No. 14-3599

**IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT**

MATHEW MARTOMA,

Defendant-Appellant

v.

UNITED STATES OF AMERICA,

Plaintiff-Appellee.

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 THE NATIONAL ASSOCIATION OF CRIMINAL DEFENSE LAWYERS AS *AMICI CURIAE* IN SUPPORT OF DEFENDANT-APPELLANT'S PETITION FOR REHEARING OR REHEARING *EN BANC*

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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 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.[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 nationwide professional association for public defenders and private criminal

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[1] Pursuant to Rule 29.1 of this 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 preparing or submitting this brief; and (3) apart from *amici* and their counsel, no other person contributed money to fund preparing or submitting this brief.

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 filed by Defendant-Appellant Mathew Martoma. As discussed below, the panel's decision improperly overrules prior Circuit precedent and represents a dramatic expansion of insider trading liability, far beyond the scope authorized by 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 of particular concern to *amici* because it creates further uncertainty in the law of insider trading, raises serious due process concerns, and makes it extraordinarily difficult for *amici*'s members to properly advise or defend their clients in insider trading investigations. The panel's decision effectively eliminates personal benefit to the tipper as an independent requirement for insider trading liability, and makes it a jury issue in every case whether the disclosure can properly be viewed as a gift of inside information, regardless of the relationship between the parties. The result is 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.

INTRODUCTION AND SUMMARY OF ARGUMENT

Insider trading law in the United States is almost entirely a creation of judicial decisions, built on the slim foundation of the basic antifraud provision of Section 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b). The absence of clear statutory standards imposes a special obligation on the judiciary to proceed cautiously in expanding insider trading liability, because substantial issues of fairness and due process can arise from case-by-case establishment of criminal standards.

Rather than exercise caution, the panel's decision represents a bold and unwarranted expansion of insider trading law. Rehearing is warranted here for at least three reasons. First, the panel improperly exceeded its authority by overruling the "meaningfully close personal relationship" standard of *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014). Despite the panel's strained arguments, there is nothing in the Supreme Court's narrow decision in *Salman* which calls into question *Newman*'s personal relationship standard. The panel's decision simply reflects its disagreement with *Newman* – but that is not an appropriate basis for a panel to overrule Circuit precedent.

Second, the panel's decision is inconsistent with *Dirks* and *Salman*. It takes all the substance out of *Dirks*' "personal benefit" requirement, by holding that an insider who discloses material non-public information with the expectation of trading *always* has an "imputed" personal benefit (Op. 31), regardless of the relationship of the parties or whether the tipper really expected any benefit from his disclosure. It reads out of *Dirks* and *Salman* the important limitation that there is a "gift" of confidential information sufficient to constitute a personal benefit only where the recipient is a "trading relative or friend." And it disregards the reasoning behind *Dirks*, which recognized the importance of market analysts in ferreting out material information and set the tipper's breach of fiduciary duty and personal benefit as the boundary between lawful and unlawful trading.

Third, the panel's decision greatly expands the scope of criminal liability for insider trading, when fundamental constitutional principles require restraint. Respect for due process principles means that courts should not judicially expand the scope of insider trading liability, in the absence of congressional guidance, to the unfair detriment of the defendant before the Court when it announces a new and expanded rule of substantive criminal law.

ARGUMENT

I. THE PANEL IMROPERLY OVERRULED BINDING CIRCUIT PRECEDENT.

"It is a longstanding rule of our Circuit that a three-judge panel is bound by a prior panel's decision until it is overruled either by this Court sitting *en banc* or by the Supreme Court." *Doscher v. Sea Port Grp. Sec., LLC*, 832 F.3d 372, 378 (2d Cir. 2016). However, unless a panel employs the Court's "mini-*en banc*" procedure, a panel may overrule Circuit precedent only "where an intervening Supreme Court decision casts doubt on the prior ruling." *Id.* (citation omitted).

The panel relied on this exception to justify its decision to overrule *Newman's* "meaningfully close personal relationship" requirement (Op. 23-24), but nothing in *Salman* "cast doubt" on this aspect of *Newman*. *Salman* merely reaffirmed *Dirks* and held that *Dirks* "easily resolve[d] the narrow issue presented." 137 S. Ct. at 427. While the Court rejected *Newman*'s separate requirement that the tipper must receive something of "pecuniary or similarly valuable nature," *id*. at 428, the Court was careful to disapprove *Newman* only "[t]o the extent" it required this showing, *id*., and expressed no view on any other aspect of *Newman*. *See United States v. Bray*, 853 F.3d 18, 26 n.5 (1st Cir. 2017) ("*Salman* did not . . . discuss the Second Circuit's 'meaningfully close personal relationship' language" and therefore "does not foreclose Bray's argument."). Indeed, as Judge Pooler pointed out (Dissent 17-18), the Government in *Salman* specifically argued that "a gift of confidential information to anyone, not just a 'trading relative or friend,' is enough to prove securities fraud," 137 S. Ct. at 426 – precisely the argument adopted by the panel here – but the Supreme Court chose not to adopt that argument.

It is telling that the panel is unable to point to anything in *Salman* which provides any real support for its holding.[2] Instead, the panel repeatedly argues that the "logic of *Salman*" somehow undermined *Newman's* "meaningfully close personal relationship" requirement. Op. 3-4, 19-20, 25, 28. But there is no new "logic" in *Salman* that wasn't already in *Dirks* and considered by the panel in *Newman.* The panel's opinion merely reflects its disagreement with *Newman* rather than anything in *Salman*. *See, e.g.*, Op. 22-23 (criticizing *Newman*'s interpretation of *Dirks*), *id.* at 25 (relying on "the straightforward logic of the gift-giving analysis in *Dirks*"), *id.* at 30-31 (criticizing *Newman*'s understanding of the nature of the required "personal benefit"). If the Court believes that *Newman* was wrongly decided, the time to address that was on the Government's petition for rehearing in *Newman* – or on Appellant's petition for rehearing now. It is

[2] The panel relied heavily on a single quotation from *Salman*, where the Court referred to the disclosure of information as a gift without specifically mentioning the limitation to a "trading relative or friend." *See, e.g.*, Op. 25, 27. But this quotation is taken out of context from the *Salman* Court's quotation of *Dirks* in a parenthetical, and does not reflect any intention to broaden the scope of the Court's otherwise narrow decision.

impermissible, however, for a panel to overrule such an important, and unimpaired, precedent.

II. THE PANEL'S RULING IS INCONSISTENT WITH *DIRKS* AND *SALMAN*, AND UNDERCUTS 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 "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.[3]

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[3] *See also SEC v. Monarch Fund*, 608 F.2d 938, 942-43 (2d Cir. 1979) (reversing judgment against investment advisor who had obtained confidential

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 panel's decision eviscerates the "personal benefit" requirement, eliminates its utility as the line between lawful and unlawful trading, and deprives it of any real meaning. The panel holds that an insider gets an imputed "personal benefit" whenever he or she discloses material non-public information to someone expected to trade on it, whether or not there is any meaningful relationship between them. Op. 27-28. The majority rejects Judge Pooler's claim in dissent that this means that a tipper *always* gets a "personal benefit," emphasizing (in italics) that its rule only applies "to someone *he expects to trade on the information*." Op. 28. But this is no limitation at all. This would obviously be true of *any* disclosure to a trader or other market professional. And the Court's ruling in *Dirks* was specifically intended to *protect* such market professionals (and

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information, because "all reasonable investors seek to obtain as much information as they can" and district court's reasoning "would mean that all investors, brokers and investment advisers . . . act at their peril.")

the efficiency of the markets) by insuring that they *would* be able to trade, without risk of liability, absent knowledge that the tipper was obtaining a personal benefit from his disclosure. The Court in *Dirks* was talking about a *real* personal benefit, not a personal benefit "imputed" to the tipper (Op. 31) by operation of law.

Dirks recognized that there could be such a real personal benefit 'when an insider makes a gift of confidential information to a trading relative or friend," 463 U.S. at 664, but this theory cannot be extended to any disclosure of confidential information, regardless of the relationship between the parties, without undermining its purpose and utility. The *Newman* Court's "meaningfully close personal relationship" standard was intended to draw the line beyond which it no longer made sense to construe a disclosure of confidential information as a gift from which the tipper received a personal benefit. The panel's holding that any disclosure of confidential information should be construed as providing a personal benefit if the tippee is expected to trade on it ignores the reasoning of *Dirks*, and eliminates "personal benefit" – and thus "breach of fiduciary duty" – as a meaningful line between legality and illegality.

The panel also added that there is liability only when the tip and trade "resembles trading by the insider followed by a gift of the profits to the recipient." Op. 28 (quoting *Salman* and *Dirks*). But the Court in *Dirks* and *Salman* used this reasoning merely to explain why a gift to a relative or friend could be viewed as a benefit to the tipper. It is a post-hoc characterization of the facts to justify the conclusion that there has been a personal benefit. It provides no additional factual element on which a jury could be instructed to determine whether or not there has been a personal benefit arising from a gift of confidential information. *Any* disclosure of material non-public information followed by trading "resemble[s]" trading by the insider followed by a cash gift.

Recognizing the breadth of its holding, the panel repeatedly placed its confidence in the ability of a jury to determine whether information was disclosed with the "expectation" of trading, "what to infer about the tipper's purpose from his relationship with the tippee," or whether the situation "resembles" trading by the insider followed by a gift to the tippee. *See* Op. 28-29 & n.8, 29-30. But delegating the personal benefit issue to the jury without any meaningful legal standard provides no protection at all, and imposes no restraint on the ability of an aggressive prosecutor to indict whenever there has been a disclosure followed by trading.

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

Despite repeated calls for enactment of an insider trading statute,[4] the scope of liability for insider trading in the United States has been developed entirely through judicial decisions. This case-by-case adjudication raises profound issues of fairness and due process. 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 preclude the panel's expansive new interpretation of insider trading law. It is 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

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[4] *See*, *e.g.*, Hon. Paul A. Engelmayer, "Congress: U.S. Needs an Insider Trading Law," N.Y.L.J (Oct. 23, 2015), available at http://www.newyorklawjournal.com/id=1202740459962.

trading has changed substantially several times since. The instructions provided to the jury here are incorrect under either *Newman* or *Salman*, and the jury was never asked to apply the standard the panel now proposes. Due process demands that the Court apply *Dirks* and *Salman* narrowly, and not broaden insider trading liability beyond the situation at the time of the alleged crime. By expanding *Dirks*, the Court 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. "Liberty finds no refuge in a jurisprudence of doubt." *Planned Parenthood v. Casey*, 505 U.S. 833 (1992).

CONCLUSION

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

Dated: October 13, 2017

Respectfully submitted,

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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 2,598 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: October 13, 2017

/s/ Ira M. Feinberg