NO. 18-972

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

REPLY BRIEF FOR PETITIONER

ALEXANDRA A.E. SHAPIRO
ERIC S. OLNEY
SHAPIRO ARATO BACH LLP
500 Fifth Avenue
40th Floor
New York, NY 10110

PAUL D. CLEMENT
Counsel of Record
ERIN E. MURPHY
C. HARKER RHODES IV
KIRKLAND & ELLIS LLP
1301 Pennsylvania Ave., NW
Washington, DC 20004
(202) 389-5000
paul.clement@kirkland.com

Counsel for Petitioner

May 14, 2019

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Other Authorities

REPLY BRIEF

The government's brief in opposition is remarkable for what it does not say. The government does not even try to put forward any substantive defense of the Second Circuit's paradoxical holding that an intention to *give* a benefit to the *tippee* somehow equates to the *receipt* of a personal benefit by the *tipper*. Nor does it try to explain how that holding could be reconciled with *Dirks v. SEC*, 463 U.S. 646 (1983), or with this Court's decision not to adopt an equivalent test in *Salman v. United States*, 137 S. Ct. 420 (2016).

The government says equally little about the substantial importance of the question presented. It does not dispute that the decision below has the practical effect of revising federal insider-trading law nationwide, as every insider-trading prosecution can be (and now will be) brought in the Second Circuit. Nor does it address the significant threat—highlighted by amici—that the Second Circuit's judicial expansion of the quasi-common-law crime of insider trading poses to the financial markets and to individual liberty.

Instead, the government proceeds as if the decision below were an unpublished opinion focused only on the sufficiency of the evidence of financial benefit to the tipper from consulting arrangements. But that is not the case the government argued or the opinion the Second Circuit wrote—and with good reason, as the tipper's own testimony disclaimed that theory. The Second Circuit's purported alternative holding cannot be reconciled with the government's trial strategy or divorced from the court's extreme

dilution of the personal benefit standard. And there is simply no denying that the Second Circuit consciously adopted a test for "personal benefit" *to the tipper* that requires nothing more than an intent to benefit *someone else* (*i.e.*, the tippee). Indeed, the notion that this is just a run-of-the-mill *quid pro quo* case is belied by the months that the panel spent waiting for *Salman*, holding reargument after *Salman*, and then writing and revising its opinion to embrace a sweeping new personal benefit test. Nor is there any denying that the panel majority's new test will now govern every prosecution in the Second Circuit, which is to say virtually every insider-trading case in the country.

The Second Circuit's test not only is inconsistent with *Dirks* but is essentially no test at all, as it captures everything but inadvertent disclosures (and thus suggests that *Dirks* itself was wrongly decided). The government has been trying, heretofore unsuccessfully, to get such a non-test for decades. Now that it has gotten its wish, it should not be allowed to shirk the responsibility of defending that sweeping ruling, especially when the personal benefit test is all that stands between lawful activity that is essential to the proper functioning of the market and activity that the government deems felonious. The issues here are too important to accept the government's effort to have its *Dirks*-defying standard and evade plenary review too.

I. The Decision Below Radically Departs From This Court's Precedents And The Many Decisions Faithfully Following Them.

The core holding of *Dirks* is straightforward: To determine whether a tipper has disclosed information

in violation of a fiduciary duty, and thus whether trading on that information is criminal, "the test is whether the [tipper] personally will benefit, directly or indirectly, from his disclosure." *Dirks*, 463 U.S. at 662; *see Salman*, 137 S. Ct. at 427 (reaffirming *Dirks*). The divided decision below turns that test on its head. Instead of asking whether *the tipper* will *receive* a benefit, it holds that the test is whether the tipper intended to *confer* one on *the tippee*. Pet.App.21. That radical holding is wrong three times over: It focuses on the wrong thing (intent to benefit another versus actual receipt of a personal benefit); divorces the federal crime of insider trading from its longstanding theoretical basis; and severs the already-tenuous connection between that quasi-common-law crime and the generic statute on which it purports to be based. *See* Pet.19-28; NACDL Br.2-3, 8-10.

Remarkably, the government makes no attempt to reconcile the Second Circuit's novel intention-to-benefit standard with *Dirks* (which found the statute inapplicable to a tip intended to benefit the tippee)—or even to defend that standard on its merits. The government recognizes that the critical question under *Dirks* is whether the *tipper* "personally will benefit" from his disclosure, not whether he intends to confer a benefit on someone else. Opp.15 (quoting *Dirks*, 463 U.S. at 662). And it refrains from embracing the majority's strained suggestion that when *Dirks* described the kind of "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, it meant to adopt the nonsensical proposition that an intent to confer a benefit on *someone else* constitutes a

"standalone personal benefit" *to the tipper*, Pet.App.16. *See* Pet.25-26; Professors Br.5-7. Faced with a misguided holding that all but eliminates the personal benefit requirement while making a hash out of *Dirks*, the government responds with deafening silence.

The government has equally little to say about the striking fact that the decision below adopts the same basic test the government urged on this Court *unsuccessfully* three years ago in *Salman*. *See* Pet.11-12, 23-25. There, the government argued criminal liability should attach "whenever the tipper discloses confidential trading information for a noncorporate purpose," regardless of whether that purpose involved any benefit to the tipper. *Salman*, 137 S. Ct. at 426. Indeed, the government specifically asserted that it should be able to obtain a conviction by showing that the tipper was trying to obtain a benefit "*either* for himself *or somebody else*." Tr. of Oral Argument 25, *Salman*, No. 15-628 (U.S. argued Oct. 5, 2016) (emphasis added). But as several members of this Court suggested at oral argument, that benefit-to-anyone approach cannot be reconciled with the line drawn in *Dirks* and consistently followed ever since. *Id.* at 28-29, 42, 46; *see* Pet.24. Unsurprisingly, this Court pointedly avoided espousing the government's approach, choosing instead to "adhere to *Dirks*." *Salman*, 137 S. Ct. at 427.

The decision below ignores that lesson. Instead of following *Dirks*, it judicially enlarges the crime of insider trading to cover any case in which the tipper intended to benefit a third party, which is at least as expansive as the no-legitimate-government-purpose

standard rejected in *Salman*. Pet.24-25; *see* Pet.App.27 (holding that jury "can often infer that a corporate insider receives a personal benefit" when he discloses inside information "without a corporate purpose"); Professors Br.7-8; NACDL Br.9-10. Indeed, the government does not dispute that if mere intent to benefit the tippee sufficed, then *Dirks* itself should have come out the other way. Pet.26-27. As Judge Pooler thus pointedly noted in dissent, the majority's approach not only allows the government to "convict based on circular reasoning," but "flirts with the possibility that the personal benefit test that goes back to *Dirks* may no longer be good law." Pet.App.47. The majority's approach also conflicts with numerous cases that have followed *Dirks* and refused to treat a disclosure intended to benefit the tippee as a personal benefit to the tipper unless the two were relatives or friends. *See* Pet.22; Professors Br.8-10.[1] The Second Circuit's stark departure from the settled jurisprudence of this Court and other circuits readily warrants review.

[1] The government's feeble attempts to distinguish these cases fall flat. It especially misreads *United States v. Bray*, 853 F.3d 18 (1st Cir. 2017). *Bray* does not hold that a personal benefit to the tipper can be inferred from a mere "intention to benefit the [tippee]." *Contra* Opp.20. On the contrary, *Bray* follows *Dirks*, holding that a benefit to the tipper can be inferred when the "*relationship* between the tipper and the recipient" suffices to infer a benefit the tipper. 853 F.3d at 26 (emphasis added). That is why *Bray* specifically analyzed whether the tipper and tippee had a "close relationship." *Id.* at 26-27.

II. The Question Presented Is Exceptionally Important.

The government not only makes no attempt to defend the core holding of the decision below, but also makes no attempt to deny the exceptional importance of the question presented. As the circuit that includes the nation's financial capital (and the world's largest securities market), the Second Circuit's decisions govern all of the countless professional traders that work in New York and all of the countless trades that pass through the city every day, effectively "defin[ing] the scope of criminal liability for market participants nationwide." NACDL Br.3; *see* Pet.28; Petition at 32-34, *United States v. Newman*, No. 15-137 (filed July 30, 2015). And because the decision below all but eliminates one of the key elements of the crime, the federal government will have every incentive to bring any insider-trading prosecution with an arguable nexus to New York (which is to say virtually all of them) in the Second Circuit. Pet.28-29; Professors Br.17. In short, it is no exaggeration to say that two judges on a divided panel have essentially rewritten the law of insider trading nationwide.

That radical revision will impose substantial costs on the nation's financial markets and on individual liberty. Professional traders play a critical role in the securities markets by ferreting out and trading on information that is better than that reflected in prevailing market prices—a process that is "necessary to the preservation of a healthy market." *Dirks*, 463 U.S. at 658. But under the decision below, anyone who trades on such information risks federal prison if the information is traced back to an insider who intended

to benefit some outsider. Pet.29-30; Professors Br.15-16.

The government offers no response or reassurance, presumably because some federal prosecutors have long sought a prohibition on trading while in possession of inside information. But Congress has never authorized that regime. Indeed, in reading the government's brief it is easy to forget that this entire insider-trading edifice is built upon the generic prohibitions in §10(b) and Rule 10(b)(5). By eviscerating the personal benefit test, the decision below severs one of the few remaining links between the government's insider-trading prosecutions and the statute that purports to justify them. Moreover, the Second Circuit's ever-shifting personal benefit law raises serious due process and fair notice concerns, and provides a powerful reminder of why this Court abolished common-law crimes. Pet.30-31; Professors Br.11-15; NACDL Br.7-8. Those concerns—and the government's marked silence in response to them—confirm the need for this Court's intervention.

III. This Case Is An Excellent Vehicle For Resolving The Critically Important Question Presented.

Unable to defend the decision below on the merits or deny its importance, the government concentrates its efforts on obscuring the court's holding and conjuring up illusory vehicle concerns. Those efforts are unavailing. The Second Circuit issued a sweeping precedential decision for a reason, and the government's efforts to convert that ruling into a narrow case-specific ruling are not accurate. Nor have they stopped the government from invoking the ruling

as a circuit precedent that eliminates the personal benefit test as a meaningful element of insider trading.[2]

1. The government attempts to portray the decision below as a routine application of plain-error principles. It claims there was no plain error here because the jury instructions were not obviously incorrect and a properly instructed jury would have convicted based on purportedly "compelling evidence of a *quid pro quo* relationship." Opp.17. Neither contention withstands scrutiny.

As for the first, the government never explains exactly which aspects of the instructions it thinks were erroneous or correct, but rather suggests that they "closely tracked the language of *Dirks*." Opp.15. In fact, they deviated from *Dirks* in two critical respects. *Dirks* allows an inference of personal benefit only when there is a "*relationship* between the [tipper] and the [tippee] that suggests … an intention to benefit the [tippee]," such as the tippee's relationship with a "trading relative or friend." 463 U.S. at 664 (emphasis added). The instructions here, by contrast, allowed the jury to convict by finding that Gilman shared inside information to "confer[] a benefit *on Mr. Martoma*," or to give him "a gift with the goal of maintaining or developing a personal friendship or a useful networking contact." Pet.App.8 (emphasis added).

---

[2] *See* U.S. Mem.4, *Marshall v. United States*, No. 17-cv-2951 (S.D.N.Y. filed July 26, 2018), Dkt.39; SEC Br.27, *SEC v. Waldman*, No. 17-cv-2088 (S.D.N.Y. filed Feb. 19, 2019), Dkt.106.

Those instructions are plainly incorrect under *Dirks*, which requires a *genuine* benefit to *the tipper*. Indeed, the majority deemed them (mostly) correct only because of its profoundly mistaken view that the "*tipper* personally benefits by giving inside information" to the tippee, Pet.App.78 (emphasis added)—a proposition that the government never advanced in any of its ever-shifting efforts to procure and then defend the conviction in this case.

As for its contention that any error was harmless, the government emphasizes the majority's cavalier claim—sharply disputed by the dissent, *see* Pet.App.46—that the government produced such "compelling evidence" of a *quid pro quo* relationship between Gilman and Martoma that a properly instructed jury *necessarily would* have found that Gilman disclosed inside information in exchange for some actual or expected *financial* benefit. Pet.App.25-26; *see* Opp.16-17. But Gilman disclaimed that theory at trial, testifying that he neither wanted nor received any financial benefit for the inside information that drove the charged trades. Pet.9, 32; *see* Pet.App.46; C.A.App.179. To be sure, the government could have persisted in a financial benefit theory despite that testimony, but doing so would have come at the cost of directly undermining the credibility of its star witness. Understandably, the government instead shifted horses and emphasized its alternative "friendship" theory to the jury. *See* Pet.32; C.A.App.158. The government cannot be faulted for that tactical choice, which was permitted by pre-*Newman* circuit law, but neither can it avoid review of the decision below by reviving a theory it walked away

from and could not have emphasized without undermining the credibility of its key witness.[3]

The government's harmless error theory is further belied by the history of this case. If the evidence that Gilman received a financial benefit for disclosing the critical efficacy data—despite his contrary testimony—really was so compelling that no rational jury could reject it, then the decision below should have been a summary order affirming the conviction on that narrow ground, not a wide-ranging precedential opinion that redefines the crime of insider trading. There likewise would have been no need for the Second Circuit to wait several months for this Court to provide guidance on *non-financial* benefit cases in *Salman*, then hold reargument after *Salman*, and ultimately spend nine months revising the initial panel decision to alter its test for non-financial personal benefits. The claim that this was a straightforward case about a financial *quid pro quo* all along blinks reality.

Ultimately, moreover, the government's harmless error argument boils down to the untenable proposition that no rational jury could decline to convict when "inside information is revealed within a paid consulting relationship." Pet.App.46. Once again, the government provides no comfort that this is not the inevitable consequence of the decision below, or that the decision will not produce an enormous

[3] The government's references to Dr. Ross are a red herring. As the Second Circuit recognized, "it was Dr. Gilman, not Dr. Ross, who gave Martoma the final efficacy data" that was the purported basis of the charged trades, so any benefit to Dr. Ross is irrelevant. Pet.App.10 n.3.

chilling effect on legitimate activity that is vital to the markets. In an area that demands bright-line rules promulgated by politically accountable actors, the regulated community is left with ambiguous judge-made rules that skew the playing field toward prosecutors and against values like fair notice.

2. Instead of confronting the question presented, the government argues that the petition is about something completely different: whether the decision below "adhered to the prior panel opinion in *Newman*." Opp.18-19; *see United States v. Newman*, 773 F.3d 438 (2d Cir. 2014). That is both incorrect and disingenuous. As the petition makes clear from the outset and throughout, the question presented is whether 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*." Pet.i. That is a question about whether the test that the Second Circuit adopted in *this* case is correct, not about whether the majority "adhered to the prior panel opinion in *Newman*." Opp.19.

To be sure, the majority decidedly did *not* adhere to *Newman* and its "meaningfully close personal relationship" test. Pet.21-22. But that is relevant not to suggest that petitioner mistakenly filed his en banc papers in this Court, but because *Newman*, unlike the decision below, adopted a test consistent with *Dirks*. In other words, the distance between the decision below and *Newman* is important not for its own sake, but as a yardstick for the conflict between the decision below and *Dirks* (not to mention decisions from other

courts adhering to *Dirks*). As *Newman* and those decisions correctly recognized, *Dirks*' gift-giving analogy applies only when the tipper and tippee have the kind of "meaningfully close personal relationship," *Newman*, 773 F.3d at 452, in which "[t]he 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.

Here, the Second Circuit not only allowed the government to invoke a gift-giving theory without abiding by that limit, but concluded that an intent to "gift" inside information to *anyone*—even "a perfect stranger," Pet.App.18—constitutes a "standalone personal benefit" to *the tipper*, Pet.App.16. In doing so, the majority expanded the federal crime of insider trading far beyond the bounds set by *Dirks*, with grave consequences for the financial markets and for individual liberty. This Court should not allow that profoundly misguided decision to become the de facto law of the land.

CONCLUSION

This Court should grant the petition.

Respectfully submitted,

ALEXANDRA A.E. SHAPIRO
ERIC S. OLNEY
SHAPIRO ARATO BACH LLP
500 Fifth Avenue
40th Floor
New York, NY 10110

PAUL D. CLEMENT
Counsel of Record
ERIN E. MURPHY
C. HARKER RHODES IV
KIRKLAND & ELLIS LLP
1301 Pennsylvania Ave., NW
Washington, DC 20004
(202) 389-5000
paul.clement@kirkland.com

Counsel for Petitioner

May 14, 2019