12/10

To: The Chief Justice
Justice Brennan
Justice White
Justice Marshall
Justice Blackmun
Justice Stevens
Justice O'Connor
Justice Scalia

L.F.P.
12/10

Ronald - Looks fine. Correct in pen the typos on p 3, 5 - & circulate today. Also add Brant's name in the caption in pen.

From: **Justice Powell**

Circulated: ____________

Recirculated: ____________

1st DRAFT

SUPREME COURT OF THE UNITED STATES

DAVID CARPENTER, KENNETH P. FELIS, AND R. FOSTER WINANS *v.* UNITED STATES — add Brant

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

No. 86–422. Decided December ——, 1986

JUSTICE POWELL, dissenting from denial of certiorari.

A divided panel of the Court of Appeals for the Second Circuit has resolved an important question of securities law in a way that appears to conflict with recent opinions of this Court. As this decision—particularly by this Court of Appeals—could have substantial precedential effect, I would grant the petition for certiorari with respect to question 1.

I

In this case, the Court of Appeals affirmed petitioners' convictions for wire fraud, mail fraud, and securities fraud. Question 1 of the petition challenges the securities fraud convictions. The convictions rest on a conspiracy involving petitioner Winans, a reporter for the Wall Street Journal, and petitioners Felis and Brant, stockbrokers with the firm of Kidder Peabody. The final party to the conspiracy was petitioner Carpenter, an employee of the Wall Street Journal who carried messages from Winans to Felis and Brant. Winans informed Brant and Felis of the dates on which the Wall Street Journal would publish columns discussing particular securities. Advance knowledge of the dates on which certain columns would appear enabled Brant and Felis to profit by trading in anticipation of price changes that would follow publication of the columns. The columns themselves consisted of public information. The only nonpublic information provided by Winans was the publication schedule for the columns.

The petitioners were charged with wire fraud, mail fraud, and securities fraud. After a bench trial, the District Court convicted petitioners. *United States* v. *Winans*, 612 F. Supp. 827 (S. D.N. Y. 1985). On appeal, the Court of Appeals for the Second Circuit affirmed. *United States* v. *Carpenter*, 791 F. 2d 1024 (1986). In the Court of Appeals' view, petitioners were guilty of criminal securities fraud under the "misappropriation" theory of liability under § 10(b) of the Securities Exchange Act of 1934, 15 U. S. C. § 78j(b), and Rule 10b–5, 17 CFR § 240.10b–5. Under this theory, a person is liable under Rule 10b–5 if he misappropriates material nonpublic information and then uses the information in connection with the purchase or sale of securities. *Id.*, at 1031–1032. The Court of Appeals noted that we left open the question of the legitimacy of the misappropriation theory in *Chiarella*. But the court noted that its Circuit has adopted that theory since our decision in *Chiarella*. See *SEC* v. *Materia*, 745 F. 2d 197 (CA2 1984), cert. denied, 471 U. S. 1053 (1985); *United States* v. *Newman*, 664 F. 2d 12 (CA2 1981), affirmed after remand, 722 F. 2d 729 (CA2), cert. denied, 464 U. S. 863 (1983).

The Court of Appeals rejected petitioners' argument that the misappropriation theory could not be applied in this case because the information was misappropriated not from the corporations whose securities were traded, but from the Wall Street Journal. The court believed that our recent opinion in *Dirks* v. *SEC*, 463 U. S. 646 (1983), offered substantial support to petitioners' contention, but concluded that "[i]t is not accurate to say that *Dirks* wrote the book on insider or outsider trading; it wrote one chapter with respect to one type of fraudulent trading." 791 F. 2d, at 1029 (quoting the District Court's opinion, *United States* v. *Winans*, 612 F. Supp. 827, 842 (S. D.N. Y. 1985)). The Court of Appeals concluded that Winans' appropriation of the Wall Street Journal's publication schedules was a fraud condemned by the securities laws. "Congress apparently has sought to proscribe

. . . trading on material, nonpublic information obtained not through skill but through a variety of "deceptive" practices, unlawful acts which we term 'misappropriation.'" *Id.*, at 1031. Judge Miner dissented from the panel's judgment. In his view:

> "[Section 10(b)] never was intended to protect the reputation, or enforce the ethical standards, of a financial newspaper. . . . [T]he securities fraud provisions were [not] designed to prohibit the type of fraudulent conduct engaged in by these defendants. Such conduct is addressed adequately by the statutes establishing the mail and wire fraud offenses of which the defendants stand convicted." *Id.*, at 1037.

II

A comparison of the Court of Appeals's opinion in this case with our recent precedents demonstrates the need for examination by this Court of the misappropriation theory. In *Chiarella*, we began our analysis of Rule 10b–5 with the proposition that parties to a business transaction generally do not have an affirmative duty to disclose information about the transaction. The Court noted, however, that a failure to disclose material information could be fraudulent in certain circumstances. "But such liability is premised upon a duty to disclose arising from a relationship of trust and confidence *between parties to a transaction*." 445 U. S., at 230 (emphasis added). Such a duty applied when corporate insiders traded in the securities of their corporation. In such a case, "the duty arose from (1) the existence of a relationship affording access to inside information intended to be available only for a corporate purpose, and (2) the unfairness of allowing a corporate insider to take advantage of that information by trading without disclosure." *Id.*, at 227 (citing *Cady, Roberts & Co.*, 40 S. E. C. 907, 912, and n. 15 (1961)).

In *Dirks* v. *SEC*, 463 U. S. 646 (1983), we examined the circumstances under which outsiders could be held liable under Rule 10b–5. We noted:

> "[U]nder certain circumstances, such as where corporate information is revealed legitimately to an underwriter, accountant, lawyer, or consultant working for the corporation, these outsiders may become fiduciaries of the shareholders. The basis for recognizing this fiduciary duty is not simply that such persons acquired nonpublic corporate information, but that they have entered into a special confidential relationship in the conduct of the business of the enterprise and are given access to information solely for corporate purposes." *Id.*, at 655, n. 14.

Thus, *Dirks* established that when outsiders have a fiduciary duty to the shareholders, they cannot purchase securities from those shareholders without first informing them of material information that might influence the decision to purchase or sell the securities.

The Court also noted that even if a particular outsider were not under a fiduciary duty to the corporation's shareholders, he could not trade on information that corporate insiders had disclosed to him improperly. See *id.*, at 659–660. As the Court explained, "[T]ippee responsibility must be related back to insider responsibility by a necessary finding that the tippee knew the information was given to him in breach of a duty by *a person having a special relationship to the issuer* not to disclose the information . . ." *Id.*, at 661 (emphasis added) (quoting *In re Investors Management Co.*, 44 S. E. C. 633 (1971)).

Applying these principles to this case, it is difficult to understand how any of the petitioners were guilty of criminal securities fraud. The Court of Appeals found no fiduciary relationship between any of the petitioners and the parties from whom they purchased securities. The only fiduciary duty discussed by the court is petitioner Winans' duty to the

Wall Street Journal. But our previous decisions establish that the duty of an individual to his employer, alone, is insufficient to support an action under Rule 10b–5. The inquiry under that section must focus on "petitioner's relationship with the sellers of the . . . securities . . . ." What we said in *Chiarella* is true here: "[Petitioner] was not their agent, he was not a fiduciary, he was not a person in whom the sellers had placed their trust and confidence. He was, in fact, a complete stranger who dealt with the sellers only through impersonal market transactions." 445 U. S., at 232–233. As the petitioners in this case had no fiduciary obligation to disclose the information before dealing in the securities, their convictions under § 10(b) and Rule 10b–5 are without support in any prior decision of this Court.

III

In *Chiarella*, the Court had no occasion to address the merits of the misappropriation theory. 445 U. S., at 236–237 and n. 21; *id.*, at 237–238 (STEVENS, J., concurring); *id.*, at 238–239 (BRENNAN, J., concurring in the judgment). The question is important because the theory broadens substantially the ambit of criminal liability under the securities laws. There appears to be little or no support for the decision below in the language or history of the Securities Act of 1934.

The Court of Appeals has had three occasions to address the misappropriation theory since we left this question open in *Chiarella*. On each occasion, it has embraced the theory. Because the Second Circuit includes New York, the court's decision in this case is of special importance. In my view, this case presents "an important question of federal law which has not been, but should be, settled by this Court." S. Ct. R. 17.1(c). The time has come for this Court to resolve that question. I dissent from the Court's denial of certiorari in this case.