McGeorge Law Review

Volume 20 | Issue 3 Article 6

1-1-1989

Carpenter v. United States: Securities Trading, Mail Fraud and Confidedntial Business Information--New Liability for Outsiders?

Douglas A. Hunt

Michael R. Seyle

Carpenter v. United States: Securities Trading, Mail Fraud and Confidential Business Information—New Liability for Outsiders?

In *Carpenter v. United States*,[1] the federal government sought civil and criminal sanctions against a Wall Street Journal (Journal) reporter who sold the contents of his stock analysis column before publication in the Journal.[2] The reporter was not a fiduciary of any corporation and his column contained no inside information.[3] Nevertheless, the District Court of New York found that the reporter and his co-conspirators violated Rule 10b-5,[4] section 10(b) of the Securities Ex-

1. 108 S. Ct. 316 (1987). David Carpenter was a co-conspirator in the scheme and was one of three petitioners in the appeal to the Supreme Court. *Id.* at 318.

2. *Id.* at 319.

3. *Id.* at 319-20. Although the information sold was not inside information in the traditional sense, it was confidential information and the reporter was well aware of the column's direct impact upon the market price of the stocks analyzed. *Id.*

4. 17 C.F.R. 240.10b-5 (1987). 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 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

change Act of 1934,[5] and the federal wire and mail fraud statutes.[6]

The Second Circuit Court of Appeals affirmed the reporter's convictions under Rule 10b-5 holding that his misappropriation of confidential information from his employer violated the intent of the securities laws.[7] The Court of Appeals also affirmed the reporter's wire and mail fraud convictions for defrauding the Journal of intangible property.[8]

In the face of much anticipation surrounding its opinion, the United States Supreme Court divided evenly on whether the misappropriation theory[9] was sufficient to support a violation of Rule 10b-5.[10] The Court, however, unanimously upheld the reporter's wire and mail fraud conviction.[11] The Court agreed with the Court of Appeals that the reporter breached a fiduciary duty to his employer by defrauding the Journal of its intangible property rights to confidential business information.[12]

The Supreme Court's lack of a definitive decision on the merits of the misappropriation theory casts significant doubt on the theory's continued viability.[13] Additionally, the Court's application of the wire and mail fraud statutes to theft of confidential information raises questions regarding the type of property the statutes protect and, in conjunction with other federal statutes, could expand the remedies available to a defrauded party.[14]

Part I of this note will trace briefly the evolution of Rule 10b-5 and the misappropriation theory.[15] Additionally, Part I will examine the history and development of the wire and mail fraud statutes.[16]

---

operate as a fraud or deceit upon any person,
in connection with the purchase or sale of any security."

Id.

5. Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1982).
6. *Carpenter*, 108 S. Ct. at 319.
7. *Id.*
8. *Id.*
9. The misappropriation theory applies 10b-5 liability to persons who trade on nonpublic information in breach of a fiduciary duty owed to the person or persons who entrusted the information to the fiduciary. LANGEVOORT, INSIDER TRADING REGULATION, 177 (1988).
10. *Carpenter*, 108 S. Ct. at 320. The Court's opinion reads: "The Court is evenly divided with respect to the convictions under the securities law and for that reason affirms the judgement of the court below on those counts." *Id.*
11. *Id.* at 321.
12. *Id.*
13. *See infra* notes 51-76 and accompanying text (discussion of merits and criticisms of misappropriation theory under Rule 10b-5).
14. *See infra* notes 181-205 and accompanying text (discussion of remedies for defrauded party under wire and mail fraud statutes).
15. *See infra* notes 19-76 and accompanying text.
16. *See infra* notes 77-104 and accompanying text.

Part II will summarize the facts of the *Carpenter* case and review the decision of the United States Supreme Court.[17] Part III will discuss the potential legal ramifications of *Carpenter* and its impact under civil RICO.[18]

I. LEGAL BACKGROUND

A. *The History of Rule 10b-5*

Rule 10b-5 of the Securities Exchange Commission (SEC) makes it unlawful to defraud or engage in fraudulent business practices in connection with the purchase and sale of securities.[19] In interpreting this statute, courts initially developed the "disclose or abstain" rule.[20] That rule requires traditional insiders[21]—typically those with a fiduciary relationship[22] to a corporation—either to disclose publicly any material[23] nonpublic information regarding corporate assets or to abstain from trading on that information.[24] However, until recently, the disclose or abstain rule did not apply unless the trading party owed a duty to the shareholders of the corporation whose stock was traded.[25]

---

17. *See infra* notes 105-155 and accompanying text.
18. *See infra* notes 156-205 and accompanying text.
19. *See* 17 C.F.R § 240.10b-5 (1987) (text of Rule 10b-5). *See also supra* note 4.
20. *See* Brudney, *Insiders, Outsiders and Informational Advantanges Under the Federal Securities Laws*, 93 HARV. L. REV. 322, 328-332 (1979) (history of the disclose or abstain rule).
21. Speed v. Transamerica Corp., 99 F. Supp. 808, 828-29 (D. Del. 1951) (holding that "traditional insiders" are corporate officers, directors or majority shareholders).
22. Frankel, *Fiduciary Law*, 71 CALIF. L. REV. 795, 800 n.17 (1983) (defining a fiduciary relationship as one of trust and confidence where the unifying characteristics are a substitutionary function, a delegation of power, and one parties dependence upon the other for a particular service).
23. *See* Basic Inc. v. Levinson, 108 S. Ct. 978, 983 (1988) (expressly adopting the standard for materiality announced in TSC Industries v. Northway, 426 U.S. 438, 449 (1976)). In *TSC Industries*, the Court held that information is material "if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote." 426 U.S. at 449. The *TSC Industries* Court further explained that to satisfy the materiality requirement "there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *Id.*
24. *See* Brudney, *supra* note 20, at 324-25 (insiders who possess information of a consequential nature must either disclose it to all of the investing public or abstain from trading until that information becomes public).
25. United States v. Chiarella, 445 U.S. 222, 231-35 (1980). The Court in *Chiarella* held that an employee of a printing firm had no fiduciary relationship with the shareholders from whom he purchased stock; therefore, he had no duty to disclose before trading and did not violate Rule 10(b)-5. *Id.*

The SEC promulgated Rule 10b-5[26] to close a loophole in the protection against fraud under section 10(b) of the Securities Act of 1934.[27] As interpreted today, Rule 10b-5 makes unlawful the use of any instrumentality of interstate commerce, the mails, or any national exchange to employ fraudulent devices, make untrue statements, or engage in fraudulent business practices in connection with the purchase or sale of any security.[28]

For almost twenty years after the enactment Rule 10b-5, courts limited their analysis of insider trading[29] to activities of traditional corporate insiders, i.e., directors, officers, and controlling shareholders.[30] Because of their position with the corporation, traditional insiders were held to owe a fiduciary responsibility to the shareholders of the corporation,.requiring them to adhere to the disclose or abstain rule.[31] Lower courts extended the disclose or abstain rule by placing liability upon "anyone" who traded on material nonpublic information, regardless of whether they owed a duty to the corporation.[32] In *Chiarella*

---

26. *See* Note, *Insider Trading and the Misappropriation Theory: Has the Second Circuit Gone Too Far?* 61 ST. JOHN'S L. REV. 78, 86-89 (1986) (history of SEC and securities regulations). Rule 10b-5 was created by the Securities Exchange Commission under the broad authority delegated by Congress to regulate securities trading and to protect the interests of public investors against manipulation of the securities markets. Prior to 1942, the SEC had promulgated rules under section 10(b) but these rules did not limit insider trading. *Id.*

27. *Id.* at 88. *See also* A. BROMBERG & L. LOWENFELS, SECURITIES FRAUD AND COMMODITIES FRAUD § 2.2(510) (Oct. 1983 & Oct. 1979) (summary of rules under section 10(b)). Section 10(b) of the Securities Exchange Act of 1934 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 . . . 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 [Securities and Exchange] Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1982).

28. Note, *supra* note 26, at 86-87.

29. LANGEVOORT, *supra* note 9, at 3-4. Insider trading is a term of art that refers to unlawful trading in securities by persons who possess material nonpublic information about the company whose shares are traded or the market for those shares. The term insider trading can be a misnomer because modernly the prohibition against this kind of trading applies to a larger class of persons than those traditionally considered to be corporate insiders. The term is often used to refer to anyone who has access to privliged information. Additionally there is circularity to the definition as the term is used only to refer to trading that is unlawful. There are numerous instances in which people who possess material nonpublic information can trade lawfully. Only after reaching a legal conclusion, then can the applicability of the term be defined. *Id.*

30. Note, *supra* note 26, at 90.

31. *Id.* at 89-90.

32. *See In re* Cady, Roberts & Co., 40 S.E.C. 907 (1961) (Rule 10b-5 restricts the trading activities of "any person" who has a relationship that allows access to material nonpublic information). *See also* Speed v. Transamerica Corp., 99 F. Supp. 808, 829 (D. Del. 1951) (extending fiduciary duties to majority shareholders); New Park Mining Co. v. Cramer, 225 F.

v. United States,[33] the Supreme Court rejected this extention of 10b-5 liability to "any person" and reaffirmed the traditional theory that 10b-5 liability arises only from a breach of fiduciary duty or other special relationship.[34]

In *Dirks v. SEC*,[35] the Supreme Court further developed the 10b-5 fiduciary duty doctrine by deciding the liability of a stock "tippee."[36] The Court held that a tippee violates Rule 10b-5 if (1) an insider breaches a fiduciary duty to the corporation's shareholders by divulging material nonpublic information to the tippee, (2) the tippee knew or should have known that the breach occurred, and (3) the tippee trades on the information.[37] Dirks was an investment analyst who analyzed insurance company securities.[38] He received information from a former officer of an insurance company that the company had fraudulently

---

Supp. 261, 266 (S.D.N.Y. 1963) (corporation allowed to sue former officers and directors, thus relaxing privity requirements under Rule 10b-5); Pettit v. American Stock Exch. 217 F. Supp. 21, 28 (S.D.N.Y. 1963) (suit permitted against wide variety of persons accused of defrauding an issuer of stock).

33. 445 U.S. 222 (1980).

34. *Id.* at 224-225. Chiarella was employed as a mark-up man for a financial printer and, in the course of his employment, printed announcements of takeover bids. While the announcements concealed the names of the acquiring and target companies with blank spaces or code names, Chiarella was able to deduce the true names of the companies. Without disclosing his knowledge of this information, Chiarella purchased shares in the target companies. The shares were then sold when the takeover bids were made public, netting Chiarella over $30,000 in profit. Chiarella was indicted on 17 counts of violating section 10(b) and Rule 10b-5. *Id.*

The Second Circuit Court of Appeals affirmed the convictions, holding the affirmative duty to disclose or refrain was imposed upon anyone who received material nonpublic information, and held those persons may not trade upon that information without prior full disclosure. *Id.* at 231. While the Court of Appeals recognized that Chiarella was not a traditional insider, it determined Chiarella was a "market insider" because of his continuing access to information about target companies. Chiarella v. United States, 588 F.2d 1358, 1365 (2d Cir. 1978), *rev'd*, 445 U.S. 222 (1979).

The Supreme Court reversed Chiarella's convictions, expressly rejecting the Second Circuit's view that anyone receiving material nonpublic information could be burdened by an affirmative duty to disclose. *Chiarella*, 445 U.S. at 235. The Court instead affirmed the common law underpinnings of section 10(b), holding the possession of material nonpublic information alone imposes no obligation to disclose or refrain from trading. The disclose or refrain duty, the Court held, arises only from a relationship of trust and confidence between parties to a business transaction. *Id.* The Court also noted that use of nonpublic market information does not always harm the market, as in the case of a securities specialist who contributes to market efficiency at the same time they exploit the informational advantage. *Id.* at 233, n.16. Thus, under *Chiarella*, a fiduciary relationship between the persons trading the securities and the shareholders of the security bought or sold must exist before Rule 10b-5 can be violated.

35. 463 U.S. 646 (1983).

36. *Dirks*, 463 U.S. at 665. A "tippee" is a person who buys or is given nonpublic information from an insider or a corporation when no one else is given that information. *In re Cady*, 40 S.E.C. at 907. The theory holds that the insider by giving the information is gaining from its selective release and taints the recipient such that he should no more be entitled to use that information in trading than the donor. *Brundey*, *supra* note 20, at 348.

37. *Dirks*, 463 U.S. at 659-61.

38. *Id.* at 658, n.18.

overstated its assets.[39] Dirks began investigating the allegations, but throughout his investigation he openly discussed the allegations with clients and friends. Many of these people sold their holdings in the company's stock before the price declined in response to the circulating rumors.[40] The SEC prosecuted Dirks for aiding and abetting those who sold stock based on the nonpublic information.[41]

The Supreme Court reversed Dirks' conviction.[42] The Court stated that whether a tippee breaches a fiduciary duty depends upon the purpose of the insider in disclosing the inside information.[43] The Court found that Dirks was not liable under Rule 10b-5 because the insider who gave Dirks the information had not breached a duty to the corporation when he divulged the information.[44] Since Dirks was not a tippee under the Court's analysis, he could divulge the information to others, with knowledge they would trade on it, without incurring liability.[45] However, the *Dirks* Court suggested the definition of "insider" might be enlarged to include those who enter into a special confidential relationship and who have access to confidential information solely for a corporate purpose.[46] Those persons become "constructive insiders"[47] and violate Rule 10b-5 when they use confidential information in the sale or purchase of securities.[48]

After *Dirks*, a violation of Rule 10b-5 requires that a tippee receive material nonpublic information from an insider, or temporary insider, who breaches a fiduciary duty to the shareholders of the corporation whose stock was traded by divulging the information.[49] In order to

---

39. *Id.* at 649.

40. *Id.* at 649-50. During the two weeks of Dirks' investigation, the price of the company's stock fell from $26 to $15 per share. *Id.*

41. *Id.* at 650-51.

42. *Id.* at 667.

43. *Id.* at 663. The Court stated that the test is an objective one focusing on "whether the insider receives a direct or indirect personal benefit from disclosure." *Id.*

44. *Id.* at 666-67. According to the Court, the corporate insider who revealed the information to Dirks did so in order to expose the fraud and not to obtain any personal benefit. He therefore did not breach a duty to the shareholders. *Id.*

45. *Id.*

46. *Id.* at 655, n.14. "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." *Id.*

47. Persons who are considered constructive insiders include underwriters, accountants, lawyers, or consultants working for the corporation. *Id.*

48. *Id.* at 660. When a constructive insider breaches this fiduciary duty, however, the Court may treat him as a tipper rather than a tippee. *Id.* at 655, n.14.

49. *See* United States v. Newman, 664 F.2d 12, 20 (2d Cir. 1981), *cert. denied*, 464 U.S. 863 (1983) (use of Rule 10b-5 and the wire and mail fraud statutes against employee who obtained inside information about one of employer's clients and made trades on that information).

prosecute individuals who owed no fiduciary duty to the corporation's shareholders, but who traded on inside corporate information, the SEC developed another definition of fiduciary duty.[50]

B. The Misappropriation Theory

In response to *Dirks* and *Chiarella*, the SEC began charging non-insiders who traded on inside information under the "misappropriation theory."[51] The theory imposes liability on anyone who trades on corporate information gained through a confidential relationship.[52] The theory, based upon agency principles,[53] provides that an employee has a fiduciary duty not to exploit for personal gain confidential information acquired in the course of employment.[54] Therefore, an employee who subsequently trades on the basis of this confidential information violates Rule 10b-5.[55] However, the misappropriation theory represents a significant departure from early 10b-5 liability analysis because it focuses upon the employee's fiduciary duty to an employer instead of upon the duty owed to the shareholders of the corporation.[56]

While the Supreme Court has never directly addressed the validity of the misappropriation theory,[57] several members of the *Chiarella* court expressed support for its use.[58] Since *Chiarella*, the SEC has

---

50. *See infra* notes 51-61 and accompanying text.

51. LANGEVOORT, *supra* note 9, at 177-79.

52. *See* Note, *supra* note 26, at 98-99.

53. *See* RESTATEMENT (SECOND) OF AGENCY § 395 (1985) (agent prohibited from using confidential information for his own benefit).

54. *See* United States v. Newman, 664 F.2d 12 (2d Cir. 1981), *cert. denied*, 464 U.S. 863 (1983) (employees guilty of securities fraud for breach of fiduciary duty to employer). The misappropriation theory is based on the principal that one who trades on confidential information acquired during the course of employment breaches a fiduciary duty to the employer and, therefore, is guilty of securities fraud if the information is used to obtain personal gain from the purchase or sale of securities. Note, *The SEC's Regulation of the Financial Press: The Legal Implications of the Misappropriation Theory*, 52 BROOKLYN L. REV. 43, 54 (1978) (history of the misappropriation theory).

55. United States v. Carpenter, 791 F.2d 1024, 1033 (2d Cir. 1986), *aff'd*, 108 S. Ct. 316 (1987).

56. *See generally* Note, *supra* note 54, at 55.

57. LANGEVOORT, *supra* note 9, at 177.

58. *See* Chiarella v. United States, 445 U.S. 222, 238-51 (1980). In a concurrence, Justice Stevens indicated that the misappropriation theory could form the basis of an action for fraud upon the acquiring corporations, but noted that they would be unable to recover damages since they were neither buyers nor sellers of the traded securities. *Id.* at 238 (Stevens, J., concurring). Chief Justice Burger and Justice Brennan would have imposed liability on Chiarella on the theory that anyone who misappropriates material nonpublic information has an affirmative duty to either disclose or refrain from trading. *Id.* at 239-45 (Burger, C.J., dissenting); *id.* at 238-39 (Brennan, J., concurring in judgment). While acknowledging the validity of the misappropriation

successfully used the misappropriation theory against nontraditional insiders in the federal courts.[59] The Second Circuit Court of Appeals continues to approve use of the theory in cases in which liability would not otherwise attach under an early 10b-5 analysis.[60] This expanded application of the misappropriation theory is not without controversy, however, and an evaluation of the criticisms of the theory's application in securities fraud cases is important for determining its present viability.[61]

C. Criticisms of the Misappropriation Theory

The use of the misappropriation theory to facilitate convictions under Rule 10b-5 has prompted criticism as an unjustified expansion of securities law.[62] Two related criticisms can trace their theoretical origins from the early Rule 10b-5 case *Sante Fe Industries v. Green*.[63] In *Sante Fe*, the Supreme Court held that a insider's breach of fiduciary duty to the corporation's shareholders is not actionable under Rule 10b-5 without a showing of actual deceit of the corporation's share-

---

theory, Justices Blackmun and Marshall would have upheld the conviction under a broad interpretation of section 10(b) as prohibiting anyone from trading on the basis of material information not legally available to the general investing public. *Id.* at 245-51 (Blackmun, J., dissenting).

59. *See* United States v. Reed, 601 F. Supp. 685, 699 (S.D.N.Y. 1985) (misappropriation theory supported the indictment of a tippee even though he would not have been liable under *Dirks*). *See also* Rothberg v. Rosenbloom, 771 F.2d 818 (3d Cir. 1985) (implicitly approving use of misappropriation theory in an *in pari delicto* defense case).

60. *See, e.g.*, United States v. Newman, 664 F.2d 12 (2d. Cir. 1981), *cert. denied*, 464 U.S. 863 (1983). The employees in *Newman* were trading on confidential information relating to acquisition and tender offers of the banking firm's clients. *Id.* at 16. While the employees of the bank owed no duty to the corporations whose stocks were being traded, the employees did breach a duty to their employers. According to the court, the employee's breach of confidentiality to their employer and subsequent trading satisfied the fiduciary relationship necessary for a 10b-5 violation. *Id.*

See also SEC v. Materia, 745 F.2d 197, 203 (2d Cir. 1984) (approving use of the theory against an employee who obtained nonpublic information through deduction), *cert. denied*, 474 U.S. 1053 (1985). Materia, like Chiarella, traded on confidential information acquired through his employment with a financial printing firm. 745 F.2d at 203. While Materia owed no fiduciary duty to those corporations whose stock was traded, the court stated that violating the promise of confidentiality to his employer was a significant breach of his fiduciary obligation. *Id.*

61. *Compare* Aldave, *Misappropriation: A General Theory of Liability for Trading on Nonpublic Information*, 13 HOFSTRA L. REV. 101, 102 (1984) (arguing the misappropriation theory is a valid method for curbing securities fraud) *with* Phillips & Zutz, *The Insider Trading Doctrine: A Need for Legislative Repair*, 13 HOFSTRA L. REV. 65, 91 (1984) (arguing the misappropriation theory is an unjustified judicial expansion of securities law).

62. *See* Phillips & Zutz, *supra* note 61, at 91 (1984) (arguing that the misappropriation theory is a misconceived effort to broaden the insider trading doctrine); Note, *supra* note 26, at 103-04 (concluding that the misappropriation theory conflicts with basic insider trading theories).

63. 430 U.S. 462 (1977).

holders.[64] The misappropriation theory is criticized by some commentators as contrary to *Sante Fe's* purchase and sale requirement because the theory imputes liability upon an employee for breach of fiduciary duty to the employer without regard to whether the defrauded party, the employer, actually traded in the corporation's securities.[65] Unlike an insider, an employee only has a fiduciary duty to refrain from using confidential information entrusted to him by the employer for personal gain: a duty not related in any sense to the purchase or sale of securities.[66]

The second criticism based on the *Sante Fe* rationale concerns the "in connection with" requirement. Under the misappropriation theory, the "in connection with the purchase or sale of securities" requirement is met when the employee buys or sells stock, in contrast to *Sante Fe's* holding that the defrauded party must be a buyer or seller.[67] Consequently, the breach of duty by an employee is not actual deception of the corporation's shareholders, but a mere breach of fiduciary duty to another outsider. Therefore, an employee who trades on confidential information which is not inside corporate information can not be said to have violated the intent of Rule 10b-5.[68]

Another criticism of the misappropriation theory arises from the Supreme Court's holding in *Dirks*.[69] Under *Dirks*, a tippee violates Rule 10b-5 only if he receives inside information from a corporate insider who breaches a duty to his corporation.[70] Under the misappropriation theory, however, a non-insider violates Rule 10b-5 if he breaches a fiduciary duty to his employer regardless of the source of the information and regardless of whether the employer owes a duty to the shareholders of the traded stock.[71] Thus, the misappropriation theory unjustifiably expands the *Dirks* standard to non-insiders who trade on information regardless of its source simply because use of the information violated an agreement to an employer.[72]

---

64. *Id.* at 473-76.
65. *See* Phillips & Zutz, *supra* note 61, at 91; LANGEVOORT, *supra* note 9, at 184.
66. Phillips & Zutz, *supra* note 61, at 91. "Disclosure by the employee would aggravate the breach of duty to the employer, not cure it." *Id.*
67. LANGEVOORT, *supra* note 9, at 204.
68. *See* Phillips & Zutz, *supra* note 61, at 91; LANGEVOORT, *supra* note 9, at 184.
69. *See* Dirks v. SEC, 463 U.S. 646 (1983).
70. *Id.* at 664.
71. *See supra* notes 51-61 and accompanying text.
72. *See* Phillips & Zutz, *supra* note 61, at 91 (arguing misappropriation cannot be properly applied to nonfiduciaries because it does not satisfy the *Dirks* test requiring receipt of personal benefit).

Additionally, some commentators argue the misappropriation theory shifts the focus of Rule 10b-5 from the protection of the investing public to the protection of the employer reputation.[73] Under the misappropriation theory, an employer could use Rule 10b-5 to prosecute an employee for theft of corporate information simply because the employee purchased or sold stocks of an unrelated company.[74] Federal prosecution of employees who steal business information will allow employers to maintain a reputation of complete business confidentiality at the expense ofthe government. Furthermore, the use of the misappropriation theory in the prosecution of financial reporters also may implicate first amendment guarantees of freedom of speech through government regulation of the financial press.[75] Theoretically, the government could prosecute a financial reporter for releasing confidential business information that would have a significant impact on market price of stocks even though the information was accurate.[76]

C. *The Wire and Mail Fraud Statutes*

Although the SEC refers the majority of insider trading cases to the Justice Department for prosecution under Rule 10b-5, federal prosecutors also can bring actions for securities fraud under the wire and mail fraud statutes.[77] Congress originally enacted the statutes to allow criminal prosecution of anyone engaged in fraudulent activity through the use of the mails.[78] Today these statutes provide an alternative method for prosecuting many types of fraud.[79]

---

73. *See, e.g.,* LANGEVOORT, *supra* note 9, at 203 (arguing that protection of reputation is not an appropriate goal of federal securities laws); Note, *supra* note 26, at 107-08 (stating that role of securities laws is to protect investors hence the misappropriation theory is improperly applied if used to protect reputation of employers).

74. Note, *supra* note 26, at 108.

75. *See* Note, *Financial Reporters, the Securities Laws and the First Amendment: Where to Draw the Line*, 53 FORDHAM L. REV. 1035, 1051-54 (1985) (arguing that SEC enforcement proceeedings have significant first amendment ramifications, including prior restraint and chilling of speech). *See also* Note, *supra* note 54, at 107 n.118 (arguing that requiring a reporter to disclose or abstain from trading is a restraint on the editorial discretion of a reporter and publisher not justified by the government's need to enforce securities laws).

76. Note, *supra* note 75, at 1053-54.

77. *See, e.g.,* United States v. Newman, 664 F.2d 12 (1981) (defendant charged with violating 10b-5 and the wire and mail fraud statutes, 18 U.S.C. §§ 1341, 1343 (1976), when he converted inside information from his employer, an investment banking firm).

78. *See, e.g.,* United States v. Lemire, 720 F.2d 1327 (D.C. Cir. 1983), *cert. denied*, 467 U.S. 1226 (1984); United States v. States, 488 F.2d 761, 763-64 (8th Cir. 1973), *cert denied*, 417 U.S. 909 (1974) (criminal sanctions under mail fraud).

79. *See* Morano, *The Mail-Fraud Statute: A Procrustean Bed*, 14 J. MARSHALL L. REV. 45,

The mail fraud statute and its companion wire fraud statute are considered as first line defenses against new types of fraudulent schemes until Congress is able to enact particularized legislation.[80] The wire and mail fraud statutes[81] each contain two elements which the government must prove for prosecution.[82] The first element requires the purposeful use of the wire or mails to carry out some essential step in the execution of a fraudulent scheme.[83] Purposeful use of the mails occurs anytime the defendant acts with knowledge that use of

---

46-48 (1980). The original mail fraud statutes were enacted in 1872 with other legislation that extended federal authority over powers once reserved to the states. *Id. See also* Rakoff, *The Federal Mail Fraud Statute*, 18 DUQ. L. REV. 771 (1980). The statute's purpose was to prevent the post office from being used as a tool to carry out fraudulent schemes. As was the norm for post-civil war legislation, the mail fraud statute was written in broad language suggesting Congress intended it to have versatile applications against schemes to defraud. *Id.* at 782.

80. *See* United States v. Maze, 414 U.S. 395, 405-408 (1974) (Burger, C.J., dissenting). One commentator has criticized the sweeping judicial application of the statutes, stating the courts were using the statutes "as a procrustean bed to fit virtually any conduct by defendants accused of a wide variety of deception." Morano, *supra* note 79, at 47.

> In Greek mythology, Procrustes invited travelers to spend the night as his guests. Procrustes was, however, far from an ideal host. Once he had succeeded in overpowering his unsuspecting guest, he forced him to lie on an iron bed and then robbed him. But worse than the robbery was Procrustes' practice of either stretching out or lopping off the legs of his victims to make their bodies conform to the length of the bed.

Id. at 47, n.3.

81. Title 18, section 1343 of the United States Code provides:

> Whoever, having devised or intending to devise any scheme or artifice to defraud, of for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, transmits or causes to be transmitted by means of wire, radio, or television communication in interstate or foreign commerce, any writings, signs, signals, pictures, or sounds for the purpose of executing such scheme or artifice, shall be fined not more than $1,000 or imprisoned not more than five years, or both.

18 U.S.C. § 1343 (1976). Title 18, section 1341 of the United States Code provides:

> Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, or to sell, dispose of, loan, exchange, alter, give away, distribute, supply or furnish or procure for unlawful use any counterfeit or spurious coin, obligation, security, or other article, or anything represented to be intimated or held out to be such counterfeit or spurious article, for the purpose of executing such scheme or artifice or attempting so to do, places in any post office or authorized depository for mail matter, any matter or thing whatever to be sent or delivered by the Postal Service, or takes or receives therefrom, any such matter or thing, or knowingly causes to be delivered by mail according to the direction thereon, or at the place at which it is directed to be delivered by the person to whom it is addressed, any such matter or thing shall be fined not more than $1,000 or imprisoned not more than five years or both.

Id. § 1341.

82. Pereira v. United States, 347 U.S. 1, 8-9 (1954). The wire fraud statute is nearly identical in wording to the mail fraud statute, except that, instead of the requisite mailing the wire fraud statute requires some interstate or international communication by means of wire, radio or television. Cases construing the mail fraud statute apply to the wire fraud statute as well. *Lemire*, 720 F.2d at 1335 n.6; United States v. Donahue, 539 F.2d 1131, 1135 (8th Cir. 1976).

83. *Pereira*, 347 U.S. at 8-9.

the mails will follow in the reasonably foreseeable course of the transaction.[84]

The second element requires the government to prove the existence of some artifice or unlawful scheme to defraud another of money or property.[85] To determine whether a scheme is unlawful, courts will look to commonly accepted moral standards and will condemn conduct which fails to match the reflection of moral uprightness and fair play.[86] Immoral conduct alone, however, will not constitute a violation of the wire and mail fraud statutes without a showing of specific intent to defraud.[87] Additionally, a conviction may result under the wire and mail fraud statutes regardless of whether the unlawful scheme is successful.[88]

The breach of a fiduciary duty can constitute a scheme to defraud within the meaning of the wire and mail fraud statutes.[89] Courts have held that violations of mail fraud statutes occur when an employee deprives his employer of honest and faithful services.[90] However, breach of fiduciary duty standing alone does not constitute wire or mail fraud.[91] Instead, courts have held that the wire and mail fraud statutes protect against breaches of fiduciary duty that result in some loss to the injured party.[92] However, the types of property that must be lost before a court will find a wire and mail fraud violation remain unsettled.[93]

---

84. *Id.*

85. U.S. v. Beistcher, 467 F.2d. 269, 273 (10th Cir. 1972).

86. *See* Blachly v. United States, 380 F.2d 665, 671 (5th Cir. 1967) (crime of mail fraud broadly construed and can be measured by a nontechnical standard). *See also* Hammerschmidt v. United States, 265 U.S. 182, 188 (1924) (words to defraud in mail fraud statute have common understanding of wronging one of property rights by dishonest methods, trickery or deceit).

87. United States v. Sparrow, 470 F.2d. 885, 889 (10th Cir. 1972). While fraudulent intent need not be directly related to the mailing element, prosecutors must prove fraudulent intent either through circumstantial evidence or through the actions of a codefendant. United States v. Mandel, 415 F. Supp. 997, 1007 (D. Md. 1976). *See also* Note, *Survey of the Mail Fraud Statute*, 8 MEM. ST. U.L. REV. 673, 678 (1978).

88. *See* United States v. Meyers, 359 F.2d 837, 839 (7th Cir. 1966) (since sections 1341 and 1343 read "scheme to defraud" and not "have committed fraud" success is not an element of wire or mail fraud).

89. United States v. George, 477 F.2d 508, 512 (7th Cir. 1971), *cert. denied*, 414 U.S. 827 (1973); Epstein v. United States, 174 F.2d 754, 764 (6th Cir. 1949).

90. *See* United States v. Kreimer, 609 F.2d 126 (5th Cir. 1980) (defendants were insurance agents); United States v. Bryza, 522 F.2d 414 (7th Cir. 1975) *cert. denied*, 426 U.S. 912 (1976) (defendant was a purchasing agent).

91. *See* United States v. Feldman, 711 F.2d 758, 763 (7th Cir. 1983).

92. *Id.*

93. *Compare* United States v. Clapps, 732 F.2d 1148, 1152 (3rd Cir. 1984) (only tangible property covered by mail fraud statute) *with* United States v. States, 448 F.2d 761, 764 (8th Cir. 1973) (intangible property protected by wire and mail fraud statute).

Many courts construed the statutory prohibitions against a scheme to defraud and the requirement for property loss as independant because these two elements appear in the disjunctive.[94] Under this approach, anyone could be convicted for wire or mail fraud if the scheme attempted to deprive citizens of intangible political or civil rights or if the scheme involved a breach of a fiduciary duty.[95]

Recently, the Supreme Court limited use of the wire and mail fraud statutes to schemes involving loss of property rights. In *McNally v. United States*,[96] the Supreme Court determined that the wire and mail fraud statutes did not extend to protect the intangible rights of citizens to good government.[97] McNally and a public official, Gray, took part in a conspiracy whereby they and other conspirators would indirectly receive a portion of the commissions paid to Kentucky's insurance agent in exchange for the continued use of the agent to obtain the state's insurance policies.[98] McNally and Gray were convicted on charges of mail fraud and conspiracy under an instruction to the jury that mail fraud included acts which deprive the citizens of the intangible right to honest and faithful government.[99]

The Supreme Court reversed the convictions as improper in view of the legislative history of the statutes.[100] The Court held that the wire and mail fraud statutes clearly protect property rights, but do not mention the intangible right of the citizenry to honest and faithful

---

94. *See, e.g., Clapps*, 732 F.2d at 1152; *States*, 488 F.2d at 764.

95. *See, e.g.*, United States v. Holzer, 816 F.2d 304 (7th Cir. 1987) (county judge convicted for scheme to deprive citizens of intangible rights); United Staes v. Mandel, 591 F.2d 1347 (4th Cir. 1979) (Governor of Maryland, same); Shushan v. United States, 117 F.2d 110 (5th Cir. 1940) *cert. denied*, 313 U.S. 574 (1941) (parish levy board member, same); United States v. Curry, 681 F.2d 406 (5th Cir. 1982) (political action committee chairman convicted for breach of fiduciary duty); United States v. Von Barta, 635 F.2d 999 (2d Cir. 1980) (securities trader, same); United States v. Bohonus, 628 F.2d 1167 (9th Cir. 1980) (insurance manager, same).

96. 107 S. Ct. 2875 (1987).

97. *Id.* at 2881.

98. *Id.* at 2878. The official was in charge of selecting insurance carriers for the state. The scheme provided that excess commissions would be paid to a company operated by McNally and the other conspirators. *Id.*

99. *Id.* at 2878-79.

100. *Id.* at 2879. The Court stated: "Insofar as the sparse legislative history reveals anything, it indicates that the original impetus behind the mail fraud statute was to protect the people from schemes to deprive them of their money and property." *Id.* The Court appeared particularly persuaded by Congress' amendment of the statute in 1909 adding the words "or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises" after the original phrase "any scheme or artifice to defraud." *Id.* at 2880. The Court held that the amendment signified Congress' intent to limit the reach of the statute. *Id.* at 2881. In a spirited dissent, Justice Stevens attacked the majority's reasoning by contending the phrases are independent, and had been construed as independent by every court to consider the matter. *Id.* at 2884 (Stevens, J., dissenting).

government.[101] The Court held that the lack of a clear and definite expression by Congress to extend the reach of the statutes to schemes involving deprivation of intangible rights provided no other possible construction.[102]

By explicitly limiting the scope of the wire and mail fraud statutes to property rights, the *McNally* court cast doubt on a long line of wire and mail fraud cases which had not required proof of property loss.[103] In addition, the Supreme Court failed to define what property rights were protected under the statutes. Consequently, the definition of "protected" property after *McNally* remained unclear. The Court's opportunity to address the issue came in *United States v. Carpenter*.[104]

II. The Case

In *United States v. Carpenter*, an evenly divided United States Supreme Court affirmed a Rule 10b-5 conviction of a Wall Street Journal reporter.[105] The affirmance, without opinion, upheld a reporter's conviction under the misappropriation theory for breaching a duty not to disclose confidential business information.[106] The Court also unanimously affirmed the reporter's conviction under the wire and mail fraud statutes for the same acts which gave rise to the Rule 10b-5 conviction.[107] The Court's opinion clarifies to a degree the controversy surrounding the types of property protected under the wire and mail fraud statutes.[108]

A. The Facts

R. Foster Winans was one of two writers working on a specialized column of the *Wall Street Journal* entitled "Heard on the Street".[109] The column highlighted corporate stocks, analyzing volume, price

101. *Id.* at 2879.
102. *Id.* at 2880.
103. *See* Coyle, *U.S. Prosecutors Reel in Wake of Mail Fraud Ruling*, 9-45 NAT. L.J. 1 (July 20, 1987) (assessment of impact of *McNally* on prosecutions under the wire and mail fraud statutes).
104. 108 S. Ct. 316. *See also infra* notes 105-155 and accompanying text.
105. 108 S. Ct. at 320.
106. *Id.* at 320-21.
107. *Id.* at 320.
108. *See infra* notes 140-148 and accompanying text.
109. United States v. Winans, 612 F. Supp. 827 (S.D.N.Y. 1985), *aff'd in part, rev'd in part*, 791 F.2d 1024 (2d Cir. 1986), *aff'd*, 108 S.Ct. 316 (1987).

movement, and quality for investment purposes.[110] The Journal gave Winans written guidelines concerning personal trading of securities by the employees.[111] Pursuant to *Journal* regulations, the contents of all articles were confidential and the sole property of the *Journal* before publication.[112]

Winans enlisted the assistance of another Journal employee, David Carpenter, to contact a stockbroker about secretly selling the contents and timing of the "Heard on the Street" column before publication.[113] After several conversations with stockbroker Peter Brant, Winans agreed to reveal the content and date of publication of future articles.[114] However, Brant and Winans agreed that Winans would not alter his evaluation of any stock because of the agreement.[115] Based on Winans'information, Brant and an associate at Kidder Peabody, Kenneth Felis, bought and sold securities.[116] The net profit from their trading amounted to $690,000 of which Winans received about $30,000.[117]

In November, 1983, the compliance department at Kidder Peabody noticed a correlation between the recommendations of the published "Heard" articles and the trading in the Felis and Brant accounts.[118] Simultaneously, Winans' supervisors at the Journal began questioning him about his personal trading.[119] Winans denied ever having received money from Brant.[120] The Securities Exchange Commission initiated a formal investigation on March 14, 1984.[121] Because of this investigation, the conspirators attempted to devise a explanation for the payments to Winans, but could not agree on a plan.[122] When the conspirators began arguing over an appropriate explanation to the SEC, Winans and Carpenter voluntarily went to the SEC and disclosed the scheme.[123]

---

110. *Winans*, 612 F. Supp. at 830. Prior to beginning work on the column, Winans was warned by the Journal about how the column's contents could affect trading and prices on the stock market. *Id.*

111. *Id.* at 830.

112. *Id.*

113. *Id.* at 831-32.

114. *Id.* at 832.

115. *Id.* For his part in the scheme Winans was given an initial sum of $15,000 through a check made out to Carpenter. *Id.* at 833.

116. *Id.* From October, 1983, until February, 1984, information from at least twenty-seven articles was given to Brant and Felis in advance of publication. *Id.*

117. *Id.* at 834.

118. *Id.* at 835. On March 1, 1984, the Securities Exchange Commission contacted David Clark who, unbeknownst to Winans, had been included in the scheme by Brant. *Id.* at 836.

119. *Id.*

120. *Id.* at 837.

121. *Id.*

122. *Id.*

123. *Id.* at 838. As part of a plea bargain agreement Brant became a witness for the government. *Id.*

The trial court found Winans and Felis guilty of securities fraud, conspiracy to commit securities fraud, numerous violations of the wire and mail fraud statutes, and conspiracy to commit wire and mail fraud.[124] Carpenter was convicted of aiding and abetting Winans and Felis.[125] The trial court found that Winans violated 10b-5 by misappropriating information obtained from his employment with the Journal.[126] Winans was also convicted of wire and mail fraud for breaching his duty of confidentiality to his employer.[127] The trial court found that Winans' concealment of his prepublication release of the contents of the "Heard" column threatened the Journal's reputation, depriving it of an intangible property right.[128]

The Second Circuit Court of Appeals upheld the convictions under Rule 10b-5 and the wire and mail fraud statutes.[129] The court held that Winans violated Rule 10b-5 when he misappropriated material nonpublic information that he gained in the course of his employment and sold it in violation of a fiduciary duty to his employer.[130] The Court of Appeals addressed Winans' wire and mail fraud convictions briefly and held that the statutes could extend to protect confidentiality and nonpublic information.[131] The Court of Appeals held that the scheme to trade on the information attempted to deprive the Journal of its intangible property right in confidential business information.[132] The appellate court also held that the scheme was sufficient to sustain convictions of wire and mail fraud because it anticipated the use of the wire and mail services to distribute the Journal.[133]

B. The Opinion

The Supreme Court divided evenly on Winans' violation of Rule 10b-5, affirming the lower court's application of the misappropriation

---

124. *Id.*
125. United States v. Carpenter, 108 S. Ct. 316, 319 (1987).
126. *Winans*, 612 F. Supp. at 838.
127. *Id.* For his part, Winans was sentenced to 18 months in prison, 5 years probation, 400 hours community service and fined $5,000. *Id.*
128. *Id.* at 836.
129. United States v. Carpenter, 791 F.2d 1024, 1026 (1986), *aff'd*, 108 S. Ct. 316 (1987).
130. *Carpenter*, 791 F.2d at 1028.
131. *Id.*
132. *Id.* at 1034-35. The appellate court agreed with the trial court that Winans' concealment of his prepublication release threatened harm to the Journal's reputation. *Id.*
133. *Id.*

theory without opinion.[134] However, the Supreme Court unanimously upheld the conspirators' convictions of wire and mail fraud.[135]

In an opinion by Justice White, the Supreme Court held that intangible property rights are protected by the wire and mail fraud statutes.[136] First, the Supreme Court held that the publication schedule and contents of the *Heard on the Street* column were the property of the Journal and protected by the wire and mail fraud statutes.[137] Second, the Court held the activities of the group constituted a scheme to defraud the Journal as defined by the statutes.[138] Finally, the Court held the fact that the Journal used the wire and mail services was sufficient to satisfy the statutes' purposeful use of the mails requirement.[139]

1. Intangible Property Rights

The principle issue presented to the Supreme Court involved defining the types of property interests protected by the wire and mail fraud statutes.[140] In *McNally*, the Supreme Court stated the wire and mail fraud statutes were limited in scope to the protection of property rights but failed to define which types of property interests were protected by the statutes.[141] The defendants in *Carpenter* argued that the Journal's interest in prepublication confidentiality was too ethereal to be considered a property right and therefore was not protected by the statutes.[142] Additionally, the defendants argued that the statutes were not designed to protect a mere injury to reputation.[143]

The *Carpenter* Court clarified *McNally* and explained that *McNally* did not limit the scope of the statutes' protection to only tangible property rights.[144] The *Carpenter* court found that confidential in-

134. United States v. Carpenter, 108 S. Ct. 316, 320 (1987). The Court stated: "The Court is evenly divided with respect to the convictions under the securities laws and for that reason affirms the judgment below on those counts." *Id.*

135. *Id.* at 316.

136. *Id.*

137. *Id.* at 321.

138. *Id.*

139. *Id.* at 322.

140. *Id.* at 320.

141. McNally v. United States, 107 S. Ct. 2875, 2879. The Court also stated the statutes did not extend to schemes to defraud citizens of the intangible right to fair and impartial government. *Id.*

142. *Carpenter*, 108 S. Ct. at 320.

143. *Id.*

144. *Id.* The Court stated: "*McNally* did not limit the scope of § 1341 to tangible as distinguished from intangible property rights." *Id.*

formation compiled in the course of business is a "recognized" property right.[145] The Court observed that the intangible nature of business information did not make it any less protected by the statutes.[146] Accordingly, the Court held that the *Journal* had a property right in keeping the timing and contents of the "Heard on the Street" column confidential before publication.[147] By selling the contents and the information as to the timing of the column in advance of publication, Winans deprived the *Journal* of its property rights to confidentiality and exclusive use of confidential business information.[148]

2. Scheme to Defraud

After determining that Winans had deprived the *Journal* of a protected property right, the Court addressed whether the conspirators' activities amounted to a scheme to defraud as proscribed by the wire and mail fraud statutes.[149] Reiterating the broad definition of fraud under the statutes, the Court agreed with the appellate court and found that Winans breached his fiduciary duty by violating his agreement with the *Journal.*[150] The Court observed that Winans employment with the *Journal* constituted an undertaking that he not reveal prepublication information about his column and observed that this undertaking occurs whether or not the employment agreement is in writing.[151] Therefore, the conspiracy to deprive the *Journal*

---

145. *Id.* (citing Ruckelshaus v. Monsanto Co., 467 U.S. 986 (1984) and Dirks v. SEC, 463 U.S. 646 (1983)).

146. *Id.* The Court noted that confidential news information has been recognized as property, quoting language from International News Service v. Associated Press, 248 U.S. 215, 236 (1918):

> [N]ews matter, however little susceptible of ownership or dominion in the absolute sense, is stock and trade, to be gathered at the cost of enterprise, organization, skill, labor, and money, and to be distributed and sold to those who will pay money for it, as for any other merchandise.

Id. at 321.

147. *Id.* at 321-22.

148. *Id.* at 321. The Court also dismissed the defendants' argument that they did not interfere with the Journal's use of the information or deprive the Journal of the first public use of the information. The Court stated the loss of exclusive use was enough, "for exclusivity is an important aspect of confidential business information and most private property for that matter." *Id.* It should be noted that the Court failed to address in its opinion the defendant's argument that mere reputation is not a protectable property right under the statutes.

149. *Id.*

150. *Id.*

151. *Id.* The Court quoted Snepp v. United States, 444 U.S. 507, 515 (1980), stating that "even in the absence of a written contract, an employee has a fiduciary obligation to protect confidential information obtained during the course of his employment." *Carpenter*, 108 S. Ct. at 321.

of its confidential information was a scheme to defraud within the proscription of the wire and mail fraud statutes.[152]

3. *Use of the Wire and Mail Services*

The conspirators argued that the Journal's use of the wires and mail to print and send the Journal to its customers did not satisfy the statutory requirement that those sevices be used to execute the scheme.[153] The Court dismissed the conspirators' claim and agreed with the trial and appellate courts that circulation of the Journal was not only anticipated but an essential part of the scheme.[154] The Court observed that if the column had not been available to the Journal's customers through the mail and wire services there would have been no effect on stock prices and no likelihood of profiting from Winans' breach of confidentiality.[155]

III. Legal Ramifications

A. *Rule 10b-5*

The decision, by an equally divided court, upholding Carpenter's securities fraud conviction under Rule 10b-5 only affirms the decision of the appellate court: it is, therefore, of no precedential value.[156] At a bare minimum, however, it appears that four Justices[157] would approve the use of the misappropriation theory in situations involving misuse of confidential information.[158] It remains an open question whether the four votes against affirming Winans' Rule 10b-5 conviction[159] signal disapproval of the misappropriation as an unjus-

---

152. *Carpenter*, 108 S. Ct. at 321.
153. *Id.* at 322.
154. *Id.*
155. *Id.*
156. *See* Neil v. Biggers, 409 U.S. 188, 191-92 (1972) (affirmance by even split not considered an actual adjudication of the case). *See also* Ohio *ex rel.* Eaton v. Price, 364 U.S. 263, 264 (1960) (affirmance by an equally divided court not entitled to precedential weight).
157. Although the exact vote was not disclosed, one commentator suggests the four votes in favor of upholding the conviction were Justices Brennan, Marshall, Stevens, and Blackmun. Langevoort, *supra* note 9, at 185.
158. *See supra* note 58 (discussion of the concurring and dissenting opinions in Chiarella v. United States, 445 U.S. 222 (1979).
159. According to Langevoort's analysis the four Justices voting against use of the misappropriation theory were Chief Justice Rehnquist and Justices O'Conner, Scalia, and White. *See supra*, note 157.

tified extension of *Chiarella* or disapproval with the application of the theory to the unusual facts of *Carpenter*.[160] A reconsideration of the issue by all nine justices of the Supreme Court is likely, given that only four votes are needed to grant certiorari. Presumably, newly appointed Justice Anthony M. Kennedy would be in a position to break the tie should the issue arise again. Given Justice Kennedy's penchant for stare decisis and deference to the legislature it is arguable that he would side with those members of the Court who do not approve of extending liability under Rule 10b-5 to situations like those in *Carpenter*.

Whatever the effect of the *Carpenter* ruling, enough confusion remains surrounding the applicability of Rule 10b-5 to the nontraditional insider to warrant congressional action.[161] Until the enactment of new legislation or a change in case law, the government has stated that it will continue to use the misappropriation theory against those involved in insider trading.[162]

B. Wire and Mail Fraud

Carpenter will have important ramifications for future prosecutions against fiduciary fraud, theft of intangible property, and securities fraud under the wire and mail fraud statutes.[163] Although *McNally's* "property" rule was seen as a devastating blow to federal prosecutors, potentially resulting in the reversal of dozens of convictions,[164]

---

160. LANGEVOORT, *supra* note 9, at 185.

161. Nash, *Insider Definition In New Law Urged*, N.Y. Times, Nov. 17, 1987, at D10, col. 1 (east coast ed.).

162. *See* Labaton, *Giuliani Sees Cases Aiding Prosecution*, N.Y. Times, Nov. 17, 1987 at D10, col. 6 (east coast ed.). "Rudolph W. Guilani, the United States Attorney in Manhattan, said yesterday that the United States Supreme Court's ruling against R. Foster Winans meant that his office 'was free to go ahead now' with insider trading cases." *Id. See also supra* notes 51-61 and accompanying text (discussion of the Second Circuit's expansion of misappropriation theory).

163. The government's unfettered access to the wire and mail fraud statutes in cases involving fiduciary fraud as approved by *Carpenter* arguably renders the misappropriation controversy moot. Federal prosecutors can reach many types of securities fraud and exact significant penalties without proving a Rule 10b-5 violation. All that need be shown is that the defendant gained information in breach of a fiduciary duty which deprived another party of intangible property and purchased securities based on that information. Carpenter v. United States, 108 S. Ct. 316, 321 (1987).

164. *See* Coyle, *U.S. Prosecutors Reel in Wake of Mail Fraud Ruling*, Nat'l L. J., July 20, 1987, at 1, col. 2. One Justice Department Official estimated that at least 185 convictions and another 100 cases under investigation at the time could be affected by *McNally*. *See* Note, *Mail Fraud: Termination of the "Intangible Rights" Doctrine—McNally v. United States, 107 S. Ct. 2875 (1987)*, 11 HARV. J.L. & PUB. POL'Y 286, 294. *See, e.g.*, United States v. Gimbel, 830 F.2d

Carpenter's explanation of *McNally* lessens *McNally's* impact.[165] However, in addition to approving wire and mail fraud prosecutions for misuse of intangible property, the *Carpenter* Court also suggested the possibility that federal prosecutors could file new charges using the intangible property rights theory in many of those cases reversed under *McNally*.[166] The degree to which *Carpenter* will extend the scope of wire and mail fraud liability remains to be seen.

The most extreme interpretation of *Carpenter* suggests the decision may extend the wire and mail fraud statutes by criminalizing breaches of confidence in the employer-employee relationship.[167] Under this view, by criminalizing the misuse of information in schemes to defraud, *Carpenter* gives employers the ability to report theft of corporate trade secrets to a federal prosecutor.[168] Additionally, *Carpenter* may provide employers the ability to retaliate against an employee who reports an employer's securities law violation to authorities by asserting the employee has leaked confidential information.[169] Also, employees who want to change employers within the same field may find their movement hampered by the threat of a wire and mail fraud prosecution if they gain employment with a competitor of their former employer.[170] Finally, by basing the decision on the employer-employee relationship, the Court's opinion gives the employer the option to decide whether an employee's conduct will be prosecuted as a federal crime or as simple theft.[171]

These concerns about *Carpenter's* potential effects make it imperative that future cases under the wire and mail fraud statutes are limited to appropriate instances. Courts should be careful to insure that all of the elements of the wire and mail fraud statutes are

---

621 (7th Cir. 1987) (indictment charging attorney with scheme to deprive Treasury Department of information not offense under wire and mail fraud statutes after *McNally*).

165. *See supra* note 144 and accompanying text.

166. *Carpenter*, 108 S. Ct. at 320. *See, e.g., McNally*, 107 S.Ct. at 2882. In *McNally*, the jury was charged it could find the defendants guilty for defrauding the citizens of their right to have government affairs conducted honestly. *Id.* at 2878-79. The Court intimated that had the government alleged the loss of control over how government money was spent the result might have been different. *Id.* at 2882. In his dissent, Justice Stevens went further, stating "Even without Congressional action, prosecutions of corrupt officials who use the mails to further their schemes may continue since it will frequently be possible to prove some loss of money or property." *Id.* at 290 (Stevens, J., dissenting).

167. Labaton, *Decision Seen as Bar to Leaks*, N.Y. Times, Nov. 18, 1987, at D1, col. 5 (national ed.).

168. *Id.*

169. *Id.*

170. *Id.*

171. *Id.*

established before allowing a conviction to stand.[172] Regardless of how far courts extend the definition of intangible property or the scope of the phrase "scheme to defraud" under the wire and mail fraud statutes, a successful prosecution requires proof of specific intent to defraud beyond a reasonable doubt.[173] Therefore, innocent acts involving an employee's use of corporate information could not give rise to criminal prosecution. In addition, the pragmatic problems an employer would face trying to interest a United States Attorney to prosecute a simple case of employee theft under the statutes would prevent all but the most extensive criminal schemes from being prosecuted. Of course, *Carpenter* requires a deprivation of some property[174] and problems of proof of loss may prevent many cases from being brought at the outset.

A more persuasive view of the effects of *Carpenter* is that the opinion did not so much open new vistas for criminal prosecution as make clear that prosecutors can confidently continue to use the wire and mail fraud statutes against schemes to deprive others of intangible forms of property.[175] Although *Carpenter* confirms *McNally's* rule that intangible rights of honest and faithful government are not actionable under the wire and mail fraud statutes,[176] the Court did not approve the unbridled use of federal law to attack every fraudulent scheme using the mails. In addition, the Court's consistent application of the requirement that the wire or mail mediums "be used to execute the scheme,"[177] suggests that a conviction would not stand under the "foreseeably contemplated use of the mails" doctrine which existed prior to *Carpenter*.[178]

---

172. In *Carpenter* the Court stated, "We have little trouble in holding that the conspiracy here to trade on the Journal's confidential information is not outside the reach of the wire and mail fraud statutues, *provided the other elements of the offenses are satisfied.*" (emphasis added). United States v. Carpenter, 108 S. Ct. 316, 321 (1987).

173. *See* United States v. Von Barta, 635 F.2d 999, 1005-06 (2d Cir. 1980) (mail fraud statute requires some misuse of property), *cert. denied*, 450 U.S. 998 (1981); United States v. Bohonus, 628 F.2d 1167, 1172 (9th Cir. 1980), *cert. denied*, 447 U.S. 928 (1980) (same).

174. *Carpenter*, 108 S. Ct. at 320 (quoting McNally v. United States, 107 S. Ct. 2875 (1987) that the mail fraud statute . . . is "limited in scope to the protection of property. . .").

175. Stewart & Wermiel, *High Court Upholds Conviction of Winans, Two Conspirators*, Wall Street Journal, Nov. 17, 1987, at 1, col. 7.

176. *Carpenter*, 108 S. Ct. at 320.

177. *Id.* at 322. The Court stated, "The courts below were quite right in observing that circulation of the 'Heard' column was not only anticipated but an essential part of the scheme." *Id.*

178. *See, e.g.*, United States v. Muni, 668 F.2d 87, 91 (2d Cir. 1981) (knowledge that use of mails was a normal and customary part of the business sufficient to satisfy use of the mails requirment).

However, the *Carpenter* Court's decision that the wire and mail fraud statutes protect intangible rights without defining what those property rights encompass reopens the question many thought was settled in *McNally*.[179] By finding an employee liable for breach of a fiduciary duty which deprived his employer of something other than money or tangible property, while at the same time reaffirming *McNally's* "no fraud for breach of intangible rights to honest government" rule, the *Carpenter* opinion seems to suggest that public officials who defraud citizens should be treated differently than employees of private businesses.[180] Absent a policy reason to justify this distinction, courts confronted with this situation in the future should refuse to accept facially the argument that *McNally* and *Carpenter* deny application of the wire and mail fraud statutes to public officials. Instead, *Carpenter* should be seen as clarifying *McNally's* loss of property requirement.

Although the wire and mail fraud statutes now clearly apply to most cases involving insider trading and fraudulent misuse of information by employees, *Carpenter* alone does nothing to improve the remedies available to the defrauded party.[181] Because only the SEC or other government agencies can prosecute securities fraud under the wire and mail fraud statutes, parties defrauded by insider trading practices or by breach of a confidential relationship must look to other remedies for damage recoveries.[182] This lack of damage remedy may be overcome through the use of other federal statutes after *Carpenter*.[183]

C. *Civil RICO*

One statutory scheme that defrauded parties may invoke is RICO.[184] Congress originally enacted the Racketeer Influenced and Corrupt Organizations Act of 1970 (RICO) to attack the infiltration of

179. *See supra* notes 96-103 and accompanying text.
180. *Carpenter*, 108 S. Ct. at 320.
181. Labaton, *Giuliani Sees Cases Aiding Prosecution*, N. Y. Times, Nov. 17, 1987, at D10, col. 6 (east coast ed.).
182. Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 754-55 (1975). Only a purchaser or seller of securities may bring a claim against the defrauding party under Rule 10b-5. Therefore, victims of fraud who did not purchase or sell securities because of the fraud must look to other remedies. *Id.*
183. *See supra* notes 184-205 and accompanying text.
184. Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §§ 1961-68 (1982).

legitimate business by organized crime.[185] Currently, many RICO claims are filed not against persons associated with criminal organizations, but against otherwise legitimate businesspersons.[186]

RICO provides both civil[187] and criminal[188] sanctions for various acts which constitute a pattern of racketeering activity or investment of income derived from a pattern of racketeering activity.[189] Under the civil remedy of RICO, any party suffering an injury to business or property due to racketeering injury may recover damages.[190] However, proving the existence of a pattern of racketeering activity for the purposes of civil liability requires more than just establishing the commission of two or more "predicate acts."[191] The injured party must establish that these predicate acts are part of a continuing course of criminal conduct.[192]

Included in the list of predicate acts, which can constitute a pattern of racketeering, are violations of the wire and mail fraud statutes.[193]

---

185. Note, *Civil RICO is a Misnomer: The Need for Criminal Procedural Protections in Actions Under 18 U.S.C.* § 1964, 100 HARV. L. REV. 1288, 1290 (1987).

186. *Id.*

187. Title 18, section 1964 of the United States Code provides:

> Any person injured in his business or property by reason of a violation of Section 1962 of this chapter may sue therefore in any appropriate United States district court and shall recover threefold the damages he sustains and the cost of the suit, including a reasonable attorney's fee.

18 U.S.C. § 1964(e) (1982).

188. *See id.* § 1963 (criminal sanctions for violations of RICO's substantive provisions).

189. Title 18, section 1963 of the United States Code provides:

> It shall be unlawful;
>
> (a) . . . for any person who has received any income derived, directly or indirectly, from a pattern of racketeering activity . . . to use or invest, directly or indirectly, any part of such income, or the proceeds of such income, in acquisition of any interest in, or the establishment or operation of, any enterprise which is engaged in, or the activities of which affect, interstate or foreign commerce . . .
>
> (b) . . . for any person through a pattern of racketeering activity . . . to acquire or maintain . . . any interest in or control of any enterprise which is engaged in, or activities of which affect, interstate or foreign commerce.
>
> (c) . . . for any person employed or associated with any enterprise engaged in, or the activities of which affect, interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity . . .
>
> (d) . . . for any person to conspire to violate any of the provisions of subsections (a), (b), or (c) of this section . . . .

Id. § 1962.

190. Abrams, *The Civil RICO Controversy Reaches the Supreme Court*, 13 HOFSTRA L. REV. 147, 152. A racketeering injury is any injury caused by a pattern of racketeering as defined by 18 U.S.C. 1962(1). This tautalogical explanantion is ambiguous at best and has been the subject of extensive court interpretation. *Id.* at 152 n.28.

191. *Id.* at 177. A predicate act is any of the numerous criminal acts proscribed by the RICO statues. Examples include murder, kidnapping, gambling, arson, extortion, and wire and mail fraud. *Id. See also* 18 U.S.C. § 1962(1) (1982) (list of activities constituting "racketeering injury").

192. *Abrams, supra* note 190, at 177.

193. 18 U.S.C. § 1962.

Since violations of the wire and mail fraud statutes often involve schemes to deprive others of property,[194] a continuing course of criminal conduct could be readily established. Consequently, a private party may bring a civil RICO action for damages resulting to a business from a frudulent wire and mail fraud scheme.[195]

RICO is an extremely attractive alternative for the private litigant for several reasons. First, civil RICO imposes treble damages upon the defrauding party and provides for the award of court costs and attorney's fees.[196] Second, no prior criminal conviction of the underlying predicate acts is necessary under civil RICO.[197] Third, the burden of proof required to establish the predicate acts is by a preponderance of the evidence, even though the predicate act is criminal in nature.[198] Finally, civil RICO allows the litigant to bring suit in federal court and append state claims.[199] In some jurisdictions (notably California), litigants may bring a civil RICO action in state court along with other state causes of action under the doctrine of concurrent jurisdiction.[200]

Until the advent of civil RICO, private litigants had no access to the wire and mail fraud statutes. However, after *Carpenter*'s determination that an employee's breach of duty to an employer could violate the wire and mail fraud statute, actions that in the past could not be litigated in a civil forum can now serve as the predicate acts for civil RICO.[201] Therefore, schemes that involve insider trading or employee misuse of confidential information and which constitute a violation of the wire and mail fraud statutes will create a private cause of action for stockholders and employers.[202] If this view of civil RICO prevails, the statute could create a federal cause of action for victims of common law fraud.[203] Similarly, a business could bring

---

194. *See, e.g.,* Carpenter v. United States, 108 S. Ct. 316 (1987); United States v. Newman, 664 F.2d 12 (2d Cir. 1981).

195. Abrams, *supra* note 190, at 179.

196. 18 U.S.C. § 1964(c) (1982).

197. Sedima, S.P.R.L. v. Imrex Co., 473 U.S. 479, 485 (1985).

198. Wilcox v. First Interstate Bank of Oregon, 815 F.2d 522, 531 (9th Cir. 1987). *See also* United States v. Cappetto, 502 F.2d 1351, 1357 (7th Cir. 1974), *cert. denied,* 420 U.S. 925 (1975); United States v. Local 560, Int'l Bhd of Teamsters, 780 F.2d 267, 279 (3d Cir. 1985), *cert. denied,* 106 S.Ct. 2247 (1986); Note, *supra* note 185, at 1290.

199. Haroco v. American Nat'l Bank & Trust Co., 747 F.2d 384 (7th Cir. 1984), *aff'd,* 469 U.S. 1157.

200. Clanci v. Superior Court, 40 Cal. 3d 903, 710 P.2d 375, 221 Cal. Rptr. 575 (1985).

201. Moss v. Morgan Stanley Inc., 719 F.2d 5, 21 (2d Cir. 1983), *cert. denied,* 104 S. Ct. 1280 (1984) .

202. *See supra* notes 163-83 and accompanying text.

203. *See supra* notes 193-95 and accompanying text.

an action under civil RICO for injury to reputation. Not only would the sanctions be potentially severe for the defendant, but also the use of the wire and mail fraud statutes, in conjunction with civil RICO, could brand the losing party a criminal and a racketeer without affording him the protections of due process of law.[204] These possible results would be beyond anything Congress could have imagined when these statutes were enacted and give some credence to the cries of commentators asking the Court to limit the breadth of civil RICO.[205]

CONCLUSION

In *United States v. Carpenter*, the United States Supreme Court split evenly on whether a financial reporter violates Rule 10b-5 by selling the contents and timing of his stock analysis column prior to publication with the knowledge that the column will affect the stock market when released.[206] The decision places the legality of the misappropriation theory in question and raises the need for Congress to resolve the issue.

Additionally, the Supreme Court held that a financial reporter violates the wire and mail fraud statutes by defrauding his employer of confidential business information.[207] The Court determined that the wire and mail fraud statutes protect intangible property rights as well as tangible property.[208] However, the Court reiterated the rule that the wire and mail fraud statutes do not prohibit public servants from defrauding citizens of the intangible right to honest and faithful government.[209] This extension of the wire and mail fraud statutes to intangible property has two significant effects. First, many convictions of public officials which were overturned because they did not satisfy the *McNally* "property" requirement can be retried if the government can allege the citizens were defrauded of "intangible property." Second, a defrauded party may now use the statutes to establish a civil RICO claim and recover damages for a breach of confidentiality that injures business reputation. These effects create

204. *See* Note, *supra* note 185, at 1290-91 (discussing cases where defendant of civil RICO found not entitled to criminal procedural protections).
205. *See, e.g.*, Note, *supra* note 185; *Abrams, supra* note 190.
206. United States v. Carpenter, 108 S. Ct. 316, 320 (1987).
207. *Id.* at 321.
208. *Id.* at 320.
209. *Id.*

the need for Congressional review of the wire and mail fraud statutes and the Racketeer Influenced Corrupt Organizations statutes.

Douglas A. Hunt
Michael R. Seyle