969), the court specifically mentioned the common law "special facts" doctrine as one source for Rule 10b–5, and it reasoned that the rule is "based in policy on the justifiable expectation of the securities marketplace that all investors trading on impersonal exchanges have relatively equal access to material information." See also *Lewelling* v. *First California Co.*, 564 F. 2d 1277, 1280 (CA9 1977); *Speed* v. *Transamerica Corp.*, 99 F. Supp. 808, 829 (Del. 1951). In addition, cases such as *Myzel* v. *Fields*, 386 F. 2d 718, 739 (CA8 1967), cert. denied, 390 U. S. 951 (1968) and *A. T. Brod & Co.* v. *Perlow*, 375 F. 2d 393, 397 (CA2 1967), have stressed that § 10 (b) and Rule 10b–5 apply to any kind of fraud by any person. The concept of the "insider" itself has been flexible; wherever confidential information has been abused, prophylaxis has followed. See, *e. g.*, *Zweig* v. *Hearst Corp.*, 594 F. 2d 1261 (CA9 1979) (financial columnist); *Shapiro* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 495 F. 2d 228 (CA2 1974) (institutional investor); *SEC* v. *Shapiro*, 494 F. 2d 1301 (CA2 1974) (merger negotiator); *Chasins* v. *Smith, Barney & Co.*, 438 F.

2d 1167 (CA2 1970) (market maker). See generally A. Bromberg, Securities Law: Fraud § 7.4 (6)(b) (1975).

I believe, and surely thought, that this broad understanding of the duty to disclose under Rule 10b–5 was recognized and approved in *Affiliated Ute Citizens* v. *United States*, 406 U. S. 128 (1972). That case held that bank agents dealing in the stock of a Ute Indian development corporation had a duty to reveal to mixed-blood Indian customers that their shares could bring a higher price on a non-Indian market of which the sellers were unaware. *Id.*, at 150–153. The Court recognized that "by repeated use of the word 'any,'" the statute and rule "are obviously meant to be inclusive." *Id.*, at 151. Although it found a relationship of trust between the agents and the Indian sellers, the Court also clearly established that the bank and its agents were subject to the strictures of Rule 10b–5 because of their strategic position in the marketplace. The Indian sellers had no knowledge of the non-Indian market. The bank agents, in contrast, had intimate familiarity with the non-Indian market, which they had promoted actively, and from which they and their bank both profited. In these circumstances, the Court held that the bank and its agents "possessed the affirmative duty under the Rule" to disclose market information to the Indian sellers, and that the latter "had the right to know" that their shares would sell for a higher price in another market. *Id.*, at 153.

It seems to me that the Court, *ante*, at 6, gives *Affiliated Ute Citizens* an unduly narrow interpretation. As I now read my opinion there for the Court, it lends strong support to the principle that a structural disparity in access to material information is a critical factor under Rule 10b–5 in establishing a duty either to disclose the information or to abstain from trading. Given the factual posture of the case, it was unnecessary to resolve the question whether such a structural disparity could sustain a duty to disclose even absent "a relationship of trust and confidence between parties to a transaction." *Ante*, at 7. Nevertheless, I think the rationale of

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Affiliated Ute Citizens definitely points toward an affirmative answer to that question. Although I am not sure I fully accept the "market insider" category created by the Court of Appeals, I would hold that persons having access to confidential material information that is not legally available to others generally are prohibited by Rule 10b–5 from engaging in schemes to exploit their structural informational advantage through trading in affected securities. To hold otherwise, it seems to me, is to tolerate a wide range of manipulative and deceitful behavior. See *Blyth & Co.*, 43 S. E. C. 1037 (1969); *Herbert L. Honohan*, 13 S. E. C. 754 (1943); see generally Brudney, Insiders, Outsiders and Informational Advantages under the Federal Securities Laws, 93 Harv. L. Rev. 322 (1979).[2]

Whatever the outer limits of the Rule, petitioner Chiarella's case fits neatly near the center of its analytical framework. He occupied a relationship to the takeover companies giving him intimate access to concededly material information that was sedulously guarded from public access. The information,

[2] The Court observes that several provisions of the federal securities laws limit but do not prohibit trading by certain investors who may possess nonpublic market information. *Ante*, at 10–11. It also asserts that "neither the Congress nor the Commission ever has adopted a parity-of-information rule." *Ante*, at 10. In my judgment, neither the observation nor the assertion undermines the interpretation of Rule 10b–5 that I support and that I have endeavored briefly to outline. The statutory provisions cited by the Court betoken a congressional purpose not to leave the exploitation of structural informational advantages unregulated. Letting Rule 10b–5 operate as a "catchall" to ensure that these narrow exceptions granted by Congress are not expanded by circumvention completes this statutory scheme. Furthermore, there is a significant conceptual distinction between parity of information and parity of *access* to material information. The latter gives free rein to certain kinds of informational advantages that the former might foreclose, such as those that result from differences in diligence or acumen. Indeed, by limiting opportunities for profit from manipulation of confidential connections or resort to stealth, equal access helps to ensure that advantages obtained by honest means reap their full reward.

in the words of *Cady, Roberts & Co.*, 40 S. E. C., at 912, was "intended to be available only for a corporate purpose and not for the personal benefit of anyone." Petitioner, moreover, knew that the information was unavailable to those with whom he dealt. And he took full, virtually riskless advantage of this artificial information gap by selling the stocks shortly after each takeover bid was announced. By any reasonable definition, his trading was "inherent[ly] unfair[]." *Ibid.* This misuse of confidential information was clearly placed before the jury. Petitioner's conviction, therefore, should be upheld and I dissent from the Court's upsetting that conviction.