

## [Securities Regulation Daily Wrap Up, TOP STORY—2d. Cir.: Key aspect of Newman ‘no longer good law’, \(Aug. 23, 2017\)](#)

Securities Regulation Daily Wrap Up

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By [Mark S. Nelson, J.D.](#)

A divided Second Circuit panel overcame its reluctance to jettison circuit law and determined that the Supreme Court's narrow re-affirmation of *Dirks*'s gift theory of insider trading in the *Salman* case had cast sufficient doubt on the validity of the Second Circuit's more restrictive *Newman* opinion such that *Salman* had eroded key aspects of *Newman*. As a result, the court upheld Mathew Martoma's insider trading conviction and suggested that concerns over the jury instruction used in Martoma's case were outweighed by evidence that a tipper received "financial benefit" for tips passed to Martoma (*U.S. v. Martoma*, August 23, 2017, Katzmann, R.).

Said the panel: "We respectfully conclude that *Salman* fundamentally altered the analysis underlying *Newman*'s 'meaningfully close personal relationship' requirement such that the 'meaningfully close personal relationship' requirement is no longer good law." This conclusion drew a dissent longer than the majority's opinion from Judge Pooler, who disputed the majority's characterization of *Dirks* and *Salman*, which she said would undermine the personal benefit rule, objected to the majority's overruling of circuit law without an en banc decision, and expressed concern over errors in the jury instruction at issue on appeal.

**Will scales tip in favor of prosecutors?** Today's decision by the Second Circuit has the immediate effect of upholding Martoma's conviction for insider trading. Martoma was a portfolio manager at S.A.C. Capital Advisors, LLC whom prosecutors accused of using tips he received to illegally trade in shares of drug companies Elan Corporation, plc and Wyeth. On appeal, Martoma urged the Second Circuit to continue to apply its *Newman* decision (Martoma was convicted before the *Newman* decision) despite the Supreme Court's later *Salman* decision, and reverse his conviction because the district court's jury instruction omitted the penultimate language from *Newman*.

Joon H. Kim, Acting U.S. Attorney for the Southern District of New York, issued a brief [statement](#): "We are gratified by the Second Circuit's affirmation of Mathew Martoma's conviction. The strength of our securities markets rests on their integrity and fairness. And the successful prosecution of those who cheat by trading on illegally obtained inside information, as Martoma did to the tune of over \$275 million, is critical to maintaining that integrity and fairness in our markets."

Kim's predecessor, Preet Bharara, had [said](#) shortly after the Second Circuit issued its 2014 *Newman* decision that the case could make prosecution of some insider trading cases more difficult and that the court had narrowed the existing understanding of insider trading law.

The [decision](#) in *Newman* would have a significant impact on cases pending in courts within the Second Circuit's reach, but the decision was only persuasive authority elsewhere. The government unsuccessfully tried to appeal [Newman](#) to the Supreme Court. Ultimately, a [similar case](#) arising in the Ninth Circuit with an opinion authored by Judge Jed Rakoff of the Southern District of New York would find its way to the Supreme Court. The justices would mull the [hypothetical](#) "sad-guy-on-the-street" scenario en route to using [Salman](#) to reaffirm *Dirks* and set the stage for the Second Circuit's *Martoma* decision.

**Personal benefit rule undiminished.** The Second Circuit panel several times noted the trajectory of Supreme Court decisions on insider trading from *Chiarella* to *O'Hagan* to *Dirks*. This recitation would lead to the conclusion that the personal benefit rule still obtains in insider trading cases, but not before a brief discussion of the sufficiency of the evidence against Martoma. Martoma had received tips about a drug from a member of an

expert network and, according to the panel, a jury could have found that this arrangement was a pecuniary quid pro quo relationship. The panel then discussed *Newman* and *Salman*.

The panel majority noted that the Supreme Court had already rejected part of *Newman* in deciding *Salman*, specifically that a tipper must receive a gain that is of 'pecuniary or similarly valuable nature' in cases alleging a gift to family or friends. Even though *Salman* did not address the exact question in *Newman*, *Salman* so overshadowed what the Second Circuit said in *Newman* that the panel majority could essentially overrule *Newman*.

Still, the majority suggested some limits on its decision in Martoma's case. Footnote 8 said that in rejecting *Newman*'s "meaningfully close personal relationship" language, the majority did not abandon the notion that the relationship between a tipper and a tippee is relevant; rather, evidence of this relationship could allow a jury to weigh "competing narratives" about whether information was disclosed in expectation that its recipient would trade on it and whether this was akin to a gift of the trading profits.

In the main text of its opinion, the majority had emphasized the tipper's expectation. "But our holding reaches only the insider who discloses inside information to someone *he expects will trade on the information*. This holding is no broader than the logic underpinning the Supreme Court's conclusion in *Salman*."

Moreover, the panel said the personal benefit requirement was alive. "As a result, our holding does not eliminate or vitiate the personal benefit rule; it merely acknowledges that it is *possible* to personally benefit from a disclosure of inside information as a gift to someone with whom one does not share a 'meaningfully close personal relationship,'" said the court. "Phrased another way, we reject, in light of *Salman*, the categorical rule that an insider can *never* personally benefit from disclosing inside information as a gift without a "meaningfully close personal relationship."

**The dissent—insider trading law "radically alter[ed]."** According to Judge Pooler, the majority disregarded Supreme Court precedent and instead dramatically expanded the potential for insider trading liability. Specifically, the dissent said the majority removed the limit imposed on insider trading liability by the personal benefit rule by holding instead that a personal benefit exists when an insider gives information to anyone, a theory similar to one advanced by the government in *Salman* and rejected by the Supreme Court in that case. Judge Pooler also said the majority's evolution of insider trading law depends on the term "gift," which she said is "vague and subjective." As a result, Judge Pooler concluded that the majority "...radically alters insider-trading law for the worse."

With respect to *Newman*, Judge Pooler acknowledged that *Salman* rejected *Newman*'s holding that the gift context requires a pecuniary or similar gain. Still, the judge would continue to apply the other *Newman* holding that a personal benefit predicated on a gift requires "a meaningfully close personal relationship" because *Salman* did not reject this part of *Newman*. The judge also would adhere to the theory, based on *Dirks* and *Salman*, that an "inference of personal benefit may be based on an insider's gift to relatives or friends, but not a gift to someone else."

Moreover, Judge Pooler would apply the disputed circuit rule about modified plain error analysis. (Martoma raised the jury instruction issue only at the appeals stage, so the majority applied the plain error standard). As a result, Judge Pooler would find the jury instruction in Martoma's case plainly erroneous and that the resulting error was not harmless.

The case is [No. 14-3599](#).

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Companies: Elan Corporation, plc; Wyeth; S.A.C. Capital Advisors, LLC

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