U.S. Supreme Court Affirms Broader View of "Personal Benefits" That Can Trigger Insider-Trading Liability

December 9, 2016

To be liable for insider trading in violation of the federal securities laws, the insider "tipper" who discloses the inside information must personally benefit, directly or indirectly, from his disclosure to a "tippee" who trades on the inside information — this establishes the liability requirement that the disclosure was in violation of the tipper's fiduciary duty of trust and confidence to the source of the information. In criminal insider trading cases, the government must also prove that a "downstream tippee" knew the information upon which he traded came from an insider or that the insider tipper received a personal benefit in exchange for the tip.

In 2014 the Second Circuit held in *U.S. v. Newman* that it was not a sufficient "personal benefit" to a tipper to provide only a "gift" of insider information to a "trading relative or friend" without the tipper also receiving "at least a potential gain of a pecuniary or similarly valuable nature."

After *Newman* was decided, many prosecutors in New York dropped charges against defendants in cases where the personal benefit alleged did not have a tangible pecuniary component, including high profile cases against associates of hedge-fund billionaire Steven A. Cohen.

One year after the Second Circuit decided *Newman*, the Ninth Circuit held—relying on the Supreme Court's opinion in *Dirks v. SEC*—that "the element of breach of fiduciary duty is met where an 'insider makes a gift of confidential information to a relative or friend,'" without any additional required finding that the tipper also received something else of value.Unlike the Second Circuit, the Ninth Circuit ruled that simply providing inside information to a relative or friend was a sufficient personal benefit to the tipper to trigger liability.

On Dec. 6, 2016, a unanimous Supreme Court sided with the Ninth Circuit. In its first insider trading opinion in nearly two decades, the court held that its prior decision in *Dirks* "easily resolves" the issue:

"*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. … *Dirks* specifies 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 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. … To the extent the Second Circuit [in *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, we agree with the Ninth Circuit that this requirement is inconsistent with *Dirks*."

In *Salman*, the tipper, Maher Kara, was an investment banker at Citigroup and shared inside information with his older brother Michael, with whom Maher enjoyed a "very close relationship." Michael in turn fed the inside information to his brother-in-law, defendant Salman. Salman traded on the information and made over $1.5 million in profits. "[T]here was no evidence that Maher received anything of a 'pecuniary or similarly valuable nature' in exchange—or that Salman knew of any such benefit." Despite this, the court affirmed Salman's conviction for insider trading based on *Dirks*.

Continued

Prosecutors and the SEC hailed the Court's decision as an affirmation of their ability to "aggressively pursue insider trading." Manhattan U.S. Attorney Preet Bharara applauded the court's ruling as standing up for "common sense" and affirming "that the law absolutely prohibits insiders from advantaging their friends and relatives at the expense of the trading public."

In rejecting Salman's challenge that the *Dirks* gift-giving standard is unconstitutionally vague, the court noted that just because some fact circumstances assessing liability for gift giving may prove difficult does not mean that the standard is unconstitutional—"for even clear rules 'produce close cases.'"

Now, prosecutors can infer a personal benefit simply by proving the "close nature" of the familial and friendly relationship between the tipper and tippee, whatever that will mean. The elastic and sometimes ubiquitous definition of "friends" and "relatives," especially in this Facebook-age of social media, may give prosecutors significant leeway to define relationships sufficient for the *Dirks* gift-giving personal benefit standard. It serves to note that the *Salman* holding is limited to cases involving insider trading by friends and relatives of tippees without a pecuniary benefit to the tipper; the majority of insider trading cases involve parties that receive tangible pecuniary benefits from disclosure of inside information.

Miller Canfield's securities lawyers represent and assist companies, officers, and directors in all securities matters, including litigation and class actions, internal investigations, as well as in regulatory investigations, examinations, and enforcement actions. If you would like more information about insider trading liability, the Supreme Court's *Salman* decision, or any other securities matter, please contact us.

Matthew P. Allen
+1.248.267.3290
allen@millercanfield.com

Thomas W. Cranmer
+1.248.267.3381
cranmer@millercanfield.com