No. 15-628

IN THE

Supreme Court of the United States

BASSAM YACOUB SALMAN,

Petitioner,

v.

UNITED STATES,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF OF THE NYU CENTER ON THE ADMINISTRATION OF CRIMINAL LAW AS *AMICUS CURIAE* IN SUPPORT OF NEITHER PARTY

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INTEREST OF *AMICUS CURIAE*

The Center on the Administration of Criminal Law ("Center") submits this brief as *amicus curiae* in support of neither party.[1] The Center is dedicated to defining good government and prosecution practices in criminal justice matters through academic research, litigation, and participation in the formulation of public policy. As the Center's name suggests, it is devoted to improving the quality of the administration of criminal justice and advocating the adoption of best practices through its scholarly, litigation, and public policy components. The Center's litigation practice aims to use the Center's empirical research and experience to assist courts in addressing issues of broad importance to the administration of the criminal justice system, and it files briefs in support of both the Government and defendants in criminal matters.

Just imposition of criminal liability requires clear rules that provide fair notice to individuals and organizations of the scope of conduct proscribed by the law. Clear rules are also essential to guide the exercise of prosecutorial discretion and avoid arbitrary or

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[1] All parties have consented to the filing of this *amicus curiae* brief. Blanket consent has been provided by Petitioner Salman, and a letter of written consent from Respondent United States has been filed with the Clerk of the Court. No portion of the brief was authored by counsel for a party. No person or entity other than the Center or its counsel made a monetary contribution to the preparation or submission of this brief.

No part of this brief purports to represent the views of New York University School of Law, or New York University, if any.

inconsistent applications of criminal statutes by prosecutors and judges. *See Burrage v. United States*, 134 S. Ct. 881, 891 (2014) (noting "the need for clarity and certainty in the criminal law" and the problems inherent in leaving "lower courts . . . to guess" about proper application of standards for criminal liability); *cf. Grayned v. City of Rockford*, 408 U.S. 104, 108 (1972) (noting that "[v]ague laws may trap the innocent by not providing fair warning" and that "if arbitrary and discriminatory enforcement is to be prevented, laws must provide explicit standards for those who apply them").

Lower courts and commentators have widely acknowledged that the rules governing insider trading currently lack such clarity, particularly in cases involving the potential liability of tippers and tippees. The Center submits this brief in support of neither party in an effort to aid the Court in clarifying the standards of liability for insider trading by tippers and tippees.

SUMMARY OF ARGUMENT

As the question presented in this case demonstrates, lower courts have long struggled to apply the "personal benefit" holding of *Dirks v. SEC*, 463 U.S. 646 (1983), in a principled manner. Lower courts have treated "personal benefit" to the tipper as if it were an "element" of the offense. *See, e.g.*, Final Jury Instructions at 41, *United States v. Salman*, No. 3:11-cr-00625-EMC (N.D. Cal. Sept. 27, 2013), ECF No. 245. But at the same time, they have had great difficulty determining in a coherent fashion whether a given benefit to the tipper is sufficiently "objective" or "consequential," or whether a friendship between the tipper and the tippee is sufficiently close, to satisfy the element. As a result, courts have reached inconsistent outcomes based on arbitrary distinctions that have no basis in § 10(b) of the 1934 Act and that have nothing to do with securities trading or even the disclosure of information that is material to securities trading.

This continued lack of clarity deprives potential defendants of fair notice regarding the legality of their conduct, confuses fact-finders, and opens the door to arbitrary and abusive enforcement of the law. Clarity is particularly important in this context, given the speed and volume of trading in the securities markets and the extraordinary efforts that law-abiding institutions and individuals undertake to comply with the law.

The Center therefore urges the Court to adopt clearer standards of tipper-tippee liability, and ones more firmly grounded in the statutory text. Criminal liability should not turn on a fact-finder's evaluation of how friendly a tipper and tippee are, or whether a tippee's assistance to the tipper meets some arbitrary threshold of significance.

Rather than treat a personal benefit as an element of a tipper-tippee case and require the Government to prove either a concrete personal benefit to the tipper or a friendship or family relationship between the tipper and the tippee that satisfies some level of "closeness," the Court should realign the standards to focus on two issues:

First, the question of whether the tipper breached her fiduciary duty should require the Government to prove that the tipper made a disclosure of material nonpublic information for some purpose *other* than to benefit the corporation and its shareholders (in a classical case) or the source of the information (in a misappropriation case). Making a disclosure for an improper purpose should suffice to establish a breach of fiduciary duty for purposes of § 10(b). *Cady, Roberts & Co.*, 40 S.E.C. 907, 911-12 (1961); *see Dirks*, 463 U.S. at 653-54. As we explain with several examples below, although the presence or absence of a personal benefit to the tipper, including what may be inferred from the relationship of the tipper to the tippee, can be relevant to this analysis, it should not be dispositive, and thus the personal benefit holding of *Dirks* should not be treated as setting forth an element of the offense.

Second, whether the tipper knew that the tippee would trade on the disclosed nonpublic information should be treated as an element of the offense, for two independent reasons:

1. As this Court recently emphasized, disclosure "in connection with the purchase or sale of any security," a statutory requirement, is fundamental to the imposition of any liability under § 10(b). 15 U.S.C. § 78j(b); *see United States v. O'Hagan*, 521 U.S. 642, 656 (1997). Without such a showing in a tipper-tippee case, the Government may have proven a breach of the tipper's fiduciary duty or a theft of information, but has not proven a violation of the securities laws. Lower courts appear to

have lost sight of this element in searching for a "personal benefit" purportedly required by *Dirks*.

2. The tipper's knowledge (or lack thereof) that the tippee would trade is also highly relevant – far more relevant than the presence or absence of a personal benefit – to the question of whether the tipper has breached her fiduciary duty with the necessary intent to defraud. For example, if the tipper knows that the tippee intends to trade on the material nonpublic information, then the tipper almost certainly could not have made the disclosure for a proper purpose. By the same token, under some circumstances, the tipper's knowledge of the tippee's intent to trade and earn a substantial profit as a result of the tip may be evidence that the tipper has received (or at least expects to receive) a personal benefit in exchange.

Unless both of these criteria are satisfied (*i.e.*, disclosure for a purpose other than to benefit the corporation or the source of the information *and* knowledge that the tippee would trade on the information), liability should not attach under the securities laws. Below, the Center proposes standards for tipper and tippee liability that encompass these clarifications. The proposed standards are consistent with this Court's seminal insider trading cases and are more administrable and fairer than the standards currently employed by lower courts attempting to adhere to *Dirks*. They thus comport with, while improving upon, relevant precedent.

ARGUMENT

I. The Personal Benefit Element Is Standardless, Leads Fact-Finders To Focus On Facts Not Typically Associated With Criminal Liability, And Yields Inconsistent Results.

In *Dirks v. SEC*, this Court held that an alleged tipper can be held liable for insider trading only if the tipper "personally will benefit, directly or indirectly" by virtue of the tip. 463 U.S. at 662. *Dirks* foresaw that this requirement could be satisfied in a number of ways, including through direct proof of a *quid pro quo* exchange, evidence that the tipper and tippee had a relationship that would suggest the tip was given as part of a *quid pro quo* arrangement or out of an "intention to benefit" the recipient, or evidence that the tip was a "gift of confidential information to a trading relative or friend." *Id.* at 664. The personal benefit requirement was put in place to ensure that only those making disclosures in breach of a fiduciary duty would be held liable for federal insider trading violations, and, to exclude a hard case, where a disclosure was not authorized, but was made by a whistleblower who plainly did not have fraudulent intent.

Both Petitioner and Respondent urge the Court to resolve this case by further interpreting this personal benefit requirement as if it were an element of the offense. *See, e.g.*, Pet. Br. at 3, *Salman v. United States*, No. 15-628 (filed May 6, 2016). Over 30 years of experience have shown, however, that application of the personal benefit requirement requires courts regularly to determine liability based on distinctions that are untethered to the text of § 10(b) and Rule 10b-

5, that are unrelated to securities trading or information that is material to securities trading, and that sometimes border on the frivolous. Adopting either party's argument would not resolve these problems. Regardless of whether a personal benefit must be a tangible pecuniary exchange, as Petitioner contends, or can involve intangible benefits and gifts to trading friends and relatives, as argued by the United States, courts' intense focus on the personal benefit requirement produces inconsistent and unprincipled outcomes. In the face of such unpredictable results, this Court should seize the opportunity to clarify the standards for insider trading liability by refocusing the inquiry on elements that are firmly grounded in the statutory text of § 10(b) itself.[2]

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[2] Given the similar analytical framework used in criminal and civil insider trading cases, the Center's brief cites to SEC enforcement actions in addition to criminal insider trading cases. We recognize, of course, that "[t]o establish a criminal violation of Rule 10b-5, the Government must prove that a person 'willfully' violated the provision." *O'Hagan*, 521 U.S. at 665 (quoting 15 U.S.C. § 78ff(a)). Furthermore, "a defendant may not be imprisoned for violating Rule 10b-5 if he proves that he had no knowledge of the Rule." *Id.* at 666 (citing 15 U.S.C. § 78ff(a)). In enforcement actions brought by the SEC, recklessness rather than willfulness may meet the requisite level of scienter. *See, e.g.*, *SEC v. Obus*, 693 F.3d 276, 286 (2d Cir. 2012); *see also Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976) (declining to address whether recklessness suffices for civil liability under § 10(b) and Rule 10b-5).

A. Petitioner's Construction Of The Personal Benefit Element – That A Tangible Pecuniary Benefit Is Always Required.

Should this Court hold that a violation of the securities laws requires proof of "an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature," as Petitioner contends, it will still leave courts with no clear standard to apply to determine what benefit is sufficiently concrete. Although Petitioner touts his personal benefit standard as a bright-line rule, it is not. Whether a particular benefit is tangible enough to warrant insider trading liability has been answered unevenly and in seemingly irreconcilable ways by the courts.

For example, the Second Circuit has struggled to determine, with consistency, whether assistance with one's job or career is sufficient to constitute a "personal benefit," when given in exchange for material nonpublic information. That court has held that the "goodwill" generated by a tip made to curry favor with one's boss could satisfy the personal benefit requirement,[3] but that "career advice" and editorial assistance on a résumé could not[4] – even though the first case involved

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[3] *Obus*, 693 F.3d at 292; *cf. SEC v. Cuban*, 620 F.3d 551, 557 n.38 (5th Cir. 2010) (noting that it would "not be difficult for a court to infer" that a CEO made a tip to "a wealthy investor and large minority stakeholder" for the personal benefit of "goodwill").

[4] *United States v. Newman*, 773 F.3d 438, 452 (2d Cir. 2014), *cert. denied*, 136 S. Ct. 242 (2015).

only potential aid in the future, while the second involved actual assistance already given.

Decisions construing the sufficiency of personal services in exchange for the tip have been similarly inconsistent. For example, courts have held that a tipper's provision of plumbing assistance on the tippee's septic tank made it "highly plausible" that the tipper and tippee had "the type of relationship where there was, at a minimum, a give and take of sorts that had the *potential* for pecuniary gain,"[5] but that a paying customer's disclosure of inside information to his barber of 15 years failed to establish a *quid pro quo* arrangement.[6] What makes these cases even more incongruous is that in the septic tank case the plumbing assistance and the tip were both given by the tipper, while in the hair-cutting case the tip was arguably a *quid pro quo* for the years of good service, as the customer gave the tip to his barber.

These distinctions cannot be reconciled, and their ability to measure the wrongfulness of a disclosure is unclear at best. Importantly, they also find no basis in the text of § 10(b) as a means for determining insider trading liability. The purported bright-line rule suggested by the Petitioner would only leave courts,

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[5] *SEC v. Andrade*, No. cv-15-231, __ F. Supp. 3d __, 2016 WL 199423, at *4 (D.R.I. Jan. 15, 2016) (internal quotation marks omitted).

[6] *SEC v. Maxwell*, 341 F. Supp. 2d 941, 943-44 (S.D. Ohio 2004).

prosecutors, and traders uncertain about the line between innocence and guilt.

B. Respondent's Construction Of The Personal Benefit Element – That Gifts To Friends And Family Constitute A Personal Benefit.

Alternatively, the United States contends that a gift of information made to a "trading relative or friend" is a sufficient benefit to establish insider trading liability, and in those circumstances proof of a tangible personal benefit is not required. *See* Br. for the United States in Opp'n at 13, *Salman v. United States*, No. 15-628 (filed Dec. 14, 2015). That test, in particular, invites courts to engage in arbitrary, idiosyncratic, and even frivolous inquiries into the personal ties between tipper and tippee to determine whether they are "close enough" to infer a relationship that is tantamount to a personal benefit to the tipper.

Cases involving the relationship between a service provider and a customer have typified these problems. For example, although the 15-year barber-customer relationship mentioned above was held to be insufficient to permit the inference of a personal benefit, a dentist-patient relationship was held to be sufficient because the dentist and tipper patient were "friendly," the tipper had previously referred business to the dentist, and the tip was "an effort to effect a reconciliation with his friend and to maintain a useful networking contact."[7] Notably, the court in the barber

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[7] *SEC v. Sargent*, 229 F.3d 68, 77 (1st Cir. 2000).

case found no "personal benefit" partly because the parties' "relative stations in life" made it unlikely that the tipper would gain a useful reputational benefit, and because, in the court's view, the considerable "magnitude" of the barber's gains – nearly $200,000 – somehow made it *less* likely that the tipper intended to provide him a gift.[8]

Cases involving friendships have proven equally problematic and also have turned on distinctions untethered to the securities laws. In one case the court held that "the undisputed fact that [tipper] and [tippee] were friends from college is sufficient to send to the jury the question whether [tipper] received a benefit,"[9] and in another, the court relied on evidence that the tipper and tippee "ate dinner, drank beers, played video games, watched TV, used drugs, and discussed their respective days, current events, and personal details of their lives."[10] In contrast, another court found no personal benefit to a tipper who was a former work colleague but not, in the court's estimation, a "friend" of the tippee, a determination based in part on evidence that the tippee was a golfer and heavy drinker and the tippee was "neither a golfer nor a drinker."[11]

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[8] *Maxwell*, 341 F. Supp. 2d at 943-44, 948-49.

[9] *Obus*, 693 F.3d at 291.

[10] *SEC v. Payton*, No. 14-cv-4644, __ F. Supp. 3d __, 2015 WL 9463182, at *4 (S.D.N.Y. Dec. 28, 2015).

[11] *SEC v. Anton*, No. 06-2274, 2009 WL 1109324, at *1 n.3, *9 (E.D. Pa. Apr. 23, 2009).

The distinctions in these cases are not just illogical and unrelated to traditional bases for criminal or regulatory punishment; they are entirely disconnected from the text of § 10(b) or Rule 10b-5. Similar questions about whether the nature of a relationship permits the inference of a personal benefit arise regularly, and their results are often difficult to explain by any uniform, objective, or statutory criteria.

Although cases involving tips to family members have proven less likely to produce inconsistent outcomes, one can easily imagine circumstances requiring a court to grapple with the question of whether a family relationship was sufficiently close to permit an inference of a personal benefit. A cousin's in-laws? An adopted child's birth mother? The *Dirks* Court's emphasis on familial relationships also assumes, counterfactually, that familial relationships are necessarily closer than other forms of relationships. But again, it is not hard to imagine situations where a tipper's relations with a family member could be more distant or unfriendly than relations with a casual acquaintance, say, his barber.

In sum, both the tangible personal benefit test advocated by Petitioner and the carve-out for friends and family advocated by the United States would require courts to find facts that are unrelated to the securities laws, and require value-laden judgments as to the threshold between "friendship" or relationships of mutual advantage and more detached societal relationships. Those judgments can differ from judge to judge and juror to juror, inviting inconsistent outcomes in criminal, as well as SEC enforcement, cases. Neither standard should be adopted.

II. The Government Should Be Required To Prove Instead That The Disclosure Was Not For A Corporate Purpose, And That The Tipper Knew A Tippee Intended To Trade.

In light of the confusion and arbitrariness that would be continued by adopting either of the competing personal benefit tests before the Court, the Center proposes standards for tipper and tippee liability that provide greater predictability and fairness and are firmly grounded in the text of the statute, while still hewing to this Court's insider trading precedents.

Specifically, the Center proposes the following standards for tipper and tippee liability, respectively: A tipper is liable for insider trading upon proof of (1) a disclosure (2) of material nonpublic information (3) in breach of a duty, meaning an unauthorized disclosure that does not serve the purposes of the company (under the classical theory) or the source of the information (under the misappropriation theory) (4) in connection with a trade, meaning that the tipper knows that the trader will purchase or sell securities while in possession of the material nonpublic information (5) in willful violation of the securities laws. Likewise, a tippee is liable for using rather than disclosing[12]

[12] *See O'Hagan*, 521 U.S. at 656 (explaining that proof of insider trading requires a showing that a defendant traded "on the basis of material, nonpublic information"); *United States v. Anderson*, 533 F.3d 623, 630 (8th Cir. 2008) ("This requires that the defendant did

material nonpublic information under these circumstances.

These proposed standards offer two important revisions to those currently employed by lower courts in insider trading tipper-tippee cases, and to the standards advocated by the Petitioner and the United States here:

First, to satisfy the third element under the Center's proposed standards (a breach of duty), the Government must show that the tipper made an unauthorized disclosure of inside information to serve the interests of *anyone* other than the corporation's shareholders (under a classical theory) or the source of the information (under a misappropriation theory); the Government would not have to prove a personal benefit to the tipper in exchange for that information (whether a tangible personal benefit directly to the tipper, or an indirect personal benefit as a result of a tip to a friend or family member).

Second, to satisfy the fourth element ("in connection with a purchase or sale of securities") with respect to a tipper or an intermediary tippee, the Government would have to prove that the tipper or intermediary tippee knew that the ultimate tippee would trade while in possession of the improperly disclosed information, underscoring one of the core elements of a securities

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not just possess the information but actually used the information."); *United States v. Smith*, 155 F.3d 1051, 1069-70 & n.28 (9th Cir. 1998).

fraud violation under § 10(b) and Rule 10b-5 – the connection to a trade.

As explained below, these two proposed revisions are more administrable and less arbitrary than the current standards lower courts have applied, and comport with this Court's case law – indeed, they restore aspects of this Court's teachings that seem to have fallen by the wayside in lower court analyses. Further, they better serve the goals of the insider trading laws as articulated by Congress and this Court.

A. The Proposed Standards Are More Administrable And Will Produce More Just Outcomes.

By focusing on the tipper's purpose in making the disclosure and her knowledge of the tippee's intention to trade, rather than the benefit received by the tipper or her relationship to the tippee, the standards suggested by the Center are more administrable for courts and juries than the personal benefit test, and they will produce more just outcomes than the current tests for liability.

Most important, instead of considering normally innocuous facts concerning the nature, duration, and intensity of the tipper and the tippee's social interactions, fact-finders will focus more specifically on the disclosure itself, including whether it was authorized by the principal and whether it was made to aid a third party's trading activity. These inquiries are grounded in the securities laws and reflect a proper and traditional focus of criminal or regulatory liability.

This salutary effect of the Center's proposed standards is demonstrated by considering its application to the Ninth Circuit's *Salman* decision, currently under review, and the Second Circuit's contrary decision in *Newman*. Under the Center's proposed standards, the liability of Maher Kara, the tipper in *Salman*, would turn on whether Kara knew that his brother would trade on that information and benefit thereby, not on the nature of their personal relationship. By the same token, the remote tippee defendants in *Newman* would not be liable if the tipper disclosed the information with his employer's authorization, as the Second Circuit suggested was the case, *see* 773 F.3d at 454-55, or if "the Government presented absolutely no testimony or any other evidence that [defendants] knew that they were trading on information obtained from insiders," *id.* at 453.

In addition to refocusing the analysis on facts concerning the disclosure and the trading, the Center's proposed standards recognize that the absence of a legitimate purpose for the disclosure, even without proof of a personal benefit, could be sufficient to establish that the disclosure was in breach of the tipper's fiduciary duty. *Cf. SEC v. Maio*, 51 F.3d 622, 632-33 (7th Cir. 1995) (noting that, "[a]bsent some legitimate reason for [the tipper's] disclosure, . . . the inference that [it] was an improper gift of confidential corporate information is unassailable," given that the tipper "did not have to make any disclosure" in the first place).

For instance, if a tipper makes an extraordinarily valuable disclosure to a tippee, but they have only a remote relationship and no money changes hands, under current law (including the standards suggested by both the Petitioner and the United States), neither party would be liable. Under the Center's proposed standards, however, a fact-finder could appropriately find that if the tipper breached her duty and provided the tippee with information, and the tipper knew that the tippee would make a large profit by trading on that information, the disclosure was for an improper purpose, and should be punished under the securities laws.[13]

As another example, under the Center's proposed standards, if the tipper makes a spiteful disclosure of confidential information to a trading acquaintance, to injure the company but without benefit to the tipper, that would also constitute an insider trading violation. By requiring proof of a personal benefit, however, the standards proposed by the Petitioner and the United States leave the possibility of liability for such a

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[13] For instance, a retiring executive, on her last day, stops a mailroom employee with whom she has never previously spoken. She advises him to dump any stock he has in the company, which, she says, is about to announce substantial losses. That executive would have no reasonable expectation of receiving a personal benefit in exchange for a tip to a stranger. Her conduct would thus go unpunished under the personal benefit test, despite being contrary to the goals of the securities laws. By contrast, under the Center's proposed standards, the disclosure qualifies as a breach, supporting liability for any trade made with the benefit of the disclosed information.

malicious disclosure uncertain, even though it is worthy of punishment under the securities laws as a betrayal of the corporation's or source's confidences to aid trading by another. *See United States v. Riley*, 90 F. Supp. 3d 176, 191 n.12 (S.D.N.Y. 2015) (noting that a malicious disclosure would "likely" be sufficient to establish a breach of fiduciary duty under insider trading laws, but citing no authority to support that proposition), *aff'd*, No. 15-1541-cr, __ F. App'x __, 2016 WL 158646 (2d Cir. Jan. 14, 2016).

Conversely, these proposed standards leave open the possibility that a tipper who receives a personal benefit in exchange for material nonpublic information, but does not know that the tipper intends to trade, would not be liable for insider trading. *Cf. O'Hagan*, 521 U.S. at 656 ("Should a misappropriator put [confidential] information to other use, the statute's prohibition would not be implicated."). For example, imagine a reporter provides a corporate insider with money, professional introductions, dinners, or other things of value in exchange for leads consisting of material nonpublic information. The insider believes that the reporter will not trade on these leads but instead may use them to investigate issues for reporting to the public via his column. On one occasion, however, the reporter trades on the information. Under current law, the insider would have breached his fiduciary duty to the corporation by disclosing the information for his own benefit, rather than that of the corporation, and would be liable notwithstanding his genuine and perhaps reasonable belief that the tippee reporter would not trade on the information. Under the Center's proposed standards, however, the insider properly would not be liable for insider trading because he had no knowledge that the reporter would trade on the information, such that his disclosures lacked a connection to a trade, a key element for insider trading offenses. *See Morrison v. Nat'l Australia Bank Ltd.*, 561 U.S. 247, 266 (2010) ("Section 10(b) does not punish deceptive conduct, but only deceptive conduct 'in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered.'" (citation omitted)).

That said, even under the Center's proposed standards, evidence of personal benefit or the relationship between the tipper and the tippee would not be categorically irrelevant. As *Dirks* made clear, evidence that the tip was made in exchange for a "pecuniary gain or a reputational benefit" or to a family member or friend could offer the necessary proof that the disclosure was unauthorized and made to benefit the tippee or tipper rather than shareholders or the source of the information. *See* 463 U.S. at 663-64. The Center's proposed standards would not alter the outcome in such cases where the breach was established through evidence that the tipper disclosed inside information as part of a *quid pro quo* arrangement or to benefit someone with whom the tipper had an established personal relationship. The point is that, under the Center's standards, liability will be more likely to turn on evidence that is directly tethered to the disclosure itself and to proving that it was made in violation of the tipper's fiduciary duty, *i.e.*, for any other than a corporate purpose, rather than evidence concerning personal relationships.

B. The Proposed Standards Are Consistent With This Court's Insider Trading Decisions.

Although the Center's proposed standards differ from lower courts' application of *Dirks* and from the standards suggested by the Petitioner and the United States, they are consistent with, and in fact derived from, the seminal insider trading decisions of this Court.

Breach of Duty. First, the Center's proposed standard for determining a breach of duty derives from *Dirks*, where the Court embraced the SEC's seminal decision on insider trading, *In re Cady, Roberts & Co.* There, the SEC explained that the duty to disclose or abstain from trading on material nonpublic information derives from a "relationship giving access, directly or indirectly, to information intended to be available *only for a corporate purpose* and not for the personal benefit *of anyone*." *Cady, Roberts*, 40 S.E.C. at 912 (emphasis added), *quoted in Dirks*, 463 U.S. at 654. *Cady, Roberts* thus reaffirmed the black letter principle that a fiduciary breaches a duty to her principal by disclosing confidential information for the purposes of anyone other than the principal. *See, e.g., Zastrow v. Journal Commc'ns, Inc.*, 718 N.W.2d 51, 60-62 (Wis. 2006) (noting that a fiduciary breaches her duty of loyalty by, "e.g., . . . disclosing the beneficiary's confidential information"); *Gracey v. Eaker*, 837 So. 2d 348, 353-54 (Fla. 2002) ("Florida courts have previously recognized a cause of action for breach of fiduciary duty in different contexts when a fiduciary has allegedly disclosed confidential information to a third party.”).[14]

Thus, *Cady, Roberts* did not focus exclusively on the presence or absence of a personal benefit; the SEC also looked at the other side of the coin, whether the disclosure was made for a corporate purpose. The Center’s proposed standards merely suggest this same refinement.

To be sure, at one point the Court in *Dirks* looked only at the personal benefit side of the coin, suggesting that the “test” for a breach “is whether the insider personally will benefit, directly or indirectly, from his disclosure,” and that “[a]bsent some personal gain, there has been no breach to stockholders.” *Dirks*, 463 U.S. at 662. That statement referred back, however, to a footnote in *Cady, Roberts* stating merely that one “significant purpose” of the securities laws “was to eliminate the idea that the use of inside information for personal advantage was a normal emolument of corporate office.” *Cady, Roberts*, 40 S.E.C. at 912 n.15. It did not stand for the proposition that a tipper breaches her fiduciary duty only where she derives a personal benefit from the disclosure of inside information. And reading the language of *Cady, Roberts* as a whole, it was clear that the SEC was suggesting a test that included a holistic evaluation of

[14] *See also* Restatement (Third) of Agency § 8.05 (2006) (“An agent has a duty . . . not to use or communicate confidential information of the principal for the agent’s own purposes or those of a third party.”).

the tipper's purpose, including a determination of whether the tip served a corporate purpose, and was not focused narrowly on the question of whether the tipper received a personal benefit. *See Dirks*, 463 U.S. at 662 ("Whether disclosure is a breach of duty therefore depends in large part on the purpose of the disclosure.").

The standard proposed by the Center is coextensive with the fiduciary duty test articulated in *Cady, Roberts*. A corporate insider breaches that duty by using or sharing inside information for the purpose of benefitting *anyone* other than the corporation's shareholders – not just herself. Similarly, if a corporate outsider owes "a duty of loyalty and confidentiality" to a source of inside information, the outsider breaches that duty by depriving the source "of the exclusive use of that information." *O'Hagan*, 521 U.S. at 652.

This suggested modification would not overturn *Dirks* and expose whistleblowers to insider trading liability. As the *Dirks* Court noted, "the facts of [that] case clearly indicate[] the tippers were motivated by a desire to expose the fraud." 463 U.S. at 666-67. When Secrist told Dirks of the fraudulent conduct, he "urged Dirks to verify the fraud and disclose it publicly." *Id.* at 649. In addition, Secrist and other employees brought that information to the attention of various regulators. *Id.*; *id.* at 668 n.2 (Blackmun, J., dissenting). In short, Secrist and other insiders attempted to disseminate the information to the public in an effort to expose corporate wrongdoing, arguably honoring their fiduciary duty to the corporation and its shareholders.

The Tippee's Intent to Trade. The Center's proposal that the Government be required to prove that the tipper knew that the tippee would trade on the information is also firmly grounded in this Court's precedent. One of the core elements of securities fraud is that the violation be "in connection with the purchase or sale of any security." 17 C.F.R. § 240.10b-5; *see Morrison*, 561 U.S. at 266.

Lower courts have often lost sight of this predicate for securities fraud liability in searching for a personal benefit as supposedly required by *Dirks*. *See, e.g.*, *Obus*, 693 F.3d at 289 (listing elements without reference to any connection to a trade). Yet as the Court emphasized in *O'Hagan*, "the fiduciary's fraud is consummated, not when the fiduciary gains the confidential information, but when, without disclosure to his principal, he uses the information to purchase or sell securities." 521 U.S. at 656; *see id.* at 656-59. Just as misappropriation of confidential information does not amount to securities fraud unless and until the misappropriator trades on that information, a tipper of inside information should not be liable for securities fraud unless she knew that a tippee would trade on that information and until a tippee actually makes the trade. Absent knowledge that the tipped information would be used for a trade, a wrongful tip should be policed not by the securities laws, but instead by the law of trade secrets, by means specified in bargained-for employment contracts, or by common law. *See id.* at 655 (noting that disclosure of a misappropriation of information negates the deception required for securities liability, but that "the fiduciary-turned-trader may remain liable under state law for breach of a duty of loyalty").

The tipper's knowledge of the tippee's intent to trade is also crucial to proving fraudulent intent, as such knowledge supports an inference, at the very least, that the tipper disclosed the information with an intent to benefit the tippee and not the corporation. Conversely, the Government's inability to prove such knowledge supports an inference that the tipper did not have fraudulent intent within the meaning of the securities laws, and committed, at most, a common law breach of fiduciary duty. *Cf. Obus*, 693 F.3d at 287 (explaining that there would be "a valid defense to scienter if the tipper [could] show that he believed in good faith that the information disclosed to the tippee would not be used for trading purposes").

CONCLUSION

For the foregoing reasons, the Center respectfully urges the Court to articulate a clearer standard for tipper-tippee insider trading liability along the lines set forth above.

Respectfully submitted,

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