How Meaningful Is a Close Relationship? When it Comes to Insider Trading Prosecution, the Second Circuit Says “Not Very”

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I. Introduction

On August 23, 2017, the Second Circuit upheld the securities fraud conviction of S.A.C. Capital Advisors LLC (“SAC”) portfolio manager Mathew Martoma in connection to an insider trading scheme concerning securities of pharmaceutical companies Elan Corporation, plc and Wyeth.¹ Involving over $275 million, the government publicly described Mr. Martoma’s insider trading scheme as the “most lucrative” in history, “on a scale that has no historical precedent.”² Between 2006 and 2008, Martoma frequently consulted with doctors from Elan and Wyeth throughout the corporations’ joint development of an Alzheimer’s treatment.³ At these meetings, Mr. Martoma often received nonpublic information while paying up to $1,500 an hour in consulting fees, despite a provision in the consulting agreement prohibiting the exchange of such information.⁴ After a phone conversation with Dr. Sidney Gilman on July 17, 2008, the chair of the safety monitoring committee for the clinical trial, Mr. Martoma, flew to Michigan to meet Gilman in person on July 19, 2008.⁵ Two days later, Martoma induced SAC to significantly reduce its positions in both Elan and Wyeth.⁶

On July 29, 2008, Dr. Gilman publicly presented the clinical trial’s undesirable final results for the first time at the International Conference on Alzheimer’s Disease, prompting Elan and Wyeth’s share prices to decline by 42% and 12%, respectively.⁷ After the stocks plummeted, SAC’s July 21 position resulted in

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¹ J.D. Candidate, 2019, Seton Hall University School of Law; B.A. Clemson University. I would like to thank Professor Stephen Lubben for his guidance in writing this Comment.

² United States v. Martoma, 869 F.3d 58 (2d Cir. 2017).

³ Martoma, 869 F.3d at 62.

⁴ Id.

⁵ Id.

⁶ Id.

⁷ Id.
capital gains of approximately $80.3 million and averted losses of approximately $194.6 million. Martoma received a $9 million bonus based largely on his involvement with the transaction.

Despite the ease with which the court could have convicted Martoma using firmly established insider trading liability principles, the Second Circuit majority focused on a contentious liability theory that has troubled appellate courts for the past five years. Writing for the *Martoma* majority, Chief Judge Katzman rearticulated the personal benefit rule, a component of the fourth prong in the test for “tipper-tippee” insider trading liability, established by Justice Powell in *Dirk v. S.E.C.* in 1983; more specifically, Chief Judge Katzman attempted to clarify when, if ever, a personal benefit may be inferred in the exchange of material, nonpublic, corporate information. This Comment will discuss why the *Martoma* majority’s interpretation of when a personal benefit may be inferred under “tipper-tippee” insider trading liability was both unnecessary and inconsistent with Supreme Court precedent. Specifically, it will examine the evolution of the personal benefit rule, its importance, and how the Second Circuit’s cannibalization of the rule may create insider trading liability for noncriminal market analysis. Part II of this Comment describes the creation and early development of United States insider trading laws, as well as the public policy rationale for prohibiting trading on material nonpublic information. Part II begins with the Securities and Exchange Act of 1934 and highlights landmark decisions in insider trading jurisprudence through 1968. Part III of this Comment explores the genesis of “tipper-tippee” liability and the personal benefit rule. Part III starts with the 1980 Supreme Court

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8 *Id.*
9 *Martoma*, 869 F.3d at 62–63.
10 The Supreme Court has historically recognized three general theories of insider trading liability: (1) the “classical” theory, (2) the “tipper-tippee” theory, and (3) the “misappropriation” theory. Bradley J. Bondi & Steven D. Lofchie, *The Laws of Insider Trading: Legal Theories, Common Defenses, and Best Practices for Ensuring Compliance*, 8 N.Y.U. J. L. & BUS. 151, 157–58 (2011). The “classical” theory applies when an insider violates his or her fiduciary duty to his or her company by trading on material nonpublic information that he or she obtained in the capacity of a fiduciary. *Id.* The “tipper-tippee” theory applies when (1) a tipper breaches his or her fiduciary duty to shareholders by disclosing material nonpublic information to a tippee, (2) the tippee knows or should know there has been a breach, (3) the tippee transacts securities based on the information, and (4) the tipper receives a personal benefit in return. *Id.* The “misappropriation” theory applies when a non-insider lawfully obtains material nonpublic information and breaches a duty owed to the source of the information by trading on the information or sharing the information for a third party to trade on it. *Id.*
12 *Martoma*, 869 F.3d at 70.
case that first acknowledged insider trading liability imposed by tipping. It then examines Justice Powell’s conception of the modern “tipper-tippee” framework established in Dirks. Part IV will detail how the inconsistent application of Dirks in the Federal Circuit culminated in the 2016 Supreme Court case Salman v. United States. It will also dissect the Second Circuit majority’s application of Dirks in Martoma, in light of the recent Supreme Court decision. Part V will illustrate why Judge Pooler’s interpretation of the tipper-tippee liability correctly outlines the Supreme Court’s intentions in Salman and the options to reconcile the Martoma decision going forward. Finally, Part VI will conclude by arguing the Second Circuit needs to clarify the proper application of Dirks and the legislature should step in and create statutory guidelines for insider trading prosecution. In its entirety, this Comment will argue that the Martoma majority unduly tilted insider trading prosecution in the government’s favor by disabling Dirks’ personal benefit requirement and potentially criminalizing behavior vital to market efficiency.

II. Motivation, Creation, and Early Development of United States Insider Trading Laws

Insider trading is defined as the buying and selling of a security by someone who has access to material nonpublic information about the security,\(^{13}\) and the American public considered it wrong for over a century.\(^{14}\) In the early 1900’s, the Supreme Court noted the inherent deception in a corporate director purchasing shares from an outside shareholder based on material information only a director could know.\(^{15}\) Since then, the government and other securities experts have proffered numerous motivations behind insider trading prohibition. The Securities and Exchange Commission (SEC or Commission) supports prioritizing the prosecution of insider trading violations to preserve “investor confidence in the fairness and integrity of the securities markets.”\(^{16}\) An independent study from Duke University suggests the enforcement of insider trading

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\(^{13}\) Bondi & Lofchie, supra note 10.  
\(^{15}\) Strong v. Repide, 213 U.S. 419, 433 (1909).  
trading regulations decreases the cost of equity by up to five percent. There is one overarching principle behind arguments supporting insider trading prohibition: if a country wants consumers to invest their wealth in its securities market, the public must be confident it is getting a fair chance of earning a return. Investors may be reluctant to put their money into a market that gives corporate insiders, or those close to insiders, a better chance at capital growth. The general motivation behind insider trading laws, and virtually all securities laws, may be attributed to the government’s interest in encouraging investing by maintaining a healthy securities market.


The Supreme Court planted the seed of United States insider trading regulations over 100 years ago when it held corporate directors have a duty to disclose nonpublic material information when trading with shareholders on that information, or must abstain from trading on it all together. The 1909 Supreme Court’s decision in Strong v. Repide made it undoubtedly clear that a director cannot trade on privileged information obtained through his or her status as an insider, but left it equally unclear who qualifies as an “insider.” That question remained unanswered twenty-five years later, after the next major development in insider trading law—the passing of the Securities and Exchange Act of 1934 (the Exchange Act).

Since the inception of the Exchange Act, courts have struggled to precisely define what actions constitute insider trading. This is, in part, because the Exchange Act itself makes no reference to trading on privileged information. Despite never mentioning the phrase “insider trading,” section 10(b) of the Exchange Act and SEC Rule 10b-5, promulgated thereunder, serve as the statutory basis for almost all modern

18 See Strong, 213 U.S. at 432.
19 Id.
insider trading convictions. Promulgated under the catch-all anti-fraud provision in section 10(b), Rule 10b-5 states:

It 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 . . . [t]o 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.

Because most federal insider trading liability theories derive from this all-encompassing ban on fraud and deceit, the lack of legislative guidance has forced judges to create a standard for prosecution entirely through adjudication.

B. Early Application of Rule 10b-5

In a 1961 case of first impression and “signal importance in [the] administration of the Federal securities acts,” the SEC laid the foundation for applying Rule 10b-5 to insider trading cases. Cady, Robert & Co. involved a director of the Curtiss-Wright Corporation, a publicly traded company, who told his associate at a registered broker-dealer firm that Curtiss-Wright planned to reduce its quarterly dividend. Upon learning this information, the brokerage associate unloaded 7,000 shares of Curtiss-Wright stock before news of the dividend went public. The SEC found respondents in violation of both section 17(a) of the Exchange Act and Rule 10b-5, stating the “anti-fraud provisions are not intended as a specification of particular acts or practices which constitute fraud, but rather are designed to encompass the infinite variety of devices by which undue advantage may be taken of investors and others.” More importantly, the SEC provided a test to determine when an insider has an affirmative duty to disclose or abstain from trading on nonpublic material information under Rule 10b-5. The Commission explained the duty of an insider does

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23 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5 (YEAR).
24 17 C.F.R. § 240.10b-5.
26 Id.
27 Id.
28 Id. at 911.
29 Id.
not arise from his or her status within a corporation, but rests on two elements: (1) “the existence of a relationship giving access, directly or indirectly, to information intended to be available only for a corporate purpose and not for the personal benefit of anyone,” and (2) “the inherent unfairness involved where a party takes advantage of such information knowing it is unavailable to those with whom he is dealing.” The SEC held insiders and their associates owe this duty to both existing stockholders and traders in the open market. This decision marked a turning point in insider trading jurisprudence and served as a base for future regulatory developments.

The Second Circuit Court of Appeals adopted the SEC’s “abstain or disclose” rule, under Rule 10b-5, in *Securities & Exchange Commission v. Texas Gulf Sulphur Co.* The Texas Gulf court held anyone who possesses “material inside information must either disclose it to the investing public, or, if he is disabled from disclosing it in order to protect a corporate confidence, or he chooses not to do so, must abstain from trading in or recommending the securities concerned while such inside information remains undisclosed.” Texas Gulf was vital to insider trading jurisprudence because it created binding precedent in the Second Circuit and articulated a workable standard for applying Rule 10b-5 to trades based on nonpublic material information. These interpretations of Rule 10b-5 created the initial precedent for prosecuting insider trading cases by establishing the duty to disclose or abstain, conferring that duty on *anyone* in possession of nonpublic material information, and expanding it to include both trading in and recommending subject securities.

### III. Tipper-Tippee Liability and the Personal Benefit Rule

After *Texas Sulphur*, insider trading jurisprudence remained fairly stagnant through the 1970’s. It was only after the Supreme Court limited the application of Rule 10b-5 did the roots for modern tipper-tippee...
liability begin to sprout.\textsuperscript{35} After the court reduced the standard established by \it{Texas Sulphur}, the government was forced to find new ways to prosecute individuals trading on nonpublic material information.\textsuperscript{36} \textit{Chiarella v. United States} and the cases that followed illustrate the shrinking of insider trading liability and the government’s attempts to tilt the standard back in the prosecution’s favor.\textsuperscript{37}

A. \textit{Chiarella v. United States}

In 1980, in one of the two most widely cited insider trading cases, the Supreme Court was tasked with determining the extent and reach of the duties and liabilities under Rule 10b-5.\textsuperscript{38} In both \textit{Cady} and \textit{Texas Sulphur}, liability under Rule 10b-5 was said to be created by the “inherent unfairness” of insiders trading on privileged information.\textsuperscript{39} When Justice Powell was faced with deciding whether a financial printer violated section 10(b) in \textit{Chiarella v. United States}, he decided “unfairness” alone was insufficient to support a conviction.\textsuperscript{40}

At the time of his arrest, Vincent Chiarella was an employee for a company tasked with printing corporate takeover bids.\textsuperscript{41} The SEC investigated and charged Chiarella under section 10(b) and Rule 10b-5 after he netted over $30,000 in fourteen months trading on privileged information obtained while printing confidential documents.\textsuperscript{42} \textit{Chiarella} is distinguishable from all aforementioned insider trading cases because the defendant was charged under section 10(b) and Rule 10b-5 even though he is not a corporate insider and did not receive any confidential information from the subject company.\textsuperscript{43} Because of this, the Court had to

\textsuperscript{36} Texas Gulf, 401 F.2d 833 (2d Cir. 1968).
\textsuperscript{37} Chiarella, 445 U.S. 222 (1980).
\textsuperscript{38} Id.
\textsuperscript{39} See Cady, 40 S.E.C. 907; see also Texas Gulf, 401 F.2d at 833.
\textsuperscript{40} Chiarella, 445 U.S. at 222 (1980).
\textsuperscript{41} Id. at 222.
\textsuperscript{42} Id.
\textsuperscript{43} See id.; see generally Cady, 40 S.E.C. at 907.
decide when and how an individual with no connection to the subject company may be found guilty of insider trading.\textsuperscript{44}

Writing for the \textit{Chiarella} majority, Justice Powell looked to the language of Rule 10b-5 to emphasize two defects in the appellate court’s reasoning behind convicting Chiarella.\textsuperscript{45} First, Justice Powell noted the “disclose or abstain” rule’s improper reliance on fairness.\textsuperscript{46} Section 10(b) and Rule 10b-5 prohibit fraudulent activity, not unfairness, and “not every instance of financial unfairness constitutes fraudulent activity under [section] 10(b).”\textsuperscript{47} The second defect Justice Powell found in Chiarella’s conviction was the absence of a duty to disclose the subject information.\textsuperscript{48} The defendant was not an agent, fiduciary, or even an acquaintance of the subject company.\textsuperscript{49} Justice Powell proclaimed affirming his conviction would be recognizing a “general duty between all participants in market transactions to forgo actions based on material, nonpublic information,” and a “formulation of such a broad duty . . . should not be undertaken absent some explicit evidence of congressional intent.”\textsuperscript{50}

Justice Powell’s opinion in \textit{Chiarella} significantly reduced insider trading liability by holding previous applications of Rule 10b-5 too broad.\textsuperscript{51} Although Rule 10b-5 is designed as a “catch-all” provision, it is designed to encompass all instances of fraud, not unfairness.\textsuperscript{52} Despite citing a lack of fiduciary duty to disclose as a reason for reversing Chiarella’s conviction, Justice Powell declined to speculate upon what elements may impress such a duty on an “outsider,” only that a duty is necessary and does not exist between all participants in market transactions.\textsuperscript{53} Three years later, in the second of the two most widely cited insider

\textsuperscript{44} \textit{Id.} at 231.
\textsuperscript{45} \textit{Id.}
\textsuperscript{46} \textit{Chiarella}, 445 U.S. at 222.
\textsuperscript{47} \textit{Id} (quoting Santa Fe Industries, Inc. v. Green, 430 U.S. 462, 474–77 (1977)).
\textsuperscript{48} \textit{Id.}
\textsuperscript{49} \textit{Id.}
\textsuperscript{50} \textit{Id.} at 233.
\textsuperscript{51} \textit{Id.}
\textsuperscript{52} \textit{Chiarella}, 445 U.S. at 233
\textsuperscript{53} \textit{Id.} at 232.
trading cases, Justice Powell was given the chance to clarify when an “outsider” has a duty imposing liability under Rule 10b-5.\textsuperscript{54}

B. \textit{Dirks v. United States:} The Introduction of the Personal Benefit Rule

Justice Powell’s majority opinion in \textit{Dirks v. S.E.C.} provided a formula for prosecuting insider trading violations that governs to this day.\textsuperscript{55} Raymond Dirks was an officer of a New York broker-dealer firm who provided investment analysis of insurance company securities to institutional investors.\textsuperscript{56} Dirks learned from Robert Secrist, a former officer of an insurance company, that the company’s finances were severely overstated due to fraudulent corporate practices.\textsuperscript{57} Secrist asked Dirks to verify the fraud and disclose it publicly.\textsuperscript{58} Dirks found Secrist’s claims to be true, and, throughout his investigation, he discussed these findings with various clients and investors.\textsuperscript{59} Although Dirks did hold any stock in the subject company, many of the people he spoke with did; five of whom liquidated over $16 million worth of shares in the company.\textsuperscript{60} Two weeks into Dirks’ investigation, the company’s stock price dropped from $26 to less than $15 per share, California insurance authorities impounded its records, and the SEC filed a complaint against it.\textsuperscript{61}

The SEC’s investigation led to Dirks appearing at a hearing in front of an administrative law judge.\textsuperscript{62} At the hearing, the SEC found him guilty of aiding and abetting insider trading violations, concluding: “Where ‘tippees’—regardless of their motivation or occupation—come into possession of material ‘information that they know is confidential and know or should know came from a corporate insider,’ they must either publicly

\textsuperscript{54} Dirks v. S.E.C., 463 U.S. 646 (1982).
\textsuperscript{55} Id.
\textsuperscript{56} Id. at 648.
\textsuperscript{57} Id. at 649.
\textsuperscript{58} Id. at 646.
\textsuperscript{59} Id.
\textsuperscript{60} Dirks, 463 U.S. at 646.
\textsuperscript{61} Id. at 650.
disclose that information or refrain from trading.\footnote{Id. (footnote omitted) (quoting Chiarella v. United States, 445 U.S. 222, 230 n.12 (1980)).} Dirks sought review by the Court of Appeals for the District of Columbia, which entered judgment against him in reliance on the SEC’s original opinion.\footnote{Dirks, 463 U.S. at 646.} The Supreme Court then granted certiorari due to the importance of the question presented.\footnote{Id.}

When Justice Powell was first presented with the facts of \textit{Dirks}, he considered the case “easy to decide” based on \textit{Chiarella}’s fiduciary duty requirement for imposing insider trading liability.\footnote{Justice Lewis F. Powell, Jr., Memorandum for Conference, Dirks v. SEC 1 (Mar. 23, 1983).} In a memorandum to his colleagues, Justice Powell explained the court must determine the source, in this case Secrist, breached a fiduciary duty in order to find that a “participant after the fact,” like Dirks, has the requisite duty.\footnote{Id.} Justice Powell could have swiftly exonerated Dirks under this simple analysis, as the SEC conceded there was no breach by Secrist, but the Justice felt “deciding this case without identifying a general principle would accomplish very little.”\footnote{Id.} With establishing a long-term solution in mind, Justice Powell set out to create a standard for deciding subsequent cases involving outsiders trading on nonpublic material information.\footnote{Id.}

Justice Powell considered himself the Supreme Court’s leader in securities law at the time, thus the most equipped for establishing a law involving the securities market.\footnote{Adam C. Pritchard, \textit{Dirks and the Genesis of Personal Benefit}, 68 SMU L. REV. 857, 859 (2015).} His major concern in sculpting what would become known as the “Dirks test” was protecting the exchange of information necessary for the health of the securities market.\footnote{Id. at 860.} In its original opinion, the SEC acknowledged the undeniable importance of allowing analysts to seek out generally unknown corporate information so their clients can benefit by trading on that information.\footnote{Dirks, Exchange Act Release No. 17480, 1981 WL 36329 (Jan. 22, 1981).} Justice Powell explained that sustaining the SEC’s decision to convict Dirks would
dissuade analysts from continuing this practice out of fear of lawsuits decided by juries determining whether a particular piece of information is legally disclosable.\textsuperscript{73}

Seeking to preserve the function of analysts without encouraging insiders to exploit their positions through tipping, Justice Powell began drafting the Dirks test.\textsuperscript{74} After multiple attempts, Justice Powell and his clerk forged the standard for establishing tipper-tippee liability and introduced the “personal benefit rule.”\textsuperscript{75} Reversing the appellate court’s decision to convict Dirks, Justice Powell, writing for the Supreme Court majority, held that convicting a tipper under Rule 10b-5 requires proof that: (1) the tipper had a fiduciary duty to keep the information in question a secret, but did not, (2) the tipper knew, or should have known, the tippee would trade on the information, and (3) the tipper received a direct or indirect personal benefit from the disclosure.\textsuperscript{76} The personal benefit requirement may be satisfied by evidence of a quid pro quo exchange,\textsuperscript{77} an exchange for a reputational benefit, or inferred when an insider gifts confidential information to a “trading relative or friend.”\textsuperscript{78} If these elements are satisfied, the tippee inherits the insider’s fiduciary duty to disclose or abstain and may be found liable under Rule 10b-5.\textsuperscript{79} Justice Powell then acknowledged “determining whether an insider personally benefits from a particular disclosure, a question of fact, will not always be easy for courts.”\textsuperscript{80} It is very unlikely Justice Powell knew how difficult answering that question of fact would prove in future cases; appellate court judges have been arguing over what constitutes a personal benefit for decades and continue to do so.

\textsuperscript{73}Pritchard, supra note 70, at 859.
\textsuperscript{74}Id.
\textsuperscript{75}Id.
\textsuperscript{76}Dirks, 463 U.S. at 647.
\textsuperscript{77}Quid pro quo translates to “something for something” and is used in law to describe the giving of one valuable thing for another. \textit{Quid pro quo}, Black’s Law Dictionary (10th ed. 2014).
\textsuperscript{78}Dirks, 463 U.S. at 664.
\textsuperscript{79}Id.
\textsuperscript{80}Id.
IV. Applying the Dirks Test in the Twenty-First Century

There were not many major developments in tipper-tippee liability insider trading cases in the years following Dirks. The next watershed moment in its jurisprudence did not come until 2014, when the Second Circuit issued its highly controversial decision in United States v. Newman.

A. Newman’s Close Personal Relationship Requirement

Todd Newman was a portfolio manager at Diamondback Capital Management, LLC (“Diamondback”) who was charged under Rule 10b-5 for allegedly participating in an insider trading scheme. The government alleged a group of analysts from multiple hedge funds and investment funds obtained material nonpublic information from employees of NVIDIA and Dell, shared it with each other, then passed it along to portfolio managers at their respective companies. Newman was one of those portfolio managers, and he was accused of executing trades based on information illegally obtained through the tipping chains.

The tipping chains the government accused Newman of participating in were elongated and convoluted. The Dell tipping chain began with a member of Dell’s investor relations department who tipped nonpublic material information to an analyst friend. The analyst then shared this information with Diamondback analyst, Jesse Tortora, who passed the information along to Newman, leaving Newman three

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81 The SEC did not like the limitations created by Dirks and sought to broaden the circumstances creating liability under Rule 10b-5. See Pritchard, supra note 70, at 859; see also SEC v. Stevens, No. 1:91-CV-01869-CSH (S.D.N.Y. Mar. 19, 1991) (where the SEC secured a settlement against a tipper when a CEO allegedly provided material nonpublic information to an investment analyst with the “hope” that the analyst would issue favorable reports about the CEO’s company in the future); Selective Disclosure and Insider Trading, Securities Act Release No. 7881, [cite the Federal Register, SEC Docket, or a service] (Aug. 15, 2000).
83 Id. at 442
84 Id. at 443.
85 Id.
86 Id.
87 Id. at 438.
levels removed from the Dell inside tipper. The NVIDIA tipping chain began with a member of NVIDIA’s finance unit who tipped inside information to a friend. The friend then shared the information with an analyst who passed it along to Jesse Tortora, and Tortora subsequently passed the information along to Newman, leaving Newman four levels removed from the NVIDIA inside tipper.

Although the government had not criminally charged either inside tipper at the time of Newman’s trial, Newman was found criminally liable because “as [a] sophisticated [trader,] he should have known that information was disclosed by insiders in a breach of fiduciary duty, and not for any legitimate corporate purpose.” At trial, Newman argued there was no evidence the tippers received a personal benefit for the information, and, even if they had, there was no evidence Newman knew about such a benefit. Despite this, the district court failed to instruct the jury on the scienter requirement for all of the elements in the Dirks test, and Newman was found guilty on all counts.

On appeal, the Second Circuit reviewed the jury instruction to determine whether the jury was misled or inadequately informed on the standard for tipper-tippee liability. Judge Barrington, writing for the Second Circuit majority, cited Dirks for the applicable law. The Judge stated because a tipper’s breach of fiduciary duty requires a direct or indirect personal benefit from the disclosure, a tippee may not be held liable if there is no benefit. A tippee may only be found liable when the insider has breached his fiduciary duty and the tippee knows or should know there was a breach. Because a tipper breaches his fiduciary duty only if he

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88 Newman, 773 F.3d at 438.
89 Id. at 443.
90 Id.
91 Id. at 443–44.
92 Id.
93 In order for an insider trading on nonpublic material information to be considered fraudulent, the prosecution must prove that there was intent greater than negligence. See Langevoort, Donald C., What Were They Thinking? Insider Trading and the Scienter Requirement, GEORGETOWN LAW FACULTY PUBLICATIONS AND OTHER WORKS, 989 (2012).
94 Newman, 773 F.3d at 444.
95 Id.
96 Id. at 446.
97 Id.
98 Id.
personally benefits, and a tippee must have knowledge of the breach to inherit liability, it naturally follows that
the government cannot meet its burden of showing the tippee knew of a breach without establishing the tippee had
knowledge of the insider’s personal benefit.99

After establishing a defendant cannot be guilty under a tipper-tippee theory without knowledge of the insider’s
personal benefit, the court went on to discuss its interpretation of the Dirks test in detail.100 Summarizing the applied
standard, the court held in order to sustain an insider trading conviction against a tippee, the Government must prove:
(1) the corporate insider was trusted with a fiduciary duty; (2) the corporate insider breached that fiduciary duty
by (a) disclosing confidential information to a tippee (b) in exchange for a personal benefit; (3) the tippee knew
about the tipper’s breach, meaning he knew the confidential information was divulged for a personal benefit;
and (4) the tippee used that information to trade in a security or tip another individual for personal benefit.101 Had
the court stopped there, the Newman decision may not have stirred up the amount of controversy that it did.

After offering a detailed interpretation of the Dirks test, the court then examined the sufficiency of the
evidence against Newman, specifically whether the circumstances warranted an inference of a personal
benefit.102 Judge Barrington quoted a case broadly defining personal benefit “‘to include not only pecuniary
gain, but also, inter alia, any reputational benefit that will translate into future earnings and the benefit one
would obtain from simply making a gift of confidential information to a trading relative or friend.’”103 The
judge then recited details of the relationships within both tipping chains.104 The Dell insider and his initial
tippee had known each other for years, attended the same business school, and previously worked at Dell
together.105 The tipper also sought career advice from the tippee in the past, sent him his resume for review,

99 Id. at 448.
100 Newman, 773 F.3d at 448.
101 Id. at 450.
102 Id.
103 Id. at 452 (quoting U.S. v. Jiau, 734 F.3d 147 (2d Cir. 2013)).
104 Id.
105 Id.
and consulted him regarding the qualifying exam for becoming a financial analyst.\footnote{Newman, 773 F.3d at 452} The NVIDIA tipper and his initial tippee were “family friends” who met at church and occasionally socialized together.\footnote{Id.} Judge Barrington abruptly dismissed the idea that these relationships could be enough to infer a personal benefit, exclaiming, “[i]f this was a ‘benefit,’ practically anything would qualify.”\footnote{Id.}

After adamantly rejecting the possibility of an inferred personal benefit, Judge Barrington attempted to clarify the requirements for such an inference under the \textit{Dirks} test.\footnote{Id.} Referencing Justice Powell’s language from \textit{Dirks} that suggests a personal benefit may be inferred when the tippee’s “trades resemble trading by the insider himself followed by a gift of the profits to the recipient,” the court held that a personal benefit cannot be inferred “without 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.”\footnote{Id.}

There was significant backlash inspired by Newman’s exoneration, specifically against the requirement of a “meaningfully close personal relationship” and a pecuniary gain to infer a personal benefit.\footnote{Id.} Solicitor General Donald B. Verrilli Jr. filed a petition claiming the decision would “hurt market participants, disadvantage scrupulous market analysts, and impair the government’s ability to protect the fairness and integrity of the securities markets.”\footnote{See Reactions Abound to Insider Trading Ruling in Newman/Chiasson Case, SEC. DIARY (Dec. 11, 2014), https://securitiesdiary.com/2014/12/11/reactions-abound-to-insider-trading-ruling-in-newmanchiasson-case/ for a list of cases, statements, and articles reacting negatively to the Second Circuit’s decision in Newman.} Verrilli’s concerns were widely shared among government officials who feared the decision would make prosecuting future insider trading violations extremely difficult.\footnote{Lawrence Hurley & Nate Raymond, U.S. Asks Supreme Court to Reverse Major Insider Trading Ruling, REUTERS (Jul. 30, 2015), http://www.reuters.com/article/us-usa-court-insidertrading/us-s-asks-supreme-court-to-reverse-major-insider-trading-ruling-idUSKCN0Q420H20150730.} SEC
spokesman John Nestor publicly labeled the decision irreconcilable with controlling Supreme Court precedent.\textsuperscript{114} Thankfully, a case was developing in California that would provide an opportunity to revisit the issues presented in \textit{Newman}.\textsuperscript{115}

B. \textit{Salman v. United States}

At the time of the trades relevant to Bassam Salman’s arrest, his brother-in-law, Maher Kara was an investment banker in Citigroup’s healthcare investment banking group.\textsuperscript{116} While working at Citigroup, Maher began sharing inside information about pending mergers and acquisitions with his brother, Michael.\textsuperscript{117} Michael traded on the information and shared it with others, including Salman.\textsuperscript{118} By the time the authorities realized what was happening, Salman realized gains of over $1.5 million from trading on the tips originating from Maher.\textsuperscript{119}

The United States District Court for the Northern District of California indicted Salman on insider trading charges in 2011, and Salman’s appeal to the Ninth Circuit was pending when \textit{Newman} was decided.\textsuperscript{120} The Ninth Circuit upheld Salman’s conviction on appeal.\textsuperscript{121} The court declined to follow \textit{Newman}’s “meaningfully close personal relationship” and pecuniary value requirements, holding that the \textit{Salman} tipper inferably received a personal benefit by making a gift of confidential information to a trading relative.\textsuperscript{122} Due to the criticism following the \textit{Newman} decision and the resultant circuit split, the Supreme Court granted certiorari in 2016 “to resolve the tension” over the proper application of the \textit{Dirks} test.\textsuperscript{123}

\textsuperscript{114} Id.
\textsuperscript{116} Id. at 421.
\textsuperscript{117} Id.
\textsuperscript{118} Id. at 424.
\textsuperscript{119} Id.
\textsuperscript{120} Id.
\textsuperscript{121} Id., 136 S. Ct. at 425.
\textsuperscript{122} Id.
\textsuperscript{123} Id.
In his appeal to the Supreme Court, Salman argued the Ninth Circuit erred by inferring Maher received a personal benefit without evidence Maher received anything of “a pecuniary or similarly valuable nature” in exchange for sharing the inside information with Michael. The Government argued that “a gift of confidential information to anyone, not just a ‘trading relative or friend,’ is enough to prove securities fraud.” The Supreme Court ultimately found Salman guilty while rejecting both arguments and overruling part of the Newman holding in the process.

Writing for the majority, Justice Alito looked to Dirks to resolve the “narrow issue” presented. Quoting Dirks, Justice Alito explained the test for insider trading liability:

whether the insider personally will benefit, directly or indirectly, from his disclosure. Thus, the disclosure of confidential information without personal benefit is not enough. In determining whether a tipper derived a personal benefit, we instructed courts to ‘focus on objective criteria, i.e., whether the insider receives a direct or indirect personal benefit from the disclosure, such as a pecuniary gain or a reputational benefit that will translate into future earnings.’ . . . This personal benefit can ‘often’ be inferred ‘from objective facts and circumstances,’ we explained, such as ‘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.’ . . . ‘The elements of fiduciary duty and exploitation of nonpublic information also exist when an insider makes a gift of confidential information to a trading relative or friend.’ In such cases, ‘[t]he tip and trade resemble trading by the insider followed by a gift of the profits to the recipient.’

Justice Alito emphasized the language from Dirks that imposes liability for gifts of confidential information to “trading relative[s] or friend[s].” Justice Alito then declared that a portion of the test resolves the case at hand because it “makes clear” that an insider gifting confidential information to a “trading relative” breaches a fiduciary duty. After affirming the appellate court’s decision to convict Salman, the Justice went on to expressly overrule a portion of Newman, holding “to the extent the Second Circuit held that the tipper

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124 Id. at 425.
125 Salman, 136 S. Ct. at 427.
126 Id.
127 Id.
128 Id. (emphasis added) (quoting United States v. Dirks, 463 U.S. 646, 647).
129 Id.
130 Id.
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.”

Throughout the Salman opinion, Justice Alito reiterated the fact Maher and Michael were brothers clearly inferred a personal benefit under Dirks. To further stress the holding was not intended to bind all cases involving an inferred personal benefit, the Justice clarified that determining whether a personal benefit exists is still a question of fact that “will not always be easy,” but did not address potential difficulties at that time “because [Salman] involve[d] ‘precisely the gift of confidential information to a trading relative’ that Dirks envisioned.”

The tension surrounding the application of the Dirks standard the Supreme Court set out to resolve did not remain settled very long. Just eight months after the Supreme Court decided Salman, the Second Circuit issued its opinion in Martoma and relit the controversy surrounding the personal benefit rule.

C. The Majority Opinion in Martoma v. United States

The summary of Martoma discussed earlier provides a bird’s-eye-view of the events leading up to Martoma’s conviction. The facts discovered at trial established that Martoma regularly met with multiple doctor insiders from both companies throughout their development of the Alzheimer’s treatment. There is proof that Martoma met with Dr. Gilman, the insider who tipped him the material information at issue, around forty-three times at a $1,000 per hour rate. Dr. Gilman’s role in the clinical trial’s safety monitoring committee created an obligation for him to keep the results of the trial confidential. Despite this, and knowing Martoma was a portfolio manager, Dr. Gilman scheduled his consultations with Martoma around

131 Salman, 136 S. Ct. at 428 (emphasis added).
132 Id.
133 Id. at 429.
135 See supra Part I.
136 Martoma, 869 F.3d 58.
137 Id.
138 Id. at 62.
the trial’s safety monitoring committee meetings, allowing him to share confidential updates on the drug’s safety without delay.\(^{139}\) The July 19, 2008 consultation, in which Gilman told Martoma the drug was not as effective as expected, occurred just three days after Gilman himself learned of the drug’s efficacy issues.\(^{140}\) Dr. Gilman specifically did not bill for the two consultations that led to Martoma’s charges because as Dr. Gilman provided at trial, that “would [have been] tantamount to confessing that he was giving Martoma inside information.”\(^{141}\)

All of Martoma’s defenses were rejected at trial.\(^{142}\) The district judge described the argument asserting Dr. Gilman did not receive a personal benefit and Martoma was not aware Dr. Gilman received a personal benefit as “meritless.”\(^{143}\) The court stated Martoma knew Dr. Gilman was getting paid for the consultations and was “well aware” Dr. Gilman did not meet with him 43 times “out of the goodness of his heart.”\(^{144}\) The court cited ample evidence of a direct benefit suggesting a quid pro quo exchange in its opinion convicting Martoma.\(^{145}\)

In his appeal to the Second Circuit, Martoma challenged the sufficiency of the evidence presented at trial and the adequacy of the trial court’s jury instruction.\(^{146}\) Judge Katzman, writing for the majority, rejected the sufficiency of evidence claim in less than 300 words by explaining a *quid pro quo* relationship can be established by an ongoing exchange-based relationship like the one shared by Martoma and Dr. Gilman.\(^{147}\) The remainder of the majority opinion addressed the challenge to the district court’s jury instruction.\(^{148}\)

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\(^{139}\) *Id.*

\(^{140}\) *Id.* at 58.

\(^{141}\) *Id.* at 67.


\(^{143}\) *Id.*

\(^{144}\) *Id.*

\(^{145}\) *Id.*

\(^{146}\) *Martoma*, 869 F.3d at 65.

\(^{147}\) *Id.* at 66–67.

\(^{148}\) *Id.* at 73–74
Martoma’s jury instruction challenge claimed the jury was not adequately instructed on the “meaningful close personal relationship” requirement created in Newman.\(^\text{149}\) The court rejected that argument claiming the “meaningful close personal relationship requirement” was overruled by Salman.\(^\text{150}\) The majority stated the Dirks court suggested that benefits from quid pro quo relationships and gifts to trading “relatives or friends” are examples of circumstances warranting inferring a personal benefit, not the basis for a test.\(^\text{151}\) Judge Katzman then compared Newman’s holding that a jury cannot infer a tipper personally benefited from a gift unless the gift was to someone with whom the tipper shared “a meaningfully close relationship with,” to Dirks.\(^\text{152}\) Acknowledging that the “meaningfully close relationship” requirement in Newman was meant to clarify the “friend” language in Dirks, Judge Katzman maintained the requirement was improper, claiming Dirks did not intend to limit inferring a personal benefit to gifting friends or family members.\(^\text{153}\) Judge Katzman stated Dirks intended to allow inferring a personal benefit when material nonpublic information is gifted, regardless of the identity of the recipient.\(^\text{154}\) The judge supported that statement by saying Dirks’ justification for finding that tippers derive a personal benefit from gifting information to friends or relatives is that “[t]he tip and trade resemble trading by the insider himself followed by a gift of the profits to the recipient.”\(^\text{155}\) Then, claiming support from the “doubt casted” in Salman, the majority three-judge panel overruled Newman by explicitly stating the “meaningfully close personal relationship requirement is no longer good law.”\(^\text{156}\)

Judge Katzman claimed that although Dirks and Salman’s discussions of gifts was limited to “trading relative[s] and friend[s],” the logic behind Dirks, reaffirmed by Salman, is that an insider personally benefits

\(^{149}\) Id. at 67.  
\(^{150}\) Id.  
\(^{151}\) Id. at 68.  
\(^{152}\) Martoma, 869 F.3d at 68.  
\(^{153}\) Id.  
\(^{154}\) Id.  
\(^{155}\) Id. at 69.  
\(^{156}\) Id. at 68.
Whenever he “disclose[s] information as a gift . . . with the expectation [the recipient would trade] on that information because “such a disclosure is the functional equivalent of trading on the information himself and giving a cash gift to the recipient.” The majority stated the Supreme Court’s statement in *Salman* that an insider benefits by “giv[ing] such information to an outsider for the same improper purpose of exploiting the information for their personal gain” was not limited by the relationships of the parties. The *Martoma* majority held that an insider benefits from disclosing inside information if 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 the tipper and tippee share a “meaningfully close personal relationship” or not. Judge Katzman justified this interpretation by claiming it does not eliminate the personal benefit rule because *Dirks* intended to allow an inferred personal benefit whenever inside information is disclosed “with the expectation that [the recipient] would trade on it.” Ultimately, the majority affirmed Martoma’s conviction after finding there was sufficient evidence of a personal benefit and the district court’s jury instruction was not clearly erroneous to affect the outcome of the trial.

D. Circuit Judge Pooler’s Dissent in *Martoma v. United States*

The *Martoma* majority’s opinion prompted a lengthy dissent by Circuit Judge Pooler. Judge Pooler stated that the majority’s holding, allowing an inferred personal benefit anytime an insider gifts inside information, effectively strips the personal benefit rule of its limiting power. The dissent provided a summary of the evolution of personal benefit rule and the recent developments in light of *Newman* and *Salman*. Judge Pooler then detailed the changes made by the majority’s decision.

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157 Id.
158 Id. at 58.
159 Id. at 71.
160 Id.
161 Id. at 73.
162 United States v. Martoma, 869 F.3d 58, 74 (Pooler, J., dissenting).
163 Id.
164 Id.
165 Id.
A major problem Judge Pooler found with the majority’s opinion was its failure to provide guidance for distinguishing a “gift” from a non-gift disclosure. Judge Pooler found removing the friend and family requirement leaves it up to the jury to arbitrarily and subjectively decide when the disclosure of nonpublic material information constitutes a gift. The dissent points out the majority’s claim that information is a “gift” when the tipper expects the tippee to trade on the information is meaningless. The tipper having knowledge the tippee would trade on the inside information is already an established component of the test for determining tipper-tippee liability, so holding it out as grounds to infer a benefit upon the insider is both redundant and provides no limitation. Eliminating the limitation, as Judge Pooler stated, was not adopted by Salman. Further, the Salman court explicitly considered that view, offered by the government to convict Salman and now held by the Martoma majority, without adopting it. Judge Pooler would have accordingly held that (1) Salman did not overrule Newman’s “meaningfully close personal relationship” requirement, and (2) Salman does not overrule the limitation from Dirks that restricts inferring a personal benefit to an insider’s gifts to relatives or friends.

E. Response to the Second Circuit’s Majority Opinion in Martoma

After the Second Circuit decided Martoma, the consensus was the majority’s opinion made prosecuting tipper-tippee insider trading cases significantly easier. It is clear the majority’s adaptation of Dirks’s personal benefit rule reduced the circumstances the government must prove to infer a tipper received a personal benefit. This comment now consider the language used in Judge Katzman’s majority opinion.

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166 Id.
167 Id. at 75.
168 Martoma, 869 F.3d at 70, 85.
169 Id. at 82
170 Id. at 86
172 Martoma, 869 F.3d at 86.
defending the reduction, to determine if *Dirks* and *Salman* really support the interpretation held by the *Martoma* court.

To determine if *Salman* warrants Judge Katzman’s overruling of the “meaningfully close personal relationship” standard from *Newman*, we must first look to the language used in *Salman’s* majority opinion. Throughout the *Salman* majority opinion, Justice Alito defined the issue at bar as “narrow” and the application of *Dirks* it invited as “precise.” When Justice Alito held a portion of *Newman* inconsistent with *Dirks*, he clarified it was only inconsistent “to the extent” that it required “something of a pecuniary or similarly valuable nature in exchange for a gift to family or friends.”

Also relevant are Justice Alito’s attempts to frame the closeness of the relationship between the tipper and the tippee. Justice Alito explicitly included significant evidence explaining how close Michael and Maher were by noting Michael was the best man at Maher’s wedding, and Maher “love[d] [his] brother very much.” Despite this, the *Martoma* majority construed *Salman’s* opinion to hold that the relationship between a tipper and tippee is irrelevant when determining whether the tipper received a personal benefit by sharing insider information.

When making the assertion *Salman* nullified the “meaningfully close personal relationship” and the trading relative or friend requirement, the Second Circuit majority provided a quote from *Salman* as the basis of its claim. The quote from *Salman* implied that one can infer a personal benefit if the tip “resembles trading by the insider followed by a gift of the profits to the recipient.” The *Martoma* majority failed to include the two sentences surrounding that quote to put it in the context Judge Alito used it in. The full excerpt from *Salman* that the *Martoma* claims justified their holding reads:

This Court adheres to the holding in Dirks, which easily resolves the case at hand: “when an insider makes a gift of confidential information to a trading relative or friend . . . [t]he tip and trade resemble

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174 *Salman*, 136 S. Ct. at 427, 429
175 *Id.* at 428.
176 *Id.*
178 *Id.*
179 *Id.*
trading by the insider himself followed by a gift of the profits to the recipient.” In these situations, the tipper personally benefits because giving a gift of trading information to a trading relative is the same thing as trading by the tipper followed by a gift of the proceeds.180

When looking at the sentences surrounding Justice Alito’s comments regarding a tip “resembling a trade by the insider followed by a gift of the profits,” it becomes apparent that Justice Alito’s description was in the context of a gift to a trading relative or friend. By removing the context, the Martoma court used a small piece of Justice Alito’s explanation to support a conflicting position. Considering this context, and the numerous attempts by Justice Alito to label the Salman decision a narrow one,181 it is difficult to understand how the Second Circuit interpreted the holding to allow inferring a benefit in all instances of gifting insider information.182

The Martoma dissent agreed that overruling Newman was not supported by Salman, but the entire dissent was not entirely agreeable. Judge Pooler found that the jury instruction’s failure to instruct the jury on Newman affected the outcome of Martoma’s case.183 Considering the personal benefit subject to the Martoma decision derived from ample evidence of a quid pro quo exchange, it is hard to see how a failure to instruct the jury on the types of relationships that allow an inferred benefit in the absence of a quid pro quo exchange would affect the outcome of the case.

The dissent was first of a plethora of criticisms of the Martoma majority’s decision. For the time being, the holding is precedent in the Second Circuit: the personal benefit requirement for tipper-tippee insider trading liability may be inferred when an insider gifts nonpublic material information, regardless of who the recipient is. Although Judge Pooler’s opinion failed to win over a majority of Second Circuit judges, commentary following the decision suggests many legal scholars agree with the dissent’s interpretation of the

181 Id. (“We adhere to Dirks, which easily resolves the narrow issue presented here.”)
182 Id. at 429 (“But there is no need for us to address those difficult cases today, because this case involves precisely the gift of confidential information to a trading relative that Dirks envisioned.”) (quoting U.S. v. Dirks, 463 U.S 646) (internal quotation marks omitted).
183 United States v. Martoma, 869 F.3d 58, 74 (Pooler, J., dissenting).
law. The decision was universally understood to have significantly broadened insider trading liability and tipped the scales back in the government’s favor after Newman, an arguably desirable result on its face. The issue is that if Newman was a brick on the scale, weighing in favor of the defendant, Martoma is a boulder on the government’s side, placed there without procedural or substantive justification.

The Second Circuit’s decision in Martoma was procedurally unsound because the court failed to follow the rule of interpanel accord in completely overruling Newman. The rule of interpanel accord holds that a circuit court decision is binding over the circuit that made it, any district within that circuit, and may be overruled only if: (1) a subsequent inconsistent decision by the Supreme Court requires its modification, or; (2) the circuit court sits en banc to overrule the prior decision.

Here, because the Second Circuit did not hear Martoma en banc, the only way to properly overrule Newman would have required a subsequent inconsistent Supreme Court decision. The Second Circuit majority cites Salman for this purpose. The problem with using Salman to justify overruling the relationship requirement when gifting inside information is that the Supreme Court did no such thing in deciding Salman. Yes, the Supreme Court overruled the requirement of a benefit with “pecuniary or similarly valuable nature” in exchange for a gift to family or friends, but the Salman decision did not remove the relationship requirement all together. Despite Salman’s limited holding, explicitly overruling Newman in part, the Martoma majority interpreted the decision as justification for overruling Newman in its entirety.


186 2A FED. PROC., L. ED. § 3:942


188 See id.

189 Id. at 428.
This interpretation is unfaithful to the logic of \textit{Salman} and conflicts with the foundational principles established in \textit{Dirks}.\footnote{Martoma, 869 F.3d 58; see also Salman, 136 S. Ct. 420, United States v. Dirks, 463 U.S. 646.} Using \textit{Salman} to avoid an \textit{en banc} hearing to overrule \textit{Newman} is inconsistent with procedural requirements and undermines the institution of respecting precedents. Invalidating the relationship requirement in gifting situations was substantively unjustified for the same reason avoiding an \textit{en banc} hearing was procedurally unjustified; the \textit{Salman} decision simply did not strike down the relationship requirement like the \textit{Martoma} majority purports it did.

V. Looking Forward: Options for Recalibrating the Scope of Insider Trading Liability

Two months after \textit{Martoma} was decided, Michael Martoma filed a petition to have his case reheard \textit{en banc}. In addition to Martoma’s petition, an amicus curiae brief seeking the same was filed by respected law professors and practitioners. The amicus brief, signed by University of California, Berkeley professor Alan Schoenfeld and endorsed by ten experts in the field, petitioned for a hearing \textit{en banc} because: (1) the panel opinion conflicts Supreme Court precedent by expanding the gift theory to apply to any tippee; (2) the panel decision conflicts with Supreme Court precedent by effectively negating the personal benefit requirement, and; (3) the vague standard in the panel’s holding will create expansive criminal liability.\footnote{Brief for Alan E. Schoenfeld et al. as Amici Curiae Supporting Appellant, United States v. Martoma, 869 F.3d 56 (2d. Cir. 2017) (No. 14-3599).} Granting the above mentioned the amicus brief would be the quickest and least invasive way for the Second Circuit to revisit its decision, but there are doubts as to whether the Second Circuit will grant the request. One reason an \textit{en banc} rehearing is unlikely is because \textit{Martoma’s} majority was written by Judge Katzman, the current Chief Judge of the Second Circuit, and only two Judges from the \textit{Newman} panel currently maintain active status.\footnote{Harry S. Davis et al., \textit{Second Circuit, in Split Decision, Overrules Limitation on Insider Trading Liability Established in U.S. v. Newman}, SRZ (Aug. 28, 2017), https://www.srz.com/images/content/1/5/v2/152281/082817-Second-Circuit-in-Split-Decision-Overrules-Limitation-on.pdf.} Another reason an \textit{en banc} rehearing is unlikely is due to how rare the Second Circuit grants
them; the Second Circuit granted only two *en banc* hearings between 2011–2016, the least of any circuit in the country.\(^{193}\)

Another option besides an *en banc* hearing is for the Supreme Court to hear the case. This option is also unlikely due to the Supreme Court’s tendency to let circuit splits develop before ruling on contentious issues. This, coupled with how recently the Supreme Court decided *Salman*, weighs strongly against *Martoma* reaching the country’s highest court any time soon.

A third option for clarifying the prosecution standard for tipper-tippee insider trading liability would be for the legislature to get involved and create a standard by statute. A statutory scheme memorializing the insider trading case law that has been developed over the last century would provide lasting clarity and help ensure consistency in future cases. This option, despite being the best available, is the most unlikely. The SEC has avoided promulgating regulations regarding insider trading in order to allow broad interpretations of Rule 10b-5, and to avoid creating a blue print for sophisticated investors to commit fraud while staying within the bounds of the law. Although the above options do not seem likely based on the current political climate\(^{194}\) and the Second Circuit’s historical mode of operating, something needs to be done to avoid significant consequences resulting from the current state of the law, as per *Martoma*.

VI. Conclusion

There has been constant tension between the government and federal courts throughout the development of American insider trading laws. The *Martoma* decision signals that tension will not be resolved any time soon. The government is consistently pushing to expand the standard for insider trading liability while the courts push back. As illustrated above, the decision in *Newman* unduly tilted the standard


in favor of defendants and made it significantly more difficult for the government to sustain an insider trading conviction. The Salman court attempted to resolve the controversy created by Newman and offered an interpretation of the Dirks test consistent with the original standard created by Justice Powell. Unfortunately, the Martroma decision negated all the clarity that Salman provided. The Second Circuit’s decision in Martoma attempted to restore the balance that was disrupted by Newman and tilted the standard unduly in the prosecutions favor.

The inconsistency in the application of Dirks, even after the Supreme Court’s attempt to provide clarity, needs to be permanently rectified. The Second Circuit was not justified in overruling Newman by a three-judge panel because the alleged doubt created by Salman, that the judges relied upon, did not exist. The Salman majority overruled the portion of Newman that went too far in the defendant’s favor but did not provide the basis for overruling the relationship requirement as the Martoma panel held it did. The Second Circuit should, but probably will not, grant Mr. Martoma’s October 2017 request to rehear his case en banc in order to clarify the applicable standard reaffirmed by Salman. Although rehearing the case is unlikely to change the outcome for Mr. Martoma, it would provide the Second Circuit with an opportunity to eliminate the vagueness the current standard creates. Further, the consistent misapplication of the standard for insider trading liability has persisted long enough that the government should step in to provide statutory guidelines. The judge-made standard derived from Rule 10b-5 has proven too uncertain for multiple decades, and the legislature needs to provide courts with clear guidelines to govern future cases.