

2017

# “Look then to be well edified, when the fool delivers the madman”: Insider-Trading Regulation After *Salman v. United States*

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## Recommended Citation

James Walsh, “*Look then to be well edified, when the fool delivers the madman*”: *Insider-Trading Regulation After Salman v. United States*, 67 Case W. Res. L. Rev. 979 (2017)  
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— Comment —

“LOOK THEN TO BE WELL EDIFIED,  
WHEN THE FOOL DELIVERS THE  
MADMAN”<sup>1</sup>: INSIDER-TRADING  
REGULATION AFTER  
SALMAN V. UNITED STATES

*“Today, the U.S. Supreme Court unanimously and ‘easily’ rejected the Second Circuit’s novel reinterpretation of insider trading law in U.S. v. Newman. In its swiftly decided opinion, the Court stood up for common sense and affirmed what we have been arguing from the outset—that the law absolutely prohibits insiders from advantaging their friends and relatives at the expense of the trading public. Today’s decision is a victory for fair markets and those who believe that the system should not be rigged.”*

—Preet Bharara, U.S. Attorney for the Southern District of New York – December 6, 2016<sup>2</sup>

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INTRODUCTION

Perhaps the above quote tells the reader everything she needs to know about the case in question. After all, Justice Alito pointed to the writing on the wall when he declared that “this case involves ‘precisely

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1. WILLIAM SHAKESPEARE, *Twelfth Night*, in THE NORTON SHAKESPEARE V.1.85–86 (Stephen Greenblatt et al. eds., 2015).
  2. Colby Hamilton, *Bharara Praises Supreme Court Decision on Insider Trading*, POLITICO (Dec. 6, 2016, 12:33 PM), <http://www.politico.com/states/new-york/albany/story/2016/12/scotus-insider-trading-decision-hailed-as-a-victory-by-bharara-107844> [<https://perma.cc/84M3-T7GB>].

the gift of confidential information to a trading relative' that *Dirks*<sup>3</sup> envisioned."<sup>4</sup> Hence, what can we take away from an opinion that, in both result and diction, is unequivocally clear? As legal scholars, we know that judicial restraint leaves open enough questions to keep the well of Note and Comment topics from running dry. In that spirit, the following pages explore the interstices in Justice Alito's opinion, specifically the plausible ambiguities the Court mentions but, in the name of judicial restraint, purposefully declines to address.<sup>5</sup>

Along these lines, circuit splits often result in countless speculative works of legal scholarship.<sup>6</sup> But in *Salman v. United States*,<sup>7</sup> the Supreme Court laid to rest the question of whether the government can convict a tippee who trades on inside information if the sole benefit to

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3. *Dirks v. SEC*, 463 U.S. 646 (1983). *Dirks* established that liability for insider trading may arise when an insider makes a gift of confidential information to a trading relative or friend. *Id.* at 664.
  4. *Salman v. United States*, 137 S. Ct. 420, 429 (2016) (quoting *United States v. Salman*, 792 F.3d 1087, 1092 (9th Cir. 2015)).
  5. See *infra* Part III (discussing insider trading regulation after *Salman*).
  6. See, e.g., Peter J. Henning, *An Insider Trading Case Heads to the Supreme Court*, 2016–2017 SUP. CT. PREVIEW 78, 81 (2016) (predicting correctly that, in *Salman*, “the government [will] . . . get what it wanted in the *Newman* case . . . a broad reading of liability for tipping inside information”); Rachel K. Paulose, *Must a Tippee Receive a Pecuniary Benefit to Establish Liability in Insider Trading Cases?*, 44 PREVIEW U.S. SUP. CT. CAS. 11, 14 (2016) (predicting that “[a] reversal of *Salman* would be consistent with the Court’s concern that the government prove scienter in criminal cases”); Zachary J. Gubler, Comment, *Reframing United States v. Salman*, 165 U. PA. L. REV. ONLINE 1, 8–9 (2016) (arguing that “the Court should clarify that insider trading liability results from the misappropriation of information, and under that theory of liability, tipper-tippee liability is not dependent on a personal benefit,” which is farther than the Court was willing to go); Katherine Drummonds, Note, *Resuscitating Dirks: How the Salman “Gift Theory” of Tippee-Tippee Personal Benefit Would Improve Insider Trading Law*, 53 AM. CRIM. L. REV. 833, 858 (2016) (predicting correctly that the Court will “uphold the ‘gift theory’ of the personal benefit requirement for tipper-tippee insider trading liability”); Shannon Seiferth, Note, *No More Quid Pro Quo: Abandoning the Personal Benefit Requirement in Insider Trading Law*, 50 U. MICH. J.L. REFORM 175, 214 (2016) (arguing that Congress should pass a statute that “prevent[s] insider trading in the sort of circumstances where it seems morally reprehensible, without chilling the use of inside information for legitimate business purposes”); Sara Almousa, Comment, *Friends with Benefits? Clarifying the Role Relationships Play in Satisfying the Personal Benefit Requirement under Tippee-Tippee Liability*, 23 GEO. MASON L. REV. 1251, 1280 (2016) (predicting correctly that, “[w]hile the Court finally agreed to rule on the [personal-benefit] issue, it will more likely adopt one of the circuit court’s interpretations”).
  7. 137 S. Ct. 420 (2016).

the tipper is their relationship with a “trading relative or friend.”<sup>8</sup> Absent a tangible benefit to the tipper, this “gift-theory” of liability<sup>9</sup> permits the government to convict a trading tippee exclusively because of their relationship with the tipper.<sup>10</sup> *Salman*, therefore, refined the understanding of a “personal benefit” in insider-trading law.<sup>11</sup>

The Supreme Court granted certiorari on *Salman*’s appeal from the Ninth Circuit because of a contemporaneous and diverging opinion by the Second Circuit,<sup>12</sup> which resulted in the aforementioned circuit split.<sup>13</sup> In *United States v. Newman*,<sup>14</sup> the Second Circuit overturned the tippees’ convictions on the grounds that the tippers, who were corporate insiders that indirectly passed inside information to the tippees via the tippees’ analysts,<sup>15</sup> did not receive a “personal benefit” from their tips.<sup>16</sup> This prompted the Supreme Court to grant certiorari in *Salman*, which culminated in a resounding win for the government.<sup>17</sup> Since “circuit splits [are purported to] . . . provide a reliable and objective measure of judicial performance,”<sup>18</sup> we are poised to review Justice Alito’s opinion in *Salman*, which the Court joined

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8. *See id.* at 427 (holding that a tipper breaches their fiduciary duty by making a gift of confidential information to a trading relative or friend).
  9. To demonstrate, Justice Ginsburg asked Defense Counsel what would happen if the insider made the trade themselves and then gifted the proceeds to the relative. Defense counsel agreed that the insider would be guilty under the Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b) (2012), to which Justice Ginsburg remarked “So what’s the difference, if the insider trades and . . . makes the proceeds a gift, or if he just says, you do the trade; here’s the gift?” Oral Argument at 1:32, *Salman v. United States*, 137 S. Ct. 420 (2016) (No. 15-628), <https://www.oyez.org/cases/2016/15-628> [<https://perma.cc/AP4W-6G43>].
  10. *Salman*, 137 S. Ct. at 429.
  11. *Id.* at 423.
  12. *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014).
  13. *See Salman*, 137 S. Ct. at 425 (“We granted certiorari to resolve the tension between the Second Circuit’s *Newman* decision and the Ninth Circuit’s decision in this case.”).
  14. 773 F.3d 438 (2d Cir. 2014).
  15. *Id.* at 442.
  16. *Id.*
  17. *See Aruna Viswanatha & Brent Kendall, Supreme Court Hardens Stance on Insider Trading*, WALL ST. J. (Dec. 7, 2016, 1:44 PM), <http://www.wsj.com/articles/supreme-court-backs-prosecutors-over-tips-from-friends-and-family-in-insider-trading-cases-1481038798> [<https://perma.cc/VD6B-NW4Q>] (arguing that “the unanimous opinion [in *Salman*] restores some of the power the government lost in a 2014 federal court case”).
  18. Eric Hansford, Note, *Measuring the Effects of Specialization with Circuit Split Resolutions*, 63 STAN. L. REV. 1145, 1161 (2011).

unanimously,<sup>19</sup> and evaluate how it impacts the future of insider-trading jurisprudence, specifically in the realm of “personal benefit.”

### I. OVERVIEW OF THE “PERSONAL BENEFIT” REQUIREMENT

Under § 10(b) of the Securities Exchange Act of 1934<sup>20</sup> and Rule 10b-5,<sup>21</sup> which the Securities and Exchange Commission promulgated pursuant to its powers under § 10(b), a person is guilty of insider trading if the Government can prove: “(i) the existence of a relationship affording access to information intended to be available only for a corporate purpose, and (ii) unfairness of allowing a corporate insider to take advantage of that information by trading without [public] disclosure.”<sup>22</sup> Wang and Steinberg describe the combination of § 10(b) and Rule 10b-5 as “one of the most potent weapons” in the federal arsenal for policing insider trading.<sup>23</sup> Defense counsel in *Salman*, however, correctly argued that “no statute defines the elements of [insider trading].”<sup>24</sup> The crime is a species of what some commentators call “federal common law.”<sup>25</sup> Thus, for “personal benefit” purposes, our inquiry focuses on the second prong of this two-prong test, which the SEC

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19. *Supra* note 17 and accompanying text.
  20. Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b) (2012).
  21. 17 C.F.R. § 240.10b-5 (2016).
  22. *Chiarella v. United States*, 445 U.S. 222, 227 (1980); *see also* Juliet P. Kostritsky, Comment, *Rationalizing Liability for Nondisclosure under 10b-5: Equal Access to Information and United States v. Chiarella*, 1980 Wis. L. REV. 162, 192 (1980) (explaining that “[t]he test based on the presence or absence of a motive to obtain personal profit goes to the heart of 10b-5, which is a concern that depriving investors of equal access to information can impair investor confidence and the capital markets”).
  23. WILLIAM K.S. WANG & MARC I. STEINBERG, *INSIDER TRADING* § 1.2, 3 (3d ed. 2010).
  24. Oral Argument, *supra* note 9, at 0:32. Defense Counsel went on to argue that “this is a statute that doesn’t even mention insider trading, much less tipping or personal benefit.” *Id.* at 1:50; *see also* *United States v. Newman*, 773 F.3d 438, 445 (2d Cir. 2014) (“[N]either the statute nor the regulations issued pursuant to it, including Rule 10b-5, expressly prohibit insider trading. Rather, the unlawfulness of insider trading is predicated on the notion that insider trading is a type of securities fraud proscribed by Section 10(b) and Rule 10b-5.” (citing *Chiarella*, 445 U.S. at 226–30)).
  25. *See* STEPHEN M. BAINBRIDGE, *INSIDER TRADING LAW AND POLICY* 29 (2014) (“The modern insider trading prohibition thus is a creature of SEC administrative actions and judicial opinions, only loosely tied to the statutory language and its legislative history.”).

announced in the seminal case *In re Cady, Roberts & Co.*,<sup>26</sup> and the Supreme Court subsequently adopted in *Chiarella*.<sup>27</sup>

In *Cady, Roberts*, the SEC opined that “information intended to be available only for a corporate purpose” must also “not [be] for the *personal benefit of anyone*.”<sup>28</sup> This applies to the tipper, the tippee, and even the elusive second- and third-level (and beyond) “remote tippees.”<sup>29</sup> We will come to appreciate, however, that the chief concern for tippees is whether the *tipper* receives a personal benefit from their tip.<sup>30</sup> Nonetheless, “personal benefits” come in both obvious and not-so-obvious forms,<sup>31</sup> some of which we will survey to grasp the possible implications of the “personal benefit” test after *Salman*.<sup>32</sup>

Following *Cady, Roberts*, courts have continued to distill the term “personal benefit,” perhaps most notably in the landmark case *Dirks v. SEC*.<sup>33</sup> In *Dirks*, the Supreme Court held that “the initial inquiry is whether there has been a breach of duty by the insider,” which “requires courts to focus on objective criteria, i.e., whether the insider receives a direct or indirect personal benefit from the disclosure, such as pecuniary gain or a reputational benefit that will translate into future earnings.”<sup>34</sup>

Because *Dirks* was essentially a whistleblower to a massive fraud, however, the Court had difficulty applying this framework to him.<sup>35</sup> He was not a company insider and, in fact, some argue that his disclosure played a vital role in uncovering one of the most egregious accounting frauds in American history.<sup>36</sup> Thus, it was not immediately clear what

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26. 40 SEC 907, 912 (1961).

27. *Chiarella*, 445 U.S. at 222.

28. *Cady, Roberts & Co.*, 40 SEC at 912 (emphasis added).

29. See, e.g., BAINBRIDGE, *supra* note 25 at 64–65 (arguing that although “remote tippees” can be liable for insider trading, “it often will be difficult to prosecute tipping chain cases, because of the potential difficulties inherent in proving the requisite knowledge on the part of remote tippees”).

30. See *id.* at 59 (“What *Dirks* proscribes is not a breach of any duty, however, but solely a breach of the duty of loyalty forbidding fiduciaries to *personally benefit* from the disclosure.”) (emphasis added).

31. See *id.* at 60–61 (explaining that a “personal benefit” can arise from many situations, some of which are a quid pro quo, a reputational benefit, sexual favors, and gifts).

32. See *infra* Part III (discussing the enforcement of insider trading laws after *Salman*).

33. 463 U.S. 646 (1983).

34. *Id.* at 663.

35. *Id.* at 654.

36. See *id.* at 652 n.8 (explaining that “[l]argely thanks to *Dirks* one of the most infamous frauds in recent memory was uncovered and exposed, while the record shows that the SEC repeatedly missed opportunities to investigate

the tipper's benefit was in revealing this information to Dirks. Yet, the Government still attempted to satisfy this requirement to justify an insider-trading conviction against him. Justice Powell clarified, however, "that there is no general duty to disclose before trading on material nonpublic information."<sup>37</sup> Further, Justice Powell explained that "not 'all breaches of fiduciary duty in connection with a securities transaction' . . . come within the ambit of Rule 10b-5."<sup>38</sup> The requisite concern is whether the breach of fiduciary duty is the result of deliberate "manipulation or deception."<sup>39</sup>

Still, the Government persisted in its argument that Dirks "breached a duty which he had assumed as a result of knowingly receiving confidential information from [Equity Funding] insiders,"<sup>40</sup> and that "tippees such as Dirks who receive non-public, material information from insiders become 'subject to the same duties as [the] insiders.'"<sup>41</sup> But this argument did not sway the *Dirks* Court; it summarily rejected this reasoning and held that "the test is whether the insider personally will benefit, directly or indirectly, from his disclosure."<sup>42</sup> Because the insiders did not personally benefit from Dirks's disclosure, there was no breach of duty to the shareholders, and because the insiders did not breach their duty, "there [was] no derivative breach" by Dirks.<sup>43</sup>

The *Dirks* Court based its decision on the fact that "the tippers received no monetary or personal benefit for revealing Equity Funding's secrets, nor was their purpose to make a gift of valuable information to Dirks."<sup>44</sup> Hence, the Court overturned Dirks's conviction because "the tippers were motivated by a desire to expose the fraud,"<sup>45</sup> not to receive

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Equity Funding") (quoting *Dirks v. SEC*, 681 F.2d 824, 829 (D.C. Cir. 1982)); *but see* BAINBRIDGE, *supra* note 25, at 43 n.16 ("The extent to which Dirks should be credited with exposing the Equity Funding fraud is a matter of debate. Arguably, it was not until state insurance regulators from California and Illinois conducted a surprise audit of an Equity Funding subsidiary that the fraud actually came to light.") (citing *Dirks*, 463 U.S. at 669 n.2 (Blackmun, J., dissenting)).

37. *Dirks*, 463 U.S. at 654.

38. *Id.* (quoting *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 472 (1977)).

39. *Dirks*, 463 U.S. 654 (quoting *Santa Fe Indus.*, 430 U.S. at 473).

40. *Dirks*, 463 U.S. at 655–56 (quoting *In re Dirks*, 21 SEC Docket 1401, 1410 n.42 (1981)).

41. *Dirks*, 463 U.S. 656 (quoting *Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 495 F.2d 228, 237 (2d Cir. 1974)).

42. *Id.* at 662.

43. *Id.*

44. *Id.* at 667.

45. *Id.*

a personal or reputational benefit, or to make a gift to Dirks. Consequently, the Supreme Court's analysis in *Salman* centers on the Second and Ninth Circuits' uneven application of the principles enunciated in *Dirks*.<sup>46</sup>

## II. MIRROR OPPOSITES: *UNITED STATES v. NEWMAN* & *SALMAN v. UNITED STATES*

Because *Salman* and *Newman* both involved “tippee” liability, the key issue in both cases was that the tippers did not receive any tangible benefit for their tips. In both instances, the insiders tipped off family members or professional friends who then tipped off others. Eventually, “remote tippees” down the line traded on the material nonpublic information.<sup>47</sup> The “misappropriation doctrine” of insider trading, which is “when a [non-insider] trades on or tips material nonpublic information in breach of a duty to the information source,”<sup>48</sup> encompasses situations like *Salman* and *Newman*.

The “misappropriation theory”<sup>49</sup> is distinct from the “classical theory” of insider trading in which “a corporate insider . . . trades ‘in the corporation’s securities on the basis of material, nonpublic information about the corporation,’ for his or her own benefit.”<sup>50</sup> In the “misappropriation doctrine,” as Justice Alito explained, “the tippee acquires the tipper’s duty to disclose or abstain from trading if the tippee knows the information was disclosed in breach of the tipper’s duty.”<sup>51</sup> Further, “the tippee may commit securities fraud by trading in disregard of that knowledge.”<sup>52</sup> This is so because, as the Second Circuit noted, “the Supreme Court explicitly rejected the notion of ‘a general duty between all participants in market transactions to forgo actions based on material,

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46. *Salman v. United States*, 137 S. Ct. 420, 425 (2016).

47. *Id.* at 423–24 (“*Salman* received lucrative trading tips from an extended family member, who had received the information from *Salman*’s brother-in-law.”); *United States v. Newman*, 773 F.3d 438, 443 (2d Cir. 2014) (“[Defendants were] three and four levels removed from the inside tipper, respectively.”).

48. WANG & STEINBERG, *supra* note 23, at § 5.4, 411.

49. *See United States v. O’Hagan*, 521 U.S. 642, 652–53 (1997) (explaining that the misappropriation theory defines securities fraud as misappropriation of confidential information in breach of a duty to the source).

50. *Id.* (quoting *Newman*, 773 F.3d at 445).

51. *Salman*, 137 S. Ct. at 423.

52. *Id.*



nonpublic information.”<sup>53</sup> Thus, to be guilty of insider trading, the tippee must know that the insider breached a duty by giving the tip. Irrespective of the form of insider trading, the elements are the same for both the classical theory and the misappropriation doctrine.<sup>54</sup>

In *Newman*, two defendants traded in Dell and NVIDIA stock after they heard news of the companies’ “earnings numbers before they were publicly released.”<sup>55</sup> This generated large windfalls for their respective hedge funds.<sup>56</sup> In the Dell trade, the insider shared inside information with a former Dell coworker who by that time was working on Wall Street.<sup>57</sup> The Government introduced evidence “that the [Dell] insider sought career advice from his ‘friend’ and that his friend edited the insider’s resume and sent it to a Wall Street recruiter.”<sup>58</sup> In the NVIDIA trade, the insider shared information with a friend from church with whom he “occasionally socialized.”<sup>59</sup> Neither the former Dell employee nor the church friend traded on the inside information, but after several steps down the chain, the “hedge fund managers . . . learned the information and used it to trade in Dell and NVIDIA.”<sup>60</sup>

*Newman* went up to the Second Circuit on appeal because the defendants argued that “the district court erred in failing to instruct the jury that it must find that a tippee *knew* that the insider disclosed confidential information in exchange for a personal benefit.”<sup>61</sup> The Government insisted that “Newman and Chiasson were criminally liable for insider trading because, as sophisticated traders, they must have known that information was disclosed by insiders in breach of a fiduciary duty,

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53. *Newman*, 773 F.3d at 445 (quoting *Chiarella v. United States*, 445 U.S. 222, 233 (1980)).

54. *Id.* at 446 (citing *SEC v. Obus*, 693 F.3d 276, 285–86 (2d Cir. 2012)).

55. *Id.* at 443.

56. See Jon Eisenberg, “Friends” Who Trade on Inside Information: How *United States v. Newman* Changes the Law, K&L GATES (Apr. 20, 2015), <http://www.klgates.com/friends-who-trade-on-inside-information-how-united-states-v-newman-changes-the-law-04-20-2015/> [https://perma.cc/5LBG-ZPU5] (“*Newman* involved two defendants who traded in Dell and NVIDIA and, as a result of those trades, made \$4 million and \$68 million for their funds.”).

57. *Id.*

58. *Id.*

59. *Id.*

60. *Id.*; see also *United States v. Newman*, 773 F.3d 438, 443 (2d Cir. 2014) (“*Newman* and Chiasson were several steps removed from the corporate insiders and there was no evidence that either was aware of the source of the inside information.”).

61. *Newman*, 773 F.3d at 442 (emphasis added).

and not for any legitimate corporate purpose.”<sup>62</sup> But the Second Circuit did not agree; instead, it overturned the convictions on the grounds “that the district court’s instruction failed to accurately advise the jury of the law.”<sup>63</sup>

After reading the *Newman* opinion, it is apparent that the Second Circuit was reluctant to expand insider-trading liability beyond its established parameters. For example, the Court explained “that the Government has not cited, nor have we found, a single case in which tippees as remote as Newman and Chiasson have been held criminally liable for insider trading.”<sup>64</sup> Further, the Court cautioned that, “although the Government might like the law to be different, nothing in the law requires a symmetry of information in the nation’s securities markets.”<sup>65</sup> We may, in turn, read *Newman* as a departure from *Dirks* because the Second Circuit held that “the Government must prove beyond a reasonable doubt that the tippee knew that an insider disclosed confidential information *and* that he did so in exchange for a personal benefit.”<sup>66</sup> Requiring concrete proof that a tippee “knew” the tipper made the tip in exchange for a “personal benefit” is a considerably more difficult test when it comes to prosecuting “remote tippees;” but whether this is sound policy is the province of the next Part.<sup>67</sup> Still, it is necessary to note that the Supreme Court’s grant of certiorari in *Salman* occurred alongside the Second Circuit’s radical deviation in *Newman*. The key takeaway from *Newman* is the Second Circuit’s holding that a jury may only infer a “personal benefit” if there is 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.”<sup>68</sup> But whether *Newman* remains good law after *Salman* is not entirely clear.<sup>69</sup>

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62. *Id.* at 443–44.

63. *Id.* at 450.

64. *Id.* at 448.

65. *Id.* at 448–49.

66. *Id.* at 442.

67. *Infra* Part III.

68. *Newman*, 773 F.3d at 452; *but see* *Salman v. United States*, 137 S. Ct. 420, 422 (2016) (“To the extent the Second Circuit held that the tipper must also receive something of a ‘pecuniary or similarly valuable nature’ in exchange for a gift to family or friends . . . we agree with the Ninth Circuit that this requirement is inconsistent with *Dirks*.”) (quoting *Newman*, 773 F.3d at 452).

69. See Jen Wieczner, *Here’s What the Supreme Court Insider Trading Ruling Means for Hedge Funds*, FORTUNE (Dec. 6, 2016), <http://fortune.com/2016/12/06/supreme-court-insider-trading-salman-hedge-fund/> [<https://perma.cc/4QC7-5F9W>] (“The *Salman* decision wouldn’t have been enough to put *Newman* in jail because ‘this case does not implicate those issues,’ the

In *Salman*, Maher Kara worked for the healthcare group at Citigroup and began to share inside information about the company's mergers and acquisitions with his brother, Michael Kara.<sup>70</sup> Early on, Maher suspected that Michael was trading on the information, but later, after a course of years, he concluded that Michael was indeed making illegal trades.<sup>71</sup> Michael also began sharing this information with Bassam Salman, who, in the meantime, had become Maher's brother-in-law after Maher's marriage to his sister.<sup>72</sup> Salman and an accomplice eventually received a windfall of over \$1.5 million from their illegal trades,<sup>73</sup> and it was clear Salman knew the source of the information. According to the Government, "it was also important to Michael that [Salman knew] that Maher was the tipper; Michael hoped it would make Maher seem more powerful and prosperous in the eyes of the Salman family."<sup>74</sup> In Part III I argue that this hankering for "recognition" is a tell-tale sign that the tipper received a "personal benefit." We should have faith in the fact-finding process to search out evidence of a tipper's desire for "recognition" (as it did in *Salman*). If the Government can prove that the tipper desired "recognition"<sup>75</sup> in exchange for their tip, whether reputational, altruistic, or professional, then that should be enough to satisfy the "personal benefit" test.

Justice Alito's opinion begins by reiterating that the test is "whether the tipper breached a fiduciary duty by disclosing the information . . . for a personal benefit [which] . . . a jury can infer . . . where the tipper receives something of value," including a gift of information to "a trading relative or friend."<sup>76</sup> Salman's central argument was that "he [could not] be held liable as a tippee because the tipper . . . did not personally receive money or property in exchange for the tips and thus did not personally benefit from them."<sup>77</sup> In other words, Salman offered a pure "pecuniary gain" reading of the *Dirks* "personal benefit"

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Court wrote in a footnote to its opinion Tuesday. Indeed, the *Salman* decision doesn't clearly define what the Supreme Court considers a "friend."").

70. Brief for the United States at 3, *Salman*, 137 S. Ct. 420 (No. 15-628).

71. *Id.*

72. *Id.* at 5.

73. *Id.*

74. *Id.* at 6.

75. The Oxford English Living Dictionary defines recognition as "[a]ppreciation or acclaim for an achievement, service or ability." *Recognition*, OXFORD DICTIONARIES, <https://en.oxforddictionaries.com/definition/recognition> [<https://perma.cc/S9DV-FA2K>] (last visited Feb. 19, 2017).

76. *Salman v. United States*, 137 S. Ct. 420, 423 (2016) (*quoting Dirks v. SEC*, 463 U.S. 646, 664 (1983)).

77. *Id.* at 424.

standard. But, in Michael Kara's own words, his insider brother gave him "timely information that the average person does not have access to," including "access to stocks, options, and [things] . . . the average person would never have or dream of."<sup>78</sup>

Despite this palpable advantage, Salman raised three predominant claims to innocence: (1) in the criminal-fraud context, the Government must prove that the fraudster personally obtained money or property, and the same standard should apply to insider trading; (2) defining a gift as a personal benefit is "indeterminate, because liability may turn on facts such as the closeness of the relationship between tipper and tippee and the tipper's purpose for disclosure;" and (3) defining a gift as a personal benefit is also "overbroad, because the Government may avoid having to prove a concrete personal benefit by simply arguing that the tipper meant to give a gift to the tippee."<sup>79</sup> Salman also raised a few ancillary arguments, citing "constitutional concerns" and difficulties arising out of "remote tippee" scenarios.<sup>80</sup>

On the other side, the Government argued "that a *gift of confidential information to anyone*, not just a 'trading relative or friend,' is enough to prove securities fraud."<sup>81</sup> The Court was not willing to extend the *Dirks* "personal benefit" test that far, but it still quickly sounded the death knell for Salman's arguments. The Court held that, in Salman's case, "the tipper benefit[ted] personally because giving a gift of trading information is the same thing as trading by the tipper followed by a gift of the proceeds."<sup>82</sup> And although the Court conceded that "in some factual circumstances assessing liability for gift-giving will be difficult,"<sup>83</sup> it concluded that "Salman's conduct [was] in the heartland of *Dirks*'s rule concerning gifts."<sup>84</sup> Outside of this gift-giving "heartland," we can only speculate as to how far future courts will extend the *Dirks* "personal benefit" test, especially since the *Salman* Court reaffirmed it on the narrowest possible grounds.

### III. INSIDER-TRADING ENFORCEMENT AFTER SALMAN

Before delving into some hypothetical "remote tippee" scenarios post-*Salman*, it is necessary to address the policy issues that underlie all insider-trading prosecutions. Among these policy considerations are:

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78. *Id.* at 425.

79. *Id.* at 426.

80. *Id.*

81. *Id.*

82. *Id.* at 428.

83. *Id.* at 428–29.

84. *Id.* at 429.

(1) adhering to the rule of lenity and providing clear standards to ensure just imposition of criminal liability under the securities laws;<sup>85</sup> (2) permitting market participants to develop insights about companies without fear of criminal repercussions, which facilitates market efficiency and effectuates pricing mechanisms;<sup>86</sup> (3) dismantling the uncertainty surrounding the “patchwork of judicial decisions cobbling together, on a case-by-case basis, what conduct gives rise to liability;”<sup>87</sup> (4) respecting separation of powers, especially because Rule 10b-5 “does not expressly prohibit insider trading;”<sup>88</sup> (5) preventing the “crowding out” effect<sup>89</sup> and earnings manipulation that springs from insider trading and impairs market efficiency;<sup>90</sup> and (6) ensuring that securities markets are not “rigged in favor of the well-connected and the influential.”<sup>91</sup>

These competing interests center on two major concerns: (1) prioritizing Congressional statutes over “judge-made” law; and (2) protecting market efficiency and integrity, which mean different things to different

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85. See Brief of the Nat’l Ass’n of Criminal Defense Lawyers and the N.Y. Council of Defense Lawyers as Amici Curiae in Support of Petitioner at 5, *Salman*, 137 S. Ct. 420 (No. 15-628) (“[T]he Ninth Circuit’s rule would criminalize a broad swath of conduct as to which Section 10(b) is at best ambiguous, the rule of lenity compels a narrower reading of that provision here.”); see also Brief of the NYU Center on the Admin. of Criminal Law as Amicus Curiae in Support of Neither Party at 3, *Salman*, 137 S. Ct. 420 (No. 15-628) (“Criminal liability should not turn on a fact-finder’s evaluation of how friendly a tipper and tippee are, or whether a tippee’s assistance to the tipper meets some arbitrary threshold of significance.”).
86. See Brief of Amicus Curiae Sec. Indus. & Fin. Mkts. Ass’n in Support of Neither Party at 10, *Salman*, 137 S. Ct. 420 (No. 15-628) (“If the markets are to operate with optimal efficiency, it is critical that the analyst (and any compliance officer asked to assist) be able to quickly and reliably determine whether trading and recommendations are permitted or prohibited in the circumstances presented.”).
87. Brief of Amicus Curiae Mark Cuban in Support of Petitioner at 2, *Salman*, 137 S. Ct. 420 (No. 15-628).
88. Brief for Amicus Curiae Cato Inst. in Support of Petitioner at 2, *Salman*, 137 S. Ct. 420 (No. 15-628).
89. See Stanislav Dolgoplov, *Insider Trading*, in THE CONCISE ENCYCLOPEDIA OF ECONOMICS (David R. Henderson ed., 2008), <http://www.econlib.org/library/Enc/InsiderTrading.html> [<https://perma.cc/25EQ-797W>] (“The ‘outside’ search for information [by analysts] is more socially valuable, even if it is occasionally more costly, [because] trading by corporate insiders may crowd out securities research on external factors.”) (emphasis added).
90. See Brief of Amicus Curiae Richard D. Freer in Support of Respondent at 12, *Salman*, 137 S. Ct. 420 (No. 15-628) (“[I]n developed economies, insider trading can harm pricing efficiency.”).
91. Brief of Occupy the SEC as Amicus Curiae in Support of Respondent at 2, *Salman*, 137 S. Ct. 420 (No. 15-628).

people.<sup>92</sup> The most common judicial precedent cited in opposition to an all-encompassing insider-trading prohibition comes from Justice Powell's majority opinion in *Dirks*: "The SEC expressly recognized that '[t]he value to the entire market of [analysts'] efforts cannot be gainsaid; market efficiency in pricing is significantly enhanced by [their] initiatives to ferret out and analyze information, and thus the analyst's work redounds to the benefit of all investors.'"<sup>93</sup> This market efficiency consideration is a major impediment to the adoption of a hardline stance against all insider trading, particularly when market analysts extract inside information and remote tippees trade on it.<sup>94</sup> But, as we will see, this apprehension to apply stiff insider trading laws because they might stifle the work of true market professionals is misguided. After all, "market professionals . . . spend significant time and resources digging up non-inside information about the economy and individual firms," but "if insider trading were legal, it's possible that all this work may not be worth it [and] . . . if these market professionals leave the market as a result, it could lead to much less efficient markets."<sup>95</sup> In other words, market professionals who conduct business the old-fashioned way are largely responsible for keeping markets efficient, not the inside traders who prey on the "efficient capital markets" argument as a form of trade protectionism for their own crooked advantage.<sup>96</sup>

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92. See, e.g., WANG & STEINBERG, *supra* note 23, at § 2.2.2, 20 ("Arguably, market efficiency is similarly enhanced by *all* insider trading, even by executives of the issuer. All such trading will move prices in the correct direction, especially if the market discerns that insider trading is taking place."); *but see* BAINBRIDGE, *supra* note 25, at 183 ("The problem is that while derivatively informed [i.e. "insider trading"] can affect price, it functions slowly and sporadically. Given the inefficiency of derivatively informed trading, the market efficiency justification for insider trading loses much of its force.").
93. *Dirks v. SEC*, 463 U.S. 646, 658 n.17 (1983).
94. Doug Bandow, *It's Time to Legalize Insider Trading*, FORBES (Jan. 20, 2011, 1:10 PM), <http://www.forbes.com/2011/01/20/legalize-insider-trading-economics-opinions-contributors-doug-bandow.html> [<https://perma.cc/R9UM-BPPQ>] ("The objective of insider trading laws is counter-intuitive [sic]: prevent people from using and markets from adjusting to the most accurate and timely information. The rules target "non-public" information, a legal, not economic concept. As a result, we are supposed to make today's trades based on yesterday's information.").
95. Christopher Matthews, *Why is Insider Trading Even Illegal?*, TIME (July 26, 2013), <http://business.time.com/2013/07/26/why-is-insider-trading-even-illegal/> [<https://perma.cc/FGR7-MJ4X>].
96. See generally George W. Dent, *Why Legalized Insider Trading Would Be a Disaster*, 38 DEL. J. CORP. L. 247, 272 (2013) (arguing that "the efficiency of stock markets depends on a steady flow of trading. Insider trading by issuers would discourage trading, with resultant damage to the efficiency of stock markets but no offsetting benefits to investors.").

Importantly, the “Salman case . . . didn’t deal with a second aspect of Newman, which made it more difficult for prosecutors to pursue cases against traders who received confidential information second- or third-hand.”<sup>97</sup> Thus, the most important issue to address in this Part is the precise issue that Justice Alito avoided in the *Salman* opinion; namely, what courts should do in factually-difficult scenarios since “[d]etermining whether an insider personally benefits from a particular disclosure . . . will not always be easy.”<sup>98</sup> This Part scrutinizes three of these potential “personal benefit” scenarios.

On October 5, 2016, the Supreme Court heard oral arguments in *Salman*.<sup>99</sup> During oral argument, two justices posed three separate questions to counsel concerning how the “personal benefit” test would apply in given hypothetical scenarios. To fully grasp how the “personal benefit” test might apply in these scenarios post-*Salman*, we must further analyze them outside the constraints of oral argument.

Initially, at the outset of the Government’s argument, Chief Justice Roberts raised the following hypothetical: What if a group of “people [are] all going away for the weekend, [and they say to the insider] why don’t you join us? [And the insider responds] I can’t, I’m working on this Google thing.”<sup>100</sup> Justice Roberts remarked that “you wouldn’t call that a gift. You’d call it a social interchange. And maybe it’s . . . something he should have been more careful about saying, but it’s quite different than a gift.”<sup>101</sup> This is thought-provoking for two reasons: (1) after this observation, Chief Justice Roberts asked the Government’s solicitor whether this would be a “personal benefit,” and the solicitor replied that it would not; and (2) Chief Justice Roberts declared that “however you read *Dirks*, it certainly doesn’t go beyond gifts.”<sup>102</sup>

Naturally, Chief Justice Roberts observed that “it’s kind of a hazy line to draw . . . between something that you characterize as a gift and something that would be characterized as social interaction.”<sup>103</sup> But Justice Breyer was not as muddled, because he stated that “if you give [inside information] to . . . anyone in the world . . . whom you happen to know, and you believe that person will trade on it, that is for a personal advantage.”<sup>104</sup> It appears then, at least to Justice Breyer, that

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97. Viswanatha & Kendall, *supra* note 17.

98. *Salman v. United States*, 137 S. Ct. 420, 429 (2016) (quoting *Dirks*, 463 U.S. at 664).

99. Oral Argument, *supra* note 9.

100. *Id.* at 27:15.

101. *Id.*

102. *Id.* at 27:38.

103. *Id.* at 28:46.

104. *Id.* at 30:07.

the gravamen of the “personal benefit” test is whether the tipper believes that the tippee will trade on the information. In this case, it is necessary to ask why else would a tipper reveal inside information unless she expected the tippee to trade on it? Clearly, in this “social interchange,” the tipper did not intentionally reveal any information; but this type of innocuous banter is not what the securities laws are designed to prevent. Rather, this hypothetical helps frame the actual evil to be remedied by an insider-trading prohibition: deterrence of tips by individuals who want “recognition,” pecuniary or otherwise, for providing a scarce resource.<sup>105</sup> When we view information as a thing of value, it is easier to understand why the misuse of that information is a crime.

By way of example, attorneys are often in the business of handling client funds. Further, probably all attorneys know folks who have fallen on hard times financially. But just because the attorney possesses the client funds does not mean the attorney can give the money away to the struggling folks she knows. The attorney is a fiduciary and must hold those funds in trust for her client. Inside information is no different. The insider holds the information in trust for the corporation. In the context of the marketplace, *bullish* information means there is money to be made and *bearish* information means there are losses to be avoided.<sup>106</sup> Information, quite literally, has so many dollar signs attached to it that it might as well be hard currency. But whether that information can benefit a needy person (or a not-so-needy person) in the insider’s circle (or not in their circle) is of no consequence because it does not belong to the insider, it belongs to the corporation. It isn’t for the insider to decide whether to reveal it because it doesn’t belong to them, and that’s why it’s a crime. The next hypothetical will further our understanding of why an insider (or tippee under the “misappropriation doctrine”) who wants “recognition” for possessing information is actually receiving a “personal benefit,” and why a “recognition” test, rather than a “personal benefit” test, makes more sense for remote tippees.

Later in oral argument, Justice Alito raised the following hypothetical: “Suppose . . . the insider is walking down the street and sees someone who has a really unhappy look on his face and says, I want to do something to make this person’s day. And so he provides the inside information to that person and says, you can make some money if you

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105. See *supra* note 74 and accompanying text.

106. See generally *Bearish and Bullish Definition*, N. AM. DERIVATIVES EXCH., INC., <https://www.nadex.com/learning-center/glossary/bearish-and-bullish-definition> [<https://perma.cc/82HJ-4ZPW>] (last visited Feb. 16, 2017) (“Traders have long used the terms ‘bearish’ and ‘bullish’ to describe two things: their own feelings about a market and what they feel is a general mood in the market as a whole.”).



trade on this.”<sup>107</sup> Justice Alito then asked the Government solicitor if this would be a violation of the “personal benefit” test, and the solicitor replied “yes.”<sup>108</sup> The tipper in this scenario is not related to the person on the street; they are not even friends. In fact, they just met. But the tipper wants to bring some good fortune to this person on the street. And this is exactly what the law is designed to prevent: it may be factually difficult to prove that the tipper wanted “recognition” as the individual who cheered up the unhappy person on the street, but it will not be as difficult as proving that the tippee “knew” that the insider’s disclosure violated a fiduciary duty. A jury could infer from the tipper’s course of conduct that she wanted to “save the day” and cheer up the unhappy person on the street, and this amounts to “recognition.”

“Recognition,” as a term of art, is distinct from the “gift theory” of liability. “Recognition” means that a tipper wants reputation or status as someone who is “in the know,” or as someone who has information no one else has. This is a “personal benefit” because, if insider trading was legal, insiders would prioritize their own interests over the interest of the firm, which is the entity that actually produces economic value. Clearly, society has a greater interest in the well-being of the firm than in the well-being of the insider. As Dent argues, “[t]he prospect of huge trading profits would tempt managers to alter many decisions, causing damage to the firm in ways that would be virtually impossible for corporate monitors to detect.”<sup>109</sup> And, as Langevoort explains, “[a] hard question in the law of insider trading is how to characterize the behavior of someone who we think should have known better but may have lacked the contemporaneous appreciation ordinarily associated with scienter.”<sup>110</sup> The answer to these questions is a “recognition” based rule that seeks to establish the tipper’s reputation as someone who discloses reliable inside information. If each tippee that trades on information from a tipper who seeks “recognition”<sup>111</sup> can be held liable, this should significantly deter even remote tippees from trading on information that the industry knows has been appropriated.

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107. Oral Argument, *supra* note 9, at 31:12.

108. *Id.* at 31:34.

109. Dent, *supra* note 96, at 248.

110. Donald C. Langevoort, *What Were They Thinking? Insider Trading and the Scienter Requirement*, in RESEARCH HANDBOOK ON INSIDER TRADING 52 (Stephen M. Bainbridge ed., 2013), <http://scholarship.law.georgetown.edu/cgi/viewcontent.cgi?article=2018&context=facpub> [<https://perma.cc/YE2K-ZAL8>].

111. Clearly, establishing this “recognition” would require wiretapping and other investigatory techniques that reveal what goes on behind closed doors.

A “recognition” based rule would prohibit disclosures that are not made for a corporate purpose, and under the “misappropriation doctrine,” any remote tippee who trades on illegally-disclosed information would subject themselves and the original tipper to liability. This is so because a successful trade, i.e. a gain or an avoided loss, would trace back to the information source and would give them “recognition” as someone who has valuable and reliable information. This type of “recognition” gives someone status in market circles, and this is the type of circuitry that has led to a culture of unfair advantage.<sup>112</sup>

This “recognition” based rule is broader than the “gift theory” of liability because a tippee does not have to know that the tipper intended the disclosure to be a gift of information; the tippee only has to know that the information yielded a profit prior to public disclosure, which gives the tipper “recognition” as a dependable source. Once the tippee trades, both the tipper and the tippee are subject to liability whether or not they know of each other’s existence or motivations. If the Government can produce viable evidence of a tipper’s reputation in the industry, then there is no reason to eschew a “recognition” based rule that sweeps into remote-tippee territory in a way *Salman* couldn’t.

Justice Alito also raised the last hypothetical, which was perhaps a tip-off that he would be the one to ultimately write the opinion: “So the person with inside information has had a few drinks at the country club and is talking to some friends and discloses the inside information [to them] . . . One of the friends then trades on the information. Now, what would you have to prove as to the mental state of the tipper and the tippee?”<sup>113</sup> First, let us ask the question a second time, why would anyone reveal inside information unless they expected that someone might trade on it? After this last hypothetical, it is much clearer that individuals with inside information want “recognition” as someone who has a thing of value that others don’t have. If others can obtain value from this individual’s information, it puts them in a position of power as someone who possesses scarce resources. This is why insider trading is theft, because these scarce resources do not belong to the person who extracts the value from them, whether for themselves or another.

There is a culture of insider trading on Wall Street that journalists have covered for a long time.<sup>114</sup> There are people who “play the game”

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112. See, e.g., Peter J. Henning, *Why Insider Trading is Wrong*, N.Y. TIMES DEALBOOK (Apr. 11, 2011, 3:51 PM), <https://dealbook.nytimes.com/2011/04/11/why-is-insider-trading-wrong/> [<https://perma.cc/CUF2-YAPU>] (explaining that Wall Street bankers, corporate lawyers, and FDA chemists have all taken advantage of inside information).

113. Oral Argument, *supra* note 9, at 40:09.

114. See, e.g., Patrick Radden Keefe, *Making Insider Trading Legal*, NEW YORKER (Oct. 27, 2015), <http://www.newyorker.com/business/currency/making-insider-trading-legal> [<https://perma.cc/UPQ7-PVBY>] (“Because there are so many hedge funds, each with its own army of analysts, the trick

and others who simply “play by the rules.” For instance, “[c]ompany insiders share tips for many reasons, not just financial compensation: the person they share the information with may be a friend or a family member, someone they want to impress, [or] someone they owe a favor.”<sup>115</sup> In other words, the person who shares the information wants “recognition” for being the one who shared the information; they want to impress someone, help their friends or family, or make good on a previous debt, perhaps from a time someone gave them inside information. If those who “play by the rules” and only trade on public information are ever to enjoy the fruits of their integrity, Congress must pass legislation that sufficiently deters individuals who want “recognition” for tipping information that does not belong to them. This sounds a bit nebulous and more than a bit suspicious, but we won’t know the true damage caused by insider trading until we have clear guidelines that prosecutors can use to attack the problem at a macro level.

There will always be the camps who believe that information is a private-property right, and in more than a few contexts it is, but when it comes to the publicly-traded securities of publicly-held companies, information belongs to everyone with a pension, 401(k), portfolio, or fund, regardless of the size, or those who are not currently trading in the market but someday desire to.<sup>116</sup> The *Salman* Court did not extend the rule beyond the limits established in *Dirks*, nor should they have. In the name of separation of powers, this is a movement that Congress must spearhead. But, as a public policy matter, the time has come for the federal government to take a hardline stance on insider trading, because there’s no telling how many more *Newman*’s are waiting in the wings of appellate courts, and how many insiders are out there seeking “recognition” and industry status as players with reliable information.

## CONCLUSION

The major takeaway from *Salman* is that the Court reaffirmed its narrow holding in *Dirks*: a gift of inside information to a trading relative or friend is enough to establish a “personal benefit” to the tipper. Outside of this narrow holding, however, *Salman* does not do much else. But that statement underscores *Salman*’s practical thrust, because as the Government’s solicitor explained during oral argument, the great majority of insider-trading cases involve a tip of inside information to a trading relative or friend.<sup>117</sup> As far as legal rules are concerned, *Salman*

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is to find some nugget of information that the rest of the market doesn’t know. This is where the culture of insider trading took hold.”).

115. *Id.*

116. Law students are one group that immediately comes to mind.

117. Oral Argument, *supra* note 9, at 45:00 (“This involves the classic, prototypical situation that actually arises in the real world and gets prosecuted.

is not groundbreaking; but in the grand scheme of insider-trading jurisprudence, it validates the Government's significant latitude to prosecute the most common situations in which insider trading occurs.

*Salman* may not extend insider-trading liability to its logical vanishing point, but it should certainly give pause to those corporate insiders willing to benefit their family and friends at the expense of the trading public and their own issuing corporations. A step towards a fair marketplace is always a step in the right direction, but critics who raise separation of powers and clarity concerns have legitimate qualms with the manner in which existing insider-trading jurisprudence has developed. Although the *Salman* Court undoubtedly reached the correct result in a legally-justifiable fashion, it is time for Congressional action to amend § 10(b) to clearly reflect that insider trading is a crime, and that it is a crime that necessitates a statute with a comprehensive sweep. Reports of rampant insider trading<sup>118</sup> means some market participants do not respect the law in its current form, and "if we desire respect for the law, we must first make the law respectable."<sup>119</sup>

*James Walsh*<sup>†</sup>

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There are very few cases that involve [the] hypothetical of somebody distributing inside information [anonymously to many different people].").

118. Andrew Ross Sorkin, *Study Asserts Startling Numbers of Insider Trading Rogues*, CNBC (Jun. 17, 2014, 3:15 AM), <http://www.cnbc.com/2014/06/17/study-asserts-startling-numbers-of-insider-trading-rogues.html> [https://perma.cc/3FRY-2RZZ] ("A quarter of all public company deals may involve some kind of insider trading, according to [a] study by two professors at the Stern School of Business at New York University and one professor from McGill University.").
119. *Avers Dissolution Faces Steel Trust*, CLEVELAND PLAIN DEALER, Oct. 16, 1912, at 14 (quoting Louis D. Brandeis's remarks at the Cleveland Athletic Club).

<sup>†</sup> J.D. Candidate, 2017, Case Western Reserve University School of Law. I thank the staff of Volume 67 of the *Case Western Reserve Law Review* for their tireless dedication to editing and producing intricate legal scholarship. I also take this opportunity to honor the memory of my grandmother, Florence "Nonnie" Tolt, whose birthday, December 6, is the same day the Supreme Court decided *Salman*. I speak for our entire family when I say that your absence has left a perpetual void, we miss you dearly, and we are all indebted to you for the many lessons you taught us about virtue, integrity, and the importance of education. Lastly, I wish to dedicate this Comment to my father, James J. Walsh Sr., for his invaluable guidance in professional and personal matters and with whom I am eternally grateful to share a close family relationship.