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Government Catches Insider Trading Supreme Court Win In *Salman*

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Conflicts among recent insider trading decisions created uncertainty for market participants, the U.S. Department of Justice (DOJ), and the U.S. Securities and Exchange Commission (SEC) as to whether defendants may be liable when a tip is gifted (rather than exchanged for something of objective pecuniary value). On December 6, 2016, the United States Supreme Court issued a unanimous decision in *U.S. v. Salman* – its first insider trading decision in years – that largely put the debate to rest. The *Salman* decision reaffirmed the Supreme Court's prior precedent and held that tipplers may face insider trading liability when the tipper gifts material nonpublic information to a relative or friend; the government need not prove that the tipper received anything of objective pecuniary value in return. A summary of recent insider trading law, the *Salman* decision, and open questions left unanswered by *Salman* follow.

Before *Salman*

Liability for insider trading arises when individuals trade on material nonpublic information in violation of a duty owed to the source of the information. In its landmark 1983 decision, *Dirks v. SEC*, the Supreme Court established that a tippee's liability depends on the tipper's liability and that a tipper breaches her duty by disclosing inside information for personal benefit. The Court in *Dirks* held that a benefit can be inferred when the tipper “makes a gift of confidential information to a trading relative or friend.”

For decades, the Supreme Court has declined to hear insider trading appeals. In the meantime, the DOJ and SEC used the *Dirks* test expansively to pursue insider trading cases against individuals who received tips from friends, relatives, and even acquaintances with practically nothing given to the tipper in return. Indeed, many recent insider trading enforcement matters have involved long chains of tipping, with trading by downstream tippees who have little, if any, connection to the original tipplers.

In 2015, the Second Circuit issued a momentous decision in *U.S. v. Newman*, which involved an attenuated tipping chain spanning numerous individuals. It held that tipper-tippee liability requires “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 *Newman* decision was regarded as effectively requiring a real, tangible payoff for the trading tip. Although petitioned by the Solicitor General to overturn *Newman*, the Supreme Court declined to grant cert. More on the *Newman* case can be

found [here](#).

Salman Returns to the Dirks Test

Shortly after the Second Circuit's *Newman* decision, the Ninth Circuit issued a decision in the *Salman* case. *Salman* involved three individuals: an investment banker; the banker's brother, who received inside information from the banker; and Salman, whose sister was engaged to (and later married) the banker and who traded on such information that the brother passed to him. The evidence at trial showed that the banker and his brother maintained a "very close relationship" and that the brother was like "a second father" to the banker. It also showed that *Salman* knew that the banker was the source of the information his brother passed on. *Salman* was convicted of insider trading and appealed.

Salman argued to the Ninth Circuit that, under *Newman*, he should escape liability because the banker did not exchange the inside information with his brother for a monetary or similarly valuable benefit. The Ninth Circuit disagreed, determining that the banker gifted the information to his brother which, in light of their close familial relationship, was a sufficient personal benefit under the *Dirks* test. The Ninth Circuit specifically refused to follow *Newman* "[t]o the extent [it] can be read to go so far" as to hold that evidence of a family relationship alone is insufficient to show personal benefit.

The Supreme Court accepted cert. in the *Salman* case. In an unanimous decision authored by Justice Samuel Alito, the Supreme Court affirmed the Ninth Circuit and held that *Salman* fit "easily" within the confines of *Dirks*. The Supreme Court emphasized the nature of the investment banker's relationship with his brother and highlighted that *Salman* knew the banker was the source of the inside information. The Supreme Court likewise rejected *Newman*'s suggestion that insider trading liability requires the tipper to have received a tangible personal benefit, finding such a requirement to be at odds with *Dirks*.

Salman Leaves Some Open Questions

In reinforcing *Dirks* and partially overturning *Newman*, the *Salman* decision helped clarify recent ambiguities in insider trading law. Yet the Supreme Court's decision also leaves questions unanswered with which future litigants will grapple. Two are worth highlighting:

Knowledge that Market-Sensitive Information was Given

The *Salman* decision did not directly address *Newman*'s requirement that a downstream tippee know or should have known that the information he traded on came from an insider; the evidence at trial demonstrated that *Salman* was well aware of its source. In a footnote, Justice Alito noted that the decision "does not implicate those issues." But by highlighting the requirement and the evidence demonstrating *Salman*'s knowledge, the Court appears to have signaled that insider trading enforcement may falter if the tippee is ignorant of the circumstances surrounding the information's source. Recent decisions by the DOJ and SEC not to pursue insider

trading actions against certain individuals who apparently did not know the source of the information further indicate this trend.

Just How Close Must the Relationship Be?

In its briefing to the Supreme Court, the DOJ argued that gifting information to anyone – whether or not a “trading relative or friend” – suffices to prove insider trading. The Court stopped short of embracing this far-reaching position, since the banker and his brother in *Salman* were unquestionably close. In many cases, the relationship will be equally clear, although individuals involved in insider trading investigations should brace themselves for some invasive questioning on this topic. The Court, however, acknowledged that “in some factual circumstances assessing liability for gift-giving will be difficult.” Future enforcement investigations and litigation in those instances may consume significant resources to determine just how close the relationship is between tipper and tippee, and also whether to distinguish between relatives and friends.

Conclusion

Although not providing the bright line rule that some had desired, the Supreme Court's *Salman* decision at least provides a sense of general direction for future insider trading liability. Nevertheless, entities and individuals facing potential insider trading matters are well advised to engage skilled outside counsel given the numerous nuances that remain in this area.