**CLIENT ALERT**

# Supreme Court Clarifies What Constitutes a "Personal Benefit" for Purposes of Insider Trading

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Can an insider trading conviction be based on an insider's "tip" to a close friend or family member, even if the insider himself received no tangible benefit? The answer may be yes, according to *Salman v. United States*, No. 15-628—the Supreme Court's first insider trading case in two decades—provided that the relationship is such that the insider can be understood as making a "gift" of the inside information. *Salman* cuts back on the Second Circuit's controversial *Newman* decision, which required a showing that the insider would at least potentially gain a tangible benefit. But *Salman* does not reach the more difficult issues raised by *Newman*, including how "close" the relationship must be, how much the person who makes the trades must know about the insider's benefit, and how these rules will apply where the person who made the trades is one or more steps removed from the original tippee.

As expected, Justice Alito's opinion for the unanimous Court in *Salman* traces the issue back to the Court's 1983 decision in *Dirks v. SEC*. That decision explained that a "tippee" can be convicted for trading on a confidential "tip" from an insider if he is aware that "the insider personally will benefit, directly or indirectly, from his disclosure." *Dirks* explained that jurors could infer that an insider received a "personal benefit" if the insider "makes a gift of confidential information to a trading relative or friend."

This issue emerged again in 2014, when the Second Circuit in *Newman* overturned the convictions of two hedge fund managers who were at the end of an insider trading chain and several steps removed from the original source. Placing a gloss on *Dirks*, the Second Circuit required proof that the insider's relationship with the tippee "generates an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature." The Supreme Court denied certiorari from that decision, perhaps because of what Supreme Court practitioners call a "vehicle problem": a reversal on the *Dirks* issue would not have made a difference in that particular case, because the Second Circuit also found a lack of evidence that the defendants *knew* about the tipper's personal benefit, which is a necessary element of an insider trading case against a tippee. In the fallout from the Second Circuit's decision, federal district courts vacated over a dozen guilty pleas and convictions, leading prosecutors and regulators to express concerns about the future of insider trading prosecutions.

In *Salman*, the Ninth Circuit declined to follow the Second Circuit's lead, creating a split among the circuits and giving the Court another chance to resolve the issue. Bassam Salman was convicted of trading on inside information he received from Michael Kara, a relative-by-marriage, who in turn had received the information from his brother

Mahar, an investment banker (and Mr. Salman's brother-in-law). Both brothers testified against Mr. Salman after pleading guilty to charges of their own. Mahar Kara testified that he shared inside information with his brother Michael with the expectation that Michael would trade on it. But Michael began sharing the information with Mr. Salman and specifically told him that the information was coming from his brother. Mr. Salman made $1.5 million through the scheme and was convicted of insider trading. While his case was pending appeal, the Second Circuit issued its opinion in *Newman*, which he relied on to argue that his conviction should be reversed. The Ninth Circuit disagreed and affirmed the conviction, explaining that Mahar Kara's disclosures to his brother (and, by extension, to his brother-in-law Bassam Salman) were "precisely the gift of confidential information to a trading relative that *Dirks* envisioned."

The Supreme Court granted certiorari and affirmed, concluding that the Second Circuit's approach—effectively requiring the insider to receive something of tangible value—"is inconsistent with *Dirks*" as long as the tip can be seen as a "gift" from the tipper to family or friends. The Court reasoned that the tipper receives a benefit simply giving a family member a gift—the opportunity to profit from insider information. As the Court observed, it was undisputed that the insider would have been convicted had he personally traded on inside information and then given the proceeds to his brother as a gift. By the same token, the insider benefited personally by giving his brother a gift of the information, so that his brother could make the trades himself. On this reasoning, the Court "easily" determined that the conviction should stand, because the defendant traded on confidential information with full knowledge that it had been improperly given by the insider to his brother. According to the Court, this conduct was "in the heartland of *Dirks*'s rule concerning gifts."

At the same time, *Salman* makes clear that not every disclosure of confidential information to a friend or relative meets the standard for "personal benefit." Indeed, at oral argument, Chief Justice Roberts questioned the Government's lawyer about how far the rule should go. He asked whether an insider could be convicted of insider trading for disclosing confidential information to friends when explaining why he or she could not go on a weekend trip; the answer was no, because there "would not be a personal benefit." He also asked whether an insider would be convicted for disclosing information while saying "whatever you do, don't go buy stock. You can't do that. That's against the law." Again, answer was no. The *Salman* decision reflects this limitation, clarifying that "the disclosure of confidential information without personal benefit is not enough."

In light of the *Salman* decision, we may well see an increase in insider trading investigations and prosecutions. Companies should consider strengthening their training and compliance programs to ensure that corporate insiders do not run afoul of the law against insider trading, as clarified by the Supreme Court.

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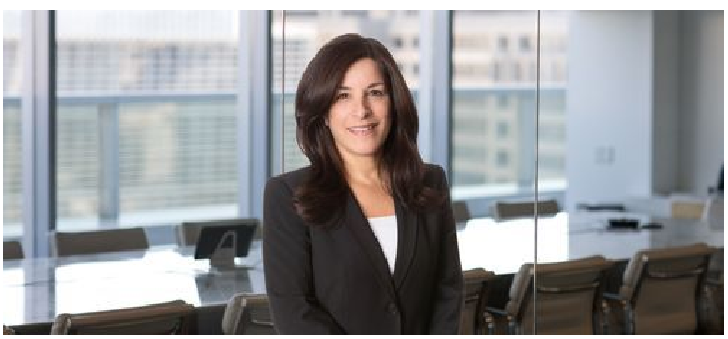

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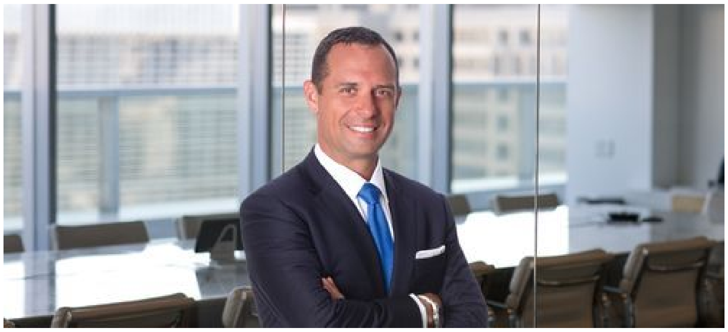

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