



December 21, 2016

Supreme Court Upholds Insider Trading Conviction Involving Family and Friends

In *Salman v. United States* 580 U.S. ____ (2016), decided December 6, 2016, the U.S. Supreme Court unanimously affirmed an insider trading conviction of a tippee on the basis of material non-public information (“MNPI”) that came from a relative, the tipper, even though there was no direct evidence that the tipper received any direct financial benefit. The Supreme Court reasoned that when the tipper and tippee are linked by close ties of family or friendship, a personal benefit can be inferred. The Supreme Court explained, “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.” The Supreme Court relied on its landmark decision, *Dirks v. SEC*, 463 U.S. 646 (1983), where the Court held that a tippee’s liability for trading on MNPI hinges on whether the tipper breached a fiduciary duty – which occurs when the tipper discloses the MNPI for a personal benefit. The *Dirks* Court held that the tippee acquires the tipper’s duty to disclose or abstain from trading on MNPI if the tippee knows the information was disclosed in breach of the tipper’s duty.

The Supreme Court’s decision in *Salman* settles a split of authority between the Second and Ninth Circuits as to whether a tipper receives a personal benefit for purposes of establishing insider trading liability when the tipper conveys MNPI to a family member or friend. Citing *Dirks*, the Court held that a gift of MNPI to a family member or friend with the expectation that it will be used for securities trading, even without the expectation of anything in return, is sufficient to satisfy the personal benefit requirement for insider trading liability.

Facts in the Ninth Circuit *Salman* Case

In the *Salman* case, Bassam Salman had been convicted of federal securities fraud for trading on MNPI that he received from his friend Mounir Kara, who in turn, received the information from his brother Maher Kara (also Salman’s future brother-in-law), who was then an investment banker at Citigroup. The issue was whether the government had to prove that the

tipper (Maher Kara) disclosed MNPI in exchange for a personal benefit in the absence of receiving a tangible financial benefit. Salman claimed he could not be held liable as a tippee because the tipper did not personally receive money or property in exchange for the tips and thus did not personally benefit from them. Salman was convicted and appealed his conviction to the Ninth Circuit.

While his appeal was pending, the Second Circuit issued its opinion in *United States v. Newman**. In *Newman* (where the defendants were several steps removed from the corporate insiders and the court found no evidence that the defendant tippees were aware of the source of the information), the Second Circuit held that “to the extent” *Dirks* permits a court to infer personal benefit to the tipper from a gift of MNPI to a trading relative or friend, the 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.”

The Ninth Circuit disagreed and refused to follow *Newman*, to the extent *Newman* went further than *Dirks* and required proof of additional gain to the tipper in cases involving gifts of MNPI to family and friends. The Ninth Circuit relied on *Dirks* and held that *Dirks* allowed the jury to infer that the tipper breached his fiduciary duty when the tipper made a “gift of confidential information to a trading relative.” Indeed, the Ninth Circuit found that the disclosure of MNPI was “precisely the gift of confidential information to a trading relative that *Dirks* envisioned.”

The Supreme Court Grants Certiorari and Affirms the Ninth Circuit Judgement

The Supreme Court granted certiorari to resolve the tension between the Second Circuit *Newman* decision and the Ninth Circuit *Salman* decision. The Supreme Court found that the Ninth Circuit properly applied *Dirks* and affirmed the judgement. The Court explained that disclosure of MNPI without personal benefit to the tipper is not enough to establish a breach of duty by the tipper – and therefore the tippee. Citing *Dirks*, the Court stated that the test to determine whether a tipper derived a “personal benefit” “often” can be inferred “from objective facts and circumstances,” such as “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.”

In deciding the *Salman* case, the Supreme Court stated that *Dirks* makes clear that a tipper breaches a fiduciary duty by making a gift of MNPI to a trading relative, and that that rule resolves the *Salman* case. Relying on *Dirks*, the Court stated 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. In such situations, the tipper personally benefits because giving a gift of trading information is the same thing as trading by the tipper followed by a gift of the proceeds.” In *Salman*, by disclosing MNPI as a gift to his brother with the expectation that he would trade on it, Maher Kara breached his duty of trust and confidence to Citigroup and its clients – a duty Salman acquired, and breached himself, by trading on the information with full knowledge that it improperly had been disclosed.

* See our analysis of the Second Circuit’s decision in *Newman* in our prior Client Alert dated January 15, 2015, available [here](#).

To the extent the Second Circuit in *Newman* held that the tipper also must receive something of a “pecuniary or similarly valuable nature” in exchange for a gift to a family member or friend, the Supreme Court agreed with the Ninth Circuit that that requirement is inconsistent with *Dirks*. The Court stated, “[M]aking a gift of inside information to a relative...is little different from trading on the information, obtaining the profits, and doling them out to the trading relative. The tipper benefits either way.”

It should be noted that the Supreme Court did not resolve several questions left open by *Newman* and *Salman*, such as, who qualifies as a “close friend,” whether a tippee must know the insider received a personal benefit to be found guilty of insider trading, and whether a gift not to a family member or friend would satisfy the personal benefit test. Issues based on trading on MNPI continually are developing. Corporate compliance personnel should remain vigilant so that MNPI is not disclosed.

If you have questions concerning what constitutes MNPI or if you would like help reviewing your policies and procedures regarding trading on MNPI, please contact Meryl Wiener, any of the undersigned, or your regular Warshaw Burstein attorney.

Frederick R. Cummings, Jr.	FCummings@wbsk.com	(212) 984-7807
Thomas Filardo	TFilardo@wbsk.com	(212) 984-7806
Marshall N. Lester	MLester@wbsk.com	(212) 984-7849
Marilyn Selby Okoshi	MOkoshi@wbsk.com	(212) 984-7874
Murray D. Schwartz	MSchwartz@wbsk.com	(212) 984-7701
Stephen W. Semian	SSemian@wbsk.com	(212) 984-7764
Kyle A. Taylor	KTaylor@wbsk.com	(212) 984-7797
Meryl E. Wiener	MWiener@wbsk.com	(212) 984-7731