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Second Circuit Expands Section 10(b) Liability to Security Fraud Committed in Breach of an Employee's Fiduciary Duty: *United States v. Newman*

Section 10(b) of the Securities Exchange Act of 1934[1] prohibits the use of any manipulative or deceptive device or contrivance in connection with the purchase or sale of any security. Although nondisclosure of material, nonpublic information in connection with the sale or purchase of securities may result in liability under the Act,[2] *Chiarella v. United States*[3] limited such fraud actionable under section 10(b) to situations in which there exists a duty to disclose arising from a relationship of trust and confidence between the parties to the transaction.[4] However, the United States Supreme Court left undecided whether the breach

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1. Securities Exchange Act of 1934, § 10(b), 15 U.S.C. § 78j (1976) provides in relevant 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—
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> . . . .
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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.

Id.

Rule 10b-5, passed pursuant to § 10(b), provides:

> It shall be unlawful for any person, directly or indirectly, by 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.

General Rules and Regulations, Securities Exchange Act of 1934, 17 C.F.R. § 240.10b-5 (1981).

2. *See, e.g.*, Affiliated Ute Citizens v. United States, 406 U.S. 128, 150-54 (1972); SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968), *cert. denied*, 404 U.S. 1005 (1971); *In re* Cady, Roberts & Co., 40 S.E.C. 907 (1961).

3. 445 U.S. 222 (1980).

4. *Id.* at 230.

of an employee's fiduciary duty to his employer and his employer's clients constitutes a violation of section 10(b) when the breach occurs in connection with the purchase or sale of securities.[5] In *United States v. Newman*[6] the United States Court of Appeals for the Second Circuit decided that issue, holding that misappropriation of confidential takeover information by an investment banking firm's employee, in violation of his fiduciary duties owed to the firm and its clients, could result in a criminal violation under section 10(b) and rule 10b-5. The court reasoned that despite the fact that neither the investment banking firm nor its clients were purchasers or sellers of securities, a finding of criminal liability was warranted since the misappropriation of material inside information was in connection with the purchase of securities.

I. *Newman*

E. Jacques Courtois was a member and later vice-president of the merger and acquisition department of Morgan Stanley & Co., Inc., an investment banking firm. Adrian Antoniu, an unindicted, alleged coconspirator,[7] held a comparable position at the investment banking firm of Kuhn Loeb & Co., now known as Lehman Brothers Kuhn Loeb Inc. Both firms represented companies engaged in corporate mergers, acquisitions, tender offers, and other takeovers. Courtois and Antoniu misappropriated confidential information entrusted to their employers by their clients concerning proposed mergers and acquisitions.[8] This information was communicated to James Newman, Franklin Carniol, and Constantine Spryopoulos, who then purchased stock in merger and takeover targets (target companies) of clients of Morgan Stanley and Kuhn Leob.[9] In order to avoid detection, the conspirators established an elaborate system of foreign bank and trust accounts and spread their purchases among several brokers. When the proposed mergers or takeovers be-

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5. *Id.* at 235-37.

6. 664 F.2d 12 (2d Cir. 1981), *rev'g* United States v. Courtois, [1981 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 98,024 (S.D.N.Y. June 5, 1981).

7. 664 F.2d at 15.

8. *Id.*

9. *Id.* At the time the conspiracy was alleged to have occurred, Newman was a securities trader and manger of the over-the-counter trading department of a New York brokerage firm; Carniol was a resident of Belgium; Spyropoulos was a Greek citizen who lived in both Greece and France. *Id.*

came known to the public, the market price of the target companies' stocks increased in value and the securities traders reaped substantial gains, which they shared with Courtois and Antoniu.[10]

Courtois, Newman, Carniol, and Spyropoulos were indicted in United States District Court for the Southern District of New York[11] under section 32 of the Securities Exchange Act of 1934[12] for willful violation of section 10(b) and rule 10b-5. The indictment also charged them with violation of the mail fraud statute[13] and conspiracy to commit securities and mail fraud.[14] Because the court recognized that Newman was liable as an aider and abettor in the conspiratorial chain,[15] and was therefore in the same position as Antoniu and Courtois, the court's analysis focused directly on whether Courtois' and Antoniu's breach of their fiduciary duty to their employers and their employers' clients could result in a violation of section 10(b) when the breach occurred in connection with the purchase or sale of securities.[16] Newman moved to dismiss the indictment on the grounds that the acts charged did not constitute violations of any federal criminal statutes.[17] The district court granted Newman's motion and ordered dismissal of all counts. The court reasoned that "there was no 'clear and definite statement' in the federal securities laws which both antedated and proscribed the acts alleged in the indictment."[18]

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10. *Id.*

11. United States v. Courtois, [1981 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 98,024, at 91,287-88 (S.D.N.Y. June 5, 1981).

12. 15 U.S.C. § 78ff (1976) (provides for criminal penalties against any person who willfully violates the Act).

13. 18 U.S.C. § 1341 (1976).

14. 18 U.S.C. § 371 (1976).

15. 18 U.S.C. § 2 (1976) (anyone who aids, abets, counsels, commands, induces, or procures the commission of an offense against the United States is punishable as a principal).

16. United States v. Courtois, [1981 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 98,024, at 91,290 (S.D.N.Y. June 5, 1981).

17. *Id.* at 91,288. Defendants Courtois, Carniol, and Spyropoulos had left the United States and the Government was unable to extradite them for arraignment. *Id.* at 91,287 n.1. The indictment against Antoniu was dismissed when he agreed to cooperate with the Government in the prosecution of the other alleged coconspirators. *Id.* at 91,288. Although only Newman was within the court's jurisdiction, all participants are referred to as defendants in this Case Note.

18. *Id.* at 91,296. The district court also dismissed the mail fraud counts, holding as a matter of law that the allegations failed to charge a crime. The court then held that the conspiracy count failed because the actions forming the subject matter of the conspiracy did not themselves constitute substantive crimes. *Id.* at 91,301.

The Second Circuit reversed the order dismissing the indictment and remanded the matter to the district court for further proceedings on the merits. The court held that the fraudulent misappropriation of confidential information by a fiduciary in connection with the purchase of securities was sufficient to constitute a criminal violation of the antifraud provisions of section 10(b) and rule 10b-5.[19] By focusing its analysis on the breach by Courtois and Antoniu of their fiduciary duties owed to Morgan Stanley and Kuhn Loeb, the court reasoned that Newman would be liable for aiding and facilitating the fraudulent misappropriation if Courtois and Antoniu were liable under section 10(b).[20] The court also reinstated the mail fraud and conspiracy counts of the indictment, concluding that they too had been improperly dismissed.[21]

Judge Dumbauld[22] concurred in the reversal of the district court's order but dissented from the reinstatement of the securities fraud counts of the indictment. He reasoned that the defendants owed no duty to the sellers of the target company securities to disclose material, nonpublic information even though some of them may have violated a fiduciary duty to their employer and its clients.[23]

II. Analysis

Section 10(b) should not be expanded to impose a duty to disclose material, nonpublic infomation on one who is neither an insider or tippee of an insider of the issuing corporation nor in a fiduciary relationship with the seller or issuer of the securities. The imposition of criminal liability upon one who is not in a special relationship of trust and confidence with the seller of the securities is not within the purpose of section 10(b) or rule 10b-5. The courts should not expand the reach of section 10(b); rather, Congress should amend the federal securities laws to provide greater control over unfair securities transactions and to

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19. 664 F.2d at 16.

20. *Id.* at 15-16.

21. *Id.* at 19-20.

22. Dumbauld, Senior District Judge of the Western District of Pennsylvania, was sitting on the court of appeals by designation.

23. 664 F.2d at 20-21 (Dumbauld, J., concurring and dissenting). Judge Dumbauld concurred in reinstating the mail fraud count of the indictment since the sophisticated fraudulent scheme involved the use of the mails and thus constituted a clear violation of the mail fraud statute. *Id.*

give sufficient notice to securities traders of the proscribed conduct.

In *Newman* the Second Circuit relied upon the literal language of rule 10b-5, "fraud . . . in connection with the purchase or sale of any security,"[24] to find that criminal liability could be imposed under section 10(b) of the Securities Exchange Act.[25] The court first reasoned that Antoniu and Courtois breached a fiduciary duty owed to their employers by misappropriating nonpublic information. Second, the court determined that this breach of a fiduciary duty was fraud upon Morgan Stanley and Kuhn Loeb and their clients.[26] Third, the court found that Newman received this misappropriated information as the tippee of Antoniu and Courtois. And finally, the court reasoned that the defendants' only purpose in participating in the fraudulent misappropriation of confidential takeover information was to purchase shares of the target companies.[27] Thus, the Second Circuit concluded that rule 10b-5 proscribed the conduct since it was fraud in connection with the purchase of securities, although neither defendants' employers nor their clients were parties in any transaction with the defendants.[28]

Although the court's holding in *Newman* seems logical from a literal reading of section 10(b) and rule 10b-5, the Second Circuit failed to follow the analysis found in previous securities fraud cases decided under section 10(b).[29] Fraud is, of course, an essential element of section 10(b) liability.[30] But the fraud which section 10(b) proscribes is not the initial fraudulent misappro-

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24. *See supra* note 1.

25. 664 F.2d at 16-19.

26. *Id.* at 17-18.

27. *Id.* at 18.

28. *Id.* at 16.

29. *See, e.g.*, First Virginia Bankshares v. Benson, 559 F.2d 1307 (5th Cir. 1977) (commercial lending institution's failure to disclose improper accounting practices of consumer finance company could result in § 10(b) fraud when the broker acting for the purchaser of the finance company was in a special relationship with the lending institution), *cert. denied*, 435 U.S. 952 (1978); State Teachers Retirement Bd. v. Fluor Corp., 500 F. Supp. 278, 291-94 (S.D.N.Y. 1980) (since the duty to disclose is an alternative duty, nondisclosure is not actionable under § 10(b) if the individual decides to abstain from trading); Rothschild v. Teledyne, Inc., 328 F. Supp. 1054 (N.D. Ill. 1971) (mere possession and nondisclosure of material, nonpublic information does not impose § 10(b) liability without a duty to disclose arising from some relationship between the plaintiff and the defendant).

30. Santa Fe Indus. v. Green, 430 U.S. 462 (1977); Superintendent of Ins. v. Bankers Life & Casualty Co., 300 F. Supp. 1083, 1101 (S.D.N.Y. 1969), *aff'd*, 430 F.2d 355 (2d Cir. 1970); Fischman v. Raytheon Mfg., 188 F.2d 783 (2d Cir. 1951).

priation of confidential information as found by the court in *Newman*.[31] Rather, it is the act of trading without disclosing material, nonpublic information that may give rise to a securities fraud violation.[32] However, the courts have established that in order to violate section 10(b), the securities trader possessing material nonpublic information must be under a duty to disclose it.[33] The United States Supreme Court held in *Chiarella* that such a duty to disclose arises "from a relationship of trust and confidence between parties to a transaction."[34] Therefore, under this *Chiarella* relationship test, liability cannot be imposed upon a purchaser or seller of securities for nondisclosure unless a special relationship between the parties to the transaction creates a duty to disclose such information.

The courts have identified those individuals falling within this special relationship test as insiders of the issuing corpora-

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31. *See infra* notes 44-47 and accompanying text.

32. *See, e.g.*, SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 848 (2d Cir. 1968), *cert. denied*, 404 U.S. 1005 (1971), in which the Second Circuit announced a "disclose or abstain" rule holding that the withholding of nonpublic information is not fraud unless the individual trades without disclosure. *See also* Wang, *Trading On Material Nonpublic Information On Impersonal Stock Markets: Who Is Harmed, And Who Can Sue Whom Under SEC Rule 10b-5?*, 54 S. CAL. L. REV. 1217, 1267, 1270 (1981).

33. *Chiarella*, 445 U.S. at 230 (liability is premised upon a duty to disclose); Frigitemp Corp. v. Financial Dynamics Fund, Inc., 524 F.2d 275, 282 (2d Cir. 1975) ("The party charged with failing to disclose market information must be under a duty to disclose it. . . ."); Gold v. DCL, Inc., 399 F. Supp. 1123, 1127 (S.D.N.Y. 1973) ("[M]ere possession and nondisclosure of material facts does not alone create liability under Rule 10b-5; there must be, in addition, some relationship which generates a duty to inform."); Phillips v. Reynolds & Co., 294 F. Supp. 1249, 1255 (E.D. Pa. 1969) ("[U]nless there is some special relationship between the parties imposing some duty to affirmatively disclose material facts concerning a security, liability should not be imposed.").

34. 445 U.S. at 230. The Supreme Court based this relationship test upon analysis of *In re* Cady, Roberts & Co., 40 S.E.C. 907 (1961), and subsequent cases. In *Cady, Roberts* the Securities and Exchange Commission decided that a corporate insider must abstain from trading in the stock of his corporation unless he first discloses all material inside information known to him. This duty to disclose arose from

> 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.

40 S.E.C. at 912 (footnote omitted). Thus, *Cady, Roberts* required that a relationship between the purchaser and the seller be found before disclosure of confidential information would be necessary to eliminate the "inherent unfairness" caused by nondisclosure. *See generally* Fleischer, Mundheim & Murphy, *An Initial Inquiry into the Responsibility to Disclose Market Information*, 121 U. PA. L. REV. 798 (1973). "The duty to disclose material, non-public information has not been imposed on every person possessing this type of information. Traditionally, this obligation has been limited to persons with a special relationship to the company affected by the information." *Id.* at 804.

tion,[35] tippees of insiders,[36] and fiduciaries of the sellers, purchasers, or issuers of the securities.[37] An insider is a "person who, due to his position or intimate association with a company, has the capability to appropriate for personal profit corporate information which is not available to the investing public."[38] The broadest interpretations of section 10(b) have limited insiders to officers, directors, major shareholders, and employees who acquire secret information relating to the employer's business.[39] Tippees are individuals who by reason of their relationship with an insider come into possession of material, nonpublic information.[40] A fiduciary is one who is in a position of trust and confidence with a seller, purchaser, or issuer of securities and may be liable under section 10(b) for a breach of his fiduciary duties when such a breach involves deception, misrepresentation, or nondisclosure in connection with the purchase or sale of securities.[41] The principles of common law agency determine whether all of the surrounding circumstances of a transaction indicate a fiduciary relationship.[42] Thus, under the special relationship test, a purchaser of stock who is neither an insider, tippee of an insider, nor a fiduciary of the issuer or the seller does not have a duty to disclose material, nonpublic information to a prospective seller.

Had the Second Circuit analyzed *Newman* under the *Chiarella* relationship test, it would have been unable to find the

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35. *See, e.g.*, SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 848 (2d Cir. 1968), *cert. denied*, 404 U.S. 1005 (1971).

36. *See, e.g.*, Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d 228, 237 (2d Cir. 1974).

37. *See, e.g.*, Affiliated Ute Citizens v. United States, 406 U.S. 128, 150-54 (1972).

38. S. GOLDBERG, SEC TRADING RESTRICTIONS AND REPORTING REQUIREMENTS FOR INSIDERS § 2.5[a] (1973).

39. *See*, SEC v. Texas Gulf Sulphur Co., 258 F. Supp. 262, 278-79 (S.D.N.Y. 1966), *aff'd in part, rev'd in part on other grounds*, 401 F.2d 833 (2d Cir. 1968), *cert. denied*, 404 U.S. 1005 (1971).

40. 2 A. BROMBERG & L. LOWENFELS, SECURITIES FRAUD & COMMODITIES FRAUD § 7.5(2), at 190.7-190.8 (rev. ed. 1981). Tippees "have been held liable under § 10(b) because they have a duty not to profit from the use of" confidential information. The tippee's duty to disclose such information arises "from his role as a participant after the fact in the insider's breach of a fiduciary duty." *Chiarella*, 445 U.S. at 230 n.12.

41. *See, e.g.*, Superintendent of Ins. v. Freedman, 443 F. Supp. 628, 634-36, 639 (S.D.N.Y. 1977), *aff'd*, 594 F.2d 852 (2d Cir. 1978); *In re* Ramey Kelly Corp., SEC Exchange Act Release No. 6209, at 5 (Mar. 17, 1960).

42. *See, e.g.*, Arleen W. Hughes, 27 S.E.C. 629, 634-39 (1948), *aff'd sub nom.*, Hughes v. SEC, 174 F.2d 969 (D.C. Cir. 1949). *See generally* 3 L. LOSS, SECURITIES REGULATION 1500-08 (2d ed. 1961); 6 L. LOSS, SECURITIES REGULATION 3628-30 (2d ed. Supp. 1969).

defendants liable under section 10(b) and rule 10b-5. Courtois and Antoniu were not insiders of the target companies whose securities they purchased. They were employees of Morgan Stanley and Kuhn Loeb, investment banking firms which neither sold nor purchased target company stock nor had a client relationship with the target companies. Courtois and Antoniu were not tippees of a corporate insider. They acquired the nonpublic information by virtue of their client relationship with potential acquiring corporations. At the time, the acquiring companies had no relationship with the target companies. Nor were Courtois and Antoniu in any fiduciary relationship with the issuers of the securities, the target companies. Although Antoniu and Courtois misappropriated confidential information from their employers and traded on the information, they were not insiders, tippees, or fiduciaries of the issuer or seller and did not have a duty to disclose the information.

Therefore, Newman, as recipient of the misappropriated information, was neither a tippee of an insider nor an insider in the issuing target company. Newman's liability under section 10(b) or rule 10b-5 must be based upon some fiduciary relationship between him and the issuer or seller of the securities. Newman was manager of the over-the-counter trading department of a New York brokerage firm, and was not in a fiduciary relationship with the issuing target company. He traded on the impersonal stock market and had no fiduciary relationship with the anonymous sellers of the securities.[43] Although Newman purchased securities based on confidential information misappropriated by Antoniu and Courtois, he did not have a duty to disclose the nonpublic information to the sellers of the securities.

In sum, none of the defendants were insiders of the issuer, tippees of an insider, or in a fiduciary relationship with the sellers or issuers of the securities. Consequently, there was no duty

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43. In exonerating Chiarella from § 10(b) liability, Justice Powell repeatedly emphasized that Chiarella had no special relationship with his sellers. "The Court of Appeals, like the trial court, failed to identify a relationship between the petitioner and the *sellers*. . . ." 445 U.S. at 231-32 (emphasis added). "No duty could arise from petitioner's relationship with the sellers of the target company's securities . . . [H]e 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." *Id.* at 232-33 (emphasis added). "[S]ilence . . . may operate as a fraud actionable under § 10(b), . . . but such liability is premised upon a duty to disclose arising from a relationship of trust and confidence *between parties* to a transaction." *Id.* at 230 (emphasis added). *See also* Wang, *supra* note 32, at 1224-25.

to disclose the nonpublic information. Section 10(b) of the Securities Exchange Act should not be judicially interpreted to impose liability when there is no duty to disclose the nonpublic information.

The Second Circuit's expansion of section 10(b) criminal liability to a noninsider, nonfiduciary is not within the purpose of section 10(b) or rule 105-5 of the Securities Exchange Act. A major purpose of the Securities Exchange Act was to eliminate the "unnecessary, unwise, and destructive speculation"[44] which led in part to the Great Depression. The Act also sought "to prevent corporate insiders and their tippees from taking unfair advantage of the uninformed outsiders."[45]

Although a principal purpose of section 10(b) and rule 10b-5 is "to protect purchasers and sellers of securities from fraud perpetrated in 'connection with the purchase or sale or any security,' "[46] the Supreme Court in *Chiarella* set limits on the extent to which rule 10b-5 may be expanded to accomplish that purpose. The imposition of criminal liability on a noninsider, nonfiduciary employee who trades in the impersonal stock market with misappropriated, nonpublic information is outside the scope of the rule. The employee may be in a better bargaining

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44. H.R. REP. No. 1383, 73d Cong., 2d Sess. 2 (1934) (letter from President Franklin D. Roosevelt to Sam Rayburn, Chairman, Interstate and Foreign Commerce Committee (Mar. 26, 1934)). Congressman Rayburn began his report to the House of Representatives, "To reach the causes of the 'unnecessary, unwise, and destructive speculation' condemned by the President's message, this bill seeks to regulate stock exchanges and the relationships of the investing public to corporations which invite public investment by listing on such exchanges." *Id.*

45. Radiation Dynamics, Inc. v. Goldmuntz, 464 F.2d 876, 890 (2d Cir. 1972). An excerpt from a Senate Report on the 1934 Act illustrates the insider problem which in part led to the passage of the Act:

> Among the most vicious practices unearthed at the hearings before the subcommittee was the flagrant betrayal of their fiduciary duties by directors and officers of corporations who used their positions of trust and the confidential information which came to them in such positions, to aid them in their market activities. Closely allied to this type of abuse was the unscrupulous employment of inside information by large stockholders who, while not directors and officers, exercised sufficient control over the destinies of their companies to enable them to acquire and profit by information not available to others.

S. REP. No. 1455, 73d Cong., 2d Sess. 55 (1934). *See, e.g.*, Speed v. Transamerica Corp., 99 F. Supp. 808, 828-29 (D. Del. 1951).

46. Smallwood v. Pearl Brewing Co., 489 F.2d 579, 589 (5th Cir.), *cert. denied*, 419 U.S. 873 (1974). *See also* SEC v. Kasser, 391 F. Supp. 1167, 1175 (D.N.J. 1975) ("It is beyond dispute that the principal objective [of the securities fraud legislation] is protection of American purchasers who are exposed to fraudulent offers or sales of securities in interstate commerce.").

position to make the purchase, but nowhere in the legislative and administrative hearings accompanying the passage of rule 10b-5 is there mention of any intention to create equalized bargaining positions in all stock transactions.[47] In addition, the Supreme Court has rejected any interpretation of section 10(b) that would create equalized bargaining positions by requiring a duty to disclose to the entire world.[48] As the Court stated, "[n]ot every instance of financial unfairness constitutes fraudulent activity under § 10(b)."[49]

Rather than expand section 10(b) to impose criminal liability upon defendants engaged in the type of conduct involved in the *Newman* case, courts should allow Congress to define the scope of criminal conduct, either by amending the federal securities laws or by encouraging the Securities and Exchange Commission to promulgate detailed and sophisticated regulations. This would provide both greater control over unfair securities transactions and sufficient notice of the proscribed conduct.[50] Although there was no detailed regulation prohibiting the conduct of the defendants at the time they transacted their purchases, rule 14e-3[51] under section 14 of the Securities Ex-

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47. Note, *Securities—Fraud—One with Regular Access to Market Information Violates Rule 10b-5 When Trading in Securities Without Disclosing that Information*—United States v. Chiarella, 10 SETON HALL L. REV. 720, 743-44 (1980); 1 A. BROMBERG & L. LOWENFELS, *supra* note 40, § 3.2(300), at 65-66.1.

48. *See Chiarella*, 445 U.S. at 234-35.

49. *Id.* at 232.

50. When neither the language nor legislative history of § 10(b) indicates an intent to include a specific offense, "the problems caused by misuse of market information have been addressed by detailed and sophisticated regulation that recognized when use of market information may not harm operation of the securities markets." *Id.* at 233. Wang argues that Congress should adopt specific statutory provisions for all stock market inside trading because rule 10b-5 liability cannot be practically applied. Wang, *supra* note 32, at 1284, 1317.

51. General Rules and Regulations, Securities Exchange Act of 1934, 17 C.F.R. § 240.14e-3 (1981). The relevant portion of the regulation reads:

> (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 to reason to know is nonpublic and which he knows or has reason to know has been acquired directly or indirectly from:
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> (1) The offering person,
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> (2) The issuer of the securities sought or to be sought by such tender offer, or
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> (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

change Act of 1934[52] has been subsequently adopted to require disclosure by individuals in possession of material, nonpublic information before trading in potential tender offer situations. The new rule would arguably prohibit the defendants' conduct.

The adoption of detailed regulations such as rule 14e-3 not only provides securities traders with a clear and definite statement of the conduct proscribed, but also provides the Securities and Exchange Commission with a more workable standard than the broad language of section 10(b) and rule 10b-5. For example, section 14(e)[53] of the Securities Exchange Act empowers the Commission to adopt rules to define a manipulative or deceptive act or practice.[54] In addition, rule 14e-3 exempts from coverage certain informational imbalances in trading when it is in the best interest of the market at large.[55] The courts could not have adequately drawn and administered these subtle distinctions by use of the broad antifraud language of section 10(b) and rule 10b-5.

III. CONCLUSION

United States v. Newman represents an unwarranted expansion of section 10(b) by imposing a duty to disclose material, nonpublic information on one who is neither an insider or a tippee of an insider of the issuing corporation nor in a fiduciary relationship with the seller or issuer of the securities. In cases of nondisclosure of nonpublic information, section 10(b) liability should be imposed only when a duty of disclosure arises out of a special relationship of trust and confidence between the purchaser and the seller. In trading situations in which there is no special relationship between the parties, yet unfairness still exists, Congress should address the problem by amending the Se-

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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.

Id.

52. 15 U.S.C. § 78n(e) (1976) (section 14 prohibits the use of any fraudulent, deceptive, or manipulative practice in connection with any tender offer or proxy statement).

53. *Id.*

54. *Id.*

55. General Rules and Regulations, Securities Exchange Act of 1934, 17 C.F.R. 240.14e-3(b), (c) (1981). *See* Note, *Securities Regulation—Absent An Affirmative Duty To Disclose, Criminal Liability for Nondisclosure Under Rule 10b-5 Will Not Be Found*—Chiarella v. United States, 3 WHITTIER L. REV. 129, 150 (1981).

curities Exchange Act, and specific regulations such as rule 14e-3 should be adopted to provide specific guidelines of the proscribed conduct.

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