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Securities Law - Second Circuit Changes Tipping Jurisprudence Holding Close Relationship No Longer Needed for Tipper-Tippee Liability under Gift Theory - United States v. Martoma, 894 F.3d 64 (2D Cir. 2017)

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SECURITIES LAW—SECOND CIRCUIT CHANGES TIPPING JURISPRUDENCE HOLDING CLOSE RELATIONSHIP NO LONGER NEEDED FOR TIPPER-TIPPEE LIABILITY UNDER GIFT THEORY—*UNITED STATES V. MARTOMA*, 894 F.3D 64 (2D CIR. 2017).

Insider trading is extremely difficult to monitor and control as most illegal conversations occur in private settings.[1] Insider trading occurs when a "tipper," a person who, because of their access to confidential information, holds material non-public information and gives that information to a "tippee," a person who then makes a trade in the stock market based on it—effectively giving that tippee an unfair advantage over all other investors.[2] Many courts have attempted to reconcile and articulate a clear standard of what type of relationship a "tipper" and "tippee" must have and what benefits the parties must gain in order to be liable for insider trading.[3] In *United States v. Martoma*,[4] the Second Circuit struggled to apply the standards developed in its previous cases regarding whether a person must have a close personal relationship to another in order to be liable for insider trading.[5] Ultimately, the Second Circuit held, in an amended decision, that a "meaningfully close personal relationship" is not required to be liable for insider trading under "gift theory."[6]

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[1] *See* Reem Heakal, *Defining Illegal Insider Trading*, INVESTOPEDIA, https://www.investopedia.com/articles/03/100803.asp [https://perma.cc/SMF6-KAX5] (last updated Aug. 22, 2017) (explaining what insider trading entails).

[2] *See id.* (defining parties and their roles in insider trading). "The tipper is the person who has broken his or her fiduciary duty when he or she has consciously revealed inside information. The tippee is the person who knowingly uses such information to make a trade (in turn also breaking his or her confidentiality)." *Id.* In most situations, both parties exchange this information for a mutual monetary benefit. *Id.*

[3] *See id.* (explaining how insider trading occurs and who parties are).

[4] 869 F.3d 58 (2d Cir. 2017).

[5] *See id.* at 66–67 (discussing application of previously adopted standard).

[6] *See id.* (providing Second Circuit's ultimate decision on "personal benefit" theory).

> [A]n insider or tipper personally benefits from a disclosure of inside information whenever the information was disclosed "with the expectation that [the recipient] would trade on it," and the disclosure "resemble[s] trading by the insider followed by a gift of the profits to the recipient," whether or not there was a "meaningfully close personal relationship" between the tipper and tippee.

Mathew Martoma ("Martoma") was a portfolio manager at the hedge fund S.A.C. Capital Advisors, LLC ("SAC"), where he had buying power of about $500 million in healthcare and pharmaceutical companies and also advised other portfolio managers.[7] In 2008, Martoma's main focus was on "bapineuzumab," a new drug being developed in clinical trials to find a cure for Alzheimer's disease.[8] Martoma hired expert networking firms and arranged paid consultations with doctors on the bapineuzumab clinical-trial monitoring committee to decide whether to invest in this new drug being clinically tried jointly by two pharmaceutical companies, Elan Corporation ("Elan") and Wyeth.[9] Both doctors Martoma arranged consultations with, Dr. Sidney Gilman and Dr. Joel Ross, were obligated to keep the clinical trial results confidential; however, they breached that obligation by sharing the material, non-public results with Martoma.[10]

On June 17, 2008, knowing the drug had not yet proven effective among the general population of Alzheimer's patients, Elan and Wyeth falsely gave hope to Alzheimer patients with certain genetic characteristics when they released the preliminary results of the bapineuzumab clinical trial.[11] In mid-July of 2008, Dr. Gilman was selected to present the final results at the International Conference on Alzheimer's Disease.[12] A day after learning the final results of Elan and Wyeth's trial, Dr. Gilman called Martoma for about an hour and a half, which resulted in Martoma purchasing

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Id. at 70 (internal citations omitted); *see* sources cited *infra* note 38 (discussing definition and applicability of "gift theory").

[7] *See Martoma*, 869 F.3d at 61 (discussing Martoma's responsibilities at SAC). Martoma recommended investments to the owner and manager of SAC, Steven Cohen. *Id.*

[8] *See id.* at 61–62 (explaining effects of bapineuzumab in clinical trials).

[9] *See id.* (describing how Martoma obtained information about bapineuzumab clinical trial).

[10] *See id.* at 62 (describing information released by both doctors during meetings with Martoma). As the chair of the safety monitoring committee, Dr. Gilman not only had an obligation to keep the results of the clinical trial confidential, but his consulting contract also reiterated this obligation. *Id.* Dr. Gilman, however, had roughly forty-three consultations with Martoma "at a rate of about $1,000 per hour," where he gave Martoma clinical trial updates and the dates of upcoming safety meetings, so that Martoma could schedule their meetings. *Id.* Martoma also arranged consultations with Dr. Ross, one of the main investigators of the clinical trials, who charged $1,500 per hour. *Id.* Similar to Dr. Gilman, even though Dr. Ross also had an obligation to keep information regarding the clinical trial confidential, nevertheless, he revealed this information, which included his patients' confidential responses to the trial. *Id.*

[11] *See id.* (describing Elan and Wyeth's press release statement).

[12] *See id.* at 62 (discussing results of clinical trial). The press release also stated that the specific and detailed results would be further explained at the July 29, 2008 International Conference on Alzheimer's Disease. *Id.* Following the press release, Elan's share price increased. *Id.*

a flight to see Dr. Gilman to further discuss the developments in person.[13] After meeting with Dr. Gilman to view a PowerPoint presentation depicting the results, which "identified two major weaknesses in the data that called into question the efficacy of the drug as compared to the placebo," Martoma contacted the owner of SAC to explain these new findings.[14] The next day, SAC reduced its position by entering into short-sale and option trades in Elan and Wyeth securities.[15] On July 29, 2008, when Dr. Gilman presented the results at the International Conference on Alzheimer's Disease, Elan and Wyeth's share prices "declined by about 42% and 12% respectively" throughout the presentation and at the closing of trading the next day, resulting in "$80.3 million in gains and $194.6 million in averted losses for SAC."[16]

On September 9, 2014, after a four-week jury trial in the United States District Court for the Southern District of New York, Martoma was found guilty of one count of conspiracy to commit securities fraud and two counts of securities fraud in connection with an insider trading scheme.[17]

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[13] *See* United States v. Martoma, 869 F.3d 58, 62 (2d Cir. 2017) (explaining Martoma's reaction to phone call).

[14] *See id.* (detailing Martoma's next steps within his company after discovering results).

[15] *See* United States v. Martoma, 869 F.3d 62–63 (2d Cir. 2017) (discussing trades Martoma entered into shortly after receiving news); *see also* Slav Fedorov, *Definition of Position in Stock Trading*, POCKET SENSE, https://pocketsense.com/definition-position-stock-trading-7283802.html [https://perma.cc/HQB8-7SJ2] (last updated July 27, 2017) (defining phrase reducing position as "selling a certain number of shares to take partial profits, to reduce exposure to a particular stock if it is not acting according to the trader's expectations, or as a precaution if market conditions deteriorate."); James Chen, *Short Selling*, INVESTOPEDIA, https://www.investopedia.com/terms/s/shortselling.asp [https://perma.cc/UJ59-RRBY] (last updated Feb. 4, 2020) (explaining short selling).

> In short selling, a position is opened by borrowing shares of a stock or other asset that the investor believes will decrease in value by a set future date–the expiration date. The investor then sells these borrowed shares to buyers willing to pay the market price. Before the borrowed shares must be returned, the trader is betting that the price will continue to decline and they can purchase them at a lower cost.

Id.; Lucas Downey, *Essential Options Trading Guide*, INVESTOPEDIA, https://www.investopedia.com/options-basics-tutorial-4583012 [https://perma.cc/8C8E-H39X] (last updated Mar. 16, 2020) ("Options are contracts that give the bearer the right, but not the obligation, to either buy or sell an amount of some underlying asset at a pre-determined price at or before the contract expires.").

[16] *See Martoma*, 869 F.3d at 62 (acknowledging Martoma received $9 million dollar bonus from his trading activity).

[17] *See* 18 U.S.C § 371 (2019) (naming statute relating to conspiracy to commit securities fraud); 15 U.S.C § 78j(b) (2019) (naming statute of securities fraud in connection with insider trading scheme); *Martoma*, 869 F.3d at 61 (describing procedural history and severity of offenses). Conspiracy to commit securities fraud arises:

Shortly after Martoma's conviction, the Second Circuit issued a decision in *United States v. Newman*, which held that the "personal benefit" a tipper derives from giving the tippee the illegal information cannot be inferred under a gift theory "in the absence of proof of a meaningfully close relationship that generates an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature."[18] Basing his complaint on the *Newman* holding, Martoma appealed the first decision, initially arguing that the jury had not been properly instructed because there was insufficient evidence to convict him.[19] However, while Martoma's appeal was pending, the Supreme Court issued a decision in *Salman v. United States*,[20] affirming the Ninth Circuit's rejection of crucial parts of the *Newman* holding.[21] In light of the Supreme Court expressly rejecting part of the *Newman* holding in *Salman*, the Second Circuit held a supplemental briefing during Martoma's appeal in which Martoma argued that *Salman* only rejected parts of the *Newman* decision; thus, making the Second Circuit's holding erroneous.[22] However, the Second Circuit once again affirmed the judgment, finding that although *Salman* abrogated *Newman* and made the lower court's jury instructions

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> [i]f two or more persons conspire either to commit any offense against the United States, or to defraud the United States, or any agency thereof in any manner or for any purpose, and one or more of such persons do any act to effect the object of the conspiracy, each shall be fined under this title or imprisoned not more than five years, or both.

§ 371. Martoma was also charged with two counts of security fraud in violation of 15 U.S.C § 78j(b), which states that a person is liable when they "use or employ, in connection with the purchase or sale of any security registered on a national securities exchange . . . deceptive device or contrivance in contravention of such . . . regulations as the Commission may prescribe as necessary . . . for the protection of investors." § 78j(b). Additionally, Martoma was charged with violating 15 U.S.C. § 78ff, which defines the penalties for defendants. *Martoma*, 869 F.3d at 61.

18 *See Martoma*, 869 F.3d at 64 (quoting United States v. Newman, 773 F.3d 438, 452 (2d Cir. 2014)) (explaining difference in interpretation between *Martoma* and *Newman*).

19 *See id.* at 64–65 (discussing Martoma's argument on appeal).

20 *See* 137 S. Ct. 420, 422 (2016) (affirming Ninth Circuit's rejection of *Newman*'s requirement of "pecuniary or similarly valuable nature").

21 *See Martoma*, 869 F.3d at 65 (discussing reasons why Supreme Court rejected *Newman* as being inconsistent with Dirks v. S.E.C., 463 U.S. 646 (1983)). The *Martoma* court discussed what the Supreme Court had decided, which was, "[t]o the extent the Second Circuit held that the tipper must also receive something of 'pecuniary or similarly valuable nature' in exchange for a gift to family or friends . . . this requirement is inconsistent with *Dirks*." *Id.* (citations omitted) (quoting Salman v. United States, 137 S. Ct. 420, 428 (2016)).

22 *See* United States v. Martoma, 894 F.3d 64, 68 (2d Cir. 2017) (discussing Martoma's argument on appeal that *Newman* was not overruled by Supreme Court).

erroneous, the instructional error did not affect Martoma's substantial rights as would be required in order to re-try the case.[23]

In the United States, the rules that govern insider trading law are Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 of the Securities and Exchange Commission ("SEC") rules.[24] Both rules "prohibit undisclosed trading on inside corporate information by individuals who are under a duty of trust and confidence, which prohibits them from secretly using such information for their personal advantage."[25] Tippees, individuals who receive a tip from corporate insiders, can also be liable for insider trading, not for the material nonpublic information they receive, but rather because the information was disclosed to them "improperly."[26] Common

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[23] *See id.* (explaining why jury instructions were erroneous when analyzing "personal benefit" based on *Salman*).

[24] *See* 15 U.S.C.A. § 78j(b) (1934) (naming federal statute regarding insider trading); Securities Exchange Commission, General Rules and Regulations, 17 C.F.R. § 240.10b-5 (2019) (naming SEC regulation regarding insider trading).

[25] *See Salman*, 137 S. Ct. at 423 (summarizing relevant rules of insider trading law). The Securities Exchange Act of 1934's Section 10(b) provides:

> [t]o use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

§ 78j(b). The Securities Exchange Commission also has its own regulations similar to the federal statute which states:

> [i]t shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> > (a) To employ any device, scheme, or artifice to defraud,
> > (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
> > (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

§ 240.10b-5.

[26] *See Salman*, 137 S. Ct. at 428 (holding defendant liable for insider trading because information was "improperly disclosed."); Dirks v. S.E.C., 463 U.S. 646, 660 (1983) (discussing when tippee liability arises); *see also* SEC v. Maio, 51 F.3d 623, 632 (7th Cir. 1995) (opining "a tippee has a derivative duty not to trade on material non-public information when the disclosure of information is *improper* and the tippee knows or should know that this is the case."); United States v. Libera, 989 F.2d 596, 600 (1993) ("[M]isappropriation theory requires the establishment of two elements: (i) a breach by the tipper of a duty owed to the owner of the nonpublic information; and (ii) the tippee's knowledge that the tipper had breached the duty."); United States v. Chestman, 947

law imposes an "affirmative duty of disclosure" on corporate insiders, such as controlling stockholders, directors, and officers in regard to securities.[27] The expansion of insider trading law has long undergone development because there is a need for more restrictions banning insider trading; however, courts are reluctant to impose such hefty burdens that have an "inhibiting influence on the role of market analysts," which is deemed necessary to preserve a healthy market.[28] Therefore, the Supreme Court and SEC have consistently found that there is no "general duty between all participants in market transactions to forgo actions based on material, nonpublic information," however, those that do have a duty and breach it, will be liable for insider trading.[29] In *Dirks v. S.E.C.*,[30] a landmark decision in securities law, the Supreme Court provided a test to determine the liability

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F.2d 551, 570 (1991) (holding tippee liability arises when tipper breaches fiduciary duty and tippee knows of this breach).

[27] *See In re* Cady, Roberts & Co., 40 S.E.C. 907, 911–12 (1961) (explaining who affirmative duty applies to in insider trading law); *see also* United States v. O'Hagan, 521 U.S. 642, 652 (1997) (quoting Chiarella v. United States, 445 U.S. 222, 228–29 (1980)) (explaining that relationships between corporate insiders and corporations "gives rise to a duty to disclose [or abstain from trading] because of the 'necessity of preventing a corporate insider from . . . tak[ing] unfair advantage of . . . uninformed stockholders.'"); *Dirks*, 463 U.S. at 653 (walking through *Cady* analysis and referring to it as "seminal case" in insider trading law); Jonathan Richman, *Supreme Court Reaffirms Personal-Benefit Requirement for Insider Trading*, PROSKAUER (Dec. 6, 2016) https://www.proskauer.com/alert/supreme-court-reaffirms-personal-benefit-requirement-for-insider-trading [https://perma.cc/2Y6Z-AY2W] (discussing future problems that may arise because of "what [Supreme Court] did *not* do").

[28] *See Dirks*, 463 U.S. at 658 (discussing public policy reasons for having duties). "The need for a ban on some tippee trading is clear." *Id.* at 659; *but see* Brief for Defendant-Appellant at 9, United States v. Martoma, 894 F.3d 64 (2d Cir. 2017) (No. 13-4807), 2014 Lexis 601 (opining subjective test "would be an enormous shift of power to prosecutors to bring insider trading to prosecutions, which will put market participants at great risk to their livelihood and freedom in circumstances that the Supreme Court in *Dirks* expressly precluded.").

[29] *See Chiarella*, 445 U.S. at 233 (holding that not all material information is considered to be breach of fiduciary duty); *see also Maio*, 51 F.3d at 631 (discussing alternative theories for breaching fiduciary duty).

> Currently there are two theories under which a breach of fiduciary duty can be established such that a violation of Rule 10b-5 arises: (1) classical theory, and (2) misappropriation theory. "Under the classical theory, a person violates [Rule 10b-5] when he or she buys or sells securities on the basis of material, non-public information and at the same time is an insider of the corporation whose securities are traded." Under misappropriation theory a person violates Rule 10b-5 by "misappropriating and trading upon material information entrusted to him by virtue of a fiduciary relationship . . . ."

Id. (citations omitted) (quoting SEC v. Cherif, 933 F.2d 403, 408–10 (7th Cir. 1991)); *see also O'Hagan*, 521 U.S. at 656 (holding misappropriation element is met because "fiduciary's fraud is consummated, not when he obtains the confidential information, but when, without disclosure to his principal, he uses the information in purchasing or selling securities.").

[30] 463 U.S. 646 (1983).

of tippees, which most courts have followed since the case was decided in 1983.[31] Once a corporate insider breaches their fiduciary duty and discloses material nonpublic information, a tippee automatically assumes "a fiduciary duty to the shareholders of a corporation not to trade on material nonpublic information," but only when the tippee knew or should have known that there had been a breach.[32]

The first step in the *Dirks* analysis is to determine whether the corporate insider's "'tip' constituted a breach of the insider's fiduciary duty."[33] To determine whether the disclosure constituted a breach of the corporate insider's fiduciary duty, the court must determine the purpose of the disclosure.[34] To establish the purpose of an insider's disclosure, *Dirks* developed the "personal benefit test," which asks "whether the insider personally will benefit, directly or indirectly, from his disclosure."[35] The

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[31] *See Dirks*, 463 U.S. at 653–55 (discussing development of insider trading law and developing test for tippee liability); *see also Salman*, 137 S. Ct. at 427 (quoting and applying "personal benefit" test developed in *Dirks*); United States v. Newman, 773 F.3d 438, 446 (2d Cir. 2014) (discussing tippee liability and how Supreme Court has interpreted personal benefit in recent cases); *Maio*, 51 F.3d at 632 (holding that defendant in case was liable "under *Dirks*" test); Brief for Defendant-Appellant at 17, United States v. Martoma, 894 F.3d 64 (2d Cir. 2017) (No. 13-4807) (stating that "[t]he requirement that a tipper must act for personal benefit before insider trading liability can exist was first articulated by the Supreme Court in *Dirks* . . . .").

[32] *See Dirks*, 463 U.S. at 660–62 (providing framework to determine when insider has breached their fiduciary duty). "[Tippee] responsibility must be related back to insider responsibility by a necessary finding that the tippee knew the information was given to him in breach of duty by a person having a special relationship to the issuer not to disclose the information . . ." *Id.* at 661 (quoting *In re* Investors Management Co., 44 S.E.C. 633, 651 (1971)).

[33] *See Dirks*, 463 U.S. at 660–61 (discussing and providing test for tipper and tippee liability); Adam Barone, *What are Some Examples of Fiduciary Duty?*, INVESTOPEDIA, https://www.investopedia.com/ask/answers/042915/what-are-some-examples-fiduciary-duty.asp [https://perma.cc/XQ33-7BSL] (last updated Sep. 11, 2019) (explaining fiduciary duty as "the relationship between two parties that obligates one to act solely in the interest of the other.").

[34] *See Dirks*, 463 U.S. at 662 (discussing when corporate insider violates their affirmative duty of disclosure); *see also O'Hagan*, 521 U.S. at 652 (explaining when person commits fraud under § 10(b) and Rule 10b-5).

> [A] person commits fraud "in connection with" a securities transaction, and thereby violates § 10(b) and Rule 10b-5, when he misappropriates confidential information for securities trading purposes, in breach of a duty owed to the source of the information . . . a fiduciary's undisclosed, self-serving use of a principal's information to purchase or sell securities, in breach of a duty of loyalty and confidentiality, defrauds the principal of the exclusive use of that information.

Id.; *Newman*, 773 F.3d at 446 (quoting SEC v. Obus, 693 F.3d 276, 284–85 (2d Cir. 2012) ("[S]uch conduct [breaching duty of disclosure] violates Section 10(b) because the misappropriator engages in deception by pretending 'loyalty to the principal while secretly converting the principal's information for personal gain.'").

[35] *See Dirks*, 463 U.S. at 662 (stating test for "personal benefit," adding "absent a breach by the insider, there is no derivative breach."); *see also Salman*, 137 S. Ct. at 423 (In *Dirks*, "this Court

"personal benefit" test requires courts to focus on objective criteria in determining whether the corporate insider derived a direct or indirect personal benefit, such as a "pecuniary gain or a reputational benefit that will translate into future earnings."[36] A corporate insider's "personal benefit" can be inferred "from objective facts and circumstances," such as "a relationship between the insider and the recipient that suggest a *quid pro quo* from the latter, or an intention to benefit the particular recipient."[37] Additionally, *Dirks* developed a "gift theory" stating that a "personal benefit" can be inferred "when an insider makes a gift of confidential information to a trading relative or friend" because the "tip trade resembles trading by the insider himself followed by a gift of the profits to the recipient."[38]

Although the *Dirks* test has been interpreted broadly throughout most circuits, the Second Circuit in *United States v. Newman* attempted to confine a gift of a personal benefit only to those tippers and tippees that have a "meaningfully close personal relationship."[39] Additionally, the Second

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explained that a tippee's liability for trading on inside information hinges on whether the tipper breached a fiduciary duty by disclosing the information."); *Maio*, 51 F.3d at 632 (applying *Dirks* by reasoning if no breach by corporate insider, then no breach by tippee). 463 U.S. 646 (1983).

[36] *See* Dirks v. S.E.C, 463 U.S. 646, 663–64 (1983) (discussing elements of "personal benefit" test); *see also Salman*, 137 S. Ct. at 421 (discussing examples provided in *Dirks* of when personal benefits exist).

[37] *See Dirks*, 463 U.S. at 664 (emphasis in original) (providing examples of personal benefits that can be inferred from objective facts and circumstances); *see also* United States v. Jiau, 734 F.3d 147, 153 (2d Cir. 2013) (applying definition of "personal benefit" established in *Dirks*); SEC v. Obus, 693 F.3d 276, 285 (2d Cir. 2012) (opining personal benefit "includes not only 'pecuniary gain,' such as a cut of the take or a gratuity from the tippee, but also a 'reputational benefit' or the benefit one would obtain from simply 'mak[ing] a gift of confidential information to a trading relative or friend.'" (citing *Dirks*, 463 U.S. at 663–64)); *see also Salman*, 137 S. Ct. at 427 (quoting "personal benefit" test developed in *Dirks* and affirming examples of personal benefits).

[38] *See Dirks*, 463 U.S. at 664 (discussing additional inferences that may qualify as personal benefit under gift theory); *see also Salman*, 137 S. Ct. at 427–28 ("*Dirks* specifies that when a tipper gives inside information to a 'trading relative or friend,' the jury can infer that the tipper meant to provide the equivalent of a cash gift."); *Obus*, 693 F.3d at 292 (finding personal benefit existed because tipper "hoped to curry favor with his boss."). "In light of the broad definition of personal benefit set forth in *Dirks*, this bar is not a high one." *Obus*, 693 F.3d at 292; *see Jiau*, 734 F.3d at 153 (indicating meals at restaurants, "iPhone[s], live lobsters, . . . gift card[s], and a jar of honey" can be considered personal benefits).

[39] *See* United States v. Newman, 773 F.3d 438, 452 (2d Cir. 2014) (explaining when personal benefit may be found).

> To the extent *Dirks* suggests that a personal benefit may be inferred from a personal relationship between the tipper and tippee, where the tippee's trades "resemble trading by the insider himself followed by a gift of the profits to the recipient," . . . we hold that such an inference is impermissible in the absence of 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.

Circuit also held that the tipper must receive something that is "'pecuniary or similarly valuable in nature' in exchange for a gift to family or friends."[40] However, when the Supreme Court had the opportunity to examine *Newman's* narrow interpretation of a "meaningfully close personal relationship" to confer a gift of a personal benefit, the Court only rejected the part of the holding concerning *Newman's* "pecuniary value" of gifts.[41] The Supreme Court's partial rejection of *Newman's* holding, leaving the Second Circuit's "meaningfully close personal relationship" untouched, has consequently caused turbulence with insider trading law.[42]

Id.; *see also* Laura Palk, *Ignorance is Bliss: Should Lack of Personal Benefit Knowledge Immunize Insider Trading?*, 13 BERKELEY BUS. L.J. 101, 148 (2016) (suggesting Congress should intervene based on controversial ruling of *Newman*); William K.S. Wang, *Application of the Federal Mail and Wire Fraud Statutes to Criminal Liability For Stock Market Insider Trading and Tipping*, 70 U. MIAMI L. REV. 220, 290 (2015) ("If the reason for the 'personal benefit' requirement is to avoid inappropriate liability for the 'tipper' in patient/psychiatrist, attorney/client, and even the whistleblower/journalist, and similar scenarios, the *Newman* definition of Rule 10b-5 'personal benefit' would be overly narrow."); Colby Hamilton, *Rakoff Denies Insider Trading Indictment Dismissal, Reprising Circuit Critic Role*, N.Y. L. J., (Dec. 6, 2018, 5:06 PM), *available at* https://www.law.com/newyorklawjournal/2018/12/06/rakoff-denies-insider-trading-indictment-dismissal-reprising-circuit-critic-role/?slreturn=20190225133919 [https://perma.cc/6ZA6-56GA] (describing *Newman* decision as causing "judicial entanglements" with established precedent).

40 *See Salman*, 137 S. Ct. at 428 (discussing Second Circuit's incorrect interpretation of *Dirks*); *Newman*, 773 F.3d at 452 ("[W]e hold that such an inference is impermissible in the absence of 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.").

41 *See Salman*, 137 S. Ct. at 428 ("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*.") (citing *Newman*, 773 F.3d at 452); *see also The Supreme Court 2016 Term: Leading Case: Federal Statutes and Regulations: Securities Exchange Act of 1934—Insider Trading—Tippee Liability—Salman v. United States*, 131 HARV. L. REV. 383, 386–88 (2017) (discussing why *Salman* Court rejected *Newman* and evolution of insider trading law); Kendall R. Pauley, Comment, *Why Salman Is A Game Changer For the Political Intelligence Industry*, 67 AM. U.L. REV. 603, 625-26 (2017) (explaining how *Salman* impacted insider trading law and establishing factors to consider when answering question of "what is a close friend?"); *Second Circuit Again Holds That Tipper/Tippee Liability Can Arise from a Gift of Inside Information Even Without a Close Relationship*, PROSKAUER (June 28, 2018), https://www.proskauer.com/alert/second-circuit-again-holds-that-tipper-tippee-liability-can-arise-from-a-gift-of-inside-information-even-without-a-close-personal-relationship [https://perma.cc/ZLQ9-JJBT] (explaining *Salman*'s impact).

42 *See* Jonathan Macey, *Martoma and Newman: Valid Corporate Purpose and the Personal Benefit Test*, 71 SMU L. REV. 869, 877 (2018) (discussing changes in insider trading law based on *Newman* and other recent decisions); *see also* Peter Henning, *What Happened to "Meaningfully Close Personal Relationship" in Insider Trading?*, CLS BLUE SKY BLOG (Aug. 22, 2018), http://clsbluesky.law.columbia.edu/2018/08/22/what-happened-to-meaningfully-close-personal-relationship-in-insider-trading/ [https://perma.cc/Y9BH-HXQG] ("The Supreme Court rather unceremoniously gutted the second part of *Newman*'s requirement in *Salman v. United States*."); Martin Klotz et. al., *"Meaningfully Close Personal Relationship" Test Survives, But Perhaps in Name Only: Second Circuit Waters Down Newman's Test*, WILLKIE FARR & GALLAGHER LLP (June 26, 2018), https://www.willkie.com/~/media/Files/Publications/2018/06/MeaningfullyClose

In *United States v. Martoma*, the main issue on appeal was whether *Newman*'s "meaningfully close personal relationship" test was still good law and thus, could be applied to Martoma—the tippee—in finding him liable for insider trading.[43] The Second Circuit faced a challenging decision in addressing this issue, as the Supreme Court had abrogated one part of the Newman holding, while simultaneously maintaining the "meaningfully close personal" relationship requirement.[44] In the first *Martoma* decision, the Second Circuit stated that the *Salman* holding completely abrogated *Newman*'s two holdings.[45] Rather than analyzing whether "*Newman's* gloss

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PersonalRelationshipTestSurvivesButPerhapsinNameOnly%20SecondCircuitWatersDownNewmansTest.pdf [https://perma.cc/QCK6-Q2J6] (discussing impact of *Newman* decision on insider trading liability framework); *The Supreme Court 2016 Term: Leading Case: Federal Statutes and Regulations: Securities Exchange Act of 1934—Insider Trading—Tippee Liability—Salman v. United States*, *supra* note 41, at 392.

> Insider trading doctrine, then, remains murky. The personal benefit test will continue to sit awkwardly within the Court's dual fiduciary duties framework, while both market participants and the SEC will continue to operate under an uncertain liability standard. The Court's reluctance to tackle these doctrinal issues directly may, however, produce an unintended benefit: If the incoherence of the doctrine leads to increasingly untenable prosecutions – or, as the SEC would surely suggest, increasingly untenable *non*prosecutions – pressure may well mount on Congress to intervene and finally provide a proper definition for the offense of insider trading.

Id. (emphasis in original); *see also* Michael Mayhew, *New Ruling Makes It Easier for Feds to Win Insider Trading Cases*, INTEGRITY RES. ASSOC. (Aug. 28, 2017), http://www.integrity-research.com/new-ruling-makes-easier-feds-win-insider-trading-cases/ [https://perma.cc/658H-B5QB] ("[I]t will now be left up to a jury to decide whether someone providing material nonpublic information who receives no specific benefit is providing an illegal 'gift' or not."); Jonathan Richman, *Second Circuit Holds That Tipper/Tippee Liability Can Arise from a Gift of Inside Information Even Without a Close Personal Relationship*, PROSKAUER (Aug. 23, 2017), https://www.corporatedefensedisputes.com/2017/08/second-circuit-holds-that-tippertippee-liability-can-arise-from-a-gift-of-inside-information-even-without-a-close-personal-relationship/ [https://perma.cc/9ZQG-6RBV] (arguing *Newman's* decision rejected "meaningfully close personal relationship" test as requirement "in order for a gift to constitute a personal benefit to the tipper.").

43 *See* United States v. Martoma, 894 F.3d 64, 76–77 (2d Cir. 2017) (discussing "meaningfully close personal relationship" as only issue on appeal).

44 *See Martoma*, 869 F.3d at 68–69 (explaining how Supreme Court did not expressly overrule both *Newman* holdings).

45 *See id.* at 69 (explaining Second Circuit's initial conclusion of *Martoma*). The Second Circuit stated:

> [w]hile the Supreme Court did not have occasion to expressly overrule *Newman*'s requirement that the tipper have a "meaningfully close personal relationship" with a tippee to justify the inference that a tipper received a personal benefit from his gift of inside information—because that aspect of *Newman* was not at issue in *Salman*–"[e]ven if the effect of a Supreme Court decision it 'subtle,' it may nonetheless alter the relevant analysis fundamentally enough to require overruling prior 'inconsistent' precedent." We

on the gift theory [was] inconsistent with *Salman*," the Second Circuit decided not to, reasoning that there were many other ways to establish *Dirks'* "personal benefit" requirement.[46]

After a supplemental hearing, the Second Circuit avoided interpreting "meaningfully close relationship" and held that Martoma was liable under the personal benefit "quid pro quo" gift theory because Martoma paid $1,000 an hour for consultations and subsequently acquired material nonpublic information, that he knew he was not supposed to have.[47] Additionally, the Second Circuit found that even if a jury could not find Martoma liable under a "quid pro quo" gift theory, Martoma could still be liable, as a rational jury could find that Dr. Gilman personally benefited by providing the tip to Martoma to intentionally benefit Martoma's trading activity in the pharmaceutical industry.[48] Because a rational jury could find Martoma guilty under either of those two theories, the Second Circuit held that, although Martoma's jury instructions were erroneous, the error did not affect Martoma's substantial rights.[49]

The Second Circuit's decision in *United States v. Martoma* has created great controversy, as some argue that the decision completely dismissed *Newman*'s "meaningfully close personal relationship," making it easier for prosecutors to prove their case.[50] Based on this unsettling decision,

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> respectfully conclude that *Salman* fundamentally altered the analysis underlying *Newman*'s "meaningfully close personal relationship" requirement such that the "meaningful close personal relationship" requirement is no longer good law.

Id. (internal citations omitted); *but see Martoma*, 869 F.3d at 75 (Pooler, J., dissenting) (discussing negative impact *Martoma* will have on insider trading law).

> Today's opinion goes far beyond that limitation, which was set by the Supreme Court in *Dirks* . . . received elaboration in this Court's opinion in *Newman* . . . and was left undisturbed by the Supreme Court in *Salman* . . . . In rejecting those precedents, the majority opinion significantly diminishes the limiting power of the personal benefit rule, and radically alters insider-trading law for the worse.

Martoma, 869 F.3d at 75 (Pooler, J., dissenting) (internal citations omitted).

46 *See Martoma*, 894 F.3d at 71 (declining to analyze prosecution's argument that *Newman* was fully abrogated in light of *Salman*).

47 *See id.* at 78 (explaining Martoma's liability under "quid pro quo" gift theory). The court explained that Martoma's argument that Dr. Gilman did not bill him for the last two sessions, suggested that they did not have a "quid pro quo" relationship. *Id.*

48 *See id.* at 79 (discussing Martoma's liability under "intention to benefit" theory).

49 *See id.* at 78 (finding Martoma's substantial rights were not affected as other methods were available to find liability).

50 *See* Mayhew, *supra* note 42 ("It will now be left up to a jury to decide whether someone providing material nonpublic information who receives no specific benefit is providing an illegal 'gift' or not. In our minds, this is leaving the door open for the government to bring a slew of confusing insider trading cases."); *see also* Klotz, *supra* note 42 at 6 (expressing process in which

a tipper could personally benefit from gifting a tippee material nonpublic information, if it was intended to benefit the tippee, without even having a "meaningfully close personal relationship," as long as the tipper thought the tippee would trade on it.[51] The holding is problematic because it immensely expands the *Dirks* holding that the Supreme Court intended to keep broad, although not overly broad that it leads to endless litigation.[52]

In the Second Circuit's first decision, Judge Pooler argued in her dissent that *Martoma*'s holding allowed an "insider [to] receive[] a personal benefit when the insider gives inside information as a 'gift' to *any* person," which was not what the majority held in *Newman* or what the Supreme Court held in *Salman*.[53] She further argued that the *Dirks* test provided a personal test in order to limit who could "gift" inside information.[54] By broadening the standard to *any* person, the Second Circuit rejected the limiting power of "personal benefit" that the Supreme Court intended to keep.[55]

As Judge Pooler argued, the fact that the Supreme Court purposely left *Newman*'s "meaningful close personal relationship" intact, and mentioned "trading relative or friend," is a strong indicator that the Supreme Court did not mean for it to apply to any person.[56] Possibly afraid to be

liability can arise is problematic). The only thing the process requires is "merely . . . showing that the tipper intended to benefit the tippee". Klotz, *supra* note 42 at 6.

[51] *See* Pauley, *supra* note 41, at 607 (arguing *Martoma* is inconsistent with *Salman* decision); *see also* Macey, *supra* note, 42 at 878 (describing *Martoma* as "easy case" that could have been resolved without broadening *Dirks* test); *Second Circuit Again Holds That Tipper/Tippee Liability Can Arise from a Gift of Inside Information Even Without a Close Relationship*, *supra* note 41 (arguing that "[t]he latest decision again means that insider-trading liability can be established in the Second Circuit 'by evidence that the tipper's disclosure of inside information was intended to benefit the tippee,' regardless of the nature of the tipper's and tippee's personal relationship.").

[52] *See* United States v. Martoma, 869 F.3d 58, 75 (2d Cir. 2017) (Pooler, J., dissenting) (stating "result [of *Martoma*] will be liability in many cases where it could previously not lie."); *see also* Henning, *supra* note 42 (opining after *Martoma* decision that "merely giving a tip to a complete stranger may actually violate Rule 10b-5."); Macey, *supra* note 42 (explaining that *Martoma* incorrectly applied Supreme Court precedent and *Newman* was close to solving ambiguity).

[53] *See Martoma*, 869 F.3d at 75 (Pooler, J., dissenting) (discussing how *Martoma* decision completely broadened "personal benefit" requirement Supreme Court established); *see also* Macey, *supra* note 42 at 879 (opining that Second Circuit lacked analysis when reviewing *Martoma*); *Securities Exchange Act of 1934—Insider Trading—Tippee Liability—Salman v. United States*, *supra* note 41 at 392 (opining insider trading law still remains unsettled).

[54] *See Martoma*, 869 F.3d at 75 (Pooler, J., dissenting) (discussing reasons Personal Benefit Test exists and why Supreme Court has left it untouched).

[55] *See id.* at 75 (Pooler, J., dissenting) (emphasis in original) ("In holding that someone who gives a gift *always* receives a personal benefit from doing so, the majority strips the long-standing personal benefit rule of its limiting power . . . . Juries, and, more dangerously, prosecutors, can now seize on this vagueness and subjectivity.").

[56] *See* Salman v. United States, 137 S. Ct. 420, 429 (2016) (analyzing gift theory while avoiding *Newman*'s narrow interpretation). In *Salman*'s six-page opinion, the Supreme Court

overruled again, the Second Circuit in *Martoma* took precautions by rejecting their "meaningfully close personal relationship" requirement, and then amending in their second decision.[57] In their second decision, the Second Circuit majority stated that there were other ways to establish Martoma's liability, and there was no need to analyze whether the gift theory was inconsistent with *Salman*.[58] The majority in *Martoma* argued that although anyone can gift inside information, it is limited only to a personal benefit to the tipper if they had the intent to benefit and the tipper expected the tippee to trade on it.[59] Despite the Second Circuit's efforts to avoid interpreting *Newman*, their ruling incorrectly applied *Salman* and has increased the exposure of strangers being liable because anyone can "intend to benefit" someone else and expect them to trade on the tip.[60]

Consequently, two strangers can now be liable for insider trading as long as the tippee traded on the material non-public information, the tipper intended to benefit the tippee, and the tipper expected the tippee to trade on the information. Due to the legal community's unsettling concern, it is likely the Supreme Court will soon officially opine over whether a tipper and tippee must have a "meaningfully close personal relationship," be a "trading relative or friend," or if a specific relationship simply does not matter. Until then, lower courts will struggle to find a balance between the Supreme Court's decision in *Salman* and the Second Circuit's amended decision in *Martoma*.

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repeatedly limited the gift of inside information to a tippee, who was a "trading relative or friend." *Id.*

57 *See Martoma*, 869 F.3d at 69 (stating *Newman* decision is no longer good law); *see also* United States v. Martoma, 894 F.3d 73–74 (2d Cir. 2017) (discussing Supreme Court's "personal benefit" analysis).

58 *See Martoma*, 894 F.3d at 71 (discussing rehearing issues and why *Newman* gift theory may not be analyzed).

59 *See id.* at 78–79 (holding multiple ways to prevent everyone from being subject to liability under *Martoma*).

60 *See Second Circuit Again Holds That Tipper/Tippee Liability Can Arise from a Gift of Inside Information Even Without a Close Personal Relationship*, *supra* note 41 (emphasis in original) (opining that *Martoma* court was trying to "avoid the risk of *en banc* reconsideration"); *see also* Klotz, *supra* note 42, at 2 (discussing impact of Second Circuit's decision). The Second Circuit "watered down the [meaningful close personal relationship] requirement so significantly that it can no longer be deemed a meaningful hurdle to prosecution." Klotz, *supra* note 42, at 2.