

# Report from Washington

## The Supreme Court Unanimously Holds That Gifts of Inside Information to Trading Relatives or Friends are Sufficient to Establish Insider Trading's Personal Benefit Element

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*"... following the logic in Dirks, the Court noted that Maher's conduct—sharing information with Michael so the latter could reap financial gains—was analogous to Maher himself trading on the inside information and providing Michael with the proceeds as a gift."*

On December 6, 2016, in *Salman v. United States*, No. 15-628, the Supreme Court unanimously held that the personal benefit necessary to establish a breach of duty and insider trading liability under *Dirks v. SEC*, 463 U.S. 646 (1983) is satisfied where a tipper gives inside information to a trading relative or friend. By clarifying that prosecutors need not show that the insider received or expected to receive a tangible benefit to sustain insider trading liability, the Court's narrow opinion resolves a recent split between the Second and Ninth Circuits in favor of the traditional approach advocated by federal prosecutors.

### Background

*Salman* concerned the type of personal benefit necessary to sustain an insider trading prosecution under federal law. Insider trading liability springs from Section 10(b) of the Securities Exchange Act of 1934 (the "1934 Act"), a catch-all clause interpreted by the Supreme Court to prohibit individuals with a duty of trust and confidence from secretly using inside corporate information for their personal advantage. *See Salman v. United States*, No. 15-628, 580 U.S. --, slip op. at 1 (2016). Because corporate insiders have fiduciary obligations arising from their relationship with the company, liability attaches to them when they breach their fiduciary duties by using the company's undisclosed information for personal gain. *Dirks*, 463 U.S. at 659.

In contrast, individuals who receive nonpublic information from insiders ("tippees") have no inherent fiduciary duties to the company whose information has been disclosed. *Id.* at 657-59. Instead, tippees assume an obligation of trust and confidentiality when an insider passes nonpublic information to the tippee in violation of the insider's fiduciary duty, and the tippee knows or should know of the insider's breach. *Id.* at 660. This means that insider trading

liability will attach to a tippee only where the insider disclosed the information for the insider's personal advantage. *Id.* at 661-62.

In *Salman*, federal prosecutors secured criminal convictions against Bassam Salman for profitable trades made using tips from a close friend, Michael Kara, who had gleaned the information from his brother, Maher Kara, an investment banker entrusted with the information as part of his job. *Salman v. United States*, 792 F.3d 1087, 1088-89 (9th Cir. 2015), *aff'd*, No. 15-628, 580 U.S. --, slip op. at 2 (2016). Maher and Michael pled guilty to insider trading charges, but Salman took his case to trial. To show that Maher personally benefited from his tips—as required to sustain derivative liability against Salman—prosecutors presented evidence that “[Maher] shared inside information with his brother to benefit him and with the expectation that his brother would trade on it.” *Salman*, No. 15-628, 580 U.S. --, slip op. at 3-4. Ultimately, the jury found this evidence sufficient to sustain a guilty verdict against Salman after being instructed that “a personal benefit includes the benefit one would obtain from simply making a gift of confidential information.” *Id.* at 12.

Salman appealed his conviction to the Ninth Circuit and, while his appeal was pending, the Second Circuit released an opinion diverging from the other circuits' interpretation of the personal benefit element. In *United States v. Newman*, the Second Circuit overturned convictions for two hedge fund managers who profited from tips passed by corporate insiders to the hedge fund managers' analysts, finding that the “casual acquaintance” relationship between the insiders and analysts was not enough to show that the insiders received a personal benefit when they tipped the analysts. 773 F.3d 438, 452-55 (2d Cir. 2014), *cert. denied*, No. 15-137 (U.S. Oct. 5, 2015). Instead, the Second Circuit found that prosecutors had to present “proof of a meaningfully close personal relationship that generates an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature.”

Relying on the Second Circuit's holding in *Newman*, Salman argued on his appeal to the Ninth Circuit that liability could not attach to him because “there was no evidence that Maher received anything of a pecuniary or similarly valuable nature in exchange” for the tips he gave to his brother. *Salman*, No. 15-628, 580 U.S. --, slip op. at 5. The Ninth Circuit declined to follow *Newman*, to the extent it could be read to require evidence that the insider receive “at least a potential gain of a pecuniary or similarly valuable nature,” and affirmed Salman's conviction. *Salman*, 792 F.3d at 1093.

## Summary of the Court's Decision

In a unanimous decision delivered by Justice Alito, the Court resolved the case on narrow grounds. The opinion began by framing each side's position. On one hand, Petitioner Salman argued that the "personal benefit" necessary to give rise to tipper/tippee liability required that the tipper receive some tangible value (or its equivalent). By contrast, the government took the position that a gift of inside information to anyone—relative or not—for non-corporate purposes could be adequate.

Ultimately, the majority concluded that an oft-cited passage in *Dirks* directly resolved the case at bar:

[T]here may be a relationship between the insider and the recipient that suggests a quid pro quo from the latter, or an intention to benefit the particular recipient. The elements of fiduciary duty and exploitation of nonpublic information also exist *when an insider makes a gift of confidential information to a trading relative or friend*. The tip and trade resemble trading by the insider himself followed by a gift of the profits to the recipient. *Dirks v. SEC*, 463 US 646, 664 (1983) (emphasis added).

After reiterating the factual finding that Maher had intended to provide Michael with inside information for the latter's benefit, the Court found that this was precisely the type of "gift-giving" *Dirks* found sufficient to satisfy the "personal benefit" requirement. Indeed, following the logic in *Dirks*, the Court noted that Maher's conduct—sharing information with Michael so the latter could reap financial gains—was analogous to Maher himself trading on the inside information and providing Michael with the proceeds as a gift. Although the Court did not conclude that *any* sharing of information for "non-corporate" purposes would be sufficient, it did clarify that "[t]o the extent the Second Circuit [in *Newman*] held that the tipper must also receive something of a 'pecuniary or similarly valuable nature' in exchange for a gift to family or friends . . . this requirement is inconsistent with *Dirks*."

## Implications

Although the Court did not expressly adopt the government's reading, its holding does resolve the dispute over whether the tipper must receive some pecuniary gain (or its equivalent) when gifting nonpublic information. It is now clear that the government can satisfy the personal benefit element of a criminal insider trading charge with proof that a tipper gave nonpublic information to a trading friend or relative. That said, as the Court expressly acknowledged, "[i]t remains the case that determining whether an insider

personally benefits from a particular disclosure, a question of fact, will not always be easy for courts.” *Id.* at 11. Going forward, fact finders in criminal prosecution cases will need to focus on objective criteria, “such as a relationship between the insider and the recipient that suggests a *quid pro quo* from the latter, or an intention to benefit the particular recipient.” *Id.* at 9.

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