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Supreme Court Opens Pathway To Increased Insider Trading Prosecutions

On Dec. 6, 2016, the U.S. Supreme Court issued its much-awaited decision in *Salman v. United States*,¹ upholding a “friends and family” insider-trading conviction and effectively overruling the Second Circuit’s decision in *United States v. Newman*. In October, we issued an alert describing the highlights of the oral argument and the implications of the Supreme Court’s impending ruling.²

Bassam Salman was convicted of insider trading for receiving secondhand stock tips from a family member. Salman’s brother-in-law, Maher Kara, was an investment banker at Citigroup. Maher passed stock tips to his older brother Mounir (“Michael”) Kara, who in turn passed the tips to Salman.

The Supreme Court unanimously upheld Salman’s conviction and rejected Salman’s argument that he should not be held liable because there was no evidence that Maher personally benefited from the tip.

In the seminal case of *Dirks v. SEC*,³ the Supreme Court held that a “tippee” (the person who receives information from an insider and uses that information to trade) can be held liable for insider trading when the tipper breached a fiduciary duty by disclosing the confidential information. The test to decide whether the tipper breached a fiduciary duty depends on whether the tipper “benefit[ed], directly or indirectly, from his disclosure.”⁴ A juror can infer a personal benefit when the tipper “makes a gift of confidential information to a trading relative or friend.”⁵ There, “[t]he tip and trade resemble trading by the insider himself followed by a gift of the profits to the recipient.”⁶

Salman argued that although Maher made a gift of trading information to Michael, there was no evidence that Maher received a personal benefit in exchange for the tips. Salman relied heavily on *United States v. Newman*, where the Second Circuit reversed the convictions of two portfolio managers who traded on insider information.⁷ In *Newman*, the Second Circuit held that the personal benefit inference in *Dirks* “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*.”⁸

The Supreme Court rejected Salman’s argument and held that the *Newman* requirement that the tipper must receive something of a “pecuniary or similarly valuable nature” in exchange for a gift to family or friends is inconsistent with *Dirks*.⁹ Accordingly, the *Dirks* rule that a tipper breaches a fiduciary duty by making a gift of confidential information to a “trading relative” “easily resolve[d] the narrow issue presented” in *Salman*.¹⁰

The Supreme Court determined that Maher would have breached his fiduciary duty had he personally traded on the information and then given the proceeds as a gift to his brother, Michael.¹¹ “It is obvious that Maher would personally benefit in that situation. But Maher effectively achieved the same result by disclosing the information to Michael, and allowing him to trade on it.”¹² By disclosing confidential information as a gift to his brother with the expectation that he would trade on it, Maher breached his

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duty of trust and confidence to Citigroup and its clients. Salman acquired that duty, and breached it himself by trading on the information with full knowledge that it had been improperly disclosed.¹³

Salman will undoubtedly lead to increased prosecutions in areas of the country where insider trading actions stalled after *Newman*. Preet Bharara, the U.S. attorney in Manhattan, has already declared *Salman* “a victory for fair markets[.]” U.S. Securities and Exchange Commission Chair Mary Jo White was also “very pleased” with the ruling. Individuals who receive trading information from a third party must be diligent in learning the ultimate source of the information and err on the side of caution before investing on what could be insider information.

Insiders can no longer rely on *Newman*’s requirement that tippees must receive a pecuniary benefit in exchange for a gift to “friends and relatives.” Indeed, although the Supreme Court limited the holding only to gifts to friends or relatives, it provided little clarity about the scope of the personal benefit requirement. The Supreme Court acknowledged that it may be difficult to determine whether a tipper received a “personal benefit” from disclosing confidential information, but that *Dirks* created a “simple and clear ‘guiding principle’” that courts can follow.¹⁴

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*This document is intended to provide you with general information regarding the U.S. Supreme Court decision in *Salman v. United States*. The contents of this document are not intended to provide specific*

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¹580 U.S. ____ (2016), available [here](#).

²See previous alert [here](#).

³463 U.S. 646 (1983).

⁴*Id.* at 662.

⁵*Id.* at 664.

⁶*Id.*

⁷773 F.3d 438 (2014), cert. denied, 577 U.S. ____ (2015).

⁸*Id.* at 773 F.3d at 452 (emphasis added).

⁹*Salman*, slip op. at 10 (quoting *Newman*, 773 F.3d at 452).

¹⁰*Id.* at 8.

¹¹*Id.* at 9.

¹²*Id.*

¹³*Id.* at 10.

¹⁴*Id.* at 11 (quoting *Dirks*, 463 U.S. at 664).