

# Client Alert

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## **In *Salman v. United States*, Supreme Court Holds that the Government Need Not Prove that an Insider Received a Pecuniary Benefit in Exchange for Tipping Inside Information**

On December 6, 2016, the Supreme Court issued a unanimous decision in *Salman v. United States*,<sup>1</sup> holding that a tipper's gift of confidential, inside information to a trading relative constituted a sufficient personal benefit to support an insider trading conviction. In *Salman*, the Supreme Court rejected any interpretation of the Second Circuit's decision in *United States v. Newman*<sup>2</sup> that would require proof that an insider received money, property, or something of tangible value in exchange for divulging confidential information, in order to establish criminal or civil liability. At the same time, the Court declined to adopt the Government's view that a showing of *any* disclosure of confidential information by an insider for *any* non-corporate purpose is sufficient to prove a personal benefit to the tipper. While *Salman* will doubtless embolden prosecutors and Government enforcement lawyers in its rejection of *Newman*, the Supreme Court was clear that "the disclosure of confidential information without personal benefit" to the disclosing insider "is not enough."<sup>3</sup> It appears, therefore, that Federal district and appellate courts will be left with the task of parsing the particular facts of each case to determine whether a tipper's "personal benefit" has sufficiently been established by the Government.

### **Background**

In *Salman*, the Supreme Court began by laying out the well-settled legal principle that so-called "tippees" of corporate insiders who violate their fiduciary duty of trust and confidence by disclosing confidential "insider" information may face criminal and civil liability for trading on such information. As the Court explained, a tippee who receives inside information "acquires the tipper's duty to disclose or abstain from trading if the tippee knows the information was disclosed in breach of the tipper's duty, and the tippee may commit securities fraud by trading in disregard of that knowledge."<sup>4</sup>

In *Dirks v. SEC*,<sup>5</sup> the Court had held that a tippee's liability for insider trading "hinges on whether the tipper breached a fiduciary duty by disclosing the information," and a breach can only occur "when the tipper discloses the inside information for a personal benefit."<sup>6</sup> In *Dirks*, the Court noted that a

jury might infer a personal benefit where a tipper “receives something of value in exchange for the tip or ‘makes a gift of confidential information to a trading relative or friend.’”<sup>7</sup>

It is the “personal benefit” requirement that has given rise to a recent flurry of judicial activity in the insider trading arena. In the 2014 *Newman* decision, the Second Circuit reversed the convictions of two portfolio managers who were accused of trading securities based on inside information obtained from a group of analysts at various hedge funds and investment firms. In overturning the defendants’ convictions, the court noted that the defendants “were several steps removed from the corporate insiders and there was no evidence that either was aware of the source of the inside information.”<sup>8</sup> However, in the most-often cited portion of its opinion, the Second Circuit also concluded that there was insufficient evidence of a personal benefit to the tippers because the inference of a personal benefit “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.”<sup>9</sup> The *Newman* opinion thus stood on two legs for its justification: (1) there was no evidence that the defendants knew they were trading on insider information that was obtained in breach of the insiders’ fiduciary duties; and (2) there was insufficient evidence to establish that a personal benefit had accrued to the original tippers.

## **The *Salman* Decision**

In contrast to *Newman*, the defendant in *Salman* had only the second of these two legs to stand on. In *Salman*, the tipper was an investment banker who had access to confidential information concerning mergers and acquisitions occurring in the healthcare industry. The tipper shared confidential information with his brother, who then shared it with the defendant, Salman. The evidence established that the original inside tipper made a gift of trading information to his brother, and that Salman knew it. Salman was convicted of conspiracy and securities fraud.

Salman appealed to the Ninth Circuit and the Supreme Court, arguing, based on *Newman*, that his conviction should be reversed because there was no evidence that the original tipper received anything of “a pecuniary or similarly valuable nature” in exchange for the information disclosed to the tipper’s brother, or that Salman knew of any such pecuniary benefit. He contended that “a tipper does not personally benefit unless the tipper’s goal in disclosing inside information is to obtain money, property, or something of tangible value.”<sup>10</sup> In contrast, the Government argued that a personal benefit is established whenever a tipper “discloses confidential trading information for a noncorporate purpose.”<sup>11</sup>

A unanimous Supreme Court rejected both arguments. In sustaining Salman’s conviction, the Court reiterated that “*Dirks* makes clear that a tipper breaches a fiduciary duty by making a gift of confidential information to a ‘trading relative.’”<sup>12</sup> As the Court explained, in those circumstances, “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.”<sup>13</sup> The Court therefore rejected any requirement in *Newman* that the tipper receive something of pecuniary value in exchange for a gift.

However, at the same time, the Court declined to adopt the Government’s argument that any disclosure of insider information for a non-corporate purpose is enough to satisfy the personal benefit requirement. The Court flatly stated that “the disclosure of confidential information without personal benefit is not enough.”<sup>14</sup>

In the end, the Court gave a victory to the Government but on narrow grounds. The holding was based entirely on *Dirks*, and the Court gave no indication that it intends to expand the personal benefit test beyond the limits of that decision. Additionally, the Government conceded that to establish criminal liability it must prove “that the tippee knew that the tipper disclosed the information for a personal benefit and that the tipper expected trading to ensue.”<sup>15</sup> Although Salman acknowledged that the Government satisfied this requirement under the Court’s reading of *Dirks*, the Government might find it challenging to prove such knowledge in future cases.

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<sup>1</sup> *Salman v. United States*, No. 15-628, slip op. (Dec. 6, 2016).

<sup>2</sup> *United States v. Newman*, 773 F.3d 438 (2014), *cert. denied*, 577 U.S. \_\_\_\_ (2015).

<sup>3</sup> *Salman*, slip op. at 8.

<sup>4</sup> *Salman*, slip op. at 2.

<sup>5</sup> *Dirks v. SEC*, 463 U.S. 646 (1983).

<sup>6</sup> *Salman*, slip op. at 2 (emphasis added).

<sup>7</sup> *Salman*, slip op. at 2 (quoting *Dirks*, 463 U.S. at 664).

<sup>8</sup> *Newman*, 773 F.3d at 443.

<sup>9</sup> *Newman*, 773 F.3d at 452.

<sup>10</sup> *Salman*, slip op. at 6.

<sup>11</sup> *Salman*, slip op. at 7.

<sup>12</sup> *Salman*, slip op. at 9.

<sup>13</sup> *Salman*, slip op. at 10.

<sup>14</sup> *Salman*, slip op. at 8.

<sup>15</sup> *Salman*, slip op. at 8.