Securities Regulation Daily Wrap Up, TOP STORY—U.S.: Justices grill Salman attorneys on the line between innocent and criminal tipping, (Oct. 5, 2016)

Securities Regulation Daily Wrap Up

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By Anne Sherry, J.D.

Can insider trading liability be predicated on a gift of information with no pecuniary benefit to the tipper? The Supreme Court's answer to that question could rewrite the law of insider trading. At oral argument on the *Salman* case, all eight justices grilled the attorneys with questions and hypotheticals intended to reveal the contours of when trading becomes criminal (*Salman v. U.S.*, October 5, 2016).

In Bassam Yacoub Salman's corner is the Second Circuit's *Newman* decision, which reversed the criminal convictions of two remote tippees because the government did not prove that the insider disclosed information in exchange for a personal benefit. But in affirming Salman's conviction, the Ninth Circuit declined to apply the *Newman* holding to the extent it held that a friendship or familial relationship was not enough to establish a personal benefit. Salman had traded on information he received from his brother-in-law; the brother-in-law had gotten the information from his brother, a Citigroup employee.

The petitioner's case: defining the limits of the crime. Arguing for Salman, Alexandra A. E. Shapiro stressed that to address separation of powers and vagueness concerns, the Court should limit the crime of insider trading "to its core"—trading by the insider or its functional equivalent. The "functional equivalent" of trading by the insider is trading by a tippee to whom the insider provided information in exchange for a financial benefit. Justice Ginsburg immediately raised the hypothetical of an insider trading in securities, then giving the proceeds to the relative. Shapiro stated that such an event would violate Section 10(b). The difference there is that the securities transaction is complete when the insider trades, regardless of what he does with the proceeds.

Shapiro again stressed that Section 10(b) does not set forth the elements of insider trading or even mention the term, much less tipping. Both *Dirks* (U.S. 1983) and *Chiarella* (U.S. 1980) make clear that not all trading on inside information is unlawful, she said. It is the insider's pecuniary gain that makes it unlawful.

But Justice Breyer raised a more holistic view of "personal benefit," observing that "the statute books are filled with instances where the public wants to know, not just how you might benefit, but how your family might benefit." He suggested that this is because in many families, "to help a close family member is like helping yourself." Shapiro returned to her core argument that Section 10(b) does not address that point.

Justice Kagan noted that the Court in *Dirks* described situations where insider trading liability arises, including "when an insider makes a gift of confidential information to a trading relative or friend." Later, summarizing its holding that the defendants were not liable, the Court wrote, "The tippers received no monetary or personal benefit, nor was their purpose to make a gift of valuable information to the tippee." Shapiro argued that the *Dirks* Court's mention of gifts was dictum, but the justices appeared unswayed. "This is like half their holding," Justice Kagan interjected. Justice Kennedy agreed. "The Court is very clearly setting out a test here. And this is part of the test."

When Justice Kennedy continued to posit that *Dirks* included a gift of information as one type of personal benefit, Shapiro again stressed that the test for insider trading has to be clear. Under the pecuniary gain test that the defendant proposes, she said, "certainly there will be many cases where the government can introduce evidence showing the kind of financial interdependence" that illustrates a financial benefit to the insider. Justice Sotomayor appeared unconvinced by the argument that the statute does not define insider trading. Congress also did not

define what's deceptive or manipulative or what defrauds, she said, but the law has "for ages" said that an insider's failure to disclose he's using corporate information is an omission that is classically a fraud.

Shapiro noted that other countries' insider trading laws use words like "insider" and define what conduct constitutes a violation. Given that there is no general duty to refrain from insider trading, "it's essential that the market participants understand when the line is crossed and when it's not." But Justice Breyer observed that the marketplace has shaped its behavior around the insider trading jurisprudence that has been formed over the decades; to suddenly adopt the Second Circuit's minority view "is really more likely to change the law that people have come to rely upon."

The government's position: if there's no corporate purpose, there's personal benefit. Arguing for the United States, Michael R. Dreeben cautioned that a pecuniary-benefit requirement would allow corporate insiders to "parcel out" inside information to friends, family, and acquaintances, injuring investor confidence and contradicting *Dirks*. Chief Justice Roberts said that not all of such sharing would be considered a gift. If you turned down some friends' invitation to go away for the weekend because you were "working on this Google thing," they might glean something from that that they could trade on, but that wouldn't make your careless sharing of the information a gift. "However you read *Dirks*, it certainly doesn't go beyond gifts," the chief justice said.

Dreeben agreed that this would not be a personal benefit. However, he said, it could give rise to tippee liability under the misappropriation theory, if there were an understanding between the parties that those types of conversations were to be kept confidential. "It's kind of a hazy line to draw," Chief Justice Roberts cautioned. Dreeben disagreed. It's on the government to show the information was given for the purpose of trading, he said, and in most cases, "there's no evidence of any legitimate corporate purpose for the disclosure whatsoever."

Justice Breyer remained unclear on the line marking when information is given for a personal purpose. Dreeben responded, "The advantage that you receive is that you are able to make a gift with somebody else's property." Justice Alito riffed off of this exchange, remarking, "It doesn't seem to me that your argument is much more consistent with *Dirks* than Ms. Shapiro's." He raised a sad-guy-on-the-street hypothetical that came up again later in the argument: "Suppose … the insider is walking down the street and sees someone who has a really unhappy look on his face and says, 'I want to do something to make this person's day.' And so he provides the information to that person and says, 'You can make some money if you trade on this.'" Dreeben said that this would be a violation, as it represents the use of corporate information for personal reasons.

Yet everyone concedes that the tipper is using information in a way that he shouldn't, Justice Breyer said; the issue is when he is liable. Returning to *Dirks*, Dreeben said that the way to understand the case is to "synthesize the various examples the Court gave to understand the principle underlying the decision." In the government's view, giving a gift of information for trading is equivalent to using the information to trade yourself, then giving the proceeds to a recipient. On a question from the Chief Justice, Dreeben affirmed that there is a dichotomy of information: if information is not given for a corporate purpose, then it is given for a personal benefit.

Justice Sotomayor questioned whether the government's construction would clarify anything in this area; instead, she suggested, the fight would simply shift to why the tipper made the gift. The tipper in *Salman*, she observed, had three reasons for sharing information: to become more knowledgeable in the health-care industry, to discuss potential drugs for the brothers' ailing father, and to make a gift of information. All of these were personal reasons, she said—how do you draw the line? Dreeben responded that only the third involved knowledge or anticipation of trading.

Returning to the sad guy on the street, Justice Breyer pointed out that *Dirks* refers to "a trading relative or friend," not just anyone. At this point, Dreeben resisted the hypothetical, stressing that this case does not involve that situation. "This involves the classic, prototypical situation that actually arises in the real world and gets prosecuted. … There aren't a lot of cases that don't involve friends or family members." Justice Sotomayor seemed skeptical that the insider who tipped the sad guy on the street would not be liable. Indeed he would, Dreeben responded, for breaching his fiduciary duty by giving information to someone to trade on. But the attorney accepted Justice Kagan's invitation to carve out the outlier situations and limit the scope to tippees who

are relatives or friends. "We are not seeking the Court to go beyond *Dirks*," he confirmed. "These are the cases that actually do arise in the real world."

Dirks "very specifically includes the gift situation," Dreeben continued as his time drew to a close. "If the Court feels more comfortable … reaffirming *Dirks* and saying that was the law in 1983, it remains the law today, that is completely fine with the government," even though in some cases, it would be clearer and more beneficial to adopt the rule that in the absence of a corporate purpose, any disclosure is a breach of fiduciary duty.

On rebuttal, however, Shapiro countered the argument that *Dirks* supports the government's test. In a footnote, the Court rejected the SEC's apparent argument "that an insider invariably violates the fiduciary duty … by transmitting nonpublic information to an outsider when he has reason to believe that the outsider may use it to the disadvantage of the shareholders."

The case is No. 15-628.

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