Supreme Court asked to clarify 'benefit' in insider trading

WASHINGTON

Prosecutors and traders looking to settle dispute on where to draw the line

BY BEN PROTESS
AND MATTHEW GOLDSTEIN

ANDREW MANGUM FOR THE NEW YORK TIMES

The Supreme Court in Washington. One of the most hotly debated issues on Wall Street is what prosecutors must prove to secure insider trading convictions based on confidential tips.

Supreme Court justices offered hope to both prosecutors and traders during arguments in the first insider trading case to come before America's high court in two decades.

A ruling by the court could clarify one of the most hotly debated issues on Wall Street: what prosecutors must prove to secure insider trading convictions based on confidential tips.

In their questioning on Wednesday, the justices grappled with where to draw the line. Even as they appeared sympathetic to the government's interpretation of the high court's past insider trading decisions, the justices were wary of radically expanding the government's power and affording prosecutors too much of a free hand in these cases.

The case now before the court, Salman v. United States, No. 15-628, comes from California and centers on the insider trading conviction of Bassam Salman in 2013. According to prosecutors, Mr. Salman placed profitable stock trades based on confidential information leaked by his future brother-in-law, Maher Kara, who had advance knowledge of corporate mergers because of his job in Citigroup's health care investment banking group.

For decades, courts have held that it is not inherently illegal to trade stocks based on material, nonpublic information like a merger or acquisition. For an insider to be guilty of sharing inside information, his leak must breach a duty to keep the information confidential and he must receive a personal benefit in exchange for the leak. By extension, the person who receives the information must generally know of that breach and benefit.

The Salman case presents a question that has vexed federal appeals courts and left prosecutors and traders alike seeking clarity: What exactly amounts to a "personal benefit"?

Prosecutors hope the court will afford them leeway in defining the benefit, arguing that if an insider provides a gift of information, that should count as a benefit. In the Salman case, Maher Kara did not receive any financial benefit but arguably leaked the information as a gift.

Mr. Salman's lawyer, Alexandra Shapiro, argued on Wednesday that the benefit must be more "tangible" — like cash or something that eventually can be monetized.

Several of the justices, citing one of the court's seminal insider trading decisions from three decades ago, seemed skeptical of her argument and poised to uphold Mr. Salman's conviction.

After all, as Justice Stephen Breyer noted, "to help a close family member is like helping yourself."

Yet the court, often skeptical of prosecutors in white-collar crime cases, also questioned the government's lawyer, Michael Dreeben, about where to draw the line. The justices seemed hesitant to afford prosecutors broad authority to apply the so-called gift test to situations in which the insider and recipient are not family or close friends.

The issue gained prominence after a 2014 decision from the United States Court of Appeals for the Second Circuit in Manhattan, United States v. Newman, that upended the Justice Department's sweeping crackdown on insider trading. Mr. Salman's argument for overturning his conviction hinges on the Newman decision, which tightened the standard for what constitutes a personal benefit by requiring prosecutors to show a tangible benefit rather than mere friendship between the tipper and recipient.

The Second Circuit, in that 2014 decision, overturned the insider trading convictions of the hedge fund managers Todd Newman and Anthony Chiasson, who were at the end of a long chain of information being passed along. In the aftermath, federal prosecutors in New York tossed out the convictions of nearly a dozen other traders and industry consultants.

Preet Bharara, the United States attorney in Manhattan, whose office secured insider trading convictions against dozens of people in the nearly $3 trillion hedge fund industry, has been an outspoken critic of the Second Circuit ruling. Mr. Bharara, who attended Wednesday's argument, has argued that the Second Circuit's decision could create "a potential bonanza for friends and family of rich people with material nonpublic information."

The Supreme Court denied the Justice Department's request that it review that ruling, though the justices could indirectly rebuke it in deciding Mr. Salman's case.

In Mr. Salman's case, the United States Court of Appeals for the Ninth Circuit in San Francisco took a different approach.

The Ninth Circuit upheld Mr. Salman's conviction and adopted the view that giving inside information to a family member qualified as a benefit, creating what some legal observers saw as a split that only the Supreme Court could reconcile.

Both the Newman and Salman appeals court decisions hinged on a 33-year-old Supreme Court case, Dirks v. Securities and Exchange Commission, that has long been the cornerstone of insider trading law.

That decision directed courts to focus on "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."

In overturning Mr. Newman's conviction, the Second Circuit seized on that financial element.

But when the Ninth Circuit upheld Mr. Salman's conviction, it focused on another passage in the Dirks decision that allowed liability "when an insider makes a gift of confidential information to a trading relative or friend."

That excerpt strikes at the heart of Mr. Salman's case. Maher Kara passed the inside information, arguably as a gift, to his brother, Michael Kara, who in turn shared it with Mr. Salman. The two families were close; Maher Kara was engaged to Mr. Salman's sister. (While Maher Kara struck a plea deal and was sentenced to three months of home confinement, Mr. Salman was sentenced to three years in prison.)

Some of the justices, appearing skeptical of Mr. Salman's argument, highlighted the passage within the Dirks ruling that references gifts to family members.

"You're asking us to cut back significantly from something that we said several decades ago," Justice Elena Kagan told Ms. Shapiro, adding that "the integrity of the markets are a very important thing for this country. And you're asking us essentially to change the rules in a way that threatens that integrity."

But a decision that just upholds Mr. Salman's conviction — and reaffirms the Dirks decision with some clarity — would disappoint some prosecutors who argue that the current unsettled nature of the law has had a chilling effect on cases.

The Justice Department's ideal ruling would uphold the conviction of Mr. Salman and then take the Ninth Circuit's ruling further so that the gift rule would not be limited to just family and close friends.

Ben Protess reported from Washington, and Matthew Goldstein from New York. Peter J. Henning and Adam Liptak contributed reporting.