CLIENT MEMORANDUM

Ninth Circuit Issues Insider Trading Decision Consistent with *Newman*

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AUTHORS

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On July 6, 2015, Judge Jed S. Rakoff, writing for the United States Court of Appeals for the Ninth Circuit, issued a decision in *United States v. Salman*, which affirmed the criminal convictions of alleged remote tippee Bassam Yacoub Salman for insider trading and conspiracy to commit insider trading.[1] Although the Ninth Circuit in *Salman* went out of its way to assert that it was not bound by the Second Circuit's decision in *United States v. Newman*[2], the decision does not actually contradict the holdings in *Newman* and is in fact consistent with that groundbreaking decision.

Background

On September 1, 2011, the United States Attorney's Office in San Francisco, California, charged Bassam Yacoub Salman with insider trading and conspiracy to commit insider trading for allegedly trading on tips he received from Michael Kara between 2004 and 2007 that resulted in profits for Salman of more than $1.1 million. Michael Kara (who pled guilty) had allegedly received the inside information from his brother Maher Kara, who was also Salman's brother-in-law, and who

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

2 *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014).

worked in Citigroup's healthcare investment banking group. Significantly, the Government presented evidence that Salman knew that Maher Kara was the source of the inside information, and that Salman knew that Maher and Michael Kara enjoyed a "close fraternal relationship."

The jury found Salman guilty and Salman subsequently appealed his conviction. After the Second Circuit issued *Newman*, which vacated the insider-trading convictions of two hedge fund managers on the grounds that the Government failed to present sufficient evidence that they knew the information they received had been disclosed in exchange for a personal benefit, Salman argued in his appellate papers that the Government's evidence was insufficient under the standard announced in *Newman*, which he urged the Ninth Circuit to adopt, to find either that Maher Kara disclosed the inside information to Michael Kara in exchange for personal benefit, or if he did, that Salman knew of such benefit.

Holding

The Ninth Circuit upheld Salman's convictions primarily upon the plain language of the Supreme Court's decision in *Dirks v. SEC*.[3] In *Dirks*, the Supreme Court addressed the liability of a tippee analyst who received material nonpublic information about possible fraud at a company from one of the company's former officers. The analyst relayed that information to some of his clients who then sold their shares. In dismissing the SEC's case against the analyst for aiding and abetting securities fraud, the Court articulated the general principle of tipping liability where an outsider ("tippee") trades on material nonpublic information received from a company insider or misappropriator ("tipper"). The Supreme Court held that the mere disclosure of material, nonpublic information by itself is insufficient to constitute a breach of an insider's fiduciary duties.[4] Rather, to determine whether an insider breached a fiduciary duty, courts are required 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."[5] However, the Court stated "*[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.*"[6]

The Ninth Circuit found that "Maher's disclosure of confidential information to Michael, knowing that he intended to trade on it, was precisely the 'gift of confidential information to a trading relative' that *Dirks* envisioned."[7] The court explained that there was evidence that by providing Michael with inside information Maher "intended to 'benefit' his brother and to 'fulfill[] whatever needs he had,'" and that Salman and Maher agreed they had to "protect" Michael. The court reasoned that given the Kara brothers "close relationship, Salman could readily have inferred Maher's intent to benefit Michael."

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3 *Dirks v. SEC*, 463 U.S. 646 (1983).

4 *Id.* at 646.

5 *Id.* at 663.

6 *Id.* at 664 (emphasis added).

7 *Salman*, at *10* (quoting *Dirks*, 463 U.S. at 664).

Therefore, the court found, "there can be no question that, under *Dirks*, the evidence was sufficient for the jury to find that Maher disclosed the information in breach of his fiduciary duties and that Salman knew as much."[8]

Salman argued that under *Newman*, "evidence of a friendship or familial relationship between tipper and tippee, standing alone, is insufficient to demonstrate that the tipper received a benefit" and that "the exchange of inside information must include 'at least a potential gain of a pecuniary or similarly valuable nature'" by the tipper.[9] As applied to his case, because there was no evidence that Maher received any such tangible benefit in exchange for the inside information, or that Salman knew of any such benefit, Salman argued that the Government failed to carry its burden.[10] The Ninth Circuit rejected Salman's argument, noting that "[t]o the extent *Newman* can be read to go so far, we decline to follow it."[11] Judge Rakoff pointed out, however, that "*Newman* itself recognized that the 'personal benefit is broadly defined to include not only pecuniary gain, but also *inter alia*, . . . the benefit one would obtain from simply making a gift of confidential information to a trading relative or friend.'"[12] Moreover, *Newman* held that evidence of an intent to provide a gift of confidential information can be shown by "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."[13] Thus, the conduct in this case would be violative of the law even under *Newman*, and *Salman* does not change the law.

Conclusion

The Ninth Circuit's decision in *Salman* does not contradict *Newman*, or change the fact that the Government under current law needs to prove that the tipper received a meaningful personal benefit from the tippee, and a remote tippee must know of that benefit to be found guilty of insider trading. It makes clear, however, that the Government can meet this burden for a remote tippee through circumstantial evidence.

This may not be the end of the story, however. The United States Attorney's Office for the Southern District of New York is still considering whether to file a petition for a writ of certiorari to the Supreme Court in *Newman*. The Southern District has until August 1, 2015 to do so.

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[8] *Id.* at 10-11.

[9] *Id.* at 13 (quoting *Newman*, 773 F. 3d at 452).

[10] *Id.*

[11] *Id.*

[12] *Id.* at 14 (quoting *Newman*, 773 F.3d at 452).

[13] *Newman*, 773 F. 3d at 452 (emphasis added).

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