'Tippee' Liability After *Salman*

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Just as a person who owes a fiduciary duty to an employer or client may not trade on nonpublic, inside information, he or she is also prohibited under federal securities laws from disclosing inside information, or "tipping," to others (the so-called "tippees") for trading purposes. Complicated questions arise, however, in assessing potential liability for the tippees who receive, and trade upon, such inside information. The Supreme Court previously explained that a tippee's liability for trading on inside information depends on whether the insider (or "tipper") breached a fiduciary duty in disclosing the information.[1] The test for determining if such a breach has occurred, in turn, hinges on "whether the insider personally will benefit, directly or indirectly, from his disclosure."[2] But less settled—and the subject of conflict among the circuits—has been the question of what counts as a "personal benefit."

In its recently issued opinion in *Salman v. United States*,[3] the Supreme Court sought to address this question. In so doing, the Court abrogated a key aspect of the Second Circuit's much-discussed opinion in *United States v. Newman*.[4] *Salman* offers some important takeaways for practitioners, investors, corporate employees, and service providers—and even would-be tippees.

United States v. Salman

Salman involved the sharing of inside information among a network of relatives and in-laws. Maher Kara was an employee at Citibank who, for a period of several years, shared inside information regarding upcoming Citibank transactions with his older brother Michael Kara. Michael then shared the information with Bassam Salman, who was Maher's brother-in-law, and with whom the family had become close. Both Michael Kara and Salman made millions of dollars trading on the inside information. They "agreed that they had to 'protect' Maher and promised to shred all of the papers" relating to their trades.[5] Rather than trade under his own account, Salman used a "series of transfers" to deposit money "into a brokerage account held jointly in the name of his wife's sister and her husband," who also profited from the trades.[6]

Unlike his brother and brother-in-law, Maher Kara did not himself trade on the inside information, nor did he receive any money from Michael Kara or Salman's trades. Rather, Maher Kara testified at Salman's trial that "'he gave Michael the inside information in order to 'benefit him' and to 'fulfill [ ] whatever needs he had'" because "he 'love[d] [his] brother very much.'"[7] Indeed, on one occasion, Maher offered Michael money in lieu of inside information, only to then provide Michael with inside information after Michael rejected the money.[8] For his part, Salman was aware of the brothers' close

relationship, having had "ample opportunity to observe Michael and Maher's interactions at their regular family gatherings," including Michael's tear-inducing speech at Maher's wedding.[9]

On this evidence, a jury convicted Salman of several counts of securities fraud and conspiracy to commit securities fraud, in violation of 15 U.S.C. §§ 78j(b) and 78ff. The Ninth Circuit affirmed, relying on guidance from the Supreme Court in *Dirks* that a jury may infer that a tipper received a "personal benefit" where he or she "makes a gift of confidential information to a trading relative or friend."[10]

Salman in the Supreme Court

Before the Supreme Court, Salman sought to limit the application of *Dirks*' gift-giving language. Salman contended that the evidence supporting his convictions was insufficient because Maher Kara "did not personally receive money or property in exchange for the tips and thus did not personally benefit from them."[11] A tipper does not "personally benefit," Salman argued, "unless the tipper's goal in disclosing inside information is to obtain money, property, or something of tangible value."[12] As support for this argument, Salman pointed to the Second Circuit decision in *United States v. Newman*.[13] *Newman* involved an extended tipper/tippee chain, in which the tippees, two hedge-fund portfolio managers, traded on information obtained from insiders via "multiple layers of analysts at hedge funds and investment firms."[14] In reversing the convictions, the Second Circuit held that the evidence was insufficient to show that the insiders received a "personal benefit," and observed that, to the extent that a "personal benefit" can be "inferred from a personal relationship," there must be 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*."[15]

The Supreme Court in *Salman* abrogated this aspect of *Newman*. Dismissing Salman's argument that the tipper's goal must be to obtain money, property, or something of tangible value, the Court reiterated its statement in *Dirks* that a gift of inside information to a relative or friend is sufficient to establish a "personal benefit" to the insider.[16] The Court reasoned that there was no question "Maher would have breached his duty had he personally traded on the information here himself [and] then given the proceeds as a gift to his brother."[17] Bestowing inside information rather than profits is no different: "Maher effectively achieved the same result by disclosing the information to Michael, and allowing him to trade on it."[18] Therefore, the Supreme Court expressly rejected *Newman* to the extent that it held that a mere gift of information to a relative or friend is not enough to support a "personal benefit" and that the insider must seek something of pecuniary value.[19]

Takeaways From *Salman*

Salman leaves us with some important takeaways. First, in making clear a mere gift of inside information to a relative or friend is sufficient to show a "personal benefit," the Court more broadly implied that *any gift* of inside information can lead to prosecution. After all, while *Dirks* contemplated a gift to "a trading relative or friend," it will be a rare circumstance where the recipient of a grant of inside information cannot be characterized, at the very least, as a "friend." And the less friendly the relationship between tipper and tippee, the more likely it will be that the exchange involved something resembling "a pecuniary gain or a reputational benefit that will translate into future earnings."[20]

Second, *Salman* does not disturb another important element (and defense) to tippee liability: A tippee is liable only if he or she "knows or should know that there has been a breach [of the tipper's fiduciary duty]."[21] In *Salman*, the government acknowledged that establishing liability against a tippee requires a showing of knowledge of the tipper's breach of fiduciary duty.[22] Thus, the requirement that the tippee knew or should have known about the source of the information and the breach of that source's fiduciary duty will remain a significant hurdle to prosecution after *Salman*. *Newman*, in fact, illustrates as much: In contrast to *Salman*, where the tippees "knew full well" the source of the information and took efforts to protect Maher by destroying records,[23] in *Newman*, the government presented no evidence that the tippees "knew they were trading on information obtained from insiders, or that those insiders received any benefit in exchange for such disclosures,"[24] rendering their convictions unsupportable.

Third, *Salman* indicates that the Supreme Court is disinclined to put limitations on what can and cannot constitute a "personal benefit." Citing *Dirks*, the Court appears willing to permit juries leeway in relying on "objective facts and circumstances" to infer a "personal benefit."[25] Rejecting the argument that the *Dirks* gift-giving standard is unconstitutionally vague, the Court explained that just because "in some factual circumstances assessing liability for gift-giving will be difficult," such difficulty "alone cannot render 'shapeless' a federal criminal prohibition, for even clear rules 'produce close cases.'"[26] In the aftermath of *Salman*, it will undoubtedly fall on future prosecutions and defense challenges to define the contours of what can constitute a "personal benefit." ⊙

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Endnotes

[1]*Dirks v. SEC*, 463 U.S. 646, 662.
[2]*Id.*
[3]*Salman v. United States,* 137 S.Ct. 420 (2016).
[4]*United States v. Newman,* 773 F.3d 438 (2014).
[5]*United States v. Salman,* 792 F.3d 1087, 1089 (9th Cir. 2015).
[6]*Id.*
[7]*Id.*
[8]*Id.*
[9]*Id.* at 1090.
[10]*Dirks,* 463 U.S. at 664.
[11]*Salman*, 137 S.Ct. at 424.
[12]*Id.* at 426.
[13]*Newman*, 773 F.3d. 438.
[14]*Id.* at 443.
[15]*Id.* at 452 (emphasis added).
[16]*Salman*, 137 S.Ct. at 427-28.
[17]*Id.* at 427.
[18]*Id.* at 428
[19]*Id.* at 428-29
[20]*Dirks*, 463 U.S. at 663.
[21]*Id.* at 660.
[22]*Salman*, 137 S.Ct. at 427.
[23]*Salman*, 792 F.3d at 1089.
[24]*Newman*, 773 F.3d at 453.
[25]*Dirks*, 463 U.S. at 663-64.
[26]*Salman*, 137 S.Ct. at 429. (quoting *Johnson v. United States*, 576 U.S. 135 S.Ct. 2551 (2015)).