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SEC Update

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US Supreme Court Unanimously Affirms *Dirks v. SEC*, Long-Standing Analysis of “Personal Benefit” for Purposes of Insider Trading Liability

The US Supreme Court recently issued a unanimous decision in *Salman v. United States*,¹ affirming the Ninth Circuit’s application of the personal benefit analysis articulated in *Dirks v. SEC*² to uphold petitioner Salman’s conviction for insider trading. The case received widespread attention following the Second Circuit’s decision in *United States v. Newman*,³ which was decided while Salman’s appeal was pending before the Ninth Circuit. In *Newman*, the Second Circuit overturned two insider trading convictions based on the personal benefit analysis under *Dirks*. The US Supreme Court granted certiorari to “resolve the tension” between the circuits.⁴

Insider trading liability arises from Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act). Under Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, individuals who owe a fiduciary duty to an issuer may not use inside information as the basis for their trading activities without proper disclosure. Such individuals also are prohibited from tipping inside information to others for

trading. If the tippee receives a tip from the tipper, and the tippee is aware that the tip is inside information but trades anyway, then the tippee may be held liable for insider trading. In *Dirks*, the Supreme Court held that the tipper breaches his fiduciary duty when he “discloses inside information for a personal benefit.”⁵ The *Dirks* Court also held that a jury can infer personal benefit when the “tipper receives something of value in exchange for the tip or makes a gift of confidential information to a trading relative or friend.”⁶

Salman concerns the “gift-giving” variant of the personal benefit analysis. Under the standard articulated in *Dirks*, when the insider gives the gift of inside information to a relative or friend, for liability purposes it is treated as if the insider had made the trade himself and then given the gift of trading profits to the friend or relative.⁷ The Second Circuit in *Newman* had likewise recognized that a “personal benefit” may include “the benefit one would obtain from simply making a gift of confidential information to a trading relative or friend.”⁸ But, the *Newman* court had held that a benefit to the tipper from such a disclosure can only be inferred where there is “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.”⁹ The *Newman* court went on to explain that this may be proven through evidence of “‘a relationship between the insider and the recipient that suggests ... an intention to benefit the [latter].’”¹⁰

In reviewing *Newman*’s holding, the Supreme Court stated 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,” this notion is inconsistent with *Dirks*.¹¹ But, given the Second Circuit’s explanation that the receipt of something of a “valuable nature” may be demonstrated by examining whether the relationship between tipper and tippee was meaningful enough to support an inference that the tipper intended to benefit the tippee,¹² we think *Salman* was consistent with *Newman* and did not reject it as some commentators have suggested.

In reaching its decision, the Court also affirmed basic principles of remote tippee liability derived from *Dirks*. Here, petitioner *Salman* received a tip from Michael Kara, his brother-in-law. Michael had received the tip from Maher Kara, his brother and an employee of an SEC registrant. It is of no consequence that *Salman* did not receive the tip directly from Maher because when Maher disclosed the inside information to Michael with the expectation that Michael would trade on it, Maher breached his fiduciary duty.¹³ Likewise, *Salman* knew the information he received from Michael was inside information and in receiving that information *Salman* acquired a fiduciary duty, which he breached by trading on the basis of that information.¹⁴

The opinion is noteworthy perhaps more for its restrained and narrow holding than for its interpretation of the personal benefit analysis. To the extent *Salman* is viewed to have swept away *Newman*’s test for when a relationship is meaningful enough to permit the inference that the transmission of information is a benefit to the gift-giver, the Court’s opinion in *Salman* left no guidance as to when a relationship short of familial will be a sufficient foundation

for prosecution. The government urged the Court to find that “a gift of confidential information to anyone, not just a ‘trading relative or friend,’ is sufficient for insider trading, but the Court did not embrace that suggestion.”¹⁵ In this sense, the holding will result in continued uncertainty as to when the transmission of information will be deemed a personal benefit to the tipper. As the US Supreme Court aptly recognized, “[i]t remains the case that [d]etermining whether an insider personally benefits from a particular disclosure, a question of fact, will not always be easy for courts.”¹⁶ The Court also declined to resolve whether the *Salman* case was a classic or misappropriation insider trading case, primarily because neither party disputed that *Dirks*’ personal benefit analysis applies to both types of insider trading cases.¹⁷ Similarly, the Court declined the opportunity to re-examine the personal benefit analysis and, instead, found such an inquiry to be unnecessary because *Salman* “involves precisely the gift of confidential information to a trading relative that *Dirks* envisioned.”¹⁸

NOTES

- ¹ *Salman v. United States*, No. 15-628, 580 U.S. ____ (2016).
- ² *Dirks v. SEC*, 463 U.S. 646 (1983).
- ³ *United States v. Newman*, 773 F.3d 438 (2014), *cert. denied*, 577 U.S. ____ (2015).
- ⁴ *Salman*, No. 15-628, slip op. at 6, 580 U.S. ____ (2016).
- ⁵ *Salman*, No. 15-628, slip op. at 2, 580 U.S. ____ (2016).
- ⁶ *Salman*, No. 15-628, slip op. at 2, 580 U.S. ____ (2016), *citing Dirks*, 463 U.S. at 664 (internal quotations omitted).
- ⁷ *Salman*, No. 15-628, slip op. at 9, 580 U.S. ____ (2016), *citing Dirks*, 463 U.S. at 664.
- ⁸ *Newman*, 773 F.3d at 452, *citing U.S. v. Jiau*, 734 F.3d 147, 153 (2d Cir. 2013).
- ⁹ *Newman*, 773 F.3d at 452.
- ¹⁰ *Newman*, 773 F.3d at 452, *citing Jiau*, 734 F.3d at 153.

¹¹ *Salman*, No. 15-628, slip op. at 10, 580 U.S. ____ (2016), citing *Newman*, 773 F.3d at 452.

¹² *Id.*

¹³ *Salman*, No. 15-628, slip op. at 10, 580 U.S. ____ (2016).

¹⁴ *Salman*, No. 15-628, slip op. at 10, 580 U.S. ____ (2016).

¹⁵ *Salman*, No. 15-628, slip op. at 7, 580 U.S. ____ (2016).

¹⁶ *Salman*, No. 15-628, slip op. at 11, 580 U.S. ____ (2016), citing *Dirks*, 463 U.S. at 664.

¹⁷ *Salman*, No. 15-628, slip op. at 6 n.2, 580 U.S. ____ (2016).

¹⁸ *Salman*, No. 15-628, slip op. at 12, 580 U.S. ____ (2016) (internal citations omitted).

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