

## Second Circuit: Supreme Court's Decision in *Salman* Abrogated *Newman*'s "Meaningfully Close Personal Relationship" Test for Tipping Liability

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On August 23, 2017, the Second Circuit held that the “meaningfully close personal relationship” test established in *U.S. v. Newman*, 773 F.3d 438 (2d Cir. 2014) for the personal benefit requirement for tipping liability “is no longer good law” in view of the Supreme Court’s decision in *Salman v. U.S.*, 137 S. Ct. 420 (2016).<sup>[1]</sup> *U.S. v. Martoma*, 2017 WL 3611518 (2d Cir. 2017) (Katzmann, J.).

### **Neither *Dirks* Nor *Salman* Limited the Personal Benefit Requirement to Instances in Which the Tippee Had a “Meaningfully Close Personal Relationship” with the Tippee**

In *Dirks v. S.E.C.*, 463 U.S. 646 (1983), the Supreme Court held that a “test” for tipping liability is “whether the insider personally will benefit, directly or indirectly, from his disclosure.” The Second Circuit explained that the *Dirks* Court “gave several examples of situations in which an insider would personally benefit from disclosing inside information: disclosing inside information in a *quid pro quo* relationship, disclosing inside information with ‘an intention to benefit the particular recipient,’ and disclosing inside information as ‘a gift . . . to a trading relative or friend.”’ *Martoma*, 2017 WL 3611518 (quoting *Dirks*, 463 U.S. 646). The *Martoma* court found that *Dirks* “did not purport to *limit* to these examples the situations in which a personal benefit can be inferred.” Rather, the court determined that “the broader inquiry underlying the examples” in *Dirks* focused on “whether the insider personally will benefit, directly or indirectly, from his disclosure.” *Id.* (quoting *Dirks*, 463 U.S. 646).

The *Martoma* court explained that in *Newman*, however, the Second Circuit “did view [the] examples [set forth in *Dirks*] as limiting the situations in which a personal benefit could be inferred.” The *Newman* court “held that the jury was *never* permitted to infer that a tippee had personally benefited from disclosing inside information as a gift unless that gift was made to someone with whom the tippee had a ‘meaningfully close relationship.’” *Martoma*, 2017 WL 3611518 (quoting *Newman*, 773 F.3d 438).

The *Martoma* court found “the examples in *Dirks*” did not “support a categorical rule that an insider can never benefit personally from gifting inside information to people other than ‘meaningfully close’ friends or family members.” While the *Martoma* court acknowledged that it would “ordinarily be neither appropriate nor possible for a panel to reverse existing Circuit precedent,” the court found the Supreme Court’s decision in *Salman* “alter[ed] the relevant analysis fundamentally enough to require overruling” *Newman*’s “meaningfully close personal relationship”

test.<sup>[2]</sup>

In *Salman*, the Supreme Court held that tipper liability attached where the defendant “disclose[d] confidential information as a gift to his brother with the expectation that he would trade on it.” 137 S. Ct. 420. The *Salman* Court stated that “when a tipper gives inside information to ‘a trading relative or friend,’ the jury can infer that the tipper meant to provide the equivalent of a cash gift.” *Id.* (quoting *Dirks*, 463 U.S. 646).

The *Martoma* court found that *Salman* “strongly reaffirmed” “the straightforward logic of the gift-giving analysis in *Dirks*.” 2017 WL 3611518. The *Martoma* court reasoned that “[n]othing in” the *Salman* opinion “supports a distinction between gifts to people with whom a tipper shares a ‘meaningfully close personal relationship’ . . . and gifts to those with whom a tipper does not share such a relationship.”

### **The Personal Benefit Requirement Is Met Whenever the Tipper Expects the Tippee to Trade on the Information, and the Disclosure Resembles Insider Trading Followed by a Gift of the Proceeds**

“[I]n light of *Salman*,” the *Martoma* court “reject[ed] . . . [Newman’s] categorical rule that an insider can *never* personally benefit from disclosing inside information as a gift without a ‘meaningfully close personal relationship.’” The court held that “an insider or tipper personally benefits from a disclosure of inside information whenever the information was disclosed with the expectation that the recipient would trade on it, and the disclosure resembles trading by the insider followed by a gift of the profits to the recipient, whether or not there was a ‘meaningfully close personal relationship’ between the tipper and the tippee.” *Id.*

The *Martoma* court offered the example of “a corporate insider [who], instead of giving a cash end-of-year gift to his doorman, gives a tip of inside information with instructions to trade on the information and consider the proceeds of the trade to be his end-of-year gift.” The court explained that in this situation, “there may not be a ‘meaningfully close personal relationship’ between the tipper and tippee, yet this clearly is an illustration of prohibited insider trading, as the insider has given a tip of valuable inside information in lieu of a cash gift and has thus personally benefited from the disclosure.”

The *Martoma* court emphasized that its holding “reaches only the insider who discloses inside information to someone *he expects will trade on the information*.” The court acknowledged that “[d]etermining whether an insider personally benefits from a particular disclosure, a question of fact, will not always be easy for courts.” *Id.* (quoting *Salman*, 137 S. Ct. 420). Given the facts of the case before it, however, the court determined that it “need not consider the outer boundaries of when a jury is entitled to infer, relying on circumstantial evidence, that a particular disclosure was made with the expectation that the recipient would trade on it, and resembled trading by the insider followed by a gift of the profits to the recipient.” *Id.*

### **In a Lengthy Dissent, Judge Pooler Opined That the Majority’s Decision “Strips the Long-Standing Personal Benefit Rule of Its Limiting Power”**

Judge Pooler, dissenting, expressed her view that “the majority opinion significantly diminishes the limiting power of the personal benefit rule” by holding that “an insider receives a personal benefit when the insider gives inside information as a ‘gift’ to *any* person.” She also observed that under the majority’s ruling, “[w]hat counts as a ‘gift’ is vague and subjective.” She predicted that “[t]he result will be liability in many cases where it could not previously lie.”

Judge Pooler strongly disagreed with the majority’s interpretation of *Salman*. She emphasized that *Salman* “left untouched” *Newman*’s “holding that, in order to allow inference of a personal benefit, gifts must be exchanged within a ‘meaningfully close personal relationship.’” She explained that “[a]n opinion considering a relationship between brothers does not need to rule on, or even address, how close two persons’ friendship must be for them really to be ‘friends.’”

In Judge Pooler’s view, “*Salman* [did] not overrule the limitation described in both *Dirks* and *Salman* itself—that an inference of personal benefit may be based on an insider’s gift to relatives or friends, but not a gift to someone else.”

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[1] Please [click here](#) to read our prior discussion of the Supreme Court’s decision in *Salman*.

[2] In *Salman*, the Supreme Court rejected *Newman*’s holding that the tipper “must also receive something of a ‘pecuniary or similarly valuable nature’ in exchange for a gift to family or friends” to satisfy the personal benefit requirement. 137 S. Ct. 420 (quoting *Newman*, 773 F.3d 438). The *Martoma* court found “the Supreme Court did not have occasion to expressly overrule *Newman*’s requirement that the tipper have a ‘meaningfully close personal relationship’ with a tippee to justify the inference that a tipper received a personal benefit from his gift of inside information—because that aspect of *Newman* was not at issue in *Salman*.” 2017 WL 3611518.

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