American University Law Review

Volume 67 | Issue 2 Article 12

2018

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Keywords
Political intelligence industry, lobbyists, Stock Act, Dirks personal gain test, Federal Securities Law, insider trading, Government employees fiduciary duties

WHY *SALMAN* IS A GAME-CHANGER FOR THE POLITICAL INTELLIGENCE INDUSTRY

KENDALL R. PAULEY*

For decades, the political intelligence (PI) industry—an expert network of lobbyists and lawyers residing in Washington, D.C.—leveraged their personal connections to extract information from the government and then sell it to securities traders who could convert this insider-knowledge into substantial profits. This practice has evaded liability by exploiting two requirements for tipper-tippee liability: a lack of fiduciary duty owed by government employees and an absence of a pecuniary exchange between government sources and the PI operative. However, this Comment argues that now, the STOCK Act and Salman *places the PI industry back within the scope of securities prohibitions.*

Although using analytics to inform investment decisions is a legal and essential component to the functioning of our financial markets, the analyzed information cannot be material, nonpublic information gathered in breach of a fiduciary duty. The PI industry claims to only gather and analyze publicly available information; however, it is clear from market data and government investigations that PI operatives utilize their personal connections and relationships to extract trading tips from government employees.

This practice may have been legally permissible in the past, but the combination of the STOCK Act and Salman *now places some PI gathering technique in jeopardy. First, the STOCK Act explicitly imputed a fiduciary duty*

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to government employees. Second, the Supreme Court's recent decision in Salman v. United States*—rejecting the "pecuniary or similarly valuable nature" exchange requirement from the* Dirks *personal gain test—impacts the PI industry.* Salman *reaffirmed* Dirks *in that the personal gain requirement could be satisfied by only the personal relationship between a tipper and a tippee, such as a friendship.*

This Comment analyzes the current state of the personal gain requirement after Salman *and applies that analysis to likely scenarios confronting a PI operative. This Comment argues that, after the STOCK Act and* Salman*, some PI practices likely violate securities laws. Consequently, PI firms ought to evaluate their information gathering techniques, and hedge funds that consume PI should adopt new compliance procedures.*

TABLE OF CONTENTS

INTRODUCTION

On November 15, 2005, USG Corp.'s shares experienced a two hundred percent increase in trading and a five percent surge in value—an unheard of growth in the usual day-to-day of Wall Street.[1] Yet oddly, USG, a building material supplier, had not released new financial information or public statements into the marketplace that day, which is the usual cause of high increases or decreases in trading.[2] If it is not the usual cause, a random flurry of excessive trading is typically a telltale sign of corporate insiders exploiting business information for their own personal gain; however, this time, the information emanated not from the boardroom but from Capitol Hill.

The day after the surge in trading, it became clear that the information had emerged from private discussions regarding a potential congressional bill when Senate Majority Leader Bill Frist (R-TN) promised a Senate vote on a bill that would create a public trust fund for asbestos liability claims.[3] Such a fund had the potential to eliminate USG's exposure to more than $3 billion of liability claims.[4] Although Frist claimed that an investigation yielded no evidence of any illicit communications by his staff, political intelligence (PI) operatives[5]—whose job is to collect information from government officials to then sell for profit—somehow extracted the material, nonpublic information and sold it to their clientele, hedge funds.[6] Those clients quickly capitalized on the information, precipitating the increase in the trading volume and reaping significant profits.[7]

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1. Brody Mullins & Kara Scannell, *Hedge Funds Hire Lobbyists to Gather Tips in Washington*, WALL ST. J. (Dec. 8, 2006, 12:01 AM), https://www.wsj.com/articles/SB116554698892944296. A stock listed on the S&P 500 during 2012 had a normal daily volatility of 0.7%. *See* Morgan Housel, *Is Today's Market More Volatile than in the Past?*, MOTLEY FOOL (Feb. 22, 2016, 10:34 AM), https://www.fool.com/investing/general/2016/02/22/is-todays-market-more-volatile-than-in-the-past.aspx.

2. Eamon Javers, *Washington Whispers to Wall Street*, BLOOMBERG BUSINESSWEEK, Dec. 26, 2005, at 42.

3. Mullins & Scannell, *supra* note 1.

4. Assoc. Press, *USG to Settle Suits Related to Asbestos*, N.Y. TIMES (Jan. 31, 2006), http://www.nytimes.com/2006/01/31/business/usg-to-settle-suits-related-to-asbestos.html.

5. *See infra* Section IV.A (describing the scope of PI operations).

6. *See* Mullins & Scannell, *supra* note 1 (suggesting a relation between the dramatic stock price increases and Senator Frist's announcement).

7. Meng Gao & Jiekun Huang, *Capitalizing on Capitol Hill: Informed Trading by Hedge Fund Managers*, 121 J. FIN. ECON. 521, 522 (2016) (indicating that traders who were guided by political intelligence traded before the announcement).

More than a decade later, this asbestos insider trading scheme remains relevant because it exemplifies the lucrative market for PI. The PI industry has avoided liability from their most nefarious acts by exploiting two gaps in tipper-tippee insider trading prohibitions: (1) the lack of a fiduciary duty for government employees and (2) the legal requirement that there must be a pecuniary personal benefit.

However, the enactment of a relatively new statute and a recent change in jurisprudence now fulfill these two missing elements.[8] First, Congress enacted the Stop Trading on Congressional Knowledge Act (STOCK Act) in 2012 as a response to scandals concerning congressional members,[9] and this Act imputes a fiduciary duty to government employees. Second, in securities law, impermissible gifting of material, nonpublic information previously required a reciprocal "personal benefit" with the prospect of a pecuniary gain or similar nature.[10] But on December 6, 2016, the U.S. Supreme Court in *Salman v. United States*[11] rejected this requirement and held that a "personal gain" to a tipper may be inferred merely from the personal relationship between the tipper and tippee.[12] Together, the STOCK Act and *Salman* now encompass all those who utilize their personal connections to gather material, nonpublic information from government insiders—namely, the PI industry.[13]

This Comment argues that the personal gain requirement articulated in *Salman*, in connection with the STOCK Act, will curtail

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8. Similar to the asbestos trading scheme, on April 2, 2013, trading within the health-care insurer industry experienced a 3.7% to 5.5% increase in the final minutes of trading. Brody Mullins, *Grassley Wants Answers on 'Political Intelligence,'* WALL ST. J. (Apr. 4, 2013, 5:44 PM), http://blogs.wsj.com/washwire/2013/04/04/grassley-wants-answers-on-political-intelligence. An hour after the markets closed, the Centers for Medicare and Medicaid Services publicly announced "a change in how the government pays private insurers to run Medicare health plans for seniors and the disabled." *Id.* In the end, traders profited approximately $662 million from the receipt of insider government information. *Id.*

9. Deirdre Walsh, *Obama Signs STOCK Act to Address "Deficit of Trust" in Washington*, CNN (Apr. 4, 2012, 2:45 PM), http://www.cnn.com/2012/04/04/politics/stock-act-signing/index.html.

10. A tipper is a person who conveys material, nonpublic information to a tippee. A tippee is a person who receives material, nonpublic information. Dirks v. SEC, 463 U.S. 646, 655–56 (1983).

11. 137 S. Ct. 420 (2016).

12. *Id.* at 425 (holding that "a gift of confidential information to anyone, not just a 'trading relative or friend,' is enough to prove securities fraud").

13. Stop Trading on Congressional Knowledge Act of 2012, Pub. L. No. 112-105, §§ 3–4, 126 Stat. 291, 292 (to be codified in scattered sections of 5 U.S.C. and 15 U.S.C.).

PI operatives' ability to gather information from the government through insider tactics. As a result, PI firms will need to rely only on public information and analytics, and hedge funds, the predominant consumers of PI, should be wary and implement prophylactic measures to avoid insider trading liability. Further, this Comment argues that the recent *United States v. Martoma*[14] decision from the Second Circuit is inconsistent with *Salman*. Therefore, this Comment serves as a guide for the courts to continue to conceptualize and identify factors within a close personal relationship between a tipper and tippee. Part I explores the origins of insider trading, and Part II discusses the circuit split leading to the Supreme Court's decision in *Salman*. Part III then surveys case law to identify factors, without the presence of any direct pecuniary gain, in a tipper-tippee relationship that satisfy the post-*Salman* personal gain requirement. Part IV introduces and explains the STOCK Act and the PI industry. Finally, Part V analyzes the PI industry and determines whether, and under what circumstances, some of the industry's tactics violate securities laws in the wake of the STOCK Act and the *Salman* decision.

I. THE STATE OF INSIDER TRADING

Insider trading prohibitions spring largely from judicial decisions construing the anti-fraud securities provisions rather than from statutory or regulatory developments.[15] The Securities and Exchange Commission (SEC) and Department of Justice (DOJ) enforce these prohibitions through enforcement actions and criminal prosecutions.[16] Although the SEC is the principle securities market regulator, often federal prosecutors also enforce the most egregious instances of insider trading; thus the SEC and DOJ are both the catalysts for developing federal insider trading jurisprudence.[17]

The SEC commenced the first insider trading enforcement as a response to fraudsters who originated from *within* a company and exploited the company's stockholders.[18] However, the SEC later sought to fulfill its mandate under the Securities Act of 1933 ("the '33

14. 869 F.3d 58 (2d Cir. 2017).
15. *See infra* Section I.A (outlining the foundation and evolution of U.S. securities laws).
16. *See* James J. Park, *Rules, Principles, and the Competition to Enforce the Securities Law*, 100 CALIF. L. REV. 115, 154 (2012).
17. *Id.*
18. *See infra* Section I.B (exploring the motivations and intent behind the adoption of insider trading laws).

Act")[19] and the Securities Exchange Act of 1934 ("the '34 Act")[20] to protect investors by expanding the scope of liability to fraudsters acting *beyond* the boardroom.[21] Accordingly, the government[22] advanced several theories of liability with mixed success to reach the outer bounds of statutory prohibitions on insider trading.[23] In that vein, one of the major theories the SEC promoted focused on capturing those who trade on information provided to them through a tip in exchange for a personal benefit.[24] Insider trading laws are thus critical to the integrity of the securities markets because they act as a deterrent to would-be fraudsters, including those lurking within the PI industry.

A. *Origins of Federal Securities Law*

The '33 Act and the '34 Act were legislative responses to the stock market's collapse during the Great Depression.[25] Concerned with "ineptitude and/or chicanery" among stockbrokers and investment bankers, Congress passed this sweeping legislation to restore confidence in the markets and encourage investment.[26] As part of the '33 Act, Congress created the SEC and authorized it to promulgate rules to protect the public, maintain fair and efficient markets, and promote capital formation.[27]

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19. Securities Act of 1933, Pub. L. 73-22, 48 Stat. 74 (codified as amended at 15 U.S.C. § 77a (2012)).

20. Securities Exchange Act of 1934, Pub. L. 73-291, 48 Stat. 881 (codified as amended at 15 U.S.C. § 78a).

21. *See infra* Section I.B (explaining the implicit prohibition of trading by anyone in possession of material, nonpublic information).

22. Because of the overlap between the DOJ's and the SEC's roles in developing insider trading liability theories, this Comment uses "government" throughout to mean either the SEC or DOJ.

23. *See infra* Sections I.B.1–2 (explaining the adoption and implications of the classical and misappropriation theories, a foundation for understanding tipper-tippee liability).

24. *See infra* Section I.B.3 (articulating how the courts apply tipper-tippee liability, an essential concept impacting the PI industry).

25. *See* Steve Thel, *The Original Conception of Section 10(b) of the Securities Exchange Act*, 42 STAN. L. REV. 385, 385–86 (1990) (arguing that Congress's intent in passing the '34 Act was to prevent speculation in securities by drawing security prices away from investment value, rather than its prevailing use today).

26. *See generally id.* at 408–13 (detailing the downfall of the market throughout the 1920s and explaining that "[f]or Congress[,] . . . short selling was the chief villain" and a main regulatory purpose of the Exchange Act); Stop Trading on Congressional Knowledge Act of 2012, Pub. L. No. 112-105, §§ 3–4, 126 Stat. 291, 292 (to be codified in scattered sections of 5 U.S.C. and 15 U.S.C.).

27. *What We Do*, U.S. SEC. AND EXCH. COMM'N, https://www.sec.gov/article/whatwedo.html (last modified June 10, 2013).

Securities take the form of various financial instruments and provide investors—whether they are individuals saving for retirement or hedge funds—the means to generate passive income with uncommitted capital.[28] The name of an instrument is not determinative of its classification as a security; courts instead look to the substance and "economic reality" of the instrument.[29] At its foundation, a security is an investment contract[30] in a common enterprise[31] that would be expected to yield profit[32] solely[33] from the efforts of a promoter or a third party.[34] The primary sale[35] of securities allows businesses to raise capital, which in turn stimulates the economy.[36] Moreover, the ability to buy and sell a security on an open market is essential for capital

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28. 15 U.S.C. § 77b(a)(1) (2012) (broadly defining a security as "any note, stock, treasury stock, security future, security-based swap, bond, debenture, . . . investment contract . . . or warrant or right to subscribe to or purchase, any of the foregoing").

29. SEC v. W.J. Howey Co., 328 U.S. 293, 298, 300 (1946).

30. *Id.* at 298–99 ("An investment contract . . . [is] a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party . . . .").

31. *See* SEC v. SG Ltd., 265 F.3d 42, 49, 53 (1st Cir. 2001) (holding that a website offering investors to pay into virtual companies satisfied the common enterprise prong because the investors shared "horizontal commonality," which is "the pooling of assets from multiple investors so that all share in the profits and risks of the enterprise").

32. *See* United Hous. Found., Inc. v. Forman, 421 U.S. 837, 852 (1975) (noting that an expectation of profits is one derived from "either capital appreciation resulting from the development of the initial investment . . . or a participation in earnings resulting from the use of investors' funds").

33. *See* SEC v. Merch. Capital, LLC, 483 F.3d 747, 755 (11th Cir. 2007) (applying the *Williamson* factors, which examine the degree of control an investor has to determine whether the efforts are solely from a third party or promoter); Williamson v. Tucker, 645 F.2d 404, 424 (5th Cir. 1988) (recognizing that there are situations where a "general partnership interest" may qualify as an investment contract if the general partner retains little ability to control the profitability of investment).

34. *W.J. Howey Co.*, 328 U.S. at 296.

35. A primary transaction is when the issuer offers and sells its own securities to investors, while a secondary transaction is when one investor resells securities of the issuer to another investor. STEPHEN J. CHOI & A.C. PRITCHARD, SECURITIES REGULATION 9–11 (4th ed. 2015).

36. *See* SEC. AND EXCH. COMM'N IPO TASK FORCE, REBUILDING THE IPO ON-RAMP: PUTTING EMERGING COMPANIES AND THE JOB MARKET BACK ON THE ROAD TO GROWTH 1 (Oct. 20, 2011), https://www.sec.gov/info/smallbus/acsec/rebuilding_the_ipo_on-ramp.pdf (explaining the importance of the Initial Public Offering (IPO) in allowing companies to "generate new jobs and revenue for the U.S. economy").

formation.[37] Recognizing this, the SEC began promulgating regulations to ensure fair and free markets for securities after their initial sale.[38]

B. The Development of Insider Trading Prohibitions

Under the '34 Act, the SEC promulgated Rule 10b-5,[39] which prohibits individuals from engaging in deceptive practices connected with the purchase or sale of securities.[40] The DOJ and SEC broadly applied Rule 10b-5 to cover a wide variety of deceptive practices.[41] Notably, the '34 Act does not define insider trading, even though the term is used in the Act to discuss liability and civil penalties.[42] Although lacking a statutory definition, the SEC and the courts construe Rule 10b-5 to implicitly prohibit insider trading.[43]

Generally, insider trading law prohibits trading of material,[44] nonpublic information[45] when the trader breaches a duty of trust or

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37. *Id.* at 3.

38. Since the '33 Act, Congress has passed several laws to expand the reach of the SEC and to promote capital formation; most recently, Congress passed the Jumpstart Our Business Startups Act (JOBS Act) to encourage capital formation of small businesses. Jumpstart Our Business Startups Act of 2012, Pub. L. No. 112-106, 126 Stat. 306 (providing that the Act's purpose is "[t]o increase American job creation and economic growth by improving access to the public capital markets for emerging growth companies"). In passing the JOBS Act, Congress "intended to ease access to capital and investments for emerging growth companies and through crowdfunding." Office of the Press Sec'y, *Statement by the Press Secretary on H.R. 3606*, WHITE HOUSE, (Apr. 5, 2012), https://obamawhitehouse.archives.gov/the-press-office/2012/04/05/statement-press-secretary-hr-3606.

39. *See* C.F.R. § 240.10b-5 (2016) (prohibiting fraud, deceit, and the omission or falsification of material facts in connection with the purchase or sale of any security).

40. *Id.* Rule 10b-5 also provides investors with a private right of action against fraudsters. *See* J. I. Case Co. v. Borak, 377 U.S. 426, 432–33 (1964) (ruling that the '34 Act implies a private right of action and reasoning that "the possibility of civil damages or injunctive relief serves as a most effective weapon [for] enforcement" of securities laws).

41. Superintendent of Ins. of N.Y. v. Bankers Life & Cas. Co., 404 U.S. 6, 12 (1971) ("Section 10(b) must be read flexibly, not technically and restrictively.").

42. *See* 15 U.S.C. §§ 78t-1, 78u-1 (2012).

43. *See, e.g.*, Dirks v. SEC, 463 U.S. 646, 653–54 (1983) (noting that inside trading is within Rule 10b-5 because it is deceitful to stockholders and unfair to the public without disclosure).

44. A fact is material if it would create a "substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." TSC Indus. v. Northway, Inc., 426 U.S. 438, 449 (1976).

45. "[N]onpublic information is information that either is not publicly available or is sufficiently more detailed and/or reliable than publicly available information to

confidence owed to the information source,[46] the security issuer, or the company shareholders.[47] Thus, despite its title, a fraudster does not have to be a corporate insider to commit insider trading.[48] Insider trading law implicitly prohibits trading of a security by anyone in possession of material, nonpublic information in violation of a fiduciary duty.[49] A trader armed with this type of information needs to disclose it to the public to trade lawfully in that security. Of course, in practice, this never happens.[50] Presently, three theories underpin insider trading prohibitions: classical, misappropriation, and tipper-tippee.[51]

1. The classical theory of insider trading

Under the classical theory, a corporate insider is prohibited from trading securities based on material, nonpublic information that the individual obtained through his or her affiliation with the corporation.[52] Corporate insiders include not only officers, directors, and controlling stockholders, but also all actors who hold fiduciary duties to a corporation, such as attorneys and consultants.[53] The rationale supporting this theory is that the corporate actors breach their fiduciary duties of trust to their company's shareholders by exploiting corporate information for personal gain.[54]

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be deemed significant, in and of itself, by reasonable investors." United States v. Contorinis, 692 F.3d 136, 144 (2d Cir. 2012).

46. *Dirks*, 463 U.S. at 664–65; *see also* SEC v. Dorozhko, 574 F.3d 42, 50 (2d Cir. 2009) (holding that cases of affirmative deceit, where a device is employed to "trick, circumvent[,] or bypass," fall within the ambit of 10b-5).

47. Chiarella v. United States, 445 U.S. 222, 228 (1980) (affirming that a duty to disclose arises when there exists a "relationship of trust and confidence").

48. *See infra* notes 68–71 and accompanying text.

49. *See infra* notes 52–54 and accompanying text.

50. *See Dirks*, 463 U.S. at 654.

51. *See* Kenneth R. Davis, *Insider Trading Flaw: Toward a Fraud-on-the-Market Theory and Beyond*, 66 AM. U. L. REV. 51, 53 n.5, 57 (2016) (distinguishing the three current theories). "Classical theory" is synonymous with "traditional theory." United States v. O'Hagan, 521 U.S. 642, 651 (1997). This Comment refers to it only as classical theory.

52. *O'Hagan*, 521 U.S. at 651.

53. *Id.* at 652 (citing *Dirks*, 463 U.S. at 655 n.14 (1983)); Cady, Roberts & Co., Exchange Act Release No. 34,6668, 40 SEC Docket 907, 913 (Nov. 8, 1961).

54. *See* Karen Schoen, *Insider Trading: The "Possession Versus Use" Debate*, 148 U. PA. L. REV. 239, 240 (1999) (exploring the debate between whether 10b requires the plaintiff to provide factual support that the defendant actually used insider information to execute a trade or whether it is sufficient to find that a defendant knowingly possessed the information while executing the trade).

In 1961, the classical theory found its footing when the SEC initiated an administrative proceeding against Cady, Roberts & Co.[55] In *Cady, Roberts & Co.*,[56] the SEC held both a director of a company and his broker liable for insider trading after the director ordered his broker to short his shares[57] in anticipation of a public announcement regarding declining future dividends.[58] Following its mandate under the '34 Act, the SEC reasoned that the defendants deceived the company's shareholders by exploiting material, nonpublic information and concluded that the defendants should have disclosed the inside information prior to trading in the company's securities.[59] The classical theory continues to be the fundamental rationale behind prohibiting insider trading; however, it permits insider trading by those unaffiliated with the company who acquire confidential information from their trusted sources within the company.[60]

2. The misappropriation theory

In contrast to the classical theory, the misappropriation theory holds liable persons who misuse confidential information to trade securities if the person simultaneously owes a duty of trust to the source of that information.[61] Under this theory, it is impermissible for the principal to use information for a self-serving purpose that deprives the principal of the exclusive use of that information.[62] The misappropriation

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55. For a discussion on the development of the classical theory, see generally Comment, *Broker Silence and Rule 10b-5: Expanding the Duty to Disclose*, 71 YALE L.J. 736, 747 (1962), which explores the prominence of the *Cady* decision in providing clarity to section 10b of the '34 Act, and Comment, Investors Management Company *and Rule 10b-5–The Tippee at Bay*, 72 COLUM. L. REV. 545, 561 (1972), which argues that the ruling in *Cady* was justified, but left unclear the requirements of tippee liability.

56. Exchange Act Release No. 34,6668, 40 SEC Docket 907 (Nov. 8, 1961).

57. Short selling is when a trader "borrow[s] shares from other investors and sell[s] them in the hope of buying them back lower at a discount." Chris Dieterich, *So, You Want to Short Shares of Snap*, WALL ST. J. (Mar. 3, 2017, 10:25 AM), http://blogs.wsj.com/moneybeat/2017/03/03/so-you-want-to-short-shares-of-snap.

58. *See Cady*, 40 SEC Docket at 911 (determining that a failure to disclose insider information constituted a violation of anti-fraud provisions).

59. The Commissioners noted that without the '34 Act, insider trading may not fall within the common law notions of fraud. *Id.* at 912.

60. Chiarella v. United States, 445 U.S. 222, 227–28 (1980).

61. United States v. O'Hagan, 521 U.S. 642, 652 (1997).

62. *Id.* at 652. A principal is a person or entity, who by mutual consent, appoints and controls an agent who owes a fiduciary duty to the principal to undertake an action on behalf of the principal. *See* DANIEL S. KLEINBERGER, EXAMPLES & EXPLANATIONS: AGENCY, PARTNERSHIPS, AND LLCS 1 (4th ed. 2012) (describing an agency relationship between an agent and a principal).

theory extends the reach of insider trading prohibitions by encompassing individuals who are not corporate officers or directors.[63]

The Supreme Court adopted the misappropriation theory in *United States v. O'Hagan*.[64] In that case, the respondent, James O'Hagan, was a partner of the law firm Dorsey & Whitney, where he learned that the firm's client, Grand Met, was going to make a tender offer[65] to acquire Pillsbury Company.[66] O'Hagan traded on this information and profited.[67]

The SEC filed an enforcement action alleging that although O'Hagan was not a traditional corporate insider, he defrauded his employer by using confidential information from its client for his own

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63. *O'Hagan*, 521 U.S. at 653 (holding that the misappropriation theory applied even though the parties involved were not officers or directors).

64. 521 U.S. 642, 653 (1997). The misappropriation theory almost never came to fruition. *See generally* CHOI & PRITCHARD, *supra* note 35, at 364 (recounting the genesis and survival of the misappropriation theory in Supreme Court jurisprudence). In 1987, the Supreme Court had initially denied certiorari to *Carpenter v. United States*, which first questioned the validity of the misappropriation theory. 484 U.S. 19 (1987) (4-4 decision), *superseded by statute*, 18 U.S.C. § 1343 (2012). Justice Powell drafted a dissent arguing that the misappropriation theory was inconsistent with insider trading precedent. *Id.* (draft dissent of Powell, J.) (No. 86-422, Dec. 10, 1986) (rejecting the misappropriation theory and arguing that because the petitioners did not owe a fiduciary duty to the seller of the securities, they could not be guilty of insider trading). After the draft letter was circulated among the justices, the Court decided to grant certiorari; however, Justice Powell retired before its rehearing, and his successor, Justice Kennedy, had not been confirmed in time to join the decision. *See* CHOI & PRITCHARD, *supra* note 35, at 364. The *Carpenter* decision was 4-4, which left intact the lower court's decision. *See* CHOI & PRITCHARD, *supra* note 35, at 364. *But see* Randall W. Quinn, *The Misappropriation Theory of Insider-Trading in the Supreme Court: A (Brief) Response to the (Many) Critics of* United States v. O'Hagan, 8 FORDHAM J. CORP. & FIN. L. 865, 868 (2003) (arguing that the misappropriation theory is consistent with statutory and regulatory schemes of securities laws).

65. A tender offer is a corporate takeover technique that involves a broad solicitation to all equity shareholders for a fixed-price that is typically at a premium over the market price. The offer is also often for a substantial number of shares, held open for only a limited amount of time, and is generally contingent upon shareholders tending a fixed number of units. *Fast Answers: Tender Offers*, SEC, https://www.sec.gov/fast-answers/answerstenderhtm.html (last modified Jan. 16, 2013).

66. *O'Hagan*, 521 U.S. at 647.

67. O'Hagan purchased over 2500 unexpired call options and over 5000 common shares of Pillsbury stock. After Grand Met announced its tender offer, shares jumped from $39 per share to $60 per share, and O'Hagan netted a profit of more than $4.3 million. *Id.* at 647–48; *see also* Saumya Vaishampayan, *Options Traders Bet on Big Swing from Netflix*, WALL ST. J. (Apr. 15, 2015), http://blogs.wsj.com/moneybeat/2015/04/15/options-traders-bet-on-big-swing-from-netflix ("A [call] option confers the right to [buy] the underlying stock at a specific price, called the strike price, by a certain time.").

benefit.[68] The Supreme Court applied the misappropriation theory, reasoning that Rule 10b-5 aims to protect the integrity of securities markets against abuses by those who acquire insider information from their employment relationship.[69] Further, the Court agreed that the misappropriation theory is within the penumbra of 10b-5's "deceptive device or contrivance" because the trader exploited the principal's trust for personal gain, thereby defrauding the principal.[70] Finally, the Court concluded that it would make "scant sense to hold a lawyer like O'Hagan [as] a section 10(b) violator if he works for a law firm representing the target of a tender offer, but not . . . the bidder."[71] Consequently, the misappropriation theory expanded the SEC's reach beyond traditional corporate insiders.

3. Tipper-tippee liability

The third theory of insider trading derives from the classical and misappropriation theories and is important because it reaches fraudsters who might otherwise escape liability by acting through others.[72] Tippees of corporate insider information are generally liable under section 10b-5 because they have a duty not to profit from the use of insider information that they knew, or should have known, was confidential and originated from a corporate insider.[73] This theory of liability is viewed as a general extension of an "after the fact" breach of the insider's fiduciary obligations.[74]

The Supreme Court addressed tipper-tippee liability in *Dirks v. SEC*.[75] Ronald Secrist, a former employee of an equity company, sought to expose fraudulent management with the help of Raymond Dirks, an investment analyst.[76] Dirks conducted an extensive investigation, discovered the company's fraud, and then contacted a

68. *O'Hagan*, 521 U.S. at 648.
69. *Id.* at 652–53.
70. *Id.* at 653.
71. *Id.* at 659.
72. *See* Dirks v. SEC, 463 U.S. 646, 664 (1983) (identifying scenarios in which behavior can be excused under the classical or misappropriation theories).
73. *See* Davis, *supra* note 51, at 77 (arguing that securities laws ought to protect the counterparty of a trade by prohibiting trading while in possession of material, nonpublic information obtained by any methods, thus abandoning any necessity for a breach of a fiduciary duty).
74. *Dirks*, 463 U.S. at 659.
75. 463 U.S. 646 (1983).
76. *Id.* at 649 (informing Dirks that Equity Funding of America vastly overstated its assets due to fraudulent practices).

reporter to publicize his findings.[77] However, before the *Wall Street Journal* published the story, Dirks informed several of his clients who invested in the company that a fraud was afoot.[78] The clients then used the information to execute timely trades, avoiding substantial monetary losses.[79]

The Supreme Court applied a four-part test to determine whether tipper-tippee liability applied to Dirks's conduct. The four factors were whether (1) the insider-tipper breached a fiduciary duty by providing the material, nonpublic information to a tippee; (2) the tipper realized a personal benefit from providing the information to the tippee; (3) the tippee knew, or should have known, the tipper breached his fiduciary duty; and (4) the tippee used the information in connection with a securities transaction.[80] The Court inferred tippee liability from the insider-tipper's breach of a fiduciary duty; thus, the Court required the government to prove that the tipper violated a duty.[81] Further, the Court focused on the information from the original tipper because, if such a breach exists, this original tip taints all subsequent tippees who receive the information.[82] In other words, if a tipper violates a fiduciary duty by communicating a tip to a tippee and that tippee in turn transmits the tip to other persons, the law attaches liability to each "remote tippee" who knew, or should have known, that the original exchange was illicit.[83]

Applying the test, the Supreme Court found that Secrist received no personal benefit from tipping Dirks because Secrist's sole motivation was to expose fraud.[84] The Court acknowledged this laudable goal of exposing fraud and held that such a noble motive was a lawful conveyance of nonpublic information.[85] The Court defined a personal

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77. *Id.*

78. *Id.*

79. *Id.* at 649 (at least five of Dirk's clients liquidated their holding of more than $16 million).

80. *Id.* at 662–64.

81. *See id.* at 659, 661–62 ("[T]ippee's duty to disclose or abstain is derivative from that of the insider's duty . . . . And absent a breach by the insider, there is no derivative breach.").

82. *See* Salman v. United States, 137 S. Ct. 420, 427–28 (2016) (finding a tippee liable for insider trading by focusing on the tipper's breach of his fiduciary duty when the tipper shared tips with his brother, who then shared those tips with the tippee).

83. *See id.* (holding that Salman was liable as a "remote tippee" because he knew Michael, the tippee, received tips from Maher, the tipper who breached his fiduciary duty).

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

85. *See id.* ("We conclude that Dirks, in the circumstances of this case, had no duty to abstain from use of the inside information that he obtained.").

benefit as "a pecuniary gain or a reputational benefit that will translate into future earnings" as well as "a gift of confidential information to a trading relative or friend."[86] However, the Court cautioned that deciding whether an insider personally benefited is a fact-intensive inquiry and thus not an easy question.[87] Finally, the Court recommended that the SEC promulgate additional rules to help define the personal benefit requirement.[88]

The SEC failed to heed the Supreme Court's suggestion and never promulgated regulations describing the personal benefit requirement.[89] Without guidance from the SEC, courts have been left to grapple with *Dirks*'s description of a personal benefit.[90] Unsurprisingly, a circuit split emerged.[91]

II. THE PERSONAL BENEFIT REQUIREMENT

The *Dirks* personal benefit requirement provided a workable framework that remained in harmony amongst the circuits for decades. However, within the past few years, this area of the law has been in flux. Starting in 2014, the Second Circuit added an additional

86. *Id.* at 663–64.

87. *Id.* at 664.

88. *Id.*

89. *See generally* David T. Cohen, Note, *Old Rule, New Theory: Revising the Personal Benefit Requirement for Tipper/Tippee Liability Under the Misappropriation Theory of Insider Trading*, 47 B.C. L. REV. 547, 565 (2006) (arguing that for misappropriation cases, courts should require a showing that the tipper was reckless as to whether (1) he or she would either benefit personally or harm to the information source; and (2) whether somebody else would trade on the information).

90. *See generally* United States v. Newman, 773 F.3d 438, 447–48 (2d Cir. 2014) (explaining that the court had not yet "been presented with the question of whether the tippee's knowledge of a tipper's breach requires knowledge of the tipper's personal benefit," but finding that a personal benefit requires a prospect of pecuniary gain), *abrogated by* Salman v. United States, 137 S. Ct. 420, 422 (2016) (holding that a personal benefit does not have to be a pecuniary gain).

91. *See* Carmen Germaine, *Appeals Courts Still Lost in Post-*Newman *Trading Muddle*, LAW360 (May 27, 2016, 11:48 PM), https://www.law360.com/articles/801331/appeals-courts-still-lost-in-post-newman-trading-muddle (commenting on the widening post-*Newman* circuit split and the need for clarity from the Supreme Court or Congress on the requisite elements and essential evidence to find liability). *Compare* *Salman*, 137 S. Ct. at 427 (noting that the Ninth Circuit held that the tipper "breached a duty because he made a 'gift of confidential information to a trading relative'") (quoting United States v. Salman, 792 F.3d 1087, 1092 (9th Cir. 2015)), *with Newman*, 773 F.3d at 448 (finding that a tipper had to breach a duty and have some prospect of pecuniary gain).

safeguard, the pecuniary requirement, to the *Dirks* personal benefit requirement.[92] Just two years later, the Supreme Court restored the *Dirks* personal gain requirement to its original state in *Salman v. United States*.[93] Ironically, in an about face shortly after *Salman*, the Second Circuit eviscerated the *Dirks* personal gains requirement in *United States v. Martoma* by fundamentally altering the *Salman* decision.[94] The *Martoma* court held that a tipper realizes a personal benefit when the tipper merely intends to provide a tip with the intent that the recipient will trade on it—without examining the objective facts evidencing a close personal relationship between the tipper and tippee.[95] The Second Circuit reasoned in *Martoma* that *Salman* altered the analysis of *Dirks* because it emphasized that a gift of information is tantamount to the tipper trading on the information and gifting the proceeds.[96] The *Martoma* decision contravenes the Supreme Court's holding in *Salman* because the Court in *Salman* expressly limited their holding to only rejecting the pecuniary exchange requirement, stressed the importance of the relationship between the tipper and tippee, and incorporated the reference "trading relative or friend" numerous times in the decision.[97] Consequently, the *Salman* personal gains requirement remains good law in most jurisdictions, and the rationale of *Martoma* lies on uncertain grounds at best.[98]

A. The Newman *Decision*

In *United States v. Newman*,[99] the Second Circuit[100] articulated a more nuanced reading of the personal gains requirement by finding that a tipper must have a prospect of pecuniary gain relatively contemporaneous with the conveyance of a tip.[101] This holding illustrates a problem with prosecuting more remote tippees as courts

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92. *See infra* Section II.A.
93. *See infra* Section II.B.
94. *See infra* Section II.C.
95. *See infra* Section II.C.
96. *See infra* Section II.C.
97. *See infra* Section II.C.
98. *See infra* Section II.C.
99. 773 F.3d 438 (2d Cir. 2014), *abrogated by* Salman v. United States, 137 S. Ct. 420 (2016).
100. *See generally* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 762 (1975) (Blackmun, J., dissenting) (acknowledging that the Second Circuit is the "Mother Court" of securities law).
101. *Newman*, 773 F.3d at 446.

struggle to find a logical break in the "daisy chain" of tips.[102] In *Newman*, the government alleged that two portfolio managers—Todd Newman and Anthony Chiasson—violated Rule 10b-5 by trading on material, nonpublic information they knew, or should have known, could have only come from a person who breached his or her fiduciary duties owed to his or her employer.[103]

At trial, the government presented evidence that a group of financial analysts exchanged information they obtained from company insiders.[104] These analysts then passed the information to Newman and Chiasson, who executed trades in Dell and NVIDIA stock, earning profits of approximately $4 million and $68 million, respectively.[105] Newman and Chiasson were several steps removed from the Dell[106] and NVIDIA[107] corporate insiders, and there was no evidence that either of them knew the source of the inside information.[108] The defendants moved to dismiss the indictment, arguing that there was no evidence that the corporate insiders provided confidential information in exchange for a personal benefit.[109] The Southern District of New York

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102. The "daisy chain" problem is where a tip is transferred several times over, akin to a game of telephone, and the government must prove that the ultimate tippee knew, or should have known, of the tipper's breach of a fiduciary duty. Franklin A. Gevurtz, *The Overlooked Daisy Chain Problem in* Salman, 58 B.C. L. REV. E. SUPP. 18 (2017), http://lawdigitalcommons.bc.edu/bclr/vol58/iss6/3 (acknowledging that there is a "daisy chain problem" in *Newman* and *Salman*, and that the Court must further articulate how the personal benefit element will factor into illegal tipping chains).

103. *Newman*, 773 F.3d at 442.

104. *Id.* at 443 ("Specifically, the Government alleged that these analysts received information from insiders at Dell and NVIDIA disclosing those companies' earnings numbers before they were publicly released in Dell's May 2008 and August 2008 earnings announcements and NVIDIA's May 2008 earnings announcement.").

105. *Id.*

106. Regarding the Dell tipping chain, evidence established that a Dell investor relations employee tipped Dell's earnings information to a Neuberger Berman analyst, Goyal, who gave the information to a Diamondback analyst, Tortora. Tortora relayed the information to Newman and a Level Global analyst, Adondakis. Chiasson then received the information from Adondakis, "making Newman and Chiasson three and four levels removed from the inside tipper, respectively." *Id.*

107. For the NVIDA tipping chain, Choi, an employee of NVIDIA's financial unit, attended church with Lim. Choi tipped Lim, who then passed the information to his co-defendant, Kuo, an analyst at Whittier Trust. Kuo then circulated the information to the group of analyst friends, including Tortora and Adondakis. They in turn gave the information to Newman and Chiasson—making Newman and Chiasson four levels removed from the inside tippers. *Id.*

108. *Id.*

109. *Id.* at 444.

denied the defendants' motion and instructed jurors that if they found "that the 'defendants traded on material, nonpublic information they knew insiders had disclosed in breach of a duty of confidentiality,'" the jurors could find the defendants guilty.[110] The jury convicted Newman and Chiasson on all counts.[111]

The Second Circuit overturned the jury verdict on the ground that the jury instruction was erroneous.[112] The court held that a tippee could only be liable if (1) the tipper breached a fiduciary duty;[113] (2) the tipper received a personal benefit in exchange for the disclosure; and (3) the tippee knew, or should have known, of the breach.[114] Amplifying the personal benefit prong, the Second Circuit held that there must be 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*."[115]

Newman sparked a debate among the securities bar.[116] Some commentators praised *Newman* as an appropriate counterweight to the growing zealous prosecutions against securities traders alleged to have benefited from insider information.[117] Other commenters argued that

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110. *Id.* at 444, 447 (citation omitted).

111. *Id.* at 444.

112. *Id.* at 442.

113. *Id.* at 447; *see also* Chiarella v. United States, 445 U.S. 222, 233 (1980) (noting that there is a "general duty between all participants in market transactions to forgo actions based on material, nonpublic information").

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

115. *Id.* at 452 (emphasis added) (citing United States v. Jiau, 734 F.3d 147, 153 (2d Cir. 2013) (holding that the exchange between an insider and the recipient should take the form of a "quid pro quo" to properly confer a benefit)).

116. *See* Reed Harasimowicz, Note, *Nothing New, Man!—The Second Circuit's Clarification of Insider Trading Liability in* United States v. Newman *Comes at a Critical Juncture in the Evolution of Insider Trading*, 57 B.C. L. REV. 765, 787–88 (2016) (arguing that *Newman* was consistent with precedent and served to rein in prosecutorial overreach). *Compare* Tebsy Paul, Comment, *Friends with Benefits: Analyzing the Implications of* United States v. Newman *for the Future of Insider Trading*, 5 AM. U. BUS. L. REV. 109, 109–10 (2015) (agreeing that the *Newman* decision was proper and that the broad interpretation of 10b-5 has damaged the overall efficiency of the market by limiting the incentives of market participants to obtain information and make informed trading decisions), *with* Laura Palk, *Ignorance Is Bliss: Should Lack of Personal Benefit Knowledge Immunize Insider Trading?*, 13 BERKELEY BUS. L.J. 101, 147 (2016) (critiquing the *Newman* decision as being inconsistent with Congress's intent to empower the SEC with broad discretion to define securities fraud).

117. *See* Opinion, *Accountability for Preet Bharara*, WALL ST. J. (Mar. 10, 2016, 7:11 PM), https://www.wsj.com/articles/accountability-for-preet-bharara-1457655074 (summarizing the Southern District of New York's denial of the government's motion to

Congress intended the '34 Act to protect the public interest by allowing the SEC to broadly define securities fraud.[118] *Newman* had at least two reverberations: first, it added an additional qualifier to *Dirks*'s personal gain requirement; and second, it precipitated a number of challenges to earlier insider trading convictions.[119]

B. The Salman *Decision*

While the government had challenged *Newman* following the Second Circuit's decision, the Supreme Court denied certiorari, which left the Second Circuit's decision in place.[120] Then, just one year later, the Ninth Circuit in *Salman* addressed the same issue of personal gain within the context of tipper-tippee 10b-5 liability.[121] The Supreme Court's unanimous decision in *Salman* revitalized the broad holding in *Dirks* and reaffirmed the power of the SEC to regulate the markets.[122]

Unlike *Newman*, the tipping chain in *Salman* was intra-family.[123] In 2002, Bassam Salman's future brother-in-law, Maher Kara, joined

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dismiss an alleged malicious prosecution case brought by a hedge fund manager against former U.S. Attorney Preet Bharara; the hedge fund manager's previous securities conviction was reversed by the Second Circuit for lack of evidence of wrongdoing).

118. *See* Katherine Drummonds, Note, *Resuscitating* Dirks*: How the* Salman *"Gift Theory" of Tipper-Tippee Personal Benefit Would Improve Insider Trading Law*, 53 AM. CRIM. L. REV. 833, 834 (2016) (critiquing the *Newman* decision because it unduly strained prosecutors and limited the SEC's broad interpretation that allowed prosecutors to enforce the laws and encourage efficient markets).

119. *See, e.g.*, United States v. Steinberg, 21 F. Supp. 3d 309, 311 (S.D.N.Y. 2014) (denying Michael Steinberg's motion for acquittal after a jury in the Southern District of New York found Steinberg, a former portfolio manager of SAC Capital Advisors who was in the same tipping chain as *Newman*, guilty of reaping $1.9 million in illegal profits; the court sentenced him to three-and-a-half years in prison); *see also* Ahiza Garcia & Evan Perez, *Insider Trading Charges Dismissed Against Michael Steinberg, 6 Others*, CNN (Oct. 22, 2015, 8:52 PM), http://money.cnn.com/2015/10/22/news/michael-steinberg-insider-trading-charges-dismissed (dismissing Steinberg's conviction because the Second Circuit found that the tipping chain in *Newman* did not amount to an illegal tip under the pecuniary gain requirement).

120. United States v. Newman, 773 F.3d 438 (2d Cir. 2014), *cert. denied*, 136 S. Ct. 242 (2015).

121. *See* United States v. Salman, 792 F.3d 1087, 1088 (9th Cir. 2015), *aff'd*, 137 S. Ct. 420, 424 (2016).

122. *See Salman*, 137 S. Ct. at 424 (holding that the court properly applied *Dirks*); Dirks v. SEC, 463 U.S. 646, 667 (1983) (concluding that the defendant had no duty to abstain from use of inside information because he lacked a connection to the corporate insider and there were no objective facts or circumstances that the insider received a personal benefit).

123. *Salman*, 137 S. Ct. at 423–24.

Citigroup's healthcare investment banking group and began to share his job experiences with his older brother, Michael Kara.[124] Between 2004 and 2007, Mahar discussed various aspects of his job, including pending mergers and acquisitions, several times with Michael, whom he suspected was trading on the information.[125] During this time, Salman and Michael grew closer to each other,[126] and Michael began to pass tips he received from Mahar along to Salman.[127] At trial, brokerage records revealed that Michael and Salman's trading patterns matched one another, yielding a profit of over $1.5 million.[128]

The trial testimony revealed a "very close relationship" between the two Kara brothers.[129] Michael was the best man at Maher's wedding to Salman's sister, and Mahar testified that he tipped Michael to "help him."[130] Michael, though, never reciprocated with any financial benefit to Mahar.[131] Trial testimony highlighted the interconnectedness among Salman, Michael, and Mahar and showed that Salman knew that the tips Michael shared with him originated from Mahar.[132] Based on this evidence, the jury convicted Salman of securities fraud.[133]

In his appeal to the Ninth Circuit, Salman argued that the district court disregarded the teachings of *Newman* and did not consider the relationship between the tipper and tippee, which required "an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature."[134] Reasoning that *Dirks* required only a fiduciary breach by sharing confidential information with a friend or relative, the Ninth Circuit declined to follow *Newman* and affirmed Salman's conviction.[135] The circuit split made this issue ripe for certiorari.

The Supreme Court granted certiorari in *Salman* to address the issue of whether a contemporaneous pecuniary gain is required for tipper-

124. *Id.* at 424.
125. *Id.*
126. *Id.*
127. *Id.*
128. *Id.*
129. *Id.*
130. *Id.*
131. *Id.* at 425.
132. *Id.*
133. *Id.* (citing United States v. Newman, 773 F.3d 438, 452 (2014)).
134. *Id.*
135. *Id.*

tippee liability.[136] Salman argued that a "tangible monetary profit" was a prerequisite to tipper-tippee liability[137] and that liability based solely off of a personal connection would spawn indeterminate and overbroad prosecutions.[138] Seeking to extend the reach of the Ninth Circuit's holding in *Salman*, the Government countered that "a tipper personally benefits whenever the tipper discloses confidential trading information for a noncorporate purpose."[139] Therefore, a gift of confidential information to anyone would constitute an exploitation of that information and the tipper would always realize a personal benefit.[140]

In reaffirming *Dirks*, the Supreme Court determined that there is no practical difference between providing an insider tip to someone and giving that person the profits of an illegal trade.[141] The Court noted that "*Dirks* specifies that when a tipper gives inside information to a 'trading relative or friend,' the jury can infer that the tipper meant to provide the equivalent of a cash gift."[142] In essence, the Court rejected *Newman*'s "pecuniary or similarly valuable nature" requirement but notably did not adopt the Government's argument for liability to extend to all noncorporate disclosures.[143]

C. The Martoma *Decision*

Drawing on *Salman*, the Second Circuit used *Martoma* as a vehicle to revisit another panels' decision in *Newman*.[144] The holding in *Salman* was narrow and rejected only the need to show that the tipper received

136. *Id.* at 426 (2016). *But see* John L. Potapchuk, Comment, *The Sky is Not Falling, Todd Newman: The Ninth Circuit Endorses a Measured Reading of* Newman*'s Definition of Personal Benefit for Insider Trading Liability in* United States v. Salman, 57 B.C. L. REV. E. SUPP. 139, 140–42 (2016), http://lawdigitalcommons.bc.edu/bclr/vol57/iss6/9 (arguing that *Salman* and *Newman* are reconcilable and together illustrate the difference between friends and family for the purposes of establishing tipper-tippee liability).

137. *Salman*, 137 S. Ct. at 426.

138. *Id.*

139. *Id.*

140. *Id.*

141. *Id.*

142. *Salman*, 137 S. Ct. at 428.

143. *Id.* Further, the Court readily dismissed Salman's argument that common law fraud requires the defendant to obtain money or property, and the Court rejected Salman's last argument that *Dirks*'s gift-giving standard is unconstitutionally vague. *Id.* The Court opined that there may arise some factual circumstances where assessing liability for gift giving will be troublesome, but that it was a far cry from "shapeless . . . criminal prohibition." *Id.* at 428–29.

144. *See id.* at 428; United States v. Martoma, 869 F.3d 58, 61 (2d Cir. 2017).

something of a "pecuniary or similarly valuable nature."[145] *Salman* never addressed the "meaningfully close personal relationship" requirement because it was obvious.[146] The tipping occurred between two brothers the Supreme Court described as "very close."[147] Thus, *Salman* was a relatively straightforward application and re-affirmation of *Dirks*.

But the *Martoma* case was entirely different. Mathew Martoma, a hedge fund manager, paid for material, nonpublic information from doctors involved in clinical trials for a new Alzheimer's drug.[148] Martoma paid those "consultants" upwards of $1500 an hour to report on the progress of the trials.[149] Ultimately, Martoma learned from his consultants that there were "two major weaknesses" in the experimental drug.[150] Acting on that inside information about the anticipated results of clinical trials, Martoma traded in shares of Elan and Wyeth in advance of the scheduled public announcement.[151] His trading averted substantial losses and earned him a $9 million bonus.[152]

Following his conviction for insider trading, Martoma appealed claiming that the jury instructions deviated from the *Newman* personal gain test.[153] In the Second Circuit, Martoma argued that his $1500 an hour consultants did not receive a personal gain.[154] Unremarkably, the court of appeals gave short shrift to this argument.[155]

In affirming Martoma's conviction, the Second Circuit, in a divided panel, concluded that while *Salman* did not expressly overrule *Newman*'s "meaningfully close personal relationship" requirement, *Salman* fundamentally altered the *Dirks* analysis.[156] Chief Judge Katzmann explained that *Salman* characterized a gift of information as

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145. *Martoma*, 869 F.3d at 80.
146. *Salman*, 137 S. Ct. at 428.
147. *Martoma*, 869 F.3d at 81 (quoting *Salman*, 137 S. Ct. at 424).
148. *Id.* at 61–62. Martoma's portfolio had "buying power of between $400 and $500 million." *Id.* at 61. The consulting contracts expressly provided that the consultant was prohibited from providing confidential information, but in practice, this was a mere toothless safeguard. *Id.* at 62.
149. *Id.* at 67.
150. *Id.* at 61–62.
151. *Id.*
152. *Id.* at 62–63.
153. *Id.* at 61.
154. *Id.*
155. *Id.* at 73 (noting that Dr. Gilman, chair of the safety monitoring committee for the clinical trial, provided "43 paid consultation sessions for which he billed $1000 an hour, [and] regularly and *intentionally* provided Martoma with confidential information" from the trial).
156. *Id.* at 69.

equivalent to a tipper trading on the information and then gifting the proceeds.[157] The *Martoma* court reasoned that a gift of inside information with the belief that the recipient would trade on it was tantamount to a personal gain because the information was used for a non-corporate purpose.[158]

In a vigorous dissent, Judge Pooler accused the majority of eliminating the personal gain requirement.[159] The dissent argued that *Salman* only overruled *Newman* "'*[t]o the extent*' that it required an insider to 'receive something of a pecuniary or similarly valuable nature' as a result of giving a gift to a friend"[160] and noted that *Salman*'s close examination of the relationship between two brothers, Michael Kara and Mahar Kara, was a needless inquiry if the Supreme Court had rejected the "meaningfully close personal relationship" requirement.[161] Judge Pooler observed that the Supreme Court emphasized this point in *Salman* when it qualified the gifting requirement "nearly a half-dozen times" with the phrase "to a trading relative or friend"—a strong signal that the friend or family standard remains good law.[162]

Martoma reads *Salman* far too broadly and uses its sweeping interpretation as a springboard to substantially weaken the personal benefit requirement. Thus, the line between lawful and unlawful trading is blurred.[163] The *Dirks* personal benefit requirement protects innocent actors because it requires the government to establish with *objective facts* that something of value was exchanged, whether immediately or in the future.[164] *Newman*'s "meaningful close personal relationship" was meant to draw a line between tips that were intended as a gift versus inadvertent innocent disclosures.[165] By focusing on the intent of the tipper, which can be established through circumstantial evidence—particularly in civil liability—*Martoma* undermines

157. *Id.*
158. *Id.* at 71, 81–82.
159. *Id.* at 74 (Pooler, J., dissenting).
160. *Id.* at 80 (citations omitted).
161. *Id.* at 80–81.
162. *Id.* at 84–85.
163. *Id.* at 86.
164. *Id.* at 76–78. An innocent actor "is unlikely to receive a benefit from sharing information unless he or she knows the information is material and nonpublic." Further, the rule places the tippee in a better position to know whether the disclosure is illicit based on the personal connection between the tipper and tippee. *Id.* at 78.
165. *Id.* at 78.

Salman.[166] *Martoma*'s holding that virtually any disclosure of information, regardless of the relationship between the parties, should be construed as providing a personal benefit ignores *Dirks* and eviscerates the concept of personal benefit as a marker between legal and illegal conduct.[167]

Despite *Martoma*, the Supreme Court's decision in *Salman* leaves lower courts outside the Second Circuit to consider the entire spectrum of potential personal gain. That spectrum begins with tippers like Dirks, who gained nothing, and ends with tipper-tippees like the Kara brothers, who exchanged inside information to get rich.[168]

III. THE LINGERING QUESTION: WHAT IS A CLOSE FRIEND?

In the wake of *Salman*, a tippee may satisfy the personal gain requirement simply by being a close friend to the tipper.[169] But what are the features of a close friendship? The current state of jurisprudence on this question provides six main guidelines for prosecutors and practitioners.

First, when examining whether a tipper has received a personal benefit, courts apply a totality-of-the-circumstances test.[170] Second, courts generally find that a tip to a coworker or someone on equal footing in business yields a personal gain.[171] Third, when a quid pro quo is not readily ascertainable, additional social ties between the tipper and tippee should be explored.[172] Fourth, sharing a collegiate connection tends to be a substantial factor that shows a close

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166. *Id.* at 77. Civil liability requires only a preponderance of the evidence, a lower standard than beyond a reasonable doubt. *Id.* at 73.

167. *Id.* at 86 (reasoning that the majority's reasoning "could cover nearly any disclosure, and thus eliminate the personal benefit rule entirely").

168. *See* Salman v. United States, 137 S. Ct. 420, 427–28 (2016) (citing that the tipper in *Salman* personally benefited by helping his brother, but the tipper in *Dirks* did not personally benefit by exposing fraud).

169. *Id.*

170. *See* United States v. Riley, 90 F. Supp. 3d 176, 189 (S.D.N.Y. 2015), *aff'd*, 638 F. App'x 56 (2d Cir. 2016) (explaining that even if none of the circumstances standing alone were sufficient, the totality of the circumstances demonstrated that the tipper anticipated a benefit), *cert. denied*, 137 S. Ct. 589 (2016).

171. *See* SEC v. Yun, 327 F.3d 1263, 1280 (11th Cir. 2003) (holding that the tipper expected to benefit by maintaining a good relationship with her coworker and partner in real estate deals).

172. *See* SEC v. Anton, No. CIV.A. 06-2274, 2009 WL 1109324, at *9–10 (E.D. Pa. Apr. 23, 2009) (finding that evidence of a lack of other social ties, such as social or personal friendship, demonstrated that tipper benefits had not occurred).

relationship.[173] Fifth, the greater the duration and intimacy of a friendship, the more likely a relationship will qualify as a personal gain under *Dirks*.[174] Sixth, if a relationship is merely professional, with no history of personal favors or any family or social connections, no personal gain exists.[175] Each of these guidelines is explained in greater detail below.

A. District Courts Define Friendship

When examining whether a tipper has received a personal benefit, courts apply a totality-of-the-circumstances test.[176] In *United States v. Riley*,[177] David Riley tipped his friend Matthew Teeple about several pending confidential tender offers.[178] The Southern District of New York applied a totality-of-the-circumstances test to evaluate all of the surrounding personal benefits provided to the tipper, Riley.[179] The court concluded that Riley and Teeple's relationship was sufficient to establish a personal benefit under *Dirks*. Teeple regularly met with Riley in San Jose, supported Riley's side business, assisted him in his job search, and provided him with investment advice.[180] This amounted to a quid pro quo relationship in anticipation of pecuniary gain.[181] Looking at the symbiotic aspects of their relationship, the court found that all aspects of a friendship were in play.

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173. *See* SEC v. Clay Capital Mgmt., LLC, 2013 WL 5946989, at *3–4 (D.N.J. Nov. 6, 2013) (finding a close friendship where the tipper and tippee attended business school together, were brothers-in-law, and the tipper was the best man at the tippee's wedding).

174. *See, e.g.*, United States v. Evans, 486 F.3d 315, 319, 323 (7th Cir. 2007) (ruling that personal gain was found where the tipper and tippee had met as freshmen in college, talked daily, and had seen each other frequently).

175. *See* SEC v. Maxwell, 341 F. Supp. 2d 941, 949–50 (S.D. Ohio 2004) (holding that the defendant did not derive any personal benefit from disclosing material, nonpublic information to his barber).

176. *See* United States v. Riley, 90 F. Supp. 3d 176, 189 (S.D.N.Y. 2015), *aff'd*, 638 F. App'x 56 (2d Cir. 2016), *cert. denied*, 137 S. Ct. 589 (2016).

177. 90 F. Supp. 3d 176 (S.D.N.Y. 2015), *aff'd*, 638 F. App'x 56 (2d Cir. 2016), *cert. denied*, 137 S. Ct. 589 (2016).

178. *Id.* at 182. Riley, the Vice President and Chief Information Officer at Foundry Networks, stayed in contact with his former colleague, Matthew Teeple, who worked as an analyst for the hedge fund, Artis Capital Management, in 2007. After Riley and Teeple traveled to San Jose together, Artis changed its financial position in Foundry. *Id.* at 181–82.

179. *Id.* at 189.

180. *Id.* at 182, 186–89.

181. *Id.* at 189.

Courts generally find that a tip to a coworker results in the tipper receiving a personal gain.[182] In *SEC v. Yun*,[183] Donna Yun, a real estate broker, provided a stock tip[184] to her coworker, Jerry Burch.[185] The Eleventh Circuit held that the relationship between Yun and Burch was sufficient for a jury to find that Yun received a personal benefit.[186] Specifically, the court noted that the two were "'friendly,' worked together for several years, and split commissions on various real estate transactions over the years."[187] In sum, relationships where one person relies on another for potential pecuniary gain generally satisfy the personal gains test.

However, in the context of former colleagues, additional personal ties between the tipper and tippee are needed when a quid pro quo is not readily ascertainable.[188] In *SEC v. Anton*,[189] Frederick Anton was the chairman of PMA Capital and allegedly tipped[190] David Johnson, a former PMA executive and shareholder.[191] The Eastern District of Pennsylvania rejected the SEC's argument[192] and held that the trial testimony failed to establish that Anton and Johnson were friends.[193] The court held that Anton did not expect any future benefit from any alleged tip.[194] The court reasoned that the two defendants had no

182. *See* SEC v. Yun, 327 F.3d 1263, 1280 (11th Cir. 2003) (finding that a jury could reasonably conclude that a tipper expected to gain from a tip given to someone the tipper had worked with for several years and had split commissions on real estate transactions).

183. 327 F.3d 1263 (11th Cir. 2003).

184. David Yun, the President of Scholastic Book Fairs, attended a senior management retreat where he learned that the company would post a loss for the quarter. The company subsequently gave a public statement noting a revised downward forecast. However, before the public announcement, he informed his wife, Donna Yun. *Id.* at 1267–68.

185. Jerry Burch purchased nearly $20,000 of put-options on Scholastic's stock before the announcement, leading to profits of $269,000. *Id.* at 1268.

186. *Id.* at 1280.

187. *Id.*

188. SEC v. Anton, No. 06-2274, 2009 WL 1109324, at *1, *9 (E.D. Pa. Apr. 23, 2009).

189. No. 06-2274, 2009 WL 1109324, at *1 (E.D. Pa. Apr. 23, 2009).

190. The stock tip concerned an upcoming earnings report and information about the suspension of future dividend payouts. In total, Johnson avoided a loss of $325,305 due to the alleged tip. *Id.* at *1–2.

191. *Id.* at *1.

192. The SEC contended that Anton's knowledge of Johnson's holdings and of the potential negative impact on earnings, coupled with Anton and Johnson's "long history and personal relationship," was sufficient for a jury to reasonably conclude that Anton could expect a personal gain. *Id.* at *9.

193. *Id.*

194. *Id.*

social or personal relationship; Johnson had "been to Anton's home only once, did not have Anton's personal contact information other than his office phone number, and had never received a gift from Anton."[195] Finally, the court noted that Anton had not spoken with Johnson following the alleged disclosure, which supported the court's conclusion that there was no personal gain.[196]

Even if the tipper and tippee are not in the same business, their social relationship can be sufficient to infer a benefit.[197] In *SEC v. Sargent*,[198] Dennis Shepard tipped his dentist, Michael Sargent, about a merger and did not receive a direct financial benefit.[199] Nevertheless, the First Circuit examined their relationship and noted that aside from their doctor-patient relationship, their families were close.[200] The court concluded that there was sufficient evidence for a jury to find a close friendship between them because Shepard "often went to Sargent for help" with his work duties, had referred over seventy-five patients to Sargent, and the two of them were generally "friendly."[201]

Sharing a collegiate connection also tends to show either the potential for a future quid pro quo or a gift to a tippee.[202] In *SEC v. Clay Capital Management, LLC*,[203] Scott Vollmar tipped his brother-in-law, James Turner, who also was his former business school classmate.[204] Additionally, Vollmar was the best man at Turner's wedding, and the two exchanged over fifty phone calls during the tip-

195. *Id.*

196. *Id.* Unfortunately for Johnson, he settled with the SEC and paid a total of over $786,000 in civil penalties. *Id.* at *2. Similar to Anton, Johnson may have also been able to defeat the SEC's claims by arguing that he did not receive a personal benefit.

197. SEC v. Sargent, 229 F.3d 68, 77 (1st Cir. 2000).

198. 229 F.3d 68 (1st Cir. 2000).

199. Dennis Shepard ran a consulting business and learned of a potential merger from his business partner, Anthony Aldridge, who sat on the board of a company involved in the merger. *Id.* at 71–72, 77.

200. *Id.* at 77.

201. *Id.* Shepard was a member of the local chamber of commerce and often went to Sargent to help procure funds for the chamber. *Id.* at 72.

202. *See generally* Stephen J. Crimmins, *Insider Trading: Where Is the Line?*, 2013 COLUM. BUS. L. REV. 330, 347 (2013) (suggesting that "virtually any 'friendship[,]'" including "[t]he simple fact they were college friends[,]" would satisfy the benefit requirement).

203. No. 2:11-CV-05020-DMC-JBC, 2013 WL 5946989, at *1 (D.N.J. Nov. 6, 2013).

204. Scott Vollmar worked for Autodesk as a director of business development and became privy to confidential information about Autodesk's financial results. Vollmar then disclosed information about Autodesk's interest in potentially acquiring Moldflow to James Turner. Turner then traded on this information, acquiring substantial profits. *Id.*

giving period.[205] The New Jersey District Court held that all of these circumstances sufficed to establish that Vollmar received a personal benefit from tipping Turner.[206]

The Southern District of New York came to a similar conclusion. In *United States v. Rajaratnam*,[207] the court found that Rajiv Goel tipped Raj Rajaratnam,[208] and Rajaratnam had sufficient personal connections with Goel to sustain Rajaratnam's conviction.[209] The court cited evidence such as the two meeting in business school and their families vacationing together as establishing a sufficient connection for a jury to infer a personal gain.[210] Therefore, classmate or college bonds tend to be examined closely.

The courts also examine the duration and intensity of a relationship. In *United States v. Evans*,[211] Paul Gianamore, a Credit Suisse financial analyst, tipped his friend, Ryan Evans, about three pending tender offers.[212] The two friends were freshman-year roommates at DePaul University, and they kept in touch through phone calls, emails, and visits while they both lived in Chicago following graduation.[213] The Seventh Circuit concluded that a reasonable jury could find that Gianamore benefitted from his financial tip because it was made as a

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205. *Id.* at *3.
206. *Id.*
207. 802 F. Supp. 2d 491 (S.D.N.Y. 2011), *aff'd*, 719 F.3d 139, 160 (2d Cir. 2013).
208. During his time as head of Galleon Management Co.'s hedge fund, Rajaratman participated in several insider trading schemes, including one that involved the receipt of insider information concerning an outside company's financial dealings. 802 F. Supp. 2d at 495, 499–500.
209. *Id.* at 507.
210. *Id.* at 506–07, 512.
211. 486 F.3d 315 (7th Cir. 2007).
212. *Id.* at 318–19. Evans's primary argument was that his co-defendant, Gianamore, was acquitted of all charges; thus, no reasonable jury could acquit a tipper (Gianamore) yet convict a tippee using the "beyond a reasonable doubt" standard. *Id.* at 320.
213. *Id.* at 319.

gift to a close friend.[214] Similarly, in *United States v. Bray*,[215] John O'Neill, an executive at Eastern Bank, tipped a fellow Oakley Country Club member.[216] The First Circuit affirmed Bray's conviction, finding that the social ties were sufficient to infer a personal gain.[217] The First Circuit pointed out that the two men knew each other for fifteen years, socialized together at their country club, dined at local restaurants, and Bray did favors for O'Neill's son over the years.[218]

If a relationship is merely professional, with no history of personal favors or any family or social connections, then a court is not likely to allow a jury to determine whether there was a personal gain. In *SEC v. Maxwell*,[219] David Maxwell provided a tip to his barber, Elton Jehn.[220] Jehn cut Maxwell's hair for fifteen years, but Maxwell only knew Jehn by his nickname, "Al."[221] During Maxwell's haircuts, they discussed "family and personal matters, as well as how things were going at [Maxwell's company]."[222] Concluding that Maxwell did not receive a

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214. *Id.* at 323–25; *see also* SEC v. Sabrdaran, No. 14-CV-04825-JSC, 2017 WL 2081339, at *1, *3, *9 (N.D. Cal. May 15, 2017) (sustaining the defendants' conviction because the evidence supported a finding of the defendants' "longstanding friendship" as determined by their frequent phone calls, emails, and Facebook messages to discuss developments in their lives, philosophy, and international travel plans to see one another); SEC v. Blackwell, 291 F. Supp. 2d 673, 682, 684, 692–93 (S.D. Ohio 2003) (finding the relationship between the tipper and tippee to be sufficient because the tippee knew the tipper for over ten years; was a close confidant; was relied upon by the tipper to manage the office; received a $30,000, interest-free loan from the tipper; and went house-hunting with the tipper).

215. 853 F.3d 18 (1st Cir. 2017).

216. *Id.* at 22. The court also noted that the Oakley Country Club in Watertown, Massachusetts, was a hotbed for criminal securities fraudsters. *Id.* at 21–22, 22 n.1 (citing United States v. McPhail, 831 F.3d 1 (1st Cir. 2016); United States v. Parigian, 824 F.3d 5 (1st Cir. 2016)).

217. *Bray*, 853 F.3d at 27 (finding that their friendship, along with O'Neill's expectation that the tip would help his reputation with Bray, was sufficient for the jury to conclude that O'Neill shared the tip for personal gain).

218. *Id.* at 22, 27. The First Circuit also noted that Bray previously extended favors to the O'Neills, such as gifting O'Neill's son his first set of golf clubs and a $1,000 check as a graduation present, and helping his son with internship and employment opportunities. *Id.* at 22.

219. 341 F. Supp. 2d 941 (S.D. Ohio 2004).

220. *Id.* at 943–44. David Maxwell was a senior executive at Worthington and knew of an upcoming tender offer to purchase his company. Jehn, a self-employed barber of forty-five years, emptied his savings accounts and took out loans to help fund purchases of stock and call options of Worthington stock; after the announcement of the merger, Jehn profited nearly $192,000. *Id.* at 943–45.

221. *Id.* at 943.

222. *Id.* at 943–44.

personal benefit, the Southern District of Ohio granted summary judgment.[223] The judge reasoned that Maxwell did not stand to gain from disclosing material, nonpublic information because the parties had no agreement to split profits, held such different "stations in life" that Maxwell could not realize any reputational benefits, and there was no evidence of any familial or social relationship.[224] Therefore, a professional relationship that lacks a social harmonic may be insufficient for a tipper to realize a personal gain.

B. *Personal Gains Findings*

In sum, a few general guideposts have emerged to assess whether a personal connection is sufficient to infer a personal benefit post-*Salman*. First, when the tipper and tippee are coworkers and rely on each other's efforts to transact business, a court is likely to find a personal benefit to the tipper.[225] However, if the relationship is merely professional without any additional social gatherings or reliance on joint efforts for future advancement, then courts will likely find no personal benefit.[226]

Second, with respect to social relationships, those spanning multiple years and involving inter-family gatherings typically meet the threshold of a personal benefit.[227] Naturally, in these circumstances, the courts have noted that a quid pro quo situation may evolve over time as favors are exchanged, such as job prospects for the tippee's child or future business between the tipper and tippee.[228] Similarly, a fact finder may infer a gift of information when a relationship between two families is strong.[229] Therefore, the personal gains test post-*Salman* can be satisfied because these types of relationships naturally spawn a future exchange or a gratuitous gift.[230]

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223. *Id.* at 949–50.
224. *Id.* at 948.
225. *See* SEC v. Yun, 327 F.3d 1263, 1280 (11th Cir. 2003); *supra* notes 182–87 and accompanying text.
226. *See* SEC v. Anton, No. 06-2274, 2009 WL 1109324, at *9 (E.D. Pa. Apr. 23, 2009); *supra* notes 189–96 and accompanying text.
227. *See Maxwell*, 341 F. Supp. 2d at 948–49; United States v. Bray, 853 F.3d 18, 27 (1st Cir. 2017).
228. *See Bray*, 853 F.3d at 22, 27; *supra* note 218.
229. *See* SEC v. Clay Capital Mgmt., LLC, No. 2:11-CV-05020-DMC-JBC, 2013 WL 5946989, at *3 (D.N.J. Nov. 6, 2013).
230. *Id.*

Further, courts appreciate that friendships forged in college or graduate school tend to last a lifetime.[231] For prior collegiate relationships, the courts discern a mix of both social bonds that could trigger the gifting rationale of *Dirks*—where instead of trading on illicit knowledge and then gifting the proceeds, one merely gifts the information—and a professional business relationship that may trigger the quid pro quo rationale.[232] Therefore, prior collegiate relationships are strong indicia of a potential personal gain.[233]

Finally, a customer relationship, by itself, is typically insufficient.[234] Courts recognize that customers expect a friendly and inviting experience.[235] For example, with a barbershop or nail salon, customers may be more likely to visit the business if the barber or stylist shares in pleasant "small-talk" with customers.[236] The courts recognize that these relationships are simply part of everyday commerce and do not, without more, meet the *Dirks* personal gains test.[237]

IV. WALL STREET TAPS K STREET

Insider trading on material, nonpublic information originating from within the government poses a unique challenge to the prosecutors and the PI operatives who collect, analyze, and distribute PI to investors. The PI industry arose when hedge funds sought to obtain a competitive advantage in the marketplace by obtaining nonpublic information about publicly traded companies.[238] Congress attempted to prevent government insiders from exploiting nonpublic information for their own personal gain by passing the STOCK Act.[239]

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231. *See* United States v. Evans, 486 F.3d 315, 319 (7th Cir. 2007); *Clay Capital Mgmt., LLC*, 2013 WL 5946989, at *3; United States v. Rajaratnam, 802 F. Supp. 2d 491, 506–07, 512 (S.D.N.Y. 2011), *aff'd*, 719 F.3d 139, 160 (2d Cir. 2013).

232. *See supra* notes 202–13 and accompanying text (providing examples of when college relationships lead to a determination of personal gain).

233. *See id.*

234. *See* SEC v. Maxwell, 341 F. Supp. 2d 941, 949 (S.D. Ohio 2004) (finding that additional factors beyond the mere client-professional relationship warrant a jury finding that the tipper personally gained from disclosing nonpublic information).

235. *Id.* at 943–44.

236. *See, e.g.*, *id.* at 944–45 (showing that a barber and his patron engaged in conversation during the patron's appointments).

237. *Id.* at 948.

238. *See* Javers, *supra* note 2, at 42 (noting that the PI business started with a few firms in the 1970s, but after hedge funds erupted, new clients with money started seeking out PI).

239. Stop Trading on Congressional Knowledge Act of 2012, Pub. L. No. 112-105, 126 Stat. 291 (to be codified in scattered sections of 5 U.S.C. and 15 U.S.C.).

Although the STOCK Act made several contributions to combat the corrupt practices of some government insiders, the legislation remains woefully inadequate to fully empower law enforcement to carry out its statutory mandates.[240]

A. The PI Industry

PI is the information gained through gathering and analyzing activities conducted by Congress, the White House, and federal agencies.[241] PI firms then sell this information to financial analysts looking for an edge in the stock market.[242] Less familiar to the general public but well known within the halls of Congress,[243] PI is gathered through several channels, such as "briefings, meetings, committee hearings, public or nonpublic documents, personal conversations, and other communication."[244] PI operatives then analyze and sell the

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240. *See* Danielle A. Austin, Note, *We the People or We the Legislature?: The STOCK Act's Compromise Between Politically-Motivated Accountability and Keeping Congress Above the Law*, 42 HOFSTRA L. REV. 267, 290–91 (2013) (finding that many provisions of the STOCK Act lack methods of enforcement).

241. U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-13-389, POLITICAL INTELLIGENCE: FINANCIAL MARKET VALUE OF GOVERNMENT INFORMATION HINGES ON MATERIALITY AND TIMING 1 (2013) [hereinafter GAO REPORT]. PI is defined as:

> information that is derived by a person from direct communication with an executive branch employee, a Member of Congress, or an employee of Congress; and provided in exchange for financial compensation to a client who intends, and who is known to intend, to use the information to inform investment decisions.

Id. (internal quotation marks omitted) (quoting Pub. L. No. 112-105, 126 Stat. 291).

242. *See* Mullins & Scannell, *supra* note 1 (reporting that PI firms are "charging hedge funds between $5,000 and $20,000 a month for tips and predictions").

243. *See* Brody Mullins & Susan Pulliam, *Buying 'Political Intelligence' Can Pay Off Big for Wall Street*, WALL ST. J., (Jan. 18, 2013), https://www.wsj.com/articles/SB10001424127887324660404578202072713156116 (describing the emergence of the PI industry and the need for regulation).

244. *See* GAO REPORT, *supra* note 241, at 4 (noting that these communications are between a PI firm representative and an executive branch employee, a legislative branch employee, or a member of Congress). From 2011 to 2012, Elizabeth Fowler, a top health-policy advisor to President Obama, met numerous PI operatives before a flurry of healthcare trading. These meetings included one with a former colleague from the Senate Finance Committee staff, Shawn Bishop, who at the time was a senior vice president at the Marwood Group, a PI firm, and a meeting with representatives from T. Rowe Price that was set up by Capitol Street, yet another PI firm. Tom Hamburger, *Political Intelligence Firms Set Up Investor Meetings at White House*, WASH. POST (May 26, 2013), https://www.washingtonpost.com/politics/political-intelligence-firms-set-up-investor-meetings-at-white-house/2013/05/26/73b06528-bccb-11e2-9b09-1638acc3942e_story.html.

information, typically in monthly subscriptions, to hedge funds.[245] The PI industry is small but lucrative for the lobbyists and lawyers who have the connections to collect it and for the hedge funds that can afford it.[246]

Hedge funds are hiring lobbyists because of their existing connections with Capitol Hill and the executive branch.[247] Lobbying is the act of advocating on behalf of another for financial compensation to influence proposed government action.[248] However, unlike lobbying firms that have to disclose which bills they are

245. *See* Mullins & Scannell, *supra* note 1 (describing how hedge funds hire lobbyists to acquire PI for a large monthly fee).

246. *Id.* (explaining that Elliott & Associates, D.E. Shaw & Co., and Angelo Gordon & Co. paid over $80,000 in fees to join a lobbying coalition to receive information on the progress of an asbestos bill); *see also* Catherine Ho, *Trump Victory Could Mean Big Business for K Street*, WASH. POST (Nov. 9, 2016), https://www.washingtonpost.com/news/powerpost/wp/2016/11/09/trump-blasted-lobbyists-on-the-campaign-trail-but-his-victory-could-mean-big-business-for-k-street (noting that lobbying firms, which predominately preside on K Street in Washington, D.C., are anticipating a windfall of business due to the radical change in agenda between President Obama and President Trump); Brody Mullins & Susan Pulliam, *Hedge Funds Pay Top Dollar for Washington Intelligence*, WALL ST. J. (Oct. 4, 2011), https://www.wsj.com/articles/SB10001424053111904070604576514791591319306 (citing Integrity Research Associates' estimate that the PI industry is approximately a $100 million a year business). *See generally* Martin Klotz et al., *SEC Reaches Settlement with Political Intelligence Firm, but Does Not Charge Insider Trading*, WILLKIE FARR & GALLAGHER LLP (Dec. 1, 2015), http://www.willkie.com/~/media/Files/Publications/2015/11/SEC_Reaches_Settlement_With_Political_Intelligence_Firm_But_Does_Not_Charge_Insider_Trading.pdf (noting how the SEC's settlement deal with Marwood Group Research LLC, in which the PI firm had to pay $375,000 for not having policies to prevent the misuse of material, nonpublic information, may show the SEC's increased willingness to settle in a post-*Newman* world where it has become more difficult to prosecute PI firms for insider trading).

247. *See* Javers, *supra* note 2, at 42 (explaining the lucrative business of PI and how the hedge fund industry is utilizing it).

248. 2 U.S.C. § 1602(8)(A), 1602(10) (2012) (stating that lobbying includes influencing legislation, federal rules, executive orders, the administration of federal programs, or the nomination of persons to a Senate-confirmed position). Although proponents of lobbying argue that the practice helps inform lawmakers in niche areas of laws in which they may be unfamiliar, advocacy groups on both sides of the aisle have long decried the practice as corrupt, resulting in legislation such as the Lobbying Disclosure Act of 1995, Pub. L. No. 104-65, 109 Stat. 691 (codified as amended at 2 U.S.C. §§ 1601–1614). *See* Katharine Q. Seelye, *Pro or Con, Lobbying Thrived*, N.Y. TIMES (Jan. 30, 2010, 8:11 PM), https://prescriptions.blogs.nytimes.com/2010/01/30/pro-or-con-lobbying-thrived (explaining that lobbying helps parties on both sides of the aisle).

influencing,[249] PI gathering remains unregulated.[250] The Lobbying Disclosure Act (LDA) requires exhaustive reporting for persons who send information or opinions to Capitol Hill with an objective of influencing legislation.[251] Yet merely asking questions to receive information is not considered "lobbying," and thus is not within the ambit of the LDA.[252]

PI firms primarily sell their services to hedge funds, which possess both the capital and human resources to convert tips and predictions into profits.[253] Hedge funds "pursue high-risk, high-yield investments for wealthy clients"[254] and were created as an outgrowth of the Investment Company Act ("ICA"). The ICA prohibits mutual funds with over 500 investors from leveraging more than twenty-five percent of its stock portfolio; this creates an opportunity for investment companies with less than 500 investors to leverage up to fifty percent of the purchase price of a stock, allowing these companies to take greater risks and potentially reap greater profits.[255] PI is valuable to hedge funds because they tend to hold assets for only a brief period of time.[256] Thus, hedge funds have been robust consumers of PI and have

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249. Lobbyists must provide quarterly reports that includes "a list of the specific issues upon which a lobbyist employed by the registrant engaged in lobbying activities, including, to the maximum extent practicable, a list of bill numbers and references to specific executive branch actions . . . ." 2 U.S.C. § 1604(b).

250. *See* Javers, *supra* note 2, at 42; *see also* Opinion Desk, *Political Intelligence Panel Discussion Concludes with Recognized Need for Increased Disclosure of Non-Public Material Collection and Use*, BUS. WIRE (June 12, 2012, 8:00 AM), http://www.businesswire.com/news/home/20120612005322/en/Political-Intelligence-Panel-Discussion-Concludes-Recognized-Increased (stating that several members of the PI industry had a discussion about defining the industry, the potential need for additional regulation, and whether PI members should be required to register as lobbyists).

251. Lobbying Disclosure Act of 1995, Pub. L. No. 104-65, §§ 3, 5, 109 Stat. 691, 692, 697 (codified as amended at 2 U.S.C. §§ 1602(8)(A), 1604).

252. 2 U.S.C. § 1602 (8)(B).

253. *See* Mullins & Scannell, *supra* note 1.

254. *See id.* (explaining that hedge funds buy and sell company stock based on PI before that information is widely known).

255. *See* ROBERT W. HAMILTON & RICHARD A. BOOTH, CORPORATE FINANCE: CASES AND MATERIALS 358–59 (4th ed. 1984) (explaining how the Federal Reserve Board's rules limit investors from purchasing stock on margin and its consequence on the formation of various investment firms).

256. "What sets hedge funds apart is their ability to act instantly on news and to employ trading options that allow them to make money whether stocks rise or fall." Jensen et al., *supra* note 253.

successfully used PI to make informed decisions on their portfolio positions, yielding bountiful profits.[257]

B. The STOCK Act

On April 4, 2012, President Barack Obama signed into law the STOCK Act, which contained several new provisions addressing congressional insider trading and PI.[258] First, the Act conferred a fiduciary duty upon all public employees and prohibits members of Congress and other federal employees from trading material, nonpublic information.[259] Second, the Act provided an affirmative duty for a "covered government person"[260] to publicize within forty-five days any purchase or sale of "stocks, bonds, commodity-futures, or other securities."[261] Third, the STOCK Act called for the Comptroller General, who leads the Government Accountability Office (GAO), and the Congressional Research Service to conduct a research study on the practice of selling PI.[262] Fourth, the STOCK Act prohibited covered persons from purchasing securities that are the subject of an initial public offering.[263]

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257. For example, the *Wall Street Journal* reported that Paul Equale, a consultant for Gerson Lehrman Group Inc., a PI firm, attended a gathering for former Senate Majority Leader Harry Reid (D-NV), where he spoke with two of the Senator's leading supporters who confirmed it would be politically inconvenient for the Senator to allow a bill benefiting the gambling industry to move forward. Mr. Equale then allegedly passed the information on to a hedge fund who was able to factor that information into its position on MGM Resorts International shares. Brody Mullins & Susan Pulliam, *Hedge Funds Pay Top Dollar for Washington Intelligence*, WALL ST. J. (Oct. 4, 2011), https://www.wsj.com/articles/SB10001424053111904070604576514791591319306.

258. *See* Press Release, White House Office of the Press Sec'y, Statement by the Press Secretary on S. 2038 (Apr. 4, 2012), https://obamawhitehouse.archives.gov/the-press-office/2012/04/04/statement-press-secretary-s-2038 (discussing the main provisions of the STOCK Act and reaffirming President Obama's commitment to government ethics reform).

259. Stop Trading on Congressional Knowledge Act of 2012, Pub. L. No. 112-105, § 4(g)(1), 126 Stat. 291, 292 (to be codified at 15 U.S.C. § 78u-1). *But see* Sung Hui Kim, *The Last Temptation of Congress: Legislator Insider Trading and the Fiduciary Norm Against Corruption*, 98 CORNELL L. REV. 845, 870 (2013) (analogizing the legislator-citizen relationship to a fiduciary relationship and arguing that the STOCK Act did not substantially change the state of insider trading for legislators).

260. Pub. L. No. 112-105, § 18, 126 Stat. 291, 304 (including members and employees of the executive branch and legislative branch as "covered government persons").

261. *Id.* § 6, 126 Stat. at 293 (setting the reporting requirements after receiving notice of any transaction under section 102(a)(5)(B) and section 101).

262. *Id.* § 7(a), 126 Stat. at 294–95 (requiring that the PI Report include a discussion of six items enumerated in the act).

263. *Id.* § 12, 126 Stat. at 300.

At a time when opinion polls ranked Americans' faith in public institutions at a record low, the STOCK Act was a common-sense political decision for legislators and the President.[264] The STOCK Act was a reaction to a series of scandals where the public learned of congressional members' alleged insider trading resulting from PI;[265] however, no prosecutions arose from these scandals.[266] The bill passed with only two "no" votes in the House and three in the Senate.[267] The STOCK Act passed with great fanfare, yet it did little to change the business of selling or tipping off analysts to the inner-workings and nonpublic deliberations of the government.[268] The purpose of the Act is two-fold: (1) to prevent congressional, judicial, and executive officers from executing trades based off of material, nonpublic information

264. Walsh, *supra* note 9.

265. *See, e.g.*, 60 Minutes, *Congress: Trading Stock on Inside Information?*, CBS NEWS (Nov. 13, 2011), https://www.cbsnews.com/news/congress-trading-stock-on-inside-information (describing Speaker John Boehner's (R-OH) and Representative Nancy Pelosi's (D-CA) well-timed and insightful stock purchases during the debate on the Affordable Care Act and 2008 legislation affecting major credit card companies); James Grimaldi & Michelle Hackman, *Donald Trump's Pick for Health Secretary Traded Medical Stocks While in House*, WALL ST. J. (Dec. 22, 2016), https://www.wsj.com/articles/donald-trumps-pick-for-health-secretary-traded-medical-stocks-while-in-house-1482451061 (discussing insider trading of Congressman Spencer Bachus (R-AL), who made $28,000 from over 200 trades).

266. *See* Amber Phillips, *Why One Expert Says Tom Price's Stock Deals May Very Well Have Broken the Law*, WASH. POST (Jan 18. 2017), https://www.washingtonpost.com/news/the-fix/wp/2017/01/18/why-one-expert-says-tom-prices-stock-deals-may-very-well-have-broken-the-law (stating that the STOCK Act has yet to yield any congressional prosecutions).

267. *See* Press Release, U.S. Congressman Tim Walz, Walz STOCK Act Passes House (Feb. 9, 2012), https://walz.house.gov/media-center/press-releases/walz-stock-act-passes-house (commenting that the passing of the STOCK Act was long overdue); Seung Min Kim, *House Approves Insider Trading Ban*, POLITICO (Feb. 9, 2012), www.politico.com/story/1012/02/house-approves-insider-trading-ban-072670.

268. Austin, *supra* note 240, at 270 (arguing that although the STOCK Act was necessary to clarify the issue of Congress's fiduciary duty, it allows too many loopholes and does not provide any proper enforcement mechanisms due to the lack of access to trading information); *see also* Paul D. Brachman, Note, *Outlawing Honest Graft*, 16 N.Y.U. J. LEGIS. & PUB. POL'Y 261, 283–97 (2013) (discussing how the U.S. Constitution's Speech and Debate Clause will frustrate investigations of illicit trading by congressional members); Tamara Keith, *How Congress Quietly Overhauled Its Insider-Trading Law*, NAT'L PUB. RADIO (Apr. 16, 2013, 5:12 PM), http://www.npr.org/sections/itsallpolitics/2013/04/16/177496734/how-congress-quietly-overhauled-its-insider-trading-law (discussing the legislators' 2013 amendment to the STOCK ACT, made in response to security risks that decreased transparency).

derived from their government jobs and (2) to identify the PI industry to establish a foundation for potential future legislation and regulations.[269]

The STOCK Act contributed two new developments to the PI industry. First, although the law does not formally regulate the industry, it does acknowledge its existence by calling for the Comptroller General to conduct a research study to discover its prevalence within the government.[270] In particular, Congress was concerned about the practice of selling material, nonpublic information to securities analysts.[271] The study yielded several conclusions from the GAO, including that the GAO could not discern the extent of the sale of PI to investors.[272] The GAO, having only found two examples during the fourteen interviews with intelligence firms, could not articulate the full extent of investors' reliance on PI to make investing decisions.[273] PI gathered using insider tactics—such as private conversations and correspondence—is bundled with other publicly accessible information and sold to investors.[274] Also, financial compensation from investor-clients to PI firms is usually not tied to a specific tip but rather to long-term analysis of an entire industrial sector.[275] Thus, the GAO study does not fully address congressional concerns.

Second, the STOCK Act explicitly imputes a fiduciary duty to members of Congress and government employees.[276] This

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269. Stop Trading on Congressional Knowledge Act of 2012, Pub. L. No. 112-105, §§ 2–3, 7, 9, 126 Stat. 291, 291–92, 295, 297 (to be codified in scattered sections of 5 U.S.C.).

270. Pub. L. No. 112-105, § 7, 126 Stat. 291, 294–95; *see* GAO REPORT, *supra* note 241, at 1 (outlining the objectives for the GAO study into the relationship between political intelligence and the financial market).

271. GAO REPORT, *supra* note 241, at 1 ("The STOCK Act directed GAO to study the role of political intelligence in the financial markets . . . [and] the extent to which investors rely on such information . . . .").

272. *See id.* at 8 (highlighting the difficulty in determining the extent of the sales due to the bundling of information and lack of consensus on the definition of PI).

273. *See id.* (noting that, even though quantifying the prevalence of these sales is extremely difficult, there are two examples of investors using political information).

274. *Id.* at 4.

275. *Id.* at 8, 11.

276. *See* Pub. L. No. 112-105, § 4(g)(1), 126 Stat. 291, 292, which states:

> [E]ach member of Congress or employee of Congress owes a duty arising from a relationship of trust and confidence to the Congress, the [U.S.] Government, and the citizens of the United States with respect to material, nonpublic information derived from such person's position as a Member of Congress or employee of Congress or gained from the performance of such person's official responsibilities.

Similar language exists for judicial and executive branch employees in a subsequent section of the STOCK Act. *Id.* § 9(a)(1)–(3), 126 Stat. at 297.

development is significant because insider trading under the classical theory is predicated on a breach of a fiduciary duty.[277] It extends the reach of the misappropriation theory to outsiders who acquire material, nonpublic government information from their employers, such as law firms or consultants who contract with the government.[278]

V. HOW *SALMAN* AND THE STOCK ACT IMPACT THE PI INDUSTRY

A. The PI Industry's Use of Personal Connections May Violate Insider Trading Laws

After the *Salman* decision, which reaffirmed *Dirks*'s expansive personal gains test, and the STOCK Act, some of the PI firms' practices may constitute insider trading and violate Rule 10b-5. PI operatives who communicate with government officials to gather material, nonpublic information may be impermissibly leveraging their personal connections with government officials to gain information.[279] Typically, PI operatives are lobbyists and/or lawyers who previously worked for the government and maintain close ties with their former co-workers or have other influences over legislators.[280] If a tippee knows, or should have known, that there has been a breach of a fiduciary duty and there is a personal benefit to the tipper, then any

277. Cady, Roberts & Co., Exchange Act Release No. 34,6668, 40 SEC Docket 907, 911–12 (Nov. 8, 1961) (holding that the defendants breached their fiduciary duty to the corporation's stockholders when they traded on material, nonpublic information because the information was property of the company); *see also* Martha L. Cochran et al., *STOCK Act Expands Insider Trading Liability: Communicating with Government Officials Carries New Risks*, ARNOLD & PORTER 1 (Apr. 2012), https://www.apks.com/~/media/files/perspectives/publications/2012/04/stock-act-expands-insider-trading-liability-comm__/files/newsletter-item/fileattachment/advisory-stock_act_expands_insider_trading_liabi__.pdf (advising clients to be wary of communications with public officials).

278. Sara Almousa, Comment, *Friends with Benefits? Clarifying the Role Relationships Play in Satisfying the Personal Benefit Requirement Under Tipper-Tippee Liability*, 23 GEO. MASON L. REV. 1251, 1258–59 (2016) (discussing the expansive application of the misappropriation theory through the Supreme Court's endorsement of the theory in *O'Hagan*, where a law firm partner violated a duty of trust and confidence, resulting in the SEC introducing Rule 10-b).

279. *See* Alexandra Stevenson & Matthew Goldstein, *Insider-Trading Case Ensnares Hedge Fund*, N.Y. TIMES (May 24, 2017), https://www.nytimes.com/2017/05/24/business/dealbook/five-accused-of-trading-illegally-on-health-policy-leaks.html (discussing the investigation into a Washington consultant for selling to a hedge fund material, nonpublic information that he received from a friend at the Centers for Medicare and Medicaid services).

280. *See supra* notes 247–50 and accompanying text.

material, nonpublic information must be disclosed before trading a security.[281] To analyze the impact of the STOCK Act and the personal gains test after *Salman*, this Part uses a hypothetical political operative (the "Operative") employed at one of the fourteen PI firms interviewed by the GAO.[282] With that hypothetical Operative in mind, this Part explores those factors that may point to a PI operative realizing a judicially cognizable personal gain on a government tipper.

Our Operative worked for four years as a legislative assistant for a member of Congress and another four years as a senior staffer with the Senate Banking Committee. The Operative is a graduate of a prestigious Washington, D.C., law school and holds a lofty partnership at a global law firm. The Operative resides in Potomac, Maryland, where the Operative also serves as an officer of the Congressional Country Club. With this pedigree, what additional circumstances might draw the Operative within the ambit of 10b-5? Moreover, when might a hedge fund that acted on information from the Operative be liable?[283]

To determine whether tipper-tippee liability applies, a court will apply the four-step test in *Dirks*.[284] In the hypothetical situation, a court would need to first determine whether the government official (the "Official"), breached a fiduciary duty and disclosed material, nonpublic information to the Operative.[285] Second, a court would need to decide whether the Official received a personal benefit from the Operative.[286] Third, a court would ask whether the Operative knew, or should have known, about the Official's breach of fiduciary duty.[287] Fourth, a court would ask whether the Operative used the information in connection with a securities transaction.[288]

The Operative would have to obtain material, nonpublic information in breach of a fiduciary duty.[289] In the context of PI,

281. *See Cady*, 40 SEC Docket at 911 (concluding that the only way to cure the harm was for the possessor of the material, nonpublic information to disclose the information before trading on it); *supra* notes 80–83 and accompanying text.

282. *See* GAO REPORT, *supra* note 241, at 2 (discussing how the GAO conducted its study by interviewing several PI firms to obtain information about the PI industry).

283. Although this hypothetical uses a hedge fund as an example, the analysis would be the same for any person or entity trading any type of security with PI. *See supra* notes 30–34 and accompanying text (describing the elements of a security).

284. *See supra* note 80 and accompanying text.

285. Dirks v. SEC, 463 U.S. 646, 663 (1983).

286. *Id.*

287. *Id.* at 665–66.

288. *Id.* at 666–67.

289. *See id.* at 663–64.

public information includes anything the public can view, listen to, or read, including public hearings on Capitol Hill or public documents.[290] Further, even if a government official breaches fiduciary duty and intentionally disseminates confidential information to the public, trading on such information is permissible because the information is public.[291] Therefore, the Operative must first receive *nonpublic* information, likely through private conversations and correspondence,[292] to be liable for insider trading.

Next, the Official must breach a fiduciary duty in communicating the information to the Operative.[293] Although the existence of this duty may have been disputed prior to the STOCK Act,[294] the statute imposes a fiduciary duty on government officials.[295] Therefore, if the other elements of *Dirks*'s first prong are satisfied—namely, tipping material, nonpublic information—then a fiduciary duty is expressly breached because the STOCK Act requires covered persons to safeguard material, nonpublic information.[296]

Further, to satisfy the remaining element within the first prong, the Official must tip material information to the Operative.[297] Material information is information that a reasonable investor would want to know before investing; further, it must add to the "total-mix" of

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290. *See supra* note 45 (explaining the difference between public and nonpublic information within the context of securities laws).

291. Once a statement is made public, the court will assume, via the efficient market hypothesis, that the information is priced into the market. *See* Halliburton Co. v. Erica P. John Fund, Inc., 134 S. Ct. 2398, 2405 (2014) (affirming the presumption of the efficient market theory, which theorizes that a stock price "reflects all public material information—including material misstatements").

292. *See supra* note 244 and accompanying text (discussing various ways in which PI can be obtained).

293. *See supra* notes 80–83.

294. *See* Lawrence Greenberg, *A Proposal for Abolishing Congressional Insider Trading*, MOTLEY FOOL (Jan. 30, 2012), https://www.fool.com/investing/general/2012/01/30/a-proposal-for-abolishing-congressional-insider-tr.aspx (acknowledging that some experts believe that a duty of trust and confidence and prohibition against insider trading existed prior to the STOCK act).

295. "[E]ach Member of Congress or employee of Congress owes a duty arising from a relationship of trust and confidence to the Congress, the [U.S.] Government, and the citizens of the United States with respect to material, nonpublic information . . . ." Pub. L. No. 112-105, § 4(g)(1), 126 Stat 291, 292.

296. All covered persons must not disclose "material, nonpublic information derived from such person's position [in the Government] or gained from the performance of such person's official responsibilities." *Id.*

297. *See supra* note 285 and accompanying text.

publicly available information.[298] Prosecuting a single tip is often problematic because the tip may be insufficient by itself to satisfy the materiality requirement.[299] When the information is paired with other tips, however, the Operative can draw a material inference that may yield a rich trading tip.[300]

The second *Dirks* prong requires the Official to realize a personal benefit in exchange for the material, nonpublic information.[301] Obviously, if the Operative pays the Official for the insider information, then this prong is satisfied.[302] However, if the Official provided the information to the Operative without a contemporaneous pecuniary exchange, the analysis examines the totality of the circumstances between the Operative and the Official to determine whether a close friendship exists.[303] Given the Operative's background, the Official may have shared prior employment, a collegiate connection, or traveled in similar social circles.

What if the Official currently works for the Senate Banking Committee and was also employed by that Committee when the Operative worked there? Would that relationship by itself be sufficient to infer a personal benefit? Probably not. Here, the Official and the Operative have a prior co-worker relationship, but unlike the relationship in *Yun*, in which the tipper and tippee relied on each

298. *See supra* note 44 (defining materiality).

299. *See* GAO REPORT, *supra* note 241; Mullins & Scannell, *supra* note 1 (explaining how traders were able to reap millions in profits through knowing about an upcoming government announcement). *But see* Stevenson & Goldstein, *supra* note 279 (where alleged single tips were sold as "consulting fees" to a hedge fund).

300. An example of this materiality problem in the asbestos trading scheme scenario, *see* Javers, *supra* note 2, at 42, would be if the PI Operative received four tips from different tippers. Hypothetically, one tip may be that legislation of "some sort" is under consideration. A second tip may be that the Senate Majority Leader has an announcement scheduled for the following day. A third tip may be that an asbestos expert was seen leaving Capitol Hill, and a fourth tip could be that a $20 billion liability fund of "some kind" was being created. Like parts of a puzzle, each tip contains a part of the picture that is unintelligible, and thus not material by itself, but when pieced together with all of the other puzzle pieces, the picture becomes cognizable.

301. *See supra* note 284 and accompanying text.

302. For example, in *United States v. Whitman*, 115 F. Supp. 3d 439, 446 (S.D.N.Y. 2015), a tipper "demanded somewhere in the range of $100,000 to $200,000" per trading tip. The court concluded that this was tantamount of a "classic example[] of an actual . . . quid pro quo" exchange in violation of the personal gains requirement.

303. *See* Dirks v. SEC, 463 U.S. 646, 664 (1983) (acknowledging that "determining whether an insider personally benefits from a particular disclosure . . . will not always be easy for courts"); *see also supra* Part III and accompanying text.

other for profits and advancement,[304] the Official and the Operative no longer work together. However, if the Official is a member of Congress and the Operative routinely organizes fundraising events for Congress, then a quid pro quo scenario similar to *Sargent* may exist. In *Sargent*, the court found a quid pro quo when the parties aided each other with patient referrals and help with the chamber of commerce.[305] Further, a personal gain in connection with a tip no longer needs to be immediate; the promise of future fundraising by the Operative for the Official would likely suffice.[306]

Next, what if the Operative and the Official shared their college years together at the same institution? While collegiate relationships can be a strong indicator of a quid pro quo or gifting relationship,[307] the mere coincidence of being on campus at the same time is insufficient to infer a close relationship.[308] Instead, a court will examine the nature and depth of the parties' relationship.[309] If, as in *Evans* and *Clay Capital*, the Operative and the Official communicated regularly and met socially over the years, a disclosure that was subsequently traded on would likely be an illicit gift to a friend.[310] *Evans* amplified this point by noting that college roommates, even those entering different professions, can spawn relationships that create similar stations in life.[311] Consequently, a personal gain may be inferred from a reasonable expectation on the part of one individual

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304. *Supra* notes 182–87 and accompanying text (explaining that Donna Yun and Jerry Burch were friendly, worked together for years, and split commissions on various real estate transactions).

305. *Supra* notes 198–206 and accompanying text.

306. *See supra* notes 176–81 (applying a totality-of-the-circumstances approach to examine a personal benefit exchange between a tipper and a tippee).

307. *See supra* notes 231–33 and accompanying text.

308. *See* Sara Almousa, *supra* note 278, at 1263–64 (holding that the career advice was insufficient to establish a benefit and was rather "merely an 'encouragement one would generally expect of a fellow alumnus or casual acquaintance'").

309. *See supra* notes 203–10 (reviewing *Clay Capital* and *Rajaratnam*, in which the courts considered the nature and extent of personal relationships between tipper and tippee).

310. *See* Dirks v. SEC, 463 U.S. 646, 664 (1983) (holding that a personal benefit is satisfied when the tipper "inten[ds] to benefit the . . . recipient . . . resembl[ing] trading by the insider himself"); United States v. Evans, 486 F.3d 315, 319 (7th Cir. 2007) (affirming the jury's decision that meeting in college and talking daily on the phone and e-mail are sufficient facts to find a personal gain); *supra* note 205 and accompanying text (commenting that the parties in *Clay Capital* exchanged over fifty phone calls during the tip-giving period).

311. SEC v. Maxwell, 341 F. Supp. 2d 941, 948 (S.D. Ohio 2004).

that a favor will be returned in the future—a quid pro quo.[312] Therefore, collegiate relationships should raise cautionary flags.

Finally, what if the Operative and the Official were both members of the same country club? Where objective circumstances point to a friendship outside of the workplace, courts do not hesitate to put the question to a jury.[313] If the Operative and the Official golf together routinely and attend club social events, their relationship may be analogous to the tipper and tippee in *Bray* who socialized together and exchanged favors.[314] Therefore, 10b-5 liability may attach if the factual circumstances indicate a close social relationship.

The third *Dirks* prong—whether the tippee should have known of the breach—involves consideration of whether the tip was nonpublic information. The STOCK Act places the public on notice that government employees owe a fiduciary duty to the government and the American people; therefore, the Operative knows, or should know, that the Official is breaching a duty.[315] The knowledge element turns on the issue of whether the tippee knew that the information was nonpublic.[316] If the Operative knows that the information is nonpublic, then the Operative also knows, or should know, that the Official breached a fiduciary duty.

The fourth *Dirks* prong is satisfied only if the information that the Operative obtains is used "in connection with" securities trading.[317] Here, if the Operative personally trades on the information, this element

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312. United States v. Riley, 90 F. Supp. 3d 176, 184 (S.D.N.Y. 2015) (explaining that the personal benefit does not need to be immediate, but rather that the tip must lead to the benefit, now or in the future).

313. United States v. Bray, 853 F.3d 18, 22, 27 (1st Cir. 2017) (finding that there was a "plausible" close relationship between two people who had met in college and maintained a social relationship).

314. *Id.* at 27 (affirming the conviction of the defendant because the tipper an tippee were members of the same golf club, "dined with each other at local bars and restaurants, and even took each other's counsel"); *see supra* notes 215–18 and accompanying text.

315. For a discussion on public notice, see generally Joseph E. Murphy, *The Duty of the Government to Make the Law Known*, 51 FORDHAM L. REV. 255, 257–63 (1982), which states that once a bill has been signed into law and published, the public is presumed to be on notice.

316. The STOCK Act requires that all covered persons must not disclose "material, *nonpublic* information" (emphasis added). Stop Trading on Congressional Knowledge Act of 2012, Pub. L. No. 112-105, § 4, 126 Stat. 291, 292 (to be codified at 15 U.S.C. § 78u-1).

317. *See* 15 U.S.C. § 78j(b) (2012) (requiring that the fraud or deceit occur "in connection with" the purchase or sale of a security).

is satisfied.[318] On the other hand, if the Operative sells the information to someone who does not trade on it, insider trading liability does not attach to the Operative.[319] Of course, PI firms service hedge funds and hedge funds buy and sell securities.[320] Thus, it seems reasonable to conclude that PI firms knowingly transmit nonpublic information to entities that satisfy the "in connection with" requirement.[321]

B. New Compliance Challenges for Hedge Funds that Consume PI

A hedge fund may have insider trading liability if it knew, or should have known, that the Operative satisfied the *Dirks* prongs. But given the bundling of PI from multiple sources and the burden of proving that the hedge fund knew its information was gathered impermissibly, finding knowledge is a high hurdle.

First, proving materiality is problematic because PI firms allegedly do not sell single tips, choosing instead to bundle the information gained from many sources into a single product, usually a monthly update.[322] Such bundling makes it difficult for prosecutors to establish that any one piece of information is material because it was embedded in a "mosaic of public information."[323] Each assertion may be either nonmaterial in and of itself or based on publicly available information; however, those pieces of information in the aggregate could provide a trading tip.[324] Nevertheless, if the government can prove that material, nonpublic information was embedded within the product, then an

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318. *See supra* notes 56–60 (discussing corporate insider fiduciary duties to the company).

319. *See* 15 U.S.C. § 78j(b).

320. *See* Javers, *supra* note 2 (explaining that the hedge fund industry consumes PI because hedge funds short-sell stocks and can leverage their positions for greater profits).

321. 15 U.S.C. § 78j(b).

322. *See* GAO REPORT, *supra* note 241, at 11 (describing how several of the PI firms interviewed by the GAO predominately sell their information as newsletters, hourly rates as services provided, or upfront fees). *But see* Stevenson & Goldstein, *supra* note 279 (alleging that single tips were sold as "consulting fees" to a hedge fund).

323. *See* Andrew Ross Sorkin, *Just Tidbits, or Material Facts for Insider Trading?*, N.Y. TIMES (Nov. 29, 2010, 8:56 PM), https://dealbook.nytimes.com/2010/11/29/just-tidbits-or-material-facts-for-insider-trading.

324. *Id.* ("[T]he mosaic theory is that each individual piece of information is nonmaterial by itself: an individual piece of information would not move the price of the security if disseminated in a public press release. Taken together, however, the bits of information can form a meaningful mosaic."). For another example of the mosaic theory, see *supra* note 300.

insider trading violation may be proved because the law prohibits all trades that utilize material, nonpublic information in breach of a duty.[325]

Second, the government must prove that the hedge fund knew, or should have known, that the PI firm employed impermissible practices to gather the illicit material, nonpublic information.[326] This also presents a challenge for prosecutors because some PI firms have disavowed insider tactics.[327] Such statements would provide hedge funds with a safe harbor to argue that it believed that the information was legally obtained.[328] But a PI firm's disclaimer may not afford any protection if there is evidence that a hedge fund had actual knowledge of illicit methods used to obtain PI.[329] Thus, it would be wise for hedge funds who consume PI to limit their communications with their PI agents to only the final product, which ideally would contain both a disclaimer and a statement of sources and methods. Finally, the longer

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325. *See* United States v. Rajaratnam, 719 F.3d 139, 159–60 (2d Cir. 2013) (holding that Rule 10b-5 does not require reliance upon material, nonpublic information for a trade, but merely possession of material, nonpublic information while executing a purchase or sale of a security).

326. Salman v. United States, 137 S. Ct. 420, 427 (2016) ("[T]o establish a defendant's criminal liability as a tippee, [the government] must prove that the tippee knew that the tipper breached a duty—in other words, that the tippee knew that the tipper disclosed the information for a personal benefit and that the tipper expected trading to ensue."); *see supra* note 80 and accompanying text.

327. *See* Brody Mullins, *Regulatory Scrutiny Transforms Washington's Political-Intelligence Business*, WALL ST. J. (June 19, 2014, 8:53 PM), https://www.wsj.com/articles/regulatory-scrutiny-transforms-washingtons-political-intelligence-business-1403223675 ("Today, instead of seeking information from congressional aides or agency officials, Mr. Vogel's firm aims to arrive at policy predictions based on publicly available metrics, such as campaign donations, lobbying expenditures, congressional voting records and polling data."). *But see* Brody Mullins & Aruna Viswanatha, *The King of 'Political Intelligence' Faces a Reckoning*, WALL ST. J. (Aug. 8, 2016), https://www.wsj.com/articles/the-king-of-political-intelligence-faces-a-reckoning-1471530464 (describing how as late as 2016, David Blaszczak, a PI operative, would gather Centers of Medicare and Medicaid Services information by leveraging his personal connections with his former agency, and sell the information to hedge funds such as Visium Asset Management for steep trading profits).

328. *See* Stephen Madsen, *How to Avoid the Pitfalls of Expert Networking*, LAW360 (Apr. 20, 2011), https://www.cravath.com/files/Uploads/Documents/Publications/3281473_1.pdf (recommending that clients who retain expert networks should "ask the expert to confirm that the information can be provided without violating obligations of confidentiality").

329. *See* United States v. Martoma, 869 F.3d 58, 61–62 (2017) (affirming the defendant's conviction even though the defendant received a representation in the consultant's contract stating that the consultant was "not to disclose any confidential information in a consultation").

and more attenuated the tipper-tippee chain, the greater the challenge in showing a link between the hedge fund and the tipper.[330]

CONCLUSION

Courts consistently ratify the SEC's core mission to ferret out fraudsters who undermine the integrity of the markets. *Salman* continued this jurisprudence by reaffirming the *Dirks* personal gain test. *Salman* recognized that the personal gain test is an inherently fact-intensive inquiry because human relationships are intrinsically complex. Yet this fact-intensive inquiry is not esoteric; the courts have developed a workable framework to analyze whether the objective facts of the case demonstrate a meaningfully close personal relationship—an important due process protection. Accordingly, an inquiry cannot be reduced to a formulaic test and instead should be left for a judge or jury to determine when a tipper realizes a personal gain. Finally, as district courts continue to grapple with the contours of personal relationships, this Comment attempts to provide a guide for prosecutors and practitioners to understand the current state of the law.

Salman's reaffirmation of the *Dirks* personal gain requirement was limited in scope and preserved due process protections for the accused. In contrast, the Second Circuit's decision in *Martoma* is inconsistent with *Dirks* and effectively eliminates the personal gain requirement. It allows prosecutors to prove merely that a defendant provided a tip intended for the recipient to trade upon it, opening the door for prosecutors utilizing circumstantial evidence to prove guilt. The *Dirks* personal gain requirement imposed an objective test to provide a necessary counterweight to governmental powers. Moreover, because federal securities laws are a creature of judicial decisions, courts should be hesitant to eliminate protections for the accused.

Additionally, Congress should revisit the STOCK Act because it is woefully inadequate in providing the requisite tools for SEC and DOJ investigators to carry out their mandates and enforce the law. Nevertheless, the STOCK Act brought attention to an underground and shameful truth concerning our government. Namely, that too many government insiders are using their positions of power for their own personal profit. Further, the STOCK Act's explicit announcement that government workers owe a fiduciary duty to the American people places government officials on notice that insider

330. *See* Gevurtz, *supra* note 102, at 19–22 (discussing the increased difficulty in convicting a tippee when a trading tip spans multiple persons).

trading laws *do* apply to them and that the transmission of insider information to others can be prosecuted.

Therefore, the PI industry should disavow insider-only tactics used to gather PI and instead rely upon only publicly available data and information. The STOCK Act was a clear warning sign to the PI industry to conform or subject themselves to liability. Moreover, for those firms who continue to gamble and use insider-only tactics after the STOCK Act, *Salman* places those firms within the crosshairs of 10b-5. Hedge funds and other consumers of PI should question their PI operatives' tactics and ensure that they comport with the law. Accordingly, it would be prudent for hedge funds that utilize PI to inform investment analysts to request a statement from their operatives attesting to the methods employed to obtain PI. Otherwise, their fund's assets may be at risk due to a PI operative's personal relationship with a government official.