Client Update

Supreme Court's Holding in *Salman v. United States* Leaves Many Important Questions Unanswered

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On December 6, 2016, the U.S. Supreme Court issued its much anticipated decision in *Salman v. United States*,[1] unanimously upholding Bassam Yacoub Salman's conviction for trading based on the basis of material nonpublic information he received from his brother-in-law. Justice Alito's opinion weighed in on the different interpretations of the "personal benefit" requirement for insider trading liability embraced by the Second Circuit in *United States v. Newman*[2] and the Ninth Circuit in *United States v. Salman*,[3] but the Court ultimately provided little clarity on the scope of that requirement beyond how it was first articulated in *Dirks v. Securities and Exchange Commission*.[4] Instead, adhering closely to the *Dirks* formulation of the personal benefit standard, the Court affirmed the Ninth Circuit's decision, holding that a tipper breaches a fiduciary duty by "mak[ing] a gift of confidential information to a 'trading relative[.]'"[5] The Court acknowledged, as it did in *Dirks*, that determining whether an insider personally benefits from a disclosure is a question of fact that "will not always be easy for courts" particularly in "difficult cases" involving more tenuous personal relationships than those at issue in *Salman*.[6] The Court, however, declined to provide further guidance to lower courts regarding the contours of the personal benefit standard as applied in those more difficult cases, thus guaranteeing that the debate around the personal benefit standard will continue.

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1 *Salman v. United States*, No. 15-628 (S. Ct. Dec. 6, 2016).
2 773 F. 3d 438 (2014), *cert. denied*, 577 U.S. ___ (2015).
3 792 F.3d 1087, 1092 (9th Cir. 2015).
4 463 U.S. 646 (1983).
5 *Salman*, 792 F.3d at 1092 (quoting *Dirks*, 463 U.S. at 664).
6 *Salman*, No. 15-1628, slip op. at 11.

BACKGROUND

Salman was charged with one count of conspiracy to commit securities fraud and four counts of securities fraud based on his receipt of material nonpublic information about Citigroup from his future brother-in-law, Michael Kara. Michael Kara had received the information from his brother, Maher Kara, an employee in Citigroup's healthcare investment banking group. Evidence at trial demonstrated that Salman was aware that Michael Kara's information had originated with Maher Kara, and that from 2004 to 2007, Salman and Michael Kara had profited from trading in securities issued by Citigroup clients just before major transactions were announced. The government also put on evidence of the close relationship between the brothers and evidence that Salman was aware of the nature of that relationship given the close ties between the Salman and Kara families. It was undisputed at trial that Maher Kara never received anything of pecuniary value in exchange for the confidential information.

After a jury trial in which Salman was convicted on all counts, he appealed to the Ninth Circuit. While his appeal was pending, the Second Circuit decided *Newman*, reversing the convictions of two portfolio managers who the government alleged had traded on material nonpublic information, finding, among other things, that the government failed to present sufficient evidence that the corporate tippers had received the "personal benefit" necessary to trigger a breach of a fiduciary duty under *Dirks*. Notably, the Second Circuit held that for a jury to infer a personal benefit from a personal relationship between the tipper and tippee, the government must prove 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."[7] The Second Circuit further explained that although *Dirks* indicates that a tipper's gain "need not be *immediately* pecuniary," to form the basis for a fraudulent breach, it must be "of some consequence."[8]

In his Ninth Circuit appeal, Salman argued that the evidence presented at trial was insufficient to sustain his conviction in light of *Newman*. Specifically, Salman argued that the government had failed to establish that Maher Kara disclosed the information to Michael Kara in exchange for a "pecuniary or similarly valuable nature."[9]

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[7] *Newman*, 773 F.3d at 452.
[8] *Id.*
[9] *Salman*, 792 F.3d at 1090.

The Ninth Circuit affirmed Salman's conviction. Citing *Dirks,* the Ninth Circuit made clear that in determining whether the requisite breach of a fiduciary or other duty has occurred, the operative language from *Dirks* that "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"[10] controlled. The court specifically rejected Salman's interpretation of *Newman* and found that Maher Kara knew that Michael Kara was trading on the material nonpublic information and this fact qualified as the "gift of confidential information to a trading relative."[11] In so doing, the Ninth Circuit reasoned that Salman's argument would "require [it] to depart from the clear holding of *Dirks* that the element of breach of fiduciary duty is met where an insider makes a gift of confidential information to a trading relative or friend."[12] The Ninth Circuit noted that *Newman* itself recognized that personal benefit is broadly defined to include not only pecuniary gain, but also the benefit one would obtain from simply making a gift of confidential information to a trading relative or friend.[13] The Ninth Circuit further explained that if Salman's theory were correct, "a corporate insider or other person in possession of confidential and proprietary information would be free to disclose that information to her relatives, and they would be free to trade on it, provided only that she asked for no tangible compensation in return."[14]

The Ninth Circuit concluded that the jury had more than enough facts to infer that Maher Kara gave confidential information to his brother with the intention to benefit him and that while Salman may not have been aware of all of the details of the brothers' relationship, as a close friend and family member through marriage, Salman must have known that when Maher Kara gave the information to Michael Kara, he did so with the "intention to benefit" his brother.[15]

The Supreme Court granted Salman's petition for writ of certiorari on January 19, 2016, to address whether the personal benefit to the insider necessary to establish insider trading under *Dirks* requires proof of "an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature,"[16] as the Second Circuit articulated in *Newman*, or whether it is enough that the insider and the tippee shared a close family relationship, as the Ninth Circuit held in *Salman*.

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[10] *Id.* at 1092.
[11] *Id.* at 1094.
[12] *Id.*
[13] *Id.* (quoting *Newman*, 773 F.3d at 452).
[14] *Id.* at 1094.
[15] *Id.*
[16] *Newman*, 773 F.3d at 452.

In his merits brief, Salman argued that under the Supreme Court's insider trading and fraud precedents, as well as constitutional and interpretative principles, the personal benefit required to support an insider trading conviction must be limited to pecuniary gain. Salman additionally argued that defining a gift as a personal benefit renders the insider trading offense both indeterminate, because liability may turn on facts such as the closeness of the relationship between tipper and tippee and the tipper's purpose for disclosure, as well as overbroad, because the government may avoid having to prove a concrete personal benefit by simply arguing that the tipper meant to give a gift to the tippee.

The government by contrast contended that under *Dirks*, a gift of confidential information to anyone, not just a "trading relative or friend," is enough to prove securities fraud.[17] Accordingly, the government argued that the personal benefit test is satisfied when the objective facts show that information was provided as a gift for securities trading and no corporate purposes exist for the disclosure.[18] The government further argued that any concerns about unlimited and indeterminate liability for remote tippees are mitigated by other statutory elements prosecutors must establish to convict a tippee for insider trading.[19]

THE OPINION

In its decision, the Court held that the Ninth Circuit properly applied *Dirks* in affirming Salman's conviction. The Court reasoned that, under *Dirks*, the jury could infer that the insider personally benefited from making a gift of confidential information to his brother. The Court reiterated that *Dirks* held that when an insider makes a gift of confidential information to a trading relative or friend, the tipper personally benefits because giving a gift of trading information to a trading relative is equivalent to trading by the tipper followed by a gift of the proceeds. The Court found that by disclosing the information to Michael Kara and allowing him to trade on it, Maher Kara effectively achieved the same result as personally trading on information and giving the proceeds as a gift to his brother. The Court noted in particular the close relationship between the brothers, as well as a history of interactions that would suggest the exchanging of favors.

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[17] *Salman*, No. 15-628, slip op. at 7 ("*Dirks*'s personal-benefit test encompasses a gift to any person with the expectation that the information will be used for trading, not just to 'a trading relative or friend'" (quoting 463 U. S. at 664; emphasis in original)).
[18] *Id.*
[19] *Id.*, slip op. at 8.

Finding Salman's conduct "at the heartland of *Dirks*'s rule concerning gifts of confidential information to trading relatives," the Court rejected Salman's appeal to the rule of lenity and his arguments that *Dirks*'s gift-giving standard was "unconstitutionally vague," at least "as applied to this case."[20] The Court found that, at most, Salman showed that "in some factual circumstances assessing liability for gift-giving will be difficult." The Court declined to address those "difficult cases" altogether because this case "involve[d] 'precisely the 'gift of confidential information to a trading relative' that *Dirks* envisioned.'"[21] The Court did not adopt in its analysis the government's expansive view that a gift of information to anyone, not just a relative or friend, would be sufficient to trigger liability, and expressly limited its holding to those gifts involving family or friends.[22]

IMPLICATIONS

Although largely viewed as a victory for the government despite the implicit repudiation of the government's expansive theory that all gifts of information are sufficient to prove securities fraud, the decision fails to clarify the scope of the personal benefit requirement. This is particularly so as applied to more remote tippees and relationships more tenuous than that of close family members or friends. The Supreme Court's articulation of its holding relative to *Newman* seems designed to narrow *Newman*'s reach while not ruling out that its analysis might apply in certain circumstances. The Court made clear that "[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," it agreed with the Ninth Circuit that this requirement was inconsistent with *Dirks*.[23] The decision leaves undisturbed *Newman's* other significant holding that remote tippees must have knowledge of the benefit associated with the original tip because "without establishing that the tippee knows of the personal benefit received by the insider in exchange for the disclosure the [g]overnment cannot meet its burden of showing that the tippee knew of a breach."[24]

What emerges from the Court's opinion is a recognition that the different glosses added by the circuit courts in their articulation of the personal benefit requirement stem in large part from the specific relationships the courts were considering, a complicating factor that limits any efforts to draw any bright lines

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[20] *Salman*, No. 15-628, slip op. at 11.
[21] *Id*. slip op. at 11-12.
[22] *Id*. slip op. at 10.
[23] *Id*.
[24] *Newman*, 773 F.3d at 448.

in this area. In *Newman*, the Second Circuit was confronted with portfolio managers three or four levels removed from the career insider where there was no evidence that the remote tippees personally knew the insider or the immediate tippee and where the only evidence that the government had introduced as to personal benefit included occasional career advice given by the immediate tippee to the tipper (and which started before the disclosure of information in one tipping chain and occasional socializing between the insider and immediate tippee through church activities in the other). It was in this context that the Second Circuit concluded that the "mere fact of a friendship, particularly of a casual or social nature" was insufficient to show a personal benefit to the tipper, observing that "[i]f this was benefit, practically anything would qualify."[25] The Supreme Court unquestionably leaves room for continued scrutiny of personal relationships not involving relatives, as the Court observed that "[i]t remains the case that '[d]etermining whether an insider personally benefits from a particular disclosure, a question of fact, will not always be easy for courts.'"[26] Although the Court declined to address the difficult cases in *Salman*, the development of additional "guiding principles" beyond *Dirks* will continue given the Securities and Exchange Commission's and the Department of Justice's sustained focus on insider trading cases.

Salman underscores the need for clients to consult with sophisticated counsel when facing government investigations and enforcement actions involving suspected insider trading activity. In addition, given the reputational risk of insider trading activity, *Salman* also serves as a reminder to corporations, banks, firms and others that routinely have access to non-public information that robust policies and procedures limiting access to and detecting the disclosure of inside information are essential to efforts to thwart potential disclosures to third parties that might trade or pass on the information.

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Please do not hesitate to contact us with any questions.

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[25] *Newman*, 773 F.3d at 452.
[26] *Salman*, No. 15-628, slip op. at 11 (citing 463 U.S. at 664).