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PERSPECTIVE

Insider trading questions remain

By Thomas Zaccaro, Nicolas Morgan and Jenifer Q. Doan

On Tuesday, the U.S. Supreme Court issued its highly anticipated insider trading decision in *Salman v. United States*, 2016 DJDAR 12012 (Dec. 6, 2016), the first time the Supreme Court has addressed insider trading in nearly two decades. While the court had the opportunity to clarify murky areas of existing judicial interpretation of insider trading liability in the tipping context, its decision was relatively narrow and simply confirmed its prior articulation of tipper liability in *Dirks v. SEC*, 463 U.S. 646 (1983). In doing so, the court left unanswered challenging questions about the scope of insider trading liability with which courts, prosecutors and defense attorneys will continue to grapple.

"Tipping" involves situations in which a corporate insider (the "tipper") provides material non-public information to a third-party (the "tippee") when the tipper "is under a duty of trust and confidence that prohibits [it] from secretly using such information for [its] personal advantage." In *Dirks*, the Supreme Court ruled that a tipper violates that duty when, among other things, he or she discloses inside information in exchange for a "personal benefit." The court granted certiorari in *Salman* on the question of whether this "personal benefit" test requires proof that the tipper received a "tangible" or "pecuniary" gain from the tip, or whether proof that the tipper gifted information to a friend or relative would suffice.

Salman itself involves the tipping of inside information among family members and close friends. Defendant- appellant Bassam Yacoub Salman was convicted of insider trading in 2013 after making profits of approximately $1 million on lucrative stock trades based on inside information he obtained from his future brother-in-law Mounir "Michael" Kara. The original tipper was Michael's brother, Maher Kara, who was an investment banker in Citigroup's healthcare investment banking group. At trial, the evidence demonstrated that Maher and Michael had a very close relationship and that Maher disclosed inside information to Michael "to benefit him with the expectation that [Michael] would trade on the information." Maher also was engaged to and later married Salman's sister, during which time Michael became friendly with Salman and shared Maher's inside information with him.

At trial, to satisfy the "personal benefit" standard, the government presented evidence of Michael and Maher's close relationship and Salman's knowledge that Maher was the original source of the inside information. The jury found Salman guilty of insider trading. Salman appealed and challenged, among other things, the sufficiency of the personal benefit evidence. The 9th U.S. Circuit Court of Appeals affirmed the conviction based on *Dirks*, which held that an insider trading violation occurs "when an insider makes a gift of confidential information to a trading relative or friend." In holding that no pecuniary or tangible benefit

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Outside the Supreme Court in Washington, where Salman v. United States was being heard, Oct. 5, 2016.

was necessary to prove a personal benefit, the 9th Circuit disagreed with the 2nd Circuit's holding in *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014), which required the government to show a meaningfully close relationship between the tipper and tippee "that generates an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature."

The Justices Follow *Dirks*

The Supreme Court's unanimous decision, authored by Justice Samuel Alito, affirmed the 9th Circuit's decision and expressly adhered to *Dirks*. Alito explained that a tippee engages in insider trading when the tipper has breached a fiduciary duty by disclosing inside information to the tippee, and the tippee "participates in the breach of the tipper's fiduciary duty." Determining whether the tipper has breached its fiduciary duty depends on the purpose of the tipper's disclosure to the tippee. "'The test ... is whether the insider personally will benefit, directly or indirectly, from his disclosure.'" Recognizing that "the disclosure of confidential information without personal benefit is not enough" for tipper liability, Alito emphasized that the required personal benefit either can be shown by objective facts, such as a "'pecuniary gain or reputational benefit that will translate into future earnings,'" or inferred from evidence of "'a relationship between the insider and recipient that suggests a quid pro quo from the latter, or an intention to benefit the particular recipient.'" In this later circumstance, Dirks explained that a personal benefit is shown "when an insider makes a gift of confidential information to a trading relative or friend."

Alito concluded that the court would adhere to *Dirks*, "which easily resolves the narrow issue presented here." Evidence in Salman's trial demonstrated that the inside information on which Salman traded was disclosed between family members, and that Maher disclosed that information to Michael for the purpose of giving him a gift. These circumstances, according to the opinion, are not any different from Maher's trading on the information himself and gifting the resulting profits to Michael. With regard to *Newman*, Alito stated that *Newman* is inconsistent with *Dirks* "[t]o the extent [*Newman*] held that the tipper must also receive something of a 'pecuniary or similarly valuable nature' in exchange for a gift to family or friends."

Questions Remain

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Narrow ruling in insider trading case

tion was disclosed between close family members and therefore fit squarely within *Dirks*. The opinion makes clear, as did *Dirks*, that a tipper's gift of inside information between relatives and friends is sufficient to demonstrate a personal benefit and corresponding breach of fiduciary duty by the tipper. Left unresolved by the decision is the type of personal benefit the government must show in *Newman*-like cases where the tippees are not "trading relatives or friends" of the tipper. Indeed, the facts of *Salman* and *Newman* were very different — *Salman* involved the sharing of information between family members and close friends while *Newman* involved tippees who were four or five steps removed from the original tippers.

In their arguments to the Supreme Court, both Salman and the government urged the court to adopt a test that would apply to all tipping scenarios. The government argued that a gift of confidential information to anyone, not just trading relatives of friends, would constitute a personal benefit. Of course, this eliminates the personal benefit test altogether because any disclosure would constitute a "gift," and would potentially criminalize inadvertent disclosures of inside information. On the other hand, Salman argued that the government should always be required to show that the tipper received some tangible, financial gain from the disclosure. Salman further argued that defining a mere gift as a personal benefit is constitutionally invalid because of the uncertainty involved in determining how close a relationship must be to satisfy *Dirks*.

Justice Sonia Sotomayor put her finger on this issue when she questioned the government during oral argument about the "difference between friend and acquaintance." Alito acknowledged that there was "no need for us to address those difficult cases today" given the narrow issue Salman presented, thus leaving courts, prosecutors and defense counsel to continue to grapple with these issues in cases involving mere acquaintances and not "trading relatives or friends."

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