

R
RDS
J /
FS

RECEIVED, U.S.
JUN 29 1979
FEDERAL BUREAU OF INVESTIGATION

IN THE
Supreme Court of the United States

October Term, 1978

No. 78-1202

VINCENT F. CHIARELLA,
Petitioner,
against

UNITED STATES OF AMERICA,
Respondent.

On Writ of Certiorari to the
United States Court of Appeals for the Second Circuit

BRIEF FOR THE PETITIONER

STANLEY S. ARKIN
MARK S. ARISOHN
ARKIN & ARISOHN, P.C.
Attorneys for Petitioner
600 Third Avenue
New York, New York 10016
(212) 869-1450

STANLEY S. ARKIN
MARK S. ARISOHN
ARTHUR T. CAMBOURIS
On the Brief

June 28, 1979

TABLE OF CONTENTS

	PAGE
Opinions Below	1
Jurisdiction	2
Constitutional Provisions, Statutes and Rules In- volved	2
Questions Presented for Review	5
Statement of the Case	6
Summary of Argument	10
Argument	
Point I—The purchase of stock on the open market based on and without disclosure of material, nonpublic information does not violate Section 10(b) of the 1934 Securities Exchange Act and Rule 10b-5 promulgated thereunder where the purchaser has no fiduciary or other special re- lationship with the issuer or its stockholders and the information was obtained from and cre- ated by a source wholly outside and unrelated to the issuer	12
A. Introduction	12
B. The Language and History of Section 10 (b) and Rule 10b-5	13
1. The Language of the Statute and Rule	14
2. Legislative History of Section 10(b)	15
3. Administrative History and Interpre- tation of the Rule	17

	PAGE
Frigitemp Corp. v. Financial Dynamics Fund, Inc., 524 F.2d 275 (2d Cir. 1975)	23
Funk v. United States, 290 U.S. 371 (1933)	57
General Time Corp. v. Talley Industries, Inc., 403 F.2d 159 (2d Cir. 1968), <i>cert. denied</i> , 393 U.S. 1026 (1969)	25, 29, 36, 40
Graham v. Seaway Radio, Inc., 28 Misc. 2d 706, 216 N.Y.S. 2d 52 (Sup. Ct. Jefferson Co. 1961)	56
Gulf & Western Industries, Inc. v. Great Atlantic & Pacific Tea Co., 356 F. Supp. 1066 (S.D.N.Y.), <i>aff'd on other grounds</i> , 476 F.2d 687 (2d Cir. 1973)	26
Gulliver's Periodicals, Ltd. v. Chas. Levy Circulating, Inc., 455 F. Supp. 1197 (N.D. Ill. 1978)	62
Harrison v. United States, 392 U.S. 219 (1968)	69
Herman Brothers Pet Supply, Inc. v. NLRB, 360 F.2d 176 (6th Cir. 1966)	58
Hotchkiss v. Fisher, 136 Kan. 530, 16 P.2d 531 (1932)	21
In the Matter of Cady, Roberts & Co., 40 S.E.C. 907 (1961)	17, 18, 19, 20, 21, 40
In re Grand Jury Impaneled January 21, 1975, 541 F.2d 373 (3d Cir. 1976)	58, 62
In re Grand Jury Proceedings, 563 F.2d 577 (3d Cir. 1977)	62, 65
In re Special Grand Jury Proceedings, 581 F.2d 589 (7th Cir.), <i>cert. denied</i> , 99 S.Ct. 721 (1978)	62
In re Reid, 155 F. 933 (E.D. Mich. 1906)	58
In re Valecia Condensed Milk Co., 240 F. 310 (7th Cir. 1917)	58
In re Winship, 397 U.S. 358 (1970)	47
International Brotherhood of Teamsters v. Daniel, —— U.S. ——, 99 S.Ct. 790 (1979)	31, 39, 48
Jacobsen Manufacturing Co. v. Sterling Precision Corp., 282 F. Supp. 598 (E.D. Wis. 1968)	27

PAGE
c,
23
57
03
S.
9, 36, 40
16
56
ie
,
r.
26
5,
62
69
30
58
2) 21
07
0, 21, 40
41
53, 62
ir.
62, 65
89
62
68
th
58
4
iel,
IL, 39
100

	PAGE
Kardon v. National Gypsum Co., 73 F. Supp. 798 (E.D. Pa. 1947)	19, 20
Kohler v. Kohler Co., 319 F.2d 634 (7th Cir. 1963)	23
Lanzetta v. New Jersey, 306 U.S. 451 (1939)	38, 44
Lewelling v. First California Co., 564 F.2d 1277 (9th Cir. 1977)	23
Mills v. Sarjem Corp., 133 F. Supp. 753 (D. N.J. 1955)	26-27
Murphy v. Waterfront, 378 U.S. 52 (1964)	67
Mutual Shares Corp. v. Genesco, Inc., 384 F.2d 540 (2d Cir. 1967)	27
Myzel v. Fields, 386 F.2d 718 (8th Cir. 1967), <i>cert.</i> <i>denied</i> , 390 U.S. 951 (1968)	23
Oliver v. Oliver, 118 Ga. 362, 45 S.E. 232 (1903)	21
Pacific Insurance Co. of New York v. Blot, 267 F. Supp. 956 (S.D.N.Y. 1967)	27
Parker v. Levy, 417 U.S. 733 (1974)	48
Radiation Dynamics, Inc. v. Goldmuntz, 464 F.2d 876 (2d Cir. 1972)	23, 40
Raley v. Ohio, 360 U.S. 423 (1959)	48
Rewis v. United States, 401 U.S. 808 (1971)	38, 44, 46
Santa Fe Industries, Inc. v. Green, 430 U.S. 462 (1977)	30, 31
Schein v. Chasen, 478 F.2d 817 (2d Cir. 1973), <i>vacated</i> , 416 U.S. 386 (1974)	23
SCM Corp. v. Xerox Corp., 70 F.R.D. 508 (D. Conn. 1976)	61
SEC v. Ayoub, CCH Fed. Sec. L. Rep. ¶95,567 (S.D.N.Y. 1976)	36
SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180 (1963)	34

	PAGE
SEC v. Chiarella, No. 77 Civ. 2534 (S.D.N.Y. 1977)	8, 36
SEC v. Great American Industries, Inc., 407 F.2d 453 (2d Cir. 1968) (<i>en banc</i>), <i>cert. denied</i> , 395 U.S. 920 (1969)	23
SEC v. Primar Typographers, Inc., CCH Fed. Sec. L. Rep. ¶95,734 (S.D.N.Y. 1976)	36
SEC v. Sloan, 436 U.S. 103 (1978)	37
SEC v. Sorg Printing Co., Inc, CCH Fed. Sec. L. Rep. ¶95,034 (S.D.N.Y. 1975)	18, 20, 36
SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968) (<i>en banc</i>), <i>cert. denied</i> , 394 U.S. 976 (1969)	20-21, 22, 32, 40
Simpson v. Oil Transfer Corp., 75 F. Supp. 819 (N.D.N.Y. 1948)	58
Speed v. Transamerica Corp., 99 F. Supp. 808 (D. Del. 1951)	19, 20
Strong v. Repide, 213 U.S. 419 (1909)	21
Tollefsen v. Phillips, 16 F.R.D. 348 (D. Mass. 1954) ...	58
Touche Ross & Co. v. Redington, — U.S. —, 47 U.S.L.W. 4732 (June 18, 1979)	37
United States v. Allery, 526 F.2d 1362 (8th Cir. 1975)	58, 62
United States v. Blasi, 462 F. Supp. 373 (M.D. Ala. 1979)	58
United States v. Caserta, 199 F.2d 905 (3d Cir. 1952)	64
United States v. Charnay, 537 F.2d 341 (9th Cir.), <i>cert. denied</i> , 429 U.S. 1000 (1976)	53
United States v. Chiarella, 450 F. Supp. 95 (S.D. N.Y.), <i>aff'd</i> , 588 F.2d 1358 (2d Cir. 1978)	<i>passim</i>
United States v. Dixon, 536 F.2d 1388 (2d Cir. 1976)	51-52
United States v. Dunn, — U.S. —, 47 U.S.L.W. 4607 (June 4, 1979)	37, 38, 44
United States v. Gillock, 587 F.2d 284 (6th Cir. 1978), <i>cert. granted</i> , 47 U.S.L.W. 3740 (May 14, 1979)	62

	PAGE
United States v. Harriss, 347 U.S. 612 (1954)	44
United States v. King, 73 F.R.D. 103 (E.D.N.Y. 1976)	58, 62
United States v. Mackey, 405 F. Supp. 854 (E.D.N.Y. 1975)	61
United States v. Naftalin, — U.S. —, 47 U.S.L.W. 4574 (May 21, 1979)	44
United States v. Nixon, 418 U.S. 683 (1974)	61
United States v. Peltz, 433 F.2d 48, <i>cert. denied</i> , 401 U.S. 955 (1971)	51-52
United States v. Pennsylvania Industrial Corp., 411 U.S. 655 (1973)	48
United States v. Thorne, 467 F. Supp. 938 (D. Conn. 1979)	58
Vazquez v. Bull, 91 F. Supp. 518 (S.D.N.Y. 1950)	58
Wolfe v. United States, 291 U.S. 7 (1934)	57
Younger v. Harris, 401 U.S. 37 (1971)	65
Zweig v. Hearst, — F.2d —, CCH Fed. Sec. L. Rep. ¶96,851 (9th Cir. 1979)	34

Constitution of the United States:

Amendment 5

Due Process Clause	<i>passim</i> (Point II)
Self-Incrimination Clause	66, 67

Statutes:

15 U.S.C. §77q(a) (Section 17[a] of the Securities Act of 1933)	17
15 U.S.C. §78j(b) (Section 10[b] of the Securities Exchange Act of 1934)	<i>passim</i>
15 U.S.C. §78m(d)(1)	26, 41

VIII

	PAGE
15 U.S.C. §78n(d)(5)	26
15 U.S.C. §78n(d)(6)	26
15 U.S.C. §78n(e)	26
15 U.S.C. §78p(b) (Section 16[b] of the Securities Exchange Act of 1934)	16
15 U.S.C. §78q(a) (Section 17[a] of the Securities Exchange Act of 1934)	37
15 U.S.C. §78ff(a) (Section 32[a] of the Securities Exchange Act of 1934)	51, 52
26 U.S.C. §3304(a)(16) and (17)	64
28 U.S.C. §1254(1)	2
38 U.S.C.A. §3301 (1972)	63
42 U.S.C. §1306	63
42 U.S.C. §2000E-5(a)	63
45 U.S.C. §351	64
45 U.S.C. §362(d)	64
New York Labor Law, §537 (McKinney 1977)	<i>passim</i> (Point IV)

Rules:

17 C.F.R. §240.10b-5 (Rule 10b-5)	<i>passim</i>
Federal Rules of Criminal Procedure, Rule 26	57
Federal Rules of Evidence, Rule 501	<i>passim</i> (Point IV)

Miscellaneous:

ALI, Proposed Official Draft of the Federal Securities Code (March 15, 1978)	23, 24, 42-43
ALI Restatement of the Law 2d, Torts §551(2)(a)	22
E. R. Aranow, H. A. Einhorn, and G. Berlstein, Developments in Tender Offers for Corporate Control (1977)	28
Brief for the SEC in opposition to petition for a writ of certiorari in <i>Coates v. SEC</i> , No. 68-897	22
A. Bromberg, Securities Law: Fraud (1969)	28, 41

	PAGE
Conference on Codification of the Federal Securities Laws, 22 Bus. Law. 793 (1967)	17
Fleischer and Mundheim, <i>Corporate Acquisition by Tender Offer</i> , 115 Penn. L. Rev. 317 (1967)	28
3 Fletcher, <i>Cyclopedia Corporations</i> (1972 revision)	22
H.R. Rep. No. 650, 93d Cong. 1st Sess. (1973)	57, 60
H.R. No. 1383, 73d Cong. 2d Sess. (1934)	16
H.R. 7852, 73d Cong. 2d Sess. (1934)	15, 16
H.R. 8720, 73d Cong. 2d Sess. (1934)	16
Hearings on Stock Exchange Regulations Before the House Committee on Interstate and Foreign Com- merce, 73d Cong. 2d Sess. (1934)	16
Krattenmaker, <i>Testimonial Privilege in Federal Courts: An Alternative to the Proposed Federal Rules of Evidence</i> , 62 Geo. L. J. 61 (1973)	63
3 L. Loss, <i>Securities Regulation</i> (2d ed. 1961)	22, 40
6 L. Loss, <i>Securities Regulation</i> (2d ed. supp. 1969)	40
2 D. Louisell & C. Mueller, <i>Federal Evidence</i> (1979) ..60, 61, 62, 63	
Manne, <i>Insider Trading and the Administrative Proc- ess</i> , 35 Geo. Wash. L. Rev. 473 (1967)	16
Manne, Henry G., <i>Insider Trading in the Stock Mar- ket</i> (1966)	17
Memorandum of the SEC submitted <i>amicus curiae</i> in <i>Pacific Ins. Co. v. Blot</i> , 67 Civ. 1386 (S.D.N.Y.)	27
Note, <i>Due Process Requirements of Definiteness in Statutes</i> , 62 Harv. L. Rev. 77 (1948)	48
Note, <i>Federal Rules of Evidence and the Law of Priv- ileges</i> , 15 Wayne L. Rev. 1287 (1969)	66
Note, <i>The Proposed Federal Rules of Evidence: Of Privileges and the Division of Rule Making Power</i> , 76 Mich. L. Rev. 1177 (1978)	60, 61
Note, <i>The Required Report Privileges</i> , 56 Nw. U. L. Rev. 283 (1961)	56

	PAGE
Remarks of Congressman Lea, 78 Cong. Rec. 7861-62 (1934)	16
Ruder, <i>Civil Liability Under Rule 10b-5: Judicial Re- vision of Legislative Intent?</i> , 57 Nw. U. L. Rev. 627 (1962)	16
Rules of Evidence for the United States Courts and Magistrates, 56 F.R.D. 183 (1972)	59, 65-67
S. 2693, 73d Cong. 2d Sess. (1934)	15
S. Rep. No. 1277, 93d Cong. 2d Sess. (1974)	60-61
S. Rep. No. 792, 73d Cong. 2d Sess. (1934)	16
S. Rep. No. 1455, 73d Cong. 2d Sess. (1934)	16
Schwartz, <i>Privileges Under the Federal Rules of Evi- dence—A Step Forward?</i> 38 U. Pitt. L. Rev. 79 (1976)	60
Securities Exchange Act Release No. 9950 (Jan. 16, 1973)	34
Securities Exchange Act Release No. 10316 (Aug. 1, 1973)	35
Securities Exchange Act Release No. 6022 (Feb. 5, 1979)	36
8 SEC Institutional Investor Study Report, H.R. Doc. No. 92-64, 92d Cong. 1st Sess. (1971)	34-35
SEC Proposed Rule 14e-2 (1979)	35-36
SEC Release No. 3220 (May 21, 1942)	17
SEC Report of the Special Study of the Options Mar- ket, H.R. Comm. Print No. 96-IFC3, 96th Cong. 1st Sess. (1978)	34
2 J. Weinstein & M. Berger, <i>Weinstein's Evidence</i> (3d ed. 1977)	60, 62, 66
8 J. Wigmore, <i>Evidence</i> (McNaughton Rev. 1961)	63

IN THE
Supreme Court of the United States
October Term, 1978

No. 78-1202

VINCENT F. CHIARELLA,
Petitioner,
against

UNITED STATES OF AMERICA,
Respondent.

**On Writ of Certiorari to the
United States Court of Appeals for the Second Circuit**

BRIEF FOR THE PETITIONER

Opinions Below

The opinion of the United States Court of Appeals for the Second Circuit (Appendix A to Chiarella's petition for a writ of certiorari) is reported at 588 F.2d 1358. The opinion of the United States District Court for the Southern District of New York (Appendix B to Chiarella's petition for a writ of certiorari) is reported at 450 F.Supp. 95.

Jurisdiction

The judgment of the Court of Appeals for the Second Circuit was entered November 29, 1978. A motion for rehearing with a suggestion for rehearing *en banc* was denied by the Court of Appeals on January 4, 1979. The petition for a writ of certiorari was filed on February 2, 1979 and was granted on May 14, 1979. The jurisdiction of this Court rests on 28 U.S.C. §1254(1).

Constitutional Provisions, Statutes and Rules Involved

Constitutional Provisions:

Constitution of the United States, Amendment 5

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment of indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offense to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

Statutes:

15 U.S.C. §78j(b) (Section 10[b] of the Securities Exchange Act of 1934):

§78j. Manipulative and deceptive devices

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.

§15 U.S.C. §78ff(a) (Section 32[a] of the Securities Exchange Act of 1934):

§78ff. Penalties

(a) Any person who willfully violates any provision of this chapter (other than Section 78dd-1 of this title), or any rule or regulation thereunder, the violation of which is made unlawful or the observance of which is required under the terms of this chapter, or any person who willfully and knowingly makes, or causes to be made, any statement in any application, report, or document required to be filed under this chapter or any rule or regulation thereunder or any undertaking contained in a registration statement as provided in subsection (d) of Section 78o of this title or by any self-regulatory organization in connection with an application for membership or participation therein or to become associated with a member thereof, which statement was false or misleading with respect to any material fact, shall upon conviction be fined not more than \$10,000, or imprisoned not more than five years, or both, except that when such person is an exchange, a fine not exceeding \$500,000 may be imposed; but no person shall be subject to imprisonment under this Section for the violation of any rule or regulation if he proves that he had no knowledge of such rule or regulation.

Rule 501, Federal Rules of Evidence:

Except as otherwise required by the Constitution of the United States or provided by Act of Congress or in rules prescribed by the Supreme Court pursuant to statutory authority, the privilege of a witness, person, government, State, or political subdivision thereof shall be governed by the principles of the common law as they may be interpreted by the courts of the United States in the light of reason and experience. However, in civil actions and proceedings, with respect to an element of a claim or defense as to which State law supplies the rule of decision, the privilege of a witness, person, government, State, or political subdivision thereof shall be determined in accordance with State law.

New York Labor Law, §537:

§537. Disclosures prohibited

1. Use of information. Information acquired from employers or employees pursuant to this Article shall be for the exclusive use and information of the commissioner in the discharge of his duties hereunder and shall not be open to the public nor be used in any court in any action or proceeding pending therein unless the commissioner is a party to such action or proceeding, notwithstanding any other provisions of law. Such information insofar as it is material to the making and determination of a claim for benefits shall be available to the parties affected and, in the commissioner's discretion, may be made available to the parties affected in connection with effecting placement.

2. Penalties. Any officer or employee of the state, who, without authority of the commissioner or as otherwise required by law, shall disclose such information shall be guilty of a misdemeanor,

fai
issu
Ex
has
info
whc

its r
Rule
Proc

Regulations:

17 C.F.R. §240.10b-5 (Rule 10b-5):

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

(1) to employ any device, scheme, or artifice to defraud,

(2) 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 circumstances under which they were made, not misleading, or

(3) 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.

Questions Presented for Review

1. Does the purchaser of stock in the open market who fails to disclose material, nonpublic information about the issuer of the stock violate Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 where the purchaser has no fiduciary relationship with the issuer and where the information was obtained from and created by a source wholly outside and unrelated to the issuer?

2. Does the Second Circuit's retroactive application of its new and expansive interpretation of Section 10(b) and Rule 10b-5 to sustain petitioner's conviction violate the Due Process Clause of the Fifth Amendment?

3. In a criminal case charging violations of Section 10(b) and Rule 10b-5, did the trial court violate this Court's holding in *Ernst & Ernst v. Hochfelder* by refusing to instruct the jury that "intent to defraud" was a requisite element of the crime?

4. Did the trial court err in admitting into evidence at petitioner's federal criminal trial a confidential statement—in this case tantamount to a confession—required to be made by petitioner to the New York State Department of Labor as a condition of seeking unemployment benefits when New York law makes the statement absolutely privileged from disclosure and makes disclosure of that statement a criminal act?

Statement of the Case

Vincent F. Chiarella was employed as a "mark-up" man in the composing room at Pandick Press, a financial printing company in New York City (R.182-83, 234-35).¹ During the course of his employment in 1975 and 1976, Chiarella worked on setting into type prospectuses and other documents for corporate customers of Pandick who were about to announce take-over bids (tender offers) for other companies (R.283-84). Pandick's customers, the prospective tender offerors, provided the textual material to be printed to Pandick, but particular information as to the identity of the corporation proposed for take-over (the target) was encoded or simply left blank (R.222-23, 228).

1. References in parentheses preceded by "R." are to pages of the original record of the proceedings in the District Court. On June 11, 1979, this Court granted Chiarella's motion to dispense with printing an appendix and for leave to proceed on the original record.

t
r
t
C
a

ha
wa
in
be
ter
per
vio
wei
to g

In each case relevant here Chiarella was able to deduce the identity of the takeover candidate (target) from data which was disclosed in the material provided for printing by the prospective offeror corporations (R.474). Then, prior to public announcement of the take-over bids or tender offers, Chiarella purchased shares of the corporation he believed was the target (R.474-78).

Chiarella successfully determined the identity of five companies targeted for take-over by customers of Pandick Press. His 17 separate purchases of target shares, prior to public announcement of the tender offers and sale of those shares after news of the tender offers became public, netted Chiarella a \$30,000 profit (GX6, 7, 10, 61).²

Since each of Chiarella's stock purchases was transacted through his broker over the open market, Chiarella never met nor had any dealings whatever with the target corporation shareholders whose stock he acquired (R.482). And Chiarella specifically denied that he intended to defraud anyone in connection with his stock purchases (R.483-84).

Prior to Chiarella's stock transactions, Pandick Press had posted a sign (GX14A) warning its employees that it was violative of company policy for any employee to utilize information learned from a customer's copy for his own benefit and that such conduct would result in the employee's termination from employment and could result in criminal penalties. Although Chiarella was aware that his conduct violated Pandick's rules, he did not believe that his actions were unlawful (R.491). Having set the type of hundreds

². Numerical references in parentheses preceded by "GX" refer to government exhibits in evidence.