

**INSIDER TRADING IN FLUX: EXPLAINING THE SECOND
CIRCUIT’S ERROR IN *UNITED STATES v. NEWMAN* AND THE
SUPREME COURT’S CORRECTION OF THAT ERROR IN
*UNITED STATES v. SALMAN***

INTRODUCTION

On October 5, 2015, the United States Supreme Court denied certiorari in *United States v. Newman*, making official the most lax laws on insider trading the U.S. had ever seen.¹ In this modern age of constant information sharing, *Newman* is a landmark decision. Petitioning for the Second Circuit to rehear the case, the government admitted that the decision was “one of the most significant developments in insider trading law in a generation.”² For approximately two years, the *Newman* decision was mandatory authority in the Second Circuit—the leading circuit in securities law. *Newman* “dramatically limit[ed] the Government’s ability to prosecute some of the most common, culpable, and market-threatening forms of insider trading.”³

So why is *Newman* such an important case? Imagine your longtime childhood friend, Director Dan, is an executive on the board of a Fortune 500 company. Director Dan, through his capacity on the board, hears about an impending merger between his firm and a smaller competitor. Because he is a “good friend,” Dan secretly informs you about this coming merger. You are not an investor, nor do you have any financial savvy whatsoever, but you decide to make stock purchases in Director Dan’s company because you know that the merger will soon increase the value of the company substantially. Sure enough, news of the merger between Director Dan’s company and its competitor rocks the stock market just weeks later. You have quadrupled your investment and benefitted lucratively from Dan’s inside information. Is there any problem with this? Were Director Dan’s actions illegal? Were your actions illegal? Before the *Newman* decision, the answer to all of these questions was undoubtedly, “Yes.” Both your actions and Dan’s actions would have been illegal under the Supreme Court’s articulation of the personal benefit requirement in *Dirks v. S.E.C.* because disclosing material, nonpublic information to a trading relative or friend was specifically identified as insider

1. 136 S. Ct. 242, 242 (2015).

2. Petition for Rehearing and Rehearing En Banc at 22–23, *U.S. v. Newman*, 773 F.3d 438 (2d Cir. 2014) (No. 13-1837(L)).

3. *Id.* at 3.

trading by the *Dirks* court.⁴ After *Newman*, however, the actions by Director Dan—although morally repugnant—did not violate insider trading law because Dan did not “personally benefit” under the Second Circuit’s new standard.⁵ Mere friendship no longer satisfied the personal benefit requirement.⁶ This hypothetical illustrates why some federal prosecutors and others who are tough on white-collar crime disagreed with the law made in *United States v. Newman*. Proving a demonstrable quid pro quo between a tipper and a tippee is a nearly impossible standard for federal prosecutors to prove beyond a reasonable doubt.⁷ The decision created poor law by providing corporate insiders with an avenue to disclose inside information to friends with impunity.

This case note argues that the Second Circuit erred in its decision to make the personal benefit requirement a more demanding standard. This note examines the heightened standard in great detail and explains why it led to frustrated federal prosecutors and, ultimately, corrective action by the U.S. Supreme Court. Part I begins with a history of the law of insider trading. Part II explains how courts interpreted and how federal prosecutors argued the personal benefit requirement in the years preceding the *Newman* decision. Part III studies *United States v. Newman* in great detail. Part IV analyzes how courts, especially the Ninth Circuit in *United States v. Salman*, decided insider trading cases in the aftermath of *Newman*. Finally, Part V argues that *Newman* set bad precedent for many reasons and praises the Supreme Court’s decision in *United States v. Salman* as a rebuke of *Newman* and a reaffirmation of *Dirks*.

I. HISTORICAL BACKGROUND: THE LAW OF INSIDER TRADING

Insider trading is a fascinating type of white-collar crime because there is no law or statute explicitly prohibiting it.⁸ Rather, it has traditionally been prosecuted criminally as a type of securities fraud under the Securities Exchange Act of 1934’s broad prohibition against using a “device, scheme, or artifice to defraud . . . in connection with the purchase or sale of any security.”⁹

4. 463 U.S. 646, 664 (1983).

5. *Newman*, 773 F.3d at 452.

6. *Id.*

7. Jon Eisenberg, “Friends” Who Trade on Inside Information: How *United States v. Newman* Changes the Law, K&L GATES (Apr. 20, 2015), http://www.klgates.com/friends-who-trade-on-inside-information-how-united-states-v-newman-changes-the-law-04-20-2015/#_edn1 [<http://perma.cc/9ZM6-4EAH>].

8. Randall Eliason, *Got a Hot Stock Tip?* *United States v. Newman Clarifies the Law of Insider Trading*, CASETEXT (July 30, 2015), <https://casetext.com/posts/got-a-hot-stock-tip-united-states-v-newman-clarifies-the-law-of-insider-trading> [<http://perma.cc/FB5U-TGL5>].

9. Security Exchange Act of 1934, 17 C.F.R. § 240.10b-5 (1934). This case note focuses only on criminal prosecution of insider trading. Insider trading may also result in civil liability for violating S.E.C. regulations, but civil liability standards are not the subject of this case note.

Since statutory law only provides this general prohibition, insider trading law has been left to courts to establish through common law. This Part will discuss the landmark cases and theories that have shaped the law of insider trading.

A. *Chiarella v. United States (1980)*

Until 1980, the law of insider trading was muddled. The law did not even distinguish between tippers—those who disclose inside information—and tippees—those who receive the inside information. In a landmark criminal case, *Chiarella v. United States*, the Supreme Court finally made that distinction by establishing different criminal standards for tippers and tippees.¹⁰

In that case, Vincent Chiarella was an employee at a financial printer.¹¹ Through his employment, he learned of an impending corporate takeover.¹² Without disclosing this knowledge to authorities, he purchased stock in the target companies and sold the shares immediately after news of the takeover went public.¹³ He made over \$30,000 through these trades.¹⁴ Chiarella was acquitted of all insider trading criminal charges because he had no duty to disclose his inside knowledge.¹⁵ Chiarella had no prior dealings with the target companies, was not a fiduciary of the companies, and was not a person in whom the sellers had placed their trust and confidence.¹⁶ “He was, in fact, a complete stranger who dealt with the sellers only through impersonal market transactions.”¹⁷

The court made an imperative distinction between tippers and tippees in this case. The “mere possession of nonpublic market information” does not give rise to a duty to publicly disclose the inside information or refrain from trading on it, according to the Supreme Court.¹⁸ Rather, the duty to publicly disclose or refrain from trading arises from “a specific relationship between two parties,” such as a corporate insider’s fiduciary duties to shareholders.¹⁹ *Chiarella*, therefore, was a landmark first step toward a clearer insider trading doctrine. Just three years later, the Supreme Court took on another insider trading case and issued, arguably, the most important insider trading decision ever.

10. 445 U.S. 222, 228, 230 (1980).

11. *Id.* at 224.

12. *Id.*

13. *Id.*

14. *Id.*

15. *Chiarella*, 445 U.S. at 231.

16. *Id.* at 232.

17. *Id.* at 232–33.

18. *Id.* at 235.

19. *Id.* at 233.

B. *Dirks v. S.E.C. (1983)*

In *Dirks v. S.E.C.*, the Supreme Court adopted the requirement that an insider must personally benefit from disclosing nonpublic information in order to be liable as a tipper.²⁰ Before the tipper-tippee distinction in *Chiarella*, prosecutors argued that anyone who traded or tipped inside information was guilty of securities fraud.²¹ The *Chiarella* Court struck down that argument by ruling “mere possession of nonpublic market information” does not create a duty to publicly disclose or refrain from trading based on the inside information.²² Continuing with the tipper-tippee distinction just three years later, the Court in *Dirks* focused tipper liability on whether the insider personally benefitted in any way by conveying or trading based on the inside information, and it focused tippee liability on the tippee’s knowledge of the breach.²³

The law generated by *Dirks* was groundbreaking, so the background facts are especially important. Raymond Dirks was an officer at a broker-dealer firm.²⁴ He received material, nonpublic information from a former officer of an insurance company that the company’s assets were overstated as a result of fraudulent corporate practices.²⁵ Dirks investigated these allegations.²⁶ Neither he nor his firm traded any of the company’s stock, but Dirks did discuss the allegations with his clients and investors.²⁷ Many clients liquidated their holdings in the company because of this information.²⁸ As rumors of the alleged fraud spread, the insurance company’s stock plummeted.²⁹ After two weeks, insurance authorities finally investigated the company’s records and discovered the fraud.³⁰ The S.E.C. censured Dirks civilly because of his role as a tippee who did not publicly disclose the inside information.³¹ The S.E.C. argued: “Where ‘tippees’—regardless of their motivation or occupation—come into possession of material ‘corporate information that they know is confidential and know or should know came from a corporate insider,’ they must either publicly disclose that information or refrain from trading.”³²

20. *Dirks v. S.E.C.*, 463 U.S. 646, 664 (1983).

21. Eisenberg, *supra* note 7.

22. *Chiarella*, 445 U.S. at 235.

23. *Dirks*, 463 U.S. at 660, 664.

24. *Id.* at 648.

25. *Id.* at 649.

26. *Id.*

27. *Id.*

28. *Dirks*, 463 U.S. at 649.

29. *Id.* at 650.

30. *Id.*

31. *Id.* at 651–52.

32. *Id.* at 651 (citing 21 S.E.C. Docket 1401, 1407 (1981) (footnote omitted) (quoting *Chiarella v. U.S.*, 445 U.S. 222, 230, n. 12 (1980))).

In a landmark 6–3 decision, the Supreme Court ruled in favor of *Dirks*. Though *Dirks* was a tippee, even tippee liability must focus on the benefit the *insider* receives.³³ The Court articulated a test for tippee liability: “[T]he test is whether the insider personally will benefit, directly or indirectly, from his disclosure. Absent some personal gain, there has been no breach of duty to stockholders. And absent a breach by the insider, there is no derivative breach.”³⁴ Therefore, a tippee is liable for insider trading only if (1) the tipper breaches his fiduciary duty (i.e. receives a personal benefit from the disclosure) and (2) the tippee “knows or should know” about the tipper’s breach.³⁵ In *Dirks*, the tipper was a former officer of the insurance company who only disclosed the inside information to expose the fraud.³⁶ The tipper did not receive a personal benefit by disclosing the information, and so he did not breach any duty owed to the insurance company’s shareholders.³⁷ “In the absence of a breach of duty to shareholders by the insiders, there was no derivative breach by *Dirks*.”³⁸

Thus, the *Dirks* decision clarified and advanced the law of insider trading. The Court characterized tippee liability as “derivative” of the tipper’s breach of duty to shareholders, and the Court further explained that a tipper breaches his duty to shareholders by personally benefitting from the trade or conveyance of inside information.³⁹ Therefore, the ultimate question of fact in insider trading cases is whether the *tipper* personally benefitted from trading or conveying the inside information.

In addition to the law it created in *Dirks*, the Supreme Court generously gave litigators a glimpse of how the Court would determine whether a tipper received a personal benefit in future cases. Evidence of a tipper’s monetary gain in exchange for the inside information obviously satisfies the personal benefit requirement. But many cases will not be so clear-cut. The Court gave examples of facts and circumstances in which it would infer a personal benefit:

For example, there may be 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. The tip and trade resemble trading by the insider himself followed by a gift of the profits to the recipient.⁴⁰

33. *Dirks*, 463 U.S. at 662.

34. *Id.*

35. *Id.* at 660.

36. *Id.* at 667.

37. *Id.*

38. *Dirks*, 463 U.S. at 667.

39. *Id.* at 662.

40. *Id.* at 664.

Therefore, *Dirks v. S.E.C.* dramatically changed the landscape of insider trading. Just three years earlier, before *Chiarella*, courts did not even distinguish between tippers and tippees. After *Dirks*, courts had well-defined tests for establishing both tipper and tippee liability and a generous suggestion from the Supreme Court about how to satisfy the personal benefit requirement.

II. THE PERSONAL BENEFIT REQUIREMENT POST-DIRKS

In the years after *Dirks*, the government successfully argued the personal benefit requirement down to a loose, easily-satisfied standard. The *Dirks* Court stated: “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.”⁴¹ Prosecutors seized on that language, citing it repeatedly to courts as evidence that a tip to a friend satisfies the personal benefit requirement.⁴² Furthermore, prosecutors pushed to broaden the definition of “friend” over the years so that even tips to mere acquaintances satisfied the personal benefit requirement.⁴³

For many years, courts agreed with prosecutors; they applied a loose, easily-satisfied personal benefit standard.⁴⁴ For example, in *S.E.C. v. Warde*, the Second Circuit determined the “close friendship” between the tipper and the tippee satisfied the personal benefit requirement.⁴⁵

As time passed, courts loosened the standard even more. *S.E.C. v. Obus* is the primary example of a court applying an overly lenient personal benefit requirement.⁴⁶ There, the tipper (Strickland) and tippee (Black) were friends from college.⁴⁷ Citing *Dirks*, the *Obus* court found the past relationship satisfied the personal benefit requirement.⁴⁸ “*Dirks* defined ‘personal benefit’ to include making a gift of information to a friend. Here, the undisputed fact that Strickland and Black were friends from college is sufficient to send to the jury the question of whether Strickland received a benefit from tipping Black.”⁴⁹

41. *Id.* (emphasis added).

42. Eisenberg, *supra* note 7.

43. *Id.*

44. United States v. Newman: *Second Circuit Ruling Portends Choppier Waters for Insider Trading Charges Against Downstream Tippees*, GIBSON DUNN (Dec. 15, 2014), <http://www.gibsondunn.com/publications/pages/US-v-Newman—Second-Circuit-Ruling-Portends-Choppier-Waters—Insider-Trading-Charges-Against-Downstream-Tippees.aspx> [http://perma.cc/5JRU-G7M5].

45. 151 F.3d 42, 48–49 (2d Cir. 1998).

46. 693 F.3d 276, 285 (2d Cir. 2012).

47. *Id.* at 291.

48. *Id.*

49. *Id.* (citations omitted).

In *United States v. Whitman*, the expert court on securities law—the Southern District of New York—noted how simple it had become to satisfy the personal benefit requirement.⁵⁰ Judge Jed Rakoff stated in his opinion that “very little in the way of a ‘benefit’ needed to be shown.”⁵¹ He identified just how permissive the standard had become: “[T]he benefit does not need to be financial or tangible in nature; it could include, for example, maintaining a useful networking contact, improving the reputation or power within the company, obtaining future financial benefits, or just maintaining or furthering a friendship.”⁵² *Whitman* illustrated just how loose the personal benefit requirement was construed in the years following *Dirks*. Even a vague reputational enhancement or “maintaining a useful networking contact” satisfied the standard.⁵³ Creative and talented prosecutors could easily satisfy it.

Thus, prosecutors pushed to loosen the personal benefit requirement since the Supreme Court articulated it in *Dirks*. What began as a lax standard in *S.E.C. v. Warde* relaxed even further over the years. The personal benefit requirement unraveled from a required showing of “close friendship” to “mere friendship” to “any reputational or networking improvement.” Because the requirement collapsed into an easily satisfied test over the years, the defense bar called for a stricter standard for prosecutors to meet.⁵⁴ Insider trading defendants typically face significant prison time, so having such a loose criminal standard seemed inherently unfair. Others argued the bare requirement was bad policy: “The government’s misreading of *Dirks* would fundamentally undermine the policy imperatives that led the Supreme Court to adopt the personal benefit test as an important market-protective limit on insider trading liability, and would deter valuable analyst-insider communications, to the detriment of the market and of all market participants.”⁵⁵ Prosecutors pushed the standard too far. Something had to give.

50. 904 F. Supp. 2d 363, 371 (2012).

51. *Id.*

52. *Id.* at n.7.

53. *Id.*

54. Mark S. Nelson, *Law Profs, Defense Bar Tell Appeals Court to Leave Newman Alone*, WOLTERS KLUWER (Feb. 26, 2015), http://www.dailyreportingsuite.com/securities/news/law_prof_defense_bar_tell_appeals_court_to_leave_newman_alone [<http://perma.cc/TEG4-VWTC>].

55. Stephen Bainbridge, *Supreme Court Denies Cert in US v. Newman Insider Trading Tipping Case*, PROFESSORBAINBRIDGE.COM (Oct. 5, 2015), <http://www.professorbainbridge.com/professorbainbridge.com/2015/10/supreme-court-denies-cert-in-us-v-newman-insider-trading-tipping-case.html> [<http://perma.cc/6PW8-3DEL>].

III. UNITED STATES V. NEWMAN

A. *Facts*

Todd Newman (“Newman”) and Anthony Chiasson (“Chiasson”) were two high-profile portfolio managers at hedge funds.⁵⁶ Newman was a portfolio manager at Diamondback Capital Management, LLC (“Diamondback”), and Chiasson managed accounts at Level Global Investors, L.P. (“Level Global”).⁵⁷ At trial, the Government presented evidence that lower-level financial analysts obtained information both directly and indirectly from corporate insiders at two publicly traded computer technology companies, Dell and NVIDIA.⁵⁸

These lower-level analysts obtained reliable information about Dell’s earnings numbers before they were publicly released in May 2008 and August 2008; the analysts also knew NVIDIA’s May 2008 earnings report before it was publicly released.⁵⁹ The analysts passed this inside information along to their superiors, Newman and Chiasson, who then executed trades of Dell and NVIDIA stock based on this inside information.⁶⁰ Their hedge funds made over \$72 million as a result of these trades.⁶¹

The flow of information, or “tipping chain,” is important to analyze the *Dirks* personal benefit requirement in this case. The Dell tipping chain started when Rob Ray, a Dell employee in the investor relations department, tipped Dell’s earnings information to Sandy Goyal, an analyst at an investment firm.⁶² Ray and Goyal were not “close” friends.⁶³ They attended business school together and worked together at Dell, but their relationship was strictly “work”—Ray sought career advice and networking help from Goyal.⁶⁴ Goyal passed the inside information along to an analyst friend at Diamondback, Jesse Tortora.⁶⁵ Tortora then relayed the information to Newman and to a Level Global analyst, Adondakis, who gave the information to Chiasson.⁶⁶ Thus, Newman was three levels removed from the insider (Ray—Goyal—Tortora—Newman), and Chiasson was four levels removed from the insider (Ray—Goyal—Tortora—Adondakis—Chiasson).⁶⁷

56. U.S. v. Newman, 773 F.3d 438, 442 (2d Cir. 2014).

57. *Id.*

58. *Id.* at 443.

59. *Id.*

60. *Id.*

61. *Newman*, 773 F.3d at 443.

62. *Id.*

63. *Id.* at 452.

64. *Id.*

65. *Id.* at 443.

66. *Newman*, 773 F.3d at 443.

67. *Id.*

The NVIDIA tipping chain was similar. An employee in NVIDIA's finance unit, Chris Choi, gave inside earnings numbers to Hyung Lim.⁶⁸ Choi and Lim were family friends who "had met through church and occasionally socialized together."⁶⁹ Lim passed along the inside information to analyst Danny Kuo.⁷⁰ Kuo, in turn, passed along the inside NVIDIA numbers to his group of analyst friends, including Tortora and Adondakis, who again relayed the information to their respective hedge fund managers, Newman and Chiasson.⁷¹ Therefore, Newman and Chiasson were four levels removed from the original tipplers in the NVIDIA chain.⁷²

B. Procedural Posture

The case had a theatrical beginning. After obtaining a search warrant, FBI agents raided the offices of Diamondback and Level Global in November 2010.⁷³ Both Diamondback and Level Global suffered great reputational and financial harm from the raid, and both firms collapsed by the end of 2012 as a result.⁷⁴

Newman and Chiasson were arrested and charged with securities fraud on January 18, 2012, in the Southern District of New York.⁷⁵ The grand jury returned an indictment on February 7, 2012, and so the case proceeded to trial.⁷⁶ With an alleged \$72 million in illicit profits, it was one of the largest insider trading prosecutions of all time.⁷⁷ After six days of trial, the jury returned a guilty verdict on all counts for both Newman and Chiasson.⁷⁸ Newman, who made \$4 million in the illegal trades, was sentenced to fifty-four months in prison and fined \$1 million.⁷⁹ Chiasson, who made \$68 million in the illegal trades, was sentenced to seventy-eight months imprisonment and was fined \$5 million.⁸⁰

68. *Id.*

69. *Id.* at 452.

70. *Id.* at 443.

71. *Newman*, 773 F.3d at 443.

72. *Id.*

73. Roger Parloff, *Why the Supreme Court Might Not Hear a Crucial Insider Trading Case*, FORTUNE (Sept. 23, 2015), <http://fortune.com/2015/09/23/supreme-court-insider-trading-newman/> [http://perma.cc/3F2L-FAK7].

74. GIBSON, *supra* note 44.

75. *Id.*; *United States v. Newman*, No. 12 CR 121(RJS), 2013 U.S. Dist. LEXIS 70242, at *1 (S.D.N.Y. May 7, 2013).

76. *Newman*, 773 F.3d at 443.

77. GIBSON, *supra* note 44.

78. *Id.*; *Newman*, 773 F.3d at 444.

79. *Newman*, 773 F.3d at 443–44.

80. *Id.* at 443–45.

C. *The Appeal*

Newman and Chiasson raised several issues on appeal to the Second Circuit, but two core issues dramatically changed the legal landscape of insider trading: the personal benefit requirement and the tippee's knowledge requirement.

1. The Personal Benefit Requirement

As explained in Part II of this case note, the personal benefit requirement eroded away after *Dirks*. In *Newman*, the insiders at Dell and NVIDIA shared material nonpublic information with friends, and so the Government argued that this gift of inside information to friends satisfied the personal benefit requirement.⁸¹ Courts routinely accepted such an argument in the years preceding *Newman*.⁸² The Second Circuit, however, “emphatically rejected” this position in *Newman*:

To the extent *Dirks* suggests that a personal benefit may be inferred from a personal relationship between the tipper and tippee . . . we hold that such an inference is impermissible in the absence of 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. [T]his requires evidence of a ‘relationship between the insider and the recipient that *suggests a quid pro quo from the latter, or an intention to benefit the [latter]*.’⁸³

This Second Circuit position is a major departure from the post-*Dirks* personal benefit requirement. Although the tipper's benefit “need not be *immediately* pecuniary,” the personal benefit “must be of some consequence.”⁸⁴

The required quid pro quo or intention to benefit was not present in *Newman*. Because the tippee, Goyal, only gave the tipper, Ray, minor suggestions on a résumé and offered advice before an interview, evidence of a personal benefit was scant in the Dell tipping chain.⁸⁵ Goyal testified that he would have given Ray such career advice regardless of the inside information, and Ray himself denied that any quid pro quo existed.⁸⁶ In the NVIDIA chain, the Second Circuit described Choi and Lim as “casual acquaintances” that had

81. Eisenberg, *supra* note 7.

82. See *S.E.C. v. Warde*, 151 F.3d 42, 48–49 (2d Cir. 1998); *S.E.C. v. Obus*, 693 F.3d 276, 291 (2d Cir. 2012); *United States v. Whitman*, 904 F. Supp. 2d 363, 371 (2012).

83. *Newman*, 773 F.3d at 452 (emphasis added).

84. *Id.*

85. *Id.* at 453.

86. *Id.*

no history of personal favors or quid pro quo.⁸⁷ Therefore, a quid pro quo did not exist in *Newman*, and so the personal benefit requirement was unsatisfied.

After *Newman*, the personal benefit requirement was no longer loose and prosecution-friendly. It was a stiff burden to satisfy.

2. Tippee's Knowledge

Until the *Newman* decision, courts—particularly the Second Circuit—were “somewhat Delphic” on the law of tippee liability.⁸⁸ In *Dirks*, the Supreme Court was clear that, even in the presence of a tipper's breach, a tippee is liable only if he “knows or should know that there has been a breach.”⁸⁹ But must the tippee also have knowledge that the tipper personally benefitted from the breach? Yes, according to the *Newman* court.⁹⁰ The Second Circuit thinks this follows naturally from *Dirks*:

For purposes of insider trading liability, the insider's disclosure of confidential information, standing alone, is not a breach. Thus, without establishing that the tippee knows of the personal benefit received by the insider in exchange for the disclosure, the Government cannot meet its burden of showing that the tippee knew of a breach.⁹¹

To know that a breach of fiduciary duty occurred, a tippee must have knowledge that the original tipper received a personal benefit. The disclosure of inside information alone will not necessarily entail the reception of a personal benefit.⁹² “[T]he Supreme Court affirmatively rejected the premise that a tipper who discloses confidential information necessarily does so to receive a personal benefit.”⁹³

In *Newman*, the tippees on trial, Newman and Chiasson, “knew next to nothing about the insiders and nothing about what, if any, personal benefit had been provided to them.”⁹⁴ Adondakis, Chiasson's direct source for the Dell information, only told Chiasson that Goyal was “talking to someone within Dell,” but mentioned nothing about any personal benefit.⁹⁵ Also, Adondakis did not even tell Chiasson that the source of the NVIDIA information worked at NVIDIA.⁹⁶ Similarly, Tortora—Newman's direct source for the Dell information—did not know how Goyal obtained the Dell numbers, much less

87. *Id.*

88. *Newman*, 773 F.3d at 447.

89. *Dirks v. S.E.C.*, 463 U.S. 646, 660 (1983).

90. *Newman*, 773 F.3d at 448.

91. *Id.*

92. *Id.* at 454.

93. *Id.*

94. *Id.* at 453.

95. *Newman*, 773 F.3d at 453.

96. *Id.*

whether any personal benefit was involved.⁹⁷ Nor did Tortora know whether a personal benefit was received for the NVIDIA information.⁹⁸ Because Newman and Chiasson did not have knowledge that the original tippers received a personal benefit and because the mere disclosure of inside information does not entail it, the defendants did not have the requisite knowledge to be liable as tippees.

Therefore, after *Newman*, the Government had to prove the existence of a quid pro quo or other intention that eventually will lead to a pecuniary benefit for the insider, and the tippee must have knowledge that the tipper received a personal benefit in exchange for the tip.⁹⁹

D. Post-Appeal

After its loss in December 2014, the Government petitioned for rehearing en banc by the Second Circuit.¹⁰⁰ The petition was denied.¹⁰¹ The Government then petitioned for writ of certiorari to the Supreme Court of the United States, and certiorari was denied on October 5, 2015.¹⁰² Thus, until the Supreme Court decided *United States v. Salman*, *Newman*'s strict personal benefit requirement and tippee knowledge requirement were controlling precedent in the Second Circuit.

IV. UNITED STATES V. SALMAN: HOW THE NINTH CIRCUIT AND OTHER COURTS REACTED TO NEWMAN

Many people feared the *Newman* decision would greatly hinder the government's ability to prosecute insider trading. The government itself claimed the decision would "dramatically limit the Government's ability to prosecute some of the most common, culpable, and market-threatening forms of insider trading."¹⁰³ Judges, however, interpreted *Newman* surprisingly narrowly after the decision in December 2014.¹⁰⁴ "A *Wall Street Journal* analysis of more than twenty cases shows that, so far, defendants in federal court who have tried to use the [*Newman*] opinion in their defense have failed

97. *Id.* at 453–54.

98. *Id.* at 454.

99. Eisenberg, *supra* note 7.

100. *Id.*

101. *Id.*

102. *U.S. v. Newman*, 136 S. Ct. 242, 242 (2015).

103. Petition for Rehearing, *supra* note 2.

104. Christopher M. Matthews, *Judge Proves Ally to Government on Insider-Trading Ruling*, WALL ST. J. (Sept. 21, 2015) <http://www.wsj.com/articles/judge-proves-ally-to-government-on-insider-trading-ruling-1442853103> [<http://perma.cc/2MSG-LBJE>].

in every instance but one.”¹⁰⁵ Since that analysis, numerous other courts distinguished or otherwise declined to follow *Newman*.¹⁰⁶

An important critique of *Newman* came in July 2015 in the Ninth Circuit decision *United States v. Salman*.¹⁰⁷ There, the Ninth Circuit declined to follow *Newman*'s articulation of the personal benefit requirement, creating a “circuit split” between the Second Circuit and Ninth Circuit—the two most influential jurisdictions in securities law.¹⁰⁸

A. *Facts*

Salman was a family-based insider trading scheme.¹⁰⁹ The fraud originated from an insider, Maher Kara, who worked in Citigroup's healthcare investment banking group.¹¹⁰ Maher discussed various aspects of his job with his older brother, Michael Kara.¹¹¹ Michael had an undergraduate degree in chemistry, so Maher—at first—only sought help from Michael in understanding concepts relevant to his investment work in the healthcare and biotechnology sectors.¹¹² The brotherly tutor session, however, quickly evolved into an illegal disclosure of material nonpublic information.

From late 2004 through early 2007, Maher “regularly disclosed to Michael information about upcoming mergers and acquisitions of and by Citigroup clients.”¹¹³ In 2003, before the disclosures, Maher got engaged to Suzie Salman.¹¹⁴ As the Kara and Salman families became friends during this engagement, Michael Kara became especially close with Suzie's brother, Bassam Yacoub Salman (“Salman”)—the defendant in this case.¹¹⁵ Michael told Salman that he was receiving inside investment information from Maher, and Michael encouraged Salman to “mirror-imag[e]” his trading activity.¹¹⁶

105. *Id.*

106. Three courts have declined to follow *Newman*; see *U.S. v. Salman*, 792 F.3d 1087 (9th Cir. 2015); *U.S. v. Parigian*, 824 F.3d 5 (1st Cir. 2016); *U.S. v. Melvin*, 143 F. Supp. 3d 1354 (N.D. Ga. 2015). Numerous others have distinguished *Newman*; see *U.S. v. Riley*, 638 F. App'x 56 (2d Cir. 2016); *U.S. v. Riley*, 90 F. Supp. 3d 176 (S.D.N.Y. 2015); *S.E.C. v. Payton*, 97 F. Supp. 3d 558 (S.D.N.Y. 2015); *U.S. v. Gupta*, 111 F. Supp. 3d 557 (S.D.N.Y. 2015); *S.E.C. v. Megalli*, 157 F. Supp. 3d 1240 (N.D. Ga. 2015); *S.E.C. v. McPhail*, No. 14-12958-RWZ, 2015 WL 5749449 (D. Mass. Sept. 30, 2015); *S.E.C. v. Andrade*, 157 F. Supp. 3d 124 (D. R.I. Jan. 15, 2016); *S.E.C. v. Spivak*, No. 15-13704-FDS, 2016 WL 3774196 (D. Mass. July 12, 2016).

107. 792 F.3d at 1087.

108. *Id.* at 1093.

109. *Id.* at 1088.

110. *Id.*

111. *Id.* at 1089.

112. *Salman*, 792 F.3d at 1089.

113. *Id.*

114. *Id.*

115. *Id.*

116. *Id.*

Salman traded through a brokerage account held by his brother-in-law, Bayyouk.¹¹⁷ From 2004 to 2007, “Bayyouk and Michael Kara executed nearly identical trades in securities issued by Citigroup clients shortly before the announcement of major transactions. As a result of these trades, Salman and Bayyouk’s account grew from \$396,000 to approximately \$2.1 million.”¹¹⁸

B. Procedural Posture

Salman was found guilty by a jury on four counts of securities fraud and one count of conspiracy to commit securities fraud; he was sentenced to three years in prison.¹¹⁹ Salman appealed his conviction, but he did not challenge the sufficiency of the evidence.¹²⁰ While Salman’s appeal was pending, the Second Circuit announced its *Newman* decision.¹²¹ Salman then filed a supplemental brief arguing that the evidence in his case was insufficient under the new personal benefit requirement in *Newman*.¹²² The Ninth Circuit granted the appeal.¹²³

C. The Ninth Circuit’s Analysis

With great irony, Judge Jed Rakoff, a U.S. District Court Judge in the Southern District of New York, wrote the decision while working as a visiting judge in the Ninth Circuit.¹²⁴ Rakoff is widely considered the nation’s leading jurist on securities law and insider trading, so his opinion is highly regarded.¹²⁵ Furthermore, he has a notorious “pro-defendant” reputation.¹²⁶ He has been called “a burr in the side of lawyers for the Justice Department and Securities and Exchange Commission.”¹²⁷ In *Salman*, however, Rakoff critiqued his own

117. *Salman*, 792 F.3d at 1089.

118. *Id.*

119. Press Release, Fed. Bureau of Investigation, Illinois Resident Sentenced to Three Years in Prison for Insider Trading (Apr. 10, 2014), <https://archives.fbi.gov/archives/sanfrancisco/press-releases/2014/illinois-resident-sentenced-to-three-years-in-prison-for-insider-trading> [http://perma.cc/CB3H-LHEA].

120. *Salman*, 792 F.3d at 1090.

121. *Id.*

122. *Id.*

123. *Id.*

124. See Christopher M. Matthews, *Prosecutors’ Unlikely Ally: Judge—Rakoff’s Rulings Question Appellate Court’s Decision on Insider-Trading Cases*, WALL ST. J., Sept. 22, 2015, at C3 (noting that the U.S. District Court for the Southern District of New York sits in the Second Circuit Court of Appeals, thus Judge Rakoff criticized his own “home circuit” Court of Appeals in *Salman*).

125. See *id.*

126. *Id.*

127. *Id.*

“home circuit” by arguing the *Newman* court erred by putting too heavy a burden on the government to prosecute insider trading.¹²⁸

Because of the new personal benefit requirement articulated in *Newman*, Salman argued the familial relationship between Maher and Michael in his case was insufficient, standing alone, to satisfy the standard.¹²⁹ Salman argued that Maher, the tipper, needed to receive a benefit of “at least a potential gain of a pecuniary or similarly valuable nature” to satisfy *Newman*’s personal benefit requirement.¹³⁰ Because Maher did not receive any tangible benefit by disclosing the inside information to his brother, Salman argued that the government failed to satisfy the personal benefit requirement.¹³¹ Under the *Newman* standard, Salman almost certainly had a winning argument.

Much to Salman’s dismay, the Ninth Circuit flatly rejected the Second Circuit’s new articulation of the personal benefit requirement.¹³² “To the extent *Newman* can be read to go so far, we decline to follow it.”¹³³ The *Salman* court based its disagreement on the personal benefit requirement’s roots in *Dirks*.¹³⁴ “[Following *Newman*] would require us to depart from the clear holding of *Dirks* that the element of breach of fiduciary duty is met where an ‘insider makes a gift of confidential information to a trading relative or friend.’”¹³⁵ The *Salman* court even went a step further, criticizing the Second Circuit for creating ill-advised policy and an environment where “a corporate insider or other person in possession of confidential and proprietary information would be free to disclose that information to her relatives, and they would be free to trade on it, provided only that she asked for no tangible compensation in return.”¹³⁶

After declining to follow *Newman*, the *Salman* court found the *Dirks* personal benefit requirement easily satisfied.¹³⁷ Maher disclosed inside, market-sensitive information to his brother, Michael, with the intention of benefitting Michael.¹³⁸ Maher himself testified at trial that he disclosed the inside information “for the purpose of benefitting and providing for his brother Michael.”¹³⁹

128. *See id.*

129. U.S. v. *Salman*, 792 F.3d 1087, 1093 (9th Cir. 2015).

130. *Id.*

131. *Id.*

132. *Id.*

133. *Id.*

134. *Salman*, 792 F.3d at 1093.

135. *Id.*

136. *Id.* at 1094.

137. *Id.*

138. *Id.*

139. *Salman*, 792 F.3d at 1094.

Thus, the Ninth Circuit critiqued and split from the Second Circuit because *Newman* directly conflicted with and “depart[ed] from” the Supreme Court’s seminal decision in *Dirks*.¹⁴⁰

D. *Post-Appeal*

After his loss in the Ninth Circuit, Salman petitioned to the United States Supreme Court for Writ of Certiorari.¹⁴¹ Salman presented this question to the highest court:

Does the personal benefit to the insider that is necessary to establish insider trading under *Dirks v. S.E.C.* require proof of “an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature,” as the Second Circuit held in *United States v. Newman*, or is it enough that the insider and the tippee shared a close family relationship, as the Ninth Circuit held in this case?¹⁴²

The Supreme Court granted certiorari and issued its decision on December 6, 2016, striking down *Newman*’s heightened personal benefit requirement.¹⁴³

V. BAD LAW: THE SECOND CIRCUIT GOT NEWMAN WRONG AND THE SUPREME COURT WAS CORRECT TO ABROGATE IT IN SALMAN

A. *Practical Problems with the Tippee Knowledge Requirement*

Recall from Part III that, in addition to heightening the personal benefit requirement, *Newman* intensified the tippee’s knowledge requirement by requiring a tippee to have knowledge of the original tipper’s personal benefit from the disclosure.¹⁴⁴ Such a knowledge requirement drastically limits tippee liability.

Technological innovations such as texting, Facebook, and Twitter allow instantaneous message sharing. In this age of instant communication, inside information can easily spread to numerous “downstream recipients” within several minutes of the insider’s disclosure. In fact, most modern-day cases of insider trading occur through “tippee chains” like those in *Newman* and *Salman*—an insider tells a friend who tells a friend who trades. Preventing tippee chains and downstream trading is more important than ever.

Prosecuting tippee chains, however, is nearly impossible under *Newman*’s knowledge requirement. “[R]emote tippees are unlikely to even know the tipper’s identity, let alone whether the tipper actually received a benefit in

140. *Id.* at 1093.

141. Petition for Writ of Certiorari, *Salman*, 792 F.3d 1087 (No. 15-628).

142. *Id.* at i (citations omitted).

143. *Salman v. United States*, No. 15-628, slip op. at 10, 580 U. S. ____ (2016).

144. *U.S. v. Newman*, 773 F.3d 438, 448 (2d Cir. 2014).

exchange for his tip.”¹⁴⁵ Links in the tippee chain are highly unlikely to tell one another about the original tipper’s personal benefit received for the initial disclosure. Tippees only care about cashing in on the inside information; they do not care about the personal benefit received by the original tipper. In fact, *not* knowing about the tipper’s personal benefit is actually preferred because the tippee then has plausible deniability as to the knowledge requirement.

Newman’s heightened tippee knowledge requirement fails to acknowledge the realities of twenty-first century information sharing and therefore leaves downstream tippees insulated from liability.

B. Newman Directly Conflicts with Dirks

In Part I, this case note discussed *Dirks* in great detail.¹⁴⁶ The Supreme Court gave two distinct scenarios in which the personal benefit requirement is satisfied:

For example, there may be 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. The tip and trade resemble trading by the insider himself followed by a gift of profits to the recipient.¹⁴⁷

The Court’s deliberate use of the language “also exist” makes clear the two separate occasions on which a personal benefit may be inferred: (1) when the insider expects something in return for the information or (2) when the insider “gives a gift” of information to a friend or relative.¹⁴⁸ The second occasion is vitally important here.

Webster’s Dictionary defines “gift” as “something that is *voluntarily* transferred by one person to another *without compensation*.”¹⁴⁹ Thus, under the plain meaning of “gift” in *Dirks*, a personal benefit may be inferred from the mere disclosure of material nonpublic information to a trading friend or relative—no compensation or receipt of a gain is required.

145. *Insider Trading After United States v. Newman, The Second Circuit’s Landmark Decision Limiting Liability Of Downstream Recipients Of Insider Information*, QUINN EMANUEL URQUHART & SULLIVAN, LLP, <http://www.quinnemanuel.com/the-firm/news-events/article-april-2015-insider-trading-after-united-states-v-newman-the-second-circuit-s-landmark-decision-limiting-liability-of-downstream-recipients-of-insider-information/> [http://perma.cc/7NPU-AA EP] (last visited Dec. 22, 2015).

146. *See supra* part I (B).

147. *Dirks v. S.E.C.*, 463 U.S. 646, 664 (1983) (emphasis added).

148. Petition for Writ of Certiorari at 18, *U.S. v. Newman*, 136 S. Ct. 242 (2015) (No. 15-137).

149. WEBSTER’S THIRD NEW INTERNATIONAL DICTIONARY 956 (Phillip Babcock Gove et. al eds., 3d ed. 1993) (emphasis added).

Newman, however, “hold[s] that such an inference is impermissible in the absence of 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.”¹⁵⁰ Requiring “an exchange that is objective, consequential, and represents at least a potential gain . . .” directly conflicts with *Dirks* because an “exchange” is, by definition, not a “gift.”¹⁵¹ An “exchange” involves “giving or taking one thing in return for another [thing],” meanwhile a “gift” involves giving something for nothing in return.¹⁵² Under *Newman*, “*Dirks*’s two categories of personal benefit are collapsed into one—and the entire ‘gift’ discussion in *Dirks* becomes superfluous.”¹⁵³ *Newman* eliminates the Supreme Court’s second inference of a personal benefit, thereby redefining the personal benefit requirement.

The Ninth Circuit agrees that *Newman*’s personal benefit requirement inherently conflicts with the Supreme Court’s articulation of the requirement in *Dirks*.¹⁵⁴ “[Following *Newman*] would require us to depart from the clear holding of *Dirks* that the element of breach of fiduciary duty is met where an ‘insider makes a gift of confidential information to a trading relative or friend.’”¹⁵⁵

The Second Circuit had no authority to redefine the personal benefit requirement crafted by the Supreme Court of the United States. Nevertheless, the Second Circuit “substituted its novel and imprecise legal rules for the ‘guiding principle’ that [the] Court carefully fashioned for factfinders in *Dirks*.”¹⁵⁶ It therefore overreached and set bad precedent in *Newman*.

C. *The Ninth Circuit and Other Influential Courts Disagree*

Before rejecting *Newman* as bad law, the *Salman* court pointed out that, although the Second Circuit is not binding on the Ninth Circuit, the court “would not lightly ignore the most recent ruling of our sister circuit in an area of law that it has frequently encountered.”¹⁵⁷ In the two years proceeding *Newman*, most courts followed the lead of the Ninth Circuit: eight courts distinguished *Newman* and three courts declined to extend it.¹⁵⁸ Three other

150. U.S. v. *Newman*, 773 F.3d 438, 452 (2d Cir. 2014).

151. *Id.*

152. WEBSTER’S, *supra* note 149, at 792.

153. Petition for Writ of Certiorari, *supra* note 141, at 19.

154. U.S. v. *Salman*, 792 F.3d 1087, 1093–94 (9th Cir. 2015).

155. *Id.* at 1093 (emphasis added).

156. Petition for Writ of Certiorari, *supra* note 141, at 22.

157. *Salman*, 792 F.3d at 1092.

158. See U.S. v. *Riley*, 638 F. App’x 56 (2d Cir. 2016); U.S. v. *Riley*, 90 F. Supp. 3d 176 (S.D.N.Y. 2015); S.E.C. v. *Payton*, 97 F. Supp. 3d 558 (S.D.N.Y. 2015); U.S. v. *Gupta*, 111 F. Supp. 3d 557 (S.D.N.Y. 2015); S.E.C. v. *Megalli*, 157 F. Supp. 3d 1240 (N.D. Ga. 2015); S.E.C. v. *McPhail*, No. 14-12958-RWZ, 2015 WL 5749449 (D. Mass. Sept. 30, 2015); S.E.C. v.

courts—including the Ninth Circuit in *Salman*—flatly rejected *Newman* by declining to follow it.¹⁵⁹ The courts that were most hostile to *Newman* were the most influential jurisdictions in securities law: the Southern District of New York (New York City), the Northern District of California (San Francisco), and the Ninth Circuit Court of Appeals.¹⁶⁰ Since the Second Circuit’s decision in December 2014, only one defendant had success using *Newman* in his defense.¹⁶¹

The unwillingness of courts to employ and extend *Newman* illustrates the uneasiness that judges and juries felt toward the decision. As this case note explained in Part IV, the Ninth Circuit split from *Newman*, calling the decision a “depart[ure] from the clear holding of *Dirks* . . .”¹⁶² Other courts also were hesitant to conflict with *Dirks*. In April 2015, before issuing the *Salman* decision, Judge Rakoff first hinted at *Newman*’s conflict with *Dirks*: “[w]hether this is the required reading of *Dirks* may not be obvious . . .”¹⁶³ *Newman*’s hostile reception by other courts specializing in securities law illustrates it was bad law that needed to be changed.

D. *Newman is Bad Policy*

Newman’s rationale creates bad policy in two interrelated ways: it undermines fundamental fairness, which thereby erodes public confidence in the securities markets.

First and most importantly, the *Newman* decision undermines notions of fundamental fairness. As this note argued previously in Part V, the heightened tippee knowledge requirement makes tippee chains and downstream trading impossible to prosecute for all practicable purposes.¹⁶⁴ Tippees, through no hard work of their own but merely by virtue of being friends or relatives with the right insiders, can benefit lucratively with impunity by trading based on inside information. Preet Bharara, U.S. Attorney for the Southern District of

Andrade, 157 F. Supp. 3d 124 (D. R.I. Jan. 15, 2016); S.E.C. v. Spivak, No. 15-13704-FDS, 2016 WL 3774196 (D. Mass. July 12, 2016). Three courts have declined to extend *Newman*; see U.S. v. Musante, 638 F. App’x 224 (4th Cir. 2016); S.E.C. v. Sabrdaran, No. 14-cv-04825-JSC, 2015 WL 901352 (N.D. Cal. Mar. 2, 2015); U.S. v. Whitman, 115 F. Supp. 3d 439 (S.D.N.Y. 2015).

159. See *Salman*, 792 F.3d; U.S. v. Parigian, 824 F.3d 5 (1st Cir. 2016); U.S. v. Melvin, 143 F. Supp. 3d 1354 (N.D. Ga. 2015).

160. See *Salman*, 792 F.3d 1087; *Riley*, 90 F. Supp. 3d 176; *Payton*, 97 F. Supp. 3d 558; *Gupta*, 111 F. Supp. 3d 557; *Whitman*, 115 F. Supp. 3d 439; *Sabrdaran*, 2015 WL 901352.

161. Matthews, *supra* note 124.

162. *Ninth Circuit Disagrees with Second Circuit on Personal Benefit Requirement for Insider Trading*, PROSKAUER ROSE LLP (July 6, 2015), <http://www.proskauer.com/publications/client-alert/ninth-circuit-disagrees-with-second-circuit-on-personal-benefit-requirement-for-insider-trading/> [<http://perma.cc/B7EQ-ZKHC>].

163. See *Payton*, 97 F. Supp. 3d at 563.

164. See *supra* part V (A).

New York, described *Newman* as “a potential bonanza for friends and family of rich people with access to material nonpublic information.”¹⁶⁵ *Newman* is unfair to legitimate analysts and honest investors who do not have access to such nonpublic information. The decision discourages diligent financial analysis and, instead, incentivizes choosing the right “golf buddies.”

This blatant unfairness destroys public confidence in the integrity of the securities markets.

Such activity [] strips investors of confidence that the markets are fair and open. While some ‘informational disparity is inevitable in the securities markets,’ a rational investor will ‘hesitate to venture capital’ in a rigged game—one in which he faces a systematic ‘informational disadvantage’ vis-à-vis insiders and their chosen beneficiaries that can never ‘be overcome with research or skill.’¹⁶⁶

Newman indeed reduces the securities markets to a “rigged game” by making tippee liability impossible to prosecute for all practicable purposes; corporate insiders and their friends can trade with impunity on inside information.¹⁶⁷ Senator Jack Reed warned Congress that the injustice advanced in *Newman* dangerously shakes citizens’ faith in government.¹⁶⁸ Reed said, “[*Newman*] defies common sense . . . [s]uch a decision is one of many that has caused too many of our citizens to lose faith in government and our courts.”¹⁶⁹ If the law permits such favoritism, it risks destroying all public confidence in securities markets, and once lost, public confidence is extremely difficult to earn back.

E. A Controversial Decision

Although Part IV noted that only one defendant in 2015 successfully used *Newman* in his defense,¹⁷⁰ other statistics indicate *Newman* was wreaking havoc on prosecution of insider trading defendants in different ways. “Justice Department officials [state] that the ruling is having an impact in unseen ways, including on investigations they say they have had to abandon as a result.”¹⁷¹

In the years immediately preceding *Newman*, Preet Bharara (“Bharara”) was aggressively pursuing insider trading cases.¹⁷² He had an impeccable track

165. Christopher M. Matthews & Aruna Viswanatha, *Prosecutor Pulls Plug on Insider Charges*, WALL ST. J., Oct. 3, 2015, at A1.

166. Petition for Writ of Certiorari, *supra* note 141, at 26–27.

167. *Id.*

168. 161 CONG. REC. S1440 (daily ed. Mar. 11, 2015) (statement of Sen. Reed).

169. *Id.*

170. *Supra* part IV.

171. *Id.*

172. Matthews & Viswanatha, *supra* note 165.

record with over eighty convictions and only one acquittal.¹⁷³ But because of the heightened requirements promulgated by *Newman*, law enforcement officials were forced to rein in insider trading investigations.¹⁷⁴ In addition, “[f]ederal prosecutors in New York also [were] forced to stall or back off insider trading investigations that lack evidence of an obvious benefit provided to the tipper.”¹⁷⁵ For example, on October 23, 2015, Bharara was forced to dismiss charges against former SAC Capital portfolio manager Michael Steinberg who had been convicted by a federal jury—and sentenced to three and a half years in prison—in an insider trading scheme that generated more than \$1.8 million in profits.¹⁷⁶ Because of the burdensome requirements set forth in *Newman*, Bharara said, “insisting on maintaining guilty pleas in these cases wouldn’t be in the interests of justice.”¹⁷⁷ Thus, since the decision over two years ago, *Newman* wreaked havoc on insider trading investigations and prosecutions.

In addition to law enforcement officials, Congress was also outraged by the *Newman* decision. Before the Supreme Court granted certiorari in *Salman* to clarify the law of insider trading, several congressional leaders already had proposed bills to overturn *Newman* and to more harshly crack down on insider trading.¹⁷⁸ In immediate response to *Newman*, Stephen F. Lynch introduced a bill to the House of Representatives on February 27, 2015, seeking to completely eliminate the personal benefit requirement as an element of insider trading.¹⁷⁹ The bill, entitled the Ban Insider Trading Act of 2015, proposed eliminating the personal benefit requirement altogether by making it unlawful to trade “based on information that the person knows or, considering factors including financial sophistication, knowledge of and experience in financial matters, position in a company, and amount of assets under management, should know is material information and inside information.”¹⁸⁰ The proposal goes far beyond merely overturning *Newman*; it seeks to vastly broaden the activities falling under the illegal purview of insider trading. Senator Jack Reed introduced a separate bill, the Stop Illegal Insider Trading Act, in the Senate just weeks later.¹⁸¹ This bill makes it illegal to trade “on the basis of material

173. *Id.*

174. *Id.*

175. Matthews, *supra* note 124.

176. Matthews & Viswanatha, *supra* note 165; Patricia Hurtado, *SAC Capital’s Steinberg Gets Insider Trading Charges Dropped*, BLOOMBERG (Oct. 22, 2015, 2:13 PM), <https://www.bloomberg.com/news/articles/2015-10-22/u-s-drops-charges-against-sac-capital-s-michael-steinberg> [<http://perma.cc/E7JJ-NSG3>].

177. *Id.*

178. QUINN, *supra* note 145.

179. H.R. 1173, 114th Cong. (1st Sess. 2015).

180. *Id.*

181. S. 702, 114th Cong. (1st Sess. 2015).

information that the person knows or has reason to know is not publicly available . . . [T]he term ‘not publicly available’ shall not include information that the person has independently developed from publicly available sources.”¹⁸² This proposal is much less expansive than the House bill, but it still seeks to overturn *Newman* and eliminate profiting from blatant information asymmetry. Both bills are in their earliest stages, only having been introduced and sent to the Finance Committee, but they “signify Congressional dissatisfaction with the Second Circuit’s decision.”¹⁸³

F. *The Future of Insider Trading Law*

1. The Supreme Court’s Abrogation of *Newman* and Reaffirmation of *Dirks*

Newman is a bad decision for the many reasons stated in this case note; therefore, the Supreme Court was correct in abrogating—or at least drastically limiting—the Second Circuit’s decision.

The Supreme Court Justices’ skeptical questions during *Salman* oral arguments on October 5, 2016 foreshadowed that the Court would overturn *Newman* and reaffirm the *Dirks* standard.¹⁸⁴ *Salman*’s attorney, Alexandra Shapiro, “immediately ran into a string of skeptical questions from the justices, mainly about her argument for a significant change in the law, which has been well settled for over 30 years.”¹⁸⁵ Justice Elena Kagan was particularly deferential to *Dirks*’s gift theory and hostile to *Salman*’s argument in support of *Newman*:

You’re asking us to cut back significantly from something that we said several decades ago [in *Dirks*], something that Congress has shown no indication that it’s unhappy with, and in a context in which, I mean, obviously the integrity of the markets are a very important thing for this country. And you’re asking us essentially to change the rules in a way that threatens that integrity.¹⁸⁶

Justice Stephen Breyer was also hostile to the *Newman* approach. He supported the “gift” rationale articulated in *Dirks*: “[W]hy are the statute books

182. *Id.*

183. QUINN, *supra* note 145.

184. See Peter J. Henning, *The Supreme Court Plays Goldilocks on Insider Trading*, N.Y. TIMES (Oct. 6, 2016), http://www.nytimes.com/2016/10/07/business/dealbook/the-supreme-court-plays-goldilocks-on-insider-trading.html?_r=0 [http://perma.cc/9TAW-BSEH]; Amy Howe, *Argument Analysis: The “Friends and Family” Solution for Insider Trading*, SCOTUSBLOG (Oct. 5, 2016, 5:03 PM), <http://www.scotusblog.com/2016/10/argument-analysis-the-friends-and-family-solution-for-insider-trading/> [http://perma.cc/S6BB-24KG].

185. Henning, *supra* note 184.

186. Transcript of Oral Argument at 21, *Salman v. U.S.*, 580 U. S. ____ (2016), https://www.supremecourt.gov/oral_arguments/argument_transcripts/2016/15-628_p86a.pdf [http://perma.cc/XU3N-D3VD].

filled with instances where the public wants to know, not just how you might benefit, but how your family might benefit? . . . Because they think very often, though it depends on families, *to help a close family member is like helping yourself.*¹⁸⁷

In its decision, the Court indeed abandoned *Newman*'s rationale and reverted to *Dirks*'s gift theory "which easily resolve[d] the narrow issue" presented in the *Salman* case.¹⁸⁸ Justice Samuel Alito authored the opinion for a unanimous Court.¹⁸⁹ "Our discussion of gift giving resolves this case . . . *Dirks* makes clear that a tipper breaches a fiduciary duty by making a gift of confidential information to 'a trading relative,' and that rule is sufficient to resolve the case at hand."¹⁹⁰ Most importantly, the Court expressly overturned *Newman*'s heightened personal benefit requirement: "To the extent the Second Circuit held that the tipper 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*."¹⁹¹

Justice Alito could have used *Salman* to propound a thorough insider trading doctrine, particularly by identifying and clarifying instances in which an insider personally benefits from disclosing confidential information; instead, the Court exercised judicial restraint, deciding only the very narrow issue it faced. Near the end of the opinion, the Court acknowledged that "[d]etermining whether an insider personally benefits from a particular disclosure, a question of fact, will not always be easy for courts."¹⁹² The Court, however, "punted" the opportunity to clarify and advance the personal benefit requirement. "[T]here 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."¹⁹³

Therefore, the Supreme Court rightfully used *Salman* to correct the Second Circuit's error in *Newman* and reinstate *Dirks* as the clear standard for the personal benefit requirement.

2. Perhaps Congress Should Weigh In

Although the Supreme Court laudably overturned *Newman*'s strict personal benefit requirement, difficult questions of whether an insider personally benefits from a disclosure will undoubtedly arise in the future. The

187. *Id.* at 8 (emphasis added).

188. *Salman v. United States*, No. 15-628, slip op. at 10, 580 U.S. ____ (2016).

189. *Id.* at 1.

190. *Id.* at 9.

191. *Id.* at 10 (citation omitted).

192. *Id.* at 11.

193. *Salman*, slip op. at 11-12.

Court could have—but unfortunately didn’t—provided clarification of the vague personal benefit standard.

Because Congress has forever shirked its duty in this area of law, perhaps it is time for legislators to statutorily define and incriminate insider trading. When introducing the Stop Illegal Insider Trading Act to the Senate, Senator Jack Reed summed up the problem that has been created by the common law: “The need for this legislation is long overdue because, in the absence of a statutory definition, an inconsistent and complicated body of common law has developed as the courts have used varying interpretations of anti-fraud statutes in order to decide insider trading cases.”¹⁹⁴ Even Judge Barrington Parker of the Second Circuit Court of Appeals noted during *Newman*’s oral argument that “the government’s position on key points of the law seems to vary based depending on which judge you’re talking to.”¹⁹⁵ Professor Thomas Lee Hazen from the University of North Carolina School of Law summarized the effect of congressional inaction best: “[V]irtually everyone is now in agreement that we’d be a lot better off if Congress would simply bite the bullet and define [insider trading] . . . the situation is a mess. That’s how you end up with cases like *Newman*.”¹⁹⁶

Thus, leaving insider trading doctrine to common law led to confusion and uncertainty. Despite the Supreme Court’s recent rebuke of *Newman*, it may be time for Congress to provide certainty by fashioning a clear definition and prohibition of “insider trading”—one that endorses *Dirks*’s gift theory as reaffirmed in *Salman*. Although it may be mere political grandstanding, the reader should watch for legislative response to recent years of insider trading confusion.

CONCLUSION

The Second Circuit erred by creating a stricter personal benefit requirement and tippee knowledge requirement for insider trading cases. *Newman* heightened the personal benefit test to a required showing of quid pro quo or at least “an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature.”¹⁹⁷ Furthermore, for a tippee to be liable, *Newman* required showing a tippee had knowledge of the insider’s personal benefit from the disclosure.

The case directly conflicts with the Supreme Court in *Dirks* by collapsing the carefully fashioned two-prong personal benefit test into a mere quid pro quo requirement. The strict tippee knowledge requirement does not comport with reality because details of the insider’s personal benefit do not get passed

194. 161 CONG. REC. S1440 (daily ed. Mar. 11, 2015) (statement of Sen. Reed).

195. *Id.*

196. *Id.*

197. U.S. v. *Newman*, 773 F.3d 438, 452 (2d Cir. 2014).

down the tippee chain. Thus, tippee liability is impossible to prosecute for all practicable purposes. *Newman* furthermore sets perverse policy incentives by undermining fundamental fairness and eroding public confidence in the securities markets. Finally, the landmark decision wreaked havoc on insider trading investigations and prosecutions during the two years it served as controlling precedent in the Second Circuit. Preet Bharara was forced to drop charges in the high-profile SAC Capital insider trading scheme as a result of *Newman*, and the Department of Justice abandoned many other investigations.

Recently in *Salman*, the Ninth Circuit split from *Newman*, and the Supreme Court granted certiorari to resolve the befuddled state of insider trading law. On December 6, 2016, the Court unanimously overturned *Newman*'s personal benefit test and endorsed *Dirks*'s gift theory as controlling law. Although the Court correctly decided *Salman* and took the important first step of abrogating *Newman*, it refused to elaborate on the personal benefit standard or address more difficult personal benefit cases. Meanwhile, criminal defendants face significant prison time because of the common law's vagueness. *Salman* is the correct first step; now Congress should consider promulgating a clear insider trading doctrine.

For all the reasons stated in this case note, the Second Circuit erred in *United States v. Newman*. The Supreme Court of the United States rightfully used *United States v. Salman* to correct the error by overturning *Newman* and reaffirming *Dirks*. Perhaps it is time for Congress to statutorily define and incriminate the elusive area of law known as "insider trading."

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