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Why Bassam Salman Should Not Have Been Convicted: Salman v. United States

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A lot of ink has been spilt on the ***United States Supreme Court'***s decision in ***Salman v. United States***, 137 S. Ct. 420 (2016). In that case, the Supreme Court upheld the criminal conviction of Mr. Bassam Salman who received lucrative trading tips from an extended family member, who had received the information from Mr. Salman's brother-in-law. The legal issue in the case was whether a gift of confidential information to a friend or family member alone is sufficient to establish the personal benefit required for tippee liability.

My issue with Mr. Salman's conviction is the "sentence first – verdict afterwards" of insider trading cases. Congress has never defined the precise rules of insider trading. Moreover, the adoption of the operative rule – Rule 10b-5 – was a decidedly *ad hoc* enterprise:

> "It was one day in the year 1943, I believe. I was sitting in my office in the S. E. C. building in Philadelphia and I received a call from Jim Treanor who was then the Director of the Trading and Exchange Division. He said, `I have just been on the telephone with Paul Rowen,' who was then the S. E. C. Regional Administrator in Boston, `and he has told me about the president of some company in Boston who is going around buying up the stock of his company from his own shareholders at $4.00 a share, and he has been telling them that the company is doing very badly, whereas, in fact, the earnings are going to be quadrupled and will be $2.00 a share for this coming year. Is there anything we can do about it?' So he came upstairs and I called in my secretary and I looked at Section 10 (b) and I looked at Section 17, and I put them together, and the only discussion we had there was where `in connection with the purchase or sale' should be, and we decided it should be at the end.
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> We called the Commission and we got on the calendar, and I don't remember whether we got there that morning or after lunch. We passed a piece of paper around to all the commissioners. All the commissioners read the rule and they tossed it on the table, indicating approval. Nobody said anything except Summer Pike who said, `Well,' he said, `we are against fraud, aren't we?' That is how it happened."

Remarks of Milton Freeman, Conference on Codification of the Federal Securities Laws, 22 Bus. Law. 793, 922 (1967) *quoted in Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 767 (1975) (Note that this Milton Freeman is not the famous economist).

Wouldn't Theory First – Verdict Afterwards Be More Fair?

Notably, Rule 10b-5 itself doesn't explicitly mention insider trading. It would be more than a half century before the SEC finally adopted a rule, Rule 10b5-1 defining just one element of insider trading – when a purchase or sale constitutes trading "on the basis of" material non public information. It is no surprise then that federal courts have struggled to define who can be guilty of insider trading and why. The result is that the crime of insider trading has a decidedly "make it up as you go along" quality. Individuals don't know where the lines are until the courts draw them and then convict. Consequently, people have gone to prison even as courts have adopted the theories for their convictions. The fact that the U.S. Supreme Court is still defining the crime more than seven decades after Mr. Freeman cobbled together Rule 10b-5 suggests that the definition of insider trading has been too inchoate to support criminal convictions. However "well tuned to an animating principle" a theory might be, I simply don't think due process exists when a crime is only defined after a conviction.

If Congress truly believes that insider trading should be a crime, it should define the exact elements of the crime rather than leave it to the courts to make up the rules as they send people to prison. The California legislature has in fact done just that in Corporations Code Section 25402. For more on Section 25402, see my article, *California's Unique Approach to Insider Trading Regulation*, 17 Insights 21 (July 2003).

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