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SALMAN V. UNITED STATES AND ITS IMPACT ON INSIDER-TRADING ENFORCEMENT

The Supreme Court's decision in the Salman *case restored the personal benefit test in insider-trading cases that had been upended by the Second Circuit's decision in the* Newman *case. The author discusses these cases, beginning with the basics of insider-trading law. He then turns to Newman's pre-*Salman *effect,* Salman's *impact on future enforcement, and remaining battleground issues.*

By Scott B. McBride *

On December 6, 2016, the U.S. Supreme Court ended two years of uncertainty surrounding what actually constituted illegal "insider-trading" for the "tippers" who pass on confidential information to others, and for the "tippees" who receive the information and trade on it. In *Salman v. United States*,[1] the Court restored the status quo ante (or most of it, anyway) that had been disrupted by the Second Circuit's landmark holding in *United States v. Newman*.[2] In *Newman*, the Second Circuit held that a gift of material non-public information for trading purposes among friends and family did not run afoul of the insider-trading laws unless there was a quid pro quo of a pecuniary nature. In its restoration, the Supreme Court likely unleashed federal enforcement authorities that were already aggressively pursuing these cases during the period of uncertainty.

This article first revisits the basics of insider-trading law; second, it describes the holdings in *Newman* and *Salman*; and third, it makes predictions about future enforcement efforts and legal battlegrounds.

I. INSIDER-TRADING LAW BASICS

A discussion of *Salman* requires a rehash of the insider-trading legal framework. There is no "insider-trading" statute, as such. Insider-trading law sprouted from the fraud provisions of Section 10(b) of the Exchange Act,[3] and from the SEC's Rule 10b-5

[1] 580 U.S. ___, 137 S. Ct. 420 (2016).

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

[3] 15 U.S.C. § 78j.

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promulgated thereunder.[4] Section 10(b) prohibits using a "manipulative or deceptive device or contrivance" in connection with securities trading, and Rule 10b-5 prohibits employing a "device, scheme, or artifice to defraud," among other imprecisely defined activities. Neither on its face has anything directly to do with insider-trading.

There are two primary theories of insider-trading rooted in these anti-fraud laws: the "classical" or "traditional" theory and the "misappropriation" theory. There is also (arguably) a third theory arising from the plain language of these rules, what may be called the "deceptive device" or "affirmative misrepresentation" theory, where the wrongdoer employs traditional methods of fraud, as in the context of computer-hacking. These are discussed below.

A. The "Classical" Theory

The classical theory involves an insider of a company who trades in breach of a duty of trust and confidence. It is deceitful, the theory goes, to take advantage of the other party to the securities transaction — buyer or seller — for personal gain when you have been entrusted with this information for corporate purposes.

The classical theory was given clarity by the Supreme Court in *Chiarella v. United States*.[5] Chiarella was a so-called "markup man," an apparently low-level employee who handled documents for a financial printing company. He was able to deduce corporate takeover targets from the documents he marked up. He traded on the information, got caught, settled with the SEC, but then got indicted and convicted.

The law of insider-trading to that point was based on the equal-access-to-information theory: if you had material inside information, you had to *disclose* it to the investing public or *refrain* from trading on the information. The issue in *Chiarella* was the legal effect of the defendant's silence, that is, the effect of his failure to tell the counter-party to his transactions that he knew a takeover was imminent. The Supreme Court rejected the equal-access theory — what it called the "parity-of-information rule" — and held that there can be no fraud, and thus no insider-trading conviction rooted in fraud, without a duty to speak. Chiarella had no such duty and thus his conviction was overturned.

B. The "Misappropriation" Theory

Chiarella left open the question of whether somebody, like Chiarella, had a duty, or could breach a duty, to an insider who gives him confidential information, like the companies that hired his employer to print out their tender offers. That question leads to the so-called "misappropriation" theory, where an outsider in essence steals the information by using it in breach of a duty to the insider who gave him the information.

The Supreme Court solidified the misappropriation theory in *United States v. O'Hagan*.[6] O'Hagan was a partner at Dorsey & Whitney in Minneapolis, and one of his law partners represented a company in its potential tender offer of Pillsbury. In possession of this information, O'Hagan bought thousands of Pillsbury call options and thousands of shares of Pillsbury stock, and made millions. Like Chiarella, he got caught and was indicted, convicted, and sentenced to prison.

The Eighth Circuit reversed his conviction, finding that O'Hagan had no duty to the shareholders that sold him the Pillsbury stock and options, but the Supreme Court reinstated the conviction. Under the misappropriation theory, the Court held, a defendant owes a duty to the *source* of the information, not to the other parties to the transaction. Justice Ginsburg, who authored the majority opinion, wrote,

> In lieu of premising liability on a fiduciary relationship between company insider and purchaser or seller of the company's stock, the misappropriation theory premises liability on a fiduciary-turned-trader's deception of those who entrusted him with access to confidential information.

The fraud is the pretense of loyalty to the principal, while converting the information for one's personal gain.

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[4] 17 C.F.R. § 240.10b-5.

[5] 445 U.S. 222 (1980).

[6] 521 U.S. 642 (1977).

O'Hagan had clearly violated the statute under this formulation.

The scope of this duty to the source of the misappropriated information has since evolved in the case law, but in 2000, the SEC expressly defined the duty in Rule 10b5-2.[7] The rule provides that a "duty of trust or confidence" exists, among other situations, when (1) a person agrees to maintain information in confidence; (2) the source and recipient have a "history, pattern, or practice of sharing confidences, such that the recipient of the information knows or reasonably should know that the" source expects it to remain confidential; or (3) when the recipient receives the information from his or her spouse, parent, child, or sibling.

C. The "Deceptive Device" or "Affirmative Misrepresentation" Theory

A third theory of liability — and it is really less of a theory than it is a direct application of the plain language of the statute and regulation — involves a "deceptive device" in the absence of a fiduciary duty. Under this theory, a breach of fiduciary duty is not required for a violation of Section 10(b) if there is an actual affirmative misrepresentation. This is the theory of liability employed in the computer-hacking insider-trading cases.

For example, the case of *SEC v. Dorozhko* involved a computer hacker who hacked into the server of an investor relations firm holding IMS Health's upcoming earnings report, which had very bad news.[8] Shortly after the breach, Dorozhko bought a tremendous volume of very risky put options and made a killing when the poor earnings were released.

In the lawsuit that followed, the district court denied the SEC's request for a preliminary injunction freezing Dorozhko's trading proceeds, reasoning that there was a low likelihood of success on the merits, because the insider-trading law requires a breach of fiduciary duty. But the Second Circuit reversed and remanded, holding that while a breach of duty is sufficient to find liability under Section 10(b), it is not necessary. The hacking itself, depending on the methods employed, can amount to a deception, the court reasoned. And the Second Circuit asked the district court on remand to determine whether the method of hacking amounted to deception or merely theft. The district court granted summary judgment for the SEC a few months later — Dorozhko did not even oppose the motion, apparently for fear that factual assertions about his hacking methods could incriminate him.[9]

II. *SECOND CIRCUIT VS. NINTH CIRCUIT*: DUELING "PERSONAL BENEFIT" TESTS

The remainder of this article addresses the chain or stream of insider traders — the "tippers" passing on the inside information and the "tippees" receiving it — where the law is (or until recently, was) murkier. With respect to tippee liability, the tippee steps into the tipper's shoes and assumes the tipper's fiduciary duty when the tippee knows that the disclosure was in breach of the tipper's duty.[10] And critically, the tipper breaches his duty when he discloses the inside information for a personal rather than a corporate benefit.

In civil cases brought by the SEC, the government need only prove that the tippee "should have known" about the tipper's breach of duty.[11] In criminal cases, though, actual knowledge is required. Much of the recent litigation centers around the "personal benefit" that a tipper receives from the tippee as part of the quid pro quo for the tip, as this was the core issue in *Salman*.

Until *Salman*, the seminal case on the issue of personal benefit was *Dirks v. SEC*.[12] Dirks was an analyst at a New York broker-dealer who covered the insurance industry. A former officer at an insurance company told him that the company engaged in a massive accounting fraud, and he encouraged Dirks to investigate, which he did. While he was doing so, however, Dirks had conversations with his firm's clients about his investigation, and many of those clients naturally sold their shares as a result.

In a thoroughly misguided enforcement action, the SEC found that Dirks had violated Section 10(b) of the Exchange Act (among others), because he breached a duty he had (somehow) assumed as a result of receiving confidential information. The Supreme Court rejected this theory, finding it inconsistent with *Chiarella*. The Court held that a tipper like Dirks is only liable if he breached a fiduciary duty, had the requisite intent, and obtained a personal benefit from the tip. The Court defined "personal benefit" somewhat broadly, to include

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[7] 17 C.F.R. § 10b5-2.

[8] 572 F.3d 42 (2d Cir. 2009).

[9] *See, e.g.*, Elizabeth A. Odian, *SEC v. Dorozhko's Affirmative Misrepresentation Theory of Insider Trading: An Improper Means to a Proper End*, 94 Marq. Law Rev. 1313, 1329-30 n.126 (2011).

[10] *Salman*, 580 U.S. at ___, Slip Op. at 2.

[11] *S.E.C. v. Obus*, 693 F.3d 276, 288 (2d Cir. 2012).

[12] 463 U.S. 646 (1983).

not just pecuniary gain, like a cut of profits, but also a "reputational benefit" or a benefit one would get from making "a gift of confidential information to a trading relative or friend."

For 30 years after *Dirks*, the "personal benefit" test was not difficult to surmount in tippee cases, given that a gift to a family member or friend qualified. The Second Circuit upended that in 2014, however, in *United States v. Newman.*[13] *Newman* involved so-called "downstream" tippees who were three or four times removed from the insider. The Second Circuit reversed the conviction of Newman, a hedge fund portfolio manager — and the conviction of another hedge fund portfolio manager — and in so doing, the court performed a probing analysis of the "personal benefit" formula and found the personal benefit lacking. Specifically, the court held that the tippee must know of the personal benefit received by the tipper as part of the breach. The government's case had failed on that basis alone, but the Second Circuit went further: first, it stated that if the government proceeds on a theory that the personal benefit is the gift of the information to a friend, the jury cannot infer such a gift in the absence of "a meaningfully close personal relationship," not a casual or social relationship; and second, even if the relationship is meaningfully close, the gift must be "objective, consequential, and represent[] at least a potential gain of a pecuniary or similarly valuable nature." This latter nugget — that a gift to a family member or friend had to have some sort of pecuniary value above and beyond the gift itself — upset a lot of stakeholders and commentators, including the SEC and the Justice Department.

Meantime, the Ninth Circuit, in *Salman v. United States*,[14] rejected *Newman* insofar as *Newman* imposed the "gift-plus-pecuniary-benefit" burden on the government. In a strange twist, Senior U.S. District Court Judge Jed S. Rakoff in the Southern District of New York, who was a critic of *Newman* and had narrowed its impact in some of his own insider-trading cases, was sitting by designation in the Ninth Circuit and wrote the opinion.

The facts of *Salman* are as follows. Maher and Michael Kara were brothers. Maher was an investment banker at Citigroup in its health care group. Maher shared confidential information about the companies he covered with his brother Michael, who secretly traded on that information. Maher eventually found out what Michael was doing, but instead of shutting him down, started helping him trade on the information. Meanwhile, Michael shared the information with others, including his friend Salman. (Salman, by the way, in addition to being Michael's friend, also happened to be Maher's brother-in-law — Maher was married to his sister.) Salman traded on the inside information and made about $1.5 million. He was indicted and went to trial. Maher and Michael pled guilty, however, and testified against their in-law and friend.

The evidence at trial revealed that Maher and Michael were very close. Michael was the best man at Maher's wedding to Salman's sister. Additionally (and critically), Michael told Salman that Maher was the source of the inside information.

In a short opinion authored by Justice Alito, the Supreme Court unanimously upheld Salman's conviction and agreed with the Ninth Circuit:

> [B]y disclosing confidential information as a gift to his brother with the expectation that he would trade on it, Maher breached his duty of trust and confidence to Citigroup and its clients — a duty Salman acquired, and breached himself, by trading on the information with full knowledge that it had been improperly disclosed.[15]

The Court agreed with Judge Rakoff and the Ninth Circuit that, under *Dirks*, there is no requirement of an additional pecuniary benefit above and beyond the gift itself, if the familial relationship or close friendship has been established.

III. *SALMAN*'S IMPACT

A. **Newman***'s Pre-***Salman** *Effect*

Any discussion of *Salman*'s impact going forward requires a look at how bad *Newman* really was for the government and markets in these cases. So how bad was it, really?

The government certainly represented that it was disastrous. The U.S. Attorney's Office for the Southern District of New York, in its petition for rehearing before the Second Circuit, wrote that the *Newman* personal benefit test "will dramatically limit the Government's ability to prosecute some of the most common, culpable, and market-threatening forms of insider-trading."[16] U.S.

[13] 773 F.3d 438 (2d Cir. 2014).

[14] 792 F.3d 1087 (9th Cir. 2015), *aff'd* 580 U.S. ___ (2016).

[15] *Salman*, 580 U.S. at ___, Slip Op. at 10.

[16] *E.g.*, Matthew Goldstein & Ben Protess, *Court Rejects Bharara's Plea to Reconsider Insider Trading Ruling*, N.Y.

Attorney Preet Bharara publicly lamented that *Newman* created "a potential bonanza for friends and family of rich people with material non-public information."[17] And putting aside the rhetoric, the Southern District did lose convictions in roughly a dozen cases. The *Newman* opinion significantly undermined its crackdown on the hedge fund industry, which is probably the biggest target of downstream tippee cases.

Likewise, the SEC's amicus brief warned of future peril: "The SEC has litigated numerous insider-trading claims in this circuit where the only personal benefit to the tipper apparent from the decisions was providing inside information to a friend . . . ."[18] The SEC also noted that, in addition to these litigated cases, it had settled many more cases on the gift-to-a-friend theory. And *Newman* purportedly put all of these cases in jeopardy.

Additionally, there were *Newman*-based motions all over the country, outside of the Second Circuit. For example, in California, former Orioles third baseman Doug DeCinces, who was indicted for allegedly trading on information tipped to him by his friend and neighbor, the head of a medical device company, moved to dismiss the indictment against him for lack of a pecuniary benefit.[19] In New Jersey, a medical device company executive named George Holley tried to undo his settlement agreement with the SEC, which he had inked only a couple of days before *Newman* was filed. Holley had tipped off his cousin to a merger deal, but there had been no pecuniary quid pro quo for the tip.[20]

At the U.S. Attorney's Office in the District of New Jersey, where I worked at the time, *Newman* was largely assumed the law of the land and did have a chilling effect on our investigations. That chilling effect was also felt by the Office's civil partners at the SEC.

All of these developments, from the dismissals to the numerous motions to the hampered investigations, suggested that a good number of insider-trading cases — past, present, and future — were either dead or in jeopardy.

B. Salman's *Loosening of the Reins*

SEC's Appetite for Insider-trading Enforcement

So now that the *Newman* burden is lifted, what will the SEC be doing? Notwithstanding the rhetoric, the SEC was already aggressively pursuing these cases. *Newman* was decided December 10, 2014, yet the two years following the decision saw significant stability and even increases in insider-trading actions.[21] Also, the SEC has been very bullish on its data analysis, which it has hyped as the future of building these cases. It has been using algorithms to analyze large quantities of trading data from the Trade Reporting and Compliance Engine (TRACE) to pull out trades and identify trading patterns that may indicate misconduct. And the SEC has been publicizing its numerous successes using data analytics. For example, in 2015 the SEC, working with the U.S. Attorneys' Offices for the District of New

footnote continued from previous page…

Times, Apr. 3, 2015, *at* https://www.nytimes.com/2015/04/04/business/dealbook/appeals-court-rejects-request-to-rehear-landmark-insider-trading-case.html?_r=0 (quoting government's brief).

[17] Matthew Goldstein & Ben Protess, *What Is a 'Personal Benefit' From Insider Trading? Justices Hear Arguments*, N.Y. Times, Oct. 5, 2016, *at* https://www.nytimes.com/2016/10/06/business/dealbook/supreme-court-insider-trading.html.

[18] Brief for the SEC as Amicus Curiae Supporting the Pet. of the United States for Reh'g En Banc, *available at* https://securitiesdiary.files.wordpress.com/2015/01/sec-amicus-brief-in-us-v-newman.pdf.

[19] DeCinces lost his motion, notwithstanding *Newman*; his multiple-week federal criminal trial commenced in early March 2017. *E.g.*, Sean Emery, *Ex-Angels Player Doug DeCinces' Federal Insider Trading Trial Begins*, The Orange County Register, Mar. 9, 2017, *at* http://www.ocregister.com/articles/decinces-746117-medical-stock.html.

[20] Holley dropped his appeal shortly after *Salman* was issued. William Gorta, *Trader Drops 3rd Cir. Appeal of SEC Insider Trading Deal*, Law360 (Jan. 3, 2017), *at* https://www.law360.com/articles/876856/trader-drops-3rd-circ-appeal-of-sec-insider-trading-deal.

[21] The SEC charged 78 parties in fiscal year 2016 and 87 in fiscal year 2015, compared to 80 parties in fiscal year 2014 (or only 52, according to the agency's FY 2014 financial report) and 44 in fiscal year 2013. Press Release, SEC Announces Enforcement Results for FY 2016 (Oct. 11, 2016) (*available at* https://www.sec.gov/news/pressrelease/2016-212.html); Press Release, SEC Announces Enforcement Results for FY 2015 (Oct. 22, 2015) (*available at* https://www.sec.gov/news/pressrelease/2015-245.html); Press Release, SEC's FY 2014 Enforcement Actions Span Securities Industry and Include First-Ever Cases (Oct. 16, 2014) (*available at* https://www.sec.gov/news/press-release/2014-230); Press Release, SEC Announces Enforcement Results for FY 2013 (Dec. 17, 2013) (*available at* https://www.sec.gov/news/press-release/2013-264).

Jersey and the Eastern District of New York, took down the largest ever computer-hacking-insider-trading scheme.[22] The District of New Jersey cracked the case of Ukranian hackers hacking into business newswires to obtain 150,000 press releases prior to their release. But the SEC was able to develop evidence of the illegal trading by seemingly unrelated traders by analyzing millions of trades and pinpointing the trading windows between the hacking and the public release of the press releases. Likewise, in a case out of the Central District of California, the SEC in 2015 charged former JP Morgan investment bank analyst Ashish Aggarwal with tipping colleagues about upcoming acquisition deals.[23] In announcing the charges, the SEC gave credit to its data analytics: "The SEC Enforcement Division's Market Abuse Unit detected the insider-trading through trading data analysis tools in its Analysis and Detection Center."

Given this momentum, and given that *Newman*'s burden has been lifted and the uncertainty with it, it is almost guaranteed that this upward trend will continue. It is unlikely that the new Administration will affect this momentum either. Unlike other laws (e.g., FCPA),[24] President Trump has never, to my knowledge, offered an opinion publicly about the insider-trading laws. And as a general matter, the pursuit of clear-cut securities fraud schemes is historically apolitical; these schemes will be pursued in any administration. President Trump's nominee to chair the SEC has already publicly announced that he is "100 percent committed to rooting out any fraud and shady practices in our financial system."[25] Additionally, the SEC is entrenched in this area — particularly with its successful data analytics — so it would appear to take a lot of effort and a strong anti-enforcement philosophy to slow these enforcement actions significantly. Of course, there is always the possibility of reductions in force or a shifting of resources to other areas. But the will to pursue these cases exists.

Future Battleground: The "Meaningfully Close" Personal Relationship

Given the likelihood of an emboldened SEC (and Justice Department) and the strong enforcement appetite for insider-trading cases, and for downstream tipper-tippee cases in particular, where is the battleground now? One portion of *Newman* that appeared to survive *Salman* is the requirement of a meaningfully close personal relationship, something more significant than a casual friendship.[26] Arguably, this requirement always existed and courts have been sorting through these relationships for years. But *Newman* crystalized it and now some defendants are seizing upon that.

Perhaps the most high-profile example of this is the case against Matthew Martoma, the former portfolio manager at S.A.C. Capital. Martoma was convicted in February 2014 of receiving tips from two doctors who worked on an Alzheimer's drug trial and then unloading millions of dollars of stock as a result. In his appeal, Martoma recently filed a letter with the Second Circuit arguing that the Supreme Court in *Salman* left open the question of whether there was the kind of meaningfully close personal friendship that would make a pecuniary benefit unnecessary. Martoma then argued that he did not have that kind of relationship with the doctors. But the U.S. Attorney's Office for the Southern District of New York countered that even the "close relationship" requirement of *Newman* is out of line with *Salman*, because *Salman* took no position on the strength of the tipper-tippee relationship.

Some observers think the Second Circuit might ultimately agree with Martoma on this point because

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[22] Press Release, Dep't of Justice, U.S. Attorney's Office, D.N.J., Nine People Charged in Largest Known Computer Hacking and Securities Fraud Scheme (Aug. 11, 2015) (*available at* https://www.justice.gov/usao-nj/pr/nine-people-charged-largest-known-computer-hacking-and-securities-fraud-scheme); Press Release, SEC Charges 32 Defendants in Scheme to Trade on Hacked News Releases: Hackers, Traders Allegedly Reaped More Than $100 Million of Illegal Profits (Aug. 11, 2015) (*available at* https://www.sec.gov/news/pressrelease/2015-163.html).

[23] Press Release, SEC Charges Former Investment Bank Analyst and Two Others with Insider Trading in Advance of Client Deals (Aug. 25, 2015) (*available at* https://www.sec.gov/news/pressrelease/2015-174.html).

[24] In 2012, while Chairman and President of the Trump Organization, President Trump stated on CNBC that the United States is "absolutely crazy" to be prosecuting FCPA violations in Mexico and Canada, and that it was a "horrible law." Trump: Dimon's Woes & Zuckerberg's Prenuptial, *available at* http://video.cnbc.com/gallery/?video=3000089630&play=1.

[25] Sarah N. Lynch, *SEC Nominee Clayton to Commit to Rooting Out Fraud*, Reuters, Mar. 22, 2017 (*available at* http://www.reuters.com/article/us-usa-sec-clayton-idUSKBN16T2B1).

[26] *See, e.g.*, *United States v. Bray*, No. 16-1579, Slip Op. at 14 n.5 (1st Cir. Feb. 24, 2017) ("*Salman* did not . . . discuss the Second Circuit's 'meaningfully close personal relationship' language, presumably because the tipper in the case 'provided inside information to a close relative,' namely, 'his brother.'") (citation omitted).

Martoma's jury was instructed that the personal benefit could include "maintaining or developing a personal friendship." The jury charge did not address the meaningfulness or closeness of that relationship. And indeed, on March 1, 2017, the Second Circuit ordered a second round of arguments, which is currently scheduled for May 9.[27]

Another excellent example of this argument is the First Circuit's recent holding in *United States v. Bray*. On February 24, 2017, the First Circuit affirmed the conviction of a Massachusetts country club member who argued that he could not be criminally liable for insider-trading, because he and the tipper were not sufficiently close. Bray told his friend John O'Neill, an Eastern Bank employee, that he was looking to raise money for a real estate deal. O'Neill, who often gave Bray stock advice, wrote the word "Wainwright" on a napkin in the club bar and slid it to Bray, who pocketed the napkin and acted on the unspoken tip to buy stock in Wainwright Bank and Trust, which O'Neill knew to be a takeover target. Bray was both sued by the SEC and indicted by the U.S. Attorney's Office for the District of Massachusetts. He was eventually convicted at trial. Rejecting Bray's argument that he and O'Neill did not have a meaningfully close relationship, the First Circuit reasoned that it was "at least 'plausible' that [O'Neill] and Bray had a close relationship," as they had known each other 15 years, socialized at their club and at local bars and restaurants, and "even [taken] each other's counsel."[28]

Future Battleground: Knowledge of Breach and Personal Benefit

In addition to the nature of the relationship, downstream tippees will continue to deny knowledge of a breach of duty or personal benefit, which is still arguably an open question after *Salman*.[29] These efforts have thus far been largely unsuccessful, however. For example, in *United States v. Goffer*,[30] U.S. District Judge Richard J. Sullivan in the Southern District of New York recently rejected the defendants' attempt to reverse their insider-trading convictions on grounds that there was insufficient evidentiary support for a finding of criminal intent. Goffer had received confidential tips from lawyers and had then tipped a lawyer and colleague named Kimelman. Goffer and Kimmelman both traded; they had started their own hedge fund, Incremental Capital, together. Judge Sullivan noted that there was plenty of evidence that Goffer thought he was trading illegally: he used burner phones and asked his conspirators to keep their trading secret. But interestingly, on the personal benefit piece in relation to Kimelman, the downstream tippee lawyer, who had argued that he was unaware of the benefit that Goffer provided to his lawyer-tippers, Judge Sullivan wrote,

> A lawyer [i.e., the lawyer or lawyers who tipped Goffer] would not betray his client's most sensitive confidence — risking loss of employment and jeopardizing his ability to obtain comparable future employment — for no benefit to himself. And a reasonable juror would have inferred that Kimelman, a former M&A attorney, understood this.

This demonstrates that the personal benefit knowledge requirement, even in a criminal case, can be very circumstantial, indirect, and (at least arguably) flimsy.

Another unsuccessful attempt was that of the defendant in *Bray*, discussed above. In addition to arguing that he did not have a meaningfully close relationship with his tipper, Bray, the Massachusetts country club member who received a stock tip on a cocktail napkin at the club bar, argued that he did not know that his friend O'Neill had breached a fiduciary duty to the source of the confidential information. Even though the jury had been incorrectly instructed that it could find Bray guilty if he knew "or should have known" that his friend breached his fiduciary duty, the First Circuit upheld his conviction, reasoning that Bray's behavior after the illegal trades, such as offering to bring O'Neill into a real estate project, enabled the jury to conclude reasonably that Bray was aware that O'Neill intended to benefit Bray. The court also reasoned that a reasonable jury could infer that Bray was aware of O'Neill's breach, owing to the "surreptitious" nature of the tip (i.e., on a cocktail napkin) as compared to previous legal tips, as well as Bray's knowledge, "presumably," of what O'Neill did at Eastern Bank (i.e., evaluate acquisition targets). The court additionally noted that Bray's conduct after receiving the tip, including self-acknowledged "ridiculous[ly]" large purchases of an illiquid stock, and his concoction of a

[27] Brendan Pierson, *Rare Re-Argument Ordered in Insider Trading Appeal of SAC's Martoma*, Reuters, Mar. 1, 2017 (*available at* http://www.reuters.com/article/us-sac-insidertrading-martoma-idUSKBN1685GC).

[28] *Bray*, Slip Op. at 15 (citation omitted).

[29] *E.g., Bray*, Slip Op. at 17-18 n.6 ("[T]he Supreme Court expressly declined to address what level or type of knowledge a criminal tippee must have regarding a tipper's receipt of a personal benefit.").

[30] *United States v. Goffer*, Crim. No. 10-56 (RJS), Op. & Order (S.D.N.Y. Jan. 17, 2017) (*available at* http://nylawyer.nylj.com/adgifs/decisions17/011917sullivan.pdf).

cover story after O'Neill revealed that they were in legal peril, did not do his argument any favors.

These arguments have not always failed, however. One high-profile example of this is the Dean Foods case involving professional gambler William "Billy" Walters and professional golfer Phil Mickelson. A Dean Foods board member allegedly tipped Walters to market-moving events. Walters allegedly turned around and tipped Mickelson, who used his $1 million in profits to repay gambling debts to Walters.[31] But there was no indication (from the public record, anyway) that the tip involved any intelligence on the source of the confidential information. Walters simply "urged" Mickelson to buy Dean Foods, and Mickelson did.[32] That would appear to be the reason Mickelson was not prosecuted and the SEC named Mickelson only as a relief defendant[33] — he had no provable knowledge of the personal benefit to the source or even who the source was.[34]

Likewise, the SEC and Justice Department both suffered losses against a downstream tippee who successfully argued before two federal juries that he was not aware of whom the source of the confidential information was and thus could not have had the requisite intent to violate the insider-trading laws. In the federal government's insider-trading investigation surrounding Sanofi Adventis' 2009 acquisition of Chattem Inc., the SEC and Justice Department pursued an accountant named Thomas Melvin, who had gotten the confidential takeover information from a client. The government additionally pursued a number of Melvin's friends and partners whom Melvin tipped, including a general contractor named Joel Jinks. In December 2015, however, a federal jury acquitted Jinks, needing only an hour to deliberate.[35] According to the jury forewoman, Melvin's testimony was that he had told Jinks that one of Melvin's clients had recommended Chattem stock. But Melvin failed to indicate whether he had told Jinks who that source was, and the jury found this lack of information sufficient to acquit. More than a year later, the SEC fared no better against Jinks, even with a lesser evidentiary burden and without the specter of *Newman*. On February 17, 2017, another federal jury cleared Jinks of any civil liability for his Chattem trades.[36]

IV. CONCLUSION

The Supreme Court's *Salman* holding provided needed clarity to an important issue in the insider-trading legal landscape. Federal enforcement authorities, who were already aggressively pursuing downstream insider traders notwithstanding *Newman*, will now likely double down on those efforts. Defendants still have a number of arguments at their disposal, however, as the legal requirements of a "meaningfully close personal relationship" between the tipper and tippee, as well as knowledge of the "personal benefit" received by the original source of the inside information, should keep many of these cases close. ■

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[31] *See* Press Release, SEC Announces Insider Trading Charges in Case Involving Sports Gambler and Board Member (May 19, 2016) (*available at* https://www.sec.gov/news/pressrelease/2016-92.html).

[32] *SEC v. Walters*, Civil No. 16-3722, Compl. ¶¶ 3, 8 (May 19, 2016) (*available at* https://www.sec.gov/litigation/complaints/2016/comp-pr2016-92.pdf).

[33] A "relief defendant" is generally defined as an individual who received ill-gotten gains as a result of the unlawful acts of other named defendants. A relief defendant is not accused of wrongdoing, but may be required to disgorge his gains if he cannot establish a legitimate claim to them.

[34] After a three-week trial, a jury convicted Walters on 10 counts of insider trading. William Gorta, *Jury Convicts Gambler Billy Walters of Insider Trading*, Law360 (Apr. 7, 2017).

[35] Ed Beeson, *Jury Clears Ga. Man of Insider Trading in Sanofi Case*, Law360, Dec. 10, 2015, *at* https://www.law360.com/articles/736561/jury-clears-ga-man-of-insider-trading-in-sanofi-case.

[36] Jack Newsham, *Jury Finds Man Traded on Inside Info About Sanofi Deal*, Law360, Feb. 17, 2017, *at* https://www.law360.com/articles/893498/jury-finds-man-traded-on-inside-info-about-sanofi-deal.