Federal Securities Regulation - Rule 10b-5 - Misappropriation of Confidential Takeover Information from an Investment Banking Firm and Its Clients for the Purpose of Purchasing Shares of the Target Companies Constitutes a Criminal Violation of Rule 10b-5

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Altman: Federal Securities Regulation - Rule 10b-5 - Misappropriation of

FEDERAL SECURITIES REGULATION—RULE 10b-5—MISAPPROPRIATION OF CONFIDENTIAL TAKEOVER INFORMATION FROM AN INVESTMENT BANKING FIRM AND ITS CLIENTS FOR THE PURPOSE OF PURCHASING SHARES OF THE TARGET COMPANIES CONSTITUTES A CRIMINAL VIOLATION OF RULE 10b-5


E. Jacques Courtois, Jr. was a member of the merger and acquisition department of Morgan Stanley & Co., Inc. (Morgan).1 Adrian Antoniu held a comparable position with Kuhn, Loeb & Co. (Kuhn Loeb).2 As a result of their positions, Courtois and Antoniu acquired confidential, nonpublic information concerning possible mergers, acquisitions, tender offers, and other takeover bids for various target companies.3 It was alleged that they misappropriated certain of this information and communicated it to co-conspirators James Newman, Franklin Carniol, and Constantine Spyropoulos.4 The latter, using methods designed to conceal their activities, purchased shares of companies that were merger and takeover targets of the clients of Morgan and Kuhn Loeb.5 When the proposed takeovers became known to the public and the target companies' stocks increased in value, the co-conspirators sold the stocks, reaped substantial gains, and divided the profits among all of the parties involved.6

The Government indicted Newman and his co-conspirators7 for

2. Id. From 1972 to 1975 Antoniu was employed by Morgan, but in 1975 he left Morgan and went to work for Kuhn Loeb, another investment banking firm. United States v. Newman, 664 F.2d 12, 15 (2d Cir. 1981). Kuhn Loeb merged with another firm and is now known as Lehman Brothers Kuhn Loeb Inc. Id.
4. Id. This information was conveyed surreptitiously to Newman, who was a securities trader and manager of the over-the-counter trading department of a New York brokerage firm. 664 F.2d at 15. Newman then passed this information to Carniol, a resident of Belgium, and Spyropoulos, a Greek citizen who lived in both Greece and France. Id.
5. [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,024, at 91,288. In order to avoid detection, the co-conspirators used secret foreign bank and trust accounts, and spread their purchases among brokers. 664 F.2d at 15.
6. 664 F.2d at 15.
7. [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,024, at 91,288. The indictment also charged Courtois, Carniol, and Spyropoulos, but only Newman was within the jurisdiction of the district court and made a party to
securities fraud, under section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5 promulgated thereunder. The district court dismissed the indictment against Newman because there was no clear and definite statement in the federal securities laws which both antedated and proscribed the acts alleged in the indictment which would have given the defendant reasonable notice that his conduct was prohibited. The United States Court of Appeals for the Second Circuit agreed with the proceedings. 664 F.2d at 15. The other defendants had left the United States and, as of the date of the proceedings in the district court, the Government had been unsuccessful in extraditing them for arraignment. [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,024, at 91,287 n.1.


It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

....

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.


It shall be unlawful for any person, directly or indirectly, 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,

(b) To 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, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.


11. [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,024, at 91,296. In reaching this conclusion, the court stated that at the time of its decision, neither the courts nor the SEC had extended rule 10b-5 to a non-insider's breach of a fiduciary duty owed to an acquiring corporation in a tender offer situation. This defendant, therefore, was not given a reasonable opportunity to know that his conduct was prohibited. Id. The court noted that although the SEC is concerned generally with the regulation of tender offers, the conduct prosecuted here was not proscribed by the SEC until 1980, when rule 14e-3 was promulgated. Id. For a discussion of rule 14e-3 and its effect, see notes 57-60 and accompanying text infra.
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reversed and remanded, holding that Newman's conduct, as alleged in the indictment, operated as a fraud on Morgan, Kuhn Loeb, and their clients in connection with the purchase of securities of the target companies, and therefore, could be found to constitute a criminal violation of rule 10b-5. United States v. Newman, 664 F.2d 12 (2d Cir. 1981).

The purpose of the Securities Act of 1933 and the Securities Exchange Act of 1934 is "to substitute a philosophy of full disclosure for the philosophy of caveat emptor and thus ... achieve a high standard of ethics in the securities industry." The reasoning behind promoting full disclosure is that investors are less likely to fall prey to fraudulent schemes if they have complete information concerning the companies in whose stock they are trading. Further, Congress enacted many antifraud provisions in an attempt to protect the market place from fraudulent activities and thereby bolster investor confidence in the United States securities market.

The district court also dismissed the mail fraud charge because the allegations failed as a matter of law to charge a crime. [1981 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 98,024, at 91,301. Consequently, once the substantive counts were dismissed, the district court held that the conspiracy count must similarly be dismissed. Id.

12. 664 F.2d at 16. The Second Circuit also held that the defendants violated the mail fraud statute. Id. at 19. Consequently, the Second Circuit held that the reinstatement of the substantive counts required the reinstatement of the conspiracy charge. Id. at 20.


The antifraud provisions of the Securities Act of 1933 include:
§ 11, which permits buyer recovery if a prospectus contained a misstatement or material omission; § 12(1), which allows the buyer to sue the seller if the buyer was not given a prospectus or if the security was not registered; § 12(2), which gives the buyer a cause of action if the seller misrepresented material facts in the sale; § 17(a), which is the forebearer of rule 10b-5 and makes it unlawful for any person to perpetrate a fraud or material misrepresentation during the sale of any security.

The Exchange Act of 1934 added § 9(e), which permits a buyer or seller to sue anyone who has willfully engaged in manipulative activities in relation to any security registered on an exchange; § 18(a),...
Section 10(b) of the 1934 Act, an antifraud provision, prohibits any "manipulative or deceptive device or contrivance" in contravention of any rule promulgated by the SEC "for the protection of investors." In 1942, pursuant to this power, the SEC adopted rule 10b-5 which prescribes the use of "any device, scheme, or artifice to defraud . . . in connection with the purchase or sale of any security." Although the

which allows a cause of action for a buyer or seller against anyone who made a false or misleading statement in any official papers filed under the Act; § 16(b), which allows any shareholder to recover for the corporation any profits earned by an insider through any purchase and sale or sale and purchase of securities that took place within a six-month period.

Id. at 196-97 n.19.


19. 17 C.F.R. § 240.10b-5 (1981). For the text of rule 10b-5, see note 10 supra. The 1934 Act dealt primarily with the issuance of new securities, and therefore, its provisions were to protect the defrauded buyer and not the defrauded seller. See Note, supra note 16, at 1127. Although the 1934 Act dealt more evenhandedly with the buyer and seller, it supplied remedies only for specialized types of unfair conduct. Id. at 1128. Section 9(e) permits a buyer or seller to sue any person who has wilfully engaged in manipulative activities, and Section 18(a) gives buyers and sellers a cause of action against those who have made false and misleading statements in any document filed under the Act. Id. Finally, in 1936 some protection was given to sellers when Section 15(c) was added to the 1934 Act. Section 15(c) prohibited fraud or misrepresentation in contravention of SEC rules in the purchase as well as the sale of securities. Id. at 1129-30. However, the problem with this section was that it applied only to transactions not taking place on an exchange, and only to brokers and dealers. Id. at 1130. Thus, a sizeable gap still remained in the securities laws dealing with fraud in the purchase of securities by persons other than brokers and dealers, and fraud in the purchase of securities effected on a national exchange. Id. In 1942 the SEC adopted rule 10b-5 in order to fill this perceived gap in the securities laws by supplying defrauded sellers with remedies already available to defrauded buyers under other provisions of the Act. Id. at 1138. See Note, Cause of Action Is Asserted Under Rule 10b-5 Where Minority Shareholder Alleges a Material Nondisclosure by Defendants That Deprived Him of a State Injunctive Remedy Against a Merger, 26 Vill. L. Rev. 777, 781 (1981) [hereinafter cited as Material Nondisclosure]; Note, supra note 17, at 197-98.

20. 17 C.F.R. § 240.10b-5. For the text of rule 10b-5, see note 10 supra. In determining whether a 10b-5 violation has occurred, many courts have struggled to define the requirement of the existence of a device, scheme, or artifice to defraud, and the requirement that the purchase or sale of securities take place in connection with the alleged fraud. Material Nondisclosure, supra note 19, at 780. See Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6 (1971). In Bankers Life, Manhattan Casualty Company's sole stockholder, Bankers Life & Casualty Co., agreed to sell all of its Manhattan stock to one Begole for $5,000,000. Id. at 7. Begole conspired with others to purchase this stock with Manhattan's own assets. Id. This was accomplished by installing a cohort as president of Manhattan and then having Manhattan sell a significant portfolio of United States Treasury bonds. Id. at 8. The proceeds from the sale of the bonds were appropriated by Begole and used to pay for the Manhattan stock. Id. The Court stated that "[t]he crux of the present case is that Manhattan suffered an injury as a result of deceptive practices touching its sale of securities as an investor." Id. at 12-13 (emphasis added).
provisions of rule 10b-5 have been described as catch-all provisions. They apply only where there is fraud. The Supreme Court has stated that when an allegation of fraud is based upon nondisclosure, there can be no fraud absent a duty to speak. Therefore, the crucial question

The Second Circuit interpreted the broad language of Bankers Life in Competitive Assoc., Inc. v. Laventhol, Krekstein, Horwath & Horwath, 516 F.2d 811 (2d Cir. 1975). Competitive Associates retained Yamada and his company—Takara Corporation—as portfolio managers after having examined allegedly false financial statements of the Takara Corporation, which had been prepared by the defendant accounting firm. Id. at 812. Competitive Associates averred that they suffered substantial losses resulting from purchases and sales of securities made by Yamada. Id. The court held that the auditing and certification activities of the defendant were conducted in connection with the purchase or sale of a security, and therefore, were within rule 10b-5. Id. at 815. See Cox, Fraud Is In The Eyes of The Beholder: Rule 10b-5’s Application To Acts of Corporate Mismanagement, 47 N.Y.U. L. Rev. 674 (1972).

The Third Circuit had occasion to interpret the language of Bankers Life in Ketchum v. Green, 557 F.2d 1022 (3d Cir.), cert. denied, 434 U.S. 940 (1977). The Ketchum court held that the complaint failed to allege a fraud which was rendered “in connection with” the purchase or sale of a security. The allegation had been that the defendants failed to disclose a plan to remove the plaintiffs from their offices in the corporation, which plan set in operation a chain of events that culminated in the forced sale of the plaintiffs’ shares of stock in the corporation. Id. at 1027. See Note, Fraudulent Activity Must Occur “In Connection With” Purchase or Sale of Securities to Violate Section 10(b), 23 Vill. L. Rev. 846 (1977-78).

21. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 203 (1976). The legislative history of § 10(b) indicates that it is a “catchall” clause to “deal with new manipulative or cunning devices.” Id. Thomas G. Corcoran, a spokesman for the drafters of the 1934 Act indicated:

Subsection (c) [§ 9(c) of H.R. 7852—later § 10(b)] says, ‘Thou shalt not devise any other cunning devices’ . . . Of course subsection (c) is a catch-all clause to prevent manipulative devices. I do not think there is any objection to that kind of clause. The Commission should have the authority to deal with new manipulative devices.


22. See Chiarella v. United States, 445 U.S. 222, 234-35 (1980). Under the common-law the elements of the tort cause of action for fraud or deceit are: 1) a false representation; 2) knowledge or belief on the part of the defendant that the representation is false, or, that he has an insufficient basis of information to make it; 3) an intention to induce the plaintiff to act or to refrain from action in reliance upon the misrepresentation; 4) justifiable reliance upon the representation on the part of the plaintiff; and 5) damage to the plaintiff, resulting from such reliance. W. Prosser, HANDBOOK OF THE LAW OF TORTS § 106 (4th ed. 1965).

23. Chiarella v. United States, 445 U.S. 222, 235 (1980). See also W. Prosser, supra note 22, at § 106. A difficult problem arises as to whether mere silence can serve as the foundation of a deceit action. Id. The general rule at common-law is that an action will not lie for tacit nondisclosure. Id. However, an exception is found where the parties stand in some confidential or fiduciary relation to one another, such as principal and agent, executor and beneficiary of an estate, bank and investing depositor, or majority and minority stockholders. Id. Hence, a tort action for deceit may be brought where the parties are in a fiduciary relationship, because in that situation the parties are under a duty to disclose all material facts. Id.
for the courts to determine in nondisclosure cases is when the duty to
speak arises.24

The early cases interpreting rule 10b-5 utilized the principles of
common-law fraud, finding that the duty to disclose could be triggered
by a relationship of trust and confidence.25 These courts required a
fiduciary duty to disclose before liability would be imposed under 10b-5
for mere silence.26

A shift in the scope of liability under rule 10b-5 began with the
decision in In re Cady, Roberts & Co.,27 where the SEC extended the
duty to disclose to a tippee of a corporate fiduciary.28 In Cady, Roberts,
a director of the Curtiss-Wright Corporation told a partner in Cady,
Roberts, a broker-dealer firm, that Curtiss-Wright had reduced their

24. See Restrictive Application of Section 10(b), supra note 15, at 479-80.

25. See, e.g., James Blackstone Mem. Library Ass'n v. Gulf M. & O. R.R.,
264 F.2d 445, 450 (7th Cir.), cert. denied, 361 U.S. 815 (1959); Trussell v.
United Underwriters, Ltd., 228 F. Supp. 757, 762 (D. Colo. 1964); Connelly v.
Balkwill, 174 F. Supp. 49, 56 (N.D. Ohio 1959), aff'd per curiam, 279 F.2d 685
(6th Cir. 1960); Tobacco & Allied Stocks, Inc. v. Transamerica Corp., 143 F.
Supp. 323, 327-28 (D. Del. 1956), aff'd, 224 F.2d 902 (3d Cir. 1957); Mills v.
Insider Trading In Corporate Securities: A Survey of Hazards and Disclosure
Obligations Under Rule 10b-5, 62 Nw. U.L. Rev. 809, 815-16 (1968); Note,
Absent An Affirmative Duty to Disclose, Criminal Liability for Nondisclosure
[hereinafter cited as Affirmative Duty To Disclose]. But see Speed v.
Transamerica Corp., 99 F. Supp. 808 (D. Del. 1951). In Speed, a majority
stockholder was found liable under rule 10b-5 for purchasing shares from minority
stockholders without the disclosure of nonpublic facts to which the majority
stockholder had access to by virtue of its position. Id. at 828-29. Although the
court held that a majority shareholder has a duty to inform the minority share-
holders of information it acquired, concerning the fact that their corporation's
assets were grossly undervalued, the court stated that its decision was not based
on the common-law notion of a fiduciary relation, but rather on notions of
fairness. Id. at 829. The court stated:

The duty of disclosure stems from the necessity of preventing a cor-
porate insider from utilizing his position to take unfair advantage of
the uninformed minority stockholders. It is an attempt to provide a
degree of equalization of bargaining position in order that the minor-
ity may exercise an informed judgment in any such transaction.

Id. See generally Note, Rule 10b-5 and the Duty to Disclose Market Infor-
mation: It Takes A Thief, 55 St. John's L. Rev. 93, 103 (1980) [hereinafter cited as It Takes A Thief].

26. See, e.g., Trussell v. United States Underwriters, Ltd., 228 F. Supp. 757,
762 (D. Colo. 1964); Connelly v. Balkwill, 174 F. Supp. 49, 56 (N.D. Ohio
1959), aff'd per curiam, 279 F.2d 685 (6th Cir. 1960); See also Note, SEC
Action Against Fraudulent Purchasers and Sellers, 59 Harv. L. Rev. 769, 773-74
(1946); Note, Purchaser's Duty to Disclose Under Securities and Exchange
Commission Rule X-10B-5, 40 Minn. L. Rev. 62, 64-65 (1955); note 23 and
accompanying text supra.


28. Id. at 912. See It Takes A Thief, supra note 25, at 104.
dividend. Acting on this information, the broker sold large numbers of Curtiss-Wright securities 29 before the news of the dividend cut reached the exchange.30

The SEC held that the broker violated section 10(b) and rule 10b-5 by failing to disclose the company’s plan to reduce dividends prior to trading.31 In reaching this conclusion, the SEC noted that the antifraud provisions are phrased in terms of “any person” 32 and, therefore, although it is clear that an obligation is required of corporate insiders—officers, directors, and controlling shareholders—these groups are not the only persons subject to the obligation.33 The Commission stated that the duty to disclose rests on two principal elements:

[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.34

29. 40 S.E.C. at 909. At approximately 11:00 a.m., the board of directors of the Curtiss-Wright Corporation authorized the transmission to the New York Stock Exchange of their decision to reduce their dividend. Id. There was a short delay in the transmission of the telegram due to technical problems, and the message was not received by the exchange until 12:29 p.m. Id. During this interval, J. Cheever Cowdin, a Curtiss-Wright director, called Robert M. Gintel, the selling broker at Cady, Roberts, to inform him that the dividend had been cut. Id.

30. Id. Upon the receipt of Cowdin’s message, Gintel, the selling broker, entered two sell orders for execution on the exchange, one to sell 2,000 shares of Curtiss-Wright stock for ten accounts, and the other to sell-short 5,000 shares for eleven accounts. Id.

31. Id. at 909-10. The sell orders were executed at 11:15 and 11:18 a.m. on November 25 at 40 3/4 and 40 5/8 respectively. Id. at 909. The announcement did not appear on the Dow Jones ticker tape until 11:48 a.m. on that day. Id. at 909-10. At that time, the exchange suspended trading of Curtiss-Wright stock due to the large number of sell orders. Id. When trading resumed two hours later, the stock was trading at 36 1/2, and closed at 34 7/8. Id. at 910.

32. Id. at 911. For the text of §10(b) and rule 10b-5, see notes 9 & 10 supra. The failure of Gintel to make a disclosure of material facts known to him violated these antifraud provisions. Id. The defrauded parties were the purchasers of the Curtiss-Wright stock, and there was, therefore, a fraud in connection with the purchase of a security in violation of rule 10b-5. Id.

The SEC similarly found that the registrant—Cady, Roberts & Co.—violated rule 10b-5 since the actions of Gintel, a member of the registrant acting in the course of his employment, are regarded as the acts of the registrant itself. Id. See also In re H. F. Schroeder & Co., 27 S.E.C. 833 (1948).

33. 40 S.E.C. at 912. For the text of rule 10b-5, see note 10 supra.

34. 40 S.E.C. at 912. The SEC noted that since rule 10b-5 is phrased in terms of “any person”, it seems clear that corporate insiders do not exhaust the class of persons upon whom the obligation of disclosure rests. Id.

35. Id. Therefore, in Cady, Roberts, the SEC made a significant departure from securities cases following common-law principles of fraud by adopting an “access test” where anyone person could be deemed to have disclosure obligations
The expansion of the scope of rule 10b-5 liability which began in Cady, Roberts culminated with the landmark decision by the Second Circuit in SEC v. Texas Gulf Sulphur Co.\textsuperscript{36} In Texas Gulf Sulphur, officers, directors, and employees of Texas Gulf Sulphur purchased stock in their corporation without disclosing facts concerning a recent discovery of copper ore to the sellers of the corporation’s securities.\textsuperscript{37} The court held that the defendants had violated rule 10b-5 since their failure to disclose amounted to a fraud in connection with the purchase or sale of a security.\textsuperscript{38} In reaching this conclusion, the court used broad language stating that the duty to disclose arose not because of any special relationship between the parties, but, rather, merely because the defendants had “possession” of material inside information.\textsuperscript{39} Although


37. Id. at 847. In March of 1959, aerial geophysical surveys were conducted in Eastern Canada by a group led by a vice-president of Texas Gulf Sulphur Company (TGS). Id. at 843. These operations revealed unusual variations in the conductivity of the rock beneath the surface, and as a result, ground explorations were begun in October 1963. Id. Drilling samples indicated extensive mineralization, and TGS’s president ordered that the results be kept secret, even as to other officers, directors, and employees of TGS. Id. Despite this order, rumors began to circulate, several months after the initial drilling, that TGS had discovered a rich mineral deposit, and in response, TGS issued a press release stating that the drillings had been inconclusive. Id. at 844-45. Four days after the press release, TGS announced the discovery of at least twenty-five million tons of ore. Id. at 846. Between the time of the initial drilling and the announcement by TGS, the individual defendants or their tippees purchased shares or calls totaling 28,360 shares of TGS stock. Id. at 847.

The individual defendants were charged with: 1) the purchase, personally or through agents, of TGS stock or call options on the basis of material inside information while such information remained undisclosed to the public or to the particular sellers; 2) the divulging of information to others for use in purchasing TGS stock or the recommendation of its purchase while the information was undisclosed to the public or to the particular sellers; 3) the acceptance of options to purchase TGS stock without disclosing the material information to either the Stock Option Committee or the TGS Board of Directors. Id. at 839-42. TGS, itself, was charged with a violation of rule 10b-5 by the issuance of a deceptive press release. Id. at 842.

38. Id. at 842-43. The defendants, who purchased stock or call options from the time of the initial drilling to the announcement by TGS, were held to have violated rule 10b-5. Id. at 842. For the text of rule 10b-5, see note 10 supra.

39. Id. at 848. The court noted that the essence of rule 10b-5 is that anyone who trades for his own benefit in the securities of a corporation who has “access, directly or indirectly, to information intended to be available only for
the court’s analysis lessened the importance of having a relationship between the recipient of the material information and the issuer of the securities, the impact of this broad test may be limited by the fact that in Texas Gulf Sulphur, the defendants did maintain a relationship with the issuer.\textsuperscript{40} Therefore, following the Texas Gulf Sulphur decision, it was still unclear whether a fiduciary relationship was necessary to trigger the duty to disclose.\textsuperscript{41}

In 1980, the Supreme Court took steps to narrow the scope of lia-

a corporate purpose and not for the personal benefit of anyone” may not take advantage of such information. \textit{Id.}, quoting \textit{In re Cady, Roberts \\& Co.}, 40 S.E.C. 907, 912 (1961). In addition, the court stated that insiders, such as directors and officers, are clearly within this rule, but further cautioned that rule 10b-5 is applicable to anyone who possesses material inside information, regardless of whether they are an insider in the strict sense. \textit{Id.} at 848. The Second Circuit then articulated a new standard in determining the applicability of rule 10b-5 with regard to nondisclosure:

[A]nyone in possession of material inside information must either disclose it to the investing public, or, if he is disabled from disclosing it in order to protect a corporate confidence, or he chooses not to do so, must abstain from trading in or recommending the securities concerned while such inside information remains undisclosed. \textit{Id.} Thus, the court established a broader test than the “access” test developed in \textit{Cady, Roberts}. \textit{See} note 35 and accompanying text supra; \textit{It Takes A Thief}, supra note 25, at 108.

\textbf{40.} 401 F.2d at 839. The defendants in Texas Gulf Sulphur included Texas Gulf Sulphur and several of its officers, directors and employees. \textit{Id.} Therefore, because the individual defendants were technically corporate insiders, the court’s statement that anyone in the possession of material inside information is precluded from trading without disclosing the information was broader than necessary. \textit{See}, \textit{e.g.}, \textit{Note, A Market Insider Analysis of Liability Under Section 10(b) and Rule 10b-5}, 46 BROOKLYN L. REV. 1103, 1113 (1980) [hereinafter cited as Insider Analysis]; \textit{It Takes A Thief}, supra note 25, at 108; \textit{Affirmative Duty to Disclose}, supra note 25, at 136-37.

\textbf{41.} \textit{See} Insider Analysis, supra note 40, at 1113. Shortly after the Texas Gulf Sulphur decision, several cases were decided which set back the development of rule 10b-5 by refusing to fix liability unless a fiduciary duty could be found. \textit{See}, \textit{e.g.}, SEC v. Great Am. Indus., Inc., 407 F.2d 453 (2d Cir. 1968) (en banc), cert. denied, 395 U.S. 920 (1969); General Time Corp. v. Talley Indus., Inc., 403 F.2d 159 (2d Cir. 1968), cert. denied, 398 U.S. 1026 (1969). \textit{But see} Crane Co. v. Westinghouse Air Brake Co., 419 F.2d 787 (2d Cir. 1969), \textit{cert. denied}, 400 U.S. 822 (1970); \textit{In re Investors Management Co., Inc.}, 44 S.E.C. 633 (1971). In Investors Management, the Commission rejected the contention that no violation could be found unless it was shown that the recipient of the information occupied a special relationship with the issuer or insider corporate source. \textit{Id.} at 643-44. The Commission held that:

one who obtains possession of material, nonpublic corporate information, which he has reason to know emanates from a corporate source, and which by itself places him in a position superior to other investors, thereby acquires a relationship with respect to that information within the purview and restraints of the antifraud provisions. \textit{Id.} Thus, in Investors Management, the SEC held that tippees and even remote tippees could violate rule 10b-5 when they know or have reason to know that they have received material nonpublic information which was improperly obtained. \textit{Id.}
bility under rule 10b-5 for nondisclosure in Chiarella v. United States.\(^42\) In Chiarella, the defendant was employed as a markup man by a financial printing company.\(^43\) As a result of his position, Chiarella learned of several pending takeover bids while preparing documents for the acquiring corporations.\(^44\) Chiarella used this information by purchasing the stock of five target companies prior to the public announcement of the tender offers and reselling for a substantial profit shortly after public notice.\(^45\) The United States Court of Appeals for the Second Circuit found that Chiarella violated section 10(b) and rule 10b-5,\(^46\) stating that "[a]nyone—corporate insider or not—who regularly receives material nonpublic information may not use that information to trade in securities without incurring an affirmative duty to disclose.

\(^42\) 445 U.S. 222 (1980). For a discussion of how the Court narrowed the scope of nondisclosure liability, see Morrison, Silence is Golden: Trading on Nonpublic Market Information, 8 SEC. REG. L.J. 211, 211-12 (1980); It Takes A Thief, supra note 25, at 113; Note, The Standard of Liability Under Rule 10b-5 In Cases of Nondisclosure, 3 W. NEW ENG. L. REV. 99 (1980) [hereinafter cited as Standard of Liability]; Affirmative Duty To Disclose, supra note 25. The expansion of rule 10b-5 had previously been halted in other areas by the Supreme Court. See, e.g., Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976) (element of scienter is required for a rule 10b-5 violation, and simple negligence is not enough); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975) (only purchaser or seller may bring a private action under rule 10b-5 for money damages).

\(^43\) 445 U.S. at 224. As an employee of the specialized printing firm, it was Chiarella's job to take the document from the customer, select the type fonts and page layouts, and then to pass the manuscript on to be set into type. United States v. Chiarella, 588 F.2d 1358, 1363 (2d Cir. 1978), rev'd, 445 U.S. 222 (1980).

\(^44\) Id. Although all the documents contained coded names of the offeror and the companies, Chiarella's expertise as a knowledgeable trader enabled him to decipher the code and ascertain the actual names of the companies. Id.

\(^45\) Id. This information was "market information," in that it referred to information about circumstances which affect the market for a company's securities but which do not affect the company's assets or earning power. 445 U.S. at 231. See Fleisher, Mundheim & Murphy, An Initial Inquiry into the Responsibility to Disclose Market Information, 121 U. PA. L. REV. 798, 799 (1975). Market information is frequently "generated by sources outside the company whose shares are affected." Id. at 807.

\(^46\) 588 F.2d 1358, 1368 (1978). Chiarella had entered into a consent decree with the SEC to return his profits to the sellers of the shares he purchased. 445 U.S. at 224. The SEC has obtained consent decrees from other printers in situations similar to those in Chiarella. See, e.g., SEC v. Manderano, [1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,357 (D.N.J. 1978); SEC v. Sorg Printing Co., [1974-1975 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 95,034 (S.D.N.Y. 1975). In affirming his conviction, the Second Circuit reemphasized the fact that Congress enacted § 10(b) to prohibit conduct which destroys the public's confidence in the securities markets. Id. at 1368. The court noted that § 10(b) was specifically designed to prohibit such manipulative and deceptive practices and concluded by stating: "It is difficult to imagine conduct less useful, or more destructive of public confidence in the integrity of our securities markets, than Chiarella's." Id. at 1369.
And if he cannot disclose, he must abstain from buying or selling."

The United States Supreme Court reversed the conviction, noting that while silence in connection with the purchase or sale of securities may operate as a fraud actionable under section 10(b), such liability for nondisclosure is premised upon a duty to disclose which arises from a relationship of trust and confidence between parties to a transaction. The Court held that since Chiarella was not a fiduciary of the selling shareholders, he had no duty to reveal his knowledge of the impending takeovers to them, and thus did not violate rule 10b-5.

Chief Justice Burger, in his dissenting opinion, opined that any person who "misappropriates" nonpublic information has an absolute duty to disclose that information or to refrain from trading. The

47. Id. at 1365 (footnote omitted) (emphasis by the court).

48. 445 U.S. at 237. The Court held that the duty to disclose arises only from a relationship between the parties, and not from the mere "ability to acquire information because of his position in the market." Id. at 231 n.14. The Supreme Court concluded that the Second Circuit failed to identify a relationship between Chiarella and the sellers that gave rise to a duty to disclose. 445 U.S. at 232. The Second Circuit's decision, the Court stated, rested solely upon the belief that the federal securities laws created a system that mandates equal access to information that is necessary to a well-reasoned and intelligent investment decision. Id. Thus, the court of appeals had suggested that the use by anyone of material information that is not generally available to all is fraudulent. Id. The Supreme Court stated that this reasoning suffers from two defects. "First, not every instance of financial unfairness constitutes fraudulent activity under § 10(b)." Id. "Second, the element required to make silence fraudulent—a duty to disclose—is absent in this case." Id.

49. Id. at 230.

50. Id. at 232-33. The Supreme Court reasoned that no duty could arise from Chiarella's relationship with the sellers of the target company's securities, for he had no prior dealings with them. Id. at 232. He was not their agent, he was not a fiduciary, and he was not a person in whom they placed their trust. Id.

51. Id. at 240 (Burger, C.J., dissenting). Chief Justice Burger, in his dissenting opinion, stated that as a general rule, neither party to an arm's length business transaction has an obligation to disclose information to the other party unless some confidential or fiduciary relation exists. Id. at 239-40 (Burger, C.J., dissenting), citing W. PROSSER, HANDBOOK OF THE LAW OF TORTS § 106 (2d ed. 1955). This permits business people to capitalize on experience and skill. Id. at 240. However, the Chief Justice reasoned that this general rule should give way when an informational advantage is obtained not by superior skill or foresight but by unlawful means. Id. Chief Justice Burger then noted that one commentator had stated:

[T]he way in which the buyer acquires the information which he conceals from the vendor should be a material circumstance. The information might have been acquired as the result of his bringing to bear a superior knowledge, intelligence, skill or technical judgment; it might have been acquired by chance; or it might be acquired by means of some tortious action on his part. . . . Any time information is acquired by an illegal act it would seem that there should be a duty to disclose that information.
Chief Justice stated that because Chiarella misappropriated information given to his employer by the offering company and "violated his duty as an agent to the offeror corporations not to use their confidential information for personal profit," his conduct violated rule 10b-5. Although the majority did not consider Chief Justice Burger's misappropriation theory because it had not been presented to the jury, four other members of the Court indicated their agreement with it. Therefore, following this decision, the validity of the misappropriation theory remained an open question, since the Chiarella Court "wisely [left] the resolution of this issue for another day." Following the Chiarella decision the SEC suggested that the misappropriation theory would be a useful technique for bringing subse-

*Id.*, quoting *Keeton, Fraud-Concealment and Non-Disclosure*, 15 *Tex. L. Rev.* 1, 25-26 (1966) (emphasis added by Chief Justice Burger). Thus, Chief Justice Burger stated that he would read §10(b) and rule 10b-5 to "encompass and build on this principle: to mean that a person who has misappropriated nonpublic information has an absolute duty to disclose that information or to refrain from trading." *Id.* at 240.

52. *Id.* at 245 (Burger, C.J., dissenting), quoting *Reply Brief for Petitioner at 4* (emphasis added by Chief Justice Burger). The Chief Justice stated that the evidence indicated that Chiarella had "misappropriated—stole to put it bluntly—valuable nonpublic information entrusted in him in the utmost confidence." *Id.* at 245 (Burger, C.J., dissenting).


54. 445 U.S. at 236. The majority concluded that it need not decide whether this theory had merit because it had not been submitted to the jury, and therefore, could not be used to affirm the conviction of the defendant. *Id.*

55. *Id.* at 238-52. Four Justices suggested a willingness to uphold the misappropriation theory. *See id.* at 239 (Brennan, J., concurring); *Id.* at 240 (Burger, C.J., dissenting); *Id.* at 249 (Blackmun & Marshall, J.J., dissenting).

56. *Id.* at 238 (Stevens, J., concurring). In his concurring opinion, Justice Stevens said:

The Court correctly does not address the second question: whether the petitioner's breach of his duty of silence—a duty he unquestionably owed to his employer and to his employer's customers—could give rise to a criminal liability under Rule 10b-5. Respectable arguments could be made in support of either position. On the one hand, if we assume that petitioner breached a duty to the acquiring companies that had entrusted confidential information to his employers, a legitimate argument could be made that his actions constituted "a fraud or a deceit" upon those companies "in connection with the purchase or sale of any security." On the other hand, inasmuch as those companies would not be able to recover damages from petitioner for violating Rule 10b-5 because they were neither purchasers nor sellers of target company securities, . . . it could also be argued that no actionable violation of Rule 10b-5 had occurred.

quent Chiarella-type cases within the reach of rule 10b-5. In addition, in September of 1980, the SEC adopted rule 14e-3 to specifically focus on the problem of insider trading in connection with tender offers. Rule 14e-3 prohibits trading on the basis of material, nonpublic information "[i]f any person has taken a substantial step or steps to commence, or has commenced, a tender offer." The importance of the


As noted, the Chiarella Court did not resolve whether trading while in possession of material, nonpublic market information misappropriated or obtained or used by unlawful means violates Rule 10b-5. The Commission continues to believe that such conduct undermines the integrity of, and investor confidence in, the securities markets, and that persons who unlawfully obtain or misappropriate material, nonpublic information violate Rule 10b-5 when they trade on such information.

Id.

58. Id. at 88,453. Rule 14e-3 mandates a "disclose or abstain from trading" rule for any person who obtains inside information concerning a tender offer from either the offeror or the target company. See Affirmative Duty To Disclose, supra note 25, at 149.

59. 17 C.F.R. § 240.14e-3 (1981). Rule 14e-3 provides in pertinent part:

(a) If any person has taken a substantial step or steps to commence, or has commenced, a tender offer (the "offering person"), it shall constitute a fraudulent, deceptive or manipulative act or practice within the meaning of section 14(e) of the Act for any other person who is in possession of material information relating to such tender offer which information he knows or has reason to know is nonpublic and which he knows or has reason to know has been acquired directly or indirectly from:

(1) The offering person,
(2) The issuer of the securities sought or to be sought by such tender offer, or
(3) Any officer, director, partner or employee or any other person acting on behalf of the offering person or such issuer, to purchase or sell or cause to be purchased or sold any of such securities or any securities convertible into or exchangeable for such securities or any option or right to obtain or to dispose of any of the foregoing securities, unless within a reasonable time prior to any purchase or sale such information and its source are publicly disclosed by press release or otherwise.

Id. See O’Connor & Assoc. v. Dean Witter Reynolds, Inc., [Current] Fed. Sec. L. Rep. (CCH) ¶ 98,443, at 92,622 (S.D.N.Y. 1982). In O’Connor, the board of directors of Amax, Inc. (Amax) made a public announcement that Standard Oil of California, Inc. (Socal) had made a proposal to acquire an equity interest in Amax. Id. at 92,623. Simultaneously with the announcement of the proposal, the Amax board announced its decision to reject the offer. Id. O’Connor & Associates (O’Connor), trader of stocks and options, had sold call options on Amax stock. Id. O’Connor brought this action seeking relief under sections 10(b) and 14(e) of the Securities Exchange Act, rules 10b-5 and 14e-3 of the Securities and Exchange Commission, and under a common law fraud theory, alleging that insiders at either Socal or Amax or both had tipped inside information to unknown customers of Dean Witter Reynolds, Inc. and A. G. Becker, Inc. and that these tippees had purchased Amax call options
Chiarella decision, however, is not diminished by the promulgation of this new rule, since in a tender offer situation, both rule 10b-5 and rule 14e-3 may be applied in fashioning a remedy.\textsuperscript{60} Furthermore, the Chiarella decision is not limited to the tender offer situation.\textsuperscript{61}

Against this background, the court in Newman was faced with determining whether the misappropriation theory, as expressed by Chief Justice Burger in his Chiarella dissent,\textsuperscript{62} could be used to impose criminal liability under rule 10b-5 on persons who allegedly used their positions within investment banking firms to obtain material nonpublic information and used that information in security trading for personal profit.\textsuperscript{63}

The Second Circuit noted that the Supreme Court in Chiarella had held there was no fraud where the defendant had no duty to speak, and since there was no fiduciary relationship between Chiarella and the sellers of the stock, no duty to disclose was present.\textsuperscript{64} However, the Newman court concluded that this case was different from Chiarella because in Newman, the Government asserted that the defendants owed a duty to Morgan, Kuhn Loeb, and their clients, and not to the sellers of the target companies' stock.\textsuperscript{65} The Government asserted that the defendants violated fiduciary duties of honesty, loyalty, and silence, and engaged in practices which operated as a fraud on Morgan, Kuhn Loeb, and their clients.\textsuperscript{66}

with knowledge of the proposed merger. \textit{Id.} at 92,623-24. The court concluded that Socal's action constituted a substantial step toward the commencement of a tender offer, and therefore, was within the scope of rule 14e-3. \textit{Id.} at 92,629-33.

\textsuperscript{60} See \textit{id.} at 92,622. The court concluded that a plaintiff alleging fraud in connection with a tender offer could obtain relief under both rule 10b-5 and rule 14e-3, since duplicative remedies may be simultaneously pursued under the securities laws. \textit{Id.} at 92,632.

\textsuperscript{61} See 445 U.S. 222 (1980). For a discussion of the Chiarella decision, see notes 42-50 and accompanying text supra. The Court did not limit its holding to the tender offer situation, but rather set out in broad language when an outsider has a duty to disclose information which is generated by sources outside the issuer. See 445 U.S. 222 (1980). \textit{See also} note 45 supra; note 101 infra.

\textsuperscript{62} See 445 U.S. at 239 (Burger, C.J., dissenting); notes 51-58 and accompanying text supra.

\textsuperscript{63} 664 F.2d at 16.

\textsuperscript{64} \textit{Id.} at 15. \textit{See} notes 48-50 and accompanying text supra.

\textsuperscript{65} 664 F.2d at 15-16.

\textsuperscript{66} \textit{Id.} The indictment alleged that Courtois and Antoniu breached the trust and confidence placed in them by their employers and their employer's clients. \textit{Id.} The indictment also charged Newman, Carniol, and Spyropoulos with aiding Courtois and Antoniu in violating the fiduciary duties of honesty, loyalty, and silence owed to Morgan, Kuhn Loeb, and their clients. \textit{Id.} at 16. Furthermore, the indictment charged that Courtois, Newman, and Carniol engaged in acts which operated as a fraud and deceit on Morgan, Kuhn Loeb, and clients of these investment banking firms. \textit{Id.}
The Newman court stated that in order to come within the purview of rule 10b-5,\(^7\) the fraud does not have to be perpetrated upon the purchasers or sellers of the securities.\(^8\) The court explained that the fact that the defrauded parties were Morgan, Kuhn Loeb, and their clients, and that the securities being purchased were stock in the target companies, would not preclude the applicability of rule 10b-5.\(^9\) The court therefore proceeded to examine the conduct alleged in the indictment more closely to determine if there was in fact a rule 10b-5 violation in these circumstances.\(^7\)

The Second Circuit first considered whether Newman's conduct amounted to fraud and deceit.\(^7\) The court concluded that by sullying the reputations of Morgan and Kuhn Loeb as safe repositories of client confidences, Newman and his cohorts defrauded these investment banking firms.\(^7\) In addition, the court found that Newman and his companions by their stock purchases had wronged the clients of Morgan and Kuhn Loeb whose takeover plans were keyed to target company stock prices fixed by market forces, and not prices artificially inflated through purchases by "purloiners of confidential information."\(^7\)

The court looked next at whether the fraud was in connection with

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67. For the text of rule 10b-5, see note 10 supra.

68. 664 F.2d at 16-17. The Second Circuit noted that the language of rule 10b-5 requires only that the fraud be in connection with a sale or purchase of a security. Id. at 17. However, the court pointed out that only purchasers and sellers of securities may bring 10b-5 suits for money damages. Id., citing Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 737, 749 (1975). See also Birnbaum v. Newport Steel Corp., 193 F.2d 461 (2d Cir.), cert. denied, 343 U.S. 956 (1952).

69. 664 F.2d at 16-17.

70. Id. at 17-18. Despite the SEC's adoption of rule 14e-3, which specifically deals with insider trading in connection with tender offers, the present case was unaffected because the acts covered in the indictment occurred prior to the promulgation of the rule. Id. at 16 n.3. For a discussion of rule 14e-3, see notes 57-61 and accompanying text supra.

71. 664 F.2d at 17-18.

72. Id. at 17. The court stated that the wrongdoing charged against Newman and his cohorts was fraud, and not simple internal corporation mismanagement. Id. See Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6 (1971). In Bankers Life, Justice Douglas suggested a limit to the broad "touch" test when he stated that § 10(b) did not seek to regulate transactions which constitute mere internal corporate mismanagement. Id. at 12. For a discussion of this "touch" test of Bankers Life, see note 20 supra.

73. 664 F.2d at 17-18. The court noted that in a tender-offer situation, increased purchases will drive up the price of the stock of the target companies, making the offering companies' offers less attractive. Id. (citation omitted). The court stated that in other areas of the law, a deceitful misappropriation of confidential information is unlawful. Id. at 18 (citations omitted). Consequently, as there is no reason to believe that Congress intended to establish a less rigorous standard under the Securities Acts, the same code of conduct should be used. Id. (citations omitted).
the purchase or sale of securities.\textnormal{74} It concluded that there was a sufficient connection between the fraud and the purchase to apply rule 10b-5, since the defendant’s sole purpose in misappropriating the confidential takeover information was to purchase shares of the target companies.\textnormal{75} The \textit{Newman} court concluded that the defendant’s conduct constituted a criminal violation of rule 10b-5 of which the defendant had clear notice, despite the fact that neither Morgan, Kuhn Loeb, nor their clients was at any time a purchaser or seller of the target company securities in any transaction with any of the defendants.\textnormal{76}

Judge Dumbauld criticized the majority for holding that Newman’s acts were a fraud in connection with the purchase or sale of any security.\textnormal{77} He opined that the Supreme Court’s decisions seem to evince a trend which would confine the scope of section 10(b) to practices harmful to participants in actual purchase-sale transactions.\textnormal{78} Thus, although the defendants deceptively violated a fiduciary duty to their employers and customers of their employers, the defrauded parties were not at that time purchasers or sellers of any target company securities and no section 10(b) and rule 10b-5 violation could be found.\textnormal{79}

It is suggested that the Second Circuit in \textit{Newman} erred in applying the misappropriation theory\textnormal{80} without carefully considering its im-

74. \textit{Id.}

75. \textit{Id.} The court relied upon a Supreme Court decision where the phrase “in connection with” was construed flexibly to include deceptive practices “touching” the sale of securities. \textit{Id.}, citing Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 12 (1971). For a discussion of \textit{Bankers Life}, see note 20 \textit{supra}.

76. 664 F.2d at 16. The court disposed of the district court’s basis for dismissing the indictment by simply stating “we believe that Rule 10b-5’s proscription of fraudulent deceptive practices upon any person in connection with the purchase or sale of a security provided clear notice to appellee that his fraudulent conduct was unlawful.” \textit{Id.} at 19. The court also held that the mail fraud statute was violated and, since both substantive counts were reinstated, the conspiracy charge was also reinstated. \textit{Id.} at 19-20. See 18 U.S.C. §§ 371, 1341 (1976).

77. 664 F.2d at 20-21 (Dumbauld, J., concurring in part and dissenting in part). Judge Dumbauld concurred in those parts of the majority opinion which found that the defendant had violated the mail fraud statute, but dissented from the majority opinion’s holding in regard to the securities fraud. \textit{Id.} Judge Dumbauld stated that he was “not certain that the deceptive practice engaged in by defendant and his confederates was a fraud in connection with the purchase or sale of any security.” \textit{Id.}


79. \textit{Id.}

80. See 664 F.2d at 15-16. The court held that Newman was engaged in acts which operated as a fraud on Morgan, Kuhn Loeb, and their clients, and that this fraud was in connection with the purchase of shares of the target companies, and therefore, constituted a criminal violation of section 10(b) and rule 10b-5. \textit{Id.} at 17-19. For a discussion of the misappropriation theory introduced by Chief Justice Burger in \textit{Chiarella}, see notes 51-53 and accompanying text \textit{supra}. 
RECENT DEVELOPMENTS

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liability should be the same regardless of whether the inside information comes from an inside source or a source outside the issuer.

It is submitted that in applying the misappropriation theory, the *Newman* court read rule 10b-5 as containing two unrelated elements. First, that the defendant's activity must amount to a fraud,88 and second, that the activity be in connection with the purchase or sale of a security.89 The problem with this interpretation is that the absence of a nexus requirement between the fraud and the purchase of the security allows the court to find a 10b-5 violation whenever it can make some connection between these elements, no matter how tenuous.90

The *Newman* court relies on the Supreme Court's decision in *Superintendent of Insurance v. Bankers Life & Casualty Co.*91 to support the proposition that for a 10b-5 violation, the deceptive practices need only "touch" the sale of securities.92 While it is agreed that *Bankers Life* did flexibly construe the "in connection with" requirement of rule 10b-5, a careful reading of the decision indicates that the fraud must result from deceptive practices "touching" the purchase or sale of securities of the defrauded party.93

Prior to the raising of the misappropriation theory in *Chiarella* and *Newman*, in all cases finding 10b-5 liability, the defrauded party was also the purchaser or seller of the securities,94 and therefore, the question of whether *Bankers Life* required such symmetry never arose. However, since the misappropriation theory now makes it possible for the defrauded party to be different from the purchaser or seller of the securities,95 it is necessary to reread *Bankers Life* with this problem in mind. It is submitted that a careful reading will show that the test adopted in *Bankers Life* requires the defrauded party to also be the

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88. See 664 F.2d at 17-18. See notes 71-73 and accompanying text supra.
89. See 664 F.2d at 18. See notes 74-75 and accompanying text supra.
90. See 664 F.2d at 17-18. The connection in *Newman* was based on the fact that information received as a result of a fraud on one corporation, was used to purchase securities of other corporations. Id. More specifically, Courtois and Antoniu defrauded their employers and their clients, and then gave information to Newman, who acting on this information, purchased stock in corporations who were the targets of proposed mergers. Id. at 15.
92. 664 F.2d at 18. For a discussion of *Bankers Life* and interpretations in the Courts of Appeals, see note 20 supra.
93. See 404 U.S. at 12-13. In *Bankers Life* there was an act which operated as a fraud on Manhattan Casualty Co., and it was alleged that this fraud was in connection with the sale of Manhattan's securities. Id. at 9-13. Therefore, the Court in *Bankers Life* was faced with a situation where the defrauded party was also the seller of securities. Id.
94. See, e.g., SEC v. Texas Gulf Sulphur Co., 401 F.2d 883 (2d Cir. 1968) (en banc), cert. denied, 394 U.S. 976 (1969) (sellers of Texas Gulf Sulphur stock were the defrauded parties); *In re Cady, Roberts & Co.* 40 S.E.C. 907 (1961) (purchasers of Curtiss-Wright stock were the defrauded parties). For a discussion of these cases, see notes 27-41 and accompanying text supra.
95. See 664 F.2d at 16; note 90 and accompanying text supra.
purchaser or seller of securities, and therefore, the misappropriation theory should not be used to sustain a rule 10b-5 violation.\footnote{96}

It is suggested that the misappropriation theory is unnecessary and that any problem caused by declaring it invalid can easily be solved. The apparent concern is that without the misappropriation theory, many defendants such as Newman and Chiarella, would go unpunished.\footnote{97} This belief is unfounded now that the SEC has adopted rule 14e-3 to specifically deal with insider trading in connection with tender offers.\footnote{98} At the present time, rule 14e-3 and rule 10b-5 are both being applied to supply duplicate sanctions for the same conduct.\footnote{99} It is suggested that there is no reason for such duplication, and the better approach is to limit rule 10b-5 to situations where the defrauded party is the purchaser or seller of the securities.\footnote{100} In all other situations where there

\footnotesize{96. See notes 93 & 95 and accompanying text supra. Despite the proposed blanket rejection of the misappropriation theory, it is arguable that the theory can be limited to a tender offer situation consistently with the Bankers Life decision. The reason is that in a tender offer situation, fraud on the acquiring corporation may be considered a fraud on the target company since the information really is being misappropriated not from one corporation, but, rather, from a transaction involving both corporations. See United States v. Courtois, [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,024, at 91,296. The district court insinuated that the defendants committed fraud upon both the acquiring and the target companies. \textit{Id}. Therefore, in a tender offer situation, the misappropriation theory could be used since in actuality the defrauded party and the issuer of securities is the target company. See note 93 and accompanying text supra.}

\footnotesize{97. See Chiarella v. United States, 445 U.S. 222 (1980). Without the use of the misappropriation theory, the Chiarella Court found that Chiarella was not liable under rule 10b-5. \textit{Id}. For a discussion of Chiarella, see notes 42-56 and accompanying text supra. See also Standard of Liability, supra note 42, at 119. The Chiarella decision created the possibility of anomalous results, as a printer such as Chiarella did not have a duty to disclose prior to trading in the securities because he obtained information from an outside source, and therefore had no fiduciary duty to the sellers of the target companies' stock, whereas a printer who received the information from the target company would have a duty to disclose. \textit{Id}. However, the misappropriation theory eliminates this problem by forbidding both of these printers from trading prior to disclosure. \textit{Id}.}

\footnotesize{98. For a discussion of rule 14e-3, see notes 58-59 and accompanying text supra.}


\footnotesize{100. See notes 93-94 and accompanying text supra; United States v. Courtois, [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,024, at 91,296. The district court stated that "[w]hile the indictment does charge that defendants committed fraud upon, \textit{inter alia}, the investment banks' corporate clients (including, in these instances, target companies), it is not a fraud perpetrated upon the companies as purchasers or sellers of securities, a requisite element under the securities laws." \textit{Id}. See also Heller, supra note 55, at 537. The defendants in Chiarella asserted the argument suggested by Justice Stevens in his concurring opinion, that rule 10b-5 applied solely to a fraud in connection with the purchase or sale of a security perpetrated upon}
is a need for some regulation.\textsuperscript{101} instead of invoking the misappropriation theory, it should be left for Congress to supply the regulation.

The misappropriation theory is burdened with many problems and inconsistencies.\textsuperscript{102} However, because the theory makes it easier to prove liability, the approval of the misappropriation theory is likely to result in increased prosecutions for insider trading.\textsuperscript{103} Further, the type of conduct which the theory was developed to control could be, and in fact now is, regulated by other means.\textsuperscript{104} It is therefore submitted that if considered by the Supreme Court, it should be rejected as an unwarranted expansion of rule 10b-5.\textsuperscript{105}

\begin{quote}
\textit{Paul M. Altman}
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the immediate buyer or seller involved in the transaction. \textit{Id.} at 537-38. For a discussion of Justice Steven’s concurring opinion in \textit{Chiarella}, see note 56 and accompanying text \textit{supra}.

\textsuperscript{101} An example of the type of non-tender offer cases that rule 10b-5 should not be extended to cover is the situation where a judge’s law clerk or a financial columnist acquires information as a result of his position of employment concerning a business transaction to take place in the future, and prior to disclosing it to the public he purchases or sells stock in one of the corporations involved.

\textsuperscript{102} See notes 80-96 and accompanying text \textit{supra}.

\textsuperscript{103} See note 81 and accompanying text \textit{supra}.

\textsuperscript{104} See notes 97-98 and accompanying text \textit{supra}.

\textsuperscript{105} See notes 81-82 and accompanying text \textit{supra}.