

CLIENT ALERT

The Gift of Giving: Supreme Court Upholds Conviction in *Salman* Insider Trading Case

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On December 6, 2016, the United States Supreme Court unanimously affirmed a conviction for conspiracy and securities fraud in connection with insider trading. *Salman v. United States*, 580 U.S. ____ (2016). The Court held that a corporate insider's gift of confidential information to a trading relative or friend is enough to infer that the insider received a personal benefit. Justice Alito delivered the highly anticipated opinion, which addresses the tension between the Ninth Circuit's decision in this case and the Second Circuit's decision in *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014), *cert. denied*, 577 U.S. ____ (2015).

In *Salman*, the Court reaffirmed the broad interpretation of tippee liability in insider trading cases and set aside the Second Circuit's *Newman* ruling with respect to what constitutes a "personal benefit." The *Newman* decision raised the bar for prosecutors in tipper-tippee insider trading cases, requiring the government to show that the tipper expected (and the tippee was aware of) a *quid pro quo* or pecuniary benefit in return for sharing the confidential information. Now, in the post-*Salman* world, the government will be able to pursue insider trading cases even when it cannot establish that the insider was expecting a benefit in exchange for the tip, as long as the tip is made to a trading relative or friend. Not surprisingly, insider trading cases rarely involve tips to complete strangers.

Background

The *Salman* case involved three primary players: Maher Kara, Michael Kara, and Bassam Salman. Maher worked at a financial institution's healthcare investment banking group and had access to highly confidential information about mergers and acquisitions involving its clients. Maher began sharing inside information with his older brother, Michael, who executed trades based on this confidential information. After receiving "tips" from his brother, Michael occasionally shared this information with Salman, who was Michael's friend and Maher's brother-in-law. Salman traded on this inside information and accumulated over \$1.5 million in profits, which he split with another relative who executed trades via a brokerage account on Salman's behalf.

Salman was indicted in the Northern District of California on one count of conspiracy to commit securities fraud (18 U.S.C. § 371) and four counts of securities fraud (15 U.S.C. §§ 78j(b), 78ff; 18 U.S.C. § 2; 17 C.F.R. § 240.10b-5). Maher and Michael both pleaded guilty and testified at Salman's trial. Ultimately, Salman was convicted on all counts and sentenced to 36 months of imprisonment, three years of supervised release, and over \$730,000 in restitution.

Salman appealed to the Ninth Circuit. While his appeal was pending, the Second Circuit issued its opinion in *Newman*. The *Newman* court recognized that in order to sustain an insider trading conviction, the government must prove that the tippee was aware that the tipper disclosed confidential information in exchange for a personal benefit. Moreover, the court held that although a factfinder may infer a personal benefit from a gift of inside information to a trading relative or friend, 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."

Relying on *Newman*, Salman argued that his conviction should be reversed because there was no evidence that Maher received anything of “a pecuniary or similarly valuable nature” in exchange for his sharing of inside information. The Ninth Circuit rejected Salman’s argument and declined to follow *Newman*. Instead, the Ninth Circuit adhered to the holding in *Dirks v. SEC*, 463 U.S. 646 (1983), which provided that a tipper personally benefits from making a gift of confidential information to a trading relative or friend, even without receiving or expecting to receive something of pecuniary value.

The Court’s Opinion

Salman appealed his conviction to the Supreme Court, arguing that an insider’s gift of confidential information to a trading relative or friend is not enough to establish securities fraud. Specifically, Salman sought to narrow *Dirks*’s “friends and family” holding, arguing that a tipper cannot personally benefit unless the tipper’s goal in disclosing the inside information is to obtain money, property, or something of tangible value. The government disagreed, contending that a tipper personally benefits whenever the tipper discloses confidential trading information to anyone (friend, family member, or anyone else) for a noncorporate purpose. Thus, the government actually sought to expand the *Dirks* holding and establish liability whenever there is a gift of inside information, regardless of the relationship between the tipper and the tippee.

Agreeing with the Ninth Circuit, the Supreme Court adhered to its holding in *Dirks*, which the Court said “easily resolves the narrow issue presented here.” The Court stated that “*Dirks* makes clear that a tipper breaches a fiduciary duty by making a gift of confidential information to a ‘trading relative,’ and that rule is sufficient to resolve the case at hand.”

Specifically, the Court relied on the “gift-giving principle” articulated in *Dirks* and refashioned it as the “gift of giving” insofar as it concluded the gift giving is a personal benefit to the giver. In this context, the Court explained that under *Dirks*, when a tipper shares confidential information with a trading relative or friend, the jury can infer that the tipper intended to provide the equivalent of a cash gift. The Court stated that in these situations, “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.” Accordingly, the Court found that Maher’s gift of inside information to his brother Michael was essentially the same as if Maher traded on the inside information and gifted the profits to Michael. “The tipper benefits either way.” Thus, it is not necessarily better to give than to receive when traders are utilizing material nonpublic information to make trading decisions.

Importantly, the Court explicitly rejected *Newman*’s “pecuniary gain” requirement, stating 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 and friends, *Newman*, 773 F.3d at 452, we agree with the Ninth Circuit that this requirement is inconsistent with *Dirks*.”

Impact and Reaction

For the last two years, the *Newman* decision temporarily reshaped insider trading law. By limiting the scope of tipper-tippee liability, *Newman* restricted the government’s ability to prosecute insider trading cases. Preet Bharara, U.S. Attorney for the Southern District of New York, warned that *Newman* would allow certain conduct to “go unpunished” and that it could lead to “a potential bonanza for friends and family of rich people with material non-public information.” In the wake of the decision, dozens of insider trading defendants sought to have their claims dismissed as a result of the ruling, and others relied on *Newman* in moving to have administrative bars lifted.

However, the *Salman* decision has put an end to the uncertainty. For defendants hoping that *Newman* would overturn their convictions, *Salman* appears to be a death knell. The Supreme Court’s decision reinforces a broad interpretation of insider trading laws, allowing the government to prosecute individuals who trade on inside information disclosed by their friends or relatives. Bharara commented on the *Salman* ruling, saying that “[t]he court stood up for common sense and affirmed what we have been arguing from the outset—that the law absolutely prohibits insiders from advantaging their friends and relatives at the expense of the trading public.”

It remains to be seen how *Salman* will affect cases involving hedge fund tippee chains, like *Newman*, for example. In the context of remote tippee liability, how far down the chain does liability extend? What level of friendship or family relationship is sufficient to allow the “personal benefit” inference? How valuable is the “gift of giving” to a tipper?

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