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INSIDER TRADING

Salman v. United States: The Supreme Court Opts for Narrow Ruling Instead of Clarity

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On December 6, 2016, a unanimous Supreme Court affirmed the Ninth Circuit's *Salman v. United States* pro-government decision in a narrow ruling, resolving the question of whether a demonstration of ''pecuniary gain'' on behalf of the tipper of inside information is necessary to impose insider trading liability on both the tipper and the tippee. In determining that no such requirement existed in the context of a trading relative or friend, the Supreme Court disagreed with the holding of *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014). The Supreme Court's comments and questions during oral argument foreshadowed that it would affirm the Ninth Circuit's decision in *Salman*, but the unanimity indicates the Supreme Court's determination to closely follow precedent as opposed to any conservative or liberal view.

What does the *Salman* decision mean for insider trading liability going forward? Other than reiterating the ''gift'' standard of *Dirks v. SEC*, 463 U.S. 646 (1983), the Supreme Court's succinct 12-page opinion does little in the way of offering any new guidance to lower courts on how to interpret and apply the gift test or the personal benefit test outside of the context of tips to friends or relatives. Because *Salman* involved ''precisely the 'gift of confidential information to a trading relative' that *Dirks* envisioned,'' the Court declined to provide guidance on what it described as the more ''difficult cases,'' while conceding that ''determining whether an insider personally benefits from a particular disclosure . . . will not always be easy for courts.'' Put simply, the *Salman* decision unfortunately does little to answer the questions created by *Dirks* and its progeny, such as what constitutes a ''close relationship,'' leaving courts and practitioners to continue protracted, fact-specific battles regarding tipper-tippee liability.

Not to be overlooked, especially for hedge fund managers, the Supreme Court left untouched part of the *Newman* holding that prosecutors must prove that information traded on came from insiders or that the insiders received a personal benefit in exchange for the tips. Therefore, *Newman's* holding still presents challenges for prosecutors for ''downstream'' tipping cases.

1. Background of Salman v. United States

Salman involved a web of familial relationships, which ultimately provided the Supreme Court with an easy opportunity to issue a narrow opinion focused specifically on *Dirks*' ''gift'' test. Defendant-Appellant Bassam Yacoub Salman was convicted of insider trading in 2013 after making profits of approximately $1 million on lucrative stock trades based on inside information he obtained from his future brother-in-law Mounir Kara (''Michael''). The original tipper was Maher Kara, an investment banker in Citibank's healthcare investment banking group and Michael Kara's brother, who testified that he provided the inside information to Michael to benefit him and with the expectation that Michael would trade on the information. To satisfy the ''personal benefit'' standard, the Government presented evidence of Salman's knowledge of the source of the information as well as his knowledge of Michael and Maher's close and mutually beneficial relationship.

Salman was found guilty on all counts. Salman appealed and challenged, among other things, the sufficiency of the personal benefit evidence. While his appeal was pending, the Second Circuit in *Newman* issued their opinion on another tipper-tippee insider trading case. There, the Second Circuit reversed the convictions of two portfolio managers who traded on inside information finding that, among other things, the Government did not demonstrate 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.''

Pointing to *Newman*, Salman contended that his conviction should also be reversed. However, the Ninth Circuit disagreed and affirmed the conviction based on *Dirks'* gift language. That language says that an insider trading violation occurs when an insider gifts confidential information to a ''trading relative or friend.'' In holding that no pecuniary or tangible benefit was necessary to prove a personal benefit, the Ninth Circuit found itself in direct conflict with the Second Circuit's holding in *Newman*. Salman petitioned for *certiorari*, hoping for better luck than the Government in the *Newman* case (which was denied *certiorari*). The Supreme Court agreed to hear *Salman*, most likely to resolve the circuit split.

2. The Supreme Court's Decision Affirms Dirks, But Provides Not Much Else.

Many commentators and practitioners predicted an affirmance of the Ninth Circuit's *Salman* decision after the mostly pro-Government questions that were posed during oral argument. Such predictions proved to be true. In a short 12-page unanimous opinion, authored by Justice Alito, the Court affirmed the *Salman* conviction and adhered to *Dirks*, which they held ''easily resolve[d] the narrow issue presented here.''

According to *Dirks*, ''when an insider makes a gift of confidential information to a trading relative or friend. . .[t]he tip and trade resemble trading by the insider himself followed by a gift of the profits to the recipient.'' Thus, the conduct in *Salman*, they reasoned, ''is in the heartland of *Dirks'* rule concerning gifts of confidential information to trading relatives.'' The Court focused on the fact that Maher would have breached his duty had he personally traded on the information himself and then given the proceeds as a gift to Michael. As Maher would have ''obviously'' benefitted in that situation, it follows that disclosing the information to Michael and allowing him to trade on it would provide a personal benefit as well. With respect to *Newman*, the Court held that *Newman* is inconsistent with *Dirks* [t]o the extent [*Newman*] held that the tipper must also receive something of a 'pecuniary or similarly valuable nature' in exchange for a gift to family or friends.''

The Court quickly dismissed Salman's argument that the *Dirks*'s gift-giving standard is ''unconstitutionally vague'' as applied to the facts of this case. It held, ''at most, Salman shows that in some factual circumstances assessing liability for gift-giving will be difficult. That alone cannot render ''shapeless'' a federal criminal prohibition. . .'' Despite acknowledging these difficult cases, the Court did not address facts or examples of more tenuous insider trading cases, suggesting it was unnecessary in light of the facts and circumstances of *Salman*.

Though several Justices seemed to indicate an interest during oral argument in using *Salman* as a springboard to reform or at least clarify the personal benefit test, the Court clearly declined to provide further guidance outside of *Dirks* to those who may need it. With the Roberts Court leaning towards issuing unanimous decisions (the Court issued the highest percentage of unanimous decisions in spring 2014), the Court may be favoring unanimity at the expense of clarity or guidance. Another possibility is that the eight-member Court is hindering the viability of workable majorities to issue more substantial opinions. Regardless of the reason, the narrow opinion leaves many unanswered questions for courts and practitioners.

3. Dirks Remains the Law of Tipper-Tippee Insider Trading Land But Further Questions Remain Unresolved.

The Court explained that *Salman* was an ''easy'' case. It determined that the facts plainly established that Maher provided material non-public information to his brother and intended the information as a *gift* his brother would trade upon, which is ''precisely the gift of confidential information to a trading relative that *Dirks*

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envisions.'' Salman breached his duty by trading on the information with full knowledge that the information had been improperly disclosed. In other words, the Court's decision in *Salman* reaffirms the rather straight-forward proposition established in *Dirks* that gifting material non-public information to a trading relative is sufficient to meet the personal benefit test.[1]

The Court's decision, however, does not address the harder question that will continue to give pause to market professionals, securities lawyers, and district courts grappling with these issues: Absent a trading relative, after *Salman*, what constitutes a sufficiently meaningful relationship to satisfy the personal benefit test and give rise to tipper-tippee liability? Unfortunately for market professionals seeking a bright-line rule to help guide their day-to-day communications with colleagues and friends, ''it remains the case that determining whether an insider personally benefits from a particular disclosure . . . [is a fact-intensive inquiry that] will not always be easy for courts.'' (Slip Op. at 11.)[2]

Moreover, while the Court in *Salman* rejected the argument that a tipper must receive something of a pecuniary gain in exchange for a gift to family or friends, the Court's decision in *Salman* did not soundly reject the Second Circuit's decision in *Newman*, which makes sense given the dramatically different facts apparent in both.[3] In *Newman*, the market professionals charged with insider trading were several layers removed from the tipper and the Second Circuit rejected the imposition of liability on such remote tippees, where the tippees did not have knowledge that the information had been improperly disclosed. In *Salman*, the tipper and the tipper were brothers who clearly had a close and personal relationship. Left unanswered is the disclosure of insider information, perhaps even inadvertently, between acquaintances who are not friends.

While the *Salman* decision remedies some of the uncertainty that was created by *Newman*'s ''pecuniary gain'' test, the Court's decision in *Salman* will likely not have a significant impact on the defense of insider trading cases. The personal benefit analysis remains a highly-factual question and the difficult cases, where the relationship between the tipper and tippee is not as straight forward as the facts demonstrated in *Salman*, will continue to be litigated in the district courts.

[1] Indeed, prosecutors who had previously been cautious in proceeding with charges against individuals in certain tipping cases have touted the *Salman* decision as a victory. Outgoing Chair of the SEC lauded the decision stating it ''reaffirms our ability to aggressively pursue illegal insider trading and bring wrongdoers to justice.''

[2] In a footnote, the Court explained that the Ninth Circuit had observed the *Salman* case was a misappropriation case and parties in *Salman* did not dispute ''that *Dirks*'s personal-benefit analysis applies in both classical and misappropriation cases.'' (Slip Op. at 6 n.2.) The Court proceeded in its analysis ''on the assumption that [the *Dirks*'s analysis in a classical theory] does'' apply in both instances, but the *Salman* decision leaves open the question whether a future case may properly challenge the personal benefit test under the misappropriation theory.

[3] The Court, indeed, pointed out that its decision did not impact the holding in *Newman* that government prosecutors must prove that remote tippees had knowledge that the information was improperly disclosed. (Slip Op. at 5, n.1.)