

Insider Trading - Will The U.S. Supreme Court Roll Back Newman?

On Wednesday, Oct. 5, 2016, the U.S. Supreme Court heard oral arguments in *Salman v. United States*—a case that could significantly impact the current status of insider trading law.

The case centers on a Chicago grocery wholesaler, Bassam Salman, who was convicted of insider trading for receiving second-hand stock tips from a family member. Salman's brother-in-law, Maher Kara, was an investment banker at Citigroup. Maher passed stock tips to his older brother Mounir ("Michael") Kara, who ran a hazardous waste business in Chicago and Michael in turn passed these tips on to Salman. Salman was convicted of making \$2.1 million on Kara's tips (which he deposited into a joint account with his wife's sister and her husband). In exchange, the government alleged Maher received a "close fraternal relationship" with Michael, which Salman was aware of¹.

The crime of insider trading is predicated on a violation of Section 10(b) of the Securities Exchange Act of 1934, which bars any "manipulative or deceptive device." Because the language of the law is vague, parties have relied on the courts to supply the legal constructs of an insider trading violation. Based on the seminal case of *Dirks v. SEC*, in order to be convicted of insider trading the law requires proof that the tipping insider "will benefit, directly or indirectly, from his disclosure." 463 U.S. 646, 662 (1983). Until recently prosecutors had wide discretion to prove such a personal benefit to the tipper. However, in 2014 in *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014), the Second Circuit vacated the insider-trading convictions of two individuals (who were third- and fourth-level tippees in lengthy tipping chains) on the grounds that prosecutors failed to present sufficient evidence of the personal benefit to the tipping insider. The government had simply relied upon "the mere fact of a friendship, particularly of a casual or social nature" between the insider and the first-level tippee *Id.* at 452. The government appealed *Newman*, but the Supreme Court denied cert. Shortly after *Newman*, Salman also appealed his conviction on the basis that the government failed to prove any personal benefit to the tipping insider in that case, Maher Kara, for the tips.

The question before the Supreme Court in *Salman* is whether the law requires proof of an actual pecuniary benefit to the tipper or whether a gift of information is enough to satisfy the personal benefit test. As the court summarized in its order granting cert, the question accepted for review was whether the law requires proof of "an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature, or is it enough that the insider and the tippee shared a close family relationship?"²

A concern of the defense bar is that if Salman's conviction is upheld, this could lead to increased prosecutions for insider trading amongst family members and friends.³ Salman further argues that if the

¹ Order, Judge Rakoff, *United States v. Salman*, No. 14-10204 (9th Cir., July 6, 2015).

² "Question Presented," *Salman v. United States*, 15-628 (cert. granted 1/19/2016), available here.

³ See e.g., Amy How "Argument Preview: Justices to Consider What Constitutes a 'Personal Benefit' in Insider Trading," *ScotusBlog* (Sept. 28, 2016). ("The federal government counters that a ruling for Salman could exacerbate

court sides with the government, the court will have acted beyond its authority and stepped into the role of Congress. As Salman argues, Congress has had the opportunity to amend Section 10(b) to clarify that a close family relationship or friendship is enough, but hasn't.⁴ The result, Salman contends, is overreaching by the Supreme Court, unbounded prosecutorial discretion, and over-criminalization. Salman's view is supported by a number of amicus briefs, including one by Marc Cuban, who was acquitted in his own insider trial against the Securities and Exchange Commission. Cuban writes, "[h]istory demonstrates that the Government will relentlessly push to expand the outer limits of what constitutes insider trading until it is reined in."⁵

By comparison, the government argues that if Salman's conviction is overturned, this will lead to unfettered insider trading, "specifically if [the insider] could secure in return a non-pecuniary benefit, such as romantic favors from a mistress or a college-admissions preference for their children," and yet avoid conviction.⁶ In its brief, the government essentially argues for a new test where a personal benefit is found when an insider shares information without a corporate purpose, such as for a gift.⁷

Early reports indicated that the justices' comments showed them leaning toward upholding Salman's conviction. "Justice Elena Kagan suggested that adopting Salman's position would overturn decades of legal principle that had helped protect the integrity of the stock markets. 'You're asking us essentially to change the rules in a way that threatens that integrity,' Kagan reportedly said."⁸ Justice Stephen Breyer reportedly noted, "to help a family member is to help yourself."⁹ Likewise, Justice Sonia Sotomayor reportedly said, "You're going to do something that saves you money by giving the tip."¹⁰

An opinion is expected early next year. Prosecutors, regulators, litigants, Supreme Court observers, and other insiders will impatiently await its ruling.

existing inequities in the stock market by making corporate insiders even more likely to pass on confidential information to friends and family.")

⁴ Brief for Bassam, *Salman, Salman v. United States of America*, No. 15-628, at *12 (Aug. 31, 2016).

⁵ Amicus Curiae Brief of Marc Cuban, *Salman v. United States of America*, No. 15-628, at *15 (May 13, 2016).

⁶ Brief for the United States, *Salman v. United States of America*, No. 15-628, at *58 (Aug. 1, 2016).

⁷ *Id.* at *54-55.

⁸ Nate Raymond "U.S. Top Court Leans Toward making Insider Trading Prosecutions Easier," Reuters (Oct. 5, 2016).

⁹ Ben Protess and Matthew Goldstein "Supreme Court to Rule on Legality of Insider Tips," *The New York Times* (Oct. 5, 2016).

¹⁰ Nate Raymond "U.S. Top Court Leans Toward making Insider Trading Prosecutions Easier," Reuters (Oct. 5, 2016).

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