

SECURITIES FRAUD: SOME GIFTS ARE BETTER LEFT UNOPENED

Posted on December 22, 2016 by White Collar Crimes & Internal Investigations



It's once again the time of year when many people exchange gifts with family members and friends. However, before unwrapping your gift from that special corporate insider in your life, there are a few things you should probably understand.

Salman v. United States

On December 6, 2016, the United States Supreme Court issued a decision—*Salman v. United States*, 137 S. Ct. 420 (2016)— holding that one can be guilty of insider trading even where a tipper makes only a “gift” of inside information to a tippee. In other words, he or she need not receive anything of pecuniary value in return for the inside tip to be convicted of securities fraud.

Section 10(b) of the Securities Exchange Act of 1934 and the Securities and Exchange Commission's Rule 10b-5 prohibit insider trading. Specifically, together, they prohibit “undisclosed trading on inside corporate information by individuals who are under a duty of trust and confidence that prohibits them from using such information for their personal advantage.” *Salman*, 137 S. Ct. at 423.

In *Salman*, the defendant was convicted of conspiracy and insider trading. His conviction was upheld by the Ninth Circuit Court of Appeals and he appealed his case to the Supreme Court arguing that he “cannot be held liable as a tippee because the tipper (his brother-in-law) did not personally receive money or property in exchange for the tips and thus did not personally benefit from them.” *Id.* at 424.

In response, the Government argued, “a tipper personally benefits whenever the tipper discloses confidential trading information for a noncorporate purpose.” Id. at 426.

Thus, in the Government's view, “a gift to a friend, a family member, or anyone else would support the inference that the tipper exploited the trading value of inside information for personal purposes and thus personally benefited from the disclosure.” Id.

While *Salman's* appeal was pending before the Ninth Circuit, the Second Circuit reversed the

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convictions of two portfolio managers who had allegedly traded on insider information. See *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014). There, the Second Circuit overturned the convictions, at least in part, because the Government had introduced no evidence that the tipper had received something of a “pecuniary or similarly valuable nature” in exchange for the “gift” of inside information to family or friends. *Id.* at 452.

Because the Second and Ninth Circuits had reached divergent conclusions on this point, the Supreme Court agreed to hear *Salman*’s appeal in an effort to resolve the tension between the Circuits.

Ultimately, the Court determined that the Ninth Circuit had gotten it right.

Dirks v. Securities and Exchange Commission

Relying on *Dirks v. Securities and Exchange Commission*, 463 U.S. 646 (1983), the Court explained, “the disclosure of confidential information without personal benefit is not enough.” *Salman*, 137 S. Ct. at 427. However, this “personal benefit can ‘often’ be inferred ‘from objective facts and circumstances...such as ‘a relationship between the insider and the recipient that suggests a *quid pro quo* from the latter, or an intention to benefit the particular recipient.’” *Id.* (quoting *Dirks*, 463 U.S. at 664).

The Court continued, “*Dirks* specifies that 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. In such situations, 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.” *Id.* at 428.

The Court concluded, “giving a gift of inside information to a relative...is little different from trading on the information, obtaining the profits, and doling them out to the trading relative. The tipper benefits either way.” *Id.* Accordingly, “*Salman*’s jury was properly instructed that a personal benefit includes ‘the benefit one would obtain from simply making a gift of confidential information to a trading relative.’” *Id.* at 429.

By discarding the Second Circuit’s requirement that a tipper must receive something of a “pecuniary or similarly valuable nature” in exchange for a “gift” of inside information to a family member or friend to be guilty of securities fraud, the Court handed the federal government a big win. *Salman* has definitively broadened the potential class of persons who might be subject to prosecution for insider trading.

So, before unwrapping that gift, it’s probably best to make sure it doesn’t contain a hot stock tip from a person under a duty to not disclose the tip. If it does, it’s probably best left unopened.

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