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Supreme Court Reaffirms Personal-Benefit Requirement for Insider Trading

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The Supreme Court confirmed today that the "personal benefit" required to establish a claim for insider trading can consist of making a gift of material, nonpublic information to a family member or friend and that an exchange of "something of a pecuniary or similarly valuable nature" is not required. The decision in *Salman v. United States* (No. 15-628) reaffirms the Court's 1983 ruling in *Dirks v. SEC* and appears to undercut the Second Circuit's 2014 decision in *United States v. Newman*, which had sought to tighten the nature of the personal-benefit requirement.

The Court's ruling does not break new ground on insider trading and leaves the law as it had been before the Second Circuit's *Newman* decision generated a round of questions about what constitutes a legally cognizable "personal benefit." But the decision is also significant because the Court reaffirmed the personal-benefit requirement and expressly declined to decide whether that requirement applies not only in "classical" cases of insider trading, but also in "misappropriation" cases.

Factual Background

The *Salman* case arose from an alleged insider-trading scheme involving members of an extended family. The tipper, who worked for an investment bank, allegedly had provided confidential information to his brother about the bank's clients, knowing that the brother would trade on the information. The brother then tipped Salman, whose sister had become engaged to and later married the tipper. The brother eventually pled guilty to insider trading and testified for the Government against Salman.

The evidence at trial showed that the tipper and his brother had enjoyed "a close and mutually beneficial relationship." The tipper testified that he "'love[d] [his] brother very much' and that he gave [him] the inside information in order to 'benefit him' and to 'fulfill[] whatever needs he had.'" The evidence also showed that Salman had been aware of the brothers' "close fraternal relationship." The jury convicted Salman, and the Ninth Circuit affirmed the conviction.

Ninth Circuit's Decision

The Ninth Circuit based its ruling on the *Dirks* decision, which had established the framework for tippee liability. *Dirks* held that tippee liability depends on tipper liability – and that a tipper breaches a fiduciary duty by disclosing confidential information only if he or she benefited directly or indirectly from the disclosure. The Supreme Court defined the "personal benefit" that constitutes the insider's breach of duty as including "a pecuniary gain or a reputational benefit that will translate into future earnings." The Court added: "[t]he elements of fiduciary duty and exploitation of nonpublic information also exist when an insider makes a gift of confidential information to a trading relative or friend."

Applying *Dirks*, the Ninth Circuit held that the tipper's "disclosure of confidential information to [his brother], knowing that [the brother] intended to trade on it, was precisely the 'gift of confidential information to a trading relative' that *Dirks* envisioned." The court also found sufficient evidence that Salman – the indirect tippee – had known the initial source of the tip and that the jury "could readily have inferred [the tipper's] intent to benefit [his tippee-brother]."

Salman contended on appeal that the Second Circuit's *Newman* decision required a more rigorous interpretation of *Dirks*'s personal-benefit requirement and that something more than a mere family relationship was needed to establish a breach of duty. *Newman* had held that, to the extent that "a personal benefit may be inferred from a personal relationship between the tipper and tippee, . . . such an 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 rejected Salman's contention that the direct tippee's familial relationship with his tipper-brother was insufficient to demonstrate that the tipper had received a benefit without "at least a potential gain of a pecuniary or similarly valuable nature." Instead, the Ninth Circuit concluded that, "[t]o the extent *Newman* can be read to go so far, we decline to follow it. Doing so would require us to depart from the clear holding of *Dirks* that the element of breach of fiduciary duty is met where an 'insider makes a gift of confidential information to a trading relative or friend.'" The court therefore held that "[p]roof that the insider disclosed material nonpublic information with the intent to benefit a trading relative or friend is sufficient to establish the breach of fiduciary duty element of insider trading."

Salman sought and obtained review from the Supreme Court as to the question: "Does the personal benefit to the insider that is necessary to establish insider trading under *Dirks* . . . require proof of 'an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature,' as the Second Circuit held in [*Newman*], . . . or is it enough that the insider and the tippee shared a close family relationship, as the Ninth Circuit held in this case?"

Supreme Court's Decision

The Supreme Court unanimously affirmed the Ninth Circuit and held that *Dirks* "easily resolves the narrow issue presented here."

The Court reiterated the rule that "a tippee is exposed to liability for trading on inside information only if the tippee participates in a breach of the tipper's fiduciary duty." The examination of tippee liability thus must start with the tipper. "Whether the tipper breached [his or her] duty depends in large part on the purpose of the disclosure to the tippee." The test for tipper liability under *Dirks* is "whether the [tipper] personally will benefit, directly or indirectly, from his disclosure." The Court thus confirmed that "the disclosure of confidential information without personal benefit is not enough."

As to the nature of the requisite personal benefit, the Court reemphasized *Dirks*'s holding 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." "[W]hen 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."

The Court rejected Salman's reliance on *Newman* and ruled that, "[t]o the extent the Second Circuit 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*."

Salman'sImplications

The *Salman* decision is short, unanimous, and tied to existing precedent. The decision therefore does not alter insider-trading law, although it might put to rest at least some of the rumblings that *Newman* had raised. But the Court's ruling is also significant for what it did *not* do.

First, the Court did not retreat from the personal-benefit requirement. The Government had urged the Court to adopt a broad distinction between disclosure for corporate purposes and disclosure for noncorporate purposes – and to hold that any disclosure for a noncorporate purpose satisfies *Dirks*. But the Court did not rule so broadly. A personal benefit is still required. Nor did the Court jettison the personal-benefit requirement and adopt a broad parity-of-information principle, which would have prohibited trading on material, nonpublic information without further analysis of breaches of duty or personal benefits.

Second, the Court assumed without deciding that the personal-benefit requirement applies in *all* insider-trading cases, whether brought under the "classical" theory (which involves a breach of duty to the issuer and its shareholders) or under the "misappropriation" theory (which involves a breach of duty to the source of the information). The parties in *Salman* did not dispute that the personal-benefit analysis applied under both theories, so the Court "proceed[ed] on the assumption that it does." The potential distinction between the two theories has been an issue since the *Newman* decision, with the Government arguing that *Newman* was a classical-theory case and that its stringent personal-benefit requirement does not apply to misappropriation-theory cases. That argument apparently remains alive at the Supreme Court level, although lower courts do not appear to have accepted it.

Third, subsequent cases might explore whether the Supreme Court meant to draw any distinctions between tips to family members and tips to friends. On the one hand, the Court held that *Dirks*'s holding that "a tipper breaches a fiduciary duty by making a gift of confidential information to '*a trading relative*' . . . [was] sufficient to resolve the case at hand" (emphasis added). On the other hand, the Court observed that, "[t]o the extent the Second Circuit held [in *Newman*] 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*" (emphasis added). Future defendants might argue that *Salman* is only about "trading relatives," not mere "friends," and that a more rigorous construction of the personal-benefit requirement is still appropriate for friends, even if not for relatives. The Government will likely respond that *Dirks* addressed both "trading relative[s] or friend[s]" and that the Supreme Court reaffirmed *Dirks*.

Fourth, the *Salman* decision did not involve another critical element of tippee liability: whether the tippee *knew or should have known* that the tipper had received a legally cognizable personal benefit (whatever that benefit might be). Even if no distinction between family and friends exists for purposes of the personal-benefit requirement, the difference could matter in connection with the tippee's knowledge of the benefit. An argument or inference that a remote tippee knew or consciously avoided knowing of the tipper's benefit might be more tenable where the direct tippee was related to the tipper than where the direct tippee was merely a friend of the tipper.

We will continue to watch how *Salman* plays out in future cases.