



10-1982

Dirks v. Securities and Exchange Commission

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Only Q: Whether a "tippee" of inside info. ~~as of~~ fraudulent conduct may use it for personal gain? (p6)

BOBTAIL BENCH MEMORANDUM

No. 82-276

Dirks v. SEC

Jim

March 21, 1983

I. Question Presented

Did the CADC err in finding that a recipient of nonpublic information concerning ongoing fraud within a corporation violates the antifraud provisions of the federal securities laws by transmitting that information to other persons, including persons who may use it in making investment decisions, when there is no element of misappropriation in transmitting or using the information?

II. Facts

Petr was an officer of a registered broker-dealer. He specialized in providing investment advice about the insurance industry, primarily to institutional investors. Petr was not directly compensated for his advisory services, but benefited when those whom he advised directed their brokerage business to the firm by which he was employed.

In March 1973, petr received information from a former employee of Equity Funding Corp. of America, the securities of which were traded on the NYSE, to the effect that the assets of that co. were vastly overstated as the result of fraudulent internal corporate practices. As a result, petr examined and analyzed publicly available data, sought confirmation of what he had been told from others in the investment community, and solicited information from then present and past officers and other employees of the co. While petr was investigating the matter, he was in contact with a number of investors and analysts with whom he candidly discussed the progress of his investigation and the information he had obtained. Some of those to whom he spoke sold their Equity Funding securities.

III. Proceedings Below

A. SEC. The SEC charged petr with violating the antifraud provisions of the federal securities laws based on his selective revelation of information about Equity Funding before making some general public disclosure. Following an administrative hearing, the SEC found that petr had "tipped" nonpublic information concerning Equity Funding in violation of these provisions. It observed that "Dirks received the information from inside corporate sources. From

** Carefully investigated*

the nature of the information, the inference must have been obvious that his sources had received it during the course of their corporate duties, and that the company intended that it should be kept in confidence." The SEC added:

In tipping potential traders, [petr] breached a duty which he had assumed as a result of knowingly receiving confidential information from [Equity Funding] insiders.... Such a tippee breaches the fiduciary duty which he assumes from the insider when the tippee knowingly transmits the information to someone who will probably trade on the basis thereof. *duty to whom?*

But SEC conceded the former employee was entitled to disclose fraud

The SEC reached that conclusion even though it recognized that Birks' informants were entitled to disclose the [Equity Funding] fraud in order to bring it to light and its perpetrators to justice." Despite its finding of a violation, the SEC imposed only a censure on petr. It observed that "[i]t is clear that [petr] played an important role in bringing [Equity Funding's] massive fraud to light, and [that] ... he reported the fraud allegations to [Equity Funding's] auditors and sought to have the information published in The Wall Street Journal."

But SEC said

no ap until later

B. CADC. The CADC entered a judgment without accompanying opinion, denying "for the reasons stated by the Commission in its opinion" petr's petn for review of the SEC's censure order. The judgment stated that petr "breached his duty to the Commission and to the public not to misuse insider information and that he was compensated for so doing." Judge Tamm dissented from the judgment.

absurd

Subsequently, the CADC issued an opinion written by Judge Wright. Judge Robb concurred in the result, and Judge Tamm dissented; neither filed a separate opinion. Judge Wright stated that petr's censure should be affirmed on the theory expressed by the SEC

Skelly Wright's op.

** CADC said Petr 'breached his duty to the public & Commission' !!!*

that petr and his tippees had assumed the "disclose-or-abstain" obligations of their insider sources. Judge Wright added that, as an employee of a broker-dealer, petr breached ethical duties not to assist his "clients [in] dump[ing] fraudulent securities on an uninformed public."

IV. Summary of the Parties' Contentions

must be some relationship
 A. Petr. The CADC's holding is inconsistent with the Court's decision in Chiarella v. United States, 445 U.S. 222 (1980) (POWELL, J.). In Chiarella, this Court held that under the antifraud provisions of the securities laws a duty to disclose nonpublic information arises only out of a relationship between the person possessing the information and those purchasing or selling the securities. This Court held that such a duty does not arise as a result of the mere possession of such information. Even the dissenting Justices in Chiarella agreed that mere possession of such information may give rise to a duty of disclosure only where it is illegally obtained, id., at 243 (BURGER, C.J., dissenting), or where it is not legally available to others in the investment community, id., at 251 (BLACKMUN, J., dissenting).

"Tippee" liability exists only where the recipient of the information improperly acquires it through a breach of a corporate insider's duty to the company and thereby himself acquires duties as a participant in the breach. See 445 U.S., at 230 n. 12. The SEC conceded, however, that petr's sources breached no duty in talking to him. Nor did petr misappropriate or illegally obtain the information from the co.

Indeed, rather than violating a duty to Equity Funding or its shareholders, or to the market in general, petr's activities brought to light a massive fraud at Equity Funding and informed the market of the true state of affairs at the co. But for petr's efforts, the fraud might well have gone undetected altogether. By misapplying controlling precedent, the CADC reached a result that is entirely contrary to public law enforcement policy and that will have a substantial negative impact throughout the securities industry. The SEC's suggestion of a duty to disclose and its "disclose or refrain" rhetoric may make sense where those in possession of the information, such as corps. or managers of corps., are in a position to make disclosure on behalf of the co.; but applying the "disclose or refrain" rhetoric to an outsider like petr who is investigating allegations of management fraud which will never be voluntarily disclosed by the management and who cannot persuade the press to publish a story will result only in discouraging independent investigation of such allegations.

B. SEC. Petr inherited the duty of the source of his information, Secrist, not to defraud purchasers of Equity Funding securities. Secrist had a duty to disclose the co.'s true condition to investors before trading with them. That duty rests upon the common-law fiduciary relationship between a corp. insider and the stockholders of the corp. rather than upon the separate and distinct duty of the insider to the corp. to preserve the confidentiality of corp. information.

At common law, an officer or director is "a quasi trustee" of the shareholders in his transactions in the shares of the co. He is

required to inform his shareholders of the corp.'s true condition before trading with them in the corp.'s stock, and his failure to do so is fraud. See Strong v. Repide, 213 U.S. 419, 435 (1909). The character of the information, whether a legitimate corp. secret or evidence of crime, is irrelevant to this disclosure duty.

Because corp. officers and directors are forbidden by their trust relationship from using undisclosed corp. information to the disadvantage of their shareholders, they may not give such information to outsiders for the same improper purpose. "Tippees" who knowingly participate with the insiders in such a breach of fiduciary duty are "as forbidden" from taking advantage of shareholders as the insiders themselves. The disclosure obligation of tippees rests upon the disclosure obligation of the insider to individual shareholders rather than any duty of silence or loyalty to the corp., and therefore the corp.'s right to preserve information as a secret is not a prerequisite to the tippee's liability.

V. Discussion

yes The parties dispute whether the information constituted "material facts" for purposes of the disclose-or-abstain rule, but the CADC, the SEC, and the ALJ all so held, and there is no reason to view this material as otherwise. I recommend assuming the materiality of the "facts" for the purposes of this case. Furthermore, the SG is correct that Judge Wright's alternative theory of liability based on petr's status as a registered broker-dealer is not before the Court under SEC v. Chenery Corp., 332 U.S. 194, 196 (1947).

Thus, the narrow question before the Court is whether a tippee of inside information on fraudulent conduct within a corp. violates

- but didn't hold - 1. a
general ban on insider
trading

the federal securities provisions by using the information for his personal gain. In Chiarella, the Court assumed, at least for purposes of analyzing Chiarella's case, that there is a federal ban on insider trading, largely because Chiarella apparently did not argue that there is not such a ban. I read your opinion as carefully "not holding" that there is such a ban, and I think you could say here that there is none. A considerable distortion of language underlies any holding that trading in a market without issuing a press release is "fraud" or "deceit." If an insider is selling, the market for the stock will move down--the direction the stock should be going; if the insider is buying, the market will also move in the appropriate direction. And although the business-property rationale restricts insider trading when secrecy is necessary to preserve the value of information to the firm that created the knowledge, this rule would mean that insider trading should be permitted to the extent the firm that created the information desires such trading. In other words, if insider trading is undesirable to shareholders and to firms, why do not firms voluntarily curtail the practice? See Dooley, Enforcement of Insider Trading Restrictions, 66 Va. L. Rev. 1, 45-47 (1980). Finally, §16 of the Securities Exchange Act has a provision explicitly dealing with some insider trading, and it is not a disclosure rule at all. One could argue, with fair support in the structure of the statute, that §16 is the sole device for addressing insider trading. See Easterbrook, Insider Trading, Secret Agents, Evidentiary Privileges, and the Production of Information, 1981 Sup. Ct. Rev. 309, 317-320. I would think that you would find this latter approach attractive.

§16 is sole device
for addressing
insider trading.

Despite the above, there may be reasons to impose a federal "disclose-or-abstain" obligation on insiders who are in an inherently unequal information position with shareholders, and you may feel obligated to do so after writing Chiarella. Assuming a federal ban on insider trading, the Court's theory supporting such a ban must be that Congress intended in 1934 that any fraud "touching" a sale of securities is unlawful under federal law, even if the fraud had nothing to do with the existence or price of the sale. It is a "fraud" for insiders to trade on material inside corp. information that might have some effect on the market price of the corp.'s shares. Because it is a fraud, they have a duty not to trade on this information without disclosure. ?

This fraud rule inevitably would lead to a rule banning all dealing on the basis of special knowledge, but for the fact that the Court has backtracked by stating that a trader must disclose only when he has a "duty" to do so. The Court announced in Chiarella that duties do not arise simply from unequal possession of information, 445 U.S., at 228 n. 10; they come, rather, from prior dealings of the trader as a fiduciary, id., at 229, from a "relationship of trust and confidence," id. Chiarella had no duty to those from whom he bought, because he had no prior dealings with them.

It is not clear to me what the Court meant by duty, but the SEC uses it in a conclusory way: People who ought not to trade have a duty not to do so. This case, in my opinion, shows the absurd limits to which the SEC's "duty" not to trade on inside information has been extended. The SEC's position is that "Dirks--standing in [the former employees'] shoes--committed a breach of the fiduciary duty

which he had assumed in dealing with them, when he passed the information on to the traders."

The SEC's "duty" is the common-law duty that an officer or director has to his shareholders: He is required to inform his shareholders of the corp.'s true condition before trading with them in the corp.'s stock. As I noted before, it takes some stretching to call this fraud; rather, the duty must rest on some notion of fairness--that it is unfair for one person to trade with another unless the two are equally knowledgeable about the subject of the deal. As the briefs point out, however, the Justices of this Court unanimously agreed in Chiarella that there is no general duty to make disclosure before trading with or tipping material nonpublic information.

Even assuming that insiders should not trade on inside corp. information, I think it is an open issue whether federal securities law bans tippee trading. The Court seems to have left open the status of "tippees" in a footnote. See id., at 230 n. 12. I would end the case on this basis: the antifraud provisions of the federal securities laws were not meant to impose a duty on tippees to disclose or abstain. When the firm is entitled to secrecy, the person who passes out a tip is the wrongdoer. He can be penalized appropriately, by his employer if not the courts. But when the release of information was not wrongful--and certainly the former employees of Equity Funding did no wrong in telling petr about the fraud--there is no justification for barring the use of the information.

It is not necessary, however, to create here such a broad rule for all tippees, because this case is much easier. Not only is

there little wrong with trading on inside information in most cases, here it is beneficial. This case presents a classic example of a situation where the legal rules should not penalize someone for investigation. Assuming that insider trading is bad, it is necessary here to reward investigation. As Professor Easterbrook stated in commenting on this case:

[Petr] did everyone a service. The sooner frauds are discovered--and the more costs a defrauder bears in deferring disclosure--the fewer frauds there will be. [Petr]'s efforts were costly. He had to have a network of contacts, many of which would never pay off. (After all, most employees have no news of similar importance to disclose.) The investigation following the tip was costly too. While courting contacts and following up leads, [petr] could not sit around soliciting clients' trades and earning commissions. The ability to pass secret information to clients enabled [petr] to profit from his investigation, which redounded to everyone's benefit.

1981 S. Ct. Rev., at 337. See Scott, Insider Trading: Rule 10b-5, Disclosure and Corporate Privacy, 9 J. Leg. Stud. 801, 818 (1980) ("Weakest of all is the case for applying an antitrading rule to a situation where some outside person or firm has invested in obtaining, not mere trading foreknowledge, but socially useful information. [T]he SEC's Equity Funding position is a boon to the successful commission and prolongation of corporate fraud. It is to be hoped that it will not survive Chiarella.").

VI. Summary

I recommend that the Court reverse the judgment of the CADC. I would find that petr had no duty to disclose or abstain. This "no duty" could be grounded on a rule that: (i) there is no federal ban on insider trading; (ii) there is no federal ban on tippee trading; or (iii) there is no federal ban on tippee trading where the tippee uses socially useful information, such as knowledge of fraud.

82-65 Dirks v. SEC

In Chiarella, the Court's opinion said:

"On who fails to disclose material information . . . commits fraud only when he under a duty to do so. And the duty to disclose arises when a party has information 'that the other party is entitled to know because of a fiduciary or other similar relation of trust and confidence between them.'"

(This is SEC language from its opinion in Cady, Roberts), 445 U.S., at 228.

". . . liability [under 10b-5] is premised upon a duty to disclose arising from a relationship of trust and confidence between parties to a transaction." p. 230.

"[a _____] of corporate insiders . . . have a duty not to profit from the use of insider information that they know is confidential, and know or should know it came from a corporate insider". (This is a quote from fn. 12, p. 230, taken from a CA2 opinion.)

*In corp.
fraud
"confidential"*

Chiarella, reversed CA2 because of two defects in its reasoning:

"First, not every instance of corporate unfairness constitutes fraudulent activity under §10(b). Second, the element required to make silence fraudulent - a duty to disclose - is absent in this case. No duty could arise from

petitioner's relationship with the sellers of the target company's securities. . . . He 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.

lfp/ss 03/21/83

82-276 Dirks v. SEC (All dates are 1973)

March 7 - following phone call preceding day from Secrist, a former employee of Equity, Dirks met for three hours with Secrist who described the fraud in detail. Secrist said regulatory agencies had failed to act on charges made by other Equity employees.

(Note: Petitioner's brief, p. 8, says that of the eight specific allegations of fraud, three were essentially correct and the remainder false).

March 12 - Dirks telephoned Herb Larson, San Francisco bureau chief of the W/S Journal. He did not reach Larson, but left a message. Also on the 12th, Dirks advised an officer of the Boston Company (a client) of what he had heard from Secrist.

First sale
March 15-16 - following a further conversation with Dirks, Boston sold \$1.2 of Equity securities (the first sales).

March 19 - Dirks reached Larson, the W/S Journal's San Francisco chief, and told him the Secrist story. Larson agreed to have a reporter investigate.

March 20 - Dirks, in Los Angeles, met with Harper, a former Vice President of Equity, who said only that he was highly suspicious of Equity's books.

Following his talk Hooper (Harper), Dirks again got in touch with Boston, and it sold some additional Equity securities.

March 21 - Dirks met with Goldbloom, Chairman of Equity, who called the allegations preposterous in light of all the regulatory bodies that had checked Equity's books. Goldbloom and other Equity employees told Dirks that insurance examiners from three states had found no wrong doing.

Also on the 21st, Dirks met personally with Blundell of the Journal.

March 23 - by this date, Dirks had spoken to one current and six former Equity employees, all of whom agreed to the fraud generally. Dirks then advised Dreyfus

*2nd Sale
- also by
Boston*

*This meeting
must have
caused
Dirks to
have doubts
whether Secrist
was right*

*Only on 23rd
- 16 days
later did
Dirks
advise other
customers.*

that held Equity securities. Dreyfus checked some of its own sources, and sold Equity securities on March 26.

March 26 - Dirks advised another holder that liquidated its Equity securities.

But also on the same day, March 26, Dirks again got in touch with Blundell and urged him to publicize the fraud charges. He met with Blundell for several hours.

March 27 - meanwhile the stock exchange - since March 22 - had been hearing rumors, and on March 27 it halted trading.

April 2 - the Journal finally published an article, and three days later Equity petitioned for bankruptcy.

* * *

Note: The foregoing summary does not indicate the full extent of Dirks' investigation - that included talking to Equity's accounting firm that merely passed on to Equity what Dirks had said.

lfp/ss 03/21/83

82-276 Dirks v. SEC

The parties' positions in this case are as follows:

The SEC

Secrist - even though a former employee - had a duty to disclose the company's true condition to investors before trading with them. This is the common law fiduciary relationship between a corporate insider and the stockholders of the corporation. This is a separate duty from that of an insider to the corporation ~~not~~^{to} preserve confidential information.

The SEC's brief (p. 17) states that "Dirks inherited the duty of Secrist not to defraud purchasers of Equity's securities" (emphasis added).

The SEC distinguishes Chiarella on the ground that here, Secrist was an insider of Equity and had a duty that Chiarella did not have. Nor did Chiarella "inherit" any duty from an insider.

The SG's Position:

This is an interesting case because the United States (SG) disagrees with the SEC.

lfp/ss 03/21/83

82-276 Dirks v. SEC

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This is an interesting case because the United States (SG) disagrees with the SEC.

The SEC, relying on Chiarella, argues that its principles "establish that petitioner had no duty to disclose or abstain from trading or tipping. He was not a fiduciary with respect to the security holders of Equity funding. He was a complete stranger to those investors. He took no action, directly or indirectly, that would induce them to repose trust or confidence in him." p. 10.

Dirks "engaged in no dishonest conduct that would justify the imposition upon him of the duties of a constructive trustee".

It is important to recognize, as apparently the SEC and CADC recognized, that:

"Petitioner's informants (Dirks and numerous others) acted lawfully when they imparted their information to him, and petitioner used that information in precisely the manner that his informants expected."

My view in this case:

It is not easy to identify any wrongdoing in this case.

Surely Secrist, and others who gave Dirks information, were not wrongdoers when they reported fraud.

proper
release
relevant³

They had unsuccessfully attempted to interest the California Commission.

It is important to ask, therefore, what fraud - or breach of duty - can Dirks be charged with? He was not an insider. He acted far more responsibly than reasonably could have been expected of him. He could have simply conveyed the initial information to clients of his firm. Instead, he made a remarkably thorough investigation, including repeated efforts to persuade the Wall Street Journal to disclose. Moreover, he had been told by Secrist that the regulatory authorities in California refused to investigate.

In these circumstances, it defies credibility to say that Dirks became a "fiduciary" with a duty not only to stockholders of Equity but also to prospective purchasers of Equity's securities.

What, one may ask, should Dirks have done? Arguably, he should have gone directly to the SEC. But initially, he had no idea whether the information was correct. Indeed, in the end only some of Secrist's specific allegations proved to be true. Dirks endeavored to have the Wall Street Journal investigate. And even after he had talked to Equity's top executives and to its

accountant, he had no confirmation of the information. He pursued the investigation.

As the brief for the United States says:

"The Commission's erroneous imposition of liability in this case has serious consequences for federal law enforcement, which frequently depends upon private initiative to uncover criminal conduct. . . . Petitioner accomplished what regulatory authorities were unable to do",
p. 11

* * *

Tailpiece:

The Wall Street Journal reporter, Blundell, was nominated for a Pulitzer Prize for his coverage of the Equity funding scandal, while petitioner was charged with violating the antifraud provisions of the federal securities law." P. 8.

I Chiarella (not a trustee case)
Established:

1. liability imposed only where there is was a ~~fiduciary~~ fiduciary duty

2. p.m. 12 is important:

"trustee's obligation arises from her role as participant, after the fact, in the insider's breach of duty"

Secret

3. Duke is easy case to decide:

No breach of duty here by an insider.

No duty not to disclose fraud.

Thus, ~~no~~ no derivative duty..

II Two categories of cases

1. Texas Gulf Sulphur

2. Investment ~~type~~ analysis type

People who serve needs of ~~the~~ information for securities markets.

Read SEC recognition
(my ~~new~~ memo p3)

Dinner

III. Analyst type case - a general principle.

Read p 4 my memo

SEC can discipline registered dealers

June

82-276 DIRKS v. SEC

Argued 3/21/83

SEC - Equity Funding Corp

Bonderman (Petr)

Petr had reputation ~~as~~ as an analyst who investigated. Also SEC had been informed year before & did nothing.

Whether a broker-dealer has a duty to report to SEC this type of info., in this case the SEC had been advised.

Dicks went to SEC on 26th, the first ~~last~~ time he was certain of the fraud. Until then info was speculative.

(J. Wright created a special broker-dealer liability)

Gouson (Rush)

~~James~~

Bonderman (Reply)

How far does chain of
Supreme Court of the United States
duties go? Memorandum

What if Seerent had
told only the reporter
of W/S Journal &
he had sold ~~short~~
Equity ~~short~~
— or simply to a
friend (not a client)
who owned Equity.

x x x

~~Must have~~.

In fact that Davis
profited essential. (To
be a tipper, must one profit?)

The Funds were also
charged by SEC as
tipper. (What happened
to the claim vs
them?)

The Chief Justice

Rev.

Dirks is in business of advising
- his business to find out what
was going on.

He had no more obligation to
disclose than any other citizen.
He verified story.

W/S Journal ignored him.

S.E.C. was neglectful.

SEC is wrong in its analysis

Justice Brennan

Aff'm

Close case. ~~But~~ Is sympathetic to SEC
but can it views go this far?

Insider didn't profit.

SEC has followed its broad
rule for 20 yrs - & this Admin
practice controls.

Justice White

Rev - Tentative

Dirks didn't unload.

His tippees may be guilty of
violating rules.

Insider Rule OK when
applied to insiders.

Justice Marshall

Opt'm

Agree with SEC

Justice Blackmun

Opt'm

With SEC.

Justice Powell

Rev

~~Securities had duty not to~~
~~defraud investors~~
See my notes

Justice Rehnquist

Reverse

Agree generally with L.F.P.

Serent got no profit
& Banker had no duty not to disclose.

Justice Stevens

Reverse (cheers)

Agree with L.F.P.

Must be a duty.

Banker breached no duty. Even if he had owned stock & sold it, but he had no duty.

A person who is an outsider has no duty.

There is a counter-vailing interest to reveal fraud.

Justice O'Connor

Reverse

Agree with L.F.P.

Judge Wright's theory is unsound as he applied it. But ultimate solution is to require fraud to be disclosed first to SEC - & would like to say this.

To: Mr. Justice Powell

From: Jim

Re: Dirks v. SEC, No. 82-276

I still have considerable doubts that federal securities law should ban any insider trading. You asked me, however, to set forth a theory for upholding insider liability and tippee liability to the extent necessary to protect the ban on insider trading. You also indicated that you wanted to reverse the judgment in this case. I am convinced that there is no satisfactory compensatory rationale for regulating insider trading. There is no evidence that insider trading causes direct harm to investors or, even assuming that it does, that the extent of injury warrants the costs of regulation. The Court then must create its theory around indirect harm. Delay in publication to permit insider trading appears to be infrequent and short-lived, thus insider trading has little or no effect on the allocational efficiency of the market.

Market confidence is probably the more promising rationale. Insider trading indirectly injures investors by reducing their welfare. The Court could support its ban on insider trading by stating that the 1934 Act was intended to promote fairness in market transactions, and insider trading, by permitting one party to gain an unfair advantage over other parties, is contrary to this purpose. I have doubts, however, whether this rationale survives your opinion in Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976), and the Court's

opinion in Santa Fe Industries v. Green, 430 U.S. 462 (1977). Your opinion in Chiarella also casts this rationale into disfavor.

Your concern, I think, is with the status of defts in rule 10b-5 cases. In Texas Gulf Sulphur, the defts were forbidden to trade on nonpublic information because they were officers and directors. The courts have unanimously held that corporate officers and directors are subject to insider trading restrictions. Tippees acquire the same status derivatively because their ultimate information source is a bona fide insider.

This unanimity concerning trading by insiders must be based on a belief that abstention from insider trading is a condition of the agency relationship between management insiders and the corporation. Insider trading is, in many respects, simply a form of secret compensation. There is also a moral side to this compensation: Insider trading is indulging one's self-interest to the point of dishonesty. Professor Dooley has characterized the agency rationale well:

Any agency relationship is characterized by a divergence between the interests of the principal and the agent. Accordingly, the agent's self-interested actions may reduce the principal's welfare, as in the cases of shirking, overconsumption of perquisites, or misappropriation. If it could be accomplished without cost, a principal would prefer that his agents behave selflessly and never deviate from pursuit of the principal's interest.... Thus, serious consequences generally attach when an agent embezzles even a modest sum of money because this behavior manifests a willingness to deviate too far from generally accepted standards of conduct in the pursuit of self-interest. Persons exhibiting these tendencies are "dishonest" and not to be trusted.

Dooley, Enforcement of Insider Trading Restrictions, 66 Va. L. Rev. 1, 40-41 (1980). Thus, insider trading is in the same line as

"payola." We do not expect fiduciaries to engage in such activities.

(faithfulness of act to employer)

In the end, I think this[^] is the real objection to insider trading. The shareholders cannot complain that the insider misappropriated something that belongs to them because the value of the information to the corporation is, if anything, only to keep it secret: that the insiders are glad to do. Although shareholders might prefer to reduce the direct compensation of agents who profit on inside information, they are more likely to object to the practice on the ground that those who do it are too little concerned with the corporation's welfare and too willing to act dishonestly to gain advantage.

Presumably, to the extent there is this "dishonesty," outside investors can appropriately discount their valuation of companies in which insiders trade, but investors, of course, presumably cannot distinguish between companies that trade on inside information and those that do not (I emphasize "presumably" because §16(a) requires some disclosure for some managers). This distinction is difficult to make not only because insider trading is difficult to detect, but also because the opportunities for insider trading are dependent on the fortuitous occurrence of significant events and are therefore distributed randomly throughout the market. Accordingly, the rational outside investor assumes that every investment of comparable risk presents the same risk of insider trading. If one assumes that outside investors prefer but cannot identify the securities of those companies that forbid insider trading, the practice can be perceived as involving a loss of welfare. There is

a loss of market confidence. Arguably, this assumption satisfies the legal requirements of §10(b) because it presupposes both investor injury (loss of welfare) and deception (a dishonest act that induces investors to enter into or remain in a relationship that they would prefer to avoid). Because insider trading is perceived to be morally reprehensible, some corporate managers will also find it repugnant and will refuse to engage in it. These "ethical" managers will bear the agency costs of insider trading, but derive no utility from it, because, as I noted earlier, it is ~~impossible~~ ^{difficult} to distinguish shares of companies that present the risk of insider trading from those that do not. Because it is, however, in their self-interest ^{to} reduce the risk to do so, ethical managers will seek to reduce the agency costs of insider trading by incurring bonding costs to signal the market of their abstention from the practice. By increasing the marginal costs of insider trading by attaching legal sanctions to it, this cost is diminished. In other words, the cost of insider trading is shifted to companies that permit such activity, and the costs of policing the activity are borne by society rather than the individual firm.

Enhancing the fiduciary relationship by reducing agency costs is the only justification I can see for regulating insider trading under the existing statutory scheme. The legal rules that the Court should develop, assuming it wishes to enter this area, should be consistent with that principle, and not the many others that are offered.

What rules could be developed from this "principle of fiduciary duty" on the part of insiders. Your opinion in Chiarella is a good

first step: a duty to disclose or abstain must be premised on a fiduciary relationship. Directors and officers are easy, of course. The tippee's status is more problematical: he does not have a fiduciary relationship with the company or its shareholders. Recognizing that your rule endangered tippee law, you specifically reserved the question of tippee liability in n. 12, and your footnote is instructive as to what to do in this case:

n 12 Chiarella

"Tippees" of corporate insiders have been held liable under §10(b) because they have a duty not to profit from the use of inside information that they know is confidential and know or should know came from a corporate insider.... The tippee's obligation has been viewed as arising from his role as a participant after the fact in the insider's breach of a fiduciary duty.

That second sentence does considerable damage to the SEC's case against Dirks. If, as the sentence suggested, an alleged tippee like Dirks violates Rule 10b-5 only when his source breaches a fiduciary duty, the Dirks' liability would depend on a finding that the former Equity Funding employees who told him of the fraud breached their agency relationship with ^{*duty to*} the corporation.

Thus, the "duty" issue in this case is simple:

A basic principle of Chiarella is that duties to disclose or abstain do not materialize from thin air; they grow out of relationships of trust and confidence. A complete outsider like Dirks has no independent relationship with the company and its stockholders, so it would seem that he cannot be guilty himself of a violation of the disclose-or-abstain rule unless he is implicated in a breach of duty by an insider informant.

*Yes
This
they
make
Dirks
care
less*

Chazen, "'Dirks' Presents Unique Corporate, Social Issues," Legal Times 14, 18 (March 14, 1983). Dirks should not be considered a participant after the fact in a breach of fiduciary duty by his informants. Employees who help uncover a corporate scandal breach

no agency relationship or duties to the company by simply disclosing such wrongdoing.

Best

A breach of a fiduciary relationship is not the end of the inquiry. In Chiarella, you noted that in Cady, Roberts & Co. the SEC emphasized the duty to disclose or abstain arose from the existence of a relationship and "the unfairness of allowing a corporate insider to take advantage of that information by trading without disclosure." This same rule should, of course, apply to tippees, because their fiduciary duty is purely derivative. Often the tip and trade are the functional equivalent of trading on the inside information by the insider followed by a gift of the profits to the recipient. To make out a tipping case against an insider, it should be necessary to prove that the insider exploited confidential information in violation of his fiduciary duties to the corporation. Similarly, a 10b-5 claim against an alleged tippee would have to be based on the theory that he knowingly assisted the insider in exploiting the confidential information, i. e., that he was an aider and abetter. This view of tipping is consistent, I think, with your statement in Chiarella that the tippee's obligation to refrain from trading arises from "his role as a participant after the fact in the insider's breach of fiduciary duty."

must prove insider exploited confidential info

True - no exploitation of info. by insiders

In this case, there was no "exploitation" by the insiders. Dirks' informants received no monetary benefit for revealing Equity Funding's secrets, nor did they have any apparent desire to make a gift of valuable information to Dirks. The informants may have had a duty not to trade on inside information without disclosure, but they did not. Therefore, even if Dirks' informants did violate a

duty to the company by disclosing, their conduct did not have one of the essential elements of breach of the agency relationship: the exploitation of corporate information by an insider.

We both know Dirks is a freak case. The situations we are concerned with are where securities analysts interview employees seeking information: is there liability? If the breach of an employee's duty alone is enough to establish tippee liability, the securities analyst will be chilled from using any of the information he gets. If, on the other hand, exploitation of confidential information by insiders is a prerequisite to tippee liability, securities analysts will be encouraged to seek information from corporate employees. I will not emphasize the obvious benefits of protecting the information-gathering duties of a securities analyst.

yes *Dirks is easy, but in these a general principle?*

There is no reason to treat securities analysts much different from reporters in general. To allow the use of material nonpublic information under the limited circumstances that I have suggested will not harm public confidence in the securities markets. Dirks has no special access to confidential information. As long as he does his job, he is ok; when the insider tries to use the analyst for his benefit, that is when there is breach of the agency relationship.

As set forth above, tippee liability depends on the purpose of the insider's disclosure. The subjectivity of this approach is minimized by focusing on: (i) the relationship between the informant and the recipient (did the informant expect something in return?); (ii) who initiated the disclosure. The informants initiated the disclosure here, but they could have little or no expectation of

Purpose or disclosure

benefit from the disclosure. A strong nonfinancial motive for providing the information would almost always be determinative.

There are hard cases:

1. Cocktail party conversations. Bragging by corporate executives, or loose talk, is not enough to create any financial benefit for the insider. I would say dissemination of that disclosure would not create any tippee liability.

2. Top executive/security analyst. This conversation may involve hard-to-detect favoritism, but where it is to build up the corporation's good will, I guess I see nothing wrong with it. I would think liability requires some personal incentive on behalf of the insider (personal exploitation).

In summary, an insider would always be liable for insider trading. A tippee would be liable where he acted as a confederate with the insider to exploit inside information. Thus, liability for tippee trading requires the presence of two elements: (i) fiduciary duty (some relationship with a insider); and (ii) exploitation that benefits the insider. The scienter requirement, of course, protects a deft who was unaware that he was receiving or passing on tipped information. *yes*

3/23

Message from Chief Justice

Re: Dirks

See 267 F. 2d 840

✓

lfp/ss 03/23/83

82-276 Dirks v. SEC

MEMO FOR CONFERENCE:

This case has wide ramifications for the securities markets. As has been evident since Texas Gulf Sulphur came down in 1968, the questions arising with respect to tippee liability have resulted in increasing litigation and uncertainty. It is evident - as evidenced by the oral arguments - that no limiting principle has been identified. The chain of liability appears to be endless.

Necessity of a duty

We made an important point in Chiarella. It did not involve a tippee, but it did establish that liability cannot be imposed in the absence of a fiduciary duty to disclose before trading. The only reference in Chiarella to tippees is in fn. 12. The critical sentence in this note says:

"The tippee's obligation has been viewed as arising from his role as a participant after the fact in the insider's breach of a fiduciary duty."

Thus, where the tippee becomes a "participant after the fact", he shares whatever duty the insider breached by

conveying the information. This analysis makes Dirks' case easy to decide. His liability depends on a finding that the former Equity Funding employees - of which Secrist was only one - who disclosed the fraud, breached their fiduciary duty to Equity Funding.

But even the SEC concedes there was no such breach of duty. None of these employees profited by disclosing fraud. They acted strictly in the public interest. Therefore, Dirks was not a participant after the fact in anyone's breach of duty.

Two Categories of Cases

Deciding this case without identifying a general principle would accomplish very little.

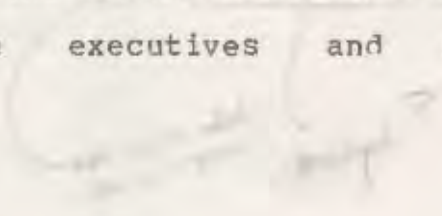
Let me make clear the ~~type of~~ situation³⁾ to which the principle would be applied. This case does not involve a Texas Gulf Sulphur situation where an officer or director of a corporation himself trades on inside information for personal gain. Nor do we have an insider - who to benefit a friend - discloses inside information on which the friend profits. The law is fairly well settled with respect to these straightforward cases.

The much broader, underlying problem in this case concerns the necessity of information being made available for the health of the securities markets. In this case, the SEC's opinion stated:

"In the course of their work, analysts actively seek out bits and pieces of corporate information not generally known to the market for the express purpose of analyzing that information and informing their clients who, in turn, can be expected to trade on the basis of the information. The value to the entire market of these efforts cannot be gainsaid: market efficiency in practice is significantly enhanced by such initiatives to ferret out and analyze information, and thus the analyst's work redounds to the benefit of the investors."

If we sustain its opinion in this case securities analysts will be far less liable to "ferret out" information. They will be concerned constantly with the uncertainty of law suits, with juries determining whether the information circulated was confidential and should not have been disclosed.

Thus, broadly speaking, there are two general types of situations: (i) the Texas Gulf Sulphur type cases; and (ii) the securities market type cases in which both corporate executives and analysts provide information.



A Rationale

B *would apply*
I suggest the following principle or rationale for the latter ~~type~~⁹ situation: A tippee's liability should depend on the purpose or intent of the insider's disclosure.

This is in one sense a subjective rule. But I think it is a principled and practical one.

The question of "purpose" (intent) will be determined - as it is so often in the law - by the facts *and objective facts*.
These include: *objective intent*

(i) The relationship between the insider and the recipient (e.g., the analyst); what were their respective purposes? Particularly, did the insider expect to profit himself or to benefit a friend rather than to inform the market generally?

(ii) Who initiated the disclosure? Typically, the analyst seeks out the corporate executive - this is commonplace. Equally commonplace, executives brief large meetings of analysts. The circumstances of the disclosure are relevant - as in this case.

It must be remembered that the recipient of the information becomes a fiduciary only derivatively: that

is, if there has been a breach of duty by the insider. This we established in Chiarella, and this is not denied by the SEC.

Of course, there will be close cases, but deciding them is the way judges make a living.

lfp/ss 03/23/83

82-276 Dirks v. SEC

MEMO FOR CONFERENCE:

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Let me make clear the type of situation to which the principle would be applied. This case does not involve a Texas Gulf Sulphur situation where an officer or director of a corporation himself trades on inside information for personal gain. Nor do we have an insider - who to benefit a friend - discloses inside information on which the friend profits. The law is fairly well settled with respect to these straightforward cases.

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The question of "purpose" (intent) will be determined - as it is so often in the law - by the facts. These include:

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is if there has been a breach of duty by the insider. This we established in Chiarella, and this is not denied by the SEC.

Of course, there will be close cases, but deciding them is the way judges make a living.

lfp/ss 05/02/83

MEMORANDUM

TO: Jim DATE: May 2, 1983
FROM: Lewis F. Powell, Jr.

82-276 Dirks v. SEC

You are to be commended for completing a draft opinion so promptly, particularly with everything else you have had to do. Although the "bottom line" in this case has been easy for us, sorting it all out in an opinion is not easy.

I begin with some general observations. One that will not surprise you is that the opinion is too long, and with more footnotes than I like. In comments below, I indicate where some cutting can be done. As you rework the draft I hope you will find other opportunities. As you know by now, I do not like to write "textbooks" or "articles" as Court opinions, nor cite every marginal primary and secondary authority. In this case particularly where rationales differed among the Justices we may have more than the usual difficulty in getting a Court. I therefore want to say no more than a lean and tightly reasoned opinion would include.

I now make some observations on each of the Parts of the draft.

Part I

Apart from an occasional marginal suggestion on the draft, this looks fine.

Part II

Much of this seems unnecessary, as indicated in my marginal notes and editing. I would start with Cady, Roberts, and move directly to the present situation - eliminating marginal material and repetition.

It is not clear to me that Cady, Roberts simply restates the common law rule. At the beginning of Part II, I gather that the "majority" rule was to the contrary. But compare n. 7 on p. 8 and n. 9 on p. 10. I do not think we need to get into this.

Part III (pp. 13-17)

This looks good to me, subject to my editing and occasional inquiry. It may be that we could eliminate a few sentences that are unnecessary to the flow of the reasoning. I did not specifically identify any.

Subpart III-A (pp. 18-23)

Apart from minor editing and a couple of questions, I have no problem with the substance of pages 18-21.

I would like, however, for you to draft a condensed version of the discussion (bottom of p. 21 through 23) of the market role of professionals, and the weighing of advantages and disadvantages. I agree with n. 19 (p. 21), but suggest you cut back materially n. 20 and n. 22. For the most part what we are talking about is not seriously questioned. Perhaps there is some helpful language even in the SEC's brief.

The difficulty is in drawing the line between the proper disclosing and use of information and that proscribed by the Securities Acts and rules. As you know, it is customary for management of listed companies to convey supplemental information (some people call in "chumming" the market) to analysts. This is done primarily in two ways: talks to, and questions and answer sessions with, large groups of analysts - in effect, open meetings. Similarly, information not available through required filings with the SEC often is given at stockholders meetings where most of the stock is

represented by proxies, and news coverage may be scant and uninforming. The more difficult type of information gathering - difficult in terms of line drawing for our purposes - is where the analysts will visit corporate headquarters and confer with senior officers. The analyst is likely to be a specialist in the particular business. When he returns to his firm, often he will circulate "buy" or "sell" recommendations to clients and persons whom the firm would like to have as clients. These recommendations are backed up by a report on the interview. The line drawing problem is one that impacts directly on both the corporate officers and the analysts. Neither can be quite sure when the "line" is crossed.

The foregoing is an important truth to be mentioned in our opinion. I do not disagree with what you have said, but would like for you to cut it back some. Rely primarily on what the SEC itself and others have said, but include the "line drawing" problem as one the Commission and courts should bear in mind.

The importance of our opinion will lie primarily in preventing too zealous scrutiny of information obtained by professionals as above described. There will be few

cases where the analyst uncovered fraud of market significance.

Subpart III-B

This brief section of the draft (pp. 24-27) is critical to our opinion. I have done some editing. All of us will have to look at every word with care. We have little or no authority for the rule we create, but this perhaps is why we took the case. I suppose you have used the best points made by Chazen. I thought his article was on target.

Part IV

I have no trouble with Part III, pp. 27-30.

Part V

Although well written, try reducing it substantially. We do not want to philosophize any more than is directly relevant to the case.

* * *

A couple of points not mentioned above:

1. In n. 18, p. 19, you refer to the Commission having said that a tippee need not have "actual knowledge" of a breach of duty of the tipper. I would be inclined to

leave this out. I do not wish to encourage the Commission to infer knowledge or claim constructive knowledge on suspicion. Elsewhere in the opinion, I think you deal with this adequately.

2. Consider whether it would be helpful to have a definitional footnote near the beginning of the opinion. The draft now uses interchangeably "stockholder/shareholder", "corporation/company" and "SEC/Commission". Perhaps it would suffice if we used the word shareholder consistently, leaving use of the other terms as you have them. As a former editor-in-chief of a law review, what do you think?

* * *

Jim, do not feel any pressure to rush to a second draft. Unless the assignments (expected this afternoon) impose unexpectedly heavy burdens on all of us, I think you can concentrate on the quality of the opinion rather than an early second draft.

L.F.P., Jr.

ss

File

lfp/ss 05/14/83

DIRKS

Memorandum to Jim and LFP:

The purpose of this memo is to consider the structure of our opinion.

There is no problem with Parts I and II. They are excellent. I am primarily interested in a close look at the structure of Part III. From p. 10 to p. 14, Part III sets forth very well the analytical background and principles that are to be applied, with emphasis on Chiarella's holding that the tippee's duty is merely "derivative", and therefore there must be a breach of duty by the tipper. I have suggested a revision of the concluding paragraph (p. 14) in my rider A for that page.

Subpart III-A (p. 14-19) may need some restructuring. It commences, properly, with the SEC's position. I have a question, indicated in the margin on p. 15, as the quote from respondent's brief (?) seems to state our rule rather than the SEC's. Apart from this, pp. 14-16 are quite good in stating and rejecting the SEC's open-ended rule that mere possession knowingly of material nonpublic information creates a fiduciary obligation.

Commencing on the last line of p. 16, the draft devotes the remainder of Subpart III-A to a demonstration of the undesirable consequences of the SEC's rule. This is emphasized also in notes 19-21. Incidentally, I would omit n. 22.

It seems to me, subject to discussion with Jim that this is not the proper place in the opinion for addressing the consequences of the SEC's position. Perhaps it would be better to move this into the final substantive section of the opinion (i.e. Part IV).

If this move were made, we would end Subpart III-A at the bottom of p. 16. Having rejected the SEC's rule, we would move directly to the substance of what is now Subpart III-B (p. 19-23). This is where we try to articulate a standard of liability. It is the most important part of the opinion. In a separate rider, I have tried a revision that focuses on scienter - a familiar concept in 10b-5 law. (Am I missing something

here?) *Yes*
 Part IV applies our reasoning to the facts of this case, and does it very well. For reasons I will state to Jim, I now would omit reliance on Chazen.

*I'm not
 sure the
 "scienter"
 test is
 applicable*

*I'll re-read
 Ernst & Ernst*

Part IV (p. 26) is not particularly helpful in its present form. It seems to me, subject to discussion, that we could move to this part the substance of what we now have on pp. 17 and 18 with respect to the consequences of the SEC's position on market efficiency. This would give us a stronger ending to the opinion.

Jim and I can discuss all of this.

L.F.P., Jr.

2

lfp/ss 05/14/83

DIRKS

This will be a rough "shot" at revising some of the language in our critical Subpart III-B (p. 19).

B

As we have shown, a tippee's liability is derivative from a breach of duty by the insider tipper of which the tippee has notice. Thus, in order to make out a tipping case against an individual, it is first necessary to establish that the insider disclosed confidential information in violation of his fiduciary duty to shareholders. It is then necessary to show that the tippee had notice of such a violation. These can present difficult factual issues. At the outset, it must be determined whether the information was both confidential and material, questions that arise in every tipping case. When these are answered affirmatively, the question remains whether the disclosure itself constituted a violation of duty. It is clear under our Rule 10b-5 cases that liability is imposed only when one acts with scienter (cite cases). There would be no breach of duty where corporate executive inadvertently or even negligently disclosed the information relied upon. The critical

question, therefore, is whether there was an intent or purpose to disclose material nonpublic information to one who could trade on the information to the detriment of shareholders. Ascertaining intention may be difficult, but this is a familiar question often confronted by courts. There are facts and circumstances that often justify inferences of wrongful purpose. For example, there may be a relationship exists the insider and the recipient that suggests a quid pro quo from the latter, or an intention to benefit the recipient. Also, such an inference may arise where the disclosure was made at the initiative of the insider rather than by the recipient tipeg.

Where a breach of fiduciary duty by the insider is established, liability may be imposed on the tipeg only when he has notice of such a breach. See supra, at _____. Again, this is a question of fact that must be resolved in light of all relevant circumstances. A securities analyst, making a study of a particular corporation that includes interviews with its officers, acquires information that may form the basis of a market letter to clients. This is a typical situation, and customarily involves participants who understand their

responsibilities and adhere to them. But there are cases, of course, where the facts -- and inferences reasonable drawn from them -- demonstrate the requisite scienter on the part of both the tipper and the tpee. This is not such a case.

(Jim: If we adopt the foregoing approach, you will have to write it out more carefully, and with appropriate documentation. I would avoid, however, unnecessary elaboration. This subpart III-B would be followed by your Part IV with limited changes. For example, the first sentence in IV would be omitted.)

L.F.P., Jr.

ss

job 05/20/83

To: Mr. Justice Powell

From: Jim

Re: Dirks v. United States, No. 82-276

In my opinion, Mark has been very helpful in his editing and has done an excellent job. You will see some new thoughts and some old thoughts formerly discarded, but I think this represents our collective judgment on how to write this opinion. I do not comment on the editing in great detail, but include Mark's drafts for your use.

I did want to respond specifically to two notes you wrote to me on the third draft. First, Prof. Loss wrote his book before Cady, Roberts, although his supplement came out in 1969. Second, please examine n. 25 with care. I hope that the new material there addresses your concerns.

5/21/83

Jim - This is an improved & strengthened draft.

Unless you wish to discuss my editing, I'd move promptly to a printed Chambers Draft.

There is ~~some~~ some repetition - perhaps quite a bit. When a printed draft is available, all three of us should review ~~up~~ with this in mind - tho some repeating is necessary.

I join you in thanking Mark - as well as you,
L & P

Santa Fe International Lobbyist to Plead Guilty in Insider-Trading Options Case

By ROBERT E. TAYLOR

Staff Reporter of THE WALL STREET JOURNAL

WASHINGTON—Lobbyist John M. Nugent agreed to plead guilty to a charge of aiding illegal trading based on inside information about the October 1981 takeover of Santa Fe International Corp. by Kuwait Petroleum Corp.

Mr. Nugent, who resigned May 5 as a vice president of Timmons & Co. a lobbying firm here, will enter his plea in federal court today, according to his lawyer, Warren L. Miller. Mr. Nugent, 39 years old, has been cooperating with government investigators in the case since January, and is "the key to breaking the case wide open," Mr. Miller said. In a news release, the U.S. attorney's office here called the case "the most significant insider trading case ever," and said more court actions are expected.

Santa Fe International isn't related in any way to Santa Fe Industries Inc.

The government, in papers filed with the charge against Mr. Nugent, indicates that at least nine Washington, D.C., stockbrokers and one of their clients made more than \$900,000 by trading options on Santa Fe stock. The government contends that their purchases resulted from Mr. Nugent's tip. And the papers say that the continuing criminal grand jury investigation is focusing on whether some of the brokers gave false testimony or attempted to obstruct the inquiry into the case by the Securities and Exchange Commission and the grand jury itself.

In its court papers, the government claims Mr. Nugent learned of the planned takeover Sept. 28, 1981, the day Santa Fe's lawyers here in the process of retaining Timmons to lobby Congress and the Reagan administration in favor of the expected merger.

According to the government, Mr. Nugent told a friend, Thomas A. Peacock, a vice president for government and public affairs of International Coal Refining Co., which is a subsidiary of Wheelabrator-Frye Inc. Mr. Peacock then told his broker, Steven R. Tatusko, at the Washington firm of Bellamah, Neuhauser & Barrett Inc., the government claims, and Mr. Tatusko passed the tip to eight other brokers at the firm and one at a second brokerage house.

Michael R. Klein, Mr. Peacock's attorney, said he couldn't comment on the allegations. "That is the subject of discussions between us and the government," he said.

Mr. Tatusko and Winthrop Securities couldn't be reached for comment.

Frederick J. Bellamah, a senior partner in the firm, said he would question whether any of his brokers knew they were trading on inside information. "I'm convinced in my own mind that nobody in this firm knew this was valid information," he said. "It was a tip or a rumor to them." Mr. Bellamah said none of the firm's brokers knew the information came from Mr. Nugent. He said some of them may have known that Mr. Peacock was a source of information, but noted that Mr. Peacock wasn't connected to Santa Fe.

In its court filing, the government said Mr. Tatusko told SEC investigators that he overheard some unidentified men talking about a planned takeover of Santa Fe in a Washington bar. In sworn statements to the SEC, other brokers said they either didn't know the source of the tip, or that it was only a vague rumor, the papers said. The government said some brokers supported Mr. Tatusko's story, and one claimed he was at the bar when Mr. Tatusko allegedly overheard the tip.

The government also said Mr. Peacock supported the bar-tip cover story by swearing that he invested after Mr. Tatusko told him of the tip. But the SEC staff contends that Mr. Peacock couldn't have visited Mr. Tatusko's offices on the morning of Oct. 1 to get the tip, as he claimed.

According to the charges, Messrs. Peacock, Tatusko and nine other brokers bought options Oct. 1 for a total of \$8,687. Trading in the stock was halted Oct. 2 for an announcement of the takeover proposal. After trading resumed, the government said, the brokers sold their options, mostly on Oct. 6, for a total of \$911,039.

This was only a part of the alleged Santa Fe insider trading. The SEC has charged other people with making insider-trading profits of \$8.5 million on investments of less than \$540,000.

Mr. Miller said his client Mr. Nugent "realizes he made a serious mistake" when he "accidentally told a friend," Mr. Peacock, about the planned takeover. According to the government, Mr. Nugent concedes "he wanted to do his friend a favor by giving him a tip about a good stock prospect," but insists he had no intention of sharing in the profits. Mr. Miller claims Mr. Nugent even refused an offer from Mr. Peacock to buy some shares for Mr. Nugent.

According to Mr. Miller, his client testified falsely before the SEC only after others had done so, "to protect his family, his job and a person he thought at the time was a close friend."

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE HARRY A. BLACKMUN

✓
May 31, 1983

Re: No. 82-276 - Dirks v. SEC

Dear Lewis:

I shall try my hand at a dissent in this case in
due course.

Sincerely,

Harry

Justice Powell

cc: The Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE JOHN PAUL STEVENS



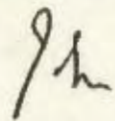
June 1, 1983

Re: 82-276 - Dirks v. Securities & Exchange
Commission

Dear Lewis:

Please join me.

Respectfully,



Justice Powell

Copies to the Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE THURGOOD MARSHALL

June 1, 1983

Re: No. 82-276-Dirks v. Securities and Exchange
Commission

Dear Lewis:

I await the dissent.

Sincerely,

TM

T.M.

Justice Powell

cc: The Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE WILLIAM H. REHNQUIST

June 1, 1983

Re: No. 82-276 Dirks v. SEC

Dear Lewis:

Please join me.

Sincerely,

Wm

Justice Powell


cc: The Conference

Steven
W H R.

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE BYRON R. WHITE

June 2, 1983



Re: 82-276 - Dirks v. SEC

Dear Lewis,

Please join me.

Sincerely yours,



Justice Powell

cc: The Conference

cpm

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE SANDRA DAY O'CONNOR

June 7, 1983

No. 82-276 Dirks v. SEC

Dear Lewis,

I am sorry that I have not gotten back to you earlier on this case. I assure you that my delay was occasioned more by the chaos of May than by anything in your draft!

Let me say that I think that you have done a fine job with your opinion, and with some changes that I do not think will affect your basic approach, I am prepared to join it even though I originally preferred another approach. My view was that irrespective of the limits of any proscription on insider and tippee trading, the information tipped by Secrist and Dirks in this case could not have come within that proscription because it was information concerning a crime, rather than a legitimate corporate matter. Although the nature of the information might not matter to the affected shareholders, I had thought that when the social and economic good was weighed against possible shareholder harm, the balance tipped in favor of dissemination of evidence of a crime. I was very concerned not to send any signal that would discourage future "detective" work on the part of those interested in uncovering corporate fraud.

As I understand your view, it focuses on the purpose of the insider in communicating to the tippee, and not on the character of the information that is communicated. Unless the insider acts from an "improper purpose" in communicating the information, the insider does not breach its fiduciary duty to the shareholders of the corporation. If the tippee does not have some independent fiduciary duty not to trade, then he is insulated from liability for further tipping or trading because he cannot be an after-the-fact participant in the insider's breach of duty. The key is the motivation of the insider, and from p. 15 of your draft, it appears that motivation is measured by the subjective good faith of the insider.

I have two primary difficulties with the approach as it now stands. First, I am concerned that the opinion not be read to preclude our later holding that information about a crime cannot be inside information. I realize that your

File

Helpful
suggestions.
I think we
can make
changes.

I agree

Time

footnote 23 may be read as reserving this question, but I would feel more comfortable with an explicit statement to this effect, appended to the end of Footnote 23. Perhaps you could add something like: "We do not decide whether the information communicated was 'material,' or whether information concerning corporate crime is properly characterized as 'inside information.'" This will make clear that the Court does not hold that there is insider and tippee liability depending on purpose even if the information communicated concerns crime.

*Suggested
addition*

My second difficulty goes to the "purpose" test that you set out at pp. 14-16 of the draft. As it now reads, the fact-finder is required to determine the subjective state of mind of the insider, and liability may be imposed only when the insider has an improper purpose, or the tippee has some independent duty not to trade. Although there may be rules of thumb, e.g., the one you suggest concerning relationship between the parties, that are used to help determine subjective intent, it nevertheless appears that the focus of the inquiry is subjective motivation. Your focus on subjective purpose is consistent with, and very much like, your approach in Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976), although that opinion is not cited in your draft.

*Ernst
&
Ernst*

The subjective purpose requirement is an inherently difficult determination to make. It requires that the tippee "predict" what is going on in the mind of his tipper. Although the SEC currently requires a tippee to make an assessment about whether information is material, that assessment requires only that the tippee determine whether "there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote." TSC Industries v. Northway, Inc., 426 U.S. 438, 449 (1976). I would imagine that most tippees have a better "feel" for whether a shareholder would consider information important than whether an insider subjectively possesses a prohibited purpose. In addition, the purpose test might prohibit the dissemination of the information in this case. If Secrist's motivation was proven to be a desire for vengeance against Equity Funding, and if the SEC determined that this was a prohibited purpose, Secrist and Dirks would violate the securities laws.

I agree

It seems that the "purpose" discussion may be omitted without altering your basic approach. Then the focus would be on whether Secrist breached a fiduciary duty. Rather than offering a general discussion of purpose, one could say

? no

no

that Secrist simply owed no duty not to relate information concerning fraud (even if the information were considered "inside information" under TSC). Since Secrist could not owe a fiduciary duty, there was no duty for Dirks to inherit.

*This is
easy
way to
decide
this
case*

I do
If you want to retain a broader approach, it might be better to focus on benefit, rather than purpose. That is, you suggest that if the insider benefits from his tipping, that may show improper purpose. As I read Santa Fe Industries, Inc. v. Green, 430 U.S. 462 (1977), In re Cady, Roberts & Co., 40 S.E.C. 907 (1961), and In re Merrill Lynch, Pierce, Fenner & Smith, Inc., 43 S.E.C. 933 (1968), the focus is more on whether the insider derives a direct or indirect benefit from his disclosure, and that benefit is primarily of a pecuniary nature. An emphasis on benefit differs from your approach only insofar as it establishes a more objective indicia of liability. If, as a factual matter, the insider did not benefit from his disclosure, then I am not inclined to be concerned with a further inquiry into his motivation. I am not sure about what will be gained from an inquiry into intent, but from my past experience on the bench, I know that a great deal of time will be lost!

True

I am interested to know your thoughts on these points.

Sincerely,

Sandra

Justice Powell

June 9, 1983

82-276 Dirks v. SEC

Dear Sandra:

I have now had an opportunity to get back to Dirks in light of your letter. As you know, with your approval and mine, Gary and Jim Browning have worked out some changes that I have reviewed this morning.

They have done well. It seems to me that your suggestions have been incorporated into the opinion clearly, and that they "fit" very well.

In a more fundamental sense, I am grateful to you for suggestions that I think are quite constructive.

I will need to keep the other "joins", but cannot believe there will be any objection.

Sincerely,

Justice O'Connor

lfp/ss

June 9, 1983

82-276 Dirks v. SEC

Dear Byron, Bill and John:

As you have been good enough to join me in this case, I write this note to say that the only changes in this second draft (other than stylistic) have resulted from my conversations with Sandra.

The reasoning of the opinion is not changed. Sandra thought my reference to the "purpose" of the insider (see pp. 15-17 of first draft) was unnecessarily subjective. She prefers using the more objective term: "benefit" to the insider, direct or indirect (see pp. 17, 18 second draft).

As the Chief has not voted, Sandra's vote will assure a Court. I also believe the changes are constructive.

I am circulating the second draft, and will assume your approval unless I hear to the contrary.

Sincerely,

Justice White
Justice Rehnquist
Justice Stevens

lfp/ss

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE SANDRA DAY O'CONNOR

June 10, 1983



Re: No. 82-276 Dirks v. SEC

Dear Lewis,

Please join me.

Sincerely,

Sandra

Justice Powell

Copies to the Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
THE CHIEF JUSTICE

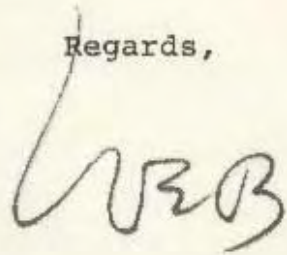
June 14, 1983

Re: No. 82-276, Dirks v. Sec

Dear Lewis:

I join.

Regards,

A handwritten signature in dark ink, appearing to be 'JPB' or similar, written over the typed word 'Regards,'.

Justice Powell

Copies to the Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE HARRY A. BLACKMUN

June 24, 1983

Re: No. 82-276 - Dirks v. SEC

Dear Lewis:

Because of the time pressure, I give you herewith a xerox copy of the dissenting opinion I have formulated in this case.

Sincerely,

Harry

Justice Powell

✓
Received
at 4 PM more
than
two
months
after
9
circulated
Dirks
Here we
are at
end of
Term!

Are facts correctly stated?

L. F. P.

Scienter is necessary? - 8 (see last sentence)

Received
6/24/83
at 4 PM

Says my op. is inconsistent with Mosser - 9-10
(but agree higher duty of trustee
not to waste assets of corp. in
reorg)

"Laudable motive" - 17 (how can this
be scienter?)
JUSTICE BLACKMUN, dissenting.

The Court today takes still another step to limit the pro-
tections provided investors by §10(b) of the Securities Exchange
Act of 1934.¹ See Chiarella v. United States, 445 U.S. 222, 246
(1980) (dissenting opinion). The device employed in this case
engrafts a special motivational requirement on the fiduciary duty
doctrine. This innovation excuses a knowing and intentional
violation of an insider's duty to shareholders if the insider
does not act from a motive of personal gain. Even on the ex-
traordinary facts of this case, such an innovation is not justi-
fied.

I

As the Court recognizes, ante, at 11, n. 17, the facts here
are unusual. After a meeting with Ronald Secrist, a former Equi-
ty Funding employee, on March 7, 1973, App. 226, petitioner Ray-

¹See, e.g., Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975); Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976); Piper v. Chris-Craft Industries, Inc., 430 U.S. 1 (1977); Chiarella v. United States, 445 U.S. 222 (1980); Aaron v. SEC, 446 U.S. 680 (1980). This trend frustrates the congressional intent that the securities laws be interpreted flexibly to protect investors, see Affiliated Ute Citizens v. United States, 406 U.S. 128, 151 (1972); SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 186 (1963), and to regulate deceptive practices "detrimental to the interests of the investor," S. Rep. No. 792, 73d Cong., 2d Sess., 18 (1934); see H.R. Rep. No. 1383, 73d Cong., 2d Sess., 10 (1934). Moreover, the Court continues to refuse to accord to SEC administrative decisions the deference it normally gives to an agency's interpretation of its own statute. See, e.g., Blum v. Bacon, 457 U.S. 132 (1982).

mond Dirks found himself in possession of material nonpublic information of massive fraud within the company.² In the Court's words, "[h]e uncovered ... startling information that required no analysis or exercise of judgment as to its market relevance." Ante, at 11, n. 17. In disclosing that information to Dirks, Secrist intended that Dirks would disseminate the information to his clients, those clients would unload their Equity Funding securities on the market, and the price would fall precipitously, thereby triggering a reaction from the authorities. App. 16, 25, 27.

Dirks complied with his informant's wishes. Instead of reporting that information to the Securities and Exchange Commission (SEC or Commission) or to other regulatory agencies, Dirks began to disseminate the information to his clients and undertook his own investigation.³ One of his first steps was to direct his

²Unknown to Dirks, Secrist also told his story to New York insurance regulators the same day. App. 23. They immediately assured themselves that Equity Funding's New York subsidiary had sufficient assets to cover its outstanding policies and then passed on the information to California regulators who in turn informed Illinois regulators. Illinois investigators, later joined by California officials, conducted a surprise audit of Equity Funding's Illinois subsidiary, id., at 87-88, to find \$22 million of the subsidiary's assets missing. On March 30, these authorities seized control of the Illinois subsidiary. Id., at 271.

³In the same administrative proceeding at issue here, the Administrative Law Judge (ALJ) found that Dirks' clients--five institutional investment advisors--violated §17(a) of the Securities Act of 1933, 15 U.S.C. §77q(a), §10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b), and Rule 10b-5, 17 CFR §240.10b-5, by trading on Dirks' tips. App. 297. All the clients were censured, except Dreyfus Corporation. The ALJ found that Dreyfus had made significant efforts to disclose the infor-

Footnote continued on next page.

associates at Delafield Childs to draw up a list of Delafield clients holding Equity Funding securities. On March 12, eight days before Dirks flew to Los Angeles to investigate Secrist's story, he reported the full allegations to Boston Company Institutional Investors, Inc., which on March 15 and 16 sold approximately \$1.2 million of Equity securities.⁴ See id., at 199. As he gathered more information, he selectively disclosed it to his clients. To those holding Equity Funding securities he gave the "hard" story--all the allegations; others received the "soft" story--a recitation of vague factors that might reflect adversely on Equity Funding's management. See id., at 211, n. 24.

Dirks' attempts to disseminate the information to nonclients were feeble, at best. On March 12, he left a message for Herbert Lawson, the San Francisco bureau chief of The Wall Street Journal. Not until March 19 and 20 did he call Lawson again, and outline the situation. William Blundell, a Journal investigative reporter based in Los Angeles, got in touch with Dirks about his

mation to Goldman, Sachs, the purchaser of its securities. App. 299, 301. None of Dirks' clients appealed these determinations. App. to Pet. for Cert. B-2, n. 1.

⁴The Court's implicit suggestion that Dirks' did not gain by this selective dissemination of advice, ante, at 2, n. 2, is inaccurate. The ALJ found that because of Dirks' information, Boston Company Institutional Investors, Inc., directed business to Delafield Childs that generated approximately \$25,000 in commissions. App. 199, 204-205. While it is true that the exact economic benefit gained by Delafield Childs due to Dirks' activities is unknowable because of the structure of compensation in the securities market, there can be no doubt that Delafield and Dirks gained both monetary rewards and enhanced reputations for "looking after" their clients.

March 20 telephone call. On March 21, Dirks met with Blundell in Los Angeles. Blundell began his own investigation, relying in part on Dirks' contacts, and on March 23 telephoned Stanley Sporkin, the SEC's Deputy Director of Enforcement. On March 26, the next business day, Sporkin and his staff interviewed Blundell and asked to see Dirks the following morning. Trading was halted by the New York Stock Exchange at about the same time Dirks was talking to Los Angeles SEC personnel. The next day, March 28, the SEC suspended trading in Equity Funding securities. By that time, Dirks' clients had unloaded close to \$15 million of Equity Funding stock and the price had plummeted from \$26 to \$15. The effect of Dirks' selective dissemination of Secrist's information was that Dirks' clients were able to shift the losses that were inevitable due to the Equity Funding fraud from themselves to uninformed market participants.

II

A

No one questions that Secrist himself could not trade on his inside information to the disadvantage of uninformed shareholders and purchasers of Equity Funding securities. See Brief for United States as Amicus Curiae 19, n. 12. Unlike the printer in Chiarella, Secrist stood in a fiduciary relationship with these shareholders. As the Court states, ante, at 5, corporate insiders have an affirmative duty of disclosure when trading with shareholders of the corporation. See Chiarella, 445 U.S., at 227. This duty extends as well to purchasers of the corporation's securities. Id., at 227, n. 8, citing Gratz v.

Claughton, 187 F.2d 46, 49 (CA2), cert. denied, 341 U.S. 920 (1951).

The Court also acknowledges that Secrist could not do by proxy what he was prohibited from doing personally. Ante, at 12; Mosser v. Darrow, 341 U.S. 267, 272 (1951). But this is precisely what Secrist did. Secrist used Dirks to disseminate information to Dirks' clients, who in turn dumped stock on unknowing purchasers. Secrist thus intended Dirks to injure the purchasers of Equity Funding securities to whom Secrist had a duty to disclose. Accepting the Court's view of tippee liability,⁵ it appears that Dirk's knowledge of this breach makes him liable as a participant in the breach after the fact. Ante, at 12, 19; Chiarella, 445 U.S., at 230, n. 12.

B

The Court holds, however, that Dirks is not liable because Secrist did not violate his duty; according to the Court, this is so because Secrist did not have the improper purpose of personal gain. Ante, at 15-16, 18-19. In so doing, the Court imposes a new, subjective limitation on the scope of the duty owed by insiders to shareholders. The novelty of this limitation is reflected in the Court's lack of support for it.⁶

⁵I interpret the Court's opinion to impose liability on tippees like Dirks when the tippee knows or has reason to know that the information is material and nonpublic and was obtained through a breach of duty by selective revelation or otherwise. See In re Investors Management Co., 44 S.E.C. 633, 641 (1971).

⁶The Court cites only Professor Brudney to support its rule. Ante, at 16, quoting from his article, Insiders, Outsiders.
Footnote continued on next page.

The insider's duty is owed directly to the corporation's shareholders.⁷ See Langevoort, *Insider Trading and the Fiduciary Principle: A Post-Chiarella Restatement*, 70 Calif. L. Rev. 1, 5 (1982); 3A W. Fletcher, *Private Corporations* §1168.2, pp. 288-289 (1975). As *Chiarella* recognized, it is based on the relationship of trust and confidence between the insider and the shareholder. 445 U.S., at 228. That relationship assures the shareholder that the insider may not take actions that will harm him unfairly.⁸

ers, and Informational Advantages Under the Federal Securities Laws, 93 Harv. L. Rev. 322, 348 (1979). Ironically, Professor Brudney's quoted statement appears in the context of his assertion that the duty of insiders to disclose prior to trading with shareholders is in large part a mechanism to correct the information available to noninsiders. Professor Brudney simply recognizes that the most common motive for breaching this duty is personal gain; he does not state, however, that the duty prevents only personal aggrandizement. *Id.*, at 345-348. Surely, the Court does not now adopt Professor Brudney's access-to-information theory, a close cousin to the equality-of-information theory it accuses the SEC of harboring. See *ante*, at 8-10.

⁷The Court correctly distinguishes this duty from the duty of an insider to the corporation not to mismanage corporate affairs or to misappropriate corporate assets. *Ante*, at 5, n. 9. That duty also can be breached when the insider trades in corporate securities on the basis of inside information. Although a shareholder suing in the name of the corporation can recover for the corporation damages for any injury the insider causes by the breach of this distinct duty, *Diamond v. Oreamuno*, 24 N.Y.2d 494, 498, 248 N.E.2d 910, 912 (1969); see *Thomas v. Roblins Industries, Inc.*, 520 F.2d 1393, 1397 (CA3 1975), insider trading generally does not injure the corporation itself. See Langevoort, *Insider Trading and the Fiduciary Principle: A Post-Chiarella Restatement*, 70 Calif. L. Rev. 1, 2, n. 5, 28, n. 111 (1982).

⁸As it did in *Chiarella*, 445 U.S., at 226-229, the Court adopts the *Cady, Roberts* formulation of the duty. *Ante*, at 5-6.

"Analytically, the obligation rests on two principal elements; first, the existence of a relationship giving
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The affirmative duty of disclosure protects against this injury. See Pepper v. Litton, 308 U.S. 295, 307, n. 15 (1939); Strong v. Rapide, 213 U.S. 419, 431-434 (1909); see also Chiarella, 445 U.S., at 228, n. 10; cf. Pepper, 308 U.S., at 307 (fiduciary obligation to corporation exists for corporation's protection).

C

The fact that the insider himself does not benefit from the breach does not eradicate the shareholder's injury.⁹ Cf. Re-

True but irrelevant

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 re Cady, Roberts & Co., 40 S.E.C. 907, 912 (1961) (footnote omitted).

The first element--on which Chiarella's holding rests--establishes the type of relationship that must exist between the parties before a duty to disclose is present. The second--not addressed by Chiarella--identifies the harm that the duty protects against: the inherent unfairness to the shareholder caused when an insider trades with him on the basis of undisclosed inside information.

⁹Without doubt, breaches of the insider's duty occur most often when an insider seeks personal aggrandizement at the expense of shareholders. Because of this, descriptions of the duty to disclose are often coupled with statements that the duty prevents unjust enrichment. See, e.g., In re Cady, Roberts & Co., 40 S.E.C. 907, 912, n. 15 (1961); Langevoort, 70 Calif. L. Rev., at 19. Private gain is certainly a strong motivation for breaching the duty.

It is, however, not an element of the breach of this duty. The reference to personal gain in Cady, Roberts, for example, is appended to the first element underlying the duty which requires that an insider have a special relationship to corporate information that he cannot appropriate for his own benefit. See n. 8, supra. It does not limit the second element which addresses the injury to the shareholder and is at issue here. See ibid. In fact, Cady, Roberts, describes the duty more precisely in a later footnote: "In the circumstances, [the insider's] relationship to his customers was such that he would have a duty not to take a

Footnote continued on next page.

Scienter

statement (Second) of Trusts §205, Comments c and d (1959) (trustee liable for acts causing diminution of value of trust); 3 A. Scott on Trusts §205, p. 1665 (1967) (trustee liable for any losses to trust caused by his breach). It makes no difference to the shareholder whether the corporate insider gained or intended to gain personally from the transaction; the shareholder still has lost because of the insider's misuse of nonpublic information. The duty is addressed not to the insider's motives,¹⁰ but to his actions and their consequences on the shareholder. Personal gain is not an element of the breach of this duty.¹¹

position adverse to them, not to take secret profits at their expense, not to misrepresent facts to them, and in general to place their interests ahead of his own." 40 S.E.C., at 916, n. 31. This statement makes clear that enrichment of the insider himself is simply one of the results the duty attempts to prevent.

¹⁰Of course, an insider is not liable in a Rule 10b-5 administrative action unless he has the requisite scienter. Aaron v. SEC, 446 U.S. 680, 691 (1980). He must know or intend that his conduct violate his duty. Secrist obviously knew and intended that Dirks would cause trading on the inside information and that Equity Funding shareholders would be harmed. The scienter requirement addresses the intent necessary to support liability; it does not address the motives behind the intent. } ? ?

¹¹The Court seems concerned that this case bears on insiders' contacts with analysts for valid corporate reasons. Ante, at 10-11. It also fears that insiders may not be able to determine whether the information transmitted is material or nonpublic. Id., at 14-15. When the disclosure is to an investment banker or some other adviser, however, there is normally no breach because the insider does not have scienter: he does not intend that the inside information be used for trading purposes to the disadvantage of shareholders. Moreover, if the insider in good faith does not believe that the information is material or nonpublic, he also lacks the necessary scienter. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 197 (1976). In fact, the scienter requirement functions in part to protect good faith errors of this type. Id., at 211, n. 31. } naive
4

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Contradictory!

This conclusion is borne out by the Court's decision in Mosser v. Darrow, 341 U.S. 267 (1951). There, the Court faced an analogous situation: a reorganization trustee engaged two employee-promoters of subsidiaries of the companies being reorganized to provide services that the trustee considered to be essential to the successful operation of the trust. In order to secure their services, the trustee expressly agreed with the employees that they could continue to trade in the securities of the subsidiaries. The employees then turned their inside position into substantial profits at the expense both of the trust and of other holders of the companies' securities.

The Court acknowledged that the trustee neither intended to nor did in actual fact benefit from this arrangement; his motives were completely selfless and devoted to the companies. 341 U.S., at 275. The Court, nevertheless, found the trustee liable to the estate for the activities of the employees he authorized.¹² The

Should the adviser receiving the information use it to trade, it may breach a separate contractual or other duty to the corporation not to misuse the information. Absent such an arrangement, however, the adviser is not barred by Rule 10b-5 from trading on that information if it believes that the insider has not breached any duty to his shareholders. See Walton v. Morgan Stanley & Co., 623 F.2d 796, 798-799 (CA2 1980).

The situation here, of course, is radically different. Ante, 11, n. 17 (Dirks received information requiring no analysis "as to its market relevance"). Secrist divulged the information for the precise purpose of causing Dirks' clients to trade on it. I fail to understand how imposing liability on Dirks will affect legitimate insider-analyst contacts.

¹²The duty involved in Mosser was the duty to the corporation in trust not to misappropriate its assets. This duty, of course, differs from the duty to shareholders involved in this case. See n. 7, supra. Trustees are also subject to a higher
Footnote continued on next page.

*Consider Mosser
is different*

Court described the trustee's defalcation as "a willful and deliberate setting up of an interest in employees adverse to that of the trust." Id., at 272. The breach did not depend on the trustee's personal gain, and his motives in violating his duty were irrelevant; like Secrist, the trustee intended that others would abuse the inside information for their personal gain. Cf. Dodge v. Ford Motor Co., 204 Mich. 459, 506-509, 170 N.W. 668, 684-685 (1919) (Henry Ford's philanthropic motives did not permit him to set Ford Motor Company dividend policies to benefit public at expense of shareholders).

As Mosser demonstrates, the breach consists in taking action disadvantageous to the person to whom one owes a duty. In this case, Secrist owed a duty to "purchasers" of Equity Funding shares. The Court's addition of the bad purpose element to a breach of fiduciary duty claim is flatly inconsistent with the principle of Mosser. I do not join this limitation of the scope of an insider's fiduciary duty to shareholders.¹³

standard of care than scienter. 3 A. Scott on Trusts §201, p. 1650 (1967). In addition, strict trustees are bound not to trade in securities at all. See Langevoort, 70 Calif. L. Rev., at 2, n. 5. These differences, however, are irrelevant to the principle of Mosser that the motive of personal gain is not essential to a trustee's liability. In Mosser, as here, personal gain accrued to the tippees. See 341 U.S., at 273.

¹³Although I disagree in principle with the Court's requirement of an improper motive, I also note that the requirement adds to the administrative and judicial burden in Rule 10b-5 cases. Assuming the validity of the requirement, the SEC's approach--a violation occurs when the insider knows that the tippee will trade with the information, Brief for SEC 31--can be seen as a presumption that the insider gains from the tipping. The Court now requires a case-by-case determination, thus prohibiting

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III

The improper purpose requirement not only has no basis in law, but it rests implicitly on a policy that I cannot accept. The Court justifies Secrist's and Dirks' action because the general benefit derived from the violation of Secrist's duty to shareholders outweighed the harm caused to those shareholders, see Heller, Chiarella, SEC Rule 14e-3 and Dirks: "Fairness" versus Economic Theory, 37 Bus. Lawyer 517, 550 (1982); Easterbrook, Insider Trading, Secret Agents, Evidentiary Privileges, and the Production of Information, 1981 S. Ct. Rev. 309, 338--in other words, because the end justified the means. Under this view, the benefit conferred on society by Secrist's and Dirks' activities may be paid for with the losses caused to shareholders trading with Dirks' clients.¹⁴

iting such a presumption.

The Court acknowledges the burdens and difficulties of this approach, but asserts that a principle is needed to guide market participants. Ante, at 16. I fail to see how the Court's rule has any practical advantage over the SEC's presumption. The Court's approach is particularly difficult to administer when the insider is not directly enriched monetarily by the trading he induces. For example, the Court does not explain why the benefit Secrist obtained--the good feeling of exposing a fraud and his enhanced reputation--is any different from the benefit to an insider who gives the information as a gift to a friend or relative. Under the Court's somewhat cynical view, gifts involve personal gain. See ibid. Secrist surely gave Dirks a gift of the commissions Dirks made on the deal in order to induce him to disseminate the information. The distinction between pure altruism and self-interest has puzzled philosophers for centuries; there is no reason to believe that courts and administrative law judges will have an easier time with it.

¹⁴This position seems little different from the theory that insider trading should be permitted because it brings relevant information to the market. See H. Manne, Insider Trading and the
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Although Secrist's general motive to expose the Equity Funding fraud was laudable, the means he chose were not. Moreover, even assuming that Dirks played a substantial role in exposing the fraud,¹⁵ he and his clients should not profit from the information they obtained from Secrist. Misprision of a felony long has been against public policy. Branzburg v. Hayes, 408 U.S. 665, 696-697 (1972); see 18 U.S.C. §4. A person cannot condition his transmission of information of a crime on a financial award. As a citizen, Dirks had at least an ethical obligation to report the information to the proper authorities. See ante, at 13, n. 20. The Court's holding is deficient in policy terms not because it fails to create a legal norm out of that ethical norm, see ibid., but because it actually rewards Dirks for his aiding and abetting.

Dirks and Secrist were under a duty to disclose the information or to refrain from trading on it.¹⁶ I agree that disclosure

Stock Market 59-76, 111-146 (1966); Manne, Insider Trading and the Law Professors, 23 Vand. L. Rev. 547, 565-576 (1970). That position, which sits at the opposite end of the theoretical spectrum from the much maligned equality-of-information theory, has never been adopted by Congress or ratified by the Court. See Langevoort, 70 Calif. L. Rev., at 1 and n. 1. The theory rejects the existence of any enforceable principle of fairness between market participants.

¹⁵The Court uncritically accepts Dirks' own view of his role in uncovering the Equity Funding fraud. See ante, at 11, n. 17. It ignores the fact that Secrist gave the same information at the same time to state insurance regulators, who proceeded to expose massive fraud in a major Equity Funding subsidiary. The fraud surfaced before Dirks ever spoke to the SEC.

¹⁶Secrist did pass on his information to regulatory authorities. His good but misguided motive may be the reason the
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in this case would have been difficult. Ante, at 13, n. 20. I also recognize that the SEC seemingly has been less than proficient in its view of the nature of disclosure necessary to satisfy the disclose-or-refrain duty. The Commission tells persons with inside information that they cannot trade on that information unless they disclose; it refuses, however, to tell them how to disclose.¹⁷ See In re Faberge, Inc., 45 S.E.C. 249, 256 (1973) (disclosure requires public release through public media designed to reach investing public generally). This seems to be a less than sensible policy, which it is incumbent on the Commission to correct. The Court, however, has no authority to remedy the problem by opening a hole in the congressionally mandated prohibition on insider trading, thus rewarding insider trading.

IV

In my view, Secrist violated his duty to Equity Funding

SEC did not join him in the administrative proceedings against Dirks and his clients. The fact that the SEC, in an exercise of prosecutorial discretion, did not charge Secrist under Rule 10b-5 says nothing about the applicable law. Cf. ante, at 18, n. 25 (suggesting otherwise). Nor does the fact that the SEC took an unsupportable legal position in proceedings below indicate that neither Secrist nor Dirks is liable under any theory. Cf. ibid. (same).

¹⁷At oral argument, the SEC's view was that Dirks' obligation to disclose would not be satisfied by reporting the information to the SEC. Tr. of Oral Arg. 27, quoted ante, at 13, n. 20. This position is in apparent conflict with the statement in its brief that speaks favorably of a safe harbor rule under which an investor satisfies his obligation to disclose by reporting the information to the Commission and then waiting a set period before trading. Brief for SEC 43-44. The SEC, however, has neither proposed nor adopted a rule to this effect, and thus persons such as Dirks have no real option other than to refrain from trading.

shareholders by transmitting material nonpublic information to Dirks with the intention that Dirks would cause his clients to trade on that information. Dirks, therefore, was under a duty to make the information publicly available or to refrain from actions that he knew would lead to trading. Because Dirks caused his clients to trade, he violated §10(b) and Rule 10b-5. Any other result is a disservice to this country's attempt to provide fair and efficient capital markets. I dissent.

To: The Chief Justice
Justice Brennan
Justice White
Justice Marshall
Justice Powell
Justice Rehnquist
Justice Stevens
Justice O'Connor ✓

From: **Justice Blackmun**

Circulated: JUN 25 1983

Recirculated: _____

1st DRAFT

SUPREME COURT OF THE UNITED STATES

No. 82-276

RAYMOND L. DIRKS, PETITIONER *v.* SECURITIES
AND EXCHANGE COMMISSION

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF
APPEALS FOR DISTRICT OF COLUMBIA

[June —, 1983]

JUSTICE BLACKMUN, dissenting.

The Court today takes still another step to limit the protections provided investors by §10(b) of the Securities Exchange Act of 1934.¹ See *Chiarella v. United States*, 445 U. S. 222, 246 (1980) (dissenting opinion). The device employed in this case engrafts a special motivational requirement on the fiduciary duty doctrine. This innovation excuses a knowing and intentional violation of an insider's duty to shareholders if the insider does not act from a motive of personal gain. Even on the extraordinary facts of this case, such an innovation is not justified.

¹ See, e. g., *Blue Chip Stamps v. Manor Drug Stores*, 421 U. S. 723 (1975); *Ernst & Ernst v. Hochfelder*, 425 U. S. 185 (1976); *Piper v. Chris-Craft Industries, Inc.*, 430 U. S. 1 (1977); *Chiarella v. United States*, 445 U. S. 222 (1980); *Aaron v. SEC*, 446 U. S. 680 (1980). This trend frustrates the congressional intent that the securities laws be interpreted flexibly to protect investors, see *Affiliated Ute Citizens v. United States*, 406 U. S. 128, 151 (1972); *SEC v. Capital Gains Research Bureau, Inc.*, 375 U. S. 180, 186 (1963), and to regulate deceptive practices "detrimental to the interests of the investor," S. Rep. No. 792, 73d Cong., 2d Sess., 18 (1934); see H. R. Rep. No. 1383, 73d Cong., 2d Sess., 10 (1934). Moreover, the Court continues to refuse to accord to SEC administrative decisions the deference it normally gives to an agency's interpretation of its own statute. See, e. g., *Blum v. Bacon*, 457 U. S. 132 (1982).

I

As the Court recognizes, *ante*, at 11, n. 17, the facts here are unusual. After a meeting with Ronald Secrist, a former Equity Funding employee, on March 7, 1973, App. 226, petitioner Raymond Dirks found himself in possession of material nonpublic information of massive fraud within the company.² In the Court's words, "[h]e uncovered . . . startling information that required no analysis or exercise of judgment as to its market relevance." *Ante*, at 11, n. 17. In disclosing that information to Dirks, Secrist intended that Dirks would disseminate the information to his clients, those clients would unload their Equity Funding securities on the market, and the price would fall precipitously, thereby triggering a reaction from the authorities. App. 16, 25, 27.

Dirks complied with his informant's wishes. Instead of reporting that information to the Securities and Exchange Commission (SEC or Commission) or to other regulatory agencies, Dirks began to disseminate the information to his clients and undertook his own investigation.³ One of his

² Unknown to Dirks, Secrist also told his story to New York insurance regulators the same day. App. 23. They immediately assured themselves that Equity Funding's New York subsidiary had sufficient assets to cover its outstanding policies and then passed on the information to California regulators who in turn informed Illinois regulators. Illinois investigators, later joined by California officials, conducted a surprise audit of Equity Funding's Illinois subsidiary, *id.*, at 87-88, to find \$22 million of the subsidiary's assets missing. On March 30, these authorities seized control of the Illinois subsidiary. *Id.*, at 271.

³ In the same administrative proceeding at issue here, the Administrative Law Judge (ALJ) found that Dirks' clients—five institutional investment advisors—violated § 17(a) of the Securities Act of 1933, 15 U. S. C. § 77q(a), § 10(b) of the Securities Exchange Act of 1934, 15 U. S. C. § 78j(b), and Rule 10b-5, 17 CFR § 240.10b-5, by trading on Dirks' tips. App. 297. All the clients were censured, except Dreyfus Corporation. The ALJ found that Dreyfus had made significant efforts to disclose the information to Goldman, Sachs, the purchaser of its securities. App. 299, 301. None of Dirks' clients appealed these determinations.

first steps was to direct his associates at Delafield Childs to draw up a list of Delafield clients holding Equity Funding securities. On March 12, eight days before Dirks flew to Los Angeles to investigate Secrist's story, he reported the full allegations to Boston Company Institutional Investors, Inc., which on March 15 and 16 sold approximately \$1.2 million of Equity securities.⁴ See *id.*, at 199. As he gathered more information, he selectively disclosed it to his clients. To those holding Equity Funding securities he gave the "hard" story—all the allegations; others received the "soft" story—a recitation of vague factors that might reflect adversely on Equity Funding's management. See *id.*, at 211, n. 24.

Dirks' attempts to disseminate the information to nonclients were feeble, at best. On March 12, he left a message for Herbert Lawson, the San Francisco bureau chief of *The Wall Street Journal*. Not until March 19 and 20 did he call Lawson again, and outline the situation. William Blundell, a *Journal* investigative reporter based in Los Angeles, got in touch with Dirks about his March 20 telephone call. On March 21, Dirks met with Blundell in Los Angeles. Blundell began his own investigation, relying in part on Dirks' contacts, and on March 23 telephoned Stanley Sporkin, the SEC's Deputy Director of Enforcement. On March 26, the next business day, Sporkin and his staff interviewed Blundell and asked to see Dirks the following morning.

App. to Pet. for Cert. B-2, n. 1.

⁴The Court's implicit suggestion that Dirks' did not gain by this selective dissemination of advice, *ante*, at 2, n. 2, is inaccurate. The ALJ found that because of Dirks' information, Boston Company Institutional Investors, Inc., directed business to Delafield Childs that generated approximately \$25,000 in commissions. App. 199, 204-205. While it is true that the exact economic benefit gained by Delafield Childs due to Dirks' activities is unknowable because of the structure of compensation in the securities market, there can be no doubt that Delafield and Dirks gained both monetary rewards and enhanced reputations for "looking after" their clients.

Trading was halted by the New York Stock Exchange at about the same time Dirks was talking to Los Angeles SEC personnel. The next day, March 28, the SEC suspended trading in Equity Funding securities. By that time, Dirks' clients had unloaded close to \$15 million of Equity Funding stock and the price had plummeted from \$26 to \$15. The effect of Dirks' selective dissemination of Secrist's information was that Dirks' clients were able to shift the losses that were inevitable due to the Equity Funding fraud from themselves to uninformed market participants.

II

A

No one questions that Secrist himself could not trade on his inside information to the disadvantage of uninformed shareholders and purchasers of Equity Funding securities. See Brief for United States as *Amicus Curiae* 19, n. 12. Unlike the printer in *Chiarella*, Secrist stood in a fiduciary relationship with these shareholders. As the Court states, *ante*, at 5, corporate insiders have an affirmative duty of disclosure when trading with shareholders of the corporation. See *Chiarella*, 445 U. S., at 227. This duty extends as well to purchasers of the corporation's securities. *Id.*, at 227, n. 8, citing *Gratz v. Claghton*, 187 F. 2d 46, 49 (CA2), cert. denied, 341 U. S. 920 (1951).

The Court also acknowledges that Secrist could not do by proxy what he was prohibited from doing personally. *Ante*, at 12; *Mosser v. Darrow*, 341 U. S. 267, 272 (1951). But this is precisely what Secrist did. Secrist used Dirks to disseminate information to Dirks' clients, who in turn dumped stock on unknowing purchasers. Secrist thus intended Dirks to injure the purchasers of Equity Funding securities to whom Secrist had a duty to disclose. Accepting the Court's view of tippee liability,⁵ it appears that Dirk's knowledge of this

⁵ I interpret the Court's opinion to impose liability on tippees like Dirks

breach makes him liable as a participant in the breach after the fact. *Ante*, at 12, 19; *Chiarella*, 445 U. S., at 230, n. 12.

B

The Court holds, however, that Dirks is not liable because Secrist did not violate his duty; according to the Court, this is so because Secrist did not have the improper purpose of personal gain. *Ante*, at 15-16, 18-19. In so doing, the Court imposes a new, subjective limitation on the scope of the duty owed by insiders to shareholders. The novelty of this limitation is reflected in the Court's lack of support for it.⁶

The insider's duty is owed directly to the corporation's shareholders.⁷ See *Langevoort*, *Insider Trading and the Fi-*

when the tippee knows or has reason to know that the information is material and nonpublic and was obtained through a breach of duty by selective revelation or otherwise. See *In re Investors Management Co.*, 44 S. E. C. 633, 641 (1971).

⁶The Court cites only Professor Brudney to support its rule. *Ante*, at 16, quoting from his article, *Insiders, Outsiders, and Informational Advantages Under the Federal Securities Laws*, 93 Harv. L. Rev. 322, 348 (1979). Ironically, Professor Brudney's quoted statement appears in the context of his assertion that the duty of insiders to disclose prior to trading with shareholders is in large part a mechanism to correct the information available to noninsiders. Professor Brudney simply recognizes that the most common motive for breaching this duty is personal gain; he does not state, however, that the duty prevents only personal aggrandizement. *Id.*, at 345-348. Surely, the Court does not now adopt Professor Brudney's access-to-information theory, a close cousin to the equality-of-information theory it accuses the SEC of harboring. See *ante*, at 8-10.

⁷The Court correctly distinguishes this duty from the duty of an insider to the corporation not to mismanage corporate affairs or to misappropriate corporate assets. *Ante*, at 5, n. 9. That duty also can be breached when the insider trades in corporate securities on the basis of inside information. Although a shareholder suing in the name of the corporation can recover for the corporation damages for any injury the insider causes by the breach of this distinct duty, *Diamond v. Oreamuno*, 24 N. Y.2d 494, 498, 248 N. E. 2d 910, 912 (1969); see *Thomas v. Roblins Industries, Inc.*, 520 F. 2d 1393, 1397 (CA3 1975), insider trading generally does not injure the cor-

duciary Principle: A Post-*Chiarella* Restatement, 70 Calif. L. Rev. 1, 5 (1982); 3A W. Fletcher, Private Corporations §1168.2, pp. 288-289 (1975). As *Chiarella* recognized, it is based on the relationship of trust and confidence between the insider and the shareholder. 445 U. S., at 228. That relationship assures the shareholder that the insider may not take actions that will harm him unfairly.⁸ The affirmative duty of disclosure protects against this injury. See *Pepper v. Litton*, 308 U. S. 295, 307, n. 15 (1939); *Strong v. Rapide*, 213 U. S. 419, 431-434 (1909); see also *Chiarella*, 445 U. S., at 228, n. 10; cf. *Pepper*, 308 U. S., at 307 (fiduciary obligation to corporation exists for corporation's protection).

C

The fact that the insider himself does not benefit from the breach does not eradicate the shareholder's injury.⁹ Cf. Re-

poration itself. See Langevoort, Insider Trading and the Fiduciary Principle: A Post-*Chiarella* Restatement, 70 Calif. L. Rev. 1, 2, n. 5, 28, n. 111 (1982).

⁸As it did in *Chiarella*, 445 U. S., at 226-229, the Court adopts the *Cady, Roberts* formulation of the duty. *Ante*, at 5-6.

⁹Analytically, 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 re Cady, Roberts & Co.*, 40 S. E. C. 907, 912 (1961) (footnote omitted).

The first element—on which *Chiarella's* holding rests—establishes the type of relationship that must exist between the parties before a duty to disclose is present. The second—not addressed by *Chiarella*—identifies the harm that the duty protects against: the inherent unfairness to the shareholder caused when an insider trades with him on the basis of undisclosed inside information.

¹Without doubt, breaches of the insider's duty occur most often when an insider seeks personal aggrandizement at the expense of shareholders. Because of this, descriptions of the duty to disclose are often coupled with statements that the duty prevents unjust enrichment. See, e. g., *In re*

statement (Second) of Trusts § 205, Comments c and d (1959) (trustee liable for acts causing diminution of value of trust); 3 A. Scott on Trusts § 205, p. 1665 (1967) (trustee liable for any losses to trust caused by his breach). It makes no difference to the shareholder whether the corporate insider gained or intended to gain personally from the transaction; the shareholder still has lost because of the insider's misuse of nonpublic information. The duty is addressed not to the insider's motives,¹⁰ but to his actions and their consequences on the shareholder. Personal gain is not an element of the breach of this duty.¹¹

Cady, Roberts & Co., 40 S. E. C. 907, 912, n. 15 (1961); Langevoort, 70 Calif. L. Rev., at 19. Private gain is certainly a strong motivation for breaching the duty.

It is, however, not an element of the breach of this duty. The reference to personal gain in *Cady, Roberts*, for example, is appended to the first element underlying the duty which requires that an insider have a special relationship to corporate information that he cannot appropriate for his own benefit. See n. 8, *supra*. It does not limit the second element which addresses the injury to the shareholder and is at issue here. See *ibid.* In fact, *Cady, Roberts*, describes the duty more precisely in a later footnote: "In the circumstances, [the insider's] relationship to his customers was such that he would have a duty not to take a position adverse to them, not to take secret profits at their expense, not to misrepresent facts to them, and in general to place their interests ahead of his own." 40 S. E. C., at 916, n. 31. This statement makes clear that enrichment of the insider himself is simply one of the results the duty attempts to prevent.

¹⁰ Of course, an insider is not liable in a Rule 10b-5 administrative action unless he has the requisite scienter. *Aaron v. SEC*, 446 U. S. 680, 691 (1980). He must know or intend that his conduct violate his duty. Secrist obviously knew and intended that Dirks would cause trading on the inside information and that Equity Funding shareholders would be harmed. The scienter requirement addresses the intent necessary to support liability; it does not address the motives behind the intent.

¹¹ The Court seems concerned that this case bears on insiders' contacts with analysts for valid corporate reasons. *Ante*, at 10-11. It also fears that insiders may not be able to determine whether the information transmitted is material or nonpublic. *Id.*, at 14-15. When the disclosure is to an investment banker or some other adviser, however, there is normally no

This conclusion is borne out by the Court's decision in *Mosser v. Darrow*, 341 U. S. 267 (1951). There, the Court faced an analogous situation: a reorganization trustee engaged two employee-promoters of subsidiaries of the companies being reorganized to provide services that the trustee considered to be essential to the successful operation of the trust. In order to secure their services, the trustee expressly agreed with the employees that they could continue to trade in the securities of the subsidiaries. The employees then turned their inside position into substantial profits at the expense both of the trust and of other holders of the companies' securities.

The Court acknowledged that the trustee neither intended to nor did in actual fact benefit from this arrangement; his motives were completely selfless and devoted to the companies. 341 U. S., at 275. The Court, nevertheless, found the trustee liable to the estate for the activities of the employees he authorized.¹² The Court described the trustee's defalcation

breach because the insider does not have scienter; he does not intend that the inside information be used for trading purposes to the disadvantage of shareholders. Moreover, if the insider in good faith does not believe that the information is material or nonpublic, he also lacks the necessary scienter. *Ernst & Ernst v. Hochfelder*, 425 U. S. 185, 197 (1976). In fact, the scienter requirement functions in part to protect good faith errors of this type. *Id.*, at 211, n. 31.

Should the adviser receiving the information use it to trade, it may breach a separate contractual or other duty to the corporation not to misuse the information. Absent such an arrangement, however, the adviser is not barred by Rule 10b-5 from trading on that information if it believes that the insider has not breached any duty to his shareholders. See *Walton v. Morgan Stanley & Co.*, 623 F. 2d 796, 798-799 (CA2 1980).

The situation here, of course, is radically different. *Ante*, 11, n. 17 (Dirks received information requiring no analysis "as to its market relevance"). Secrist divulged the information for the precise purpose of causing Dirks' clients to trade on it. I fail to understand how imposing liability on Dirks will affect legitimate insider-analyst contacts.

¹²The duty involved in *Mosser* was the duty to the corporation in trust

tion as "a willful and deliberate setting up of an interest in employees adverse to that of the trust." *Id.*, at 272. The breach did not depend on the trustee's personal gain, and his motives in violating his duty were irrelevant; like *Secrist*, the trustee intended that others would abuse the inside information for their personal gain. Cf. *Dodge v. Ford Motor Co.*, 204 Mich. 459, 506-509, 170 N. W. 668, 684-685 (1919) (Henry Ford's philanthropic motives did not permit him to set Ford Motor Company dividend policies to benefit public at expense of shareholders).

As *Mosser* demonstrates, the breach consists in taking action disadvantageous to the person to whom one owes a duty. In this case, *Secrist* owed a duty to purchasers of Equity Funding shares. The Court's addition of the bad purpose element to a breach of fiduciary duty claim is flatly inconsistent with the principle of *Mosser*. I do not join this limitation of the scope of an insider's fiduciary duty to shareholders.¹³

not to misappropriate its assets. This duty, of course, differs from the duty to shareholders involved in this case. See n. 7, *supra*. Trustees are also subject to a higher standard of care than scienter. 3 A. Scott on Trusts § 201, p. 1650 (1967). In addition, strict trustees are bound not to trade in securities at all. See *Langevoort*, 70 Calif. L. Rev., at 2, n. 5. These differences, however, are irrelevant to the principle of *Mosser* that the motive of personal gain is not essential to a trustee's liability. In *Mosser*, as here, personal gain accrued to the tippees. See 341 U. S., at 273.

¹³ Although I disagree in principle with the Court's requirement of an improper motive, I also note that the requirement adds to the administrative and judicial burden in Rule 10b-5 cases. Assuming the validity of the requirement, the SEC's approach—a violation occurs when the insider knows that the tippee will trade with the information, Brief for SEC 31—can be seen as a presumption that the insider gains from the tipping. The Court now requires a case-by-case determination, thus prohibiting such a presumption.

The Court acknowledges the burdens and difficulties of this approach, but asserts that a principle is needed to guide market participants. *Ante*, at 16. I fail to see how the Court's rule has any practical advantage over

III

The improper purpose requirement not only has no basis in law, but it rests implicitly on a policy that I cannot accept. The Court justifies Secrist's and Dirks' action because the general benefit derived from the violation of Secrist's duty to shareholders outweighed the harm caused to those shareholders, see *Heller*, *Chiarella*, SEC Rule 14e-3 and *Dirks*: "Fairness" versus Economic Theory, 37 Bus. Lawyer 517, 550 (1982); Easterbrook, *Insider Trading, Secret Agents, Evidentiary Privileges, and the Production of Information*, 1981 S. Ct. Rev. 309, 338—in other words, because the end justified the means. Under this view, the benefit conferred on society by Secrist's and Dirks' activities may be paid for with the losses caused to shareholders trading with Dirks' clients.¹⁴

Although Secrist's general motive to expose the Equity Funding fraud was laudable, the means he chose were not.

the SEC's presumption. The Court's approach is particularly difficult to administer when the insider is not directly enriched monetarily by the trading he induces. For example, the Court does not explain why the benefit Secrist obtained—the good feeling of exposing a fraud and his enhanced reputation—is any different from the benefit to an insider who gives the information as a gift to a friend or relative. Under the Court's somewhat cynical view, gifts involve personal gain. See *ibid.* Secrist surely gave Dirks a gift of the commissions Dirks made on the deal in order to induce him to disseminate the information. The distinction between pure altruism and self-interest has puzzled philosophers for centuries; there is no reason to believe that courts and administrative law judges will have an easier time with it.

¹⁴This position seems little different from the theory that insider trading should be permitted because it brings relevant information to the market. See H. Manne, *Insider Trading and the Stock Market* 59-76, 111-146 (1966); Manne, *Insider Trading and the Law Professors*, 28 Vand. L. Rev. 547, 565-576 (1970). That position, which sits at the opposite end of the theoretical spectrum from the much maligned equality-of-information theory, has never been adopted by Congress or ratified by the Court. See Langevoort, 70 Calif. L. Rev., at 1 and n. 1. The theory rejects the existence of any enforceable principle of fairness between market participants.

*where does
the Court
say this?*

Moreover, even assuming that Dirks played a substantial role in exposing the fraud,¹⁵ he and his clients should not profit from the information they obtained from Secrist. Misprision of a felony long has been against public policy. *Branzburg v. Hayes*, 408 U. S. 665, 696-697 (1972); see 18 U. S. C. § 4. A person cannot condition his transmission of information of a crime on a financial award. As a citizen, Dirks had at least an ethical obligation to report the information to the proper authorities. See *ante*, at 13, n. 20. The Court's holding is deficient in policy terms not because it fails to create a legal norm out of that ethical norm, see *ibid.*, but because it actually rewards Dirks for his aiding and abetting.

Dirks and Secrist were under a duty to disclose the information or to refrain from trading on it.¹⁶ I agree that disclosure in this case would have been difficult. *Ante*, at 13, n. 20. I also recognize that the SEC seemingly has been less than proficient in its view of the nature of disclosure necessary to satisfy the disclose-or-refrain duty. The Commission tells persons with inside information that they cannot trade on that information unless they disclose; it refuses, however, to tell them how to disclose.¹⁷ See *In re Faberge, Inc.*, 45

¹⁵ The Court uncritically accepts Dirks' own view of his role in uncovering the Equity Funding fraud. See *ante*, at 11, n. 17. It ignores the fact that Secrist gave the same information at the same time to state insurance regulators, who proceeded to expose massive fraud in a major Equity Funding subsidiary. The fraud surfaced before Dirks ever spoke to the SEC.

¹⁶ Secrist did pass on his information to regulatory authorities. His good but misguided motive may be the reason the SEC did not join him in the administrative proceedings against Dirks and his clients. The fact that the SEC, in an exercise of prosecutorial discretion, did not charge Secrist under Rule 10b-5 says nothing about the applicable law. Cf. *ante*, at 18, n. 25 (suggesting otherwise). Nor does the fact that the SEC took an unsupportable legal position in proceedings below indicate that neither Secrist nor Dirks is liable under any theory. Cf. *ibid.* (same).

¹⁷ At oral argument, the SEC's view was that Dirks' obligation to disclose would not be satisfied by reporting the information to the SEC. Tr. of Oral Arg. 27, quoted *ante*, at 13, n. 20. This position is in apparent

S. E. C. 249, 256 (1973) (disclosure requires public release through public media designed to reach investing public generally). This seems to be a less than sensible policy, which it is incumbent on the Commission to correct. The Court, however, has no authority to remedy the problem by opening a hole in the congressionally mandated prohibition on insider trading, thus rewarding insider trading.

IV

In my view, Secrist violated his duty to Equity Funding shareholders by transmitting material nonpublic information to Dirks with the intention that Dirks would cause his clients to trade on that information. Dirks, therefore, was under a duty to make the information publicly available or to refrain from actions that he knew would lead to trading. Because Dirks caused his clients to trade, he violated § 10(b) and Rule 10b-5. Any other result is a disservice to this country's attempt to provide fair and efficient capital markets. I dissent.

conflict with the statement in its brief that speaks favorably of a safe harbor rule under which an investor satisfies his obligation to disclose by reporting the information to the Commission and then waiting a set period before trading. Brief for SEC 43-44. The SEC, however, has neither proposed nor adopted a rule to this effect, and thus persons such as Dirks have no real option other than to refrain from trading.

job 06/25/83

To: Mr. Justice Powell

From: Jim

Re: Dirks

I have attempted in the attached footnote to restate your concerns in the rider that you prepared this morning. My reason for pause in not attacking directly JUSTICE BLACKMUN's distinction between "motive" and "scienter" is that we make one between "purpose" and "scienter." We have to use the word "purpose," in my opinion, to slide from the SEC's language in the older cases to the requirement in your case that the Cady, Roberts duty includes not only fiduciary duty, but a duty not to gain. Therefore, to the extent that JUSTICE BLACKMUN uses "motive" the same way we use "purpose," his distinction is somewhat helpful to us. Therefore, perhaps we can use his distinction somewhat to our advantage.

The following suggested footnote would go after the citation to Aaron on p. 16. Am I on the right track?

*Does HAB use "motive" same way we do
"purpose"? See HP 15, 16*

RIDER F

The dissenting opinion correctly draws a distinction between our requirement that the insider's breach must involve personal gain and the requirement that the insider act with scienter. See ante, at 8, and n. 10. As we said in Ernst & Ernst v. Hochfelder, 425 U.S. 185, 199 (1976), the statutory words "manipulative," "device," and "contrivance connote intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities." But not all conduct done with scienter violates Rule 10b-5, just as all fraudulent acts done without scienter also do not come within the ban of the federal securities laws. Rather, there must be both scienter and a fraudulent act. We are concerned in this case with those acts that are fraudulent, i. e., those that deceive or manipulate the market. Determination whether a particular act, such as trading securities or disclosing information, is fraudulent turns on objective criteria, such as the existence of a fiduciary duty and personal gain from the use of nonpublic information. The determination whether those acts were done intentionally by a particular individual, however, is inherently a subjective inquiry.

lfp/ss 06/25/83

Rider A, p. (Dirks)

DIRKSB SALLY-POW

Consider adding a note along the following lines:

In applying Rule 10b-5, the dissent would draw a distinction impossible as a guide to conduct or to administer by courts and the SEC. It concedes that an insider is not liable under the Rule "unless he has the requisite scienter". See n. 10, post. The dissent then proposes a new definition of scienter: "[T]he scienter requirement addresses the intent necessary to support liability; it does not address the motives behind the intent." Id. Therefore, ^{since} ~~see~~ Secrist "knew and intended that Dirks would cause trading", he possessed the requisite scienter regardless of what his motives may have been. This distinction ignores both the language of 10b-5

and the meaning of "scienter". See Ernst & Ernst v. Hochfelder, 425 U.S. 185, 197-199 (1976) (the language "manipulative", "device", and "contrivance" connote⁵₁ "intentional or willful conduct designed to deceive or defraud investors") Even the unique facts of this case illustrate the distinction that the dissent overlooks. ~~Dirks~~^{Secrist} certainly intended to convey relevant information that management was unlawfully concealing, and - so far as the record goes - he quite honestly believed that persuading Dirks to investigate was the best way to disclose the fraud. The dissent acknowledges that any other means of "disclosures would have been difficult", post, at 13, and yet^{it}_^ would charge Secrist with a breach of fiduciary duty even though there was no motive to["]_^ deceive or defraud investors". We recognize the inherent

difficult of detemining ~~either the~~ ^{the} intent or motive of an
 actor in a particular situation. Each connotes the need
 for a subjective inquiry. Courts, however, necessarily
 look to objective evidence to ascertain the ^{scienter} ~~statutory~~
 requirement, ~~of intent to deceive, manipulate or defraud.~~
 The standard adopted by the Court today ~~in cases of this~~
~~kind~~ is whether the insider receives a direct or indirect
 personal benefit from the disclosure. Imperfect as this
 may be, it is a ^{fair and essentially objective} standard. The dissent's distinction
 between "intent" and "motive" is without precedent and is
 standardless.

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE Wm. J. BRENNAN, JR.

June 27, 1983

No. 82-276

Dirks v. SEC

Dear Harry,

Please join me in your dissent in
the above.

Sincerely,

Bill

Justice Blackmun

Copies to the Conference

pp. 1, 5, 10, 14

To: The Chief Justice
Justice Brennan
Justice White
Justice Marshall
Justice Powell
Justice Rehnquist
Justice Stevens
Justice O'Connor

From: **Justice Blackmun**

Circulated: _____

Recirculated: JUN 28 1983

2nd DRAFT

SUPREME COURT OF THE UNITED STATES

No. 82-276

RAYMOND L. DIRKS, PETITIONER *v.* SECURITIES
AND EXCHANGE COMMISSION

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

[June —, 1983]

JUSTICE BLACKMUN, with whom JUSTICE BRENNAN and
JUSTICE MARSHALL join, dissenting.

The Court today takes still another step to limit the protections provided investors by §10(b) of the Securities Exchange Act of 1934.¹ See *Chiarella v. United States*, 445 U. S. 222, 246 (1980) (dissenting opinion). The device employed in this case engrafts a special motivational requirement on the fiduciary duty doctrine. This innovation excuses a knowing and intentional violation of an insider's duty to shareholders if the insider does not act from a motive of personal gain. Even on the extraordinary facts of this case, such an innovation is not justified.

¹ See, e. g., *Blue Chip Stamps v. Manor Drug Stores*, 421 U. S. 723 (1975); *Ernst & Ernst v. Hochfelder*, 425 U. S. 185 (1976); *Piper v. Chris-Craft Industries, Inc.*, 430 U. S. 1 (1977); *Chiarella v. United States*, 445 U. S. 222 (1980); *Aaron v. SEC*, 446 U. S. 680 (1980). This trend frustrates the congressional intent that the securities laws be interpreted flexibly to protect investors, see *Affiliated Ute Citizens v. United States*, 406 U. S. 128, 151 (1972); *SEC v. Capital Gains Research Bureau, Inc.*, 375 U. S. 180, 186 (1963), and to regulate deceptive practices "detrimental to the interests of the investor," S. Rep. No. 792, 73d Cong., 2d Sess., 18 (1934); see H. R. Rep. No. 1383, 73d Cong., 2d Sess., 10 (1934). Moreover, the Court continues to refuse to accord to SEC administrative decisions the deference it normally gives to an agency's interpretation of its own statute. See, e. g., *Blum v. Bacon*, 457 U. S. 132 (1982).

Changes that we saw in the letter, plus one more on p. 11.

JOB

I

As the Court recognizes, *ante*, at 11, n. 17, the facts here are unusual. After a meeting with Ronald Secrist, a former Equity Funding employee, on March 7, 1973, App. 226, petitioner Raymond Dirks found himself in possession of material nonpublic information of massive fraud within the company.² In the Court's words, "[h]e uncovered . . . startling information that required no analysis or exercise of judgment as to its market relevance." *Ante*, at 11, n. 17. In disclosing that information to Dirks, Secrist intended that Dirks would disseminate the information to his clients, those clients would unload their Equity Funding securities on the market, and the price would fall precipitously, thereby triggering a reaction from the authorities. App. 16, 25, 27.

Dirks complied with his informant's wishes. Instead of reporting that information to the Securities and Exchange Commission (SEC or Commission) or to other regulatory agencies, Dirks began to disseminate the information to his clients and undertook his own investigation.³ One of his

² Unknown to Dirks, Secrist also told his story to New York insurance regulators the same day. App. 23. They immediately assured themselves that Equity Funding's New York subsidiary had sufficient assets to cover its outstanding policies and then passed on the information to California regulators who in turn informed Illinois regulators. Illinois investigators, later joined by California officials, conducted a surprise audit of Equity Funding's Illinois subsidiary, *id.*, at 87-88, to find \$22 million of the subsidiary's assets missing. On March 30, these authorities seized control of the Illinois subsidiary. *Id.*, at 271.

³ In the same administrative proceeding at issue here, the Administrative Law Judge (ALJ) found that Dirks' clients—five institutional investment advisors—violated § 17(a) of the Securities Act of 1933, 15 U. S. C. § 77q(a), § 10(b) of the Securities Exchange Act of 1934, 15 U. S. C. § 78j(b), and Rule 10b-5, 17 CFR § 240.10b-5, by trading on Dirks' tips. App. 297. All the clients were censured, except Dreyfus Corporation. The ALJ found that Dreyfus had made significant efforts to disclose the information to Goldman, Sachs, the purchaser of its securities. App. 299, 301. None of Dirks' clients appealed these determinations.

first steps was to direct his associates at Delafield Childs to draw up a list of Delafield clients holding Equity Funding securities. On March 12, eight days before Dirks flew to Los Angeles to investigate Secrist's story, he reported the full allegations to Boston Company Institutional Investors, Inc., which on March 15 and 16 sold approximately \$1.2 million of Equity securities.⁴ See *id.*, at 199. As he gathered more information, he selectively disclosed it to his clients. To those holding Equity Funding securities he gave the "hard" story—all the allegations; others received the "soft" story—a recitation of vague factors that might reflect adversely on Equity Funding's management. See *id.*, at 211, n. 24.

Dirks' attempts to disseminate the information to nonclients were feeble, at best. On March 12, he left a message for Herbert Lawson, the San Francisco bureau chief of *The Wall Street Journal*. Not until March 19 and 20 did he call Lawson again, and outline the situation. William Blundell, a *Journal* investigative reporter based in Los Angeles, got in touch with Dirks about his March 20 telephone call. On March 21, Dirks met with Blundell in Los Angeles. Blundell began his own investigation, relying in part on Dirks' contacts, and on March 23 telephoned Stanley Sporkin, the SEC's Deputy Director of Enforcement. On March 26, the next business day, Sporkin and his staff interviewed Blundell and asked to see Dirks the following morning.

App. to Pet. for Cert. B-2, n. 1.

⁴The Court's implicit suggestion that Dirks' did not gain by this selective dissemination of advice, *ante*, at 2, n. 2, is inaccurate. The ALJ found that because of Dirks' information, Boston Company Institutional Investors, Inc., directed business to Delafield Childs that generated approximately \$25,000 in commissions. App. 199, 204-205. While it is true that the exact economic benefit gained by Delafield Childs due to Dirks' activities is unknowable because of the structure of compensation in the securities market, there can be no doubt that Delafield and Dirks gained both monetary rewards and enhanced reputations for "looking after" their clients.

Trading was halted by the New York Stock Exchange at about the same time Dirks was talking to Los Angeles SEC personnel. The next day, March 28, the SEC suspended trading in Equity Funding securities. By that time, Dirks' clients had unloaded close to \$15 million of Equity Funding stock and the price had plummeted from \$26 to \$15. The effect of Dirks' selective dissemination of Secrist's information was that Dirks' clients were able to shift the losses that were inevitable due to the Equity Funding fraud from themselves to uninformed market participants.

II

A

No one questions that Secrist himself could not trade on his inside information to the disadvantage of uninformed shareholders and purchasers of Equity Funding securities. See Brief for United States as *Amicus Curiae* 19, n. 12. Unlike the printer in *Chiarella*, Secrist stood in a fiduciary relationship with these shareholders. As the Court states, *ante*, at 5, corporate insiders have an affirmative duty of disclosure when trading with shareholders of the corporation. See *Chiarella*, 445 U. S., at 227. This duty extends as well to purchasers of the corporation's securities. *Id.*, at 227, n. 8, citing *Gratz v. Claghton*, 187 F. 2d 46, 49 (CA2), cert. denied, 341 U. S. 920 (1951).

The Court also acknowledges that Secrist could not do by proxy what he was prohibited from doing personally. *Ante*, at 12; *Mosser v. Darrow*, 341 U. S. 267, 272 (1951). But this is precisely what Secrist did. Secrist used Dirks to disseminate information to Dirks' clients, who in turn dumped stock on unknowing purchasers. Secrist thus intended Dirks to injure the purchasers of Equity Funding securities to whom Secrist had a duty to disclose. Accepting the Court's view of tippee liability,⁶ it appears that Dirk's knowledge of this

⁶ I interpret the Court's opinion to impose liability on tippees like Dirks

breach makes him liable as a participant in the breach after the fact. *Ante*, at 12, 19; *Chiarella*, 445 U. S., at 230, n. 12.

B

The Court holds, however, that Dirks is not liable because Secrist did not violate his duty; according to the Court, this is so because Secrist did not have the improper purpose of personal gain. *Ante*, at 15-16, 18-19. In so doing, the Court imposes a new, subjective limitation on the scope of the duty owed by insiders to shareholders. The novelty of this limitation is reflected in the Court's lack of support for it.⁶

The insider's duty is owed directly to the corporation's shareholders.⁷ See *Langevoort, Insider Trading and the Fi-*

when the tippee knows or has reason to know that the information is material and nonpublic and was obtained through a breach of duty by selective revelation or otherwise. See *In re Investors Management Co.*, 44 S. E. C. 633, 641 (1971).

⁶The Court cites only a footnote in an SEC decision and Professor Brudney to support its rule. *Ante*, at 15-16. The footnote, however, merely identifies one result the securities laws are intended to prevent. It does not define the nature of the duty itself. See n. 9, *infra*. Professor Brudney's quoted statement appears in the context of his assertion that the duty of insiders to disclose prior to trading with shareholders is in large part a mechanism to correct the information available to noninsiders. Professor Brudney simply recognizes that the most common motive for breaching this duty is personal gain; he does not state, however, that the duty prevents only personal aggrandizement. *Insiders, Outsiders, and Informational Advantages Under the Federal Securities Laws*, 93 Harv. L. Rev. 322, 345-348 (1979). Surely, the Court does not now adopt Professor Brudney's access-to-information theory, a close cousin to the equality-of-information theory it accuses the SEC of harboring. See *ante*, at 8-10.

⁷The Court correctly distinguishes this duty from the duty of an insider to the corporation not to mismanage corporate affairs or to misappropriate corporate assets. *Ante*, at 5, n. 9. That duty also can be breached when the insider trades in corporate securities on the basis of inside information. Although a shareholder suing in the name of the corporation can recover for the corporation damages for any injury the insider causes by the breach

duciary Principle: A Post-*Chiarella* Restatement, 70 Calif. L. Rev. 1, 5 (1982); 3A W. Fletcher, Private Corporations §1168.2, pp. 288-289 (1975). As *Chiarella* recognized, it is based on the relationship of trust and confidence between the insider and the shareholder. 445 U. S., at 228. That relationship assures the shareholder that the insider may not take actions that will harm him unfairly.⁸ The affirmative duty of disclosure protects against this injury. See *Pepper v. Litton*, 308 U. S. 295, 307, n. 15 (1939); *Strong v. Rapide*, 213 U. S. 419, 431-434 (1909); see also *Chiarella*, 445 U. S., at 228, n. 10; cf. *Pepper*, 308 U. S., at 307 (fiduciary obligation to corporation exists for corporation's protection).

C

The fact that the insider himself does not benefit from the breach does not eradicate the shareholder's injury.⁹ Cf. Re-

of this distinct duty, *Diamond v. Oreamuno*, 24 N. Y. 2d 494, 498, 248 N. E. 2d 910, 912 (1969); see *Thomas v. Roblins Industries, Inc.*, 520 F. 2d 1393, 1397 (CA3 1975), insider trading generally does not injure the corporation itself. See Langevoort, Insider Trading and the Fiduciary Principle: A Post-*Chiarella* Restatement, 70 Calif. L. Rev. 1, 2, n. 5, 28, n. 111 (1982).

⁸As it did in *Chiarella*, 445 U. S., at 226-229, the Court adopts the *Cady, Roberts* formulation of the duty. *Ante*, at 5-6.

"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 re Cady, Roberts & Co.*, 40 S. E. C. 907, 912 (1961) (footnote omitted).

The first element—on which *Chiarella's* holding rests—establishes the type of relationship that must exist between the parties before a duty to disclose is present. The second—not addressed by *Chiarella*—identifies the harm that the duty protects against: the inherent unfairness to the shareholder caused when an insider trades with him on the basis of undisclosed inside information.

⁹Without doubt, breaches of the insider's duty occur most often when an insider seeks personal aggrandizement at the expense of shareholders.

statement (Second) of Trusts § 205, Comments c and d (1959) (trustee liable for acts causing diminution of value of trust); 3 A. Scott on Trusts § 205, p. 1665 (1967) (trustee liable for any losses to trust caused by his breach). It makes no difference to the shareholder whether the corporate insider gained or intended to gain personally from the transaction; the shareholder still has lost because of the insider's misuse of nonpublic information. The duty is addressed not to the insider's motives,¹⁰ but to his actions and their consequences on the shareholder. Personal gain is not an element of the breach of this duty.¹¹

Because of this, descriptions of the duty to disclose are often coupled with statements that the duty prevents unjust enrichment. See, e. g., *In re Cady, Roberts & Co.*, 40 S. E. C. 907, 912, n. 15 (1961); Langevoort, 70 Calif. L. Rev., at 19. Private gain is certainly a strong motivation for breaching the duty.

It is, however, not an element of the breach of this duty. The reference to personal gain in *Cady, Roberts* for example, is appended to the first element underlying the duty which requires that an insider have a special relationship to corporate information that he cannot appropriate for his own benefit. See n. 8, *supra*. It does not limit the second element which addresses the injury to the shareholder and is at issue here. See *ibid*. In fact, *Cady, Roberts*, describes the duty more precisely in a later footnote: "In the circumstances, [the insider's] relationship to his customers was such that he would have a duty not to take a position adverse to them, not to take secret profits at their expense, not to misrepresent facts to them, and in general to place their interests ahead of his own." 40 S. E. C., at 916, n. 31. This statement makes clear that enrichment of the insider himself is simply one of the results the duty attempts to prevent.

¹⁰Of course, an insider is not liable in a Rule 10b-5 administrative action unless he has the requisite scienter. *Aaron v. SEC*, 446 U. S. 680, 691 (1980). He must know or intend that his conduct violate his duty. Secrist obviously knew and intended that Dirks would cause trading on the inside information and that Equity Funding shareholders would be harmed. The scienter requirement addresses the intent necessary to support liability; it does not address the motives behind the intent.

¹¹The Court seems concerned that this case bears on insiders' contacts with analysts for valid corporate reasons. *Ante*, at 10-11. It also fears that insiders may not be able to determine whether the information transmitted is material or nonpublic. *Id.*, at 14-15. When the disclosure is to

This conclusion is borne out by the Court's decision in *Mosser v. Darrow*, 341 U. S. 267 (1951). There, the Court faced an analogous situation: a reorganization trustee engaged two employee-promoters of subsidiaries of the companies being reorganized to provide services that the trustee considered to be essential to the successful operation of the trust. In order to secure their services, the trustee expressly agreed with the employees that they could continue to trade in the securities of the subsidiaries. The employees then turned their inside position into substantial profits at the expense both of the trust and of other holders of the companies' securities.

The Court acknowledged that the trustee neither intended to nor did in actual fact benefit from this arrangement; his motives were completely selfless and devoted to the companies. 341 U. S., at 275. The Court, nevertheless, found the trustee liable to the estate for the activities of the employees he authorized.¹² The Court described the trustee's defalca-

an investment banker or some other adviser, however, there is normally no breach because the insider does not have scienter: he does not intend that the inside information be used for trading purposes to the disadvantage of shareholders. Moreover, if the insider in good faith does not believe that the information is material or nonpublic, he also lacks the necessary scienter. *Ernst & Ernst v. Hochfelder*, 425 U. S. 185, 197 (1976). In fact, the scienter requirement functions in part to protect good faith errors of this type. *Id.*, at 211, n. 31.

Should the adviser receiving the information use it to trade, it may breach a separate contractual or other duty to the corporation not to misuse the information. Absent such an arrangement, however, the adviser is not barred by Rule 10b-5 from trading on that information if it believes that the insider has not breached any duty to his shareholders. See *Walton v. Morgan Stanley & Co.*, 623 F. 2d 796, 798-799 (CA2 1980).

The situation here, of course, is radically different. *Ante*, at 11, n. 17 (Dirks received information requiring no analysis "as to its market relevance"). Secrist divulged the information for the precise purpose of causing Dirks' clients to trade on it. I fail to understand how imposing liability on Dirks will affect legitimate insider-analyst contacts.

¹²The duty involved in *Mosser* was the duty to the corporation in trust

tion as "a willful and deliberate setting up of an interest in employees adverse to that of the trust." *Id.*, at 272. The breach did not depend on the trustee's personal gain, and his motives in violating his duty were irrelevant; like Secrist, the trustee intended that others would abuse the inside information for their personal gain. Cf. *Dodge v. Ford Motor Co.*, 204 Mich. 459, 506-509, 170 N. W. 668, 684-685 (1919) (Henry Ford's philanthropic motives did not permit him to set Ford Motor Company dividend policies to benefit public at expense of shareholders).

As *Mosser* demonstrates, the breach consists in taking action disadvantageous to the person to whom one owes a duty. In this case, Secrist owed a duty to purchasers of Equity Funding shares. The Court's addition of the bad purpose element to a breach of fiduciary duty claim is flatly inconsistent with the principle of *Mosser*. I do not join this limitation of the scope of an insider's fiduciary duty to shareholders.¹³

not to misappropriate its assets. This duty, of course, differs from the duty to shareholders involved in this case. See n. 7, *supra*. Trustees are also subject to a higher standard of care than scienter. 3 A. Scott on Trusts § 201, p. 1650 (1967). In addition, strict trustees are bound not to trade in securities at all. See *Langevoort*, 70 Calif. L. Rev., at 2, n. 5. These differences, however, are irrelevant to the principle of *Mosser* that the motive of personal gain is not essential to a trustee's liability. In *Mosser*, as here, personal gain accrued to the tippees. See 341 U. S., at 273.

¹³ Although I disagree in principle with the Court's requirement of an improper motive, I also note that the requirement adds to the administrative and judicial burden in Rule 10b-5 cases. Assuming the validity of the requirement, the SEC's approach—a violation occurs when the insider knows that the tippee will trade with the information, Brief for SEC 31—can be seen as a presumption that the insider gains from the tipping. The Court now requires a case-by-case determination, thus prohibiting such a presumption.

The Court acknowledges the burdens and difficulties of this approach, but asserts that a principle is needed to guide market participants. *Ante*, at 16. I fail to see how the Court's rule has any practical advantage over the SEC's presumption. The Court's approach is particularly difficult to

III

The improper purpose requirement not only has no basis in law, but it rests implicitly on a policy that I cannot accept. The Court justifies Secrist's and Dirks' action because the general benefit derived from the violation of Secrist's duty to shareholders outweighed the harm caused to those shareholders, see Heller, *Chiarella*, SEC Rule 14e-3 and *Dirks*: "Fairness" versus Economic Theory, 37 Bus. Lawyer 517, 550 (1982); Easterbrook, *Insider Trading, Secret Agents, Evidentiary Privileges, and the Production of Information*, 1981 S. Ct. Rev. 309, 338—in other words, because the end justified the means. Under this view, the benefit conferred on society by Secrist's and Dirks' activities may be paid for with the losses caused to shareholders trading with Dirks' clients.¹⁴

administer when the insider is not directly enriched monetarily by the trading he induces. For example, the Court does not explain why the benefit Secrist obtained—the good feeling of exposing a fraud and his enhanced reputation—is any different from the benefit to an insider who gives the information as a gift to a friend or relative. Under the Court's somewhat cynical view, gifts involve personal gain. See *ibid.* Secrist surely gave Dirks a gift of the commissions Dirks made on the deal in order to induce him to disseminate the information. The distinction between pure altruism and self-interest has puzzled philosophers for centuries; there is no reason to believe that courts and administrative law judges will have an easier time with it.

¹⁴This position seems little different from the theory that insider trading should be permitted because it brings relevant information to the market. See H. Manne, *Insider Trading and the Stock Market* 59-76, 111-146 (1966); Manne, *Insider Trading and the Law Professors*, 23 Vand. L. Rev. 547, 565-576 (1970). The Court also seems to embrace a variant of that extreme theory, which postulates that insider trading causes no harm at all to those who purchase from the insider. *Ante*, at 18, n. 27. Both the theory and its variant sit at the opposite end of the theoretical spectrum from the much maligned equality-of-information theory, and never have been adopted by Congress or ratified by this Court. See Langevoort, 70 Calif. L. Rev., at 1 and n. 1. The theory rejects the existence of any enforceable principle of fairness between market participants.

Although Secrist's general motive to expose the Equity Funding fraud was laudable, the means he chose were not. Moreover, even assuming that Dirks played a substantial role in exposing the fraud,¹⁵ he and his clients should not profit from the information they obtained from Secrist. Misprision of a felony long has been against public policy. *Branzburg v. Hayes*, 408 U. S. 665, 696-697 (1972); see 18 U. S. C. § 4. A person cannot condition his transmission of information of a crime on a financial award. As a citizen, Dirks had at least an ethical obligation to report the information to the proper authorities. See *ante*, at 13, n. 20. The Court's holding is deficient in policy terms not because it fails to create a legal norm out of that ethical norm, see *ibid.*, but because it actually rewards Dirks for his aiding and abetting.

Dirks and Secrist were under a duty to disclose the information or to refrain from trading on it.¹⁶ I agree that disclosure in this case would have been difficult. *Ante*, at 13, n. 20. I also recognize that the SEC seemingly has been less than helpful in its view of the nature of disclosure necessary to satisfy the disclose-or-refrain duty. The Commission tells persons with inside information that they cannot trade on that information unless they disclose; it refuses, however, to

¹⁵ The Court uncritically accepts Dirks' own view of his role in uncovering the Equity Funding fraud. See *ante*, at 11, n. 17. It ignores the fact that Secrist gave the same information at the same time to state insurance regulators, who proceeded to expose massive fraud in a major Equity Funding subsidiary. The fraud surfaced before Dirks ever spoke to the SEC.

¹⁶ Secrist did pass on his information to regulatory authorities. His good but misguided motive may be the reason the SEC did not join him in the administrative proceedings against Dirks and his clients. The fact that the SEC, in an exercise of prosecutorial discretion, did not charge Secrist under Rule 10b-5 says nothing about the applicable law. Cf. *ante*, at 18, n. 25 (suggesting otherwise). Nor does the fact that the SEC took an unsupportable legal position in proceedings below indicate that neither Secrist nor Dirks is liable under any theory. Cf. *ibid.* (same).

tell them how to disclose.¹⁷ See *In re Faberge, Inc.*, 45 S. E. C. 249, 256 (1973) (disclosure requires public release through public media designed to reach investing public generally). This seems to be a less than sensible policy, which it is incumbent on the Commission to correct. The Court, however, has no authority to remedy the problem by opening a hole in the congressionally mandated prohibition on insider trading, thus rewarding such trading.

IV

In my view, Secrist violated his duty to Equity Funding shareholders by transmitting material nonpublic information to Dirks with the intention that Dirks would cause his clients to trade on that information. Dirks, therefore, was under a duty to make the information publicly available or to refrain from actions that he knew would lead to trading. Because Dirks caused his clients to trade, he violated § 10(b) and Rule 10b-5. Any other result is a disservice to this country's attempt to provide fair and efficient capital markets. I dissent.

¹⁷ At oral argument, the SEC's view was that Dirks' obligation to disclose would not be satisfied by reporting the information to the SEC. Tr. of Oral Arg. 27, quoted *ante*, at 13, n. 20. This position is in apparent conflict with the statement in its brief that speaks favorably of a safe harbor rule under which an investor satisfies his obligation to disclose by reporting the information to the Commission and then waiting a set period before trading. Brief for SEC 43-44. The SEC, however, has neither proposed nor adopted a rule to this effect, and thus persons such as Dirks have no real option other than to refrain from trading.

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE HARRY A. BLACKMUN

June 28, 1983

Re: No. 82-276 - Dirks v. SEC

Dear Lewis:

In response to the changes made in your third draft, I shall make the following changes in the dissent:

1. The opening paragraph of footnote 6 will be made to read:

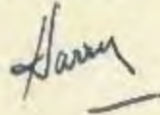
"⁶The Court cites only a footnote in an SEC decision and Professor Brudney to support its rule. Ante, at 15-16. The footnote, however, merely identifies one result the securities laws are intended to prevent. It does not define the nature of the duty itself. See n. 9, infra. Professor Brudney's quoted statement ..."

2. I shall add the following to my footnote 14, immediately following "(1970)" on the fifth line:

"The Court also seems to embrace a variant of that extreme theory, which postulates that insider trading causes no harm at all to those who purchase from the insider. Ante, at 18, n. 27. Both the theory and its variant sit at the opposite end of the theoretical spectrum from the much maligned equality-of-information theory, and have never been adopted by Congress or ratified by this Court. See Langevoort, 70 Calif. L. Rev. ..."

Apart from these changes, I am content.

Sincerely,



Justice Powell

cc: The Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE THURGOOD MARSHALL

June 28, 1983

Re: No. 82-276-Dirks v. Securities and Exchange
Commission

Dear Harry:

Please join me in your dissent.

Sincerely,

T.M.
T.M.

Justice Blackmun

cc: The Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE JOHN PAUL STEVENS

June 28, 1983 *Done*

Re: 82-276 - Dirks v. Securities & Exchange
Commission

Dear Lewis:

The last paragraph in your footnote 27 which begins on page 19 and runs over onto page 20 troubles me somewhat. I think there may be a causal connection between insider trading and outsiders' losses in some situations. I wonder, therefore, if you really need that last paragraph and would consider either omitting it, or perhaps just omitting the reference to the Sixth Circuit case.

It seems to me that you have effectively answered Harry in the earlier portions of that footnote.

Respectfully,

JP

Justice Powell

*This is a case
that was mentioned yesterday.*

lfp/ss 06/30/83 82-276 Dirks v. SEC

This is an appeal from the United States Court of Appeals for the District of Columbia.

Petitioner Dirks was an officer of a broker-dealer. ~~The~~^{He} specialized in insurance securities. Ronald Secrist, /a former officer of Equity Funding of America, /had sought unsuccessfully to bring to the attention of the public /fraudulent practices of Equity's top management. The fraud primarily concerned insurance reserves.

Hoping that Dirks, /a specialist in insurance securities, /could assist in disclosing the fraud, Secrist gave his information to Dirks. In turn, Dirks conducted his own investigation. He urged the Wall Street Journal to publish a story, ~~and~~ ^{he} At the same time /disclosed the information to five investment advisers /who liquidated substantial holdings of Equity Funding stock.

When the authorities finally were persuaded to move, /the market value of Equity Funding stock had plummeted. The company was placed in bankruptcy.

In a subsequent proceeding by the SEC, /Dirks was found to have violated Rule 10b-5 /by disclosing the ^{allegations} ~~ations~~ of fraud to persons who traded. Dirks was censured for his conduct.

*The CA dismissed Dirks'
petition.*

The Court of Appeals dismissed Dirks' petition for review.

Since its decision in In re Cady, Roberts & Co. in 1961, the Commission - and courts - have sought to prevent corporate insiders from breaching their duty to stockholders by trading on material/non-public information. Nor could insiders/- referred to as "tipppers"/- avoid liability by conveying the information to some favored "tippee". As former Commissioner Smith write, the "focus" under Rule 10b-5 is on "policing insiders . . . rather than on policing information per se and its possession".

A tippee's liability therefore is derivative: he stands in the shoes of the tipper. In our recent decision in Chiarella we held that "a duty to disclose does not arise in the absence of a fiduciary relationship".

In this case, the SEC made no finding that Secrist breached any duty when he disclosed a massive fraud. It held, nevertheless, that Dirks - the tippee - violated 10b-5 when he passed on the information to people who traded.

It is conceded that Dirks, on his own, had no relationship with Equity stockholders. Whether a particular

*disclosure
by the insider
is a breach
of duty,*

disclosure by the insider ~~is~~^{is} a breach of duty/depends primarily on his purpose, i.e., whether the insider - the tipper - personally will benefit, directly or indirectly. Secrist gained nothing from his efforts to bring the fraud to public attention. As there was no insider breach of duty, Dirks was under no derivative duty.

Accordingly, we reverse the Court of Appeals.

Justice Blackmun has filed a dissenting opinion, in which Justices Brennan and Marshall have concurred.

82-276# Dirks v. SEC (Jim)

LFP for the Court

1st draft 5/28/83

2nd draft 6/9/83

3rd draft 6/27/83

4th draft 6/29/83

Joined by CJ, BRW, JPS, WHR, SOC
Copy to Mr. Lind 6/2/83

HAB dissent

1st draft 6/25/83

2nd draft 6/28/83

Joined by WJB, TM

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ANDREW W. VOLLMER
KATHY S. WEINMAN
BARBARA S. WELLBERRY
DAVID WESTIN
THOMAS W. WHITE
JUDITH BARRY WISH
JOHN W. ZUCKER

Mr. Henry
Reporter c
Supreme Co
United S
Washington

Dear Mr. L

The lawyers in the Dixie case from last Term have pointed out a small error in your brief. The opinion quotes the definition of "insider" information, rather than the definition of "market" information. I have suggested new language (p. 10 of the opinion). Both the old and the new language are quotations from the SEC's brief, pages 23 and 22 respectively. The brief is attached. Joe

As notice provided on the slip opinion in the above-mentioned case, we wish to inform you of a possible typographical or other formal error in that Opinion. The second paragraph of note 15, page 10, of the Opinion of the Court, states, in part:

Apparently recognizing the weakness of its argument in light of Chia-rella, the SEC attempts to distinguish that case factually as involving not "inside" information, but rather "market" information, i.e., "information generated within the company relating to its assets or earnings." Brief for Respondent 23.

However, the phrase quoted from the Brief for Respondent as a definition of "market" information, was in fact presented in the Brief of Respondent as a definition of "inside" information. Since the concept of "inside" information differs significantly from the concept of "market" or "outside" information, the Court may wish to amend the slip opinion to indicate that the quoted phrase defines

Mr. Henry C. Lind
July 6, 1983
Page Two

"inside", rather than "market" information. Indeed, the Court may wish to define "market" information in the footnote by referring to other sources, some of which are cited elsewhere in the opinion, e.g., Brudney, Insiders, Outsiders, and Informational Advantages Under the Federal Securities Laws, 93 Harv. L. Rev. 322, 329 (1979); Fleischer, Mundheim & Murphy, An Initial Inquiry into the Responsibility to Disclose Market Information, 121 U. Pa. L. Rev. 798, 799 (1973); Barry, The Economics of Outside Information and Rule 10(b)(5), 129 U. Pa. L. Rev. 1307, 1309-10 and n.11 (1981).

Sincerely,

Arthur F. Mathews

Arthur F. Mathews

Andrew B. Weissman

Andrew B. Weissman

January 3, 1984

82-276 Dirks v. Securities and Exchange Commission

MEMORANDUM TO THE CONFERENCE:

One of the lawyers in this case has written Henry Lind a letter pointing out a minor inaccuracy in n. 15, pp. 9 and 10.

In the first sentence of the second paragraph in that note, I will change the language of the "i.e." clause (p. 10) to read "information originating outside the company and usually about the supply and demand for the company's securities".

Absent dissent, I will advise Henry Lind that it is appropriate to make this change in the official reports.

L.F.P., Jr.

SS

bc: Mr. Henry Lind

Full

lfp/ss 05/14/83

Rider A, p. 26 (Dirks)

DIRKS26 SALLY-POW

The SEC, of course, has an obligated to enforce its rules against insider trading. For the reasons stated above, we think it has gone beyond any "evidence of congressional intent" in imposing its disclose-or-abstain rule in the absence of a fiduciary duty not to disclose. We think the SEC view that a duty to disclose arises from the mere possession of nonpublic market information could have a seriously inhibiting influence on the role of market analysts that the Commission itself recognizes is essential. It is commonplace for analysts to "ferret out and analyze information", see SEC Docket, at 1406, and this customarily is done by meeting with and questioning corporate officers and others who may viewed as insiders.

Information so obtained may be the basis for judgments as to the market worth of a corporation's securities. The analyst's judgment in this respect may be made available in market letters or otherwise to clients of his firm. In the very nature of the information and indeed of the stock markets themselves, such information cannot be made simultaneously to all of the corporation's stockholders or the public generally.

The line between what the corporate insider may disclose to the analyst, and what in turn the analyst properly may deduce or disclose, will not always be an easy one to draw. Yet, the SEC's rule, adopted in this case, has no limiting principle. The mere possession of inside information without regard to a breach of fiduciary duty to the corporation's stockholders, affords no

guidance either to corporate executives or market analysts.

lfp/ss 05/14/83

Rider A, p. 26 (Dirks)

(or to be included in a revision of IV)

DIRKS26 SALLY-POW

The SEC, of course, has an obligation to enforce its rules against insider trading. We also appreciate the inherent difficulties even in identifying possible violations in view of the millions of transactions on the securities exchanges. We think, however, that the Commission has gone beyond any "evidence of congressional intent," see Chiarella at p. ____, in imposing its disclose-or-abstain rule in the absence of a

fiduciary duty not to disclose. Imposing a duty to disclose merely because of possession of nonpublic

material market information could have a seriously inhibiting influence on the role of market analysts that the SEC itself recognizes is essential. It is commonplace

by its own view of what is reasonable under the circumstances.

FN 20
The obligation it seeks to impose on all those who knowingly possess material nonpublic information, ~~is~~ no legal limit, and the liability of trading types would ~~be~~ ^{be} limited only by its own view of what is reasonable under the circumstances.

21
combines sentence
- text
w/ n 21

for analysts to "ferret out and analyze information", see SEC Docket, at 1406, and this customarily is done by meeting with and questioning corporate officers and others who may ^{be} viewed as insiders. Information so obtained may be the basis for judgments as to the market worth of a corporation's securities. The analyst's judgment in this respect ~~may be~~ ^{is} made available in market letters or otherwise to clients of his firm. In the very nature of the information and indeed of the markets themselves, such information cannot be made simultaneously to all of the corporation's stockholders or the public generally.

The line between what the corporate insider may disclose to the analyst, and what in turn the analyst properly may deduce or disclose, will not -- as we ^{have said} ~~have~~ said -- always be an easy one to draw. Yet, the SEC's

rule, adopted in this case, has no limiting principle. A rule imposing liability from the mere possession and use of ~~inside~~ information without regard to ^{any} a breach of fiduciary duty to the corporation's stockholders, affords no guidance either to corporate executives or market analysts.

Jim: Something along these lines might be included in IV if we restructure our opinion as I have suggested.

2

lfp/ss 05/14/83

DIRKS

This will be a rough "shot" at revising some of the language in our critical Subpart III-B (p. 19).

B

As we have shown, a tippee's liability is derivative from a breach of duty by the insider tipper of which the tippee has notice. Thus, in order to make out a tipping case against an individual, it is first necessary to establish that the insider disclosed confidential information in violation of his fiduciary duty to shareholders. It is then necessary to show that the tippee had notice of such a violation. These can present difficult factual issues. At the outset, it must be determined whether the information was both confidential and material, questions that arise in every tipping case. When these are answered affirmatively, the question remains whether the disclosure itself constituted a violation of duty. It is clear under our Rule 10b-5 cases that liability is imposed only when one acts with scienter (cite cases). There would be no breach of duty where corporate executive inadvertently or even negligently disclosed the information relied upon. The critical

question, therefore, is whether there was an intent or purpose to disclose material nonpublic information to one who could trade on the information to the detriment of shareholders. Ascertaining intention may be difficult, but this is a familiar question often confronted by courts. There are facts and circumstances that often justify inferences of wrongful purpose. For example, there may be a relationship exists the insider and the recipient that suggests a quid pro quo from the latter, or an intention to benefit the recipient. Also, such an inference may arise where the disclosure was made at the initiative of the insider rather than by the recipient tinee.

Where a breach of fiduciary duty by the insider is established, liability may be imposed on the tinee only when he has notice of such a breach. See supra, at _____. Again, this is a question of fact that must be resolved in light of all relevant circumstances. A securities analyst, making a study of a particular corporation that includes interviews with its officers, acquires information that may form the basis of a market letter to clients. This is a typical situation, and customarily involves participants who understand their

responsibilities and adhere to them. But there are cases, of course, where the facts -- and inferences reasonable drawn from them -- demonstrate the requisite scienter on the part of both the tipper and the tpee. This is not such a case.

(Jim: If we adopt the foregoing approach, you will have to write it out more carefully, and with appropriate documentation. I would avoid, however, unnecessary elaboration. This subpart III-B would be followed by your Part IV with limited changes. For example, the first sentence in IV would be omitted.)

L.F.P., Jr.

ss

lfp/ss 05/14/83

Rider A, p. 1 (Dirks)

DIRKS1 SALLY-POW

Petitioner received material nonpublic information from "insiders" of a corporation with which he had no connection. He disclosed this information to investors and analysts who were prompted to use the information in trading in the shares of the corporation. The question is whether petitioner violated the antifraud provisions of the federal securities laws by this disclosure.

lfp/ss 05/14/83

Rider A, p. 14 (Dirks)

DIRKS14 SALLY-POW

Mere possession of inside information did not impose an obligation to disclose or abstain in Chiarella. Similarly, merely receiving information from a corporate insider is not enough to impose such an obligation. The recipient of insider information (a "tippee") cannot be "a participant after the fact", see Chairella, at n. 12, or a "constructive trustee", see n. 17, supra, unless the provider of the information (the "insider") has breached his duty to the corporation's shareholders. Moreover, the tippee must have had "notice of the violation of duty". Loss, 3, L. Loss, (?) Securities Regulations 1451 (1961).

Note to Jim and myself: If the above summary is correct, the next question analytically on the facts of this case is whether the insiders breached their duty. The answer on the facts is easy. Not even the SEC claims a breach by Secrest. Therefore this case could be decided quite narrowly on its facts. It still would be an important case, as the basic principle would be established. We would like, in addition, to make clear that the typical situation in which this question may arise is where analysts - in the normal course of their work - obtain and use confidential information. Determining whether the tipper has breached a duty and whether the tippee had notice, present two difficult questions. The standard we propose with respect to the tipper is his purpose or motive - essentially a subjective standard. It will be

even more difficult to show whether or not the tipee had notice of an improper motive. These are the questions that make this case so difficult.

File

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Rider A, p. 14 (Dirks)

DIRKS14 SALLY-POW

| ← Mere possession of inside information did not impose an obligation to disclose or abstain in Chiarella. Similarly, merely receiving information from a corporate insider is not enough to impose such an obligation. The recipient of insider information (a "tippee") cannot be "a participant after the fact", see Chairella, at n. 12, or a "constructive trustee", see n. 17, supra, unless the provider of the information (the "insider") has breached his duty to the corporation's shareholders. Moreover, the tippee must have had "notice of the violation of duty". Loss, 3, L. Loss, (?) Securities Regulations 1451 (1961).

LM
lfp/ss 05/16/83 Rider A, n. 28, p. 25 (Dirks)

DIRKS24 SALLY-POW

Consider a revision of n. 28 as follows:

We agree with the view expressed in Investor's Management Co. by Commissioner Smith. He observed that in this type of case it is "important . . . to focus on policing insiders and what they do . . . rather than on policing information per se and its possession, which I think is impracticable." See n. 19, p. 16. The root of the problem lies with the conduct of insiders, and we think emphasis should continue to be upon such conduct as it clearly was Cady Roberts.

Similarly, following the Texas Gulf Sulphur decision, Commissioner (and later Chairman) Budge spoke of

the limitation - now abandoned by the SEC - that should apply in insider trading cases under Rule 10b-5:

Turning to the realm of possible defendants in the present and potential civil actions, the Commission certainly does not contemplate suing every person who may come accross inside information. In the Texas Gulf action neither tippees nor persons in the vast rank and file of employees have been named as defendants. In my view, the Commission in future cases normally should not join rank and file employees of persons outside the company such as an analyst or reporter who learn of insider information.

Speech of Hamer Budge to the New York Regional Group of the American Society of Corporate Secretaries, Inc. (Nov. 18, 1965) (emphasis added), reprinted in Budge, The Texas Gulf Sulphur Case--What It is and What It Isn't, Corp. Secretary No. 127, at 6 (Dec. 17, 1965).

Jim - There re-emphasize H&B's strength: actual benefit to come & injury to others.

RIDER B (p19)

The dissenting opinion talks at length about shareholder "losses," "injury," and "damages" without identifying the exact harm that the shareholders suffered. See post, at 4, 7, 8, 11. Some insight into the dissent's concern can be seen in its assertion that "[t]he effect of Dirks' selective dissemination of Secrist's information was that Dirks' clients were able to shift the losses that were inevitable due to the Equity Funding fraud from themselves to uninformed market participants." Id., at 4. As a descriptive matter, the dissent is correct, but the legal significance of that conclusion is difficult to understand. As the dissent notes, the special obligation on insiders [effectively] is a duty not to trade at all on material nonpublic information. Id., at 12-13. And once it is conceded that there is no duty to disclose absent trading, it is hard to escape the conclusion in Fridrich v. Bradford, 542 F.2d 307, 318 (CA6 1976), cert. denied, 429 U.S. 1053 (1977), *concluded as a general matter* that there is no causal connection between inside trading and outsiders' losses:

"Investors must be prepared to accept the risk of trading in an open market without complete or always accurate information." *Thus,*

There can be no argument that Secrist and Dirks created new

"victims" by disclosing the information to persons who traded. If

In fact anything, they prevented the fraud from continuing and *victimizing* growing to

include many more investors. *One well may doubt, therefore,* Indeed, it is difficult to understand

how Secrist and Dirks' silence on the existence of the Equity

Funding fraud would have served "this country's attempt to provide

fair and efficient capital markets." Post, at 14.

In one sense as market values fluctuate, there always are winners and losers (victims). Thus, there is little legal significance to the dissent's

intentionally
finding a breach of fiduciary duty
whenever inside information is disclosed

RIDER C

JUSTICE BLACKMUN's dissenting opinion agrees with us that the SEC's legal position in the proceedings below is "unsupportable," but adopts ~~the SEC's~~ ^{the} new theory ^{belatedly advanced by the SEC in these} of the case. But by presumptively making all disclosures that ~~are intended to~~ facilitate trading breaches of fiduciary duty, the dissenting opinion effectively would achieve the same result as the SEC's old theory, i. e., ^{mere} possession of inside information while trading would be a Rule 10b-5 violation. That ~~all~~ disclosures of inside information are ^{not} breaches of fiduciary duty, clearly is not correct, see p. 14, supra, but even if, ^{this were true,} it were, the Court has rejected the view that all breaches of corporate fiduciary duties are violations of the federal securities laws, see Santa Fe Industries, Inc. v. Green, 430 U.S. 462, 472-474 (1977); p. 6, supra. ^{There is no evidence that Secrist} It is difficult to see how Secrist manipulated or ^{intended to "deceive or defraud" anyone.} deceived anyone in this case. Transmission of material nonpublic information with ^{knowledge} the intention that others will trade on ^{it} that information is simply not enough, without more, to ^{establish a} show the breach of an insider's duty to the corporation's shareholders.

cite Ernst

RIDER E

Too
marginal use
for use in a
court opinion

The dissenting opinion makes some policy arguments to support its view that that our decision "actually rewards Dirks for his aiding and abetting," post, at 12, and that there is a legal duty "not to condition ... transmission of information of a crime on a financial award," id. It ^{would be} ~~is~~ a novel view for a society premised on individual freedom ^{and incentive}, however, that Government's failure to punish an activity is the same as rewarding the participants. And William Blundell, who was nominated for a Pulitzer Prize for his coverage of the Equity Funding scandal, see 681 F.2d, at 832 (Wright, J.), as well as many other reporters, might be surprised to learn that reporting of criminal activity for a livelihood violates public policy.

RIDER D

Too
marginal
to use

The dissenting opinion is concerned that the requirement that the insider must personally gain before he breaches his Cady, Roberts duty will add a significant administrative and judicial burden in Rule 10b-5 cases. See post, at 10-11, n. 13. Although we preclude the SEC's use of a presumption that the insider necessarily violates his fiduciary duty when the insider knows that the tippee will trade with the information, we certainly do not discourage the SEC from all uses of presumptions to facilitate its prosecution of inside-trading cases. The voluntary disclosure of material nonpublic information might be, for example, presumptively a breach where the informant clearly had a motive for favoring the recipient, e. g., familial or personal relationships. Such presumptions would, of course, be rebuttable.

Jim: When does this go?

RIDER A (p 4)

JUSTICE BLACKMUN's dissenting opinion minimizes the role Dirks played in making public the Equity Funding fraud. See post, at 3 and 12, n. 15. The dissent ~~stands practically alone in its effort~~^{would} ~~to~~ rewrite the history of Dirks' ~~extraordinary~~^{extensive painstaking} investigative efforts. See, e. g., App. 115 (testimony of Stanley Goldblum, Equity Funding's Chairman and principal architect of the fraud) (giving Dirks "personal credit" for uncovering the fraud); 21 S.E.C., at 1412 ("It is clear that Dirks played an important role in bringing [Equity Funding's] massive fraud to light, and it is also true that he reported the fraud allegation to [Equity Funding's] auditors and sought to have the information published in the Wall Street Journal."); 681 F.2d, at 829 (Wright; J.) ("Largely thanks to Dirks one of the most infamous frauds in recent memory was uncovered and exposed, while the record shows that the SEC repeatedly missed opportunities to investigate Equity Funding.").

Jim - no use quoting a crook in same
A with SEC & Skelly Wright!

lfp/ss 05/16/83 Rider A, p. (Dirks)

DIRKSB SALLY-POW

Add the substance of the following note at some
appropriate place in Part V:

On its facts, this case is the unusual one.

Dirks is an analyst in a broker-dealer firm, and he did interview management in the course of his investigation. He uncovered startling information that required no analysis or exercise of judgment as to its market relevance. The principle at issue here, extends far beyond these facts. As we note above, the SEC's rule - applicable without regard to any breach of duty by an insider that creates a derivative duty - could have wide ramifications.

lfp/ss 05/16/83 Rider A, fn 20, p. 18 (Dirks)

DIRKS18 SALLY-POW

Suggested revision of n. 20:

The SEC's decision in this case is at odds with that of Walton v. Morgan, Stanley & Co., 623 F.2d 796 (CA2 1980). The defendant investment banking firm, representing one of its own corporate clients, investigated another corporation that was a possible target of a takeover bid by its client. In the course of negotiations the investment banking firm was given, on a confidential basis, unpublished material information. Subsequently, after the proposed takeover was abandoned, the firm was charged with relying on the information when it traded in the target corporation's stock. Apparently it was conceded that the firm knew the information was confidential, but it had been received in arm's length negotiations. In the absence of any fiduciary relationship, the Court of Appeals found no basis for

imposing a tippee liability on the investment firm. See

id., at 799.

May 23, 1983

82-276 Dirks v. SEC

Rider A, page 15

As this case illustrates, all disclosures of confidential corporate information are not inconsistent with the duty insiders owe to shareholders. The more usual context in which ^{there is a question whether disclosure violates} ~~the question of insider duty may~~ ^{insiders disclose information to} ~~rise~~ is when security analysts [↑] receive corporate ~~information from insiders.~~ See n. 16 [↑] supra. It may not be clear - either to the corporate insider or to the recipient analyst - whether the information will be viewed as material nonpublic ^{it} information. There may be situations ✓ where both the insider and the analyst recipient have acted in good faith, and yet release of the information affected the market. Whether disclosure is a breach of duty therefore depends in large part on the purpose or good faith of the insider who made the disclosure. Absent an improper purpose, there has been no breach of duty to stockholders - e.g., a corporate official mistakenly thinks the information already has been disclosed or that it is not material enough to affect the market. And ~~in~~ ^{the absence of} ¹ ⁶ a breach by the insider, there is no derivative breach.

lfp/ss 05/23/83

Rider B, p. 15, fn. 20 (Dirks)

DIRK15B SALLY-POW

We do not suggest that knowingly trading on inside information is "socially desirable or even that it is devoid of moral considerations". Dooley, at 55. Nor do we ~~suggest~~ ^{imply} an absence of ~~all~~ ^{to} responsibility to disclose promptly indications of illegal actions by a corporation to the proper authorities - typically the SEC and Exchange authorities in cases involving securities. Depending on the circumstances, ^{and} even where permitted by law, ¹ one's trading on material nonpublic information is behavior that may fall below ethical standards of conduct adopted by professional organizations of the securities business. ^{But} ¹ In ^{statutory} an area of the law such as securities regulation, where

legal principles of general application must be applied,
there may be

lfp/ss 05/23/83

Rider A, p. 16 (Dirks)

DIRKS16 SALLY-POW

Determining the purpose of any one disclosure, a question of fact, will not always be easy. ^{But} ~~It~~ is essential, we think, to have a guiding principle: as stated by Commissioner Smith, there must be a breach of the insider's fiduciary duty. The rule adopted by the SEC in this case would have no limiting principle.²²

CFR

Full

May 23, 1983

82-276 Dirks v. SEC

Rider A, page 15

As this case illustrates, all disclosures of confidential corporate information are not inconsistent with the duty insiders owe to shareholders. The more usual context in which the question of insider duty may arise is when security analysts receive corporate information from insiders. See n. 16 supra. It may not be clear - either to the corporate insider or to the recipient analyst - whether the information will be viewed as material nonpublic[#] information. There may be situations[✓] where both the insider and the analyst recipient have acted in good faith, and yet release of the information affected the market. Whether disclosure is a breach of duty therefore depends in large part on the purpose or good faith of the insider who made the disclosure. Absent an improper purpose, there has been no breach of duty to stockholders - e.g., a corporate official mistakenly thinks the information already has been disclosed or that it is not material enough to affect the market. And ~~in~~ ⁺ the absence of a breach by the insider, there is no derivative breach.

lfp/ss 05/23/83

Rider A, p. 16 (Dirks)

DIRKS16 SALLY-POW

Determining the purpose of any one disclosure, a question of fact, will not always be easy. It is essential, we think, to have a guiding principle: as stated by Commissioner Smith, there must be a breach of the insider's fiduciary duty. The rule adopted by the SEC in this case would have no limiting principle.²²

lfp/ss 05/23/83

Rider B, p. 15, fn. 20 (Dirks)

DIRK15B SALLY-POW

We do not suggest that knowingly trading on inside information is "socially desirable or even that it is devoid of moral considerations". Dooley, at 55. Nor do we suggest an absence of all responsibility to disclose promptly indications of illegal actions by a corporation to the proper authorities - typically the SEC and Exchange authorities in cases involving securities. Depending on the circumstances, even where permitted by law one's trading on material nonpublic information is behavior that may fall below ethical standards of conduct adopted by professional organizations of the securities business. In an area of the law such as securities regulation, where

legal principles of general application must be applied,

there may be

lfp/ss 06/25/83

Rider A, p. (Dirks)

DIRKSB SALLY-POW

Consider adding a note along the following lines:

In applying Rule 10b-5, the dissent would draw a distinction impossible as a guide to conduct or to administer by courts and the SEC. It concedes that an insider is not liable under the Rule "unless he has the requisite scienter". See n. 10, post. The dissent then proposes a new definition of scienter: "[T]he scienter requirement addresses the intent necessary to support liability; it does not address the motives behind the intent." Id. Therefore, ²~~see~~ Secrist "knew and intended that Dirks would cause trading", ^(and) he possessed the requisite scienter regardless of what his motives may have been. This distinction ignores both the language of 10b-5

and the meaning of "scienter". See Ernst & Ernst v. Hochfelder, 425 U.S. 185, 197-199 (1976) (the language "manipulative", "device", and "contrivance" connote "intentional or willful conduct designed to deceive or defraud investors") Even the unique facts of this case illustrate the distinction that the dissent overlooks. Dirks certainly intended to convey relevant information that management was unlawfully concealing, and - so far as the record goes - he quite honestly believed that persuading Dirks to investigate was the best way to disclose the fraud. The dissent acknowledges that any other means of "disclosures would have been difficult", post, at 13, and yet would charge Secrist with a breach of fiduciary duty even though there was no motive to deceive or defraud investors". We recognize the inherent

difficult of determining either the intent or motive of an actor in a particular situation. Each connotes the need for a subjective inquiry. Courts, however, necessarily look to objective evidence to ascertain the statutory requirement of intent to deceive, manipulate or defraud. The standard adopted by the Court today in cases of this kind is whether the insider receives a direct or indirect personal benefit from the disclosure. Imperfect as this may be it is a standard. The dissent's distinction between "intent" and "motive" is without precedent and is standardless.

RIDER D

Scienter--"a mental state embracing intent to deceive, manipulate, or defraud," Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193, n. 12 (1976)--is an independent element of a Rule 10b-5 violation. See Aaron v. SEC, 446 U.S. 680, 695 (1980). Contrary to the dissent's suggestion, see post, at p. 7, n. 10, motivation is not irrelevant to the issue of scienter. It is not enough that an insider's conduct results in harm to investors; rather, a violation may be found only where there is "intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities." Ernst & Ernst v. Hochfelder, supra, at 199. The issue in this case, however, is not whether Secrist or Dirks acted with scienter, but rather ^{whether} there was any deceptive or fraudulent conduct at all, i.e., whether Secrist's disclosure constituted a breach of his fiduciary duty and thereby caused injury to shareholders. See n. 27, infra. Only if there was such a breach did Dirks, a tippee, acquire a fiduciary duty to disclose or abstain.

RIDER E

The dissent argues

Without the element of personal gain, we cannot agree that "Secrist violated his duty to Equity Funding shareholders by transmitting material nonpublic information to Dirks with the intention that Dirks would cause his clients to trade on that information." Post, at 12. By ~~finding~~ *perceiving* a breach of fiduciary duty whenever inside information is intentionally disclosed to securities traders, the dissenting opinion effectively would achieve the same result as the SEC's ~~theory~~ *mistaken* below, i. e., mere possession of inside information while trading ~~would be~~ *frequently would be viewed as* a Rule 10b-5 violation. The dissent agrees that an insider does not violate Rule 10b-5 unless he intend[s] that the inside information be used for trading purposes to the disadvantage of shareholders." Post, at 8, n. 11. But ~~the~~ *its* premise of the dissent is that all intentional disclosures to those who will trade ~~will be~~ *are likely to* to the disadvantage of shareholders. All ~~clear~~ *But Chiarella was explicitly* trading on and disclosures of inside information are not, however, breaches of an insider's fiduciary duty. See Chiarella, 445 U.S., at 233; p. 14, supra. ~~To be a violation of the federal securities laws, there must be fraud. See Ernst & Ernst v. Hochfelder~~ *constitute* See Chiarella, 445 U.S., at 233; p. 14, supra. ~~To be a violation of the federal securities laws, there must be fraud. See Ernst & Ernst v. Hochfelder~~ *of Rule 10b-5* 425 U.S. 185, 199 (1976) (statutory words "manipulative," "device," and "contrivance ... connote intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities") (emphasis added).

← There is no evidence that Secrist's disclosure was intended to or did in fact "deceive or defraud" anyone. Secrist certainly intended to convey relevant information that management was unlawfully concealing, and -- so far as the record shows -- he

Use language here from Chiarella p 233

Moreover,

may be

Other efforts had proved fruitless,
believed that persuading Dirks to investigate was the best way to disclose the fraud. Under any objective standard, Secrist received no direct or indirect personal benefit from the disclosure.

The dissenting opinion ~~talks at length about~~ *focuses on* shareholder "losses," "injury," and "damages," but as the court noted in Fridrich v. Bradford, 542 F.2d 307, 318 (CA6 1976), cert. denied, 429 U.S. 1053 (1977), there is no clear causal connection between inside trading and outsiders' losses: "Investors must be prepared to accept the risk of trading in an open market without complete or always accurate information." In one sense, as market values fluctuate and investors act on inevitably incomplete or incorrect information, there always are winners and losers; those who have "lost" have not been defrauded. *Inside trading for personal gain is fraudulent.*

On the other hand, and thus is a violation of the federal securities laws, because most investors would prefer to own stock where directors and officers do not secretly compensate themselves and "indulg[e themselves] to the point of dishonesty" by trading on information not available to shareholders. Dooley, *See* Enforcement of Insider Trading Restrictions, 66 Va. L. Rev. 1, 39-41, 70 (1980), ~~thus inevitably undermining market confidence.~~ *See*

See ~~no. 10, supra.~~ Thus, there is little legal significance to the dissent's argument that Secrist and Dirks created new "victims" by disclosing the information to persons who traded. In fact, they prevented the fraud from continuing and victimizing many more investors. *One well may doubt whether Secrist and Dirks' silence on the existence of the Equity Funding fraud would have served "this*

*Just -
This
investor
the reply
that they should
have gone to SEC*

country's attempt to provide fair and efficient capital markets."

Post, at 12.

Secret

Various agencies failed to act - 2

use 5 Cady, Roberts - purpose of act is eliminate⁵
or use of info. by "insiders" for
"personal advantage" (this is
incompatible with HAB's view)

6 Chevella - no gen. duty to disclose - 4
Duty does not arise from "mere
possession of info." - 6, 10

use See also p 7
→ HAB would re-write Chevella. Cf 6, 10

use 8 SEC in this case: Secret "entitled to
disclose" - 8
(distinguished last
sentence & SEC)

use 13 Commissioner Smith - "focus on insiders"
- not on policy
information. - 13

L.F.P.

Renewed
5/1/82

See memo to
Jim in addition
to editing.

job 04/30/83

FIRST DRAFT: Dirks v. SEC, No. 82-276

JUSTICE POWELL delivered the opinion of the Court.

This case presents the question whether an individual who ~~is~~ ^{has no connection with} not an officer or director of a corporation but nonetheless receives material nonpublic information concerning ongoing criminal conduct within the corporation from an officer or director violates the antifraud provisions of the federal securities laws by transmitting that information to persons who use the information to buy or sell the corporation's stock.

I

In March 1973, petitioner was an officer at a New York broker-dealer firm, providing investment analysis on insurance company securities to institutional investors. On March 6, petitioner received information from Ronald Secrist, a former officer of Equity Funding of America, a diversified company primarily engaged in selling life insurance and mutual funds, to the effect that the assets of that company were vastly overstated as the result of

fraudulent internal corporate practices. Secrist stated that regulatory agencies had failed to act on similar charges made by Equity Funding employees, and urged petitioner to verify the fraud and publicly disclose it.

Petitioner decided to investigate personally the allegations, ^{He flew} by flying to Los Angeles, where Equity Funding had its headquarters, ^{and} to interview ^{ed several officers of} employees of the company. Despite denials of wrongdoing by ^{its} Equity

~~Funding's~~ senior management, petitioner obtained substantial corroboration of the charges of fraud from current and former company employees. Neither petitioner nor his firm owned or traded any Equity Funding stock, but throughout his investigation, petitioner candidly discussed with a number of investors and analysts the progress of his investigation and the information he had obtained. Not surprisingly, some of the persons who spoke with petitioner and learned of the alleged fraud sold their holdings of Equity Funding securities. Five investment advisers who communicated with petitioner liquidated securities worth more than \$16 million.

During the entire week that petitioner was in Los

Angeles, he was in touch regularly with William Blundell, the Wall Street Journal's Los Angeles bureau chief. Petitioner urged Blundell to write a story for the Journal on the ^{fraud} ~~allegations of fraud at Equity Funding~~. Blundell, however, was afraid that publishing such damaging rumors supported only by hearsay from former employees might be libelous and declined to write the story, discounting the allegations because he did not believe that such a huge fraud could go undetected.

During the two-week period in which petitioner pursued his investigation and spread word of Secrist's charges, the price of Equity Funding stock fell precipitously from \$26 per share to less than \$15. This led the New York Stock Exchange (NYSE) to halt trading on March 27. Shortly thereafter state insurance authorities impounded Equity Funding's records and uncovered evidence of the fraud. Only then did the Securities and Exchange Commission (SEC) file a complaint against Equity Funding¹

¹As early as 1971, the SEC had received allegations of fraudulent accounting practices at Equity Funding. Moreover, on March 9, 1973, an official of the California Insurance Department informed the SEC's regional office in Los Angeles of Secrist's charges of fraud. Petitioner
Footnote continued on next page.

Jim - As this story is not likely to please the SEC or the W/S Journal, cite in notes the source ~~of~~ on which we rely.

and only then, on April 2, did the Journal publish a front page story based largely on information assembled by

petitioner. Equity Funding immediately went into receivership.²

(and after a hearing, found after investigated pett's role in the disclosure of the fraud,)

The SEC's response to these events was to find that

had petitioner aided and abetted violations of §17(a) of the

Securities Act of 1933, 15 U.S.C. §77q(a) (1976),³ §10(b)

of the Securities Exchange Act of 1934, 15 U.S.C.

§78j(b),⁴ and Commission Rule 10b-5, 17 C.F.R. §240.10b-5

himself voluntarily presented his information at the SEC's regional office beginning on March 27.

*Jim - 8
cite
source →*

²A federal grand jury in Los Angeles subsequently returned a 105-count indictment against 22 persons, including many of Equity Funding's officers and directors. Those proceedings were concluded by entry of guilty pleas or convictions after trial of all defendants for one or more of the counts against them.

³Section 17(a) provides:

"It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly--

"(1) to employ any device, scheme, or artifice to defraud, or

"(2) to obtain money or property by means of any untrue statement of a material fact or any omission 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

"(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser."

⁴Section 10(b) provides:

Footnote continued on next page.

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no transaction
in Equity stock.*

*Jim - We should expand 5.
a bit on Petr. benefited,
As I recall, he advised
institutional customers of his
firm (as well as others?)
& his firm made \$ — in connection*

(1982),⁵ when he repeated the allegations of fraud to 7

members of the investment community *including customers of his firm* who later sold their

Equity Funding stock. The Commission concluded: "Where

'tippees'--regardless of their motivation or occupation--

come into possession of material information that they

know is confidential and know or should know came from a 7

corporate insider,' they must either publicly disclose

that information or refrain from trading." 21 S.E.C.

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange--

.... "(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

⁵Rule 10b-5 provides:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

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

"(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

"(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."

Docket 1401, 1407 (1981) (footnote omitted) (quoting Chiarella v. United States, 445 U.S. 222, 230 n. 12 (1980)). Recognizing, however, that petitioner played "an important role in bringing [Equity Funding]'s massive fraud to light," 21 S.E.C. Docket, at 1412-1413, the Commission only censured petitioner for his conduct.⁶

The Court of Appeals for the District of Columbia entered a judgment without accompanying opinion, denying, "for the reasons stated by the Commission in its opinion," petitioner's petition for review of the censure order. Judge Tamm dissented from the judgment. Subsequently, Judge Wright, a member of the panel, issued an opinion. Judge Robb concurred in the result, and Judge Tamm dissented; neither filed a separate opinion. Judge Wright believed that "the obligations of corporate fiduciaries pass to all those to whom they disclose their information before it has been disseminated to the public at large."

⁶Section 15 of the Securities Exchange Act, 15 U.S.C. §78o(b)(4)(E), provides that the Commission may impose certain sanctions, including a censure, on any person associated with a registered broker-dealer who has "willfully aided [or] abetted" any violation of the federal securities laws. See 15 U.S.C. §78ff(a) (providing criminal penalties).

681 F.2d 824, 839 (1982). Alternatively, Judge Wright concluded that, as an employee of a broker-dealer, petitioner "had [violated] obligations to the SEC and to the public completely independent of any obligations he acquired" from sources at Equity Funding. Id., at 840.

We granted a writ of certiorari, ___ U.S. ___ (1982), because of the importance to the ^{SEC and the} securities industry of the question presented by this case. We now reverse the judgment of the Court of Appeals.

II

The majority rule in this country is that, while corporate officers and directors ^{have a fiduciary duty to} owe their corporation fiduciary duties to preserve its assets and to maintain its secrets, that duty does not apply to the stockholder in the sale and purchase of stock. See, e. g., Treadway Companies, Inc. v. Care Corp., 638 F.2d 357, 375-377 (CA2 1980); 3A Fletcher Cyclopedia of the Laws of Private Corporations §1168.1 (1975 & 1982 Supp.). A minority of jurisdictions, however, have recognized an independent fiduciary duty running from the corporate officers and directors to individual shareholders with whom they trade

in the corporation's stock. See, e. g., Oliver v. Oliver, 118 Ga. 362, 45 S.E. 232 (1903); Stewart v. Harris, 69 Kan. 498, 77 P. 277 (1904); 3A Fletcher, supra, §1168.2. These courts hold that, while he is not forbidden to deal with a shareholder, an officer or director's relationship of trust requires him to "inform such stockholder of the true condition of the affairs of the corporation" before trading with him. Stewart, 69 Kan., at 508, 77 P., at 281. Cf. Strong v. Repide, 213 U.S. 419, 431-435 (1909) (duty to disclose because of special circumstances).

Consistent with this latter ^{fiduciary} "agency" duty owed by insiders directly to their company's shareholders, the SEC

41 In the seminal case of In re Cady, Roberts & Co., 40 S.E.C. 907 (1961), ^{the SEC} recognized that a breach of the insiders' agency duties to shareholders also could be a violation of Rule 10b-5.⁷ The Commission acknowledged

⁷There are good reasons to view the breach of this particular common-law duty as a violation of the federal securities laws. The breach of an insider's trustee duties to the corporation are peculiarly within the corporation's ability to police, for incompetence or negligence in management, while not beneficial to any particular corporation's stock, do not undermine the integrity of the securities market as a whole. Corporations may have little incentive, on the other hand, to sanction violations of an insider's agency duties to shareholders, and the breaches of this duty are

Footnote continued on next page.

that the special obligation to disclose⁸ or abstain from trading traditionally has been required of officers, directors, and controlling stockholders, id., at 911, but did not so limit the breadth of the duty required by the federal securities laws.

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.

particularly difficult for outsiders to detect. Consequently, investors that prefer to own stock where the directors and officers do not secretly compensate themselves and "indulge themselves] to the point of dishonesty" by trading on information not available to market participants generally may have difficulty distinguishing between corporations that tolerate such practices and those that do not. See Dooley, Enforcement of Insider Trading Restrictions, 66 Va. L. Rev. 1, 39-41, 70 (1980). These dishonest acts induce investors to enter into or remain in a relationship that they would prefer to avoid, and the resulting loss of welfare inevitably undermines market confidence. See In re Faberge, Inc., 45 S.E.C. 249, 254 (1973). Thus, insider trading satisfies the legal requirements of §10b because it presupposes both investor injury and deception. See Dooley, supra, at 41. We agree with the Cady, Roberts Commission that "[a] significant purpose of the Exchange Act was to eliminate the idea that use of inside information for personal advantage was a normal emolument of corporate office." See 40 S.E.C., at 912 n. 15. See Foremost-McKesson, Inc. v. Provident Securities Co., 423 U.S. 232, 255 (1976); §16 of the Securities Act of 1934, 15 U.S.C. §78p; H.R. Rep. No. 1383, 73d Cong., 2d Sess. 13 (1934); S. Rep. No. 792, 73d Cong., 2d Sess. 3, 9 (1934).

⁸The SEC's disclosure duty is not just to the immediate purchasers or sellers: "Proper and adequate disclosure of significant corporate developments can only be effected by public release through the appropriate public media, designed to achieve a broad dissemination to the investing public generally and without favoring any special person or group." Faberge, Inc., 45 S.E.C., at 256.

*Given
Sound
reasoning
but adds
little. We
must cut
back on
the notes.*

Id., at 912 (footnote omitted). See Chiarella, 445 U.S.,
at 241 (BURGER, C.J., dissenting); In re Van Alstyne, Noel

& Co., 43 S.E.C. 1080, 1085 (1969) (noting "the inherent
unfairness involved where one, with access by virtue of a
special relationship to the issuer to material
information...intended to be available only for a
corporate purpose and not for his personal benefit, takes
advantage of such information knowing it is unavailable to
the investing public"); In re Merrill Lynch, Pierce,
Fenner & Smith, Inc., 43 S.E.C. 933, 936 (1968). Thus,
the Commission has expanded the class of individuals who
fall under the federal disclose-or-abstain obligation, and
premised the disclosure requirement simply on "(i) the
existence of a relationship affording access to inside
information intended to be available only for a corporate
purpose, and (ii) the unfairness of allowing a corporate
insider to take advantage of that information by trading
without disclosure." Chiarella, 445 U.S., at 227.⁹

⁹The Cady, Roberts conditions for imposing a duty to disclose or abstain from trading are not arbitrary limitations on the use of inside information, but are consistent with the common-law rules and grounded in the policies underlying the federal securities laws. As a
Footnote continued on next page.

*Jim -
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don't
need any of
this as
it repeats
substance
of Cady
quote on
preceding
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*Keep
this
note*

In Chiarella, we quoted with approval the Cady,
Roberts statement of the basis for the disclose-or-abstain
rule and adopted the Commission's twin elements for
finding a violation of Rule 10b-5's¹⁰ insider-trading
restrictions--a fiduciary relationship and the
exploitation of confidential information acquired as a
result of that relationship. See 445 U.S., at 227. The
Justices of this Court unanimously agreed that there is no
general duty¹¹ to make disclosure before trading with
material nonpublic information,¹² and recognized that "a

general proposition, there is no duty to disclose information to the public at large before engaging in a commercial transaction or before imparting the information to other persons. See Chiarella, 445 U.S., at 228; id., at 239-240 (BURGER, C.J., dissenting). Moreover, it is evident that stock ownership and securities trading by insiders are not necessarily detrimental to the corporation, to shareholders, or to society. Thus, the Cady, Roberts elements are simply an acknowledgement that it is only some uses of inside information, and then only under certain circumstances, that will create liability.

¹⁰Although §10(b) and §17(a) both extend to a wide variety of fraudulent practices, there are certain differences in their coverage. See Aaron v. SEC, 446 U.S. 680, 687-702 (1980). In determining whether there is a duty to disclose nonpublic information before trading or tipping, however, identical principles apply.

¹¹The Court of Appeals in Chiarella had affirmed petitioner's conviction by holding 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." 445 U.S., at 231 (emphasis in original).

¹²See 445 U.S., at 233; id., at 237 (STEVENS, J., concurring); id., at 238-239 (BRENNAN, J., concurring in the result); id., at 239-240 (BURGER, C.J., dissenting).
Footnote continued on next page.

Jim - This sentence does not expand Aaron, does it?

duty to disclose under §10(b) does not arise from the mere possession of nonpublic market information." Id., at 235. Instead, such a duty arises either from the existence of a fiduciary relationship or some act of misappropriation or conversion.¹³

Chiarella turned on the absence of a fiduciary relationship, ^{as} ~~because~~ this was the ~~one~~ element of an insider-trading violation that was missing from the case against petitioner there. ~~But~~ we also recognized ^{that it was} ~~it to~~ be the "act of trading which essentially constitutes the violation of Rule 10b-5, for it is this which brings the illicit benefit to the insider, and it is this conduct which impairs the integrity of the market and which is the target of the rule." Friedrich v. Bradford, 542 F.2d 307,

("As a general rule, neither party to an arm's-length business transaction has an obligation to disclose information to the other unless the parties stand in some confidential or fiduciary relation."); id., at 252, n. 2 (BLACKMUN, J., dissenting) (recognizing that there is no obligation to disclose material nonpublic information obtained through the exercise of "diligence or acumen" and "honest means," as opposed to "stealth").

¹³See 445 U.S., at 227-235; id., at 238-239 (BRENNAN, J., concurring in the result); id., at 239-243 (BURGER, C.J., dissenting) (duty of disclosure arises from mere possession only where information is illegally obtained); id., at 245-247 (BLACKMUN, J., dissenting) (mere possession creates duty where information not legally available to others in the investment community).

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318 (CA6 1976), cert. denied, 429 U.S. 1055 (1977). See 445 U.S., at 227; id., at 228-229 ("This relationship [between insiders and shareholders] gives rise to a duty to disclose because of the 'necessity of preventing a corporate insider from... tak[ing] unfair advantage of the uninformed minority stockholders.'" (quoting Speed v. Transamerica Corp., 99 F. Supp. 808, 829 (Del. 1951)); id., at 249 (BLACKMUN, J., dissenting) ("Both the SEC and the courts have stressed the insider's misuse of secret knowledge as the gravamen of illegal conduct."). As the Commission noted in Cady, Roberts, unjust enrichment, the insider's exploitation of information "not for the personal benefit of anyone," is also an element of a violation of the duty to disclose or abstain. Thus, an insider, because of the fiduciary status he has to the shareholders of his corporation, will be liable where he exploits material nonpublic information for personal gain and fails to disclose that information before doing so.

III

Unlike insiders who ~~typically~~ have a fiduciary relationship with the corporation's shareholders, the

I assume there was a Blackmun on the Del. Ct

and its

Jim - I assume the term "insider" is broader than "officer + director". ^{Perhaps} we should have a definitional note. Has SEC defined "insider". What about the office boy?

14.

typical tippee ^{has no such} ~~does not have a~~ fiduciary relationship ^s with. 21

the company or its shareholders. ^{view of this absence} 14 In ~~the absence of such~~

~~a~~ relationship, it ^{has been} is unclear how the tippee acquires a "duty" to refrain from trading on inside information.

What is clear is the prophylactic need for a ban on

~~at least some~~ tippee trading. Because corporate ^{insiders} ~~officers~~ 21

~~and directors~~ are forbidden by their ^{fiduciary} agency relationship

from using undisclosed corporate information to their

personal advantage, they may not give such information to

outsiders for the same improper purpose. "[T]hat which

^{these} 14 To be sure, under certain circumstances, such as where corporate information is revealed legitimately to an underwriter, accountant, or attorney working for the company, outsiders may, as a result of such relationship, become fiduciaries of the company. The basis for imposing fiduciary duties is not simply that such persons acquired nonpublic corporate information, but that they have entered into a confidential relationship in the conduct of the business of the enterprise and are given access to information solely for corporate purposes. See SEC v. Monarch Fund, 608 F.2d 938, 942 (CA2 1979); In re Investors Management Co., 44 S.E.C. 633, 645 (1971); In re Van Alostne, Noel & Co., 43 S.E.C. 1080, 1084-1085 (1969); In re Merrill Lynch, Pierce, Fenner & Smith, Inc., 43 S.E.C. 933, 937 (1968); In re Cady, Roberts & Co., 40 S.E.C., at 912. When such ^{a person} ~~trustee~~ breaches his fiduciary relationship, he may be treated more properly as a tipper than a tippee. See Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d 228, 237 (CA2 1974) (investment banker learned material information through his work on a proposed public offering for the company). For ^{such} ~~trustee~~ duties to be imposed, however, "there must be some expectation of trust and confidence with respect to the information imparted, and the person receiving the information must assent at least implicitly to the expectation." Langevoort, Insider Trading and the Fiduciary Principle: A Post-Chiarella Restatement, 70 Calif. L. Rev. 1, 30 (1982).

Jim: Good note ↑

the trustee has no right to do he has no right to authorize...." Mosser v. Darrow, 341 U.S. 267, 272 (1951). *Similarly,* *those* Further, the transactions of ~~all~~ who knowingly participate with the *fiduciary* trustee in such a breach are "as forbidden" as transactions "on behalf of the trustee himself." Id. See Jackson v. Smith, 254 U.S. 586, 589 (1921); Jackson v. Ludeling, 88 U.S. 616, 631-632 (1874). As the Court explained in Mosser, a contrary rule "would open up opportunities for devious dealings in the name of the others that the trustee could not conduct in his own." 341 U.S., at 271.¹⁵

Hence, as we noted in Chiarella, "[t]he tippee's obligation has been viewed as arising from his role as a participant after the fact in the insider's breach of a fiduciary duty." 445 U.S., at 230 n. 12.¹⁶ As the SEC

¹⁵"Either the transactions so traded could be concluded by a relative or an acquaintance of the insider, or implied understandings could arise under which reciprocal tips between insiders in different corporations could be given." SEC v. Texas Gulf Sulphur Co., 446 F.2d 1301, 1308 (CA2), cert. denied, 404 U.S. 1005 (1971).

¹⁶For this proposition, the Court cited Subcommittees of American Bar Association Section of Corporation, Banking, and Business Law, Comment Letter on Material, Non-Public Information (Oct. 15, 1973) reprinted in BNA, Securities Regulation & Law Report No. 233, at D1, D2 (Jan. 2, 1974), which states:

concedes, the tippee's duty is purely "derivative" of his 23
 informant's duty. Tr. of Oral Arg. 38. See Chiarella,
 445 U.S., at 246 (BLACKMUN, J., dissenting); Investors
Management, 44 S.E.C., at 651 (Smith, Commissioner,
 concurring in the result) ("[T]ippee responsibility must
 be related back to insider responsibility by a necessary 24
 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."). It therefore is clear that, although
 tippees may assume an insider's ~~agency~~ duties to 24
 shareholders, this is not because they receive inside
 information, ~~but~~ rather because they receive ~~it~~ ^{the}
~~information~~ improperly. As THE CHIEF JUSTICE stated in
Chiarella, a disclosure obligation should exist "when an
 informational advantage is obtained, not by superior 25
 experience, foresight, or industry, but by some unlawful

[I]t appears that the Commission's view is based upon the premise that the tippee who does trade upon such information is a participant after the fact in the tipping corporate official's breach of fiduciary duty, and, under common law principles, the tippee may be held responsible for the consequences of that breach in appropriate cases.

means." 445 U.S., at 240 (BURGER, C.J., dissenting) (emphasis added).¹⁷

When tipping properly is viewed as a means of indirectly violating the disclose-or-abstain rule, it is

~~clear that~~ the elements of a rule 10b-5 violation in a tipping case should be the same as in an insider trading

case. Thus, just as possession of inside information did

not impose an obligation to disclose or abstain in

Chiarella, so being a "tippee" of corporate insiders is

not enough to inherit such a duty. In other words, the

simple release of information may violate trustee duties

to the company, but it violates no obligations running

¹⁷Professor Loss has traced tippee liability to the concept in the law of restitution that "[w]here a fiduciary in violation of his duty to the beneficiary communicates confidential information to a third person, the third person, if he had notice of the violation of duty, holds upon a constructive trust for the beneficiary any profit which he makes through the use of such information." 3 L. Loss, Securities Regulation 1451 (1961) (quoting Restatement of Restitution §201(2) (1937)). Other authorities have likewise expressed the view that tippee liability exists only where there has been a breach of trust by an insider. See, e.g., Ross v. Licht, 263 F. Supp. 395, 410 (SDNY 1973); Brudney, Insiders, Outsiders, and Informational Advantages Under the Federal Securities Laws, 93 Harv. L. Rev. 322, 348 (1979); Fleischer, Mundheim & Murphy, An Initial Inquiry Into the Responsibility to Disclose Market Information, 121 U. Pa. L. Rev. 798, 818 n. 76 (1973) ("The extension of rule 10b-5 restrictions to tippees of corporate insiders can best be justified on the theory that they are participating in the insider's breach of his fiduciary duty.").

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A

The Commission's position, as stated in its opinion, is that "tippees such as [petitioner] who receive non-public material information from insiders become 'subject to the same duty as [the] insider,'" 21 S.E.C. Docket, at 1410 n. 42 (quoting Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d 228, 237 (CA2 1974) (quoting Ross v. Licht, 263 F. Supp., at 410)), and that "a tippee breaches the fiduciary duty which he assumes from the insider when the tippee knowingly transmits the information to someone who will probably trade on the basis thereof," 21 S.E.C. Docket, at 1410 n. 42. The outsider, by simply possessing nonpublic information while trading with a shareholder, is thus a participant in the insider's breach of duty to the shareholder and violates an his inherited obligation to the shareholder when he is on notice that the insider himself is disabled from using the information without disclosure.

Courts are not free to "disregard [an] agency's view" of one of its statutes and to construe the statute based

June - Does the SEC's view require an insider breached notice thereof by the tippee? I don't think so. We say later that Secret is not accused of breach of duty. Cf n 18 on next page.

on their "own view of what would best serve the purpose and policy" of the statute. See Federal Election Commission v. Democratic Senatorial Campaign Committee, 454 U.S. 27, 36 (1981). The SEC's theory here,¹⁸ however, differs little from ~~the SEC's~~ ^{its view} theory that we rejected as inconsistent with congressional intent in Chiarella. In essence, the Commission's position is that ^a ~~the~~ duty to disclose or abstain ^{arose} ~~passed~~ automatically ^{when} ~~to~~ petitioner

^{formerly}
¹⁸The SEC itself has recognized that tippee liability properly is imposed only in circumstances where the "tippee" knows, or has reason to know, that the insider has improperly disclosed inside corporate information. In Investors Management Co., the Commission stated that in finding tippee liability one element is that the tippee knew or had reason to know "that the information was non-public and had been obtained improperly by selective revelation or otherwise." Id., at 641 (emphasis added). Commissioner Smith, concurring in Investors Management, expressly read this test to mean that before a tippee can be held liable it must be shown that he received information in breach of an insider's duty not to disclose it. Id., at 649 (warning against interpretations that would "penalize or thwart the quest for new knowledge by analysts and researchers"). Indeed, before this case, the Commission apparently never held that tippee liability may be imposed where there has been no breach of fiduciary duty by the insider.

What the Commission has said is that a recipient of the information need not have "actual knowledge that the information was disclosed in a breach of fiduciary duty not to reveal it." Faberge, Inc., 45 S.E.C., at 256 (emphasis added). See Investors Management Co., 44 S.E.C., at 643. These statements simply indicate that a breach of duty by the insider is required, but that constructive knowledge of the breach will suffice. The imposition of tippee liability under such circumstances is thus nothing more than an application of the well-accepted common-law principle that one who acquires nonpublic information through participation in a breach of duty may become a "constructive trustee" with fiduciary duties with respect to that information. See 5 A. Scott, Scott on Trusts §506, at 3569-3570 (1967).

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received from Secret regardless
with the inside information, and the mere act of disclosure
of whether the latter had breached his duty.
of nonpublic information by corporate insiders, regardless

of how proper and legal, conferred on petitioner duties of 29

In short the SEC held
disclosure. In holding, however, that the mere possession

of nonpublic material information does not give^s rise to a

duty to disclose, see 445 U.S., at 235, we in Chiarella

The Court explicitly declined to find
specifically refused to find

a general duty between all participants in 30
market transactions to forgo actions based on
material, nonpublic information. Formulation of
such a broad duty, which departs radically from
the established doctrine that arises from a
specific relationship between two 30
parties...should not be undertaken absent some
explicit evidence of congressional intent.

Id., at 233. 31

We therefore ~~once~~ again must reject the SEC's
imposition of the abstain-or-disclose obligation on anyone

who
that knowingly possesses material nonpublic information

and trades. As we noted in Chiarella, adopting the SEC's

rule could have consequences *well* far beyond any that we have 31

assurance Congress intended. By imposing the abstain-or-

disclosure obligation on all who knowingly come into

possession of material nonpublic information, the

would affect adversely
~~Commission~~ endangers the normal and beneficial market-

June - ~~11-12-23~~ pp 21-23, overargue
the ~~role~~ role of market analysts.
There is an imp. point but SEC
doesn't really deny ~~the~~ their importance
~~try~~ Try condensing this.

facilitating functions of many persons engaged in 32

maintaining an orderly securities market. To require

market participants to cease trading in a particular

security any time they knowingly possess nonpublic

information could, ~~bring the entire market~~ ^{affect adversely the} for that

security, ~~to a halt~~. We have no reason to assume that 32

Congress intended such a ~~dramatic~~ ^{drastic} result. Although we

scrutinize the trading activities of insiders and their

confederates, we have had no reason to consider ^{that} the

advantages that market professionals ^{may} gain in their normal

roles ~~as hostile to~~ ^{are incompatible with} the provisions or objectives of the 33

federal securities laws.¹⁹

But not only could the Commission's tippee-trading

¹⁹As this Court recognized in Chiarella, 445 U.S., at 233, Congress has expressly exempted ^{certain} many market professionals from the general statutory prohibition set forth in §11(a)(1) of the Act, 15 U.S.C. §78k(a)(1), against members of a national securities exchange trading for their own account. We specifically observed, 445 U.S., at 233 n. 16, that "[t]he exception is based upon Congress' recognition that [market professionals] contribute to a fair and orderly marketplace at the same time they exploit the informational advantage that comes from their possession of [nonpublic information]." As the Commission itself has recognized, "market professionals have been permitted to enjoy these market information and competitive advantages because they have obligations to the markets for the securities that they trade and have made significant contributions to the continuity, liquidity and depth of the markets for these securities." SEC, Report of the Special Study of the Options Markets, House Comm. on Int. and For. Commerce, Comm. Print No. IFC3, 96th Cong., 1st Sess. 1-4 (1978).

rules impair market orderliness, they also could penalize analytical excellence and, indeed, would place in jeopardy those analysts who have sufficient insight to observe values not generally perceived or to recognize the existence of unsoundness or even fraud in securities before the common crowd.²⁰ As the entire federal securities law structure manifests, public policy favors the unfettered dissemination of information, and this is especially true where the information concerns criminal fraud within the corporation. Yet the resources available to government law enforcement agencies to investigate all

²⁰The SEC here also recognized the positive side to information-gathering by securities analysts: "The value to the entire market of these efforts cannot be gainsaid; market efficiency in pricing is significantly enhanced by such initiatives to ferret out and analyze information, and thus the analyst's work redounds to the benefit of the investors." 21 S.E.C. Docket, at 1406. Accordingly, the Commission acknowledges the need to accommodate the two goals of market efficiency and fairness, and would permit analysts to "utilize non-public, inside information which in itself is immaterial in order to fill in 'interstices in analysis.'" 21 S.E.C. Docket, at 1409 (quoting Investors Management, 44 S.E.C., at 646). An analyst is free to "weav[e] together a series of publicly available facts and nonmaterial inside disclosures to form a 'mosaic' which is only material after the bits and pieces are assembled into one picture." 21 S.E.C. Docket, at 1409. But the Commission's rule is inherently imprecise, and imprecision prevents parties from ordering their actions in accord with legal requirements. Tippees are in a poor position to distinguish information that is "interstices in analysis" and that which is material in itself. Tippees would necessarily act at their peril in exploiting such information, and this risk almost certainly would chill the socially desirable activities of securities analysts.

rumors are limited, and private parties with a financial incentive to pursue evidence of wrongdoing provide a valuable supplement, see, e. g., J.I. Case Co. v. Borak, 377 U.S. 426, 432 (1964), even if their investigation is not motivated by altruism. Investigative efforts can be costly, and if an investigation does not hold out the possibility of financial or at least reputational benefit which may translate into financial benefit at some later point, no analyst will be likely to devote substantial resources and expose himself to personal danger²¹ to investigate rumors of corporate fraud.²²

²¹It is doubtful that many corporate conspiracies can be uncovered without obtaining information from an inside source. Evidence of an ongoing criminal conspiracy involving those who control the company will not likely become public through the Commission's periodic disclosure requirements.

²²This empirical assumption in no way suggests that knowingly trading on inside information by securities analysts is "socially desirable or even that it is devoid of moral considerations." Dooley, supra, at 55. Nor does it suggest that it is unreasonable to expect that all citizens, including securities analysts, have a social obligation to disclose promptly indications of illegal actions by a corporation to the proper authorities--typically the SEC in cases involving securities. See Lorie, Public Policy for American Capital Markets 11 (1974). On the contrary, any trading on inside information clearly is behavior that falls below the standard of conduct to which many aspire. See Code of Ethics and Standards of Professional Conduct of the Financial Analysts Federation (as amended May 9, 1982). That conclusion does not, however, further analysis very far. There are "significant distinctions between actual obligations and ethical ideals." S. Rep. No. 75, 94th Cong., 1st Sess. 237-238 (1975). Recognizing that insider

Footnote continued on next page.

B

35

It is first necessary, in order
~~We believe that,~~ to make out a tipping case against

an insider, ~~under the federal antifraud provisions, it is~~

~~first necessary~~ to prove that the insider exploited

confidential information in violation of his fiduciary

duties to ~~the~~ ^{whether} shareholders. ~~Liability for disclosing~~ 36

~~material nonpublic information thus depends on the purpose~~

~~of the disclosure. An informant~~ ^{The tipper} will be liable if (i) he

discloses material, nonpublic information to ~~someone~~ ^{who}

trades on the information and (ii) the purpose of the

disclosure was to ~~get~~ ^{receive some} a benefit in return ~~from the~~ 36

~~recipient~~ or to make a gift of ^{the} information to the

recipient, ~~by giving him an advantage over other traders.~~ ^{to enable him to gain a market advantage} ~~Page~~

Similarly, a 10b-5 claim against an alleged tippee must be

based on the theory that he knowingly²³ ~~assisted the~~ ^{participated with}

trading imposes costs on society that should not be tolerated, Congress legislated against such actions, but it presumably attempted to reduce those costs as efficiently as possible in such a sensitive and important area as securities trading. We believe that the deterrence of the SEC's insider-trading rules, while certainly discouraging insider trading, would impose its own, perhaps greater costs on the securities industry, without any assurance of corresponding benefit. In the absence of more explicit congressional direction, we are not inclined to assume that Congress through its securities laws meant to upset the established role of securities dealers and analysts in the American securities

Footnote continued on next page.

Footnote(s) 23 will appear on following pages.

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insider in exploiting the confidential information: in 37
 essence that he was an aider and abetter. A recipient of
 such a tip would be liable if he used the information in
 connection with securities trading, knowing the purpose of
 the disclosure.²⁴ See Chazen, 'Dirks' Presents Unique

industry as the SEC's rules would do.

*cite
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²³It is clear that a tipper or tippee does not
 violate Rule 10b-5 unless he acts with scienter. The
 scienter requirement protects a defendant who was unaware
 that he was receiving or passing on inside information.
 But this requirement is of little benefit to the tippers
 or tippees who, such as petitioner, knowingly tips or
 trades on inside information.

24

"All these elements can be found in classic
 tipping situations, such as an arrangement under
 which a securities firm gives its customers
 confidential information it learns from
 investment banking clients in exchange for
 brokerage business. The tip violates the
 securities firm's duty to keep the information
 in confidence; it is also a means by which the
 securities firm exploits the information for its
 own benefit. Similarly, the customer who
 directs brokerage to the securities firm in
 exchange for confidential information aids and
 abets the violation, in that the customer's
 willingness to pay for the information with
 'soft dollars' makes it possible for the
 securities firm to take advantage of the
 information without trading itself.

The twin elements--breach of fiduciary duty
 and exploitation of information--are also
 present, though not quite so obviously, when an
 insider makes a gift of confidential information
 to a relative or friend, with the expectation
 that the recipient will trade on the
 information. The tip and trade are the
 functional equivalent of trading by the insider
 followed by a gift of the profits to the
 recipient. Again, the requirements for aiding
 and abetting liability are satisfied as the
 insider could not utilize this means of
 benefitting the recipient unless the recipient
 were prepared to play his part by trading on the
 information."

Footnote continued on next page.

We think the Commission is unduly concerned.

Corporate, Social Issues, Legal Times 14, 18 (March 14, 1983). 37

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E

The SEC argues that, if insider-trading liability also does not exist when the information is transmitted for a proper purpose but used wrongfully, i. e., for trading, it would be a rare situation when the parties could not fabricate some ostensibly legitimate business justification for transmitting the information. But with the tippee-trading rules that we have set out above, the courts are not required to read the parties' minds. As in

other areas of the law, courts are permitted to infer purpose from the surrounding circumstances. Two factors in particular would tend to show that the informant acted with an improper purpose. First, it is reasonable to infer improper purpose when there is a relationship between the informant and the recipient that suggests that the informant expected a quid pro quo from the recipient, such as when the recipient is a customer, or that the informant wished to benefit the recipient, such as when

See Chazen, 'Dirks' Presents Unique Corporate, Social Issues, Legal Times 14, 18 (March 14, 1983).

they are relatives or friends. Second, a disclosure was made at the initiative of the informant rather than in response to questioning by the recipient may ^{create an} ~~raise~~ a ^{inference} ~~presumption~~ that the insider seeks to exploit information available to him. On the other hand, a strong nonfinancial motive for providing the information would be evidence that the disclosure was not made with a forbidden purpose. See id.

III IV

^{Our} The review of the ^{rationalized} ~~bases~~ for insider-trading and tipping restrictions underscores the weakness of the SEC's ~~case~~ ⁶ against petitioner.²⁵ First, the Equity Funding employees did not violate their ^{fiduciary} ~~agency~~ duty to the company's shareholders by providing information to petitioner.²⁶ Petitioner's informants received no

²⁵ Petitioner contends that he was not a "tippee" because the information he received constituted unverified allegations of fraud that were ~~vigorously~~ denied by management and were not "material facts" under the securities laws that required disclosure before trading. He also argues that the information he received was not truly "inside" information, i. e., intended for a confidential corporate purpose, but was merely evidence of a crime. For purposes of deciding this case, however, we assume the correctness of the SEC's findings, ^{must} that petitioner was a tippee of material, inside information.

²⁶ In this Court, the SEC contends that an insider violates a fiduciary duty to the corporation's

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monetary benefit for revealing Equity Funding's secrets, nor did they have an apparent desire to make a gift of valuable information to petitioner. Second, it is undisputed that petitioner himself was a stranger to Equity Funding, with no preexisting fiduciary duty to those who sold or bought Equity Funding stock.²⁷ He took no action, directly or indirectly, that induced the

shareholders by transmitting nonpublic corporate information to an outsider when he has reason to believe that the outsider will take advantage of the shareholders. "Thus, regardless of any ultimate motive to bring to public attention the derelictions at Equity Funding, Secrist breached his duty to Equity Funding shareholders." Brief for Respondent 31. The Commission, however, did not charge Secrist with any wrongdoing, and we do not understand the SEC to have relied on Secrist's breach of any "duty" in finding that petitioner breached his duty to Equity Funding's shareholders. See J.A. 250 (decision of administrative law judge) ("One who knows himself to be a beneficiary of non-public, selectively disclosed inside information must fully disclose or refrain from trading."); 21 S.E.C., at 1410, n. 42 ("Presumably, [petitioner's] informants were entitled to disclose the [Equity Funding] fraud in order to bring it to light and its perpetrators to justice."); Brief of Respondent in the Court of Appeals, at 50 ("The Commission and the courts have repeatedly held that possession of inside information makes one an insider, regardless of whether possession of the information is obtained lawfully or through a breach of fiduciary duty to the issuer."); *id.*, at 51 ("[T]he knowing possession of inside information by any person imposes a duty to abstain or disclose."); *id.*, at 55; 681 F.2d 824, 838 (Wright, J.) (assuming Secrist breached no duty because of "SEC's failure to dispute the issue"). The merits of such a duty are therefore not before the Court. See SEC v. Chenery Corp., 332 U.S. 194, 196-197 (1947).

²⁷Judge Wright held that petitioner acquired a fiduciary duty by virtue of his position as an employee of a broker-dealer. The Commission, however, did not consider Judge Wright's alternate theory in its decision, nor did it present that theory to the Court of Appeals or to this Court.

Good note

?

stockholders or officers of Equity Funding to repose trust or confidence in him.²⁸ And clearly petitioner did not misappropriate or illegally obtain information about Equity Funding. Petitioner acquired the information from sources who were legally free to give it to him.²⁹ Under such circumstances, petitioner did not acquire any duty to the corporation's shareholders and thus ~~had~~ ^{he breached} no duty to ~~breach~~ when he passed on the information to other investors.

Indeed, rather than violating a duty to Equity Funding or its shareholders, or to the market in general, petitioner's ~~activities~~ ^{personally and careful investigation} brought to light a massive fraud

²⁸There was no expectation by petitioner's sources that he would keep their information in confidence, nor could there legitimately have been any such expectation. He was not given information ~~in order to assist in the conduct of the business of Equity Funding but, rather, to expose a massive fraud at the company.~~ As a result, to find liability in this case, the Commission again was reduced to finding a general duty applicable to anyone possessing what is found to be material nonpublic information, even though this Court made clear in Chiarella that no such duty exists.

²⁹Even under the broadest formulation of the abstain-or-disclose doctrine articulated in Chiarella, petitioner would be immune from liability. Here, other analysts were free to contact Equity Funding's present and former employees, and petitioner obtained the information in question through a combination of good fortune and diligent investigative technique. In a free enterprise economy, "advantages obtained by honest means" are entitled to "reap their full reward." 445 U.S., at 252 n. 2 (BLACKMUN, J., dissenting).

at Equity Funding and informed the market of the true state of affairs at the company.³⁰ Until the Equity Funding fraud was exposed, the information in the trading market was grossly inaccurate. But for petitioner's efforts, the fraud might well have gone undetected longer.

IV V

On the Commission and the federal courts has fallen the responsibility to develop specific trading rules that are consistent with the purposes underlying the federal securities laws. Although we must construct rules that preclude tippee trading which circumvents the prohibitions of our insider-trading restrictions, those rules must not

³⁰Although the Commission's disclose-or-abstain obligation is phrased in the conjunctive, in an exchange market with millions of impersonal transactions every hour, disclosure by individual shareholders is not very practical. Thus the special obligation on insiders is a duty not to trade at all on material nonpublic information. This fact is made obvious by the facts of this case. It is hard to imagine how, given his position as an outsider and the SEC's failure to investigate the fraud allegations, petitioner could have gone about publicizing them other than the way he did--by talking to the press and to anyone else who would listen to him.

Once it is conceded, as the Commission does, that there is no independent duty to disclose, it is hard to escape the conclusion in Fridrich v. Bradford, 542 F.2d 307, 318 (CA6 1976), cert. denied, 429 U.S. 1053 (1977), that there is no causal connection between insider trading and outsiders' losses: "Investors must be prepared to accept the risk of trading in an open market without complete or always accurate information." Thus, there can be no argument that petitioner created new victims by trading.

There is no evidence

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His disclosures were not limited to customers.

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sweep so broadly that they chill legitimate, socially useful market activity. Corporations must conduct certain business in private, while the securities market, to serve the important public interest in raising and allocating vast sums of capital in the most efficient and orderly manner possible, needs as much material information as possible about the public companies that it serves. Insiders have much discretion in delaying the disclosure of material information, and securities analysts play a beneficial role in assaulting the corporate citadel for inside information. Rule 10b-5 should not be used, absent clear congressional intent to that effect, to upset the beneficial balance that the securities market has enjoyed by the check the competing interests have on each other. While the federal securities laws are appropriate bars to the exploitation of information by corporate insiders,³¹

³¹We find ourselves in agreement with many of Commissioner Smith's statements in Investors Management Co.:

"It is important in this type of case to focus on policing insiders and what they do, which I think appropriate, rather than on policing information per se and its possession, which I think impracticable. I believe the emphasis in the law should continue to be upon the conduct of corporate insiders and their privies, as it

Footnote continued on next page.

they should not be used to protect corporations from securities analysts performing their normal information-gathering roles.

IV

We conclude that petitioner, in the circumstances of this case, had no duty to abstain from ^{facilitation by others} trading on the inside information that he obtained. The judgment of the Court of Appeals therefore is

Reversed.

has been since Strong v. Repide, 213 U.S. 419 (1909) and as it was in Cady Roberts, Texas Gulf and Merrill Lynch, rather than upon a concept--too vague for me to apply with any consistency--of relative informational advantages in the marketplace."

44 S.E.C., at 648 (concurring in the judgment).

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SECOND DRAFT: Dirks v. SEC, No. 82-276

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JUSTICE POWELL delivered the opinion of the Court.

(A) This case presents the question whether an individual who has no connection with a corporation but receives material nonpublic information concerning ongoing criminal conduct within the corporation from an officer or director violates the antifraud provisions of the federal securities laws by transmitting that information to persons who use the information to buy or sell the corporation's stock.

I

In 1973, petitioner was an officer at a New York broker-dealer firm, providing investment analysis on insurance company securities to institutional investors.¹ On March 6, petitioner received information from Ronald Secrist, a former officer of Equity Funding of America

¹The facts stated here are taken from more detailed statements set forth by the Administrative Law Judge, J.A., at 176-180, 225-247; the opinion of the Securities and Exchange Commission (SEC), 21 S.E.C. Docket 1401, 1402-1406 (1981); and the opinion of Judge Wright in the Court of Appeals, 681 F.2d 824, 829-833 (CA DC 1982).

(Equity Funding), a diversified corporation primarily engaged in selling life insurance and mutual funds, to the effect that the assets of that corporation were vastly overstated as the result of fraudulent internal corporate practices. Secrist stated that regulatory agencies had failed to act on similar charges made by Equity Funding employees, and urged petitioner to verify the fraud and publicly disclose it.

Petitioner decided to investigate personally the allegations. He flew to Los Angeles, where Equity Funding had its headquarters, and interviewed several officers and employees of the corporation. Despite denials of wrongdoing by its senior management, petitioner obtained substantial corroboration of the charges of fraud from current and former corporation employees. Neither petitioner nor his firm owned or traded any Equity Funding stock, but throughout his investigation, petitioner candidly discussed with a number of investors and analysts the progress of his investigation and the information he had obtained. Not surprisingly, some of the persons who spoke with petitioner and learned of the alleged fraud

sold their holdings of Equity Funding securities. Five investment advisers who communicated with petitioner liquidated securities worth more than \$16 million.²

During the entire week that petitioner was in Los Angeles, he was in touch regularly with William Blundell, the Wall Street Journal's Los Angeles bureau chief.

Petitioner urged Blundell to write a story for the Journal on the fraud allegations. Blundell, however, was afraid

that publishing such damaging rumors supported only by hearsay from ^{current and} former employees might be libelous and

declined to write the story, discounting the allegations because ~~he~~ ^{they were denied} he did not believe that such a ^{major} ~~huge~~ massive fraud could go undetected.

During the two-week period in which petitioner pursued his investigation and spread word of Secrist's charges, the price of Equity Funding stock fell precipitously from \$26 per share to less than \$15. This

²Petitioner received from his firm a salary plus a commission for securities transactions above a certain amount which his clients directed through his firm. Some of the firms to which petitioner gave information on the Equity Funding fraud directed or promised to direct commission business to petitioner's firm. See 681 F.2d, at 829, 831; 21 S.E.C. Docket, at 1402, 1404.

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led the New York Stock Exchange to halt trading on March 27. Shortly thereafter state insurance authorities impounded Equity Funding's records and uncovered evidence of the fraud. Only then did the Securities and Exchange Commission (SEC) file a complaint against Equity Funding³ and only then, on April 2, did the Journal publish a front page story based largely on information assembled by petitioner. Equity Funding immediately went into receivership.⁴

The SEC investigated petr's role in the disclosure of the fraud, and after a hearing by an administrative law judge, found that petitioner aided and abetted violations of §17(a) of the Securities Act of 1933, 15 U.S.C. §77q(a) (1976),⁵ §10(b) of the Securities Exchange Act of 1934, 15

³As early as 1971, the SEC had received allegations of fraudulent accounting practices at Equity Funding. Moreover, on March 9, 1973, an official of the California Insurance Department informed the SEC's regional office in Los Angeles of Secrist's charges of fraud. Petitioner himself voluntarily presented his information at the SEC's regional office beginning on March 27.

⁴A federal grand jury in Los Angeles subsequently returned a 105-count indictment against 22 persons, including many of Equity Funding's officers and directors. Those proceedings were concluded by entry of guilty pleas or convictions after trial of all defendants for one or more of the counts against them. See Brief for Petitioner 15; J.A. 149-153.

Footnote(s) 5 will appear on following pages.

U.S.C. §78j(b),⁶ and SEC Rule 10b-5, 17 C.F.R. §240.10b-5

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(1982),⁷ when he repeated the allegations of fraud to

⁵Section 17(a) provides:

"It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly--

"(1) to employ any device, scheme, or artifice to defraud, or

"(2) to obtain money or property by means of any untrue statement of a material fact or any omission 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

"(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser."

⁶Section 10(b) provides:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange--

....

"(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the SEC may prescribe as necessary or appropriate in the public interest or for the protection of investors."

⁷Rule 10b-5 provides:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

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

"(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

"(c) To engage in any act, practice, or

Footnote continued on next page.

members of the investment community--including clients of his firm--who later sold their Equity Funding stock. The SEC concluded: "Where 'tippees'--regardless of their motivation or occupation--come into possession of material '...information that they know is confidential and know or should know came from a corporate insider,' they must either publicly disclose that information or refrain from trading." 21 S.E.C. Docket 1401, 1407 (1981) (footnote omitted) (quoting Chiarella v. United States, 445 U.S. 222, 230 n. 12 (1980)). Recognizing, however, that petitioner played "an important role in bringing [Equity Funding]'s massive fraud to light," 21 S.E.C. Docket, at 1412-1413, the SEC only censured petitioner for his conduct.⁸

The Court of Appeals for the District of Columbia

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."

⁸Section 15 of the Securities Exchange Act, 15 U.S.C. §78o(b)(4)(E), provides that the SEC may impose certain sanctions, including a censure, on any person associated with a registered broker-dealer who has "willfully aided [or] abetted" any violation of the federal securities laws. See 15 U.S.C. §78ff(a) (providing criminal penalties).

entered judgment without accompanying opinion, denying, "for the reasons stated by the SEC in its opinion," petitioner's petition for review of the censure order. Judge Tamm dissented from the judgment. Judge Wright, a member of the panel, subsequently issued an opinion. Judge Robb concurred in the result, and Judge Tamm dissented; neither filed a separate opinion. Judge Wright believed that "the obligations of corporate fiduciaries pass to all those to whom they disclose their information before it has been disseminated to the public at large." 681 F.2d 824, 839 (1982). Alternatively, Judge Wright concluded that, as an employee of a broker-dealer, petitioner "had [violated] obligations to the SEC and to the public completely independent of any obligations he acquired" from sources at Equity Funding. Id., at 840.

We granted a writ of certiorari, ___ U.S. ___ (1982), because of the importance to the SEC and the securities industry of the question presented by this case. We now reverse the judgment of the Court of Appeals.

II

In the seminal case of In re Cady, Roberts & Co., 40

S.E.C. 907 (1961), the SEC recognized that a breach of the insiders'⁹ agency duties to shareholders¹⁰ also could be a violation of Rule 10b-5.¹¹ The SEC did not limit, however, its special obligation to disclose¹² or abstain to officers, directors, and controlling shareholders, id.,

Rather, it was
at 911, ~~but~~ found ~~it~~ to exist whenever two factors were

⁹We use the word "insiders" to include directors, officers, controlling shareholders, and those special employees and agents of the corporation who have regular access to the corporation's confidential information. See Feldman v. Simkins Industries, Inc., 492 F. Supp. 839, 844 (ND Calif. 1980), aff'd, 679 F.2d 1299 (CA9 1982); n. 15, infra.

¹⁰An insider's duty to the corporation's shareholders not to trade on inside information is to be distinguished from the common-law duty that insiders also have to the corporation itself not to mismanage corporate assets, of which confidential information is one. See 3A Fletcher Cyclopedia of the Laws of Private Corporations §§1168.1, 1168.2 (1975 & 1982 Supp.). We believe that a breach of the duty to shareholders satisfies the legal requirements of §10(b) because it presupposes both investor injury and deception, Santa Fe Industries, Inc. v. Green, 430 U.S. 462, 471-474 (1977); Dooley, Enforcement of Insider Trading Restrictions, 66 Va. L. Rev. 1, 41 (1980), and agree with the Cady, Roberts Commission that "[a] significant purpose of the Exchange Act was to eliminate the idea that use of inside information for personal advantage was a normal emolument of corporate office." See 40 S.E.C., at 912 n. 15.

¹¹Of the three provisions on which the SEC rested its decision, Rule 10b-5 is generally the most inclusive, and we will refer to it when we note the statutory basis for the SEC's inside trading rules.

¹²The SEC's ^{view of the} disclosure duty ^{extends beyond} is ~~not just to~~ the immediate purchasers or sellers: "Proper and adequate disclosure of significant corporate developments can only be effected by public release through the appropriate public media, designed to achieve a broad dissemination to the investing public generally and without favoring any special person or group." Faberge, Inc., 45 S.E.C., at 256.

present:

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.

Id., at 912 (footnote omitted).¹³

In Chiarella, we quoted with approval the Cady, Roberts statement of the basis for the disclose-or-abstain rule and adopted the SEC's twin elements for finding a violation of Rule 10b-5's inside-trading restrictions--a fiduciary relationship and the exploitation of confidential information acquired as a result of that relationship. See 445 U.S., at 227. The Court unanimously agreed that there is no general duty to make

¹³The Cady, Roberts conditions for imposing a duty to disclose or abstain from trading are not arbitrary limitations on the use of inside information, but are consistent with the common-law rules and grounded in the policies underlying the federal securities laws. As a general proposition, there is no duty to disclose information to the public at large before engaging in a commercial transaction or before imparting the information to other persons. See Chiarella, 445 U.S., at 228; id., at 239-240 (BURGER, C.J., dissenting). Moreover, it is evident that stock ownership and securities trading by insiders are not detrimental to the corporation, to shareholders, or to society. Thus, the Cady, Roberts elements are simply an acknowledgement that it is only some uses of inside information, and then only under certain circumstances, that will create liability.

disclosure before trading with material nonpublic information,¹⁴ and recognized that "a duty to disclose under §10(b) does not arise from the mere possession of nonpublic market information." Id., at 235. Such a duty arises rather from the existence of a fiduciary relationship. See 445 U.S., at 227-235.

The case against the petitioner in Chiarella failed for lack of a fiduciary relationship. But ^{of course} it is clear that there also can be no liability for an inside trade where there is no trading. Thus, an insider will be liable where he exploits material nonpublic information for personal gain and fails to disclose that information before doing so.

III

Unlike insiders who have independent fiduciary duties to both the corporation and its shareholders, the typical tippee has no such relationships.¹⁵ In view of the

¹⁴See 445 U.S., at 233; id., at 237 (STEVENS, J., concurring); id., at 238-239 (BRENNAN, J., concurring in the result); id., at 239-240, 252, n. 2 (BURGER, C.J., dissenting); id., at 252, n. 2 (BLACKMUN, J., dissenting).

¹⁵To be sure, under certain ^{lawyer} circumstances, such as where corporate information is revealed legitimately to an underwriter, accountant, or attorney working for the

Footnote continued on next page.

absence of similar relationships, it has been unclear how

^a
the tippee acquires the duty to refrain from trading on
inside information.

What is clear is the prophylactic need for a ban on

155

some tippee trading. ~~Because~~ ^{As} insiders are forbidden by

their fiduciary relationship from using undisclosed

corporate information to their personal advantage, they

may not give such information to outsiders for the same

improper purpose. See 18 U.S.C. §78t(b). "[T]hat which

160

the trustee has no right to do he has no right to

authorize...." Mosser v. Darrow, 341 U.S. 267, 272

corporation, these outsiders may, ~~as a result of such relationship~~, become fiduciaries of the corporation and of its shareholders. The basis for imposing fiduciary duties 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. See SEC v. Monarch Fund, 608 F.2d 938, 942 (CA2 1979); In re Investors Management Co., 44 S.E.C. 633, 645 (1971); In re Van Alostne, Noel & Co., 43 S.E.C. 1080, 1084-1085 (1969); In re Merrill Lynch, Pierce, Fenner & Smith, Inc., 43 S.E.C. 933, 937 (1968); In re Cady, Roberts & Co., 40 S.E.C., at 912. When such a person breaches his fiduciary relationship, he may be treated more properly as a tipper than a tippee. See Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d 228, 237 (CA2 1974) (investment banker, ~~learned material information through his work on a proposed public offering for the corporation~~). For such duties to be imposed, however, "there must be some expectation of trust and confidence with respect to the information imparted, and the person receiving the information must assent at least implicitly to the expectation." Langevoort, Insider Trading and the Fiduciary Principle: A Post-Chiarella Restatement, 70 Calif. L. Rev. 1, 30 (1982).

had access
to material
info when
working

(1951). Similarly, the transactions of those who knowingly participate with the fiduciary in such a breach are "as forbidden" as transactions "on behalf of the trustee himself." Id. See Jackson v. Smith, 254 U.S. 586, 589 (1921); Jackson v. Ludeling, 88 U.S. 616, 631-632 (1874). As the Court explained in Mosser, a contrary rule "would open up opportunities for devious dealings in the name of the others that the trustee could not conduct in his own." 341 U.S., at 271. See SEC v. Texas Gulf Sulphur Co., 446 F.2d 1301, 1308 (CA2), cert. denied, 404 U.S. 1005 (1971).

Hence, as we noted in Chiarella, "[t]he tippee's obligation has been viewed as arising from his role as a participant after the fact in the insider's breach of a fiduciary duty." 445 U.S., at 230 n. 12.¹⁶ As the SEC

¹⁶For this proposition, the Court cited Subcommittees of American Bar Association Section of Corporation, Banking, and Business Law, Comment Letter on Material, Non-Public Information (Oct. 15, 1973) reprinted in BNA, Securities Regulation & Law Report No. 233, at D1, D2 (Jan. 2, 1974), which states:

[I]t appears that the Commission's view is based upon the premise that the tippee who does trade upon such information is a participant after the fact in the tipping corporate official's breach of fiduciary duty, and, under common law principles, the tippee may be held responsible for the consequences of that breach in

Footnote continued on next page.

concedes, the tippee's duty is purely "derivative" of his informant's duty. Tr. of Oral Arg. 38. See Chiarella, 445 U.S., at 246 (BLACKMUN, J., dissenting). It therefore is clear that, although tippees may assume an insider's duty to the corporation's shareholders, this is not because they receive inside information, rather they receive it improperly. As THE CHIEF JUSTICE stated in Chiarella, a disclosure obligation should exist "when an informational advantage is obtained, not by superior experience, foresight, or industry, but by some unlawful means." 445 U.S., at 240 (BURGER, C.J., dissenting) (emphasis added).¹⁷

appropriate cases.

See also id., at D-1 ("As to 'tipper' and 'tippee' liability, it was clear that a corporate official who is not allowed to benefit directly from the use of material undisclosed information ought not to be able to benefit indirectly by passing on the information to relatives, friends or others for the same purpose.").

¹⁷Professor Loss has linked tippee liability to the concept in the law of restitution that "[w]here a fiduciary in violation of his duty to the beneficiary communicates confidential information to a third person, the third person, if he had notice of the violation of duty, holds upon a constructive trust for the beneficiary any profit which he makes through the use of such information." 3 L. Loss, Securities Regulation 1451 (1961) (quoting Restatement of Restitution §201(2) (1937)). Other authorities have likewise expressed the view that tippee liability exists only where there has been a breach of trust by an insider. See, e. g., Ross v. Licht, 263 F. Supp. 395, 410 (SDNY 1967); Brudney, Insiders, Outsiders, and Informational Advantages Under

Footnote continued on next page.

fine -
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eliminate

Similarly, merely receiving ~~and using~~^{14.} information from a corporate insider is not enough to impose such an obligation

When tipping properly is viewed as a means of indirectly violating the disclose-or-abstain rule, the elements of a rule 10b-5 violation in a tipping case should be the same as in an inside-trading case. Thus,

more of outside
just as possession of inside information did not impose an obligation to disclose or abstain in Chiarella, so being a tippee of corporate insiders is not enough to inherit such a duty. A tippee will not be liable for aiding and abetting an insider's exploitation of material nonpublic information unless the insider breaches his duties to the corporation's shareholders, [by using his access to confidential information for personal gain.]

A

The SEC's position, as stated in its opinion, is that

"tippees such as [petitioner] who receive non-public

the Federal Securities Laws, 93 Harv. L. Rev. 322, 348 (1979); Fleischer, Mundheim & Murphy, An Initial Inquiry Into the Responsibility to Disclose Market Information, 121 U. Pa. L. Rev. 798, 818 n. 76 (1973) ("The extension of rule 10b-5 restrictions to tippees of corporate insiders can best be justified on the theory that they are participating in the insider's breach of his fiduciary duty."). Cf. Restatement (Second) of Agency §312, comment c (1958) ("A person who, with notice that an agent is thereby violating his duty to his principal, receives confidential information from the agent, may be [deemed]...a constructive trustee.").

Given - since we have not defined personal gain at this point, should it then come out here?

*Jim - The SEC's rule as stated
here assumes a breach*

15.

material information from insiders become 'subject to the same duty as [the] insider,' 21 S.E.C. Docket, at 1410 n. 42 (quoting Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d 228, 237 (CA2 1974) (quoting Ross v. Licht, 263 F. Supp. 395, 410 (SDNY 1967)), and that "a tippee breaches the fiduciary duty which he assumes from the insider when the tippee knowingly transmits the information to someone who will probably trade on the basis thereof," 21 S.E.C. Docket, at 1410 n. 42.

"The outsider who uses the nonpublic information by trading with a shareholder is a participant in the insider's breach of duty to the shareholder, and thus violates his inherited obligation to the shareholder when he is on notice that the insider is himself disabled from using the information without disclosure."

Petitioner for Respondent 31.

Brief
Petitioner for

Courts are not free to "disregard [an] agency's view"

of one of its statutes and to construe the statute based on their "own view of what would best serve the purpose and policy" of the statute. See Federal Election Commission v. Democratic Senatorial Campaign Committee,

Jim - This sentence requires knowledge by the tippee of the insider's breach. Print this consistent with our view? But we object to this

Jim - This is a familiar statement that need not be repeated

Then also inconsistent with the 1st sentence on next pg.

220

225

position in this case

454 U.S. 27, 36 (1981). ~~The SEC's theory here,~~¹⁸ ~~however,~~

differs little from its view that we rejected as

inconsistent with congressional intent in Chiarella.^{18/} In

short, the ~~SEC's position is that~~ anyone who knowingly

possesses nonpublic material information has a ^{"fiduciary"} duty to

disclose before trading. In Chiarella, we specifically

refused to find

a general duty between all participants in market transactions to forgo actions based on material, nonpublic information. Formulation of such a broad duty, which departs radically from the established doctrine that arises from a specific relationship between two parties...should not be undertaken absent some explicit evidence of congressional intent.

Id., at 233.

We again reject the imposition of the abstain-or-

disclose obligation ^{*solely because a person*} ~~on anyone who~~ knowingly possesses

material nonpublic information and trades.¹⁹ As we noted

¹⁸The SEC itself formerly recognized that tippee liability properly is imposed only in circumstances where the "tippee" knows, or has reason to know, that the insider has improperly disclosed inside corporate information. In Investors Management Co., the SEC stated that in finding tippee liability one element is that the tippee knew or had reason to know "that the information was non-public and had been obtained improperly by selective revelation or otherwise." 44 S.E.C., at 641 (emphasis added). Commissioner Smith expressly read this test to mean that before a tippee can be held liable it must be shown that he received information in breach of an insider's duty not to disclose it. Id., at 649

Footnote continued on next page.

Footnote(s) 19 will appear on following pages.

in Chiarella, adopting the SEC's rule could have consequences well beyond any that we have assurance Congress intended.²⁰ *As the SEC expressly recognized that* "[t]he value to the entire market of [analysts'] efforts cannot be gainsaid; market efficiency in pricing is significantly

250

(concurring in the result) (see n. 25, supra).

¹⁹ The SEC apparently realizes that the obligation it seeks to impose on all those who knowingly possess material nonpublic information has no legal limit and that liability is limited only by its own view of what is reasonable under the circumstances. As Commissioner Budge stated shortly after the SEC filed the Texas Gulf Sulphur action: "The Commission certainly does not contemplate suing every person who may come across inside inform[at]ion.... Obviously, persons such as the taxi driver, the barber, or the caddy who by chance overhear a bit of corporate news should not be named as defendants in civil actions brought by the Commission." Budge, The Texas Gulf Sulphur Case--What It Is and What It Isn't, Corp. Secretary No. 127, at 6 (1965) (quoted in 6 L. Loss, supra, at 3564). We find ourselves in agreement with Commissioner Smith in Investors Management Co. when he said: "It is important in this type of case to focus on policing insiders and what they do, which I think appropriate, rather than on policing information per se and its possession, which I think impracticable." 44 S.E.C., at 648 (concurring in the judgment).

²⁰ To require market participants to cease trading in a particular security any time they knowingly possess nonpublic information could affect adversely the market for that security. Although we scrutinize the trading activities of insiders and their confederates, we have had no reason to consider that the advantages that market professionals may gain in their normal roles are incompatible with the provisions or objectives of the federal securities laws. As this Court recognized in Chiarella, 445 U.S., at 233, Congress has expressly exempted many market professionals from the general statutory prohibition set forth in §11(a)(1) of the Act, 15 U.S.C. §78k(a)(1), against members of a national securities exchange trading for their own account. We specifically observed, 445 U.S., at 233 n. 16, that "[t]he exception is based upon Congress' recognition that [market professionals] contribute to a fair and orderly marketplace at the same time they exploit the informational advantage that comes from their possession of [nonpublic information]."

Put this thought somewhere else - tho I'd not phrase it in terms of what SEC "realizes"

enhanced by [their] initiatives to ferret out and analyze information, and thus the analyst's work redounds to the benefit of all investors." S.E.C. Docket, at 1406.²¹ Yet

the SEC's tippee-trading rules could be used to penalize

analytical excellence and place in jeopardy those analysts *who do the research and* ~~it~~ who have the insight to recognize ~~the~~ value and unsoundness

before they are reflected in the market. Moreover, the

resources available to government law enforcement agencies

to investigate all rumors are limited, and private parties

with a financial incentive to pursue evidence of

wrongdoing provide a valuable supplement, see, e. g., J.I.

Case Co. v. Borak, 377 U.S. 426, 432 (1964), even if their

investigation is not motivated by altruism. Investigative

efforts can be costly, and if an investigation does not

hold out the possibility of financial or at least

reputational benefit *that* ~~which~~ may translate into financial

Good note. *its* ²¹The SEC ~~contends~~ *asserts* that "[a]nalysts remain free to obtain from corporate management corporate information that is not itself material for purposes of filling in the 'interstices in analysis'...." Brief for Respondent 42 (quoting Investors Management Co., 44 S.E.C., at 646). But ~~the SEC's~~ rule is inherently imprecise, and imprecision prevents parties from ordering their actions in accord with legal requirements. Unless the line between permissible and impermissible disclosures and uses is bright, neither corporate insiders nor analysts can be sure when the line is crossed.

benefit at some later point, ^{there will be less incentive for} ~~no~~ analyst will be likely to devote ^{time and} substantial resources to investigate rumors of corporate fraud.²²

B

As we have shown, a tippee's liability is derivative from the tipper's ^{breach of duty} ~~liability~~. See p. __, supra. Thus, in order to make out a tipping case against an individual, it is first necessary to ^{establish such a breach:} ~~prove~~ that the insider exploited ^{disclosed} confidential information in violation of his fiduciary ¹ duties to shareholders. See p. __, supra. Whether disclosure of material nonpublic information is ^{such} a breach ^{essentially} of duty therefore depends ¹ on the purpose of the

²²This empirical assumption in no way suggests that knowingly trading on inside information by securities analysts is "socially desirable or even that it is devoid of moral considerations." Dooley, supra, at 55. Nor does it suggest that it is unreasonable to expect that all citizens, including securities analysts, have a social obligation to disclose promptly indications of illegal actions by a corporation to the proper authorities--typically the SEC in cases involving securities. See Lorie, Public Policy for American Capital Markets 11 (1974). There are, however, "significant distinctions between actual legal obligations and ethical ideals." SEC, Report of the Special Study of the Securities Markets, H.R. Doc. No. 95, 88th Cong., 1st Sess., pt. 1, 237-238 (1963). Recognizing that inside trading imposes costs on society that should not be tolerated, Congress legislated against such actions, but it presumably attempted to reduce those costs as efficiently as possible in such a sensitive and important area as securities trading. We believe that the deterrence of the SEC's inside-trading rules would impose its own, perhaps greater costs on the securities industry, without any assurance of corresponding benefit.

Jim -
This
is too
much
editorializing.
Not my
style &
other
writers
may like it.
etc

disclosure.²³ The tipper will be liable if (i) he discloses material nonpublic information to one who trades on the information and (ii) the purpose of the disclosure was to receive some benefit in return or to make a gift of the information to the recipient to enable him to gain a market advantage over other traders. See p. __, supra. Similarly, a 10b-5 claim against an alleged tippee must be based on the theory that he knowingly²⁴ participated with the insider in exploiting the confidential information.²⁵

²³The SEC's decision in this case is sharply at odds with the decision in Walton v. Morgan Stanley & Co., 623 F.2d 796 (CA2 1980). There, the Court of Appeals held that an investment banking firm did not acquire or breach any fiduciary duty to a corporation that was not a client when it traded in the corporation's stock on the basis of confidential earnings reports it acquired from the corporation while investigating it for a client. See id., at 798-799. The investment banking firm had received the information legitimately, and while the firm knew that the information was confidential corporate data that came from inside the corporation, and had been expected to keep it so, the corporation had secured no agreement that the firm would do so. In the absence of any confidentiality agreement, or other fiduciary relationship, the court held, the investment bankers did not acquire any duty with respect to this information simply by receiving it legitimately. See id., at 799.

²⁴It is clear that a tipper or tippee does not violate Rule 10b-5 unless he acts with scienter. See Aaron v. SEC 446 U.S. 680, 695 (1980). The scienter requirement protects a defendant who was unaware that he was receiving or passing on inside information. See State Teachers Retirement Board v. Fluor Corp., 654 F.2d 843, 854-855 (CA2 1981). But this requirement is of little benefit to the tippers or tippees who, such as petitioner, knowingly tip or trade on inside information.]?

²⁵As Commissioner Smith stated in Investors Management Co.:

Footnote continued on next page.

Jim - This seems different to me. The firm knew the info. was confidential corp. info. To be sure, the "insider's" purpose may not have been subjectively improper, but was the disclosure proper? I am doubtful about relying on Walton

Jim: ~~has~~ the "scienter" we have considered in prior cases ~~included~~ meant "knowledge" rather than intent to defraud?

A recipient of such a tip would be liable if he used the information in connection with securities trading, knowing the purpose of the disclosure.²⁶ See Chazen, 'Dirks'

29

"[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, and that the information must be shown not only to have been material and non-public, but also to have substantially contributed to the trading which occurred."

44 S.E.C., at 651 (concurring in the result). See 681 F.2d, at 839, n. 16 (Wright, J.).

26

"All these elements can be found in classic tipping situations, such as an arrangement under which a securities firm gives its customers confidential information it learns from investment banking clients in exchange for brokerage business. The tip violates the securities firm's duty to keep the information in confidence; it is also a means by which the securities firm exploits the information for its own benefit. Similarly, the customer who directs brokerage to the securities firm in exchange for confidential information aids and abets the violation, in that the customer's willingness to pay for the information with 'soft dollars' makes it possible for the securities firm to take advantage of the information without trading itself."

omit?

The twin elements--breach of fiduciary duty and exploitation of information--are also present, though not quite so obviously, when an insider makes a gift of confidential information to a relative or friend, with the expectation that the recipient will trade on the information. The tip and trade are the functional equivalent of trading by the insider followed by a gift of the profits to the recipient. Again, the requirements for aiding and abetting liability are satisfied as the insider could not utilize this means of benefitting the recipient unless the recipient were prepared to play his part by trading on the information."

See Chazen, 'Dirks' Presents Unique Corporate, Social / Issues, Legal Times 14, 18 (March 14, 1983).

But was
the firm's
duty
derivative
from the
some breach
by an
"insider"?
What was the
breach?

Jim - I
am now
doubtful
about
relying
on a
summary
news
commentary

??

~~Presents Unique Corporate, Social Issues, Legal Times 14,~~

~~18 (March 14, 1983)~~

The SEC argues that, if inside-trading liability also does not exist when the information is transmitted for a proper purpose but used wrongfully, i. e., for trading, it would be a rare situation when the parties could not fabricate some ostensibly legitimate business justification for transmitting the information. We think the SEC is unduly concerned. As in other areas of the law, courts are permitted to infer purpose from the surrounding circumstances. Two factors in particular would tend to show that the informant acted with an improper purpose. First, it ^{may be} ~~is~~ reasonable to infer improper purpose when there is a relationship between the informant and the recipient that suggests ^{an} ~~that the~~ ^{expectation of} ~~informant expected~~ a quid pro quo from the recipient, such as ~~when the recipient is a customer, or that the informant~~ ^{or an intention} ~~wished to benefit the recipient, such as when they are~~

^a ~~relative~~ or friends. Second, that a disclosure was made ^{where} at the initiative of the informant rather than in response to questioning by the recipient, ⁻⁻ ~~may create~~ an inference

may arise *desired*
 that the insider ~~seeks~~ to exploit information ~~available~~ to

~~him~~. On the other hand, a ~~strong~~ nonfinancial motive for providing the information would be evidence that the disclosure was not made with a forbidden purpose. *See*

ibid.

IV

Our review of the rationales for inside-trading and tipping rules highlights the absence of any *actionable violation* *by* ~~case~~ against

petitioner
~~petitioner~~.²⁷ *First*. The Equity Funding employees did not violate their fiduciary duty to the corporation's shareholders by providing information to petitioner.²⁸

²⁷ Petitioner contends that he was not a "tippee" because the information he received constituted unverified allegations of fraud that were denied by management and were not "material facts" under the securities laws that required disclosure before trading. He also argues that the information he received was not truly "inside" information, i. e., intended for a confidential corporate purpose, but was merely evidence of a crime. For purposes of deciding this case, however, we must assume the correctness of the SEC's findings, accepted by the Court of Appeals, that petitioner was a tippee of material inside information.

is said to
²⁸ *views purpose as wholly*
 In this court, the SEC contends that an insider violated a fiduciary duty to the corporation's shareholders by transmitting nonpublic corporate information to an outsider when he has reason to believe that the outsider will *take advantage* of the shareholders. "Thus, regardless of any ultimate motive to bring to public attention the derelictions at Equity Funding, Secrist breached his duty to Equity Funding shareholders." Brief for Respondent 31. The SEC, however, did not charge Secrist with any wrongdoing, and we do not understand the SEC to have relied on Secrist's breach of any "duty" in finding that petitioner breached his duty to Equity Funding's shareholders. See J.A. 250 (decision of Footnote continued on next page.

use it to disadvantage

Petitioner's informants received no monetary benefit for revealing Equity Funding's secrets, nor did they have an apparent desire to make a gift of valuable information to petitioner. ~~Second,~~ *It* is undisputed that petitioner himself was a stranger to Equity Funding, with no preexisting fiduciary duty to ~~these who sold or bought~~ *the shareholders of* Equity Funding stock.²⁹ He took no action, directly or indirectly, that induced the shareholders or officers of

administrative law judge) ("One who knows himself to be a beneficiary of non-public, selectively disclosed inside information must fully disclose or refrain from trading."); 21 S.E.C., at 1410, n. 42 ("Presumably, [petitioner's] informants were entitled to disclose the [Equity Funding] fraud in order to bring it to light and its perpetrators to justice."); Brief of Respondent in the Court of Appeals, at 47-50; *id.*, at 51 ("[K]nowing possession of inside information by any person imposes a duty to abstain or disclose."); *id.*, at 52-54; *id.*, at 55 ("[T]his obligation arises not from the manner in which such information is acquired...."); 681 F.2d 824, 838 (Wright, J.) ~~("We have assumed that [petitioner's] informants did not breach their fiduciary duties to Equity Funding simply by disclosing what they knew of its fraudulent practices....")~~ ~~("the SEC fail[s] to dispute the issue")~~, Chazen, *supra*, at 18 ("The SEC has not bothered to argue this point; it apparently has chosen to rest its case on the theory that there is a general duty to refrain from knowingly trading on inside information regardless of how it is obtained."); Langevoort, *supra*, at 30 ("The Commission presumed that the insiders were entitled to disclose the information and therefore committed no breach of fiduciary duty in doing so."). The merits of such a duty are therefore not before the Court. See *SEC v. Chenery Corp.*, 332 U.S. 194, 196-197 (1947).

²⁹Judge Wright held that petitioner acquired a fiduciary duty by virtue of his position as an employee of a broker-dealer. The SEC, however, did not consider Judge Wright's alternate theory in its decision, nor did it present that theory to the Court of Appeals or to this Court.

Jim - On Chazen's article was not in a scholarly journal. I am now doubtful about citing it. Let's discuss. Also, in n 28 we make our point more effectively by not over-arguing it.

Equity Funding to repose trust or confidence in him, and there was no expectation by petitioner's sources that he would keep their information in confidence. And clearly petitioner did not misappropriate or illegally obtain information about Equity Funding. Petitioner acquired the information from sources who were legally free to give it

to him. ^{In these} Under such circumstances, petitioner ^{was} did not ^{under no fiduciary} acquire any duty to the corporation's shareholders, ^{see Chiarella, supra, at 233,} and thus he ^{therefore} breached no duty when he passed on the information to other investors.

Indeed, ^{in this case} rather than violating a duty to Equity Funding's shareholders, petitioner's careful investigation brought to light a massive fraud at Equity Funding and informed the market of the true state of affairs at the corporation. Until the Equity Funding fraud was exposed, the information in the trading market was grossly inaccurate. But for petitioner's efforts, the fraud might well have gone undetected longer.³⁰

³⁰ ^{To be sure, resulted in} ~~there certainly can be no argument that petitioner's disclosures were unfair to Equity Funding's shareholders or created new victims of the corporation's fraud. As the facts of this case make obvious, the special disclose-or-abstain obligation is more a duty not~~
Footnote continued on next page.

*Jim -
check my
cite to
Chiarella*

Although the SEC must ^{enforce its} ~~construct~~ rules that preclude tippee trading, ^{that} ~~which would otherwise~~ ^{circumvent} the prohibitions of its ^{against} inside-trading, restrictions, ^{such} ~~these~~ rules must not ^{be construed} ~~sweep~~ so broadly that they ^{inhibit} ~~chill~~ legitimate, socially useful market activity. Insiders have ^{much} discretion in delaying the disclosure of material information, and securities analysts play a ^{necessary inf} beneficial role in ^{discussing} ~~probing~~ corporations for relevant information. Rule 10b-5 should not be used to shield corporations from securities analysts performing their normal information-gathering roles.

VI

We conclude that petitioner, in the circumstances of

to trade at all on material nonpublic information than it is a duty to disclose. It is hard to imagine, ^{how} given his position as an outsider and the SEC's failure to investigate the fraud allegations, petitioner could have gone about publicizing them other than the way he did--by talking to the press, to customers of his firm (to whom he owed some duty), and indeed, to anyone else who would listen to him. ^{absent or rather as a tippee,} ~~And once it is conceded, as the SEC does,~~ ^{con-} ~~that there is no independent duty to disclose.~~ ^{ceder} See Elkind v. Liggitt & Myers, Inc., 635 F.2d 156, 169, and n. 26 (CA2 1980). ^{how} ~~It is hard to escape the conclusion, in~~ Fridrich v. Bradford, 542 F.2d 307, 318 (CA6 1976), cert. denied, 429 U.S. 1052 (1977), ~~that there is no causal connection between inside trading and outsiders' losses:~~ "Investors must be prepared to accept the risk of trading in an open market without complete or always accurate information."

As held in

June - 9
understand
the SEC to
say there
is a duty
not to
disclose
info.
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by a tippee.

this case, had no duty to abstain from facilitating trading by others on the inside information that he obtained. The judgment of the Court of Appeals therefore is

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Reversed.

W.F.P.
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job 05/20/83

FOURTH DRAFT: Dirks v. SEC, No. 82-276

JUSTICE POWELL delivered the opinion of the Court.

Petitioner received material nonpublic information from "insiders" of a corporation with which he had no connection. He disclosed this information to investors who relied on it in trading in the shares of the corporation. The question is whether petitioner violated the antifraud provisions of the federal securities laws by this disclosure.

I

In 1973, petitioner was an officer of a New York broker-dealer firm, providing investment analysis on insurance company securities to institutional investors.¹ On March 6, petitioner received information from Ronald Secrist, a former officer of Equity Funding of America. Secrist alleged that the assets of Equity Funding, a

¹The facts stated here are taken from more detailed statements set forth by the administrative law judge, App. 176-180, 225-247; the opinion of the Securities and Exchange Commission, 21 S.E.C. Docket 1401, 1402-1406 (1981); and the opinion of Judge Wright in the Court of Appeals, 220 U.S. App. D.C. 309, 314-318, 681 F.2d 824, 829-833 (1982).

diversified corporation primarily engaged in selling life insurance and mutual funds, were vastly overstated as the result of fraudulent internal corporate practices. Secrist also stated that various regulatory agencies had failed to act on similar charges made by Equity Funding employees, and urged petitioner to verify the fraud and disclose it publicly.

Petitioner decided to investigate the allegations. He visited Equity Funding's headquarters in Los Angeles and interviewed several officers and employees of the corporation. Its senior management denied any wrongdoing, but current and former corporation employees corroborated the charges of fraud. Neither petitioner nor his firm owned or traded any Equity Funding stock, but throughout his investigation petitioner candidly discussed with a number of investors and analysts the information he had obtained. Some of these persons sold their holdings of Equity Funding securities, including five investment advisers who liquidated securities worth more than \$16 million.²

Footnote(s) 2 will appear on following pages.

During the entire week that petitioner was in Los Angeles, he was in touch regularly with William Blundell, the Wall Street Journal's Los Angeles bureau chief. Petitioner urged Blundell to write a story on the fraud allegations. Blundell discounted the allegations because he did not believe that such a massive fraud could go undetected. He declined to write the story, fearing that publishing such damaging rumors supported only by hearsay from current and former employees might be libelous.

During the two-week period in which petitioner pursued his investigation and spread word of Secrist's charges, the price of Equity Funding stock fell precipitously from \$26 per share to less than \$15 per share. This led the New York Stock Exchange to halt trading on March 27. Shortly thereafter California

²Petitioner received from his firm a salary plus a commission for securities transactions above a certain amount that his clients directed through his firm. See 21 S.E.C. Docket, at 1402, n. 3. But "[i]t is not clear how many of those with whom [petitioner] spoke promised to direct some brokerage business through [petitioner's firm] to compensate [petitioner], or how many actually did so." 220 U.S. App. D.C., at 316, 681 F.2d, at 831. The Boston Company Institutional Investors, Inc., promised petitioner about \$25,000 in commissions, but it is unclear whether Boston actually generated any brokerage business for petitioner's firm. See App. 199, 204-205; 21 S.E.C. Docket, at 1404, n. 10; 220 U.S. App. D.C., at 316, n. 5, 681 F.2d, at 831, n. 5.

insurance authorities impounded Equity Funding's records and uncovered evidence of the fraud. Only then did the Securities and Exchange Commission (SEC) file a complaint against Equity Funding³ and only then, on April 2, did the Wall Street Journal publish a front-page story based largely on information assembled by petitioner. Equity Funding immediately went into receivership.⁴

The SEC investigated petitioner's role in the disclosure of the fraud. After a hearing by an administrative law judge, the SEC found that petitioner had aided and abetted violations of §17(a) of the Securities Act of 1933, 15 U.S.C. §77q(a),⁵ §10(b) of the

³As early as 1971, the SEC had received allegations of fraudulent accounting practices at Equity Funding. Moreover, on March 9, 1973, an official of the California Insurance Department informed the SEC's regional office in Los Angeles of Secrist's charges of fraud. Petitioner himself voluntarily presented his information at the SEC's regional office beginning on March 27.

⁴A federal grand jury in Los Angeles subsequently returned a 105-count indictment against 22 persons, including many of Equity Funding's officers and directors. All defendants were found guilty of one or more counts, either by a plea of guilty or a conviction after trial. See Brief for Petitioner 15; App. 149-153.

⁵Section 17(a) provides:

"It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly--

"(1) to employ any device, scheme, or

Footnote continued on next page.

Securities Exchange Act of 1934, 15 U.S.C. §78j(b),⁶ and
 SEC Rule 10b-5, 17 C.F.R. §240.10b-5 (1982),⁷ when he
 repeated the allegations of fraud to members of the

artifice to defraud, or

"(2) to obtain money or property by means of any untrue statement of a material fact or any omission 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

"(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser."

⁶Section 10(b) provides:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange--

....

"(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

⁷Rule 10b-5 provides:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

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

"(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

"(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."

investment community--including clients of his firm--who later sold their Equity Funding stock. The SEC concluded: "Where 'tippees'--regardless of their motivation or occupation--come into possession of material 'information that they know is confidential and know or should know came from a corporate insider,' they must either publicly disclose that information or refrain from trading." 21 S.E.C. Docket 1401, 1407 (1981) (footnote omitted) (quoting Chiarella v. United States, 445 U.S. 222, 230 n., 12 (1980)). Recognizing, however, that petitioner "played an important role in bringing [Equity Funding's] massive fraud to light," 21 S.E.C. Docket, at 1412, the SEC only censured him.⁸

Petitioner sought review in the Court of Appeals for the District of Columbia Circuit. Without opinion, the court entered judgment against petitioner "for the reasons stated by the Commission in its opinion." App. to Pet.

⁸Section 15 of the Securities Exchange Act, 15 U.S.C. §78o(b)(4)(E), provides that the SEC may impose certain sanctions, including censure, on any person associated with a registered broker-dealer who has "willfully aided [or] abetted" any violation of the federal securities laws. See 15 U.S.C. §78ff(a) (providing criminal penalties).

for Cert. C-2. Judge Wright, a member of the panel, subsequently issued an opinion. Judge Robb concurred in the result, and Judge Tamm dissented; neither filed a separate opinion. Judge Wright believed that "the obligations of corporate fiduciaries pass to all those to whom they disclose their information before it has been disseminated to the public at large." 220 U.S. App. D.C. 309, 324, 681 F.2d 824, 839 (1982). Alternatively, Judge Wright concluded that, as an employee of a broker-dealer, petitioner had violated "obligations to the SEC and to the public completely independent of any obligations he acquired" from sources at Equity Funding. Id., at 325, 681 F.2d, at 840.

We granted a writ of certiorari, ___ U.S. ___ (1982), because of the importance to the SEC and to the securities industry of the question presented by this case. We now reverse the judgment of the Court of Appeals.

II

In the seminal case of In re Cady, Roberts & Co., 40 S.E.C. 907 (1961), the SEC recognized that "[a]n affirmative duty to disclose material information has been

traditionally imposed on corporate 'insiders,' particularly officers, directors, or controlling stockholders," id., at 911, and that a breach of that duty to shareholders⁹ also could be a violation of Rule 10b-5.¹⁰ The SEC did not, however, limit this obligation to

⁹An insider's duty to the corporation's shareholders not to trade on inside information differs from the common-law duty that insiders also have to the corporation itself not to mismanage corporate assets, of which confidential information is one. See 3 Fletcher Cyclopaedia of the Laws of Private Corporations §§848, 900 (1975 ed. and Supp. 1982); 3A Fletcher, supra, §§1168.1, 1168.2. There are good reasons to view the breach of the duty to shareholders as also a violation of the federal securities laws. The breach of an insider's duties to the corporation are peculiarly within the corporation's ability to police, for incompetence or negligence in management, while not beneficial to any particular corporation's stock, is not necessarily fraud and does not undermine the integrity of the securities market as a whole. Corporations may have little incentive, on the other hand, to prevent violations of an insider's agency duties to shareholders, and the breaches of this duty are particularly difficult for outsiders to detect. Consequently, investors that prefer to own stock where the directors and officers do not secretly compensate themselves and "indulge themselves" to the point of dishonesty" by trading on information not available to market participants generally may have difficulty distinguishing between corporations that tolerate such practices and those that do not. See Dooley, Enforcement of Insider Trading Restrictions, 66 Va. L. Rev. 1, 39-41, 70 (1980). These dishonest acts induce investors to enter into or remain in a relationship that they would prefer to avoid, and the resulting loss of welfare inevitably undermines market confidence. See In re Faberge, Inc., 45 S.E.C. 249, 254 (1973). Thus, inside trading violates Rule 10b-5 because it presupposes both investor injury and deception. See Dooley, supra, at 41. We agree with the Cady, Roberts Commission that "[a] significant purpose of the Exchange Act was to eliminate the idea that use of inside information for personal advantage was a normal emolument of corporate office." See 40 S.E.C., at 912, n. 15.

¹⁰Rule 10b-5 is generally the most inclusive of the three provisions on which the SEC rested its decision in this case, and we will refer to it when we note the statutory basis for the SEC's inside-trading rules.

Jim -
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this out.
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no need
to argue
what
"insider
trading"
is a
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is not too
persuasive.
A senior
officer gross
neglect or
fraud to the
corp. (e.g.
stealing,
falsifying
records, etc.)
hurts all
shareholders
as well as
the corp.

disclose¹¹ or abstain to these insiders. See id., at 911.

Rather, the duty was found to exist whenever two factors were present:

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.

Id., at 912 (footnote omitted).

In Chiarella, we quoted with approval the Cady, Roberts statement of the basis for the disclose-or-abstain rule and adopted the SEC's twin elements for finding a violation of Rule 10b-5's inside-trading restrictions:

"(i) the existence of a relationship affording access to inside information intended to be available only for a corporate purpose, and (ii) the unfairness of allowing a corporate insider to take advantage of that information by

¹¹The SEC views the disclosure duty as extending beyond the immediate purchasers or sellers: "Proper and adequate disclosure of significant corporate developments can only be effected by a public release through the appropriate public media, designed to achieve a broad dissemination to the investing public generally and without favoring any special person or group." Faberge, Inc., 45 S.E.C., at 256.

trading without disclosure." 445 U.S., at 227. The Court agreed that there is no general duty to make disclosure before trading with material nonpublic information,¹² and held that "a duty to disclose under §10(b) does not arise from the mere possession of nonpublic market information." Id., at 235. Such a duty arises rather from the existence of a fiduciary relationship. See id., at 227-235.

The fraud in an inside-trading case ~~is not~~ is not, of

course, the mere possession of inside information or simply the person's relationship with the shareholders "by virtue of [his] position." Cady, Roberts, 40 S.E.C., at 911. Rather, it is the "inherent unfairness involved

where one [with access by virtue of a special relationship to the issuer to material information intended to be available only for a corporate purpose and not for personal gain] takes advantage of such information knowing it is unavailable to the investing public." In re Merrill

¹²See 445 U.S., at 233; id., at 237 (STEVENS, J., concurring); id., at 238-239 (BRENNAN, J., concurring in the judgment); id., at 239-240 (BURGER, C.J., dissenting). Cf. id., at 252, n. 2 (BLACKMUN, J., dissenting) (recognizing that there is no obligation to disclose material nonpublic information obtained through the exercise of "diligence or acumen" and "honest means," as opposed to "stealth").

Jim -
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Lynch, Pierce, Fenner & Smith, Inc., 43 S.E.C. 933, 936 (1968). It is therefore clear that there ^{is} ~~can be~~ no breach of the Cady, Roberts duty that insiders have to shareholders unless the insider exploits the information available to him for his personal benefit. Thus, an insider will be liable under Rule 10b-5 for inside trading only where he exploits material nonpublic information for personal gain and fails to disclose that information before doing so.

III

^{were explicit in saying}
We ~~made clear~~ in Chiarella ~~that~~ there can be no duty

to disclose where the person who has traded on inside information "was not [the corporation's] agent, he was not a fiduciary, [or] he was not a person in whom the sellers [of the securities] had placed their trust and confidence." 445 U.S., at 232. Not to require such a fiduciary relationship, we recognized, would "depar[t] radically from the established doctrine that duty arises from a specific relationship between two parties" and would amount to "recognizing a general duty between all participants in market transactions to forgo actions based

*June 9 tend
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frequently*

on material, nonpublic information." Id., at 232, 233.

This requirement of a specific relationship between the shareholders and the individual trading on inside information, however, has created analytical difficulties for the SEC in policing tippees who trade on inside information. Unlike insiders who have independent fiduciary duties to both the corporation and its shareholders, the typical tippee has no such relationships.¹³ In view of this absence, it has been unclear how a tippee acquires the duty to refrain from trading on inside information.

¹³Under certain circumstances, such as where corporate information is revealed legitimately to an underwriter, accountant, or lawyer working for the corporation, these outsiders may become fiduciaries of the shareholders. The basis for recognizing such fiduciary duties is not simply that such persons acquired nonpublic corporate information, but also 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. See SEC v. Monarch Fund, 608 F.2d 938, 942 (CA2 1979); In re Investors Management Co., 44 S.E.C. 633, 645 (1971); In re Van Alostne, Noel & Co., 43 S.E.C. 1080, 1084-1085 (1969); In re Merrill Lynch, Pierce, Fenner & Smith, Inc., 43 S.E.C. 933, 937 (1968); Cady, Roberts, 40 S.E.C., at 912. When such a person breaches his fiduciary relationship, he may be treated more properly as a tipper than a tippee. See Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d 228, 237 (CA2 1974) (investment banker had access to material information when working on a proposed public offering for the corporation). For such duties to be imposed, however, the corporation must expect the outsider to keep the disclosed nonpublic information confidential, and the person receiving the information must agree at least implicitly to such an arrangement.

A

The SEC's position, as stated in its opinion, is
that:

"In tipping potential traders, [petitioner] breached a duty which he had assumed as a result of knowingly receiving confidential information from [Equity Funding] insiders. Tippees such as [petitioner] who receive non-public material information from insiders become 'subject to the same duty as [the] insiders.' Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., [495 F.2d 228, 237 (CA2 1974) (quoting Ross v. Licht, 263 F. Supp. 395, 410 (SDNY 1967))]. Such a tippee breaches the fiduciary duty which he assumes from the insider when the tippee knowingly transmits the information to someone who will probably trade on the basis thereof.... Presumably, [petitioner's] informants were entitled to disclose the [Equity Funding] fraud in order to bring it to light and its perpetrators to justice. However, [petitioner]-standing in their shoes--committed a breach of the fiduciary duty which he had assumed in dealing with them, when he passed the information on to traders.

21 S.E.C. Docket, at 1410, n. 42.

~~We think that~~ ^T the SEC's position in this case differs little from its view that we rejected as inconsistent with congressional intent in Chiarella. In ^{that case,} ~~Chiarella~~, the Court of Appeals agreed with the SEC and affirmed the conviction there by holding 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.'" United States v. Chiarella, 588 F.2d 1358,

of material ~~information~~ information received from
an insider, whatever the circumstances¹⁴
of the disclosure may be, ~~creating~~
~~respects restriction on~~ in subject to
a restriction on its use in the market
prior to¹⁴ public disclosure.

1365 (CA2 1978) (emphasis in original). Here, the SEC 22
maintains that anyone who knowingly receives nonpublic
material information has a fiduciary duty to disclose
before trading. The SEC fails to explain, however, why or
how the possession of nonpublic information imposed on
petitioner a fiduciary duty with Equity Funding's 22
shareholders when Chiarella's possession did not.¹⁴

The SEC must consider the difference between this

case and Chiarella to be that disclosure from an insider
somehow ~~possesses~~ ^{possesses} the disclosed information with more
accompanying duties than the information that Chiarella
came by without the direct involvement of an insider. But
as we ~~made clear~~ ^{emphasized} in Chiarella, mere possession of
nonpublic information does not ^{give rise to} bring the Cady, Roberts
duty; only a specific relationship does that. In effect,

¹⁴Apparently recognizing the weakness of its
argument in light of Chiarella, the SEC attempts to
distinguish that case factually as involving not "inside"
information, but rather "market" information, i. e.,
"information generated within the company relating to its
assets or earnings." Brief for Respondent 23. This Court
drew no such distinction in Chiarella and, as THE CHIEF
JUSTICE noted, "[i]t is clear that §10(b) and Rule 10b-5
by their terms and by their history make no such
distinction." 445 U.S., at 241, n.1 (dissenting opinion).
See ALI Fed. Sec. Code §1603, Comment (2)(j) (Proposed
Official Draft 1978).

Jim - I
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Does it say
what I've
said
above?

then, the SEC's theory of tippee liability seems rooted
 more in the ~~discredited~~ ^{rejected} idea that the antifraud provisions
 require equal access to ^{all} material nonpublic information
 than in the principle set forth in Cady, Roberts and
Chiarella that only some persons, under some
 circumstances, will be barred from trading while in
 possession of ~~material nonpublic~~ ^{such} information.¹⁵ Judge
 Wright correctly read our opinion in Chiarella, however,
 as repudiating any notion that traders must enjoy equal
 information before trading: "[T]he 'information' theory is
 rejected. Because the disclose-or-refrain duty is
 extraordinary, it attaches only when a party has legal
 obligations other than a mere duty to comply with the
 general antifraud proscriptions in the federal securities

¹⁵In Chiarella, we noted that formulation of an
 equal information rule "should not be undertaken absent
 some explicit evidence of congressional intent." 445
 U.S., at 233. Rather than adopting such a radical view of
 securities trading, Congress has expressly exempted many
 market professionals from the general statutory
 prohibition set forth in §11(a)(1) of the Securities
 Exchange Act, 15 U.S.C. §78k(a)(1), against members of a
 national securities exchange trading for their own
 account. See *id.*, at 233, n. 16. We observed in
Chiarella that "[t]he exception is based upon Congress'
 recognition that [market professionals] contribute to a
 fair and orderly marketplace at the same time they exploit
 the informational advantage that comes from their
 possession of [nonpublic information]." Ibid.

laws." 220 U.S. App. D.C., at 322, 681 F.2d, at 837. See Chiarella, 445 U.S., at 235, n. 20 (BLACKMUN, J., dissenting).

We therefore reject the view that a duty to disclose or abstain exists solely because a person knowingly receives material nonpublic information and trades. Imposing such a duty could have an inhibiting influence on the role of market analysts that the SEC itself recognizes is essential.¹⁶ It is commonplace for analysts to "ferret out and analyze information," 21 S.E.C., at 1406, and this often is done by meeting with and questioning corporate officers and others who may be viewed as insiders. Such meetings customarily involve participants who understand

¹⁶The SEC expressly recognized that "[t]he value to the entire market of [analysts'] efforts cannot be gainsaid; market efficiency in pricing is significantly enhanced by [their] initiatives to ferret out and analyze information, and thus the analyst's work redounds to the benefit of all investors." 21 S.E.C., at 1406. The SEC asserts that "[a]nalysts remain free to obtain from corporate management corporate information that is not itself material for purposes of filling in the 'interstices in analysis'" Brief for Respondent 42 (quoting Investors Management Co., 44 S.E.C., at 646). But its rule is inherently imprecise, and imprecision prevents parties from ordering their actions in accord with legal requirements. Unless the parties know where the line is between permissible and impermissible disclosures and uses, neither corporate insiders nor analysts can be sure when the line is crossed. Cf. Adler v. Klawans, 267 F.2d 840, 845 (CA2 1959) (Burger, J., sitting by designation).

their responsibilities and adhere to them. And information that the analysts obtain normally may be the basis for judgments as to the market worth of a corporation's securities. The analyst's judgment in this respect is made available in market letters or otherwise to clients of the firm. A different judgment may be made by a different analyst: ~~Different~~ views make a market.¹⁷

In the very nature of this type of information, and indeed of the markets themselves, such information cannot be made simultaneously available to all of the corporation's stockholders or the public generally.

In effect, the SEC's view would mean that the duty to disclose accompanies the inside information, resting on all those who possess nonpublic material information. That is the general duty ~~which~~ we rejected in Chiarella.

We reaffirm ^{today} that "[a] duty [to disclose] arises from the

¹⁷On its facts, this case is the unusual one. Petitioner is an analyst in a broker-dealer firm, and he did interview management in the course of his investigation. He uncovered, however, startling information that required no analysis or exercise of judgment as to its market relevance. Nonetheless, the principle at issue here extends beyond these facts. The SEC's rule--applicable without regard to any breach by an insider--could have wide ramifications on reporting by analysts of ~~more-mundane~~ investment news. *views and*

relationship between parties ... and not merely from one's ability to acquire information because of his position in the market." 445 U.S., at 232-233, n. 14.

B

It is clear under Cady, Roberts that, not only are insiders forbidden by their fiduciary relationship from using undisclosed corporate information to their personal advantage, but they may not give such information to an outsider for the same improper purpose of exploiting the information for their personal gain. See 15 U.S.C. §78t(b). Similarly, the transactions of those who knowingly participate and profit with the fiduciary in such a breach are "as forbidden" as transactions "on behalf of the trustee himself." Mosser v. Darrow, 341 U.S. 267, 272 (1951). See Jackson v. Smith, 254 U.S. 586, 589 (1921); Jackson v. Ludeling, 88 U.S. 616, 631-632 (1874). As the Court explained in Mosser, a contrary rule "would open up opportunities for devious dealings in the name of the others that the trustee could not conduct in his own." 341 U.S., at 271. See SEC v. Texas Gulf Sulphur Co., 446 F.2d 1301, 1308 (CA2), cert. denied, 404

What is
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of §78(t)(4)?

U.S. 1005 (1971).

Hence, as we noted in Chiarella, "[t]he tippee's obligation has been viewed as arising from his role as a participant after the fact in the insider's breach of a fiduciary duty." 445 U.S., at 230, n. 12. Tippees may assume an insider's duty to the corporation's shareholders not because they receive inside information, but rather because they receive it improperly.¹⁸ And clearly not all disclosures are improper simply because people trade as a result. The SEC's rules are meant to promote many such disclosures. Rather, for Rule 10b-5 purposes, the disclosure is improper where it would violate the insider's duties under Cady, Roberts. Thus, a tippee assumes a fiduciary duty to the shareholders of a corporation not to trade on material nonpublic information

¹⁸The SEC itself has recognized that tippee liability properly is imposed only in circumstances where the tippee knows, or has reason to know, that the insider has disclosed improperly inside corporate information. In Investors Management Co., the SEC stated that one element of tippee liability is that the tippee knew or had reason to know "that [the information] was non-public and had been obtained improperly by selective revelation or otherwise." 44 S.E.C., at 641 (emphasis added). Commissioner Smith read this test to mean that a tippee can be held liable only if he received information in breach of an insider's duty not to disclose it. Id., at 650 (concurring in the result). See n. 19, supra.

only when the insider breaches his fiduciary duty to the shareholders by disclosing the information to the tippee and the tippee knows of that breach.¹⁹ As Commissioner Smith perceptively observed in Investors Management Co.:

"It is important in this type of case to focus on policing insiders and what they do, which I think appropriate, rather than on policing information per se and its possession, which I think impracticable. I believe the emphasis in the law should continue to be upon the conduct of corporate insiders and their privies, as it has been since Strong v. Repide, 213 U.S. 419 (1909) and as it was in Cady Roberts, Texas Gulf and Merrill Lynch, rather than upon a concept--too vague for me to apply with any consistency--of relative informational advantages in the marketplace."

44 S.E.C., at 648 (concurring in the result).

¹⁹Professor Loss has linked tippee liability to the concept in the law of restitution that "[w]here a fiduciary in violation of his duty to the beneficiary communicates confidential information to a third person, the third person, if he had notice of the violation of duty, holds upon a constructive trust for the beneficiary any profit which he makes through the use of such information." 3 L. Loss, Securities Regulation 1451 (2d ed. 1961) (quoting Restatement of Restitution §201(2) (1937)). Other authorities likewise have expressed the view that tippee liability exists only where there has been a breach of trust by an insider. See, e. g., Ross v. Licht, 263 F. Supp. 395, 410 (SDNY 1967); A. Jacobs, The Impact of Rule 10b-5, §167, at 7-4 (1975) ("[T]he better view is that a tipper must know or have reason to know the information is nonpublic and was improperly obtained."); Fleischer, Mundheim & Murphy, An Initial Inquiry Into the Responsibility to Disclose Market Information, 121 U. Pa. L. Rev. 798, 818, n. 76 (1973) ("The extension of rule 10b-5 restrictions to tippees of corporate insiders can best be justified on the theory that they are participating in the insider's breach of his fiduciary duty."). Cf. Restatement (Second) of Agency §312, comment c (1958) ("A person who, with notice that an agent is thereby violating his duty to his principal, receives confidential information from the agent, may be [deemed] ... a constructive trustee.").

of which the tippee had knowledge.

"notice" part of tippee in this case

Good both points

both

John: This note only encompasses two points: breach by tipper & notice of knowledge of breach by tippee. The note would be clearer if the quoted on these points were consecutive.

John - 9/1
this is repeated in Prof. Loss supplement, cite it. Was the supplement merely an "add on" or was it a 2nd Ed.?

C

Tipping thus properly is viewed as a means of indirectly violating the Cady, Roberts disclose-or-abstain rule. Accordingly, the elements of a Rule 10b-5 violation in a tipping case should be the same as in an inside-trading case. Mere possession of inside information does not impose an obligation to disclose or abstain. See Chiarella, supra. Similarly, mere receipt of information from a corporate insider is not enough to impose such an obligation. The recipient or tippee of inside information thus cannot be "a participant after the fact," Chiarella, 445 U.S., at 230, n. 12, unless the insider or provider of the information has breached his duty to the corporation's shareholders, i. e., he has a specific relationship to the shareholders of the corporation and he exploits confidential information received as a result of that relationship for his personal benefit.²⁰

²⁰The legal conclusion that all trading on nonpublic inside information by securities analysts does not violate the antifraud provisions of the securities laws in no way suggests that knowingly trading on inside information by securities analysts is "socially desirable or even that it is devoid of moral considerations." Dooley, at 55. Nor does it suggest that it is unreasonable to expect that all citizens, including securities analysts, have an

Footnote continued on next page.

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 be limited
 to analyst.
 E.g. yesterday's
 story in W/Street
 Journal.

Jim - Has the SEC ever explicitly rejected Smith's views?
Were they relied upon by
Peters' counsel or commented upon
by SG's Brief in this case? We
don't want to be "mouse-trapped".

Because all disclosures of confidential corporate information are not inconsistent with the duty insiders owe to shareholders, all disclosures will not qualify as exploitation. Whether disclosure of material nonpublic information is a breach of duty therefore depends in large part on the purpose of the disclosure.²¹ As Commissioner Smith stated in Investors Management Co.:

"[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, and that the information must be shown not only to have been

obligation to disclose promptly indications of illegal actions by a corporation to the proper authorities--typically the SEC and exchange authorities in cases involving securities. On the contrary, trading on material nonpublic information is behavior that falls below the standard of conduct to which many aspire. That conclusion does not, however, further analysis very far. There are "significant distinctions between actual legal obligations and ethical ideals." SEC, Report of the Special Study of Securities Markets, H.R. Doc. No. 95, 88th Cong., 1st Sess., pt. 1, pp. 237-238 (1963).

²¹An example of a case turning on the court's determination that the disclosure did not impose any fiduciary duties on the recipient of the inside information is Walton v. Morgan Stanley & Co., 623 F.2d 796 (CA2 1980). There, the defendant investment banking firm, representing one of its own corporate clients, investigated another corporation that was a possible target of a takeover bid by its client. In the course of negotiations the investment banking firm was given, on a confidential basis, unpublished material information. Subsequently, after the proposed takeover was abandoned, the firm was charged with relying on the information when it traded in the target corporation's stock. For purposes of the decision, it was assumed that the firm knew the information was confidential, but that it had been received in arm's-length negotiations. See id., at 798. In the absence of any fiduciary relationship, the Court of Appeals found no basis for imposing tippee liability on the investment firm. See id., at 799.

highly ethical

What about actual Analyst Code of Ethics?



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material and non-public, but also to have substantially contributed to the trading which occurred."

44 S.E.C., at 651 (concurring in the result).

There are facts and circumstances that often may justify an inference that the insider has breached his fiduciary duty. For example, there may be a relationship that exists between the insider and the recipient that suggests a quid pro quo from the latter, or an intention to benefit the particular recipient. The elements of fiduciary duty and exploitation of nonpublic information certainly exist when an insider makes a gift of confidential information to a trading relative or friend. The tip and trade resemble trading by the insider ^{himself} followed by a gift of the profits to the recipient.

Determining the purpose of any one disclosure may not always be easy. And the rules and presumptions that will govern disclosures under the various situations that will arise may not be easy for the SEC and the courts to draw. But some clear lines for the securities industry must be drawn and the liability for trading may not follow inside information throughout the entire securities market. In

contrast, the rule set forth by the SEC in this case would have no limiting principle.²²

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IV

Under the inside-trading and tipping rules set forth above, we find that there was no actionable violation by petitioner.²³ It is undisputed that petitioner himself

²²Without legal limitations, market participants are forced to rely on the reasonableness of the SEC's litigation strategy, but that can be hazardous, as the facts of this case make plain. Following the SEC's filing of the Texas Gulf Sulphur action, Commissioner (and later Chairman) Budge spoke of the various implications of applying Rule 10b-5 in inside trading cases:

Turning to the realm of possible defendants in the present and potential civil actions, the Commission certainly does not contemplate suing every person who may have come across inside information. In the Texas Gulf action neither tippees nor persons in the vast rank and file of employees have been named as defendants. In my view, the Commission in future cases normally should not join rank and file employees or persons outside the company such as an analyst or reporter who learns of inside information.

Speech of Hamer Budge to the New York Regional Group of the American Society of Corporate Secretaries, Inc. (Nov. 18, 1965) (emphasis added), reprinted in Budge, The Texas Gulf Sulphur Case--What It Is and What It Isn't, Corp. Secretary No. 127, at 6 (Dec. 17, 1965).

²³Petitioner contends that he was not a "tippee" because the information he received constituted unverified allegations of fraud that were denied by management and were not "material facts" under the securities laws that required disclosure before trading. He also argues that the information he received was not truly "inside" information, i. e., intended for a confidential corporate purpose, but was merely evidence of a crime. The Solicitor General agrees. See Brief for United States as Amicus Curiae 22. For purposes of deciding this case, however, we assume the correctness of the SEC's findings, accepted by the Court of Appeals, that petitioner was a tippee of material inside information.

was a stranger to Equity Funding, with no pre-existing
 fiduciary duty to its shareholders.²⁴ He took no action,
 directly or indirectly, that induced the shareholders or
 officers of Equity Funding to repose trust or confidence
 in him. There was no expectation by petitioner's sources
 that he would keep their information in confidence. Nor
 did petitioner ~~did~~ misappropriate or illegally obtain
^{the} information about Equity Funding. Unless the insiders
 breached their Cady, Roberts duty to shareholders in
^{disclosing}
~~passing~~ the nonpublic information to petitioner, he
 breached no duty when he passed ^{it} on ~~the information~~ to
 investors as well as to the Wall Street Journal.

In this case, ^{we think it also} ~~it~~ is clear that the Equity Funding
 employees did not violate their Cady, Roberts duty to the
 corporation's shareholders by providing information to
 petitioner.²⁵ The tippers received no monetary or

²⁴Judge Wright found that petitioner acquired a fiduciary duty by virtue of his position as an employee of a broker-dealer. See 220 U.S. App. D.C., at 325-327, 681 F.2d, at 840-842. The SEC, however, did not consider Judge Wright's alternate theory in its decision, nor did it present that theory to the Court of Appeals. The SEC also has not argued Judge Wright's theory in this Court. See Brief for Respondent 21, n. 27. The merits of such a duty are therefore not before the Court. See SEC v. Chenery Corp., 332 U.S. 194, 196-197 (1947).

Footnote(s) 25 will appear on following pages.

Reider A p 26

To stockholders

In the absence of a breach of duty by the insiders, there was no derivative breach by petitioner. See n 19. As we said in Chiarella, petitioner therefore could not have been "a participant after the fact ~~in an insider's~~ after the fact ~~in an~~ insider's breach of fiduciary duty". 445 U.S. at 230, n 12.

public attention the derelictions at Equity Funding, Secrist breached his duty to Equity Funding shareholders." Brief for Respondent 31. It is clear, however, that this "duty" differs markedly from the one that the SEC identified in Cady, Roberts and that has been the basis for federal tippee-trading rules to date. Nevertheless, it is unnecessary for us to determine whether such a duty exists and whether its breach also satisfies the requirements for a violation of the federal antifraud provisions. See n. 9, supra. The SEC did not charge Secrist with any wrongdoing, and we do not understand the SEC to have relied on Secrist's breach of any "duty" in finding that petitioner breached his duty to Equity Funding's shareholders. See App. 250 (decision of administrative law judge) ("One who knows himself to be a beneficiary of non-public, selectively disclosed inside information must fully disclose or refrain from trading."); 21 S.E.C., at 1410, n. 42 ("Presumably, [petitioner's] informants were entitled to disclose the [Equity Funding] fraud in order to bring it to light and its perpetrators to justice."); Brief of Respondent in the Court of Appeals, at 47-50; id., at 51 ("[K]nowing possession of inside information by any person imposes a duty to abstain or disclose."); id., at 52-54; id., at 55 ("[T]his obligation arises not from the manner in which such information is acquired"); 220 U.S. App. D.C., at 322-323, 681 F.2d, at 838 (Wright, J.).

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on behalf
of the
SEC

Jim - I really question the usefulness of this little speech. We have made the basic point about. See pp 16, 17 & 216.

Although Rule 10b-5 must preclude tippee-trading that

circumvents the prohibitions of the inside-trading restrictions, those rules must not sweep so broadly that they ~~chill~~ legitimate, socially useful market activity.

Corporations must conduct certain business in private, while the securities market, to serve the important public

interest in raising and allocating vast sums of capital in

the ^{an} most efficient and orderly manner, ~~possible~~, needs as

much material information as possible about the public

corporations that it serves. Insiders have ~~much~~

discretion in delaying the disclosure of material

information, and securities analysts play a beneficial

role in probing the corporate structure for inside

information. Rule 10b-5 should not be used, absent clear

congressional intent to that effect, to upset the

beneficial balance that the securities market has enjoyed

by the check the competing interests have on each other.

While the federal securities laws are appropriate bars to

the exploitation of information by corporate insiders,

they should not be used to protect corporations from

securities analysts performing their normal information-

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We conclude that petitioner, in the circumstances of this case, had no duty to abstain from ^{use of} ~~facilitating~~ trading ~~by others~~ on the inside information that ~~he~~ ^{he} obtained. The judgment of the Court of Appeals therefore is

Reversed.

MAY 22 1983

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

From: **Justice Powell**

Circulated: _____

Recirculated: _____

CHAMBERS DRAFT

SUPREME COURT OF THE UNITED STATES

No. 82-276

RAYMOND L. DIRKS, PETITIONER *v.* SECURITIES
AND EXCHANGE COMMISSION

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF
APPEALS FOR DISTRICT OF COLUMBIA

[May —, 1983]

JUSTICE POWELL delivered the opinion of the Court.

Petitioner received material nonpublic information from "insiders" of a corporation with which he had no connection. He disclosed this information to investors who relied on it in trading in the shares of the corporation. The question is whether petitioner violated the antifraud provisions of the federal securities laws by this disclosure.

I

In 1973, petitioner was an officer of a New York broker-dealer firm, providing investment analysis on insurance company securities to institutional investors.¹ On March 6, petitioner received information from Ronald Secrist, a former officer of Equity Funding of America. Secrist alleged that the assets of Equity Funding, a diversified corporation primarily engaged in selling life insurance and mutual funds, were vastly overstated as the result of fraudulent internal corporate practices. Secrist also stated that various regula-

¹The facts stated here are taken from more detailed statements set forth by the administrative law judge, App. 176-180, 225-247; the opinion of the Securities and Exchange Commission, 21 S.E.C. Docket 1401, 1402-1406 (1981); and the opinion of Judge Wright in the Court of Appeals, 220 U. S. App. D.C. 309, 314-318, 681 F. 2d 824, 829-833 (1982).

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tory agencies had failed to act on similar charges made by Equity Funding employees. He urged petitioner to verify the fraud and disclose it publicly.

Petitioner decided to investigate the allegations. He visited Equity Funding's headquarters in Los Angeles and interviewed several officers and employees of the corporation. Its senior management denied any wrongdoing, but current and former corporation employees corroborated the charges of fraud. Neither petitioner nor his firm owned or traded any Equity Funding stock, but throughout his investigation petitioner candidly discussed with a number of investors and analysts the information he had obtained. Some of these persons sold their holdings of Equity Funding securities, including five investment advisers who liquidated securities worth more than \$16 million.²

During the entire week that petitioner was in Los Angeles, he was in touch regularly with William Blundell, the *Wall Street Journal's* Los Angeles bureau chief. Petitioner urged Blundell to write a story on the fraud allegations. Blundell discounted the allegations because he did not believe that such a massive fraud could go undetected. He declined to write the story, fearing that publishing such damaging rumors supported only by hearsay from current and former employees might be libelous.

During the two-week period in which petitioner pursued his investigation and spread word of Secrist's charges, the

² Petitioner received from his firm a salary plus a commission for securities transactions above a certain amount that his clients directed through his firm. See 21 S.E.C. Docket, at 1402, n. 8. But "It is not clear how many of those with whom [petitioner] spoke promised to direct some brokerage business through [petitioner's firm] to compensate [petitioner], or how many actually did so." 220 U. S. App. D.C., at 316, 681 F. 2d, at 831. The Boston Company Institutional Investors, Inc., promised petitioner about \$25,000 in commissions, but it is unclear whether Boston actually generated any brokerage business for petitioner's firm. See App. 199, 204-205; 21 S.E.C. Docket, at 1404, n. 10; 220 U. S. App. D.C., at 316, n. 5, 681 F. 2d, at 831, n. 5.

price of Equity Funding stock fell precipitously from \$26 per share to less than \$15 per share. This led the New York Stock Exchange to halt trading on March 27. Shortly thereafter California insurance authorities impounded Equity Funding's records and uncovered evidence of the fraud. Only then did the Securities and Exchange Commission (SEC) file a complaint against Equity Funding³ and only then, on April 2, did the *Wall Street Journal* publish a front-page story based largely on information assembled by petitioner. Equity Funding immediately went into receivership.⁴

The SEC investigated petitioner's role in the disclosure of the fraud. After a hearing by an administrative law judge, the SEC found that petitioner had aided and abetted violations of § 17(a) of the Securities Act of 1933, 15 U. S. C. § 77q(a),⁵ § 10(b) of the Securities Exchange Act of 1934, 15

³ As early as 1971, the SEC had received allegations of fraudulent accounting practices at Equity Funding. Moreover, on March 9, 1973, an official of the California Insurance Department informed the SEC's regional office in Los Angeles of Secrist's charges of fraud. Petitioner himself voluntarily presented his information at the SEC's regional office beginning on March 27.

⁴ A federal grand jury in Los Angeles subsequently returned a 105-count indictment against 22 persons, including many of Equity Funding's officers and directors. All defendants were found guilty of one or more counts, either by a plea of guilty or a conviction after trial. See Brief for Petitioner 15; App. 149-153.

⁵ Section 17(a) provides:

"It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

"(1) to employ any device, scheme, or artifice to defraud, or

"(2) to obtain money or property by means of any untrue statement of a material fact or any omission 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

"(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser."

U. S. C. § 78j(b),⁶ and SEC Rule 10b-5, 17 CFR § 240.10b-5 (1982),⁷ when he repeated the allegations of fraud to members of the investment community—including clients of his firm—who later sold their Equity Funding stock. The SEC concluded: "Where 'tippees'—regardless of their motivation or occupation—come into possession of material 'information that they know is confidential and know or should know came from a corporate insider,' they must either publicly disclose that information or refrain from trading." 21 S.E.C. Docket 1401, 1407 (1981) (footnote omitted) (quoting *Chiarella v. United States*, 445 U. S. 222, 230 n. 12 (1980)). Recognizing, however, that petitioner "played an important role in bringing [Equity Funding's] massive fraud to light," 21 S.E.C. Docket, at 1412, the SEC only censured him.⁸

⁶Section 10(b) provides:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

"(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

⁷Rule 10b-5 provides:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

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

"(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

"(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."

⁸Section 15 of the Securities Exchange Act, 15 U. S. C. § 78o(b)(4)(E), provides that the SEC may impose certain sanctions, including censure, on any person associated with a registered broker-dealer who has "willfully

Petitioner sought review in the Court of Appeals for the District of Columbia Circuit. Without opinion, the court entered judgment against petitioner "for the reasons stated by the Commission in its opinion." App. to Pet. for Cert. C-2. Judge Wright, a member of the panel, subsequently issued an opinion. Judge Robb concurred in the result, and Judge Tamm dissented; neither filed a separate opinion. Judge Wright believed that "the obligations of corporate fiduciaries pass to all those to whom they disclose their information before it has been disseminated to the public at large." 220 U. S. App. D.C. 309, 324, 681 F. 2d 824, 839 (1982). Alternatively, Judge Wright concluded that, as an employee of a broker-dealer, petitioner had violated "obligations to the SEC and to the public completely independent of any obligations he acquired" from sources at Equity Funding. *Id.*, at 325, 681 F. 2d, at 840.

We granted a writ of certiorari, U. S. (1982), because of the importance to the SEC and to the securities industry of the question presented by this case. We now reverse the judgment of the Court of Appeals.

II

In the seminal case of *In re Cady, Roberts & Co.*, 40 S.E.C. 907 (1961), the SEC recognized that "[a]n affirmative duty to disclose material information has been traditionally imposed on corporate 'insiders,' particularly officers, directors, or controlling stockholders," *id.*, at 911, and that a breach of that duty to shareholders² also could be a violation

aided [or] abetted" any violation of the federal securities laws. See 15 U. S. C. § 78ff(a) (providing criminal penalties).

²An insider's duty to the corporation's shareholders not to trade on inside information differs from the common-law duty that insiders also have to the corporation itself not to mismanage corporate assets, of which confidential information is one. See 3 Fletcher Cyclopaedia of the Laws of Private Corporations §§ 848, 900 (1975 ed. and Supp. 1982); 3A Fletcher, *supra*, §§ 1168.1, 1168.2. There are good reasons to view the breach of the duty to shareholders as also a violation of the federal securities laws.

of Rule 10b-5.¹⁰ The SEC did not, however, limit this obligation to disclose¹¹ or abstain to these insiders. See *id.*, at 911. Rather, the duty was found to exist whenever two factors were present:

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. *Id.*, at 912 (footnote omitted).

In *Chiarella*, we quoted with approval the *Cady, Roberts* statement of the basis for the disclose-or-abstain rule and adopted the SEC's twin elements for finding a violation of Rule 10b-5's inside-trading restrictions: "(i) the existence of a relationship affording access to inside information intended to be available only for a corporate purpose, and (ii) the unfairness of allowing a corporate insider to take advantage of that information by trading without disclosure." 445 U. S., at 227. The Court agreed that there is no general duty to make

Inside trading violates Rule 10b-5 because it presupposes both investor injury and deception. See Dooley, *Enforcement of Insider Trading Restrictions*, 66 Va. L. Rev. 1, 41 (1980). We agree with the *Cady, Roberts* Commission that "[a] significant purpose of the Exchange Act was to eliminate the idea that use of inside information for personal advantage was a normal emolument of corporate office." See 40 S.E.C., at 912, n. 15.

¹⁰ Rule 10b-5 is generally the most inclusive of the three provisions on which the SEC rested its decision in this case, and we will refer to it when we note the statutory basis for the SEC's inside-trading rules.

¹¹ The SEC views the disclosure duty as extending beyond the immediate purchasers or sellers: "Proper and adequate disclosure of significant corporate developments can only be effected by a public release through the appropriate public media, designed to achieve a broad dissemination to the investing public generally and without favoring any special person or group." *In re Faberge, Inc.*, 45 S.E.C. 249, 256 (1973).

disclosure before trading with material nonpublic information,¹² and held that "a duty to disclose under § 10(b) does not arise from the mere possession of nonpublic market information." *Id.*, at 235. Such a duty arises rather from the existence of a fiduciary relationship. See *id.*, at 227-235.

The fraud in an inside-trading case is the "inherent unfairness involved where one [with access by virtue of a special relationship to the issuer to material information intended to be available only for a corporate purpose and not for personal gain] takes advantage of such information knowing it is unavailable to the investing public." *In re Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 43 S.E.C. 933, 936 (1968). It is therefore clear that there is no breach of the *Cady, Roberts* duty that insiders have to shareholders unless the insider exploits the information available to him for his personal benefit. Thus, an insider will be liable under Rule 10b-5 for inside trading only where he exploits material nonpublic information for personal gain and fails to disclose that information before doing so.

III

We were explicit in *Chiarella* in saying that there can be no duty to disclose where the person who has traded on inside information "was not [the corporation's] agent, he was not a fiduciary, [or] he was not a person in whom the sellers [of the securities] had placed their trust and confidence." 445 U. S., at 232. Not to require such a fiduciary relationship, we recognized, would "depar[t] radically from the established doctrine that duty arises from a specific relationship between two parties" and would amount to "recognizing a general

¹² See 445 U. S., at 233; *id.*, at 237 (STEVENS, J., concurring); *id.*, at 238-239 (BRENNAN, J., concurring in the judgment); *id.*, at 239-240 (BURGER, C. J., dissenting). Cf. *id.*, at 252, n. 2 (BLACKMUN, J., dissenting) (recognizing that there is no obligation to disclose material nonpublic information obtained through the exercise of "diligence or acumen" and "honest means," as opposed to "stealth").

duty between all participants in market transactions to forgo actions based on material, nonpublic information." *Id.*, at 232, 233. This requirement of a specific relationship between the shareholders and the individual trading on inside information, however, has created analytical difficulties for the SEC in policing tippees who trade on inside information. Unlike insiders who have independent fiduciary duties to both the corporation and its shareholders, the typical tippee has no such relationships.¹² In view of this absence, it has been unclear how a tippee acquires the duty to refrain from trading on inside information.

A

The SEC's position, as stated in its opinion, is that:

"In tipping potential traders, [petitioner] breached a duty which he had assumed as a result of knowingly receiving confidential information from [Equity Funding]

¹² Under certain circumstances, such as where corporate information is revealed legitimately to an underwriter, accountant, or lawyer working for the corporation, these outsiders may become fiduciaries of the shareholders. The basis for recognizing such fiduciary duties is not simply that such persons acquired nonpublic corporate information, but also 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. See *SEC v. Monarch Fund*, 608 F. 2d 938, 942 (CA2 1979); *In re Investors Management Co.*, 44 S.E.C. 638, 645 (1971); *In re Van Aylstne, Noel & Co.*, 43 S.E.C. 1080, 1084-1085 (1969); *In re Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 43 S.E.C. 933, 937 (1968); *Cady, Roberts*, 40 S.E.C., at 912. When such a person breaches his fiduciary relationship, he may be treated more properly as a tipper than a tippee. See *Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 495 F. 2d 228, 237 (CA2 1974) (investment banker had access to material information when working on a proposed public offering for the corporation). For such duties to be imposed, however, the corporation must expect the outsider to keep the disclosed nonpublic information confidential, and the person receiving the information must agree at least implicitly to such an arrangement.

insiders. Tippees such as [petitioner] who receive nonpublic material information from insiders become 'subject to the same duty as [the] insiders.' *Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, [495 F. 2d 228, 237 (CA2 1974) (quoting *Ross v. Licht*, 263 F. Supp. 395, 410 (SDNY 1967))]. Such a tippee breaches the fiduciary duty which he assumes from the insider when the tippee knowingly transmits the information to someone who will probably trade on the basis thereof. . . . Presumably, [petitioner's] informants were entitled to disclose the [Equity Funding] fraud in order to bring it to light and its perpetrators to justice. However, [petitioner]—standing in their shoes—committed a breach of the fiduciary duty which he had assumed in dealing with them, when he passed the information on to traders. 21 S.E.C. Docket, at 1410, n. 42.

The SEC's position in this case differs little from its view that we rejected as inconsistent with congressional intent in *Chiarella*. In that case, the Court of Appeals agreed with the SEC and affirmed the conviction there by holding 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." *United States v. Chiarella*, 588 F. 2d 1358, 1365 (CA2 1978) (emphasis in original). Here, the SEC maintains that anyone who knowingly receives nonpublic material information has a fiduciary duty to disclose before trading. Apparently, the SEC believes this case differs from *Chiarella* in that here the petitioner's receipt of inside information from an insider brought the duties of an insider, while *Chiarella* received the information without the direct involvement of an insider and thus inherited no *Cady*, *Roberts* duty. The SEC still fails to explain, however, why or how the possession of nonpublic information imposed on petitioner a fiduciary duty with *Equity Funding's* sharehold-

ers when Chiarella's possession did not.¹⁴ As we emphasized in *Chiarella*, mere possession of nonpublic information does not give rise to the *Cady, Roberts* duty; only a specific relationship does that.

In effect, then, the SEC's theory of tippee liability seems rooted more in the rejected idea that the antifraud provisions require equal access to all material nonpublic information than in the principle set forth in *Cady, Roberts* and *Chiarella* that only some persons, under some circumstances, will be barred from trading while in possession of such information.¹⁵ Judge Wright correctly read our opinion in *Chiarella*, however, as repudiating any notion that traders must enjoy equal information before trading: "[T]he 'information' theory is rejected. Because the disclose-or-refrain duty is extraordinary, it attaches only when a party has legal obligations other than a mere duty to comply with the general antifraud prescriptions in the federal securities laws." 220 U. S. App.

¹⁴ Apparently recognizing the weakness of its argument in light of *Chiarella*, the SEC attempts to distinguish that case factually as involving not "inside" information, but rather "market" information, i. e., "information generated within the company relating to its assets or earnings." Brief for Respondent 23. This Court drew no such distinction in *Chiarella* and, as THE CHIEF JUSTICE noted, "[i]t is clear that § 10(b) and Rule 10b-5 by their terms and by their history make no such distinction." 445 U. S., at 241, n. 1 (dissenting opinion). See ALI Fed. Sec. Code § 1603, Comment (2)(j) (Proposed Official Draft 1978).

¹⁵ In *Chiarella*, we noted that formulation of an absolute equal information rule "should not be undertaken absent some explicit evidence of congressional intent." 445 U. S., at 233. Rather than adopting such a radical view of securities trading, Congress has expressly exempted many market professionals from the general statutory prohibition set forth in § 11(a)(1) of the Securities Exchange Act, 15 U. S. C. § 78k(a)(1), against members of a national securities exchange trading for their own account. See *id.*, at 233, n. 16. We observed in *Chiarella* that "[t]he exception is based upon Congress' recognition that [market professionals] contribute to a fair and orderly marketplace at the same time they exploit the informational advantage that comes from their possession of [nonpublic information]." *Ibid.*

D.C., at 322, 681 F. 2d, at 837. See *Chiarella*, 445 U. S., at 235, n. 20 (BLACKMUN, J., dissenting).

We therefore reject the view that a duty to disclose or abstain exists solely because a person knowingly receives material nonpublic information and trades. Imposing such a duty could have an inhibiting influence on the role of market analysts that the SEC itself recognizes is essential.¹⁶ It is commonplace for analysts to "ferret out and analyze information," 21 S.E.C., at 1406, and this often is done by meeting with and questioning corporate officers and others who may be viewed as insiders. Such meetings customarily involve participants who understand their responsibilities and adhere to them. And information that the analysts obtain normally may be the basis for judgments as to the market worth of a corporation's securities. The analyst's judgment in this respect is made available in market letters or otherwise to clients of the firm. A different judgment may be made by a different analyst: different views make a market.¹⁷ In the

¹⁶ The SEC expressly recognized that "[t]he value to the entire market of [analysts'] efforts cannot be gainsaid; market efficiency in pricing is significantly enhanced by [their] initiatives to ferret out and analyze information, and thus the analyst's work redounds to the benefit of all investors." 21 S.E.C., at 1406. The SEC asserts that "[a]nalysts remain free to obtain from corporate management corporate information that is not itself material for purposes of filling in the 'interstices in analysis'" Brief for Respondent 42 (quoting *Investors Management Co.*, 44 S.E.C., at 646). But its rule is inherently imprecise, and imprecision prevents parties from ordering their actions in accord with legal requirements. Unless the parties know where the line is between permissible and impermissible disclosures and uses, neither corporate insiders nor analysts can be sure when the line is crossed. Cf. *Adler v. Klawans*, 267 F. 2d 840, 845 (CA2 1959) (Burger, J., sitting by designation).

¹⁷ On its facts, this case is the unusual one. Petitioner is an analyst in a broker-dealer firm, and he did interview management in the course of his investigation. He uncovered, however, startling information that required no analysis or exercise of judgment as to its market relevance. Nonetheless, the principle at issue here extends beyond these facts. The SEC's rule—applicable without regard to any breach by an insider—could

very nature of this type of information, and indeed of the markets themselves, such information cannot be made simultaneously available to all of the corporation's stockholders or the public generally.

In effect, the SEC's view would mean that the duty to disclose accompanies the inside information, resting on all those who possess nonpublic material information. That is the general duty we rejected in *Chiarella*. We reaffirm today that "[a] duty [to disclose] arises from the relationship between parties . . . and not merely from one's ability to acquire information because of his position in the market." 445 U. S., at 232-233, n. 14.

B

Although there are problems with the SEC's theory of tippee liability, the prophylactic need for a ban on some tippee trading is clear. And it is also clear that the tippee's duty to disclose or abstain is derivative from that of the insider's duty. See Tr. of Oral Arg. 38. Cf. *Chiarella*, 445 U. S., at 246, n. 1 (BLACKMUN J., dissenting). Under *Cady, Roberts*, not only are insiders forbidden by their fiduciary relationship from using undisclosed corporate information to their personal advantage, but they may not give such information to an outsider for the same improper purpose of exploiting the information for their personal gain. See 15 U. S. C. § 78t(b) (making it unlawful to do indirectly any act made unlawful by the federal securities acts "by means of any other person"). Similarly, the transactions of those who knowingly participate and profit with the fiduciary in such a breach are "as forbidden" as transactions "on behalf of the trustee himself." *Mosser v. Darrow*, 341 U. S. 267, 272 (1951). See *Jackson v. Smith*, 254 U. S. 586, 589 (1921); *Jackson v. Ludeling*, 88 U. S. 616, 631-632 (1874). As the

have wide ramifications on reporting by analysts of investment views and news.

Court explained in *Mosser*, a contrary rule "would open up opportunities for devious dealings in the name of the others that the trustee could not conduct in his own." 341 U. S., at 271. See *SEC v. Texas Gulf Sulphur Co.*, 446 F. 2d 1301, 1308 (CA2), cert. denied, 404 U. S. 1005 (1971).

Hence, as we noted in *Chiarella*, "[t]he tippee's obligation has been viewed as arising from his role as a participant after the fact in the insider's breach of a fiduciary duty." 445 U. S., at 230, n. 12. Tippees may assume an insider's duty to the shareholders not because they receive inside information, but rather because they receive it *improperly*.¹⁸ And clearly not all disclosures are improper simply because people trade as a result. The SEC's rules are meant to promote many such disclosures. Rather, for Rule 10b-5 purposes, the disclosure is improper where it would violate the insider's duties under *Cady, Roberts*. Thus, a tippee assumes a fiduciary duty to the shareholders of a corporation not to trade on material nonpublic information only when the insider breaches his fiduciary duty to the shareholders by disclosing the information to the tippee and the tippee knows of that breach.¹⁹ As Commissioner Smith perceptively observed in *Investors Management Co.*:

¹⁸The SEC itself has recognized that tippee liability properly is imposed only in circumstances where the tippee knows, or has reason to know, that the insider has disclosed improperly inside corporate information. In *Investors Management Co.*, the SEC stated that one element of tippee liability is that the tippee knew or had reason to know "that [the information] was non-public and had been obtained *improperly* by selective revelation or otherwise." 44 S.E.C., at 641 (emphasis added). Commissioner Smith read this test to mean that a tippee can be held liable only if he received information in breach of an insider's duty not to disclose it. *Id.*, at 650 (concurring in the result). See n. 19, *supra*.

¹⁹Professor Loss has linked tippee liability to the concept in the law of restitution that "[w]here a fiduciary in violation of his duty to the beneficiary communicates confidential information to a third person, the third person, if he had notice of the violation of duty, holds upon a constructive trust for the beneficiary any profit which he makes through the use of such

"It is important in this type of case to focus on policing insiders and what they do, which I think appropriate, rather than on policing information *per se* and its possession, which I think impracticable. I believe the emphasis in the law should continue to be upon the conduct of corporate insiders and their privies, as it has been since *Strong v. Repide*, 213 U. S. 419 (1909) and as it was in *Cady Roberts*, *Texas Gulf* and *Merrill Lynch*, rather than upon a concept—too vague for me to apply with any consistency—of relative informational advantages in the marketplace." 44 S.E.C., at 648 (concurring in the result).

C

Tipping thus properly is viewed as a means of indirectly violating the *Cady, Roberts* disclose-or-abstain rule. Accordingly, the elements of a Rule 10b-5 violation in a tipping case should be the same as in an inside-trading case. Mere possession of inside information does not impose an obligation to disclose or abstain. See *Chiarella*, *supra*. Similarly, mere receipt of information from a corporate insider is not enough to impose such an obligation. The recipient or tippee of in-

information." 3 L. Loss, *Securities Regulation* 1451 (2d ed. 1961) (quoting Restatement of Restitution § 201(2) (1937)). Other authorities likewise have expressed the view that tippee liability exists only where there has been a breach of trust by an insider of which the tippee had knowledge. See, e. g., *Ross v. Licht*, 263 F. Supp. 395, 410 (SDNY 1967); A. Jacobs, *The Impact of Rule 10b-5*, § 167, at 7-4 (1975) ("[T]he better view is that a tipper must know or have reason to know the information is nonpublic and was improperly obtained."); Fleischer, *Mundheim & Murphy, An Initial Inquiry Into the Responsibility to Disclose Market Information*, 121 U. Pa. L. Rev. 798, 818, n. 76 (1973) ("The extension of rule 10b-5 restrictions to tippees of corporate insiders can best be justified on the theory that they are participating in the insider's breach of his fiduciary duty."). Cf. Restatement (Second) of Agency § 312, comment c (1958) ("A person who, with notice that an agent is thereby violating his duty to his principal, receives confidential information from the agent, may be [deemed] . . . a constructive trustee.").

side information thus cannot be "a participant after the fact," *Chiarella*, 445 U. S., at 230, n. 12, unless the insider or provider of the information has breached his duty to the corporation's shareholders, *i. e.*, he has a specific relationship to the shareholders of the corporation and he exploits confidential information received as a result of that relationship for his personal benefit.²⁰

Because all disclosures of confidential corporate information are not inconsistent with the duty insiders owe to shareholders, all disclosures will not qualify as exploitation. Whether disclosure of material nonpublic information is a breach of duty therefore depends in large part on the purpose of the disclosure.²¹ As Commissioner Smith stated in *Investors Management Co.*:

²⁰ The legal conclusion that all trading on nonpublic inside information by securities analysts does not violate the antifraud provisions of the securities laws in no way suggests that knowingly trading on inside information is "socially desirable or even that it is devoid of moral considerations." Dooley, at 55. Nor does it suggest that it is unreasonable to expect that all citizens, including securities analysts, have an obligation to disclose promptly indications of illegal actions by a corporation to the proper authorities—typically the SEC and exchange authorities in cases involving securities. On the contrary, trading on material nonpublic information is behavior that may fall below highly ethical standards of conduct. This conclusion does not, however, further legal analysis very far. There are "significant distinctions between actual legal obligations and ethical ideals." SEC, Report of the Special Study of Securities Markets, H. R. Doc. No. 95, 88th Cong., 1st Sess., pt. 1, pp. 237-238 (1963).

²¹ An example of a case turning on the court's determination that the disclosure did not impose any fiduciary duties on the recipient of the inside information is *Walton v. Morgan Stanley & Co.*, 623 F. 2d 796 (CA2 1980). There, the defendant investment banking firm, representing one of its own corporate clients, investigated another corporation that was a possible target of a takeover bid by its client. In the course of negotiations the investment banking firm was given, on a confidential basis, unpublished material information. Subsequently, after the proposed takeover was abandoned, the firm was charged with relying on the information when it traded in the target corporation's stock. For purposes of the decision, it was assumed

"[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, and that the information must be shown not only to have been material and non-public, but also to have substantially contributed to the trading which occurred." 44 S.E.C., at 651 (concurring in the result).

There are facts and circumstances that often may justify an inference that the insider has breached his fiduciary duty. For example, there may be a relationship that exists between the insider and the recipient that suggests a *quid pro quo* from the latter, or an intention to benefit the particular recipient. The elements of fiduciary duty and exploitation of nonpublic information certainly exist when an insider makes a gift of confidential information to a trading relative or friend. The tip and trade resemble trading by the insider himself followed by a gift of the profits to the recipient.

Determining the purpose of any one disclosure may not always be easy. And the rules and presumptions that will govern disclosures under the various situations that will arise may not be easy for the SEC and the courts to draw. But some clear lines for the securities industry must be drawn and the liability for trading may not follow inside information throughout the entire securities market. In contrast, the rule set forth by the SEC in this case would have no limiting principle.²²

that the firm knew the information was confidential, but that it had been received in arm's-length negotiations. See *id.*, at 798. In the absence of any fiduciary relationship, the Court of Appeals found no basis for imposing tippee liability on the investment firm. See *id.*, at 799.

²² Without legal limitations, market participants are forced to rely on the reasonableness of the SEC's litigation strategy, but that can be hazardous, as the facts of this case make plain. Following the SEC's filing of the

IV

Under the inside-trading and tipping rules set forth above, we find that there was no actionable violation by petitioner.²³ It is undisputed that petitioner himself was a stranger to Equity Funding, with no pre-existing fiduciary duty to its shareholders.²⁴ He took no action, directly or indirectly,

Texas Gulf Sulphur action, Commissioner (and later Chairman) Budge spoke of the various implications of applying Rule 10b-5 in inside trading cases:

Turning to the realm of possible defendants in the present and potential civil actions, the Commission certainly does not contemplate suing every person who may have come across inside information. In the *Texas Gulf* action neither tippees nor persons in the vast rank and file of employees have been named as defendants. In my view, the Commission in future cases normally should not join rank and file employees or persons outside the company *such as an analyst or reporter* who learns of inside information.

Speech of Hamer Budge to the New York Regional Group of the American Society of Corporate Secretaries, Inc. (Nov. 18, 1965) (emphasis added), reprinted in Budge, *The Texas Gulf Sulphur Case—What It Is and What It Isn't*, Corp. Secretary No. 127, at 6 (Dec. 17, 1965).

²³ Petitioner contends that he was not a "tippee" because the information he received constituted unverified allegations of fraud that were denied by management and were not "material facts" under the securities laws that required disclosure before trading. He also argues that the information he received was not truly "inside" information, i. e., intended for a confidential corporate purpose, but was merely evidence of a crime. The Solicitor General agrees. See Brief for United States as *Amicus Curiae* 22. For purposes of deciding this case, however, we assume the correctness of the SEC's findings, accepted by the Court of Appeals, that petitioner was a tippee of material inside information.

²⁴ Judge Wright found that petitioner acquired a fiduciary duty by virtue of his position as an employee of a broker-dealer. See 220 U. S. App. D.C., at 325-327, 681 F. 2d, at 840-842. The SEC, however, did not consider Judge Wright's alternate theory in its decision, nor did it present that theory to the Court of Appeals. The SEC also has not argued Judge Wright's theory in this Court. See Brief for Respondent 21, n. 27. The merits of such a duty are therefore not before the Court. See *SEC v. Chenery Corp.*, 332 U. S. 194, 196-197 (1947).

that induced the shareholders or officers of Equity Funding to repose trust or confidence in him. There was no expectation by petitioner's sources that he would keep their information in confidence. Nor did petitioner misappropriate or illegally obtain the information about Equity Funding. Unless the insiders breached their *Cady, Roberts* duty to shareholders in disclosing the nonpublic information to petitioner, he breached no duty when he passed it on to investors as well as to the *Wall Street Journal*.

In this case, we think it also is clear that the Equity Funding employees did not violate their *Cady, Roberts* duty to the corporation's shareholders by providing information to petitioner.²⁵ The tippers received no monetary or personal benefit for revealing Equity Funding's secrets, nor did they have an apparent purpose or desire to make a gift of valuable information to petitioner. As the facts of this case clearly indi-

²⁵ In this Court, the SEC appears to contend that an insider invariably violates a fiduciary duty to the corporation's shareholders by transmitting nonpublic corporate information to an outsider when he has reason to believe that the outsider may use it to the disadvantage of the shareholders. "Thus, regardless of any ultimate motive to bring to public attention the derelictions at Equity Funding, Secrist breached his duty to Equity Funding shareholders." Brief for Respondent 81. This perceived "duty" differs markedly from the one that the SEC identified in *Cady, Roberts* and that has been the basis for federal tippee-trading rules to date. In fact, the SEC did not charge Secrist with any wrongdoing, and we do not understand the SEC to have relied on any theory of a breach of duty by Secrist in finding that petitioner breached his duty to Equity Funding's shareholders. See App. 250 (decision of administrative law judge) ("One who knows himself to be a beneficiary of non-public, selectively disclosed inside information must fully disclose or refrain from trading."); 21 S.E.C., at 1410, n. 42 ("Presumably, [petitioner's] informants were entitled to disclose the [Equity Funding] fraud in order to bring it to light and its perpetrators to justice."); Brief on behalf of the SEC in the Court of Appeals, at 47-50; *id.*, at 51 ("[K]nowing possession of inside information by any person imposes a duty to abstain or disclose."); *id.*, at 52-54; *id.*, at 55 ("[T]his obligation arises not from the manner in which such information is acquired. . . ."); 220 U. S. App. D.C., at 322-323, 681 F. 2d, at 838 (Wright, J.).

cate, the tippees were motivated solely by a desire to expose the fraud. See *supra*, at ——. In the absence of a breach of duty to shareholders by the insiders, there was no derivative breach by petitioner. See n. 19, *supra*. As we said in *Chiarella*, petitioner therefore could not have been “a participant after the fact in [an] insider’s breach of a fiduciary duty.” 445 U. S., at 230, n. 12.

V

We conclude that petitioner, in the circumstances of this case, had no duty to abstain from use of the inside information that he obtained. The judgment of the Court of Appeals therefore is

Reversed.

MAY 22 1983

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

L.F.P.
5/23

From: Justice Powell

Circulated: _____

Recirculated: _____

CHAMBERS DRAFT

SUPREME COURT OF THE UNITED STATES

No. 82-276

RAYMOND L. DIRKS, PETITIONER *v.* SECURITIES
AND EXCHANGE COMMISSION

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF
APPEALS FOR DISTRICT OF COLUMBIA

[May —, 1983]

JUSTICE POWELL delivered the opinion of the Court.

Petitioner received material nonpublic information from "insiders" of a corporation with which he had no connection. He disclosed this information to investors who relied on it in trading in the shares of the corporation. The question is whether petitioner violated the antifraud provisions of the federal securities laws by this disclosure.

I

In 1973, petitioner was an officer of a New York broker-dealer firm, providing investment analysis on insurance company securities to institutional investors.¹ On March 6, petitioner received information from Ronald Secrist, a former officer of Equity Funding of America. Secrist alleged that the assets of Equity Funding, a diversified corporation primarily engaged in selling life insurance and mutual funds, were vastly overstated as the result of fraudulent internal corporate practices. Secrist also stated that various regula-

¹ The facts stated here are taken from more detailed statements set forth by the administrative law judge, App. 176-180, 225-247; the opinion of the Securities and Exchange Commission, 21 S.E.C. Docket 1401, 1402-1406 (1981); and the opinion of Judge Wright in the Court of Appeals, 220 U. S. App. D.C. 309, 314-318, 681 F. 2d 824, 829-833 (1982).

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tory agencies had failed to act on similar charges made by Equity Funding employees. He urged petitioner to verify the fraud and disclose it publicly.

Petitioner decided to investigate the allegations. He visited Equity Funding's headquarters in Los Angeles and interviewed several officers and employees of the corporation. Its senior management denied any wrongdoing, but current and former corporation employees corroborated the charges of fraud. Neither petitioner nor his firm owned or traded any Equity Funding stock, but throughout his investigation petitioner candidly discussed with a number of investors and analysts the information he had obtained. Some of these persons sold their holdings of Equity Funding securities, including five investment advisers who liquidated securities worth more than \$16 million.²

During the entire week that petitioner was in Los Angeles, he was in touch regularly with William Blundell, the *Wall Street Journal's* Los Angeles bureau chief. Petitioner urged Blundell to write a story on the fraud allegations. Blundell discounted the allegations because he did not believe that such a massive fraud could go undetected. He declined to write the story, fearing that publishing such damaging rumors supported only by hearsay from current and former employees might be libelous.

During the two-week period in which petitioner pursued his investigation and spread word of Secrist's charges, the

² Petitioner received from his firm a salary plus a commission for securities transactions above a certain amount that his clients directed through his firm. See 21 S.E.C. Docket, at 1402, n. 3. But "[i]t is not clear how many of those with whom [petitioner] spoke promised to direct some brokerage business through [petitioner's firm] to compensate [petitioner], or how many actually did so." 220 U. S. App. D.C., at 316, 681 F. 2d, at 831. The Boston Company Institutional Investors, Inc., promised petitioner about \$25,000 in commissions, but it is unclear whether Boston actually generated any brokerage business for petitioner's firm. See App. 199, 204-205; 21 S.E.C. Docket, at 1404, n. 10; 220 U. S. App. D.C., at 316, n. 5, 681 F. 2d, at 831, n. 5.

price of Equity Funding stock fell precipitously from \$26 per share to less than \$15 per share. This led the New York Stock Exchange to halt trading on March 27. Shortly thereafter California insurance authorities impounded Equity Funding's records and uncovered evidence of the fraud. Only then did the Securities and Exchange Commission (SEC) file a complaint against Equity Funding³ and only then, on April 2, did the *Wall Street Journal* publish a front-page story based largely on information assembled by petitioner. Equity Funding immediately went into receivership.⁴

The SEC investigated petitioner's role in the disclosure of the fraud. After a hearing by an administrative law judge, the SEC found that petitioner had aided and abetted violations of § 17(a) of the Securities Act of 1933, 15 U. S. C. § 77q(a),⁵ § 10(b) of the Securities Exchange Act of 1934, 15

³ As early as 1971, the SEC had received allegations of fraudulent accounting practices at Equity Funding. Moreover, on March 9, 1973, an official of the California Insurance Department informed the SEC's regional office in Los Angeles of Secrist's charges of fraud. Petitioner himself voluntarily presented his information at the SEC's regional office beginning on March 27.

⁴ A federal grand jury in Los Angeles subsequently returned a 105-count indictment against 22 persons, including many of Equity Funding's officers and directors. All defendants were found guilty of one or more counts, either by a plea of guilty or a conviction after trial. See Brief for Petitioner 15; App. 149-153.

⁵ Section 17(a) provides:

"It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

"(1) to employ any device, scheme, or artifice to defraud, or

"(2) to obtain money or property by means of any untrue statement of a material fact or any omission 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

"(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser."

U. S. C. § 78j(b),⁶ and SEC Rule 10b-5, 17 CFR § 240.10b-5 (1982),⁷ when he repeated the allegations of fraud to members of the investment community—including clients of his firm—who later sold their Equity Funding stock. The SEC concluded: "Where 'tippees'—regardless of their motivation or occupation—come into possession of material 'information that they know is confidential and know or should know came from a corporate insider,' they must either publicly disclose that information or refrain from trading." 21 S.E.C. Docket 1401, 1407 (1981) (footnote omitted) (quoting *Chiarella v. United States*, 445 U. S. 222, 230 n. 12 (1980)). Recognizing, however, that petitioner "played an important role in bringing [Equity Funding's] massive fraud to light," 21 S.E.C. Docket, at 1412, the SEC only censured him.⁸

⁶Section 10(b) provides:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

"(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

⁷Rule 10b-5 provides:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

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

"(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

"(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."

⁸Section 15 of the Securities Exchange Act, 15 U. S. C. § 78o(b)(4)(E), provides that the SEC may impose certain sanctions, including censure, on any person associated with a registered broker-dealer who has "willfully

Petitioner sought review in the Court of Appeals for the District of Columbia Circuit. Without opinion, the court entered judgment against petitioner "for the reasons stated by the Commission in its opinion." App. to Pet. for Cert. C-2. Judge Wright, a member of the panel, subsequently issued an opinion. Judge Robb concurred in the result, and Judge Tamm dissented; neither filed a separate opinion. Judge Wright believed that "the obligations of corporate fiduciaries pass to all those to whom they disclose their information before it has been disseminated to the public at large." 220 U. S. App. D.C. 309, 324, 681 F. 2d 824, 839 (1982). Alternatively, Judge Wright concluded that, as an employee of a broker-dealer, petitioner had violated "obligations to the SEC and to the public completely independent of any obligations he acquired" from sources at Equity Funding. *Id.*, at 325, 681 F. 2d, at 840.

We granted a writ of certiorari, U. S. (1982), because of the importance to the SEC and to the securities industry of the question presented by this case. We now reverse the judgment of the Court of Appeals.

II

In the seminal case of *In re Cady, Roberts & Co.*, 40 S.E.C. 907 (1961), the SEC recognized that "[a]n affirmative duty to disclose material information has been traditionally imposed on corporate 'insiders,' particularly officers, directors, or controlling stockholders," *id.*, at 911, and that a breach of that duty to shareholders⁹ also could be a violation

aided [or] abetted" any violation of the federal securities laws. See 15 U. S. C. § 78ff(a) (providing criminal penalties).

⁹ An insider's duty to the corporation's shareholders not to trade on inside information differs from the common-law duty that insiders also have to the corporation itself not to mismanage corporate assets, of which confidential information is one. See 3 *Fletcher Cyclopedic of the Laws of Private Corporations* §§ 848, 900 (1975 ed. and Supp. 1982); 3A *Fletcher, supra*, §§ 1168.1, 1168.2. There are good reasons to view the breach of the duty to shareholders as also a violation of the federal securities laws.

of Rule 10b-5.¹⁰ The SEC did not, however, limit this obligation to disclose¹¹ or abstain to these insiders. See *id.*, at 911. Rather, the duty was found to exist whenever two factors were present:

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. *Id.*, at 912 (footnote omitted).

In *Chiarella*, we quoted with approval the *Cady, Roberts* statement of the basis for the disclose-or-abstain rule and adopted the SEC's twin elements for finding a violation of Rule 10b-5's inside-trading restrictions: "(i) the existence of a relationship affording access to inside information intended to be available only for a corporate purpose, and (ii) the unfairness of allowing a corporate insider to take advantage of that information by trading without disclosure." 445 U. S., at 227. The Court agreed that there is no general duty to make

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Inside trading violates Rule 10b-5 because it presupposes both investor injury and deception. See Dooley, *Enforcement of Insider Trading Restrictions*, 66 Va. L. Rev. 1, 41 (1980). We agree with the *Cady, Roberts* Commission that "[a] significant purpose of the Exchange Act was to eliminate the idea that use of inside information for personal advantage was a normal emolument of corporate office." See 40 S.E.C., at 912, n. 15.

¹⁰ Rule 10b-5 is generally the most inclusive of the three provisions on which the SEC rested its decision in this case, and we will refer to it when we note the statutory basis for the SEC's inside-trading rules.

¹¹ The SEC views the disclosure duty as extending beyond the immediate purchasers or sellers: "Proper and adequate disclosure of significant corporate developments can only be effected by a public release through the appropriate public media, designed to achieve a broad dissemination to the investing public generally and without favoring any special person or group." *In re Faberge, Inc.*, 45 S.E.C. 249, 256 (1973).

^a disclosure before trading with material nonpublic information,¹³ and held that “a duty to disclose under § 10(b) does not arise from the mere possession of nonpublic market information.” *Id.*, at 235. Such a duty arises rather from the existence of a fiduciary relationship. See *id.*, at 227-235.

The fraud in an inside-trading case is the “inherent unfairness involved where one [with access by virtue of a special relationship to the issuer to material information intended to be available only for a corporate purpose and not for personal gain] takes advantage of such information knowing it is unavailable to the investing public.” *In re Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 43 S.E.C. 933, 936 (1968). It is therefore clear that there is no breach of the *Cady, Roberts* duty that insiders have to shareholders unless the insider exploits the information available to him for his personal benefit. Thus, an insider will be liable under Rule 10b-5 for inside trading only where he ~~exploits~~ material nonpublic information for personal gain and fails to disclose that information before doing so.

*Jim: are
the words
“personal
gain” in
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*“takes
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III

We were explicit in *Chiarella* in saying that there can be no duty to disclose where the person who has traded on inside information “was not [the corporation’s] agent, he was not a fiduciary, [or] he was not a person in whom the sellers [of the securities] had placed their trust and confidence.” 445 U. S., at 232. Not to require such a fiduciary relationship, we recognized, would “depar[t] radically from the established doctrine that duty arises from a specific relationship between two parties” and would amount to “recognizing a general

¹³ See 445 U. S., at 233; *id.*, at 237 (STEVENS, J., concurring); *id.*, at 238-239 (BRENNAN, J., concurring in the judgment); *id.*, at 239-240 (BURGER, C. J., dissenting). Cf. *id.*, at 252, n. 2 (BLACKMUN, J., dissenting) (recognizing that there is no obligation to disclose material nonpublic information obtained through the exercise of “diligence or acumen” and “honest means,” as opposed to “stealth”).

duty between all participants in market transactions to forgo actions based on material, nonpublic information." *Id.*, at 232, 233. This requirement of a specific relationship between the shareholders and the individual trading on inside information, ~~however~~, has created analytical difficulties for the SEC in policing tippees who trade on inside information. Unlike insiders who have independent fiduciary duties to both the corporation and its shareholders, the typical tippee has no such relationships.¹³ In view of this absence, it has been unclear how a tippee acquires the duty to refrain from trading on inside information.

A

The SEC's position, as stated in its opinion, is that:

"In tipping potential traders, [petitioner] breached a duty which he had assumed as a result of knowingly receiving confidential information from [Equity Funding]

in this case,

¹³ Under certain circumstances, such as where corporate information is revealed legitimately to an underwriter, accountant, or lawyer working for the corporation, these outsiders may become fiduciaries of the shareholders. The basis for recognizing such fiduciary duties is not simply that such persons acquired nonpublic corporate information, but also 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. See *SEC v. Monarch Fund*, 608 F. 2d 938, 942 (CA2 1979); *In re Investors Management Co.*, 44 S.E.C. 633, 645 (1971); *In re Van Alostne, Noel & Co.*, 43 S.E.C. 1080, 1084-1085 (1969); *In re Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 43 S.E.C. 933, 937 (1968); *Cady, Roberts*, 40 S.E.C., at 912. When such a person breaches his fiduciary relationship, he may be treated more properly as a tipper than a tippee. See *Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 495 F. 2d 228, 237 (CA2 1974) (investment banker had access to material information when working on a proposed public offering for the corporation). For such duties to be imposed, however, the corporation must expect the outsider to keep the disclosed nonpublic information confidential, and the person receiving the information must agree at least implicitly to such an arrangement.

insiders. Tippees such as [petitioner] who receive non-public material information from insiders become 'subject to the same duty as [the] insiders.' *Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, [495 F. 2d 228, 237 (CA2 1974) (quoting *Ross v. Licht*, 263 F. Supp. 395, 410 (SDNY 1967))]. Such a tippee breaches the fiduciary duty which he assumes from the insider when the tippee knowingly transmits the information to someone who will probably trade on the basis thereof. . . . Presumably, [petitioner's] informants were entitled to disclose the [Equity Funding] fraud in order to bring it to light and its perpetrators to justice. However, [petitioner]—standing in their shoes—committed a breach of the fiduciary duty which he had assumed in dealing with them, when he passed the information on to traders. 21 S.E.C. Docket, at 1410, n. 42.

The SEC's position in this case differs little from its view that we rejected as inconsistent with congressional intent in *Chiarella*. In that case, the Court of Appeals agreed with the SEC and affirmed the conviction there by holding 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." *United States v. Chiarella*, 588 F. 2d 1358, 1365 (CA2 1978) (emphasis in original). Here, the SEC maintains that anyone who knowingly receives non-public material information has a fiduciary duty to disclose before trading. Apparently, the SEC believes this case differs from *Chiarella* in that here the petitioner's receipt of inside information from an insider brought the duties of an insider, while *Chiarella* received the information without the direct involvement of an insider and thus inherited no *Cady, Roberts* duty. The SEC still fails to explain, however, why or how the possession of nonpublic information imposed on petitioner a fiduciary duty ~~with~~ Equity Funding's sharehold-

to

ers when Chiarella's possession did not.¹⁴ As we emphasized in *Chiarella*, mere possession of nonpublic information does not give rise to the *Cady, Roberts* duty; only a specific relationship does that.

In effect, then, the SEC's theory of tippee liability seems rooted ~~more~~ in the rejected idea that the antifraud provisions require equal access to all material nonpublic information than in the principle set forth in *Cady, Roberts* and *Chiarella* that only some persons, under some circumstances, will be barred from trading while in possession of such information.¹⁵ Judge Wright correctly read our opinion in *Chiarella*, however, as repudiating any notion that traders must enjoy equal information before trading: "[T]he 'information' theory is rejected. Because the disclose-or-refrain duty is extraordinary, it attaches only when a party has legal obligations other than a mere duty to comply with the general antifraud prescriptions in the federal securities laws." 220 U. S. App.

This is a significant departure from

¹⁴ Apparently recognizing the weakness of its argument in light of *Chiarella*, the SEC attempts to distinguish that case factually as involving not "inside" information, but rather "market" information, i. e., "information generated within the company relating to its assets or earnings." Brief for Respondent 23. This Court drew no such distinction in *Chiarella* and, as THE CHIEF JUSTICE noted, "[i]t is clear that § 10(b) and Rule 10b-5 by their terms and by their history make no such distinction." 445 U. S., at 241, n. 1 (dissenting opinion). See ALI Fed. Sec. Code § 1603, Comment (2)(j) (Proposed Official Draft 1978).

¹⁵ In *Chiarella*, we noted that formulation of an absolute equal information rule "should not be undertaken absent some explicit evidence of congressional intent." 445 U. S., at 233. Rather than adopting such a radical view of securities trading, Congress has expressly exempted many market professionals from the general statutory prohibition set forth in § 11(a)(1) of the Securities Exchange Act, 15 U. S. C. § 78k(a)(1), against members of a national securities exchange trading for their own account. See *id.*, at 233, n. 16. We observed in *Chiarella* that "[t]he exception is based upon Congress' recognition that [market professionals] contribute to a fair and orderly marketplace at the same time they exploit the informational advantage that comes from their possession of [nonpublic information]." *Ibid.*

Jim - We have used "reject"
a couple of times

D.C., at 322, 681 F. 2d, at 837. See *Chiarella*, 445 U. S., at 235, n. 20 (BLACKMUN, J., dissenting).

We therefore reject the view that a duty to disclose or abstain exists solely because a person knowingly receives material nonpublic information and trades. Imposing such a duty could have an inhibiting influence on the role of market analysts that the SEC itself recognizes is essential.¹⁶ It is commonplace for analysts to "ferret out and analyze information," 21 S.E.C., at 1406, and this often is done by meeting with and questioning corporate officers and others who may be viewed as insiders. Such meetings customarily involve participants who understand their responsibilities and adhere to them. And information that the analysts obtain normally may be the basis for judgments as to the market worth of a corporation's securities. The analyst's judgment in this respect is made available in market letters or otherwise to clients of the firm. A different judgment may be made by a different analyst: ~~different~~ views make a market.¹⁷ In the

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¹⁶The SEC expressly recognized that "[t]he value to the entire market of [analysts'] efforts cannot be gainsaid; market efficiency in pricing is significantly enhanced by [their] initiatives to ferret out and analyze information, and thus the analyst's work redounds to the benefit of all investors." 21 S.E.C., at 1406. The SEC asserts that "[a]nalysts remain free to obtain from corporate management corporate information that is not itself material for purposes of filling in the 'interstices in analysis' . . ." Brief for Respondent 42 (quoting *Investors Management Co.*, 44 S.E.C., at 646). But its rule is inherently imprecise, and imprecision prevents parties from ordering their actions in accord with legal requirements. Unless the parties know where the line is between permissible and impermissible disclosures and uses, neither corporate insiders nor analysts can be sure when the line is crossed. Cf. *Adler v. Klawans*, 267 F. 2d 840, 845 (CA2 1959) (Burger, J., sitting by designation).

¹⁷On its facts, this case is the unusual one. Petitioner is an analyst in a broker-dealer firm, and he did interview management in the course of his investigation. He uncovered, however, startling information that required no analysis or exercise of judgment as to its market relevance. Nonetheless, the principle at issue here extends beyond these facts. The SEC's rule—applicable without regard to any breach by an insider—could

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very nature of this type of information, and indeed of the markets themselves, such information cannot be made simultaneously available to all of the corporation's stockholders or the public generally.

In effect, the SEC's view would mean that the duty to disclose accompanies the inside information, resting on all those who possess nonpublic material information. That is the general duty we rejected in *Chiarella*. We reaffirm today that "[a] duty [to disclose] arises from the relationship between parties . . . and not merely from one's ability to acquire information because of his position in the market." 445 U. S., at 232-233, n. 14.

B

Although there are problems with the SEC's theory of tippee liability, the prophylactic need for a ban on some tippee trading is clear. And it is also clear that the tippee's duty to disclose or abstain is derivative from that of the insider's duty. See Tr. of Oral Arg. 38. Cf. *Chiarella*, 445 U. S., at 246, n. 1 (BLACKMUN J., dissenting). Under *Cady, Roberts*, not only are insiders forbidden by their fiduciary relationship from using undisclosed corporate information to their personal advantage, but they may not give such information to an outsider for the same improper purpose of exploiting the information for their personal gain. See 15 U. S. C. § 78t(b) (making it unlawful to do indirectly any act made unlawful by the federal securities acts "by means of any other person"). Similarly, the transactions of those who knowingly participate and profit with the fiduciary in such a breach are "as forbidden" as transactions "on behalf of the trustee himself." *Mosser v. Darrow*, 341 U. S. 267, 272 (1951). See *Jackson v. Smith*, 254 U. S. 586, 589 (1921); *Jackson v. Ludeling*, 88 U. S. 616, 631-632 (1874). As the

have wide ramifications on reporting by analysts of investment views and news.

Court explained in *Mosser*, a contrary rule "would open up opportunities for devious dealings in the name of the others that the trustee could not conduct in his own." 341 U. S., at 271. See *SEC v. Texas Gulf Sulphur Co.*, 446 F. 2d 1301, 1308 (CA2), cert. denied, 404 U. S. 1005 (1971).

Hence, as we noted in *Chiarella*, "[t]he tippee's obligation has been viewed as arising from his role as a participant after the fact in the insider's breach of a fiduciary duty." 445 U. S., at 230, n. 12. Tippees may assume an insider's duty to the shareholders not because they receive inside information, but rather because they receive it *improperly*.¹⁶ And clearly not all disclosures are improper simply because people trade as a result. The SEC's rules are ~~meant~~ to promote many such disclosures. Rather, for Rule 10b-5 purposes, the disclosure is improper where it would violate the insider's duties under *Cady, Roberts*. Thus, a tippee assumes a fiduciary duty to the shareholders of a corporation not to trade on material nonpublic information only when the insider breaches his fiduciary duty to the shareholders by disclosing the information to the tippee and the tippee knows of that breach.¹⁷ As Commissioner Smith perceptively observed in *Investors Management Co.*:

designed

¹⁶The SEC itself has recognized that tippee liability properly is imposed only in circumstances where the tippee knows, or has reason to know, that the insider has disclosed improperly inside corporate information. In *Investors Management Co.*, the SEC stated that one element of tippee liability is that the tippee knew or had reason to know "that [the information] was non-public and had been obtained *improperly* by selective revelation or otherwise." 44 S.E.C., at 641 (emphasis added). Commissioner Smith read this test to mean that a tippee can be held liable only if he received information in breach of an insider's duty not to disclose it. *Id.*, at 650 (concurring in the result). See n. 19, *supra*.

¹⁷Professor Loss has linked tippee liability to the concept in the law of restitution that "[w]here a fiduciary in violation of his duty to the beneficiary communicates confidential information to a third person, the third person, if he had notice of the violation of duty, holds upon a constructive trust for the beneficiary any profit which he makes through the use of such

"It is important in this type of case to focus on policing insiders and what they do, which I think appropriate, rather than on policing information *per se* and its possession, which I think impracticable. I believe the emphasis in the law should continue to be upon the conduct of corporate insiders and their privies, as it has been since *Strong v. Repide*, 213 U. S. 419 (1909) and as it was in *Cady Roberts*, *Texas Gulf* and *Merrill Lynch*, rather than upon a concept—too vague for me to apply with any consistency—of relative informational advantages in the marketplace." 44 S.E.C., at 648 (concurring in the result).

C

Tipping thus properly is viewed as a means of indirectly violating the *Cady, Roberts* disclose-or-abstain rule. Accordingly, the elements of a Rule 10b-5 violation in a tipping case should be the same as in an inside-trading case. Mere possession of inside information does not impose an obligation to disclose or abstain. See *Chiarella*, *supra*. Similarly, mere receipt of information from a corporate insider is not enough to impose such an obligation. The recipient or tippee of in-

information." 3 L. Loss, *Securities Regulation* 1451 (2d ed. 1961) (quoting Restatement of Restitution § 201(2) (1937)). Other authorities likewise have expressed the view that tippee liability exists only where there has been a breach of trust by an insider of which the tippees had knowledge. See, e. g., *Ross v. Licht*, 263 F. Supp. 395, 410 (SDNY 1967); A. Jacobs, *The Impact of Rule 10b-5*, § 167, at 7-4 (1975) ("[T]he better view is that a tipper must know or have reason to know the information is nonpublic and was improperly obtained."); Fleischer, *Mundheim & Murphy*, *An Initial Inquiry Into the Responsibility to Disclose Market Information*, 121 U. Pa. L. Rev. 798, 818, n. 76 (1973) ("The extension of rule 10b-5 restrictions to tippees of corporate insiders can best be justified on the theory that they are participating in the insider's breach of his fiduciary duty."). Cf. Restatement (Second) of Agency § 312, comment c (1968) ("A person who, with notice that an agent is thereby violating his duty to his principal, receives confidential information from the agent, may be [deemed] . . . a constructive trustee.").

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you think
we are
saying this
too
frequently?
If we
keep this
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side information thus cannot be "a participant after the fact," *Chiarella*, 445 U. S., at 230, n. 12, unless the insider or provider of the information has breached his duty to the corporation's shareholders, i. e., he has a specific relationship to the shareholders of the corporation and he exploits confidential information received as a result of that relationship for his personal benefit.²⁰

Because all disclosures of confidential corporate information are not inconsistent with the duty insiders owe to shareholders, all disclosures will not qualify as exploitation. Whether disclosure of material nonpublic information is a breach of duty therefore depends in large part on the purpose of the disclosure.²¹ As Commissioner Smith stated in *Investors Management Co.*:

"The legal conclusion that all trading on nonpublic inside information by securities analysts does not violate the antifraud provisions of the securities laws in no way suggests that knowingly trading on inside information is "socially desirable or even that it is devoid of moral considerations." Dooley, at 55. Nor does it suggest that it is unreasonable to expect that all citizens, including securities analysts, have an obligation to disclose promptly indications of illegal actions by a corporation to the proper authorities—typically the SEC and exchange authorities in cases involving securities. On the contrary, trading on material nonpublic information is behavior that may fall below highly ethical standards of conduct. This conclusion does not, however, further legal analysis very far. There are "significant distinctions between actual legal obligations and ethical ideals." SEC, Report of the Special Study of Securities Markets, H. R. Doc. No. 95, 88th Cong., 1st Sess., pt. 1, pp. 237-238 (1963).

²¹ An example of a case turning on the court's determination that the disclosure did not impose any fiduciary duties on the recipient of the inside information is *Walton v. Morgan Stanley & Co.*, 623 F. 2d 796 (CA2 1980). There, the defendant investment banking firm, representing one of its own corporate clients, investigated another corporation that was a possible target of a takeover bid by its client. In the course of negotiations the investment banking firm was given, on a confidential basis, unpublished material information. Subsequently, after the proposed takeover was abandoned, the firm was charged with relying on the information when it traded in the target corporation's stock. For purposes of the decision, it was assumed

← (A)

← (B)

no responsibility

"[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, and that the information must be shown not only to have been material and non-public, but also to have substantially contributed to the trading which occurred." 44 S.E.C., at 651 (concurring in the result).

There are facts and circumstances that often may justify an inference that the insider has breached his fiduciary duty. For example, there may be a relationship that exists between the insider and the recipient that suggests a *quid pro quo* from the latter, or an intention to benefit the particular recipient. The elements of fiduciary duty and exploitation of nonpublic information certainly exist when an insider makes a gift of confidential information to a trading relative or friend. The tip and trade resemble trading by the insider himself followed by a gift of the profits to the recipient.

Determining the purpose of any one disclosure may not always be easy. ~~And the rules and presumptions that will govern disclosures under the various situations that will arise may not be easy for the SEC and the courts to draw.~~ But some clear lines for the securities industry must be drawn and the liability for trading may not follow inside information throughout the entire securities market. In contrast, the rule set forth by the SEC in this case would have no limiting principle.²²

that the firm knew the information was confidential, but that it had been received in arm's-length negotiations. See *id.*, at 798. In the absence of any fiduciary relationship, the Court of Appeals found no basis for imposing tippee liability on the investment firm. See *id.*, at 799.

²² Without legal limitations, market participants are forced to rely on the reasonableness of the SEC's litigation strategy, but that can be hazardous, as the facts of this case make plain. Following the SEC's filing of the

IV

Under the inside-trading and tipping rules set forth above, we find that there was no actionable violation by petitioner.²³ It is undisputed that petitioner himself was a stranger to Equity Funding, with no pre-existing fiduciary duty to its shareholders.²⁴ He took no action, directly or indirectly,

Texas Gulf Sulphur action, Commissioner (and later Chairman) Budge spoke of the various implications of applying Rule 10b-5 in inside trading cases:

Turning to the realm of possible defendants in the present and potential civil actions, the Commission certainly does not contemplate suing every person who may have come across inside information. In the *Texas Gulf* action neither tippees nor persons in the vast rank and file of employees have been named as defendants. In my view, the Commission in future cases normally should not join rank and file employees or persons outside the company such as an analyst or reporter who learns of inside information.

Speech of Hamer Budge to the New York Regional Group of the American Society of Corporate Secretaries, Inc. (Nov. 18, 1965) (emphasis added), reprinted in Budge, *The Texas Gulf Sulphur Case—What It Is and What It Isn't*, Corp. Secretary No. 127, at 6 (Dec. 17, 1965).

²³ Petitioner contends that he was not a "tippee" because the information he received constituted unverified allegations of fraud that were denied by management and were not "material facts" under the securities laws that required disclosure before trading. He also argues that the information he received was not truly "inside" information, *i. e.*, intended for a confidential corporate purpose, but was merely evidence of a crime. The Solicitor General agrees. See Brief for United States as *Amicus Curiae* 22. For purposes of deciding this case, however, we assume the correctness of the SEC's findings, accepted by the Court of Appeals, that petitioner was a tippee of material inside information.

²⁴ Judge Wright found that petitioner acquired a fiduciary duty by virtue of his position as an employee of a broker-dealer. See 220 U. S. App. D.C., at 325-327, 681 F. 2d, at 840-842. The SEC, however, did not consider Judge Wright's alternate theory in its decision, nor did it present that theory to the Court of Appeals. The SEC also has not argued Judge Wright's theory in this Court. See Brief for Respondent 21, n. 27. The merits of such a duty are therefore not before the Court. See *SEC v. Chenery Corp.*, 332 U. S. 194, 196-197 (1947).

that induced the shareholders or officers of Equity Funding to repose trust or confidence in him. There was no expectation by petitioner's sources that he would keep their information in confidence. Nor did petitioner misappropriate or illegally obtain the information about Equity Funding. Unless the insiders breached their *Cady, Roberts* duty to shareholders in disclosing the nonpublic information to petitioner, he breached no duty when he passed it on to investors as well as to the *Wall Street Journal*.

In this case, we think it also is clear that the Equity Funding employees did not violate their *Cady, Roberts* duty to the corporation's shareholders by providing information to petitioner.²⁵ The tippers received no monetary or personal benefit for revealing Equity Funding's secrets, nor did they have an apparent purpose or desire to make a gift of valuable information to petitioner. As the facts of this case clearly indi-

²⁵ In this Court, the SEC appears to contend that an insider invariably violates a fiduciary duty to the corporation's shareholders by transmitting nonpublic corporate information to an outsider when he has reason to believe that the outsider may use it to the disadvantage of the shareholders. "Thus, regardless of any ultimate motive to bring to public attention the derelictions at Equity Funding, Secrist breached his duty to Equity Funding shareholders." Brief for Respondent 31. This perceived "duty" differs markedly from the one that the SEC identified in *Cady, Roberts* and that has been the basis for federal tippee-trading rules to date. In fact, the SEC did not charge Secrist with any wrongdoing, and we do not understand the SEC to have relied on any theory of a breach of duty by Secrist in finding that petitioner breached his duty to Equity Funding's shareholders. See App. 250 (decision of administrative law judge) ("One who knows himself to be a beneficiary of non-public, selectively disclosed inside information must fully disclose or refrain from trading."); 21 S.E.C., at 1410, n. 42 ("Presumably, [petitioner's] informants were entitled to disclose the [Equity Funding] fraud in order to bring it to light and its perpetrators to justice."); Brief on behalf of the SEC in the Court of Appeals, at 47-50; *id.*, at 51 ("[K]nowing possession of inside information by any person imposes a duty to abstain or disclose."); *id.*, at 52-54; *id.*, at 55 ("[T]his obligation arises not from the manner in which such information is acquired. . . ."); 220 U. S. App. D.C., at 322-323, 681 F. 2d, at 838 (Wright, J.).

cate, the tippees were motivated solely by a desire to expose the fraud. See *supra*, at —. In the absence of a breach of duty to shareholders by the insiders, there was no derivative breach by petitioner. See n. 19, *supra*. As we said in *Chiarella*, petitioner therefore could not have been “a participant after the fact in [an] insider’s breach of a fiduciary duty.” 445 U. S., at 230, n. 12.

V

We conclude that petitioner, in the circumstances of this case, had no duty to abstain from use of the inside information that he obtained. The judgment of the Court of Appeals therefore is

Reversed.

*Jim - Make these
changes & print
& circulate a 1st Draft.*

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

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*This reflects
in quality & closeness
of analysis the vast
patience & thought you
have devoted to this case,
& the helpful editing
of co-clerks. Whether it
"sells" or not, I think we
are analytically & practically
sound.*

CHAMBERS DRAFT II

SUPREME COURT OF THE UNITED STATES

No. 82-276

L 7 P
**RAYMOND L. DIRKS, PETITIONER v. SECURITIES
AND EXCHANGE COMMISSION**

**ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF
APPEALS FOR DISTRICT OF COLUMBIA**

[May —, 1983]

JUSTICE POWELL delivered the opinion of the Court.

Petitioner Raymond Dirks received material nonpublic information from "insiders" of a corporation with which he had no connection. He disclosed this information to investors who relied on it in trading in the shares of the corporation. The question is whether Dirks violated the antifraud provisions of the federal securities laws by this disclosure.

I

In 1973, Dirks was an officer of a New York broker-dealer firm and provided investment analysis of insurance company securities to institutional investors.¹ On March 6, Dirks received information from Ronald Secrist, a former officer of Equity Funding of America. Secrist alleged that the assets of Equity Funding, a diversified corporation primarily engaged in selling life insurance and mutual funds, were vastly overstated as the result of fraudulent corporate practices. Secrist also stated that various regulatory agencies had failed

¹The facts stated here are taken from more detailed statements set forth by the administrative law judge, App. 176-180, 225-247; the opinion of the Securities and Exchange Commission, 21 S.E.C. Docket 1401, 1402-1406 (1981); and the opinion of Judge Wright in the Court of Appeals, 220 U. S. App. D.C. 309, 314-318, 681 F. 2d 824, 829-833 (1982).

to act on similar charges made by Equity Funding employees. He urged Dirks to verify the fraud and disclose it publicly.

Dirks decided to investigate the allegations. He visited Equity Funding's headquarters in Los Angeles and interviewed several officers and employees of the corporation. Its senior management denied any wrongdoing, but current and former corporation employees corroborated the charges of fraud. Neither Dirks nor his firm owned or traded any Equity Funding stock, but throughout his investigation he openly discussed with a number of clients openly investors and investors the information he had obtained. Some of these persons sold their holdings of Equity Funding securities, including five investment advisers who liquidated securities worth more than \$16 million.²

During the week that Dirks was in Los Angeles, he was in touch regularly with William Blundell, the *Wall Street Journal's* Los Angeles bureau chief. Dirks urged Blundell to write a story on the fraud allegations. Blundell discounted the allegations because he did not believe that such a massive fraud could go undetected. He declined to write the story, fearing that publishing such damaging rumors supported only by hearsay from current and former employees might be libelous.

During the two-week period in which Dirks pursued his investigation and spread word of Secrist's charges, the price of

² Dirks received from his firm a salary plus a commission for securities transactions above a certain amount that his clients directed through his firm. See 21 S.E.C. Docket, at 1402, n. 3. But "[i]t is not clear how many of those with whom Dirks spoke promised to direct some brokerage business through [Dirks' firm] to compensate [him], or how many actually did so." 220 U. S. App. D.C., at 816, 681 F. 2d, at 831. The Boston Company Institutional Investors, Inc., promised Dirks about \$25,000 in commissions, but it is unclear whether Boston actually generated any brokerage business for his firm. See App. 199, 204-205; 21 S.E.C. Docket, at 1404, n. 10; 220 U. S. App. D.C., at 316, n. 5, 681 F. 2d, at 831, n. 5.

Equity Funding stock fell precipitously from \$26 per share to less than \$15 per share. This led the New York Stock Exchange to halt trading on March 27. Shortly thereafter California insurance authorities impounded Equity Funding's records and uncovered evidence of the fraud. Only then did the Securities and Exchange Commission (SEC) file a complaint against Equity Funding³ and only then, on April 2, did the *Wall Street Journal* publish a front-page story based largely on information assembled by Dirks. Equity Funding immediately went into receivership.⁴

The SEC investigated Dirks' role in the disclosure of the fraud. After a hearing by an administrative law judge, the SEC found that Dirks had aided and abetted violations of §17(a) of the Securities Act of 1933, 15 U. S. C. §77q(a),⁵ §10(b) of the Securities Exchange Act of 1934, 15 U. S. C.

³As early as 1971, the SEC had received allegations of fraudulent accounting practices at Equity Funding. Moreover, on March 9, 1973, an official of the California Insurance Department informed the SEC's regional office in Los Angeles of Secrist's charges of fraud. Dirks himself voluntarily presented his information at the SEC's regional office beginning on March 27.

⁴A federal grand jury in Los Angeles subsequently returned a 105-count indictment against 22 persons, including many of Equity Funding's officers and directors. All defendants were found guilty of one or more counts, either by a plea of guilty or a conviction after trial. See Brief for Petitioner 15; App. 149-153.

⁵Section 17(a) provides:

"It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

"(1) to employ any device, scheme, or artifice to defraud, or

"(2) to obtain money or property by means of any untrue statement of a material fact or any omission 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

"(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser."

§ 78j(b),⁶ and SEC Rule 10b-5, 17 CFR § 240.10b-5 (1982),⁷ when he repeated the allegations of fraud to members of the investment community who later sold their Equity Funding stock. The SEC concluded: "Where 'tippees'—regardless of their motivation or occupation—come into possession of material 'information that they know is confidential and know or should know came from a corporate insider,' they must either publicly disclose that information or refrain from trading." 21 S.E.C. Docket 1401, 1407 (1981) (footnote omitted) (quoting *Chiarella v. United States*, 445 U. S. 222, 230 n. 12 (1980)). Recognizing, however, that Dirks "played an important role in bringing [Equity Funding's] massive fraud to light," 21 S.E.C. Docket, at 1412, the SEC only censured him.⁸

⁶ Section 10(b) provides:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

"(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

⁷ Rule 10b-5 provides:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

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

"(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

"(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."

⁸ Section 15 of the Securities Exchange Act, 15 U. S. C. § 78o(b)(4)(E), provides that the SEC may impose certain sanctions, including censure, on any person associated with a registered broker-dealer who has "willfully

Dirks sought review in the Court of Appeals for the District of Columbia Circuit. Without opinion, the court entered judgment against Dirks "for the reasons stated by the Commission in its opinion." App. to Pet. for Cert. C-2. Judge Wright, a member of the panel, subsequently issued an opinion. Judge Robb concurred in the result, and Judge Tamm dissented; neither filed a separate opinion. Judge Wright believed that "the obligations of corporate fiduciaries pass to all those to whom they disclose their information before it has been disseminated to the public at large." 220 U. S. App. D.C. 309, 324, 681 F. 2d 824, 839 (1982). Alternatively, Judge Wright concluded that, as an employee of a broker-dealer, Dirks had violated "obligations to the SEC and to the public completely independent of any obligations he acquired" from sources at Equity Funding. *Id.*, at 325, 681 F. 2d, at 840.

In view of the importance to the SEC and to the securities industry of the question presented by this case, we granted a writ of certiorari. — U. S. — (1982). We now reverse.

II

In the seminal case of *In re Cady, Roberts & Co.*, 40 S.E.C. 907 (1961), the SEC recognized that the common law in some jurisdictions imposes on "corporate 'insiders,' particularly officers, directors, or controlling stockholders" an "affirmative duty of disclosure . . . when dealing in securities." *Id.*, at 911, and n. 13.⁹ The SEC found that, not only

aided [or] abetted" any violation of the federal securities laws. See 15 U. S. C. § 78ff(a) (providing criminal penalties).

⁹The duty that insiders owe to the corporation's shareholders not to trade on inside information differs from the common-law duty that officers and directors also have to the corporation itself not to mismanage corporate assets, of which confidential information is one. See 3 Fletcher *Cyclopedia of the Laws of Private Corporations* §§ 848, 900 (1975 ed. and Supp. 1982); 3A Fletcher §§ 1168.1, 1168.2. We agree with the *Cady, Roberts* Commission that "[a] significant purpose of the Exchange Act was to eliminate the idea that use of inside information for personal advantage

did breach of this duty recognized at common law satisfy the elements for a violation of Rule 10b-5,¹⁰ but that individuals other than insiders could ~~have the obligation~~ to disclose material nonpublic information¹¹ before trading or to abstain from trading altogether:

be obligated

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. *Id.*, at 912 (footnote omitted).

In *Chiarella*, we quoted with approval the *Cady, Roberts* statement of the basis for the disclose-or-abstain rule and adopted the SEC's twin elements for finding a violation of Rule 10b-5's inside-trading restrictions: "(i) the existence of a relationship affording access to inside information intended to be available only for a corporate purpose, and (ii) the unfairness of allowing a corporate insider to take advantage of that information by trading without disclosure." 445 U. S., at 227. In examining whether *Chiarella* had an obligation to disclose or abstain, the Court found that there is no general

was a normal emolument of corporate office." See 40 S.E.C., at 912, n. 15.

¹⁰ Rule 10b-5 is generally the most inclusive of the three provisions on which the SEC rested its decision in this case, and we will refer to it when we note the statutory basis for the SEC's inside-trading rules.

¹¹ The SEC views the disclosure duty as requiring more than disclosure to purchasers or sellers: "Proper and adequate disclosure of significant corporate developments can only be effected by a public release through the appropriate public media, designed to achieve a broad dissemination to the investing public generally and without favoring any special person or group." *In re Fabergé, Inc.*, 45 S.E.C. 249, 256 (1973). As used in this opinion, "nonpublic information" will refer to information that has not been so disclosed.

duty to disclose before trading on material nonpublic information,¹² and held that “a duty to disclose under § 10(b) does not arise from the mere possession of nonpublic market information.” *Id.*, at 235. Such a duty arises rather from the existence of a fiduciary relationship. See *id.*, at 227–235.

Not “all breaches of fiduciary duty in connection with a securities transaction,” however, come within the ambit of Rule 10b–5. *Santa Fe Industries, Inc. v. Green*, 430 U. S. 462, 472 (1977). There must also be “manipulation or deception.” *Id.*, at 473. The fraud in an inside-trading case is the “inherent unfairness involved where one ‘takes advantage’ of ‘information intended to be available only for a corporate purpose and not for the personal benefit of anyone.’” *In re Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 43 S.E.C. 933, 936 (1968). Thus, an insider will be liable under Rule 10b–5 for inside trading only where he makes “secret profits” from material nonpublic information, *Cady, Roberts*, 40 S.E.C., at 916, n. 31, and fails to disclose that information before doing so.

III

We were explicit in *Chiarella* in saying that there can be no duty to disclose where the person who has traded on inside information “was not [the corporation’s] agent, . . . was not a fiduciary, [or] was not a person in whom the sellers [of the securities] had placed their trust and confidence.” 445 U. S., at 232. Not to require such a fiduciary relationship, we recognized, would “depar[t] radically from the established doctrine that duty arises from a specific relationship between two parties” and would amount to “recognizing a general

¹² See 445 U. S., at 233; *id.*, at 237 (STEVENS, J., concurring); *id.*, at 238–239 (BRENNAN, J., concurring in the judgment); *id.*, at 239–240 (BURGER, C. J., dissenting). Cf. *id.*, at 252, n. 2 (BLACKMUN, J., dissenting) (recognizing that there is no obligation to disclose material nonpublic information obtained through the exercise of “diligence or acumen” and “honest means,” as opposed to “stealth”).

duty between all participants in market transactions to forgo actions based on material, nonpublic information." *Id.*, at 232, 233. This requirement of a specific relationship between the shareholders and the individual trading on inside information has created analytical difficulties for the SEC in policing tippees who trade on inside information. Unlike insiders who have independent fiduciary duties to both the corporation and its shareholders, the typical tippee has no such relationship.¹⁸ In view of this absence, it has been unclear how a tippee acquires the *Cady, Roberts* duty to refrain from trading on inside information.

A

The SEC's position, as stated in its opinion in this case, is that a tippee inherits the *Cady, Roberts* obligation to shareholders when he receives inside information from an insider:

"In tipping potential traders, Dirks breached a duty

¹⁸ Under certain circumstances, such as where corporate information is revealed legitimately to an underwriter, accountant, or lawyer 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 rather 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. See *SEC v. Monarch Fund*, 608 F. 2d 938, 942 (CA2 1979); *In re Investors Management Co.*, 44 S.E.C. 633, 645 (1971); *In re Van Aylstne, Noel & Co.*, 43 S.E.C. 1080, 1084-1085 (1969); *In re Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 43 S.E.C. 933, 937 (1968); *Cady, Roberts*, 40 S.E.C., at 912. When such a person breaches his fiduciary relationship, he may be treated more properly as a tipper than a tippee. See *Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 495 F. 2d 228, 237 (CA2 1974) (investment banker had access to material information when working on a proposed public offering for the corporation). For such a duty to be imposed, however, the corporation must expect the outsider to keep the disclosed nonpublic information confidential, and the person receiving the information must agree at least implicitly to such an arrangement.

Im - Rarely
would a lawyer
or accountant
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which he had assumed as a result of knowingly receiving confidential information from [Equity Funding] insiders. Tippees such as Dirks who receive non-public material information from insiders become 'subject to the same duty as [the] insiders.' *Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.* [495 F. 2d 228, 237 (CA2 1974) (quoting *Ross v. Licht*, 263 F. Supp. 395, 410 (SDNY 1967))]. Such a tippee breaches the fiduciary duty which he assumes from the insider when the tippee knowingly transmits the information to someone who will probably trade on the basis thereof. . . . Presumably, Dirks' informants were entitled to disclose the [Equity Funding] fraud in order to bring it to light and its perpetrators to justice. However, Dirks—standing in their shoes—committed a breach of the fiduciary duty which he had assumed in dealing with them, when he passed the information on to traders." 21 S.E.C. Docket, at 1410, n. 42.

This view differs little from the view that we rejected as inconsistent with congressional intent in *Chiarella*. In that case, the Court of Appeals agreed with the SEC and affirmed Chiarella's conviction by holding 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." *United States v. Chiarella*, 588 F. 2d 1358, 1365 (CA2 1978) (emphasis in original). Here, the SEC maintains that anyone who knowingly receives nonpublic material information has a fiduciary duty to disclose before trading.¹⁴

¹⁴ Apparently, the SEC believes this case differs from *Chiarella* in that Dirks receipt of inside information from Secrist, an insider, carried Secrist's duties with it, while Chiarella received the information without the direct involvement of an insider and thus inherited no duty to disclose or abstain. The SEC fails to explain, however, why the receipt of nonpublic information from an insider automatically carries with it the fiduciary

We again decline to accept the view that a duty to disclose or abstain exists solely because a person knowingly receives material nonpublic information from an insider and trades. Imposing such a duty could have an inhibiting influence on the role of market analysts that the SEC itself recognizes is essential.¹⁶ It is commonplace for analysts to "ferret out and analyze information," 21 S.E.C., at 1406,¹⁶ and this often is

duty of the insider. As we emphasized in *Chiarella*, mere possession of nonpublic information does not give rise to a duty to disclose or abstain; only a specific relationship does that. And we do not believe that the mere receipt of information from an insider creates such a special relationship between the tippee and the corporation's shareholders.

Apparently recognizing the weakness of its argument in light of *Chiarella*, the SEC attempts to distinguish that case factually as involving not "inside" information, but rather "market" information, i. e., "information generated within the company relating to its assets or earnings." Brief for Respondent 23. This Court drew no such distinction in *Chiarella* and, as THE CHIEF JUSTICE noted, "[i]t is clear that § 10(b) and Rule 10b-5 by their terms and by their history make no such distinction." 445 U. S., at 241, n. 1 (dissenting opinion). See ALI Fed. Sec. Code § 1603, Comment (2)(j) (Proposed Official Draft 1978).

"The SEC expressly recognized that "[t]he value to the entire market of [analysts'] efforts cannot be gainsaid; market efficiency in pricing is significantly enhanced by [their] initiatives to ferret out and analyze information, and thus the analyst's work redounds to the benefit of all investors." 21 S.E.C., at 1406. The SEC asserts that "[a]nalysts remain free to obtain from corporate management corporate information that is not itself material for purposes of filling in the 'interstices in analysis' . . ." Brief for Respondent 42 (quoting *Investors Management Co.*, 44 S.E.C., at 646). But its rule is inherently imprecise, and imprecision prevents parties from ordering their actions in accord with legal requirements. Unless the parties have some guidance as to where the line is between permissible and impermissible disclosures and uses, neither corporate insiders nor analysts can be sure when the line is crossed. Cf. *Adler v. Klawans*, 267 F. 2d 840, 845 (CA2 1959) (Burger, J., sitting by designation).

* On its facts, this case is the unusual one. Dirks is an analyst in a broker-dealer firm, and he did interview management in the course of his investigation. He uncovered, however, startling information that required no analysis or exercise of judgment as to its market relevance. Nonetheless, the principle at issue here extends beyond these facts. The SEC's

done by meeting with and questioning corporate officers and others who may be viewed as insiders. And information that the analysts obtain normally may be the basis for judgments as to the market worth of a corporation's securities. The analyst's judgment in this respect is made available in market letters or otherwise to clients of the firm. In the very nature of this type of information, and indeed of the markets themselves, such information cannot be made simultaneously available to all of the corporation's stockholders or the public generally.

In effect, then, the SEC's theory of tippee liability appears rooted in the rejected idea that the antifraud provisions require equal information. This is a significant departure from the principle set forth in *Cady, Roberts* and *Chiarella* that only some persons, under some circumstances, will be barred from trading while in possession of ~~such~~ information.¹⁷

rule—applicable without regard to any breach by an insider—could have wide ramifications on reporting by analysts of investment views and news.

Despite the unusualness, however, of Dirks' "find," the central role that he played in uncovering the fraud at Equity Funding, and that analysts in general can play in ~~probing corporate structures for evidence of wrongdoing, should be appreciated.~~ Dirks' careful investigation brought to light a massive fraud at the corporation. And until the Equity Funding fraud was exposed, the information in the trading market was grossly inaccurate. But for Dirks' efforts, the fraud might well have gone undetected longer. The SEC should be wary of using Rule 10b-5 to shield corporations from the socially beneficial scrutiny of securities analysts performing their normal roles.

¹⁷In *Chiarella*, we noted that formulation of an absolute equal information rule "should not be undertaken absent some explicit evidence of congressional intent." 445 U. S., at 233. Rather than adopting such a radical view of securities trading, Congress has expressly ~~excepted~~ many market professionals from the general statutory prohibition set forth in § 11(a)(1) of the Securities Exchange Act, 15 U. S. C. § 78k(a)(1), against members of a national securities exchange trading for their own account. See *id.*, at 233, n. 16. We observed in *Chiarella* that "[t]he exception is based upon Congress' recognition that [market professionals] contribute to a fair and orderly marketplace at the same time they exploit the informa-

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revealing
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But corps. do
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Judge Wright correctly read our opinion in *Chiarella* as repudiating any notion that traders must enjoy equal information before trading: "[T]he 'information' theory is rejected. Because the disclose-or-refrain duty is extraordinary, it attaches only when a party has legal obligations other than a mere duty to comply with the general antifraud proscriptions in the federal securities laws." 220 U. S. App. D.C., at 322, 681 F. 2d, at 837. See *Chiarella*, 445 U. S., at 235, n. 20 (BLACKMUN, J., dissenting).

The SEC's view would mean that the duty to disclose accompanies the inside information, resting on all those who possess nonpublic material information. That is the general duty we rejected in *Chiarella*. We reaffirm today that "[a] duty [to disclose] arises from the relationship between parties . . . and not merely from one's ability to acquire information because of his position in the market." 445 U. S., at 232-233, n. 14.

B

Although there are problems with the SEC's theory of tippee liability, the prophylactic need for a ban on some tippee trading is clear. Under *Cady, Roberts*, not only are insiders forbidden by their fiduciary relationship from using undisclosed corporate information to their personal advantage, but they may not give such information to an outsider for the same improper purpose of exploiting the information for their personal gain. See 15 U. S. C. § 78t(b) (making it unlawful to do indirectly any act made unlawful by the federal securities acts "by means of any other person"). Similarly, the transactions of those who knowingly participate and profit with the fiduciary in such a breach are "as forbidden" as transactions "on behalf of the trustee himself." *Mosser v. Darrow*, 341 U. S. 267, 272 (1951). See *Jackson*

tional advantage that comes from their possession of [nonpublic information]." *Ibid.*

v. *Smith*, 254 U. S. 586, 589 (1921); *Jackson v. Ludeling*, 88 U. S. 616, 631-632 (1874). As the Court explained in *Mosser*, a contrary rule "would open up opportunities for devious dealings in the name of the others that the trustee could not conduct in his own." 341 U. S., at 271. See *SEC v. Texas Gulf Sulphur Co.*, 446 F. 2d 1301, 1308 (CA2), cert. denied, 404 U. S. 1005 (1971). Thus, the tippee's duty to disclose or abstain is derivative from that of the insider's duty. See Tr. of Oral Ar. 38. Cf. *Chiarella*, 445 U. S., at 246, n. 1 (BLACKMUN, J., dissenting).

As we noted in *Chiarella*, "[t]he tippee's obligation has been viewed as arising from his role as a participant after the fact in the insider's breach of a fiduciary duty." 445 U. S., at 230, n. 12. Tippees may assume an insider's duty to the shareholders not because they receive inside information, but rather because ~~they receive it~~ *improperly*.¹⁵ And for Rule 10b-5 purposes, the insider's disclosure is improper where it would violate his duty under *Cady, Roberts*. Thus, a tippee assumes a fiduciary duty to the shareholders of a corporation not to trade on material nonpublic information only when the insider breaches his fiduciary duty to the shareholders by disclosing the information to the tippee and the tippee knows or should know that there has been a breach.¹⁶ As Commis-

it has been made available to them

¹⁵The SEC itself has recognized that tippee liability properly is imposed only in circumstances where the tippee knows, or has reason to know, that the insider has disclosed improperly inside corporate information. In *Investors Management Co.*, the SEC stated that one element of tippee liability is that the tippee knew or had reason to know "that [the information] was non-public and had been obtained *improperly* by selective revelation or otherwise." 44 S.E.C., at 641 (emphasis added). Commissioner Smith read this test to mean that a tippee can be held liable only if he received information in breach of an insider's duty not to disclose it. *Id.*, at 650 (concurring in the result).

¹⁶Professor Loss has linked tippee liability to the concept in the law of restitution that "[w]here a fiduciary in violation of his duty to the beneficiary communicates confidential information to a third person, the third person, if he had notice of the violation of duty, holds upon a constructive

supra at —

sioner Smith perceptively observed in *Investors Management Co.*:

"It is important in this type of case to focus on policing insiders and what they do, which I think appropriate, rather than on policing information *per se* and its possession, which I think impracticable. I believe the emphasis in the law should continue to be upon the conduct of corporate insiders and their privies, as it has been since *Strong v. Repide*, 213 U. S. 419 (1909) and as it was in *Cady Roberts*, *Texas Gulf* and *Merrill Lynch*, rather than upon a concept—too vague for me to apply with any consistency—of relative informational advantages in the marketplace." 44 S.E.C., at 648 (concurring in the result).

C

Tipping thus properly is viewed as a means of indirectly violating the *Cady, Roberts* disclose-or-abstain rule. Accordingly, the elements of a Rule 10b-5 violation in a tipping case should be the same as in an inside-trading case. Mere receipt of information from a corporate insider is not enough to

trust for the beneficiary any profit which he makes through the use of such information.'" 3 L. Loss, *Securities Regulation* 1451 (2d ed. 1961) (quoting Restatement of Restitution § 201(2) (1937)). Other authorities likewise have expressed the view that tippee liability exists only where there has been a breach of trust by an insider of which the tippee had knowledge. See, e. g., *Ross v. Licht*, 268 F. Supp. 395, 410 (SDNY 1967); A. Jacobs, *The Impact of Rule 10b-5*, § 167, at 7-4 (1975) ("[T]he better view is that a tipper must know or have reason to know the information is nonpublic and was improperly obtained."); Fleischer, *Mundheim & Murphy*, *An Initial Inquiry Into the Responsibility to Disclose Market Information*, 121 U. Pa. L. Rev. 798, 818, n. 76 (1973) ("The extension of rule 10b-5 restrictions to tippees of corporate insiders can best be justified on the theory that they are participating in the insider's breach of his fiduciary duty."). Cf. Restatement (Second) of Agency § 312, comment c (1958) ("A person who, with notice that an agent is thereby violating his duty to his principal, receives confidential information from the agent, may be [deemed] . . . a constructive trustee.").

impose an obligation to disclose or abstain. The recipient or tippee of inside information thus cannot be "a participant after the fact," *Chiarella*, 445 U. S., at 230, n. 12, unless the insider or provider of the information has breached his duty to the corporation's shareholders, and the tippee knows or should know that there has been a breach.³⁰

All disclosures of confidential corporate information are not inconsistent with the duty insiders owe to shareholders. In contrast to the extraordinary facts of this case, the more typical situation in which there will be a question whether disclosure violates the insider's *Cady, Roberts* duty is when insiders disclose information to analysts. See n. 16, *supra*. In some situations, both the insider and the analyst recipient will act in good faith, and yet release of the information may affect the market. For example, it may not be clear—either to the corporate insider or to the recipient analyst—whether

³⁰ We do not suggest that knowingly trading on inside information is "socially desirable or even that it is devoid of moral considerations." Dooley, at 55. Nor do we imply an absence of responsibility to disclose promptly indications of illegal actions by a corporation to the proper authorities—typically the SEC and exchange authorities in cases involving securities. Depending on the circumstances, and even where permitted by law, one's trading on material nonpublic information is behavior that may fall below ethical standards of conduct. But in a statutory area of the law such as securities regulation, where legal principles of general application must be applied, there may be "significant distinctions between actual legal obligations and ethical ideals." SEC, Report of the Special Study of Securities Markets, H. R. Doc. No. 95, 88th Cong., 1st Sess., pt. 1, pp. 237-238 (1963).

At oral argument, the following exchange took place:

"QUESTION: So, it would not have satisfied his obligation under the law to go to the SEC first?

"[SEC's counsel]: That is correct. That an insider has to observe what has come to be known as the abstain or disclosure rule. Either the information has to be disclosed to the market if it is inside information . . . or the insider must abstain." Tr. of Oral Arg. 27. Thus, it is clear that Rule 10b-5 does not impose any obligation simply to tell the SEC about the fraud before trading.

the information will be viewed as material nonpublic information. Corporate officials may mistakenly think the information already has been disclosed or that it is not material enough to affect the market. Whether disclosure is a breach of duty therefore depends in large part on the purpose or good faith of the insider who made the disclosure. Absent an improper purpose, there has been no breach of duty to stockholders. And absent a breach by the insider, there is no derivative breach.²¹ As Commissioner Smith stated in *Investors Management Co.*:

"[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, and that the information must be shown not only to have been material and non-public, but also to have substantially contributed to the trading which occurred." 44 S.E.C., at 651 (concurring in the result).

There are facts and circumstances that often may justify an inference that the insider has breached his fiduciary duty. For example, there may be a relationship that exists between

²¹ An example of a case turning on the court's determination that the disclosure did not impose any fiduciary duties on the recipient of the inside information is *Walton v. Morgan Stanley & Co.*, 623 F. 2d 796 (CA2 1980). There, the defendant investment banking firm, representing one of its own corporate clients, investigated another corporation that was a possible target of a takeover bid by its client. In the course of negotiations the investment banking firm was given, on a confidential basis, unpublished material information. Subsequently, after the proposed takeover was abandoned, the firm was charged with relying on the information when it traded in the target corporation's stock. For purposes of the decision, it was assumed that the firm knew the information was confidential, but that it had been received in arm's-length negotiations. See *id.*, at 798. In the absence of any fiduciary relationship, the Court of Appeals found no basis for imposing tippee liability on the investment firm. See *id.*, at 799.

the insider and the recipient that suggests a *quid pro quo* from the latter, or an intention to benefit the particular recipient. The elements of fiduciary duty and exploitation of nonpublic information certainly exist when an insider makes a gift of confidential information to a trading relative or friend. The tip and trade resemble trading by the insider himself followed by a gift of the profits to the recipient.

Determining the purpose of any one disclosure, a question of fact, will not always be easy. But it is essential, we think, to have a guiding principle, and we believe that there must be a breach of the insider's fiduciary duty before the tippee inherits the duty to disclose or abstain. In contrast, the rule adopted by the SEC in this case would have no limiting principle.²²

IV

Under the inside-trading and tipping rules set forth above, we find that there was no actionable violation by Dirks.²³ It

²² Without legal limitations, market participants are forced to rely on the reasonableness of the SEC's litigation strategy, but that can be hazardous, as the facts of this case make plain. Following the SEC's filing of the *Texas Gulf Sulphur* action, Commissioner (and later Chairman) Budge spoke of the various implications of applying Rule 10b-5 in inside-trading cases:

"Turning to the realm of possible defendants in the present and potential civil actions, the Commission certainly does not contemplate suing every person who may have come across inside information. In the *Texas Gulf* action neither tippees nor persons in the vast rank and file of employees have been named as defendants. In my view, the Commission in future cases normally should not join rank and file employees or persons outside the company *such as an analyst or reporter* who learns of inside information." Speech of Hamer Budge to the New York Regional Group of the American Society of Corporate Secretaries, Inc. (Nov. 18, 1965) (emphasis added), reprinted in Budge, *The Texas Gulf Sulphur Case—What It Is and What It Isn't*, Corp. Secretary No. 127, at 6 (Dec. 17, 1965).

²³ Dirks contends that he was not a "tippee" because the information he received constituted unverified allegations of fraud that were denied by management and were not "material facts" under the securities laws that

is undisputed that Dirks himself was a stranger to Equity Funding, with no pre-existing fiduciary duty to its shareholders.²⁴ He took no action, directly or indirectly, that induced the shareholders or officers of Equity Funding to repose trust or confidence in him. There was no expectation by Dirks sources that he would keep their information in confidence. Nor did Dirks misappropriate or illegally obtain the information about Equity Funding. Unless the insiders breached their *Cady, Roberts* duty to shareholders in disclosing the nonpublic information to Dirks, he breached no duty when he passed it on to investors as well as to the *Wall Street Journal*.

We also think it is clear that the Equity Funding employees did not violate their *Cady, Roberts* duty to the corporation's shareholders by providing information to Dirks.²⁵ The

required disclosure before trading. He also argues that the information he received was not truly "inside" information, i. e., intended for a confidential corporate purpose, but was merely evidence of a crime. The Solicitor General agrees. See Brief for United States as *Amicus Curiae* 22. For purposes of deciding this case, however, we assume the correctness of the SEC's findings, accepted by the Court of Appeals, that petitioner was a tippee of material inside information.

²⁴Judge Wright found that Dirks acquired a fiduciary duty by virtue of his position as an employee of a broker-dealer. See 220 U. S. App. D.C., at 325-327, 681 F. 2d, at 840-842. The SEC, however, did not consider Judge Wright's novel theory in its decision, nor did it present that theory to the Court of Appeals. The SEC also has not argued Judge Wright's theory in this Court. See Brief for Respondent 21, n. 27. The merits of such a duty are therefore not before the Court. See *SEC v. Chenery Corp.*, 332 U. S. 194, 196-197 (1947).

²⁵In this Court, the SEC appears to contend that an insider invariably violates a fiduciary duty to the corporation's shareholders by transmitting nonpublic corporate information to an outsider when he has reason to believe that the outsider may use it to the disadvantage of the shareholders. "Thus, regardless of any ultimate motive to bring to public attention the derelictions at Equity Funding, Secrist breached his duty to Equity Funding shareholders." Brief for Respondent 21. This perceived "duty" differs markedly from the one that the SEC identified in *Cady, Roberts* and

tippers received no monetary or personal benefit for revealing Equity Funding's secrets, nor did they have an apparent purpose or desire to make a gift of valuable information to Dirks. As the facts of this case clearly indicate, the tippers were motivated by a desire to expose the fraud. See *supra*, at 1-2. In the absence of a breach of duty to shareholders by the insiders, there was no derivative breach by Dirks. See n. 19, *supra*. Dirks therefore could not have been "a participant after the fact in [an] insider's breach of a fiduciary duty." *Chiarella*, 445 U. S., at 230, n. 12.

V

We conclude that Dirks, in the circumstances of this case, had no duty to abstain from use of the inside information that he obtained. The judgment of the Court of Appeals therefore is

Reversed.

that has been the basis for federal tippee-trading rules to date. In fact, the SEC did not charge Secrist with any wrongdoing, and we do not understand the SEC to have relied on any theory of a breach of duty by Secrist in finding that Dirks breached his duty to Equity Funding's shareholders. See App. 250 (decision of administrative law judge) ("One who knows himself to be a beneficiary of non-public, selectively disclosed inside information must fully disclose or refrain from trading."); 21 S.E.C., at 1410, n. 42 ("Presumably, Dirks' informants were entitled to disclose the [Equity Funding] fraud in order to bring it to light and its perpetrators to justice."); Brief on behalf of the SEC in the Court of Appeals, at 47-50; *id.*, at 51 ("[K]nowing possession of inside information by any person imposes a duty to abstain or disclose."); *id.*, at 52-54; *id.*, at 55 ("[T]his obligation arises not from the manner in which such information is acquired. . . ."); 220 U. S. App. D.C., at 322-323, 681 F. 2d, at 838 (Wright, J.).

MAY 27 1983

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

From: **Justice Powell**

Circulated: _____

Recirculated: _____

CHAMBERS DRAFT III

SUPREME COURT OF THE UNITED STATES

No. 82-276

RAYMOND L. DIRKS, PETITIONER *v.* SECURITIES
AND EXCHANGE COMMISSION

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF
APPEALS FOR DISTRICT OF COLUMBIA

[June —, 1983]

JUSTICE POWELL delivered the opinion of the Court.

Petitioner Raymond Dirks received material nonpublic information from "insiders" of a corporation with which he had no connection. He disclosed this information to investors who relied on it in trading in the shares of the corporation. The question is whether Dirks violated the antifraud provisions of the federal securities laws by this disclosure.

I

In 1973, Dirks was an officer of a New York broker-dealer firm who specialized in providing investment analysis of insurance company securities to institutional investors.¹ On March 6, Dirks received information from Ronald Secrist, a former officer of Equity Funding of America. Secrist alleged that the assets of Equity Funding, a diversified corporation primarily engaged in selling life insurance and mutual funds, were vastly overstated as the result of fraudulent corporate practices. Secrist also stated that various regula-

¹ The facts stated here are taken from more detailed statements set forth by the administrative law judge, App. 176-180, 225-247; the opinion of the Securities and Exchange Commission, 21 S.E.C. Docket 1401, 1402-1406 (1981); and the opinion of Judge Wright in the Court of Appeals, 220 U. S. App. D.C. 309, 314-318, 681 F. 2d 824, 829-833 (1982).

tory agencies had failed to act on similar charges made by Equity Funding employees. He urged Dirks to verify the fraud and disclose it publicly.

Dirks decided to investigate the allegations. He visited Equity Funding's headquarters in Los Angeles and interviewed several officers and employees of the corporation. The senior management denied any wrongdoing, but the corporation employees corroborated the charges of fraud. Neither Dirks nor his firm owned or traded any Equity Funding stock, but throughout his investigation he openly discussed the information he had obtained with a number of clients investors. Some of these persons sold their holdings of Equity Funding securities, including five investment advisers who liquidated holdings of more than \$16 million.²

While Dirks was in Los Angeles, he was in touch regularly with William Blundell, the *Wall Street Journal's* Los Angeles bureau chief. Dirks urged Blundell to write a story on the fraud allegations. Blundell did not believe that such a massive fraud could go undetected and declined to write the story. He feared that publishing such damaging rumors might be libelous.

During the two-week period in which Dirks pursued his investigation and spread word of Secrist's charges, the price of Equity Funding stock fell from \$26 per share to less than \$15 per share. This led the New York Stock Exchange to halt trading on March 27. Shortly thereafter California insur-

²Dirks received from his firm a salary plus a commission for securities transactions above a certain amount that his clients directed through his firm. See 21 S.E.C. Docket, at 1402, n. 3. But "[i]t is not clear how many of those with whom Dirks spoke promised to direct some brokerage business through [Dirks' firm] to compensate [Dirks], or how many actually did so." 220 U. S. App. D.C., at 316, 681 F. 2d, at 831. The Boston Company Institutional Investors, Inc., promised Dirks about \$25,000 in commissions, but it is unclear whether Boston actually generated any brokerage business for his firm. See App. 199, 204-205; 21 S.E.C. Docket, at 1404, n. 10; 220 U. S. App. D.C., at 316, n. 5, 681 F. 2d, at 831, n. 5.

ance authorities impounded Equity Funding's records and uncovered evidence of the fraud. Only then did the Securities and Exchange Commission (SEC) file a complaint against Equity Funding³ and only then, on April 2, did the *Wall Street Journal* publish a front-page story based largely on information assembled by Dirks. Equity Funding immediately went into receivership.⁴

The SEC began an investigation into Dirks' role in the exposure of the fraud. After a hearing by an administrative law judge, the SEC found that Dirks had aided and abetted violations of § 17(a) of the Securities Act of 1933, 15 U. S. C. § 77q(a),⁵ § 10(b) of the Securities Exchange Act of 1934, 15 U. S. C. § 78j(b),⁶ and SEC Rule 10b-5, 17 CFR § 240.10b-5

³ As early as 1971, the SEC had received allegations of fraudulent accounting practices at Equity Funding. Moreover, on March 9, 1973, an official of the California Insurance Department informed the SEC's regional office in Los Angeles of Secrist's charges of fraud. Dirks himself voluntarily presented his information at the SEC's regional office beginning on March 27.

⁴ A federal grand jury in Los Angeles subsequently returned a 105-count indictment against 22 persons, including many of Equity Funding's officers and directors. All defendants were found guilty of one or more counts, either by a plea of guilty or a conviction after trial. See Brief for Petitioner 15; App. 149-153.

⁵ Section 17(a) provides:

"It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

"(1) to employ any device, scheme, or artifice to defraud, or

"(2) to obtain money or property by means of any untrue statement of a material fact or any omission 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

"(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser."

⁶ Section 10(b) provides:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of

(1982),⁷ by repeating the allegations of fraud to members of the investment community who later sold their Equity Funding stock. The SEC concluded: "Where 'tippees'—regardless of their motivation or occupation—come into possession of material 'information that they know is confidential and know or should know came from a corporate insider,' they must either publicly disclose that information or refrain from trading." 21 S.E.C. Docket 1401, 1407 (1981) (footnote omitted) (quoting *Chiarella v. United States*, 445 U. S. 222, 230 n. 12 (1980)). Recognizing, however, that Dirks "played an important role in bringing [Equity Funding's] massive fraud to light," 21 S.E.C. Docket, at 1412, the SEC only censured him.⁸

Dirks sought review in the Court of Appeals for the District of Columbia Circuit. The court entered judgment

any facility of any national securities exchange—

"(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

⁷ Rule 10b-5 provides:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

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

"(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

"(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."

⁸ Section 15 of the Securities Exchange Act, 15 U. S. C. § 78o(b)(4)(E), provides that the SEC may impose certain sanctions, including censure, on any person associated with a registered broker-dealer who has "willfully aided [or] abetted" any violation of the federal securities laws. See 15 U. S. C. § 78ff(a) (providing criminal penalties).

against Dirks "for the reasons stated by the Commission in its opinion." App. to Pet. for Cert. C-2. Judge Wright, a member of the panel, subsequently issued an opinion. Judge Robb concurred in the result, and Judge Tamm dissented; neither filed a separate opinion. Judge Wright believed that "the obligations of corporate fiduciaries pass to all those to whom they disclose their information before it has been disseminated to the public at large." 220 U. S. App. D.C. 309, 324, 681 F. 2d 824, 839 (1982). Alternatively, Judge Wright concluded that, as an employee of a broker-dealer, Dirks had violated "obligations to the SEC and to the public completely independent of any obligations he acquired" as a result of receiving the information. *Id.*, at 325, 681 F. 2d, at 840.

In view of the importance to the SEC and to the securities industry of the question presented by this case, we granted a writ of certiorari. — U. S. — (1982). We now reverse.

II

In the seminal case of *In re Cady, Roberts & Co.*, 40 S.E.C. 907 (1961), the SEC recognized that the common law in some jurisdictions imposes on "corporate 'insiders,' particularly officers, directors, or controlling stockholders" an "affirmative duty of disclosure . . . when dealing in securities." *Id.*, at 911, and n. 13.⁹ The SEC found that, not only did breach of this common-law duty also establish the elements of a Rule 10b-5 violation,¹⁰ but that individuals other

⁹The duty that insiders owe to the corporation's shareholders not to trade on inside information differs from the common-law duty that officers and directors also have to the corporation itself not to mismanage corporate assets, of which confidential information is one. See 3 Fletcher Cyclopedic of the Laws of Private Corporations §§ 848, 900 (1975 ed. and Supp. 1982); 3A Fletcher §§ 1168.1, 1168.2. In holding that breaches of this duty to shareholders violated the Securities Exchange Act, the Cady, Roberts Commission recognized, and we agree that "[a] significant purpose of the Exchange Act was to eliminate the idea that use of inside information for personal advantage was a normal emolument of corporate office." See 40 S.E.C., at 912, n. 15.

¹⁰Rule 10b-5 is generally the most inclusive of the three provisions on

than corporate insiders could be obligated to disclose material nonpublic information¹¹ before trading or to abstain from trading altogether. *Id.*, at 912. In *Chiarella*, we accepted the two elements set out initially in *Cady Roberts* for establishing a Rule 10b-5 violation: "(i) the existence of a relationship affording access to inside information intended to be available only for a corporate purpose, and (ii) the unfairness of allowing a corporate insider to take advantage of that information by trading without disclosure." 445 U. S., at 227. In examining whether *Chiarella* had an obligation to disclose or abstain, the Court found that there is no general duty to disclose before trading on material nonpublic information,¹² and held that "a duty to disclose under § 10(b) does not arise from the mere possession of nonpublic market information." *Id.*, at 235. Such a duty arises rather from the existence of a fiduciary relationship. See *id.*, at 227-235.

Not "all breaches of fiduciary duty in connection with a securities transaction," however, come within the ambit of Rule 10b-5. *Santa Fe Industries, Inc. v. Green*, 430 U. S. 462, 472 (1977). There must also be "manipulation or deception." *Id.*, at 473. In an inside-trading case this fraud derives from

which the SEC rested its decision in this case, and we will refer to it when we note the statutory basis for the SEC's inside-trading rules.

¹¹ The SEC views the disclosure duty as requiring more than disclosure to purchasers or sellers: "Proper and adequate disclosure of significant corporate developments can only be effected by a public release through the appropriate public media, designed to achieve a broad dissemination to the investing public generally and without favoring any special person or group." *In re Faberge, Inc.*, 45 S.E.C. 249, 256 (1973). As used in this opinion, "nonpublic information" will refer to information that has not been so disclosed.

¹² See 445 U. S., at 233; *id.*, at 237 (STEVENS, J., concurring); *id.*, at 238-239 (BRENNAN, J., concurring in the judgment); *id.*, at 239-240 (BURGER, C. J., dissenting). Cf. *id.*, at 252, n. 2 (BLACKMUN, J., dissenting) (recognizing that there is no obligation to disclose material nonpublic information obtained through the exercise of "diligence or acumen" and "honest means," as opposed to "stealth").

the "inherent unfairness involved where one takes advantage" of "information intended to be available only for a corporate purpose and not for the personal benefit of anyone." *In re Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 43 S.E.C. 933, 936 (1968). Thus, an insider will be liable under Rule 10b-5 for inside trading only where he fails to disclose material nonpublic information before trading on it and thus makes "secret profits." *Cady, Roberts*, 40 S.E.C., at 916, n. 31.

III

We were explicit in *Chiarella* in saying that there can be no duty to disclose where the person who has traded on inside information "was not [the corporation's] agent, . . . was not a fiduciary, [or] was not a person in whom the sellers [of the securities] had placed their trust and confidence." 445 U. S., at 232. Not to require such a fiduciary relationship, we recognized, would "depar[t] radically from the established doctrine that duty arises from a specific relationship between two parties" and would amount to "recognizing a general duty between all participants in market transactions to forgo actions based on material, nonpublic information." *Id.*, at 232, 233. This requirement of a specific relationship between the shareholders and the individual trading on inside information has created analytical difficulties for the SEC in policing tippees who trade on inside information. Unlike insiders who have independent fiduciary duties to both the corporation and its shareholders, the typical tippee has no such relationship.¹³ In view of this absence, it has been unclear

¹³ Under certain circumstances, such as where corporate information is revealed legitimately to an underwriter, accountant, or lawyer 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 rather 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

how a tippee acquires the *Cady, Roberts* duty to refrain from trading on inside information.

A

The SEC's position, as stated in its opinion in this case, is that a tippee inherits the *Cady, Roberts* obligation to shareholders whenever he receives inside information from an insider:

"In tipping potential traders, Dirks breached a duty which he had assumed as a result of knowingly receiving confidential information from [Equity Funding] insiders. Tippees such as Dirks who receive non-public material information from insiders become 'subject to the same duty as [the] insiders.' *Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.* [495 F. 2d 228, 237 (CA2 1974) (quoting *Ross v. Licht*, 263 F. Supp. 395, 410 (SDNY 1967))]. Such a tippee breaches the fiduciary duty which he assumes from the insider when the tippee knowingly transmits the information to someone who will probably trade on the basis thereof. . . . Presumably, Dirks' informants were entitled to disclose the [Equity Funding] fraud in order to bring it to light and its perpetrators to justice. However, Dirks—standing in their shoes—committed a breach of the fiduciary duty

corporate purposes. See *SEC v. Monarch Fund*, 608 F. 2d 923, 942 (CA2 1979); *In re Investors Management Co.*, 44 S.E.C. 633, 645 (1971); *In re Van Aylstne, Noel & Co.*, 43 S.E.C. 1080, 1084-1085 (1969); *In re Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 43 S.E.C. 933, 937 (1968); *Cady, Roberts*, 40 S.E.C., at 912. When such a person breaches his fiduciary relationship, he may be treated more properly as a tipper than a tippee. See *Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 495 F. 2d 228, 237 (CA2 1974) (investment banker had access to material information when working on a proposed public offering for the corporation). For such a duty to be imposed, however, the corporation must expect the outsider to keep the disclosed nonpublic information confidential, and the relationship at least must imply such a duty.

which he had assumed in dealing with them, when he passed the information on to traders." 21 S.E.C. Docket, at 1410, n. 42.

This view differs little from the view that we rejected as inconsistent with congressional intent in *Chiarella*. In that case, the Court of Appeals agreed with the SEC and affirmed *Chiarella*'s conviction, holding 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." *United States v. Chiarella*, 588 F. 2d 1358, 1365 (CA2 1978) (emphasis in original). Here, the SEC maintains that anyone who knowingly receives nonpublic material information from an insider has a fiduciary duty to disclose before trading.¹⁴

In effect, the SEC's theory of tippee liability in both cases appear rooted in the idea that the antifraud provisions require equal information. This is a significant departure from

¹⁴ Apparently, the SEC believes this case differs from *Chiarella* in that *Dirks*' receipt of inside information from *Secrist*, an insider, carried *Secrist*'s duties with it, while *Chiarella* received the information without the direct involvement of an insider and thus inherited no duty to disclose or abstain. The SEC fails to explain, however, why the receipt of nonpublic information from an insider automatically carries with it the fiduciary duty of the insider. As we emphasized in *Chiarella*, mere possession of nonpublic information does not give rise to a duty to disclose or abstain; only a specific relationship does that. And we do not believe that the mere receipt of information from an insider creates such a special relationship between the tippee and the corporation's shareholders.

Apparently recognizing the weakness of its argument in light of *Chiarella*, the SEC attempts to distinguish that case factually as involving not "inside" information, but rather "market" information, i. e., "information generated within the company relating to its assets or earnings." Brief for Respondent 23. This Court drew no such distinction in *Chiarella* and, as THE CHIEF JUSTICE noted, "[i]t is clear that § 10(b) and Rule 10b-5 by their terms and by their history make no such distinction." 445 U. S., at 241, n. 1 (dissenting opinion). See ALI Fed. Sec. Code § 1603, Comment (2)(j) (Proposed Official Draft 1978).

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.¹⁵ Judge Wright correctly read our opinion in *Chiarella* as repudiating any notion that all traders must enjoy equal information before trading: "[T]he 'information' theory is rejected. Because the disclose-or-refrain duty is extraordinary, it attaches only when a party has legal obligations other than a mere duty to comply with the general antifraud proscriptions in the federal securities laws." 220 U. S. App. D.C., at 322, 681 F. 2d, at 837. See *Chiarella*, 445 U. S., at 235, n. 20. We reaffirm today that "[a] duty [to disclose] arises from the relationship between parties . . . and not merely from one's ability to acquire information because of his position in the market." 445 U. S., at 232-233, n. 14.

Imposing a duty to disclose or abstain solely because a person knowingly receives material nonpublic information from an insider and trades on it could have an inhibiting influence on the role of market analysts that the SEC itself recognizes is essential.¹⁶ It is commonplace for analysts to "ferret out

¹⁵ In *Chiarella*, we noted that formulation of an absolute equal information rule "should not be undertaken absent some explicit evidence of congressional intent." 445 U. S., at 233. Rather than adopting such a radical view of securities trading, Congress has expressly exempted many market professionals from the general statutory prohibition set forth in § 11(a)(1) of the Securities Exchange Act, 15 U. S. C. § 78k(a)(1), against members of a national securities exchange trading for their own account. See *id.*, at 233, n. 16. We observed in *Chiarella* that "[t]he exception is based upon Congress' recognition that [market professionals] contribute to a fair and orderly marketplace at the same time they exploit the informational advantage that comes from their possession of [nonpublic information]." *Ibid.*

¹⁶ The SEC expressly recognized that "[t]he value to the entire market of [analysts'] efforts cannot be gainsaid; market efficiency in pricing is significantly enhanced by [their] initiatives to ferret out and analyze information, and thus the analyst's work redounds to the benefit of all investors." 21 S.E.C., at 1406. The SEC asserts that analysts remain free to obtain

and analyze information," 21 S.E.C., at 1406,¹⁷ and this often is done by meeting with and questioning corporate officers and others who are insiders. And information that the analysts obtain normally may be the basis for judgments as to the market worth of a corporation's securities. The analyst's judgment in this respect is made available in market letters or otherwise to clients of the firm. In the very nature of this type of information, and indeed of the markets themselves, such information cannot be made simultaneously available to all of the corporation's stockholders or the public generally.

B

The conclusion that recipients of inside information do not invariably acquire a duty to disclose or abstain does not mean

from management corporate information for purposes of "filling in the 'interstices in analysis'" Brief for Respondent 42 (quoting *Investors Management Co.*, 44 S.E.C., at 646). But this rule is inherently imprecise, and imprecision prevents parties from ordering their actions in accord with legal requirements. Unless the parties have some guidance as to where the line is between permissible and impermissible disclosures and uses, neither corporate insiders nor analysts can be sure when the line is crossed. Cf. *Adler v. Klawans*, 267 F. 2d 840, 845 (CA2 1959) (Burger, J., sitting by designation).

"On its facts, this case is the unusual one. Dirks is an analyst in a broker-dealer firm, and he did interview management in the course of his investigation. He uncovered, however, startling information that required no analysis or exercise of judgment as to its market relevance. Nonetheless, the principle at issue here extends beyond these facts. The SEC's rule—applicable without regard to any breach by an insider—could have serious ramifications on reporting by analysts of investment views.

Despite the unusualness, of Dirks' "find," the central role that he played in uncovering the fraud at Equity Funding, and that analysts in general can play in revealing information that corporations may have reason to withhold from the public is an important one. Dirks' careful investigation brought to light a massive fraud at the corporation. And until the Equity Funding fraud was exposed, the information in the trading market was grossly inaccurate. But for Dirks' efforts, the fraud might well have gone undetected longer.

that such tippee always are free to trade on the information. The need for a prophylactic ban on some tippee trading is clear. Not only must insiders be forbidden by their fiduciary relationship from personally using undisclosed corporate information to their advantage, but they may not give such information to an outsider for the same improper purpose of exploiting the information for their personal gain. See 15 U. S. C. § 78t(b) (making it unlawful to do indirectly "by means of any other person" any act made unlawful by the federal securities laws). Similarly, the transactions of those who knowingly participate with the fiduciary in such a breach are "as forbidden" as transactions "on behalf of the trustee himself." *Mosser v. Darrow*, 341 U. S. 267, 272 (1951). See *Jackson v. Smith*, 254 U. S. 586, 589 (1921); *Jackson v. Ludeling*, 88 U. S. 616, 631-632 (1874). As the Court explained in *Mosser*, a contrary rule "would open up opportunities for devious dealings in the name of the others that the trustee could not conduct in his own." 341 U. S., at 271. See *SEC v. Texas Gulf Sulphur Co.*, 446 F. 2d 1301, 1308 (CA2), cert. denied, 404 U. S. 1005 (1971). Thus, the tippee's duty to disclose or abstain is derivative from that of the insider's duty. See Tr. of Oral Ar. 38. Cf. *Chiarella*, 445 U. S., at 246, n. 1 (BLACKMUN, J., dissenting). As we noted in *Chiarella*, "[t]he tippee's obligation has been viewed as arising from his role as a participant after the fact in the insider's breach of a fiduciary duty." 445 U. S., at 230, n. 12.

Thus, some tippees must assume an insider's duty to the shareholders not because they receive inside information, but rather because it has been made available to them *improperly*.¹³ And for Rule 10b-5 purposes, the insider's disclosure

¹³ The SEC itself has recognized that tippee liability properly is imposed only in circumstances where the tippee knows, or has reason to know, that the insider has disclosed improperly inside corporate information. In *In-*

is improper only where it would violate his *Cady, Roberts* duty. Thus, a tippee assumes a fiduciary duty to the shareholders of a corporation not to trade on material nonpublic information only when the insider has breached his fiduciary duty to the shareholders by disclosing the information to the tippee and the tippee knows or should know that there has been a breach.¹⁹ As Commissioner Smith perceptively observed in *Investors Management Co.*: "It is important in this type of case to focus on policing insiders and what they do, which I think appropriate, rather than on policing informa-

vestors Management Co., *supra*, at —, the SEC stated that one element of tippee liability is that the tippee knew or had reason to know "that [the information] was non-public and had been obtained *improperly* by selective revelation or otherwise." 44 S.E.C., at 641 (emphasis added). Commissioner Smith read this test to mean that a tippee can be held liable only if he received information in breach of an insider's duty not to disclose it. *Id.*, at 650 (concurring in the result).

¹⁹ Professor Loss has linked tippee liability to the concept in the law of restitution that "[w]here a fiduciary in violation of his duty to the beneficiary communicates confidential information to a third person, the third person, if he had notice of the violation of duty, holds upon a constructive trust for the beneficiary any profit which he makes through the use of such information." 3 L. Loss, *Securities Regulation* 1451 (2d ed. 1961) (quoting Restatement of Restitution § 201(2) (1937)). Other authorities likewise have expressed the view that tippee liability exists only where there has been a breach of trust by an insider of which the tippee had knowledge. See, e. g., *Ross v. Licht*, 263 F. Supp. 395, 410 (SDNY 1967); A. Jacobs, *The Impact of Rule 10b-5*, § 167, at 7-4 (1975) ("[T]he better view is that a tipper must know or have reason to know the information is nonpublic and was improperly obtained."); Fleischer, *Mundheim & Murphy, An Initial Inquiry Into the Responsibility to Disclose Market Information*, 121 U. Pa. L. Rev. 798, 818, n. 76 (1973) ("The extension of rule 10b-5 restrictions to tippees of corporate insiders can best be justified on the theory that they are participating in the insider's breach of his fiduciary duty."). Cf. Restatement (Second) of Agency § 312, comment c (1958) ("A person who, with notice that an agent is thereby violating his duty to his principal, receives confidential information from the agent, may be [deemed] . . . a constructive trustee.").

tion *per se* and its possession, which I think impracticable.” 44 S.E.C., at 648 (concurring in the result). Tipping thus properly is viewed as a means of indirectly violating the *Cady, Roberts* disclose-or-abstain rule.²⁰

C

In determining whether a tippee is under an obligation to disclose or abstain, it thus is necessary to determine whether the insiders “tip” constituted a breach of the insider’s fiduciary duty. All disclosures of confidential corporate information are not inconsistent with the duty insiders owe to shareholders. In contrast to the extraordinary facts of this case, the more typical situation in which there will be a question whether disclosure violates the insider’s *Cady, Roberts* duty is when insiders disclose information to analysts. See n. 16, *supra*. In some situations, both the insider and the analyst

²⁰ We do not suggest that knowingly trading on inside information is ever “socially desirable or even that it is devoid of moral considerations,” Dooley, Enforcement of Insider Trading Restrictions, 66 Va. L. Rev. 1, 55 (1980). Nor do we imply an absence of responsibility to disclose promptly indications of illegal actions by a corporation to the proper authorities—typically the SEC and exchange authorities in cases involving securities. Depending on the circumstances, and even where permitted by law, one’s trading on material nonpublic information is behavior that may fall below ethical standards of conduct. But in a statutory area of the law such as securities regulation, where legal principles of general application must be applied, there may be “significant distinctions between actual legal obligations and ethical ideals.” SEC, Report of the Special Study of Securities Markets, H. R. Doc. No. 95, 88th Cong., 1st Sess., pt. 1, pp. 237–238 (1963). The SEC recognizes this. At oral argument, the following exchange took place:

“QUESTION: So, it would not have satisfied his obligation under the law to go to the SEC first?

“[SEC’s counsel]: That is correct. That an insider has to observe what has come to be known as the abstain or disclosure rule. Either the information has to be disclosed to the market if it is inside information . . . or the insider must abstain.” Tr. of Oral Arg. 27.

Thus, it is clear that Rule 10b-5 does not impose any obligation simply to tell the SEC about the fraud before trading.

recipient will act in good faith, and yet release of the information may affect the market. For example, it may not be clear—either to the corporate insider or to the recipient analyst—whether the information will be viewed as material nonpublic information. Corporate officials may mistakenly think the information already has been disclosed or that it is not material enough to affect the market. Whether disclosure is a breach of duty therefore depends in large part on the purpose or good faith of the insider who made the disclosure. Absent an improper purpose, there has been no breach of duty to stockholders. And absent a breach by the insider, there is no derivative breach.²¹ As Commissioner Smith stated in *Investors Management Co.*:

“[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, and that the information must be shown not only to have been material and non-public, but also to have substantially contributed to the trading which occurred.” 44 S.E.C., at 651 (concurring in the result).

²¹ An example of a case turning on the court's determination that the disclosure did not impose any fiduciary duties on the recipient of the inside information is *Walton v. Morgan Stanley & Co.*, 623 F. 2d 796 (CA2 1980). There, the defendant investment banking firm, representing one of its own corporate clients, investigated another corporation that was a possible target of a takeover bid by its client. In the course of negotiations the investment banking firm was given, on a confidential basis, unpublished material information. Subsequently, after the proposed takeover was abandoned, the firm was charged with relying on the information when it traded in the target corporation's stock. For purposes of the decision, it was assumed that the firm knew the information was confidential, but that it had been received in arm's-length negotiations. See *id.*, at 798. In the absence of any fiduciary relationship, the Court of Appeals found no basis for imposing tippee liability on the investment firm. See *id.*, at 799.

There are facts and circumstances that often may justify an inference that the insider has breached his fiduciary duty. For example, there may be a relationship that exists between the insider and the recipient that suggests a *quid pro quo* from the latter, or an intention to benefit the particular recipient. The elements of fiduciary duty and exploitation of nonpublic information certainly exist when an insider makes a gift of confidential information to a trading relative or friend. The tip and trade resemble trading by the insider himself followed by a gift of the profits to the recipient.

Determining the purpose of any one disclosure, a question of fact, will not always be easy for courts. But it is essential, we think, to have a guiding principle for those whose daily activities must be limited and instructed by the SEC's inside-trading rules, and we believe that there must be a breach of the insider's fiduciary duty before the tippee inherits the duty to disclose or abstain. In contrast, the rule adopted by the SEC in this case would have no limiting principle.²²

IV

²² Without legal limitations, market participants are forced to rely on the reasonableness of the SEC's litigation strategy, but that can be hazardous, as the facts of this case make plain. Following the SEC's filing of the *Texas Gulf Sulphur* action, Commissioner (and later Chairman) Budge spoke of the various implications of applying Rule 10b-5 in inside-trading cases:

"Turning to the realm of possible defendants in the present and potential civil actions, the Commission certainly does not contemplate suing every person who may have come across inside information. In the *Texas Gulf* action neither tippees nor persons in the vast rank and file of employees have been named as defendants. In my view, the Commission in future cases normally should not join rank and file employees or persons outside the company *such as an analyst or reporter* who learns of inside information." Speech of Hamer Budge to the New York Regional Group of the American Society of Corporate Secretaries, Inc. (Nov. 18, 1965) (emphasis added), reprinted in Budge, *The Texas Gulf Sulphur Case—What It Is and What It Isn't*, Corp. Secretary No. 127, at 6 (Dec. 17, 1965).

Under the inside-trading and tipping rules set forth above, we find that there was no actionable violation by Dirks.²³ It is undisputed that Dirks himself was a stranger to Equity Funding, with no pre-existing fiduciary duty to its shareholders.²⁴ He took no action, directly or indirectly, that induced the shareholders or officers of Equity Funding to repose trust or confidence in him. There was no expectation by Dirks's sources that he would keep their information in confidence. Nor did Dirks misappropriate or illegally obtain the information about Equity Funding. Unless the insiders breached their *Cady, Roberts* duty to shareholders in disclosing the nonpublic information to Dirks, he breached no duty when he passed it on to investors as well as to the *Wall Street Journal*.

We also think it is clear that the Equity Funding employees did not violate their *Cady, Roberts* duty to the corporation's shareholders by providing information to Dirks.²⁵ The

²³ Dirks contends that he was not a "tippee" because the information he received constituted unverified allegations of fraud that were denied by management and were not "material facts" under the securities laws that required disclosure before trading. He also argues that the information he received was not truly "inside" information, i. e., intended for a confidential corporate purpose, but was merely evidence of a crime. The Solicitor General agrees. See Brief for United States as *Amicus Curiae* 22. For purposes of deciding this case, however, we assume the correctness of the SEC's findings, accepted by the Court of Appeals, that petitioner was a tippee of material inside information.

²⁴ Judge Wright found that Dirks acquired a fiduciary duty by virtue of his position as an employee of a broker-dealer. See 220 U. S. App. D.C., at 325-327, 681 F. 2d, at 840-842. The SEC, however, did not consider Judge Wright's novel theory in its decision, nor did it present that theory to the Court of Appeals. The SEC also has not argued Judge Wright's theory in this Court. See Brief for Respondent 21, n. 27. The merits of such a duty are therefore not before the Court. See *SEC v. Chenery Corp.*, 332 U. S. 194, 196-197 (1947).

²⁵ In this Court, the SEC appears to contend that an insider invariably violates a fiduciary duty to the corporation's shareholders by transmitting nonpublic corporate information to an outsider when he has reason to be-

tippers received no monetary or personal benefit for revealing Equity Funding's secrets, nor did they have an apparent purpose or desire to make a gift of valuable information to Dirks. As the facts of this case clearly indicate, the tippers were motivated by a desire to expose the fraud. See *supra*, at 1-2. In the absence of a breach of duty to shareholders by the insiders, there was no derivative breach by Dirks. See n. 19, *supra*. Dirks therefore could not have been "a participant after the fact in [an] insider's breach of a fiduciary duty." *Chiarella*, 445 U. S., at 230, n. 12.

V

We conclude that Dirks, in the circumstances of this case, had no duty to abstain from use of the inside information that he obtained. The judgment of the Court of Appeals therefore is

Reversed.

lieve that the outsider may use it to the disadvantage of the shareholders. "Thus, regardless of any ultimate motive to bring to public attention the derelictions at Equity Funding, Secrist breached his duty to Equity Funding shareholders." Brief for Respondent 31. This perceived "duty" differs markedly from the one that the SEC identified in *Cady, Roberts* and that has been the basis for federal tippee-trading rules to date. In fact, the SEC did not charge Secrist with any wrongdoing, and we do not understand the SEC to have relied on any theory of a breach of duty by Secrist in finding that Dirks breached his duty to Equity Funding's shareholders. See App. 250 (decision of administrative law judge) ("One who knows himself to be a beneficiary of non-public, selectively disclosed inside information must fully disclose or refrain from trading."); SEC's Reply to Notice of Supplemental Authority before the SEC 4 ("If Secrist was acting properly, Dirks inherited a duty to [Equity Funding]'s shareholders to refrain from improper private use of the information"); Brief on behalf of the SEC in the Court of Appeals, at 47-50; *id.*, at 51 ("[K]nowing possession of inside information by any person imposes a duty to abstain or disclose."); *id.*, at 52-54; *id.*, at 55 ("[T]his obligation arises not from the manner in which such information is acquired. . . ."); 220 U. S. App. D.C., at 322-323, 681 F. 2d, at 838 (Wright, J.).

MAY 28 1983

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

From: **Justice Powell**

Circulated: **MAY 26 1983**

Recirculated: _____

1st DRAFT

SUPREME COURT OF THE UNITED STATES

No. 82-276

RAYMOND L. DIRKS, PETITIONER *v.* SECURITIES
AND EXCHANGE COMMISSION

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF
APPEALS FOR DISTRICT OF COLUMBIA

[June —, 1983]

JUSTICE POWELL delivered the opinion of the Court.

Petitioner Raymond Dirks received material nonpublic information from "insiders" of a corporation with which he had no connection. He disclosed this information to investors who relied on it in trading in the shares of the corporation. The question is whether Dirks violated the antifraud provisions of the federal securities laws by this disclosure.

I

In 1973, Dirks was an officer of a New York broker-dealer firm who specialized in providing investment analysis of insurance company securities to institutional investors.¹ On March 6, Dirks received information from Ronald Secrist, a former officer of Equity Funding of America. Secrist alleged that the assets of Equity Funding, a diversified corporation primarily engaged in selling life insurance and mutual funds, were vastly overstated as the result of fraudulent corporate practices. Secrist also stated that various regula-

¹The facts stated here are taken from more detailed statements set forth by the administrative law judge, App. 176-180, 225-247; the opinion of the Securities and Exchange Commission, 21 S.E.C. Docket 1401, 1402-1406 (1981); and the opinion of Judge Wright in the Court of Appeals, 220 U. S. App. D.C. 309, 314-318, 681 F. 2d 824, 829-833 (1982).

tory agencies had failed to act on similar charges made by Equity Funding employees. He urged Dirks to verify the fraud and disclose it publicly.

Dirks decided to investigate the allegations. He visited Equity Funding's headquarters in Los Angeles and interviewed several officers and employees of the corporation. The senior management denied any wrongdoing, but certain corporation employees corroborated the charges of fraud. Neither Dirks nor his firm owned or traded any Equity Funding stock, but throughout his investigation he openly discussed the information he had obtained with a number of clients and investors. Some of these persons sold their holdings of Equity Funding securities, including five investment advisers who liquidated holdings of more than \$16 million.²

While Dirks was in Los Angeles, he was in touch regularly with William Blundell, the *Wall Street Journal's* Los Angeles bureau chief. Dirks urged Blundell to write a story on the fraud allegations. Blundell did not believe, however, that such a massive fraud could go undetected and declined to write the story. He feared that publishing such damaging rumors might be libelous.

During the two-week period in which Dirks pursued his investigation and spread word of Secrist's charges, the price of Equity Funding stock fell from \$26 per share to less than \$15 per share. This led the New York Stock Exchange to halt trading on March 27. Shortly thereafter California insur-

² Dirks received from his firm a salary plus a commission for securities transactions above a certain amount that his clients directed through his firm. See 21 S.E.C. Docket, at 1402, n. 3. But "[i]t is not clear how many of those with whom Dirks spoke promised to direct some brokerage business through [Dirks' firm] to compensate Dirks, or how many actually did so." 220 U. S. App. D.C., at 316, 681 F. 2d, at 831. The Boston Company Institutional Investors, Inc., promised Dirks about \$25,000 in commissions, but it is unclear whether Boston actually generated any brokerage business for his firm. See App. 199, 204-205; 21 S.E.C. Docket, at 1404, n. 10; 220 U. S. App. D.C., at 316, n. 5, 681 F. 2d, at 831, n. 5.

ance authorities impounded Equity Funding's records and uncovered evidence of the fraud. Only then did the Securities and Exchange Commission (SEC) file a complaint against Equity Funding³ and only then, on April 2, did the *Wall Street Journal* publish a front-page story based largely on information assembled by Dirks. Equity Funding immediately went into receivership.⁴

The SEC began an investigation into Dirks' role in the exposure of the fraud. After a hearing by an administrative law judge, the SEC found that Dirks had aided and abetted violations of § 17(a) of the Securities Act of 1933, 15 U. S. C. § 77q(a),⁵ § 10(b) of the Securities Exchange Act of 1934, 15 U. S. C. § 78j(b),⁶ and SEC Rule 10b-5, 17 CFR § 240.10b-5

³ As early as 1971, the SEC had received allegations of fraudulent accounting practices at Equity Funding. Moreover, on March 9, 1973, an official of the California Insurance Department informed the SEC's regional office in Los Angeles of Secrist's charges of fraud. Dirks himself voluntarily presented his information at the SEC's regional office beginning on March 27.

⁴ A federal grand jury in Los Angeles subsequently returned a 105-count indictment against 22 persons, including many of Equity Funding's officers and directors. All defendants were found guilty of one or more counts, either by a plea of guilty or a conviction after trial. See Brief for Petitioner 15; App. 149-153.

⁵ Section 17(a) provides:

"It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

"(1) to employ any device, scheme, or artifice to defraud, or

"(2) to obtain money or property by means of any untrue statement of a material fact or any omission 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

"(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser."

⁶ Section 10(b) provides:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of

(1982),⁷ by repeating the allegations of fraud to members of the investment community who later sold their Equity Funding stock. The SEC concluded: "Where 'tippees'—regardless of their motivation or occupation—come into possession of material 'information that they know is confidential and know or should know came from a corporate insider,' they must either publicly disclose that information or refrain from trading." 21 S.E.C. Docket 1401, 1407 (1981) (footnote omitted) (quoting *Chiarella v. United States*, 445 U. S. 222, 230 n. 12 (1980)). Recognizing, however, that Dirks "played an important role in bringing [Equity Funding's] massive fraud to light," 21 S.E.C. Docket, at 1412, the SEC only censured him.⁸

Dirks sought review in the Court of Appeals for the District of Columbia Circuit. The court entered judgment

any facility of any national securities exchange—

"(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

⁷ Rule 10b-5 provides:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

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

"(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

"(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."

⁸ Section 15 of the Securities Exchange Act, 15 U. S. C. § 78o(b)(4)(E), provides that the SEC may impose certain sanctions, including censure, on any person associated with a registered broker-dealer who has "willfully aided [or] abetted" any violation of the federal securities laws. See 15 U. S. C. § 78ff(a) (providing criminal penalties).

against Dirks "for the reasons stated by the Commission in its opinion." App. to Pet. for Cert. C-2. Judge Wright, a member of the panel, subsequently issued an opinion. Judge Robb concurred in the result and Judge Tamm dissented; neither filed a separate opinion. Judge Wright believed that "the obligations of corporate fiduciaries pass to all those to whom they disclose their information before it has been disseminated to the public at large." 220 U. S. App. D.C. 309, 324, 681 F. 2d 824, 839 (1982). Alternatively, Judge Wright concluded that, as an employee of a broker-dealer, Dirks had violated "obligations to the SEC and to the public completely independent of any obligations he acquired" as a result of receiving the information. *Id.*, at 325, 681 F. 2d, at 840.

In view of the importance to the SEC and to the securities industry of the question presented by this case, we granted a writ of certiorari. — U. S. — (1982). We now reverse.

II

In the seminal case of *In re Cady, Roberts & Co.*, 40 S.E.C. 907 (1961), the SEC recognized that the common law in some jurisdictions imposes on "corporate 'insiders,' particularly officers, directors, or controlling stockholders" an "affirmative duty of disclosure . . . when dealing in securities." *Id.*, at 911, and n. 13.⁹ The SEC found not only did breach of this common-law duty also establish the elements of a Rule 10b-5 violation,¹⁰ but that individuals other than cor-

⁹ The duty that insiders owe to the corporation's shareholders not to trade on inside information differs from the common-law duty that officers and directors also have to the corporation itself not to mismanage corporate assets, of which confidential information is one. See 3 Fletcher Cyclopedic of the Laws of Private Corporations §§ 848, 900 (1975 ed. and Supp. 1982); 3A Fletcher §§ 1168.1, 1168.2. In holding that breaches of this duty to shareholders violated the Securities Exchange Act, the *Cady, Roberts* Commission recognized, and we agree, that "[a] significant purpose of the Exchange Act was to eliminate the idea that use of inside information for personal advantage was a normal emolument of corporate office." See 40 S.E.C., at 912, n. 15.

¹⁰ Rule 10b-5 is generally the most inclusive of the three provisions on

porate insiders could be obligated either to disclose material nonpublic information¹¹ before trading or to abstain from trading altogether. *Id.*, at 912. In *Chiarella*, we accepted the two elements set out in *Cady Roberts* for establishing a Rule 10b-5 violation: "(i) the existence of a relationship affording access to inside information intended to be available only for a corporate purpose, and (ii) the unfairness of allowing a corporate insider to take advantage of that information by trading without disclosure." 445 U. S., at 227. In examining whether *Chiarella* had an obligation to disclose or abstain, the Court found that there is no general duty to disclose before trading on material nonpublic information,¹² and held that "a duty to disclose under § 10(b) does not arise from the mere possession of nonpublic market information." *Id.*, at 235. Such a duty arises rather from the existence of a fiduciary relationship. See *id.*, at 227-235.

Not "all breaches of fiduciary duty in connection with a securities transaction," however, come within the ambit of Rule 10b-5. *Santa Fe Industries, Inc. v. Green*, 430 U. S. 462, 472 (1977). There must also be "manipulation or deception." *Id.*, at 473. In an inside-trading case this fraud derives from the "inherent unfairness involved where one takes advantage" of "information intended to be available only for a cor-

which the SEC rested its decision in this case, and we will refer to it when we note the statutory basis for the SEC's inside-trading rules.

¹¹The SEC views the disclosure duty as requiring more than disclosure to purchasers or sellers: "Proper and adequate disclosure of significant corporate developments can only be effected by a public release through the appropriate public media, designed to achieve a broad dissemination to the investing public generally and without favoring any special person or group." *In re Fabergé, Inc.*, 45 S.E.C. 249, 256 (1973).

¹²See 445 U. S., at 233; *id.*, at 237 (STEVENS, J., concurring); *id.*, at 238-239 (BRENNAN, J., concurring in the judgment); *id.*, at 239-240 (BURGER, C. J., dissenting). Cf. *id.*, at 252, n. 2 (BLACKMUN, J., dissenting) (recognizing that there is no obligation to disclose material nonpublic information obtained through the exercise of "diligence or acumen" and "honest means," as opposed to "stealth").

porate purpose and not for the personal benefit of anyone." *In re Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 43 S.E.C. 933, 936 (1968). Thus, an insider will be liable under Rule 10b-5 for inside trading only where he fails to disclose material nonpublic information before trading on it and thus makes "secret profits." *Cady, Roberts*, 40 S.E.C., at 916, n. 31.

III

We were explicit in *Chiarella* in saying that there can be no duty to disclose where the person who has traded on inside information "was not [the corporation's] agent, . . . was not a fiduciary, [or] was not a person in whom the sellers [of the securities] had placed their trust and confidence." 445 U. S., at 232. Not to require such a fiduciary relationship, we recognized, would "depar[t] radically from the established doctrine that duty arises from a specific relationship between two parties" and would amount to "recognizing a general duty between all participants in market transactions to forgo actions based on material, nonpublic information." *Id.*, at 232, 233. This requirement of a specific relationship between the shareholders and the individual trading on inside information has created analytical difficulties for the SEC in policing tippees who trade on inside information. Unlike insiders who have independent fiduciary duties to both the corporation and its shareholders, the typical tippee has no such relationships.¹³ In view of this absence, it has been unclear

¹³ Under certain circumstances, such as where corporate information is revealed legitimately to an underwriter, accountant, or lawyer 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 rather 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. See *SEC v. Monarch Fund*, 608 F. 2d 938, 942 (CA2 1979); *In re Investors Management Co.*, 44 S.E.C. 633, 645 (1971); *In re Van Alstyne, Nosi & Co.*, 48 S.E.C. 1080, 1084-1085 (1969); *In re Merrill*

how a tippee acquires the *Cady, Roberts* duty to refrain from trading on inside information.

A

The SEC's position, as stated in its opinion in this case, is that a tippee inherits the *Cady, Roberts* obligation to shareholders whenever he receives inside information from an insider:

"In tipping potential traders, Dirks breached a duty which he had assumed as a result of knowingly receiving confidential information from [Equity Funding] insiders. Tippees such as Dirks who receive non-public material information from insiders become 'subject to the same duty as [the] insiders.' *Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.* [495 F. 2d 228, 237 (CA2 1974) (quoting *Ross v. Licht*, 263 F. Supp. 395, 410 (SDNY 1967))]. Such a tippee breaches the fiduciary duty which he assumes from the insider when the tippee knowingly transmits the information to someone who will probably trade on the basis thereof. . . . Presumably, Dirks' informants were entitled to disclose the [Equity Funding] fraud in order to bring it to light and its perpetrators to justice. However, Dirks—standing in their shoes—committed a breach of the fiduciary duty which he had assumed in dealing with them, when he passed the information on to traders." 21 S.E.C.

Lynch, Pierce, Fenner & Smith, Inc., 43 S.E.C. 933, 937 (1968); *Cady, Roberts*, 40 S.E.C., at 912. When such a person breaches his fiduciary relationship, he may be treated more properly as a tipper than a tippee. See *Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 495 F. 2d 228, 237 (CA2 1974) (investment banker had access to material information when working on a proposed public offering for the corporation). For such a duty to be imposed, however, the corporation must expect the outsider to keep the disclosed nonpublic information confidential, and the relationship at least must imply such a duty.

Docket, at 1410, n. 42.

This view differs little from the view that we rejected as inconsistent with congressional intent in *Chiarella*. In that case, the Court of Appeals agreed with the SEC and affirmed Chiarella's conviction, holding 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." *United States v. Chiarella*, 588 F. 2d 1358, 1365 (CA2 1978) (emphasis in original). Here, the SEC maintains that anyone who knowingly receives nonpublic material information from an insider has a fiduciary duty to disclose before trading.¹⁴

In effect, the SEC's theory of tippee liability in both cases appears rooted in the idea that the antifraud provisions require equal information among all traders. This conflicts with the principle set forth in *Chiarella* that only some persons, under some circumstances, will be barred from trading

¹⁴ Apparently, the SEC believes this case differs from *Chiarella* in that Dirks' receipt of inside information from Secrist, an insider, carried Secrist's duties with it, while Chiarella received the information without the direct involvement of an insider and thus inherited no duty to disclose or abstain. The SEC fails to explain, however, why the receipt of nonpublic information from an insider automatically carries with it the fiduciary duty of the insider. As we emphasized in *Chiarella*, mere possession of nonpublic information does not give rise to a duty to disclose or abstain; only a specific relationship does that. And we do not believe that the mere receipt of information from an insider creates such a special relationship between the tippee and the corporation's shareholders.

Apparently recognizing the weakness of its argument in light of *Chiarella*, the SEC attempts to distinguish that case factually as involving not "inside" information, but rather "market" information, i. e., "information generated within the company relating to its assets or earnings." Brief for Respondent 23. This Court drew no such distinction in *Chiarella* and, as THE CHIEF JUSTICE noted, "[i]t is clear that § 10(b) and Rule 10b-5 by their terms and by their history make no such distinction." 445 U. S., at 241, n. 1 (dissenting opinion). See ALI Fed. Sec. Code § 1603, Comment (2)(j) (Proposed Official Draft 1978).

while in possession of material nonpublic information.¹⁵ Judge Wright correctly read our opinion in *Chiarella* as repudiating any notion that all traders must enjoy equal information before trading: "[T]he 'information' theory is rejected. Because the disclose-or-refrain duty is extraordinary, it attaches only when a party has legal obligations other than a mere duty to comply with the general anti-fraud proscriptions in the federal securities laws." 220 U. S. App. D.C., at 322, 681 F. 2d, at 837. See *Chiarella*, 445 U. S., at 235, n. 20. We reaffirm today that "[a] duty [to disclose] arises from the relationship between parties . . . and not merely from one's ability to acquire information because of his position in the market." 445 U. S., at 232-233, n. 14.

Imposing a duty to disclose or abstain solely because a person knowingly receives material nonpublic information from an insider and trades on it could have an inhibiting influence on the role of market analysts, which the SEC itself recognizes is necessary to the preservation of a healthy market.¹⁶

¹⁵ In *Chiarella*, we noted that formulation of an absolute equal information rule "should not be undertaken absent some explicit evidence of congressional intent." 445 U. S., at 233. Rather than adopting such a radical view of securities trading, Congress has expressly exempted many market professionals from the general statutory prohibition set forth in § 11(a)(1) of the Securities Exchange Act, 15 U. S. C. § 78k(a)(1), against members of a national securities exchange trading for their own account. See *id.*, at 233, n. 16. We observed in *Chiarella* that "[t]he exception is based upon Congress' recognition that [market professionals] contribute to a fair and orderly marketplace at the same time they exploit the informational advantage that comes from their possession of [nonpublic information]." *Ibid.*

¹⁶ The SEC expressly recognized that "[t]he value to the entire market of [analysts'] efforts cannot be gainsaid; market efficiency in pricing is significantly enhanced by [their] initiatives to ferret out and analyze information, and thus the analyst's work redounds to the benefit of all investors." 21 S.E.C., at 1406. The SEC asserts that analysts remain free to obtain from management corporate information for purposes of "filling in the in-

It is commonplace for analysts to "ferret out and analyze information," 21 S.E.C., at 1406,¹⁷ and this often is done by meeting with and questioning corporate officers and others who are insiders. And information that the analysts obtain normally may be the basis for judgments as to the market worth of a corporation's securities. The analyst's judgment in this respect is made available in market letters or otherwise to clients of the firm. It is the nature of this type of information, and indeed of the markets themselves, that such information cannot be made simultaneously available to all of the corporation's stockholders or the public generally.

B

The conclusion that recipients of inside information do not invariably acquire a duty to disclose or abstain does not mean

terstices in analysis'" Brief for Respondent 42 (quoting *Investors Management Co.*, 44 S.E.C., at 646). But this rule is inherently imprecise, and imprecision prevents parties from ordering their actions in accord with legal requirements. Unless the parties have some guidance as to where the line is between permissible and impermissible disclosures and uses, neither corporate insiders nor analysts can be sure when the line is crossed. Cf. *Adler v. Klawans*, 267 F. 2d 840, 845 (CA2 1959) (Burger, J., sitting by designation).

¹⁷On its facts, this case is the unusual one. Dirks is an analyst in a broker-dealer firm, and he did interview management in the course of his investigation. He uncovered, however, startling information that required no analysis or exercise of judgment as to its market relevance. Nonetheless, the principle at issue here extends beyond these facts. The SEC's rule—applicable without regard to any breach by an insider—could have serious ramifications on reporting by analysts of investment views.

Despite the unusualness of Dirks' "find," the central role that he played in uncovering the fraud at Equity Funding, and that analysts in general can play in revealing information that corporations may have reason to withhold from the public, is an important one. Dirks' careful investigation brought to light a massive fraud at the corporation. And until the Equity Funding fraud was exposed, the information in the trading market was grossly inaccurate. But for Dirks' efforts, the fraud might well have gone undetected longer.

that such tippees always are free to trade on the information. The need for a prophylactic ban on some tippee trading is clear. Not only are insiders forbidden by their fiduciary relationship from personally using undisclosed corporate information to their advantage, but they may not give such information to an outsider for the same improper purpose of exploiting the information for their personal gain. See 15 U. S. C. § 78t(b) (making it unlawful to do indirectly "by means of any other person" any act made unlawful by the federal securities laws). Similarly, the transactions of those who knowingly participate with the fiduciary in such a breach are "as forbidden" as transactions "on behalf of the trustee himself." *Mosser v. Darrow*, 341 U. S. 267, 272 (1951). See *Jackson v. Smith*, 254 U. S. 586, 589 (1921); *Jackson v. Ludeling*, 88 U. S. 616, 631-632 (1874). As the Court explained in *Mosser*, a contrary rule "would open up opportunities for devious dealings in the name of the others that the trustee could not conduct in his own." 341 U. S., at 271. See *SEC v. Texas Gulf Sulphur Co.*, 446 F. 2d 1301, 1308 (CA2), cert. denied, 404 U. S. 1005 (1971). Thus, the tippee's duty to disclose or abstain is derivative from that of the insider's duty. See Tr. of Oral Ar. 38. Cf. *Chiarella*, 445 U. S., at 246, n. 1 (BLACKMUN, J., dissenting). As we noted in *Chiarella*, "[t]he tippee's obligation has been viewed as arising from his role as a participant after the fact in the insider's breach of a fiduciary duty." 445 U. S., at 230, n. 12.

Thus, some tippees must assume an insider's duty to the shareholders not because they receive inside information, but rather because it has been made available to them *improperly*.¹³ And for Rule 10b-5 purposes, the insider's disclosure

¹³The SEC itself has recognized that tippee liability properly is imposed only in circumstances where the tippee knows, or has reason to know, that the insider has disclosed improperly inside corporate information. In *Investors Management Co.*, *supra*, the SEC stated that one element of tippee liability is that the tippee knew or had reason to know "that [the

is improper only where it would violate his *Cady, Roberts* duty. Thus, a tippee assumes a fiduciary duty to the shareholders of a corporation not to trade on material nonpublic information only when the insider has breached his fiduciary duty to the shareholders by disclosing the information to the tippee and the tippee knows or should know that there has been a breach.¹⁸ As Commissioner Smith perceptively observed in *Investors Management Co.*: "It is important in this type of case to focus on policing insiders and what they do . . . rather than on policing information *per se* and its possession . . ." 44 S.E.C., at 648 (concurring in the result). Tipping thus properly is viewed only as a means of indirectly violating the *Cady, Roberts* disclose-or-abstain rule.²⁰

information] was non-public and had been obtained *improperly* by selective revelation or otherwise." 44 S.E.C., at 641 (emphasis added). Commissioner Smith read this test to mean that a tippee can be held liable only if he received information in breach of an insider's duty not to disclose it. *Id.*, at 650 (concurring in the result).

¹⁸ Professor Loss has linked tippee liability to the concept in the law of restitution that "[w]here a fiduciary in violation of his duty to the beneficiary communicates confidential information to a third person, the third person, if he had notice of the violation of duty, holds upon a constructive trust for the beneficiary any profit which he makes through the use of such information." 3 L. Loss, *Securities Regulation* 1451 (2d ed. 1961) (quoting Restatement of Restitution § 201(2) (1937)). Other authorities likewise have expressed the view that tippee liability exists only where there has been a breach of trust by an insider of which the tippee had knowledge. See, e. g., *Ross v. Licht*, 263 F. Supp. 395, 410 (SDNY 1967); A. Jacobs, *The Impact of Rule 10b-5*, § 167, at 7-4 (1975) ("[T]he better view is that a tipper must know or have reason to know the information is nonpublic and was improperly obtained."); Fleischer, *Mundheim & Murphy, An Initial Inquiry Into the Responsibility to Disclose Market Information*, 121 U. Pa. L. Rev. 798, 818, n. 76 (1973) ("The extension of rule 10b-5 restrictions to tippees of corporate insiders can best be justified on the theory that they are participating in the insider's breach of his fiduciary duty."). Cf. Restatement (Second) of Agency § 312, comment c (1958) ("A person who, with notice that an agent is thereby violating his duty to his principal, receives confidential information from the agent, may be [deemed] . . . a constructive trustee.").

²⁰ We do not suggest that knowingly trading on inside information is ever

C

In determining whether a tippee is under an obligation to disclose or abstain, it thus is necessary to determine whether the insider's "tip" constituted a breach of the insider's fiduciary duty. All disclosures of confidential corporate information are not inconsistent with the duty insiders owe to shareholders. In contrast to the extraordinary facts of this case, the more typical situation in which there will be a question whether disclosure violates the insider's *Cady, Roberts* duty is when insiders disclose information to analysts. See n. 16, *supra*. In some situations, both the insider and the analyst recipient will act in good faith, and yet release of the information may affect the market. For example, it may not be clear—either to the corporate insider or to the recipient analyst—whether the information will be viewed as material

"socially desirable or even that it is devoid of moral considerations." Dooley, Enforcement of Insider Trading Restrictions, 66 Va. L. Rev. 1, 55 (1980). Nor do we imply an absence of responsibility to disclose promptly indications of illegal actions by a corporation to the proper authorities—typically the SEC and exchange authorities in cases involving securities. Depending on the circumstances, and even where permitted by law, one's trading on material nonpublic information is behavior that may fall below ethical standards of conduct. But in a statutory area of the law such as securities regulation, where legal principles of general application must be applied, there may be "significant distinctions between actual legal obligations and ethical ideals." SEC, Report of the Special Study of Securities Markets, H. R. Doc. No. 95, 88th Cong., 1st Sess., pt. 1, pp. 237-238 (1963). The SEC recognizes this. At oral argument, the following exchange took place:

"QUESTION: So, it would not have satisfied his obligation under the law to go to the SEC first?

"[SEC's counsel]: That is correct. That an insider has to observe what has come to be known as the abstain or disclosure rule. Either the information has to be disclosed to the market if it is inside information . . . or the insider must abstain." Tr. of Oral Arg. 27.

Thus, it is clear that Rule 10b-5 does not impose any obligation simply to tell the SEC about the fraud before trading.

nonpublic information. Corporate officials may mistakenly think the information already has been disclosed or that it is not material enough to affect the market. Whether disclosure is a breach of duty therefore depends in large part on the purpose or good faith of the insider who made the disclosure. Absent an improper purpose, there has been no breach of duty to stockholders. And absent a breach by the insider, there is no derivative breach.²¹ As Commissioner Smith stated in *Investors Management Co.*:

"[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, and that the information must be shown not only to have been material and non-public, but also to have substantially contributed to the trading which occurred." 44 S.E.C., at 651 (concurring in the result).

There are facts and circumstances that often may justify an inference that the insider has breached his fiduciary duty. For example, there may be a relationship between the insider and the recipient that suggests a *quid pro quo* from the

²¹ An example of a case turning on the court's determination that the disclosure did not impose any fiduciary duties on the recipient of the inside information is *Walton v. Morgan Stanley & Co.*, 623 F. 2d 796 (CA2 1980). There, the defendant investment banking firm, representing one of its own corporate clients, investigated another corporation that was a possible target of a takeover bid by its client. In the course of negotiations the investment banking firm was given, on a confidential basis, unpublished material information. Subsequently, after the proposed takeover was abandoned, the firm was charged with relying on the information when it traded in the target corporation's stock. For purposes of the decision, it was assumed that the firm knew the information was confidential, but that it had been received in arm's-length negotiations. See *id.*, at 798. In the absence of any fiduciary relationship, the Court of Appeals found no basis for imposing tippee liability on the investment firm. See *id.*, at 799.

latter, or an intention to benefit the particular recipient. The elements of fiduciary duty and exploitation of nonpublic information certainly exist when an insider makes a gift of confidential information to a trading relative or friend. The tip and trade resemble trading by the insider himself followed by a gift of the profits to the recipient.

Determining the purpose of any one disclosure, a question of fact, will not always be easy for courts. But it is essential, we think, to have a guiding principle for those whose daily activities must be limited and instructed by the SEC's inside-trading rules, and we believe that there must be a breach of the insider's fiduciary duty before the tippee inherits the duty to disclose or abstain. In contrast, the rule adopted by the SEC in this case would have no limiting principle.²²

IV

Under the inside-trading and tipping rules set forth above, we find that there was no actionable violation by Dirks.²³ It

²² Without legal limitations, market participants are forced to rely on the reasonableness of the SEC's litigation strategy, but that can be hazardous, as the facts of this case make plain. Following the SEC's filing of the *Texas Gulf Sulphur* action, Commissioner (and later Chairman) Budge spoke of the various implications of applying Rule 10b-5 in inside-trading cases:

"Turning to the realm of possible defendants in the present and potential civil actions, the Commission certainly does not contemplate suing every person who may have come across inside information. In the *Texas Gulf* action neither tippees nor persons in the vast rank and file of employees have been named as defendants. In my view, the Commission in future cases normally should not join rank and file employees or persons outside the company *such as an analyst or reporter who learns of inside information.*" Speech of Hamer Budge to the New York Regional Group of the American Society of Corporate Secretaries, Inc. (Nov. 18, 1965) (emphasis added), reprinted in Budge, *The Texas Gulf Sulphur Case—What It Is and What It Isn't*, Corp. Secretary No. 127, at 6 (Dec. 17, 1965).

²³ Dirks contends that he was not a "tippee" because the information he received constituted unverified allegations of fraud that were denied by management and were not "material facts" under the securities laws that

is undisputed that Dirks himself was a stranger to Equity Funding, with no pre-existing fiduciary duty to its shareholders.²⁴ He took no action, directly or indirectly, that induced the shareholders or officers of Equity Funding to repose trust or confidence in him. There was no expectation by Dirks's sources that he would keep their information in confidence. Nor did Dirks misappropriate or illegally obtain the information about Equity Funding. Unless the insiders breached their *Cady, Roberts* duty to shareholders in disclosing the nonpublic information to Dirks, he breached no duty when he passed it on to investors as well as to the *Wall Street Journal*.

We also think it is clear that the Equity Funding employees did not violate their *Cady, Roberts* duty to the corporation's shareholders by providing information to Dirks.²⁵ The

required disclosure before trading. He also argues that the information he received was not truly "inside" information, i. e., intended for a confidential corporate purpose, but was merely evidence of a crime. The Solicitor General agrees. See Brief for United States as *Amicus Curiae* 22. For purposes of deciding this case, however, we assume the correctness of the SEC's findings, accepted by the Court of Appeals, that petitioner was a tippee of material inside information.

²⁴ Judge Wright found that Dirks acquired a fiduciary duty by virtue of his position as an employee of a broker-dealer. See 220 U. S. App. D. C., at 325-327, 681 F. 2d, at 840-842. The SEC, however, did not consider Judge Wright's novel theory in its decision, nor did it present that theory to the Court of Appeals. The SEC also has not argued Judge Wright's theory in this Court. See Brief for Respondent 21, n. 27. The merits of such a duty are therefore not before the Court. See *SEC v. Chenery Corp.*, 332 U. S. 194, 196-197 (1947).

²⁵ In this Court, the SEC appears to contend that an insider invariably violates a fiduciary duty to the corporation's shareholders by transmitting nonpublic corporate information to an outsider when he has reason to believe that the outsider may use it to the disadvantage of the shareholders. "Thus, regardless of any ultimate motive to bring to public attention the derelictions at Equity Funding, Secrist breached his duty to Equity Funding shareholders." Brief for Respondent 31. This perceived "duty" differs markedly from the one that the SEC identified in *Cady, Roberts* and

tippers received no monetary or personal benefit for revealing Equity Funding's secrets, nor did they have an apparent purpose or desire to make a gift of valuable information to Dirks. As the facts of this case clearly indicate, the tippers were motivated by a desire to expose the fraud. See *supra*, at 1-2. In the absence of a breach of duty to shareholders by the insiders, there was no derivative breach by Dirks. See n. 19, *supra*. Dirks therefore could not have been "a participant after the fact in [an] insider's breach of a fiduciary duty." *Chiarella*, 445 U. S., at 230, n. 12.

V

We conclude that Dirks, in the circumstances of this case, had no duty to abstain from use of the inside information that he obtained. The judgment of the Court of Appeals therefore is

Reversed.

that has been the basis for federal tippee-trading rules to date. In fact, the SEC did not charge Secrist with any wrongdoing, and we do not understand the SEC to have relied on any theory of a breach of duty by Secrist in finding that Dirks breached his duty to Equity Funding's shareholders. See App. 250 (decision of administrative law judge) ("One who knows himself to be a beneficiary of non-public, selectively disclosed inside information must fully disclose or refrain from trading."); SEC's Reply to Notice of Supplemental Authority before the SEC 4 ("If Secrist was acting properly, Dirks inherited a duty to [Equity Funding]'s shareholders to refrain from improper private use of the information."); Brief on behalf of the SEC in the Court of Appeals, at 47-50; *id.*, at 51 ("[K]nowing possession of inside information by any person imposes a duty to abstain or disclose."); *id.*, at 52-54; *id.*, at 55 ("[T]his obligation arises not from the manner in which such information is acquired. . . ."); 220 U. S. App. D.C., at 322-323, 681 F. 2d, at 838 (Wright, J.).

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

L.F.P.

MAY 28 1983

*Jim - This still looks
satisfactory to me.*

From: Justice Powell

Circulated: MAY 28 1983

Recirculated: _____

1st DRAFT

SUPREME COURT OF THE UNITED STATES

No. 82-276

RAYMOND L. DIRKS, PETITIONER *v.* SECURITIES
AND EXCHANGE COMMISSION

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF
APPEALS FOR DISTRICT OF COLUMBIA

[June —, 1983]

JUSTICE POWELL delivered the opinion of the Court.

Petitioner Raymond Dirks received material nonpublic information from "insiders" of a corporation with which he had no connection. He disclosed this information to investors who relied on it in trading in the shares of the corporation. The question is whether Dirks violated the antifraud provisions of the federal securities laws by this disclosure.

I

sketch ~~that~~
In 1973, Dirks was an officer of a New York broker-dealer firm ~~who~~ specialized in providing investment analysis of insurance company securities to institutional investors.¹ On March 6, Dirks received information from Ronald Secrist, a former officer of Equity Funding of America. Secrist alleged that the assets of Equity Funding, a diversified corporation primarily engaged in selling life insurance and mutual funds, were vastly overstated as the result of fraudulent corporate practices. Secrist also stated that various regula-

¹ The facts stated here are taken from more detailed statements set forth by the administrative law judge, App. 176-180, 225-247; the opinion of the Securities and Exchange Commission, 21 S.E.C. Docket 1401, 1402-1406 (1981); and the opinion of Judge Wright in the Court of Appeals, 220 U. S. App. D.C. 309, 314-318, 681 F. 2d 824, 829-833 (1982).

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tory agencies had failed to act on similar charges made by Equity Funding employees. He urged Dirks to verify the fraud and disclose it publicly.

Dirks decided to investigate the allegations. He visited Equity Funding's headquarters in Los Angeles and interviewed several officers and employees of the corporation. The senior management denied any wrongdoing, but certain corporation employees corroborated the charges of fraud. Neither Dirks nor his firm owned or traded any Equity Funding stock, but throughout his investigation he openly discussed the information he had obtained with a number of clients and investors. Some of these persons sold their holdings of Equity Funding securities, including five investment advisers who liquidated holdings of more than \$16 million.²

While Dirks was in Los Angeles, he was in touch regularly with William Blundell, the *Wall Street Journal's* Los Angeles bureau chief. Dirks urged Blundell to write a story on the fraud allegations. Blundell did not believe, however, that such a massive fraud could go undetected and declined to write the story. He feared that publishing such damaging rumors might be libelous.

During the two-week period in which Dirks pursued his investigation and spread word of Secrist's charges, the price of Equity Funding stock fell from \$26 per share to less than \$15 per share. This led the New York Stock Exchange to halt trading on March 27. Shortly thereafter California insur-

² Dirks received from his firm a salary plus a commission for securities transactions above a certain amount that his clients directed through his firm. See 21 S.E.C. Docket, at 1402, n. 3. But "[i]t is not clear how many of those with whom Dirks spoke promised to direct some brokerage business through [Dirks' firm] to compensate Dirks, or how many actually did so." 220 U. S. App. D.C., at 316, 681 F. 2d, at 831. The Boston Company Institutional Investors, Inc., promised Dirks about \$25,000 in commissions, but it is unclear whether Boston actually generated any brokerage business for his firm. See App. 199, 204-205; 21 S.E.C. Docket, at 1404, n. 10; 220 U. S. App. D.C., at 316, n. 5, 681 F. 2d, at 831, n. 5.

hearsay

ance authorities impounded Equity Funding's records and uncovered evidence of the fraud. Only then did the Securities and Exchange Commission (SEC) file a complaint against Equity Funding³ and only then, on April 2, did the *Wall Street Journal* publish a front-page story based largely on information assembled by Dirks. Equity Funding immediately went into receivership.⁴

The SEC began an investigation into Dirks' role in the exposure of the fraud. After a hearing by an administrative law judge, the SEC found that Dirks had aided and abetted violations of § 17(a) of the Securities Act of 1933, 15 U. S. C. § 77q(a),⁵ § 10(b) of the Securities Exchange Act of 1934, 15 U. S. C. § 78j(b),⁶ and SEC Rule 10b-5, 17 CFR § 240.10b-5

³ As early as 1971, the SEC had received allegations of fraudulent accounting practices at Equity Funding. Moreover, on March 9, 1973, an official of the California Insurance Department informed the SEC's regional office in Los Angeles of Secrist's charges of fraud. Dirks himself voluntarily presented his information at the SEC's regional office beginning on March 27.

⁴ A federal grand jury in Los Angeles subsequently returned a 105-count indictment against 22 persons, including many of Equity Funding's officers and directors. All defendants were found guilty of one or more counts, either by a plea of guilty or a conviction after trial. See Brief for Petitioner 15; App. 149-153.

⁵ Section 17(a) provides:

"It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

"(1) to employ any device, scheme, or artifice to defraud, or

"(2) to obtain money or property by means of any untrue statement of a material fact or any omission 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

"(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser."

⁶ Section 10(b) provides:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of

(1982),⁷ by repeating the allegations of fraud to members of the investment community who later sold their Equity Funding stock. The SEC concluded: "Where 'tippees'—regardless of their motivation or occupation—come into possession of material 'information that they know is confidential and know or should know came from a corporate insider,' they must either publicly disclose that information or refrain from trading." 21 S.E.C. Docket 1401, 1407 (1981) (footnote omitted) (quoting *Chiarella v. United States*, 445 U. S. 222, 230 n. 12 (1980)). Recognizing, however, that Dirks "played an important role in bringing [Equity Funding's] massive fraud to light," 21 S.E.C. Docket, at 1412, the SEC only censured him.⁸

Dirks sought review in the Court of Appeals for the District of Columbia Circuit. The court entered judgment

any facility of any national securities exchange—

"(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

⁷ Rule 10b-5 provides:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

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

"(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

"(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."

⁸ Section 15 of the Securities Exchange Act, 15 U. S. C. § 78o(b)(4)(E), provides that the SEC may impose certain sanctions, including censure, on any person associated with a registered broker-dealer who has "willfully aided [or] abetted" any violation of the federal securities laws. See 15 U. S. C. § 78ff(a) (providing criminal penalties).

against Dirks "for the reasons stated by the Commission in its opinion." App. to Pet. for Cert. C-2. Judge Wright, a member of the panel, subsequently issued an opinion. Judge Robb concurred in the result and Judge Tamm dissented; neither filed a separate opinion. Judge Wright believed that "the obligations of corporate fiduciaries pass to all those to whom they disclose their information before it has been disseminated to the public at large." 220 U. S. App. D.C. 309, 324, 681 F. 2d 824, 839 (1982). Alternatively, Judge Wright concluded that, as an employee of a broker-dealer, Dirks had violated "obligations to the SEC and to the public completely independent of any obligations he acquired" as a result of receiving the information. *Id.*, at 325, 681 F. 2d, at 840.

In view of the importance to the SEC and to the securities industry of the question presented by this case, we granted a writ of certiorari. — U. S. — (1982). We now reverse.

II

In the seminal case of *In re Cady, Roberts & Co.*, 40 S.E.C. 907 (1961), the SEC recognized that the common law in some jurisdictions imposes on "corporate 'insiders,' particularly officers, directors, or controlling stockholders" an "affirmative duty of disclosure . . . when dealing in securities." *Id.*, at 911, and n. 13.⁹ The SEC found not only did breach of this common-law duty also establish the elements of a Rule 10b-5 violation,¹⁰ but that individuals other than cor-

⁹The duty that insiders owe to the corporation's shareholders not to trade on inside information differs from the common-law duty that officers and directors also have to the corporation itself not to mismanage corporate assets, of which confidential information is one. See 3 Fletcher Encyclopedia of the Laws of Private Corporations §§848, 900 (1975 ed. and Supp. 1982); 2A Fletcher §§1168.1, 1168.2. In holding that breaches of this duty to shareholders violated the Securities Exchange Act, the *Cady, Roberts* Commission recognized, and we agree, that "[a] significant purpose of the Exchange Act was to eliminate the idea that use of inside information for personal advantage was a normal emolument of corporate office." See 40 S.E.C., at 912, n. 15.

¹⁰Rule 10b-5 is generally the most inclusive of the three provisions on

porate insiders could be obligated either to disclose material nonpublic information¹¹ before trading or to abstain from trading altogether. *Id.*, at 912. In *Chiarella*, we accepted the two elements set out in *Cady Roberts* for establishing a Rule 10b-5 violation: "(i) the existence of a relationship affording access to inside information intended to be available only for a corporate purpose, and (ii) the unfairness of allowing a corporate insider to take advantage of that information by trading without disclosure." 445 U. S., at 227. In examining whether *Chiarella* had an obligation to disclose or abstain, the Court found that there is no general duty to disclose before trading on material nonpublic information,¹² and held that "a duty to disclose under § 10(b) does not arise from the mere possession of nonpublic market information." *Id.*, at 235. Such a duty arises rather from the existence of a fiduciary relationship. See *id.*, at 227-235.

Not "all breaches of fiduciary duty in connection with a securities transaction," however, come within the ambit of Rule 10b-5. *Santa Fe Industries, Inc. v. Green*, 430 U. S. 462, 472 (1977). There must also be "manipulation or deception." *Id.*, at 473. In an inside-trading case this fraud derives from the "inherent unfairness involved where one takes advantage" of "information intended to be available only for a cor-

which the SEC rested its decision in this case, and we will refer to it when we note the statutory basis for the SEC's inside-trading rules.

"The SEC views the disclosure duty as requiring more than disclosure to purchasers or sellers: 'Proper and adequate disclosure of significant corporate developments can only be effected by a public release through the appropriate public media, designed to achieve a broad dissemination to the investing public generally and without favoring any special person or group.'" *In re Faberge, Inc.*, 45 S.E.C. 249, 256 (1973).

"See 445 U. S., at 233; *id.*, at 237 (STEVENS, J., concurring); *id.*, at 238-239 (BRENNAN, J., concurring in the judgment); *id.*, at 239-240 (BURGER, C. J., dissenting). Cf. *id.*, at 252, n. 2 (BLACKMUN, J., dissenting) (recognizing that there is no obligation to disclose material nonpublic information obtained through the exercise of "diligence or acumen" and "honest means," as opposed to "stealth").

porate purpose and not for the personal benefit of anyone." *In re Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 43 S.E.C. 933, 936 (1968). Thus, an insider will be liable under Rule 10b-5 for inside trading only where he fails to disclose material nonpublic information before trading on it and thus makes "secret profits." *Cady, Roberts*, 40 S.E.C., at 916, n. 31.

III

We were explicit in *Chiarella* in saying that there can be no duty to disclose where the person who has traded on inside information "was not [the corporation's] agent, . . . was not a fiduciary, [or] was not a person in whom the sellers [of the securities] had placed their trust and confidence." 445 U. S., at 232. Not to require such a fiduciary relationship, we recognized, would "depar[t] radically from the established doctrine that duty arises from a specific relationship between two parties" and would amount to "recognizing a general duty between all participants in market transactions to forgo actions based on material, nonpublic information." *Id.*, at 232, 233. This requirement of a specific relationship between the shareholders and the individual trading on inside information has created analytical difficulties for the SEC in policing tippees who trade on inside information. Unlike insiders who have independent fiduciary duties to both the corporation and its shareholders, the typical tippee has no such relationships.¹⁸ In view of this absence, it has been unclear

and courts $\frac{E}{x}$

¹⁸ Under certain circumstances, such as where corporate information is revealed legitimately to an underwriter, accountant, or lawyer 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 rather 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. See *SEC v. Monarch Fund*, 608 F. 2d 938, 942 (CA2 1979); *In re Investors Management Co.*, 44 S.E.C. 633, 645 (1971); *In re Van Aylstne, Noel & Co.*, 43 S.E.C. 1080, 1084-1085 (1969); *In re Merrill*

how a tippee acquires the *Cady, Roberts* duty to refrain from trading on inside information.

A

The SEC's position, as stated in its opinion in this case, is that a tippee inherits the *Cady, Roberts* obligation to shareholders whenever he receives inside information from an insider:

"In tipping potential traders, Dirks breached a duty which he had assumed as a result of knowingly receiving confidential information from [Equity Funding] insiders. Tippees such as Dirks who receive non-public material information from insiders become 'subject to the same duty as [the] insiders.' *Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.* [495 F. 2d 228, 237 (CA2 1974) (quoting *Ross v. Licht*, 263 F. Supp. 395, 410 (SDNY 1967))]. Such a tippee breaches the fiduciary duty which he assumes from the insider when the tippee knowingly transmits the information to someone who will probably trade on the basis thereof. . . . Presumably, Dirks' informants were entitled to disclose the [Equity Funding] fraud in order to bring it to light and its perpetrators to justice. However, Dirks—standing in their shoes—committed a breach of the fiduciary duty which he had assumed in dealing with them, when he passed the information on to traders." 21 S.E.C.

Lynch, Pierce, Fenner & Smith, Inc., 43 S.E.C. 938, 937 (1968); *Cady, Roberts*, 40 S.E.C., at 912. When such a person breaches his fiduciary relationship, he may be treated more properly as a tipper than a tippee. See *Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 495 F. 2d 228, 237 (CA2 1974) (investment banker had access to material information when working on a proposed public offering for the corporation). For such a duty to be imposed, however, the corporation must expect the outsider to keep the disclosed nonpublic information confidential, and the relationship at least must imply such a duty.

Docket, at 1410, n. 42.

This view differs little from the view that we rejected as inconsistent with congressional intent in *Chiarella*. In that case, the Court of Appeals agreed with the SEC and affirmed Chiarella's conviction, holding 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." *United States v. Chiarella*, 588 F. 2d 1358, 1365 (CA2 1978) (emphasis in original). Here, the SEC maintains that anyone who knowingly receives nonpublic material information from an insider has a fiduciary duty to disclose before trading.¹⁴

In effect, the SEC's theory of tippee liability in both cases appears rooted in the idea that the antifraud provisions require equal information among all traders. This conflicts with the principle set forth in *Chiarella* that only some persons, under some circumstances, will be barred from trading

"Apparently, the SEC believes this case differs from *Chiarella* in that Dirks' receipt of inside information from Secrist, an insider, carried Secrist's duties with it, while Chiarella received the information without the direct involvement of an insider and thus inherited no duty to disclose or abstain. The SEC fails to explain, however, why the receipt of nonpublic information from an insider automatically carries with it the fiduciary duty of the insider. As we emphasized in *Chiarella*, mere possession of nonpublic information does not give rise to a duty to disclose or abstain; only a specific relationship does that. And we do not believe that the mere receipt of information from an insider creates such a special relationship between the tippee and the corporation's shareholders.

Apparently recognizing the weakness of its argument in light of *Chiarella*, the SEC attempts to distinguish that case factually as involving not "inside" information, but rather "market" information, i. e., "information generated within the company relating to its assets or earnings." Brief for Respondent 23. This Court drew no such distinction in *Chiarella* and, as THE CHIEF JUSTICE noted, "[i]t is clear that § 10(b) and Rule 10b-5 by their terms and by their history make no such distinction." 445 U. S., at 241, n. 1 (dissenting opinion). See ALI Fed. Sec. Code § 1603, Comment (2)(j) (Proposed Official Draft 1978).

while in possession of material nonpublic information.¹⁵ Judge Wright correctly read our opinion in *Chiarella* as repudiating any notion that all traders must enjoy equal information before trading: "[T]he 'information' theory is rejected. Because the disclose-or-refrain duty is extraordinary, it attaches only when a party has legal obligations other than a mere duty to comply with the general anti-fraud proscriptions in the federal securities laws." 220 U. S. App. D.C., at 322, 681 F. 2d, at 837. See *Chiarella*, 445 U. S., at 235, n. 20. We reaffirm today that "[a] duty [to disclose] arises from the relationship between parties . . . and not merely from one's ability to acquire information because of his position in the market." 445 U. S., at 232-233, n. 14.

Imposing a duty to disclose or abstain solely because a person knowingly receives material nonpublic information from an insider and trades on it could have an inhibiting influence on the role of market analysts, which the SEC itself recognizes is necessary to the preservation of a healthy market.¹⁶

¹⁵ In *Chiarella*, we noted that formulation of an absolute equal information rule "should not be undertaken absent some explicit evidence of congressional intent." 445 U. S., at 233. Rather than adopting such a radical view of securities trading, Congress has expressly exempted many market professionals from the general statutory prohibition set forth in § 11(a)(1) of the Securities Exchange Act, 15 U. S. C. § 78k(a)(1), against members of a national securities exchange trading for their own account. See *id.*, at 233, n. 16. We observed in *Chiarella* that "[t]he exception is based upon Congress' recognition that [market professionals] contribute to a fair and orderly marketplace at the same time they exploit the informational advantage that comes from their possession of [nonpublic information]." *Ibid.*

¹⁶ The SEC expressly recognized that "[t]he value to the entire market of [analysts'] efforts cannot be gainsaid; market efficiency in pricing is significantly enhanced by [their] initiatives to ferret out and analyze information, and thus the analyst's work redounds to the benefit of all investors." 21 S.E.C., at 1406. The SEC asserts that analysts remain free to obtain from management corporate information for purposes of "filling in the 'in-

It is commonplace for analysts to "ferret out and analyze information," 21 S.E.C., at 1406,¹⁷ and this often is done by meeting with and questioning corporate officers and others who are insiders. And information that the analysts obtain normally may be the basis for judgments as to the market worth of a corporation's securities. The analyst's judgment in this respect is made available in market letters or otherwise to clients of the firm. It is the nature of this type of information, and indeed of the markets themselves, that such information cannot be made simultaneously available to all of the corporation's stockholders or the public generally.

B

The conclusion that recipients of inside information do not invariably acquire a duty to disclose or abstain does not mean

terstices in analysis'" Brief for Respondent 42 (quoting *Investors Management Co.*, 44 S.E.C., at 646). But this rule is inherently imprecise, and imprecision prevents parties from ordering their actions in accord with legal requirements. Unless the parties have some guidance as to where the line is between permissible and impermissible disclosures and uses, neither corporate insiders nor analysts can be sure when the line is crossed. Cf. *Adler v. Klawans*, 267 F. 2d 840, 845 (CA2 1959) (Burger, J., sitting by designation).

¹⁷ On its facts, this case is the unusual one. Dirks is an analyst in a broker-dealer firm, and he did interview management in the course of his investigation. He uncovered, however, startling information that required no analysis or exercise of judgment as to its market relevance. Nonetheless, the principle at issue here extends beyond these facts. The SEC's rule—applicable without regard to any breach by an insider—could have serious ramifications on reporting by analysts of investment views.

Despite the unusualness of Dirks' "find," the central role that he played in uncovering the fraud at Equity Funding, and that analysts in general can play in revealing information that corporations may have reason to withhold from the public, is an important one. Dirks' careful investigation brought to light a massive fraud at the corporation. And until the Equity Funding fraud was exposed, the information in the trading market was grossly inaccurate. But for Dirks' efforts, the fraud might well have gone undetected longer.

that such tippees always are free to trade on the information. The need for a prophylactic ban on some tippee trading is clear. Not only are insiders forbidden by their fiduciary relationship from personally using undisclosed corporate information to their advantage, but they may not give such information to an outsider for the same improper purpose of exploiting the information for their personal gain. See 15 U. S. C. § 78t(b) (making it unlawful to do indirectly "by means of any other person" any act made unlawful by the federal securities laws). Similarly, the transactions of those who knowingly participate with the fiduciary in such a breach are "as forbidden" as transactions "on behalf of the trustee himself." *Mosser v. Darrow*, 341 U. S. 267, 272 (1951). See *Jackson v. Smith*, 254 U. S. 586, 589 (1921); *Jackson v. Ludeling*, 88 U. S. 616, 631-632 (1874). As the Court explained in *Mosser*, a contrary rule "would open up opportunities for devious dealings in the name of the others that the trustee could not conduct in his own." 341 U. S., at 271. See *SEC v. Texas Gulf Sulphur Co.*, 446 F. 2d 1301, 1308 (CA2), cert. denied, 404 U. S. 1005 (1971). Thus, the tippee's duty to disclose or abstain is derivative from that of the insider's duty. See Tr. of Oral Ar. 38. Cf. *Chiarella*, 445 U. S., at 246, n. 1 (BLACKMUN, J., dissenting). As we noted in *Chiarella*, "[t]he tippee's obligation has been viewed as arising from his role as a participant after the fact in the insider's breach of a fiduciary duty." 445 U. S., at 230, n. 12.

Thus, some tippees must assume an insider's duty to the shareholders not because they receive inside information, but rather because it has been made available to them *improperly*.¹² And for Rule 10b-5 purposes, the insider's disclosure

¹²The SEC itself has recognized that tippee liability properly is imposed only in circumstances where the tippee knows, or has reason to know, that the insider has disclosed improperly inside corporate information. In *Investors Management Co.*, *supra*, the SEC stated that one element of tippee liability is that the tippee knew or had reason to know "that [the

is improper only where it would violate his *Cady, Roberts* duty. Thus, a tippee assumes a fiduciary duty to the shareholders of a corporation not to trade on material nonpublic information only when the insider has breached his fiduciary duty to the shareholders by disclosing the information to the tippee and the tippee knows or should know that there has been a breach.¹⁹ As Commissioner Smith perceptively observed in *Investors Management Co.*: "It is important in this type of case to focus on policing insiders and what they do . . . rather than on policing information *per se* and its possession . . ." 44 S.E.C., at 648 (concurring in the result). Tipping thus properly is viewed only as a means of indirectly violating the *Cady, Roberts* disclose-or-abstain rule.²⁰

information] was non-public and had been obtained *improperly* by selective revelation or otherwise." 44 S.E.C., at 641 (emphasis added). Commissioner Smith read this test to mean that a tippee can be held liable only if he received information in breach of an insider's duty not to disclose it. *Id.*, at 650 (concurring in the result).

¹⁹ Professor Loss has linked tippee liability to the concept in the law of restitution that "[w]here a fiduciary in violation of his duty to the beneficiary communicates confidential information to a third person, the third person, if he had notice of the violation of duty, holds upon a constructive trust for the beneficiary any profit which he makes through the use of such information." 3 L. Loss, *Securities Regulation* 1451 (2d ed. 1961) (quoting Restatement of Restitution § 201(2) (1937)). Other authorities likewise have expressed the view that tippee liability exists only where there has been a breach of trust by an insider of which the tippee had knowledge. See, e. g., *Ross v. Licht*, 263 F. Supp. 395, 410 (SDNY 1967); A. Jacobs, *The Impact of Rule 10b-5*, § 167, at 7-4 (1975) ("[T]he better view is that a tipper must know or have reason to know the information is nonpublic and was improperly obtained."); Fleischer, *Mundheim & Murphy, An Initial Inquiry Into the Responsibility to Disclose Market Information*, 121 U. Pa. L. Rev. 798, 818, n. 76 (1973) ("The extension of rule 10b-5 restrictions to tippees of corporate insiders can best be justified on the theory that they are participating in the insider's breach of his fiduciary duty."). Cf. Restatement (Second) of Agency § 312, comment c (1958) ("A person who, with notice that an agent is thereby violating his duty to his principal, receives confidential information from the agent, may be [deemed] . . . a constructive trustee.").

²⁰ We do not suggest that knowingly trading on inside information is ever

C

In determining whether a tippee is under an obligation to disclose or abstain, it thus is necessary to determine whether the insider's "tip" constituted a breach of the insider's fiduciary duty. All disclosures of confidential corporate information are not inconsistent with the duty insiders owe to shareholders. In contrast to the extraordinary facts of this case, the more typical situation in which there will be a question whether disclosure violates the insider's *Cady, Roberts* duty is when insiders disclose information to analysts. See n. 16, *supra*. In some situations, both the insider and the analyst recipient will act in good faith, and yet release of the information may affect the market. For example, it may not be clear—either to the corporate insider or to the recipient analyst—whether the information will be viewed as material

"socially desirable or even that it is devoid of moral considerations." Dooley, *Enforcement of Insider Trading Restrictions*, 66 Va. L. Rev. 1, 55 (1980). Nor do we imply an absence of responsibility to disclose promptly indications of illegal actions by a corporation to the proper authorities—typically the SEC and exchange authorities in cases involving securities. Depending on the circumstances, and even where permitted by law, one's trading on material nonpublic information is behavior that may fall below ethical standards of conduct. But in a statutory area of the law such as securities regulation, where legal principles of general application must be applied, there may be "significant distinctions between actual legal obligations and ethical ideals." SEC, *Report of the Special Study of Securities Markets*, H. R. Doc. No. 95, 88th Cong., 1st Sess., pt. 1, pp. 237-238 (1963). The SEC recognizes this. At oral argument, the following exchange took place:

"QUESTION: So, it would not have satisfied his obligation under the law to go to the SEC first?

"[SEC's counsel]: That is correct. That an insider has to observe what has come to be known as the abstain or disclosure rule. Either the information has to be disclosed to the market if it is inside information . . . or the insider must abstain." Tr. of Oral Arg. 27.

Thus, it is clear that Rule 10b-5 does not impose any obligation simply to tell the SEC about the fraud before trading.]

Jim - I don't think this is helpful on the main point that ethical standards may be higher than law requires..

What about citing common law allowing the taking advantage of confid. information?

nonpublic information. Corporate officials may mistakenly think the information already has been disclosed or that it is not material enough to affect the market. Whether disclosure is a breach of duty therefore depends in large part on the purpose or good faith of the insider who made the disclosure. Absent an improper purpose, there has been no breach of duty to stockholders. And absent a breach by the insider, there is no derivative breach.²¹ As Commissioner Smith stated in *Investors Management Co.*:

"[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, and that the information must be shown not only to have been material and non-public, but also to have substantially contributed to the trading which occurred." 44 S.E.C., at 651 (concurring in the result).

There are facts and circumstances that often may justify an inference that the insider has breached his fiduciary duty. For example, there may be a relationship between the insider and the recipient that suggests a *quid pro quo* from the

²¹ An example of a case turning on the court's determination that the disclosure did not impose any fiduciary duties on the recipient of the inside information is *Walton v. Morgan Stanley & Co.*, 623 F. 2d 796 (CA2 1980). There, the defendant investment banking firm, representing one of its own corporate clients, investigated another corporation that was a possible target of a takeover bid by its client. In the course of negotiations the investment banking firm was given, on a confidential basis, unpublished material information. Subsequently, after the proposed takeover was abandoned, the firm was charged with relying on the information when it traded in the target corporation's stock. For purposes of the decision, it was assumed that the firm knew the information was confidential, but that it had been received in arm's-length negotiations. See *id.*, at 798. In the absence of any fiduciary relationship, the Court of Appeals found no basis for imposing tippee liability on the investment firm. See *id.*, at 799.

latter, or an intention to benefit the particular recipient. The elements of fiduciary duty and exploitation of nonpublic information certainly exist when an insider makes a gift of confidential information to a trading relative or friend. The tip and trade resemble trading by the insider himself followed by a gift of the profits to the recipient.

Determining the purpose of any one disclosure, a question of fact, will not always be easy for courts. But it is essential, we think, to have a guiding principle for those whose daily activities must be limited and instructed by the SEC's inside-trading rules, and we believe that there must be a breach of the insider's fiduciary duty before the tippee inherits the duty to disclose or abstain. In contrast, the rule adopted by the SEC in this case would have no limiting principle.²²

IV

Under the inside-trading and tipping rules set forth above, we find that there was no actionable violation by Dirks.²³ It

²² Without legal limitations, market participants are forced to rely on the reasonableness of the SEC's litigation strategy, but that can be hazardous, as the facts of this case make plain. Following the SEC's filing of the *Texas Gulf Sulphur* action, Commissioner (and later Chairman) Budge spoke of the various implications of applying Rule 10b-5 in inside-trading cases:

"Turning to the realm of possible defendants in the present and potential civil actions, the Commission certainly does not contemplate suing every person who may have come across inside information. In the *Texas Gulf* action neither tippees nor persons in the vast rank and file of employees have been named as defendants. In my view, the Commission in future cases normally should not join rank and file employees or persons outside the company *such as an analyst or reporter* who learns of inside information." Speech of Hamer Budge to the New York Regional Group of the American Society of Corporate Secretaries, Inc. (Nov. 18, 1965) (emphasis added), reprinted in Budge, *The Texas Gulf Sulphur Case—What It Is and What It Isn't*, Corp. Secretary No. 127, at 6 (Dec. 17, 1965).

²³ Dirks contends that he was not a "tippee" because the information he received constituted unverified allegations of fraud that were denied by management and were not "material facts" under the securities laws that

is undisputed that Dirks himself was a stranger to Equity Funding, with no pre-existing fiduciary duty to its shareholders.²⁴ He took no action, directly or indirectly, that induced the shareholders or officers of Equity Funding to repose trust or confidence in him. There was no expectation by Dirks's sources that he would keep their information in confidence. Nor did Dirks misappropriate or illegally obtain the information about Equity Funding. Unless the insiders breached their *Cady, Roberts* duty to shareholders in disclosing the nonpublic information to Dirks, he breached no duty when he passed it on to investors as well as to the *Wall Street Journal*.

We also think it is clear that the Equity Funding employees did not violate their *Cady, Roberts* duty to the corporation's shareholders by providing information to Dirks.²⁵ The

required disclosure before trading. He also argues that the information he received was not truly "inside" information, *i. e.*, intended for a confidential corporate purpose, but was merely evidence of a crime. The Solicitor General agrees. See Brief for United States as *Amicus Curiae* 22. For purposes of deciding this case, however, we assume the correctness of the SEC's findings, accepted by the Court of Appeals, that petitioner was a tippee of material inside information.

²⁴ Judge Wright found that Dirks acquired a fiduciary duty by virtue of his position as an employee of a broker-dealer. See 220 U. S. App. D.C., at 325-327, 681 F. 2d, at 840-842. The SEC, however, did not consider Judge Wright's novel theory in its decision, nor did it present that theory to the Court of Appeals. The SEC also has not argued Judge Wright's theory in this Court. See Brief for Respondent 21, n. 27. The merits of such a duty are therefore not before the Court. See *SEC v. Chenery Corp.*, 332 U. S. 194, 196-197 (1947).

²⁵ In this Court, the SEC appears to contend that an insider invariably violates a fiduciary duty to the corporation's shareholders by transmitting nonpublic corporate information to an outsider when he has reason to believe that the outsider may use it to the disadvantage of the shareholders. "Thus, regardless of any ultimate motive to bring to public attention the derelictions at Equity Funding, Secrist breached his duty to Equity Funding shareholders." Brief for Respondent 31. This perceived "duty" differs markedly from the one that the SEC identified in *Cady, Roberts* and

tippers received no monetary or personal benefit for revealing Equity Funding's secrets, nor did they have an apparent purpose or desire to make a gift of valuable information to Dirks. As the facts of this case clearly indicate, the tippers were motivated by a desire to expose the fraud. See *supra*, at 1-2. In the absence of a breach of duty to shareholders by the insiders, there was no derivative breach by Dirks. See n. 19, *supra*. Dirks therefore could not have been "a participant after the fact in [an] insider's breach of a fiduciary duty." *Chiarella*, 445 U. S., at 230, n. 12.

V

We conclude that Dirks, in the circumstances of this case, had no duty to abstain from use of the inside information that he obtained. The judgment of the Court of Appeals therefore is

Reversed.

that has been the basis for federal tippee-trading rules to date. In fact, the SEC did not charge Secrist with any wrongdoing, and we do not understand the SEC to have relied on any theory of a breach of duty by Secrist in finding that Dirks breached his duty to Equity Funding's shareholders. See App. 250 (decision of administrative law judge) ("One who knows himself to be a beneficiary of non-public, selectively disclosed inside information must fully disclose or refrain from trading."); SEC's Reply to Notice of Supplemental Authority before the SEC 4 ("If Secrist was acting properly, Dirks inherited a duty to [Equity Funding]'s shareholders to refrain from improper private use of the information."); Brief on behalf of the SEC in the Court of Appeals, at 47-50; *id.*, at 51 ("[K]nowing possession of inside information by any person imposes a duty to abstain or disclose."); *id.*, at 52-54; *id.*, at 55 ("[T]his obligation arises not from the manner in which such information is acquired. . . ."); 220 U. S. App. D.C., at 322-323, 681 F. 2d, at 838 (Wright, J.).

IV

Under the inside-trading and tipping rules set forth above, we find that there was no actionable violation by Dirks.²³ It is undisputed that Dirks himself was a stranger to Equity Funding, with no pre-existing fiduciary duty to its shareholders.²⁴ He took no action, directly or indirectly, that in-

reasonableness of the SEC's litigation strategy, but that can be hazardous, as the facts of this case make plain. Following the SEC's filing of the *Texas Gulf Sulphur* action, Commissioner (and later Chairman) Budge spoke of the various implications of applying Rule 10b-5 in inside-trading cases:

"Turning to the realm of possible defendants in the present and potential civil actions, the Commission certainly does not contemplate suing every person who may have come across inside information. In the *Texas Gulf* action neither tippees nor persons in the vast rank and file of employees have been named as defendants. In my view, the Commission in future cases normally should not join rank and file employees or persons outside the company such as an analyst or reporter who learns of inside information." Speech of Harner Budge to the New York Regional Group of the American Society of Corporate Secretaries, Inc. (Nov. 18, 1965) (emphasis added), reprinted in Budge, *The Texas Gulf Sulphur Case—What It Is and What It Isn't*, Corp. Secretary No. 127, at 6 (Dec. 17, 1965).

²³ Dirks contends that he was not a "tippee" because the information he received constituted unverified allegations of fraud that were denied by management and were not "material facts" under the securities laws that required disclosure before trading. He also argues that the information he received was not truly "inside" information, i. e., intended for a confidential corporate purpose, but was merely evidence of a crime. The Solicitor General agrees. See Brief for United States as *Amicus Curiae* 22. We need not decide, however, whether the information constituted "material facts," or whether information concerning corporate crime is properly characterized as "inside information." For purposes of deciding this case, we assume the correctness of the SEC's findings, accepted by the Court of Appeals, that petitioner was a tippee of material inside information.

²⁴ Judge Wright found that Dirks acquired a fiduciary duty by virtue of his position as an employee of a broker-dealer. See 220 U. S. App. D. C., at 325-327, 681 F. 2d, at 840-842. The SEC, however, did not consider Judge Wright's novel theory in its decision, nor did it present that theory to the Court of Appeals. The SEC also has not argued Judge Wright's theory in this Court. See Brief for Respondent 21, n. 27. The merits of such a duty are therefore not before the Court. See *SEC v. Chenery*

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

27P

Changes: 1-2, 5, 7-8, 11, 14-17

Sandra approved before 9 circulated. } →

From: Justice Powell

Circulated: 6/9

Recirculated:

2nd DRAFT

SUPREME COURT OF THE UNITED STATES

Jim - take a look:
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2-SEC's rule: motivation (No. 82-276) is immaterial

RAYMOND L. DIRKS, PETITIONER v. SECURITIES
AND EXCHANGE COMMISSION

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF
APPEALS FOR DISTRICT OF COLUMBIA

[June —, 1983]

JUSTICE POWELL delivered the opinion of the Court.

Petitioner Raymond Dirks received material nonpublic information from "insiders" of a corporation with which he had no connection. He disclosed this information to investors who relied on it in trading in the shares of the corporation. The question is whether Dirks violated the antifraud provisions of the federal securities laws by this disclosure.

I

In 1973, Dirks was an officer of a New York broker-dealer firm who specialized in providing investment analysis of insurance company securities to institutional investors.¹ On March 6, Dirks received information from Ronald Secrist, a former officer of Equity Funding of America. Secrist alleged that the assets of Equity Funding, a diversified corporation primarily engaged in selling life insurance and mutual funds, were vastly overstated as the result of fraudulent corporate practices. Secrist also stated that various regula-

¹The facts stated here are taken from more detailed statements set forth by the administrative law judge, App. 176-180, 225-247; the opinion of the Securities and Exchange Commission, 21 S. E. C. Docket 1401, 1402-1406 (1981); and the opinion of Judge Wright in the Court of Appeals, 220 U. S. App. D. C. 309, 314-318, 681 F. 2d 824, 829-833 (1982).

tory agencies had failed to act on similar charges made by Equity Funding employees. He urged Dirks to verify the fraud and disclose it publicly.

Dirks decided to investigate the allegations. He visited Equity Funding's headquarters in Los Angeles and interviewed several officers and employees of the corporation. The senior management denied any wrongdoing, but certain corporation employees corroborated the charges of fraud. Neither Dirks nor his firm owned or traded any Equity Funding stock, but throughout his investigation he openly discussed the information he had obtained with a number of clients and investors. Some of these persons sold their holdings of Equity Funding securities, including five investment advisers who liquidated holdings of more than \$16 million.²

While Dirks was in Los Angeles, he was in touch regularly with William Blundell, the *Wall Street Journal's* Los Angeles bureau chief. Dirks urged Blundell to write a story on the fraud allegations. Blundell did not believe, however, that such a massive fraud could go undetected and declined to write the story. He feared that publishing such damaging hearsay might be libelous.

During the two-week period in which Dirks pursued his investigation and spread word of Secrist's charges, the price of Equity Funding stock fell from \$26 per share to less than \$15 per share. This led the New York Stock Exchange to halt trading on March 27. Shortly thereafter California insur-

² Dirks received from his firm a salary plus a commission for securities transactions above a certain amount that his clients directed through his firm. See 21 S. E. C. Docket, at 1402, n. 8. But "[i]t is not clear how many of those with whom Dirks spoke promised to direct some brokerage business through [Dirks' firm] to compensate Dirks, or how many actually did so." 220 U. S. App. D. C., at 316, 681 F. 2d, at 831. The Boston Company Institutional Investors, Inc., promised Dirks about \$25,000 in commissions, but it is unclear whether Boston actually generated any brokerage business for his firm. See App. 199, 204-205; 21 S. E. C. Docket, at 1404, n. 10; 220 U. S. App. D. C., at 316, n. 5, 681 F. 2d, at 831, n. 5.

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ance authorities impounded Equity Funding's records and uncovered evidence of the fraud. Only then did the Securities and Exchange Commission (SEC) file a complaint against Equity Funding² and only then, on April 2, did the *Wall Street Journal* publish a front-page story based largely on information assembled by Dirks. Equity Funding immediately went into receivership.⁴

The SEC began an investigation into Dirks' role in the exposure of the fraud. After a hearing by an administrative law judge, the SEC found that Dirks had aided and abetted violations of § 17(a) of the Securities Act of 1933, 15 U. S. C. § 77q(a),⁵ § 10(b) of the Securities Exchange Act of 1934, 15 U. S. C. § 78j(b),⁶ and SEC Rule 10b-5, 17 CFR § 240.10b-5

² As early as 1971, the SEC had received allegations of fraudulent accounting practices at Equity Funding. Moreover, on March 9, 1973, an official of the California Insurance Department informed the SEC's regional office in Los Angeles of Secrist's charges of fraud. Dirks himself voluntarily presented his information at the SEC's regional office beginning on March 27.

⁴ A federal grand jury in Los Angeles subsequently returned a 105-count indictment against 22 persons, including many of Equity Funding's officers and directors. All defendants were found guilty of one or more counts, either by a plea of guilty or a conviction after trial. See Brief for Petitioner 15; App. 149-153.

⁵ Section 17(a) provides:

"It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

"(1) to employ any device, scheme, or artifice to defraud, or

"(2) to obtain money or property by means of any untrue statement of a material fact or any omission 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

"(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser."

⁶ Section 10(b) provides:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of

(1982),¹ by repeating the allegations of fraud to members of the investment community who later sold their Equity Funding stock. The SEC concluded: "Where 'tippees'—regardless of their motivation or occupation—come into possession of material information that they know is confidential and know or should know came from a corporate insider,² they must either publicly disclose that information or refrain from trading." 21 S. E. C. Docket 1401, 1407 (1981) (footnote omitted) (quoting *Chiarella v. United States*, 445 U. S. 222, 230 n. 12 (1980)). Recognizing, however, that Dirks "played an important role in bringing [Equity Funding's] massive fraud to light," 21 S. E. C. Docket, at 1412, the SEC only censured him.³

Dirks sought review in the Court of Appeals for the District of Columbia Circuit. The court entered judgment

any facility of any national securities exchange—

"(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

¹ Rule 10b-5 provides:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

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

"(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

"(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."

²Section 15 of the Securities Exchange Act, 15 U. S. C. § 78o(b)(4)(E), provides that the SEC may impose certain sanctions, including censure, on any person associated with a registered broker-dealer who has "willfully aided [or] abetted" any violation of the federal securities laws. See 15 U. S. C. § 78ff(a) (providing criminal penalties).

against Dirks "for the reasons stated by the Commission in its opinion." App. to Pet. for Cert. C-2. Judge Wright, a member of the panel, subsequently issued an opinion. Judge Robb concurred in the result and Judge Tamm dissented; neither filed a separate opinion. Judge Wright believed that "the obligations of corporate fiduciaries pass to all those to whom they disclose their information before it has been disseminated to the public at large." 220 U. S. App. D. C. 309, 324, 681 F. 2d 824, 839 (1982). Alternatively, Judge Wright concluded that, as an employee of a broker-dealer, Dirks had violated "obligations to the SEC and to the public completely independent of any obligations he acquired" as a result of receiving the information. *Id.*, at 325, 681 F. 2d, at 840.

In view of the importance to the SEC and to the securities industry of the question presented by this case, we granted a writ of certiorari. — U. S. — (1982). We now reverse.

II

In the seminal case of *In re Cady, Roberts & Co.*, 40 S. E. C. 907 (1961), the SEC recognized that the common law in some jurisdictions imposes on "corporate 'insiders,' particularly officers, directors, or controlling stockholders" an "affirmative duty of disclosure . . . when dealing in securities." *Id.*, at 911, and n. 13.⁹ The SEC found that not only did breach of this common-law duty also establish the elements of a Rule 10b-5 violation,¹⁰ but that individuals other

⁹ The duty that insiders owe to the corporation's shareholders not to trade on inside information differs from the common-law duty that officers and directors also have to the corporation itself not to mismanage corporate assets, of which confidential information is one. See 3 Fletcher Cyclopaedia of the Laws of Private Corporations §§ 848, 900 (1975 ed. and Supp. 1982); 3A Fletcher §§ 1168.1, 1168.2. In holding that breaches of this duty to shareholders violated the Securities Exchange Act, the *Cady, Roberts* Commission recognized, and we agree, that "[a] significant purpose of the Exchange Act was to eliminate the idea that use of inside information for personal advantage was a normal emolument of corporate office." See 40 S. E. C., at 912, n. 15.

¹⁰ Rule 10b-5 is generally the most inclusive of the three provisions on

than corporate insiders could be obligated either to disclose material nonpublic information¹¹ before trading or to abstain from trading altogether. *Id.*, at 912. In *Chiarella*, we accepted the two elements set out in *Cady Roberts* for establishing a Rule 10b-5 violation: "(i) the existence of a relationship affording access to inside information intended to be available only for a corporate purpose, and (ii) the unfairness of allowing a corporate insider to take advantage of that information by trading without disclosure." 445 U. S., at 227. In examining whether *Chiarella* had an obligation to disclose or abstain, the Court found that there is no general duty to disclose before trading on material nonpublic information,¹² and held that "a duty to disclose under § 10(b) does not arise from the mere possession of nonpublic market information." *Id.*, at 235. Such a duty arises rather from the existence of a fiduciary relationship. See *id.*, at 227-235.

Not "all breaches of fiduciary duty in connection with a securities transaction," however, come within the ambit of Rule 10b-5. *Santa Fe Industries, Inc. v. Green*, 430 U. S. 462, 472 (1977). There must also be "manipulation or deception." *Id.*, at 473. In an inside-trading case this fraud derives from the "inherent unfairness involved where one takes advantage" of "information intended to be available only for a cor-

which the SEC rested its decision in this case, and we will refer to it when we note the statutory basis for the SEC's inside-trading rules.

¹¹ The SEC views the disclosure duty as requiring more than disclosure to purchasers or sellers: "Proper and adequate disclosure of significant corporate developments can only be effected by a public release through the appropriate public media, designed to achieve a broad dissemination to the investing public generally and without favoring any special person or group." *In re Faberge, Inc.*, 45 S. E. C. 249, 256 (1973).

¹² See 445 U. S., at 233; *id.*, at 237 (STEVENS, J., concurring); *id.*, at 238-239 (BRENNAN, J., concurring in the judgment); *id.*, at 239-240 (BURGER, C. J., dissenting). Cf. *id.*, at 252, n. 2 (BLACKMUN, J., dissenting) (recognizing that there is no obligation to disclose material nonpublic information obtained through the exercise of "diligence or acumen" and "honest means," as opposed to "stealth").

porate purpose and not for the personal benefit of anyone." *In re Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 43 S. E. C. 933, 936 (1968). Thus, an insider will be liable under Rule 10b-5 for inside trading only where he fails to disclose material nonpublic information before trading on it and thus makes "secret profits." *Cady, Roberts*, 40 S. E. C., at 916, n. 31.

III

We were explicit in *Chiarella* in saying that there can be no duty to disclose where the person who has traded on inside information "was not [the corporation's] agent, . . . was not a fiduciary, [or] was not a person in whom the sellers [of the securities] had placed their trust and confidence." 445 U. S., at 232. Not to require such a fiduciary relationship, we recognized, would "depar[t] radically from the established doctrine that duty arises from a specific relationship between two parties" and would amount to "recognizing a general duty between all participants in market transactions to forgo actions based on material, nonpublic information." *Id.*, at 232, 233. This requirement of a specific relationship between the shareholders and the individual trading on inside information has created analytical difficulties for the SEC and courts in policing tippees who trade on inside information. Unlike insiders who have independent fiduciary duties to both the corporation and its shareholders, the typical tippee has no such relationships.¹² In view of this absence, it

must be
fiduciary
relationship

¹² Under 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 rather 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. See *SEC v. Monarch Fund*, 608 F. 2d 938, 942 (CA2 1979); *In re Investors Management Co.*, 44 S. E. C. 633, 645 (1971); *In re Van Alostne, Noel & Co.*, 43 S. E. C. 1080, 1084-1085 (1969);

has been unclear how a tippee acquires the *Cady, Roberts* duty to refrain from trading on inside information.

A

The SEC's position, as stated in its opinion in this case, is that a tippee "inherits" the *Cady, Roberts* obligation to shareholders whenever he receives inside information from an insider:

"In tipping potential traders, Dirks breached a duty which he had assumed as a result of knowingly receiving confidential information from [Equity Funding] insiders. Tippees such as Dirks who receive non-public material information from insiders become 'subject to the same duty as [the] insiders.' *Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.* [495 F. 2d 228, 237 (CA2 1974) (quoting *Ross v. Licht*, 263 F. Supp. 395, 410 (SDNY 1967))]. Such a tippee breaches the fiduciary duty which he assumes from the insider when the tippee knowingly transmits the information to someone who will probably trade on the basis thereof. . . . Presumably, Dirks' informants were entitled to disclose the [Equity Funding] fraud in order to bring it to light and its perpetrators to justice. However, Dirks—standing in their shoes—committed a breach of the fiduciary duty which he had assumed in dealing with them, when he passed the information on to traders." 21 S. E. C.

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In re Merrill Lynch, Pierce, Fenner & Smith, Inc., 43 S. E. C. 933, 937 (1968); *Cady, Roberts*, 40 S. E. C., at 912. When such a person breaches his fiduciary relationship, he may be treated more properly as a tipper than a tippee. See *Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 495 F. 2d 228, 237 (CA2 1974) (investment banker had access to material information when working on a proposed public offering for the corporation). For such a duty to be imposed, however, the corporation must expect the outsider to keep the disclosed nonpublic information confidential, and the relationship at least must imply such a duty.

Docket, at 1410, n. 42.

This view differs little from the view that we rejected as inconsistent with congressional intent in *Chiarella*. In that case, the Court of Appeals agreed with the SEC and affirmed Chiarella's conviction, holding 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." *United States v. Chiarella*, 588 F. 2d 1358, 1365 (CA2 1978) (emphasis in original). Here, the SEC maintains that anyone who knowingly receives nonpublic material information from an insider has a fiduciary duty to disclose before trading.¹⁴

In effect, the SEC's theory of tippee liability in both cases appears rooted in the idea that the antifraud provisions require equal information among all traders. This conflicts with the principle set forth in *Chiarella* that only some persons, under some circumstances, will be barred from trading

¹⁴ Apparently, the SEC believes this case differs from *Chiarella* in that Dirks' receipt of inside information from Seerist, an insider, carried Seerist's duties with it, while Chiarella received the information without the direct involvement of an insider and thus inherited no duty to disclose or abstain. The SEC fails to explain, however, why the receipt of nonpublic information from an insider automatically carries with it the fiduciary duty of the insider. As we emphasized in *Chiarella*, mere possession of nonpublic information does not give rise to a duty to disclose or abstain; only a specific relationship does that. And we do not believe that the mere receipt of information from an insider creates such a special relationship between the tippee and the corporation's shareholders.

Apparently recognizing the weakness of its argument in light of *Chiarella*, the SEC attempts to distinguish that case factually as involving not "inside" information, but rather "market" information, i. e., "information generated within the company relating to its assets or earnings." Brief for Respondent 23. This Court drew no such distinction in *Chiarella* and, as THE CHIEF JUSTICE noted, "[i]t is clear that § 10(b) and Rule 10b-5 by their terms and by their history make no such distinction." 445 U. S., at 241, n. 1 (dissenting opinion). See ALI Fed. Sec. Code § 1603, Comment (2)(j) (Proposed Official Draft 1978).

while in possession of material nonpublic information.¹⁵ Judge Wright correctly read our opinion in *Chiarella* as repudiating any notion that all traders must enjoy equal information before trading: "[T]he 'information' theory is rejected. Because the disclose-or-refrain duty is extraordinary, it attaches only when a party has legal obligations other than a mere duty to comply with the general antifraud proscriptions in the federal securities laws." 220 U. S. App. D. C., at 322, 681 F. 2d, at 837. See *Chiarella*, 445 U. S., at 235, n. 20. We reaffirm today that "[a] duty [to disclose] arises from the relationship between parties . . . and not merely from one's ability to acquire information because of his position in the market." 445 U. S., at 232-233, n. 14.

Imposing a duty to disclose or abstain solely because a person knowingly receives material nonpublic information from an insider and trades on it could have an inhibiting influence on the role of market analysts, which the SEC itself recognizes is necessary to the preservation of a healthy market.¹⁶

¹⁵ In *Chiarella*, we noted that formulation of an absolute equal information rule "should not be undertaken absent some explicit evidence of congressional intent." 445 U. S., at 233. Rather than adopting such a radical view of securities trading, Congress has expressly exempted many market professionals from the general statutory prohibition set forth in § 11(a)(1) of the Securities Exchange Act, 15 U. S. C. § 78k(a)(1), against members of a national securities exchange trading for their own account. See *id.*, at 233, n. 16. We observed in *Chiarella* that "[t]he exception is based upon Congress' recognition that [market professionals] contribute to a fair and orderly marketplace at the same time they exploit the informational advantage that comes from their possession of [nonpublic information]." *Ibid.*

¹⁶ The SEC expressly recognized that "[t]he value to the entire market of [analysts'] efforts cannot be gainsaid; market efficiency in pricing is significantly enhanced by [their] initiatives to ferret out and analyze information, and thus the analyst's work redounds to the benefit of all investors." 21 S. E. C., at 1406. The SEC asserts that analysts remain free to obtain from management corporate information for purposes of "filling in the 'interstices in analysis' . . ." Brief for Respondent 42 (quoting *Investors Management Co.*, 44 S. E. C., at 646). But this rule is inherently impre-

Chiarella

It is commonplace for analysts to "ferret out and analyze information," 21 S. E. C., at 1406,¹⁷ and this often is done by meeting with and questioning corporate officers and others who are insiders. And information that the analysts obtain normally may be the basis for judgments as to the market worth of a corporation's securities. The analyst's judgment in this respect is made available in market letters or otherwise to clients of the firm. It is the nature of this type of information, and indeed of the markets themselves, that such information cannot be made simultaneously available to all of the corporation's stockholders or the public generally.

B

The conclusion that recipients of inside information do not invariably acquire a duty to disclose or abstain does not mean that such tippees always are free to trade on the information. The need for a ban on some tippee trading is clear. Not only

cise, and imprecision prevents parties from ordering their actions in accord with legal requirements. Unless the parties have some guidance as to where the line is between permissible and impermissible disclosures and uses, neither corporate insiders nor analysts can be sure when the line is crossed. Cf. *Adler v. Klawans*, 267 F. 2d 840, 845 (CA2 1959) (Burger, J., sitting by designation).

"On its facts, this case is the unusual one. Dirks is an analyst in a broker-dealer firm, and he did interview management in the course of his investigation. He uncovered, however, startling information that required no analysis or exercise of judgment as to its market relevance. Nonetheless, the principle at issue here extends beyond these facts. The SEC's rule—applicable without regard to any breach by an insider—could have serious ramifications on reporting by analysts of investment views.

Despite the unusualness of Dirks' "find," the central role that he played in uncovering the fraud at Equity Funding, and that analysts in general can play in revealing information that corporations may have reason to withhold from the public, is an important one. Dirks' careful investigation brought to light a massive fraud at the corporation. And until the Equity Funding fraud was exposed, the information in the trading market was grossly inaccurate. But for Dirks' efforts, the fraud might well have gone undetected longer.

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are insiders forbidden by their fiduciary relationship from personally using undisclosed corporate information to their advantage, but they may not give such information to an outsider for the same improper purpose of exploiting the information for their personal gain. See 15 U. S. C. § 78t(b) (making it unlawful to do indirectly "by means of any other person" any act made unlawful by the federal securities laws). Similarly, the transactions of those who knowingly participate with the fiduciary in such a breach are "as forbidden" as transactions "on behalf of the trustee himself." *Mosser v. Darrow*, 341 U. S. 267, 272 (1951). See *Jackson v. Smith*, 254 U. S. 586, 589 (1921); *Jackson v. Ludeling*, 88 U. S. 616, 631-632 (1874). As the Court explained in *Mosser*, a contrary rule "would open up opportunities for devious dealings in the name of the others that the trustee could not conduct in his own." 341 U. S., at 271. See *SEC v. Texas Gulf Sulphur Co.*, 446 F. 2d 1301, 1308 (CA2), cert. denied, 404 U. S. 1005 (1971). Thus, the tippee's duty to disclose or abstain is derivative from that of the insider's duty. See Tr. of Oral Ar. 38. Cf. *Chiarella*, 445 U. S., at 246, n. 1 (BLACKMUN, J., dissenting). As we noted in *Chiarella*, "[t]he tippee's obligation has been viewed as arising from his role as a participant after the fact in the insider's breach of a fiduciary duty." 445 U. S., at 230, n. 12.

Thus, some tippees must assume an insider's duty to the shareholders not because they receive inside information, but rather because it has been made available to them *improperly*.¹⁸ And for Rule 10b-5 purposes, the insider's disclosure

¹⁸ The SEC itself has recognized that tippee liability properly is imposed only in circumstances where the tippee knows, or has reason to know, that the insider has disclosed improperly inside corporate information. In *Investors Management Co.*, *supra*, the SEC stated that one element of tippee liability is that the tippee knew or had reason to know "that [the information] was non-public and had been obtained *improperly* by selective revelation or otherwise." 44 S. E. C., at 641 (emphasis added). Commissioner Smith read this test to mean that a tippee can be held liable only if

is improper only where it would violate his *Cady, Roberts* duty. Thus, a tippee assumes a fiduciary duty to the shareholders of a corporation not to trade on material nonpublic information only when the insider has breached his fiduciary duty to the shareholders by disclosing the information to the tippee and the tippee knows or should know that there has been a breach.¹⁹ As Commissioner Smith perceptively observed in *Investors Management Co.*: "It is important in this type of case to focus on policing insiders and what they do . . . rather than on policing information *per se* and its possession . . ." 44 S. E. C., at 648 (concurring in the result). Tipping thus properly is viewed only as a means of indirectly violating the *Cady, Roberts* disclose-or-abstain rule.²⁰

he received information in breach of an insider's duty not to disclose it. *Id.*, at 650 (concurring in the result).

¹⁹ Professor Loss has linked tippee liability to the concept in the law of restitution that "[w]here a fiduciary in violation of his duty to the beneficiary communicates confidential information to a third person, the third person, if he had notice of the violation of duty, holds upon a constructive trust for the beneficiary any profit which he makes through the use of such information." 3 L. Loss, *Securities Regulation* 1451 (2d ed. 1961) (quoting Restatement of Restitution § 201(2) (1937)). Other authorities likewise have expressed the view that tippee liability exists only where there has been a breach of trust by an insider of which the tippee had knowledge. See, e. g., *Ross v. Licht*, 263 F. Supp. 395, 410 (SDNY 1967); A. Jacobs, *The Impact of Rule 10b-5*, § 167, at 7-4 (1975) ("[T]he better view is that a tipper must know or have reason to know the information is nonpublic and was improperly obtained."); Fleischer, Mundheim & Murphy, *An Initial Inquiry Into the Responsibility to Disclose Market Information*, 121 U. Pa. L. Rev. 798, 818, n. 76 (1973) ("The extension of rule 10b-5 restrictions to tippees of corporate insiders can best be justified on the theory that they are participating in the insider's breach of his fiduciary duty."). Cf. Restatement (Second) of Agency § 312, comment c (1958) ("A person who, with notice that an agent is thereby violating his duty to his principal, receives confidential information from the agent, may be [deemed] . . . a constructive trustee.").

²⁰ We do not suggest that knowingly trading on inside information is ever "socially desirable or even that it is devoid of moral considerations."

C

In determining whether a tippee is under an obligation to disclose or abstain, it thus is necessary to determine whether the insider's "tip" constituted a breach of the insider's fiduciary duty. All disclosures of confidential corporate information are not inconsistent with the duty insiders owe to shareholders. In contrast to the extraordinary facts of this case, the more typical situation in which there will be a question whether disclosure violates the insider's *Cady, Roberts* duty is when insiders disclose information to analysts. See n. 16, *supra*. In some situations, the insider will act consistently with his fiduciary duty to shareholders, and yet release of the information may affect the market. For example, it may not be clear—either to the corporate insider or to the recipient analyst—whether the information will be viewed as material nonpublic information. Corporate officials may mistakenly

Dooley, Enforcement of Insider Trading Restrictions, 66 Va. L. Rev. 1, 55 (1980). Nor do we imply an absence of responsibility to disclose promptly indications of illegal actions by a corporation to the proper authorities—typically the SEC and exchange authorities in cases involving securities. Depending on the circumstances, and even where permitted by law, one's trading on material nonpublic information is behavior that may fall below ethical standards of conduct. But in a statutory area of the law such as securities regulation, where legal principles of general application must be applied, there may be "significant distinctions between actual legal obligations and ethical ideals." SEC, Report of the Special Study of Securities Markets, H. R. Doc. No. 95, 88th Cong., 1st Sess., pt. 1, pp. 237-238 (1963). The SEC recognizes this. At oral argument, the following exchange took place:

"QUESTION: So, it would not have satisfied his obligation under the law to go to the SEC first?

"[SEC's counsel]: That is correct. That an insider has to observe what has come to be known as the abstain or disclosure rule. Either the information has to be disclosed to the market if it is inside information . . . or the insider must abstain." Tr. of Oral Arg. 27.

Thus, it is clear that Rule 10b-5 does not impose any obligation simply to tell the SEC about the fraud before trading.

This standard was identified by the SEC itself in Cady, Roberts: a purpose of the Act was to eliminate "use of inside info. personal advantage"; 40 SEC at 942, n.15.

Thus, the test is think the information already has been disclosed or that it is not material enough to affect the market. Whether disclosure is a breach of duty therefore depends in large part on the purpose of the disclosure, i.e., whether the insider personally will benefit, directly or indirectly from it. Absent an improper purpose, there has been no breach of duty to stockholders. And absent a breach by the insider, there is no derivative breach.²¹ As Commissioner Smith stated in *Investors Management Co.*:

"[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, and that the information must be shown not only to have been material and non-public, but also to have substantially contributed to the trading which occurred." 44 S. E. C., at 651 (concurring in the result).

The SEC argues that, if inside-trading liability does not exist when the information is transmitted for a proper purpose but is used for trading, it would be a rare situation when the parties could not fabricate some ostensibly legitimate

²¹ An example of a case turning on the court's determination that the disclosure did not impose any fiduciary duties on the recipient of the inside information is *Walton v. Morgan Stanley & Co.*, 623 F. 2d 796 (CA2 1980). There, the defendant investment banking firm, representing one of its own corporate clients, investigated another corporation that was a possible target of a takeover bid by its client. In the course of negotiations the investment banking firm was given, on a confidential basis, unpublished material information. Subsequently, after the proposed takeover was abandoned, the firm was charged with relying on the information when it traded in the target corporation's stock. For purposes of the decision, it was assumed that the firm knew the information was confidential, but that it had been received in arm's-length negotiations. See *id.*, at 798. In the absence of any fiduciary relationship, the Court of Appeals found no basis for imposing tippee liability on the investment firm. See *id.*, at 799.

this disclosure such a

join - why not substitute Smith's statement now on p 13 (focus on "insider" - not on "disclosure info") for this statement. Then move this to p 13 - using only first 5 lines, to the comma?

expects to

business justification for transmitting the information. We think the SEC is unduly concerned. In determining whether the insider's purpose in making a particular disclosure is fraudulent, the SEC and the courts are not required to read the parties' minds. Scienter no doubt is relevant in determining whether the tipper has violated his Cady, Roberts duty, but to determine whether the disclosure itself "deceive[s], manipulate[s], or defraud[s]" shareholders, Aaron v. SEC, 446 U. S. 680, 686 (1980), courts should focus on whether the insider receives a direct or indirect personal benefit from the disclosure, such as a clear pecuniary gain or a reputational benefit that will translate into future earnings. Cf. Brudney, *Insiders, Outsiders, and Informational Advantages Under the Federal Securities Laws*, 93 Harv. L. Rev. 324, 348 (1979) ("The theory . . . is that the insider, by giving the information out selectively, is in effect selling the information to its recipient for cash, reciprocal information, or other things of value for himself. . ."). There are facts and circumstances that often may justify such an inference. For example, there may be a relationship between the insider and the recipient that suggests a *quid pro quo* from the latter, or an intention to benefit the particular recipient. The elements of fiduciary duty and exploitation of nonpublic information also exist when an insider makes a gift of confidential information to a trading relative or friend. The tip and trade resemble trading by the insider himself followed by a gift of the profits to the recipient.

Determining whether an insider personally benefits from a particular disclosure, a question of fact, will not always be easy for courts. But it is essential, we think, to have a guiding principle for those whose daily activities must be limited and instructed by the SEC's inside-trading rules, and we believe that there must be a breach of the insider's fiduciary duty before the tippee inherits the duty to disclose or abstain. In contrast, the rule adopted by the SEC in this case would have no limiting principle.²²

²² Without legal limitations, market participants are forced to rely on the

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duced the shareholders or officers of Equity Funding to repose trust or confidence in him. There was no expectation by Dirk's sources that he would keep their information in confidence. Nor did Dirks misappropriate or illegally obtain the information about Equity Funding. Unless the insiders breached their *Cady, Roberts* duty to shareholders in disclosing the nonpublic information to Dirks, he breached no duty when he passed it on to investors as well as to the *Wall Street Journal*.

We also think ^{g d} it is clear that the Equity Funding employees ~~did not violate~~ ^{neither Secrist nor the other} their *Cady, Roberts* duty to the corporation's shareholders by providing information to Dirks.²⁵ The tippers received no monetary or personal benefit for revealing Equity Funding's secrets, nor ~~did they have an apparent~~ ^{was their}

Corp., 332 U. S. 194, 196-197 (1947).

²⁵ In this Court, the SEC appears to contend that an insider invariably violates a fiduciary duty to the corporation's shareholders by transmitting nonpublic corporate information to an outsider when he has reason to believe that the outsider may use it to the disadvantage of the shareholders. "Thus, regardless of any ultimate motive to bring to public attention the derelictions at Equity Funding, Secrist breached his duty to Equity Funding shareholders." Brief for Respondent 31. This perceived "duty" differs markedly from the one that the SEC identified in *Cady, Roberts* and that has been the basis for federal tippee-trading rules to date. In fact, the SEC did not charge Secrist with any wrongdoing, and we do not understand the SEC to have relied on any theory of a breach of duty by Secrist in finding that Dirks breached his duty to Equity Funding's shareholders. See App. 250 (decision of administrative law judge) ("One who knows himself to be a beneficiary of non-public, selectively disclosed inside information must fully disclose or refrain from trading."); SEC's Reply to Notice of Supplemental Authority before the SEC 4 ("If Secrist was acting properly, Dirks inherited a duty to [Equity Funding]'s shareholders to refrain from improper private use of the information."); Brief on behalf of the SEC in the Court of Appeals, at 47-50; *id.*, at 51 ("[K]nowing possession of inside information by any person imposes a duty to abstain or disclose."); *id.*, at 52-54; *id.*, at 55 ("[T]his obligation arises not from the manner in which such information is acquired. . . ."); 220 U. S. App. D. C., at 322-323, 681 F. 2d, at 838 (Wright, J.).

purpose ~~or desire~~^{to} to make a gift of valuable information to Dirks. As the facts of this case clearly indicate, the tippers were motivated by a desire to expose the fraud. See *supra*, at 1-2. In the absence of a breach of duty to shareholders by the insiders, there was no derivative breach by Dirks. See n. 19, *supra*. Dirks therefore could not have been "a participant after the fact in [an] insider's breach of a fiduciary duty." *Chiarella*, 445 U. S., at 230, n. 12.

V

We conclude that Dirks, in the circumstances of this case, had no duty to abstain from use of the inside information that he obtained. The judgment of the Court of Appeals therefore is

Reversed.

JUN 27 1983

Changes: 1, 4-6, 8-11, 13-20

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

From: Justice Powell

Circulated: _____

Recirculated: JUN 27 1983

3rd DRAFT

SUPREME COURT OF THE UNITED STATES

No. 82-276

RAYMOND L. DIRKS, PETITIONER *v.* SECURITIES
AND EXCHANGE COMMISSION

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF
APPEALS FOR DISTRICT OF COLUMBIA

[June —, 1983]

JUSTICE POWELL delivered the opinion of the Court.

Petitioner Raymond Dirks received material nonpublic information from "insiders" of a corporation with which he had no connection. He disclosed this information to investors who relied on it in trading in the shares of the corporation. The question is whether Dirks violated the antifraud provisions of the federal securities laws by this disclosure.

I

In 1973, Dirks was an officer of a New York broker-dealer firm who specialized in providing investment analysis of insurance company securities to institutional investors.¹ On March 6, Dirks received information from Ronald Secrist, a former officer of Equity Funding of America. Secrist alleged that the assets of Equity Funding, a diversified corporation primarily engaged in selling life insurance and mutual funds, were vastly overstated as the result of fraudulent corporate practices. Secrist also stated that various regula-

¹ The facts stated here are taken from more detailed statements set forth by the administrative law judge, App. 176-180, 225-247; the opinion of the Securities and Exchange Commission, 21 S. E. C. Docket 1401, 1402-1406 (1981); and the opinion of Judge Wright in the Court of Appeals, 220 U. S. App. D. C. 309, 314-318, 681 F. 2d 824, 829-833 (1982).

tory agencies had failed to act on similar charges made by Equity Funding employees. He urged Dirks to verify the fraud and disclose it publicly.

Dirks decided to investigate the allegations. He visited Equity Funding's headquarters in Los Angeles and interviewed several officers and employees of the corporation. The senior management denied any wrongdoing, but certain corporation employees corroborated the charges of fraud. Neither Dirks nor his firm owned or traded any Equity Funding stock, but throughout his investigation he openly discussed the information he had obtained with a number of clients and investors. Some of these persons sold their holdings of Equity Funding securities, including five investment advisers who liquidated holdings of more than \$16 million.²

While Dirks was in Los Angeles, he was in touch regularly with William Blundell, the *Wall Street Journal's* Los Angeles bureau chief. Dirks urged Blundell to write a story on the fraud allegations. Blundell did not believe, however, that such a massive fraud could go undetected and declined to write the story. He feared that publishing such damaging hearsay might be libelous.

During the two-week period in which Dirks pursued his investigation and spread word of Secrist's charges, the price of Equity Funding stock fell from \$26 per share to less than \$15 per share. This led the New York Stock Exchange to halt trading on March 27. Shortly thereafter California insur-

² Dirks received from his firm a salary plus a commission for securities transactions above a certain amount that his clients directed through his firm. See 21 S. E. C. Docket, at 1402, n. 3. But "[i]t is not clear how many of those with whom Dirks spoke promised to direct some brokerage business through [Dirks' firm] to compensate Dirks, or how many actually did so." 220 U. S. App. D. C., at 316, 681 F. 2d, at 831. The Boston Company Institutional Investors, Inc., promised Dirks about \$25,000 in commissions, but it is unclear whether Boston actually generated any brokerage business for his firm. See App. 199, 204-205; 21 S. E. C. Docket, at 1404, n. 10; 220 U. S. App. D. C., at 316, n. 5, 681 F. 2d, at 831, n. 5.

ance authorities impounded Equity Funding's records and uncovered evidence of the fraud. Only then did the Securities and Exchange Commission (SEC) file a complaint against Equity Funding² and only then, on April 2, did the *Wall Street Journal* publish a front-page story based largely on information assembled by Dirks. Equity Funding immediately went into receivership.³

The SEC began an investigation into Dirks' role in the exposure of the fraud. After a hearing by an administrative law judge, the SEC found that Dirks had aided and abetted violations of § 17(a) of the Securities Act of 1933, 15 U. S. C. § 77q(a),⁴ § 10(b) of the Securities Exchange Act of 1934, 15 U. S. C. § 78j(b),⁵ and SEC Rule 10b-5, 17 CFR § 240.10b-5

²As early as 1971, the SEC had received allegations of fraudulent accounting practices at Equity Funding. Moreover, on March 9, 1973, an official of the California Insurance Department informed the SEC's regional office in Los Angeles of Secrist's charges of fraud. Dirks himself voluntarily presented his information at the SEC's regional office beginning on March 27.

³A federal grand jury in Los Angeles subsequently returned a 105-count indictment against 22 persons, including many of Equity Funding's officers and directors. All defendants were found guilty of one or more counts, either by a plea of guilty or a conviction after trial. See Brief for Petitioner 15; App. 149-153.

⁴Section 17(a) provides:

"It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

"(1) to employ any device, scheme, or artifice to defraud, or

"(2) to obtain money or property by means of any untrue statement of a material fact or any omission 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

"(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser."

⁵Section 10(b) provides:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of

(1982),⁷ by repeating the allegations of fraud to members of the investment community who later sold their Equity Funding stock. The SEC concluded: "Where 'tippees'—regardless of their motivation or occupation—come into possession of material 'information that they know is confidential and know or should know came from a corporate insider,' they must either publicly disclose that information or refrain from trading." 21 S. E. C. Docket 1401, 1407 (1981) (footnote omitted) (quoting *Chiarella v. United States*, 445 U. S. 222, 230 n. 12 (1980)). Recognizing, however, that Dirks "played an important role in bringing [Equity Funding's] massive fraud to light," 21 S. E. C. Docket, at 1412,⁸ the SEC only censured him.⁹

any facility of any national securities exchange—

"(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

⁷ Rule 10b-5 provides:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

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

"(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

"(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."

⁸ JUSTICE BLACKMUN's dissenting opinion minimizes the role Dirks played in making public the Equity Funding fraud. See *post*, at 3 and 11, n. 15. The dissent would rewrite the history of Dirks' extensive investigative efforts. See, e. g., 21 S. E. C., at 1412 ("It is clear that Dirks played an important role in bringing [Equity Funding's] massive fraud to light, and it is also true that he reported the fraud allegation to [Equity

Dirks sought review in the Court of Appeals for the District of Columbia Circuit. The court entered judgment against Dirks "for the reasons stated by the Commission in its opinion." App. to Pet. for Cert. C-2. Judge Wright, a member of the panel, subsequently issued an opinion. Judge Robb concurred in the result and Judge Tamm dissented; neither filed a separate opinion. Judge Wright believed that "the obligations of corporate fiduciaries pass to all those to whom they disclose their information before it has been disseminated to the public at large." 220 U. S. App. D. C. 309, 324, 681 F. 2d 824, 839 (1982). Alternatively, Judge Wright concluded that, as an employee of a broker-dealer, Dirks had violated "obligations to the SEC and to the public completely independent of any obligations he acquired" as a result of receiving the information. *Id.*, at 325, 681 F. 2d, at 840.

In view of the importance to the SEC and to the securities industry of the question presented by this case, we granted a writ of certiorari. — U. S. — (1982). We now reverse.

II

In the seminal case of *In re Cady, Roberts & Co.*, 40 S. E. C. 907 (1961), the SEC recognized that the common law in some jurisdictions imposes on "corporate 'insiders,' particularly officers, directors, or controlling stockholders" an "affirmative duty of disclosure . . . when dealing in securities." *Id.*, at 911, and n. 13.¹⁰ The SEC found that not only

Funding's] auditors and sought to have the information published in the *Wall Street Journal*."); 681 F. 2d, at 829 (Wright, J.) ("Largely thanks to Dirks one of the most infamous frauds in recent memory was uncovered and exposed, while the record shows that the SEC repeatedly missed opportunities to investigate Equity Funding.").

¹⁰Section 15 of the Securities Exchange Act, 15 U. S. C. § 78o(b)(4)(E), provides that the SEC may impose certain sanctions, including censure, on any person associated with a registered broker-dealer who has "willfully aided [or] abetted" any violation of the federal securities laws. See 15 U. S. C. § 78ff(a) (providing criminal penalties).

¹¹The duty that insiders owe to the corporation's shareholders not to

did breach of this common-law duty also establish the elements of a Rule 10b-5 violation,¹¹ but that individuals other than corporate insiders could be obligated either to disclose material nonpublic information¹² before trading or to abstain from trading altogether. *Id.*, at 912. In *Chiarella*, we accepted the two elements set out in *Cady Roberts* for establishing a Rule 10b-5 violation: "(i) the existence of a relationship affording access to inside information intended to be available only for a corporate purpose, and (ii) the unfairness of allowing a corporate insider to take advantage of that information by trading without disclosure." 445 U. S., at 227. In examining whether *Chiarella* had an obligation to disclose or abstain, the Court found that there is no general duty to disclose before trading on material nonpublic information,¹³

trade on inside information differs from the common-law duty that officers and directors also have to the corporation itself not to mismanage corporate assets, of which confidential information is one. See 3 Fletcher Cyclopaedia of the Laws of Private Corporations §§ 848, 900 (1975 ed. and Supp. 1982); 3A Fletcher §§ 1168.1, 1168.2. In holding that breaches of this duty to shareholders violated the Securities Exchange Act, the *Cady Roberts* Commission recognized, and we agree, that "[a] significant purpose of the Exchange Act was to eliminate the idea that use of inside information for personal advantage was a normal emolument of corporate office." See 40 S. E. C., at 912, n. 15.

¹¹ Rule 10b-5 is generally the most inclusive of the three provisions on which the SEC rested its decision in this case, and we will refer to it when we note the statutory basis for the SEC's inside-trading rules.

¹² The SEC views the disclosure duty as requiring more than disclosure to purchasers or sellers: "Proper and adequate disclosure of significant corporate developments can only be effected by a public release through the appropriate public media, designed to achieve a broad dissemination to the investing public generally and without favoring any special person or group." *In re Faberge, Inc.*, 45 S. E. C. 249, 256 (1973).

¹³ See 445 U. S., at 233; *id.*, at 237 (STEVENS, J., concurring); *id.*, at 238-239 (BRENNAN, J., concurring in the judgment); *id.*, at 239-240 (BURGER, C. J., dissenting). Cf. *id.*, at 252, n. 2 (BLACKMUN, J., dissenting) (recognizing that there is no obligation to disclose material nonpublic information obtained through the exercise of "diligence or acumen" and "hon-

and held that "a duty to disclose under § 10(b) does not arise from the mere possession of nonpublic market information." *Id.*, at 235. Such a duty arises rather from the existence of a fiduciary relationship. See *id.*, at 227-235.

Not "all breaches of fiduciary duty in connection with a securities transaction," however, come within the ambit of Rule 10b-5. *Santa Fe Industries, Inc. v. Green*, 430 U. S. 462, 472 (1977). There must also be "manipulation or deception." *Id.*, at 473. In an inside-trading case this fraud derives from the "inherent unfairness involved where one takes advantage" of "information intended to be available only for a corporate purpose and not for the personal benefit of anyone." *In re Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 43 S. E. C. 933, 936 (1968). Thus, an insider will be liable under Rule 10b-5 for inside trading only where he fails to disclose material nonpublic information before trading on it and thus makes "secret profits." *Cady, Roberts*, 40 S. E. C., at 916, n. 31.

III

We were explicit in *Chiarella* in saying that there can be no duty to disclose where the person who has traded on inside information "was not [the corporation's] agent, . . . was not a fiduciary, [or] was not a person in whom the sellers [of the securities] had placed their trust and confidence." 445 U. S., at 232. Not to require such a fiduciary relationship, we recognized, would "depar[t] radically from the established doctrine that duty arises from a specific relationship between two parties" and would amount to "recognizing a general duty between all participants in market transactions to forgo actions based on material, nonpublic information." *Id.*, at 232, 233. This requirement of a specific relationship between the shareholders and the individual trading on inside information has created analytical difficulties for the SEC

est means," as opposed to "stealth").

and courts in policing tippees who trade on inside information. Unlike insiders who have independent fiduciary duties to both the corporation and its shareholders, the typical tippee has no such relationships.¹⁴ In view of this absence, it has been unclear how a tippee acquires the *Cady, Roberts* duty to refrain from trading on inside information.

A

The SEC's position, as stated in its opinion in this case, is that a tippee "inherits" the *Cady, Roberts* obligation to shareholders whenever he receives inside information from an insider:

"In tipping potential traders, Dirks breached a duty which he had assumed as a result of knowingly receiving confidential information from [Equity Funding] insiders. Tippees such as Dirks who receive non-public material information from insiders become 'subject to the same duty as [the] insiders.' *Shapiro v. Merrill Lynch*,

¹⁴ Under 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 rather 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. See *SEC v. Monarch Fund*, 608 F. 2d 938, 942 (CA2 1979); *In re Investors Management Co.*, 44 S. E. C. 633, 645 (1971); *In re Van Alstyne, Noel & Co.*, 43 S. E. C. 1080, 1084-1085 (1969); *In re Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 43 S. E. C. 933, 937 (1968); *Cady, Roberts*, 40 S. E. C., at 912. When such a person breaches his fiduciary relationship, he may be treated more properly as a tipper than a tippee. See *Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 495 F. 2d 228, 237 (CA2 1974) (investment banker had access to material information when working on a proposed public offering for the corporation). For such a duty to be imposed, however, the corporation must expect the outsider to keep the disclosed nonpublic information confidential, and the relationship at least must imply such a duty.

Pierce, Fenner & Smith, Inc. [495 F. 2d 228, 237 (CA2 1974) (quoting *Ross v. Licht*, 263 F. Supp. 395, 410 (SDNY 1967))]. Such a tippee breaches the fiduciary duty which he assumes from the insider when the tippee knowingly transmits the information to someone who will probably trade on the basis thereof. . . . Presumably, Dirks' informants were entitled to disclose the [Equity Funding] fraud in order to bring it to light and its perpetrators to justice. However, Dirks—standing in their shoes—committed a breach of the fiduciary duty which he had assumed in dealing with them, when he passed the information on to traders." 21 S. E. C. Docket, at 1410, n. 42.

This view differs little from the view that we rejected as inconsistent with congressional intent in *Chiarella*. In that case, the Court of Appeals agreed with the SEC and affirmed *Chiarella's* conviction, holding 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." *United States v. Chiarella*, 588 F. 2d 1358, 1365 (CA2 1978) (emphasis in original). Here, the SEC maintains that anyone who knowingly receives nonpublic material information from an insider has a fiduciary duty to disclose before trading.¹²

¹² Apparently, the SEC believes this case differs from *Chiarella* in that Dirks' receipt of inside information from Secrist, an insider, carried Secrist's duties with it, while *Chiarella* received the information without the direct involvement of an insider and thus inherited no duty to disclose or abstain. The SEC fails to explain, however, why the receipt of nonpublic information from an insider automatically carries with it the fiduciary duty of the insider. As we emphasized in *Chiarella*, mere possession of nonpublic information does not give rise to a duty to disclose or abstain; only a specific relationship does that. And we do not believe that the mere receipt of information from an insider creates such a special relationship between the tippee and the corporation's shareholders.

Apparently recognizing the weakness of its argument in light of *Chia-*

In effect, the SEC's theory of tippee liability in both cases appears rooted in the idea that the antifraud provisions require equal information among all traders. This conflicts with 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.¹⁶ Judge Wright correctly read our opinion in *Chiarella* as repudiating any notion that all traders must enjoy equal information before trading: "[T]he 'information' theory is rejected. Because the disclose-or-refrain duty is extraordinary, it attaches only when a party has legal obligations other than a mere duty to comply with the general antifraud proscriptions in the federal securities laws." 220 U. S. App. D. C., at 322, 681 F. 2d, at 837. See *Chiarella*, 445 U. S., at 235, n. 20. We reaffirm today that "[a] duty [to disclose] arises from the relationship between parties . . . and not merely from one's ability to acquire information because of his position in the market." 445 U. S., at 232-233, n. 14.

rella, the SEC attempts to distinguish that case factually as involving not "inside" information, but rather "market" information, i. e., "information generated within the company relating to its assets or earnings." Brief for Respondent 23. This Court drew no such distinction in *Chiarella* and, as THE CHIEF JUSTICE noted, "[i]t is clear that § 10(b) and Rule 10b-5 by their terms and by their history make no such distinction." 445 U. S., at 241, n. 1 (dissenting opinion). See ALI Fed. Sec. Code § 1603, Comment (2)(j) (Proposed Official Draft 1978).

¹⁶ In *Chiarella*, we noted that formulation of an absolute equal information rule "should not be undertaken absent some explicit evidence of congressional intent." 445 U. S., at 233. Rather than adopting such a radical view of securities trading, Congress has expressly exempted many market professionals from the general statutory prohibition set forth in § 11(a)(1) of the Securities Exchange Act, 15 U. S. C. § 78k(a)(1), against members of a national securities exchange trading for their own account. See *id.*, at 233, n. 16. We observed in *Chiarella* that "[t]he exception is based upon Congress' recognition that [market professionals] contribute to a fair and orderly marketplace at the same time they exploit the informational advantage that comes from their possession of [nonpublic information]." *Ibid.*

Imposing a duty to disclose or abstain solely because a person knowingly receives material nonpublic information from an insider and trades on it could have an inhibiting influence on the role of market analysts, which the SEC itself recognizes is necessary to the preservation of a healthy market.¹⁷ It is commonplace for analysts to "ferret out and analyze information," 21 S. E. C., at 1406,¹⁸ and this often is done by meeting with and questioning corporate officers and others who are insiders. And information that the analysts obtain normally may be the basis for judgments as to the market

¹⁷The SEC expressly recognized that "[t]he value to the entire market of [analysts'] efforts cannot be gainsaid; market efficiency in pricing is significantly enhanced by [their] initiatives to ferret out and analyze information, and thus the analyst's work redounds to the benefit of all investors." 21 S. E. C., at 1406. The SEC asserts that analysts remain free to obtain from management corporate information for purposes of "filling in the 'interstices in analysis' . . ." Brief for Respondent 42 (quoting *Investors Management Co.*, 44 S. E. C., at 646). But this rule is inherently imprecise, and imprecision prevents parties from ordering their actions in accord with legal requirements. Unless the parties have some guidance as to where the line is between permissible and impermissible disclosures and uses, neither corporate insiders nor analysts can be sure when the line is crossed. Cf. *Adler v. Klawans*, 267 F. 2d 840, 845 (CA2 1959) (Burger, J., sitting by designation).

¹⁸On its facts, this case is the unusual one. Dirks is an analyst in a broker-dealer firm, and he did interview management in the course of his investigation. He uncovered, however, startling information that required no analysis or exercise of judgment as to its market relevance. Nonetheless, the principle at issue here extends beyond these facts. The SEC's rule—applicable without regard to any breach by an insider—could have serious ramifications on reporting by analysts of investment views.

Despite the unusualness of Dirks' "find," the central role that he played in uncovering the fraud at Equity Funding, and that analysts in general can play in revealing information that corporations may have reason to withhold from the public, is an important one. Dirks' careful investigation brought to light a massive fraud at the corporation. And until the Equity Funding fraud was exposed, the information in the trading market was grossly inaccurate. But for Dirks' efforts, the fraud might well have gone undetected longer. See n. 8, *supra*.

worth of a corporation's securities. The analyst's judgment in this respect is made available in market letters or otherwise to clients of the firm. It is the nature of this type of information, and indeed of the markets themselves, that such information cannot be made simultaneously available to all of the corporation's stockholders or the public generally.

B

The conclusion that recipients of inside information do not invariably acquire a duty to disclose or abstain does not mean that such tippees always are free to trade on the information. The need for a ban on some tippee trading is clear. Not only are insiders forbidden by their fiduciary relationship from personally using undisclosed corporate information to their advantage, but they may not give such information to an outsider for the same improper purpose of exploiting the information for their personal gain. See 15 U. S. C. § 78t(b) (making it unlawful to do indirectly "by means of any other person" any act made unlawful by the federal securities laws). Similarly, the transactions of those who knowingly participate with the fiduciary in such a breach are "as forbidden" as transactions "on behalf of the trustee himself." *Mosser v. Darrow*, 341 U. S. 267, 272 (1951). See *Jackson v. Smith*, 254 U. S. 586, 589 (1921); *Jackson v. Ludeling*, 88 U. S. 616, 631-632 (1874). As the Court explained in *Mosser*, a contrary rule "would open up opportunities for devious dealings in the name of the others that the trustee could not conduct in his own." 341 U. S., at 271. See *SEC v. Texas Gulf Sulphur Co.*, 446 F. 2d 1301, 1308 (CA2), cert. denied, 404 U. S. 1005 (1971). Thus, the tippee's duty to disclose or abstain is derivative from that of the insider's duty. See Tr. of Oral Ar. 38. Cf. *Chiarella*, 445 U. S., at 246, n. 1 (BLACKMUN, J., dissenting). As we noted in *Chiarella*, "[t]he tippee's obligation has been viewed as arising from his role as a participant after the fact in the insider's breach of a fiduciary duty." 445 U. S., at 230, n. 12.

Thus, some tippees must assume an insider's duty to the shareholders not because they receive inside information, but rather because it has been made available to them *improperly*.¹⁹ And for Rule 10b-5 purposes, the insider's disclosure is improper only where it would violate his *Cady, Roberts* duty. Thus, a tippee assumes a fiduciary duty to the shareholders of a corporation not to trade on material nonpublic information only when the insider has breached his fiduciary duty to the shareholders by disclosing the information to the tippee and the tippee knows or should know that there has been a breach.²⁰ As Commissioner Smith perceptively ob-

¹⁹ The SEC itself has recognized that tippee liability properly is imposed only in circumstances where the tippee knows, or has reason to know, that the insider has disclosed improperly inside corporate information. In *Investors Management Co.*, *supra*, the SEC stated that one element of tippee liability is that the tippee knew or had reason to know "that [the information] was non-public and had been obtained *improperly* by selective revelation or otherwise." 44 S. E. C., at 641 (emphasis added). Commissioner Smith read this test to mean that a tippee can be held liable only if he received information in breach of an insider's duty not to disclose it. *Id.*, at 650 (concurring in the result).

²⁰ Professor Loss has linked tippee liability to the concept in the law of restitution that "[w]here a fiduciary in violation of his duty to the beneficiary communicates confidential information to a third person, the third person, if he had notice of the violation of duty, holds upon a constructive trust for the beneficiary any profit which he makes through the use of such information." 3 L. Loss, *Securities Regulation* 1451 (2d ed. 1961) (quoting Restatement of Restitution §201(2) (1937)). Other authorities likewise have expressed the view that tippee liability exists only where there has been a breach of trust by an insider of which the tippee had knowledge. See, e. g., *Ross v. Licht*, 263 F. Supp. 395, 410 (SDNY 1967); A. Jacobs, *The Impact of Rule 10b-5*, §167, at 7-4 (1975) ("[T]he better view is that a tipper must know or have reason to know the information is nonpublic and was improperly obtained."); Fleischer, *Mundheim & Murphy, An Initial Inquiry Into the Responsibility to Disclose Market Information*, 121 U. Pa. L. Rev. 798, 818, n. 76 (1973) ("The extension of rule 10b-5 restrictions to tippees of corporate insiders can best be justified on the theory that they are participating in the insider's breach of his fiduciary duty."). Cf. Restatement (Second) of Agency §312, comment c (1958) ("A person who,

served in *Investors Management Co.*: "[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" 44 S. E. C., at 651 (concurring in the result). Tipping thus properly is viewed only as a means of indirectly violating the *Cady, Roberts* disclose-or-abstain rule.²¹

C

In determining whether a tippee is under an obligation to disclose or abstain, it thus is necessary to determine whether

with notice that an agent is thereby violating his duty to his principal, receives confidential information from the agent, may be [deemed] . . . a constructive trustee."²²

²¹ We do not suggest that knowingly trading on inside information is ever "socially desirable or even that it is devoid of moral considerations." Dooley, *Enforcement of Insider Trading Restrictions*, 66 Va. L. Rev. 1, 55 (1980). Nor do we imply an absence of responsibility to disclose promptly indications of illegal actions by a corporation to the proper authorities—typically the SEC and exchange authorities in cases involving securities. Depending on the circumstances, and even where permitted by law, one's trading on material nonpublic information is behavior that may fall below ethical standards of conduct. But in a statutory area of the law such as securities regulation, where legal principles of general application must be applied, there may be "significant distinctions between actual legal obligations and ethical ideals." SEC, *Report of the Special Study of Securities Markets*, H. R. Doc. No. 95, 88th Cong., 1st Sess., pt. 1, pp. 237-238 (1963). The SEC recognizes this. At oral argument, the following exchange took place:

"QUESTION: So, it would not have satisfied his obligation under the law to go to the SEC first?

"[SEC's counsel]: That is correct. That an insider has to observe what has come to be known as the abstain or disclosure rule. Either the information has to be disclosed to the market if it is inside information . . . or the insider must abstain." Tr. of Oral Arg. 27.

Thus, it is clear that Rule 10b-5 does not impose any obligation simply to tell the SEC about the fraud before trading.

the insider's "tip" constituted a breach of the insider's fiduciary duty. All disclosures of confidential corporate information are not inconsistent with the duty insiders owe to shareholders. In contrast to the extraordinary facts of this case, the more typical situation in which there will be a question whether disclosure violates the insider's *Cady, Roberts* duty is when insiders disclose information to analysts. See n. 16, *supra*. In some situations, the insider will act consistently with his fiduciary duty to shareholders, and yet release of the information may affect the market. For example, it may not be clear—either to the corporate insider or to the recipient analyst—whether the information will be viewed as material nonpublic information. Corporate officials may mistakenly think the information already has been disclosed or that it is not material enough to affect the market. Whether disclosure is a breach of duty therefore depends in large part on the purpose of the disclosure. This standard was identified by the SEC itself in *Cady, Roberts*: a purpose of the securities laws was to eliminate "use of inside information for personal advantage." 40 S. E. C., at 912, n. 15. See n. 10, *supra*. Thus, the test is whether the insider personally will benefit, directly or indirectly, from his disclosure. Absent some personal gain, there has been no breach of duty to stockholders. And absent a breach by the insider, there is no derivative breach.²² As Commissioner Smith stated in *In-*

²² An example of a case turning on the court's determination that the disclosure did not impose any fiduciary duties on the recipient of the inside information is *Walton v. Morgan Stanley & Co.*, 623 F. 2d 796 (CA2 1980). There, the defendant investment banking firm, representing one of its own corporate clients, investigated another corporation that was a possible target of a takeover bid by its client. In the course of negotiations the investment banking firm was given, on a confidential basis, unpublished material information. Subsequently, after the proposed takeover was abandoned, the firm was charged with relying on the information when it traded in the target corporation's stock. For purposes of the decision, it was assumed that the firm knew the information was confidential, but that it had been

vestors Management Co.: "It is important in this type of case to focus on policing insiders and what they do . . . rather than on policing information *per se* and its possession. . . ." 44 S. E. C., at 648 (concurring in the result).

The SEC argues that, if inside-trading liability does not exist when the information is transmitted for a proper purpose but is used for trading, it would be a rare situation when the parties could not fabricate some ostensibly legitimate business justification for transmitting the information. We think the SEC is unduly concerned. In determining whether the insider's purpose in making a particular disclosure is fraudulent, the SEC and the courts are not required to read the parties' minds. *Scienter* in some cases is relevant in determining whether the tipper has violated his *Cady, Roberts* duty.³⁰ But to determine whether the disclosure itself "deceive[s], manipulate[s], or defraud[s]" shareholders, *Aaron v. SEC*, 446 U. S. 680, 686 (1980), the initial inquiry is whether there has been a breach of duty by the insider. This requires courts to focus on objective criteria, *i. e.*,

received in arm's-length negotiations. See *id.*, at 798. In the absence of any fiduciary relationship, the Court of Appeals found no basis for imposing tippee liability on the investment firm. See *id.*, at 799.

³⁰ *Scienter*—"a mental state embracing intent to deceive, manipulate, or defraud," *Ernst & Ernst v. Hochfelder*, 425 U. S. 185, 193, n. 12 (1976)—is an independent element of a Rule 10b-5 violation. See *Aaron v. SEC*, 446 U. S. 680, 695 (1980). Contrary to the dissent's suggestion, see *post*, at p. 7, n. 10, motivation is not irrelevant to the issue of *scienter*. It is not enough that an insider's conduct results in harm to investors; rather, a violation may be found only where there is "intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities." *Ernst & Ernst v. Hochfelder*, *supra*, at 199. The issue in this case, however, is not whether *Secrist* or *Dirks* acted with *scienter*, but rather whether there was any deceptive or fraudulent conduct at all, *i. e.*, whether *Secrist*'s disclosure constituted a breach of his fiduciary duty and thereby caused injury to shareholders. See n. 27, *infra*. Only if there was such a breach did *Dirks*, a tippee, acquire a fiduciary duty to disclose or abstain.

whether the insider receives a direct or indirect personal benefit from the disclosure, such as a pecuniary gain or a reputational benefit that will translate into future earnings. Cf. 40 S. E. C., at 912, n. 15; Brudney, *Insiders, Outsiders, and Informational Advantages Under the Federal Securities Laws*, 93 Harv. L. Rev. 324, 348 (1979) ("The theory . . . is that the insider, by giving the information out selectively, is in effect selling the information to its recipient for cash, reciprocal information, or other things of value for himself. . . ."). There are objective facts and circumstances that often justify such an inference. For example, there may be a relationship between the insider and the recipient that suggests a *quid pro quo* from the latter, or an intention to benefit the particular recipient. The elements of fiduciary duty and exploitation of nonpublic information also exist when an insider makes a gift of confidential information to a trading relative or friend. The tip and trade resemble trading by the insider himself followed by a gift of the profits to the recipient.

Determining whether an insider personally benefits from a particular disclosure, a question of fact, will not always be easy for courts. But it is essential, we think, to have a guiding principle for those whose daily activities must be limited and instructed by the SEC's inside-trading rules, and we believe that there must be a breach of the insider's fiduciary duty before the tippee inherits the duty to disclose or abstain. In contrast, the rule adopted by the SEC in this case would have no limiting principle.²⁴

²⁴ Without legal limitations, market participants are forced to rely on the reasonableness of the SEC's litigation strategy, but that can be hazardous, as the facts of this case make plain. Following the SEC's filing of the *Texas Gulf Sulphur* action, Commissioner (and later Chairman) Budge spoke of the various implications of applying Rule 10b-5 in inside-trading cases:

"Turning to the realm of possible defendants in the present and potential civil actions, the Commission certainly does not contemplate suing every

IV

Under the inside-trading and tipping rules set forth above, we find that there was no actionable violation by Dirks.²⁵ It is undisputed that Dirks himself was a stranger to Equity Funding, with no pre-existing fiduciary duty to its shareholders.²⁶ He took no action, directly or indirectly, that induced the shareholders or officers of Equity Funding to repose trust or confidence in him. There was no expectation by Dirks's sources that he would keep their information in confidence. Nor did Dirks misappropriate or illegally obtain the information about Equity Funding. Unless the insiders

person who may have come across inside information. In the Texas Gulf action neither tippees nor persons in the vast rank and file of employees have been named as defendants. In my view, the Commission in future cases normally should not join rank and file employees or persons outside the company *such as an analyst or reporter* who learns of inside information." Speech of Hamer Budge to the New York Regional Group of the American Society of Corporate Secretaries, Inc. (Nov. 18, 1965) (emphasis added), reprinted in Budge, *The Texas Gulf Sulphur Case—What It Is and What It Isn't*, Corp. Secretary No. 127, at 6 (Dec. 17, 1965).

²⁵ Dirks contends that he was not a "tippee" because the information he received constituted unverified allegations of fraud that were denied by management and were not "material facts" under the securities laws that required disclosure before trading. He also argues that the information he received was not truly "inside" information, *i. e.*, intended for a confidential corporate purpose, but was merely evidence of a crime. The Solicitor General agrees. See Brief for United States as *Amicus Curiae* 22. We need not decide, however, whether the information constituted "material facts," or whether information concerning corporate crime is properly characterized as "inside information." For purposes of deciding this case, we assume the correctness of the SEC's findings, accepted by the Court of Appeals, that petitioner was a tippee of material inside information.

²⁶ Judge Wright found that Dirks acquired a fiduciary duty by virtue of his position as an employee of a broker-dealer. See 220 U. S. App. D. C., at 325-327, 681 F. 2d, at 840-842. The SEC, however, did not consider Judge Wright's novel theory in its decision, nor did it present that theory to the Court of Appeals. The SEC also has not argued Judge Wright's theory in this Court. See Brief for Respondent 21, n. 27. The merits of such a duty are therefore not before the Court. See *SEC v. Chenery Corp.*, 332 U. S. 194, 196-197 (1947).

breached their *Cady, Roberts* duty to shareholders in disclosing the nonpublic information to Dirks, he breached no duty when he passed it on to investors as well as to the *Wall Street Journal*.

It is clear that neither Secrist nor the other Equity Funding employees violated their *Cady, Roberts* duty to the corporation's shareholders by providing information to Dirks.²⁷

²⁷ In this Court, the SEC appears to contend that an insider invariably violates a fiduciary duty to the corporation's shareholders by transmitting nonpublic corporate information to an outsider when he has reason to believe that the outsider may use it to the disadvantage of the shareholders. "Thus, regardless of any ultimate motive to bring to public attention the derelictions at Equity Funding, Secrist breached his duty to Equity Funding shareholders." Brief for Respondent 31. This perceived "duty" differs markedly from the one that the SEC identified in *Cady, Roberts* and that has been the basis for federal tippee-trading rules to date. In fact, the SEC did not charge Secrist with any wrongdoing, and we do not understand the SEC to have relied on any theory of a breach of duty by Secrist in finding that Dirks breached his duty to Equity Funding's shareholders. See App. 250 (decision of administrative law judge) ("One who knows himself to be a beneficiary of non-public, selectively disclosed inside information must fully disclose or refrain from trading."); SEC's Reply to Notice of Supplemental Authority before the SEC 4 ("If Secrist was acting properly, Dirks inherited a duty to [Equity Funding]'s shareholders to refrain from improper private use of the information."); Brief on behalf of the SEC in the Court of Appeals, at 47-50; *id.*, at 51 ("[K]nowing possession of inside information by any person imposes a duty to abstain or disclose."); *id.*, at 52-54; *id.*, at 55 ("[T]his obligation arises not from the manner in which such information is acquired. . . ."); 220 U. S. App. D. C., at 322-323, 681 F. 2d, at 838 (Wright, J.).

The dissent argues that "Secrist violated his duty to Equity Funding shareholders by transmitting material nonpublic information to Dirks with the intention that Dirks would cause his clients to trade on that information." *Post*, at 12. By perceiving a breach of fiduciary duty whenever inside information is intentionally disclosed to securities traders, the dissenting opinion effectively would achieve the same result as the SEC's theory below, *i. e.*, mere possession of inside information while trading would be viewed as a Rule 10b-5 violation. But *Chiarella* made it explicitly clear there is no general duty to forgo market transactions "based on material, nonpublic information." 455 U. S., at 233. Such a duty would "depar(t) radically from the established doctrine that duty arises from a specific rela-

The tippers received no monetary or personal benefit for revealing Equity Funding's secrets, nor was their purpose to make a gift of valuable information to Dirks. As the facts of this case clearly indicate, the tippers were motivated by a desire to expose the fraud. See *supra*, at 1-2. In the absence of a breach of duty to shareholders by the insiders, there was no derivative breach by Dirks. See n. 18, *supra*. Dirks therefore could not have been "a participant after the fact in [an] insider's breach of a fiduciary duty." *Chiarella*, 445 U. S., at 230, n. 12.

(20)
^

V

We conclude that Dirks, in the circumstances of this case,

relationship between two parties." *Ibid.* See p. 7, *supra*.

Moreover, to constitute a violation of Rule 10b-5, there must be fraud. See *Ernst & Ernst v. Hochfelder*, 425 U. S. 185, 199 (1976) (statutory words "manipulative," "device," and "contrivance . . . connote[] intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities") (emphasis added). There is no evidence that Secrist's disclosure was intended to or did in fact "deceive or defraud" anyone. Secrist certainly intended to convey relevant information that management was unlawfully concealing, and—so far as the record shows—he believed that persuading Dirks to investigate was the best way to disclose the fraud. Other efforts had proved fruitless. Under any objective standard, Secrist received no direct or indirect personal benefit from the disclosure.

The dissenting opinion focuses on shareholder "losses," "injury," and "damages," but as the court noted in *Friedrich v. Bradford*, 542 F. 2d 307, 318 (CA6 1976), cert. denied, 429 U. S. 1053 (1977), there is no clear causal connection between inside trading and outsiders' losses: "Investors must be prepared to accept the risk of trading in an open market without complete or always accurate information." In one sense, as market values fluctuate and investors act on inevitably incomplete or incorrect information, there always are winners and losers; but those who have "lost" have not necessarily been defrauded. On the other hand, inside trading for personal gain is fraudulent, and is a violation of the federal securities laws. See *Dooley, supra*, at 39-41, 70. Thus, there is little legal significance to the dissent's argument that Secrist and Dirks created new "victims" by disclosing the information to persons who traded. In fact, they prevented the fraud from continuing and victimizing many more investors.

had no duty to abstain from use of the inside information that he obtained. The judgment of the Court of Appeals therefore is

Reversed.

JUN 27 1983

Justice -

On p. 20, n. 27, I added
two words for stylistic purposes.
OK? I apologize for not
pointing that out to you
earlier today. JOE

3rd DRAFT

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

From: **Justice Powell**

Circulated: _____

Recirculated: _____

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SUPREME COURT OF THE UNITED STATES

No. 82-276

RAYMOND L. DIRKS, PETITIONER v. SECURITIES
AND EXCHANGE COMMISSION

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF
APPEALS FOR DISTRICT OF COLUMBIA

[June —, 1983]

JUSTICE POWELL delivered the opinion of the Court.

Petitioner Raymond Dirks received material nonpublic information from "insiders" of a corporation with which he had no connection. He disclosed this information to investors who relied on it in trading in the shares of the corporation. The question is whether Dirks violated the antifraud provisions of the federal securities laws by this disclosure.

I

In 1973, Dirks was an officer of a New York broker-dealer firm who specialized in providing investment analysis of insurance company securities to institutional investors.¹ On March 6, Dirks received information from Ronald Secrist, a former officer of Equity Funding of America. Secrist alleged that the assets of Equity Funding, a diversified corporation primarily engaged in selling life insurance and mutual funds, were vastly overstated as the result of fraudulent corporate practices. Secrist also stated that various regula-

¹The facts stated here are taken from more detailed statements set forth by the administrative law judge, App. 176-180, 225-247; the opinion of the Securities and Exchange Commission, 21 S. E. C. Docket 1401, 1402-1406 (1981); and the opinion of Judge Wright in the Court of Appeals, 220 U. S. App. D. C. 309, 314-318, 681 F. 2d 824, 829-833 (1982).

tory agencies had failed to act on similar charges made by Equity Funding employees. He urged Dirks to verify the fraud and disclose it publicly.

Dirks decided to investigate the allegations. He visited Equity Funding's headquarters in Los Angeles and interviewed several officers and employees of the corporation. The senior management denied any wrongdoing, but certain corporation employees corroborated the charges of fraud. Neither Dirks nor his firm owned or traded any Equity Funding stock, but throughout his investigation he openly discussed the information he had obtained with a number of clients and investors. Some of these persons sold their holdings of Equity Funding securities, including five investment advisers who liquidated holdings of more than \$16 million.²

While Dirks was in Los Angeles, he was in touch regularly with William Blundell, the *Wall Street Journal's* Los Angeles bureau chief. Dirks urged Blundell to write a story on the fraud allegations. Blundell did not believe, however, that such a massive fraud could go undetected and declined to write the story. He feared that publishing such damaging hearsay might be libelous.

During the two-week period in which Dirks pursued his investigation and spread word of Secrist's charges, the price of Equity Funding stock fell from \$26 per share to less than \$15 per share. This led the New York Stock Exchange to halt trading on March 27. Shortly thereafter California insur-

²Dirks received from his firm a salary plus a commission for securities transactions above a certain amount that his clients directed through his firm. See 21 S. E. C. Docket, at 1402, n. 3. But "[i]t is not clear how many of those with whom Dirks spoke promised to direct some brokerage business through [Dirks' firm] to compensate Dirks, or how many actually did so." 220 U. S. App. D. C., at 316, 681 F. 2d, at 831. The Boston Company Institutional Investors, Inc., promised Dirks about \$25,000 in commissions, but it is unclear whether Boston actually generated any brokerage business for his firm. See App. 199, 204-205; 21 S. E. C. Docket, at 1404, n. 10; 220 U. S. App. D. C., at 316, n. 5, 681 F. 2d, at 831, n. 5.

ance authorities impounded Equity Funding's records and uncovered evidence of the fraud. Only then did the Securities and Exchange Commission (SEC) file a complaint against Equity Funding³ and only then, on April 2, did the *Wall Street Journal* publish a front-page story based largely on information assembled by Dirks. Equity Funding immediately went into receivership.⁴

The SEC began an investigation into Dirks' role in the exposure of the fraud. After a hearing by an administrative law judge, the SEC found that Dirks had aided and abetted violations of § 17(a) of the Securities Act of 1933, 15 U. S. C. § 77q(a),⁵ § 10(b) of the Securities Exchange Act of 1934, 15 U. S. C. § 78j(b),⁶ and SEC Rule 10b-5, 17 CFR § 240.10b-5

³As early as 1971, the SEC had received allegations of fraudulent accounting practices at Equity Funding. Moreover, on March 9, 1973, an official of the California Insurance Department informed the SEC's regional office in Los Angeles of Secrist's charges of fraud. Dirks himself voluntarily presented his information at the SEC's regional office beginning on March 27.

⁴A federal grand jury in Los Angeles subsequently returned a 105-count indictment against 22 persons, including many of Equity Funding's officers and directors. All defendants were found guilty of one or more counts, either by a plea of guilty or a conviction after trial. See Brief for Petitioner 15; App. 149-153.

⁵Section 17(a) provides:

"It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

"(1) to employ any device, scheme, or artifice to defraud, or

"(2) to obtain money or property by means of any untrue statement of a material fact or any omission 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

"(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser."

⁶Section 10(b) provides:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of

(1982),⁷ by repeating the allegations of fraud to members of the investment community who later sold their Equity Funding stock. The SEC concluded: "Where 'tippees'—regardless of their motivation or occupation—come into possession of material 'information that they know is confidential and know or should know came from a corporate insider,' they must either publicly disclose that information or refrain from trading." 21 S. E. C. Docket 1401, 1407 (1981) (footnote omitted) (quoting *Chiarella v. United States*, 445 U. S. 222, 230 n. 12 (1980)). Recognizing, however, that Dirks "played an important role in bringing [Equity Funding's] massive fraud to light," 21 S. E. C. Docket, at 1412,⁸ the SEC only censured him.⁹

any facility of any national securities exchange—

"(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

⁷ Rule 10b-5 provides:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

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

"(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

"(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."

⁸JUSTICE BLACKMUN's dissenting opinion minimizes the role Dirks played in making public the Equity Funding fraud. See *post*, at 3 and 11, n. 15. The dissent would rewrite the history of Dirks' extensive investigative efforts. See, e. g., 21 S. E. C., at 1412 ("It is clear that Dirks played an important role in bringing [Equity Funding's] massive fraud to light, and it is also true that he reported the fraud allegation to [Equity

Dirks sought review in the Court of Appeals for the District of Columbia Circuit. The court entered judgment against Dirks "for the reasons stated by the Commission in its opinion." App. to Pet. for Cert. C-2. Judge Wright, a member of the panel, subsequently issued an opinion. Judge Robb concurred in the result and Judge Tamm dissented; neither filed a separate opinion. Judge Wright believed that "the obligations of corporate fiduciaries pass to all those to whom they disclose their information before it has been disseminated to the public at large." 220 U. S. App. D. C. 309, 324, 681 F. 2d 824, 839 (1982). Alternatively, Judge Wright concluded that, as an employee of a broker-dealer, Dirks had violated "obligations to the SEC and to the public completely independent of any obligations he acquired" as a result of receiving the information. *Id.*, at 325, 681 F. 2d, at 840.

In view of the importance to the SEC and to the securities industry of the question presented by this case, we granted a writ of certiorari. — U. S. — (1982). We now reverse.

II

In the seminal case of *In re Cady, Roberts & Co.*, 40 S. E. C. 907 (1961), the SEC recognized that the common law in some jurisdictions imposes on "corporate 'insiders,' particularly officers, directors, or controlling stockholders" an "affirmative duty of disclosure . . . when dealing in securities." *Id.*, at 911, and n. 13.¹⁰ The SEC found that not only

Funding's) auditors and sought to have the information published in the *Wall Street Journal*."); 681 F. 2d, at 829 (Wright, J.) ("Largely thanks to Dirks one of the most infamous frauds in recent memory was uncovered and exposed, while the record shows that the SEC repeatedly missed opportunities to investigate Equity Funding.").

¹⁰Section 15 of the Securities Exchange Act, 15 U. S. C. § 78o(b)(4)(E), provides that the SEC may impose certain sanctions, including censure, on any person associated with a registered broker-dealer who has "willfully aided [or] abetted" any violation of the federal securities laws. See 15 U. S. C. § 78ff(a) (providing criminal penalties).

¹¹The duty that insiders owe to the corporation's shareholders not to

did breach of this common-law duty also establish the elements of a Rule 10b-5 violation,¹¹ but that individuals other than corporate insiders could be obligated either to disclose material nonpublic information¹² before trading or to abstain from trading altogether. *Id.*, at 912. In *Chiarella*, we accepted the two elements set out in *Cady Roberts* for establishing a Rule 10b-5 violation: "(i) the existence of a relationship affording access to inside information intended to be available only for a corporate purpose, and (ii) the unfairness of allowing a corporate insider to take advantage of that information by trading without disclosure." 445 U. S., at 227. In examining whether *Chiarella* had an obligation to disclose or abstain, the Court found that there is no general duty to disclose before trading on material nonpublic information,¹³

trade on inside information differs from the common-law duty that officers and directors also have to the corporation itself not to mismanage corporate assets, of which confidential information is one. See 3 Fletcher Cyclopedia of the Laws of Private Corporations §§ 848, 900 (1975 ed. and Supp. 1982); 3A Fletcher §§ 1168.1, 1168.2. In holding that breaches of this duty to shareholders violated the Securities Exchange Act, the *Cady Roberts* Commission recognized, and we agree, that "[a] significant purpose of the Exchange Act was to eliminate the idea that use of inside information for personal advantage was a normal emolument of corporate office." See 40 S. E. C., at 912, n. 15.

¹¹ Rule 10b-5 is generally the most inclusive of the three provisions on which the SEC rested its decision in this case, and we will refer to it when we note the statutory basis for the SEC's inside-trading rules.

¹² The SEC views the disclosure duty as requiring more than disclosure to purchasers or sellers: "Proper and adequate disclosure of significant corporate developments can only be effected by a public release through the appropriate public media, designed to achieve a broad dissemination to the investing public generally and without favoring any special person or group." *In re Faberge, Inc.*, 45 S. E. C. 249, 256 (1973).

¹³ See 445 U. S., at 233; *id.*, at 237 (STEVENS, J., concurring); *id.*, at 238-239 (BRENNAN, J., concurring in the judgment); *id.*, at 239-240 (BURGER, C. J., dissenting). Cf. *id.*, at 252, n. 2 (BLACKMUN, J., dissenting) (recognizing that there is no obligation to disclose material nonpublic information obtained through the exercise of "diligence or acumen" and "hon-

and held that "a duty to disclose under § 10(b) does not arise from the mere possession of nonpublic market information." *Id.*, at 235. Such a duty arises rather from the existence of a fiduciary relationship. See *id.*, at 227-235.

Not "all breaches of fiduciary duty in connection with a securities transaction," however, come within the ambit of Rule 10b-5. *Santa Fe Industries, Inc. v. Green*, 430 U. S. 462, 472 (1977). There must also be "manipulation or deception." *Id.*, at 473. In an inside-trading case this fraud derives from the "inherent unfairness involved where one takes advantage" of "information intended to be available only for a corporate purpose and not for the personal benefit of anyone." *In re Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 43 S. E. C. 933, 936 (1968). Thus, an insider will be liable under Rule 10b-5 for inside trading only where he fails to disclose material nonpublic information before trading on it and thus makes "secret profits." *Cady, Roberts*, 40 S. E. C., at 916, n. 31.

III

We were explicit in *Chiarella* in saying that there can be no duty to disclose where the person who has traded on inside information "was not [the corporation's] agent, . . . was not a fiduciary, [or] was not a person in whom the sellers [of the securities] had placed their trust and confidence." 445 U. S., at 232. Not to require such a fiduciary relationship, we recognized, would "depar[t] radically from the established doctrine that duty arises from a specific relationship between two parties" and would amount to "recognizing a general duty between all participants in market transactions to forgo actions based on material, nonpublic information." *Id.*, at 232, 233. This requirement of a specific relationship between the shareholders and the individual trading on inside information has created analytical difficulties for the SEC

est means," as opposed to "stealth").

and courts in policing tippees who trade on inside information. Unlike insiders who have independent fiduciary duties to both the corporation and its shareholders, the typical tippee has no such relationships.¹⁴ In view of this absence, it has been unclear how a tippee acquires the *Cady, Roberts* duty to refrain from trading on inside information.

A

The SEC's position, as stated in its opinion in this case, is that a tippee "inherits" the *Cady, Roberts* obligation to shareholders whenever he receives inside information from an insider:

"In tipping potential traders, Dirks breached a duty which he had assumed as a result of knowingly receiving confidential information from [Equity Funding] insiders. Tippees such as Dirks who receive non-public material information from insiders become 'subject to the same duty as [the] insiders.' *Shapiro v. Merrill Lynch*,

¹⁴Under 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 rather 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. See *SEC v. Monarch Fund*, 608 F. 2d 938, 942 (CA2 1979); *In re Investors Management Co.*, 44 S. E. C. 633, 645 (1971); *In re Van Aylstne, Noel & Co.*, 43 S. E. C. 1080, 1084-1085 (1969); *In re Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 43 S. E. C. 933, 937 (1968); *Cady, Roberts*, 40 S. E. C., at 912. When such a person breaches his fiduciary relationship, he may be treated more properly as a tipper than a tippee. See *Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 495 F. 2d 228, 237 (CA2 1974) (investment banker had access to material information when working on a proposed public offering for the corporation). For such a duty to be imposed, however, the corporation must expect the outsider to keep the disclosed nonpublic information confidential, and the relationship at least must imply such a duty.

Pierce, Fenner & Smith, Inc. [495 F. 2d 228, 237 (CA2 1974) (quoting *Ross v. Licht*, 263 F. Supp. 395, 410 (SDNY 1967))]. Such a tippee breaches the fiduciary duty which he assumes from the insider when the tippee knowingly transmits the information to someone who will probably trade on the basis thereof. . . . Presumably, Dirks' informants were entitled to disclose the [Equity Funding] fraud in order to bring it to light and its perpetrators to justice. However, Dirks—standing in their shoes—committed a breach of the fiduciary duty which he had assumed in dealing with them, when he passed the information on to traders." 21 S. E. C. Docket, at 1410, n. 42.

This view differs little from the view that we rejected as inconsistent with congressional intent in *Chiarella*. In that case, the Court of Appeals agreed with the SEC and affirmed *Chiarella*'s conviction, holding 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." *United States v. Chiarella*, 588 F. 2d 1358, 1365 (CA2 1978) (emphasis in original). Here, the SEC maintains that anyone who knowingly receives nonpublic material information from an insider has a fiduciary duty to disclose before trading.¹⁵

¹⁵ Apparently, the SEC believes this case differs from *Chiarella* in that Dirks' receipt of inside information from Secrist, an insider, carried Secrist's duties with it, while *Chiarella* received the information without the direct involvement of an insider and thus inherited no duty to disclose or abstain. The SEC fails to explain, however, why the receipt of nonpublic information from an insider automatically carries with it the fiduciary duty of the insider. As we emphasized in *Chiarella*, mere possession of nonpublic information does not give rise to a duty to disclose or abstain; only a specific relationship does that. And we do not believe that the mere receipt of information from an insider creates such a special relationship between the tippee and the corporation's shareholders.

Apparently recognizing the weakness of its argument in light of *Chia-*

In effect, the SEC's theory of tippee liability in both cases appears rooted in the idea that the antifraud provisions require equal information among all traders. This conflicts with 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.¹⁵ Judge Wright correctly read our opinion in *Chiarella* as repudiating any notion that all traders must enjoy equal information before trading: "[T]he 'information' theory is rejected. Because the disclose-or-refrain duty is extraordinary, it attaches only when a party has legal obligations other than a mere duty to comply with the general antifraud prescriptions in the federal securities laws." 220 U. S. App. D. C., at 322, 681 F. 2d, at 837. See *Chiarella*, 445 U. S., at 235, n. 20. We reaffirm today that "[a] duty [to disclose] arises from the relationship between parties . . . and not merely from one's ability to acquire information because of his position in the market." 445 U. S., at 232-233, n. 14.

rella, the SEC attempts to distinguish that case factually as involving not "inside" information, but rather "market" information, i. e., "information generated within the company relating to its assets or earnings." Brief for Respondent 23. This Court drew no such distinction in *Chiarella* and, as THE CHIEF JUSTICE noted, "[i]t is clear that § 10(b) and Rule 10b-5 by their terms and by their history make no such distinction." 445 U. S., at 241, n. 1 (dissenting opinion). See ALI Fed. Sec. Code § 1603, Comment (2)(j) (Proposed Official Draft 1978).

"In *Chiarella*, we noted that formulation of an absolute equal information rule 'should not be undertaken absent some explicit evidence of congressional intent.' 445 U. S., at 233. Rather than adopting such a radical view of securities trading, Congress has expressly exempted many market professionals from the general statutory prohibition set forth in § 11(a)(1) of the Securities Exchange Act, 15 U. S. C. § 78k(a)(1), against members of a national securities exchange trading for their own account. See *id.*, at 233, n. 16. We observed in *Chiarella* that '[t]he exception is based upon Congress' recognition that [market professionals] contribute to a fair and orderly marketplace at the same time they exploit the informational advantage that comes from their possession of [nonpublic information].' *Ibid.*

Imposing a duty to disclose or abstain solely because a person knowingly receives material nonpublic information from an insider and trades on it could have an inhibiting influence on the role of market analysts, which the SEC itself recognizes is necessary to the preservation of a healthy market.¹⁷ It is commonplace for analysts to "ferret out and analyze information," 21 S. E. C., at 1406,¹⁸ and this often is done by meeting with and questioning corporate officers and others who are insiders. And information that the analysts obtain normally may be the basis for judgments as to the market

¹⁷ The SEC expressly recognized that "[t]he value to the entire market of [analysts'] efforts cannot be gainsaid; market efficiency in pricing is significantly enhanced by [their] initiatives to ferret out and analyze information, and thus the analyst's work redounds to the benefit of all investors." 21 S. E. C., at 1406. The SEC asserts that analysts remain free to obtain from management corporate information for purposes of "filling in the 'interstices in analysis'" Brief for Respondent 42 (quoting *Investors Management Co.*, 44 S. E. C., at 646). But this rule is inherently imprecise, and imprecision prevents parties from ordering their actions in accord with legal requirements. Unless the parties have some guidance as to where the line is between permissible and impermissible disclosures and uses, neither corporate insiders nor analysts can be sure when the line is crossed. Cf. *Adler v. Klawans*, 267 F. 2d 840, 845 (CA2 1959) (Burger, J., sitting by designation).

¹⁸ On its facts, this case is the unusual one. Dirks is an analyst in a broker-dealer firm, and he did interview management in the course of his investigation. He uncovered, however, startling information that required no analysis or exercise of judgment as to its market relevance. Nonetheless, the principle at issue here extends beyond these facts. The SEC's rule—applicable without regard to any breach by an insider—could have serious ramifications on reporting by analysts of investment views.

Despite the unusualness of Dirks' "find," the central role that he played in uncovering the fraud at Equity Funding, and that analysts in general can play in revealing information that corporations may have reason to withhold from the public, is an important one. Dirks' careful investigation brought to light a massive fraud at the corporation. And until the Equity Funding fraud was exposed, the information in the trading market was grossly inaccurate. But for Dirks' efforts, the fraud might well have gone undetected longer. See n. 8, *supra*.

worth of a corporation's securities. The analyst's judgment in this respect is made available in market letters or otherwise to clients of the firm. It is the nature of this type of information, and indeed of the markets themselves, that such information cannot be made simultaneously available to all of the corporation's stockholders or the public generally.

B

The conclusion that recipients of inside information do not invariably acquire a duty to disclose or abstain does not mean that such tippees always are free to trade on the information. The need for a ban on some tippee trading is clear. Not only are insiders forbidden by their fiduciary relationship from personally using undisclosed corporate information to their advantage, but they may not give such information to an outsider for the same improper purpose of exploiting the information for their personal gain. See 15 U. S. C. § 78t(b) (making it unlawful to do indirectly "by means of any other person" any act made unlawful by the federal securities laws). Similarly, the transactions of those who knowingly participate with the fiduciary in such a breach are "as forbidden" as transactions "on behalf of the trustee himself." *Mosser v. Darrow*, 341 U. S. 267, 272 (1951). See *Jackson v. Smith*, 254 U. S. 586, 589 (1921); *Jackson v. Ludeling*, 88 U. S. 616, 631-632 (1874). As the Court explained in *Mosser*, a contrary rule "would open up opportunities for devious dealings in the name of the others that the trustee could not conduct in his own." 341 U. S., at 271. See *SEC v. Texas Gulf Sulphur Co.*, 446 F. 2d 1301, 1308 (CA2), cert. denied, 404 U. S. 1005 (1971). Thus, the tippee's duty to disclose or abstain is derivative from that of the insider's duty. See Tr. of Oral Ar. 38. Cf. *Chiarella*, 445 U. S., at 246, n. 1 (BLACKMUN, J., dissenting). As we noted in *Chiarella*, "[t]he tippee's obligation has been viewed as arising from his role as a participant after the fact in the insider's breach of a fiduciary duty." 445 U. S., at 230, n. 12.

Thus, some tippees must assume an insider's duty to the shareholders not because they receive inside information, but rather because it has been made available to them *improperly*.¹⁹ And for Rule 10b-5 purposes, the insider's disclosure is improper only where it would violate his *Cady, Roberts* duty. Thus, a tippee assumes a fiduciary duty to the shareholders of a corporation not to trade on material nonpublic information only when the insider has breached his fiduciary duty to the shareholders by disclosing the information to the tippee and the tippee knows or should know that there has been a breach.²⁰ As Commissioner Smith perceptively ob-

¹⁹ The SEC itself has recognized that tippee liability properly is imposed only in circumstances where the tippee knows, or has reason to know, that the insider has disclosed improperly inside corporate information. In *Investors Management Co.*, *supra*, the SEC stated that one element of tippee liability is that the tippee knew or had reason to know "that [the information] was non-public and had been obtained *improperly* by selective revelation or otherwise." 44 S. E. C., at 641 (emphasis added). Commissioner Smith read this test to mean that a tippee can be held liable only if he received information in breach of an insider's duty not to disclose it. *Id.*, at 650 (concurring in the result).

²⁰ Professor Loss has linked tippee liability to the concept in the law of restitution that "[w]here a fiduciary in violation of his duty to the beneficiary communicates confidential information to a third person, the third person, if he had notice of the violation of duty, holds upon a constructive trust for the beneficiary any profit which he makes through the use of such information." 3 L. Loss, *Securities Regulation* 1451 (2d ed. 1961) (quoting Restatement of Restitution § 201(2) (1937)). Other authorities likewise have expressed the view that tippee liability exists only where there has been a breach of trust by an insider of which the tippee had knowledge. See, e. g., *Ross v. Licht*, 263 F. Supp. 395, 410 (SDNY 1967); A. Jacobs, *The Impact of Rule 10b-5*, § 167, at 7-4 (1975) ("[T]he better view is that a tipper must know or have reason to know the information is nonpublic and was improperly obtained."); Fleischer, *Mundheim & Murphy*, *An Initial Inquiry Into the Responsibility to Disclose Market Information*, 121 U. Pa. L. Rev. 798, 818, n. 76 (1973) ("The extension of rule 10b-5 restrictions to tippees of corporate insiders can best be justified on the theory that they are participating in the insider's breach of his fiduciary duty."). Cf. Restatement (Second) of Agency § 312, comment c (1958) ("A person who,

served in *Investors Management Co.*: "[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 . . ." 44 S. E. C., at 651 (concurring in the result). Tipping thus properly is viewed only as a means of indirectly violating the *Cady, Roberts* disclose-or-abstain rule.²¹

C

In determining whether a tippee is under an obligation to disclose or abstain, it thus is necessary to determine whether

with notice that an agent is thereby violating his duty to his principal, receives confidential information from the agent, may be [deemed] . . . a constructive trustee.").

"We do not suggest that knowingly trading on inside information is ever 'socially desirable or even that it is devoid of moral considerations.'" Dooley, *Enforcement of Insider Trading Restrictions*, 66 Va. L. Rev. 1, 55 (1980). Nor do we imply an absence of responsibility to disclose promptly indications of illegal actions by a corporation to the proper authorities—typically the SEC and exchange authorities in cases involving securities. Depending on the circumstances, and even where permitted by law, one's trading on material nonpublic information is behavior that may fall below ethical standards of conduct. But in a statutory area of the law such as securities regulation, where legal principles of general application must be applied, there may be "significant distinctions between actual legal obligations and ethical ideals." SEC, *Report of the Special Study of Securities Markets*, H. R. Doc. No. 95, 88th Cong., 1st Sess., pt. 1, pp. 237-238 (1963). The SEC recognizes this. At oral argument, the following exchange took place:

"QUESTION: So, it would not have satisfied his obligation under the law to go to the SEC first?

"[SEC's counsel]: That is correct. That an insider has to observe what has come to be known as the abstain or disclosure rule. Either the information has to be disclosed to the market if it is inside information . . . or the insider must abstain." Tr. of Oral Arg. 27.

Thus, it is clear that Rule 10b-5 does not impose any obligation simply to tell the SEC about the fraud before trading.

the insider's "tip" constituted a breach of the insider's fiduciary duty. All disclosures of confidential corporate information are not inconsistent with the duty insiders owe to shareholders. In contrast to the extraordinary facts of this case, the more typical situation in which there will be a question whether disclosure violates the insider's *Cady, Roberts* duty is when insiders disclose information to analysts. See n. 16, *supra*. In some situations, the insider will act consistently with his fiduciary duty to shareholders, and yet release of the information may affect the market. For example, it may not be clear—either to the corporate insider or to the recipient analyst—whether the information will be viewed as material nonpublic information. Corporate officials may mistakenly think the information already has been disclosed or that it is not material enough to affect the market. Whether disclosure is a breach of duty therefore depends in large part on the purpose of the disclosure. This standard was identified by the SEC itself in *Cady, Roberts*: a purpose of the securities laws was to eliminate "use of inside information for personal advantage." 40 S. E. C., at 912, n. 15. See n. 10, *supra*. Thus, the test is whether the insider personally will benefit, directly or indirectly, from his disclosure. Absent some personal gain, there has been no breach of duty to stockholders. And absent a breach by the insider, there is no derivative breach.²² As Commissioner Smith stated in *In-*

²² An example of a case turning on the court's determination that the disclosure did not impose any fiduciary duties on the recipient of the inside information is *Walton v. Morgan Stanley & Co.*, 623 F. 2d 796 (CA2 1980). There, the defendant investment banking firm, representing one of its own corporate clients, investigated another corporation that was a possible target of a takeover bid by its client. In the course of negotiations the investment banking firm was given, on a confidential basis, unpublished material information. Subsequently, after the proposed takeover was abandoned, the firm was charged with relying on the information when it traded in the target corporation's stock. For purposes of the decision, it was assumed that the firm knew the information was confidential, but that it had been

vestors Management Co.: "It is important in this type of case to focus on policing insiders and what they do . . . rather than on policing information *per se* and its possession. . . ." 44 S. E. C., at 648 (concurring in the result).

The SEC argues that, if inside-trading liability does not exist when the information is transmitted for a proper purpose but is used for trading, it would be a rare situation when the parties could not fabricate some ostensibly legitimate business justification for transmitting the information. We think the SEC is unduly concerned. In determining whether the insider's purpose in making a particular disclosure is fraudulent, the SEC and the courts are not required to read the parties' minds. *Scienter* in some cases is relevant in determining whether the tipper has violated his *Cady, Roberts* duty.²³ But to determine whether the disclosure itself "deceive[s], manipulate[s], or defraud[s]" shareholders, *Aaron v. SEC*, 446 U. S. 680, 686 (1980), the initial inquiry is whether there has been a breach of duty by the insider. This requires courts to focus on objective criteria, *i. e.*,

received in arm's-length negotiations. See *id.*, at 798. In the absence of any fiduciary relationship, the Court of Appeals found no basis for imposing tippee liability on the investment firm. See *id.*, at 799.

²³ *Scienter*—"a mental state embracing intent to deceive, manipulate, or defraud," *Ernst & Ernst v. Hochfelder*, 425 U. S. 185, 193, n. 12 (1976)—is an independent element of a Rule 10b-5 violation. See *Aaron v. SEC*, 446 U. S. 680, 695 (1980). Contrary to the dissent's suggestion, see *post*, at p. 7, n. 10, motivation is not irrelevant to the issue of *scienter*. It is not enough that an insider's conduct results in harm to investors; rather, a violation may be found only where there is "intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities." *Ernst & Ernst v. Hochfelder*, *supra*, at 199. The issue in this case, however, is not whether Secrist or Dirks acted with *scienter*, but rather whether there was any deceptive or fraudulent conduct at all, *i. e.*, whether Secrist's disclosure constituted a breach of his fiduciary duty and thereby caused injury to shareholders. See n. 27, *infra*. Only if there was such a breach did Dirks, a tippee, acquire a fiduciary duty to disclose or abstain.

whether the insider receives a direct or indirect personal benefit from the disclosure, such as a pecuniary gain or a reputational benefit that will translate into future earnings. Cf. 40 S. E. C., at 912, n. 15; Brudney, *Insiders, Outsiders, and Informational Advantages Under the Federal Securities Laws*, 93 Harv. L. Rev. 324, 348 (1979) ("The theory . . . is that the insider, by giving the information out selectively, is in effect selling the information to its recipient for cash, reciprocal information, or other things of value for himself. . . ."). There are objective facts and circumstances that often justify such an inference. For example, there may be a relationship between the insider and the recipient that suggests a *quid pro quo* from the latter, or an intention to benefit the particular recipient. The elements of fiduciary duty and exploitation of nonpublic information also exist when an insider makes a gift of confidential information to a trading relative or friend. The tip and trade resemble trading by the insider himself followed by a gift of the profits to the recipient.

Determining whether an insider personally benefits from a particular disclosure, a question of fact, will not always be easy for courts. But it is essential, we think, to have a guiding principle for those whose daily activities must be limited and instructed by the SEC's inside-trading rules, and we believe that there must be a breach of the insider's fiduciary duty before the tippee inherits the duty to disclose or abstain. In contrast, the rule adopted by the SEC in this case would have no limiting principle.²⁴

²⁴ Without legal limitations, market participants are forced to rely on the reasonableness of the SEC's litigation strategy, but that can be hazardous, as the facts of this case make plain. Following the SEC's filing of the *Texas Gulf Sulphur* action, Commissioner (and later Chairman) Budge spoke of the various implications of applying Rule 10b-5 in inside-trading cases:

"Turning to the realm of possible defendants in the present and potential civil actions, the Commission certainly does not contemplate suing every

IV

Under the inside-trading and tipping rules set forth above, we find that there was no actionable violation by Dirks.²⁵ It is undisputed that Dirks himself was a stranger to Equity Funding, with no pre-existing fiduciary duty to its shareholders.²⁶ He took no action, directly or indirectly, that induced the shareholders or officers of Equity Funding to repose trust or confidence in him. There was no expectation by Dirks's sources that he would keep their information in confidence. Nor did Dirks misappropriate or illegally obtain the information about Equity Funding. Unless the insiders

person who may have come across inside information. In the Texas Gulf action neither tippees nor persons in the vast rank and file of employees have been named as defendants. In my view, the Commission in future cases normally should not join rank and file employees or persons outside the company *such as an analyst or reporter* who learns of inside information." Speech of Hamer Budge to the New York Regional Group of the American Society of Corporate Secretaries, Inc. (Nov. 18, 1965) (emphasis added), reprinted in Budge, *The Texas Gulf Sulphur Case—What It Is and What It Isn't*, Corp. Secretary No. 127, at 6 (Dec. 17, 1965).

²⁵ Dirks contends that he was not a "tippee" because the information he received constituted unverified allegations of fraud that were denied by management and were not "material facts" under the securities laws that required disclosure before trading. He also argues that the information he received was not truly "inside" information, *i. e.*, intended for a confidential corporate purpose, but was merely evidence of a crime. The Solicitor General agrees. See Brief for United States as *Amicus Curiae* 22. We need not decide, however, whether the information constituted "material facts," or whether information concerning corporate crime is properly characterized as "inside information." For purposes of deciding this case, we assume the correctness of the SEC's findings, accepted by the Court of Appeals, that petitioner was a tippee of material inside information.

²⁶ Judge Wright found that Dirks acquired a fiduciary duty by virtue of his position as an employee of a broker-dealer. See 220 U. S. App. D. C., at 325-327, 681 F. 2d, at 840-842. The SEC, however, did not consider Judge Wright's novel theory in its decision, nor did it present that theory to the Court of Appeals. The SEC also has not argued Judge Wright's theory in this Court. See Brief for Respondent 21, n. 27. The merits of such a duty are therefore not before the Court. See *SEC v. Chenery Corp.*, 332 U. S. 194, 196-197 (1947).

breached their *Cady, Roberts* duty to shareholders in disclosing the nonpublic information to Dirks, he breached no duty when he passed it on to investors as well as to the *Wall Street Journal*.

It is clear that neither Secrist nor the other Equity Funding employees violated their *Cady, Roberts* duty to the corporation's shareholders by providing information to Dirks.²⁷

²⁷ In this Court, the SEC appears to contend that an insider invariably violates a fiduciary duty to the corporation's shareholders by transmitting nonpublic corporate information to an outsider when he has reason to believe that the outsider may use it to the disadvantage of the shareholders. "Thus, regardless of any ultimate motive to bring to public attention the derelictions at Equity Funding, Secrist breached his duty to Equity Funding shareholders." Brief for Respondent 31. This perceived "duty" differs markedly from the one that the SEC identified in *Cady, Roberts* and that has been the basis for federal tippee-trading rules to date. In fact, the SEC did not charge Secrist with any wrongdoing, and we do not understand the SEC to have relied on any theory of a breach of duty by Secrist in finding that Dirks breached his duty to Equity Funding's shareholders. See App. 250 (decision of administrative law judge) ("One who knows himself to be a beneficiary of non-public, selectively disclosed inside information must fully disclose or refrain from trading."); SEC's Reply to Notice of Supplemental Authority before the SEC 4 ("If Secrist was acting properly, Dirks inherited a duty to [Equity Funding]'s shareholders to refrain from improper private use of the information."); Brief on behalf of the SEC in the Court of Appeals, at 47-50; *id.*, at 51 ("[K]nowing possession of inside information by any person imposes a duty to abstain or disclose."); *id.*, at 52-54; *id.*, at 55 ("[T]his obligation arises not from the manner in which such information is acquired. . . ."); 220 U. S. App. D. C., at 322-323, 681 F. 2d, at 838 (Wright, J.).

The dissent argues that "Secrist violated his duty to Equity Funding shareholders by transmitting material nonpublic information to Dirks with the intention that Dirks would cause his clients to trade on that information." *Post*, at 12. By perceiving a breach of fiduciary duty whenever inside information is intentionally disclosed to securities traders, the dissenting opinion effectively would achieve the same result as the SEC's theory below, *i. e.*, mere possession of inside information while trading would be viewed as a Rule 10b-5 violation. But *Chiarella* made it explicitly clear there is no general duty to forgo market transactions "based on material, nonpublic information." 455 U. S., at 233. Such a duty would "depar[t] radically from the established doctrine that duty arises from a specific rela-

The tippers received no monetary or personal benefit for revealing Equity Funding's secrets, nor was their purpose to make a gift of valuable information to Dirks. As the facts of this case clearly indicate, the tippers were motivated by a desire to expose the fraud. See *supra*, at 1-2. In the absence of a breach of duty to shareholders by the insiders, there was no derivative breach by Dirks. See n. 19, *supra*. Dirks therefore could not have been "a participant after the fact in [an] insider's breach of a fiduciary duty." *Chiarella*, 445 U. S., at 230, n. 12.

V

We conclude that Dirks, in the circumstances of this case,

tionship between two parties." *Ibid.* See p. 7, *supra*.

Moreover, to constitute a violation of Rule 10b-5, there must be fraud. See *Ernst & Ernst v. Hochfelder*, 425 U. S. 185, 199 (1976) (statutory words "manipulative," "device," and "contrivance . . . connote intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities") (emphasis added). There is no evidence that Secrist's disclosure was intended to or did in fact "deceive or defraud" anyone. Secrist certainly intended to convey relevant information that management was unlawfully concealing, and—so far as the record shows—he believed that persuading Dirks to investigate was the best way to disclose the fraud. Other efforts had proved fruitless. Under any objective standard, Secrist received no direct or indirect personal benefit from the disclosure.

The dissenting opinion focuses on shareholder "losses," "injury," and "damages," but as the court noted in *Friedrich v. Bradford*, 542 F. 2d 307, 318 (CA6 1976), cert. denied, 429 U. S. 1053 (1977), there is no clear causal connection between inside trading and outsiders' losses: "Investors must be prepared to accept the risk of trading in an open market without complete or always accurate information." In one sense, as market values fluctuate and investors act on inevitably incomplete or incorrect information, there always are winners and losers; but those who have "lost" have not necessarily been defrauded. On the other hand, inside trading for personal gain is fraudulent, and is a violation of the federal securities laws. See *Dooley, supra*, at 39-41, 70. Thus, there is little legal significance to the dissent's argument that Secrist and Dirks created new "victims" by disclosing the information to persons who traded. In fact, they prevented the fraud from continuing and victimizing many more investors.

had no duty to abstain from use of the inside information that he obtained. The judgment of the Court of Appeals therefore is

Reversed.

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

From: **Justice Powell**

Circulated: _____

Recirculated: _____

JUN 28 1983

Changes: 1, 20

4th DRAFT

SUPREME COURT OF THE UNITED STATES

No. 82-276

**RAYMOND L. DIRKS, PETITIONER v. SECURITIES
AND EXCHANGE COMMISSION**

**ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF
APPEALS FOR DISTRICT OF COLUMBIA**

[June —, 1983]

JUSTICE POWELL delivered the opinion of the Court.

Petitioner Raymond Dirks received material nonpublic information from "insiders" of a corporation with which he had no connection. He disclosed this information to investors who relied on it in trading in the shares of the corporation. The question is whether Dirks violated the antifraud provisions of the federal securities laws by this disclosure.

I

In 1973, Dirks was an officer of a New York broker-dealer firm who specialized in providing investment analysis of insurance company securities to institutional investors.¹ On March 6, Dirks received information from Ronald Secrist, a former officer of Equity Funding of America. Secrist alleged that the assets of Equity Funding, a diversified corporation primarily engaged in selling life insurance and mutual funds, were vastly overstated as the result of fraudulent corporate practices. Secrist also stated that various regula-

¹ The facts stated here are taken from more detailed statements set forth by the administrative law judge, App. 176-180, 225-247; the opinion of the Securities and Exchange Commission, 21 S. E. C. Docket 1401, 1402-1406 (1981); and the opinion of Judge Wright in the Court of Appeals, 220 U. S. App. D. C. 309, 314-318, 681 F. 2d 824, 829-833 (1982).

*Announced
July 1, 1983*

tory agencies had failed to act on similar charges made by Equity Funding employees. He urged Dirks to verify the fraud and disclose it publicly.

Dirks decided to investigate the allegations. He visited Equity Funding's headquarters in Los Angeles and interviewed several officers and employees of the corporation. The senior management denied any wrongdoing, but certain corporation employees corroborated the charges of fraud. Neither Dirks nor his firm owned or traded any Equity Funding stock, but throughout his investigation he openly discussed the information he had obtained with a number of clients and investors. Some of these persons sold their holdings of Equity Funding securities, including five investment advisers who liquidated holdings of more than \$16 million.²

While Dirks was in Los Angeles, he was in touch regularly with William Blundell, the *Wall Street Journal's* Los Angeles bureau chief. Dirks urged Blundell to write a story on the fraud allegations. Blundell did not believe, however, that such a massive fraud could go undetected and declined to write the story. He feared that publishing such damaging hearsay might be libelous.

During the two-week period in which Dirks pursued his investigation and spread word of Secrist's charges, the price of Equity Funding stock fell from \$26 per share to less than \$15 per share. This led the New York Stock Exchange to halt trading on March 27. Shortly thereafter California insur-

² Dirks received from his firm a salary plus a commission for securities transactions above a certain amount that his clients directed through his firm. See 21 S. E. C. Docket, at 1402, n. 3. But "[i]t is not clear how many of those with whom Dirks spoke promised to direct some brokerage business through [Dirks' firm] to compensate Dirks, or how many actually did so." 220 U. S. App. D. C., at 316, 681 F. 2d, at 831. The Boston Company Institutional Investors, Inc., promised Dirks about \$25,000 in commissions, but it is unclear whether Boston actually generated any brokerage business for his firm. See App. 199, 204-205; 21 S. E. C. Docket, at 1404, n. 10; 220 U. S. App. D. C., at 316, n. 5, 681 F. 2d, at 831, n. 5.

ance authorities impounded Equity Funding's records and uncovered evidence of the fraud. Only then did the Securities and Exchange Commission (SEC) file a complaint against Equity Funding³ and only then, on April 2, did the *Wall Street Journal* publish a front-page story based largely on information assembled by Dirks. Equity Funding immediately went into receivership.⁴

The SEC began an investigation into Dirks' role in the exposure of the fraud. After a hearing by an administrative law judge, the SEC found that Dirks had aided and abetted violations of § 17(a) of the Securities Act of 1933, 15 U. S. C. § 77q(a),⁵ § 10(b) of the Securities Exchange Act of 1934, 15 U. S. C. § 78j(b),⁶ and SEC Rule 10b-5, 17 CFR § 240.10b-5

³ As early as 1971, the SEC had received allegations of fraudulent accounting practices at Equity Funding. Moreover, on March 9, 1973, an official of the California Insurance Department informed the SEC's regional office in Los Angeles of Secrist's charges of fraud. Dirks himself voluntarily presented his information at the SEC's regional office beginning on March 27.

⁴ A federal grand jury in Los Angeles subsequently returned a 105-count indictment against 22 persons, including many of Equity Funding's officers and directors. All defendants were found guilty of one or more counts, either by a plea of guilty or a conviction after trial. See Brief for Petitioner 15; App. 149-153.

⁵ Section 17(a) provides:

"It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

"(1) to employ any device, scheme, or artifice to defraud, or

"(2) to obtain money or property by means of any untrue statement of a material fact or any omission 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

"(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser."

⁶ Section 10(b) provides:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of

(1982),⁷ by repeating the allegations of fraud to members of the investment community who later sold their Equity Funding stock. The SEC concluded: "Where 'tippees'—regardless of their motivation or occupation—come into possession of material 'information that they know is confidential and know or should know came from a corporate insider,' they must either publicly disclose that information or refrain from trading." 21 S. E. C. Docket 1401, 1407 (1981) (footnote omitted) (quoting *Chiarella v. United States*, 445 U. S. 222, 230 n. 12 (1980)). Recognizing, however, that Dirks "played an important role in bringing [Equity Funding's] massive fraud to light," 21 S. E. C. Docket, at 1412,⁸ the SEC only censured him.⁹

any facility of any national securities exchange—

"(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

⁷ Rule 10b-5 provides:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

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

"(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

"(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."

⁸ JUSTICE BLACKMUN's dissenting opinion minimizes the role Dirks played in making public the Equity Funding fraud. See *post*, at 3 and 11, n. 15. The dissent would rewrite the history of Dirks' extensive investigative efforts. See, e. g., 21 S. E. C., at 1412 ("It is clear that Dirks played an important role in bringing [Equity Funding's] massive fraud to light, and it is also true that he reported the fraud allegation to [Equity

Dirks sought review in the Court of Appeals for the District of Columbia Circuit. The court entered judgment against Dirks "for the reasons stated by the Commission in its opinion." App. to Pet. for Cert. C-2. Judge Wright, a member of the panel, subsequently issued an opinion. Judge Robb concurred in the result and Judge Tamm dissented; neither filed a separate opinion. Judge Wright believed that "the obligations of corporate fiduciaries pass to all those to whom they disclose their information before it has been disseminated to the public at large." 220 U. S. App. D. C. 309, 324, 681 F. 2d 824, 839 (1982). Alternatively, Judge Wright concluded that, as an employee of a broker-dealer, Dirks had violated "obligations to the SEC and to the public completely independent of any obligations he acquired" as a result of receiving the information. *Id.*, at 325, 681 F. 2d, at 840.

In view of the importance to the SEC and to the securities industry of the question presented by this case, we granted a writ of certiorari. — U. S. — (1982). We now reverse.

II

In the seminal case of *In re Cady, Roberts & Co.*, 40 S. E. C. 907 (1961), the SEC recognized that the common law in some jurisdictions imposes on "corporate 'insiders,' particularly officers, directors, or controlling stockholders" an "affirmative duty of disclosure . . . when dealing in securities." *Id.*, at 911, and n. 13.¹⁰ The SEC found that not only

Funding's] auditors and sought to have the information published in the *Wall Street Journal*"); 681 F. 2d, at 829 (Wright, J.) ("Largely thanks to Dirks one of the most infamous frauds in recent memory was uncovered and exposed, while the record shows that the SEC repeatedly missed opportunities to investigate Equity Funding.").

⁹Section 15 of the Securities Exchange Act, 15 U. S. C. § 78o(b)(4)(E), provides that the SEC may impose certain sanctions, including censure, on any person associated with a registered broker-dealer who has "willfully aided [or] abetted" any violation of the federal securities laws. See 15 U. S. C. § 78ff(a) (providing criminal penalties).

¹⁰The duty that insiders owe to the corporation's shareholders not to

did breach of this common-law duty also establish the elements of a Rule 10b-5 violation,¹¹ but that individuals other than corporate insiders could be obligated either to disclose material nonpublic information¹² before trading or to abstain from trading altogether. *Id.*, at 912. In *Chiarella*, we accepted the two elements set out in *Cady Roberts* for establishing a Rule 10b-5 violation: "(i) the existence of a relationship affording access to inside information intended to be available only for a corporate purpose, and (ii) the unfairness of allowing a corporate insider to take advantage of that information by trading without disclosure." 445 U. S., at 227. In examining whether *Chiarella* had an obligation to disclose or abstain, the Court found that there is no general duty to disclose before trading on material nonpublic information,¹³

trade on inside information differs from the common-law duty that officers and directors also have to the corporation itself not to mismanage corporate assets, of which confidential information is one. See 3 *Fletcher Cyclopedia of the Laws of Private Corporations* §§ 848, 900 (1975 ed. and Supp. 1982); 3A *Fletcher* §§ 1168.1, 1168.2. In holding that breaches of this duty to shareholders violated the Securities Exchange Act, the *Cady Roberts* Commission recognized, and we agree, that "[a] significant purpose of the Exchange Act was to eliminate the idea that use of inside information for personal advantage was a normal emolument of corporate office." See 40 S. E. C., at 912, n. 15.

¹¹ Rule 10b-5 is generally the most inclusive of the three provisions on which the SEC rested its decision in this case, and we will refer to it when we note the statutory basis for the SEC's inside-trading rules.

¹² The SEC views the disclosure duty as requiring more than disclosure to purchasers or sellers: "Proper and adequate disclosure of significant corporate developments can only be effected by a public release through the appropriate public media, designed to achieve a broad dissemination to the investing public generally and without favoring any special person or group." *In re Faberge, Inc.*, 45 S. E. C. 249, 256 (1973).

¹³ See 445 U. S., at 233; *id.*, at 237 (STEVENS, J., concurring); *id.*, at 238-239 (BRENNAN, J., concurring in the judgment); *id.*, at 239-240 (BURGER, C. J., dissenting). Cf. *id.*, at 252, n. 2 (BLACKMUN, J., dissenting) (recognizing that there is no obligation to disclose material nonpublic information obtained through the exercise of "diligence or acumen" and "hon-

and held that "a duty to disclose under § 10(b) does not arise from the mere possession of nonpublic market information." *Id.*, at 235. Such a duty arises rather from the existence of a fiduciary relationship. See *id.*, at 227-235.

Not "all breaches of fiduciary duty in connection with a securities transaction," however, come within the ambit of Rule 10b-5. *Santa Fe Industries, Inc. v. Green*, 430 U. S. 462, 472 (1977). There must also be "manipulation or deception." *Id.*, at 473. In an inside-trading case this fraud derives from the "inherent unfairness involved where one takes advantage" of "information intended to be available only for a corporate purpose and not for the personal benefit of anyone." *In re Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 43 S. E. C. 933, 936 (1968). Thus, an insider will be liable under Rule 10b-5 for inside trading only where he fails to disclose material nonpublic information before trading on it and thus makes "secret profits." *Cady, Roberts*, 40 S. E. C., at 916, n. 31.

III

We were explicit in *Chiarella* in saying that there can be no duty to disclose where the person who has traded on inside information "was not [the corporation's] agent, . . . was not a fiduciary, [or] was not a person in whom the sellers [of the securities] had placed their trust and confidence." 445 U. S., at 232. Not to require such a fiduciary relationship, we recognized, would "depar[t] radically from the established doctrine that duty arises from a specific relationship between two parties" and would amount to "recognizing a general duty between all participants in market transactions to forgo actions based on material, nonpublic information." *Id.*, at 232, 233. This requirement of a specific relationship between the shareholders and the individual trading on inside information has created analytical difficulties for the SEC

est means," as opposed to "stealth").

and courts in policing tippees who trade on inside information. Unlike insiders who have independent fiduciary duties to both the corporation and its shareholders, the typical tippee has no such relationships.¹⁴ In view of this absence, it has been unclear how a tippee acquires the *Cady, Roberts* duty to refrain from trading on inside information.

A

The SEC's position, as stated in its opinion in this case, is that a tippee "inherits" the *Cady, Roberts* obligation to shareholders whenever he receives inside information from an insider:

"In tipping potential traders, Dirks breached a duty which he had assumed as a result of knowingly receiving confidential information from [Equity Funding] insiders. Tippees such as Dirks who receive non-public material information from insiders become 'subject to the same duty as [the] insiders.' *Shapiro v. Merrill Lynch*,

¹⁴ Under 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 rather 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. See *SEC v. Monarch Fund*, 608 F. 2d 938, 942 (CA2 1979); *In re Investors Management Co.*, 44 S. E. C. 633, 645 (1971); *In re Van Alostne, Noel & Co.*, 43 S. E. C. 1080, 1084-1085 (1969); *In re Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 43 S. E. C. 938, 937 (1968); *Cady, Roberts*, 40 S. E. C., at 912. When such a person breaches his fiduciary relationship, he may be treated more properly as a tipper than a tippee. See *Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 495 F. 2d 228, 237 (CA2 1974) (investment banker had access to material information when working on a proposed public offering for the corporation). For such a duty to be imposed, however, the corporation must expect the outsider to keep the disclosed nonpublic information confidential, and the relationship at least must imply such a duty.

Pierce, Fenner & Smith, Inc. [495 F. 2d 228, 237 (CA2 1974) (quoting *Ross v. Licht*, 263 F. Supp. 395, 410 (SDNY 1967))]. Such a tippee breaches the fiduciary duty which he assumes from the insider when the tippee knowingly transmits the information to someone who will probably trade on the basis thereof. . . . Presumably, Dirks' informants were entitled to disclose the [Equity Funding] fraud in order to bring it to light and its perpetrators to justice. However, Dirks—standing in their shoes—committed a breach of the fiduciary duty which he had assumed in dealing with them, when he passed the information on to traders." 21 S. E. C. Docket, at 1410, n. 42.

This view differs little from the view that we rejected as inconsistent with congressional intent in *Chiarella*. In that case, the Court of Appeals agreed with the SEC and affirmed Chiarella's conviction, holding 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." *United States v. Chiarella*, 588 F. 2d 1358, 1365 (CA2 1978) (emphasis in original). Here, the SEC maintains that anyone who knowingly receives nonpublic material information from an insider has a fiduciary duty to disclose before trading.¹⁵

¹⁵ Apparently, the SEC believes this case differs from *Chiarella* in that Dirks' receipt of inside information from Secrist, an insider, carried Secrist's duties with it, while Chiarella received the information without the direct involvement of an insider and thus inherited no duty to disclose or abstain. The SEC fails to explain, however, why the receipt of nonpublic information from an insider automatically carries with it the fiduciary duty of the insider. As we emphasized in *Chiarella*, mere possession of nonpublic information does not give rise to a duty to disclose or abstain; only a specific relationship does that. And we do not believe that the mere receipt of information from an insider creates such a special relationship between the tippee and the corporation's shareholders.

Apparently recognizing the weakness of its argument in light of *Chia-*

In effect, the SEC's theory of tippee liability in both cases appears rooted in the idea that the antifraud provisions require equal information among all traders. This conflicts with 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.¹⁶ Judge Wright correctly read our opinion in *Chiarella* as repudiating any notion that all traders must enjoy equal information before trading: "[T]he 'information' theory is rejected. Because the disclose-or-refrain duty is extraordinary, it attaches only when a party has legal obligations other than a mere duty to comply with the general antifraud prescriptions in the federal securities laws." 220 U. S. App. D. C., at 322, 681 F. 2d, at 837. See *Chiarella*, 445 U. S., at 235, n. 20. We reaffirm today that "[a] duty [to disclose] arises from the relationship between parties . . . and not merely from one's ability to acquire information because of his position in the market." 445 U. S., at 232-233, n. 14.

rella, the SEC attempts to distinguish that case factually as involving not "inside" information, but rather "market" information, i. e., "information generated within the company relating to its assets or earnings." Brief for Respondent 23. This Court drew no such distinction in *Chiarella* and, as THE CHIEF JUSTICE noted, "[i]t is clear that § 10(b) and Rule 10b-5 by their terms and by their history make no such distinction." 445 U. S., at 241, n. 1 (dissenting opinion). See ALI Fed. Sec. Code § 1603, Comment (2)(j) (Proposed Official Draft 1978).

¹⁶ In *Chiarella*, we noted that formulation of an absolute equal information rule "should not be undertaken absent some explicit evidence of congressional intent." 445 U. S., at 233. Rather than adopting such a radical view of securities trading, Congress has expressly exempted many market professionals from the general statutory prohibition set forth in § 11(a)(1) of the Securities Exchange Act, 15 U. S. C. § 78k(a)(1), against members of a national securities exchange trading for their own account. See *id.*, at 233, n. 16. We observed in *Chiarella* that "[t]he exception is based upon Congress' recognition that [market professionals] contribute to a fair and orderly marketplace at the same time they exploit the informational advantage that comes from their possession of [nonpublic information]." *Ibid.*

Imposing a duty to disclose or abstain solely because a person knowingly receives material nonpublic information from an insider and trades on it could have an inhibiting influence on the role of market analysts, which the SEC itself recognizes is necessary to the preservation of a healthy market.¹⁷ It is commonplace for analysts to "ferret out and analyze information," 21 S. E. C., at 1406,¹⁸ and this often is done by meeting with and questioning corporate officers and others who are insiders. And information that the analysts obtain normally may be the basis for judgments as to the market

¹⁷The SEC expressly recognized that "[t]he value to the entire market of [analysts'] efforts cannot be gainsaid; market efficiency in pricing is significantly enhanced by [their] initiatives to ferret out and analyze information, and thus the analyst's work redounds to the benefit of all investors." 21 S. E. C., at 1406. The SEC asserts that analysts remain free to obtain from management corporate information for purposes of "filling in the 'interstices in analysis' . . ." Brief for Respondent 42 (quoting *Investors Management Co.*, 44 S. E. C., at 646). But this rule is inherently imprecise, and imprecision prevents parties from ordering their actions in accord with legal requirements. Unless the parties have some guidance as to where the line is between permissible and impermissible disclosures and uses, neither corporate insiders nor analysts can be sure when the line is crossed. Cf. *Adler v. Klawans*, 267 F. 2d 840, 845 (CA2 1959) (Burger, J., sitting by designation).

¹⁸On its facts, this case is the unusual one. Dirks is an analyst in a broker-dealer firm, and he did interview management in the course of his investigation. He uncovered, however, startling information that required no analysis or exercise of judgment as to its market relevance. Nonetheless, the principle at issue here extends beyond these facts. The SEC's rule—applicable without regard to any breach by an insider—could have serious ramifications on reporting by analysts of investment views.

Despite the unusualness of Dirks' "find," the central role that he played in uncovering the fraud at Equity Funding, and that analysts in general can play in revealing information that corporations may have reason to withhold from the public, is an important one. Dirks' careful investigation brought to light a massive fraud at the corporation. And until the Equity Funding fraud was exposed, the information in the trading market was grossly inaccurate. But for Dirks' efforts, the fraud might well have gone undetected longer. See n. 8, *supra*.

worth of a corporation's securities. The analyst's judgment in this respect is made available in market letters or otherwise to clients of the firm. It is the nature of this type of information, and indeed of the markets themselves, that such information cannot be made simultaneously available to all of the corporation's stockholders or the public generally.

B

The conclusion that recipients of inside information do not invariably acquire a duty to disclose or abstain does not mean that such tippees always are free to trade on the information. The need for a ban on some tippee trading is clear. Not only are insiders forbidden by their fiduciary relationship from personally using undisclosed corporate information to their advantage, but they may not give such information to an outsider for the same improper purpose of exploiting the information for their personal gain. See 15 U. S. C. § 78t(b) (making it unlawful to do indirectly "by means of any other person" any act made unlawful by the federal securities laws). Similarly, the transactions of those who knowingly participate with the fiduciary in such a breach are "as forbidden" as transactions "on behalf of the trustee himself." *Mosser v. Darrow*, 341 U. S. 267, 272 (1951). See *Jackson v. Smith*, 254 U. S. 586, 589 (1921); *Jackson v. Ludeling*, 88 U. S. 616, 631-632 (1874). As the Court explained in *Mosser*, a contrary rule "would open up opportunities for devious dealings in the name of the others that the trustee could not conduct in his own." 341 U. S., at 271. See *SEC v. Texas Gulf Sulphur Co.*, 446 F. 2d 1301, 1308 (CA2), cert. denied, 404 U. S. 1005 (1971). Thus, the tippee's duty to disclose or abstain is derivative from that of the insider's duty. See Tr. of Oral Ar. 38. Cf. *Chiarella*, 445 U. S., at 246, n. 1 (BLACKMUN, J., dissenting). As we noted in *Chiarella*, "[t]he tippee's obligation has been viewed as arising from his role as a participant after the fact in the insider's breach of a fiduciary duty." 445 U. S., at 230, n. 12.

Thus, some tippees must assume an insider's duty to the shareholders not because they receive inside information, but rather because it has been made available to them *improperly*.¹⁹ And for Rule 10b-5 purposes, the insider's disclosure is improper only where it would violate his *Cady, Roberts* duty. Thus, a tippee assumes a fiduciary duty to the shareholders of a corporation not to trade on material nonpublic information only when the insider has breached his fiduciary duty to the shareholders by disclosing the information to the tippee and the tippee knows or should know that there has been a breach.²⁰ As Commissioner Smith perceptively ob-

¹⁹ The SEC itself has recognized that tippee liability properly is imposed only in circumstances where the tippee knows, or has reason to know, that the insider has disclosed improperly inside corporate information. In *Investors Management Co.*, *supra*, the SEC stated that one element of tippee liability is that the tippee knew or had reason to know "that [the information] was non-public and had been obtained *improperly* by selective revelation or otherwise." 44 S. E. C., at 641 (emphasis added). Commissioner Smith read this test to mean that a tippee can be held liable only if he received information in breach of an insider's duty not to disclose it. *Id.*, at 650 (concurring in the result).

²⁰ Professor Loss has linked tippee liability to the concept in the law of restitution that "[w]here a fiduciary in violation of his duty to the beneficiary communicates confidential information to a third person, the third person, if he had notice of the violation of duty, holds upon a constructive trust for the beneficiary any profit which he makes through the use of such information." 3 L. Loss, *Securities Regulation* 1451 (2d ed. 1961) (quoting Restatement of Restitution § 201(2) (1937)). Other authorities likewise have expressed the view that tippee liability exists only where there has been a breach of trust by an insider of which the tippee had knowledge. See, e. g., *Ross v. Licht*, 263 F. Supp. 395, 410 (SDNY 1967); A. Jacobs, *The Impact of Rule 10b-5*, § 167, at 7-4 (1975) ("[T]he better view is that a tipper must know or have reason to know the information is nonpublic and was improperly obtained."); Fleischer, *Mundheim & Murphy*, *An Initial Inquiry Into the Responsibility to Disclose Market Information*, 121 U. Pa. L. Rev. 798, 818, n. 76 (1973) ("The extension of rule 10b-5 restrictions to tippees of corporate insiders can best be justified on the theory that they are participating in the insider's breach of his fiduciary duty."). Cf. Restatement (Second) of Agency § 312, comment c (1958) ("A person who,

served in *Investors Management Co.*: “[Tippee 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” 44 S. E. C., at 651 (concurring in the result). Tipping thus properly is viewed only as a means of indirectly violating the *Cady, Roberts* disclose-or-abstain rule.²¹

C

In determining whether a tippee is under an obligation to disclose or abstain, it thus is necessary to determine whether

with notice that an agent is thereby violating his duty to his principal, receives confidential information from the agent, may be [deemed] . . . a constructive trustee.”).

²¹ We do not suggest that knowingly trading on inside information is ever “socially desirable or even that it is devoid of moral considerations.” Dooley, *Enforcement of Insider Trading Restrictions*, 66 Va. L. Rev. 1, 55 (1980). Nor do we imply an absence of responsibility to disclose promptly indications of illegal actions by a corporation to the proper authorities—typically the SEC and exchange authorities in cases involving securities. Depending on the circumstances, and even where permitted by law, one’s trading on material nonpublic information is behavior that may fall below ethical standards of conduct. But in a statutory area of the law such as securities regulation, where legal principles of general application must be applied, there may be “significant distinctions between actual legal obligations and ethical ideals.” SEC, *Report of the Special Study of Securities Markets*, H. R. Doc. No. 95, 88th Cong., 1st Sess., pt. 1, pp. 237–238 (1963). The SEC recognizes this. At oral argument, the following exchange took place:

“QUESTION: So, it would not have satisfied his obligation under the law to go to the SEC first?

“[SEC’s counsel]: That is correct. That an insider has to observe what has come to be known as the abstain or disclosure rule. Either the information has to be disclosed to the market if it is inside information . . . or the insider must abstain.” Tr. of Oral Arg. 27.

Thus, it is clear that Rule 10b-5 does not impose any obligation simply to tell the SEC about the fraud before trading.

the insider's "tip" constituted a breach of the insider's fiduciary duty. All disclosures of confidential corporate information are not inconsistent with the duty insiders owe to shareholders. In contrast to the extraordinary facts of this case, the more typical situation in which there will be a question whether disclosure violates the insider's *Cady, Roberts* duty is when insiders disclose information to analysts. See n. 16, *supra*. In some situations, the insider will act consistently with his fiduciary duty to shareholders, and yet release of the information may affect the market. For example, it may not be clear—either to the corporate insider or to the recipient analyst—whether the information will be viewed as material nonpublic information. Corporate officials may mistakenly think the information already has been disclosed or that it is not material enough to affect the market. Whether disclosure is a breach of duty therefore depends in large part on the purpose of the disclosure. This standard was identified by the SEC itself in *Cady, Roberts*: a purpose of the securities laws was to eliminate "use of inside information for personal advantage." 40 S. E. C., at 912, n. 15. See n. 10, *supra*. Thus, the test is whether the insider personally will benefit, directly or indirectly, from his disclosure. Absent some personal gain, there has been no breach of duty to stockholders. And absent a breach by the insider, there is no derivative breach.²² As Commissioner Smith stated in *In-*

²² An example of a case turning on the court's determination that the disclosure did not impose any fiduciary duties on the recipient of the inside information is *Walton v. Morgan Stanley & Co.*, 623 F. 2d 796 (CA2 1980). There, the defendant investment banking firm, representing one of its own corporate clients, investigated another corporation that was a possible target of a takeover bid by its client. In the course of negotiations the investment banking firm was given, on a confidential basis, unpublished material information. Subsequently, after the proposed takeover was abandoned, the firm was charged with relying on the information when it traded in the target corporation's stock. For purposes of the decision, it was assumed that the firm knew the information was confidential, but that it had been

vestors Management Co.: "It is important in this type of case to focus on policing insiders and what they do . . . rather than on policing information *per se* and its possession. . . ." 44 S. E. C., at 648 (concurring in the result).

The SEC argues that, if inside-trading liability does not exist when the information is transmitted for a proper purpose but is used for trading, it would be a rare situation when the parties could not fabricate some ostensibly legitimate business justification for transmitting the information. We think the SEC is unduly concerned. In determining whether the insider's purpose in making a particular disclosure is fraudulent, the SEC and the courts are not required to read the parties' minds. *Scienter* in some cases is relevant in determining whether the tipper has violated his *Cady, Roberts* duty.²³ But to determine whether the disclosure itself "deceive[s], manipulate[s], or defraud[s]" shareholders, *Aaron v. SEC*, 446 U. S. 680, 686 (1980), the initial inquiry is whether there has been a breach of duty by the insider. This requires courts to focus on objective criteria, *i. e.*,

received in arm's-length negotiations. See *id.*, at 798. In the absence of any fiduciary relationship, the Court of Appeals found no basis for imposing tippee liability on the investment firm. See *id.*, at 799.

²³ *Scienter*—"a mental state embracing intent to deceive, manipulate, or defraud," *Ernst & Ernst v. Hochfelder*, 425 U. S. 185, 193, n. 12 (1976)—is an independent element of a Rule 10b-5 violation. See *Aaron v. SEC*, 446 U. S. 680, 695 (1980). Contrary to the dissent's suggestion, see *post*, at p. 7, n. 10, motivation is not irrelevant to the issue of *scienter*. It is not enough that an insider's conduct results in harm to investors; rather, a violation may be found only where there is "intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities." *Ernst & Ernst v. Hochfelder*, *supra*, at 199. The issue in this case, however, is not whether Secrist or Dirks acted with *scienter*, but rather whether there was any deceptive or fraudulent conduct at all, *i. e.*, whether Secrist's disclosure constituted a breach of his fiduciary duty and thereby caused injury to shareholders. See n. 27, *infra*. Only if there was such a breach did Dirks, a tippee, acquire a fiduciary duty to disclose or abstain.

whether the insider receives a direct or indirect personal benefit from the disclosure, such as a pecuniary gain or a reputational benefit that will translate into future earnings. Cf. 40 S. E. C., at 912, n. 15; Brudney, *Insiders, Outsiders, and Informational Advantages Under the Federal Securities Laws*, 93 Harv. L. Rev. 324, 348 (1979) ("The theory . . . is that the insider, by giving the information out selectively, is in effect selling the information to its recipient for cash, reciprocal information, or other things of value for himself. . . ."). There are objective facts and circumstances that often justify such an inference. For example, there may be a relationship between the insider and the recipient that suggests a *quid pro quo* from the latter, or an intention to benefit the particular recipient. The elements of fiduciary duty and exploitation of nonpublic information also exist when an insider makes a gift of confidential information to a trading relative or friend. The tip and trade resemble trading by the insider himself followed by a gift of the profits to the recipient.

Determining whether an insider personally benefits from a particular disclosure, a question of fact, will not always be easy for courts. But it is essential, we think, to have a guiding principle for those whose daily activities must be limited and instructed by the SEC's inside-trading rules, and we believe that there must be a breach of the insider's fiduciary duty before the tippee inherits the duty to disclose or abstain. In contrast, the rule adopted by the SEC in this case would have no limiting principle.²⁴

²⁴ Without legal limitations, market participants are forced to rely on the reasonableness of the SEC's litigation strategy, but that can be hazardous, as the facts of this case make plain. Following the SEC's filing of the *Texas Gulf Sulphur* action, Commissioner (and later Chairman) Budge spoke of the various implications of applying Rule 10b-5 in inside-trading cases:

"Turning to the realm of possible defendants in the present and potential civil actions, the Commission certainly does not contemplate suing every

IV

Under the inside-trading and tipping rules set forth above, we find that there was no actionable violation by Dirks.²⁸ It is undisputed that Dirks himself was a stranger to Equity Funding, with no pre-existing fiduciary duty to its shareholders.²⁹ He took no action, directly or indirectly, that induced the shareholders or officers of Equity Funding to repose trust or confidence in him. There was no expectation by Dirks's sources that he would keep their information in confidence. Nor did Dirks misappropriate or illegally obtain the information about Equity Funding. Unless the insiders

person who may have come across inside information. In the Texas Gulf action neither tippees nor persons in the vast rank and file of employees have been named as defendants. In my view, the Commission in future cases normally should not join rank and file employees or persons outside the company *such as an analyst or reporter who learns of inside information.*" Speech of Hamer Budge to the New York Regional Group of the American Society of Corporate Secretaries, Inc. (Nov. 18, 1965) (emphasis added), reprinted in Budge, *The Texas Gulf Sulphur Case—What It Is and What It Isn't*, Corp. Secretary No. 127, at 6 (Dec. 17, 1965).

²⁸ Dirks contends that he was not a "tippee" because the information he received constituted unverified allegations of fraud that were denied by management and were not "material facts" under the securities laws that required disclosure before trading. He also argues that the information he received was not truly "inside" information, *i. e.*, intended for a confidential corporate purpose, but was merely evidence of a crime. The Solicitor General agrees. See Brief for United States as *Amicus Curiae* 22. We need not decide, however, whether the information constituted "material facts," or whether information concerning corporate crime is properly characterized as "inside information." For purposes of deciding this case, we assume the correctness of the SEC's findings, accepted by the Court of Appeals, that petitioner was a tippee of material inside information.

²⁹ Judge Wright found that Dirks acquired a fiduciary duty by virtue of his position as an employee of a broker-dealer. See 220 U. S. App. D. C., at 325-327, 681 F. 2d, at 840-842. The SEC, however, did not consider Judge Wright's novel theory in its decision, nor did it present that theory to the Court of Appeals. The SEC also has not argued Judge Wright's theory in this Court. See Brief for Respondent 21, n. 27. The merits of such a duty are therefore not before the Court. See *SEC v. Chenery Corp.*, 332 U. S. 194, 196-197 (1947).

breached their *Cady, Roberts* duty to shareholders in disclosing the nonpublic information to Dirks, he breached no duty when he passed it on to investors as well as to the *Wall Street Journal*.

It is clear that neither Secrist nor the other Equity Funding employees violated their *Cady, Roberts* duty to the corporation's shareholders by providing information to Dirks.²⁷

²⁷ In this Court, the SEC appears to contend that an insider invariably violates a fiduciary duty to the corporation's shareholders by transmitting nonpublic corporate information to an outsider when he has reason to believe that the outsider may use it to the disadvantage of the shareholders. "Thus, regardless of any ultimate motive to bring to public attention the derelictions at Equity Funding, Secrist breached his duty to Equity Funding shareholders." Brief for Respondent 31. This perceived "duty" differs markedly from the one that the SEC identified in *Cady, Roberts* and that has been the basis for federal tippee-trading rules to date. In fact, the SEC did not charge Secrist with any wrongdoing, and we do not understand the SEC to have relied on any theory of a breach of duty by Secrist in finding that Dirks breached his duty to Equity Funding's shareholders. See App. 250 (decision of administrative law judge) ("One who knows himself to be a beneficiary of non-public, selectively disclosed inside information must fully disclose or refrain from trading."); SEC's Reply to Notice of Supplemental Authority before the SEC 4 ("If Secrist was acting properly, Dirks inherited a duty to [Equity Funding]'s shareholders to refrain from improper private use of the information."); Brief on behalf of the SEC in the Court of Appeals, at 47-50; *id.*, at 51 ("[K]nowing possession of inside information by any person imposes a duty to abstain or disclose."); *id.*, at 52-54; *id.*, at 55 ("[T]his obligation arises not from the manner in which such information is acquired. . . ."); 220 U. S. App. D. C., at 322-323, 681 F. 2d, at 838 (Wright, J.).

The dissent argues that "Secrist violated his duty to Equity Funding shareholders by transmitting material nonpublic information to Dirks with the intention that Dirks would cause his clients to trade on that information." *Post*, at 12. By perceiving a breach of fiduciary duty whenever inside information is intentionally disclosed to securities traders, the dissenting opinion effectively would achieve the same result as the SEC's theory below, *i. e.*, mere possession of inside information while trading would be viewed as a Rule 10b-5 violation. But *Chiarella* made it explicitly clear there is no general duty to forgo market transactions "based on material, nonpublic information." 455 U. S., at 233. Such a duty would "depar[t] radically from the established doctrine that duty arises from a specific rela-

The tippers received no monetary or personal benefit for revealing Equity Funding's secrets, nor was their purpose to make a gift of valuable information to Dirks. As the facts of this case clearly indicate, the tippers were motivated by a desire to expose the fraud. See *supra*, at 1-2. In the absence of a breach of duty to shareholders by the insiders, there was no derivative breach by Dirks. See n. 20, *supra*. Dirks therefore could not have been "a participant after the fact in [an] insider's breach of a fiduciary duty." *Chiarella*, 445 U. S., at 230, n. 12.

V

We conclude that Dirks, in the circumstances of this case, had no duty to abstain from use of the inside information that

tionship between two parties." *Ibid.* See p. 7, *supra*.

Moreover, to constitute a violation of Rule 10b-5, there must be fraud. See *Ernst & Ernst v. Hochfelder*, 425 U. S. 185, 199 (1976) (statutory words "manipulative," "device," and "contrivance . . . connote intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities") (emphasis added). There is no evidence that Secrist's disclosure was intended to or did in fact "deceive or defraud" anyone. Secrist certainly intended to convey relevant information that management was unlawfully concealing, and—so far as the record shows—he believed that persuading Dirks to investigate was the best way to disclose the fraud. Other efforts had proved fruitless. Under any objective standard, Secrist received no direct or indirect personal benefit from the disclosure.

The dissenting opinion focuses on shareholder "losses," "injury," and "damages," but in many cases there may be no clear causal connection between inside trading and outsiders' losses. In one sense, as market values fluctuate and investors act on inevitably incomplete or incorrect information, there always are winners and losers; but those who have "lost" have not necessarily been defrauded. On the other hand, inside trading for personal gain is fraudulent, and is a violation of the federal securities laws. See Dooley, *supra*, at 39-41, 70. Thus, there is little legal significance to the dissent's argument that Secrist and Dirks created new "victims" by disclosing the information to persons who traded. In fact, they prevented the fraud from continuing and victimizing many more investors.

he obtained. The judgment of the Court of Appeals therefore is

Reversed.

Justice Powell

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SUPREME CO

STATES

HENRY C. LIND
Reporter of Decisions.

DIRKS v. SECURITIES AND
EXCHANGE COMMISSION

CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR
THE DISTRICT OF COLUMBIA CIRCUIT

No. 82-276. Argued March 21, 1983—Decided July 1, 1983

While serving as an officer of a broker-dealer, petitioner, who specialized in providing investment analysis of insurance company securities to institutional investors, received information from a former officer of an insurance company that its assets were vastly overstated as the result of fraudulent corporate practices and that various regulatory agencies had failed to act on similar charges made by company employees. Upon petitioner's investigation of the allegations, certain company employees corroborated the fraud charges, but senior management denied any wrongdoing. Neither petitioner nor his firm owned or traded any of the company's stock, but throughout his investigation he openly discussed the information he had obtained with a number of clients and investors, some of whom sold their holdings in the company. The Wall Street Journal declined to publish a story on the fraud allegations, as urged by petitioner. After the price of the insurance company's stock fell during petitioner's investigation, the New York Stock Exchange halted trading in the stock. State insurance authorities then impounded the company's records and uncovered evidence of fraud. Only then did the Securities and Exchange Commission (SEC) file a complaint against the company, and only then did the Wall Street Journal publish a story based largely on information assembled by petitioner. After a hearing concerning petitioner's role in the exposure of the fraud, the SEC found that he had aided and abetted violations of the antifraud provisions of the federal securities laws, including § 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5, by repeating the allegations of fraud to members of the investment community who later sold their stock in the insurance company. Because of petitioner's role in bringing the fraud to light, however, the SEC only censured him. On review, the Court of Appeals

Syllabus

entered judgment against petitioner.

Held:

1. Two elements for establishing a violation of § 10(b) and Rule 10b-5 by corporate insiders are the existence of a relationship affording access to inside information intended to be available only for a corporate purpose, and the unfairness of allowing a corporate insider to take advantage of that information by trading without disclosure. A duty to disclose or abstain does not arise from the mere possession of nonpublic market information. Such a duty arises rather from the existence of a fiduciary relationship. *Chiarella v. United States*, 445 U. S. 222. There must also be "manipulation or deception" to bring a breach of fiduciary duty in connection with a securities transaction within the ambit of Rule 10b-5. Thus, an insider is liable under the Rule for inside trading only where he fails to disclose material nonpublic information before trading on it and thus makes secret profits. Pp. 5-7.

2. Unlike insiders who have independent fiduciary duties to both the corporation and its shareholders, the typical tippee has no such relationships. There must be a breach of the insider's fiduciary duty before the tippee inherits the duty to disclose or abstain. Pp. 7-16.

(a) The SEC's position that a tippee who knowingly receives nonpublic material information from an insider invariably has a fiduciary duty to disclose before trading rests on the erroneous theory that the antifraud provisions require equal information among all traders. A duty to disclose arises from the relationship between parties and not merely from one's ability to acquire information because of his position in the market. Pp. 8-11.

(b) A tippee, however, is not always free to trade on inside information. His duty to disclose or abstain is derivative from that of the insider's duty. Tippees must assume an insider's duty to the shareholders not because they receive inside information, but rather because it has been made available to them improperly. Thus, a tippee assumes a fiduciary duty to the shareholders of a corporation not to trade on material nonpublic information only when the insider has breached his fiduciary duty to the shareholders by disclosing the information to the tippee and the tippee knows or should know that there has been a breach. Pp. 11-18.

(c) In determining whether a tippee is under an obligation to disclose or abstain, it is necessary to determine whether the insider's "tip" constituted a breach of the insider's fiduciary duty. Whether disclosure is a breach of duty depends in large part on the personal benefit the insider receives as a result of the disclosure. Absent an improper purpose, there is no breach of duty to stockholders. And absent a breach by the insider, there is no derivative breach. Pp. 14-16.

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3. Under the inside-trading and tipping rules set forth above, petitioner had no duty to abstain from use of the inside information that he obtained, and thus there was no actionable violation by him. He had no pre-existing fiduciary duty to the insurance company's shareholders. Moreover, the insurance company's employees, as insiders, did not violate their duty to the company's shareholders by providing information to petitioner. In the absence of a breach of duty to shareholders by the insiders, there was no derivative breach by petitioner. Pp. 16-18.

220 U. S. App. D. C. 309, 681 F. 2d 824, reversed.

POWELL, J., delivered the opinion of the Court, in which BURGER, C. J., and WHITE, REHNQUIST, STEVENS, and O'CONNOR, JJ., joined. BLACKMUN, J., filed a dissenting opinion, in which BRENNAN and MARSHALL, JJ., joined.