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Salman v. United States: Supreme Court Addresses Scope of Criminal Insider-Trading Liability for Tippees

An Insider's Gift of Confidential Information to Friends or Relatives Can Establish Securities Fraud

SUMMARY

Yesterday, the Supreme Court resolved a split between the Second and Ninth Circuit Courts of Appeals and addressed the scope of criminal insider-trading liability for tippees. In *Salman v. United States*, No. 15-628, the Court unanimously held that a tippee can be held liable for trading on material, non-public information received from an insider relative or friend even where the tipper received no direct financial benefit from disclosing such information. In so holding, the Court rejected the Second Circuit's holding in *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014), that, for the tippee to have liability, "the tipper must also receive something of a 'pecuniary or similarly valuable nature' in exchange for [providing material, non-public information] to family or friends."¹ Affirming the Ninth Circuit's decision below, the Court held that "a gift of confidential information to a trading relative or friend" satisfies the "personal benefit" requirement for an insider-trading violation.

While *Salman* helpfully clarifies ambiguity on tippee liability that was introduced by the *Newman* decision, the decision does not provide meaningful guidance on who is a "relative or friend," or what constitutes a "personal benefit" sufficient to meet its test.

BACKGROUND

Section 10(b) of the Securities Exchange Act of 1934 prohibits individuals who owe a duty of trust and confidence from trading on material, non-public information in breach of that duty.² These individuals also may not "tip" such inside information to others for the purposes of trading. A tipper breaches her fiduciary duty when she discloses material, non-public information for a "personal benefit."³ A tippee who receives

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and trades on such information can also be liable for insider trading if “the tippee knows or should know that there has been a breach [of the insider’s fiduciary duty].”⁴

In December 2014, the Second Circuit questioned the validity of these settled principles when, in *United States v. Newman*, it purported to place new limits on the scope of tippee liability.⁵ *Newman* held that a tippee can be liable only if she knew that the tipper had received a “personal benefit” of a “pecuniary or similarly valuable nature” in exchange for the information. *Newman* raised questions about what constituted such a “pecuniary” benefit and whether recipients of mere gifts of information from friends or relatives were now insulated from tippee liability.

THE SALMAN DECISION

Bassam Salman was convicted of multiple counts of securities fraud and conspiracy to commit securities fraud. At trial, the Government offered evidence that Maher Kara, an investment banker at Citigroup, provided inside information to his brother Michael Kara. Without his brother’s knowledge, Michael then gave the information to Salman, Michael’s friend and Maher’s brother-in-law.⁶ On appeal, Salman argued that his conviction should be overturned because, under *Newman*, “there was no evidence that Maher received anything of ‘a pecuniary or similarly valuable nature’ in exchange” for the information—or that Salman knew of any such benefit.⁷ The Ninth Circuit disagreed and affirmed Salman’s conviction. The Supreme Court granted review “to resolve the tension between the Second Circuit’s *Newman* decision and the Ninth Circuit’s decision.”⁸

Yesterday, the Supreme Court unanimously held that a tipper has liability for insider trading when he “receives a direct or indirect personal benefit from the disclosure,” including “by making a gift of confidential information to a trading relative or friend.”⁹ The Court explained that “[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.”¹⁰ A tippee is exposed to the same liability in turn if she knows that the information was disclosed in breach of the tipper’s duty. The Court therefore affirmed Salman’s conviction because the tipper “disclos[ed] confidential information as a gift to his brother with the expectation that he would trade on it,” and Salman “trade[d] on the information with full knowledge that it had been improperly disclosed.”¹¹

The Court recognized that “in some factual circumstances assessing liability for gift-giving will be difficult.”¹² It nonetheless rejected the Second Circuit’s holding that a “tipper must also receive something of a ‘pecuniary or similarly valuable nature’ in exchange for a gift to family or friends.”¹³ Rather, “a personal benefit includes the benefit one would obtain from simply making a gift of confidential information to a trading relative.”¹⁴

IMPLICATIONS

Salman removes the uncertainty about insider-trading liability introduced by *Newman*, reaffirming the long-standing principle that a mere gift of information to “a trading relative or friend” is sufficient to constitute the requisite “personal benefit” to support liability for both the tipper and tippee. Yet *Salman* left unanswered important questions about the reach of liability, including:

- (1) what sort of relationship is sufficient to meet the “relative or friend test”?
- (2) where a tippee is not a “friend or relative,” what constitutes an exchange sufficient to constitute a non-pecuniary “personal benefit”? and
- (3) what will constitute legally sufficient proof of knowledge of a “personal benefit” by remote, downstream tippees?

For traders, *Salman* underscores the continuing risks associated with all trading on the basis of material, non-public information, even when the precise circumstances of the disclosure of information are opaque.

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ENDNOTES

- ¹ *United States v. Salman*, No. 15-628, slip op. at 10 (quoting *United States v. Newman*, 773 F.3d 438, 452 (2d Cir. 2014)).
- ² 15 U.S.C. § 78j(b); *United States v. O’Hagan*, 521 U.S. 642, 650-52 (1997).
- ³ *Dirks v. SEC*, 463 U.S. 646, 663 (1983).
- ⁴ *Id.* at 660.
- ⁵ 773 F.3d 438 (2d Cir. 2014).
- ⁶ *Salman*, No. 15-628, at 3-4.
- ⁷ *Id.* at 5 (quoting *Newman*, 773 F.3d at 452).
- ⁸ *Id.* at 6.
- ⁹ *Id.* at 9 (quoting *Dirks*, 463 U.S. at 663-64).
- ¹⁰ *Id.* at 11.
- ¹¹ *Id.* at 10.
- ¹² *Id.* at 11.
- ¹³ *Id.* at 10 (quoting *Newman*, 773 F.3d at 452).
- ¹⁴ *Id.* at 12 (internal quotation marks omitted).

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CONTACTS

New York

Nicolas Bourtin	+1-212-558-3920	bourtinn@sullcrom.com
Jay Clayton	+1-212-558-3445	claytonwj@sullcrom.com
Nicole Friedlander	+1-212-558-4332	friedlandern@sullcrom.com
Steven R. Peikin	+1-212-558-7228	peikins@sullcrom.com
Kenneth M. Raisler	+1-212-558-4675	raislerk@sullcrom.com
Karen Patton Seymour	+1-212-558-3196	seymourk@sullcrom.com
Samuel W. Seymour	+1-212-558-3156	seymours@sullcrom.com
Alexander J. Willscher	+1-212-558-4104	willschera@sullcrom.com

Washington, D.C.

Jeffrey B. Wall	+1-202-956-7660	wallj@sullcrom.com
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