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## Supreme Court Confirms Broad Reach of Insider Trading Liability

Today, the Supreme Court issued its decision in *Salman v. United States*, clarifying the personal benefit standard of insider trading under the federal securities laws. In resolving what it called a “narrow” issue, the Court reaffirmed the long-standing “guiding principle” of *Dirks v. SEC* that disclosing nonpublic material information to a “trading relative or friend,” even without any showing of pecuniary or tangible gain to the tipper, can give rise to criminal insider trading liability.<sup>1</sup> In such situations, the Court concluded, giving is as good as receiving, “the commonsense point . . . made in *Dirks*.”<sup>2</sup> That is, the “tip and trade resemble trading by the insider followed by a gift of the profits to the recipient.”<sup>3</sup> *Salman* thus underscores that market participants should continue to exercise vigilance when disseminating or receiving any material nonpublic information.

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The Court’s decision today resolves a brewing dispute among the lower courts concerning the scope of tipper-tippee liability in insider trading cases. In particular, the Supreme Court took up *Salman* to decide whether a tipper had received a personal benefit for purposes of insider trading liability when he or she makes a gift of material nonpublic information to a relative who thereafter trades on that information. The Supreme Court answered in the affirmative, overturning some lower courts, including the Second Circuit, which had previously held that a tipper must also receive something of a “pecuniary or similarly valuable nature” in exchange for the tip.

The disagreement among federal courts over the definition of personal benefit, which has caused uncertainty among regulated professionals and their business networks and social contacts, stems from the Supreme Court’s last ruling on this issue, made more than three decades ago in 1983. In *Dirks v. SEC*, the Court explained that an unlawful personal benefit could be either a benefit that was effectively a cash equivalent, such as “pecuniary gain or a reputational benefit that will translate into future earnings” or, alternatively, “mak[ing] a gift of confidential information to a trading relative or friend.”<sup>4</sup>

In 2014, the Second Circuit in *United States v. Newman* held that a corporate insider who made a gift of confidential information could not be held criminally liable unless the insider also received a personal benefit that “represent[ed] at least a potential gain of a pecuniary or similarly valuable nature.”<sup>5</sup> In the 2015 *United States v. Salman* decision, however, the Ninth Circuit rejected the Second Circuit’s limited reading of *Dirks* and affirmed an insider trading conviction on the basis of an insider who had simply “ma[de] a gift of confidential information to a trading relative or friend.”<sup>6</sup> Today, the Supreme Court affirmed the Ninth Circuit’s decision and thereby overruled the Second Circuit’s more limited reading of insider trading liability.

<sup>1</sup> *Salman v. United States*, 580 U.S. \_\_\_, Op. at 8 (2016).

<sup>2</sup> *Id.* at 11.

<sup>3</sup> *Id.* at 10 (quoting *Dirks v. SEC*, 463 U.S. 646, 663 (1983)).

<sup>4</sup> 463 U.S. 646, 663-64 (1983).

<sup>5</sup> 773 F.3d 438, 451- 452 (2d Cir. 2014).

<sup>6</sup> 792 F.3d 1087, 1092 (9th Cir. 2015).

## The *Salman* Decision

*Salman* centered on the relationship, and exchange of insider information, between two brothers, one of whom worked at a large investment bank.<sup>7</sup> For more than two years, Maher Kara, who was the banker and the defendant's brother-in-law, "regularly disclosed" to his brother, Michael Kara, information about upcoming mergers and acquisitions of and by the bank's clients.<sup>8</sup> Michael traded on that information and also passed it along to Bassam Salman, the defendant.<sup>9</sup> Salman in turn gave the information to another relative, Karim Bayyouk.<sup>10</sup> Salman and Bayyouk, the downstream tippees, then traded on the information and netted over \$1.5 million in profits.<sup>11</sup>

The Ninth Circuit found that Maher had disclosed the confidential information knowing that Michael intended to trade on it.<sup>12</sup> According to the Ninth Circuit, the government had met its burden under *Dirks* because Maher had testified that, by providing Michael with inside information, Maher intended to benefit his brother and to fulfill whatever needs he had.<sup>13</sup> On one occasion, for example, after Michael requested a favor because he "owe[d] somebody" but turned down Maher's offer of money, "Maher gave him a tip about an upcoming acquisition instead."<sup>14</sup> To the Ninth Circuit, this was "precisely the 'gift of confidential information to a trading relative' that *Dirks* envisioned."<sup>15</sup>

The Supreme Court agreed, concluding that, under the long-standing rule set forth in *Dirks*, an insider effectively receives a concrete personal benefit where the disclosure of confidential information is made to a "trading relative or friend."<sup>16</sup> The Court explained that when a tipper gives inside information to a trading relative or friend "the tipper benefits personally because giving a gift of trading information is the same thing as trading by the tipper followed by a gift of the proceeds."<sup>17</sup> In *Salman*, the corporate insider, Maher, "would have breached his duty had he personally traded on the information . . . himself [and] then given the proceeds as a gift to his brother."<sup>18</sup> By disclosing the information to his brother and allowing him to trade on it, "Maher effectively achieved the same result."<sup>19</sup> The Court also overturned *Newman* to the extent it "held the tipper must receive something of a 'pecuniary or similarly valuable nature' in exchange for a gift to family or friends."<sup>20</sup>

Notably, however, the Court's *Salman* narrow ruling is limited to tips made to friends and family. It leaves open the possibility that tips made to acquaintances may be subject to a different standard and may, for example, still require the exchange of something "pecuniary or similarly valuable" to result in insider trading liability. And it leaves undisturbed the requirement that the government show that a trading defendant knew that a corporate insider received a personal benefit in exchange for the tip.

## Implications

*Salman* makes clear that the Court's decades-old *Dirks* decision set forth the correct standard for the definition of personal benefit. Under the right circumstances, as exemplified by *Salman*, the government may prosecute tippers and tippees where the insider conferred gifts or profits to a relative or friend. Thus, in *Salman*'s wake, government

<sup>7</sup> *Id.* at 1088-89.

<sup>8</sup> *Id.* at 1089.

<sup>9</sup> *Id.*

<sup>10</sup> *Id.*

<sup>11</sup> *Id.*

<sup>12</sup> *Id.* at 1092.

<sup>13</sup> *Id.*

<sup>14</sup> *Id.* at 1089.

<sup>15</sup> *Id.* at 1092.

<sup>16</sup> *Op.* at 10 (2016).

<sup>17</sup> *Id.*

<sup>18</sup> *Id.* at 9.

<sup>19</sup> *Id.*

<sup>20</sup> *Id.* at 10.

regulators will likely pursue insider trading cases with increased vigor. Absent a need to show that a corporate tipper disclosed confidential information for a tangible benefit or pecuniary gain, the government will likely launch more investigations and litigate more cases involving exchanges with only social or reputational benefits to the tipper. In particular, arrangements in *Salman*'s mold, where a corporate insider disseminates confidential information to a family member in order to obtain private advantage, may attract increased scrutiny from the government. All told, *Salman* may make it easier for the government to go after downstream tippees, including those who are multiple levels removed from the corporate insider, as long as they possess knowledge of the initial exchange that was made for direct or indirect personal benefit.

After *Salman*, corporate professionals are advised to trade with at least the same diligence and care as they have always undertaken. Legal and compliance departments are encouraged to continue monitoring trading activity and encouraging an open dialogue with employees regarding the dissemination and receipt of material nonpublic information. That said, the personal benefit test is a legal issue that need not influence trading decisions. Regulators will likely assess whether there was a personal benefit only after the government has issued a subpoena or otherwise initiated an investigation. But in the meantime, government enforcement activities carry the risk of reputational harm to the business, distraction from core business concerns, and added legal fees and expenses.

If you have any questions, or would like to discuss the above or any related matter, please contact the Ropes & Gray attorney with whom you regularly work.