

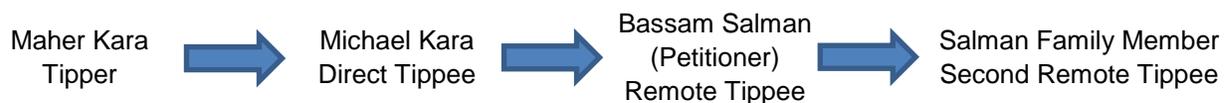
## White Collar Update: Supreme Court Rejects Second Circuit's Narrow Interpretation of Insider-Trading Law

December 8, 2016

To be guilty of insider trading, a tipper of inside information must receive a “personal benefit” in exchange for his tips. On December 6, 2016, the Supreme Court unanimously held in *Salman v. United States*<sup>1</sup> that a tipper receives a “personal benefit” when he gifts inside information to a trading relative or friend. *Salman* reaffirmed *Dirks v. SEC*<sup>2</sup> and partly overturned the Second Circuit’s decision in *United States v. Newman*, which interpreted “personal benefit” to require more than a friendship or familial relationship between the tipper and tippee.<sup>3</sup> *Newman* instead required a close personal relationship “that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature.” The *Salman* decision is a win for prosecutors, including U.S. Attorney Preet Bharara, who said that the *Newman* ruling made it “very hard if not impossible to bring a certain kind of insider trading case.”<sup>4</sup> Even so, the Supreme Court acknowledged that “determining whether an insider personally benefits from a particular disclosure, a question of fact, will not always be easy for courts.” And the Supreme Court left untouched the other holding in *Newman* that a tippee must *know* that the tipper disclosed the information for a personal benefit to be liable. *Salman* therefore decided a narrow issue on distinct facts.

### Factual Background

Bassam Salman’s future brother-in-law Maher Kara joined Citigroup in 2002. Maher 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 securities fraud. The district court sentenced Salman to three years of imprisonment.



<sup>1</sup> *Bassam Yacoub Salman v. United States*, No. 15-628 (S. Ct. Dec. 6, 2016).

<sup>2</sup> 463 U.S. 646 (1983).

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

<sup>4</sup> Matt Turner, *Sheriff of Wall Street: We're No Longer Able to Bring Certain Insider Trading Cases*, OAKRIDGER (Jan. 17, 2016).

The question in the case focused on the relationship between Maher and Michael. The prosecution established that Maher and Michael were “very close” brothers. Michael was “a second father to Maher” and served as best man when Maher married Salman’s sister. The prosecution also established that Maher provided Michael with the inside information to “help him” and to “fulfill whatever needs he had.”

### The Supreme Court Rejects *Newman*’s More Demanding Personal-Benefit Test

Calling this an easy case, a unanimous Supreme Court held that its 1983 decision in *Dirks v. SEC* “resolve[d] the narrow issue presented” and affirmed the Ninth Circuit’s determination that this evidence was sufficient to prove that Maher’s disclosure to Michael was done in exchange for a personal benefit. *Dirks* held that a tippee may be liable for insider trading only if the tipper personally benefits from the exchange. Although *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,” the Supreme Court in *Salman* focused on *Dirks*’s explanation 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.*”<sup>5</sup> As *Dirks* explained, in the gift-giving context, “[t]he tip and trade resemble trading by the insider followed by a gift of the profits to the recipient.”<sup>6</sup> The *Salman* Court noted that *Dirks*’s discussion of gift-giving decided the issue presented because Maher provided his brother the inside information as a gift.

The Court also rejected the Second Circuit’s articulation of the personal-benefit standard in *Newman*: “[t]o the extent the Second Circuit held that the tipper must also receive something of a ‘pecuniary or similarly valuable nature’ in exchange for a gift to family or friends, we agree with the Ninth Circuit that this requirement is inconsistent with *Dirks.*”<sup>7</sup> *Newman* had held that a personal benefit could not be proven simply by showing a personal relationship between the tipper and the tippee, but instead required a close personal relationship “that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature.”<sup>8</sup>

### Implications of the Supreme Court’s Decision

The Supreme Court’s decision makes insider-trading prosecutions easier, but a line-drawing problem remains. After *Newman*, prosecutors dismissed a series of insider-trading cases because of an apparent inability to meet *Newman*’s personal-benefit test. Prosecutors no longer face that hurdle—when an insider provides information to a relative or friend, a jury may infer that the “tipper meant to provide the equivalent of a cash gift.” Nevertheless, applying the Supreme Court’s personal-benefit standard to ambiguous facts will remain a challenge. As the *Salman* Court acknowledged, “determining whether an insider personally benefits from a particular disclosure, a question of fact, will not always be easy for courts.” *Salman* was an easy case because Maher and Michael had an objectively close relationship. But “assessing liability for gift-giving will be difficult” when the relationship between a tipper and tippee is less obvious. The *Salman* Court therefore did not embrace the prosecution’s argument that providing confidential information to *anyone* is sufficient to prove a personal benefit.

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<sup>5</sup> *Dirks*, 463 U.S. at 664 (emphasis added).

<sup>6</sup> *Id.*

<sup>7</sup> *Salman*, No. 15-628 at 10.

<sup>8</sup> *Newman*, 773 F.3d at 452.

The Supreme Court also left untouched *Newman*'s other holding that, to be liable, a tippee must *know* that the tipper disclosed the information for a personal benefit. Although *Salman* declined to address the issue, the opinion implicitly supported the knowledge requirement because the Court noted that "Salman knew that Maher had made such a gift" when reciting the evidence that proved Salman's guilt. The requirement that the tippee know that the tipper provided the inside information for a personal benefit remains good law in the Second Circuit, where many insider-trading cases are prosecuted.

Ultimately, the *Salman* decision returns the definition of personal benefit to the status quo before *Newman*. Tips of inside information to family members and friends are actionable on the theory that the tips are gifts (as if the tipper traded herself and then gave the proceeds to the family member or friend) and tips to others will raise the difficult factual question of whether the tipper received a personal benefit.

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If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

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