LEXOLOGY

Salman v. United States: Supreme Court Considers Heightened Personal Benefit Standard for Tipper/Tippee Insider Trading Liability

USA | October 5 2016

On October 5, 2016, the United States Supreme Court began hearing argument in *Salman v. United States,* 1 one of the most closely watched insider trading cases to reach the high court in recent years. Salman could resolve a circuit split between the Second and Ninth Circuits and clarify generally what constitutes a personal benefit to the insider sufficient to establish insider trading under the longstanding tippertippee framework set forth in *Dirks v. SEC*, 463 U.S. 646 (1983). The personal benefit requirement is the line defining when a tippee trading on material, nonpublic information commits securities fraud. For that reason, lawyers and securities professionals alike hope that the Court's decision in Salman will clarify the nature and type of personal benefit that must be shown in insider trading cases.

It is well settled that liability for insider trading is not limited only to persons trading for their own benefit. A person may also be subject to liability when an insider or misappropriator in possession of material, nonpublic information (the "tipper") discloses the information to an outsider (the "tippee"), who then trades on the basis of the nonpublic information. However, under these circumstances a tipper is liable for insider trading only if he receives a "personal benefit" for disclosing the information. In *Dirks v. SEC*, 463 U.S. 646 (1983), the tipper divulged confidential information to a tippee in order to expose corporate fraud. The Supreme Court

found that because the tipper did not personally benefit from disclosing the nonpublic information to the tippee, the tipper did not violate insider trading laws. Moreover, Dirks held that in order for liability to extend to a tippee, "the test is whether the insider personally will benefit, directly or indirectly, from his disclosure [to the tippee;] [a]bsent some personal gain, there has been no breach of duty to stockholders . . . [a]nd absent a breach by the insider, there is no derivative breach [by tippees]."2 The Dirks Court also specifically held 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."3 The Ninth Circuit's decision in Salman relied upon this language as it noted that this "quoted language [from Dirks] governs this case."4

The personal benefit rule established in Dirks became a particular source of controversy when the Second Circuit adopted a strict standard for proving a tipper/tippee theory of liability. In *United States v. Newman,* 773 F.3d 438 (2d Cir. 2014), the Second Circuit overturned the conviction of two tippee defendants convicted of insider trading, holding that "in order to sustain a conviction for insider trading, the government must prove beyond a reasonable doubt that the tippee knew that the insider disclosed confidential information and that the insider did so in exchange for a personal benefit."5 The Second Circuit invoked Dirks directly, stating that "[t]o the extent Dirks suggests that a personal benefit may be inferred from a personal relationship between the tipper and tippee, where the tippee's trades `resemble trading by the insider himself followed by a gift of the profits to the recipient,' 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."6 Thus, the Newman decision made it significantly more difficult for the government to win insider trading convictions based on a tipper/tippee theory of liability. Not surprisingly, Newman has been criticized by some, particularly in the law enforcement community, on various grounds including that it misinterpreted the proof of personal benefit needed under the Supreme Court's decision in Dirks. The government petitioned for certiorari in the Newman case and that petition was denied on October 5, 2015.7

On July 6, 2015, the Ninth Circuit decided *United States v. Salman*.8 This case stemmed from insider trading charges brought against Bassam Yacoub Salman for a scheme involving Salman, his brother-in-law, and several other members of both men's family. In approximately 2002, Maher Kara joined a financial firm's health care investment banking group and later began sharing confidential information about the firm's business dealings with his brother, Michael Kara. During this same time period, Maher became engaged to Salman's sister. The Salman and Kara families developed a close relationship, and Salman and Michael in particular developed a very close friendship. From approximately 2004 to 2007, Michael began sharing the inside information he learned from Maher with Salman.

The brokerage records introduced at trial showed that Salman and Michael executed nearly identical trades in securities issued by the firm's clients just before major transactions took place. The government also presented evidence that Salman was aware that his brother-in-law, Maher, was the source of the information he received from Michael. For instance, Michael testified that he directly told Salman that the information they were trading on came from Maher. The government also put forth evidence of a close fraternal relationship between Maher and Michael Kara. Michael had helped pay for Maher's college tuition and also gave a heartfelt speech at his wedding to Salman's sister. Finally, the government put forth evidence that Salman was aware of the close relationship between Michael and Maher, particularly in light of the fact that the Salman and Kara families interacted on a regular basis. It was undisputed at trial that Michael never paid nor provided anything of pecuniary value in exchange for the confidential information.

Salman was indicted on September 1, 2011, for one count of conspiracy to commit securities fraud and four counts of securities fraud based on a tipper/tippee theory. Salman was convicted on all five counts. Salman ultimately appealed this decision to the Ninth Circuit arguing that the government's evidence presented at trial was insufficient in light of the Second Circuit's decision in *United States v. Newman*. More specifically, Salman argued that because the government put forth no evidence that Maher received a tangible benefit in exchange for the information, nor did they put forth any evidence that Salman knew of any such benefit, the government failed to carry its burden under Newman. The Ninth Circuit declined to follow the Newman decision and held that because "Maher's disclosure of confidential information to Michael, knowing that he intended to trade on it, was precisely the `gift of confidential information to a trading relative' that Dirks envisioned."9 As to Salman's knowledge of the personal benefit, the court found that because of the close relationship between Salman and the Kara brothers, Salman could have easily inferred Maher's intent to benefit Michael.10 The Ninth Circuit noted that if Salman's theory were accepted, "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."11

Salman filed a petition for writ of certiorari, which the Court granted on January 19, 2016, on the question of whether "the personal benefit to the insider that is necessary to establish insider trading under Dirks v. SEC, 463 U.S. 646 (1983), requires proof of `an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature,' as the Second Circuit held in United States v. Newman, 773 F.3d 438 (2d Cir. 2014), cert. denied, No. 15-137 (U.S. Oct. 5, 2015)," or whether it is "enough that the insider and the tippee shared a close family relationship as the Ninth Circuit held" in the Salman case?12 Oral argument is set for October 5, 2016.

In the decades since the Dirks decision, the personal benefit requirement has been hotly debated. Many argue that the government has taken an increasingly expansive view of the personal benefit requirement in an effort to prosecute downstream tippers on remote theories of liability. While the Second Circuit's decision in Newman was criticized by some, it signified a welcome clarification in insider trading law, particularly as it applied to more remote tippees. The Court's decision in Salman is significant and marks the first case the Supreme Court has ever heard on a downstream or secondary theory of tipper/tippee liability in an insider trading case. Dirks did not consider remote tippees like Salman and Newman and, as such, there is much at stake here for both the government and private parties.

A potential decision from the Supreme Court on this important issue has attracted the interest of the business community. Mark Cuban, the owner of the Dallas Mavericks and one of the stars of the reality show "Shark Tank," filed an amicus brief in support of Salman. In his brief, he urges the Court to reject what he characterizes as an overly expansive view of insider trading.13 Daryl Payton, a broker from Euro Specific Capital who was convicted of insider trading earlier this year, also filed an amicus brief invoking the facts of his indictment to show that the current state of insider trading laws, particularly as it applies to remote tippees, is "untenable" and needs to be refined.14 Finally, "Occupy the SEC," an outgrowth of the Occupy Wall Street Movement, filed an amicus brief urging the Court to move in the opposite direction and adopt a more expansive concept of insider trading liability.15

The SEC and Department of Justice also have much at stake in the outcome of Salman. Shortly after the Second Circuit's decision in Newman, a district court judge vacated the guilty pleas on insider trading charges by four defendants because the court "was skeptical that the pleas were sufficient in light of Newman's clarification of the personal benefit and tippee knowledge requirements of tipping liability for insider trading."16 In addition, after the Supreme Court denied the government's petition for a writ of certiorari in Newman, federal prosecutors dismissed insider trading charges in similar cases against a portfolio manager from SAC Capital Advisors LP, who was convicted and sentenced to three-and-a-half years in prison, and against six cooperating witnesses who also pleaded guilty. One of those witnesses succeeded in having an SEC administrative bar against him lifted as well.

The Court's consideration of Salman has also affected current insider trading prosecutions. For example, on September 21, 2016, the SEC charged the Chairman and CEO of a registered investment adviser with insider trading. That same day, the defendant wrote a letter to his investors informing them that he was gravely disappointed with the SEC's charges. He also explained that he had been told by the Department of Justice that the US Attorneys

Office which was conducting an investigation parallel to the SEC's had not completed its investigation and had decided to put any potential charges on hold pending the Supreme Court's decision in Salman.

Ultimately, a decision from the Supreme Court in Salman could fill in some of the gaps left in the wake of the Dirks decision. Given the increasing focus of the SEC and the Department of Justice on prosecuting insider trading cases, the Salman decision promises to have significant impact on the enforcement of insider trading law.

Matthew Rossi, Joseph De Simone, Richard M. Rosenfeld , Melanie M. Burke and Brantley Webb