

Supreme Court Will Weigh Insider Trading, Securities Act Class Action Requirements

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In its 2016 fall term, the U.S. Supreme Court will have the opportunity to consider two cases involving securities laws, one of which is already on the calendar for oral argument. The cases concern the “personal benefit” required to establish liability for insider trading and the jurisdictional requirements for class actions under the Securities Act of 1933. Depending on how the Court rules, the implications for companies, their constituents and practitioners could be profound.

Insider Trading: *Salman v. U.S.*

In its first insider trading case since 1997, the Supreme Court will consider whether the personal benefit required to establish insider trading liability must involve a pecuniary element, or whether a gift or other social benefit is enough. Legal observers hope the Supreme Court’s decision in *Salman v. U.S.* will resolve the years-long uncertainty around the definition of personal benefit first articulated in *Dirks v. SEC*.

Much of the confusion over what is required to establish insider trading liability arises from the U.S. Court of Appeals for the 2nd Circuit’s 2014 decision in *United States v. Newman*. In *Newman*, the 2nd Circuit substantially reduced the potential liability of those who indirectly receive confidential information by holding that someone who receives a tip cannot be convicted unless he “knows of the personal benefit received by the insider in exchange for the disclosure.” In addition, *Newman* held that the personal benefit received by the person giving the tip must be a quid pro quo and “of some consequence.” Although the 2nd Circuit in *Newman* rejected the argument that friendship, association or other relationship could provide the personal benefit necessary to impose liability, the court did not clearly define what constitutes a benefit “of some consequence.” In 2014, the Supreme Court declined to review the *Newman* decision, leaving open for debate the question of what qualifies as a personal benefit sufficient to establish insider trading liability.

The petition in *Salman* could resolve that question. Bassam Salman’s petition seeks to overturn his conviction of trading on information he received from his brother-in-law, Michael Kara. Michael received trading tips from his brother, Maher Kara, an investment banker. In his petition, Salman stated that Maher gave his brother Michael tips as gifts in order to get Michael “off his back.” Salman argued that this gift did not constitute a personal benefit “of some consequence” as described in *Newman*.

The U.S. Court of Appeals for the 9th Circuit declined to follow *Newman*, holding that this exchange was sufficient to confer a personal benefit under the Supreme Court’s decision in *Dirks*. The 9th Circuit relied on the Supreme Court’s recognition in *Dirks* that an insider can personally benefit from disclosing confidential information when he “makes a gift of confidential information to a trading relative or friend.” Thus, the 9th Circuit held that Maher’s disclosure of confidential information to Michael was the type of “gift” referenced in *Dirks*.

In its response to Salman’s petition, the government argued that limiting insider trading liability for tippees to instances in which the insider receives a “pecuniary gain” would “seriously harm investors and damage confidence in the fairness of the nation’s securities markets [because] [f]avored tippees could reap instant, no-risk profits at the expense of stockholders, free from securities-law liability.”

Given the scope of what could potentially constitute a personal benefit “of some consequence,” the Supreme Court’s decision in *Salman* is expected to bring much-needed clarity to the requirements for establishing insider trading liability. Oral arguments on Salman’s petition are currently set for October 5, 2016.

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State Courts' Jurisdiction Over Securities Act Claims: *Cyan Inc. v. Beaver County Employees Retirement Fund*

Petitioners in *Cyan Inc. v. Beaver County Employees Retirement Fund* are seeking the Supreme Court's assistance in resolving a key threshold issue in securities litigation: whether state courts have jurisdiction over securities class actions that allege only claims under the Securities Act.

In 2013, Cyan, a network support products provider, challenged a California superior court's jurisdiction to hear a shareholder class action involving alleged violations of Section 11 of the Securities Act. Cyan argued that the Securities Litigation Uniform Standards Act (SLUSA) of 1988 deprived state courts of jurisdiction over securities class actions brought on behalf of at least 50 people under the Securities Act, compelling dismissal of the case.

The superior court rejected Cyan's argument, holding that the court was bound by a 2011 California appellate court decision, *Luther v. Countrywide Financial*. In *Countrywide*, the California Court of Appeal held that SLUSA continued state court jurisdiction over securities class actions brought under the Securities Act. Cyan sought review of the superior court's decision by the California Court of Appeal and the California Supreme Court. Both courts declined to review the decision.

Now, Cyan is asking the Supreme Court to resolve whether SLUSA removes state courts' jurisdiction over class actions brought under the Securities Act. Cyan's petition argues that the court in *Countrywide* misread SLUSA's requirements and that "chaos has resulted from the lower courts' efforts to resolve the

jurisdictional question" of state courts' ability to hear Securities Act claims. Cyan pointed out that there is no consistency among the courts on the issue, noting that conflicts "have arisen not only between district courts in the same circuit, but also between district judges of the same district, and even between decisions of the same district judge." In its petition, Cyan pointed out that since *Countrywide* was decided, California state court securities class action filings have spiked by 1,400 percent.

On August 24, 2016, respondents filed their brief in opposition to Cyan's petition, arguing that the Supreme Court lacks jurisdiction to hear the matter because the superior court's order was not a final judgment. Respondents further argued that contrary to Cyan's assertion, SLUSA permits federal Securities Act claims to remain in state court but allows for the removal and dismissal of securities class actions brought under state law. Respondents asserted that Cyan overstated the division among federal district courts on the question of state courts' ability to hear Securities Act class actions. Further, respondents attributed the increase in California state court Securities Act class action filings to the increase in the number of initial public offering filings, not to the *Countrywide* decision.

The Supreme Court has not yet decided whether it will hear Cyan's case. A decision to grant Cyan's petition, and any subsequent ruling on the jurisdictional question, could have significant implications for the future of class action litigation. A ruling that SLUSA deprives state courts of jurisdiction over Securities Act class actions would bring an abrupt (and for defendants, a welcome) end to the recent proliferation of state court Securities Act class actions.