

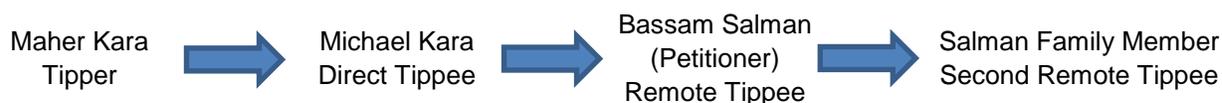
White Collar Update: Supreme Court Will Decide Reach of Insider Trading Law Based on Circuit Split

January 25, 2016

To be guilty of insider trading, a tipper of inside information must receive a “personal benefit” in exchange for his tips. On January 19, 2016, the Supreme Court granted *certiorari* in *Salman v. United States*¹ to decide what the prosecution must prove to establish that a tipper received a “personal benefit.” In *Salman*, the Ninth Circuit held that a personal benefit is established when tips are made to a relative or friend as a gift.² The Ninth Circuit disagreed with the Second Circuit’s opinion in *United States v. Newman*, which interpreted “personal benefit” to require more than a friendship or familial relationship between the tipper and tippee.³ In July 2015, the Department of Justice unsuccessfully petitioned the Supreme Court to hear and reverse *Newman*. United States Attorney Preet Bharara from the Southern District of New York has said that the *Newman* ruling will make it “very hard if not impossible to bring a certain kind of insider trading case.”⁴ Although the Supreme Court declined to hear *Newman*, that it has decided to hear *Salman* so soon after suggests that it wants to clarify the proper standard and that *Salman* provides the perfect opportunity to do so.

Factual Background

Bassam Salman’s future brother-in-law Maher Kara joined Citigroup in 2002. Maher was part of Citigroup’s healthcare investment banking group and began discussing his work with his older brother Mounir (“Michael”) Kara. Maher (the “tipper”) provided Michael (the “direct tippee”) with advance notice of mergers and acquisitions involving Citigroup clients, and Michael began trading on this information. During this time, Maher became engaged to Salman’s sister. Salman and Michael became friends, and Michael started sharing the inside information he gained from Maher with Salman (the first “remote tippee”). Salman then placed money in an account owned by another family member (the second “remote tippee”), informed him of the inside information, and split the profits gained from his trading. A jury found Salman guilty of one count of conspiracy to commit securities fraud and four counts of substantive securities fraud. The district court sentenced Salman to three years of imprisonment.



¹ *Bassam Yacoub Salman v. United States*, No. 15-628 (S. Ct. Jan. 19, 2016).

² *United States v. Salman*, 792 F.3d 1087, 1092 (9th Cir. 2015).

³ *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014).

⁴ Matt Turner, *Sheriff of Wall Street: We’re No Longer Able to Bring Certain Insider Trading Cases*, OakRidger (Jan. 17, 2016).

The Ninth Circuit's Disagreement with *Newman*

On appeal to the Ninth Circuit, Salman argued that the evidence was insufficient to prove that Maher's (the tipper's) disclosure of inside information to Michael (the direct tippee) was done in exchange for a personal benefit. The Ninth Circuit found the evidence sufficient, relying on the Supreme Court's 1983 decision in *Dirks v. SEC*.⁵ *Dirks* held that the determination of a personal benefit focuses on "objective criteria," such as money payments or "reputational benefit[s] that will translate into future earnings."⁶ But the *Dirks* Court also noted that "[t]he 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*."⁷ The Ninth Circuit held that Salman's case fell directly within this last example because Maher had provided Michael (a relative) with the inside information as a gift.

Salman relied on *Newman* to argue that a tipper who merely gifts inside information to a family member does not receive a personal benefit. In *Newman*, the Second Circuit held that a personal benefit may not be proven simply by showing that there was a personal relationship between the tipper and the tippee.⁸ Under *Newman*, only a close personal relationship "that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature" is sufficient.⁹ The Ninth Circuit in *Salman* suggested that Salman misinterpreted *Newman* to require more than a familial or friendship relationship between a tipper and tippee. But the Ninth Circuit also held that even if *Newman* could be read as Salman suggested, it would not follow *Newman* on this point because doing so would conflict with *Dirks*'s recognition that providing inside information as a gift to a friend or relative was sufficient.

The Second Circuit's Recent Interpretation of *Newman*

The Second Circuit recently had its first opportunity to apply *Newman* in *United States v. Riley*.¹⁰ Riley argued on appeal that the prosecution in his insider trading trial failed to prove that he received a personal benefit. The Second Circuit summarily disagreed, holding that Riley "mistakenly" relied on *Newman* because Riley received an immediate benefit when his tippee provided him with investment advice. Although *Newman* expressed concern with interpreting "personal benefit" so expansively as to make the requirement a "nullity,"¹¹ *Riley* suggests that the Second Circuit will not interpret personal benefit so narrowly as to deter the prosecution of insider trading schemes involving a clear *quid pro quo*.

Implications of the Supreme Court's Grant of *Certiorari*

The Supreme Court declined to grant the Department of Justice's petition for *certiorari* in *Newman* despite claims that *Newman*'s interpretation of personal benefit would harm the securities markets. That it granted *certiorari* on *Salman*'s broader interpretation might suggest that the Supreme Court agrees with *Newman* and has taken this case to correct the Ninth Circuit's contrary ruling. Another possibility is that *Newman* was a poor vehicle for the Supreme Court to decide this issue. In addition to defining "personal benefit,"

⁵ 463 U.S. 646 (1983).

⁶ *Id.* at 664.

⁷ *Id.* (emphasis added).

⁸ *Newman*, 773 F.3d at 452.

⁹ *Id.*

¹⁰ No. 15-1541-cr (2d Cir. Jan. 14, 2016) (summary order)

¹¹ *Id.*

Newman also held that for a tippee to be liable he must *know* that the tipper disclosed the information for a personal benefit.¹² In *Newman*, the Second Circuit held that there was no proof that the defendants knew that the tippers were personally benefiting from disclosing the tips. Although this ruling provided an independent ground for affirming the Second Circuit’s decision to vacate the convictions, the Department of Justice did not appeal this issue to the Supreme Court. The Second Circuit’s opinion, then, would not have been affected regardless of what the Supreme Court decided on the “personal benefit” issue.

Salman, by contrast, squarely presents the issue of personal benefit. Indeed, the Ninth Circuit recognized that the second key holding in *Newman*—the issue of a tippee’s knowledge of a tipper’s personal benefit—was “not at issue,” thus setting the stage for the Supreme Court to decide what counts as a personal benefit under the insider trading laws.¹³

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¹² *Newman*, 773 F.3d at 450.

¹³ *Salman*, 792 F.3d at 1091 n.2.