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3 Takeaways From The 9th Circ.'s Insider Trading Ruling

By **Stephanie Russell-Kraft**

Law360, New York (July 7, 2015, 8:09 PM ET) -- U.S. District Judge Jed S. Rakoff on Monday added yet another twist to the growing mess of insider trading law when he penned a Ninth Circuit decision to uphold a conviction in a family insider trading scheme, underscoring the ambiguity of the Second Circuit's landmark Newman decision and increasing the likelihood that the government will appeal it.

The appellate court upheld a San Francisco federal jury's finding that Bassam Yacoub Salman committed securities fraud by indirectly receiving insider tips from his future brother-in-law Maher Kara, then an investment banker at Citigroup Global Markets Inc. According to prosecutors, Salman received information from Maher Kara's brother Michael Kara, a close friend.

On appeal, Salman argued that the ruling conflicted with Newman because prosecutors hadn't shown Maher disclosed information to Michael in exchange for a clear, pecuniary benefit or that Salman even knew about it.

But, citing the Supreme Court's 1983 decision in Dirks v. SEC, Rakoff said there was enough evidence to support the conviction because Maher, the insider, breached his fiduciary duty by disclosing information to Michael, a trading relative, and that Salman clearly knew about that breach when he traded.

Here, Law360 takes a look at the three main takeaways of that holding:

Newman's Implications Remain Unclear

In its landmark Dirks ruling, the Supreme Court held that insider trading tippers must receive a so-called personal benefit in exchange for the information they disclose. The ruling was intended to prevent whistleblowers or other insiders with good reason for disclosing information from facing prosecution.

The court defined that benefit as a "a pecuniary gain or a reputational benefit that will translate into future earnings," but also found that the tippers can be found to exploit nonpublic information when they make "a gift of confidential information to a trading relative or friend."

In December, the Second Circuit took that reasoning up a notch by ruling that a benefit may only be inferred from a personal relationship with 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."

Since then, some observers, including Judge Rakoff, have wondered if Newman is fully compatible with Dirks.

“Whether this is the required reading of Dirks may not be obvious, and it may not be so easy for a lower court, which is bound to follow both decisions, to reconcile the two,” Rakoff wrote in April, ruling in Securities and Exchange Commission v. Payton et al. that Newman didn’t preclude civil charges against two former brokers accused of trading on inside information about a $1.2 billion IBM Corp. acquisition.

In the Salman ruling, Rakoff again examined the differences in the two decisions and aligned himself firmly with the language of Dirks, writing that “to the extent Newman can be read to go so far” as to hold that evidence of a familial relationship alone is insufficient to prove personal benefit, “we decline to follow it.”

So the question that remains is what exactly the Second Circuit meant in Newman, according to David Miller, a former assistant U.S. attorney for the Southern District of New York.

"The language is very carefully drafted,” Miller, now a partner at Morgan Lewis & Bockius LLP, said. “[Rakoff] states that if Newman is saying a pecuniary quid pro quo is required even when there is a gift of confidential information to a family member, then the Ninth Circuit declines to follow the Second Circuit.“

Bob Appleton, a partner at Day Pitney LLP, said he initially read Rakoff’s ruling to be in conflict with Newman, but then reconsidered after thinking about the different fact underlying the two decisions.

“It’s not inconsistent with Newman, it’s a different circumstance,” Appleton said, adding that it nonetheless limits Newman to some extent.

If the Second Circuit never intended for prosecutors to show pecuniary benefits in close-knit family-based insider trading schemes, then the two rulings aren’t necessarily incompatible. But if it did, Rakoff might have just set up a circuit split ripe for Supreme Court review.

A Supreme Court Appeal May Be in the Cards

Newman was decided in December, and the Second Circuit denied Manhattan U.S. Attorney Preet Bharara’s request for an en banc rehearing in April. But the case may not be over just yet.

The bullish prosecutor, who made a name for himself by racking up 80 insider trading guilty pleas and convictions, still has three weeks to decide whether to appeal the decision to the Supreme Court.

If Bharara and Solicitor General Donald B. Verrilli Jr. choose to argue that Salman is inconsistent with Newman — or that, at the very least, Salman underscores Newman’s ambiguities — they may have a better shot at certiorari, attorneys say.

"Salman is important because, as the government is making a decision on whether to appeal to the Supreme Court, you now have a Ninth Circuit opinion by a very well-known Southern District judge stating that if Newman suggests that the provision of confidential information by an insider to a family member requires a pecuniary quid pro quo, we’re not following Newman on that point,” Morgan Lewis’ Miller said.

Appleton and his Day Pitney partner Stan Twardy also said the decision increases the chances the government will appeal Newman to the Supreme Court.

“This may give them further reason to seek cert,” Appleton said.

Of course, Salman may also choose to appeal the Ninth Circuit ruling up to the justices if an en banc review falls through.

Once a case is before the justices, the court could use the ambiguity in the relationship between the two decisions to help make a decision either way, according to Jonathan Richman, co-head of Proskauer Rose LLP’s securities litigation group.

“If the Supreme Court wants to say there’s no direct conflict here, it can say that,” Richman said.” On the other hand, it can say there’s some tension here and we might want to clean up the law and clarify what we meant in Dirks.”

Rakoff Is Still the King of Insider Trading Law

Although Judge Rakoff has become one of the most vocal advocates for a clear congressional insider trading statute, he has also been one of the most important judges shaping the application of existing law in the courts.

His assignment to this appeal was pure coincidence — he sits on a few Ninth Circuit panels each year, and cases are assigned by lot — but his opinion shows he knows what he’s talking about.

The senior judge cut his teeth on securities law in the U.S. Attorney's Office for the Southern District of New York, where he helped bring the government’s first criminal insider trading case, bringing an indictment against Vincent Chiarella in January 1978. Later, in private practice, he represented numerous people involved in insider trading cases, including the former investment banker who later became the subject of James Stewart’s bestseller "Den of Thieves."

Since Rakoff was appointed to the bench in 1995, he’s presided over a slew of insider trading suits, including both the civil and criminal cases brought against former Goldman Sachs Group Inc. director Rajat Gupta. Just last week, Rakoff denied Gupta’s bid to strike his insider trading conviction, ruling he tried to use the Newman defense too late in his appeal.

"Judge Rakoff has demonstrated that he’s one of the most important jurists in insider trading law,” Miller said. “His opinions show his adherence to insider trading precedent, including Dirks v. SEC.”

--Editing by Chris Yates and Philip Shea.