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# COMMUNICATIONS +

## Litigation PR Briefing Note

### ***Salman v. United States,*** **A “Case” for Insider Trading**

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**MONTIETH & COMPANY**

# BRIEFING NOTE + A “Case” for Insider Trading



## Is brotherly love a “personal benefit”?

On December 6, 2016, in a unanimous ruling delivered by Justice Alito, the Supreme Court ruled that it could very well be. The case of *Salman v. United States* affirmed the Ninth Circuit’s opinion, which had previously held that it was enough that the insider and the tippee shared a close family relationship and the benefit need not be tangible. The decision comes after hearing arguments on October 5, 2016 to reconcile conflicting opinions in the 1983 Supreme Court decision in *Dirks v. SEC* and the Second Circuit’s 2014 opinion in *United States v. Newman*.

An insider trading case had not been before the Court in nearly two decades. The issue before the Court was whether the personal benefit to the insider that is necessary to establish insider trading under *Dirks*, requires proof of ‘an exchange that is objective, consequential, and

represents at least a potential gain of a pecuniary or similarly valuable nature,’ in the case of *Newman*.

The Court’s 8-0 ruling that prosecutors need not prove that a tipper received cash or a tangible benefit in exchange for giving tips to family and friends sends a message to Wall Street insiders who may incidentally profit from confidential information.

## Background

Petitioner Bassam Salman traded on highly confidential information he received from his brother-in-law Michael Kara. Michael had passed along this information, which he obtained from his older brother Maher Kara, a Citigroup investment banker. Maher and Michael were “very close” and Maher frequently discussed his job with his brother, including seeking advice and sharing inside tips about mergers and acquisitions, stocks, and options which Michael then in turn traded on.

Maher, initially unaware of his brother’s activities, eventually caught on and still obliged his younger brother and shared tips “to help him” and to “fulfill whatever needs he had,” rather than loaning him money. Michael capitalized on this information and shared it with Salman who eventually reaped more than \$1.5 million in profits.

## Insider Trading Law

Insider trading is not actually expressly prohibited by Congress. Rather, it’s proscribed by the courts’ interpretation of Section 10(b) of the Securities Exchange Act of 1934 and the Securities Exchange Commission’s Rule 10b-5 which makes it unlawful “for any person, directly or indirectly, . . . [t]o use or employ, in connection with the purchase or sale of any security, . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe.”

With no mention in the statute of “insider trading,” the elements of the crime, or even tipping others off, developing case law has set the standard for prohibiting trading on inside information for those with a fiduciary duty and further sharing that information for others to tip on. Under *Dirks*, when a tipper discloses confidential information to a

tippee for a personal benefit that fiduciary duty is breached. A “personal benefit” may occur “where the tipper receives something of value in exchange for the tip or makes a gift of confidential information to a trading relative or friend.”

However, under *Newman*, the relationship must “generate an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature.” The *Newman* case overturned the convictions of two fund managers for insider trading and heightened the requirement for prosecutors in insider trading cases. Accordingly, prosecutors could not make a case unless they could prove the insider received money or a tangible benefit in exchange for the confidential tip.

Thus, prior to *Salman*, it was unclear what that *personal benefit* must be.

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## The Court’s Decision

The Court employed the Dirks test to resolve *Salman* and determine the personal benefit requirement. Dirks held that “[t]he 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.” When a corporate insider with a fiduciary duty trades on confidential information and reaps a profit and gives that profit to a friend or family member, that is clearly a personal benefit. The same is true when instead of gifting that monetary profit, the insider just gives the information/tip for the friend or family member to trade on it themselves.

Here, Maher gifted his brother, Michael, the confidential information rather than giving him cash and knew that his brother would trade on it, thus breaching his fiduciary duty. The duty extended to *Salman* because he knew Maher was improperly disclosing it to Michael.

## Additional Resources

- + Supreme Court of the United States—*Salman v. United States Opinion*
- + *New York Times*—Supreme Court Sides With Prosecutors in Insider Trading Case
- + *The National Law Review*—Supreme Court Weighs in on Insider Trading
- + *Bloomberg*—Insider-Trading Prosecutions Backed by U.S. Supreme Court

## WHAT IT MEANS FOR PROSECUTORS & FINANCIAL PROFESSIONALS

While Wall Street will seemingly become less regulated under the new administration of President-elect Donald Trump, this decision actually makes it easier to prosecute insider-trading cases and rejects the standard set in *Newman*.

With *Salman* now decided, this is no longer the case. United States Attorney Preet Bharara, prosecutor for the Southern District of New York, praised the Supreme Court’s decision in a statement noting that it is “a victory for fair markets and those who believe that the system should not be rigged.” Justice Kagan also suggested during the oral arguments that this case was for the “sake of the integrity of the markets.” The decision sends the message that those that profit from confidential information should be held accountable. However, prosecution of these cases will still be very fact-intensive, as many have argued the law as it stands is too vague.

If the goal is to curb corruption and limit the lucrative business of trading on inside information, which isn’t entirely unlawful, perhaps the courts should push it back to Congress to set the standard.

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\* For additional information, contact Montieth Illingworth at [montieth@montiethco.com](mailto:montieth@montiethco.com)