14-3599

United States Court of Appeals

for the

Second Circuit

UNITED STATES OF AMERICA,

Appellee,

– v. –

MATHEW MARTOMA,

Defendant-Appellant.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF FOR THE NEW YORK COUNCIL OF DEFENSE LAWYERS AND NATIONAL ASSOCIATION OF CRIMINAL DEFENSE LAWYERS AS *AMICI CURIAE* IN SUPPORT OF DEFENDANT-APPELLANT'S PETITION FOR REHEARING *EN BANC*

SUSAN R. NECHELES
HAFETZ & NECHELES LLP
President, New York Council of Defense Lawyers
10 East 40th Street, 48th Floor
New York, New York 10016
(212) 997-7400

IRA M. FEINBERG
HOGAN LOVELLS US LLP
875 Third Avenue
New York, New York 10022
(212) 918-3000

Attorneys for Amici Curiae
(For Continuation of Appearances See Inside Cover)

RICHARD D. WILLSTATTER
GREEN & WILLSTATTER
Vice Chair, NACDL Amicus Curiae Committee
200 Mamaroneck Avenue, Suite 605
White Plains, New York 10601
(914) 948-5656

Attorneys for Amici Curiae

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page(s)

Cases

Statutes

Other Authorities

STATEMENT OF INTEREST OF *AMICI CURIAE*

The New York Council of Defense Lawyers ("NYCDL") is a not-for-profit association of more than 300 lawyers (including many former federal prosecutors) whose principal area of practice is the defense of criminal cases in New York's federal and state courts. NYCDL's mission includes protecting individual rights guaranteed by the Constitution, enhancing the quality of defense representation, and promoting the proper administration of criminal justice. NYCDL offers the Court the perspective of experienced practitioners who regularly handle some of the most complex criminal cases in the federal courts, including many of the insider trading cases tried in this Circuit.[1]

The National Association of Criminal Defense Lawyers ("NACDL") is a nonprofit voluntary professional bar association that works on behalf of criminal defense attorneys to ensure justice and due process for those accused of crime. Founded in 1958, it has a nationwide membership of thousands of direct members, and up to 40,000 including affiliates. NACDL's members include private criminal defense lawyers, public defenders, law professors and judges. NACDL is the only

---

[1] Pursuant to Rule 29.1 of the Court's Local Rules, the NYCDL and NACDL certify that (1) this brief was authored entirely by counsel for *amici curiae*, and not by counsel for any party, in whole or part; (2) no party and no counsel for any party contributed money to fund the preparation or submission of this brief; and (3) apart from *amici* and their counsel, no other person contributed money to fund preparing or submitting this brief.

nationwide professional association for public defenders and private criminal defense lawyers. NACDL files numerous amicus briefs each year in the U.S. Supreme Court and other federal and state courts.

Amici submit this brief in support of the Petition for Rehearing *En Banc* filed by Defendant-Appellant Mathew Martoma. As discussed below, the panel majority's amended opinion – while this time purporting not to overturn this Court's decision in *United States v. Newman*, 773 F.3d 438, 452 (2d Cir. 2014) – in fact adopts a new test of tippee liability that is inconsistent with both *Newman* and the Supreme Court's decisions in *Dirks v. SEC*, 463 U.S. 646 (1983), and *United States v. Salman*, 137 S. Ct. 420 (2016). The panel's decision is inconsistent with *Dirks* because it effectively eliminates personal benefit to the tipper as an independent requirement for insider trading liability, and it is inconsistent with *Newman* because it makes the existence of a "meaningfully close personal relationship," required by *Newman*, completely irrelevant to conviction.

The panel's decision is of particular concern to *amici* because it creates great uncertainty in the law of insider trading, and makes it extraordinarily difficult for *amici*'s members to properly advise or defend their clients in insider trading investigations and prosecutions. It will also make it impossible for district judges in this Circuit to know with confidence how to instruct a jury in an insider trading

prosecution. For all the reasons set out below, *amici* urge the Court to grant rehearing *en banc* and provide much needed clarity to insider trading law.

INTRODUCTION AND SUMMARY OF ARGUMENT

This appeal has had what can only be described as a tortured history. It had to be argued twice, when the panel decided to request reargument following the Supreme Court's decision in *Salman*. And now it has had to be decided twice, and twice faced petitions for rehearing.

In the panel's first attempt to decide this appeal, in August 2017, the panel majority – in an effort to avoid ordering a retrial in light of the significant changes in insider trading law since Martoma's trial in 2014 – took it upon itself to explicitly overrule this Court's decision in *Newman*. *Newman* held that in order to invoke the theory that a tipper receives a "personal benefit" sufficient to sustain insider trading liability when she makes a gift of confidential information to a "trading relative or friend," *see Dirks*, 463 U.S. at 664, there had to be a "meaningfully close personal relationship" between them. *Newman*, 773 F.3d at 453. The panel majority initially held that the "logic" of the Supreme Court's decisions in *Dirks* and *Salman* invalidated this holding, A86, even though the *Salman* opinion was explicitly "narrow," *Salman*, 137 S. Ct. at 427, the Supreme Court said nothing about this issue, and the Government had explicitly urged the Supreme Court to adopt this broad position and the Court had declined the

invitation. *See id.* at 426; A115-16 (Judge Pooler's dissent from the panel's original opinion).

After Martoma's petition for rehearing pointed out that this ruling was beyond the panel's authority, as well as inconsistent with *Dirks* and *Salman*, the panel majority has now shifted gears. The panel majority has now issued a complete re-write of its opinion, which asserts that it "need not decide" whether *Newman*'s "meaningfully close personal relationship" test survived *Salman*. A14. But the panel can take that position only by dramatically reinterpreting that requirement in a way that is inconsistent with both *Newman* and the Supreme Court's decisions. The panel now holds that a "meaningfully close personal relationship" is not necessary at all, notwithstanding *Newman*'s express holding to the contrary. Indeed, the panel holds that a "personal benefit" to the tipper is not required either, notwithstanding the express holding of *Dirks*. Instead, the panel holds, over Judge Pooler's strong objection, that all that is required is that the tipper have a free-standing "intention to benefit" the tippee, even in the absence of any relationship at all between them. A22-24.

As discussed below, this holding is utterly inconsistent with *Dirks*, *Salman* and *Newman*. It also represents a dramatic and unwarranted expansion of insider trading law, in violation of basic due process principles. And it creates enormous uncertainty and confusion about the law of insider trading.

Going forward, in light of the panel's new opinion, how is a district judge in this Circuit supposed to instruct a jury in an insider trading prosecution? The panel purports not to overrule *Newman* – but apparently would disapprove of a jury instruction that said that a "meaningfully close personal relationship" was required. The panel holds that no personal benefit to the tipper is required, and a conviction is valid as long as the tipper had an "intention to benefit" the tippee – but a conviction based on that jury instruction would likely be reversed by the Supreme Court, if not by this Court.

This Court has always played a leading role in the development of insider trading law, given the central importance of the New York financial markets, and this Court has a special responsibility to ensure that its decisions create a coherent body of insider trading law. The present confusion about the substance of insider trading law is intolerable. However reluctant the Court may ordinarily be to convene *en banc*, it is urgent that the whole Court step in in this case to address the confusion caused by the panel's opinion.

ARGUMENT

I. THE PANEL'S RULING IS INCONSISTENT WITH *NEWMAN*, *DIRKS* AND *SALMAN*, AND UNDERMINES THE VITALITY OF THE "PERSONAL BENEFIT" REQUIRMENT.

The fundamental principles governing "tippee" liability were established in *Dirks*. The Court explicitly rejected the SEC's position that any trading based on disclosure of material non-public information was unlawful. 463 U.S. at 655-59. The Court's reasons are important here. The Court recognized that precluding trading by anyone who obtains material non-public information from an insider "could have an inhibiting influence on the role of market analysts," whose activities are "necessary" for the "preservation of a healthy market." *Id*. at 658. The Court explained that it was the *job* of analysts to "ferret out and analyze information," often from "corporate officers and others who are insiders," *id*., and that these activities "significantly enhanced" "market efficiency in pricing," "to the benefit of all investors." *Id*. at 658 n.17. The Court therefore thought it "essential" that there be a clear "guiding principle" to distinguish between lawful and unlawful trading, 463 U.S. at 664, so that market participants are not "forced to rely on the reasonableness of the [Government's] litigation strategy." *Id*. at 664 n.24.

This is the important function served by the "personal benefit" requirement. The Court held that trading by a tippee is unlawful only if "the insider has breached his fiduciary duty . . . , and the tippee knows . . . there has been a breach."

Id. at 660. And "the test" for whether there has been a breach of fiduciary duty "is whether the insider personally will benefit, directly or indirectly, from his disclosure." *Id*. at 662.

The Court further held that the personal benefit test is met "when an insider makes a gift of confidential information to a trading relative or friend," because "[t]he tip and trade resemble trading by the insider himself followed by a gift of the profits to the recipient." *Id*. at 664. In *Newman*, this Court held that to give the "personal benefit" requirement any real meaning, the "gift" theory could apply only when there was a "meaningfully close personal relationship" between the tipper and tippee, 773 F.3d at 452. Absent such a relationship, "practically anything would qualify" as a personal benefit, *id*., and the "personal benefit" requirement would lose any force as a limiting principle.

The panel majority's opinion throws these important limits on the proper scope of insider trading liability to the wind. Although the panel purports not to be calling *Newman* into question, A14 – indeed, to be following *Newman*'s reasoning, A30-31 – Judge Pooler is right that the majority's purported acceptance of *Newman* is "semantic" rather than real. A40. The panel asserts that "meaningfully close personal relationship" does not mean what it says, and that the test is satisfied if there was *either* "a relationship between the insider and the recipient that suggests a *quid pro quo*," *or* "an intention to benefit" the tippee. A30.

There is no support for this interpretation of *Newman* or *Dirks*. The panel's holding is based largely on the placement of a comma in a key sentence of *Dirks*, A22-23, but the panel's interpretation rips that sentence from its context. Nothing in *Dirks* supports the idea that a free-standing "intention to benefit" the tippee is sufficient to show a personal benefit to the tipper. Indeed, if this "intention to benefit" the tippee standard had been applied, *Dirks* might well have come out the other way.[2] The Court's "test" for a breach of fiduciary duty by the insider in *Dirks* focused expressly and exclusively on whether there was a personal benefit to the *tipper* in making the disclosure, not whether there was any intent to benefit the *tippee*, and that is how this Court has consistently interpreted it. *See* A49-50 (Judge Pooler's dissent, collecting cases). The Court in *Dirks* made clear that the "gift" theory of personal benefit worked only where there was a gift to a "trading relative or friend," and said nothing about a tip to a complete stranger.

The panel's holding is also squarely in conflict with the Supreme Court's explicit holding in *Dirks*, reaffirmed in *Salman*, that "the test" of whether an insider has breached his fiduciary duty is whether he received a personal benefit from sharing the information. *Dirks*, 463 U.S. at 662; *Salman*, 137 S. Ct. at 427. It

---

[2] In *Dirks*, the corporate insider (Secrist) disclosed confidential information about the fraud at Equity Funding to Dirks, a broker-dealer, which enabled him to advise his clients to sell Equity Funding stock and thereby avoid huge losses. 463 U.S. at 649. The tip thus knowingly provided an enormous benefit to Dirks, even if Secrist also urged Dirks to investigate the fraud.

is hard to understand how the panel majority – having apparently belatedly recognized that it had no authority to overrule a prior panel decision (*Newman*) – concluded that it was appropriate for this Court to disregard the governing test established by the Supreme Court in *Dirks* and *Salman*. But that is what the panel has done. There is no way that the panel's "intention to benefit the tippee" test can be reconciled with the Supreme Court's test that the *tipper* must receive a personal benefit.

The panel's test deprives the personal benefit test of any real meaning, and strips it of its crucial role – as the Court explained in *Dirks*, 463 U.S. at 664 & n.24 – in providing clear guidance to market participants and a check on overzealous law enforcement. As Judge Pooler points out, the panel's test is completely subjective, and could easily lead to prosecution of a market insider who shares information with the best of motives (as in *Dirks*) if it also provides a benefit to the tippee. A42-43. The result would be an enormous shift of power to prosecutors to bring insider trading prosecutions, which will put market participants at great risk to their livelihood and freedom in circumstances that the Supreme Court in *Dirks* expressly precluded.

II. CONSTITUTIONAL PRINCIPLES COUNSEL AGAINST THE PANEL'S EXPANSIVE EXTENSION OF INSIDER TRADING LAW.

Insider trading law in the United States is almost entirely a creation of judicial decisions, built on the slim foundation of the basic anti-fraud provision of

Section 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b). Despite repeated calls for enactment of an insider trading statute,[3] the scope of liability for insider trading in the United States has been developed entirely through judicial decisions. The absence of clear statutory standards imposes a special obligation on the judiciary to proceed cautiously in addressing insider trading liability, because substantial issues of fairness and due process can arise from case-by-case establishment of criminal standards.

The Due Process Clause demands that individuals receive "fair warning" before being punished for their conduct. *United States v. Bass*, 404 U.S. 336, 348 (1971). "[N]o citizen should be held accountable for a violation of a statute whose commands are uncertain." *United States v. Santos*, 553 U.S. 507, 514 (2008). Similarly, "[t]he rule of lenity requires ambiguous criminal laws to be interpreted in favor of the defendants subjected to them." *Id*. Where "any doubt" exists, the "ambiguity concerning the ambit of criminal statutes should be resolved in favor of lenity." *Yates v. United States*, 135 S. Ct. 1074, 1088 (2015) (citation omitted).

These fundamental principles apply here, and raise substantial concerns about the panel's expansive new interpretation of insider trading law. It is

---

[3] *See, e.g.*, Hon. Paul A. Engelmayer, "Congress: U.S. Needs an Insider Trading Law," N.Y.L.J. (Oct. 23, 2015), http://www.newyorklawjournal.com/id=1202740459962; Hon. Jed S. Rakoff, "A Statutory Solution to Insider Trading," 27 Sec. Litig. 2, American Bar Association (Winter 2017).

fundamentally unfair to prosecute someone based on legal standards that have emerged since their conduct. Martoma's alleged trading took place in 2008, and the scope of liability for insider trading has changed substantially several times since. As the panel recognized, A31-32, the instructions provided to the jury here are incorrect under either *Newman* or *Salman*. Due process demands that the Court apply *Dirks* and *Salman* narrowly, and not broaden insider trading liability beyond the clearly established law at the time of the alleged crime. By creating a new standard that goes well beyond *Dirks*, the panel has set a "trap for the innocent," *United States v. Cardiff*, 344 U.S. 174, 176 (1952), and created the potential for arbitrary law enforcement.

CONCLUSION

For the foregoing reasons, *amici* urge that the Court grant Appellant's petition for rehearing *en banc*.

Dated: August 15, 2018

Respectfully submitted,

By: /s/ Ira M. Feinberg

IRA M. FEINBERG
HOGAN LOVELLS US LLP
875 Third Avenue
New York, New York 10022
ira.feinberg@hoganlovells.com
Tel: (212) 918-3000

RICHARD D. WILLSTATTER
GREEN & WILLSTATTER
200 Mamaroneck Avenue, Suite 605
White Plains, New York 10601
willstatter@msn.com
Tel: (914) 948-5656
Vice Chair, NACDL Amicus Curiae Committee

SUSAN R. NECHELES
HAFETZ & NECHELES LLP
10 East 40th Street, 48th Floor
New York, New York 10016
snecheles@hafetznecheles.com
Tel: (212) 997-7400
President, New York Council of Defense Lawyers

Attorneys for Amici Curiae

CERTIFICATE OF COMPLIANCE

Pursuant to Federal Rules of Appellate Procedure 29(a)(4)(G) and 29(b)(4), the undersigned counsel certifies as follows:

1. This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) and Local Rule 32.1 because the brief contains 2547 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(f).

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using Microsoft Word 2010 software in Times New Roman 14-point font in the text and footnotes.

Dated: August 15, 2018

/s/ Ira M. Feinberg