Supreme Court Resolves Circuit Split On Insider Trading, Partially Overruling Newman

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For the first time since 1997, the United States Supreme Court explored the requirements for proving a federal securities fraud claim based on insider trading, in *Salman v. United States* (Dec. 6, 2016). The *Salman* opinion confirms that a factfinder may infer a personal benefit to a tipper from a gift of confidential information to a trading relative or friend, without the added requirement of “proof of a meaningful relationship” that had been imposed by the Second Circuit in *United States v. Newman*, 773 F.3d 438 (2d Cir. 2015). Salman thus resolves a circuit split that had developed between the Second and Ninth Circuits.

Historically, individuals have been found to have engaged in securities fraud under “classical” theory or “misappropriation” theory. Under classical theory, corporate “insiders” (directors, officers, and others deemed to hold a temporary fiduciary status) either trade on inside information or tip the information to someone who does. *Dirks v. S.E.C.*, 463 U.S. 646 (1983). Under misappropriation theory, the person trading or tipping inside information need not owe fiduciary duties generally to a corporation and its stockholders, but must violate some relationship of trust and confidence through which she received the information. *United States v. O'Hagan*, 521 U.S. 642, 650-52 (1997). In both cases, then, the person engaging in insider trading has committed an act of deception by violating a relationship of trust and confidence. Also, in both cases, the actionable deception is to the source of information and not to the other party to the trade or the general trading public, even though the latter may be injured by the trader's conduct. *See id.* The Supreme Court has not read the federal securities laws as establishing “a general duty between all participants in market transactions to forgo actions based on material, nonpublic information.” *Chiarella v. United States*, 445 U.S. 222, 233 (1980).

In the 2015 *Newman* case, the Second Circuit further limited the ability of the government to bring insider trading cases. The court acknowledged that language in the Supreme Court's *Dirks* opinion could be read as permitting a factfinder to infer that a tipper received a personal benefit by providing confidential information to a trading relative or friend, but added that 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.” *Newman*, 773 F.3d at 452. The *Newman* opinion called into question hard-won victories by the federal government against insider trading defendants in the Southern District of New York.

The Ninth Circuit took a different direction in *Salman*. In that case, confidential information originally was obtained by an investment banker at Citigroup, Maher Kara, who shared it with his brother Michael. Unbeknownst to Maher, Michael then shared the information with others including the defendant, Bassam Salman, whose sister was married to Maher. On appeal, the Ninth Circuit refused to follow *Newman*, considering itself bound by *Dirks*' statement that a tipper benefits personally by making a “gift” of confidential information to a trading relative or friend. To the extent *Newman* required that the tipper receive an additional benefit by providing the information, the Ninth Circuit declined to follow it. *United States v. Salman*, 792 F.3d 1087, 1093 (9th Cir. 2015).

In a unanimous opinion by Justice Alito, the Supreme Court agreed with the Ninth Circuit, explaining that its discussion of gift giving in *Dirks* resolved the case. As conceded by Salman's counsel at oral argument, Maher indisputably would have breached his duty by trading on inside information himself and then making a cash gift of all trading proceeds to his brother. Maher “effectively achieved the same result by disclosing the information to Michael, and allowing him to trade on it.” Viewed in this light, it was unnecessary to find an additional pecuniary benefit resulting from the exchange of information:

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. Here, by disclosing confidential information as a gift to his brother with the expectation that he would trade on it, Maher breached his duty of trust and confidence to Citigroup and his clients – a duty Salman acquired, and breached himself, by trading on the information with full knowledge that it had been improperly disclosed.

Thus, *Salman* also appears to confirm that for an insider trading charge to succeed, the recipient of confidential information must know that it was disclosed in violation of a relationship of trust and confidence.

Salman was in many respects an “easy case,” because of the obvious and undisputed family relationships among the actors involved. It remains to be seen whether the Second Circuit will continue to apply *Newman* or some new standard to cases in which the tipper and tippee are not in the same family and the benefit of making a gift of information is arguably less obvious. In this regard, the Supreme Court stated in footnote 1 of its opinion that its decision did not implicate the questions of proof arising in the *Newman* case. Practitioners also may observe that in footnote 2, the Supreme Court noted that the parties did not dispute the assumption that *Dirks*' personal-benefit analysis applies both in “classical” and “misappropriation” cases, and therefore did not resolve whether both theories applied (as the government claimed) or only the misappropriation theory applied (as Salman claimed).

Salman v. United States (Dec. 6, 2016)

United States v. Newman, 773 F.3d 438 (2d Cir. 2015)