U.S. Supreme Court Unanimously Holds that Insider's Gift of Confidential Information to Trading Relative or Friend Is Sufficient To Establish "Personal Benefit" Under Insider-Trading Law

In a much anticipated decision announced yesterday that reaffirms traditional boundaries for insider-trading liability, the U.S. Supreme Court unanimously held in *United States v. Salman* that, consistent with its decision in *Dirks v. SEC*, 463 U.S. 646 (1983), a gift of confidential information by an insider to a relative or close friend, who then trades on that information, is sufficient to establish the existence of a "personal benefit" (and thus a breach of the tipper's fiduciary duty), which is a key element of insider trading liability under Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and U.S. Securities and Exchange Commission Rule 10b-5 ("Rule 10b-5"). Moreover, in affirming the conviction in the *Salman* case, the Court clarified that last year's Second Circuit decision in *United States v. Newman* is inconsistent with *Dirks* to the extent it required a showing "that the tipper must also receive something of a 'pecuniary or similarly valuable nature' in exchange for a gift to family or friends", 773 F.3d3d 438, 452 (2d Cir. 2014), cert. denied, 577 U. S. ___ (2015). Thus, even though the ultimate result of the holding in *Newman*—which overturned the convictions of two tippees with no familial relationship to the tippers because there was insufficient evidence of the tipper's "personal benefit"—stands, the *Salman* decision establishes that the heightened standard the Second Circuit adopted does not apply to insider-trading cases involving tippers and tippees who are family or close friends.

Background

No federal law specifically defines insider trading. Thus, courts, and therefore prosecutors, rely entirely upon the language in Section 10(b) of the Exchange Act and Rule 10b–5 to punish those who improperly benefit from their misuse of material, non-public information. As a result, courts struggle to articulate the scope of liability for individuals, commonly referred to as "tippees," who receive and trade upon inside information.

In *Dirks v. United States*, the leading Supreme Court case on tippee liability, the Supreme Court explained that a tippee is liable for trading on inside information when: (1) the insider, commonly referred to as the "tipper," had a fiduciary duty to the company whose inside information he or she disclosed; (2) the tipper provided confidential information to the tippee for the purpose of receiving, directly or indirectly, a "personal benefit"; and (3) the tippee knew or should have known that there was a breach of fiduciary duty on the part of the insider. 463 U.S. at 661–65.

The *Dirks* Court explained that a "personal benefit" could be inferred "from objective facts and circumstances," 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 664. Moreover, the Court held 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." *Id.*

Despite the apparent clarity of this rule, the Second and Ninth Circuits have diverged in their recent interpretation of what is required to show such a benefit.

United States v. Newman

In December 2012, Todd Newman of Diamondback Capital Management, LLC and Anthony Chiasson of Level Global Investors, L.P. were convicted in the Southern District of New York for obtaining and trading on material non-public information regarding Dell and NVIDIA. *Newman*, 773 F.3d at 444. According to the U.S. Department of Justice ("DOJ"), corporate insiders at Dell and NVIDIA had provided inside information to groups of financial analysts, who provided the information to analysts at Diamondback and Level Global, who then passed the information along to Newman and Chiasson. *Id.* at 443. Regarding the alleged existence of a "personal benefit," the DOJ argued that Newman and Chiasson, "as sophisticated traders . . . must have known that information was disclosed by insiders in breach of a fiduciary duty, and not for any legitimate corporate purpose." *Id.* at 443–44.

After finding that the Government had failed to prove that the tippers had received a sufficiently tangible or concrete benefit to establish a breach of fiduciary duty under *Dirks*, the Second Circuit vacated both convictions.[1] *Id.* at 455. The Court explained that "[t]o the extent *Dirks* suggests that a personal benefit may be inferred from a personal relationship between the tipper and tippee . . . we hold that such an inference is impermissible in the absence of 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." *Id.* at 452. The Court therefore arguably raised the threshold for establishing a "personal benefit" under *Dirks* in the Second Circuit—a conclusion with which the Ninth Circuit did not agree.

United States v. Salman

Nearly one year after the *Newman* defendants were convicted, Bassam Yacoub Salman was convicted of insider trading in the Northern District of California. *United States v. Salman*, 792 F.3d 1087, 1090 (9th Cir. 2015), *affirmed in*, 2016 WL 7078448 (Dec. 6, 2016). Salman was accused of receiving material, non-public information regarding numerous companies within the healthcare sector from his brother-in-law, Michael Kara, who had in turn received the information from his brother, a Citigroup healthcare investment banking employee, Maher Kara. *Id.* at 1089. The Maher brothers previously had pled guilty to their own insider trading charges and provided testimony at trial against Salman. *Id.* The evidence showed that Salman traded on the inside information, knowing that Michael was obtaining the confidential information from his brother, Maher. *Id.*

The Ninth Circuit upheld Salman's conviction and called into question the Second Circuit's interpretation of "personal benefit" in *Newman.* According to the Ninth Circuit, *Dirks* directly governed the issue at hand by making clear that a "personal benefit" includes situations "when an insider makes a gift of confidential information to a trading relative or friend." *Id.* at 1092 (quoting

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[1] In throwing out the defendants' convictions, the Second Circuit also relied on the fact that the Government failed to introduce evidence that the defendants knew or should have known the source of the inside information. *Newman*, 773 F.3d at 453–54.

Dirks, 463 U.S. at 664). Since Maher's disclosure to Michael was "precisely the gift of confidential information to a trading relative that *Dirks* envisioned," and because Salman was himself aware of Maher's identity and relationship with Michael, *id*. at 1092, the Ninth Circuit found that the evidence was sufficient to sustain Salman's conviction, *id.* at 1094. And to the extent that *Newman* could be read to hold "that evidence of a friendship or familial relationship between tipper and tippee, standing alone, is insufficient to demonstrate that the tipper received a benefit," the Ninth Circuit expressly disagreed. *Id.* at 1093.

On December 6, 2016, the Supreme Court voted 8-0 to uphold Salman's conviction. *United States v. Salman*, 2016 WL 7078448 (Dec. 6, 2016). Writing for the unanimous court, Justice Alito confirmed that *Dirks'* definition of "personal benefit" as a gift of confidential information to a "trading relative" was "sufficient to resolve the case at hand." *Id.* at *8. Indeed, the Court found that Maher's disclosure to Michael was essentially the "equivalent of a cash gift." *Id.* The Court observed that, under *Dirks*, Salman's subsequent trading while knowingly in possession of the confidential information originally provided by Maher to his brother, Michael "easily resolves the narrow issue presented here." *Id.* at *7.

Implications

The Supreme Court's decision in *Salman* resets the insider-trading liability landscape to be consistent with its ruling in *Dirks*. In its decision, the Supreme Court has likely made it easier for prosecutors to secure convictions for insider trading in cases where a tipper discloses information to a family member or close friend. In situations where disclosure is not to a family member or close friend, however, the *Newman* requirement that a "personal benefit" be "objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature," likely remains in place – at least in the Second Circuit. *Newman*, 773 F.3d at 452. The Supreme Court in *Salman* refrained from elaborating on the many issues posed by recent insider-trading cases and chose instead to resolve the narrow issue presented. Moving forward, individuals and entities grappling with insider-trading investigations and proceedings should be cognizant of the *Salman* Court's unequivocal revalidation of *Dirks* when shaping their strategies.

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