Blaszczak II: 2nd Circuit Reverses Course and Overturns Insider Trading Convictions

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February 1, 2023

Key Points

- In the wake of the Supreme Court's "Bridgegate" decision in *Kelly v. United States*, a divided panel in the 2nd Circuit reversed its prior decision in *United States v. Blaszczak*, and held that a federal agency did not have a property interest in confidential information concerning reimbursement rates for health care providers. The court further held that trafficking in such information did not meet the statutory definition of fraud or the conversion of government property under Title 18.
- This decision will have broad implications for future prosecutions under Title 18 and possibly any statutory scheme involving the use or misuse of government property.
- The government's concession that *Kelly* applied to the conduct in *Blaszczak* is noteworthy and raises questions as to how the government and the courts will interpret the scope of *Kelly*, and now *Blaszczak*, in future cases and whether it may even extend to confidential information belonging to private actors.
- Whereas recent 2nd Circuit decisions created a measure of stability in the law of insider trading post-*United States v. Martoma*, 894 F.3d 64 (2d Cir. 2018) ("*Martoma II*"), this divided opinion will likely serve to destabilize insider trading jurisprudence anew.

On December 27, 2022, the 2nd Circuit issued its second decision in *United States v. Blaszczak*, 56 F.4th 230 (2d Cir. 2022) ("*Blaszczak II*") following the Supreme Court's vacatur and remand of its prior decision upholding the convictions of defendants David Blaszczak, Theodore Huber, Robert Olan and Christopher Worrall. *United States v. Blaszczak*, 947 F.3d 19 (2d Cir. 2019) ("*Blaszczak I*"). On remand, a divided three-judge panel granted the government's request to remand the cases to the district court to dismiss all except the two conspiracy convictions, which the panel vacated and remanded for reconsideration before a jury. While the result was not entirely surprising in light of the Department of Justice's concessions in response to recent Supreme Court precedent, *Blaszczak II* will have a significant impact on insider trading and fraud prosecutions and beyond.

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Blaszczak I

In March 2018, the government filed a superseding indictment in the Southern District of New York alleging that Worrall, an employee at the Centers for Medicare & Medicaid Services (CMS), had disclosed CMS's confidential information to Blaszczak, a hedge fund consultant, regarding the timing and substance of proposed CMS rule changes that would affect the Medicare and Medicaid reimbursement rates for certain types of medical care. Blaszczak then tipped Huber and Olan, employees at a health care-focused hedge fund, and they shorted shares of companies that would be negatively affected by the reimbursement rate changes. The government's indictment included counts for Title 15 securities fraud, wire fraud (18 U.S.C. § 1343), Title 18 securities fraud (18 U.S.C. § 1348), conversion of U.S. property (18 U.S.C. § 641) and conspiracy. On May 3, 2018, a jury acquitted all defendants on the Title 15 securities fraud counts, but found all of the defendants guilty on at least some Title 18 fraud and conversion counts and, with the exception of Worrall, on the conspiracy counts.

In December 2019, the 2nd Circuit upheld the convictions in *Blaszczak I*. The panel held that (i) the confidential information misappropriated from CMS constituted "property" or "a thing of value" under the relevant statutes; and (ii) that the "personal benefit" test first articulated in *Dirks v. SEC*—which stipulates that tipper-tippee liability under Title 15 securities fraud requires a jury to find that (a) the tipper disclosed material nonpublic information in order to receive a personal benefit and (b) that the tippee was aware of the tipper's breach of duty and receipt of such a benefit—did not apply to Title 18 wire or securities fraud.[1]

While the *Blaszczak* defendants' petition for certiorari was pending, on May 7, 2020, the Supreme Court issued its opinion in *Kelly v. United States*, 140 S. Ct. 1565 (2020), the "Bridgegate" case.[2] In *Kelly*, the Supreme Court found that the Port Authority's lane closures on the George Washington Bridge—done at the behest of the staff of then-New Jersey Governor Chris Christie ostensibly as part of a traffic study, but in reality as an act of political retaliation against the mayor of Fort Lee—did not constitute wire fraud under Title 18 because it did not deprive the Port Authority of money or property. Rather, the Court ruled that the *Kelly* defendants, in determining the distribution of bridge lanes, were exercising the government's regulatory rights of "allocation, exclusion, and control." *Id*. at 1573. Such rights, the Court held, did not give the Port Authority a property interest in the lanes on the bridge and therefore the purported conduct did not fall within the scope of conduct prohibited under Title 18. *Id*.

In the wake of *Kelly*, the Solicitor General filed a brief with the Supreme Court confessing error in *Blaszczak*. According to the Solicitor General, in light of *Kelly*, "information typically must have economic value in the hands of the relevant government entity to constitute 'property'" under Title 18, and the confidential information in *Blaszczak* did not constitute "property" under controlling authority. In response, the Supreme Court granted certiorari, vacated the 2nd Circuit's decision in *Blaszczak I* and remanded the case for further consideration in light of *Kelly*.

Blaszczak II

The Government's Positio

n remand, the U.S. Attorney's Office for the Southern District of New York explained that it was constrained to confess error at the direction of the Solicitor General's Office

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and conceded that the Department of Justice's position was that CMS's confidential information on proposed changes to reimbursement rates did not qualify as "property," "money" or "a thing of value" for the purposes of Title 18. The government requested that the case be remanded to the district court so that it could dismiss the substantive fraud and conversion counts.[3] With respect to the conspiracy convictions, the government took the position that those convictions should be affirmed because defendants were convicted not only of conspiring to convert government property in violation of § 641, but also conspiring to commit Title 15 securities fraud and to defraud the United States in violation of 18 U.S.C. § 371. The government conceded that the jury's general verdict consisted of both legally valid and legally invalid objects, but asserted that any error was harmless because "the § 371 defraud-clause objects were not affected by *Kelly* and remain legally valid." *Blaszczak II*, 56 F.4th at 237.

The Majority Opinion

Writing for the 2-1 majority, Circuit Judge Amalya Kearse—who dissented in *Blaszczak I*—agreed with the government's interpretation of *Kelly* and held that CMS's confidential information did not constitute "property" for the purposes of securities or wire fraud under Title 18. While Judge Kearse acknowledged that the government's confession of error did not compel her conclusion, she agreed that the substantive fraud counts could not stand in the wake of *Kelly*. Judge Kearse reasoned that because the relevant information obtained from CMS is "regulatory in character," such information should not be considered "money or property of the victim; and they are not a 'thing of value' to CMS that is susceptible to being 'converted.'" *Id*. at 244. Judge Kearse relied on both *Kelly* and *Cleveland v. United States*, 531 U.S. 12, 23 (2000), in which the Supreme Court held that unissued poker-machine licenses in the hands of the state did not constitute property, such that fraudulently concealing information in order to obtain such licenses did not constitute mail fraud under 18 U.S.C. § 1341. The government's right to determine who should get a benefit and who should not did not create a property interest on the part of the government; thus, a scheme to alter such a regulatory choice is not an appropriation of the government's property. *Blaszczak II*, 56 F.4th at 244.

The majority opinion went to considerable lengths to distinguish its conclusions from the Supreme Court's decision in *Carpenter v. United States*, 484 U.S. 19 (1987), in which the Supreme Court upheld the mail and wire fraud convictions of a defendant who had traded on confidential information obtained from *The Wall Street Journal*. The *Carpenter* Court held that the *Journal* had a property right in keeping information related to its future publications confidential and in making exclusive use of the information before publication, and that the sharing of this information deprived the *Journal* of "its right to exclusive use of the information." *Id*. at 26. The Court stressed that "exclusivity is an important aspect of confidential business information and most private property for that matter." *Id*. at 26-27. Judge Kearse emphasized that information was the *Journal's* "stock in trade, to be gathered at the cost of enterprise, organization, skill, labor, and money, and to be distributed and sold to those who [would] pay money for it." *Blaszczak II*, 56 F.4th at 243. By contrast, "CMS is not a commercial entity, it does not sell, or offer for sale, a service or a product." *Id*.

The majority opinion also distinguished *United States v. Girard*, 601 F.2d 69, 71 (2d Cir. 1979), in which the 2nd Circuit held that the Drug Enforcement Administration's (DEA) confidential information concerning informants qualified as a thing of value under 18 U.S.C. § 641 (conversion of government property). Judge Kearse wrote that

the theft of this informant information would undermine the DEA's operations and potentially imperil the wellbeing of undercover agents and informants and therefore had "inherent value" that the CMS information lacked. *Blaszczak II*, 56 F.4th at 244.

With respect to the conspiracy convictions, Judge Kearse noted that the jury did not reveal which of the enumerated goals of the conspiracy it found that the government had proven. *Id*. at 245. She disagreed with the government's argument that this lack of clarity was harmless, noting that had the jury concluded that the basis was the conversion of "property," the convictions would no longer be valid. *Id*. at 246. As a result, the defendants' conspiracy convictions were vacated and were remanded for resubmission to a jury. *Id*.

The Concurring Opinion

Judge John Walker joined the majority but authored a separate concurrence, joined by Judge Kearse, that focused on the portion of *Blaszczak I* holding (which was not at issue in the remand) that securities fraud under Title 18 does not require proof that the tipper received a "personal benefit." Judge Walker noted the apparent incongruity between the requirements for criminal liability under Title 18 and the more stringent requirements for civil (and criminal) liability under Title 15, arguing that it should not require fewer elements to prove a criminal conviction than to impose civil penalties for what Judge Walker deemed to be similar conduct. *Id*. at 249.

The Dissent

In a forceful dissent, Judge Richard Sullivan, who authored the majority opinion in *Blaszczak I*, criticized the majority for concluding that the Title 18 fraud statutes did not apply to the *Blaszczak* defendants' conduct, asserting that neither *Kelly* nor the government's concession compelled such an outcome. Judge Sullivan criticized the majority's conclusion that confidential information in the hands of a government agency is not property, noting that neither the securities fraud nor the mail fraud statutes make any distinction between tangible and intangible property, or between information in the possession of the government and information in the possession of a private entity. Moreover, Judge Sullivan argued, the conduct at issue in *Blaszczak* is far closer to the conduct in *Carpenter* or *Girard* than it is to the conduct at issue in *Kelly* or in *Cleveland*. In both *Kelly* and *Cleveland*, the defendants' schemes were designed to alter regulatory decision making whereas the *Blaszczak* defendants' objective was to misappropriate CMS's confidential information and trade on it. *Id*. at 253. Judge Sullivan criticized the majority opinion for equating "altering" with "obtaining," explaining that "altering" points to "interfering with the state's regulatory role as sovereign," whereas "obtaining" points to "interfering with the state's role as a property holder." *Id*. at 254. Judge Sullivan also criticized Judge Walker's concurrence as an advisory opinion, noting that the "personal benefit" test is a judge-made doctrine that is premised on the statutory purpose of the Securities Exchange Act of 1934 and there is no reason to extend that rule to a different statutory provision under Title 18. *Id*. at 261-63.

Conclusion

The decision in *Blaszczak II* will likely have significant implications on future insider trading and fraud prosecutions.

- First, the majority opinion significantly narrows the ability of prosecutors to bring cases under Title 18 related to the theft of government information. While prosecutors may still seek to bring charges under Title 15, they will be required to satisfy the requirements of the "personal benefit" test, something that the prosecutors in the *Blaszczak* case were unsuccessful in doing.
- Second, and relatedly, the distinction the court drew between government and private property interests may gain traction beyond the realm of insider trading and securities fraud; indeed, any statutory scheme involving the use or misuse of government property may be impacted by the majority's analysis in *Blaszczak II*.
- Third, Judge Kearse's majority opinion suggests that even with respect to private entities, information must be part of the victim's "stock in trade" to constitute property or a "thing of value" for the purposes of Title 18. But, as Judge Sullivan points out in his dissent, in numerous cases courts have deemed misappropriated information to be property notwithstanding that such information was not part of the victim's "stock in trade." Whether courts, and perhaps the government, will place limits on what constitutes the intangible property of private individuals and entities is therefore an open question after *Blaszczak II*.
- Lastly and more broadly, the decision injects uncertainty into the law of insider trading at a time when it had begun to stabilize following *Martoma II*, and could create the impetus for Congress to take up insider trading legislation to close what may be perceived as a gap in enforcement.

[1] Akin Gump's client alert analyzing the 2nd Circuit's *Blaszczak I* ruling can be found at https://www.akingump.com/a/web/112960/aokJq/us-v-blaszczak-the-2nd-circuit-makes-it-easier-to-prosecute.pdf.

[2] Akin Gump's client alert on *Kelly v. United States* can be found at https://www.akingump.com/a/web/cd4EqhHV4SqhhTR4ymxAob/rMMuN/supreme-court-overturns-bridgegate-convictions.pdf.

[3] Because the government agreed with the *Blaszczak* defendants that the substantive fraud and conversion counts should be remanded and dismissed, the 2nd Circuit appointed Akin Gump's Katherine R. Goldstein as *amicus curiae* to argue that *Kelly* did not invalidate *Blaszczak I's* holding that CMS's confidential information constituted property for the purposes of Title 18.

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