

# Supreme Court Vacates Second Circuit Ruling Expanding Insider Trading Liability

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On January 11, 2021, the Supreme Court in a summary disposition vacated the U.S. Court of Appeals for the Second Circuit's major insider trading decision in *United States v. Blaszcak*, 947 F.3d 19 (2d Cir. 2019), remanding the case to the Second Circuit for further consideration in light of the Supreme Court's recent decision in *Kelly v. United States*, 140 S.Ct. 1565 (2020). See *Blaszcak v. United States*, 2021 WL 78043 (Jan. 11, 2021); *Olan v. United States*, 2021 WL 78042 (Jan. 11, 2021). The Supreme Court's decision raises important questions regarding whether, and to what extent, the Second Circuit will retreat from the significant expansion of insider trading liability it enunciated in *Blaszcak* barely more than one year ago.

## ***United States v. Blaszcak***

As we described in greater detail in a [prior client alert](#), in *Blaszcak*, the U.S. Department of Justice ("DOJ") alleged that, between 2009 and 2014, certain Centers for Medicare & Medicaid Services ("CMS") employees disclosed confidential information relating to planned changes to medical treatment reimbursement rates to David Blaszcak, a former CMS employee who became a "political intelligence" consultant for hedge funds. Blaszcak allegedly provided this "predecisional" confidential information to employees of the hedge fund Deerfield Management Company, L.P., which then shorted stocks of healthcare companies that would be hurt by the planned reimbursement rate changes.

The DOJ indicted Blaszcak, one CMS employee, and two Deerfield employees for the alleged insider trading scheme. After an April 2018 trial, the jury returned a split verdict, acquitting all the defendants on certain counts, but finding the defendants guilty on other counts, including conversion, wire fraud, and (except for the CMS employee) Title 18 securities fraud. The defendants appealed.

In December 2019, the Second Circuit upheld the convictions and, in doing so, heightened the risk of investigation and prosecution in certain types of insider trading cases in two significant respects. First, in traditional civil and criminal insider trading cases against both tippees and tippees for Title 15 securities fraud under the Securities Exchange Act, the government must prove, among other things, that the tipper breached a duty in exchange for a direct or indirect personal benefit, and that the downstream tippee knew that the tipper had done so. The Second Circuit held that, by contrast, there is no "personal benefit" requirement in criminal insider trading cases charging Title 18 offenses like wire fraud and the criminal securities fraud provisions added in 2002 in the Sarbanes-Oxley Act.

Second, the court held that the "predecisional" confidential information relating to planned medical treatment reimbursement rate changes constituted government "property" necessary to bring insider trader cases under an embezzlement or misappropriation theory. In so holding, the Second Circuit found that this confidential government information was more akin to *The Wall Street Journal's* confidential business information

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that the Supreme Court held constituted property for insider trading purposes in *Carpenter v. United States*, 484 U.S. 19 (1987), than to the fraudulently-obtained Louisiana state video poker licenses that the Supreme Court found did not constitute property in *Cleveland v. United States*, 531 U.S. 12 (2000), because “the State’s core concern” in granting video poker licenses was “regulatory.”

The Second Circuit’s decision thus expanded potential criminal insider trading liability in cases where there was limited-to-no evidence of a personal benefit to the tipper or that the downstream tippee knew of such a benefit, as well as in cases involving disclosure of nonpublic government information.

## ***Kelly v. United States***

In May 2020, five months after the Second Circuit’s decision in *Blaszczak*, the Supreme Court in *Kelly* addressed the scope of government “property” under federal fraud statutes. Specifically, the Supreme Court reviewed the criminal convictions of two “Bridgegate” defendants on federal-program and wire fraud charges arising out of their alleged involvement in a scheme to limit the number of lanes in Fort Lee, New Jersey accessing the George Washington Bridge as political retribution against the city’s mayor. To convict under both fraud provisions, the government was required to show “that an object of their fraud was money or property.”

The Supreme Court reversed the convictions, holding that “[t]he realignment of the toll lanes was an exercise of regulatory power—something this Court has already held fails to meet the statutes’ property requirement. And the [traffic engineers and toll collectors’] labor was just the incidental cost of that regulation, rather than itself an object of the officials’ scheme.” In reaching this conclusion, the Supreme Court relied heavily on *Cleveland*, noting that the defendants “exercised the regulatory rights of ‘allocation, exclusion, and control,’” and “under *Cleveland*, that run-of-the-mine exercise of regulatory power cannot count as the taking of property.”

## ***Blaszczak* Appeal to Supreme Court**

In September 2020, three of the *Blaszczak* defendants petitioned the Supreme Court for a writ of certiorari, arguing that the Second Circuit had improperly expanded criminal insider trading liability by holding that there was no “personal benefit” requirement in Title 18 insider trading cases and that, contrary to the Supreme Court’s rulings in *Cleveland* and *Kelly*, predecisional confidential information constituted government property. See Petition for a Writ of Certiorari, *Blaszczak v. United States* (Sept. 4, 2020) (No. 20-5649); Petition for a Writ of Certiorari, *Olan v. United States*, 2020 WL 5439755 (Sept. 4, 2020).

Rather than address the propriety of the Second Circuit’s decision head-on, the government in its response brief instead argued that “the appropriate course is to grant the petitions for writs of certiorari, vacate the decision below, and remand the case for further consideration in light of *Kelly*.” Mem. for the United States, *Blaszczak v. United States* (Nov. 24 2020) (Nos. 20-306 & 20-5649).

On reply, the petitioners argued that the Supreme Court should squarely rule on their petition, rather than vacate and remand, noting that the Second Circuit may only “reverse[] itself on the ‘property’ issue,” without needing to again address its prior holding that there was no personal benefit requirement in Title 18 insider trading cases. Reply Brief for Petitioners, *Olan v. United States*, 2020 WL 7345516 (Dec. 8, 2020). As a result, “unless the [Second Circuit’s] existing erasure of the personal-benefit requirement...is repudiated, prosecutors in the Second Circuit will continue to feel free to charge insider-trading crimes even where there is no proof of personal benefit. And district courts in the Circuit (where most insider-trading prosecutions are brought) would likely follow the Second Circuit’s lead even if it were not technically binding....”

Despite the concerns that petitioners raised, on January 11, 2021, the Supreme Court

agreed to the course that the government proposed, granting certiorari and directing that “[t]he judgment is vacated, and the case is remanded to the...Second Circuit for further consideration in light of *Kelly*...” *Blaszczak v. United States*, 2021 WL 78043 (Jan. 11, 2021); *Olan v. United States*, 2021 WL 78042 (Jan. 11, 2021).

## Implications of Supreme Court’s *Blaszczak* Decision

It is unclear at this juncture what effect, if any, the Supreme Court’s decisions in *Kelly* and *Blaszczak* will have on the Second Circuit’s expansion of insider trading liability. In an expansive reading, for example, the Second Circuit could distinguish the “exercise of regulatory power” in *Kelly* from the “predecisional” government information in *Blaszczak* and continue to analogize confidential government information to the confidential business information that the Supreme Court ruled in *Carpenter* constitutes property for insider trading purposes. In a narrower reading, the Second Circuit could find that the principle of *Kelly* should apply to predecisional government information and thus that it does not constitute property under Title 18 securities fraud.

If the Second Circuit concludes that, after *Kelly*, confidential government information does not constitute property, the Court could reverse the convictions on this ground while leaving unaddressed its prior holding that there is no personal benefit requirement in Title 18 insider trader cases. As the petitioners warned the Supreme Court, prosecutors in this scenario would likely treat this silence as a green light to continue to charge insider-trading crimes where there is little to no evidence of a personal benefit to the tipper, or tippee knowledge of that benefit. Of course, under such circumstances, prosecutors would not have the benefit of *Blaszczak* to rely on, and thus there could be litigation risk to the government depending on the facts of the particular case.

Clouding the picture even further is that the Second Circuit ruling in *Blaszczak* was a 2-1 decision. And one of the two judges who joined in the majority ruling has since retired. As a result, the outcome of *Blaszczak* could be impacted significantly by the views of the third judge assigned to the panel. Should that new judge join with the original dissenting judge, the *Blaszczak* holding will change substantially. In addition, regardless of how the Second Circuit rules on remand, the losing side may seek the Supreme Court’s review of that decision. *Blaszczak* will therefore continue to be an important case to monitor in the ongoing court battles to define the scope of insider trading liability.

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Gibson Dunn’s lawyers are available to assist with any questions you may have regarding these developments. For additional information, please feel free to contact the Gibson Dunn lawyer with whom you usually work, any member of the firm’s Securities Enforcement or White Collar Defense and Investigations practice groups, or the following authors:

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