No. ______

In the
Supreme Court of the United States

MATHEW MARTOMA,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Second Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

In *Dirks v. SEC*, 463 U.S. 646 (1983), this Court held that when a corporate insider (the "tipper") provides inside information to an outsider (the "tippee") who trades on that information, the tippee is not liable for insider trading unless the insider breached a fiduciary duty in disclosing the information. To determine whether the tipper breached a fiduciary duty, "the test is whether the [tipper] personally will benefit, directly or indirectly, from his disclosure." *Id.* at 662.

Three years ago, the government tried to convince this Court to abandon this requirement of personal benefit to the insider and instead to impose liability on the tippee whenever the insider discloses information with the intention of benefitting the tippee. *See Salman v. United States*, 137 S. Ct. 420 (2016). This Court declined that invitation, but the Second Circuit has now accepted the government's suggestion, adopting a standard that, as several Justices recognized at oral argument in *Salman*, is incompatible with *Dirks* and its personal benefit requirement.

The question presented is:

Whether, in an insider trading prosecution, the government must demonstrate that *the tipper received* a personal benefit in exchange for providing insider information, as required by *Dirks*, or whether it suffices for the government to show that the tipper intended to *confer* a benefit on *the tippee*.

PARTIES TO THE PROCEEDING

Mathew Martoma is the petitioner here and was the defendant-appellant below. The United States is the respondent here and was the appellee below.

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Three years ago, the government asked this Court to radically alter its insider trading caselaw to all but eliminate the personal benefit test of *Dirks v. SEC*, 463 U.S. 646 (1983), and make it easier for the government to prove that someone who trades on inside information has committed a federal crime. *See Salman v. United States*, 137 S. Ct. 420 (2016). This Court pointedly declined to eviscerate *Dirks*, and instead reinforced and refined it by clarifying the kind of relationships and benefits that suffice under *Dirks*. While this Court was empowered to abandon *Dirks* and declined, the Second Circuit, which was duty-bound to follow *Dirks*, eviscerated it instead in the sharply divided decision below. That decision is flatly inconsistent with the letter and underlying theory of this Court's cases and the many lower court decisions faithfully following them, and it threatens both individual liberty and the markets. It is bad enough that we have what amounts to a common-law crime of insider trading, instead of finely reticulated statutory prohibitions. But if there is to be a quasi-common-law crime, then the rules of the road need to be clear and consistent, and they need to emanate from this Court.

It has long been settled law that not all trading on inside information violates federal law. Instead, for decades, this Court has adhered to the rule that the tippee's liability depends on the tipper's culpability, such that an outsider's trading on a tip from an insider violates the law only if the insider breached a fiduciary duty in disclosing the information. And *Dirks* establishes that whether the tipper has breached a fiduciary duty depends on whether the insider received some personal benefit from the tip. Accordingly, not every intentional disclosure of inside information gives rise to liability, and simply trading while in possession of inside information is not a crime. Indeed, there was no breach in *Dirks* itself even though the insider intentionally disclosed information to Dirks, a professional analyst, knowing Dirks would benefit. Instead, in every insider trading case premised on a tip—whether the government seeks to prosecute the tipper or the tippee—the government must prove that the information was provided for some personal benefit to the insider.

The decision below changes all that. According to that decision, the government no longer needs to prove that the tipper/insider himself received a personal benefit. Instead, in the Second Circuit, it now suffices for the government to prove that the insider intended to benefit *the tippee/outsider*. That test focuses on the wrong question and radically dilutes the government's burden. Rather than focus on whether the insider himself actually *received* a personal benefit, the test embraced below focuses on whether the insider intended to *confer* a benefit on the outsider. Those are not the same thing or even close substitutes. The former is the rule of *Dirks*, and the latter is the inconsistent and diluted standard that is now the law of the Second Circuit.

The decision below fully merits this Court's review. It oversteps the authority of a lower court. And by setting the rules in the circuit that governs our nation's securities markets, it threatens both individual liberty and the proper functioning of the markets.

While the Second Circuit attempted to insulate its decision from this Court's review with an alternative holding that the tipper received a financial *quid pro quo*, that gambit is unavailing. The dissent's analysis and the majority's own actions demonstrate that the Second Circuit did not radically rewrite insider trading law for sport. If the government had an adequate financial *quid pro quo* theory, it would not have relied on the theory that the tip was a gift between friends and on a jury instruction that even the panel below found fatally flawed. Nor, if the alternative financial theory sufficed, would the panel have waited months for this Court to clarify the gift theory in *Salman*, held reargument after *Salman*, and then spent nine months rewriting its opinion in an effort to avoid en banc review.

In short, there is no denying that the decision below is a conscious effort to establish circuit precedent going forward. The panel majority's equally conscious effort to avoid this Court's review of that new precedent should not be validated. A rule that makes any intent to benefit an outsider a substitute for an actual personal benefit to an insider criminalizes the everyday activities of professional traders and is fundamentally unfaithful to this Court's precedent. There is no justification for such fundamental and baleful changes to insider trading law. But if such changes are to occur at all, they should come from this Court or Congress, not from a divided panel of the Second Circuit.

OPINIONS BELOW

The Second Circuit's amended opinion is reported at 894 F.3d 64 and reproduced at App.1-48. Its initial (now superseded) opinion is reported at 869 F.3d 58 and reproduced at App.50-119.

JURISDICTION

The Second Circuit issued its initial divided panel opinion on August 23, 2017. After Martoma filed a timely petition for rehearing, the court withdrew that decision and issued an amended (and still divided) panel opinion on June 25, 2018. The Second Circuit then denied a timely petition for rehearing of the revised opinion on August 27, 2018. On November 1, 2018, Justice Ginsburg extended the time within which to file a petition for certiorari to December 26, 2018. On December 10, 2018, Justice Ginsburg further extended the time for filing a petition to January 24, 2019. This Court has jurisdiction under 28 U.S.C. §1254(1).

STATUTORY AND REGULATORY PROVISIONS INVOLVED

Relevant statutory and regulatory provisions are reproduced at App.120-21.

STATEMENT OF THE CASE

A. Legal Background

There is, regrettably, no statutory provision clearly defining the federal crime of insider trading. Instead, the principal statutory basis for that crime is that font of many an implied civil cause of action, §10(b) of the Securities Exchange Act of 1934, which makes it unlawful for any person to "use or employ, in connection with the purchase or sale of any security … any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [SEC] may prescribe." 15 U.S.C. §78j(b). That openended and generic (in the sense of not directly addressing the specific issue of when trading on inside information is a federal crime) language is matched by the equally generic language of the relevant SEC regulation, Rule 10b-5, which prohibits the use of "any device, scheme, or artifice to defraud … in connection with the purchase or sale of any security." 17 C.F.R. §240.10b-5.

The consequences of Congress' failure to specify the precise metes and bounds of what constitutes a federal felony have been predictable. Prosecutors have taken that omission as an invitation to convert the sparse text into a general prohibition on trading while in possession of inside information. And courts, especially this Court, have resisted those efforts, repeatedly holding that neither §10(b) nor Rule 10b-5 imposes any "'general duty between all participants in market transactions to forgo actions based on material, nonpublic information.'" *United States v. O'Hagan*, 521 U.S. 642, 661 (1997) (quoting *Chiarella v. United States*, 445 U.S. 222, 233 (1980)). Instead, under this Court's precedent, such a duty arises only "from the existence of a fiduciary relationship" between the insider and the owner of the inside information. *Dirks*, 463 U.S. at 654. Accordingly, §10(b) and Rule 10b-5 only "prohibit undisclosed trading on inside corporate information by individuals who are under a duty of trust and confidence that prohibits them from secretly using such information for their personal advantage." *Salman*, 137 S. Ct. at 423; *see Chiarella*, 445 U.S. at 233.[1]

[1] This Court first elucidated this requirement in a "classical" insider trading case, where the tipper owed a fiduciary duty to

The same rule applies when the government prosecutes the outsider/tippee rather than the insider/tipper. *See Salman*, 137 S. Ct. at 423; *Dirks*, 463 U.S. at 659-64. In such cases, the liability of outsider/tippee depends on the culpability of insider/tipper, and the outsider's bare act of trading on inside information is not necessarily deceptive or fraudulent, let alone criminal. For outsiders who acquire inside information without knowledge of an insider's violation of a fiduciary duty, there is no "general duty" to other "participants in market transactions to forgo actions based on material, nonpublic information." *O'Hagan*, 521 U.S. at 661. Instead, the tippee acquires a derivative duty to refrain from trading "only when *the* [*tipper*] has breached his fiduciary duty … by disclosing the information to the tippee and the tippee knows or should know that there has been a breach." *Dirks*, 463 U.S. at 660 (emphasis added). Unless the government can prove that *the insider/tipper* breached a fiduciary duty, the outsider/tippee is free to trade.

To prove that breach, the government must prove that the tipper disclosed the inside information to receive some personal benefit. *Id.* at 663. To determine whether the tipper received such a benefit, courts must "focus on objective criteria, *i.e.*, whether

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the shareholders of the corporation for which he worked. *See Salman*, 137 S. Ct. at 425 n.2 (discussing *Dirks*). But the requirement also has been applied (as here) in so-called "misappropriation" cases, where the tipper allegedly breached a duty owed to the source of the inside information. *Id.*; *see* App.14 n.5; *SEC v. Obus*, 693 F.3d 276, 285-86 (2d Cir. 2012).

the insider receives a direct or indirect personal benefit from the disclosure." *Id.*

As the Court explained in *Dirks* and reiterated in *Salman*, that does not necessarily mean that the government must always identify a tangible benefit that the tipper directly received. Instead, there are some "objective facts and circumstances" from which a personal benefit may be inferred. *Id.* at 664. The classic example, well illustrated by the facts of *Salman*, is that a personal benefit may be inferred "when an insider makes a gift of confidential information to a trading relative or friend." *Id.* In that situation, "[t]he tip and trade resemble trading by the insider himself followed by a gift of the profits to the recipient." *Id.* But absent that kind of relationship, the government may not seek to infer a personal benefit based solely on the fact that the tipper gave valuable inside information to the tippee. The focus remains on the insider's fiduciary duty and the receipt of a personal benefit *by the insider*, not on whether a benefit was conveyed to a trading outsider. Put differently, there needs to be a *quid pro quo* that benefits the insider; the mere intent to confer a *quid* does not suffice. Otherwise, criminal liability for insider trading would become untethered from the violation of a fiduciary duty that makes the trading fraudulent and unlawful under §10(b) and Rule 10b-5. *Id.* at 654.

B. Proceedings Below

1. Petitioner Mathew Martoma was hired in 2006 as a portfolio manager at S.A.C. Capital Advisors, LLC ("SAC"), a hedge fund owned and managed by Steven Cohen. App.4. His role as a portfolio manager was to

find profitable investments for the funds he managed, and to recommend investments to Cohen, who personally managed SAC's largest portfolio. App.4. Like any other professional trader, Martoma frequently spoke with paid expert consultants to learn as much as possible about the fields in which his portfolio was invested. App.5.

Martoma's investment portfolio focused on pharmaceutical and healthcare companies, including Elan Corporation, plc ("Elan") and Wyeth. App.4. At the time, Elan and Wyeth were jointly developing an experimental drug called bapineuzumab as a potential treatment for Alzheimer's disease. App.4. Martoma therefore frequently consulted with many experts about Alzheimer's disease in general and bapineuzumab in particular. App.5. Those experts included Dr. Sidney Gilman, who was involved in a clinical trial for the drug. Martoma never paid Gilman directly for these consultations; instead, following industry custom, SAC contracted with expert networks, and the networks paid Gilman for his time. App.5 & n.1.

In July 2008, Elan and Wyeth were scheduled to present results from the bapineuzumab clinical trial at the International Conference on Alzheimer's Disease. App.6. Shortly before that presentation, SAC sold much of its stake in Elan and Wyeth and avoided substantial losses when the results were released and proved disappointing. App.7.

Although those trades were consistent with contemporaneous public information, the government charged Martoma with insider trading under §10(b) and Rule 10b-5. The government relied at trial on cooperating testimony from Gilman, who was never prosecuted but claimed that he gave the trial results to Martoma before they were released. App.5-7. The government also relied on evidence that Martoma spoke with and visited Gilman after Gilman learned the results of the trial, and then spoke with Cohen shortly before the trades were made. App.5-7.

2. To convict Martoma, the government was required to prove that Gilman (the alleged tipper) had breached a fiduciary duty to Elan and Wyeth by divulging information to Martoma (the alleged tippee) in exchange for some personal benefit. *Dirks*, 463 U.S. at 662-63; *see supra* pp.5-7. To satisfy that personal benefit element, the government pursued two theories. First, it claimed that Gilman had given Martoma inside information in exchange for the fees that Gilman earned from their previous consultations (which, according to the government, concerned the drug's safety, not its efficacy). But that financial *quid pro quo* theory was disavowed by Gilman himself, who testified at trial that he received no fees or anything else of value in exchange for the trial results that purportedly drove Martoma's and Cohen's trading (which concerned the drug's efficacy, not its safety). C.A.App.179. Second, the government argued that the jury could infer that Gilman received a personal benefit from the gift of inside information to his "friend" Martoma. Its evidence of "friendship" was remarkably thin—amounting to nothing more than occasional exchanges of pleasantries over email and one chat over coffee—but at the time of trial, such evidence arguably sufficed in the Second Circuit. C.A.App.175-76, 178; *see* App.44-46.

The jury was instructed that it could find that the government had proven the necessary personal benefit to Gilman if Gilman gave Martoma inside information for the purpose of "obtaining some future advantage, developing or maintaining a business contact or a friendship, or enhancing [Gilman's] reputation." App.8. The jury was further instructed that it could find that element met if Gilman gave Martoma information "with the intention of benefiting [himself] in some manner, or with the intention of conferring a benefit on Mr. Martoma, or as a gift with the goal of maintaining or developing a personal friendship or a useful networking contact." App.8. The jury convicted, and the court sentenced Martoma to nine years in prison—one of the longest sentences ever imposed in an insider trading case.

3. Shortly after Martoma was convicted, and while his appeal was pending, the Second Circuit issued *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014), a seminal decision on the personal benefit requirement. In *Newman*, the court held that the government may not infer from just any relationship—especially a "friendship" of a "casual or social nature"—that the tipper received a personal benefit from giving inside information to the tippee. *Id.* at 452. Otherwise, the court explained, "the personal benefit requirement would be a nullity," as the government can almost *always* identify at least a casual acquaintance between a tipper and a tippee. *Id.* Instead, the court held that a "tip and trade resemble trading by the insider himself followed by a gift of the profits to the recipient," *Dirks*, 463 U.S. at 664, only when the tipper and tippee share 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." 773 F.3d at 452. The government asked this Court to review that decision, and this Court declined. *United States v. Newman*, 136 S. Ct. 242 (2015).

The following year, after the initial argument in Martoma's appeal, this Court granted certiorari in *Salman* to decide whether a personal benefit may be inferred from a meaningfully close personal relationship alone. *See* Pet. for Cert. i, *Salman v. United States*, No. 15-628 (U.S. filed Nov. 10, 2015). In *Salman*, the tipper and tippee were brothers, and it was undisputed that they shared a "close family relationship." *Id.* The defendant nonetheless argued that the government must separately prove that the tipper gave his brother the inside information in exchange for a benefit that was "objective, consequential, and represent[ed] at least a potential gain of a pecuniary or similarly valuable nature." *Id.*

Not content to rely on the argument that *Dirks* does not require a pecuniary benefit when tips are conveyed to relatives or close friends, the government urged this Court to effectively eliminate the personal benefit requirement altogether. According to the government, liability should attach "whenever the tipper discloses confidential trading information for a noncorporate purpose," regardless of whether that noncorporate purpose involves any actual or potential personal benefit to the tipper. 137 S. Ct. at 426. As such, in the government's view, "a gift [of inside information] to a friend, a family member, *or anyone else* would support the inference that the tipper exploited the trading value of inside information for personal purposes and thus personally benefited from the disclosure." *Id.* (emphasis added).

This Court pointedly declined to adopt that view, which would leave the personal benefit rule standing in name only. Instead, in a unanimous opinion, the Court reaffirmed the personal benefit test and "adher[ed] to *Dirks*," reiterating that a personal benefit to the tipper may be inferred "when a tipper gives inside information to 'a trading relative or friend.'" *Id.* at 427-28 (quoting *Dirks*, 463 U.S. at 664). In that situation, the Court explained, the tipper presumptively benefits because "[m]aking a gift of inside information to a relative … is little different from trading on the information, obtaining the profits, and doling them out to the trading relative." *Id.* at 428.

At the same time, the Court consciously refrained from extending this "gift-giving" theory beyond the context of friends and relatives, making clear that it was overruling *Newman* only "[t]o the extent [it] held that the tipper must … receive something of a 'pecuniary or similarly valuable nature' in exchange for a gift *to family or friends*." *Id.* (emphasis added). *Salman* thus left untouched *Newman*'s rule based on *Dirks* that the "gift" theory may be invoked only when the tipper and the tippee share a "meaningfully close personal relationship," as well as *Newman*'s rule that in all other contexts, the government must prove an "exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature." 773 F.3d at 452.

4. The Second Circuit waited for this Court to resolve *Salman* before issuing an opinion here, and it ordered reargument shortly after *Salman* came down. A few months later, a sharply divided panel affirmed Martoma's conviction in an opinion that consciously reshaped Second Circuit law. The majority acknowledged that under *Newman*, the government could not rely on the relationship between the tipper and tippee to infer the necessary personal benefit to the tipper in the absence of a "meaningfully close personal relationship." App.64 (quoting *Newman*, 773 F.3d at 452). Under that standard, the jury instruction in this case was erroneous because it did not require the jury to find that Gilman and Martoma had a meaningfully close personal relationship. Instead, under the instruction, Gilman's hope of "develop[ing] a personal friendship" with Martoma could suffice. App.8.

The majority nevertheless affirmed the conviction. The majority first expressly discarded *Newman*'s "meaningfully close personal relationship" test, holding that *Salman* had "fundamentally altered the analysis." App.68-69. The majority proceeded to hold that the personal benefit element is satisfied *whenever* a tipper discloses inside information with the expectation that the tippee will trade on it, *whatever* the relationship between the two. App.70-72. Judge Pooler dissented, explaining that the majority's approach would "strip[] the long-standing personal benefit rule of its limiting power" and "radically alter[] insider trading law for the worse." App.81.

5. Martoma sought rehearing en banc, explaining that *Salman* did not overrule *Newman*'s "meaningfully close personal relationship" test, but rather made clear on its face that it was overruling *Newman only* "[t]o the extent [*Newman*] held that the tipper must … receive something of a 'pecuniary or similarly valuable nature' in exchange for a gift *to family or friends*." 137 S. Ct. at 428 (emphasis added). After mulling the rehearing petition for nine months, the Second Circuit vacated its opinion and issued a substantially revised amended opinion, once again consciously reshaping Second Circuit law and once again prompting a dissent.

This time, the majority did not purport to overrule *Newman expressly*. Yet it proceeded to adopt a theory that nullifies both *Newman*'s "meaningfully close personal relationship" test and the personal benefit requirement itself. The majority again concluded that the government need not prove either that the tipper sought some financial or quasi-financial *quid pro quo*, or that the tipper and tippee shared a meaningfully close personal relationship. Instead, the majority held that the personal benefit requirement is satisfied as long as the tipper disclosed the information with an "intention to benefit" *the tippee*. App.16-17.

The majority purported to derive that test from a half-sentence in *Dirks*: "For example, there may be a relationship between the insider and the recipient that suggests a *quid pro quo* from the latter, or an intention to benefit the particular recipient." 463 U.S. at 664. According to the majority, the final clause in that sentence does not describe the kind of "relationship between the insider and the recipient" from which a personal benefit may be inferred. App.16. Instead, the majority read that final clause as establishing that an "intention to benefit" *the tippee* is itself a "standalone personal benefit" to *the tipper*, regardless of the relationship between the two. App.17. In the majority's view, the personal benefit requirement would be satisfied even if the tipper disclosed inside information to *confer* a benefit on "a perfect stranger"—whether or not the tipper expected to *receive* any benefit in return. App.18.

The majority recognized (with considerable understatement) that "few reported decisions have relied" on this standalone "intent to benefit theory." App.20. Nevertheless, the majority insisted that its view was "more consonant with *Dirks* as a whole" because the existence of an intention to benefit the tippee shows that the tipper "lacked a legitimate corporate purpose," which (according to the majority) is what the personal benefit requirement "is designed to test." App.17-18. As for *Newman*, the majority purported to retain the "meaningfully close personal relationship" test but relegated it to cases in which the government *chooses* to invoke a "gift" theory, as opposed to the newly-minted "intention to benefit" the tippee theory. App.23-24. The majority did not confront the problem that the government did *not* rely on this newly-minted "intention to benefit the tippee" theory at trial in this case. Nor did it explain why going forward the government would ever bother invoking the more demanding "gift" theory, which requires a meaningfully close relationship, rather than rely on its new "intention to benefit" theory, which treats an intent to give a benefit to anyone, including a perfect stranger, as sufficient.

The majority recognized that even under its amended opinion, the jury instructions in this case were erroneous because they permitted the jury to convict on a "gift" theory without finding a meaningfully close personal relationship. App.24. But after having recognized the flawed instructions on the "gift" theory, having waited a year for *Salman* to address the "gift" theory, and having issued a revised opinion adopting an entirely new and diluted "intent-to-give" test, the majority declared the instructional error harmless on the theory that the jury must have decided that Gilman received a financial "*quid pro quo*" for the efficacy data he purportedly provided because he was paid for his earlier consulting sessions involving safety issues. App.25-26.

Judge Pooler dissented from all of this. She explained that while the majority "purport[ed] to agree" with *Newman*'s "meaningfully close personal benefit" test, its "apparent concessions are semantic rather than substantial." App.30. Like its earlier approach, the majority's amended decision "eliminate[s] the rule that has been with us since *Dirks* that the government must prove objective facts indicating that the tipper benefitted from her relationship with the tippee." App.38. Judge Pooler reaffirmed that the instructional error was not harmless, as a reasonable jury could easily have doubted whether the consulting relationship between Gilman and Martoma suggested any improper *quid pro quo*. App.46. As she explained, the majority's contrary ruling would mean that "whenever inside information is revealed within a paid consulting relationship … a fact-finder *must* infer that the insider was paid to breach his duties." App.46 (emphasis added).

REASONS FOR GRANTING THE PETITION

Whatever its other uncertainties, the law of insider trading used to be relatively clear on one thing: Under *Dirks*, the touchstone for liability in a prosecution of either a tipper or tippee was whether the insider/tipper received a personal benefit. That benefit could be direct (a cash kickback on the tippee's trades) or indirect (a cash infusion for a trading relative could obviate the need for the insider to extend him a loan). And in narrow circumstances, a benefit to the insider could be inferred from the benefit to a close relative or friend. But the focus was always on whether the insider/tipper *received* an objective benefit, not on whether the insider/tipper subjectively intended to *confer* a benefit on the outsider/tippee. That focus on the insider's benefit followed directly from *Dirks* and this Court's repeated emphasis that the linchpin of liability is the insider/tipper's breach of a fiduciary duty.

The decision below disregards all that and allows the government to impose criminal liability based on the insider/tipper's mere intent to benefit an outsider. Indeed, under the decision below, the intention to *confer* a benefit on a perfect stranger substitutes for a showing of a close personal relationship or the *receipt* of any personal benefit by *the tipper*. That decision is fundamentally inconsistent with the holding and underlying theory of *Dirks*, and it poses a clear and present danger to individual liberty and efficient markets in the nation's financial epicenter.

All of that would be troubling and certworthy enough, but in so holding the Second Circuit adopted the same *Dirks*-defying argument that this Court declined to embrace in *Salman*. In *Salman*, the government implored this Court to impose liability whenever the tipper lacked a "legitimate corporate purpose" for sharing the inside information with the tippee. Under that test, the government could satisfy this burden by proving *either* that *the tipper* received a personal benefit for the tip, *or* that the tipper intended to benefit *the tippee* by sharing the information. As several members of this Court recognized at oral argument, that test would impose liability for a tip to a personal stranger in the absence of any *quid pro quo* and would mark a radical departure from *Dirks*. This Court, which was fully empowered to accept the government's invitation to rewrite *Dirks*, rejected the invitation, "adhere[d] to *Dirks*," and clarified the kind of relationships and benefits that suffice under *Dirks*. The Second Circuit, by contrast, had no power to rewrite *Dirks*, yet it accepted the government's invitation, expressly authorized criminal liability for a tip to a perfect stranger, and rendered proof of meaningful relationships and benefits beside the point.

The decision below not only is wrong and flatly inconsistent with this Court's precedent, but has devastating consequences for the state of individual liberty and efficient markets in the nation's financial capital. It is bad enough that we have what amounts to a federal common-law crime of insider trading, rather than clear statutory lines separating permissible trading from federal felonies. But no rational Congress would have criminal liability turn on whether the insider/tipper intended to benefit the tippee. That test does nothing to distinguish fraud from permissible trading and comes preciously close to making trading while in possession of inside information a felony. Neither Congress nor this Court has ever embraced that regime. The Second Circuit should not be permitted to unilaterally impose it on the nation's financial capital.

I. The Decision Below Is A Radical Departure From This Court's Precedents And The Many Decisions Faithfully Following Them.

A. Under *Dirks*, the Government Must Prove Either a Personal Benefit to the Insider/Tipper or a Meaningfully Close Personal Relationship From Which Such a Benefit May Be Inferred.

One searches the United States Code in vain for the clear criminal prohibition on insider trading. Title 18 contains nothing. And Title 15 contains nothing explicit, at least as to corporate outsiders. Instead, the sources for the criminal prohibition and Martoma's nine-year prison sentence are nothing more than §10(b)'s generic prohibition on manipulation and deception and Rule 10b-5's equally generic prohibition on fraudulent practices. While this Court has never responded to all this by citing *United States v. Hudson*, 11 U.S. 32 (1812) (prohibiting common-law crimes), and telling Congress to enact clear criminal prohibitions, it also has never granted the government's wish to impose a "general duty" on "all participants in market transactions to forgo actions based on material, nonpublic information"—a rule that would impose criminal liability on *anyone* who knowingly trades on inside information. *Dirks*, 463 U.S. at 655 (quoting *Chiarella*, 445 U.S. at 233).

Instead, this Court has tethered the criminal prohibition on insider trading to the prohibition of fraud, which in turn requires a "breach" of the insider/tipper's "fiduciary duty." *Id.* at 660. Without such a breach by the insider/tipper, there is no fraud, and so there is no criminal liability for either the tipper or tippee. And "the test" for identifying such a breach is clear: "whether the insider personally will benefit, directly or indirectly, from his disclosure." *Id.* at 662.

That personal benefit may be proven by evidence of an actual *quid pro quo* resulting in an objective benefit to the insider, like "a pecuniary gain or a reputational benefit that will translate into future earnings." *Id.* at 663. There also are some narrow categories of "objective facts and circumstances" from which a personal benefit to the insider may be inferred. *Id.* at 664. "For example, there may be a relationship between the insider and the recipient that suggests a *quid pro quo* from the latter, or an intention to benefit the particular recipient." *Id.* In other words, there may be relationships that are so close that a benefit to the outsider itself is a benefit to the insider, such as when information is gifted to a spouse or paramour. As the Court explained, in that situation, a benefit to the tipper may be inferred because "[t]he tip and trade resemble trading by the insider himself followed by a gift of the profits to the recipient." *Id.*

Importantly, not just any relationship will suffice to give rise to that inference. After all, *Dirks*' gift-giving analogy is just an analogy; the *test* remains whether the insider/tipper *received* a personal benefit, not whether the insider/tipper intended to *convey* a benefit to someone else. The point of *Dirks*' analogy is simply that some relationships are so close that a benefit to the tippee itself provides a benefit to the tipper.

That necessarily requires meaningful limits on when the gift-giving analogy may be invoked, as the notion that an insider would trade on valuable inside information and then give the profits to a "casual or social" acquaintance, *Newman*, 773 F.3d at 452—let alone a perfect stranger—blinks reality. The inference makes sense only if the tipper and the tippee have the kind of relationship in which the tipper would give the tippee other valuable gifts. That is precisely why *Newman* limited the gift-giving analogy to cases in which the tipper and the tippee have a "meaningfully close personal relationship." *Id.* at 452. Anything less would untether the analogy from the fundamental requirement that the government show a personal benefit to the insider/tipper and demonstrate a breach of fiduciary duty. Without a personal benefit to the insider/tipper, there is no breach of fiduciary duty. And without a breach of fiduciary duty, there is no federal felony.

Newman was not alone in recognizing that not every tipper-tippee relationship suffices to give rise to an inference that the mere act of giving inside information to the tippee provides a personal benefit to the tipper. For instance, in a decision issued a few months after *Salman*, the First Circuit considered a tipper and tippee who were members of the same country club and who "maintained a social relationship." *United States v. Bray*, 853 F.3d 18, 22 (1st Cir. 2017). On appeal, the tippee argued that the government could not establish a personal benefit to the tipper based solely on that "casual, as opposed to close," friendship. *Id.* at 26. Acknowledging this Court's guidance that a personal benefit can be inferred from a gift to a "trading relative or friend," *id.* (quoting *Dirks*, 463 U.S. at 664), the First Circuit accepted the premise that a passing acquaintance would not be enough to give rise to the inference of a personal benefit. Instead, the First Circuit carefully examined the evidence of the relationship between the tipper and tippee and affirmed only after concluding that it was sufficient for the jury to infer a "close relationship" between the two. *Id.* at 27.

Numerous other cases likewise have embraced the critical language from *Dirks* limiting the "gift" theory of personal benefit to instances where the tippee is a relative or friend. *See, e.g.*, *United States v. McPhail*, 831 F.3d 1, 10-11 (1st Cir. 2016) ("relative or friend"); *SEC v. Cuban*, 620 F.3d 551, 557 n.38 (5th Cir. 2010) ("trading friend or relative"); *United States v. Evans*, 486 F.3d 315, 321 (7th Cir. 2007) ("trading relative or friend"); *SEC v. Rocklage*, 470 F.3d 1, 7 n.4 (1st Cir. 2006) ("relative or friend"); *SEC v. Sargent*, 229 F.3d 68, 77 (1st Cir. 2000) ("friend or relative"). As those decisions reflect, most lower courts (like this Court in *Dirks* and *Salman*) have been careful to avoid suggesting that the government may bring insider trading charges based on nothing more than a tip followed by a trade. Instead, the personal benefit requirement demands something more: either an actual or expected *quid pro quo*, or the kind of "meaningfully close personal relationship" from which a personal benefit to the insider can be inferred. *Newman*, 773 F.3d 452.

B. The Decision Below Squarely Conflicts With *Dirks*, *Salman*, and the Many Cases That Faithfully Follow Them.

The decision below marks a dramatic departure from *Dirks*, *Salman*, and other cases faithfully following them. According to the majority, the relevant question is not whether *the insider/tipper received* a personal benefit for providing the inside information, but rather whether the insider/tipper intended to *convey* a benefit to *the tippee*. That makes no sense. The fundamental requirement is that the insider/tipper receive a *quo* (personal benefit) for the *quid* of inside information. A mere intent to provide a *quid* to an outsider does not establish a *quo* for the insider/tipper. It focuses on the wrong end of the transaction, and it substitutes a subjective test about what the insider intended to confer for an objective test about what the insider actually received back.

Not surprisingly, a test that focuses on the wrong end of the transaction produces untenable results. The Second Circuit was explicit that under its test, if "a tipper discloses inside information to a perfect stranger and says, in effect, you can make a lot of money by trading on this," that suffices to prove that *the tipper* received a personal benefit. App.18. But *Dirks* requires an actual benefit to the insider/tipper and in narrow circumstances allows an actual gift to a close associate of the insider to suffice. The one thing that most certainly does not suffice is a mere intent to give a gift to a perfect stranger. But by focusing on the subjective intent behind the *quid* rather than the objective reality of a *quo*, the Second Circuit expressly embraced an absurd result.

And not just any absurd result; it is precisely the absurd result that this Court pointedly declined to embrace three years ago in *Salman*, where the government argued that "a gift of confidential information to *anyone*, not just a 'trading relative or friend,' is enough to prove securities fraud." 137 S. Ct. at 426 (emphasis added). The majority's "perfect stranger" hypothetical is essentially the hypothetical Justice Alito posed at oral argument in *Salman* to illustrate why the government's position was not "consistent with *Dirks*." Tr. of Oral Argument 28-29, *Salman*, No. 15-628 (U.S. argued Oct. 5, 2016) ("Now suppose someone, 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 trade on this."). While the government was happy to abandon *Dirks* and deem the gift to the perfect stranger—unhappy or not—a crime, members of this Court viewed that *reductio ad absurdum* as absurd. *See, e.g.*, *id.* at 42 (Justice Breyer: "I am worried about line drawing, and you want to draw a line so that friend, relative, doesn't matter…."); *id.* at 46 (Justice Sotomayor: "So it's irrelevant whether it's a friend or family member?").

This Court's skepticism was warranted, but at least the government was making that argument to the sole court—this Court—with the authority to rewrite *Dirks* if appropriate. The Second Circuit is not similarly empowered, but it nonetheless embraced a theory that members of this Court correctly recognized is fundamentally inconsistent with *Dirks*. That is clear enough from the decision below. As the majority explained, in its view, the personal benefit requirement is not truly an independent requirement, but rather is simply one means of determining whether the insider "lacked a legitimate corporate purpose" for disclosing the information. App.18.[2] That may have been the government's argument in *Dirks* and *Salman*, but it is decidedly not the view this Court adopted in either case.

The majority purported to derive its intent-to-benefit-the-tippee standard from a single line of *Dirks* identifying as an "example" of the kind of "objective facts and circumstances" that may justify inferring a personal benefit "a relationship between the insider and the recipient that suggests a *quid pro quo* from the latter, or an intention to benefit the particular recipient." 463 U.S. at 664. According to the majority, the meaning of this sentence is "ambiguous" because "[t]he comma separating the 'intention to benefit' and 'relationship ... suggesting a *quid pro quo*' phrases can be read to sever any connection between them,"

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[2] Indeed, Judge Rakoff recently characterized the decision below in exactly that way, concluding that any disclosure of inside information not made for a "corporate or otherwise permissible purpose" automatically meets the personal benefit requirement under the decision below, and that courts that believe that *Dirks* actually requires a personal benefit to the tipper "appear[] to have … misunderstood" *Dirks*. *United States v. Pinto-Thomaz*, 2018 WL 6378118, at *3 (S.D.N.Y. Dec. 6, 2018) (Rakoff, J.).

making “an intention to benefit the recipient” “a standalone personal benefit under *Dirks*.” App.17.

That reading of *Dirks* is implausible. The sentence immediately preceding the “[f]or example” sentence is followed by a parenthetical specifically explaining how there can be specific types of “relationships” in which “an intention to benefit the particular recipient” evinces an effort to benefit the insider himself. *See* 463 U.S. at 663-64 (citing a law review article for the proposition that “the insider, by giving the information out *selectively*, is in effect selling the information to its recipient for cash, reciprocal information, or other things of value *for himself*” (emphasis added)). In context, then, it is clear beyond cavil that *Dirks* was explaining what kinds of *relationships* can give rise to an inference that the insider/tipper himself benefited, not establishing an independent and nonsensical proposition that “an intention to benefit the particular recipient” necessarily amounts to a benefit to the tipper as well.

Indeed, if the mere intent to benefit the tippee were enough to establish a personal benefit to the tipper, then *Dirks* should have come out the other way. The insider/tipper in *Dirks* (Secrist) did not give the inside information to Dirks unintentionally or randomly. Instead, Secrist specifically conveyed the information to Dirks, a professional analyst, knowing and expecting that Dirks would benefit from it. While the tip in *Dirks* may have been primarily “motivated by a desire to expose the fraud,” 463 U.S. at 667, Secrist plainly singled Dirks out and intended to benefit him—especially given that Dirks was an analyst who was paid a commission on trades made through his firm. *See id.* at 649 n.2; *id.* at 668-69 & n.4 (Blackmun, J., dissenting). Accordingly, if an intent to benefit *the tippee* sufficed to demonstrate a benefit to *the tipper*, then *Dirks* should have come out the other way.

That likely explains why the government in *Salman* did not even attempt to explain how an intention to benefit *the tippee* somehow translates into a benefit to *the insider/tipper*. Instead, the government was perfectly candid in admitting that, in its view, the real test should be whether there was "any legitimate corporate purpose for the disclosure," and the government should be able to satisfy that test by proving that "the insider is providing [the inside information] for the purpose of obtaining a personal advantage, *either* for himself *or somebody else*." Tr. of Oral Argument 25-27 (emphasis added).

That may be the test that the government wanted, and it may be a test that this Court has the power to adopt. But it is decidedly not the test that *Dirks* established, and it is decidedly not a test that the Second Circuit has the power to adopt. *Dirks* squarely held, and *Salman* expressly reiterated, that the test is "'whether *the insider* personally will benefit, directly or indirectly, from his disclosure.'" *Salman*, 137 S. Ct. at 426 (emphasis added) (quoting *Dirks*, 463 U.S. at 662); *see* App.32 (*Dirks* asks "not whether the [tipper] wished ill on shareholders or wished good on the tippee, but whether she received something in return for her tip"). Indeed, scores of decisions have understood both *Dirks* and *Salman* in exactly that way. If that test is to be supplanted, that determination must come from this Court, not from a two-judge majority on the Second Circuit.

II. The Question Presented Is Exceptionally Important, And This Is An Excellent Vehicle For Resolving It.

1. If permitted to stand, the decision below will have implications for individual liberty and efficient markets that extend far beyond this case. Given New York City's role as the nation's financial capital, any insider trading decision from the Second Circuit has outsized importance—not only because of the numerous professional traders who work in New York, and the numerous trades that pass through the city, but because of the numerous insider trading prosecutions brought there and the special prominence of those prosecutions. That exceptional weight is magnified where (as here) a decision radically lightens the government's burden of proof.

Given the wide latitude the United States has in deciding where to bring prosecutions, *see* 18 U.S.C. §3237(a), and the reality that virtually any securities transaction will touch New York, a Second Circuit decision eliminating any meaningful burden on the government to show an actual benefit to the insider/tipper will attract even more insider trading prosecutions to the Southern District of New York (with a corresponding decrease in the number of opportunities for other circuits to address the same issues). Why prove an actual benefit to the insider/tipper in Boston when a mere intent to benefit an outsider will suffice in Manhattan? Why establish a meaningful personal relationship in Los Angeles when the mere intent to confer a benefit to a perfect stranger carries the day in New York? And there will be a massive multiplier effect in terms of liberty lost as the decision manifests itself not in trials but in pleas. Facing a government armed with the intent-to-benefit-the-outsider test and able to point to Martoma's nine-year sentence, it will be the rare defendant that puts the government to its drastically reduced burden.

The decision below also will have a profound—and profoundly chilling—effect on the nation's markets. Professional traders are expected and encouraged to unearth as much information as possible to analyze their investment opportunities and trade on it, a process that is "necessary to the preservation of a healthy market." *Dirks*, 463 U.S. at 658. That process naturally includes "meeting with and questioning corporate officers and others who are insiders," *id.*, who may often reveal material nonpublic information for reasons that are multifaceted, opaque, and/or "not inconsistent with the duty insiders owe to shareholders." *Id.* at 661-62. If all it takes is an intent to benefit an outsider, the threat of prosecution will have a strong "inhibiting influence" on the very activities that ensure accurate market pricing, *id.* at 658, as traders will fear that engaging in basic market research could put them at risk of years in federal prison. By offering the appearance, but not the reality, of a meaningful personal benefit requirement, the decision below eliminates any "essential … guiding principle" for traders attempting to conduct thorough market research within the bounds of the law. *Id.* at 664. The ultimate cost in terms of lost liberty and efficiency is enormous.[3]

The inability of the Second Circuit to settle on a coherent test underscores the need for this Court's review. During the pendency of this direct appeal alone, the Second Circuit has substantially revised its views on this issue three times: first in *Newman*, then in its initial decision in this case, and then again in its amended decision. That uncertainty has been catastrophic not just for Martoma, who waited four years just to have his direct appeal resolved, but for other defendants, including some who face prosecution for trades that were lawful under *Newman* when made but that the government now claims are unlawful under the decision below. *See Pinto-Thomaz*, 2018 WL 6378118, at *5.

These "repeated attempts and repeated failures to craft a principled … standard" raise serious due process and fair notice concerns. *Johnson v. United States*, 135 S. Ct. 2551, 2558 (2015). This ever-shifting caselaw leaves traders "in the dark about what the law demands" or when it will stop changing, and "allow[s] prosecutors and courts to make it up" after the fact. *Sessions v. Dimaya*, 138 S. Ct. 1204, 1223-24 (2018) (Gorsuch, J., concurring in part and in the judgment). It is bad enough that the answer to what is criminal and what is permissible does not lie within the pages of the United States Code. If clear and consistent

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[3] Notably, research conducted in the aftermath of *Newman* shows that market participants do indeed follow and react to changes in insider trading law. *See, e.g.*, Menesh Patel, *Does Insider Trading Law Change Behavior? An Empirical Analysis* (Jan. 26, 2018), available at https://bit.ly/2FS1vwJ.

answers and guidance do not even lie within the pages of F.3d, then there is no substitute for this Court's intervention.

2. This case presents an excellent vehicle for the Court to provide a clear and coherent test for insider trading, as this case itself has been the source of the Second Circuit's two most recent conscious efforts to set forth the personal benefit rule. And while the majority below attempted to shield its decision from this Court's review by claiming that the conceded instructional error was harmless, that effort is wrong and disingenuous. If this case really could be resolved on that purportedly independent ground, then the panel would not have spent months waiting for *Salman*, it would not have held reargument after *Salman*, and it would not have spent months revising its initial opinion to preserve its core while warding off en banc review. The simple reality is that the panel wanted to use this case to rewrite insider trading law, and it proceeded to do exactly that. That conscious effort should not escape this Court's review.

The majority acknowledged that the district court erred when it instructed the jury that it could find a personal benefit on the theory that Gilman gave Martoma the equivalent of a multi-million dollar gift in hopes of "developing or maintaining … a friendship." App.13. But the majority determined that there was no need to instruct on the "gift" theory at all, because the jury could have found a personal benefit to Gilman on its newly-minted "intention to benefit" theory instead (even though the government never actually presented that theory to the jury). App.24-25; *but see Chiarella*, 445 U.S. at 236 ("[W]e cannot affirm a criminal conviction on the basis of a theory not presented to the jury[.]").[4] The majority then breezily concluded that any instructional error "did not affect Martoma's substantial rights" because the government purportedly produced such "compelling evidence" of a *quid pro quo* relationship between Gilman and Martoma that the jury *must* have found that Gilman provided the inside information in exchange for some *financial* benefit. App.25.

That conclusion is belied not only by Gilman's testimony that he neither wanted nor received any financial compensation for the inside information he purportedly provided, C.A.App.179; *see* App.46, but also by the government's repeated invocation of a "friendship" theory at trial, *see, e.g.*, C.A.App.158 (arguing Gilman tipped Martoma because he "began to view [him] as a friend"). The government requested a (flawed) instruction on the "friendship" theory precisely because its *quid pro quo* theory was devastated by Gilman's concession that he never sought or received anything of value for the efficacy data that allegedly was the basis of Martoma's and Cohen's trades. The jury also demonstrated its skepticism regarding the government's *quid pro quo* theory, sending a note early in its deliberations to ask

[4] This, of course, gives the lie to the majority's claim that it was not overruling *Newman*. While the panel suggested that *Newman* would continue to apply in cases where the government chooses to rely on a "gift" theory, App.3-4, 23-25, under the majority's decision, the government need never rely on a "gift" theory, which requires establishing a meaningfully close personal relationship, because it can always rely on an "intention to benefit" theory, under which an intent to give a gift (*i.e.*, a benefit) to a perfect stranger suffices. App.23-25.

whether the consulting fees that Gilman received could qualify as a "personal benefit." C.A.App.267. In response, the court simply re-read its prior erroneous instruction—and despite that government-friendly erroneous instruction, the jury still took three days of deliberations to reach its verdict. On this record, there is simply no way to be sure that the jury must have found a financial *quid pro quo* rather than impermissibly convicting based on a "developing" friendship. App.13; *see Chiarella*, 445 U.S. at 236. Indeed, if this record compels the conclusion that a reasonable jury "would have" convicted on a *quid pro quo* theory, App.26, then a jury would be required to convict "whenever inside information is revealed within a paid consulting relationship," App.46—a result even the majority refused to embrace, App.26.

The majority's harmless error thus can be understood only as an effort to shield its newly-minted intent-to-benefit-an-outsider test from this Court's review. If payments to Gilman for consultations on safety data really were an adequate substitute for the lack of any financial benefit for efficacy data, and evidence of that *quid pro quo* really were compelling, there would have been no need to wait months for *Salman*, no need for reargument in light of *Salman*, no need to undermine *Newman*, and no need to spend months rewriting an opinion that eviscerates *Dirks*. And, of course, if the financial *quid pro quo* really were compelling and sufficient, there was no basis for the majority to explicate the metes and bounds of the personal benefit test at all, let alone to adopt a misguided test that makes the intent to provide a *quid* a substitute for a *quo*. In reality, then, the majority's alternative holding is every bit as flawed as its principal holding, and the two can and should be reexamined in tandem.

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An objective personal benefit requirement is critical to ensure that professional traders can conduct the diligent market research that is "necessary to the preservation of a healthy market." *Dirks*, 463 U.S. at 658. The decision below eliminates that requirement, forcing traders to choose between investing without adequate research or risking prison time if the government later decides that some piece of information they learned was provided with an intention to benefit them. Especially given the number of professional traders that the Second Circuit's decision will govern—and especially given the significant confusion in that court on this issue in recent years—that ruling cries out for review.

CONCLUSION

For the foregoing reasons, this Court should grant the petition.

Respectfully submitted,

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