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PROCEEDINGS BEFORE

THE SUPREME COURT

OF THE

UNITED STATES

CAPTION: UNITED STATES, Petitioner v. JAMES HERMAN O'HAGAN

CASE NO: 96-842

PLACE: Washington, D.C.

DATE: Wednesday, April 16, 1997

PAGES: 1-52

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1 IN THE SUPREME COURT OF THE UNITED STATES

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3 UNITED STATES, :

4 Petitioner :

5 v. : No. 96-842

6 JAMES HERMAN O'HAGAN :

7 - - - - - - - - - - - - - - - -X

8 Washington, D.C.

9 Wednesday, April 16, 1997

10 The above-entitled matter came on for oral

11 argument before the Supreme Court of the United States at

12 10:02 a.m.

13 APPEARANCES:

14 MICHAEL R. DREEBEN, ESQ., Deputy Solicitor General,

15 Department of Justice, Washington, D.C.; on behalf of

16 the Petitioner.

17 JOHN D. FRENCH, ESQ., Minneapolis, Minnesota; on behalf of

18 the Respondent.

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1 P R O C E E D I N G S

2 (10:02 a.m.)

3 CHIEF JUSTICE REHNQUIST: We'll hear argument

4 now in Number 96-842, United States v. James Herman

5 O'Hagan.

6 Mr. Dreeben.

7 ORAL ARGUMENT OF MICHAEL R. DREEBEN

8 ON BEHALF OF THE PETITIONER

9 MR. DREEBEN: Mr. Chief Justice, and may it

10 please the Court:

11 Information is the lifeblood of the securities

12 markets. Markets thrive on legitimate efforts to acquire,

13 analyze, and use information, but the deceptive

14 acquisition and use of information in securities trading

15 serves no legitimate purpose. Respondent's securities

16 trading involved just such deception.

17 Respondent is a lawyer whose firm was entrusted

18 with the confidential plans of a client that had planned

19 to make a tender offer for the Pillsbury company. While

20 posing as a loyal partner in his law firm, respondent

21 misappropriated that information in breach of his

22 fiduciary duties to the firm and his client and reaped

23 personal profits in virtually risk-free trading in

24 Pillsbury stock and options.

25 By engaging in that form of deception in

1 connection with his trading, respondent violated three
2 prohibitions of Federal law: section 10(b) of the
3 Securities Exchange Act, section 14(e) of the Exchange
4 Act, and the mail fraud statute.
5 Now, the misappropriation theory under section
6 10(b) of the Securities Exchange Act posits that a
7 fiduciary or other person with a similar relationship of
8 trust and confidence commits deception on the legitimate
9 owner of information if that fiduciary or other agent
10 misappropriates the information by using it in securities
11 trading, contrary to the view of the United States Court
12 of Appeals for the Eighth Circuit.
13 QUESTION: Mr. Dreeben, just by
14 misappropriating? I mean, suppose the defendant here had
15 instead come clean, and he told his superiors in the law
16 firm that he was going to use this information. Then he
17 would not be posing as a loyal employee any more, and it
18 would have been okay.
19 MR. DREEBEN: He would not have deceived his
20 employer. He still would have breached independent
21 fiduciary duties that he owed to that employer.
22 QUESTION: And you say he would still have
23 breached the securities laws.
24 MR. DREEBEN: No, I do not think he would have
25 breached the securities laws.

1 QUESTION: So that's the line. He didn't tell
2 them that he was going to go out and use it.
3 MR. DREEBEN: That's absolutely correct, and the
4 reason why that is significant is that section 10(b)
5 prohibits deceptive devices and contrivances. It requires
6 deception.
7 The misappropriation theory does involve a
8 breach of fiduciary duty, but the distinctive factor about
9 that breach is that it is a deceptive breach. It
10 involves, just as the facts did in Carpenter v. United
11 States, an agent entrusted with information by a principal
12 under the understanding between the parties that the agent
13 would not use that information for any personal gain
14 without obtaining the principal's agreement.
15 QUESTION: Well, Mr. Dreeben, then if someone
16 stole the lawyer's briefcase and discovered the
17 information and traded on it, no violation?
18 MR. DREEBEN: That's correct, Justice O'Connor.
19 QUESTION: And if a partner perhaps in the law
20 firm, the lawyer let his daughter know about the planned
21 merger inadvertently and the daughter relied on the
22 information and bought stock options, violation? The
23 daughter has no obligation to disclose.
24 MR. DREEBEN: Correct, Justice O'Connor, and the
25 answer to that is probably not, although there has been

1 litigation about whether in particular circumstances a
2 family relationship is sufficiently imbued with a business
3 context that there is a duty that runs to it, but I accept
4 the general thrust of your hypotheticals.
5 There are forms of improper conduct that section
6 10(b) does not reach, and the reason why section 10(b)
7 does not reach them is it is a statute that is framed to
8 reach fraudulent deceptive activity in connection with
9 securities trading. That is --
10 QUESTION: Well, Mr. Dreeben, where is -- the
11 thing that bothers me about the case here is, where is the
12 connection between the deceptive device and the purchase
13 or sale of a security?
14 MR. DREEBEN: The connection, Chief Justice
15 Rehnquist, lies in the fact that the misappropriation does
16 not occur until the lawyer uses the information as the
17 basis for his trades. It is that very information which
18 drives his participation in the market and allows the
19 profits to be reached -- reaped by him.
20 QUESTION: But he didn't deceive anyone who sold
21 him securities.
22 MR. DREEBEN: That is true. The
23 misappropriation theory doesn't rely on the notion that he
24 owed a duty of disclosure to the shareholders on the other
25 side of the transaction, but it does satisfy the requisite

1 connection between the fraud and the securities trading,
2 because it is only in the trading that the fraud is
3 consummated. There could be no closer --
4 QUESTION: But you think of fraud being
5 practiced on a person who is damaged by it.
6 MR. DREEBEN: I think that under the common law
7 view of fraud, Chief Justice Rehnquist, that is an
8 accurate statement, but the securities laws are not framed
9 to pick up only those violations that are covered by
10 common law fraud. Congress did not pass a statute that
11 says, it is unlawful to commit fraud on the purchaser or
12 seller of securities.
13 Congress did not pass a law even that said it is
14 unlawful to commit fraud in a securities transaction. It
15 passed a law with a broader phrase, in connection with a
16 securities transaction, because the very aim of this
17 section was to pick up unforeseen, cunning, deceptive
18 devices that people might cleverly use in the securities
19 markets --
20 QUESTION: That's rather unusual, for a criminal
21 statute to be that open-ended, isn't it?
22 MR. DREEBEN: I don't think that it's unusual to
23 give the text of this statute its natural reading. What
24 it requires is proof of fraud, and then it requires proof
25 that there's a connection between the fraud and the

1 trading. In this case, as I've said, there could be no
2 closer connection. It is only by the trading itself that
3 the fraud is consummated, and that is exactly a connection
4 that is picked up by the language of the statute.
5 QUESTION: What if Grand Met had its own
6 strategy to purchase shares for some reason to make the
7 price go up temporarily? I don't know quite how the
8 hypothetical would play out, but suppose this was in Grand
9 Met's interest, and yet all the facts were the same. The
10 lawyer -- it didn't know the lawyer was doing it. It was
11 doing it on it's own, but what the lawyer did was also
12 helping its grand scheme.
13 MR. DREEBEN: That --
14 QUESTION: Would there be a misappropriation
15 there?
16 MR. DREEBEN: Yes, there would. First of all
17 that wouldn't have any effect on the violation that
18 respondent committed on his law firm. He owed his law
19 firm a duty of trust and confidence in addition to the
20 duty he owed to the client, but more importantly than
21 that, in this case there was no evidence that Grand Met
22 knew about --
23 QUESTION: But in the hypothetical you and I are
24 discussing, if he came clean with the law firm and the
25 whole law firm was doing it, then no violation?

1 MR. DREEBEN: If he didn't deceive anyone by
2 doing this, he would not --
3 QUESTION: What if he didn't tell the client.
4 MR. DREEBEN: Well, then the client would be
5 deceived. Whoever does not know about this and has not
6 authorized it is a victim of the fraud, just as in the
7 Carpenter case, if Weinans had gone to the Wall Street
8 Journal and said, look, you know, you're not paying me
9 very much. I'd like to make a little bit more money by
10 buying stock, the stocks that are going to appear in my
11 Heard on the Street column, and the Wall Street Journal
12 said, that's fine, there would have been no deception of
13 the Wall Street Journal.
14 The statute does require deception, but there
15 can be no doubt in a case like this that there is
16 deception. This is the identical kind of fraudulent
17 conduct that the Court had before it in the Carpenter
18 case.
19 QUESTION: Well, I'm not so sure I agree with
20 you on that point, at least as to the -- the Wall Street
21 Journal in Carpenter was said to have a property interest
22 in the confidentiality, or in the use of the notes for the
23 column. Here, there doesn't seem to be any property
24 interest involved.
25 MR. DREEBEN: Well, the property interest here

1 is exactly the same as it was in Carpenter. It's the
2 information itself, which Grand Met has a right to
3 determine how it would be used.
4 It has a right to maintain its exclusive right
5 to use the information and not to have the agents, upon
6 whom it must rely if it's going to engage in any kind of
7 business activity, misappropriate that information for
8 personal gain, and I think it's a very well-settled
9 concept of the common law and of the law of fraud that
10 information is a species of property, so that --
11 QUESTION: Mr. -- I'm sorry. I didn't mean to
12 interrupt.
13 MR. DREEBEN: So the deceptive conduct here is,
14 in essence, indistinguishable from the deceptive conduct
15 that the Court found in the Carpenter case.
16 QUESTION: Do you take the position that every
17 relationship of trust also implies the duty to disclose if
18 the trust is to be breached?
19 MR. DREEBEN: I don't, Justice Souter. I think
20 that --
21 QUESTION: How do we know this is such a case
22 and the others are not, then?
23 MR. DREEBEN: Well, this is such a case because
24 it involves a relationship right at the core of what has
25 been defined as the principal agent-fiduciary trustee

1 relationship.

2 QUESTION: Well, but so does a -- I suppose a

3 lawyer in a trust relationship with his client in the

4 handling of funds, and yet if a lawyer -- I presume that

5 if a lawyer disclosed to his client that he was going to

6 commingle, or he was going to borrow, as it were, the

7 client's funds for personal reasons, that that would not

8 be a defense either to a professional or a statutory

9 charge against him.

10 Perhaps I'm wrong there, but I assumed it would

11 not, so I'm not sure why, then, number 1 there is a

12 disclosure obligation here, whereas a disclosure

13 obligation there would be of no point --

14 MR. DREEBEN: The --

15 QUESTION: -- and the one would be a defense and

16 the other wouldn't.

17 MR. DREEBEN: Justice Souter, the reason why it

18 makes a difference is that the disclosure obligation is a

19 prerequisite to obtaining the consent of the principal or

20 the owner of the trust.

21 QUESTION: But I thought -- maybe I

22 misunderstood your answer earlier. I thought that if

23 there were a disclosure but no consent that would in

24 effect preclude liability. You're saying there must be a

25 disclosure and consent.

1 MR. DREEBEN: To satisfy the common law rule
2 that a trustee may not use the property that's been
3 entrusted with him, there would have to be consent. To
4 satisfy the requirement of the Securities Act that there
5 be no deception, there would only have to be disclosure.
6 QUESTION: I thought that was what you answered
7 Justice Scalia when he asked the question.
8 QUESTION: Yes, that's what I thought, too.
9 MR. DREEBEN: That's correct.
10 QUESTION: And -- but there would be in that
11 case other sanctions immediately.
12 MR. DREEBEN: That's correct.
13 QUESTION: If you told the law firm, look, I'm
14 going to do this, the law firm isn't going to consent but
15 it's not likely he'll retain his job, and there might be
16 other sanctions.
17 MR. DREEBEN: That's correct. It would still
18 be --
19 QUESTION: In that case it's not 10(b)5.
20 MR. DREEBEN: It's not 10(b)5. It would still
21 be a breach of fiduciary duty, but that makes the point
22 that I'm trying to make here. Not every breach of
23 fiduciary duty involves deception, but a breach of
24 fiduciary duty when that breach involves the obligation to
25 make disclosure does involve deception. That, in fact, is

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1 the foundation of this Court's rulings in Chiarella and
2 Dirks that an insider in a corporation has a duty to his
3 shareholders to make disclosure before trading with them.
4 QUESTION: There's one thing that I'm still not
5 clear on, and that is, what is it that is peculiar about
6 some breaches of trust, or some obligations of trust, that
7 raise the disclosure obligation whereas others do not have
8 a disclosure obligation that would at all be relevant?
9 MR. DREEBEN: The answer, Justice Souter, is
10 that there are some things that a trustee cannot do even
11 if he does disclose them. They will still be breaches of
12 fiduciary duty, but there are some breaches of fiduciary
13 duty that inherently require a breach of the duty to make
14 disclosure.
15 QUESTION: You rely on disclosure as just a
16 reverse mechanism for defining deception.
17 MR. DREEBEN: Correct. I think that it's clear
18 under this Court's decisions in Chiarella and Dirks that
19 generally silence is not fraudulent in conducting a
20 transaction, but it becomes fraudulent if there is a duty
21 to make disclosure, and the Court in the Chiarella and
22 Dirks cases looked to well-settled understandings which it
23 then believed were incorporated into 10(b) about when
24 disclosure is required.
25 QUESTION: If you read a horn-book on tort law

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1 does it say that the essence of deception is
2 nondisclosure? That's what you're asking us to write, I
3 suppose.
4 MR. DREEBEN: I'm not asking the Court to do
5 anything more than to reaffirm the basic principle that it
6 adopted in Carpenter v. United States that an agent who
7 misappropriates his principal's property by posing as a
8 loyal employee when in fact he's reaping personal gain
9 with that property has committed a form of deception,
10 indeed, a form of fraud, and that fraud satisfies both the
11 mail fraud statute and it satisfies section 10(b).
12 QUESTION: May I ask you one question, Mr.
13 Dreeben? I'm a little puzzled by your statement that --
14 if I understood you correctly, that if the defendant here
15 had disclosed to his partners, that would have avoided
16 liability, and you're suggesting there was therefore no
17 duty to disclose to the client.
18 MR. DREEBEN: No, I think there is a duty to
19 disclose to the client as well. I think that there are
20 two victims, direct victims of the deception.
21 QUESTION: But supposing in this case he had
22 disclosed to his partner, and his partner had just kept
23 the information to himself, and then he had gone -- the
24 defendant had gone ahead with his trading. Would there be
25 a violation?

1 MR. DREEBEN: Yes, there would, but we would not
2 have been able to charge it the same way as we charged
3 this case.
4 QUESTION: I see. You then would have said
5 there was a breach of the firm's duty to the client.
6 MR. DREEBEN: That's correct. In this case, the
7 jury was instructed that it could rely on a finding of a
8 breach of duty either to the law firm or to the client or
9 to both, and it had to be unanimous about which one it
10 found, but it had to find one or the other, or it could
11 find both, and if there was disclosure, the party that
12 received the disclosure would not be a victim of the fraud
13 on our theory.
14 QUESTION: Mr. Dreeben --
15 QUESTION: Now, Mr. Dreeben, we -- this Court
16 has always required either a misrepresentation or an
17 omission to find 10(b) liability, I think, and you say
18 there was an omission here by the failure to disclose.
19 MR. DREEBEN: Yes, and I say that there is an
20 omission by the failure to disclose in exactly the same
21 way as there was in Carpenter. I also believe that the
22 Court has never ruled out what seems commonsensical under
23 10(b), the idea that the conduct itself, even without a
24 statement or an omission, can be deceptive.
25 I mean, here you have a lawyer who worked in his

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1 firm, came to work every day posing as a loyal partner,
2 engaging his partners in discussions about firm business,
3 under the understanding that he was doing this in the
4 interests of the firm, when in fact, as the jury
5 concluded, he used the information that he acquired to
6 finance -- to enable his own securities purchases and to
7 profit --
8 QUESTION: Well, any, any fraud is deception,
9 then. I assume that, you know, if a lawyer takes the
10 client's money that's supposed to be in a trust account
11 and just removes it posing as an honest lawyer, I mean,
12 you know, everybody who commits any fraud is guilty of
13 deception. Isn't that right?
14 MR. DREEBEN: And the Court -- yes, Justice
15 Scalia, and the Court said --
16 QUESTION: What if I appropriate some of my
17 client's money in order to buy stock?
18 MR. DREEBEN: The fact --
19 QUESTION: Have I violated the securities laws?
20 MR. DREEBEN: I do not think that you have.
21 QUESTION: Why not? Isn't that in connection
22 with the purchase of security just as much as this one is?
23 MR. DREEBEN: It's not just as much as this one
24 is, because in this case it is the use of the information
25 that enables the profits, pure and simple. There would be

1 no opportunity to engage in profit --

2 QUESTION: Same here. I didn't have the money.

3 The only way I could buy this stock was to get the money.

4 MR. DREEBEN: The difference --

5 QUESTION: And I got the money posing as an

6 honest lawyer.

7 MR. DREEBEN: The difference, Justice Scalia, is

8 that once you have the money you can do anything you want

9 with it. In a sense, the fraud is complete at that point,

10 and then you go on and you can use the money to finance

11 any number of other activities, but the connection is far

12 less close than in this case, where the only value of this

13 information for personal profit for respondent was to take

14 it and profit in the securities markets by trading on it.

15 QUESTION: Why isn't the client entrusted just

16 as totally when he entrusts money as when he entrusts

17 information? I don't under -- I guess my problem is --

18 MR. DREEBEN: He does, Justice Souter.

19 QUESTION: -- the same as Justice Scalia's. I

20 don't -- if we're starting with a breach of trust, I don't

21 see why a breach of trust with respect to a fact which is

22 communicated gives rise to a disclosure obligation when a

23 breach of trust with respect to some other thing of value,

24 e.g., the contents of the trust account, does not.

25 MR. DREEBEN: I perhaps was not clear in

1 answering Justice Scalia, Justice Souter. It is just as
2 much of a breach, and it is just as much fraudulent and
3 deceptive, and that, in fact, is what the Court said in
4 Carpenter. Embezzlement is a form of fraud.
5 The question is whether that fraud is in
6 connection with the purchase or sale of the security, and
7 the question is whether that form of fraud which I submit
8 is complete at the time the money is obtained is in
9 connection with the purchase or sale versus this one.
10 QUESTION: So that every breach does give rise
11 to a duty to disclose.
12 MR. DREEBEN: Every breach that involves the
13 misuse of information entrusted to a person or the misuse
14 of property entrusted to a person --
15 QUESTION: Yes.
16 MR. DREEBEN: -- for personal gain, yes.
17 QUESTION: Okay.
18 MR. DREEBEN: That's hornbook law, and I don't
19 think that there's any dispute about that at all.
20 QUESTION: So what you're saying is, is in this
21 case the misappropriation can only be of relevance, or is
22 of substantial relevance, is with reference to the
23 purchase of securities.
24 MR. DREEBEN: Exactly.
25 QUESTION: When you take the money out of the

1 accounts you can go to the racetrack, or whatever.

2 MR. DREEBEN: That's exactly right, and because

3 of that difference, three can be no doubt that this kind

4 of misappropriation of property is in connection with the

5 purchase or sale of securities.

6 Other kinds of misappropriation of property may

7 or may not, but this is a unique form of fraud, unique to

8 the securities markets, in fact, because the only way in

9 which respondent could have profited through this

10 information is by either trading on it or by tipping

11 somebody else to enable their trades.

12 QUESTION: With respect to the tip, I wasn't

13 quite sure of your answer to Justice O'Connor when she

14 brought up the child. Were you responding to her word

15 inadvertent, because if this parent tipped off the child

16 and told the child to purchase the security, surely there

17 would be --

18 MR. DREEBEN: Yes.

19 QUESTION: -- responsibility.

20 MR. DREEBEN: Yes, there would. In a case like

21 that, Justice Ginsburg, a fiduciary cannot do indirectly

22 what he's prohibited from doing directly, and so using the

23 child as the medium for conducting the transaction would

24 be equally forbidden.

25 I think Justice O'Connor's question was getting

1 at the point about whether the child would be committing
2 fraud on the parent if the child engaged in this trading
3 after having learned inadvertently
4 QUESTION: Right. Now --
5 MR. DREEBEN: -- of the information, and I --
6 QUESTION: Let me ask you whether you think
7 section 14(e) provides you with an easier argument for
8 liability than 10(b).
9 MR. DREEBEN: Well, I certainly think that 14(e)
10 provides us with a perfectly valid argument for liability.
11 The theory under section 14 is that Congress specifically
12 gave the Commission regulatory authority in the area of
13 tender offers because it recognized that tender offers
14 pose a very significant threat to investors in the target
15 company having the ability to make decisions about whether
16 to buy, sell, or hold when a tender offer is on the
17 horizon.
18 Congress also knew that there is a great
19 opportunity for insider profiting because the information
20 about a tender offer is necessarily circulated to many
21 professionals in advance of the tender offer who then have
22 the opportunity to go out and trade on it, and as a result
23 of its recognition about the dangers of fraudulent and
24 deceptive practices and tender offers, Congress was not
25 content to rely simply on section 10(b) but drafted a new

1 and different antifraud provision which is backed up by
2 regulatory authority that gives the SEC the power to
3 define and prescribe means reasonably designed to prevent
4 fraudulent, deceptive, manipulative conduct.
5 QUESTION: You omitted one little part there
6 from that sentence, Mr. Dreeben -- designed to prevent
7 such acts and practices as are fraudulent, deceptive, or
8 manipulative.
9 MR. DREEBEN: That's correct, Justice --
10 QUESTION: And it seems to me one could read
11 that as saying that that does not give the SEC authority
12 to define what is fraudulent, what is deceptive or
13 manipulative, but simply to define practices which are in
14 fact fraudulent, and you can't expand on the definition of
15 fraudulent or deceptive.
16 MR. DREEBEN: There are several reasons, Chief
17 Justice Rehnquist, why I think that you're correct that I
18 omitted the words, acts or practices as are fraudulent,
19 but I think that the statute is accurately paraphrased the
20 way that I read it.
21 First, the regulatory authority that is found in
22 section 14(e) was modeled on a different section of the
23 securities laws, not section 10(b), but section 15(c),
24 which dealt with regulating broker-dealers, and in that
25 context Congress had specifically given the SEC the

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1 authority to define fraudulent practices because it wanted
2 to establish a higher standard of obligations and duties
3 than would otherwise be imposed by the common law. It
4 adopted that language in section 14(e) after the SEC had
5 previously exercised its power to create new obligations
6 that weren't found in the common law, unless it's
7 reasonable to infer that Congress expected that authority
8 to be exercised in that fashion.
9 QUESTION: Well, except, now, the Schreiber case
10 indicated that the SEC can't define offensive conduct more
11 broadly than the statute provides.
12 MR. DREEBEN: Actually the Schreiber case,
13 Justice O'Connor, didn't involve any SEC regulation at
14 all. It involved simply the question about whether a
15 fully disclosed act would be deemed manipulative under the
16 first sentence of section 14(e). There were no
17 regulations at issue in the case whatsoever.
18 QUESTION: But there certainly is language in
19 that opinion. I think footnote 11 indicates that SEC
20 can't go more broadly than the terms of the statute.
21 MR. DREEBEN: I think the footnote, read in
22 context, says that the mere promulgation of the regulatory
23 authority for the SEC, the addition of the sentence that
24 gave the SEC regulatory authority, didn't change the
25 meanings of the words in the first sentence, but the Court

1 expressly recognized that Congress had authority -- that
2 Congress had given authority to the SEC not only to define
3 acts or practices as are fraudulent but to prescribe means
4 reasonably designed to prevent them, and the Court
5 explicitly said there that the SEC could prohibit
6 nondeceptive conduct as a means reasonably designed to
7 prevent fraud.
8 So the Court in Schreiber I think did
9 acknowledge that the SEC has very vast regulatory power in
10 order to protect against the abuses that Congress had
11 identified in the tender offer context. Rule 14(e)3 does
12 that by establishing a flat ban on trading by persons who
13 come into possession of information about an upcoming
14 tender offer when they know that it was received from the
15 bidder or somebody acting on its behalf, and that flat ban
16 serves two valuable purposes.
17 The first is that it protects shareholders who
18 are going to be facing a tender offer, or who actually are
19 facing a tender offer, from not having adequate time and
20 adequate information to make a decision whether to buy,
21 sell, or hold.
22 It also prevents collusion between the bidder
23 and other parties operating in the marketplace that has
24 not disclosed to the marketplace, as the Williams Act
25 requires, from buying up stock from unsuspecting

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1 shareholders in the target company.

2 A second purpose that is served by 14(e)3 is the

3 prevention of fraudulent activity that involves, as this

4 case did, the deceptive acquisition of information from

5 the bidder or law firm's accountants, investment bankers

6 that represent it, and it thereby serves to prevent that

7 kind of fraud from occurring, which is a very great

8 danger, and which involves a very great danger of not

9 being detected, because this is in essence a crime that

10 involves surreptitious activity that is not often easy to

11 bring to light.

12 So 14(e)3 carves out in the tender offer context

13 very special heightened rules. It carves out and creates

14 in the tender offer context a disclose or abstain from

15 trading obligation, but it does not apply, as section

16 10(b) does, to the rest of the universe of securities

17 transactions in which the misuse of information can pose

18 very serious threats.

19 QUESTION: Well, 10(e) perhaps does not require

20 a breach of fiduciary duty, or does it?

21 MR. DREEBEN: I'm sorry, which section?

22 QUESTION: 10(e), liability under -- excuse me,

23 QUESTION: 14.

24 QUESTION: 14(e). Does that require a breach of

25 fiduciary duty?

1 MR. DREEBEN: As the SEC has defined the acts
2 that are prohibited in 14(e)3, it does not.
3 QUESTION: Right.
4 MR. DREEBEN: And I think that that is
5 justified, Justice O'Connor, on two bases. First, Rule
6 14(e)3 in essence creates the duty to make disclosure,
7 drawing on Congress' recognition that tender offers pose
8 particular shareholder harms, and they pose particular
9 dangers that the shareholders will not be able to make an
10 important decision.
11 The SEC drew on the regulatory authority it was
12 given to impose a duty to make disclosure, and second, the
13 SEC's rule prevents violations that are akin to the
14 misappropriation violation that occurs under section 10(b)
15 by ensuring that when someone has material information of
16 this character, they simply may not trade, even when there
17 is no proof of a breach of fiduciary duty and deception in
18 that.
19 QUESTION: So that would extend liability to the
20 thief?
21 MR. DREEBEN: It would extend liability to the
22 thief so long as the thief acquired the information from
23 the bidder or somebody acting on its behalf and knew that.
24 Now, what is important about section 10(b)'s
25 application to fraudulent conduct of this kind is that

1 investors in the securities markets rely on the fact that
2 the markets are essentially honest. No investor expects
3 that he may have the skill, expertise, or analytical
4 ability of everybody else in the market, and everyone who
5 enters the market knows that they may be trading with
6 somebody who's smarter than you are or better informed,
7 and you're going to lose.
8 But investors do assume that they are not
9 trading with someone who acquired the informational
10 advantage simply by fraud, simply by stealing information
11 in breach of a fiduciary duty and using it for trading.
12 That --
13 QUESTION: Mr. Dreeben, may I -- you've come
14 back to 10(b), and I had a question that I wanted to ask
15 you and then I got distracted, and I'd like to pose it
16 now.
17 You made it clear, I think, that if the
18 defendant in this case had simply disclosed his intention
19 to use the information but did not receive authority, that
20 there still would be a violation.
21 MR. DREEBEN: No, I think that my position on
22 that is that if there is disclosure to the client there
23 would be no deception of the client. If there's
24 disclosure to the firm, there would be no deception of the
25 firm. There might be --

1 QUESTION: Okay. That's the point at which I
2 guess I got mixed up. You've clarified it now.
3 MR. DREEBEN: Okay. Thank you.
4 I would like to reserve the remainder of my time
5 for rebuttal.
6 QUESTION: Very well, Mr. Dreeben. Mr. French,
7 we'll hear from you.
8 ORAL ARGUMENT OF JOHN D. FRENCH
9 ON BEHALF OF THE RESPONDENT
10 MR. FRENCH: Mr. Chief Justice, and may it
11 please the Court:
12 The respondent in this case was a regular
13 substantial investor in the stock market. He was
14 convicted of 57 counts arising out of an alleged
15 securities fraud and sentenced to 41 months in prison.
16 The basis of that conviction was a set of legal
17 theories that are not incorporated into the text of any
18 statute, that have sown confusion among the courts, and
19 that provide no guidance to participants in the stock
20 market.
21 I ask the Court to consider briefly the
22 application of the Government's theories to what are, for
23 purposes of this appeal, the undisputed facts in this
24 case. I am not now contesting facts. I am asking the
25 Court to think about the way the Government's theories

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1 apply to these facts.

2 On August 12, 1988, the Wall Street Journal

3 reported that a British firm called Grand Metropolitan had

4 put its hotel subsidiary, Intercontinental, up for auction

5 to raise money for an acquisition.

6 On August 18, just 6 days later, a financial

7 columnist named Dan Dorfman, announced on the Cable News

8 Network that people close to Grand Metropolitan -- and

9 that is a common synonym in the trade for people inside

10 Grand Metropolitan -- are telling people in the street

11 that Grand Metropolitan is interested in acquiring

12 Pillsbury.

13 Also on August 18, a broker called respondent to

14 advise that he'd received a $9 million order to buy

15 250,000 shares of Pillsbury stock for a customer in

16 London.

17 QUESTION: Mr. French, I gather you're trying to

18 convince us that the doctrine would apply even if all the

19 relevant information were in the public domain, and I'm

20 assuming that we have a case that the jury found the

21 relevant information was not in the public domain.

22 MR. FRENCH: What I'm suggesting is that if a

23 theory can be applied to result in a conviction of

24 Mr. O'Hagan on the basis of facts which very clearly in

25 the record indicated that he placed all of his orders for

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1 Pillsbury options before August 26, and the Government
2 only indicts him, as the prosecutor says, for trades made
3 from August 26 on, then the theory is grotesque. You
4 cannot, with --
5 QUESTION: The reason it's grotesque, as I
6 understand your presentation, is because the relevant
7 information was in the public domain at the time he made
8 his purchases.
9 MR. FRENCH: The relevant information was in the
10 public domain and, as Your Honor knows, you may only be
11 convicted, even under the Government's theory, if you
12 trade on the basis of.
13 QUESTION: Right, but I would like to try and
14 address the question of what we do with a case in which
15 the facts are the way the Government presents them and the
16 way presumably the jury thought they were, namely that
17 your client acted entirely on the basis of inside
18 information that was not in the public domain.
19 MR. FRENCH: That's --
20 QUESTION: And in that connection I'd be curious
21 to know your view on whether, if it was -- instead of your
22 client, if it had been the partner who was in charge of
23 the matter within the firm who had done this, would you
24 say he would also be -- would he be covered or not, in
25 your view?

1 MR. FRENCH: In my view, we are dealing here
2 with a statute that involves, as Mr. Dreeben said,
3 disclosure.
4 If Mr. O'Hagan had made -- had had this private,
5 nonpublic information that you're hypothesizing and
6 disclosed to the Dorsey firm that he was going to trade on
7 it, according to the Government's theory he couldn't have
8 been prosecuted.
9 To me, that seems to be preposterous. What's
10 wrong with the Government's theory is, it doesn't have
11 anything to do with unfair advantage being taken of a
12 participant in the marketplace.
13 QUESTION: Well, I'm -- my question is, what if
14 he had been the partner in charge of the matter within the
15 firm, and had acted entirely on the basis of nonpublic
16 information. Could the statute apply in that situation,
17 in your view?
18 MR. FRENCH: In my view, according to the
19 Government's theory, the statute would apply.
20 No. In my view, the statute cannot apply.
21 There has been no --
22 QUESTION: Even if this man were the only lawyer
23 working on the matter in the firm for the client.
24 MR. FRENCH: That's correct.
25 QUESTION: And had a clear duty to his client

1 not to disclose.

2 MR. FRENCH: That's correct, Justice Stevens.

3 In my view, it could not apply because --

4 QUESTION: But Mr. French, you would give a

5 different answer, would you not, if the lawyer were in the

6 firm that was assisting Pillsbury in this matter?

7 MR. FRENCH: I certainly would, Your Honor.

8 QUESTION: You have two lawyers, both with the

9 same information, but one is working for the target

10 company and the other is working for the potential

11 takeover company, and you would distinguish those two

12 cases.

13 So everything that you said in the beginning, if

14 we just made one change, made O'Hagan with the firm that's

15 representing Pillsbury, there would be liability and you

16 wouldn't contest that.

17 MR. FRENCH: I wouldn't be here today, Your

18 Honor. The --

19 QUESTION: Is --

20 MR. FRENCH: The statute encompasses deception,

21 and in the context of a nondisclosure, deception occurs in

22 the presence of a fiduciary duty. The lawyer inside

23 Pillsbury has a fiduciary duty to the Pillsbury

24 shareholders. The lawyer outside Pillsbury does not have

25 a fiduciary duty to the Pillsbury shareholders.

1 QUESTION: Well, are you basing your --
2 QUESTION: Deceive the sellers not just deceive
3 somebody who's working for the -- for -- right?
4 MR. FRENCH: That's correct. He has to have
5 deceived the sellers in order --
6 QUESTION: That's the basis for the distinction.
7 MR. FRENCH: A deception in connection with the
8 purchase or sale of a security is the basis of --
9 QUESTION: But what you're focusing on is not
10 the definition of fraud, not the definition of deception,
11 but in connection with securities.
12 MR. FRENCH: I'm focusing on two things, Your
13 Honor. First of all, I believe that what the Congress
14 tried to adopt here was something to prevent securities
15 fraud.
16 I don't believe the Congress is attempting to
17 regulate the relationships between lawyers and their
18 firms, which are regulated by codes of professional
19 responsibility, or husbands and wives, or fathers and
20 sons, which is the context in which these misappropriation
21 cases come up.
22 QUESTION: Well, is it wrong for me to proceed
23 through the statute and the relevant -- and 10(b)5 by
24 asking first, is there fraud? Second, is it in connection
25 with the sale of securities? And it seems to me that in

1 the case that Justice Stevens put to you, where the
2 principal partner working for Grand Met starts trading on
3 the inside information, that there is fraud in the sense
4 of deception.
5 MR. FRENCH: It is possible --
6 QUESTION: Now -- now, maybe that's right, maybe
7 that's wrong under your view, and I'd like to hear why.
8 Now, I could understand if you went further and
9 said there's not in connection with the sale of
10 securities, but that's quite a different point.
11 MR. FRENCH: There is not even deception there.
12 There is theft, and contrary to Mr. Dreeben's position,
13 theft of a piece of information is no different from theft
14 of money. It's not fraud.
15 You can be prosecuted for the theft vis-a-vis
16 yourself and the person from whom you stole, or the person
17 from whom you stole may proceed against you to recover the
18 money, but it's not deception. Otherwise, every single
19 theft would result in a prosecution for fraud, and that
20 never happens.
21 QUESTION: What about the Carpenter case, Mr.
22 French? What about the Carpenter case? I mean, doesn't
23 that suggest that theft can be brought within the
24 securities statute?
25 MR. FRENCH: It suggests that theft can be

1 brought within the mail fraud statute, Your Honor. As to
2 the securities fraud statute, the Court was equally
3 divided, and therefore I don't know what the Court thinks
4 with respect to that issue. The Government cannot rely on
5 Carpenter with respect to the mail fraud claim.
6 QUESTION: Is it possible that some of these
7 difficult cases -- you know, what you call the
8 preposterous cases, the mothers, whatever it is -- would
9 be fairly dealt with through a requirement that a criminal
10 conviction must be willful?
11 I notice that word was in the criminal section,
12 and does wilful mean that in this area, if you don't know
13 the law, that's an excuse, so therefore in any of these
14 borderline cases a defendant who didn't realize that what
15 he was doing was against the securities law would be home
16 free, and this would be reserved for the instances where
17 people know that what they're doing is wrong as a matter
18 of securities law.
19 I'd like your reaction to that. I'm not certain
20 whether that's correct or not.
21 MR. FRENCH: Yes, Justice Breyer. I have
22 several problems with it.
23 One is that under the misappropriation theory no
24 one will ever really know, because the misappropriation
25 theory, even in the courts that have adopted it and follow

1 it, is so confusing that the courts themselves -- the
2 court in Chestman, for example, says when you get outside
3 the relationship with the shareholder, the -- knowing
4 whether or not the relationship applies is unclear.
5 QUESTION: But you see, that's the basis of my
6 question. The defendant would be entitled to an
7 instruction that if he didn't know that what he was doing
8 was unlawful, he hasn't done it willfully.
9 I'm thinking of Ratzlaf. I'm thinking of the
10 cases that interpret willfully, and I wonder if that saves
11 for the Government -- saves them from your argument,
12 because you're arguing this is all very unclear, and
13 that's what I'd like a response to.
14 MR. FRENCH: Well, it would be very helpful if
15 that turned out to be, as the Government prosecutes these
16 cases, the instruction. There are several instructions in
17 this case, as the record shows, against Mr. O'Hagan, that
18 tell the jury that he doesn't have to know elements of the
19 offense, for instance that he didn't have to know
20 substantial steps were taken.
21 But to me, it doesn't answer the question. I
22 believe, as Judge Luttig said in the Bryan case, this mode
23 of analysis pulls apart a unitary concept. The unitary
24 concept is deception or manipulation in connection with
25 the purchase or sale of a security. To me, that means the

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1 buyer or seller of the security deceives the person on the
2 other side of the transaction. It's not as if you deceive
3 someone over here and then later on you benefit from it by
4 dealing with somebody else.
5 Mr. Dreeben's remark, it seems to me, fits with
6 my theory of this case. He says, there -- it has to be in
7 connection with the purchase or sale of a security because
8 the only way Mr. O'Hagan could profit was in the purchase
9 or sale of a security. Not so. That assumes Mr. O'Hagan
10 has no imagination. Mr. O'Hagan could have said, I now
11 have a useful piece of information. I have
12 misappropriated it. I'm going to profit on it by selling
13 it to the trade press. I can get a good fee for this
14 information.
15 So the misappropriation would have occurred, but
16 it had been disconnected from the purchase or sale of the
17 security.
18 QUESTION: It's not entirely disconnected. The
19 trade press would only be interested in it because the
20 people who read the trade press would be able to buy
21 securities on the basis of this confidential information.
22 QUESTION: I doubt if they would have --
23 QUESTION: They would have just pushed it one
24 step further back, but it still necessarily --
25 QUESTION: They wouldn't have paid this kind of

1 price for it, either.

2 MR. FRENCH: All right. I'll give you another

3 hypothetical, Your Honor, because I'm firmly convinced

4 that the statute doesn't read the way Mr. Dreeben says it

5 does. You cannot disconnect the misappropriation from the

6 purchase and sale of securities and say it's satisfied.

7 Mr. O'Hagan's office in Minneapolis is across

8 the street from the Pillsbury Company. He could have said

9 to himself, I have always wanted the business of the

10 Pillsbury Company. I will walk across the street,

11 misappropriating this information of my law firm and its

12 client, deliver it to the Pillsbury Company, and suggest

13 to the Pillsbury Company that in the future they might

14 find it very desirable to use me for legal work.

15 That wouldn't have had anything to do with the

16 purchase and sale of the security, and yet it would have

17 profited Mr. O'Hagan if it had worked.

18 QUESTION: Yes, but all you're saying is, he

19 could have done a lot of things that were not in

20 connection with the sale of the security, but what he did

21 it seems to me was in connection with the sale of the

22 security.

23 MR. FRENCH: The cases of this Court have

24 confined the statute to relationships between market

25 participants. I admit not merely buyers and sellers.

1 They've included brokers. They've included other
2 investors.
3 But at the time of the alleged fraud, neither
4 Dorsey & Whitney nor Grand Met was a market participant.
5 Grand Met had a desire for a takeover. It had no money
6 for the takeover. The transactions presumably ended by
7 August 26. Grand Met's own chief financial officer said
8 that by September 18th they still didn't have the money.
9 They wanted to make a takeover. They couldn't
10 make a takeover. It wasn't until October 4th that the
11 takeover was proposed, was announced, so we have, I think
12 for the very first time, a proposal by the Government that
13 a fraud on a nonmarket participant be deemed to be in
14 connection with the purchase and sale of securities.
15 QUESTION: Well, the rule is written that way.
16 The rule -- I know you're going to bring me back to the
17 statute, but just so far as the rule is concerned, the
18 rule says it's unlawful to have a deceit or a fraud upon
19 any person --
20 MR. FRENCH: Right.
21 QUESTION: -- in connection with the purchase or
22 sale of securities. It doesn't say upon a purchaser or
23 seller of securities. That's what it would say if your
24 theory were to be adopted.
25 MR. FRENCH: I agree it says any person, but it

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1 seems to me that rules are not allowed to stray outside
2 the scope of their statute.
3 QUESTION: Then we have to assume that Congress
4 wouldn't intend -- on your theory we could take the
5 insiders, the most complete insiders of a corporation, say
6 Grand Met if it were American, and they could go out and
7 buy all the shares they wanted, knowing that those
8 companies are about to be taken over. They can buy the
9 shares of the companies that are about to be taken over,
10 and that would be lawful under the securities law, in your
11 view.
12 MR. FRENCH: It would up until a point, but
13 there's a whole panoply of regulation relating to tender
14 offers. Once you've embarked on a tender offer you have
15 to announce it, and there's restraints on how you can
16 conduct it, and you cannot make misrepresentations in
17 connection with it.
18 I do not think this particular reading of this
19 statute is necessary to keep tender offers clean.
20 QUESTION: Mr. French, would you tell me, if
21 your position is the one we adopt, what becomes of the
22 1988 legislation that provides -- provided for a private
23 right of action? It appeared that Congress was operating
24 on the basis of certain understandings about what 10(b)
25 and 14(e) meant.

1 MR. FRENCH: Well, Justice Ginsburg, two things
2 about the 1988 legislation. First, it was adopted --
3 whatever they mean, it was adopted after my client's acts,
4 and therefore it seems to me he can't have anticipated --
5 QUESTION: Oh, I don't mean with respect to your
6 case, but you're asking us to make a ruling that will
7 govern not simply this day and case --
8 MR. FRENCH: Yes.
9 QUESTION: -- but that will interpret 10(b) and
10 14(e), and so I would like to know what becomes of that
11 later legislation. Is it in shambles?
12 MR. FRENCH: I think what I'd like the Court to
13 do is think about all of the legislation and attempted
14 legislation throughout the 1980's in thinking about that
15 issue. In 1984, the SEC went to the Congress and proposed
16 legislation that would have covered this subject matter,
17 would have covered the misappropriation area, and then
18 when Congress got ready to enact it said no, we would
19 prefer vagueness and ambiguity. Please don't enact it.
20 Then in 1987, when the SEC went to the Congress
21 with a proposal to enact the misappropriation theory, the
22 Congress rejected it.
23 Then in '88 it enacted something having to do
24 with participants in the market that once again did not
25 amend the language of 10(b)5, so it seems to me there is

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1 no basis for saying, as some of the amici have said, that
2 the Congress has codified these theories into law. It has
3 not enacted any of this into law.
4 So my answer is the 1984 legislation and the
5 1988 legislation have to be left to apply to 10b-5 as
6 interpreted ultimately by this Court, and the Congress, if
7 it wants to get the misappropriation theory into law, has
8 to write it into law.
9 QUESTION: So you disagree with what one of the
10 amici briefs said, that -- I think it was the one from the
11 NASAA -- stated that you virtually conceded that O'Hagan's
12 conduct would have violated the 1988 act if it had post-
13 dated that legislation.
14 MR. FRENCH: I disagree, Your Honor. The amici
15 briefs -- one of the amicus briefs says the Congress
16 codified the misappropriation theory. The Government says
17 the Congress has validated the misappropriation theory. A
18 third amicus brief says the Congress has not codified the
19 misappropriation theory, but ratified it.
20 I don't know what ratified or validated means in
21 these circumstances. I know what enact means. Congress
22 has not enacted it. So yes, I disagree.
23 QUESTION: Why hasn't Congress -- what I'm
24 actually thinking, Congress has -- think of the case of
25 the insider for the company itself, the company that's

1 going to take over another company. Everybody knows that
2 those insiders shouldn't go out and buy up stock in the
3 takeover target secretly, and it deceives everybody in the
4 company for which he works.
5 So the SEC, the expert organization, decides
6 that that's so. It fits within the language of the
7 statute. And then of course you would be worried about
8 criminal liability for vague theories, but that's where I
9 came back to the word willfully. So I'm really asking
10 this to see if there's anything more you want to say in
11 that area.
12 MR. FRENCH: I'd be happy --
13 QUESTION: Should I see it as a delegation
14 problem, an expert agency, literal language complied with,
15 and criminal liability taken -- unfair criminal liability
16 taken care of by willfully? I'm sketching that out for
17 you so that I can get it --
18 MR. FRENCH: Yes, Justice Breyer.
19 What we have is a -- and I am not in a position
20 to ask this Court to reverse several decades' worth of
21 law, but what we have is a situation that's slipped its
22 moorings. Insider trading was supposed to be governed by
23 section 16(b).
24 Katie Roberts worked very hard to get insider
25 trading under 10(b) more than 30 years after the statute

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1 was passed by saying it depends upon nondisclosure as
2 between participants to a transaction. This Court went
3 along with that in Chiarella, but not further.
4 What the Congress needs, if it wants to get
5 passed -- and I can even conceptually do that. I can --
6 in my mind I can say, misrepresentation -- deception can
7 encompass nondisclosure when there is a duty to speak. I
8 can't get beyond that.
9 So if the Congress wants within the framework of
10 60 years of law to get beyond misrepresentation or
11 nondisclosure constituting deception when there's a duty
12 to speak, it should pass a statute about it, which it has
13 not.
14 Perhaps I should move to 14(e). It seems to me
15 that there are two serious problems with 14(e) which I
16 think the Government cannot deal with. One is the agency
17 has not promulgated rules designed to help prevent frauds
18 from arising. It simply redefined the word fraud.
19 The statute prohibits fraudulent, deceptive, or
20 manipulative acts. The SEC announces that something is a
21 fraudulent, deceptive, or manipulative act which doesn't
22 have any element of fraud in it. It just says you can't
23 trade if you have the information.
24 Again, if you look at one of the courts that's
25 gone along with the rule, SEC v. Maio in the Seventh

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1 Circuit, says the rule requires a duty to disclose
2 regardless of whether such information was obtained
3 through a breach of fiduciary duty, so it seems to me that
4 the rule has just outstripped the statute it's supposed to
5 be implementing, and that's impermissible.
6 The second thing wrong with the rule is, the
7 rule says you mustn't trade in connection with a tender
8 offer. The SEC has said you may not trade if substantial
9 steps have been taken toward a tender offer. That's not
10 in the law. That is an accretion to the law that's not
11 there. It --
12 QUESTION: But their rulemaking authority under
13 the law allows them to go beyond the law. It allows them
14 to make rules that will prevent a violation of the law.
15 You concede that that allows them to make unlawful by rule
16 some things that are not made unlawful by the statute,
17 don't you? Or don't you?
18 MR. FRENCH: I do, but I don't concede that it
19 authorizes them to change the criminal application of this
20 statute.
21 If the Court when it has an --
22 QUESTION: I don't really understand your
23 response. If it authorizes them to go beyond the law --
24 you mean only for civil purposes? Is that what you're
25 saying?

1 MR. FRENCH: I'm -- I'll say two things. First,
2 it plainly can't do it in the criminal context because it
3 can't transform fraud into nonfraud and say, this is
4 criminal, but beyond that, what I think it can do --
5 QUESTION: Before you go beyond that, it's not
6 transforming fraud into nonfraud. It's saying, this is
7 nonfraud. It's not covered by the statute, but we're
8 prohibiting it nonetheless because the statute allows us
9 to do it. It allows us to prohibit things in order to
10 prevent fraud, not just to prohibit fraud but to prohibit
11 other things in order to prevent fraud. That's how the
12 statute reads.
13 MR. FRENCH: No, Your Honor. This redefines the
14 word, fraud. It says, it shall be, it shall constitute
15 fraudulent activity if you purchase after substantial
16 steps have been taken.
17 QUESTION: That's a different point you're
18 making. You are making the point that this rule might
19 have been okay if it had read differently, if it had read,
20 thou shalt not do this.
21 Instead, however, it reads doing this
22 constitutes fraud under the -- under 14(e), and that's
23 simply false, so the rule is false. It's not that it --
24 MR. FRENCH: The rule is false. The rule is --
25 QUESTION: It's not that it does something that

1 the Commission couldn't. It does it in the wrong way.
2 MR. FRENCH: The rule is false. Moreover --
3 QUESTION: But could it have done it another
4 way?
5 MR. FRENCH: I don't think it could do -- let me
6 try to do this in conjunction. I don't think it could do
7 this in another way because there's no definition of
8 substantial steps, and it is not possible for most
9 participants in securities transactions to know that
10 substantial steps have been taken.
11 QUESTION: Well, but that's essentially a
12 vagueness argument.
13 MR. FRENCH: It certainly is a vague --
14 QUESTION: I suppose rather than a breach of
15 delegated -- or an excess of delegated authority.
16 MR. FRENCH: That's correct. May I take an
17 example in an area in which I practice heavily. The
18 Federal Trade Commission Act prohibits deceptive acts,
19 unfair or deceptive acts or practices. In the context of
20 that statute the agency, in prosecuting for deception,
21 just takes straightforward misrepresentations, lots of
22 different kinds but straightforward misrepresentations.
23 In the concept of unfairness, it treads very
24 carefully, conducts investigations, promulgates trade
25 regulation rules, and then says we have identified a

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1 practice here that we deem to be unfair. We haven't
2 amended the law to allow us to prohibit things that are
3 fair. We've identified this act as unfair. And then it
4 goes forward on a very careful basis with prosecutions
5 that only lead to injunctive results.
6 QUESTION: But that basically is then kind of an
7 administrative process argument, and once again it seems
8 to me you're not saying when you make that argument that
9 they have exceeded their -- that the essential problem is
10 that they have exceeded their delegated authority, but the
11 contrast that you are drawing is that they were more
12 careful about predicating their exercise of delegated
13 authority.
14 MR. FRENCH: And they certainly have been more
15 careful.
16 QUESTION: But if that's the nub of what you're
17 arguing, it's not that they've exceeded the authority in
18 our case, if that's the point of your argument, but that
19 they just didn't go about it the right way. Their process
20 was defective.
21 MR. FRENCH: No, I really am going beyond that.
22 I am --
23 QUESTION: Okay, then I don't --
24 MR. FRENCH: I am saying -- I am saying that
25 when the statute says you must not commit fraud in

1 connection with a tender offer, the agency cannot say, you
2 are also subject to prosecution when -- even when you
3 don't commit fraud, and even when no tender offer has been
4 launched, but because substantial steps have been taken.
5 That rewrites the law. That is not a rule that implements
6 the law. It rewrites the law, and that's the distinction
7 I'm drawing.
8 QUESTION: Mr. French, does the Federal Trade
9 Commission Act say that the Federal Trade Commission
10 shall, by rules and regulations, define and prescribe
11 means reasonably designed to prevent unfair or deceptive
12 trade practices.
13 MR. FRENCH: I don't recall the language
14 producing the implementation.
15 QUESTION: I don't think it does. That's the
16 crucial sentence here which allows this agency, as I think
17 the Federal Trade Commission Act does not allow the
18 Federal Trade Commission to go beyond what the statute
19 says and to define other things as unlawful in order to
20 prevent the things that the statute prohibits.
21 I think that's the fair meaning of that
22 sentence, now. Maybe you say that's an unconstitutional
23 delegation or something, but it seems to me you have to
24 grapple with the reality that Congress has told this
25 agency, you can make unlawful things that the statute does

1 not make unlawful.

2 MR. FRENCH: You can put into a class of
3 prohibited conduct in some way or another things that you
4 define as reasonably designed to prevent fraudulent acts.

5 QUESTION: And suppose you go on and say, and we
6 will treat these as if they were fraudulent acts?

7 MR. FRENCH: I do not believe you can go on and
8 say, you may treat -- we will treat these as fraudulent
9 acts. There has to be for people to be not at risk all
10 the times --

11 QUESTION: Well but the sanction is the same.
12 It just says that the sanction mechanisms of the statute
13 are employed.

14 MR. FRENCH: You may not, Your Honor, I think,
15 put people at risk of prosecution for fraudulent acts
16 committed in connection with a tender offer by announcing
17 that nonfraudulent acts are fraudulent acts and can be
18 prosecuted when there isn't any --

19 QUESTION: Well, there has to be the premise
20 that they're necessary to avoid other fraudulent acts.

21 QUESTION: Of course, the text says fraudulent,
22 deceptive, or manipulative. It's kind of a broad term.

23 MR. FRENCH: It certainly is, but I believe the
24 Court in Schreiber has equated deceptive and manipulative
25 under this statute with deceptive and manipulative under

1 10(b), so it has some content that narrows somewhat the
2 breadth of it.
3 I don't know if the Court wishes me to speak on
4 the subject of mail fraud. Mr. Dreeben did not, and I'm
5 willing to leave it to the briefs. I would say with
6 respect to that that all that happened here is that in the
7 Eighth Circuit, the Eighth Circuit --
8 QUESTION: Mr. French, your time has expired.
9 MR. FRENCH: Thank you, Mr. Chief Justice.
10 QUESTION: Mr. Dreeben, you have a little over a
11 minute left.
12 REBUTTAL ARGUMENT OF MICHAEL R. DREEBEN
13 ON BEHALF OF THE PETITIONER
14 MR. DREEBEN: Thank you, Mr. Chief Justice.
15 In order to convict respondent on the section
16 10(b) count, the jury had to find that he acted with the
17 intent to deceive, manipulate, or deprive -- these are in
18 the jury instructions at page 199 of the joint appendix --
19 and the statutory requirement for the imposition of
20 imprisonment requires that he be shown to have knowledge
21 of the regulation or rule that he violated.
22 He cannot show that -- if he shows that he did
23 not have knowledge of it, he cannot be imprisoned, but the
24 statute does require proof of wilfulness in order to
25 sustain any criminal conviction.

1 QUESTION: Mr. Dreeben, I hate to use up any of
2 your short time, but there's a new point which came out in
3 oral argument here which I don't recall in the briefs, and
4 I want to know what your response to it is, and that is,
5 assuming that 14(e), as I think is true, does allow this
6 agency to make unlawful things that the statute itself
7 does not, has it purported to do that in its regulation?
8 MR. DREEBEN: Justice Scalia --
9 QUESTION: And if it has not purported to do
10 that, has not purported by that regulation to prescribe
11 means reasonably designed, but rather in its regulation
12 simply redefines what constitutes fraud or deception, then
13 is that an exercise of the power that's given by that
14 second sentence of 14(e)?
15 MR. DREEBEN: I think that it is, Justice
16 Scalia. The ultimate -- may I answer?
17 QUESTION: Yes.
18 MR. DREEBEN: The ultimate question is whether
19 the SEC's prohibition on trading, which is clearly
20 described in the rule, is within its statutory authority,
21 which is a question for the court, and the court may
22 determine that the SEC's prohibition does satisfy the
23 statute based on either the defining prong or the means
24 reasonably designed to prevent, and it's analysis of the
25 reasons that are given.

1 We address this question in our brief in
2 opposition in the Chestman case.
3 CHIEF JUSTICE REHNQUIST: Thank you, Mr.
4 Dreeben. I think you've answered the question. The case
5 is submitted.
6 (Whereupon, at 11:02 a.m., the case in the
7 above-entitled matter was submitted.)
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UNITED STATES, Petitioner v. JAMES HERMAN O'HAGAN
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BY Ann Mari Federico

(REPORTER)