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## Insider Trading Showdown: “Personal Benefit” to be Tested at the U.S. *By Robert Hoff and Ivana Greco*

By granting cert and agreeing to hear an appeal from the Ninth Circuit Court of Appeals’ decision in *United States v. Salman*, 792 F.3d 1087 (9th Cir. 2015), the U.S. Supreme Court may clarify the scope of the “personal benefit” prong of insider trading law. Clarity on this aspect of insider trading law could be a welcome development for prosecutors, defendants and their counsel, traders and compliance professionals. The Supreme Court’s case also has the potential to upend the most significant insider trading case in recent history, the Second Circuit Court of Appeals’ decision in *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014).

### IT STARTS WITH DIRKS

A recitation of all the elements and permutations of insider trading law as it might be applied to different factual scenarios is unnecessary for purposes of this article. For present purposes, it is worth briefly stating the pertinent elements of tipper/tippee liability, as it is the tipper/tippee scenario that the Supreme Court is likely to address.

The tipper/tippee scenario applies when an insider – the tipper – shares material nonpublic information with someone – the tippee – who trades on the information. There can be multiple tippers and tippees in a chain of communications, and the elements of insider trading liability must be proven as to each tippee in the chain of communications for that tippee to be liable.

A discussion of the elements of tipper/tippee liability starts with the seminal U.S. Supreme Court case, *Dirks v. S.E.C.*, 463 U.S. 646 (1983). The Court held that “a tippee assumes a fiduciary duty to the shareholders of a corporation not to trade on material nonpublic information only when the insider has breached his fiduciary duty to the shareholders by disclosing the information to the tippee and the tippee knows or should know that there has been a breach.” *Id.* at 660. Moreover, in determining whether the insider/tipper breached his fiduciary duty by sharing material non-public information, “the test is whether the insider personally will benefit, directly or indirectly, from his disclosure. Absent some personal gain, there has been no breach of duty to stockholders.” *Id.* at 662. And because a tippee’s liability derives from the tipper’s, “absent a breach by the insider, there is no derivative breach” by the tippee. *Id.*

The Court also addressed what a personal benefit meant for purposes of this analysis. It held that, determining whether the tipper shared information in breach of a duty to the insider “requires courts to focus on objective criteria, i.e., whether the insider receives a direct or indirect personal benefit from the disclosure, *such as a pecuniary gain or a reputational benefit that will translate into future earnings*. There are objective facts and

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circumstances that often justify such an inference. For example, there may be a relationship between the insider and the recipient that suggests a *quid pro quo* from the latter, or an *intention to benefit the particular recipient*.” *Id.* at 663-64 (emphasis added; citations omitted). The Court then stated that “[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 664 (emphasis added). It is this latter part of the analysis that has generated significant debate and which *Newman* directly addressed.

### ALONG CAME NEWMAN

In 2014, the Second Circuit Court of Appeals in *Newman* sent shockwaves through the securities industry when the Court overturned the insider trading convictions of two individuals. Significantly, the Court held that, to prove the personal benefit prong of insider trading law where the personal benefit is premised on a relationship or friendship (as opposed to, say, an exchange of money), prosecutors must prove that a tipper and tippee had “a meaningfully close personal relationship that generates an exchange that is objective, consequential, and represents at least a potential gain of pecuniary or similarly valuable nature.” 773 F.3d at 452. In other words, as the Court said, the exchange of information had to include a *quid pro quo* from the tippee or an intention to benefit the tippee because of the relationship between the tipper and tippee. *Id.* The Court noted that the “mere fact” that the tipper and tippee are friends is not always enough to prove a personal benefit to the tipper, especially if the relationship between them is casual or social in nature. *Id.* *Newman* also held that

all tippees, including remote tippees as the defendants in *Newman* were, must have knowledge of the personal benefit to the tipper to be liable.

Although *Newman* was arguably just interpreting the plain language of *Dirks*, the case was important because it seemed to scale back what had previously been interpreted as a very broad definition of “personal benefit.” Following *Dirks*, especially its statement that a personal benefit to the tipper could exist when “an insider makes a gift of confidential information to a trading relative or friend,” 463 U.S. at 664, courts across the country allowed many types of relationships between tipplers and tippees to qualify as a personal benefit to the tipper even absent evidence of a tangible *quid pro quo*. Those cases theorized, very generally speaking, that a tipper necessarily benefited from sharing information with a friend or relative by the mere fact of furthering the relationship. But *Newman* held that mere friendship, or a social or casual relationship, is not always enough.

After *Newman*, many questioned how its personal benefit standard would be applied in future cases. In particular, how close must the relationship be between tipper and tippee to satisfy the personal benefit prong? Would courts conclude that some family relationships were closer than others, such as those between siblings versus those between cousins? Would factual issues arise as to the degree of “closeness” between family members or friends? Would courts infer an “intention to benefit” some close family members, but not other family members?

### SALMAN MAY ANSWER THE QUESTIONS

The U.S. Supreme Court denied cert in *Newman*, leaving the case standing as the law in the Second Circuit, and as an important decision for other jurisdictions to consider. But in *United States v. Salman*, the U.S. Supreme Court may soon provide answers to the questions *Newman* left open.

The pertinent facts of *Salman* are as follows. Salman’s brother-in-law, Maher Kara, worked at Citigroup. He regularly shared confidential inside information about upcoming mergers and acquisitions with his brother, Michael Kara, who traded on the information. After Maher married Salman’s sister, the families grew close and Salman and Michael became friends.

Michael began to share with Salman the inside information that he learned from Maher, and Salman also began to trade on the information. 792 F.3d at 1089.

The government presented evidence that Salman knew Maher was the source of the information. The government also presented evidence that Maher and Michael enjoyed a “close and mutually beneficial relationship,” including that “Michael helped pay for Maher’s college, that he stood in for their deceased father at Maher’s wedding,” and that “Michael coached Maher in basic science to help him succeed at his job.” *Id.* Furthermore, Maher testified that he loved Michael very much, and that he gave Michael the inside information to benefit him and fulfill whatever needs Michael had. For example, Michael once asked Maher for money, and instead of providing the money, Maher gave Michael a tip

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about an upcoming acquisition. *Id.* The government further presented evidence that Salman knew of Maher and Michael’s close relationship. A jury convicted Salman of conspiracy and insider trading based on these facts.

Salman appealed his conviction, arguing, among other things, that the evidence was insufficient to satisfy *Newman*’s personal benefit test, which he urged the Ninth Circuit to adopt. In particular, he contended that the evidence was insufficient to find that Maher disclosed information to Michael in exchange for a “tangible” personal benefit, which he claimed *Newman* required. *Id.* at 1090, 1093. The evidence of the close relationship between Maher and Michael was not enough according to Salman’s interpretation of *Newman*, because Maher did not receive a tangible benefit from Michael in exchange for the information Maher shared.

The Ninth Circuit declined to adopt *Newman* (at least, Salman’s interpretation of it), and relied instead, on *Dirks*’ holding that a personal benefit is satisfied by “a gift of confidential information to a trading relative or friend.” *Id.* at 1092 (quoting *Dirks*, 463 U.S. at 664). The Court easily held that the evidence satisfied *Dirks*.

As to Salman’s reading of *Newman*, which would have required a “tangible” benefit from Michael to Maher in exchange for information, the Ninth Circuit held that such a reading would require an impermissible departure from *Dirks*. Moreover, under Salman’s reading of *Newman*, “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.” *Id.* at 1094. But that is not the *Dirks* test. Rather, the Ninth Circuit 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 duty element of insider trading.” *Id.*

After the Ninth Circuit’s ruling, Salman petitioned the Supreme Court for a writ of certiorari. The Court granted cert on the following question:

Does the personal benefit to the insider that is necessary to establish insider trading under *Dirks v. SEC*, 463 U.S. 636 (1983), require 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 is it enough that the insider and the tippee shared a close family relationship, as the Ninth Circuit held in this case?

### NEWMAN, SALMAN AND THE SUPREME COURT

Arguably, the outcomes in *Salman* and *Newman* are entirely consistent. While the *Salman* Court declined to adopt the defendant’s interpretation of *Newman* as requiring a tangible benefit, it is likely that Salman’s conviction would have been upheld under the *Newman* test. After all, *Newman* acknowledged that *Dirks* held that the personal benefit prong could be satisfied by evidence that the tipper and tippee had such a close relationship that

the tipper intended to benefit the tippee because of the relationship. *Newman*, 773 F.3d at 452. That standard is likely satisfied where one sibling tips another and testifies that he did so in order to benefit his sibling, which is what occurred in *Salman*. The tougher question from *Newman* is whether the outcome would be the same for a less “close” family relationship. *Salman* did not present that closer question.

Even though the outcomes of *Salman* and *Newman* may be consistent, the reasoning of the two opinions appears to be in tension. The U.S. Supreme Court’s decision to take on *Salman* and the personal benefit question presents the Court with the opportunity to clarify what the personal benefit standard is for courts across the country. Its decision has the potential to be groundbreaking. One only needs to consider the immediate impact *Newman* has had on the federal government’s pending and concluded insider trading cases – resulting in guilty pleas being reversed and cases being dropped – to realize that *Newman* raised the bar for prosecutors and likely slowed their efforts to prosecute insider trading.

If the Supreme Court rejects the *Newman* standard, or announces a standard that is more lenient than *Newman* has been interpreted to be, prosecutors may be given renewed motivation to pursue insider trading cases. In all events, expect the Supreme Court’s *Salman* decision to clarify the scope of the personal benefit test so interested parties – prosecutors, defense lawyers, traders, and compliance professionals – have a better idea of the scope of insider trading law.