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Martoma and *Newman*: Valid Corporate Purpose and the Personal Benefit Test

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MARTOMA AND *NEWMAN*: VALID CORPORATE PURPOSE AND THE PERSONAL BENEFIT TEST

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ABSTRACT

The law of insider trading in the United States is fundamentally grounded on a theory of property rights in information. Those to whom property rights in information have been allocated may trade without violating the prohibitions on trading contained in § 10(b) of the Securities Exchange Act. Similarly, those who use material, nonpublic information for a valid corporate purpose have not violated the law. On the other hand, those who pilfer for personal gain material inside information belonging to a corporation do so at their legal peril. Those with property rights in inside information may authorize others to trade on the basis of that information as long as doing so is consistent with a valid corporate purpose.

The personal benefit test should be viewed as a mechanism for determining when a tipper has acted with a valid corporate purpose or other legitimate objective when providing a tip. Approaching insider trading cases by focusing on whether a corporate insider/tipper had a valid corporate purpose for providing at tip harkens back to the important insight into SEC Rule 10b-5 made in SEC v. Texas Gulf Sulphur, *which is that "the essence of the Rule is that anyone who, trading for his own account in the securities of a corporation has "access, directly or indirectly, to information intended to be available only for a corporate purpose and not for the personal benefit of anyone" may not take "advantage of such information knowing it is unavailable to those with whom he is dealing."*[1] *By parity of reasoning, trading—and tipping—done in furtherance of a valid corporate purpose rather than in furtherance of a venal personal gain, should be permitted.*

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1. SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 848 (2d Cir. 1968) (en banc).

I. INTRODUCTION

THE world of insider trading law entered a new era of doctrinal confusion in the summer of 2017 when a panel of the United States Court of Appeals for the Second Circuit issued a split eighty-one page opinion in *United States v. Martoma*[2] in which the circuit took the unusual step of purporting to overrule another recent Second Circuit opinion, *United States. v. Newman*.[3] Both cases struggled with the question of whether a professional trader for a hedge fund could be found guilty of illegal insider trading for trading on a tip of material, non-public information that originated with a "tipper" who worked in the company to which the material, nonpublic information pertained. In *Newman*, the court held that a person inside a company who is the source of a tip of insider information (the tipper) must receive a consequential "personal benefit . . . that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature"[4] for the person who ultimately receives that information and trades on it to be guilty of insider trading. Rejecting that approach, the court in *Martoma* held that any time a corporate insider discloses material, nonpublic information with the expectation that the person receiving such information (the tippee) will actually trade on it, the person trading on it is guilty of insider trading.

In both *Newman* and *Martoma*, the panels purported to apply the law of insider trading articulated in *Dirks v. SEC*.[5] In that seminal case, the U.S. Supreme Court opined that a tippee could not be convicted of insider trading unless the tipper received a personal benefit. Specifically, in *Dirks*, the U.S. Supreme Court held that a corporate insider who receives material, nonpublic information from a corporate insider/tipper and then trades on the information can also be held liable under § 10(b) and Rule 10b-5, but "only when the insider has breached his fiduciary duty to the shareholders by disclosing the information to the tippee and the tippee knows or should know that there has been a breach."[6] The test for whether there has been a breach of a fiduciary duty or other duty of loyalty and confidentiality "is whether the [tipper] personally will benefit, directly or indirectly, from his disclosure" to the tippee.[7]

2. 869 F.3d 58 (2d Cir. 2017).
3. 773 F.3d 438 (2d Cir. 2014).
4. *Id.* at 452.
5. 463 U.S. 646 (1983).
6. *Id.* at 660.
7. *Id.* at 662.

In this essay I argue that if one keeps the first principles underlying insider trading law in mind, the doctrinal confusion in the Second Circuit can be resolved. In particular, the personal benefit test should be viewed as a mechanism for determining when a tipper has acted with a valid corporate purpose or other legitimate objective when providing a tip. An approach to insider trading cases involving tipping that focuses on whether a corporate insider/tipper had a valid corporate purpose for providing a tip harkens back to the important insight *SEC v. Texas Gulf Sulphur Co.* made into SEC Rule 10b-5, which is that

> [t]he essence of the Rule is that anyone who, trading for his own account in the securities of a corporation has "access, directly or indirectly, to information intended to be available only for a corporate purpose and not for the personal benefit of anyone" may not take "advantage of such information knowing it is unavailable to those with whom he is dealing."[8]

Building on the insight that material, nonpublic information can be used for a valid corporate purpose, this essay urges that courts recognize a distinction between legitimate tipping, which serves a valid corporate purpose, and illegitimate tipping, which does not. In this essay I argue that the Second Circuit panel in *Newman* grasped the critical distinction between legitimate corporate tipping and illegitimate corporate disclosure, and that the panel in *Martoma* created analytical confusion because it did not grasp this distinction.

In my view, the *Newman* panel was right to reverse the convictions of the trading defendants, because the tipping in that case may well have been motivated by a valid corporate purpose. Moreover, in this essay I identify the following three flaws in the reasoning of the *Martoma* opinion that led me to reject its conclusion that the personal benefit requirement in *Dirks* is satisfied anytime a tipper passes along information to a tippee:

> (1) The tipper in *Dirks*, Ronald Secrist, had every "expectation" that Raymond Dirks would trade on the basis of his tip, and yet the Court in *Dirks* did not think that tipping with such an expectation of trading would satisfy its personal benefit test. For this reason alone, the *Martoma* personal benefit test seems suspect.
> (2) The result in *Martoma* was meant to apply to fact patterns like those in *Dirks* and *Newman*, where corporate insiders/tippers supply information to professional stock market analysts. The Second Circuit panel in *Martoma* ignores the fact that information flows from insiders to analysts are specifically endorsed in *Dirks*.
> (3) The tipping in *Newman*, which was done with the expectation that the tippees would trade on the basis of the information provided by the tippers, may have served the valid corporate purpose of improving the quality of the secondary markets on which the tippers' companies shares traded.

8. 401 F.2d 833, 848 (2d Cir. 1968).

II. VALID CORPORATE PURPOSES AND AUTHORIZED AND UNAUTHORIZED TRADING

The question of whether and how to trade or otherwise utilize material inside information is, from a corporation's perspective, a matter of business judgment. The information belongs to the corporation that is the source of the information, and as such, "[a] company's confidential information . . . qualifies as property to which the company has a right of exclusive use."[9] The reason that trading on the basis of material inside information is generally illegal is that it is "the fraudulent appropriation to one's own use of the money or goods entrusted to one's care by another."[10]

An important, albeit highly controversial, insight into the implications of the business property theory of insider trading is buried in footnote nine of *O'Hagan*, which contains a profound vision of how material, nonpublic information is to be allocated within a firm and is well worth quoting in its entirety:

> [T]he textual requirement of deception precludes § 10(b) liability when a person trading on the basis of nonpublic information has disclosed his trading plans to, or obtained authorization from, the principal—even though such conduct may affect the securities markets in the same manner as the conduct reached by the misappropriation theory. Contrary to Justice [Thomas'] suggestion, see *post*, at 689–691, the fact that § 10(b) is only a partial antidote to the problems it was designed to alleviate does not call into question its prohibition of conduct that falls within its textual proscription. Moreover, once a disloyal agent discloses his imminent breach of duty, his principal may seek appropriate equitable relief under state law. Furthermore, in the context of a tender offer, the principal who authorizes an agent's trading on confidential information may, in the Commission's view, incur liability for an Exchange Act violation under Rule 14e–3(a).[11]

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9. United States v. O'Hagan, 521 U.S. 642, 654 (1997) (quoting Carpenter v. United States, 484 U.S. 19, 25–27 (1987)).

10. *Id.* (quoting *Carpenter*, 484 U.S. at 27).

11. *Id.* at 659 n.9. SEC Rule 14e-3(a) provides that:

> (a) If any person has taken a substantial step or steps to commence, or has commenced, a tender offer (the "offering person"), it shall constitute a fraudulent, deceptive or manipulative act or practice within the meaning of § 14(e) of the Act for any other person who is in possession of material information relating to such tender offer which information he knows or has reason to know is nonpublic and which he knows or has reason to know has been acquired directly or indirectly from: (1) The offering person; (2) The issuer of the securities sought or to be sought by such tender offer; or (3) Any officer, director, partner or employee or any other person acting on behalf of the offering person or such issuer, to purchase or sell or cause to be purchased or sold any of such securities or any securities convertible into or exchangeable for any such securities or any option or right to obtain or to dispose of any of the foregoing securities, unless within a reasonable time prior to any purchase or sale such information and its source are publicly disclosed by press release or otherwise.

17 C.F.R. § 240.14e-3(a) (2017).

In this footnote, the *O'Hagan* Court indicates that an insider who has obtained authorization from her principal (i.e. the source and owner of the information) is free to trade on that information without legal restriction because there has been no theft or other abuse of the property rights of the rightful owner of the information. Just as the owner of the information has the right to use the information that it owns, so too does the owner have the power to allocate the use of the information to somebody else.

Understanding the rather straightforward, but critical, point made explicit in footnote nine of *O'Hagan*—that owners of information are free to allocate trading rights in such information—will go a long way towards clarifying the apparent confusion about tippee liability in insider trading law. Simply put, and as described below, where a tipper is providing material nonpublic information to a tippee for a valid business purpose, and gives the tippee authorization to trade, the reasoning in *O'Hagan* and the explicit language in footnote nine of that opinion clarify that there is no tippee liability for violating the insider trading laws.

The Court's decision in *O'Hagan* makes clear that the theory can be used not only to prohibit such trading, but also to license and enable such trading. A second and almost entirely ignored insight from *O'Hagan* is that in situations where a company *knows* that an insider is going to be trading on the basis of material, nonpublic information, then trading on the basis of such information does not violate § 10(b) of the Exchange Act of 1934, because there is no deception, and deception is a necessary element of the crime of insider trading under the statute.

III. VALID CORPORATE PURPOSES AND THE PERSONAL BENEFIT TEST

To this point, this Article has identified the theoretical foundation of insider trading law as both grounded in and motivated by a theory of property rights. Material, nonpublic information can legally be used in trading by the corporation that owns the property rights in the information. It may also be used by tippees who have received nonpublic information from his or her corporate owner and then trade with the permission of either that owner or an agent of the owner . But material, nonpublic information may not be used by anyone other than the owners of that information or their sanctioned licensees.

The property rights perspective on insider trading jurisprudence can be used to shed light on the role of the personal benefit test first espoused in *Dirks v. SEC*. As I have argued previously, the Court established the personal benefit test "as the tool to distinguish wrongful insider trading that should be outlawed from insider trading that is rightful because it reveals fraud or makes markets more efficient."[12] Here, I argue that the personal

12. Jonathan R. Macey, *The Genius of the Personal Benefit Test*, 69 STAN. L. REV. ONLINE 64, 67 (2016).

benefit test also facilitates the task of determining which tips of material inside information are consistent with a valid corporate purpose and which are not.

The personal benefit test addresses the problem of agency costs, which generally speaking are the costs to investors and other owners/principals that arise when the people acting on their behalf, who are known as "agents," use organizational resources for their own benefit rather than for the benefit of the owners.[13] Because the corporations that own material, nonpublic information are inanimate, they can only act through agents, such as corporate officers and directors. These agents are supposed to make decisions and take actions on behalf of the corporation, and are bound by fiduciary duties to do so. But they sometimes act on their own behalves rather than on behalf of their principals, the shareholders.

Thus, an elemental problem facing corporations and their shareholders is how to control the actions of their agents. One way that agency costs within a corporation manifest themselves is by the misuse of material, nonpublic information. Insider trading law plays an important role in mitigating the agency costs within public companies that manifest themselves in the form of illicit trading on the basis of material, nonpublic information. And this is where the personal benefit test developed in *Dirks* comes into play.

The problem that *Dirks* attempts to solve emanates from the fact that some, but not all, instances of trading on the basis of material, nonpublic information reflect agency costs. Trading that lacks a valid corporate purpose and is inconsistent with the best interests of the company reflect agency costs. Significantly, however, not all trading on the basis of material, nonpublic information is harmful to the corporation that is the owner/source of such information. Sometimes corporations may legitimately want trading on the basis of material insider information.

In particular, corporations and their shareholders have a strong interest in ensuring that their shares trade efficiently. A company's stock trades in efficient markets when share prices reflect all publicly available information.[14] Efficient capital markets are important from a societal perspective because if markets are inefficient, then capital will not be allocated to its most efficient, highest valuing users, and the economy will generally suffer as high value projects are ignored and low value projects are funded due to capital market mispricing. In addition, if securities markets are inefficient and stocks are mispriced, then capital markets will be unable to perform their important role of disciplining poorly-performing manag-

13. *See* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 308 (1976) (formally defining agency costs as the sum of the costs of monitoring and bonding a set of contracts among agents with conflicting interests, plus the residual loss incurred because the cost of full enforcement of contracts exceeds the benefits).

14. *See* RICHARD A. BREALEY ET AL., PRINCIPLES OF CORPORATE FINANCE 214 (9th ed. 2008).

ers and rewarding highly-performing managers. In other words, standard tools of corporate governance, such as incentive-based compensation tied to share price performance, will not work if the stock markets in which such shares trade are inefficient.

Moving from a macro-perspective to a micro-perspective, investors benefit significantly when the shares they own trade efficiently. Efficiency in this context means that share prices reflect all relevant information about a company's prospects. Where share prices trade efficiently, the share price serves as a highly valuable source of information about how their investment is performing. In efficient capital markets, poorly performing managers will be appropriately disciplined through the market for corporate control, and high-performing managers will be properly compensated for the value they add to the enterprise.

Perhaps the most important ways that markets become efficient is through the activities of professional traders, such as stock market analysts.[15] As Ron Gilson and Reinier Kraakman observed in an important article on stock market efficiency, stock market analysts have a profound effect on share prices.[16] These analysts constitute that "the dominant minority of informed traders is the community of market professionals, such as arbitrageurs, researchers, brokers and portfolio managers, who devote their careers to acquiring information and ho[n]ing evaluative skills."[17]

Achieving efficient capital markets is a worthwhile goal from both a capital market perspective and from the perspective of individual companies. Because corporate insiders, by definition, have more information about companies than outsiders, corporate insiders are a valuable source of information about firms. Significantly, professional securities analysts rated issuer-analyst relations programs and, in particular, personal conversations with managers as their most valuable source of firm-specific information.[18] Thus, interactions between stock market analysts and corporate insiders can serve the important goal of causing stock market prices to become more efficient.

For these very reasons, the U.S. Supreme Court has explicitly endorsed the important role that stock market analysts play in preserving healthy capital markets. In particular, the Court has made it clear that imposing restrictions on trading by those in possession of material, nonpublic information should be done only sparingly, because such restrictions:

> could have an inhibiting influence on the role of market analysts, which the SEC itself recognizes is necessary to the preservation of a

15. *See* Comm. on Interstate and Foreign Commerce, 95th Cong., Rep. of the Advisory Committee on Corporate Disclosure to the SEC 11–14, 66–68, 621, 644–47 (Comm. Print 1977) [hereinafter Corporate Disclosure Report]; Ronald J. Gilson & Reinier H. Kraakman, *The Mechanism of Market Efficiency*, 70 Va. L. Rev. 549, 569–72 (1984).

16. *See* Gilson & Kraakman, *supra* note 15, at 571.

17. *Id.*

18. Corporate Disclosure Report, *supra* note 15, at 67, *cited with approval in* Gilson & Kraakman, *supra* note 15, at 569 n.63.

> healthy market. It is commonplace for analysts to 'ferret out and analyze information,' . . . and this often is done by meeting with and questioning corporate officers and others who are insiders. And information that the analysts obtain normally may be the basis for judgments as to the market worth of a corporation's securities. The analyst's judgment in this respect is made available in market letters or otherwise to clients of the firm. It is the nature of this type of information, and indeed of the markets themselves, that such information cannot be made simultaneously available to all of the corporation's stockholders or the public generally.[19]

Once we recognize the tension between the agency cost problem within the corporation and the important role that securities analysts play in the capital markets, we can easily see the dilemma that the U.S. Supreme Court has faced in its insider trading cases involving tippees. On the one hand, an insider's tip of material, nonpublic information sometimes will be a manifestation of agency costs within the firm. This of course will be the case when an insider tips a close friend or relative, or when an insider receives a payment from a tippee in exchange for revealing some material, nonpublic information. As explored above, such tipping can impose substantial costs on the corporation by raising the costs of valuable corporate initiatives, such as mergers and acquisitions. On the other hand, at other times, an insider's tip of material, nonpublic information will be consistent with a valid corporate purpose, such as making the market for the stock of the underlying company more efficient.

The utility of the personal benefit test is that it provides a practical and effective mechanism for distinguishing appropriate tips that the U.S. Supreme Court has expressed a desire to encourage from inappropriate tips that reflect agency costs. Where a corporate insider receives no pecuniary or non-pecuniary personal benefit from providing a tip, then it stands to reason that the tip was made for some valid corporate purpose. On the other hand, where a corporate insider receives such a personal benefit from tipping, then one reasonably can infer a nefarious purpose.

Thus, the only reason that the personal benefit test exists in the first place is to distinguish "good" tipping—i.e., tipping that is done to further some valid corporate purpose—from "bad" tipping—i.e., tipping that benefits an insider/tipper at the expense of the firm and reflects agency costs. Significantly, then, if there were no such thing as good tipping, there would be no reason for the personal benefit test.

In sum, the purpose of the personal benefit test is to provide a mechanism for courts to determine whether, under a particular set of facts, a tip is consistent with the tipper's fiduciary duties, and thus consistent with the law (good tipping), or whether the insider's "tip" constituted a breach of the insider's fiduciary duty (bad tipping).

Under current law, liability for trading on the basis of a tip from an insider depends largely on whether the tipper receives something as a

19. Dirks v. SEC, 463 U.S. 646, 658–59 (citations omitted).

result of the disclosure. Absent an improper purpose for a tip, as evidenced by the receipt of a personal benefit, there is no breach of duty to the corporation/source of the information. Absent a breach of such a duty by the insider, there is no derivative breach by the tipper and no insider trading liability.[20]

IV. THE CURRENT CONFUSION

The above analysis provides a basis for evaluating the rival approaches to tippee liability for insider trading in the recent Second Circuit split between the panels deciding *United States v. Newman* and *United States v. Martoma*. Stated succinctly, the analysis here suggests that while the holding in *Martoma* is undoubtedly correct, the reasoning in *Martoma* is deeply problematic. Further, the reasoning in *Newman* is mildly problematic for the following two reasons.

First, the holding in *Martoma* is inconsistent with the Court's analysis in *Dirks* because *Martoma* imposes insider trading liability in tipper cases anytime a tipper has an expectation that the tippee will trade on the basis of the tip. The *Martoma* court appears to ignore the fact that the insider/tipper in *Dirks* (Ronald Secrist) knew that his tippee (Raymond Dirks) was going to trade on the basis of that information, either directly or indirectly. As such, the U.S. Supreme Court in *Dirks* rejected liability on the very theory of liability espoused by the Second Circuit panel in *Martoma*, which held that a tipper is liable for insider trading merely for receiving a tip from somebody who expects that the tipper will trade on the basis of the tip.

A second and even more fundamental flaw in the reasoning in *Martoma* is that, unlike its sister case, *Newman*, the Second Circuit in *Martoma* ignores the critical distinction in insider trading cases between tipping that is done for a valid corporate purpose and tipping that is done merely to benefit the tipper at the expense of the corporation, whose interests she is ostensibly serving.

A. *Martoma*, *Dirks*, and the "Expectation of Trading" Test

Matthew Martoma was convicted for trading in the stock of two pharmaceutical companies, Élan Corporation, plc (Elan) and Wyeth. These companies were jointly developing an experimental drug called bapineuzumab to treat Alzheimer's disease. Martoma worked as a portfolio manager at S.A.C. Capital Advisors, LLC (SAC), a hedge fund owned and managed by Steven A. Cohen. At SAC, Martoma managed an investment portfolio with buying power between $400 and $500 million that was focused on pharmaceutical and healthcare companies.

Martoma's tipper was Dr. Sidney Gilman, a chaired professor at the University of Michigan Medical School and chair of the safety monitoring

20. *See id.* at 664 (holding that a violation of the law occurs "when an insider makes a gift of confidential information to a trading relative or friend").

committee that was established by Elan and Wyeth to monitor the bapineuzumab clinical trial. While serving as chair of the safety monitoring committee, Dr. Gilman Gerson was matched with Martoma through the Lehrman Group, which is an expert network firm whose business model involves earning fees by connecting hedge fund investors with experts in various fields who receive fees from the hedge funds for providing the hedge funds with the benefits of their expertise.[21]

Dr. Gilman participated in approximately forty-three consultations with Martoma at the rate of around $1,000 per hour.[22] On July 19, 2008, Dr. Gilman showed Martoma a PowerPoint presentation that presented empirical results of various trials evaluating the efficacy of bapineuzumab in clinical settings. Martoma spoke with the Steven Cohen, the owner of SAC, on the following day, Sunday, July, 20, 2008. On the next trading day, Monday, July 21, 2008, SAC began to sell its shares in Elan and Wyeth securities and also began entering into short sale and options trades that would be profitable if Elan's and Wyeth's stocks fell.[23]

About a week later, on July 29, 2008, Dr. Gilman publicly presented the results from the bapineuzumab trial at a conference on Alzheimer's disease that he previously shared with Martoma. Elan's share price began to decline immediately, even before Dr. Gilman had finished making his presentation.[24] By the close of trading the next day, the share prices of Elan's and Wyeth's stocks had declined by about 42% and 12%, respectively.[25] The court found that the trades that Martoma and Cohen made in advance of the announcement resulted in approximately $80.3 million in gains and $194.6 million in averted losses for SAC.[26] Martoma personally received a $9 million bonus based in large part on his trading activity in Elan and Wyeth.[27]

Martoma was an easy case. As the panel observed, in the context of the ongoing "relationship of *quid pro quo*" between Gilman and Martoma, where Dr. Gilman regularly disclosed confidential information in exchange for fees, "'a rational trier of fact could have found the essential elements of the crime [of insider trading] beyond a reasonable doubt' under a pecuniary *quid pro quo* theory."[28]

What is novel about the decision in *Martoma* is that it interprets the *Dirks* personal benefit test in a new and aggressive way. Specifically, the Second Circuit in *Martoma* held that a tip of information to anybody, even a total stranger, would satisfy the *Dirks* personal benefit test as long as the tipping insider anticipated that the recipient of the information

21. *See* Andrew Ross Sorkin, *Knowledge Is Money, but the Peril Is Obvious*, N.Y. TIMES: DEALBOOK (Nov. 26, 2012, 9:32 PM), https://dealbook.nytimes.com/2012/11/26/knowledge-is-money-but-the-peril-is-obvious [https://perma.cc/2HXT-BTZ5].
22. United States v. Martoma, 869 F.3d 58, 66 (2d Cir. 2017).
23. *Id.* at 62.
24. *Id.*
25. *Id.*
26. *Id.*
27. *Id.*
28. *Id.* at 67 (alteration in original) (citations omitted).

would trade on it. In the court's words, "we hold that an insider or tipper personally benefits from a disclosure of inside information whenever the information was disclosed 'with the expectation that [the recipient] would trade on it,'" regardless of whether there was a "'meaningfully close personal relationship' between the tipper and tippee."[29]

The Second Circuit reasoned in *Martoma* that the *Dirks* personal benefit test was satisfied by Dr. Gilman's tip to Martoma because Gilman expected that Martoma would trade on the basis of his tip about the drug trials. Strangely, however, the *Martoma* panel never explained the basis for its key assumption, that Dr. Gilman expected Martoma to trade on the basis of his tip about the drug trials.

For example, there was no evidence presented that Gilman asked Martoma if he planned to trade on the basis of the information. There was also no evidence that Martoma told Gilman that he planned to trade on the basis of the information. Oddly, the *Martoma* court simply seems to assume that Gilman expected Martoma to trade on the basis of the information provided.

The lack of analysis of how the court's new "expectation of trading" test was met is especially odd considering the fact that the decision followed immediately on the heels of the U.S. Supreme Court's decision in *Salman v. United States*.[30] The Second Circuit in *Martoma* makes much of the fact that the Court in *Salman* found that there was a disclosure made by one brother to another brother "with the expectation that he would trade on it."[31] Unlike *Martoma*, in *Salman*, there was a sound factual basis for the conclusion that the tipper had an expectation of trading.

The insider trading issues in *Salman* arose in 2002, when one brother, Maher Kara, joined Citigroup's healthcare investment banking group and began discussing certain aspects of his work with his older brother, Mathew Kara. At trial, Maher Kara testified that he shared inside information with his brother to benefit him, with the expectation that his brother would trade on it. Maher testified that he disclosed the information to Michael to "help him" and to "fulfil[l] whatever needs he had."[32] The record goes onto include a finding that while Maher regretted tipping his brother, he expected his brother to trade anyway.[33]

In contrast, in *Martoma*, the evidence that there was an expectation that Martoma would trade on the tips provided by Dr. Gilman appears to be derived from the fact that Martoma was a market professional who managed a large portfolio of securities. This seems like an obvious and logical assumption to make. What is left unexplored by the *Martoma* court, however, is that like Matthew Martoma, the tippee in *Dirks* (Raymond Dirks) was also a market professional. In other words, there was

29. *Id.* at 70.
30. 137 S. Ct. 420 (2016).
31. *Martoma*, 869 F.3d at 65 (citing *Salman*, 137 S. Ct. at 428).
32. *Salman*, 137 S. Ct. at 424.
33. *Id.*

just as much reason to expect that Raymond Dirks would trade (or induce others to trade) on the basis of the tips provided to him by his tipper as there was to expect that Matthew Martoma would trade. Dirks, after all, was known to be "an officer of a New York broker-dealer firm who specialized in providing investment analysis of insurance company securities to institutional investors."[34] Dirks "openly discussed the information he had obtained [from Ronald Secrist, his tipper] with a number of clients and investors. Some of these persons sold their holdings of Equity Funding securities, including five investment advisers who liquidated holdings of more than $16 million."[35]

Thus, there is at least as much justification for concluding that trading would follow the tipper's tip in *Dirks* as for concluding that trading would follow the tipper's tip in *Martoma*. In fact, in direct contradiction to the Second Circuit's reasoning in *Martoma*, the U.S. Supreme Court in *Dirks* appears to condone the idea that analysts can facilitate trading on the basis of the tips that they receive from insiders. Specifically, as noted above, Justice Powell writing in *Dirks* approved of efforts by analysts to "'ferret out and analyze information' . . . by meeting with and questioning corporate officers and others who are insiders."[36]

Further, the information that the analysts obtain from insiders "normally may be the basis for judgments as to the market worth of a corporation's securities,"[37] and is "made available in market letters or otherwise to clients of the firm"[38] who, of course, are expected to trade. After all, there is no other reason for them to receive such information. Thus, the formulation in *Martoma* that the personal benefit test of *Dirks* is satisfied when an insider/tipper provides information to an analyst or other market professional with the expectation that the analyst will trade on that information is certainly erroneous, as it is inconsistent with the fact that in *Dirks*, the Court specifically condoned the very tipping where there was an expectation of trading, which the Second Circuit condemned in *Martoma*.

Thus, the portion of *Martoma* that holds the personal benefit test is satisfied when information is gratuitously provided to a stranger whenever there is an expectation that the information will be used to trade in securities seems clearly wrong in light of the fact that this is precisely what happened in *Dirks* itself.

B. *Martoma*, *Newman*, *Dirks* and the Search for a Valid Corporate Purpose

Within the framework of this Article, an important question in insider trading cases involving tippers and tippees relates to the motivation for

34. Dirks v. SEC, 463 U.S. 646, 648 (1983).
35. *Id.* at 649.
36. *Id.* at 658 (citations omitted).
37. *Id.* at 658–59.
38. *Id.* at 659.

such tipping. As argued above, tipping may be motivated for benign reasons, such as a desire to ferret out fraud (*Dirks*), or it may be motivated for venal reasons, such as avarice. The role of the personal benefit test is that it provides a workable test for distinguishing benign tipping from venal tipping.

In *Martoma*, the tipping was done by a researcher conducting clinical trials on behalf of two pharmaceutical companies. Because it is impossible to imagine a valid corporate purpose that might have been served by Gilman's tipping, it is safe to conclude that there was no valid corporate purpose served by his tipping in that case.

Among the things that make *United States v. Newman* such an interesting case is that there is a strong argument to be made that a valid corporate purpose was served by the tipping in that case. In *Newman*, financial analysts at various hedge funds and investment firms obtained material, nonpublic information from employees of publicly traded technology companies. After obtaining the information, the analysts shared it among each other and subsequently passed this information to the portfolio managers at their respective companies.

Newman is a profoundly important insider trading case, far more important than *Salman* or *Martoma*, because unlike *Salman and Martoma*, *Newman* presents the issue of insider trading liability in the context of a fact pattern in which the motivations of the tippers are worth exploring. Like the tippers in *Chiarella* and *O'Hagan*, the tippers in *Salman* and *Martoma* had venal, self-serving motivations for tipping. No coherent argument can be made that the tips provided by these tippers served any legitimate corporate purpose.

In contrast, the motivations of the tippers in *Newman* are harder to discern. The tippers in *Newman* were Rob Ray of Dell's investor relations department—who tipped information regarding Dell's consolidated earnings numbers—and Chris Choi of NVIDIA's finance unit. They were acquaintances, but not close friends, of the analysts to whom their tips were made.

It seems clear that the motivations of these tippers should be a paramount focus in any insider trading inquiry. By way of illustration, if we imagine that tippers Ray or Choi were providing information about an ongoing fraud at Dell or NVIDIA, then the reasoning in *Dirks* would appear to apply directly such that, given the absence of any meaningful pecuniary benefit for the tips, there would be no insider trading liability associated with tipping or trading under these circumstances.

But the reasoning in *Dirks* is not limited to situations in which the tipping and subsequent trading occur in the context of a fraud along the lines of what occurred at Equity Funding in the *Dirks* case. Rather, as long as tipping is done (a) without receipt of a personal benefit and (b) in furtherance of a valid corporate purpose, then trading on the basis of such a tip should not be actionable. In particular, as noted above,[39] tipping to attract greater analyst coverage or to improve the accuracy (efficiency) of the capital markets' price setting mechanisms are valid corporate purposes that have been explicitly recognized by the Court in *Dirks* as providing justifications for tipping to market professionals who will be expected to engage in trading on the basis of such material, nonpublic information.

V. CONCLUSION

The point of this article is to show that the law of insider trading in the United States is fundamentally grounded on a theory of property rights in information. Those to whom property rights in information have been allocated may trade without violating the prohibitions on trading contained in § 10(b) of the Securities Exchange Act. Those, like Chiarella and O'Hagan, and Salman and Martoma, who pilfer material inside information belonging to a corporation, do so at their own legal peril.

Those with property rights in inside information may authorize others to trade on the basis of that information so long as doing so is consistent with a valid corporate purpose.

39. *See supra* text accompanying notes 14–19.