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White-Collar Crime

Expert Analysis

'Salman': Addressing Vagueness In Insider Trading Law

By **Elkan Abramowitz** And **Jonathan Sack**

The Supreme Court's highly anticipated decision in *Salman v. United States*[1] restated what most commentators saw as the preexisting law of tipper/tippee liability in *Dirks v. SEC*.[2] However, the court broke new ground in its discussion of the vagueness doctrine: the principle that criminal laws must provide clear notice of the conduct they prohibit. For the first time, the court explicitly defended judicially fashioned insider trading doctrine against the common charge that it is too vague and fails to provide a clear and predictable standard for securities professionals, much less the average person.

Below, after describing the vagueness arguments made in *Salman*, we explain the Supreme Court's grounds for rejecting these arguments and suggest potential limitations to the court's vagueness analysis.

Personal Benefit Standard

Tipper/tippee liability is shorthand for the liability of tippers who disclose material, nonpublic information (MNPI) for purposes of securities trading, and the liability of tippees who trade on that information or disclose it to other tippees down the line.

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In *Dirks*, the seminal Supreme Court case on tipper-tippee liability, the court held that the securities laws do not require that all market participants have equal access to information, and therefore trading on MNPI does not necessarily violate the securities laws. *Dirks* ruled that a tippee who trades on MNPI violates the securities laws only if the tipper breached a fiduciary duty and the tippee was aware of the tipper's breach. Thus, a tipper's breach of duty—not the unfairness of trading on information that other market participants do not have—is what makes insider trading fraudulent and unlawful.

Under *Dirks*, a breach of fiduciary duty occurs when the tipper "personally will benefit, directly or indirectly, from his disclosure" of MNPI to the tippee; disclosures made for reasons other than personal benefit do not breach a fiduciary duty and thus do not violate the securities laws. The court explained that a personal benefit can be inferred "from objective facts and circumstances," such as "a relationship between the insider and the recipient that suggests a quid pro quo," or "an intention to benefit the particular recipient." The requisite intention to benefit exists "when an insider makes a gift of confidential information to a trading relative or friend," such that the "tip and trade resemble trading by the insider followed by a gift of the profits to the recipient."

The Salman Decision

The Salman case turned on the definition of the personal benefit standard.

ELKAN ABRAMOWITZ *and* JONATHAN SACK *are members of Morvillo Abramowitz Grand Iason & Anello P.C.* CURTIS LEITNER, *counsel to the firm, contributed to this article.*

The tipper, Maher Kara, was an investment banker in Citigroup's healthcare group. The tippee, Mounir (known as Michael) Kara, was Maher's older brother. Maher told Michael about upcoming corporate transactions that he learned at Citigroup. Unbeknownst to Maher, Michael tipped Bassam Salman, Maher's brother-in-law, with the MNPI that Michael received from Maher.

Both Maher and Michael pleaded guilty to insider trading and testified as cooperating witnesses at Salman's trial. The evidence at trial showed that Maher and Michael had a "very close relationship" and that Michael was like "a second father" to Maher. Maher testified that he tipped Michael to "help him," to "fulfill whatever needs he had," and to get Michael to stop pestering him. Further, Maher expected that Michael would trade based on his tips. A jury convicted Salman of insider trading.

On appeal to the Ninth Circuit, Salman seized on the Second Circuit's decision in *United States v. Newman*,[3] which indicated that the personal benefit standard requires "at least a potential gain of a pecuniary or similarly valuable nature" by the tipper. Salman argued that Maher, the tipper, did not receive a benefit of a "pecuniary or similarly valuable nature" by tipping Michael, as Maher received nothing more than the satisfaction of helping his brother. The Ninth Circuit held that *Newman's* pecuniary benefit standard was inconsistent with *Dirks,* which explicitly stated that a tipper could receive a personal benefit from giving a gift of MNPI to a family member or friend. Accordingly, the court found that Maher received the requisite personal benefit from providing MNPI to his brother and affirmed Salman's conviction.

Vagueness Challenge

In the Supreme Court, Salman launched a direct attack on the *Dirks'* gift-giving principle, arguing that it was unconstitutionally vague and a violation of the rule of lenity. Both the Cato Institute and the National Association of Criminal Defense Lawyers submitted amicus briefs supporting Salman's vagueness arguments.

The vagueness doctrine, which arises from the due process clause, prohibits its enforcement of a law that fails to "give ordinary people fair notice of the conduct it punishes," or is "so standardless that it invites arbitrary enforcement."[4] The doctrine informs statutory interpretation because, under the constitutional avoidance canon, courts are directed to interpret ambiguous statutes so as to avoid vagueness objections. The rule of lenity, which the Supreme Court describes as a "junior version of the vagueness doctrine," holds that ambiguities in a criminal law should be resolved to apply the law "only to conduct clearly covered."[5]

> The Supreme Court in 'Salman' declined to let the inevitability of borderline cases call into question the clarity of the general rule that a tipper gets a personal benefit by making a gift of inside information.

The vagueness doctrine and the rule of lenity thus serve purposes that are fundamental to the rule of law. First, they ensure that individuals are given fair notice of what conduct is prohibited before they suffer criminal sanctions. Second, they ensure that the legislature—not judges—defines crimes.

Salman argued that the gift-giving principle in *Dirks* was too indeterminate under these standards. When a tipper gives a gift of inside information to a friend or relative, the only personal benefit to the tipper—that is, what makes his conduct unlawful—is the psychological or emotional satisfaction that the tipper experiences by giving the gift. If a tipper's personal satisfaction is sufficient to meet the personal benefit standard, Salman's argument ran, then a prosecutor could take the position that any motivation for sharing inside information triggers criminal liability.[6]

To take an example that came up at oral argument in *Salman*, an executive could get satisfaction from brightening a random stranger's day by giving him a valuable tip. (The government took the position that the tip would be illegal if the executive intended it to be a gift.)[7] In another example, a whistleblower could receive personal satisfaction from disclosing illegal activities at a publicly traded company; the whistleblower might take pride in assisting the authorities, or he might enjoy taking down a hated boss. In both examples a fact-finder could readily find psychic benefit to the tipper, but in neither case would the rule in *Dirks* make the tippers liable. Salman argued that the Dirks personal benefit standard does not draw a clear enough line between proper and improper personal benefits, and thus between permissible and impermissible trading, thereby lending itself to arbitrary enforcement.

In addition, Salman argued that this vagueness problem is exacerbated by the lack of connection between the personal benefit standard and the text of a statute or a regulation. There is no federal insider trading law, and Congress has repeatedly declined to define insider trading.[8] The Securities and Exchange Commission has explicitly deferred to "judicial opinions construing" the securities laws and regulations.[9] As a result, the crime of insider trading is defined by judicial interpretations of the catch-all securities fraud statute, which prohibits "any manipulative or deceptive device or contrivance" in connection with a securities transaction—hardly a model of clarity.[10]

Because Congress—not the Supreme Court—should be responsible for defining insider trading, Salman urged the court to adopt a narrow interpretation of the personal benefit standard. Specifically, Salman argued that the personal benefit standard should be limited to pecuniary and other tangible benefits, which would provide a clearer standard of conduct than the one set forth in *Dirks*.

Vagueness and Close Cases

The Supreme Court rejected Salman's pecuniary benefit standard and maintained *Dirks*' gift-giving principle. The court defended the gift-giving principle against Salman's vagueness challenge by drawing a distinction between (1) the meaning of the gift-giving standard and (2) the application of the standard in close cases. The court explained that, "[a]t most, Salman shows that in some factual circumstances assessing liability for gift giving will be difficult." But the prospect of difficult cases "cannot render shapeless a federal criminal prohibition, for even clear rules produce close cases." Thus, the court declined to let the inevitability of borderline cases call into question the clarity of the general rule that a tipper gets a personal benefit by making a gift of inside information. As the court noted, "Salman's conduct [was] in the heartland of *Dirks*' rule concerning gifts," since Maher passed MNPI to Michael to "fulfill whatever needs he had."

Yet the court's analysis does not fully dispose of lingering vagueness concerns. First, the facts that determine whether a particular gift of inside information is a "close case" or "in the heartland" of the gift-giving principle depend on highly subjective judgments about the relationship between the tipper and tippee, and the tipper's subjective reasons for disclosing MNPI. These facts will often be unavailable to downstream tippees, who will not be in position to evaluate the circumstances of the original tip. As a result, future cases against downstream tippees—and many of the recent Southern District insider trading cases involved such tippees—will likely continue to present very close cases as to the downstream tippee's knowledge of the precise relationship between the tipper and original tippee.

Second, the court's treatment of "close cases" does not fully refute the argument that certain close cases can show that a standard is genuinely unclear. For example, *Dirks* recognized that securities analysts may legitimately seek "to ferret out and analyze information" by "meeting with and questioning corporate officers and others who are insiders" at publicly traded companies.

Interactions between analysts and insiders are likely to share the characteristics of a friendly or social relationship and will often present reputational and career opportunities for insiders. Thus, the disclosure of MNPI could be made for legitimate corporate purposes, for example, when a corporate officer gives a presentation to a select group of investors or analysts, but also implicate personal benefits associated with friendship or an ongoing business relationship.[11] Close cases in this area raise questions about the clarity and scope of the personal benefit standard.

Conclusion

The Supreme Court in *Salman* made clear that the definition of personal benefit in *Dirks* remains intact and secure. But the facts in *Salman* presented a relatively easy case for finding sufficient personal benefit and imposing liability on a downstream tippee. White-collar defense counsel will continue to grapple with the inherent uncertainties of what constitutes a personal benefit in the hard cases to come.

1. 137 S. Ct. 420, 421 (2016).
2. 463 U.S. 646 (1983).
3. 773 F.3d 438, 452 (2d Cir. 2014).
4. *Johnson v. United States*, 135 S. Ct. 2551, 2556 (2015).
5. *United States v. Lanier*, 520 U.S. 259, 266 (1997).
6. Brief of the National Association of Criminal Defense Lawyers, *Salman v. United States*, No. 15-628, at 9.
7. Oral Argument Transcript, *Salman v. United States*, No. 15-628, at 45-46.
8. Supra n. 6, at 17-18.
9. 17 C.F.R. §240.10b5-1.
10. 15 U.S.C. §78j(b).
11. Selective disclosures are governed by Regulation FD, 17 C.F.R. §243, which, broadly speaking, seeks to limit selective disclosure of material information. But Regulation FD does not eliminate all selective communications with analysts.