No. 86-422

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

DAVID CARPENTER, KENNETH P. FELIS, and
R. FOSTER WINANS,
Petitioners,

v.

UNITED STATES OF AMERICA,
Respondent.

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

REPLY BRIEF FOR PETITIONERS

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Petitioners David Carpenter, Kenneth P. Felis and R. Foster Winans respectfully submit this reply both to the government's brief on the merits and to the government's supplemental brief, which addressed the significance to this case of *McNally v. United States*, 107 S. Ct. 2875 (1987).

ARGUMENT

POINT I

McNALLY CONFIRMS THAT THE MAIL AND WIRE FRAUD STATUTES DO NOT EXTEND TO SIMPLE BREACHES OF PRIVATE WORKRULES, INTANGIBLE INJURIES, AND INCIDENTAL MAILINGS AND WIRINGS

In our main brief, we enumerated three independent reasons why petitioners' convictions under the mail and wire fraud statutes cannot stand. Pet. Br. at 31–46.[1] First, such convictions cannot be premised on a breach of internal corporate workrules. Second, the mail and wire fraud statutes do not apply to the intangible interests on which the courts below based their verdicts. Third, the charged mailings and wirings — involving the routine printing of The Wall Street Journal (the "Journal") and its subsequent normal distribution — were neither caused by petitioners nor made for the purpose of executing their scheme, as the statutes require. Each of these reasons is a separate, distinct and compelling ground for reversal. Each demonstrates that the government and the courts below unjustifiably expanded the mail and wire fraud statutes beyond all reason and principle.

We submit that nothing in the government's brief on the merits detracts from these three reasons for reversal. Notwithstanding the fact that the government expressly conceded below, and the district court expressly found, that criminal liability here was "premised on [a violation of]

1. Citations to petitioners' brief are denoted as "Pet. Br.;" citations to the government's brief in opposition and to its supplemental brief are denoted as "Gov't Br." and "Gov't Supp. Br.," respectively. Other citations are in the form denoted in our main brief.

corporate internal policy," 612 F. Supp. at 843; 59a — specifically, a breach of the Journal's conflicts of interest rules — the government's main brief attempts to recast this case as one of "deliberate failure by one party in a relationship of trust and confidence to correct a misimpression held by the other party. . . ." Gov't Br. at 27. Quite aside from the fact that this novel interpretation was neither charged in the indictment, argued below, nor adopted by either of the lower courts, it amounts to little more than wordplay, for any breach of an employer's internal workrules occurring over time can be recast in those terms. Thus, in arguing that Winans committed a federal crime by "continuing [to] *pose* as a loyal employee," Gov't Br. at 26 (emphasis in original), and "fail[ing] to disclose his rejection of [the Journal's] understandings," Gov't Br. at 17, the government advances a boundless theory of mail and wire fraud liability which criminalizes any undisclosed workrule violation by an employee, even if the employer has not expressly imposed any such duty of disclosure. Gov't Br. at 17 n.12.

Subsequent to the filing of the government's brief, this Court decided *McNally v. United States*, 107 S. Ct. 2875 (1987). That case further confirms that the decisions below were demonstrably wrong. *McNally* makes clear that the statutory proscription against "schemes to defraud" extends only to conduct intended to cause deprivation of money or property; it does not criminalize breaches of employee duty that deprive an employer of his "intangible rights," such as his "right" to his employee's "loyalty."

Here, the courts below, lacking the guidance of *McNally*, held that the "seemingly limitless"[2] mail and wire fraud statutes criminalize both employee disloyalty and nondisclosure which contemplates harm to an employer's

2. 612 F. Supp. at 843; 60a.

intangible interests. 612 F. Supp. at 844–45; 63a–64a.[3] The courts below concluded that an illegal scheme to defraud was established by findings that (1) Winans' disclosures and non-disclosures violated a "practice" of confidentiality at the Journal, which "inexorably" demonstrated that he breached a fiduciary duty, *id.* at 844; 62a, and that (2) "such unethical conduct" contemplated injury to the Journal's "reputation for journalistic integrity." *Id.* at 845; 63a.[4] In light of *McNally*, these findings were plainly insufficient and warrant reversal.

McNally rejected such an overexpansive view of mail and wire fraud and reaffirmed that these statutes are limited "to protect[ing] the people from schemes to deprive them of their money or property."[5] Because the courts below did not find, or even look for, any "scheme" by petitioners "aimed at causing deprivation of money or property,"[6] there is no legally sufficient basis to impose criminal sanctions upon petitioners under the mail and wire fraud statutes.

In its post–*McNally* supplemental brief, the government suggests two theories to try to satisfy (after–the–fact) the requirement of intended deprivation of money or property. The government summarizes these two theories as follows:

> [First], [p]etitioners here took, used, and damaged specific (albeit intangible) property belonging to an identifiable victim: information about the *Heard* column that the Journal was entitled to prohibit others from misusing, so as to preserve, inter alia, the value of the column as an attraction for readers. And [second] petitioners' conduct threatened to have a destructive effect on the Journal's general reputation. These property rights existed independently of the Journal's interest in the loyalty of its employees.

Gov't Supp. Br. at 8. As to the first theory, it is perhaps enough to note that it was never relied on below; indeed, the notion that the Heard column's "attractiveness" to readers (an amorphous form of "property" at best) was somehow fraudulently stolen by petitioners was never relied on by the government at any stage of these proceedings until its supplemental brief to this Court.[7]

More generally, the government's assumption — that "information about the Heard column" (*i.e.*, its timing and tenor),[8] as opposed to the columns themselves, is, in fact, the "property" of the Journal or its parent, Dow Jones & Co., Inc. — is questionable at best. The only proof of Dow Jones' "ownership" of knowledge of the timing and tenor of forthcoming articles is a statement in the Dow Jones conflicts of interest policy that such information is "deemed" by Dow Jones to be its property.[9] Such unilateral "deeming" made in one clause hidden deep within the company handbook does not,

3. *See also* 791 F.2d at 1035; 24a.

4. Pushing one step further, the courts below held that non–employees Carpenter and Felis were likewise criminally liable for benefitting from Winans' breaches, even though they were either only "generally aware" of the Journal's rules or not aware of them at all. Pet. Br. at 32. This flatly violates this Court's holding in *Ingram v. United States*, 360 U.S. 672 (1959).

5. *McNally*, 107 S. Ct. at 2879.

6. *Id.* at 2880.

7. The *post hoc* and wholly irrelevant character of this argument is further evidenced by the fact that the Indictment in this case does not charge a scheme to deprive the Journal of either of these alleged forms of "property," but only a scheme "to obtain money." *See* Indictment, paragraphs 9, 40 and 43 (App. 3, 15 and 18).

8. All other information about the column, in particular the information used as the basis for the column, was public knowledge. 791 F.2d at 1037; 28a (Miner, J., dissenting); 612 F. Supp. at 830 n.2; 35a n.2.

9. App. 41.

in fact, make such information the property of Dow Jones. Moreover, as a matter of law, there is considerable doubt whether Dow Jones' copyright can fairly be held to extend to advance (and therefore unpublished) information about the timing and tenor of Heard columns.[10]

Beyond all this, the government's further contention that petitioners "deprived" the Journal of this "property" is flatly wrong. Petitioners' use or possession of such information in no way affected the Journal's ability to use it. At most, petitioners' conduct can be said to have interfered with the Journal's right to *exclusive* use of the information. However, such exclusivity of use of the information only has value *vis a vis* the Journal's competitors[11] and no disclosures to competitors were made in this case.[12]

The second prong of the government's deprivation of property analysis — threat to reputation — likewise misses the mark. For one thing, reputation is not generally regarded as property, and the government offers no principled basis to demonstrate why reputation should be considered "property" here, when it is not under other federal laws. This Court has recognized that reputation "is simply one of a number [of interests] which the State may protect against injury by virtue

10. *See generally Harper & Row Publishers, Inc. v. Nation Enterprises*, 723 F.2d 195, 202 (2d Cir. 1983), *rev'd on other grounds*, 471 U.S. 539 (1985); *H.C. Wainwright & Co. v. Wall Street Transcript Corp.*, 418 F. Supp. 620, 624 (S.D.N.Y. 1976), *aff'd*, 558 F.2d 91 (2d Cir. 1977), *cert. denied*, 434 U.S. 1014 (1978); *Time, Inc. v. Bernard Geis Assoc.*, 293 F. Supp. 130, 143 (S.D.N.Y. 1968).

11. *See, e.g., International News Service v. The Associated Press*, 248 U.S. 215, 240 (1918).

12. If petitioners' conduct had inflicted cognizable injury on the Journal's actual property, one would have expected the Journal to sue petitioners and their numerous alleged co-conspirators. No such suit was ever brought, nor did the Journal claim any disgorged profits.

of its tort law, providing a forum for vindication of those interests by means of damages actions," but is "neither 'liberty' nor 'property' guaranteed against state deprivation without due process of law."[13] As in *Paul v. Davis*, "the interest in reputation alone which [the government] seeks to vindicate in this action in federal court is quite different from the 'property' " cognizable under the mail and wire fraud statutes.[14]

Moreover, petitioners' conduct cannot be viewed as a scheme aimed at depriving the Journal of its reputation, since, as the government itself points out, the Journal's good reputation is the very thing that "made petitioners' scheme work."[15] Indeed, the district court found that petitioners intended that there be continued readership "confidence" in the Journal, and that such a result was "consistent with the[ir] goals."[16] 612

13. *Paul v. Davis*, 424 U.S. 693, 712 (1976).

14. *Id.* at 711. Cases cited by the government attributing monetary value to intangibles in the contexts of particular competitive industries involving thefts of trade secrets, defamation, and sales of good will are inapposite to establish the *general* "proprietary interest" in reputation urged by the government here, nor do they remotely apply to the facts of this case. Defamation actions, for example, allow recovery to redress an injury to reputation only when it can be measured in terms of quantifiable damage to another, tangible interest (such as loss of employment). *See, e.g., Emory v. Peeler*, 756 F.2d 1547, 1554 (11th Cir. 1985); *Pirre v. Printing Developments, Inc.*, 468 F. Supp. 1028, 1037 (S.D.N.Y.), *aff'd*, 614 F.2d 1290 (2d Cir. 1979).

15. Gov't Supp. Br. at 7 n.5.

16. While the district court went on to hold that the loss to the Journal's reputation that (supposedly) would be incident to exposure of petitioners' scheme satisfied the "contemplated harm" requirement of the statute, 612 F. Supp. at 845; 63a, this confuses an element of the crime itself (namely, an intentional scheme to fraudulently deprive a victim of his money or property) with an effect of its exposure (namely, bad publicity for all concerned). The Second Circuit has itself now apparently recognized this error. *See United States v. Starr*, 816 F.2d 94, 99–101 (2d Cir. 1987) (fact

F. Supp. at 835 n.4; 44a n.4.[17]

McNally also puts in sharper focus the inadequacy of the mails and interstate wires alleged in this case. If, as the government now contends, the "property" in question was the Journal's publication schedule, it is clear that any intended "deprivation" of such property (assuming *arguendo* that such a "deprivation" was cognizable as fraud under *McNally*) was completed before the time of the mailings and wirings. Petitioners thus could not have "caused" the mailings and the wirings for the "purpose of executing" the already completed fraud.[18]

In sum, the federal mail and wire fraud statutes do not exist to regulate intracorporate affairs or redress intracorporate misconduct by criminalizing a newspaper columnist's failure to comply with the corporate policies established by his employer. The imposition of criminal sanctions upon petitioners under the facts of this case exceeds the historical limits of the mail and wire fraud statutes recently reaffirmed by this

that exposure of defendants' scheme led to "defeated expectations" on the part of its victims did not satisfy requirement of contemplated harm).

17. With respect to the government's final contention that "an employee's breach of duty that deprives an employer of bargained–for services may well defraud the employer of money, since the employer in such a case 'is not getting what he paid for,' " it is sufficient to note the government's concession that petitioners were not prosecuted under such a theory. Gov't Supp. Br. at 8 n.6 (quoting *McNally*, 107 S. Ct. at 2890 n.10 (Stevens, J., dissenting)). Moreover, such a theory would stand *McNally* on its head by converting, without limitation, any breach of contract into a mail fraud. *See Ingber v. Enzor*, 664 F. Supp. 814 (S.D.N.Y. 1987) (recognizing that "payment of . . . [a] . . . salary, a routine and budgeted expenditure, does not constitute a loss of money or property as contemplated by *McNally* and the mail fraud statute").

18. *See United States v. Maze*, 414 U.S. 395 (1974); *United States v. Kwiat*, 817 F.2d 440 (7th Cir. 1987); *United States v. Taylor*, 789 F.2d 618 (8th Cir. 1986); *United States v. Iorizzo*, 786 F.2d 52 (2d Cir. 1986).

Court, and "involves the Federal Government in setting standards of disclosure and good [reputation]" for corporate employers.[19] Because neither Congress nor this Court has "spoken in clear and definite language"[20] to proscribe petitioners' activities, their convictions under the mail and wire fraud statutes should be reversed.

POINT II

NOTHING IN EXISTING FEDERAL SECURITIES LAW WARRANTS THE IMPOSITION OF CRIMINAL SANCTIONS AGAINST PETITIONERS

In our main brief, we argued that, just as petitioners' conduct did not fall within the vast reach of the mail and wire fraud statutes, similarly it did not fall within the somewhat more constricted confines of the federal securities laws, for it involved no breach of duty to a market participant. In response, the government, confronted now with *McNally*, goes so far as to argue that securities fraud is somehow broader than even mail or wire fraud and criminalizes any breach of any duty to anyone, as long as securities are somewhere involved. This novel theory would transform Rule 10b–5 into a law governing any number of relationships outside the securities markets by imposing liability for securities fraud where the party defrauded has no interest in the purchase, sale or value of the securities traded. This is simply not the law nor should it be.

In straining to establish petitioners' criminal liability for securities fraud based upon Winans' breach of duty to the Journal, the government loses sight of this Court's unambiguous declaration that "[n]ot 'all breaches of fiduciary

19. *See McNally*, 107 S. Ct. at 2881.

20. *Id.*

duty in connection with a securities transaction' come within the ambit of Rule 10b–5."[21] The government's theory that securities trading becomes securities fraud upon a showing of *any* "breach of *any* duty to *anyone*"[22] completely contradicts "the principle set forth in *Chiarella* that only *some* persons, under *some* circumstances, will be barred from trading while in possession of material nonpublic information,"[23] and the "requirement" of *Chiarella*,[24] reaffirmed in *Dirks*, that "a *specific* [and relevant] relationship [must exist] between the shareholders and the individual trading on inside information."[25] The government's argument that a securities fraud conviction may be premised upon any incidental duty imposed by any third party "market observer"[26] which has no interest or involvement in the underlying securities transaction creates "a new and different theory of liability"[27] that ignores the limiting principles carefully established by this Court and reads the Exchange Act " 'more broadly than its language and statutory scheme reasonably permit.' "[28]

The government purports to find support for its extraordinarily expansive views in the so–called "misappropriation theory," which it interprets as warranting the prosecution of anyone who misappropriates information from anyone else as

21. *Dirks v. SEC*, 463 U.S. 646, 654 (1983) (quoting *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 472 (1977)).

22. Gov't Br. at 39 (emphasis supplied); *see Chiarella v. United States*, 445 U.S. 222, 228–30 (1980).

23. *Dirks*, 463 U.S. at 657 (emphasis supplied).

24. *Chiarella*, 445 U.S. at 232–33.

25. *Dirks*, 463 U.S. at 655 (emphasis supplied).

26. Gov't Br. at 45.

27. *Chiarella*, 445 U.S. at 234.

28. *Touche Ross & Co. v. Redington*, 442 U.S. 560, 578 (1979) (quoting *SEC v. Sloan*, 436 U.S. 103, 116 (1978)); *see Chiarella*, 445 U.S. at 234.

long as the misappropriator thereafter uses the information in connection with the purchase or sale of securities. Gov't Br. at 37. As so interpreted, the "misappropriation theory" would violate not only *Chiarella* and *Dirks* but also common sense. Rather than reading the securities laws as laws designed to protect market participants against securities fraud, the government would read them as laws designed to protect anyone against any kind of fraud as long as there was some subsequent contact with a securities trade.

However, no fair reading of the lower court decisions that have adopted a "misappropriation theory" warrants the government's excessive claims. The "misappropriation theory" of securities fraud liability as heretofore applied does not encompass breaches of duty owing exclusively to third parties who are not market participants, and does not support the imposition of criminal sanctions against petitioners based upon Winans' alleged breach of duty to the Journal. Rather, the "fraud" established in every other case applying any kind of "misappropriation theory" involved a breach of duty ultimately owing to a person or entity having an interest in the purchase, sale or value of the securities being traded. In all of these cases, the breached duty found cognizable under the federal securities laws was the duty of confidentiality owed to securities market participants (acquiring companies contemplating tender offers) by entities (*i.e.*, printers, investment banks) whose corporate clients (those same securities market participants) had entrusted them with nonpublic securities–related information. An employee trading upon these client confidences may commit securities fraud under the "misappropriation theory," or any other theory, not because he has breached his employer's particular confidentiality policy, but because he has violated a duty of confidentiality owed to his employer's client, a participant in the very securities market transactions affected by the misappropriator's trades and the entity which is thereby itself defrauded in its capacity as an investor.[29] Without any such underlying breach of duty to a market participant, the "misappropriation theory" does not criminalize Winans' intracorporate misconduct.

Having posited its illogical and extraordinarily expansive "misappropriation theory," the government purports to find support for it in judicial precedent, statutory language and history, and social policy; but its arguments in this regard cannot withstand scrutiny.

First, as to precedent, the government relies primarily on inferences from language in the various opinions in *Chiarella*.[30] However, *Chiarella* — unlike this case, but like all other "misappropriation" cases — involved a defendant employee who used confidential securities-related information entrusted by his employer's clients (market participants) to his employer, who had a fiduciary duty to safeguard that information. Concomitantly, the "misappropriation theory" of securities fraud liability presented to this Court in *Chiarella* proposed only that an employee's breach of "a duty of silence owed to the *acquiring companies* . . . that had entrusted confidential information to his employer . . . constituted 'a fraud or deceit' upon *those companies*" cognizable under the federal securities laws.[31] The validity of such a "misappropriation theory," in which a client, itself a market participant, is defrauded in connection with its own contemplated securities purchases, is simply irrelevant to this case, where there is no claim that any market participant was defrauded.[32]

29. *See* Pet. Br. at 21 n.36.

30. Gov't Br. at 40.

31. *Chiarella*, 445 U.S. at 237–38 (Stevens, J., concurring) (emphasis supplied).

32. *See* Note, *Insider Trading and the Misappropriation Theory: Has the Second Circuit Gone Too Far?*, 61 St. John's L. Rev. 78, 100–12

Second, as to statutory language and history, the government's extraordinary suggestion[33] that the scheme to defraud language of Rule 10b–5 was somehow meant to be given a broader meaning than the scheme to defraud language of the mail and wire statutes, despite their common antecedent,[34] is wholly without support. Contrary to the government's claim that "*McNally* is entirely inapposite to petitioners' convictions under Section 10(b) and Rule 10b–5,"[35] which require only a vague "injury to the integrity of the market"[36] rather than an injury to property, the legislative history, though sparse, at least demonstrates that Rule 10b–5 was derived from section 17 of the Securities Act of 1933, which (following on the mail fraud statute) expressly contains the words "to obtain money or property."[37] As stated by Judge Friendly in *SEC v. Texas Gulf Sulphur Co.*:[38]

> Although the authority for the Rule comes from § 10(b) of the Securities and Exchange Act of 1934, the draftsmen turned their backs on that section and borrowed the words of § 17 of the Securities Act of 1933, simply broadening these to include frauds on the seller as well as the buyer.[39]

(1987).

33. Gov't Supp. Br. at 8–11.

34. False Pretenses Act of 1757, 2 Geo., ch. 24.

35. Gov't Supp. Br. at 8.

36. *Id.* at 9–10.

37. Elsewhere, the government concedes that Rule 10b–5 and section 17 are "nearly identical" and should be similarly construed. Gov't Br. at 38 n.36; *see Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 212–13 n.32 (1976).

38. 401 F.2d 833 (2d Cir. 1968), *cert. denied sub nom. Coates v. SEC*, 394 U.S. 976 (1969).

39. *Id.* at 867.

The origin of the rule makes clear that the draftsmen were addressing a scheme to defraud an investor of money or securities, which of course is property; they were not addressing conduct toward a third party (*i.e.*, a newspaper) which was not buying or selling securities.[40]

The government's purported reliance on the legislative history of the Insider Trading Sanctions Act of 1984 (the "ITSA")[41] also misses the mark. The most that the legislative history of the ITSA suggests — assuming *arguendo* that its legislative history is suggestive of Congress's intent in 1934 — is an endorsement of the result in *United States v. Newman.*[42] Extension of the "misappropriation theory" beyond market participants, however, was not presented in *Newman*, which involved the defrauding of the *client* corporation in connection with the *client's* contemplated purchase of stock.[43] Indeed, a more recent legislative proposal defining insider trading by the Securities and Exchange Commission itself represents an implicit admission by the Commission that the law heretofore has not unambiguously covered Winans' conduct (as fair notice and due process require).[44]

Likewise, other recent legislative proposals in Congress have been accompanied by express acknowledgments of Congress's prior failure to address any form of the

40. *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 767 (1974) (Blackmun, J., dissenting).

41. Pub. L. No. 98–376, 98 Stat. 1264; *see* Gov't Br. at 49 n.53.

42. 664 F.2d 12 (2d Cir. 1981), *aff'd after remand*, 722 F.2d 729 (2d Cir.), *cert. denied*, 464 U.S. 863 (1983).

43. *Id.* at 15.

44. *See* Securities and Exchange Commission, *Proposed Legislation, "The Insider Trading Act of 1987" And Memorandum of Support Submitted to the Subcommittee on Securities of the U.S. Senate* (Aug. 7, 1987).

"misappropriation theory," let alone the expansive form which the government proposes here. Thus, for example, the Explanatory Memorandum accompanying the D'Amato/Riegle bill[45] notes that "the major linchpin on which many governmental insider trading cases are predicated today — the misappropriation theory — is itself a judicially–created construct, the parameters of which have never been addressed by either Congress or the Supreme Court"[46] and the current basis for which has "required tortured analyses of business, personal and other relationships in order to find [liability]."[47] The Memorandum adds that "[t]he *Winans* case is an example of this phenomenon, since the prosecution depended, at least in part, upon the fortuity of the adoption of a Code of Conduct by the *Wall Street Journal*, upon which a breach of duty by Mr. Winans was predicated . . . [rather than] on statutory principles. . . ."[48]

Third, as to policy, the government's attempt to support its expanded "misappropriation theory" by portraying it as necessary to fill "a large and illogical loophole in the securities laws"[49] is neither accurate nor relevant. It is inaccurate because, assuming the availability of Rule 14e–3, there is no gap which would be filled by the government's expansion of the "misappropriation theory," except the inability to sustain

45. *See* Explanatory Memorandum accompanying introduction of S. 1380, the proposed "Insider Trading Proscriptions Act of 1987," introduced by Senators D'Amato and Riegle on June 17, 1987.

46. *Id.* at 2.

47. *Id.* at 7 n.7. The Explanatory Memorandum stresses that "as a matter of fundamental fairness to those who seek to conform their conduct to the law," the "Congress should determine whether the [misappropriation] theory has sound policy bases, articulate those bases and establish guidelines for application of the theory." *Id.* at 2.

48. *Id.* at 2–3.

49. Gov't Br. at 41.

this conviction on appeal.[50] It is irrelevant because it is simply not the function of courts to fill in "gaps" in the statutory definition of crimes.[51] Rather, it is settled beyond peradventure that courts are not empowered to create "constructive offenses" to punish criminal defendants whose cases are not shown to be "plainly within the statute" upon which they are convicted.[52]

50. Ivan Boesky and other defendants whose prosecutions are cited by the government, Gov't Br. at 42 n.43, were subject to liability under Rule 14e–3. *SEC v. Siegel*, No. 87 Civ. 0963 (RO) (S.D.N.Y. Feb. 13, 1987); *SEC v. Boesky*, No. 86 Civ. 8767 (RO) (S.D.N.Y. Nov. 14, 1986); *SEC v. Levine*, No. 86 Civ. 3726 (RO) (S.D.N.Y. June 5, 1986). In addition, the government, without resort to any "misappropriation theory," had no difficulty in prosecuting them on a variety of traditional charges, such as tax evasion, *see United States v. Siegel*, No. 87 Crim. 378 (RJW) (S.D.N.Y. Feb. 13, 1987); *United States v. Levine*, No. 86 Crim. 519 (GLG) (S.D.N.Y. June 5, 1986), and they were further subject to potential state law liability, which the government, in its overweening desire to federalize the entire law of corporate behavior, consistently ignores. They might also have violated section 10(b) if the Court answers affirmatively the question left open in *Chiarella* and concludes that they defrauded acquiring corporations in connection with *such* corporations' contemplated purchases of target company stock. The government's suggestion that, unless its expanded formulation of the "misappropriation theory" is accepted, law clerks will freely be able to trade on advance knowledge of their judges' securities–impacting decisions, Gov't Br. at 42 n.44, simply ignores the "temporary insider" prohibitions set forth in footnote 14 of *Dirks*. 463 U.S. at 655 n.14. Outsiders such as underwriters, accountants, lawyers or corporate consultants become temporary insiders because of their confidential relationship to the corporation and access to inside information. By analogy, persons who obtain access to confidential information by virtue of their public positions may similarly become temporary insiders with duties to market participants.

51. As this Court noted in *Dirks*, "in a statutory area of the law such as securities regulation, where legal principles of general application must be applied . . . behavior that may fall below ethical standards of conduct" is not always illegal. 463 U.S. at 661 n.21.

52. *See, e.g., McNally*, 107 S. Ct. at 2882.

The government goes further still and suggests that Rule 10b–5 must be read to embrace petitioners' conduct because of the general policy of the Exchange Act to promote "fairness" in the marketplace. This, of course, is just one more attempt to exhume the parity–of–information theory buried in *Chiarella*.[53] More basically, we submit that the general purpose of the Exchange Act to " 'insure the maintenance of fair and honest markets' "[54] does not suffice to criminalize anything the government considers unfair or dishonest any more than does the general purpose of the mail fraud statute to promote honesty in the postal system.[55]

A policy of "fairness," moreover, simply does not support a rule under which trading by Winans is criminal when identical trading by his employer, Dow Jones, would not be. While the government attempts to avoid the obvious incongruity with the suggestion that such trading by Dow Jones may have been prosecuted under a different theory, the two cases which it cites, *SEC v. Blavin*[56] and *Zweig v. Hearst Corp.*,[57]

53. 445 U.S. at 233, 235 n.20.

54. Gov't Br. at 35 (quoting 15 U.S.C. § 78b (1982)).

55. While the government seems to recognize that section 10(b) gives the *Commission* authority to adopt rules to promote the public interest or protect investors, Gov't Br. at 43, it fails to appreciate that this statute does not and cannot give the *courts* any such legislative authority. Nor, for that matter, does it give private employers the legislative authority to criminalize employee conduct.

56. 557 F. Supp. 1304 (E.D. Mich. 1983), *aff'd*, 760 F.2d 706 (6th Cir. 1985). Unlike this case, *Blavin* involved an "investment advisor" who had a specific federally recognized fiduciary relationship with his clients arising under the Investment Advisors Act of 1940. 557 F. Supp. at 1309; *See Aaron v. SEC*, 446 U.S. 680, 693–94 (1980); *SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 192–93 (1963).

57. 594 F.2d 1261 (9th Cir. 1979). *Zweig*, like this case, did involve a newspaper reporter who was not an investment adviser. 594 F.2d at 1262. The case, however, involved affirmative misrepresentations and, in its broader implications, has been uniformly criticized in subsequent Ninth

are readily distinguishable. Moreover, we note, had any alternative theory of prosecution been available, the government would hardly have been expected to proceed *solely*, in a matter of "first impression," 791 F.2d at 1027; 8a, upon the expanded formulation of the "misappropriation theory."

Noteworthy too in this broad "policy" argument by the government is its implicit abandonment of the theories relied upon below. Instead of defending the lower courts' reliance upon reputational injury as a basis for the imposition of criminal liability under the securities laws, the government proposes new findings of "fact" on appeal to this Court, and argues that petitioners' conduct "damage[d] . . . the 'public interest,' "[58] was " 'unfair and inconsistent with the investing public's legitimate expectation of honest and fair securities markets . . .,' "[59] and "inflicted a wound on the market and all of the participants in it."[60] In addition to this implicit abandonment of the reputational harm theory as a basis for securities fraud liability, the government's suggestion that the "unfairness" of petitioners' trading brings their conduct within the ambit of section 10(b) reflects, as noted, a fundamental misconception about the role of the judiciary in enforcing the federal securities laws. To sustain petitioners' securities fraud convictions based upon undefined subjective standards such as "unfairness" would require this Court to read new language

Circuit cases and legal commentary. *See, e.g., Feldman v. Simkins Industries, Inc.*, 492 F. Supp. 839, 846 (N.D. Cal. 1980)("[a]ssuming for purposes of this discussion the continuing validity of *Zweig* notwithstanding *Chiarella*, it is a case of active market manipulation and conflict of interest, not merely nondisclosure"), *aff'd*, 679 F.2d 1299, 1304 (9th Cir. 1982)(also questioning continuing validity of *Zweig*). *See* Note, *The Inadequacy of Rule 10b-5 to Address Outside Trading by Reporters*, 38 Stan. L. Rev. 1549, 1558-59 (1986).

58. Gov't Br. at 43.

59. *Id.* at 44 (quoting H.R. Rep. 98-355, at 5).

60. *Id.* at 45.

into the securities laws and impose a test of conduct which provides no genuine guidance.[61] The existing statutory scheme of federal securities regulation neither authorizes the criminalization of petitioners' conduct based on its perceived "unfairness," nor otherwise warrants the affirmance of petitioners' convictions.

61. These dual infirmities were recently condemned by this Court in *Tanner v. United States*, 107 S. Ct. 2739, 2752-53 (1987). In like manner, the government's reliance on the broad "in connection with" language of the statute, Gov't Br. at 37, is misplaced. This patently ambiguous phrase must necessarily be construed consistently with the language and overall purpose of the statute — which, as we argue, is to protect investors and other market participants from being defrauded. To interpret it instead (as the government does) in isolation, as a roving warrant to criminalize any "unfair" activity that bears any incidental connection, however remote, to the purchase or sale of securities is to deprive the term of its logical meaning and context.

CONCLUSION

For the reasons set forth above and in our main brief, the judgment of the Court of Appeals for the Second Circuit should be reversed with instructions to dismiss the indictment.

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Respectfully submitted,

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