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SECURITIES REGULATION—NINTH CIRCUIT DECLINES TO FOLLOW NARROW PRESENTATION OF NOVEL INSIDER TRADING INTERPRETATION ISSUED BY SECOND CIRCUIT SECURITIES LAW "EXPERTS"

*Jordan Bruns**

IN *United States v. Salman*, the Court of Appeals for the Ninth Circuit was urged to adopt a recent change to the standard of insider trading announced and adopted by the Court of Appeals for the Second Circuit in *United States v. Newman*.[1] Though the Second Circuit's ruling is not legally binding on the Ninth Circuit, the Ninth Circuit faced a direct challenge by the defendant-appellant to adopt this *Newman* standard and reverse his conviction for conspiracy and insider trading.[2] In declining to follow the *Newman* standard and affirming the conviction, the Ninth Circuit held that proof of material, nonpublic information disclosed by an insider with the intent to benefit a trading relative or friend was sufficient evidence to establish a breach of fiduciary duty and, thus, insider trading.[3] Though this appears to be a controversial circuit split on its face, in actuality, the difference in the interpretation of Supreme Court precedent stems from the circuit courts' being faced with two very different insider trading cases.[4] The Ninth Circuit correctly upheld the conviction, but its narrow interpretation of the *Newman* standard was inappropriate in the context of this fairly traditional misappropriation scenario.

This case involves an insider trading scheme among Bassam Yacoub Salman (Salman) and members of his extended family.[5] In 2002, Maher Kara (Maher) joined Citigroup as an investment banker in their health-

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1. United States v. Salman, 792 F.3d 1087, 1088 (9th Cir. 2015); United States v. Newman, 773 F.3d 438, 450 (2d Cir. 2014) *cert. denied*, 136 S. Ct. 242 (2015).
2. *See Salman*, 792 F.3d at 1088.
3. *Id.* at 1094.
4. *Compare Salman*, 792 F.3d at 1088–89 (involving a short chain of causation among family members in a misappropriation insider trading case), *with Newman*, 773 F.3d at 443 (involving a remote tippee in a classical insider trading case).
5. *Salman*, 792 F.3d at 1088.

care group.[6] In 2004, his older brother, Michael Kara (Michael), began to solicit confidential information about Citigroup's upcoming transactions.[7] Maher suspected Michael was trading on the information, but still "knowingly obliged" Michael's requests from 2004 to 2007.[8] In 2003, Maher became engaged to Salman's sister.[9] As the two families grew more familiar with one another, Salman and Michael most notably became "fast friends."[10] Michael began to share his inside information with Salman, and encouraged Salman to mirror his trading moves.[11] Salman acquiesced and discretely made the trades through a brokerage account held jointly by his wife's sister and her husband.[12] Profits from these trades totaled upwards of $2 million from 2004 to 2007.[13]

In 2013, a jury found Salman guilty of one count of conspiracy to commit securities fraud and four counts of securities fraud.[14] During the trial, Michael, who had already plead guilty, testified for the government that Salman had inquired about where Michael had gotten the information and "Michael told him, directly, that it came from Maher."[15] Michael also testified to once confronting Salman about being careless with the information after finding evidence of the trades left out openly in Salman's office, and to he and Salman's agreement that "they [both] had to 'protect' Maher."[16] To further bolster its case, the government offered evidence of Maher and Michael's "close and mutually beneficial relationship," including the following facts: Michael paid a portion of Maher's college tuition, Michael "stood in for their deceased father at Maher's wedding," and Michael taught Maher scientific concepts to help further his career.[17] Maher testified that he gave Michael the inside information to "benefit" Michael and meet Michael's "needs."[18] In a specific instance, Michael asked Maher for information as a "favor" because he "owe[d] somebody," but refused to take money from Maher so that he could receive an inside tip about a pending acquisition from Maher instead.[19] Lastly, the government illustrated that Salman knew of Michael and Maher's "close fraternal relationship" by offering examples of times when Salman was a witness to such intimate and demonstrable exchanges between the brothers at family events.[20]

After the jury found Salman guilty, Salman was denied his motion for a

6. *Id.*
7. *Id.* at 1089.
8. *Id.*
9. *Id.*
10. *Id.*
11. *Id.*
12. *Id.*
13. *Id.*
14. *Id.* at 1088.
15. *Id.* at 1089.
16. *Id.*
17. *Id.*
18. *Id.*
19. *Id.*
20. *Id.* at 1090.

new trial and thus appealed to the Ninth Circuit.[21] In his opening brief, Salman did not challenge the sufficiency of the evidence.[22] However, after the Second Circuit's *Newman* decision was issued, Salman moved to file a supplemental brief, asserting that the government's evidence was "insufficient under the standard announced in *Newman*," which he argued the Ninth Circuit should adopt.[23] The Ninth Circuit granted the motion, allowed the government to respond, and held they had jurisdiction to address Salman's claim on the merits.[24]

In an opinion written by the Honorable Jed S. Rakoff, the court held "the evidence was more than sufficient for a rational jury to find both that inside information was disclosed in breach of a fiduciary duty, and that Salman knew of that breach at the time he traded on it."[25] The court declined to follow *Newman*, reasoning that to do so would require the court to depart from clear Supreme Court precedent in *Dirks v. S.E.C.*[26] There, the Supreme Court determined breach of fiduciary duty, the fundamental element in insider trading cases, is met where an "insider makes a gift of confidential information to a trading relative or friend."[27] Maher asserted that he had disclosed the inside information to benefit and provide for his brother, thus breaching his fiduciary duty to Citigroup by receiving the personal benefit of benefitting a relative.[28]

In affirming Salman's insider trading conviction, the Ninth Circuit relied on the well-established Supreme Court precedent in *Dirks*.[29] As background, there are two theories that serve as the foundation of insider trading: the "classical" and "misappropriation" theories.[30] Under the classical theory, insider trading occurs when an insider trades the corporation's own securities based on material, nonpublic information about the corporation.[31] The scope of liability for insider trading was expanded under the misappropriation theory, under which liability may be found where an "outsider" possesses material, nonpublic information about a corporation and uses that information to trade in breach of the fiduciary duty owed by the insider providing the information.[32] *Dirks* further expanded insider trading liability by forbidding insiders and misappropriators from giving undisclosed information (acting as a "tipper") to an outsider ("tippee") for the "same improper purpose of exploiting the

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21. *Id.*
22. *Id.*
23. *Id.*
24. *Id.*
25. *Id.* at 1094, n.* (noting Judge Rakoff is the Senior District Judge for the Southern District of New York sitting by designation in the Ninth Circuit).
26. *Id.* at 1093.
27. *Id.* (quoting Dirks v. S.E.C., 463 U.S. 646, 664 (1983)).
28. *Id.* at 1094.
29. *Id.* at 1094.
30. United States v. Newman, 773 F.3d 438, 445 (2d Cir. 2014), *cert. denied*, 136 S. Ct. 242 (2015).
31. *Id.* (citing Chiarella v. United States, 445 U.S. 222, 230 (1980)).
32. *Id.* at 445–46. (citing United States v. O'Hagan, 521 U.S. 642, 652–53 (1997)).

information for their personal gain."[33] In the present case, Salman received the inside information from a misappropriator, making him a tippee.[34]

The *Salman* court noted that, under *Dirks*, the test for whether an insider breached its fiduciary duty "is whether the insider will personally benefit, directly or indirectly, from [the] disclosure."[35] The court said that "a tippee is equally liable if 'the tippee knows or should know that there has been [such] a breach,'" and thus, knows of the personal benefit.[36] It read *Dirks* to define a "personal benefit" as "'a pecuniary gain or a reputational benefit that will translate into future earnings,'" or an insider's "gift of confidential information to a trading relative or friend."[37] Under the Ninth Circuit's analysis, Maher's admission to leaking inside information to Michael, knowing that Michael was trading on it, is exactly the "gift of confidential information to a relative" that *Dirks* governs, since Maher testified that he revealed the information to benefit his brother and fulfill his needs.[38] In regards to Salman's knowledge, Michael asserted that he "directly" told Salman that Maher provided the inside information that the two had traded on, and Michael and Salman had both agreed that because of this they needed to "protect" Maher.[39] Salman was also aware of Michael and Maher's close, fraternal relationship, making it reasonable for a jury to determine that "Salman could readily have inferred Maher's intent to benefit Michael."[40] Therefore, under *Dirks*, the Ninth Circuit concluded that the evidence was sufficient for the jury to find that Maher had disclosed the information in breach of his fiduciary duties and that Salman knew the breach and the personal benefit derived therefrom.[41]

Newman expanded the *Dirks* standard, holding that when a court can infer a personal benefit from a personal relationship between the tipper and tippee, "such an inference is impermissible in the absence of proof of a *meaningfully close personal relationship* that generates an exchange that is objective, consequential, and *represents at least a potential gain of a pecuniary or similarly valuable nature*."[42] This led the Second Circuit to conclude that evidence in the case of remote, fourth-tier tippees, was circumstantial and not sufficient to support the inference that the insiders received personal benefit and the remote tippees knew they were trading on information from the insiders.[43] In refusing to follow this interpretation of *Dirks*, the Ninth Circuit reasoned that following the *Newman*

33. *Salman*, 792 F.3d at 1091 (citing Dirks v. S.E.C., 463 U.S. 646, 659 (1983)).
34. *Id.* at 1092.
35. *Id.* (quoting *Dirks*, 463 U.S. at 662).
36. *Id.* (quoting *Dirks*, 463 U.S. at 660).
37. *Id.* (quoting *Dirks*, 463 U.S. at 663–64).
38. *Id.* (citing *Dirks*, 463 U.S. at 664).
39. *Id.*
40. *Id.*
41. *Id.*
42. *Id.* at 1093.
43. *Id.*

standard would require it to depart from the holding in *Dirks* that insiders breach their fiduciary duty when theygift inside information to a relative on which that relative could trade.[44] The evidence presented by the government clearly showed that Maher breached his fiduciary duty when he disclosed "material[,] nonpublic information" with the intent to benefit a relative; thus, the court found, the government met the Supreme Court's *Dirks* standard.[45]

Though the Ninth Circuit reached the right outcome in this straightforward insider trading scheme, the court could have done so without overtly declining to follow *Newman* (just as Judge Rakoff did in *S.E.C. v. Payton*[46]), but rather, by factually distinguishing between the two cases and their policy implications. *Newman* involved an appeal from the convictions of two former portfolio managers for insider trading.[47] Through a chain of insiders and analysts, the defendants in *Newman* were about four levels removed from the initial inside tippers, but eventually made trades based on nonpublic information.[48] The defendants in *Newman* also claimed that they did not know where the information came from, proffering evidence that information of a similar type (but not from an insider) is often passed from analysts to portfolio managers in a similar format.[49] *Salman* presented a strikingly different situation.

In *Salman*, there was a short chain of causation—from brother to brother to an extended family member—and each actor was aware of the information's origin and confidential nature.[50] By distinguishing between these two very important factual differences, the Ninth Circuit could have acknowledged the *Newman* standard without explicitly disclaiming it by pointing to the different contexts of the two cases. The Ninth Circuit could have reasoned that the "gift of confidential information to a relative" provision in *Dirks* still applied in this case where there was no issue of a remote tippee, but rather, a common familial trading scheme.[51]

Additionally, the differing policy implications noted in both cases support the conclusion that the Ninth Circuit could have acknowledged the *Newman* standard, but rationalized against its use in the context of *Salman*. In the case of a remote tippee, the Second Circuit supported its novel interpretation of *Dirks* in order to counter recent insider trading prosecutions that are "increasingly targeted at remote tippees many levels removed from corporate insiders."[52] This promotes efficiency in the national securities markets by narrowing a court's focus to the actual

44. *Id.*
45. *Id.* at 1094.
46. *See* S.E.C. v. Payton, 97 F. Supp. 3d 558, 565 (S.D.N.Y. 2015) (noting that, in this case, Judge Rakoff was bound by the Second Circuit's *Newman* standard).
47. United States v. Newman, 773 F.3d 438, 442 (2d Cir. 2014), *cert. denied*, 136 S. Ct. 242 (2015).
48. *Id.* at 443.
49. *Id.* at 443, 454.
50. *Salman*, 792 F.3d at 1089.
51. *See id.* at 1089, 1092.
52. *Newman*, 773 F.3d at 448.

breach of fiduciary duty.[53] This is a strong policy argument in the case of the "remote, downstream tippee" in a circuit that handles the majority of securities regulation cases, but it is not relevant in the context of an insider trading scheme like in *Salman*.[54] The Ninth Circuit based their holding on the policy rationale that if a narrow interpretation of the *Newman* standard is accepted then any corporate insider or misappropriator could disclose inside information to relatives, who could then trade on it, so long as he or she asks for no "tangible compensation."[55] This rationale focuses specifically on insider trading in the context of a short chain of causation between family members who all know where the inside information is coming from, identical to the facts in *Salman*.[56] Had the Ninth Circuit distinguished the two cases based on their facts, it could have narrowed the holding of *Salman* so that *Salman* did not directly conflict with the Second Circuit's *Newman* standard and the policy objectives behind that standard.[57] Both circuit courts could have fulfilled the separate policy objectives without alienating each other by simply emphasizing the specific insider trading scheme that each holding aimed to regulate.

Additionally, the court only evaluated the *Newman* standard under the narrow interpretation that Salman, as the appellant-defendant, presented to the court. In his supplemental brief, Salman read *Newman* to hold that "evidence of a friendship or familial relationship between the tipper and tippee, standing alone, is insufficient to demonstrate that the tipper received a benefit."[58] Thus, Salman argued that there was insufficient evidence to uphold the conviction.[59] Rather than trying to distinguish this case based on the facts or interpret the *Newman* holding more broadly, the Ninth Circuit simply declined to follow the Second Circuit.[60] Had the court interpreted the *Newman* standard more broadly based on the "*quid pro quo*" provision, the Ninth Circuit could have determined that the conviction would still be upheld under the *Newman* standard, while still using *Dirks* as the primary and binding authority.[61] *Newman* holds that evidence of a personal benefit inferred from a personal relationship between the tipper and tippee is impermissible *unless* there is evidence of "a relationship between the insider and recipient that suggests a *quid pro quo* from the latter, or an intention to benefit from the [latter]."[62] Had the Ninth Circuit used this language, as Judge Rakoff did in *Payton*, the

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53. *See id.* at 449.
54. Bryan Neil Hoffman and Kevin C. McAdam, *Holland & Hart Discuss* Newman *Cert., A Potential Tipping Point for Insider Trading Liability*, CLS BLUE SKY BLOG (Aug. 25, 2015), http://clsbluesky.law.columbia.edu/2015/08/25/newman-cert-a-potential-tipping-point-for-insider-trading-liability/ [perma.cc/EB9E-3F6F].
55. *Salman*, 792 F.3d at 1094.
56. *See id.*
57. *See generally Salman*, 792 F.3d at 1087; *Newman*, 773 F.3d at 438.
58. *Salman*, 792 F.3d at 1093.
59. *Id.*
60. *Id.*
61. *Newman*, 773 F.3d at 452.
62. *Id.* (quoting United States v. Jiau, 734 F.3d 147, 153 (2d Cir. 2013)) (emphasis added).

court could have easily interpreted the evidence in *Salman* to fit this exception.[63] Maher testified that he gave Michael inside information to benefit his brother, while evidence was also presented that Michael helped pay Maher's college tuition, "stood in for their deceased father at Maher's wedding," and helped teach Maher scientific concepts for his job.[64] Both brothers benefitted one another, thus forming a *quid pro quo* relationship that could be interpreted as an exception to the *Newman* holding.[65] Maher also testified of his intention to benefit his brother by disclosing the inside information.[66] In this way—by interpreting *Newman* broadly as described above—the Ninth Circuit could have reconciled the two seemingly conflicting cases.

While reading the Ninth Circuit's opinion in *Salman*, it is important to keep in mind that it is written by Judge Rakoff, who is well respected and known as an expert in the field of securities regulation.[67] Sitting as a visiting judge in the overworked and overburdened Ninth Circuit allowed Judge Rakoff to write an opinion rejecting the *Newman* standard and exert influence although he normally would be bound to follow Second Circuit precedent.[68] Additionally, the Supreme Court denied the petition of certiorari to review *Newman* on October 5, 2015, leaving the door open for a petition from Salman.[69]

With the circuit split still pending, the Supreme Court may choose to review *Salman* due to its express denial of the Second Circuit's interpretation of the law in *Newman*. The Ninth Circuit could have distinguished this case based on the facts and context, policy, or by broadly interpreting *Newman*, all of which would have been effective means to avoid overtly declining to follow the Second Circuit. Instead, the Ninth Circuit did decline to follow *Newman*'s new interpretation of insider trading law, relying on the established Supreme Court precedent in *Dirks*.[70] Had the Ninth Circuit taken a less adversarial route to reconcile the two cases, a much less controversial decision would have resulted. Nonetheless, the court did arrive at the correct outcome.

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63. *See* S.E.C. v. Payton, 97 F. Supp. 3d 558, 562 (2015).

64. *Salman*, 792 F.3d at 1089.

65. *See Payton*, 97 F. Supp. 3d at 562 (illustrating Judge Rakoff's interpretation of a *quid pro quo* relationship as one in which there is evidence that both parties intended to benefit one another).

66. *Salman*, 792 F.3d at 1092.

67. *Jed Rakoff, Adjunct Professor*, COLUMBIA LAW SCHOOL, http://web.law.columbia.edu/courses/instructors/8698(Judge Rakoff serves as a professor at Columbia Law School, teaching several courses, including White Collar Crime) [perma.cc/7V3G-7A8H].

68. Jacob Gershman, *Rakoff and Ninth Circuit Throw Cold Water on Insider Trading Ruling*, WALL ST. J.: LAW BLOG (July 6, 2013, 5:20 PM), http://blogs.wsj.com/law/2015/07/06/rakoff-and-ninth-circuit-throw-cold-water-on-insider-trading-ruling/ [perma.cc/EJQ4-MG3G].

69. United States v. Newman, 136 S. Ct. at 242.

70. *See Salman*, 792 F.3d at 1092.