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Supreme Court Reaffirms *Dirks*, Confirms that a Gift of Information to a Trading Relative or Friend Satisfies Personal Benefit Requirement for Insider Trading

The Supreme Court yesterday issued its first opinion addressing the scope of insider trading liability in nearly twenty years. In a much anticipated decision, the Court in *Salman* v. *United States* addressed whether insider trading liability can arise where a tipper makes a "gift" of confidential information to a trading friend or relative but receives no financial or other tangible benefit in return. Relying on the 1983 seminal insider trading case, *Dirks* v. *SEC*, the Supreme Court answered that question in the affirmative.

In *Dirks*, the Court articulated the so-called personal benefit test. In particular, the Court held that trading on inside information is unlawful only if there has been a breach of a duty of trust and confidence, and that the test for determining whether such a breach has occurred is whether the insider personally benefits from the disclosure. The precise contours of the personal benefit requirement have been subject to debate and uncertainty following the Second Circuit's landmark decision in 2014 in *United States* v. *Newman*.

The Court in *Salman* unanimously reaffirmed *Dirks*' personal benefit requirement for insider trading liability and held that, under *Dirks*, a gift of confidential information to a friend or relative may satisfy that requirement. The Court also rejected the Second Circuit's holding in *Newman* to the extent that it required a more substantial showing in the context of a gift to a friend or relative.

The Court did not, however, resolve the uncertainty around the personal benefit requirement. Instead, the Court narrowly limited its holding to tipping a *friend or relative* and expressly declined to address more broadly the scope of the personal benefit requirement outside of that specific context. That approach may be the result of the Court's recognition of a potentially significant distinction between a disclosure to a friend or relative, on the one hand, and to a market professional, such as a research analyst, on the other. Although the Court did not reach that issue, it did not adopt the government's argument that a gift of confidential information "to anyone, not just a 'trading relative or friend'" would be sufficient to satisfy *Dirks*.

Factual Background of *Salman*

Salman was a "remote" tippee who was convicted after trial of trading on material, nonpublic information about impending mergers and acquisitions. The tipper, Maher Kara, was an investment banker who provided confidential information about corporate transactions he was working on to his brother, Michael

Kara. Michael used the information to execute trades for himself and provided the information to Salman (whose sister was engaged to and later married Maher). Salman, in turn, also traded on the information.[1]

Maher testified at trial that he initially shared information with his brother on the understanding that his brother was not trading on it.[2] However, at some point, Maher suspected his brother Michael was trading on the information, but nevertheless continued to tip him.[3] Maher testified that he knowingly tipped Michael "to help him" and "fulfil[l] whatever needs he had."[4]

The District Court instructed the jury that to convict Salman of insider trading, it needed to find that the insider (here, Maher) personally benefitted from the disclosure of material, nonpublic information.[5] The District Court instructed the jury that "personal benefit" to the insider could include "the benefit one would obtain from simply making a gift of confidential information to a trading relative or friend. The benefit does not need to be financial or tangible in nature."[6]

Salman appealed his conviction to the Ninth Circuit Court of Appeals, arguing that absent a pecuniary or tangible benefit, a gift to a relative or friend could not satisfy the personal benefit requirement. The Court of Appeals affirmed, and the Supreme Court granted certiorari. Following oral argument in October of this year, the Court issued its decision yesterday.

Dirks and the Personal Benefit Requirement

The Supreme Court has repeatedly rejected a "parity of information" theory, holding that there is no "general duty between all participants in market transactions to forgo actions based on material, nonpublic information."[7] Rather, in *Dirks*, the Supreme Court held that, under the "classical theory" of insider trading, a duty to refrain from trading arises only when the information has been improperly obtained—that is, when the tipper has provided information in breach of a fiduciary duty to shareholders.[8] The Court in *Dirks* viewed it as "essential" that there be a "guiding principle" for market participants "whose daily activities must be limited and instructed by the SEC's inside-trading rules."[9] Accordingly, the Court held that the "test" for determining whether a fiduciary breach has occurred is "whether the insider personally will benefit, directly or indirectly, from his disclosure."[10] "Absent some personal gain" by the insider, there has been no breach and thus no duty to refrain from trading.[11]

This personal benefit test requires courts to focus on "objective criteria," such as whether the insider obtains "a pecuniary gain or a reputational benefit that will translate into future earnings."[12] The Court in *Dirks* explained that "objective facts and circumstances [will] often justify such an inference," such as "when an insider makes a gift of confidential information to a trading relative or friend."[13] In that circumstance, "[t]he tip and trade resemble trading by the insider himself followed by a gift of the profits to the recipient."[14]

In *United States* v. *Newman*, the Second Circuit sought to impose greater limits on the scope of the personal benefit requirement.[15] In *Newman*, a case in which portfolio managers at two hedge funds were convicted after trial, the government argued that the personal benefit to the inside tipper included career advice and friendship.[16] The *Newman* panel held that the evidence was insufficient to support the government's theory that the tippers received a personal benefit in exchange for providing inside information.[17] For evidence of a personal benefit to be sufficient, the court wrote, there must be "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." [18]

The Supreme Court's Decision in *Salman*

Salman argued to the Court that a gift to a trading relative or friend is not enough to establish securities fraud and that, instead, it is necessary that the "tipper's goal in disclosing inside information [be] to obtain money, property, or something of tangible value."[19] In support of these arguments, Salman argued that defining a gift as a personal benefit fails the *Dirks* standard of establishing a limiting principle and renders the offense indeterminate and overbroad.[20]

The government, on the other hand, argued that a gift of confidential information "to anyone, not just a 'trading relative or friend,' is enough to prove securities fraud."[21] In the government's view, the personal benefit test set forth in *Dirks* is intended to distinguish between disclosures of information that are motivated by a corporate (and therefore permissible) purpose and those disclosures of information that are motivated by a personal (and therefore impermissible) purpose. Thus, the government argued that the personal benefit requirement is satisfied when confidential information is disclosed by a tipper acting in the absence of a corporate purpose.[22] Because Maher had no corporate purpose for providing information to his brother about the deals he was working on, it was reasonable, in the government's view, for the jury to infer that he was doing so for a personal benefit.

The Supreme Court affirmed *Salman's* conviction. In doing so, it narrowly framed the issue as follows: whether a gift of confidential information to a trading *relative or friend* satisfies the personal benefit requirement. In answering that question, the Court reaffirmed the personal benefit test articulated in *Dirks.* The Court characterized the issue presented as a "narrow" one that was "easily resolve[d]" by *Dirks*.[23] As the Court explained, "*Dirks* makes clear 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."[24] According to the Court, under *Dirks*, "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."[25]

The Court also noted that to the extent that the Second Circuit's holding in *Newman* requires that the tipper receive something of a "pecuniary or similarly valuable nature" in the context of "a gift to family or friends," such a requirement is inconsistent with *Dirks*, and therefore should be rejected.[26] The Court acknowledged, as it had in *Dirks*, that "determining whether an insider personally benefits from a particular disclosure . . . will not always be easy for courts," but found no difficulty resolving that question under the facts presented in *Salman* because the case involved "precisely the gift of confidential information to a trading relative that *Dirks* envisioned."[27]

Discussion

By construing the issue presented narrowly and limiting its holding only to gifts to friends or relatives, the Court provided little clarity about the scope of the personal benefit requirement *outside of* that specific context. In fact, the Court repeatedly emphasized that its holding was restricted solely to the context of gifts to "friends and relatives," perhaps reflecting a recognition of the potential significance of a distinction between disclosures to a friend or relative and disclosures to a market professional. Notably, the Court elected not to adopt the government's argument that a gift to "anyone" satisfies the personal benefit requirement.

Although the Court did not directly address the sharing of material nonpublic information by a corporate insider with a market professional, the reasoning of *Dirks* may be understood to support a heightened requirement in that context to achieve the stated objectives of the personal benefit test.

In particular, the personal benefit test was designed to provide a "guiding principle" to market participants "whose daily activities must be limited and instructed by the SEC's insider-trading rules."[28] The *Dirks* Court imposed that requirement because it thought it was "essential" to provide clear guidance to industry professionals to avoid chilling their communications with company management. Unlike a disclosure to a friend or relative, there are often corporate, non-personal reasons for disclosures by corporate insiders to market professionals. Indeed, company management frequently speaks to and meets with analysts and institutional investors, and they do so based on a belief that it is in the corporation's best interest. Thus, while a disclosure of information to a friend or relative may be enough to support an inference of a personal benefit, a disclosure by management to a securities analyst may not, standing alone, support such an inference.

Conclusion

In its highly anticipated ruling, the *Salman* Court reaffirmed *Dirks* and its personal benefit requirement, but failed to provide clarity about the scope and application of the personal benefit requirement outside of the narrow facts presented in *Salman*. The Court expressly limited its holding to tipping friends and relatives, and held that, under the plain language of *Dirks*, a gift is sufficient in that particular context.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

Bruce Birenboim
212-373-3165
bbirenboim@paulweiss.com

Charles E. Davidow
202-223-7380
cdavidow@paulweiss.com

Andrew J. Ehrlich
212-373-3166
aehrlich@paulweiss.com

Michael E. Gertzman
212-373-3281
mgertzman@paulweiss.com

Udi Grofman
212-373-3918
ugrofman@paulweiss.com

Brad S. Karp
212-373-3316
bkarp@paulweiss.com

Daniel J. Kramer
212-373-3020
dkramer@paulweiss.com

Lorin L. Reisner
212-373-3250
lreisner@paulweiss.com

Walter G. Ricciardi
212-373-3350
wricciardi@paulweiss.com

Richard A. Rosen
212-373-3305
rrosen@paulweiss.com

Audra J. Soloway
212-373-3289
asoloway@paulweiss.com

Theodore V. Wells Jr.
212-373-3089
twells@paulweiss.com

Richard C. Tarlowe
212-373-3035
rtarlowe@paulweiss.com

Law clerk Ryan Streit contributed to this client alert.

[1] *Salman* v. *United States*, No. 15-628, slip op. at 3 (U.S. Sup. Ct. Dec. 6, 2016).

[2] *Id.*

[3] *Id.*

[4] *Id.* at 4.

[5] Brief for Pet.'r at 10, *United States* v. *Salman*, No. 15-628, at 14-15 (S.Ct. May 6, 2016).

[6] *Id.* at 15.

[7] *Chiarella* v. *United States*, 445 U.S. 222, 233 (1980).

[8] The Supreme Court has recognized two theories of insider trading liability: "classical" and "misappropriation." The "classical theory" of insider trading liability applies when a "corporate insider trades in the securities of his corporation on the basis of material, nonpublic information." *United States* v. *O'Hagan*, 521 U.S. 642, 651-52 (1997). The "misappropriation theory," by contrast, applies when an investor "misappropriates confidential information for securities trading purposes, in breach of a duty owed to the source of the information." *Id.* at 652.

[9] *Dirks* v. *SEC*, 463 *U.S.* 646, 664 (1983).

[10] *Id.* at 662.

[11] *Id.*

[12] *Id.* at 663.

[13] *Id.* at 664.

[14] *Id*.

[15] 773 F.3d 438 (2d Cir. 2014).

[16] *Id.* at 452-53.

[17] *Id.* at 452.

[18] *Id.* Additionally, in *Newman*, the Second Circuit addressed a related question that is not at issue in *Salman* and that no longer appears to be in dispute: whether a remote tippee is required to have knowledge of the receipt of a personal benefit by the insider. Based on its reading of *Dirks*, the Second Circuit held that "a tippee's knowledge of the insider's breach necessarily requires knowledge that the insider disclosed confidential information in exchange for personal benefit." *Id.* at 452.

[19] *Salman*, No. 15-628, slip op. at 6.

[20] *Id.* at 7.

[21] *Id.*

[22] *Id.*

[23] *Id.* at 8.

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[24] *Id*. at 9.

[25] *Id.* at 10.

[26] *Id.*

[27] *Id.* at 12.

[28] *Dirks*, 463 U.S. at 664.