Sentencing Commission Revisits Fraud-on-the-Market Guidelines
By Gregory J. O’Connell and Vera Kachnowski

At the start of each year, the United States Sentencing Commission proposes amendments to the Sentencing Guidelines. While the 2016 proposed amendments are currently in the comment period, an amendment that was made during the prior cycle is worth examining. On April 9, 2015, the Commission voted to promulgate amendments to the fraud Guideline, §2B1.1, to address four areas of concern, including the treatment of fraud-on-the-market offenses. These securities offenses, which may be prosecuted under 18 U.S.C. §§ 1348 and 1350, involve manipulation of stock prices that is presumed to affect all shareholders. Calculating the exact loss to shareholders is difficult, though, and raises concerns that a defendant might be held responsible for market movements unrelated to their fraud. In the civil context, various calculation methods have been applied to these types of offenses, often requiring expert testimony. Meanwhile, the 2014 Guidelines had provided the following rebuttable presumption in an Application Note to §2B1.1:

Read more...

Is the CFTC Attempting to Lower its Standard?
Determining Specific Intent in the CEA’s Anti-Manipulation Provisions
By Lisa Totino

On January 12th, the Managed Funds Association, Chicago Mercantile Exchange Group Inc., Commodity Markets Council, Futures Industry Association and the Intercontinental Exchange (collectively, "financial industry groups") sought permission to file an amicus curiae brief in U.S. CFTC v. Donald R. Wilson Jr. & DRW Investments to weigh in on the legal standard required for manipulation and attempted manipulation of the price of a futures contract, namely the IDEX USD Three-Month Interest Rate Swap Futures Contract from at least January 2011 through August 2011. As set forth in their amicus brief, the financial industry groups are concerned that the Commodity Futures Trading Commission (the "CFTC" or the "Commission") is advancing the view that, to satisfy the specific intent element of a claim for manipulation or attempted manipulation, it need only prove "an intent to affect price" and not intent to create a "artificial" or "distorted" price, as required under the traditional standard. In response to the financial industry groups’ request for leave to file an amicus brief, on January 19th, the Commission urged the court to deny the brief. In doing so, the Commission relied primarily on procedural grounds (i.e., that the amicus brief is not useful, untimely, and without merit) and argued that such issues have been "thoroughly litigated" through 80-pages of pre-trial motions.

Read more...

AML Regulatory Alert: Federal Court Rules That Anti-Money Laundering Law Applies To Compliance Officers
By David M. Rosenfield
In its September 2015 memo known as the "Yates Memo," the Department of Justice ("DOJ") outlined its new objective to hold individuals accountable in corporate misconduct cases. A recent federal district court ruling against former MoneyGram Compliance Chief Thomas Haider is an example of how the DOJ's new corporate misconduct policy, as it applies to individuals, is likely to work. The Haider suit is a case against a compliance officer for anti-money laundering ("AML") control failures. What previously would have been viewed as extremely unlikely - a compliance officer being held individually accountable for AML control failures - is now an issue that corporate compliance officers must take very seriously. In almost all cases prior to the Haider decision, only corporations themselves, and not individual employees, were held responsible for improper conduct. Following Haider, corporate compliance officers at financial institutions must protect themselves by ensuring that their companies enforce robust, effective AML policies and procedures, and file all necessary Suspicious Activity Reports ("SARs").

Read more...

Insider Trading Showdown: "Personal Benefit" to be Tested at the U.S. Supreme Court
By Robert Hoff and Ivana Greco

By granting cert and agreeing to hear an appeal from the Ninth Circuit Court of Appeals' decision in United States v. Salman, 792 F.3d 1087 (9th Cir. 2015), the U.S. Supreme Court may clarify the scope of the "personal benefit" prong of insider trading law. Clarity on this aspect of insider trading law could be a welcome development for prosecutors, defendants and their counsel, traders and compliance professionals. The Supreme Court's case also has the potential to upend the most significant insider trading case in recent history, the Second Circuit Court of Appeals' decision in United States v. Newman, 773 F.3d 438 (2d Cir. 2014).

Read more...
Sentencing Commission Revisits Fraud-on-the-Market Guidelines
by Gregory J. O’Connell and Vera Kachnowski*

At the start of each year, the United States Sentencing Commission proposes amendments to the Sentencing Guidelines. While the 2016 proposed amendments are currently in the comment period, an amendment that was made during the prior cycle is worth examining. On April 9, 2015, the Commission voted to promulgate amendments to the fraud Guideline, §2B1.1, to address four areas of concern, including the treatment of fraud-on-the-market offenses. These securities offenses, which may be prosecuted under 18 U.S.C. §§ 1348 and 1350, involve manipulation of stock prices that is presumed to affect all shareholders. Calculating the exact loss to shareholders is difficult, though, and raises concerns that a defendant might be held responsible for market movements unrelated to their fraud. In the civil context, various calculation methods have been applied to these types of offenses, often requiring expert testimony. Meanwhile, the 2014 Guidelines had provided the following rebuttable presumption in an Application Note to §2B1.1:

[T]he actual loss attributable to the change in value of the security or commodity is the amount determined by— (I) calculating the difference between the average price of the security or commodity during the period that the fraud occurred and the average price of the security or commodity during the 90-day period after the fraud was disclosed to the market, and (II) multiplying the difference in average price by the number of shares outstanding.3

Many had suggested that a simpler loss calculation method would be better.

The Proposal

In January 2015, the Commission responded to these concerns by proposing a significant change in approach.4 Instead of using §2B1.1(b)(1)’s loss table, the Commission proposed that:

---

* Gregory O’Connell is a Partner and Vera Kachnowski is an Associate at De Feis O’Connell & Rose, P.C., a firm specializing in white collar defense
1 Some commentators have also suggested that losses are a faulty measure of damages because “for every innocent purchaser (seller) of a security who suffered a loss by buying (selling) at an artificially inflated (deflated) price, there exists an innocent seller (purchaser) of the very same security who earns a profit by selling (buying) at precisely the same artificially inflated (deflated) price.” See Letter from Prof. Joseph Grundfest, Stanford Law School, to Hon. Patti Saris, at 3-6 (Mar. 16, 2015) (outlining critiques of this “circularity” problem yielding no net economic loss).
2 Id. at 1-3.
If the offense involved (i) the fraudulent inflation or deflation in the value of a publicly traded security or commodity and (ii) the submission of false information in a public filing with the Securities and Exchange Commission or similar regulator, the enhancement determined above shall be based on the gain that resulted from the offense rather than the loss.5

The gain-based model would have a floor of not less than 14 to 22 levels.6 If the proposal were accepted, the rebuttable loss calculation method would have been deleted from the Guidelines.7

The Response

Perhaps not surprisingly, the Department of Justice opposed the proposed move to a gain-based model on the grounds that it ignores Dodd-Frank’s directive that securities fraud penalties address the often-significant harm to the public, even where a defendant gains little.8 The DOJ also expressed concerns that the Commission’s definition of fraud-on-the-market would reach not only “major public company fraud cases” where loss calculations are difficult, but also run of the mill pump-and-dump cases, where loss is more easily measured.9 Moreover, the DOJ suggested that the defense bar would seek to analogize unrelated fraud cases to benefit from the gain-based calculation.10 Finally, the DOJ noted that Application Note 3(b) already provides the option for courts to use “the gain that resulted from the offense as an alternative measure of loss” if there is “a loss but it reasonably cannot be determined,” suggesting that no amendment is needed.11

The defense bar, by contrast, was generally supportive of the proposal. The ABA endorsed the move to a gain-based model and suggested that it should be extended to other offenses as well.12 The Federal Defenders, for their part, maintained that the best method of calculating loss is a “market-adjusted model,” following Dura Pharmaceuticals, Inc., v. Broudo, 544 U.S. 336 (2005).13 They noted that this method “measures the loss actually caused by the fraud. Since the loss amount is used in §2B1.1 as a proxy for culpability, price changes that are

---

5 Id. at 2590 (emphasis added).
6 Id.
7 Id.
9 Id. at 34-35.
11 Wroblewski Letter at 35 (citing §2B1.1, n.(3)(B), also suggesting that gain is no easier to calculate than loss).
12 Testimony of James E. Felman, on behalf of the American Bar Association, at 15-16 (Mar. 12, 2015).
13 Statement of Michael Caruso on behalf of the Federal Public and Community Defenders, at 18 (Mar. 12, 2015) (citing United States v. Rutkoske, 506 F.3d 170, 179 (2d Cir. 2007); United States v. Olis, 429 F.3d 540, 546 (5th Cir. 2005)).
not attributable to the defendant’s conduct should not be included in the loss amount.”

As a second-best alternative, however, the Defenders also considered that a gain-based approach would be simpler and more accurate than the current loss calculation. That said, the Defenders opposed the proposed floor of 14-22 levels, viewing it as arbitrary and noting that a court is always free to depart upwards if the seriousness of the offense has not been captured.

The Practitioners Advisory Group joined in the concern that the proposed floor was arbitrary and agreed that gain “is often a better measure of culpability than loss when loss is driven largely by the severity of the stock market reaction to the public disclosure of the fraud multiplied by the number of outstanding shares.” They noted that numerous extrinsic factors affect stock price making the loss attributable to the actual fraud very difficult to differentiate.

As such, the PAG supported a gain-based model by endorsing the Commission’s alternative suggestion that fraud-on-the-market cases be sentenced under §2B1.4 (Insider Trading), which uses such approach. The New York Council of Defense Lawyers agreed with this alternative.

The National Association of Criminal Defense Lawyers, however, opposed the new approach and floor, noting that in “many securities fraud cases the defendant gained little or nothing by his conduct,” and, as such, “imposing a minimum 14- to 22-level enhancement would be highly arbitrary and, in all but exceptional cases, profoundly unjust.” Instead, they suggested “the Commission craft a new guideline for fraud-on-the-market cases,” with a new base offense level based on the conduct itself, along with enhancements or reductions.

---

14 Id. (emphasis in original).
15 Id.
16 Id. at 18-19 (citing §2B1.1, n.20(A)). In this regard, they note that the median level for all such offenses in 2012 and 2013 was 14, so setting the floor lower is inconsistent with the data. Id. at 19.
17 Testimony of Eric A. Tirschwell, Vice-Chair, Practitioners Advisory Group, at 9-10 (Mar. 12, 2015).
18 Id. (citing Dura Pharms.).
19 Id. at 8-9 (noting that because “fraud on the market cases generally follow a relatively prototypical format, the lengthy list of specific offense characteristics set out in § 2B1.1 would not need to be imported,” with the exception of §2B1.1(b)(19), which is specific to securities fraud, and proposing that the definition of the offense be expanded).
21 Letter from Theodore Simon, President, National Association of Criminal Defense Lawyers, to Hon. Patti Saris, at 13 (Mar. 18, 2015) [hereinafter Simon Letter]; see also Letter from Washington Legal Foundation to Hon. Patti Sari, at 5-6 (Mar. 18, 2015) (arguing that imposing minimum floor on “defendants who derived no pecuniary benefit from their conduct is not only arbitrary but unduly severe” and suggesting consideration instead of “such factors as the actual loss relative to the defendant’s intended gain from the offense, the motivation for the crime, the defendant’s role as a principal or merely as a participant, the scope and duration of the offense, and the defendant’s risk of recidivism”).
The Result

Ultimately, the Commission decided not switch to a gain-based model but rather to modify Application Note 3(F)(ix) to §2B1.1. Instead of requiring courts to apply the rebuttable presumption outlined above, the Application Note to the 2015 amendments now states that “the court in determining loss may use any method that is appropriate and practicable under the circumstances.”23 The Application Note provides that “one such method the court may consider” is the loss calculation method that was previously outlined.24 Although this move does not go as far as many would have liked, and the Commission’s 2016 proposal does not address the issue further, the change to the Application Note provides more flexibility to apply alternative calculations that might better capture a defendant’s individual culpability in these cases.

24 Id.
Is the CFTC Attempting to Lower its Standard? Determining Specific Intent in the CEA’s Anti-Manipulation Provisions
Lisa Totino

On January 12th, the Managed Funds Association, Chicago Mercantile Exchange Group Inc., Commodity Markets Council, Futures Industry Association and the Intercontinental Exchange (collectively, “financial industry groups’) sought permission to file an *amicus curiae* brief in *U.S. CFTC v. Donald R. Wilson Jr. & DRW Investments* to weigh in on the legal standard required for manipulation and attempted manipulation of the price of a futures contract, namely the IDEX USD Three-Month Interest Rate Swap Futures Contract from at least January 2011 through August 2011. As set forth in their *amicus brief*, the financial industry groups are concerned that the Commodity Futures Trading Commission (the “CFTC” or the “Commission”) is advancing the view that, to satisfy the specific intent element of a claim for manipulation or attempted manipulation, it need only prove “an intent to affect price” and not intent to create a “artificial” or “distorted” price, as required under the traditional standard. In response to the financial industry groups’ request for leave to file an *amicus* brief, on January 19th, the Commission urged the court to deny the brief. In doing so, the Commission relied primarily on procedural grounds (i.e., that the *amicus* brief is not useful, untimely, and without merit) and argued that such issues have been “thoroughly litigated” through 80-pages of pre-trial motions.

What are the CEA’s anti-manipulation provisions?

On July 14, 2011, pursuant to Section 753 of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd Frank Act”), the CFTC adopted two rules that amended Commodity Exchange Act (“CEA”) section 6(c) and expanded the CFTC’s pre-existing anti-manipulation and anti-fraud authority.

The first rule, Rule 180.1, established the Commission’s new fraud-based authority unrelated to price. This standard was largely modeled off of Securities Exchange Act section 10(b)-5 and removes two key elements of the traditional manipulation standard (specific intent and artificiality); however, it is significantly broader than 10(b)-5 (as it covers attempts). The second rule, Rule 180.2, which is relevant in the instant case, implements the Commission’s long-standing authority to prohibit price manipulation under pre-Dodd Frank law. In applying Rule 180.2, the Commission uses it’s the “traditional four-part test for manipulation that has developed in case law arising under [CEA sections] 6(c) and 9(a)(2).” Adopting Release, 76 Fed. Reg. 41398, 41407 (July 14, 2011). Under *the traditional* test, four elements must be satisfied to prove manipulation of a commodity price. First, the accused must have had the ability to influence market prices. Second, the accused must have specifically intended to create or affect a price or price trend that does not reflect legitimate forces of supply and demand. Third, artificial prices must have existed. Fourth, the accused must have caused the artificial prices. *Id.* See also CFTC Fact Sheet relating to its anti-manipulation and anti-fraud rules, Rules 180.1 and 180.2. In its the Adopting Release, the CFTC states that, it would

---

“continue interpreting the prohibition on price manipulation and attempted price manipulation to encompass every effort to improperly influence the price of a swap, commodity, or commodity futures contract” and “an illegal effect on price can often be conclusively presumed from the nature of the conduct in question and other factual circumstances not requiring expert economic analysis.” 76 Fed. Reg. at 41407-408 (emphasis added). However, the CFTC neither prescribed what constitutes an “improper influence” nor why a new dictation of the rule was necessary in light of past jurisprudence.

Discussion of the brief

On one hand, the financial industry groups contend that the CFTC is attempting to lower its anti-manipulation standard and expand its authority under the CEA. As explained in the amicus brief, the jurisprudence for price manipulation developed over time to draw a clear line “between trading misconduct and legitimate trading,” from which the Commission currently retreats. For instance, in the seminal case In re Indiana Farm Bureau Coop Ass’n, Inc., which the brief primarily relies, the court confirmed the specific intent requirement: “[t]o meet the specific intent element of a claim for manipulation or attempted manipulation of a futures contract, the Commission must plead that Defendants ‘acted (or failed to act) with the purpose or conscious object of causing or effecting a price or price trend in the market that did not reflect the legitimate forces of supply and demand’” CFTC Docket No. 75-14 (Dec. 17, 1982) (emphasis added) (citation omitted). Furthermore, the financial industry groups contend that the CFTC previously “considered and rejected the legal standard that it is now urging this Court to adopt.” Moreover, commenting on the very nature of trading, the brief continues that market participants — short of having the purpose to create “artificial” or “distorted” prices — “have a right to trade in their own best interests without regard to the positions of others.” In fact, engaging in trading activities based on market fundamentals that involve a profit motive promotes well-functioning markets and price discovery. “[T]rading with the expectation that the trades will move the price closer to the trader’s view of fair value,” the financial industry groups assert, “is a critical part of the price information dissemination and price discovery functions of the markets.” For example, Even if a trader’s view of prices is based on inaccurate or incomplete information, bids or purchases nevertheless disseminate new price information and encourage others to trade and, therefore, facilitate price discovery.

On the other hand, this may all be a matter of semantics. As the amicus brief acknowledges, the CFTC simply quoted an shorthand phrasing of the rule: “[t]he CFTC relies on an oft-quoted short-hand summary of the elements of attempted manipulation: (1) an intent to affect the market price of the commodity, and (2) some overt act in furtherance of that intent;” thus, the Commission may not have been attempting to depart from the traditional anti-manipulation standard. Even if the Commission was not attempting to depart from the traditional standard, this may still be an important issue to address for the future of anti-manipulation litigation.

Moving forward
If the overbroad application of the anti-manipulation provisions of the CEA is adopted by the court, the financial industry groups are concerned that the new legal standard would interfere with, among other things, lawful business conduct, price discovery, liquidity, and hedging activities. For instance, market participants may be deterred from legitimate trading to avoid the risk of being subjected to anti-manipulation litigation. In addition, as the financial industry groups also discussed, this new standard would depart from “decades of settled law.” See, e.g., In re Indiana Farm Bureau Coop Ass’n. Inc., CFTC Docket No. 75-14 (Dec. 17, 1982); In re Hohenberg Bros. Co., CFTC No. 75-4, 1977 WL 13562 (Feb. 18, 1977). As such, regulators who try to bring future manipulation and attempted manipulation cases may incorrectly rely on a watered down standard and cross the line between prosecuting “trading misconduct and legitimate trading” activities.
Federal Court Rules That Anti-Money Laundering Law Applies To Compliance Officers

In its September 2015 memo known as the “Yates Memo,” the Department of Justice (“DOJ”) outlined its new objective to hold individuals accountable in corporate misconduct cases. A recent federal district court ruling against former MoneyGram Compliance Chief Thomas Haider is an example of how the DOJ’s new corporate misconduct policy, as it applies to individuals, is likely to work. The Haider suit is a case against a compliance officer for anti-money laundering (“AML”) control failures. What previously would have been viewed as extremely unlikely—a compliance officer being held individually accountable for AML control failures—is now an issue that corporate compliance officers must take very seriously. In almost all cases prior to the Haider decision, only corporations themselves, and not individual employees, were held responsible for improper conduct. Following Haider, corporate compliance officers at financial institutions must protect themselves by ensuring that their companies enforce robust, effective AML policies and procedures, and file all necessary Suspicious Activity Reports (“SARs”).

U.S. Department of the Treasury v. Thomas Haider

On January 8, 2016, a federal district court in Minnesota held that compliance officers and other individuals at companies subject to the Bank Secrecy Act (“BSA”), 31 U.S.C. §§ 5311, et seq., can be held responsible for AML failures. The ruling in U.S. Department of the Treasury v. Thomas Haider, 2016 WL 107940 (D. Minn., Jan. 8, 2016), was a setback for former MoneyGram Chief Compliance Officer Thomas Haider who, in 2014, was hit with a $1 million fine by the Financial Crimes Enforcement Network (“FinCEN”). FinCEN’s action against Haider resulted from the money transfer company’s $100 million settlement with the federal government in November 2012, in which MoneyGram admitted to wire fraud and money laundering violations. MoneyGram entered into a deferred prosecution agreement with the DOJ, admitting, that it had “willfully” failed to implement an effective AML program.

In the federal civil action against Haider, his attorneys challenged FinCEN’s ability to levy a penalty against an individual under the provisions of the BSA. Haider’s attorneys had previously claimed that the action was “unfounded,” and the wrong case in which to reinforce the principle of individual responsibility.

On December 18, 2014, FinCEN assessed a $1 million civil monetary penalty against Haider, alleging his willful failure to ensure that MoneyGram: (a) implemented and maintained an effective AML program, and (b) filed timely SARs. The same day that FinCEN assessed the penalty, the U.S. Treasury Department (“the government”) filed its federal action, seeking an order reducing the assessment to a judgment and enjoining Haider from working for any “financial institution.” Haider thereafter moved to dismiss the government’s case.

Haider’s primary challenge against the assessment was under 31 U.S.C. § 5318(h), which provides, in pertinent part, that, “[i]n order to guard against money laundering through financial institutions, each financial institution shall establish anti-money laundering programs.” Haider argued that the court should dismiss the government’s claim under § 5318(h) because, by its very terms, it only applies to financial institutions and not to individuals. Haider also argued that, in contrast to § 5318(h), § 5318(g) provides that, “any
financial institution, and any director, officer, employee, or agent of any financial institution, [may be required] to report any suspicious transactions relevant to a possible violation of law or regulation." In response, the government argued that the BSA's more general civil penalty provision, § 5321(a)(1), had to be considered in determining whether Haider was personally subject to a penalty under § 5318(h). Section 5321(a)(1), in turn, permits the imposition of a civil penalty against a “domestic financial institution or nonfinancial trade or business, and a partner, director, officer, or employee of a domestic financial institution or nonfinancial trade or business, willfully violating this subchapter or a regulation prescribed or order issued under this subchapter [ …].” The federal district court agreed with the government and ruled that the provision of the BSA which requires institutions to establish money laundering programs is governed by the BSA's broader civil penalty provision, 5321(a)(1), which permits a penalty to be levied against a “partner, director, officer, or employee” of a company. 2016 WL 107940 at *3.

For more information about the issues in this alert, please contact:

David M. Rosenfield at +1 212 592 1513 or drosenfield@herrick.com
Insider Trading Showdown: “Personal Benefit” to be Tested at the U.S. Supreme Court

Robert Hoff and Ivana Greco

By granting cert and agreeing to hear an appeal from the Ninth Circuit Court of Appeals’ decision in *United States v. Salman*, 792 F.3d 1087 (9th Cir. 2015), the U.S. Supreme Court may clarify the scope of the “personal benefit” prong of insider trading law. Clarity on this aspect of insider trading law could be a welcome development for prosecutors, defendants and their counsel, traders and compliance professionals. The Supreme Court’s case also has the potential to upend the most significant insider trading case in recent history, the Second Circuit Court of Appeals’ decision in *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014).

It starts with *Dirks*

A recitation of all the elements and permutations of insider trading law as it might be applied to different factual scenarios is unnecessary for purposes of this article. For present purposes, it is worth briefly stating the pertinent elements of tipper/tippee liability, as it is the tipper/tippee scenario that the Supreme Court is likely to address.

The tipper/tippee scenario applies when an insider – the tipper – shares material nonpublic information with someone – the tippee – who trades on the information. There can be multiple tippers and tippees in a chain of communications, and the elements of insider trading liability must be proven as to each tippee in the chain of communications for that tippee to be liable.

A discussion of the elements of tipper/tippee liability starts with the seminal U.S. Supreme Court case, *Dirks v. S.E.C.*, 463 U.S. 646 (1983). The Court held that “a tippee assumes a fiduciary duty to the shareholders of a corporation not to trade on material nonpublic information only when the insider has breached his fiduciary duty to the shareholders by disclosing the information to the tippee and the tippee knows or should know that there has been a breach.” *Id.* at 660. Moreover, in determining whether the insider/tipper breached his fiduciary duty by sharing material non-public information, “the test is whether the insider personally will benefit, directly or indirectly, from his disclosure. Absent some personal gain, there has been no breach of duty to stockholders.” *Id.* at 662. And because a tippee’s liability derives from the tipper’s, “absent a breach by the insider, there is no derivative breach” by the tippee. *Id.*

The Court also addressed what a personal benefit meant for purposes of this analysis. It held that, determining whether the tipper shared information in breach of a duty to the insider “requires courts to focus on objective criteria, i.e., whether the insider receives a direct or indirect personal benefit from the disclosure, *such as a pecuniary gain or a reputational benefit that will translate into future earnings*. There are objective facts and circumstances that often justify such an inference. For example, there may be 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.* at 663-64 (emphasis added; citations omitted). The Court then stated 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.*” *Id.* at 664 (emphasis added). It is this latter part of the analysis that has generated significant debate and which *Newman* directly addressed.
Along came *Newman*

In 2014, the Second Circuit Court of Appeals in *Newman* sent shockwaves through the securities industry when the Court overturned the insider trading convictions of two individuals. Significantly, the Court held that, to prove the personal benefit prong of insider trading law where the personal benefit is premised on a relationship or friendship (as opposed to, say, an exchange of money), prosecutors must prove that a tipper and tippee had “a meaningfully close personal relationship that generates an exchange that is objective, consequential, and represents at least a potential gain of pecuniary or similarly valuable nature.” 773 F.3d at 452. In other words, as the Court said, the exchange of information had to include a *quid pro quo* from the tippee or an intention to benefit the tippee because of the relationship between the tipper and tippee. *Id.* The Court noted that the “mere fact” that the tipper and tippee are friends is not always enough to prove a personal benefit to the tipper, especially if the relationship between them is casual or social in nature. *Id.* *Newman* also held that all tippees, including remote tippees as the defendants in *Newman* were, must have knowledge of the personal benefit to the tipper to be liable.

Although *Newman* was arguably just interpreting the plain language of *Dirks*, the case was important because it seemed to scale back what had previously been interpreted as a very broad definition of “personal benefit.” Following *Dirks*, especially its statement that a personal benefit to the tipper could exist when “an insider makes a gift of confidential information to a trading relative or friend,” 463 U.S. at 664, courts across the country allowed many types of relationships between tippers and tippees to qualify as a personal benefit to the tipper even absent evidence of a tangible *quid pro quo*. Those cases theorized, very generally speaking, that a tipper necessarily benefited from sharing information with a friend or relative by the mere fact of furthering the relationship. But *Newman* held that mere friendship, or a social or casual relationship, is not always enough.

After *Newman*, many questioned how its personal benefit standard would be applied in future cases. In particular, how close must the relationship be between tipper and tippee to satisfy the personal benefit prong? Would courts conclude that some family relationships were closer than others, such as those between siblings versus those between cousins? Would factual issues arise as to the degree of “closeness” between family members or friends? Would courts infer an “intention to benefit” some close family members, but not other family members?

*Salman* may answer the questions

The U.S. Supreme Court denied cert in *Newman*, leaving the case standing as the law in the Second Circuit, and as an important decision for other jurisdictions to consider. But in *United States v. Salman*, the U.S. Supreme Court may soon provide answers to the questions *Newman* left open.

The pertinent facts of *Salman* are as follows. Salman’s brother-in-law, Maher Kara, worked at Citigroup. He regularly shared confidential inside information about upcoming mergers and acquisitions with his brother, Michael Kara, who traded on the information. After Maher married Salman’s sister, the families grew close and Salman and Michael became friends.
Michael began to share with Salman the inside information that he learned from Maher, and Salman also began to trade on the information. 792 F.3d at 1089.

The government presented evidence that Salman knew Maher was the source of the information. The government also presented evidence that Maher and Michael enjoyed a “close and mutually beneficial relationship,” including that “Michael helped pay for Maher’s college, that he stood in for their deceased father at Maher’s wedding,” and that “Michael coached Maher in basic science to help him succeed at his job.” Id. Furthermore, Maher testified that he loved Michael very much, and that he gave Michael the inside information to benefit him and fulfill whatever needs Michael had. For example, Michael once asked Maher for money, and instead of providing the money, Maher gave Michael a tip about an upcoming acquisition. Id. The government further presented evidence that Salman knew of Maher and Michael’s close relationship. A jury convicted Salman of conspiracy and insider trading based on these facts.

Salman appealed his conviction, arguing, among other things, that the evidence was insufficient to satisfy Newman’s personal benefit test, which he urged the Ninth Circuit to adopt. In particular, he contended that the evidence was insufficient to find that Maher disclosed information to Michael in exchange for a “tangible” personal benefit, which he claimed Newman required. Id. at 1090, 1093. The evidence of the close relationship between Maher and Michael was not enough according to Salman’s interpretation of Newman, because Maher did not receive a tangible benefit from Michael in exchange for the information Maher shared.

The Ninth Circuit declined to adopt Newman (at least, Salman’s interpretation of it), and relied instead, on Dirks’ holding that a personal benefit is satisfied by “a gift of confidential information to a trading relative or friend.” Id. at 1092 (quoting Dirks, 463 U.S. at 664). The Court easily held that the evidence satisfied Dirks.

As to Salman’s reading of Newman, which would have required a “tangible” benefit from Michael to Maher in exchange for information, the Ninth Circuit held that such a reading would require an impermissible departure from Dirks. Moreover, under Salman’s reading of Newman, “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.” Id. at 1094. But that is not the Dirks test. Rather, 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.” Id.

After the Ninth Circuit’s ruling, Salman petitioned the Supreme Court for a writ of certiorari. The Court granted cert on the following question:

Does the personal benefit to the insider that is necessary to establish insider trading under Dirks v. SEC, 463 U.S. 636 (1983), 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 United States v. Newman, 773 F.3d 438 (2d Cir. 2014), cert. denied, No. 15-137 (U.S. Oct. 5, 2015), or is it enough that the insider and the tippee shared a close family relationship, as the Ninth Circuit held in this case?
Arguably, the outcomes in *Salman* and *Newman* are entirely consistent. While the *Salman* Court declined to adopt the defendant’s interpretation of *Newman* as requiring a tangible benefit, it is likely that Salman’s conviction would have been upheld under the *Newman* test. After all, *Newman* acknowledged that *Dirks* held that the personal benefit prong could be satisfied by evidence that the tipper and tippee had such a close relationship that the tipper intended to benefit the tippee because of the relationship. *Newman*, 773 F.3d at 452. That standard is likely satisfied where one sibling tips another and testifies that he did so in order to benefit his sibling, which is what occurred in *Salman*. The tougher question from *Newman* is whether the outcome would be the same for a less “close” family relationship. *Salman* did not present that closer question.

Even though the outcomes of *Salman* and *Newman* may be consistent, the reasoning of the two opinions appears to be in tension. The U.S. Supreme Court’s decision to take on *Salman* and the personal benefit question presents the Court with the opportunity to clarify what the personal benefit standard is for courts across the country. Its decision has the potential to be groundbreaking. One only needs to consider the immediate impact *Newman* has had on the federal government’s pending and concluded insider trading cases – resulting in guilty pleas being reversed and cases being dropped – to realize that *Newman* raised the bar for prosecutors and likely slowed their efforts to prosecute insider trading.

If the Supreme Court rejects the *Newman* standard, or announces a standard that is more lenient than *Newman* has been interpreted to be, prosecutors may be given renewed motivation to pursue insider trading cases. In all events, expect the Supreme Court’s *Salman* decision to clarify the scope of the personal benefit test so interested parties – prosecutors, defense lawyers, traders, and compliance professionals – have a better idea of the scope of insider trading law.