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Securities Regulation: Nondisclosure of Insider Information, Chiarella v. United States

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NOTES

SECURITIES REGULATION: NONDISCLOSURE OF INSIDER INFORMATION
Chiarella v. United States

Vincent Chiarella, an employee of a Wall Street printing firm, deduced from limited information he received during the course of his employment the names of target companies and acquiring companies involved in five separate tender-offer takeover bids. Acting on this information, he made several purchases of target company stock before the tender offers were announced publicly, and he profited thereby. The Securities and Exchange Commission (SEC) indicted Chiarella on seventeen counts[1] of "willful misuse of material,[2] nonpublic information in connection with the purchase or sale of securities," purportedly in violation of section 10(b)[3] of the Securities

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1. The indictments were brought under section 32(a), the criminal provision of the Securities Exchange Act of 1934, 15 U.S.C. § 78ff(a) (1976):

> 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 78(o) 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.

Each count of the seventeen indictments represented a confirmation slip mailed to Chiarella, verifying his transactions in the securities which he made by telephone. The mailings were sufficient to invoke federal jurisdiction under the securities laws. United States v. Chiarella, 588 F.2d 1358, 1364 n.6 (2d Cir. 1978).

2. The information concerning the impending tender offers was stipulated to be material. United States v. Chiarella, 588 F.2d 1358, 1364 n.5 (2d Cir. 1978).

3. Section 10(b) of the 1934 Act, 15 U.S.C. § 78(j) (1976), states:

> 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:
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> (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.

Exchange Act of 1934 and rule 10b-5[4] of the SEC. The second circuit upheld the lower court's conviction,[5] concluding that Chiarella's conduct did violate rule 10b-5. The Supreme Court reversed, holding that the petitioner had no affirmative duty to disclose the information before trading in the securities and therefore was improperly convicted. *Chiarella v. United States*, 100 S. Ct. 1108 (1980).

Trading on "insider information" is prohibited by section 10(b) and rule 10b-5 of the securities regulations, which were adopted as a portion of the New Deal's response to the financial disaster beginning October 29, Black Tuesday, 1929. The collapse of the securities market was caused mainly by the pervasive deceit, fraud, manipulation, and concealment of facts in regard to securities purchased by the public investor.[6] The rule prohibiting trading on "insider information"—a circumstance in which purchases or sales are made by persons who have access to information which is not available to those with whom they trade—evolved from section 10(b) of the Securities Exchange Act of 1934.[7] The 1934 Act was a safeguard to

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4. 17 C.F.R. 240.10b-5 (1979) states:

> 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,
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> (a) To employ any device, scheme, or artifice to defraud,
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> (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
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> (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.

5. This was the first criminal prosecution under section 10(b) for nondisclosure. Chiarella v. United States, 100 S. Ct. 1108, 1118 n.20 (1980). The regulations make available civil actions to injured parties whose stocks are involved in insider transactions.

6. The securities regulations adopted during the depression of 1929 to 1933 were not the original brainchild of the New Deal administration. The regulations followed a history of securities regulation beginning in England in 1285, when Edward I authorized the licensing of brokers in the City of London. For a detailed history of securities legislation, *see generally* 1 L. LOSS, SECURITIES REGULATION 3-158 (2d ed. 1961).

7. The acts promulgated by Congress purporting to prohibit fraudulent acts in regard to securities regulation were based on common law notions of fraud. "Statutes build on the common law and, especially when statutes are new, judges and lawyers who are trained in the common law are apt to look to it for guidance." 3 L. LOSS, SECURITIES REGULATION 1430 (2d ed. 1961). The Securities Exchange Act of 1934 (referred to as the 1934 Act) was preceded by the Securities Act of 1933. The Act of 1933 was adopted to police the sale of new stock issues or distributions of outstanding securities. The 1934 Act was targeted at the trading markets to protect investors from price manipulations. 1 A. BROMBERG & L. LOWENFELS, SECURITIES FRAUD & COMMODITIES FRAUD § 2.2, at 16 (1979).

protect investors from manipulation of stocks on the trading markets, and section 10(b) was designed to be a catchall.[8] The 1934 Act was concerned only with the manipulation of stock prices on the trading markets. Until 1941, section 10(b) prohibited only fraudulent acts in connection with the *sale* of securities. In 1942, SEC rule 10b-5 was drafted to encompass fraudulent acts in connection with the purchase of securities by any person.[9]

Developed largely by court decisions, rule 10b-5 has had its most important applications in imposing sanctions on insider trading situations. During the 1960's and early 1970's the applicability of

8. Thomas G. Corcoran, a member of the Roosevelt Administration, explained this section [10(b)] of the first revision of the bill: "Subsection (c) says, 'Thou shalt not devise any other cunning devices.' . . . Of course subsection (c) is a catchall 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." The devices Corcoran was concerned with here were short sales, stop-loss orders, puts, straddles, and various other securities transactions which are subject to manipulation. STOCK EXCHANGE REGULATION HEARINGS BEFORE HOUSE COMM. ON INTERSTATE AND FOREIGN COMMERCE ON H.R. 7852 AND H.R. 8720, 73d Congress, 2d Sess. 115 (1934).

9. Before the 1934 Act and rule 10b-5, the SEC had to rely on section 17 of the 1933 Act, which covers only offers to sell or actual sales. By combining section 17 with section 10(b), Milton Freeman, an SEC staff attorney, in 1941 drafted rule 10b-5. Rule 10b-5 was motivated by an incident that came to the SEC's attention in 1942 in which a corporate officer was purchasing stock from shareholders without disclosing nonpublic information known to the officer. *See* Ward LaFrance Truck Corp., 13 S.E.C. 373 (1943). Mr. Freeman narrated the casual origin of the rule years later:

> It was one day in the year 1943, I believe. I was sitting in my office in the S.E.C. building in Philadelphia and I received a call from Jim Treanor who was then the Director of the Trading and Exchange Division. He said, "I have just been on the telephone with Paul Rowen," who was then the S.E.C. Regional Administrator in Boston, "and he has told me about the president of some company in Boston who is going around buying up the stock of his company from his own shareholders at $4.00 a share, and he has been telling them that the company is doing very badly, whereas, in fact, the earnings are going to be quadrupled and will be $2.00 a share for this coming year. Is there anything we can do about it?" So he came upstairs and I called in my secretary and I looked at Section 10(b) and I looked at Section 17, and I put them together, and the only discussion we had there was where "in connection with the purchase or sale" should be, and we decided it should be at the end.
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> We called the Commission and we got on the calendar, and I don't remember whether we got there that morning or after lunch. We passed a piece of paper around to all the commissioners. All the commissioners read the rule and they tossed it on the table, indicating approval. Nobody said anything except Sumner Pike who said, "Well," he said, "we are against fraud, aren't we?" That is how it happened.
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> Louis is absolutely right that I never thought that twenty-odd years later it would be the biggest thing that ever happened.

Conference on Codification of the Federal Securities Law, 22 BUS. LAW. 793, 922 (1967).

rule 10b-5 was expanded through decisions of the SEC and of the Supreme Court[10] that interpreted the congressionally-intended functions of rule 10b-5 to encompass a broader range of persons subject to its sanctions. This group included individuals whose liability resulted from nondisclosure or "silence" as was considered in *Chiarella.*

The first category of insiders to be held liable under the regulations for nondisclosure of material corporate information were corporate officers and directors.[11] In *Kardon v. National Gypsum Company*,[12] the two plaintiffs (father and son) and the two defendants (brothers) each owned one-fourth of the stock in a corporation in which they were also corporate officers. The defendants secretly negotiated the sale of their paper products manufacturing company's assets to National Gypsum for $1,500,000. Without disclosing these negotiations, the defendants purchased from each plaintiff their respective one-fourth stock ownership in the corporation for $504,000. The defendants consummated the transaction with National Gypsum shortly thereafter. The *Kardon* court determined that the defendant corporate officers had violated rule 10b-5 since the rule imposed upon the defendants an affirmative duty to disclose, based on the fiduciary obligations[13] inherent in the defendants' insider status.[14]

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10. *See, e.g.*, Affiliated Ute Citizens v. United States, 406 U.S. 128 (1972); Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d 228 (2d Cir. 1974); SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968); Hooper v. Mountain States Securities Corp., 282 F.2d 195 (5th Cir. 1960); Brennan v. Midwestern United Life Ins. Co., 259 F. Supp. 673 (N.D. Ind. 1966); Cochran v. Channing Corp., 211 F. Supp. 239 (S.D.N.Y. 1962); *In re* Cady, Roberts & Co., 40 S.E.C. 907 (1961); Speed v. Transamerica Corp., 99 F. Supp. 808 (D. Del. 1951); Kardon v. National Gypsum Co., 69 F. Supp. 512 (E.D. Pa. 1946).

11. Along with corporate officers and directors, controlling shareholders who were neither officers nor directors were held to be subject to an affirmative duty to disclose. *See* Speed v. Transamerica Corp., 99 F. Supp. 808 (D. Del. 1951).

12. 69 F. Supp. 512 (E.D. Pa. 1946).

13. The fiduciary obligations of the corporate officers created an affirmative duty to disclose material information, as discussed in the Restatement of Torts and by Loss. "[T]here is still not common law liability in deceit for complete non-disclosure, as distinguished from a half truth, unless the one party to a business transaction 'by concealment or other action' intentionally prevents the other from acquiring material information," RESTATEMENT OF TORTS § 550 (1938), or the one party is under a duty to the other to exercise reasonable care to disclose the matter in question "because of a fiduciary or other similar relation of trust and confidence between them."-*Id.* at § 551 (2)(a). *See* 3 L. LOSS, *supra* note 7, at 1434.

14. The court relied on established principles of fiduciary relationships to impose liability on the corporate officers and to give rule 10b-5 effect.

Perhaps all that would be necessary for this decision would be the determination that the conduct of the defendants came within the terms of the Act [Securities

Later decisions extended the liability standards of corporate officers and directors for nondisclosure of material insider information to tippees. *In re Cady, Roberts & Company*,[15] an SEC proceeding, presented a situation in which Cady, Roberts, a brokerage firm, employed Cowdin, who was also on the board of Curtis-Wright Corporation. The Curtis-Wright Corporation recently had announced its invention of an innovative internal combustion engine. Curtis-Wright's stock price increased steadily for several months. The board of Curtis-Wright, with Cowdin present, decided to declare a lower dividend than customarily had been paid, in light of the stock's price rise. Cowdin quickly telephoned an associate at Cady, Roberts, who executed several transactions on the basis of this information. The SEC proceeding followed shortly thereafter, concluding that both Cady, Roberts and Cowdin's partner, whom Cowdin had "tipped off," had willfully violated section 17(a) of the Securities Act of 1933, section 10(b) of the Securities Exchange Act of 1934, and rule 10b-5. After considering the traditional obligations of corporate officers, directors, and controlling shareholders, the Commission determined:

> These three groups (officers, directors and controlling shareholders), however, do not exhaust the classes of persons upon whom there is such an obligation. Analytically, the obligation rests on two principal elements; first, 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. In considering these elements under the broad language of the antifraud provision we are not to be circumscribed by fine distinctions and rigid classifications.[16]

The Commission held that persons who had received tips from corporate insiders could be held liable for trading on inside information. The extension of liability to tippees was necessary to effectively deter insider trading, since corporate insiders would be able to circumvent liability by disclosing material, nonpublic information to

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> Exchange Act of 1934] and the remedy sought is one provided by law for redress. However, the broad terms of the Act are to be made effective in a case like the present one through application of well known and well established equitable principles governing fiduciary relationships.

Kardon v. National Gypsum Co., 73 F. Supp. 798, 803 (E.D. Pa. 1946).

15. 40 S.E.C. 907 (1961).

16. *Id.* at 912.

third parties.[17] This expansion of rule 10b-5 to tippees also was premised on the existence of a fiduciary responsibility, as in the *Kardon* case, since the duty to disclose was intertwined with a "relationship giving access, directly or *indirectly*"[18] to corporate information—a relationship enjoyed by the traditional corporate insider.

Beginning with *SEC v. Texas Gulf Sulphur*,[19] the second circuit became aware of an additional possible purpose of rule 10b-5: the broad intention of Congress to give all investors equal access to the rewards of participation in the securities marketplace, including equal access to material information.[20] The Texas Gulf Sulphur Corporation was involved in exploratory mineral drilling operations on properties near Timmons, Ontario in late November, 1963. The first test core revealed a strike of unheard of proportions of copper, zinc, and silver. Just a few days after examination of the test core, several corporate officers, employees, and their tippees began purchasing shares of TGS stock. The defendants in *Texas Gulf Sulphur* were held civilly liable for trading on inside information. In fact, the Court of Appeals for the Second Circuit held that *anyone* in *possession* of material inside information must either disclose that information or refrain from trading on it.[21] The second circuit seemed to

17. Insiders gain from releasing nonpublic information to their selected tippees through reciprocal agreements, status, prestige, cash, or any other type of compensation. The tippee, as a selected recipient of the insider, should not be allowed to trade on this nonpublic information; the insider is prohibited from doing this. *See, e.g.*, Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d 228 (2d Cir. 1974); SEC v. Shapiro, 494 F.2d 1301 (2d Cir. 1974).

18. *In re* Cady, Roberts & Co., 40 S.E.C. 907, 912 (1961) (emphasis added).

19. 401 F.2d 833 (2d Cir. 1968).

20. The second circuit voiced its theory of equal access of information by investors in *Texas Gulf Sulphur*: "[Rule 10b-5] is based in policy on the justifiable expectation of the securities marketplace that all investors trading on impersonal exchanges have relatively equal access to material information . . . ." SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 848 (2d Cir. 1968).

21. The essence of the Rule [Rule 10b-5] is that anyone who, trading for his own account in the securities of a corporation has "access, directly or indirectly, to information intended to be available only for a corporate purpose and not for the personal benefit of anyone" may not take "advantage of such information knowing it is unavailable to those with whom he is dealing," i.e. the investing public. Matter of Cady, Roberts & Co., 40 SEC 907, 912 (1961). Insiders, as directors or management officers, are, of course, by this Rule precluded from so unfairly dealing; but the Rule is also applicable to one possessing the information who may not strictly be termed an "insider" within the meaning of Sec. 16(b) of the Act. . . . Thus, *anyone 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.

Id. (emphasis added).

omit the *Cady, Roberts* requirement of "a relationship giving access" to inside information, but the defendants in *Texas Gulf Sulphur* were all in a position or relationship with TGS which gave access to inside information. Therefore, the court's omission of the *Cady, Roberts* requirement of an "insider" relationship should not be considered controlling.[22]

In a later case, *Frigitemp Corp. v. Financial Dynamics Fund, Inc.*,[23] the second circuit seemed to retrench from its earlier *Texas Gulf Sulphur* decisions. The plaintiffs in *Frigitemp* alleged that Financial Dynamics Fund, Inc. (FDF) had purchased $1,000,000 of a 5% convertible subordinated debenture issued by Frigitemp Corp. without disclosing material, confidential inside information regarding Frigitemp's financial status. The complaint alleged that the defendants failed to disclose to Frigitemp their purchasing most of the outstanding stock of Frigitemp on the basis of the insider knowledge FDF possessed and that by so doing the defendants violated 10(b) and 10b-5. The second circuit held that "[t]he party charged with failing to disclose market information must be under a duty to disclose it . . . ."[24] The second circuit, however, did not follow *Frigitemp* in deciding *Chiarella*.

In *Chiarella*, the defendant was an employee of Pandick Press, a printing firm specializing in corporate documents for Wall Street corporations. Employed as a mark-up man, Chiarella received the initial printing orders from customers and selected typefaces and page layouts.[25] Between September, 1975, and November, 1976, "Chiarella handled the raw material for five separate takeover bids."[26] The takeover bids, when handed to Chiarella by the acquiring companies' representatives, were coded with fictitious names or left with certain vital information deleted. Chiarella, however, as an experienced stock market trader, deduced from the limited information available to him the names of both the target companies and acquiring companies. Armed with this "sure bet"[27] information, Chiarella "bought cheap and, soon after [the tender offer was made public], sold dear,"[28] realizing a profit of over $30,000.[29] The Securities and Ex-

22. In a 1968 second circuit case, *General Time Corp. v. Talley Industries, Inc.*, 403 F.2d 159, 164 (2d Cir. 1968), the court explained: "We know of no rule of law, applicable at the time, that a purchaser of stock, who was not an 'insider' and had no fiduciary relation to a prospective seller, had any obligation to reveal circumstances that might raise a seller's demands and thus abort the sale."

23. 524 F.2d 275 (2d Cir. 1975).

24. *Id.* at 282.

25. *See* United States v. Chiarella, 588 F.2d 1358, 1363 (2d Cir. 1978).

26. *Id.* at 1363.

27. *Id.*

28. *Id.* at 1362.

29. *Id.* at 1363.

change Commission quickly began an investigation into Chiarella's good fortune, not quite believing that he had stumbled into five separate takeover wars in a row by chance. In May, 1977, the SEC persuaded Chiarella to distribute his profits to the sellers of the target stocks. The SEC's indictments of Chiarella soon followed. The second circuit concluded that Chiarella's conduct violated rule 10b-5; the court therefore upheld the lower court's conviction by referring to the "black letter law [of *Texas Gulf Sulphur*] that 'anyone in possession of material inside information must either disclose or refrain from trading if prohibited from disclosing.'"[30] The decision was reached without dealing with the *Texas Gulf Sulphur* dicta problem and the 1975 *Frigitemp* case.[31]

After considering previous SEC rulings, the court holdings in *Texas Gulf Suphur, Cady, Roberts & Company, Frigitemp*, and the intent of Congress with regard to the scope of rule 10b-5, the Supreme Court reversed the second circuit's decision affirming Chiarella's conviction. The Court found that a fiduciary relationship between the parties must precipitate a duty to disclose, and that without this duty, silence cannot amount to a violation of rule 10b-5. The Supreme Court stated that "a duty to disclose under § 10(b) does not arise from mere possession of non-public market information,"[32] as the second circuit would suggest. The Court found that Chiarella owed no affirmative duty to the sellers of the target company stocks. This outcome, however, would not seem to be the Court's final position on the matter, since other considerations in the opinion reflect the unsettled nature of the problem.

For example, the Solicitor General, in his brief to the Supreme Court, forwarded another theory to uphold Chiarella's conviction. That argument develops the tenet that the "petitioner breached a

30. *Id.* at 1364. The court held 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. And if he cannot disclose, he must abstain from buying or selling." *Id.* at 1365 (emphasis in original). This "black letter law," however, was not supported by *Texas Gulf Sulphur*, as the case presented distinguishable facts.

31. In his dissent in *United States v. Chiarella*, Circuit Judge Meskill noted that imposing liability on a defendant who had no fiduciary duty to speak before trading in securities was not supported by any case. Judge Meskill stated:

> The majority holds that Chiarella committed a § 10(b) violation by breaking the "disclose or abstain" rule of *SEC v. Texas Gulf Sulphur*. . . . However, we have been cited no case in which even civil liability for nondisclosure has been imposed under § 10(b) on anyone other than an insider, the tippee of an insider, or one standing in a special relationship with other traders.

588 F.2d at 1373 (Meskill, J., dissenting).

32. Chiarella v. United States, 100 S. Ct. 1108, 1118 (1980).

duty to the acquiring corporation when he acted upon information that he obtained by virtue of his position as an employee of a printer employed by the corporation."[33] The Court wisely left the resolution of this question for a future case, as Chiarella could not have been prosecuted in the court under a theory which had not been presented to the jury. According to the Solicitor General's misappropriation theory, Chiarella could be found to have perpetrated a fraud on both the tender offeror and his employer by using the information for personal gain. Pandick Press warned its employees that all information they received through the course of their employment was of a confidential nature and was not to be used for personal gain, and counsel for Chiarella admitted that "[w]e do not dispute the proposition that Chiarella violated his duty as an agent of the offeror corporations not to use their confidential information for personal profit."[34] According to the Solicitor General's theory, the fraud would be in connection with the purchase or sale of securities within the meaning of rule 10b-5 and therefore could be classified as a violation.

Chief Justice Burger in dissent acknowledged the misappropriation theory presented by the Solicitor General. Recognizing that no general duty to disclose exists in arms-length transactions, Chief Justice Burger stated that "the rule should give way when an informational advantage is obtained not by superior experience, foresight or industry, but by some unlawful means."[35] It seems that Chief Justice Burger would place an absolute duty to disclose information obtained in such a fashion.

The problem with the conversion theory is that Chiarella perpetrated the fraud only upon the employer and the tender offeror and not on the sellers of the stock. It would seem that Chiarella could be prosecuted in a SEC enforcement proceeding, but perhaps the misappropriation theory would be inadequate to support a private cause of action.[36] In *Blue Chip Stamps v. Manor Drug Stores*,[37] the Supreme Court recognized and upheld the *Birnbaum* rule,[38] which

33. *Id.* at 1118.
34. *Id.* at 1123.
35. *Id.* at 1120.
36. Brodskey, *Trading on Inside Market Information*, 183 N.Y.L.J. 1 (1980).
37. 421 U.S. 723 (1975).
38. Birnbaum v. Newport Steel Corp., 193 F.2d 461, 464 (2d Cir. 1952):

When Congress intended to protect the stockholders of a corporation against a breach of fiduciary duty by corporate insiders, it left no doubt as to its meaning. . . . 15 U.S.C.A. § 78p(b), expressly gave the corporate issuer or its stockholders a right of action against corporate insiders using their position to profit in the sale or exchange of corporate securities. . . . and that Rule X-10B-5 extended protection only to the defrauded purchaser or seller.

states that a private damages action under rule 10b-5 is confined to actual purchasers or sellers of securities.[39] Since the defrauded parties (the tender offeror and Pandick Press) were neither purchasers nor sellers of securities, a private action against Chiarella seems unavailable; therefore, the sellers of the stock, whom the laws are designed to protect, could obtain no relief.

Another indication that the Court might resolve this situation differently was its mention[40] of proposed rule 14(e) (which became effective October 14, 1980). Rule 14(e) was developed by the Commission specifically to regulate trading in target company securities prior to the bidder's public announcement of the intended tender offer. Because the Commission had then proposed and has now adopted rule 14(e), the Court may have determined that section 10(b) and rule 10b-5 were neither equipped, nor intended, to regulate a *Chiarella* situation. Rule 14(e) makes any person who knows or has reason to believe that a bidder will make a tender offer for securities and who purchases or causes to be purchased any of that company's securities before the public announcement of the tender offer subject to liability, since this would constitute a fraudulent, deceptive, or manipulative act or practice.[41]

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39. 421 U.S. at 731.

40. The Court made reference to proposed rule 14(e) in regard to warehousing: "Significantly, however, the Commission has acted to bar warehousing under its authority to regulate tender offers after recognizing that action under § 10(b) would rest on a 'somewhat different theory' than that previously used to regulate insider trading as fraudulent activity." Chiarella v. United States, 100 S. Ct. 1108, 1117-18 (1980). The Court pointed out that the Commission's recognition of a somewhat different theory for liability had led it to propose 14(e) to provide an adequate regulation to control warehousing and future *Chiarella* situations.

41. SEC Proposed Rule § 240.14e-2, 44 Fed. Reg. 9987-88 (1979). The Commission, following the *Chiarella* decision, adopted as final rule 14e-3 under regulation 14E, pursuant to sections 14(e) and 23(a) of the Securities Exchange Act of 1934. The rule states in 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 any 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.

SEC Final Rule § 240.14e-3, 45 Fed. Reg. 60410, 60418 (1980).

With the promulgation of rule 14(e), future Chiarella-like insiders will not escape liability, as 14(e) is addressed specifically to nondisclosure of nonpublic tender offer information. However, the court may be faced with a similar legal scenario that does not precisely fit the 14(e) statutory scheme or any other SEC rule. In those situations, the court will have to trace again the liability of a person possessing inside information from *Kardon* (affirmative duty to disclose as a result of the fiduciary obligations inherent in an insider's status) through *In re Cady, Roberts* (duty to disclose arising out of a relationship giving access to corporate information) to the holding in *Chiarella* to determine the question of liability. If there is no statutory provision, then the court probably will also be able to consider liability based upon the Solicitor General's misappropriation theory, which was strongly urged by Chief Justice Burger. Chiarella was not convicted—but, a future "Chiarella" in a nontender offer situation, even absent a specific statutory provision, may be convicted of violating 10(b) and 10b-5.[42]

Rodolfo J. Aguilar, Jr.

In re Grand Jury Subpoenas—JUVENILES' RIGHT TO COUNSEL INSIDE THE GRAND JURY

Grand jury subpoenas were issued to David and Eric Graham, ages 16 and 12, after their mother was found murdered in their home. Their father filed a motion to quash the subpoenas. The trial court appointed counsel to represent the minors to avoid any possible conflict of interest, and after the argument on the motions, the court quashed the subpoenas. The state sought to reinstate the subpeonas and to require the attendance of the children before the grand jury. The Louisiana Supreme Court granted certiorari and *held* that it would violate the concepts of fundamental fairness embodied in the

42. The Court was reluctant to allow Chiarella to evade liability. It is conceivable that had the misappropriation theory been timely advanced, Chiarella's conviction would have been affirmed. Justice Stevens' concurring opinion reflects the attitude of the Court:

> I write simply to emphasize the fact that we have not placed any stamp of approval on what this petitioner did, nor have we held that similar actions must be considered lawful in the future. Rather, we have merely held that petitioner's criminal conviction cannot rest on the theory that he breached a duty he did not owe.

Chiarella v. United States, 100 S. Ct. 1108, 1120 (1980).