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Supreme Court to Review Insider-Trading Decision on Personal Benefit

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The Supreme Court agreed today to review the Court of Appeals for the Ninth Circuit's decision concerning the "personal benefit" required to establish a claim for insider trading. The grant of certiorari in *Salman v. United States* (No. 15-628) could resolve a possible split between the Ninth Circuit and the Second Circuit on the type of "personal benefit" that constitutes a violation of the federal securities laws.

Factual Background

The *Salman* case arose from an alleged insider-trading scheme involving members of an extended family. The tipper, who worked for an investment bank, had allegedly provided confidential information to his brother about the bank's clients, knowing that the brother would trade on the information. The brother then tipped Salman, whose sister had become engaged to and later married the tipper. The brother eventually pled guilty to insider trading and testified for the Government against Salman.

The evidence at trial showed that the tipper and his brother had enjoyed "a close and mutually beneficial relationship." The tipper testified that he "'love[d] [his] brother very much' and that he gave [him] the inside information in order to 'benefit him' and to 'fulfill[] whatever needs he had.'" The evidence also showed that Salman had been aware of the brothers' "close fraternal relationship." The jury convicted Salman, and the Ninth Circuit affirmed the conviction.

Ninth Circuit's Decision

The Ninth Circuit based its ruling on the Supreme Court's 1983 decision in *Dirks v. SEC*, which had established the framework for tippee liability. *Dirks* held that tippee liability depends on tipper liability – and that a tipper breaches a fiduciary duty by disclosing confidential information only if he or she benefited directly or indirectly from the disclosure. The Court defined the "personal benefit" that constitutes the insider's breach of duty as including "a pecuniary gain or a reputational benefit that will translate into future earnings." "The elements of fiduciary duty and exploitation of nonpublic information also exist when an insider makes a gift of confidential information to a trading relative or friend."

Applying *Dirks*, the Ninth Circuit held that the tipper's "disclosure of confidential information to [his brother], knowing that [the brother] intended to trade on it, was precisely the 'gift of confidential information to a trading relative' that *Dirks* envisioned." The court also found sufficient evidence that Salman – the indirect tippee – had known the initial source of the tip and "could readily have inferred [the tipper's] intent to benefit [his tippee-brother]."

Salman contended on appeal that the Second Circuit's 2014 decision in *United States v. Newman* required a more rigorous interpretation of *Dirks*'s personal-benefit requirement and that something more than a mere family relationship was needed to establish a breach of duty. *Newman* had held that, to the extent that "a personal benefit may be inferred from a personal relationship between the tipper and tippee, . . . 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."

The Ninth Circuit rejected Salman's contention that the direct tippee's familial relationship with his tipper-brother was insufficient to demonstrate that the tipper had received a benefit without "at least a potential gain of a pecuniary or similarly valuable nature." Instead, the Ninth Circuit concluded that, "[t]o the extent *Newman* can be read to go so far, we decline to follow it. Doing so would require us to depart from the clear holding of *Dirks* that the element of breach of fiduciary duty is met where an 'insider makes a gift of confidential information to a trading relative or friend.'"

The court added that, if evidence of a desire to benefit a friend or relative could not establish a tipper's breach of duty, "a corporate insider or other person in possession of confidential and proprietary information would be free to disclose that information to her relatives, and they would be free to trade on it, provided only that she asked for no tangible compensation in return." Accordingly, the Ninth Circuit held that "[p]roof that the insider disclosed material nonpublic information with the intent to benefit a trading relative or friend is sufficient to establish the breach of fiduciary duty element of insider trading."

Supreme Court's Grant of Certiorari

Salman's certiorari petition to the Supreme Court posed the question for review as: "Does the personal benefit to the insider that is necessary to establish insider trading under *Dirks* . . . require proof of 'an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature,' as the Second Circuit held in [*Newman*], . . . or is it enough that the insider and the tippee shared a close family relationship, as the Ninth Circuit held in this case?" The petition thus contended that the Ninth Circuit's decision conflicted with the Second Circuit's *Newman* ruling.

The grant of certiorari will enable the Supreme Court to resolve whether the Ninth Circuit's and the Second Circuit's standards are inconsistent with each other and whether they do or do not comport with *Dirks*. However, the Court could also conclude that the type of close family relationship between the tipper and tippee in *Salman* (a fraternal relationship) can justify inferences about a personal benefit that are not permissible where the relationship is more attenuated (as between mere acquaintances or, perhaps, friends, as in *Newman*). The Court's decision could also be influenced by the fact that the indirect tippee in *Salman* was virtually a family member of the tipper, while the remote tippees in *Newman* had not known the tippers at all. The Court could even revisit its *Dirks* decision and articulate a new standard concerning the need (or lack of need) for a personal benefit.

The Government had previously tried to obtain certiorari in *Newman* based in part on the alleged split between the Second and the Ninth Circuits. But the Supreme Court had denied certiorari – perhaps because of the Second Circuit's finding no evidence that the defendant remote tippees had known that the tipper had received a personal benefit, of whatever kind. In those circumstances, the personal-benefit standard became irrelevant to the outcome.

The Supreme Court in *Salman* denied certiorari on the second question that Salman had presented: whether a "failure to investigate suspicious circumstances, without more, [can] constitute the 'deliberate actions' to avoid knowledge that this Court found necessary to establish willful blindness . . . ." The Court thus declined to review the Ninth Circuit's holding that conscious avoidance of knowledge of a personal benefit can suffice to establish liability.