TIPS WITH BENEFITS: INSIDER TRADING AT ORAL ARGUMENTS IN *SALMAN*

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INTRODUCTION

On Wednesday, October 5th, the Supreme Court heard oral arguments in *Salman v. United States*,[1] an insider trading case involving an investment banker who provided his brother with information about pending confidential business transactions.[2] The brother, in turn, shared the information with his brother-in-law, defendant Bassam Salman.[3] The case is about when a "remote tippee"—a person who is steps removed from an insider source and trades on inside information—can be held criminally liable for trading on the information. The Ninth Circuit held that because the tippee had a "close familial relationship" with the inside source, he could be held criminally liable.[4] This stands in contrast with the Second Circuit's 2014 holding in *United States v. Newman* that the exchange of information must pose potential pecuniary gain for the insider who made the first disclosure, in order for a remote tippee to be found criminally liable.[5] On its face, *Salman* is a vehicle for the Court to resolve the circuit split on this narrow issue. However, oral arguments indicated that the Court may also use *Salman* as an opportunity to examine and speak on the fundamental purposes of insider trading law. This article is part of a two-part series about *Salman*. This piece presents *Salman*'s background and prior insider trading cases to shed light on the precedential ambiguities the Court confronted during oral arguments. It further discusses the flaws in both Salman's and the government's arguments and potential repercussions of the Supreme Court adopting either of the dueling standards. The second piece in this series will explore scholars' proposals seeking to resolve the present difficulty of determining tippee liability by focusing on whether the confidential information was misappropriated.[6]

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[1] Salman v. United States, No. 15-628 (U.S. argued Oct. 5, 2016).

[2] Br. for Pet'r at 11, United States v. Salman, No. 15-628 (U.S. May 6, 2016). The unannounced business transactions included confidential information on future mergers and acquisitions.

[3] *Id*.

[4] United States v. Salman, 792 F.3d 1087, 1093 (9th Cir. 2015).

[5] United States v. Newman, 773 F.3d 438, 452 (2d Cir. 2014) (holding that such an exchange must be "objective, consequential, and represent[] at least a potential gain of a pecuniary or similarly valuable nature.").

[6] *See infra* notes 56–58 and accompanying text.

I. THE FACTS AND POSTURE OF *SALMAN*

Salman is appealing his conviction for insider training after the Ninth Circuit held that his close familial relationship with the insider was sufficient to infer knowledge of the insider's receipt of a personal benefit. Salman's sister married Maher Kara, who was an investment banker for Citigroup's healthcare sector and had a fiduciary duty to keep confidential his clients' information on upcoming mergers and acquisitions.[7] Maher often consulted with his brother, Michael Kara, who has an undergraduate degree in chemistry, to gain knowledge about scientific concepts.[8] Although Maher repeatedly told Michael that the information he was sharing was confidential, he claimed he had no actual knowledge that Michael would trade on the information.[9] Nevertheless, the trial court held that knowledge could be inferred through deliberate ignorance[10] and found circumstantial evidence proving Salman knew Maher was gaining a personal benefit by tipping a trading relative in breach of his fiduciary duty.[11] Thus, Salman was guilty of insider trading.[12]

On appeal, Salman urged the Ninth Circuit to adopt the Second Circuit's *Newman* standard, which requires proving that the insider received a pecuniary gain in exchange for the information—not just a personal benefit from "gifting" a trading relative.[13] Under *Newman*, the government would be required to demonstrate that Salman knew that Maher disclosed the information in exchange for Maher's "potential gain of a pecuniary or similarly valuable nature."[14] Both the Ninth Circuit and the Second Circuit were interpreting the Supreme Court's "personal benefit" test outlined in *Dirks v. SEC*.[15] Salman argued that when Maher

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[7] *Salman*, 792 F.3d at 1088–91 (9th Cir. 2015).
[8] Br. for Pet'r at 8–9.
[9] *Id*. at 11 (Michael was persistently asking for information, but "flat-out denied" trading on it when Maher confronted him). Maher said he knowingly tipped him in order "to get him off his back, and to benefit him." *Id.*
[10] United States v. Salman, No. CR-11-0625 EMC, 2013 WL 6655176, at *3 (N.D. Cal. Dec. 17, 2013), aff'd, 792 F.3d 1087 (9th Cir. 2015) (finding that [Salman] acted knowingly if he "was aware of a high probability that he obtained information that had been disclosed in violation of a duty of trust and confidence, and deliberately avoided learning the truth.").
[11] *Id*. at *6 (Michael told Salman that Maher was the source of the information and that they had to "protect" Maher).
[12] *Id.*
[13] *Salman*, 792 F.3d at 1093 (finding that *Newman* held that evidence of a friendship or familial relationship between tipper and tippee, standing alone, is insufficient to demonstrate that the tipper received a benefit).
[14] United States v. Newman, 773 F.3d 438, 452 (2d Cir. 2014).
[15] Dirks v. SEC., 463 U.S. 646, 662 (1983) ("[T]he test is whether the insider personally will benefit, directly or indirectly, from his disclosure.").

provided the information to his brother Michael, the mere exchange did not—absent more—constitute the type of benefit *Newman* required. He further argued that the government could not show that Salman knew that Maher received any such benefit in exchange for the inside information and therefore could not be held liable.[16] The Ninth Circuit, however, ultimately declined to follow *Newman*, reasoning that to do so would contravene the assertion in *Dirks* that a trader is liable when an "insider makes a gift of confidential information to a trading relative or friend."[17]

II. *DIRKS* AS APPLIED IN THE PARTIES' BRIEFS

Dirks, also a tipper-tippee case, dealt with a corporate insider who disclosed nonpublic information.[18] In that case, the insider disclosed information about his company's suspected fraud to defendant, Dirks. Dirks, in turn, advised his clients to sell their shares, thereby saving them over $17 million and causing the company to go into bankruptcy proceedings.[19] The Court in *Dirks* made clear that there is no general duty to abstain from trading on nonpublic information.[20] Rather, it is a breach of fiduciary duty that gives rise to liability.[21] The problem, however, is that a remote tippee would seem to bear no direct fiduciary duty to a company's shareholders.[22] This creates a gap in the so-called "classical theory" of insider trading—which requires a direct fiduciary duty and breach. To fill this gap, the Court held that a tippee assumes fiduciary liability to the shareholders upon receiving the tip, presuming that the tippee knows or should know that the insider disclosed the information in breach of his own fiduciary duty.[23]

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[16] *Salman*, 792 F.3d at 1093.

[17] *Salman*, 792 F.3d at 1093 ("Doing so would require us to depart from the clear holding of *Dirks* that the element of breach of fiduciary duty is met where an 'insider makes a gift of confidential information to a trading relative or friend.'" (quoting *Dirks,* 463 U.S. at 664)).

[18] *Dirks*, 463 U.S. at 646.

[19] *Id*. at 648–53.

[20] *Id*. at 654 ("[A] duty to disclose under § 10(b) does not arise from the mere possession of nonpublic market information. Such a duty arises rather from the existence of a fiduciary relationship." (quoting Chiarella v. United States, 445 U.S. 222 (1980))).

[21] *Id*. at 654 ("[A] duty arises rather from the existence of a fiduciary relationship." (quoting *Chiarella*, 445 U.S. at 239 (Brennan, J., concurring))).

[22] *Id.* at 655 ("Unlike insiders who have independent fiduciary duties to both the corporation and its shareholders, the typical tippee has no such relationships. In view of this absence, it has been unclear how a tippee acquires the duty to refrain from trading on inside information.").

[23] *Id*. at 660 ("Thus, a tippee assumes a fiduciary duty to the shareholders of a corporation not to trade on material nonpublic information only when the insider has breached his fiduciary duty to the shareholders by disclosing the information to the

In their briefs, Salman and the government used language in *Dirks* to encourage the Court to adopt dueling standards—standards which push toward poles of a liability spectrum. The government argued that any time an insider discloses any information that does not serve a "corporate purpose," the insider has exchanged their fiduciary duty for personal benefit.[24] Salman, on the other hand, argued that *Dirks* prescribed a narrow "limiting principle" in which the personal benefit is only established when the insider receives a pecuniary gain.[25] "Personal benefit" of the insider was key to both analyses.

The government emphasized language in *Dirks* in which the Court stated that when "information intended to be available only for a corporate purpose and not for the personal benefit of anyone" is used for the tipper's personal trading advantage, the tippee is liable for criminal insider trading.[26] The government argued that when the insider discloses the information for a non-corporate purpose, the insider is assumed to have received a personal benefit in exchange for that information.[27] The weakness with the government's broad approach is that it glosses over situations in which the information is leaked negligently or solely for the tippee's benefit. It interprets *Dirks* to hold that "personal benefit" exists whenever a "corporate purpose" does not.[28] The government is seeking to further broaden *Dirks*'s language by arguing that "personal benefit" encompasses a gift of confidential information to anyone, not just a trading relative or friend.[29]

Salman's briefs instead embrace the Second Circuit's view in *Newman* that the government may not "prove the receipt of a personal benefit by the mere fact of a friendship, particularly of a casual or social nature."[30] To do so would effectively make actual "personal benefit"

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tippee and the tippee knows or should know that there has been a breach.").

[24] Br. for the United States at 18, Salman v. United States, No. 15-628 (U.S. Aug. 1, 2016) ("[T]he existence of 'personal benefit' is simply the flip side of the absence of a corporate purpose.").

[25] Br. for Pet'r at 22; *Dirks*, 463 U.S. at 654 ("Absent some personal gain, there has been no breach of duty to stockholders.").

[26] *Dirks*, 463 U.S. at 646–47 ("Two elements for establishing a violation of [insider trading] by corporate insiders are the existence of a relationship affording access to inside information intended to be available only for a corporate purpose, and the unfairness of allowing a corporate insider to take advantage of that information by trading without disclosure.").

[27] Br. for the United States at 25 (arguing that "the factfinder need not investigate the exact nature of the personal reasons" when information is gifted).

[28] *Id.* at 19 ("The existence of 'personal benefit' is simply the flip side of the absence of a corporate purpose.").

[29] *Id.* at 27 (arguing that *Dirks*' personal-benefit test encompasses a gift to any person with the expectation that the information will be used for trading, not just to a "trading relative or friend" (quoting *Dirks*, 463 U.S. at 664)).

[30] United States v. Newman, 773 F.3d 438, 452 (2d Cir. 2014) (noting that under the government's broad standard, "the personal benefit requirement would be a nullity.").

irrelevant.[31] When interpreting *Dirks*, the *Newman* court relied on "proof of 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."[32] Salman argues that *Dirks*' interchangeable use of "gain" with "benefit," and its focus on insiders who "exploit" corporate information for "profit" show that the Court was principally concerned with situations in which the insider tips for pecuniary gain.[33] Salman also downplays the *Dirks* hypothetical in which an insider merely gifts information to a trading relative or friend.[34] Salman argues that to portray such gifts as conveying a personal benefit would require making an inference that is far short of actual proof of personal benefit.[35] The problem with Salman's proposed standard is that many relationships on Wall Street are "favor-based," not exchanges for cash.[36] To ignore this reality would hinder legitimate prosecution of some true insider traders.

III. ORAL ARGUMENT: THE COURT GRAPPLES WITH A STANDARD FOR REMOTE TIPPEES

At oral argument, the Court probed the benefits of different permutations on the parties' proposed standards.[37] The justices indicated that Salman's actions mirrored conduct generally subject to criminal liability,[38] expressing concern that excusing Salman's conduct would be

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[31] *Id*.
[32] *Id*. at 452.
[33] Br. for Pet'r at 29.
[34] Dirks v. SEC., 463 U.S. 646, 664 (1983) ("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.").
[35] Reply Br. for Pet'r at 7; Salman v. United States, No. 15-628 (U.S. Aug. 31, 2016) ("The Court introduced these concepts as 'facts and circumstances that often justify . . . an inference' of a breach of duty." (quoting *Dirks,* 463 U.S. at 664)).
[36] James B. Stewart, *Justices Take On a Muddled Issue: Insider Trading*, The New York Times (Jan. 28, 2016), http://www.nytimes.com/2016/01/29/business/justices-take-on-a-muddled-issue-insider-trading.html. "'Wall Street is a big favor bank,' said John C. Coffee Jr., a professor and expert in securities law at Columbia Law School. 'There's a culture of reciprocity.'" *Id*.
[37] *See* Tr. of Oral Argument, Salman v. United States, No. 15-628 (U.S. Oct. 5, 2016), https://www.supremecourt.gov/oral_arguments/argument_transcripts/2016/15-628_p86a.pdf.
[38] Justice Breyer described the facts as prosecutable "fraud" and "deceit." *Id*. at 23. Justice Kagan referred to the actions as "a kind of embezzlement or conversion." *Id*. at 13–14. Justice Sotomayor referred to Salman's conduct as the type of thing considered "classically, a fraud." *Id*. at 15. Justice Breyer analogized the authority of the Securities and Exchange Commission ("SEC") to prosecute under a broad enabling statute to antitrust laws. *Id*. at 16–17.

contrary to established precedent.[39] Nevertheless, oral argument did not reveal a consensus on a single standard for interpreting *Dirks* in this case and in other remote-tippee cases.[40] Justice Kagan analogized Maher to a thief who steals $100 from a co-worker to buy a gift for a good friend, which he otherwise could not afford.[41] Salman responded that Maher disclosed the information merely to stop his brother's pestering, and if that is considered to be a benefit, nearly anything would satisfy the test.[42] Salman pressed the central contention from the briefs—that the Court should adopt a narrow standard that requires proof of a tangible gain or potential for financial benefit.[43]

The Deputy Solicitor General, on the other hand, advocated the government's preferred standard: a remote tippee cannot trade on information that he knows was disclosed in breach of a duty of loyalty to the corporation (i.e., for no corporate purpose).[44] He nevertheless conceded that the case at hand could be decided based on the "family" language in *Dirks* that includes gifting information to a trading relative or friend.[45] The Court tested the outer reaches of the government's standard, especially with respect to remote tippees.[46] The government responded to Justice Ginsburg's concern about "how far down the line" liability stretches[47] by stating that the tippee must have actual knowledge based on objective factors, but that this knowledge can come from "conscious avoidance."[48] Under this standard, a tipper must likewise

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[39] Justice Breyer stated that to adopt the Second Circuit's position from *Newman* would be "really more likely to change the law that people have come to rely upon than it is to keep to it." *Id.* at 16. Justice Kagan similarly observed that such changes to the law would threaten the integrity of the market. *Id.* at 21.

[40] *Id.* at 28. Justice Alito stated that "[i]t doesn't seem to me that [the Deputy Solicitor General's] argument is much more consistent with *Dirks* than [Salman's argument].").

[41] *Id.* at 12–14. Justice Kagan focused on the non-corporate individual motivation, observing that "we all have our own interests and purposes behind giving gifts. Some of those might be very practical and pragmatic. Some of them might be more altruistic. But we give gifts for individual interests and purposes." *Id*. at 13.

[42] Counsel for Salman stated, "Well, if that's a benefit, virtually anything is, and then the Court would be going back to the rule that [was] expressly rejected in *Chiarella* . . . that [there is a] general duty . . . to refrain from insider trading." *Id.* at 19.

[43] Counsel for Salman argued that the gain "has to be tangible. It doesn't have to be cash. It has to be something that is either immediately pecuniary or can be translated into financial." *Id.* at 20.

[44] The Deputy Solicitor General interpreted *Dirks* to "draw[] a line between people who had information for corporate purposes and used it consistently with those purposes, and people who had access to corporate information made available to them only for corporate purposes and used it for personal benefit." *Id.* at 30.

[45] The Deputy Solicitor General stated that "it is completely fine with the government" if the Court decides the case by relying on the "gift" language of Dirks. *Id*. at 50–51.

[46] Justice Kennedy asked "How far out does liability extend?" *Id.* at 17. Justice Ginsburg asked "How far down the line do you go?" *Id.* at 35–36.

[47] *Id.* at 35–36.

[48] *Id*. at 49–51.

have an understanding that the tippee's trading would happen, although it is not necessary to prove that the tipper intends that the tippee trade.[49] Justice Alito challenged the government's proposed standard with the difficulty in discerning knowledge and mental state, posing a hypothetical in which an insider becomes drunk and inadvertently discloses information to friends.[50] Chief Justice Roberts expressed concern with whether the government's proposal would broaden *Dirks* by also encompassing a social interchange.[51] The government responded that liability would turn on whether the tippee knew that the information was disclosed in breach because the core of *Dirks* is that a person must not breach the fiduciary duty of loyalty to the company.[52] Justice Alito was not persuaded that this was the Court's holding.[53]

CONCLUSION

The lower courts have struggled to define the contours of "personal benefit" or "personal purpose." If the personal-benefit standard relies on close familial or friendship relations, what counts as close enough?[54] If it relies on particular types of benefit, how does it distinguish between what violates the law and what does not?[55] These questions, however, are moot if the Supreme Court abolishes the personal benefit test altogether. A forthcoming piece will inquire into several securities law scholars' proposals advocating for a synthesized doctrine without a personal-benefit test.[56] Such a doctrine would be inspired by cases that lay out the Court's misappropriation theory, such as *United States v. O'Hagan*. There, a lawyer who was advising the acquiring company in a tender offer misappropriated information about the upcoming merger by

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[49] *Id*. at 51. The Deputy Solicitor General clarified that a requirement of knowledge is that "the tipper understood that the tippee would trade. It's not a requirement that the person intend that the tippee trade. It's just an understanding and knowledge that it would happen." *Id*.

[50] *Id*. at 37.

[51] Chief Justice Roberts stated that disclosures made during a "social interchange" cannot be considered a gift. *Id.* at 24–25.

[52] The Deputy Solicitor General argued, "The advantage that you receive is that you are able to make a gift with somebody else's property. . . . [A]nd the line that the Court [in *Dirks*] selected tracks the basic duty of loyalty in corporate law." *Id.* at 28.

[53] Justice Alito criticized the Deputy Attorney General's reading of *Dirks*, stating, "It doesn't seem to me that your argument is much more consistent with *Dirks* than [Salman's counsel]." *Id.* at 28.

[54] *See, e.g.*, *id.* at 48.

[55] *See, e.g.*, *id.* at 8.

[56] *See* Donald C. Langevoort, *Informational Cronyism*, 69 STAN. L. REV. ONLINE 37 (2016); Donna M. Nagy, *Beyond* Dirks*: Gratuitous Tipping and Insider Trading*, 42 J. CORP. L. 1 (forthcoming 2016), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2665820.

buying stock of the target company.[57] Despite the lawyer's lack of a direct fiduciary duty to the target company, the Court found a breach of a duty of trust and confidence when the trading activity was premised on confidential information that the company entrusted him with.[58] The misappropriation theory stands for the proposition that any breach of the fiduciary duty of loyalty to the company by the insider, whether in family or business settings, should be unlawful. Tippees like Salman would be liable so long as they are in a position to reasonably understand that the confidential information was disclosed in disloyalty.[59]

[57] United States v. O'Hagan, 521 U.S. 642 (1997)

[58] *O'Hagan*, 521 U.S. at 652 ("[T]he misappropriation theory premises liability on a fiduciary-turned-trader's deception of those who entrusted him with access to confidential information.").

[59] *See* Langevoort, *supra* note 57, at 40 (stating that "any disloyalty should suffice, so long as the tippee is in a position to understand that the disloyalty motivated the tip.").