Harvard Law School Forum on
Corporate Governance and Financial Regulation

SUPPORTED BY: CSC

Scope of Insider-Trading "Tippee" Liability

Posted by John F. Savarese, Wachtell, Lipton, Rosen & Katz, on Friday, January 22, 2016

Editor's note: John F. Savarese is a partner in the Litigation Department of Wachtell, Lipton, Rosen & Katz. This post is based on a Wachtell Lipton memorandum by Mr. Savarese and George T. Conway III.

In an insider-trading case that will be closely watched until it is decided before the end of June, the U.S. Supreme Court granted certiorari yesterday to decide critical open questions about what is required to establish insider trading by a remote "tippee"—specifically, what kind of personal benefit must a "tipper" receive, and what knowledge of that benefit must the "tippee" have, for a conviction or sanction to stand.

The case is *Salman v. United States*, No. 15-628, and it involves a criminal defendant who traded on the basis of stock recommendations given to him by the brother of a Citigroup investment banker. The banker had given material nonpublic information about pending M&A deals as a gift to benefit his brother, who in turn gave the information to the defendant, Salman. Salman was convicted, and on appeal, he urged the Ninth Circuit to follow the requirements adopted by the Second Circuit in 2014 in*United States v. Newman*: that the government must prove that a remote tippee like Salman knew of the "personal benefit" that the original tipper received in exchange for the tip; and that the benefit must be "objective, consequential, and represent at least a potential gain of a pecuniary or similarly valuable nature." Affirming Salman's conviction, the Ninth Circuit refused to follow *Newman*, and held that it was sufficient for the government to establish that the tipper had made "a gift of confidential information to a trading relative or friend." In so holding, the Ninth Circuit created a significant circuit split over the proper scope of remote tippee liability for insider trading.

To resolve this conflict, the Supreme Court must revisit its 1983 decision in *Dirks v. SEC*. *Dirks* held that, to establish tippee liability, the government must show, first, that the tipper of inside information "personally will benefit, directly or indirectly, from his disclosure," for "[a]bsent some personal gain, there has been no breach of duty;" and, second, that the "tippee knows or should know that there has been a breach." The Ninth Circuit in *Salman* and the Second Circuit in *Newman* each grounded their decisions in *Dirks*, but drew divergent lessons from it.

The Court's eventual answer will define the outer boundaries of insider trading liability in future cases. But as we advised in our post on *Newman*, whatever the Court's answer turns out to be, corporations and financial institutions that have established compliance policies and systems to prevent the misuse of confidential information by their employees should continue to maintain, and vigilantly enforce, such controls. Although *Salman* may well reshape the outer boundaries of the law in this area, the core proscriptions against disseminating material nonpublic information will remain firmly in place, and as the recent *In the Matter of Marwood Group Research* proceeding illustrates, companies can face significant liability for failing to maintain robust systems and procedures to prevent the misuse of confidential information.