

Supreme Court Clarifies Insider Trading Liability for Confidential Tips

December 7, 2016

The Supreme Court's unanimous decision this week in *Salman v. United States*¹ clarified what constitutes a "personal benefit" for purposes of insider trading liability. In its first merits ruling in an insider trading case in two decades, the Court affirmed the Ninth Circuit's holding that the personal benefit requirement may be met when an inside tipper simply gifts confidential information to a trading relative or friend. In so holding, the Supreme Court significantly narrowed a key aspect of the Second Circuit's landmark insider trading decision in *United States v. Newman*,² which had required prosecutors to prove that the tipper received something "of a pecuniary or similarly valuable nature"—a more difficult standard to meet.

Before *Newman* was decided, the United States Attorney's Office for the Southern District of New York had prioritized insider trading prosecutions, obtaining dozens of convictions and over a billion dollars in fines since 2009.³ After *Newman*, however, prosecutors were forced to dismiss several indictments, and some commentators wondered what the future held for insider trading prosecutions.⁴ The Supreme Court's recent decision should reduce that uncertainty and may bring a renewed focus on insider trading investigations.

If you have any questions concerning this memorandum, please reach out to your regular firm contact or any of our partners and counsel listed under [White Collar Defense and Investigations](#) in the "Our Practice" section of our website.

NEW YORK
One Liberty Plaza
New York, NY 10006-1470
T: +1 212 225 2000
F: +1 212 225 3999

¹ No. 15-268, 580 U.S. __ (Dec. 6, 2016), slip op. available at https://www.supremecourt.gov/opinions/16pdf/15-628_m6ho.pdf.

² 773 F.3d 438 (2d Cir. 2014), cert. denied, 136 S. Ct. 242 (2015).

³ Patricia Hurtado & Michael Keller, *How the Feds Pulled Off the Biggest Insider-Trading Investigation in U.S. History*, BLOOMBERG, <http://www.bloomberg.com/graphics/2016-insider-trading/> (June 1, 2016).

⁴ Ben Protess & Matthew Goldstein, *What Is a 'Personal Benefit' From Insider Trading? Justices Hear Arguments*, N.Y. TIMES, <http://www.nytimes.com/2016/10/06/business/dealbook/supreme-court-insider-trading.html> (Oct. 5, 2016).



Insider Trading Background

To establish liability for insider trading, the government must prove that a defendant: (i) traded in securities while (ii) in possession of material, nonpublic information, which was (iii) obtained as a result of a breach of duty.⁵ The Supreme Court first addressed the question of tipper-tippee liability in the seminal case *Dirks v. SEC*,⁶ in which an employee of a broker-dealer received information from a former officer for an insurance company about a fraud at the company. Dirks investigated, and discussed the findings of his review with his clients, who traded on the information. In considering whether there had been a breach of duty, and thus an insider trading violation, the Supreme Court held that, to show a breach of a duty through tipping, the insider must “personally [] benefit, directly or indirectly, from [the] disclosure.”⁷ The Court explained that insiders derive a personal benefit when, for instance, they make a “quid pro quo exchange” for the tip or “gift the confidential information to a trading relative or friend.”⁸ Because the corporate insider who provided the information to Dirks received no personal benefit (and in fact sought to expose a fraud by disclosing the information), the Supreme Court concluded that there was no breach of a duty.

The Second Circuit Narrows “Personal Benefit” in *Newman*

Thirty years later, the Second Circuit weighed in on the definition of “personal benefit” in *Newman*,⁹ which involved two hedge fund portfolio managers, Newman and Chiasson, who were “remote tippees” that received confidential information through a chain of tips about technology companies Dell and NVIDIA.¹⁰ After each defendant was convicted, the Second Circuit reversed in a much discussed opinion.¹¹

The court first held that, to be liable for insider trading, a remote tippee must know both that the insider breached his duty by disclosing confidential information *and* that the insider did so for a personal benefit.¹² The Second Circuit went further, however, and found that the Government failed to prove at trial that the tippers received a personal benefit in exchange for their disclosures.¹³ Noting that the evidence showed nothing more than mere casual friendships between the insiders and the initial tippees, the Second Circuit held that this was insufficient to show a personal benefit.¹⁴ If this were enough to establish a “personal benefit,” the Second Circuit reasoned, the requirement would be rendered a “nullity.”¹⁵ Instead, the court explained, a personal benefit requires “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.”¹⁶

Under this definition of personal benefit, the court concluded that Newman and Chiasson were not liable as tippees. The Dell analyst had tipped the confidential information to a business school classmate who had provided him nothing more than routine career advice.¹⁷ Because the Dell analyst received nothing of value from providing the information to a friend, he did not personally benefit from the tip.¹⁸ Similarly, the two individuals at the top of the NVIDIA tipping chain were casual church acquaintances; the government presented no evidence that the two exchanged anything of pecuniary value.¹⁹

The Ninth Circuit Weighs in on “Personal Benefit”

Less than a year after the Second Circuit decided *Newman*, the Ninth Circuit weighed in on the definition of “personal benefit” in *United States v.*

⁵ See, e.g., *Chiarella v. United States*, 445 U.S. 222, 226-30 (1980).

⁶ 463 U.S. 646, 649 (1983).

⁷ *Id.*

⁸ *Id.* at 664.

⁹ *Newman*, 773 F.3d at 452.

¹⁰ *Id.* at 443.

¹¹ *Id.*

¹² *Id.* at 448.

¹³ *Id.* at 452.

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ *Id.* at 453.

¹⁸ *Id.*

¹⁹ *Id.*

Salman.²⁰ A jury convicted Bassam Salman of securities fraud for trading on material nonpublic information that he received as a “remote tippee.” The information originated with Salman’s brother-in-law, Maher Kara, who worked for Citigroup’s healthcare investment group.²¹ The inside information was passed from Maher to his own brother Mounir (“Michael”) Kara, who, in addition to trading on the information himself, provided it to Salman. Salman also traded on the information, netting hundreds of thousands of dollars and an insider trading conviction.²²

On appeal, the Ninth Circuit addressed the question of whether Maher, the insider, had received a “personal benefit” that would subject Salman to liability as a tippee.²³ Relying on *Newman*, Salman argued that a personal benefit requires at least the potential for pecuniary gain or something of a similarly valuable nature.²⁴

The Ninth Circuit rejected Salman’s argument. In a decision written by Judge Jed S. Rakoff of the United States District Court for the Southern District of New York, sitting by designation, the court relied on *Dirks*’s plain language: an insider receives a personal benefit, and breaches his duty, when the “insider makes a gift of confidential information to a trading relative or friend.”²⁵ Maher had testified that “he intended to ‘benefit’ his brother and to ‘fulfill[] whatever needs he had.’”²⁶ Unlike in *Newman*, the Government offered evidence that Salman knew about Maher’s improper disclosure, given that Salman was aware that Maher was his source, and Salman therefore agreed “they had to ‘protect’ Maher from exposure.”²⁷ Accordingly, the Ninth Circuit concluded that Salman was liable because Maher breached his duty by disclosing the confidential information in exchange for a personal

benefit, and Salman knew about the breach.²⁸ In holding that Maher’s gift to his brother was a sufficient personal benefit, the Ninth Circuit created a rift with the Second Circuit’s decision in *Newman*.

The Supreme Court Addresses “Personal Benefit”

The Supreme Court granted a writ of certiorari in *Salman* to resolve this split and address what constitutes a “personal benefit” received by an insider for purposes of insider trading liability. Specifically, is the government required to prove “an exchange that is objective, consequential, and represents at least a potential gain of pecuniary or similarly valuable nature” as the Second Circuit held in *Newman*, or is it enough that the insider gave a gift of confidential information to a trading relative or friend, as the Ninth Circuit held in *Salman*?

The Court unanimously agreed with the Ninth Circuit’s interpretation, concluding that an insider receives a personal benefit by gifting confidential information to a trading relative or friend even if there is no exchange of something of pecuniary or similar value.²⁹ The Court closely followed its ruling in *Dirks*, which “ma[de] clear that a tipper breaches a fiduciary duty by making a gift of confidential information to a ‘trading relative.’”³⁰ The Court reasoned that the tipper benefits personally by gifting the information “because giving a gift of trading information is the same thing as trading by the tipper followed by a gift of the proceeds.”³¹ In fact, as the Court noted, the brothers here effectively viewed the tip as cash: “Maher offered his brother money but [his brother] asked for information instead[, and] Maher then disclosed an upcoming acquisition.”³² Applying the *Dirks* rule here, the Court determined that Maher breached a duty of trust and confidence to Citigroup and its clients when he gifted the confidential information to his brother with the knowledge that he would trade on it.³³ When Salman received the

²⁰ 792 F.3d 1087 (9th Cir. 2015), *aff’d*, 580 U.S. __ (Dec. 6, 2016).

²¹ *Id.* at 1088-89.

²² *Id.* at 1090.

²³ *Id.* at 1091.

²⁴ *Id.* at 1092.

²⁵ *Id.* at 1093.

²⁶ *Id.*

²⁷ *Id.*

²⁸ *Id.* at 1093.

²⁹ *Salman*, slip op. at 8-9.

³⁰ *Id.* at 9.

³¹ *Id.* at 10.

³² *Id.* at 4.

³³ *Id.*

information, he thus “acquired” that duty and subsequently breached it “by trading on the information with full knowledge that it had been improperly disclosed.”³⁴

In reaching its conclusion, the Court rejected Salman’s argument, based on *Newman*, that “personal benefit” requires that the tipper receive something of a pecuniary or similarly valuable nature in exchange for the tip.³⁵ To the extent *Newman* required such an exchange, the Court held that such a rule was “inconsistent with *Dirks*.”³⁶ The Court also rejected Salman’s contention that *Dirks*’s gift-giving standard is unconstitutionally vague as applied: while some factual circumstances would produce close cases, that alone does not render the rule “‘hopeless[ly] indetermina[te].’”³⁷ Similarly, the Court found the rule of lenity inapplicable given that Salman’s conduct was “in the heartland of *Dirks*’s rule concerning gifts.”³⁸

Conclusion

While the Supreme Court’s decision in *Salman* resolved the “narrow issue” of whether a gift of confidential information to a trading relative constitutes a personal benefit,³⁹ several key questions remain open. Most significantly, the Court’s standard does not provide much guidance regarding gifts of material nonpublic information to casual acquaintances—the particular facts at issue in *Newman*—and the opinion in fact reiterated *Dirks*’s warning “that ‘[d]etermining whether an insider personally benefits from a particular disclosure, a question of fact, will not always be easy for courts.’”⁴⁰ In addition, the Court noted that the second basis for the *Newman* court’s holding, requiring a tippee’s knowledge of the underlying breach and exchange of a

personal benefit, was not addressed by its decision.

Nonetheless, the Court’s opinion eliminates any doubt that “gifts” of material nonpublic information can serve as a basis for insider trading liability. In particular, federal prosecutors can now establish a personal benefit when, even in the absence of an exchange of something of pecuniary or similar value, an insider gifts confidential information to trading relatives or friends. While it remains to be seen whether this wider latitude in tipper-tippee insider trading liability will see a return to pre-*Newman* levels of insider trading prosecutions, it is clear that such cases will face an easier path after the Supreme Court’s decision in *Salman*.

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³⁴ *Id.*

³⁵ *Id.*

³⁶ *Id.* at 11

³⁷ *Id.* at 11 (quoting *Johnson v. United States*, No. 13-7120, 576 U.S. ___, slip op. at 5, 7 (2015)).

³⁸ *Id.* at 11.

³⁹ *Id.* at 8.

⁴⁰ *Id.* at 11 (quoting *Dirks*, 463 U.S. at 664).