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THE EVER-CHANGING SCOPE OF INSIDER TRADING LIABILITY FOR TIPPEES IN THE SECOND CIRCUIT

Sari Rosenfeld*

ABSTRACT

Liability under insider trading law continues to change as federal courts attempt to find new ways to hold insiders liable under the law. As recently as two years ago, the Second Circuit—in analyzing past decisions regarding tipper-tippee insider trading violations—blurred the distinction between legal and illegal insider trading when it fundamentally altered the idea of "personal benefit." These various decisions provide the basis for antifraud provisions of securities law applying to insider trading, the consequences of which can be detrimental. This Note will discuss the standard that the Second Circuit uses to hold tippees liable for insider trading violations under the Exchange Act Rule 10b-5. It will begin by exploring a line of cases that lead up to Second Circuit’s decision to alter the personal benefit test, which shifted more responsibility than ever onto the tipper’s state of mind. This Note will analyze that test and discuss the implications and problems that come with it. These include a greater likelihood that tippees will engage in deceptive behavior to extract material, non-public information from tippers. They also increase the potential that more parties caught in the middle of these situations will receive hefty prison sentences. Following that analysis, this Note will suggest an alternative approach—qualifying the personal benefit test to make it depend on more objective factors than it currently does. It will then discuss the court’s decision to amend and supersede its initial holding and replace it with a test which did not have a substantive impact on the outcome. It will ultimately conclude that the same test should apply.

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I. INSIDER TRADING LIABILITY FOR TIPPERS AND TIPPEES

Insider trading occurs when an insider accesses material, non-public information, then uses that information to buy or sell a security, where the information provides a certain profit. If the scheme involves two people, the person who receives the information is referred to as the “tippee,” and the person from whom the tippee receives the information, the “tipper.” Over time, case law has interpreted the antifraud provision of the Securities Exchange Act to restrict market players from distributing this information and from using it—specifically applying this to the tipper and tippee relationship. It has done this because both using and distributing the information allows people to have an unfair advantage in trading. This conduct violates Rule 10b-5 of the Exchange Act, which is the general catch-all antifraud provision, promulgated by the Securities and Exchange Commission (SEC). Rule 10b-5, which does not explicitly refer to insider trading, provides that:

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5. See Miller et al., supra note 2.
It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.7

Rule 10b-5 is more widely used by private plaintiffs than any other anti-fraud provision of federal securities law.8 Interestingly enough, the rule itself does not provide an explicit cause of action for these private plaintiffs. But in 1946, a federal district court recognized an implied cause of action.9 Ever since, private plaintiffs can sue for insider trading violations, along with other fraudulent behavior, including tippee liability.

Insider trading violations under Rule 10b-5 provide judges the ability to sentence offenders to harsh consequences. According to the SEC, the maximum penalty a defendant can receive for violating insider trading law is 20 years in prison, the maximum individual fine is $5,000,000, and the maximum fine for non-natural persons, such as an entity whose securities are traded in the public markets is $25,000,00010—all situations that are worth avoiding.

A. Duty to Disclose or Abstain from Trading

In 1961, the SEC decided that to avoid insider trading liability, a tipper must abstain from trading in the shares of his own corporation, unless he first discloses all material information that he knows to the market.11 Just seven years later, the Second Circuit took this rule and applied it to people beyond directors and corporations—broadening the scope of those who could be held liable for insider trading violations.12 In that case, Texas Gulf Sulphur Co, the Court states the following:

“[A]n individual in possession of material inside information must either disclose it to the investing public, or, if he is disabled from disclosing it in order to protect a corpo-
rate confidence, or he chooses not to do so, must abstain from trading in or recommend-  

ing the securities concerned while such inside information remains undisclosed.”

B. Classical and Misappropriation Theories

Insider trading law evolved into two theories: the Classical Theory and the  

Misappropriation Theory. Under the Classical Theory, an individual violates  

insider trading law by trading securities (without disclosure) based on material,  

non-public information. That insider can be held liable by trading in the  

shares of his own company for a profit. The Classical Theory also applies to a  

temporary insider, who can be held liable by trading for profit on information  

gained while he was in a fiduciary relationship with the issuer. Misappropria-

tion Theory applies when the insider misappropriates confidential information  

for trading purposes, in a breach of duty to the source of information. This is  

what differentiates it from the Classical Theory, where the insider has instead  

deceived shareholders.

Although these theories do have fundamental differences, the elements of  

tipping liability are ultimately the same under both. And many courts have  

recognized that the idea of personal benefit, a critical factor in determining a  

tippee’s liability for insider trading, can apply under both theories.

C. Receiving Information

In 1983, the Supreme Court held that tippees could also be found liable for  

insider trading violations under the Classical Theory when the tippee receives  

material nonpublic information and trades on it. But the Court limited this  

liability: under Dirks, the tippee could only be held liable in situations where  

the tipper breached his fiduciary duty to the shareholders by disclosing the  

information to the tippee. And in this situation, the tippee either must know, or  

should have known, that there was a breach. Dirks therefore found that the  

tippee’s duty is derivative.

13. Id.
15. Id.
16. Id.
18. The personal benefit test is discussed infra pg. 6.
21. Id. at 663.
22. Id. at 660.
D. The Personal Benefit Test

Whether there is a derivative breach will depend on whether the tipper benefited either directly or indirectly from this disclosure—something that came to be known as the personal benefit test.23 According to the Court, either a pecuniary gain or a reputational benefit counts as a direct or indirect personal benefit if it translates into future earnings.24 Alternatively, the tipper can benefit from gifting information to a relative or a friend.25 Absent this personal gain, there is no breach to the shareholders,26 and by extension, there is no derivative breach.27

To put a complicated rule into context, the following occurred in Dirks: Dirks specialized in providing investment analyses for insurance companies.28 While employed, he received insider information from a former officer of an insurance company that, because of fraudulent corporate practices, the insurance company was overstating its assets.29 Dirks did not trade in the insurance company’s stock. After he received the information, he decided to investigate the matter.30 Throughout his investigation of the company, Dirks discussed the information he learned with clients and investors, and some of these acted on this information.31 The Court found that the tipper who gave Dirks the information had no monetary or personal benefit from giving him the information,32 and therefore did not breach a duty to their shareholders.33 Rather, the Court attributed the insider’s motivation as exposing fraud.34 Because Dirks had no derivative breach, he had no duty to abstain and was therefore not guilty of violating Rule 10b-5 for insider trading.35

II. THE SECOND CIRCUIT AND SUPREME COURT ATTEMPTS TO CHANGE THE PERSONAL BENEFIT TEST.

The Dirks decision left courts confused about the personal benefit test.36 Dirks itself provided neither a definition nor concrete guidance on what person-
al benefit really means, but satisfaction of the personal benefits test was necessary to find the tippee liable. All it did was give several examples of what a personal benefit might be as general guidelines for applying the test.

In 2014 the Second Circuit in light of the Dirks decision, provided its own conclusion on what it means to personally benefit in the Newman case. The court held that personal benefit requires a “meaningfully close personal relationship that generates an exchange that is objective, consequential, and represents at least a potential gain of pecuniary or similarly valuable nature.” The court in Newman emphasized the idea that although the gain need not be immediately pecuniary, it must “be of some consequence.” Its analysis suggests that somehow, the tipper must gain something, either as money or through a relationship with another that will lead to opportunities to profit. According to the court, this potential comes from this close relationship between the tipper and tippee.

A. The Supreme Court Expands the Personal Benefit Test.

Three years ago, however, the Supreme Court expanded its test for insider trader liability when it held that the tipper’s benefit received need not be pecuniary at all. The tipper can instead “personally benefit” without receiving a monetary interest. Salman v. United States involved an insider who shared information from his job as an investment banker with his brother, who began to trade on the information. Although he was not initially aware of his brother’s activities, the insider later actively assisted the brother in his trades. Without the insider’s knowledge, the brother shared this insider information with others, including the insider’s brother-in-law, Salman, who traded on the information and received a huge windfall.

37. See Dirks, 463 U.S. at 663.
38. Id. at 663–64 (“[T]his requires courts to focus on objective criteria, i.e., whether the insider receives a direct or indirect personal benefit from the disclosure, such as a pecuniary gain or a reputational benefit that will translate into future earnings.”).
40. Newman, 773 F.3d at 452.
41. Id. at 453.
42. Id. at 452.
43. See Salman, 137 S. Ct. at 422.
44. Id. at 424.
45. Id.
46. Id.
47. Id. (“By the time the authorities caught on, Salman had made over $1.5 million in profits that he split with another relative who executed trades via a brokerage account on Salman’s behalf.”).
The Supreme Court decided that when a tipper discloses inside information to a tippee, the Court will treat the situation as if the tipper gave the tippee a cash gift. This rule applies to tipping family members and friends. Gifting information to a family member or friend is therefore insider trading because the tipper still benefits from this gift. As the majority opinion explained, “the tipper benefits personally because giving a gift of trading information is the same thing as trading by the tipper followed by a gift of the proceeds.” There is therefore no need for a true, monetary interest because, according to the court, the tipper already got its equivalent.

The Court did not define how close a relationship must be between the tipper and the tippee for its new rule to apply. From acquaintances to friends to close friends, anyone could in theory be a tipper under the Court’s vague language.

B. Under the Second Circuit, Tipping is Now a Personal Benefit.

The Second Circuit tried to answer the question of how close a tipper must be to a tippee for insider trading liability to apply when a three-judge panel heard Mathew Martoma’s appeal in August 2017. In this case, United States v. Martoma, the Second Circuit originally said that a meaningfully close relationship is not necessary and explicitly overruled Newman. But in June 2018, the Second Circuit revisited its own decision and superseded it—once again adding to the confusion. However, before discussing how the Second Circuit has continued to convolute the personal benefit test—not once, but twice—it is important to understand the facts of the case and how they come into play.

The defendant, Mathew Martoma, managed a portfolio for a hedge fund run by prominent investor Steven Cohen. Martoma invested in two pharmaceutical companies that were developing drugs for Alzheimer’s; he advised Cohen to do the same for the hedge fund’s main portfolio. Soon thereafter, Martoma consulted with a knowledgeable doctor who was working on the clinical trial

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48. Id. at 428.
49. Id.
50. Id.; Levine, supra note 39.
51. Salman, 137 S. Ct. at 428.
52. See id.
54. 869 F.3d at 70.
55. See United States v. Martoma, 894 F.3d 64 (2d Cir. 2018).
56. Martoma, 869 F.3d at 61.
57. Id.
58. Id.
for the Alzheimer’s drug. This doctor, Dr. Gilman, charged him $1,000 per hour, and Martoma consulted him on forty-three different occasions. Gilman, as a member of the safety monitoring committee, “had an obligation to keep the results of the clinical trial confidential.” He broke that confidence when he provided Martoma with extensive information about the clinical trial. Martoma did not just consult with Dr. Gilman though. He also engaged Dr. Joel Ross, another doctor working on the trial. That doctor charged him even more money than Dr. Gilman did. Dr. Ross was similarly obligated to keep the information confidential.

In July 2008, Martoma and Gilman met to discuss data on the drug. After their meeting, Martoma no longer believed that the stocks were profitable. He quickly contacted Mr. Cohen and convinced him to sell his position in these companies. Between Martoma and Cohen, the hedge fund avoided $194 million in losses by selling stocks before trial results were revealed to the public; in fact, by short-selling the shares, the fund made an $80.3 million profit. Martoma received a $9 million bonus for his trading activity. His “predictions” were correct.

Martoma was convicted for insider trading violations and subsequently appealed. On his appeal, he challenged that, under the language in Newman, he and Dr. Gilman did not have what constituted a “meaningfully close personal relationship.” Martoma also argued that Dr. Gilman did not receive any gain that was pecuniary or similarly valuable in nature because of Mr. Martoma’s trading. The Court uniquely responded to this appeal—it interpreted the Salman court’s interpretation of Newman, and ultimately overruled Newman. This is important because it reflects the first time that a federal circuit court has interpreted Salman. The Second Circuit came to the following conclusion: the

59. Id.
60. Id.
61. Id.
62. Id.
63. Id. at 62.
64. See id. at 61–62.
65. Id. at 62.
66. Id.
67. See id.
68. Id.
70. Martoma, 869 F.3d at 62.
71. Id. at 63.
72. Id. at 64.
73. Id. at 64–65.
74. McGinnis et al., supra note 1, at 1.
Salman Court already overruled the Newman court’s requirement of a close personal relationship. 75  This was no longer good law. 76  Chief Judge Katzmann explained that it is possible to benefit from a tipper-tippee relationship, outside of a meaningfully close relationship. 77

The Second Circuit came up with two requirements: (1) for a tippee to be liable, the tipper must have disclosed the information to the tippee with the expectation that the tippee would trade on the information, 78 and (2) the disclosure must also result in a “gift of the profits to the recipient.” 79 And, as stated above, this expectation did not take into account the strength of the tipper-tippee relationship.

C. The Problematic Nature of the Original Martoma Test

The original personal benefit test that Martoma set out before it superseded its own decision was problematic because of the expectation prong. Absent the requirement of a meaningfully close relationship, the bar to meet the personal benefit requirement for tippee liability was—at that point—much lower. This would make it much easier to prosecute individuals, but that was not the problem with the test. Whether it is appropriate to lower the bar for tippee liability is of course, subject to debate. What was problematic with that test, though, was attempting to understand how the court was trying to define expectation.

The standard itself was unclear. This is because that test—had it survived—would have led to consequences for some tippees, while other tippees who deceive tippers into feeding them information might walk away from a situation with zero liability for insider trading violations, without a meaningful distinction between the tippees. It is important to note that the court explained the following with regards to the first prong: the holding reaches only the insider who discloses inside information to someone he expects will trade on the information. 80 In other words, if the tipper were to accidentally leak information to the tippee but never thought that the tippee would actively trade on this information, then there would be no personal benefit under Martoma, and the tippee could not have been liable for insider trading.

The main problem with the expectation standard set out in this case is that it was a vague concept, and the court neglected to define better what it means. What is even more confusing, is that under this test, there could have been endless possibilities regarding expectation, and the court did not elaborate on any of...
them. It instead alluded to the fact that personal benefit is a factual inquiry, leaving room for the lower courts to interpret what it means.\(^81\) The subjectivity of the test as a whole was dangerous.

The expectation standard might have instead led to the unequal treatment of tippees, even when they behave in the same way, because their liability ultimately depends on the tippee’s beliefs. For example, there may be a hypothetical situation, involving Tipper A, who is an employee of the same technology company as Tipper B. Tipper A accidentally leaks information to Close Friend. And Tipper A did not, in any way, and under any (potential) test, expect that Close Friend will trade on the information. Close Friend then trades and profits on that information. Meanwhile, Tipper B discloses confidential information to Another Close Friend—perhaps carelessly—and has a small inkling that Another Close Friend might trade on the information. Another Close Friend, like Close Friend, trades on the information and receives a windfall.

According to the initial *Martoma* decision, Another Close Friend would have been liable for insider trading violation while Close Friend is not. Why should two people, who behaved identically and used their knowledge to trade in the markets, end up in entirely different situations? In both cases, the tippee gained an unfair advantage over the market, and used that advantage to profit over the unaware market.

An initial read of the Second Circuit decision—before the court superseded its own decision—led me to formulate several alternative tests that could better define the expectation standard. The first approach I considered was a modified subjective expectation test. It is true that the original test was already subjective in the sense that expectation could be measured in a multitude of ways. To overcome this hurdle, this test would have to lay out particular examples that would consider the tipper’s knowledge about the tippee’s overall sophistication as a purchaser and knowledge of the market. In theory, it sounds like a good test. But it would be too complicated.

For example, in a hypothetical world, we have Tipper A, who works for a technology company that went public. For some reason, Tipper A believes that the company is about to enter a period of financial hardship—although there is no concrete evidence of this in the securities market. Tipper A then tells all of this to Close Friend while the two have a cup of coffee. Perhaps the law should require Tipper A to only expect that Close Friend will then trade on the information if Tipper A knows that Close Friend is familiar enough with the securities market to understand that this might be a good opportunity to sell shares. But requiring Tipper A to know how much that Close Friend knows about the securities market would be problematic. This is because both policing such a situation and finding good evidence would be challenging. A rule like this would make more sense than the previous scenario if the goal of insider trading law is to prohibit sophisticated tippees from abusing the system. The issue is that knowing something about the tippee suggests that the two have a previous-

\(^81\) *Dirks*, 463 U.S. at 664.
ly existing relationship, perhaps even a close relationship. And according to the
original Martoma decision, that factor is legally irrelevant.

But there is an even larger issue behind all of this—the tippee could easily
deceive the tipper into thinking the tippee does not know anything about the
market. For example, the tippee might put on a confused face, sit back, listen,
pretend he or she does not understand what is going on, and then use the infor-
mation to his or her advantage. In that case, the tippee would get away with the
conduct because the tipper did not hold the expectation. And this would defeat
the purpose of the original rule altogether. After all, subsection (c) of Rule 10b-
5 says that it is unlawful to "engage in any act, practice, or course of business
which operates or would operate as a fraud or deceit upon any person." 82 A rule
like that would do exactly the opposite—inducing more deceitful behavior by
tippees to avoid 10b-5 liability.

Courts could, therefore, take a different approach and create an objective
expectation test. That test would instead ask what the tipper would reasonably
expect to occur in a situation like this. But that test would also be problematic
because it would be implying ordinary negligence—and because insider trading
is a crime, this would be an unusual standard to use. The test would, therefore,
need to specifically require criminal negligence to determine what a reasonable
expectation would be.

Perhaps the best idea would be to hold the act of tipping the information it-
self to be enough. The tipper, by giving out information, should expect that an-
yone he gives the information to will trade on that information. This would
solve the problems of dealing with different levels of sophistication. This test
would also solve the fairness problem—all tippees would be equally liable. A
test like this, however, would be far too extreme because it would require tipp-
ers to constantly monitor their behavior to the point where they do not speak at
all. It would also essentially create a strict liability situation, which means that
there would be no room for error when it comes to leaking out information,
even if done by accident.

For example, we might have a situation where Tipper A is completely dis-
traught about the situation and calls Close Friend to vent his frustrations. Is it
fair to require Tipper A to assume that Close Friend will trade on the infor-
mation? This would certainly deter Tipper A from tipping the information in
general, but that would require Tipper A to be overly cautious in any kind of
these situations, and that might burden the market’s overall efficiency. 83 Al-
though this Note does not argue that insider trading is valuable, it is important to
note that arguments for allowing insider trading can help us understand why
communication, in general, cannot be cut off altogether. Some people believe
that insider trading allows more information—other than what is publicly dis-

82. 17 C.F.R. § 240. 10b-5.
closed—to be reflected in a security’s price. 84 As a result, this makes the price more accurate. 85 A better test for insider trading should take into account the need for active communication regarding the security. The communication should just be executed in a manner that is fair for all market participants. The test should, therefore, encourage informed traders to participate in the market—allowing people to talk to some extent.

Of the three options presented, option 2 is the best test for determining how to hold tippees liable under insider trading law. Given my own interpretation of the court’s goals, along with the fact that liability only reaches the tippee following the tipper’s expectation, focusing on how to narrow the expectation standard so that insider trading law targets the right people seemed like the best solution. And that solution would be reached through objective criteria. The best way to do this would be to place a reasonableness qualifier on expectation. The results would be better: it would shift the focus from the tipper’s belief on this individual tippee to what the tipper would reasonably expect the tippee to do with the information, based on society’s general expectation and standards. And it would be harder for tippees to get away with deceptive behavior. This is because the tipper could have suspected that the insider would trade before the tippee ever traded. Such an improved test would set guidelines for the kind of care that tippers should take in determining who to speak to, if anyone at all, when it comes to material, non-public information, and provide the tipper with advance notice of the kind of behavior that would lead to liability.

III. THE SECOND CIRCUIT FURTHER CONFUSES THE PERSONAL BENEFIT TEST’S LANGUAGE

A. From Expectation to Intention

Not long after providing its confusing interpretation of insider trading, the Second Circuit edited its opinion in Martoma and superseded it. It appears, however, that the amended test presents exactly the same issues that made Martoma confusing in the first place.

B. The Amended Decision

Martoma II, as amended, removed the expectation test as the primary means for interpreting personal benefit. 86 Instead, the court explained that there is no need to decide if Newman’s gloss on gift theory is inconsistent with Salman because there are many ways to find a personal benefit. 87

84. Id.
85. Id.
86. See generally Martoma, 869 F.3d at 58, amended by 894 F.3d 64 (2d Cir. 2018).
87. Martoma, 869 F.3d at 71.
Subsequently, the court explains its decision by reapplying the logic in *Dirks*.\(^8^8\) The court interpreted *Dirks* as allowing for many ways to gain a personal benefit.\(^8^9\) And this interpretation, according to the majority, is rooted in intention.\(^9^0\) According to the majority, the key area of disagreement between its holding and the dissent is whether intention requires a relationship as its foundation.\(^9^1\) The majority believes that the relationship is necessary, while the dissent does not.\(^9^2\)

The reason the court chooses to analyze this is because the language in *Dirks* can be read to suggest both that a relationship is a specific requirement and a lack thereof.\(^9^3\) The court in *Martoma II* decided to read that sentence in a way that separated intention from a close personal relationship.\(^9^4\) And the reason that the Second Circuit did this was to show that as long as the tipper wants the tippee to trade on the information, it should not matter whether they had some sort of pre-existing relationship.\(^9^5\) What is important, instead, is the outcome.\(^9^6\)

C. Distinguishing Expectation from Intent to Benefit

While *Martoma II* does not rely upon expectation in its opinion,\(^9^7\) its slight change in language does not seem to make any difference. *Martoma II* narrows the *Martoma I* decision in finding it unnecessary to determine if Newman's the-

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88. *Id.* at 74.
89. *See id.*
90. *Id.*
91. *Id.*
92. *Id.*
93. *Dirks v. S.E.C.* 463 U.S. 646, 664 (1983) (using the following language to explain 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.”).
94. *See Martoma*, 894 F.3d at 74.
95. *See id.*
96. *See id.* at 75 (“For example, suppose a tipper discloses inside information to a perfect stranger and says, in effect, you can make a lot of money by trading on this. Under the dissent’s approach, this plain evidence that the tipper intended to benefit the tippee would be insufficient to show a breach of the tipper’s fiduciary duty to the firm due to the lack of a personal relationship. *Dirks* and *Warde* do not demand such a result. Rather, the statement ‘you can make a lot of money by trading on this,’ following the disclosure of material non-public information, suggests an intention to benefit the tippee in breach of the insider’s fiduciary duty.”); *See also id.* (“The tipper’s intention to benefit the tippee proves a breach of fiduciary duty because it demonstrates that the tipper improperly used inside information for personal ends and thus lacked a legitimate corporate purpose. That is precisely what, under *Dirks*, the personal benefit element is designed to test. *See Dirks*, 463 U.S. at 662. Is evidence that an insider intended to benefit an outsider with valuable confidential information any less probative of the absence of a legitimate corporate purpose than evidence that the tippee gave the tipper trivialities like shellfish and a gift card? *See United States v. Jiao*, 734 F.3d 147, 153 (2d Cir. 2013)).
97. *See generally id.*
ory was inconsistent with the *Salman* decision. Yet, the two versions of the decisions put us back in the same place, and with the same problem.

Both decisions still acknowledge the idea that a court can find a personal benefit without a meaningfully close relationship. Some sources have interpreted the amended decision as opening the door to more prosecutions of tippees for insider trading. And if the goal of the courts is to hold these tippees liable, then this interpretation makes sense. Courts are placing an emphasis on the tipper’s awareness of how the tippee might benefit from the tip because it could deter tippers from improperly tipping. At the same time, the amended decision in no way erases the same problem discussed earlier in this Note—that is, if you are to view the original expectation test and intent test the same way I do.

In fact, I do not see any difference between the concepts of expectation and intent. Both are prefaced on the tipper’s prediction of how the tippee will use the information. It would only make sense that if a tipper “intends” for someone to benefit from a tip, there must be an expectation that the person will use the information and trade on it. Otherwise the tippee just sits on the information and nothing changes from the status quo.

**D. As a Result, the New Test Does Not Rid Itself of its Problematic Nature**

Additionally, the test’s lack of specificity still makes it too subjective. Due to a lack of a reasonableness qualifier, the new test can still allow a tippee to get away with using deceptive behavior to encourage the tipper to give away information. The majority opinion in *Martoma II* even seems to acknowledge this flaw to some extent because it tries to rebut the test’s inherent subjectivity. Despite its attempt, the test remains subjective.

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99. See id.

100. *Martoma*, 894 F.3d at 76 (“Finally, we are warned that this approach creates a ‘subjective’ test and allows for convictions based on sheer speculation into the tipper’s motives. See Dissent, op. at 83–84, 88. These fears are unwarranted. Intent elements are everywhere in our law and are generally proved with circumstantial evidence. See, e.g., United States v. Heras, 609 F.3d 101, 106 (2d Cir. 2010) (‘The law has long recognized that criminal intent may be proved by circumstantial evidence alone.’); United States v. Salameh, 152 F.3d 88, 143 (2d Cir. 1998) (‘[A]s a general rule most evidence of intent is circumstantial.’). Insider trading is no different. A factfinder may infer the tipper intended to benefit the tippee from the sort of objective evidence that is commonly offered in insider trading cases. To return to the example above, the statement ‘you can make a lot of money by trading on this’ is strong circumstantial evidence of the tipper’s intention to benefit the tippee. And the requirement of proof beyond a reasonable doubt remains a formidable barrier to convictions resting on speculation. See United States v. Torres, 604 F.3d 58, 66 (2d Cir. 2010). We are thus satisfied that the personal benefit element can be met by evidence that the tipper’s disclosure of inside information was intended to benefit the tippee. And as is clear from the purpose of the personal benefit element, the ‘broad definition of personal benefit set forth in *Dirks,*’ and the variety of benefits we have upheld, the evidentiary ‘bar is not a high one.’ *Obus*, 693 F.3d at 292.”).
Just like with the old test, the addition of a reasonableness qualifier could solve a lot of problems and ultimately hold responsible parties liable. As a result, the test would then read that the tipper might “reasonably intend that the tippee will benefit from the tip.” Measuring the tipper’s behavior against the reasonable person would make it harder for tippers to get away with behavior that results in massive windfalls for the tippee, simply because the tipper did not “intend” the benefit. This would place the tipper on notice to disclose information legally and to be cautious about speaking—to the extent necessary.

IV. CONCLUSION

The Second Circuit’s expansion of the personal benefit test is a clear attempt to make it easier for courts to prosecute tippees for insider trading violations. This move signifies the court’s distaste for insider trading, and goal to prevent those with an insider advantage from strategically obtaining millions of dollars in windfalls. The Second Circuit, however, has failed to acknowledge that tippees may abuse the test through deception. Replacing the current test with an objective intent test would help protect against that kind of behavior.