LOVE IS ALL YOU NEED: THE SUPREME COURT CLARIFIES THE STANDARD FOR TIPPER–TIPPEE LIABILITY UNDER INSIDER TRADING

I. INTRODUCTION

Regulation of the securities market resulted from the industry's growing importance in the economy and the corrupt culture of dishonesty that resulted in unfairness.[1] That was in the 1930s but still holds true today; the size of the finance industry is significant,[2] and insider-trading networks are prevalent, grossing nearly $1 billion over the past four years.[3] To curb insider trading, securities law prohibits individuals from making undisclosed trades based on material nonpublic information (MNI).[4] Such individuals may be corporate insiders, owing a fiduciary duty to their shareholders, or outsiders, owing a duty of "trust and confidence" to the source of the information.[5] These individuals can also face liability for disclosing MNI to others who then trade on it, but only if the tipper received a personal benefit.[6]

The Supreme Court recently clarified in *Salman v. United States* what constitutes a personal benefit in order to hold a tipper liable for insider trading.[7] In a nutshell, the Court held that a tangible exchange between the tipper and tippee for MNI is unnecessary to find liability.[8] While many commentators will be disappointed because the new standard lacks clarity and inconsistent holdings will continue, the Court correctly sided with fairness in the securities market and properly acknowledged that "[d]etermining whether an insider personally benefits from a particular disclosure, a question of fact, will not always be easy for courts."[9]

II. BACKGROUND

The Court formulated the personal benefits test in *Dirks v. SEC*.[10] The case concerned corporate insiders who tipped a security analyst to

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1. Sara Almousa, *Friends with Benefits? Clarifying the Role Relationships Play in Satisfying the Personal Benefit Requirement under Tipper-Tippee Liability*, 23 GEO. MASON L. REV. 1251, 1252 (2016).
2. *See* Robin Greenwood & David Scharfstein, *The Growth of Finance*, 27 J. ECON. PERSPECTIVES 3, 3 (2013).
3. Almousa, *supra* note 1, at 1251.
4. *Id.* at 1253.
5. *Id.* at 1257–58 (explaining the classical and misappropriation theories of liability).
6. *Id.* at 1259.
7. Salman v. United States, 137 S.Ct. 420 (2016).
8. *Id.* at 429.
9. *Id.* (citing Dirks v. SEC, 463 U.S. 646, 663 (1983)).
10. *Dirks*, 463 U.S. at 664.

expose fraud.[11] Because the disclosure was for a corporate purpose, disclosing fraud, and not a personal purpose, the Court found no liability.[12] The Court noted that the personal benefits test should focus on objective criteria to determine whether the tipper received a personal benefit from the disclosure, such as a "pecuniary gain or reputational benefit that will translate into future earnings."[13] The Court also noted that a personal benefit can be inferred from facts and circumstances, such as "when an insider makes a gift of confidential information to a trading relative or friend."[14]

Dirks received much criticism, partly because it resulted in many inconsistent holdings throughout the nation.[15] Many questioned whether it was necessary under *Dirks* that there be an objective, tangible exchange for MNI or if it was sufficient that the tipper and tippee be friends or family. If the latter, how close should the relationship be and what constitutes a personal benefit? Courts were thus unsure what the standard was to find a personal benefit and what role the nature of the relationship between a tipper and tippee should be.[16] After a circuit split, the issue reached the Supreme Court.

In *United States v. Newman*, the original tipper was a corporate insider who tipped an analyst MNI about a company's nonpublic earnings.[17] The analyst disclosed to another analyst, who in turn tipped Newman.[18] Newman argued that the original tipper did not personally benefit from the disclosure because he received no tangible benefit for his tip.[19] The Second Circuit agreed, holding that the original tipper did not receive any tangible personal benefit and rebutting the government's argument that career advice and reputational benefits were sufficient.[20]

In *United States v. Salman*, the original tipper was an investment banker who tipped his brother MNI about impending mergers and acquisitions.[21] The brother tipped his brother-in-law, Salman, who traded on the information.[22] Salman argued that *Newman* applied and there was insufficient evidence that the original tipper received a tangible benefit in

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11. *Id.* at 667.
12. *Id.*
13. *Id.* at 663.
14. *Id.* at 664.
15. Nicholas Morgan, Thomas A. Zaccaro & Jenifer Q. Doar, *Salman v. US: Will It Change the "Personal Benefit" Test?*, Law360 (August 3, 2016), http://www.law360.com/articles/823740/salman-v-us-will-it-change-the-personal-benefit-test [hereinafter Morgan].
16. Almousa, *supra* note 1, at 1252.
17. United States v. Newman, 773 F.3d 438, 443 (2nd Cir. 2014).
18. *Id.*
19. *Id.* at 444.
20. *Id.* at 452 (noting that if general career advice and friendship were sufficient personal benefits, then practically anything would qualify).
21. United States v. Salman, 792 F.3d 1087, 1088 (9th Cir. 2015).
22. *Id.*

exchange for tipping his brother.[23] The Ninth Circuit held that proof of a tangible benefit is not required under *Dirks* and that the intention of the original tipper to convey the information as a gift was sufficient.[24]

The Supreme Court granted certiorari for the *Salman* decision and affirmed.[25] The Court held that tipping MNI to a relative or friend constitutes a gift and satisfies the personal benefits test because it is the same as if the tipper traded and relayed the profits to the tippee.[26] The Court "resolve[d] [this] narrow issue" by adhering to the language in *Dirks*.[27] The Court held further that it disagreed with *Newman* "[t]o the extent that the Second Circuit held that [a] tipper must also receive something of a pecuniary or similarly valuable nature in exchange for a gift to family or friends."[28]

III. DISCUSSION

The Court's decision settles the question whether a tangible exchange is required to satisfy the personal benefits test. Difficulties and dissatisfaction will persist, however, because the Court provided little guidance to determine what constitutes a personal benefit in the absence of a tangible exchange, which requires an assessment of the relationship between the tipper and tippee. In other words, courts and juries will have to determine whether facts and circumstances allow the inference that a tipper disclosed MNI as a gift to "a trading relative or friend."[29]

The Court did little but emphasize that *Dirks* is good law and provides sufficient guidance to find a tipper liable.[30] Ascertaining whether the type of relationship between the tipper and tippee satisfies the personal benefits test, therefore, will require a case-by-case analysis. The Court recognized this difficulty but concluded it was worth the effort to prevent insider trading.[31]

Developing case law will provide guidance to the courts regarding the types of relationships that satisfy the personal benefits test. Case law already generally finds that the personal benefits test is satisfied even when the tipper did not receive a pecuniary or reputational gain.[32] Cases will thus come down to whether there is sufficient evidence to prove that

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23. *Id.* at 1093.
24. *Id.*
25. *Salman*, 137 S.Ct. at 429.
26. *Id.* at 427–28.
27. *Id.*
28. *Id.* at 429 (finding it inconsistent with *Dirks*).
29. *Dirks*, 463 U.S. at 664.
30. *See* Walter Pavlo, *SCOTUS Weighs In On Insider Trading To Get Us Back Where We Started*, FORBES (Dec. 8, 2016), http://www.forbes.com/sites/walterpavlo/2016/12/08/scotus-weighs-in-on-insider-trading-to-get-us-back-where-we-started/#6d3a68c1b43c.
31. *Salman*, 137 S.Ct. at 429 (noting that determining whether a tipper benefits from a disclosure will not always be easy for the courts).
32. Almousa, *supra* note 1, at 1268.

a tip was made to benefit a relationship between the tipper and tippee.[33] Courts will also benefit in remembering the distinction between disclosing information for corporate purposes and for personal gain.[34]

Prohibiting insider trading ensures that individuals do not profit from information that belongs to the corporation. Had the Court sided with Salman and found that the personal benefits test always required a tangible exchange, albeit providing a clearer standard, would have resulted in allowing some insider trading to go unchecked.[35] It would have meant, for example, allowing Salman to incur no liability from his $1.5 million profit, despite the only reason for his financial success being his relationship to his brother.[36] Thus, the Court correctly held that a tipper who relays MNI to a trading relative or friend is sufficient to find liability for insider trading.

IV. CONCLUSION

The financial industry's prominence in the economy requires restraint against its abuses. Insider trading ensures that certain individuals do not personally profit from misappropriating MNI that properly belongs to the company. By holding that it is not required that a tipper obtain a tangible benefit in return for his disclosure of MNI, prosecutors can now charge traders whose only reason for profiting is their privileged position and relationships.

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33. *Id.* at 1272.

34. *Dirks*, 463 U.S. at 653–54; *see also* Donald C. Langevoort, *Investment Analysts and the Law of Insider Trading*, 76 VA. L. REV. 1023, 1024 (1990) (noting disclosures to analysts are typically not unlawful because they serve a variety of corporate purposes, such as enhancing the company's standing with the investor community or strengthening existing lines of communication).

35. *See* Morgan, *supra* note 15 (mentioning Salman's argument that failing to require an objective exchange would result in an "indeterminate" standard and provide grounds for prosecutorial overreach).

36. *Salman*, 137 S.Ct. at 421–22.

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