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Second Circuit Broadens 'Personal Benefits' Triggering Insider Trading Liability

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Who Needs Family or Friends?
An Inside Tipper's Gift of Inside Information to a Consulting Client is Now a Sufficient "Personal Benefit" to the Tipper to Trigger Insider Trading Liability

As noted in our December 9, 2016, Client Alert, the Supreme Court in *Salman v. U.S.* ruled that the required "personal benefit" to the person disclosing inside information (the tipper) does not need to be "pecuniary" or something of a "similarly valuable nature." Instead, the Supreme Court relied on its prior opinion in *Dirks v. SEC*, and found that a "gift" of inside information provided to the tipper's family member or friend can be inferred by a jury as intent by the tipper to "provide the equivalent of a cash gift," which is the personal benefit to the tipper. *Salman*, 137 S. Ct. 420, 427-28 (2016). "In such situations, the tipper benefits personally because giving a gift of trading information is the same thing as trading by the tipper followed by a gift of the proceeds." *Id.* at 428. The Supreme Court in *Salman* overruled as "inconsistent with *Dirks*" the Second Circuit's 2014 holding in *U.S. v. Newman* that "the tipper must also receive something of a 'pecuniary or similarly valuable nature' in exchange for a gift to family or friends." *Id.* at 428. The Supreme Court did not directly address the other requirement in *Newman* that a non-pecuniary, non-monetary "personal benefit" can only be established with "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." *U.S. v. Newman*, 773 F.3d 438, 452 (2nd Cir. 2014) (emphasis added).

After *Salman*, our Alert and other commentators wondered how prosecutors and plaintiffs would prove the "close nature" of the familial or friendly relationship between the tipper and tippee sufficient to establish a "personal benefit" to the tipper that did not involve money or something else of similar value.

On August 23, 2017, the Second Circuit panel in *U.S. v. Martoma* completely overruled the Second Circuit panel in *Newman* and found that a tipper can be found to personally benefit by providing inside information as a "gift" to someone with whom the tipper does not share a "meaningfully close personal relationship." ___ F.3d ___, 2017 WL 3611518, *8 (2nd Cir. 2017). Now, prosecutors and plaintiffs have even more leeway (and can be more creative) in arguing that non-pecuniary benefits to tippers who share inside information with anyone provides sufficient "personal benefit" to the tipper to trigger insider trading liability.

Martoma was the largest insider trading scheme ever successfully prosecuted by the federal government. The evidence in the case established that acclaimed neurologist Dr. Sidney Gilman was chairman of the safety monitoring committee for the clinical trial of bapineuzumab, a drug to treat Alzheimer's disease. The drug was jointly developed by two pharmaceutical companies. Defendant Martoma was a portfolio manager at SAC Capital Advisors, LLC, a hedge fund owned and managed by Steven A. Cohen. Martoma had acquired shares of the two pharma companies in his portfolio. After purchasing the shares in the pharma companies, Martoma hired Dr. Gilman to consult with him about the bapineuzumab drug and Alzheimer's disease. Dr. Gilman participated in 43 consultations with Martoma at a rate of $1,000 per hour. The consulting contract required Dr. Gilman to keep results of the clinical trial confidential. Despite this, Dr. Gilman provided Martoma with confidential updates on the drug's safety that he received during meetings of the safety monitoring committee.

On July 17, 2008, the pharma companies issued a press release reporting "encouraging" results from the clinical trial, and that the results of the trials would be released on July 29, 2008 by Dr. Gilman. On July 17, 2008, Dr. Gilman spoke with Martoma on the phone for 90 minutes about "two major weaknesses in the data" of the drug trials. On July 19, 2008, Martoma flew to Ann Arbor, Michigan where Dr. Gilman showed Martoma a PowerPoint presentation containing the drug trial results and explained the data to Martoma. Important to the case, Dr. Gilman did not bill Martoma for the July 17 and July 19 meetings. On July 21, 2008, Martoma and SAC reduced their positions in the pharma company stock and entered into short-sale options that would profit Martoma if the stock fell in value. When Dr. Gilman announced the drug trial results on July 29, 2008, the stock price declined over 40%, resulting in Martoma gaining $80.3 million and averting $194.6 million in losses on the pharma company stock. Martoma was convicted at trial of insider trading.

Martoma argued on appeal that his conviction should be reversed because Dr. Gilman did not receive any pecuniary gain or other value for the inside information he gave Martoma in the July 17 and 19 meetings, and that he and Dr. Gilman did not have a "meaningfully close personal relationship," which Martoma argued was required by *Newman* even after the Supreme Court's decision in *Salman*. Rejecting the first claim of error, the *Martoma* court found that Dr. Gilman being paid $1,000 an hour for 43 consulting sessions was a "relationship of *quid pro quo*" that gave rise to the opportunity for future pecuniary gain to Dr. Gilman, especially in light of the consistent past pecuniary gain resulting from Dr. Gilman's provision of inside information.

Second, even assuming Dr. Gilman had not received any pecuniary benefit from the disclosures to Martoma, the *Martoma* court rejected the requirement from *Newman* that Dr. Gilman (the tipper) must enjoy a "meaningfully close personal relationship" with Martoma (the tippee) to be liable for gifting inside information. The *Martoma* court found nothing from the *Dirks* opinion to support a "categorical rule that an insider can never benefit personally from gifting inside information to people other than 'meaningfully close' friends or family members." *Martoma, supra* at *7. The Martoma court found that the Supreme Court's *Salman* decision "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." *Id.* In so ruling, the *Martoma* court focused on the Supreme Court's point in *Salman* that gifting inside information to a tippee with the expectation that the tippee will trade on the information is the "functional equivalent" of the tipper trading on the information himself and giving the cash to the tippee. "Nothing in *Salman's* reaffirmation of this logic supports a distinction between gifts to people with whom a tipper shares a meaningfully close personal relationship . . . and gifts to those with whom a tipper does not share such a relationship." *Id.* at *8.

The *Martoma* Dissent Argues that a "Friends and Family" Requirement Avoids Making the "Personal Benefit" Standard Entirely Meaningless

The dissent in *Martoma* argues that requiring gifted inside information be presented to family or friends will help provide guidance on when a gift is actually a gift that provides a "personal benefit" to the giver — resulting in securities fraud liability — and a gift that provides no such "personal benefit" — and thus no securities fraud liability:

"Gifts to family and friends are more likely to confer a benefit upon the gift-giver because, as noted above, 'to help a close family member or friend is like helping yourself.' . . . . When gifts pass to relatives or friends, there is thus far greater reason than usual to believe that the gift-giver has benefited personally, as the same benefits rarely accompany

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a gift to a casual acquaintance or a stranger. . . . [I]nsiders typically have no legitimate commercial reason to share business secrets with friends and family." *Martoma*, __ F.3d ___ (2017), at *21 (Pooler, J., dissenting).

Not limiting insider trading liability to gifted information to family or friends risks, according to the dissent, permitting liability to "extend[] much too far" such that "the term 'gift' could cover nearly any disclosure, and thus eliminate the personal benefit rule entirely." *Id*. at *22.

Miller Canfield's securities lawyers represent and assist companies, officers, and directors in all securities matters, including litigation and class actions, internal investigations, as well as in regulatory investigations, examinations, and enforcement actions. If you would like more information about insider trading liability, the Supreme Court's *Salman* decision, the Second Circuit decisions in *Newman* or *Martoma*, or any other securities matter, please contact us.

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