

Bateman Eichler Vs. Berner

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Appellant : Bateman Eichler

Respondent : Berner

Judgement :

Bateman Eichler v. Berner - 472 U.S. 299 (1985)

U.S. Supreme Court Bateman Eichler v. Berner, 472 U.S. 299 (1985)

Bateman Eichler, Hill Richards, Inc. v. Berner

No. 84-679

Argued April 15, 1985

Decided June 11, 1985

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*CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE
NINTH CIRCUIT*

SYLLABUS

Respondent investors (hereafter respondents) filed a damages action in Federal District Court, alleging that they incurred substantial trading losses after a securities broker (employed by petitioner) and the officer of a corporation fraudulently induced respondents to purchase stock in the corporation by divulging false and materially incomplete information about the corporation on the pretext that it was accurate inside information. Respondents contended that this alleged scheme violated, *inter alia*, 10(b) of the Securities Exchange Act of 1934 and Securities and Exchange Commission Rule 10b-5 promulgated thereunder. The District Court dismissed the complaint on the ground that, because respondents themselves had violated the same laws under which recovery was sought by trading on what they believed was inside information, they were *in pari delicto* with the broker and corporate insider, and thus were barred from recovery. The Court of Appeals reversed.

Held: There is no basis at this stage of the litigation for applying the *in pari delicto* defense to bar respondents' action. Pp. [472 U. S. 306](#) -319.

(a) An implied private damages action under the federal securities laws may be barred on the grounds of the plaintiff's own culpability only where (i) as a direct result of his own actions, the plaintiff bears at least substantially equal responsibility for the violations he seeks to redress, and (ii) preclusion of suit would not significantly interfere with the effective enforcement of the securities laws and protection of the investing public. *Cf. Perma Life Mufflers, Inc. v. International Parts Corp.*, [392 U. S. 134](#) . Pp. [472 U. S. 306](#) -311.

(b) Because a tippee's duty to disclose material nonpublic information typically is derivative from the insider-tipper's duty, the tippee in these circumstances cannot be said to be as culpable as the tipper whose breach of duty gave rise to the tippee's liability in the first place. Moreover, insiders and broker-dealers who selectively disclose material nonpublic information about the issuer commit a potentially broader range of violations than do tippees who trade on the basis of that information. Absent other culpable actions by a tippee that can fairly be said to

outweigh these violations by insiders and broker-dealers, the tippee cannot

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properly be characterized as being of substantially equal culpability as his tippers. Pp. [472 U. S. 311](#) -314.

(c) Denying the *in pari delicto* defense in such circumstances will best promote protection of the investing public and the national economy. First, allowing a defrauded tippee to bring suit against his defrauding tipper promotes the important goal of exposing wrongdoers and rendering them more easily subject to civil, administrative, and criminal penalties. Second, deterrence of insider trading most frequently will be maximized by bringing enforcement pressures to bear on the sources of such information -- corporate insiders and broker-dealers. Third, insiders and broker-dealers will in many circumstances be more responsive to the deterrent pressures of potential sanctions. Finally, there are means other than the *in pari delicto* defense to deter tippee trading. Although there might well be situations in which the relative culpabilities of tippees and their sources merit a different mix of deterrent incentives, in cases such as the instant one, the public interest will most frequently be advanced if defrauded tippees are permitted to bring suit and to expose illegal practices by corporate insiders and broker-dealers to full public view for appropriate sanctions. Pp. [472 U. S. 315](#) -319.

730 F.2d 1319, affirmed.

BRENNAN, J., delivered the opinion of the Court, in which WHITE, BLACKMUN, POWELL, REHNQUIST, STEVENS, and O'CONNOR, JJ., joined. BURGER, C.J., concurred in the judgment. MARSHALL, J., took no part in the decision of the case.

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JUSTICE BRENNAN delivered the opinion of the Court.

The question presented by this case is whether the common law *in pari delicto* defense bars a private damages action under the federal securities laws against corporate insiders and broker-dealers who fraudulently induce investors to purchase securities by misrepresenting that they are conveying material nonpublic information about the issuer.

I

The respondent investors filed this action in the United States District Court for the Northern District of California, alleging that they incurred substantial trading losses as a result of a conspiracy between Charles Lazzaro, a registered securities broker employed by the petitioner Bateman Eichler, Hill Richards, Inc. (Bateman Eichler), and Leslie Neadeau, President of T.O.N.M. Oil & Gas Exploration Corporation (TONM), to induce them to purchase large quantities of TONM over-the-counter stock by divulging false and materially incomplete information about the company on the pretext that it was accurate inside information. [[Footnote 1](#)] Specifically, Lazzaro is alleged to have told the respondents that he personally knew TONM insiders and had learned, *inter alia*, that (a) "[v]ast amounts of gold had been discovered in Surinam, and TONM had options on thousands of acres in gold-producing

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regions of Surinam"; [[Footnote 2](#)] (b) the discovery was "not publicly known, but would subsequently be announced"; (c) TONM was currently engaged in negotiations with other companies to form a joint venture for mining the Surinamese gold; and (d) when this information was made public,

"TONM stock, which was then selling from \$1.50 to \$3.00/share, would increase in value from \$10 to \$15/share within a short period of time, and . . . might increase to \$100/share"

within a year. Complaint 16-17, App. 10-12. [[Footnote 3](#)] Some of the respondents aver that they contacted Neadeau and inquired whether Lazzaro's tips were accurate; Neadeau stated that the information was "not public

knowledge," and "would neither confirm nor deny those claims," but allegedly advised that "Lazzaro was a very trustworthy and a good man." *Id.*, 19, App. 12.

The respondents admitted in their complaint that they purchased TONM stock, much of it through Lazzaro, "on the premise that Lazzaro was privy to certain information not otherwise available to the general public." *Id.*, 15, App. 10. Their shares initially increased dramatically in price, but ultimately declined to substantially below the purchase price when the joint mining venture fell through. *Id.*, 22-26, App. 13-14. [[Footnote 4](#)]

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Lazzaro and Neadeau are alleged to have made the representations set forth above knowing that the representations "were untrue and/or contained only half-truths, material omissions of fact and falsehoods," [[Footnote 5](#)] intending that the respondents would rely thereon, and for the purpose of "influenc[ing] and manipul[at]ing the price of TONM stock" so as "to profit themselves through the taking of commissions and secret profits." *Id.*, 23, 30, 38, App. 13, 15-16. [[Footnote 6](#)] The respondents contended that this scheme violated, *inter alia*, 10(b) of the Securities Exchange Act of 1934, 48 Stat. 891, 15 U.S.C. 78j(b), [[Footnote 7](#)] and Securities and Exchange Commission

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(SEC) Rule 10b-5 promulgated thereunder, 17 CFR 240.10b-5 (1984). [[Footnote 8](#)] They sought capital losses and lost profits, punitive damages, and costs and attorney's fees. App. 26. [[Footnote 9](#)]

The District Court dismissed the complaint for failure to state a claim. The court reasoned that "trading on insider information is itself a violation of rule 10b-5," and that the allegations in the complaint demonstrated that the respondents themselves had "violated the particular statutory provision under which recovery is sought." App. to Pet. for Cert. C-2. Thus, the court concluded, the respondents were *in pari delicto* with Lazzaro and Neadeau, and absolutely barred from

recovery. *Ibid.*

The Court of Appeals for the Ninth Circuit reversed. *Berner v. Lazzaro*, 730 F.2d 1319 (1984). Although it

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assumed that the respondents had violated the federal securities laws, *id.* at 1324, the court nevertheless concluded that

"securities professionals and corporate officers who have allegedly engaged in fraud should not be permitted to invoke the *in pari delicto* doctrine to shield themselves from the consequences of their fraudulent misrepresentation,"

id. at 1320. The Court of Appeals noted that this Court had sharply restricted the availability of the *in pari delicto* defense in antitrust actions, see *Perma Life Mufflers, Inc. v. International Parts Corp.*, [392 U. S. 134](#) (1968), and concluded that, essentially for three reasons, there was no basis "for creating a different rule for private actions initiated under the federal securities laws," 730 F.2d at 1322. First, the court reasoned that, in cases such as this, defrauded tippees are not in fact "equally responsible" for the violations they allege. *Ibid.* Second, the court believed that allowing the defense in these circumstances would be "totally incompatible with the overall aims of the securities law" because the threat of a private damages action is necessary to deter "insider-tipster[s]" from defrauding the public. *Id.* at 1323. Finally, the court noted the availability of means other than an outright preclusion of suit to deter tippees from trading on inside information. *Id.* at 1324, n. 3.

The lower courts have divided over the proper scope of the *in pari delicto* defense in securities litigation. [[Footnote 10](#)] We granted certiorari. 469 U.S. 1105 (1985). We affirm.

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The common law defense at issue in this case derives from the Latin, *in pari delicto potior est conditio defendentis*: "In a case of equal or mutual fault . . . the position of the [defending] party . . . is the better one." [[Footnote 11](#)] The defense is grounded on two premises: first, that courts should not lend their good offices to mediating disputes among wrongdoers; [[Footnote 12](#)] and second, that denying judicial relief to an admitted wrongdoer is an effective means of deterring illegality. [[Footnote 13](#)] In its classic formulation,

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the *in pari delicto* defense was narrowly limited to situations where the plaintiff truly bore at least substantially equal responsibility for his injury, because

"in cases where both parties are *in delicto*, concurring in an illegal act, it does not always follow that they stand *in pari delicto*; for there may be, and often are, very different degrees in their guilt."

1 J. Story, *Equity Jurisprudence* 304-305 (13th ed. 1886) (Story). Thus there might be an "inequality of condition" between the parties, *id.* at 305, or "a confidential relationship between th[em]" that determined their "relative standing" before a court, 3 J. Pomeroy, *Equity Jurisprudence* 942a, p. 741 (5th ed.1941) (Pomeroy). In addition, the public policy considerations that undergirded the *in pari delicto* defense were frequently construed as precluding the defense even where the plaintiff bore substantial fault for his injury:

"[T]here may be on the part of the court itself a necessity of supporting the public interests or public policy in many cases, however reprehensible the acts of the parties may be."

1 Story 305. Notwithstanding these traditional limitations, many courts have given the *in pari delicto* defense a broad application to bar actions where plaintiffs simply have been involved generally in "the same sort of wrongdoing" as defendants. *Perma Life Mufflers, Inc. v. International Parts Corp.*, 392 U.S. at [392 U. S. 138](#) . [[Footnote 14](#)]

In *Perma Life*, we emphasized "the inappropriateness of invoking broad common law barriers to relief where a private suit serves important public purposes." *Ibid.* That case involved a treble-damages action against a Midas Muffler franchisor by several of its dealers, who alleged that the franchise agreement created a conspiracy to restrain trade in violation

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of the Sherman and Clayton Acts. [[Footnote 15](#)] The lower courts barred the action on the grounds that the dealers, as parties to the agreement, were *in pari delicto* with the franchisor. In reversing that determination, the opinion for this Court emphasized that there was no indication that Congress had intended to incorporate the defense into the antitrust laws, which

"are best served by insuring that the private action will be an ever-present threat to deter anyone contemplating [illegal] business behavior."

Id. at [392 U. S. 139](#) . Accordingly, the opinion concluded that

"the doctrine of *in pari delicto*, with its complex scope, contents, and effects, is not to be recognized as a defense to an antitrust action."

Id. at [392 U. S. 140](#) . The opinion reserved the question whether a plaintiff who engaged in "truly complete involvement and participation in a monopolistic scheme" -- one who "aggressively support[ed] and further[ed] the monopolistic scheme as a necessary part and parcel of it" -- could be barred from pursuing a damages action, finding that the muffler dealers had relatively little bargaining power and that they had been coerced by the franchisor into agreeing to many of the contract's provisions. *Ibid.*

In separate opinions, five Justices agreed that the concept of "equal fault" should be narrowly defined in litigation arising under federal regulatory statutes. [[Footnote 16](#)]

"[B]ecause of the strong public interest in eliminating restraints on competition, . . . many of the refinements of moral worth demanded of plaintiffs by . . . many of the

variations of *in pari delicto* should not be applicable in the antitrust field."

Id. at [392 U. S. 151](#) (MARSHALL, J., concurring in result). The five Justices concluded, however, that where a plaintiff truly bore at least substantially equal responsibility for the violation, a defense

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based on such fault -- whether or not denominated *in pari delicto* -- should be recognized in antitrust litigation. [[Footnote 17](#)]

Bateman Eichler argues that *Perma Life* -- with its emphasis on the importance of analyzing the effects that fault-based defenses would have on the enforcement of congressional goals -- is of only marginal relevance to a private damages action under the federal securities laws. Specifically, Bateman Eichler observes that Congress *expressly* provided for private antitrust actions -- thereby manifesting a

"desire to go beyond the common law in the antitrust statute in order to provide substantial encouragement to private enforcement and to help deter anticompetitive conduct"

-- whereas private rights of action under 10(b) of the Securities Exchange Act of 1934 are merely *implied* from that provision [[Footnote 18](#)] -- thereby, apparently, supporting a broader application of the *in pari delicto* defense. Brief for Petitioner 32. Bateman Eichler buttresses this argument by observing that, unlike the Sherman and Clayton Acts, the securities laws contain savings provisions directing that

"[t]he rights and remedies provided by [those laws] shall be in addition to any and all other rights and remedies that may exist at law or in equity [[Footnote 19](#)]"

-- again, apparently, supporting a broader scope for fault-based defenses than recognized in *Perma Life*.

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We disagree. Nothing in *Perma Life* suggested that public policy implications should govern only where Congress expressly provides for private remedies; the classic formulation of the *in pari delicto* doctrine itself required a careful consideration of such implications before allowing the defense. See *supra* at [472 U. S. 307](#) . Moreover, we repeatedly have emphasized that implied private actions provide "a most effective weapon in the enforcement" of the securities laws, and are "a necessary supplement to Commission action." *J. I. Case Co. v. Borak*, [377 U. S. 426](#) , [377 U. S. 432](#) (1964); see also *Blue Chip Stamps v. Manor Drug Stores*, [421 U. S. 723](#) , [421 U. S. 730](#) (1975). In addition, we have eschewed rigid common law barriers in construing the securities laws. See, e.g., *Herman & MacLean v. Huddleston*, [459 U. S. 375](#) , [459 U. S. 388](#) -389 (1983) (common law doctrines are sometimes of "questionable pertinence" in applying the securities laws, which were intended "to rectify perceived deficiencies in the available common law protections by establishing higher standards of conduct in the securities industry"); *A. C. Frost & Co. v. Coeur d'Alene Mines Corp.*, [312 U. S. 38](#) , [312 U. S. 43](#) (1941) (rejecting the unclean hands defense on the facts of the case because it would "seriously hinder, rather than aid, the real purpose" of the securities laws). [[Footnote 20](#)] We therefore conclude that the views expressed in *Perma Life* apply with full force to implied causes of action under the federal securities laws. Accordingly, a private action for damages in these circumstances may be barred on the grounds of the plaintiff's own culpability only where, (1) as a direct result of his own actions, the plaintiff bears at least substantially equal responsibility for the violations he seeks

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to redress, and (2) preclusion of suit would not significantly interfere with the effective enforcement of the securities laws and protection of the investing public.

A

The District Court and Court of Appeals proceeded on the assumption that the respondents had violated 10(b) and Rule 10b-5, see *supra* at [472 U. S. 304](#) - 305 -- an assumption we accept for purposes of resolving the issue before us. Cf.

A. C. Frost & Co. v. Coeur d'Alene Mines Corp., *supra*, at [312 U. S. 40](#) -41. [[Footnote 21](#)]

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Bateman Eichler contends that the respondents' delictum was substantially *par* to that of Lazzaro and Neadeau for two reasons. First, whereas many antitrust plaintiffs participate in illegal restraints of trade only "passively" or as the result of economic coercion, as was the case in *Perma Life*, the ordinary tippee acts *voluntarily* in choosing to trade on inside information. Second, 10(b) and Rule 10b-5 apply literally to "any person" who violates their terms, and do not recognize gradations of culpability.

We agree that the typically voluntary nature of an investor's decision impermissibly to trade on an inside tip renders the investor more blameworthy than someone who is party to a contract solely by virtue of another's overweening bargaining power. We disagree, however, that an investor who engages in such trading is necessarily as blameworthy as a corporate insider or broker-dealer who discloses the information for personal gain. Notwithstanding the broad reach of 10(b) and Rule 10b-5, there are important distinctions

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between the relative culpabilities of tippers, securities professionals, and tippees in these circumstances. The Court has made clear in recent Terms that a tippee's use of material nonpublic information does not violate 10(b) and Rule 10b-5 unless the tippee owes a corresponding duty to disclose the information. *Dirks v. SEC*, [463 U. S. 646](#) , [463 U. S. 654](#) -664 (1983); *Chiarella v. United States*, [445 U. S. 222](#) , [445 U. S. 230](#) , n. 12 (1980). That duty typically is "derivative from . . . the insider's duty." *Dirks v. SEC*, *supra*, at [463 U. S. 659](#) ; see also *id.* at [463 U. S. 664](#) . In other words, "[t]he tippee's obligation has been viewed as arising from his role as a participant after the fact in the insider's breach of a fiduciary duty" toward corporate shareholders. *Chiarella v. United States*, *supra*, at [445 U. S. 230](#) , n. 12. [[Footnote 22](#)] In the context of insider trading, we do not believe

that a person whose liability is solely derivative can be said to be as culpable as one whose breach of duty gave rise to that liability in the first place. [[Footnote 23](#)]

Moreover, insiders and broker-dealers who selectively disclose material nonpublic information commit a potentially broader range of violations than do tippees who trade on the basis of that information. A tippee trading on inside information will in many circumstances be guilty of fraud against individual shareholders, a violation for which the tipper shares responsibility. But the insider, in disclosing such information, also frequently breaches fiduciary duties toward the issuer itself. [[Footnote 24](#)] And in cases where the tipper

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intentionally conveys false or materially incomplete information to the tippee, the tipper commits an additional violation: fraud against the tippee. Such conduct is particularly egregious when committed by a securities professional, who owes a duty of honesty and fair dealing toward his clients. *Cf.* 3 Pomeroy 942a, at 741. Absent other culpable actions by a tippee that can fairly be said to outweigh these violations by insiders and broker-dealers, we do not believe that the tippee properly can be characterized as being of substantially equal culpability as his tippers.

There is certainly no basis for concluding at this stage of this litigation that the respondents were *in pari delicto* with Lazzaro and Neadeau. The allegations are that Lazzaro and Neadeau masterminded this scheme to manipulate the market in TONM securities for their own personal benefit, and that they used the purchasing respondents as unwitting dupes to inflate the price of TONM stock. The respondents may well have violated the securities laws, and in any event we place no "stamp of approval" on their conduct. *Chiarella v. United States, supra*, at [445 U. S. 238](#) (STEVENS, J., concurring). But accepting the facts set forth in the complaint as true -- as we must in reviewing the District Court's dismissal on the pleadings -- Lazzaro and Neadeau

"awakened in [the respondents] a desire for wrongful gain that might otherwise have remained dormant, inspired in [their] mind[s] an unfounded idea that [they were] going to secure it, and then, by fraud and false pretenses, deprived [them] of [their] money,"

Stewart v. Wright, 147 F. 321, 328-329 (CA8), *cert. denied*, 203 U.S. 590 (1906) -- actions that, if they occurred, were far more culpable under any reasonable view than the respondents' alleged conduct. [[Footnote 25](#)]

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B

We also believe that denying the *in pari delicto* defense in such circumstances will best promote the primary objective of the federal securities laws -- protection of the investing public and the national economy through the promotion of "a high standard of business ethics . . . in every facet of the securities industry." *SEC v. Capital Gains Research Bureau, Inc.*, [375 U. S. 180](#) , [375 U. S. 186](#) -187 (1963). Although a number of lower courts have reasoned that a broad rule of *caveat tippee* would better serve this goal, [[Footnote 26](#)] we believe the contrary position adopted by other courts represents the better view. [[Footnote 27](#)]

To begin with, barring private actions in cases such as this would inexorably result in a number of alleged fraudulent practices going undetected by the authorities and unremedied. The SEC has advised us that it

"does not have the resources to police the industry sufficiently to ensure that false tipping does not occur or is consistently discovered,"

and that, "[w]ithout the tippees' assistance, the Commission could not effectively prosecute false tipping -- a difficult practice to detect." Brief for SEC as *Amicus Curiae* 25. See also H.R.Rep. No. 93-355, p. 6 (1983) ("In recent years, the securities markets have grown dramatically in size and complexity, while Commission enforcement resources have declined"). Thus it is particularly

important to permit

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"litigation among guilty parties [that will serve] to expose their unlawful conduct and render them more easily subject to appropriate civil, administrative, and criminal penalties."

Kuehnert v. Texstar Corp., 412 F.2d 700, 706, n. 3 (CA5 1969) (Godbold, J., dissenting). The *in pari delicto* defense, by denying any incentive to a defrauded tippee to bring suit against his defrauding tipper, would significantly undermine this important goal. [[Footnote 28](#)]

Moreover, we believe that deterrence of insider trading most frequently will be maximized by bringing enforcement pressures to bear on the sources of such information -- corporate insiders and broker-dealers.

"The true insider or the broker-dealer is at the fountainhead of the confidential information. . . . If the prophylactic purpose of the law is to restrict the use of all material inside information until it is made available to the investing public, then the most effective means of carrying out this policy is to nip in the bud the source of the information, the tipper, by discouraging him from 'making the initial disclosure which is the first step in the chain of dissemination.' This can most readily be achieved by making unavailable to him the defense of *in pari delicto* when sued by his tippee upon charges based upon alleged misinformation."

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Voisin, Cannon, Inc., 325 F.Supp. 50, 57-58 (SDNY 1971).

In addition, corporate insiders and broker-dealers will in many circumstances be more responsive to the deterrent pressure of potential sanctions; they are more likely than ordinary investors to be advised by counsel, and thereby to be informed

fully of the "allowable limits on their conduct." *Kuehnert v. Texstar Corp.*, 412 F.2d at 706 (Godbold, J., dissenting). [[Footnote 29](#)] Although situations might well arise in which the relative culpabilities of the tippee and his insider source merit a different mix of deterrent incentives, we therefore conclude that, in tipper-tippee situations such as the one before us, the factors discussed above preclude recognition of the *in pari delicto* defense. [[Footnote 30](#)]

Lower courts reaching a contrary conclusion have typically asserted that, absent a vigorous allowance of the *in pari delicto* defense, tippees would have, "in effect, an enforceable

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warranty that secret information is true," *id.* at 705, and thus no incentive not to trade on that information. [[Footnote 31](#)] These courts have reasoned, in other words, that tippees in such circumstances would be in "the enviable position of *heads-I-win tails-you-lose*," *Wolfson v. Baker*, 623 F.2d 1074, 1082 (CA5 1980), *cert. denied*, 450 U.S. 966 (1981) -- if the tip is correct, the tippee will reap illicit profits, while if the tip fails to yield the expected return, he can sue to recover damages.

We believe the "enforceable warranty" theory is overstated, and overlooks significant factors that serve to deter tippee trading irrespective of whether the *in pari delicto* defense is allowed. First, tippees who bring suit in an attempt to cash in on their "enforceable warranties" expose themselves to the threat of substantial civil and criminal penalties for their own potentially illegal conduct. [[Footnote 32](#)] Second, plaintiffs in litigation under 10(b) and Rule 10b-5 may only recover against defendants who have acted with *scienter*. See *Ernst & Ernst v. Hochfelder*, [425 U. S. 185](#) (1976). Thus,

"if the tip merely fails to 'pan out,' or if the information itself proves accurate but the stock fails to move in the anticipated direction, the investor stands to lose all of his investment. Only in the situation where the investor has been deliberately defrauded will he be able to maintain a private suit in an attempt to recoup his

money."

730 F.2d at 1324, n. 3. [[Footnote 33](#)]

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We therefore conclude that the public interest will most frequently be advanced if defrauded tippees are permitted to bring suit and to expose illegal practices by corporate insiders and broker-dealers to full public view for appropriate sanctions. As the Ninth Circuit emphasized in this case, there is no warrant to giving corporate insiders and broker-dealers "a license to defraud the investing public with little fear of prosecution." *Id.* at 1323.

Affirmed.

CHIEF JUSTICE BURGER concurs in the judgment.

JUSTICE MARSHALL took no part in the decision of this case.

[[Footnote 1](#)]

The investors named Lazzaro, Neadeau, TONM, and Bateman Eichler as defendants. Complaint 5-8, App. 7-8. The investors charged that Neadeau and TONM had "directly and indirectly participated with, aided and abetted, and conspired with" Lazzaro in the scheme. *Id.*, 9, App. 8; see also *id.*, 40, App. 17. Bateman Eichler's liability was premised on its status as a "controlling person" of Lazzaro within the meaning of 20(a) of the Securities Exchange Act of 1934, 48 Stat. 899, 15 U.S.C. 78t(a). Complaint 15, 39, App. 7, 16-17. See n. [25](#) *infra*.

Although Lazzaro, Neadeau, and TONM also are respondents in this Court, see this Court's Rule 19.6, we shall use "respondents" to refer exclusively to the investor plaintiffs, who are defending the judgment of the Court of Appeals for the Ninth Circuit in this Court.

[[Footnote 2](#)]

Gold exploration has been conducted in Surinam for more than 100 years, but production has declined dramatically since early in this century. Complaint 11, App. 9. The areas in which TONM had been engaged in exploration "were historically mined by Surinamese natives using primitive methods," and were accessible to the outside world "primarily by motorized canoes and helicopter." *Id.*, 12, App. 9. Lazzaro allegedly told the investors that TONM's discovery "compared favorably to, if not better than, those in South Africa," and that development "would not require deep mining" because "[g]eologists in Surinam were finding gold nuggets in dry creek beds." *Id.*, 16, App. 11.

[[Footnote 3](#)]

Lazzaro also allegedly told the investors that, after the announcement, TONM shareholders "would *automatically* receive" additional stock in TONM's subsidiary, International Gold and Diamond Exploration Corp., Inc., "without the payment of any additional monies." *Ibid.* (emphasis in original).

[[Footnote 4](#)]

The respondents purchased the stock in late 1979 and early 1980 for between \$1.50 and \$3 per share, and the price of the stock rose to \$7 per share by the fourth quarter of 1980. *Id.*, 22, App. 13. "[S]ome or all" of the respondents claim to have told Lazzaro at this time that they wanted to sell their shares, but

"Lazzaro stated that he would let the plaintiffs know when to sell the TONM stock, and that they should not sell just because the stock had reached \$7.00/share, because it would go higher still."

Ibid. The stock then plummeted "to approximately \$1.00 per share" by the end of 1980, and fell to "less than . . . \$1.00 a share" early the next year. *Id.*, 24-25, App. 14.

[[Footnote 5](#)]

In the alternative, Lazzaro and Neadeau are alleged to have made these representations "recklessly, with wanton disregard for the truth." *Id.*, 32, App. 15.

[[Footnote 6](#)]

Neadeau is alleged to have owned approximately 100,000 shares of the outstanding common stock of TONM, and Lazzaro is alleged to have "controlled over a million shares of TONM stock through stock purchased by himself and his clients." *Id.*, 8, 23, App. 8, 13. See also *id.*, 16, App. 12 ("Lazzaro and his relatives owned a large block of TONM stock"). The investors charged that

"Lazzaro could thereby and did influence and manipulate the price of TONM stock through purchases and sales thereof, and through the dissemination of false information to plaintiffs and others."

Id., 23, App. 13.

[[Footnote 7](#)]

That section provides:

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

" * * * *"

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

[[Footnote 8](#)]

That Rule provides:

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

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

"(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or"

"(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."

[[Footnote 9](#)]

In addition, the respondents sought recovery pursuant to 17(a) of the Securities Act of 1933, 48 Stat. 84, as amended, 15 U.S.C. 77q(a), see Complaint, 48-50, App. 20, which the parties and the courts below have treated as comparable to 10(b) for purposes of applying the *in pari delicto* defense. We express no view as to whether a private right of action exists under 17(a). Compare *Keys v. Wolfe*, 709 F.2d 413, 416 (CA5 1983), with *Stephenson v. Calpine Conifers II, Ltd.*, 652 F.2d 808, 815 (CA9 1981). The respondents also alleged various other federal claims and pendent state law claims that are not before us.

[[Footnote 10](#)]

See, e.g., *Tarasi v. Pittsburgh National Bank*, 555 F.2d 1152 (CA3) (allowing defense), *cert. denied*, 434 U.S. 965 (1977); *Malamphy v. Real-Tex Enterprises, Inc.*, 527 F.2d 978 (CA4 1975) (per curiam) (sustaining submission of defense to jury); *Woolf v. S.D. Cohn & Co.*, 515 F.2d 591, 601-605 (CA5 1975) (rejecting defense on facts of case), *on rehearing*, 521 F.2d 225, *vacated and remanded on other grounds*, 426 U.S. 944 (1976); *Kuehnert v. Texstar Corp.*, 412 F.2d 700 (CA5 1969) (allowing defense); *Kirkland v. E. F. Hutton & Co.*, 564 F.Supp. 427, 433-437 (ED Mich.1983) (rejecting defense on motion for summary judgment); *Grumet v. Shearson/American Express, Inc.*, 564 F.Supp. 336 (NJ 1983) (allowing defense); *Xaphes v. Shearson, Hayden, Stone, Inc.*, 508 F.Supp. 882, 884-887 (SD Fla.1981) (rejecting defense on motion to dismiss); *Moholt v. Dean Witter Reynolds, Inc.*, 478 F.Supp. 451 (DC 1979) (rejecting defense on motion

for summary judgment); *In re Haven Industries, Inc.*, 462 F.Supp. 172, 177-180 (SDNY 1978) (allowing defense); *Nathanson v. Weis, Voisin, Cannon, Inc.*, 325 F.Supp. 50 (SDNY 1971) (rejecting defense); *Wohl v. Blair & Co.*, 50 F.R.D. 89 (SDNY 1970) (denying motion to strike defense). *Cf. Silverberg v. Paine, Webber, Jackson & Curtis, Inc.*, 710 F.2d 678, 691 (CA11 1983); *Mallis v. Bankers Trust Co.*, 615 F.2d 68, 76 (CA2 1980), *cert. denied*, 449 U.S. 1123 (1981); *Can-Am Petroleum Co. v. Beck*, 331 F.2d 371, 373 (CA10 1964).

[[Footnote 11](#)]

Black's Law Dictionary 711 (5th ed.1979).

[[Footnote 12](#)]

See, e.g., *Higgins v. McCrea*, [116 U. S. 671](#) , [116 U. S. 685](#) (1886); *Austin's Adm'x v. Winston's Ex'x*, 11 Va. 33, 47 (1806) ("He who comes here for relief must draw his justice from pure fountains"). See also *Holman v. Johnson*, 1 Cowp. 341, 343, 98 Eng.Rep. 1120, 1121 (K. B. 1775):

"The objection, that a contract is immoral or illegal as between plaintiff and defendant, sounds at all times very ill in the mouth of the defendant. It is not for his sake, however, that the objection is ever allowed. . . . The principle of public policy is this; *ex dolo malo non oritur actio* [out of fraud no action arises]. . . . It is upon that ground the Court goes; not for the sake of the defendant, but because they will not lend their aid to such a plaintiff."

[[Footnote 13](#)]

See, e.g., *McMullen v. Hoffman*, [174 U. S. 639](#) , [174 U. S. 669](#) -670 (1899):

"To refuse to grant either party to an illegal contract judicial aid for the enforcement of his alleged rights under it tends strongly towards reducing the number of such transactions to a minimum. The more plainly parties understand that, when they enter into contracts of this nature, they place themselves outside the protection of the law, so far as that protection consists in aiding them to enforce such contracts, the less inclined will they be to enter into them. In that way, the public secures the

benefit of a rigid adherence to the law."

[[Footnote 14](#)]

See also *Tarasi v. Pittsburgh National Bank*, 555 F.2d at 1157; L. Loss, *Fundamentals of Securities Regulation* 1197 (1983); Comment, *Availability of an In Pari Delicto Defense in Rule 10b-5 Tippee Suits*, 77 *Colum.L.Rev.* 1084, 1086, n. 15 (1977).

[[Footnote 15](#)]

Sherman Act, 26 Stat. 209 *et seq.*, as amended, 15 U.S.C. 1 *et seq.*; Clayton Act, 38 Stat. 730 *et seq.*, as amended, 15 U.S.C. 12 *et seq.*

[[Footnote 16](#)]

See 392 U.S. at [392 U. S. 145](#) (WHITE, J., concurring); *id.* at [392 U. S. 147](#) - 148 (Fortas, J., concurring in result); *id.* at [392 U. S. 148](#) -149, [392 U. S. 151](#) (MARSHALL, J., concurring in result); *id.* at [392 U. S. 154](#) -155 (Harlan, J., joined by Stewart, J., concurring in part and dissenting in part).

[[Footnote 17](#)]

JUSTICE WHITE concluded that "the *in pari delicto* defense in its historic formulation is not a useful concept" in antitrust law, but emphasized that he "would deny recovery where plaintiff and defendant bear substantially equal responsibility for injury resulting to one of them." *Id.* at [392 U. S. 143](#) , [392 U. S. 146](#) . The other four Justices would have allowed explicit, though limited, use of the *in pari delicto* defense itself. *Id.* at [392 U. S. 147](#) (Fortas, J., concurring in result); *id.* at [392 U. S. 148](#) -149 (MARSHALL, J., concurring in result); *id.* at [392 U. S. 153](#) (Harlan, J., joined by Stewart, J., concurring in part and dissenting in part).

[[Footnote 18](#)]

See *Blue Chip Stamps v. Manor Drug Stores*, [421 U. S. 723](#) , [421 U. S. 730](#) (1975); *Superintendent of Insurance v. Bankers Life & Cas. Co.*, [404 U. S. 6](#) ,

[404 U. S. 13](#) , n. 9 (1971).

[[Footnote 19](#)]

See 16 of the Securities Act of 1933, 48 Stat. 84, 15 U.S.C. 77p; 28(a) of the Securities Exchange Act of 1934, 48 Stat. 903, as amended, 15 U.S.C. 78bb(a).

[[Footnote 20](#)]

In *Frost*, we quoted approvingly from an SEC memorandum arguing that

""[i]t appears to us to be entirely immaterial whether, in such a case, the agreement is labelled *void*' or *the parties are held to be ` in pari delicto*. ' There, labels, as often is the case, merely state the conclusion reached, but do not aid in solution of the problem. The ultimate issue is whether the result in the particular case would effectuate or frustrate the purposes of the Act.""

312 U.S. at [312 U. S. 44](#) , n. 2.

[[Footnote 21](#)]

We note, however, the inappropriateness of resolving the question of the respondents' fault solely on the basis of the allegations set forth in the complaint. A tippee generally has a duty to disclose or to abstain from trading on material nonpublic information only when he knows or should know that his insider source "has breached his fiduciary duty to the shareholders by disclosing the information" -- in other words, where the insider has sought to "benefit, directly or indirectly, from his disclosure." *Dirks v. SEC*, [463 U. S. 646](#) , [463 U. S. 660](#) , [463 U. S. 662](#) (1983). Such benefit can derive from the insider's use of the information to secure a "pecuniary gain," a "reputational benefit that will translate into future earnings," or simply to confer "a gift of confidential information to a trading relative or friend." *Id.* at [463 U. S. 663](#) -664. See also *id.* at [463 U. S. 655](#) , n. 14 (alternative basis for liability where tippee has "entered into a special confidential relationship in the conduct of the business of the enterprise and [is] given access to information solely for corporate purposes"). Although the respondents certainly were aware that Lazzaro stood to gain from disclosure by the commissions he

would earn, it is uncertain whether they had any basis to believe that Neadeau -- the insider from whose potential breach all liability flows -- had violated his fiduciary duties to TONM's shareholders by revealing the joint venture information to Lazzaro. The respondents might well have believed that Neadeau provided the information to Lazzaro as a favor or otherwise acted against the shareholders' interests, but the complaint does not set forth sufficient facts to conclude that this was the case.

In addition, we accept the lower courts' assumption about the respondents' violations notwithstanding the uncertain character of the information the respondents traded on. The complaint rather strongly suggests that much of the information Lazzaro conveyed about the explorations and joint venture negotiations was true, but that it was deceptive by virtue of exaggeration and the failure to include additional material information. See Complaint, 10-12, 18, 20, 30, App. 8-9, 12-13, 15. If this was the case, and if the respondents otherwise acquired a derivative duty within the meaning of *Dirks*, there is no question that their trading on the basis of this information violated the securities laws. If the information was *entirely* false, the SEC and Bateman Eichler contend that the respondents, by trading on what they believed was material nonpublic information, are nevertheless guilty of at least an *attempted* violation of the securities laws if they otherwise believed that Neadeau had breached his fiduciary duties. This view has drawn substantial support among the lower courts. See, e.g., *Tarasi v. Pittsburgh National Bank*, 555 F.2d at 1159-1160; *Kuehnert v. Texstar Corp.*, 412 F.2d at 704; *Grumet v. Shearson/American Express, Inc.*, 564 F.Supp. at 340. The respondents, on the other hand, contend that they could not have inherited any duty to disclose false information, and that the case is properly viewed as governed by the doctrine of legal impossibility, which would bar any liability, rather than factual impossibility, which would permit liability on an attempt theory. See also Note, The Availability of the *In Pari Delicto* Defense in Tippee-Tipper Rule 10b-5 Actions After *Dirks v. SEC*, 62 Wash.U.L.Q. 519, 540-542 (1984). Because this issue has not been fully briefed and was not considered by the courts below, we express no views on it, and simply proceed on the assumption that the respondents' activities rendered them *in delicto*.

[[Footnote 22](#)]

We also have noted that a tippee may be liable if he otherwise "misappropriate[s] or illegally obtains the information." *Dirks v. SEC*, *supra*, at [463 U. S. 665](#) . Cf. H.R.Rep. No. 98-355, pp. 14-15 (1983).

[[Footnote 23](#)]

Our view is reinforced by Congress' recent enactment of the Insider Trading Sanctions Act of 1984, 2, 98 Stat. 1264-1265, 15 U.S.C. 78u(d)(2) (1982 ed., Supp. III), which imposes civil penalties on nontrading tippers out of the belief that, "[a]bsent the tipper's misconduct, the tippee's trading would not occur," and that a tipper is therefore "most directly culpable in a violation," H.R.Rep. No. 98-355, at 9.

[[Footnote 24](#)]

See *Dirks v. SEC*, 463 U.S. at [463 U. S. 655](#) ; Comment, 77 Colum.L.Rev. *supra*, n. 14, at 1094, and n. 64.

[[Footnote 25](#)]

Bateman Eichler has sought a reversal of the Ninth Circuit's judgment solely on the grounds that the investors were *in pari delicto* with its employee Lazzaro. *Amicus* Securities Industry Association (SIA), however, contends that the *in pari delicto* defense should in any event bar recovery against a brokerage firm whose only role has been that of a "controlling person" of the defrauding employee, see [n](#) 1, *supra*, and whose liability is therefore "vicarious" and "secondary." Brief for SIA as *Amicus Curiae* 20-24. This issue was not addressed by the Ninth Circuit, and Bateman Eichler has not raised it either in this Court or in the Ninth Circuit. We therefore express no views with respect to the liability of brokerage firms as "controlling persons" in cases such as this.

[[Footnote 26](#)]

See, e.g., *Tarasi v. Pittsburgh National Bank*, 555 F.2d at 1163-1164; *Kuehnert v. Texstar Corp.*, 412 F.2d at 705; *Grumet v. Shearson/American Express, Inc.*,

564 F.Supp. at 340; *Wohl v. Blair & Co.*, 50 F.R.D. at 93.

[[Footnote 27](#)]

See, e.g., *Kuehnert v. Texstar Corp.*, *supra*, at 706 (Godbold, J., dissenting); *Kirkland v. E. F. Hutton & Co.*, 564 F.Supp. at 435-436; *Nathanson v. Weis, Voisin, Cannon, Inc.*, 325 F.Supp. at 54-57.

[[Footnote 28](#)]

Our analysis is buttressed by reference to 9(e) of the Securities Exchange Act of 1934, 48 Stat. 890, 15 U.S.C. 78i(e), which allows coconspirators a right of contribution against "any person who, if joined in the original suit, would have been liable to make the same payment." This provision overrides the common law rule against contribution from coconspirators, which was grounded on the premise that "parties generally *in pari delicto* should be left where they are found." *Texas Industries, Inc. v. Radcliff Materials, Inc.*, [451 U. S. 630](#) , [451 U. S. 635](#) (1981). As the Commission observes,

"[s]urely, the Congress that provided that a brokerage professional such as Lazzaro could recover from his fellow manipulators should be understood to have also permitted the victims of Lazzaro's manipulative scheme to sue him."

Brief for SEC as *Amicus Curiae* 26.

[[Footnote 29](#)]

It also has been suggested that

"tippees constitute a potentially larger class, and deterrent measures aimed exclusively at tippees, even if proportionately as successful, will still leave a large number of violations undeterred. Thus, [even if] tippers and tippees are assumed to be equally responsive to deterrent measures, it would appear preferable to increase deterrent pressure against tippers by allowing tippee recovery."

Comment, 77 Colum.L.Rev. *supra*, n. 14, at 1096-1097 (footnote omitted).

[[Footnote 30](#)]

Some courts have suggested that,

"even in a case where the fault of plaintiff and defendant were relatively equal, simultaneous and mutual, the court might still reject the [*in pari delicto*] defense if it appeared that the defendant's unlawful activities were of a sort likely to have a substantial impact on the investing public, and the primary legal responsibility for and ability to control that impact is with defendant."

Wolf v. S.D. Cohn & Co., 515 F.2d at 604; *see also Mallis v. Bankers Trust Co.*, 615 F.2d at 76, n. 6. Because there is no basis at this stage of the litigation for concluding that the respondents bore substantially equal responsibility for the violations they seek to redress, we need not address the circumstances in which preclusion of suit might otherwise significantly interfere with the effective enforcement of the securities laws and protection of the investing public.

[[Footnote 31](#)]

See, e.g., Wolfson v. Baker, 623 F.2d 1074, 1082 (CA5 1980), *cert. denied*, 450 U.S. 966 (1981); *Tarasi v. Pittsburgh National Bank*, 555 F.2d at 1163-1164; *In re Haven Industries, Inc.*, 462 F.Supp. at 179-180.

[[Footnote 32](#)]

In addition to potential liability under 10(b) and Rule 10b-5, investors also are subject to liability under 2 and 3 of the Insider Trading Sanctions Act of 1984, 98 Stat. 1264-1265, 15 U.S.C. 78u(d)(2), 78ff(a) (1982 ed., Supp. III), which imposes severe civil sanctions on persons who have illegally used inside information, as well as criminal fines of up to \$100,000.

[[Footnote 33](#)]

The SEC also argues that courts should deter tippees in cases such as this by limiting potential recovery to out-of-pocket losses. The courts below did not address this issue, and we express no views on the proper measure of relief. *Cf.*

Perma Life Mufflers, Inc. v. International Parts Corp., 392 U.S. at [392 U. S. 140](#) .

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