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PERSPECTIVE

Justices to weigh tippee liability

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On Wednesday, the U.S. Supreme Court will hear argument in *Salman v. United States*, one of the most important insider trading cases before the court in decades. In *Salman*, the court is expected to address the scope of "tippee liability," which arises when a corporate insider tips material, non-public information to a third party, who then trades on that information. In those cases, among other things, the government must prove that the tipper received a "personal benefit" in exchange for the tip. In the last two years, a split in the circuits has developed in interpreting the "personal benefit," which government attorneys, defense lawyers and securities professionals hope the court will now resolve in *Salman*.

The Personal Benefit Test

"Tippee liability" was first articulated more than 30 years ago in *Dirks v. SEC*, 463 U.S. 646 (1983). In Dirks, the Supreme Court opined that insiders are forbidden by their fiduciary relationship not only "from personally using undisclosed corporate information to their advantage," but also from giving "such information to an outsider for the same improper purpose of exploiting the information for their personal gain." In these circumstances, "a tippee assumes a fiduciary duty to the shareholders of a corporation not to trade on material nonpublic information" if the insider "has breached his fiduciary duty to the shareholders by disclosing the information to the tippee and the tippee knows or should know that there has been a breach."

Imposing the tipper's duty to disclose the inside information or abstain from trading on a tippee does not arise from all tips of inside information. The government must still prove that "the insider personally will benefit, directly or indirectly, from his disclosure. Absent some personal gain, there has been no breach of duty to stockholders. And absent a breach by the insider, there is no derivative breach [by the tippee]." The *Dirks* court explained that this inquiry focuses on objective criteria, "such as a pecuniary gain or a reputational benefit that will translate into future earnings." But, later in its opinion, the court also stated that "the elements of fiduciary duty and exploitation of nonpublic information also exist when an insider makes a gift of confidential information to a trading relative or friend. The tip and trade resemble trading by the insider himself followed by a gift of the profits to the recipient."

United States v. Newman Narrows the Interpretation of the Personal Benefit Test

In the 30 years after *Dirks*, courts and government prosecutors adopted expansive views of the gift component of the personal benefit test to include virtually any exchange of inside information between friends or family members as giving rise to tipping liability. This broad approach to the personal benefit test, however, was rejected by the 2nd U.S. Circuit Court of Appeals in *United States v. Newman*, 779 F.3d 438 (2d Cir. 2014), *cert. denied* 136 S. Ct. 242 (2015). In *Newman*, two hedge fund managers were convicted of insider trading under a tipper/tippee theory. The defendants were remote tippees several layers removed from the insiders who originally had disclosed the nonpublic information in violation of their fiduciary duties. The 2nd Circuit reversed the convictions upon finding that the tippees were too remote from the original tippers to have inherited the insiders' fiduciary duties. Interpreting the "personal benefit" test, the court concluded that such a benefit must be proven by a "meaningfully close personal relationship that generates an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature."

The 9th Circuit Creates a Circuit Split in Salman

In *United States v. Salman*, 792 F.3d 1087 (9th Cir. 2015), the 9th U.S. Circuit Court of Appeals disagreed with *Newman*'s narrow interpretation of the personal benefit test. Unlike the remote tippees in *Newman*, Salman was convicted of receiving and trading on inside information he obtained from his brother-in-law, who in turn had received the information from his brother, a member of Citigroup's health care investment banking group. Relying on *Newman*, Salman appealed and argued that the government failed to prove that the original tipper received any pecuniary gain from the tips. The 9th Circuit rejected this argument and affirmed the conviction, finding that gifts of confidential information between family members alone, even in the absence of a pecuniary gain by the tipper, satisfied *Dirks*. In reaching this conclusion, the 9th Circuit expressly declined to follow *Newman* and relied on the language of *Dirks* that seemingly allowed personal benefit to be shown by "a gift of confidential information to a trading relative or friend."

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The Supreme Court Argument

The Supreme Court accepted certiorari in *Salman* on the question of whether the "personal benefit" test requires proof of "an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature," or whether "it is enough that the insider and the tippee shared a close family relationship." The briefs filed by the parties and amici outline the various approaches the court may take in resolving the case. The government argues that *Dirks* does not require a personal benefit to be pecuniary in nature and expressly allows for gifts between family members to satisfy the personal benefit test. Conversely, Salman argues that allowing personal benefit to be shown merely by gifts of inside information is too "indeterminate" and evidence of a pecuniary benefit is necessary to prevent prosecutorial overreach. One amici — the NYU Center on the Administration of Criminal Law — urged the court to eliminate the personal benefit test altogether and simplify tipping liability by requiring proof only that the tipper disclosed inside information for an improper purpose and knew that the tippee would trade on that information.

Certainly, the court may ultimately adopt one of these three positions and clarify the standards for tippee liability. Adopting *Newman*'s analysis would heighten the standards for the government by making insider trading liability difficult to prove when inside information is shared between family members or friends without evidence of the exchange of a pecuniary benefit. On the other hand, adopting *Salman*'s analysis would frustrate the demand for clarity and allow the government to charge insider trading when there is little or no evidence of a personal benefit. Or, the court could simply reconcile *Salman* and *Newman* based on the tippees' varying degrees of remoteness from the tippers in those cases and avoid ruling on the personal benefit altogether (although this result seems unlikely given that the court accepted certiorari in the first place). Another potential result is that the eight justices split evenly and fail to issue a majority decision, leaving the circuit split unresolved. Needless to say, government and defense attorneys, as well as securities professionals, will be eagerly awaiting the Supreme Court's decision.

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