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No. 78-1202

AUG 10 1978

In the Supreme Court of the United States

OCTOBER TERM, 1978

VINCENT F. CHIARELLA, PETITIONER

v.

UNITED STATES OF AMERICA

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

BRIEF FOR THE UNITED STATES

WADE H. MCCREE, JR.

Solicitor General

PHILIP B. HEYMANN

Assistant Attorney General

KENNETH S. GELLER

Deputy Solicitor General

STEPHEN M. SHAPIRO

Assistant to the Solicitor General

SARA CRISCITELLI

JOHN S. SIFFERT

Attorneys

Department of Justice

Washington, D.C. 20530

RALPH C. FERRARA

General Counsel

PAUL GONSON

Principal Associate General Counsel

JAMES H. SCHROPP

Assistant General Counsel

MYRNA SIEGEL

Attorney

Securities and Exchange Commission

Washington, D.C. 20549

INDEX

	Page
Opinions below	1
Jurisdiction	1
Questions presented	2
Statutes and rule involved	2
Statement	4
Summary of Argument	15
Argument	23
I. Petitioner's secret conversion of material confidential information from the corporations that retained his printing firm, and his use of that information to purchase securities from uninformed investors, violated Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5	23
A. Section 10(b) and Rule 10b-5 apply to any deceptive practice used in connection with a purchase or sale of securities, not just the species of fraud involving insider information or a special relationship between buyer and seller.....	25
B. Petitioner defrauded the corporations that entrusted him with confidential information when he secretly converted that information and used it for personal profit in the stock market	28

Argument—Continued

Page

1. Pre-announcement secrecy is essential to the success of tender offers	30
2. As an agent, petitioner was forbidden to engage in self-dealing affecting the subject matter of his agency without making full disclosure	35
3. Petitioner's fraud occurred "in connection with" the purchase of securities and therefore violated the statute and the rule..	36
C. Petitioner defrauded public investors by purchasing securities from them on the basis of material non-public information that he converted from the customers of his financial printing firm	38
1. The rule of caveat emptor has never applied to transactions based on converted information that is inaccessible to other traders	39
2. The federal securities laws were intended to replace the doctrine of caveat emptor with that of full disclosure and to forbid misuse of confidential business information for personal enrichment in the stock market	43

3. The fact that petitioner misappropriated non-public market information, rather than inside corporate information, does not immunize his conduct 49
- a. Section 10(b) and Rule 10b-5 apply to petitioner's scheme even though the precise factual pattern involved here has not been presented in prior litigated cases 49
- b. The statutory context shows that Section 10(b) applies to all frauds, including market information frauds 53
- c. This Court and the lower federal courts have applied Section 10(b) and Rule 10b-5 to market information frauds 56
- d. The Securities and Exchange Commission has applied Section 10(b) and Rule 10b-5 to various kinds of market information frauds 59
- e. Petitioner's proposed limitation of the statute and the rule would lead to absurd results 61

Argument—Continued

Page

4. Petitioner's conversion of market information for the purpose of exploiting uninformed investors bears no resemblance to the actions of business firms engaged in bona fide economic activity	63
II. Section 10(b) and Rule 10b-5 and their relevant interpretations provided fair notice that petitioner's conduct was unlawful	72
III. The district court correctly charged the jury on the state of mind element of petitioner's offense	80
IV. The district court correctly received in evidence an admission made by petitioner to the New York Department of Labor	88
Conclusion	97
Appendix	1a

CITATIONS

Cases:

<i>A. T. Brod & Co. v. Perlow</i> , 375 F.2d 393..	26, 37, 50
<i>Affiliated Ute Citizens v. United States</i> , 406 U.S. 128	17, 24, 26, 37, 43, 56, 57, 58
<i>Allen v. Barhoff</i> , 90 Conn. 184, 96 A. 928	36
<i>Allico National Corp. v. Amalgamated Meat Cutters & Butcher Workmen of North America</i> , 397 F.2d 727	37

Cases—Continued

Page

<i>Blyth & Co., In re</i> , [1967-1969 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,647	59
<i>Bowie v. City of Columbia</i> , 378 U.S. 347..	79
<i>Boyce Motor Lines, Inc. v. United States</i> , 342 U.S. 337	78
<i>Branzburg v. Hayes</i> , 408 U.S. 665	92
<i>Brophy v. Cities Serv. Co.</i> , 31 Del. Ch. 241, 70 A.2d 5	48
<i>Cady, Roberts & Co., In re</i> , 40 S.E.C. 907..	45
<i>California v. Byers</i> , 402 U.S. 424	95
<i>Carter v. Boehm</i> , 3 Burr. 1905	40
<i>Charles Hughes & Co. v. SEC</i> , 139 F.2d 434, cert. denied, 321 U.S. 786	59
<i>Clegg v. Conk</i> , 507 F.2d 1351, cert. denied, 422 U.S. 1007	84
<i>Coleco Industries, Inc. v. Berman</i> , 567 F.2d 569, cert. denied, No. 77-1725 (Oct. 2, 1978)	85
<i>Courtland v. Walston & Co.</i> , 340 F. Supp. 1076	59
<i>Coyne v. O'Connor</i> , 121 N.Y.S. 2d 100....	91
<i>Diamond v. Oreamuno</i> , 24 N.Y.2d 494, 248 N.E.2d 910	48
<i>Doyen v. Bauer</i> , 211 Minn. 140, 300 N.W. 451	36
<i>Edward J. Mawod & Co. v. SEC</i> , 591 F.2d 588	85
<i>Electronic Specialty Co. v. International Controls Corp.</i> , 409 F.2d 937	67
<i>Ericson v. Nebraska-Iowa Farm Inv. Co.</i> , 134 Neb. 391, 278 N.W. 841	36
<i>Ernst & Ernst v. Hochfelder</i> , 425 U.S. 185	<i>passim</i>

Cases—Continued

	Page
<i>First Virginia Bankshares v. Benson</i> , 559 F.2d 1307, cert. denied, 435 U.S. 952....	85
<i>Foremost-McKesson, Inc. v. Provident Securities Co.</i> , 423 U.S. 232	47
<i>Fridrich v. Bradford</i> , 542 F.2d 307	46
<i>FTC v. Mandel Brothers, Inc.</i> , 359 U.S. 385	61
<i>Funk v. United States</i> , 290 U.S. 371	92
<i>Garner v. United States</i> , 424 U.S. 648.....	94, 95
<i>General Time Corp. v. Talley Industries, Inc.</i> , 403 F.2d 159	68
<i>Gorin v. United States</i> , 312 U.S. 19	78
<i>Grand Jury Impaneled January 21, 1975, In re</i> , 541 F.2d 373	92, 94
<i>Grin v. Shine</i> , 187 U.S. 181	36
<i>Hanson v. Edgerly</i> , 29 N.H. 343	40
<i>Herbert v. Lando</i> , No. 77-1105 (Apr. 18, 1979)	91
<i>Herbert L. Honohan, In re</i> , 13 S.E.C. 754	59, 91
<i>Holland v. Moreton</i> , 10 Utah 2d 390, 353 P.2d 989	36
<i>Hygrade Provision Co. v. Sherman</i> , 266 U.S. 497	78
<i>Investors Management Co., In re</i> , 44 S.E.C. 633	47, 48
<i>Jenkins v. McCormack</i> , 184 Kan. 842, 339 P.2d 8	40
<i>Jones v. Arnold</i> , 359 Mo. 161, 221 S.W.2d 187	40
<i>Kohler v. Kohler Co.</i> , 319 F.2d 634	46
<i>Kotteakos v. United States</i> , 328 U.S. 750..	97
<i>Kuehnert v. Texstar Corp.</i> , 412 F.2d 700..	48
<i>Laidlaw v. Organ</i> , 15 U.S. (2 Wheat.) 177	40

Cases—Continued

Page

<i>Lanza v. Drexel & Co.</i> , 479 F.2d 1277.....	84
<i>Lingsch v. Savage</i> , 213 Cal.App.2d 729, 29 Cal.Rptr. 201	40
<i>McLean v. Alexander</i> [Current] Fed. Sec. L. Rep. (CCH) ¶ 96,879	85
<i>Mansbach v. Prescott, Ball & Turben</i> , [Current] Fed. Sec. L. Rep. (CCH) ¶ 96,861	85
<i>Mayer, George, In re</i> , Securities and Ex- change Act Release No. 84591 (1978)..	34
<i>Myers v. Linebarger</i> , 134 Ark. 231, 203 S.W. 580	36
<i>Myzel v. Fields</i> , 386 F.2d 718, cert. de- nied, 390 U.S. 951	46
<i>Nash v. United States</i> , 229 U.S. 373	21, 75
<i>Nelson v. Serwold</i> , 576 F.2d 1332, cert. denied, No. 78-182 (Nov. 13, 1978)....	85
<i>New Jersey v. Portash</i> , No. 77-1489 (Mar. 20, 1979)	95
<i>NLRB v. Bell Aerospace Co.</i> , 416 U.S. 267	71
<i>Omaechevarria v. Idaho</i> , 246 U.S. 343.....	78
<i>Pennaluna & Co. v. SEC</i> , 410 F.2d 861, cert. denied, 396 U.S. 1007	46
<i>People v. Mancuso</i> , 255 N.Y. 463	73
<i>Phillips v. Homfray</i> , L.R. 6 Ch. 770	41
<i>Rolf v. Blyth, Eastman Dillon & Co.</i> , 570 F.2d 38, cert. denied, No. 78-560 (Dec. 4, 1978)	85
<i>Rondeau v. Mosinee Paper Corp.</i> , 422 U.S. 49	66, 67
<i>Rothmiller v. Stein</i> , 143 N.Y. 581, 38 N.E. 718	40
<i>Sanders v. John Nuveen & Co.</i> , 554 F.2d 790	85

Cases—Continued

	Page
<i>Santa Fe Industries, Inc. v. Green</i> , 430 U.S. 462	25, 27, 38
<i>SEC v. Ayoub</i> , [1975-1976 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,567	60
<i>SEC v. Capital Gains Research Bureau, Inc.</i> , 375 U.S. 180	19, 37, 43, 57
<i>SEC v. Chenery Corp.</i> , 332 U.S. 194	71
<i>SEC v. Chiarella</i> , SEC Litigation Release No. 7935 (May 25, 1977)	34
<i>SEC v. Geon Industries, Inc.</i> , 531 F.2d 39	62
<i>SEC v. Hancock</i> , SEC Litigation Release No. 505 (Mar. 18, 1949)	60
<i>SEC v. Healy</i> , SEC Litigation Release No. 6589 (S.D.N.Y. 1974)	61
<i>SEC v. Manderano</i> , [1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,357..	60
<i>SEC v. National Securities, Inc.</i> , 393 U.S. 453	53, 67
<i>SEC v. Primar Typographers, Inc.</i> , [1976-1977 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,734	60
<i>SEC v. Rosenberg</i> , [1974-1975 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,766	60-61
<i>SEC v. Shapiro</i> , 494 F.2d 1301	20, 58
<i>SEC v. Sorg Printing Co.</i> , [1974-1975 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,767	5, 20, 60
<i>SEC v. Stone</i> , SEC Litigation Release No. 8527 (S.D. N.Y. 1978)	61
<i>SEC v. Texas Gulf Sulphur Co.</i> , 401 F.2d 833, cert. denied, 394 U.S. 976	18, 37, 46, 48, 49, 84

Cases—Continued

	Page
<i>Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.</i> , 495 F.2d 228	48
<i>Sim v. Edenborn</i> , 242 U.S. 131	36
<i>Simmons v. Evans</i> , 185 Tenn. 282, 206 S.W.2d 295	40
<i>Special April 1977 Grand Jury, In re</i> , 581 F.2d 589	92
<i>Speed v. Transamerica Corp.</i> , 99 F. Supp. 808	73
<i>Stewart v. Wyoming Rancho Co.</i> , 128 U.S. 383	40
<i>Stier v. Smith</i> , 473 F.2d 1205	46
<i>Strong v. Repide</i> , 213 U.S. 419	36
<i>Sundstrand Corp. v. Sun Chemical Corp.</i> , 553 F.2d 1033, cert. denied, 434 U.S. 875	85
<i>Superintendent of Insurance v. Bankers Life & Casualty Co.</i> , 404 U.S. 6	17, 26, 37, 50, 74
<i>Touche Ross & Co. v. Redington</i> , No. 78-309 (June 18, 1979)	25
<i>United States v. Brown</i> , 555 F.2d 336.....	51
<i>United States v. Bryan</i> , 339 U.S. 323.....	92
<i>United States v. Carter</i> , 217 U.S. 286.....	36
<i>United States v. Charnay</i> , 537 F.2d 341, cert. denied, 429 U.S. 1000	86
<i>United States v. Cortese</i> , 540 F.2d 640.....	92
<i>United States v. Craig</i> , 528 F.2d 773, cert. denied, 425 U.S. 973	92
<i>United States v. D'Honau</i> , 459 F.2d 73....	75
<i>United States v. Dixon</i> , 536 F.2d 1388.....	86
<i>United States v. Hancock</i> , SEC Litigation Release No. 530 (Aug. 8, 1949)	60
<i>United States v. Kordel</i> , 397 U.S. 1	95
<i>United States v. Koss</i> , 506 F.2d 1103.....	75

Cases—Continued

	Page
<i>United States v. Lam Lek Chong</i> , 544 F.2d 58	84
<i>United States v. Lovasco</i> , 431 U.S. 783....	94
<i>United States v. Naftalin</i> , No. 78-561 (May 21, 1979)	16, 24, 38, 46, 50, 67, 74, 79
<i>United States v. National Dairy Products Corp.</i> , 372 U.S. 29	78
<i>United States v. Nixon</i> , 418 U.S. 683.....	23, 90
<i>United States v. Nobles</i> , 422 U.S. 225.....	92
<i>United States v. Peltz</i> , 433 F.2d 48.....	76, 86
<i>United States v. Persky</i> , 520 F.2d 283.....	75
<i>United States v. Petrillo</i> , 332 U.S. 1	78
<i>United States v. Powell</i> , 423 U.S. 87	79
<i>United States v. Ragen</i> , 314 U.S. 513.....	78
<i>United States v. Re</i> , 336 F.2d 306, cert. denied, 379 U.S. 904	75
<i>United States v. United States Gypsum Co.</i> , 438 U.S. 422	21, 22, 78-79
<i>United States v. Wolfson</i> , 289 F. Supp. 903	75
<i>Wardell v. Railroad Company</i> , 103 U.S. 651	36
<i>Wofle v. United States</i> , 291 U.S. 7	92
<i>Wright v. Heizer Corp.</i> , 560 F.2d 236.....	85
<i>Zweig v. Hearst Corporation</i> [Current] Fed. Sec. L. Rep. (CCH) ¶ 96,851	59

Constitution, statutes, regulation and rules:

United States Constitution Fifth Amend- ment (Due Process Clause)	21, 94
Federal Unemployment Tax Act, 26 U.S.C. 3304(a)(16) and (17)	92

Constitution, statutes, regulation and rules—Continued	Page
Securities Act of 1933, Section 17(a), 15 U.S.C. 77q(a)	29, 44, 50
Securities Exchange Act of 1934, 15 U.S.C. 78a <i>et seq.</i> :	
Section 9	56
Section 9(a) (1), 15 U.S.C. 78i(a) (1)	55
Section 10(b), 15 U.S.C. 78j(b).....	<i>passim</i>
Section 11	56
Section 11(a) (1) (A)-(D), 15 U.S.C. 78k(a) (1) (A)-(D)	69
Section 11(b), 15 U.S.C. 78k(b).....	53, 55, 69
Section 13(d), 15 U.S.C. 78m(d).....	65
Section 13(d) (1), 15 U.S.C. 78m(d) (1)	66
Section 14(d), 15 U.S.C. 78n(d).....	63
Section 14(d) (1), 15 U.S.C. 78n(d) (1)	65
Section 14(e), 15 U.S.C. 78n(e).....	4
Section 16(b), 15 U.S.C. 78p(b).....	46
Section 32(a), 15 U.S.C. 78ff(a).....	3, 74, 80, 86
Williams Act, Pub. L. No. 90-439, 82 Stat. 454	31
Mass. Ann. Laws ch. 151A, § 46 (Michie/Law. Co-op 1976)	93
N.Y. Lab. Law § 537 (McKinney 1977) ..	89
Wash. Rev. Code (Supp. 1978):	93
§ 50.13.060	93
§ 50.13.070	93
17 C.F.R. 240.10b-5	<i>passim</i>
Fed. R. Evid. 103(a) (1)	92

Constitution, statutes, regulation
and rules—Continued

	Page
Fed. R. Evid. 402	23, 90
Fed. R. Evid. 501	90
Fed. R. Evid. 502	93

Miscellaneous:

ALI <i>Federal Securities Code</i> (Proposed Official Draft 1978)	71
<i>Black's Law Dictionary</i> (Rev. 4th ed. 1968)	82
Borden & Weiner, <i>An Investment Deci- sion Analysis of Cash Tender Offer Disclosure</i> , 23 N.Y.L.Sch. L. Rev. 553 (1978)	52
<i>Bouvier's Law Dictionary</i> (3d rev. 1914)..	82
G. Bower, <i>The Law Relating to Action- able Non-Disclosure</i> (1915)	36, 41
G. Bower & A. Turner, <i>The Law of Ac- tionable Misrepresentation</i> (1974)	41, 64
1 A. Bromberg, <i>Securities Law Fraud: SEC Rule 10b-5</i> (1977)	28, 74
Bucklo, <i>The Supreme Court Attempts to Define Scienter under Rule 10b-5: Ernst & Ernst v. Hochfelder</i> , 29 Stan. L. Rev. 213 (1977)	84
36A C.J.S. (1961)	35
Comment, <i>The Application of Rule 10b-5 to "Market Insiders": United States v. Chiarella</i> , 92 Harv. L. Rev. 1538 (1979)	72
77 Cong. Rec. 2918 (1933)	44
78 Cong. Rec. 7697 (1934)	44
78 Cong. Rec. 7863 (1934)	65
78 Cong. Rec. 7865-7866 (1934)	44

Miscellaneous—Continued	Page
78 Cong. Rec. 7925 (1934)	65
78 Cong. Rec. 8013 (1934)	65
78 Cong. Rec. 8031 (1934)	55, 65
113 Cong. Rec. 854 (1967)	66
113 Cong. Rec. 856 (1967)	66
2 T. Cooley, <i>Law of Torts</i> (4th ed. 1932) ..	39
43 Fed. Reg. 51473 (1978)	93
A. Fleischer, <i>Tender Offers: Defenses, Responses, and Planning</i> (1978)	32
Fleischer, Mundheim & Murphy, <i>An Initial Inquiry Into The Responsibility To Disclose Market Information</i> , 121 U. Pa. L. Rev. 798 (1973)	72
<i>Full Disclosure of Corporate Equity Ownership and in Corporate Takeover Bids: Hearings on S. 510 Before the Subcomm. on Securities of the Senate Comm. on Banking and Currency, 90th Cong., 1st Sess.</i> (1967)	31-32
1 F. Harper & F. James, <i>The Law of Torts</i> (1956)	40, 42, 84
Hayes & Taussig, <i>Tactics of Cash Takeover Bids</i> , 45 Harv. Bus. Rev. 135 (1967)	32, 33
H.R. Conf. Rep. No. 93-1597, 93d Cong., 2d Sess. (1974)	94
H.R. Conf. Rep. No. 94-229, 94th Cong., 1st Sess. (1975)	44
H.R. Rep. No. 1383, 73d Cong., 2d Sess. (1934)	43, 54, 55, 69
H.R. Rep. No. 93-650, 93d Cong., 1st Sess. (1973)	94
A. Jacobs, <i>The Impact of Rule 10b-5</i> (1978)	37, 48, 68

Miscellaneous—Continued

Page

Reuben & Elden, <i>How To Be A Target Company</i> , 23 N.Y. L. Sch. L. Rev. 423 (1978)	34
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W. Seavey, <i>Agency</i> (1964)	35
S. Rep. No. 550, 90th Cong., 1st Sess. (1967)	66
S. Rep. No. 792, 73d Cong., 2d Sess. (1934)	24, 43, 54
S. Rep. No. 1455, 73d Cong., 2d Sess. (1934)	54, 55
S. Rep. No. 93-1277, 93d Cong., 2d Sess. (1974)	94
Statistical Spotlight, <i>Forbes</i> , Feb. 9, 1979..	52
Troubh, <i>Purchased Affection: A Primer On Cash Tender Offers</i> , 54 Harv. Bus. Rev. 79 (1976)	33, 52
8 J. Wigmore, <i>Evidence</i> (McNaughton rev. 1961)	92
12 <i>Williston on Contracts</i> (3d ed. 1970)..	39
2 C. Wright, <i>Federal Practice and Procedure</i> (Criminal) (1969 ed.)	84

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BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A34) is reported at 588 F.2d 1358. The opinion of the district court denying petitioner's motion to dismiss the indictment (Pet. App. B1-B3) is reported at 450 F. Supp. 95.

JURISDICTION

The judgment of the court of appeals was entered on November 29, 1978. A petition for rehearing was

denied 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).

QUESTIONS PRESENTED

1. Whether petitioner's purchase of securities based on material non-public information converted from the customers of the financial printing firm that employed him violated Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder.

2. Whether petitioner had fair notice that his conduct was prohibited by Section 10(b) and Rule 10b-5.

3. Whether the district court's instructions to the jury on mens rea were correct.

4. Whether the district court correctly received in evidence an admission by petitioner that was privileged under state, but not federal, law.

STATUTES AND RULE INVOLVED

Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), provides:

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.

Section 32 of the Securities Exchange Act of 1934, 15 U.S.C. 78ff, provides in pertinent part:

(a) Any person who willfully violates any provision of this chapter, 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 * * * shall upon conviction be fined not more than \$10,000, or imprisoned not more than five years, or both * * * 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 10b-5 of the Securities and Exchange Commission, 17 C.F.R. 240.10b-5, provides in pertinent part:

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, [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.

handle the documents of Pandick's customers (Tr. 181-182).

Because of the highly confidential nature of much of Pandick's financial printing business (Tr. 284-290, 344-345), the firm had a long-standing rule forbidding employees to disclose or use for personal advantage any information contained in documents submitted by customers (Tr. 190). In the summer of 1975, following the filing of an SEC injunctive proceeding against another printing firm as a result of misuse of non-public information contained in draft tender offer prospectuses, Pandick Press formally warned its employees that misuse of information contained in customer documents was both improper and illegal (Tr. 200-212, 285-287; Gov. Ex. 54).² Pandick Press posted 8" by 10" notices in large, bold-face print, stating the following (Tr. 200; Gov. Ex. 14A):

TO ALL EMPLOYEES:

The information contained in all type set and printing done by Pandick Press, Inc., is the private and personal property of the customer.

You are forbidden to use any information learned from customer's copy, proofs or printed jobs for your own or anyone else's benefit, friend or family or talking about it except to give or

² The complaint in *SEC v. Sorg Printing Co.*, [1974-1975 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,767 (S.D. N.Y.), filed on August 21, 1974, charged that several employees at Sorg had violated Section 10(b) and Rule 10b-5 by using material non-public information concerning forthcoming tender offers to purchase the securities of target companies.

receive instructions. Any violation of this rule will result in your being fired immediately and without warning.

In addition, you are liable to criminal penalties of 5 years in jail and \$10,000 fine for each offense.

If you see or hear anybody violating this, report it immediately to your supervisor or to Mr. Green or Mr. Fertig. Failure to report violations will result in your being fired.

These large warning notices were posted by the punch clock that petitioner used every day and in the hallway leading from the elevator to the composing room where he worked (Tr. 206-210; Gov. Ex. 13). Pandick also posted additional warning signs on its bulletin boards, distributed warnings in pay envelopes sent to all employees, and printed warnings on the back of the employees' punch cards (Gov. Exs. 15, 16, 17; Tr. 201-202). To assure further that this message was conveyed, Pandick distributed warning cards to all of its employees and requested that they sign and return them (Tr. 202, 286, 525-529; Gov. Exs. 18, 64).³

In addition to working at Pandick Press, petitioner was an active stock market trader (Tr. 472). He communicated with his broker between 10 and 15 times per day (Tr. 473), studied financial literature, and, when possible, watched the "ticker" at his broker's office (Tr. 474). Based on the confidential information available to him at Pandick Press, pe-

³ The text of the warning cards appears in the Appendix, *infra*.

petitioner devised a scheme to improve his returns in the stock market. The scheme involved ascertaining the identities of companies subject to forthcoming tender offers or acquisitions through use of the confidential documents entrusted to him by the customers of Pandick Press. Because the customers submitted tender offer draft prospectuses with the names of the target corporations left blank or in code, petitioner went to extraordinary lengths to determine the identities of the target companies.⁴ He did this by making note of facts contained in draft prospectuses, such as the market on which the stock was traded, the number of outstanding shares, the par value of the stock, and the high and low bids for the preceding year, and comparing the information with that contained in stock guide books he had obtained from his broker (Gov. Exs. 11A, 11B, 11C, 11D). Petitioner admitted to another employee at Pandick Press that he used this technique to determine the identities of target corporations and that he purchased stock on the basis of the non-public information he learned (Tr. 353-354).

Between September 1975 and November 1976, petitioner purchased the stock of five target companies whose identities he discovered by deciphering confidential material submitted by customers of Pandick

⁴ In order to preserve strict confidentiality, the offering corporation would either use a fictitious name for itself and its target or would leave that information blank with sufficient space to permit the type to be set accurately at the last minute. See Pet. App. A3; Gov. Exs. 22-1, 23A, 28, 31, 34, 38, 60.