

Litigation Alert

December 8, 2016

United States v. Salman: Supreme Court Reaffirms “Friends With Benefits” Test In Insider Trading Cases

On December 6, 2016, in an opinion written by Justice Alito, the Supreme Court unanimously affirmed the Ninth Circuit’s decision in *Salman v. United States*, a closely-watched insider trading tipping case. *Salman* builds upon *Dirks v. SEC*, 463 U.S. 646 (1983), a landmark decision in insider trading law decided more than thirty years ago. In *Dirks*, the Supreme Court established the basic template for tipper-tippee liability, holding that: (a) a tipper is liable if he or she discloses material nonpublic information to someone else in breach of a fiduciary duty and in order to receive a personal benefit; and (b) a tippee is liable if he or she knows that the tipper has disclosed inside information in breach of a duty and for a personal benefit, but trades on the basis of the information anyway. 463 U.S. at 659-60.

In *Salman*, the Court clarified the nature of the “personal benefit” that must be established in tipper-tippee insider trading cases. Under *Salman*, the government is not necessarily required to prove that tippers receive a concrete, pecuniary benefit in exchange for their tips; rather, liability can be established if a tipper provides inside information as a gift to a trading relative or friend. Though *Salman* pares back one aspect of the Second Circuit’s landmark 2014 decision *United States v. Newman*, 773 F.3d 438 (2014), key questions remain undecided, including: (1) how close the relationship between the tipper and tippee must be under the “gift” theory of personal benefit, and (2) what happens in the absence of clear evidence that the tipper intended to provide a gift to the tippee. The *Salman* decision also appears to resolve a longstanding ambiguity in *Dirks* by making clear that in order to incur liability, the tippee must have actually known of the tipper’s breach of duty and consequent personal benefit.

As previously [reported](#), Petitioner Bassam Salman (the trading tippee) was convicted of conspiracy and insider trading following a jury trial, based on trades that he made using material, nonpublic information he obtained from his brother-in-law (the intermediary tippee), who, in turn, had obtained the information from his brother, a former investment banker at Citigroup (the tipper). The tipper was aware that his brother, the intermediary tippee, traded on the information that he had provided, but was unaware that his brother also passed the inside information to others, including Salman. The evidence established that Salman, by contrast, knew that the tipper had made a gift of trading information to his brother, the intermediary tippee.

Before the Ninth Circuit considered Salman’s case, the Second Circuit issued its *Newman* decision (as previously [reported](#)), which required the government in tipper/tippee insider trading cases to present “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.” *Newman*, 773 F.3d 438, 452 (2d Cir. 2014). Relying on *Newman*, *Salman* argued before the Ninth Circuit

that his conviction should be thrown out because there was no evidence that the tipper received a “pecuniary or similarly valuable” benefit from his brother in exchange for providing the inside information. The Ninth Circuit disagreed, holding that under *Dirks*, a tippee can be held liable as part of an insider trading prosecution “when an insider makes a gift of confidential information to a trading relative or friend.” *U.S. v. Salman*, 792 F.3d 1087, 1092 (9th Cir. 2015) (quoting *Dirks*, 463 U.S. at 664). The Ninth Circuit therefore held that “[p]roof that the insider disclosed material nonpublic information with the intent to benefit a trading relative or friend is sufficient to establish the breach of fiduciary element of insider trading,” with no proof of something resembling a “pecuniary” benefit necessary. *Id.* at 1094.

In *Salman*, the Supreme Court endorsed the Ninth Circuit’s approach, holding that *Dirks* “easily resolve[d]” the case. Slip Op. at 8. As the Court held, under *Dirks*, a tipper is liable for disclosures of inside information that will allow the tipper to “personally benefit, directly or indirectly, from his disclosure.” *Id.* at 8-9 (quoting *Dirks*, 463 U.S. at 662-63). *Dirks* identified two clear-cut examples of a personal benefit for the tipper: “pecuniary gain” (e.g. a cash kickback from the tippee) and a “reputational benefit that would translate into future earnings” (e.g. the tipper cultivates a relationship with an influential tippee, who helps him get a more lucrative job). See *id.* at 9 (quoting *Dirks*, 463 U.S. at 663). However, under *Dirks* these are not the only ways that a personal benefit can be established: “[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.* at 9 (quoting *Dirks*, 463 U.S. at 664) (emphasis added by Court in *Salman*). “In such cases, [t]he tip and trade resemble trading by the insider followed by a gift of the profits to the recipient.” *Id.* (quoting *Dirks*, 463 U.S. at 664).

The Court concluded that the gift theory of personal benefit from *Dirks* squarely applied to the case against *Salman*. In *Salman*, the tipper provided information to a “close relative” – his brother, the intermediary tippee. It is perfectly clear that the tipper would have incurred liability had he personally traded on the information and given the proceeds to his brother as a gift. Instead, the tipper achieved the “same result” by giving the material, nonpublic information to his brother, the intermediary tippee, and allowing him to trade on it. As the *Salman* court reasoned, “*Dirks* specifies that when a tipper gives inside information to ‘a trading relative or friend,’ the jury can infer that the tipper meant to provide the equivalent of a cash gift.” *Id.* at 10. In *Salman* this inference was especially powerful because in one instance, the intermediary tippee had asked his brother for a favor; the brother offered money but the intermediary tippee asked for information instead. See *id.* at 11. This shows the essential equivalence, on the facts of the *Salman* case, of inside information and money.

The Court concluded that because the tipper disclosed confidential information as a gift to his brother “with the expectation that he would trade on it,” the tipper breached his duty of trust and confidence to Citigroup and its clients. *Id.* at 10. *Salman*, the tippee, acquired this duty and breached it “by trading on the information with full knowledge that it had been improperly disclosed.” *Id.* Alluding to *Newman*, the Court noted 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, . . . we agree with the Ninth Circuit that this requirement is inconsistent with *Dirks*.” *Id.* at 10.

Requirement that the Tippee Must Know that the Tippee Received a Personal Benefit

As previously [reported](#), the Second Circuit in *Newman* separately held that, in order for a tippee to be liable for insider trading, the government must prove that he or she knew of the tipper's breach of duty and the associated personal benefit. This knowledge requirement was not at issue in the *Salman* appeal, see Slip Op. at 5 n.1., but language in *Salman* indicates that the Court agreed with the Second Circuit's knowledge requirement. Near the beginning of the opinion the Court stated that "[t]he tippee acquires the tipper's duty to disclose or abstain from trading if the tippee knows the information was disclosed in breach of the tipper's duty," *id.* at 2 (emphasis added), and the Court made clear that *Salman*, the trading tippee, had "full knowledge" that the inside information had been improperly disclosed (i.e. for a personal benefit). See *id.* at 10.

The *Salman* Court's clear and straightforward statement of the tippee's knowledge requirement would seem to clarify what has long seemed to be a bit of loose language in *Dirks*, where the Court stated that the tippee can be liable if he or she "knows or should know that there has been a breach." 463 U.S. at 660. The "knows or should know" formulation, which suggests a negligence theory that is incompatible with any recognized understanding of securities fraud under Section 10(b) of the Securities Exchange Act, has caused confusion in the lower courts as exemplified in the Second Circuit's difficult-to-follow decision in *SEC v. Obus*. See 693 F.3d 276 (2d Cir. 2012). One hopes that *Salman* will now put to rest any lingering questions about the nature of the knowledge requirement for tippee liability.

Salman's Narrow Ruling Leaves Open Several Difficult Questions

Though *Salman* makes clear that providing inside information as a gift to a close friend or family member is sufficient to satisfy the "personal benefit" element of tipper/tippee insider trading, the Court resolved only the "narrow issue" presented in the case—namely, whether a fact-finder may infer "personal benefit" when the tipper "mak[es] a gift of confidential information to a trading relative" or friend. The Court did not address several more "difficult" questions, and acknowledged that "[d]etermining whether an insider personally benefits from a particular disclosure, a question of fact, will not always be easy for courts." Slip Op. at 11 (quoting *Dirks*, 463 U.S. at 664).

The Court did not resolve whether its analysis in *Salman* would apply to situations where the tipping is not between close friends or family members. In more ambiguous situations – e.g. an alleged tip to a casual acquaintance – the Second Circuit's analysis in *Newman* will be helpful in determining whether the relationship between the tipper and tippee is close enough to fall under the *Dirks/Salman* analysis. In *Newman*, the Second Circuit noted that if the government could "meet its burden by proving that two individuals were alumni of the same school or attended the same church, the personal benefit requirement would be a nullity." *Newman*, 773 F.3d at 452. We can expect further push and pull between the government and defense counsel on this issue. The government's brief in *Salman* suggests that its position would be that "a gift of confidential information to *anyone*, *not just a 'trading relative or friend,'* is enough to prove securities fraud." Slip Op. at 7 (quoting government's brief) (emphasis added).

Second, *Salman* does not resolve what will happen when the source of the material nonpublic information—the would-be “tipper”—is simply boasting or engaging in loose talk about work, and there is no direct evidence that they intended to provide a gift to the would-be “tippee.” The Supreme Court’s analysis in *Salman* suggests that in these circumstances the government may have difficulty proving that the “personal benefit” requirement has been met. The Court noted that in *Dirks*, the Court had found “it dispositive that the tippers ‘received no monetary or personal benefit’ from their tips to Dirks, ‘nor was their purpose to make a gift of valuable information to Dirks.’” *Id.* at 9 (quoting *Dirks*, 463 U.S. at 667) (emphasis added by *Salman* Court). Such analysis suggests that when the tipper does not intend a “gift” of information to the tippee, liability cannot attach. However, we may expect the government will attempt to rely on circumstantial evidence to fill this gap, or, if possible under the facts of the case, change gears and rely on SEC Rule 10b5-2 to transform the tipper/tippee case to one of misappropriation by arguing that the source (a/k/a the tipper) had an expectation of confidentiality, and the trader (a/k/a the tippee) breached their own duty of trust or confidence.

Ultimately, it is clear that though *Salman* pared back the *Newman* decision, the Supreme Court did not address many of the vexing and fact-specific questions that attend questions of personal benefit and breach of duty. Courts will likely continue to grapple with these issues for some time, especially within the Second Circuit, where many insider trading cases have been litigated.

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