Harvard Law School Forum on Corporate Governance

United States v. Blaszczak Continues to Reshape Insider Trading Law

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Editor's note: Charles J. Clark, Gary Stein, and Craig S. Warkol are Partners at Schulte Roth & Zabel LLP. This post is based on a SRZ memorandum by Mr. Clark, Mr. Stein, Mr. Warkol, Peter H. White, Douglas I. Koff and Benjamin Lewson. Related research from the Program on Corporate Governance includes Insider Trading via the Corporation (discussed on the Forum here) by Jesse M. Fried.

On Dec. 27, 2022, the U.S. Court of Appeals for the Second Circuit issued another decision in United States v. Blaszczak ("Blaszczak II"), this time delivering a victory to defendants accused of insider trading based on non-public predecisional government information.[1] The case was heard by the Second Circuit following remand from the Supreme Court after its ruling in Kelly v. United States, 140 S. Ct. 1565 (2020), clarifying what can be considered "property" under federal criminal statutes. We had previously written about the Blaszczak case while the decision from the Second Circuit was pending[2] and, earlier, after the Second Circuit's initial ruling in the case.[3]

Blaszczak is a prime example of how the law of insider trading is judge-made. To bring insider trading cases in the absence of a federal statute targeting insider trading, prosecutors have adapted various more general statutes, including the anti-fraud prohibitions in Section 10(b) of the Securities Exchange Act and Rule 10b-5 promulgated thereunder and, increasingly, a potpourri of other federal statutes. Blaszczak illustrates the overlapping, conflicting and uncertain scope of these different laws. Going forward, Blaszczak will continue to influence how insider trading cases are prosecuted, although what impact it will have remains to be seen.

Background

The underlying prosecution was brought based on allegations that David Blaszczak shared non-public information given to him by Christopher Worrall, an employee of the Centers of Medicare and Medicaid Services ("CMS") at the time. The information related to upcoming announcements by CMS adjusting the reimbursement rates for Medicare and Medicaid services. Blaszczak allegedly shared this information with hedge fund analysts Robert Olan and Theodore Huber so they could make investments relating to public companies with the understanding that this news would impact those companies' stock prices.

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[1] United States v. Blaszczak, 56 F.4th 230 (2d Cir. 2022).

[2] See United States v. Blaszczak Poised to Further Reshape Insider Trading Law, SRZ Securities Enforcement Quarterly July 2021, available here.

[3] See Insider Trading Law in Flux – What Advisers Need to Know, SRZ Client Alert, Jan. 29, 2020, available here.

In 2017, the U.S. Attorney's Office in Manhattan brought insider trading charges against all four individuals, emphasizing that "[j]ust like trading on material nonpublic corporate information can be a federal crime, so can trading based on secret government information, as alleged to have happened here."[4] In time, this announcement would prove less than prescient.

In 2018, a jury in the Southern District of New York acquitted all four defendants on charges that they committed securities fraud under § 10(b), but found the defendants guilty of several other crimes under other statutes, including violating and/or conspiring to violate:

- 18 U.S.C. § 1343, the federal wire fraud statute;
- 18 U.S.C. § 1348, a federal criminal securities fraud statute that is separate from § 10(b) and was enacted in 2002 as part of the Sarbanes-Oxley Act;
- 18 U.S.C. § 641, which makes it a crime to convert property of the United States; and
- 18 U.S.C. § 371, which outlaws conspiracies to defraud the United States.

The Appeals – *Blaszczak I*

The *Blaszczak* defendants appealed their convictions to the Second Circuit ("*Blaszczak I*"). In 2019, the Second Circuit upheld the defendants' convictions in *Blaszczak I* for wire fraud and Title 18 securities fraud and, in so doing, held that these statutes do *not* require proof of a "personal benefit" to the tipper, or knowledge of such a benefit on the part of a downstream tippee, as required in insider trading cases brought under § 10(b).[5]

The defendants in *Blaszczak I* also argued that their convictions should be vacated because "nonpublic predecisional information" does not constitute "property" for purposes of the criminal statutes at issue. Convictions based on the wire fraud and Title 18 securities fraud statutes are limited to schemes to defraud a victim of "money or property," and convictions based on § 641 require that the confidential information be a "thing of value." According to defendants' argument, if CMS's confidential information did not constitute "property" or a "thing of value" then those convictions were invalid. By a 2-1 vote, however, the Second Circuit rejected this argument in *Blaszczak I*.

The appeals continued.

The Appeals – To the Supreme Court

In 2020, before the Blaszczak defendants had sought further review of the Second Circuit's decision, the Supreme Court decided *Kelly v. United States*, which dealt with the "property" or "thing of value" issue central to the defendants' argument in *Blaszczak I*.[6] Kelly involved New Jersey government officials charged with wire fraud for falsely claiming to be conducting a "traffic study" in order to limit the number of lanes available to access the George Washington Bridge as political retribution against a New Jersey mayor.

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[4] Press Release, U.S. Attorney's Office for the SDNY, Four Charged in Scheme to Commit Insider Trading Based on Confidential Government Information (May 24, 2017), available here.

[5] United States v. Blaszczak, 947 F.3d 19 (2d Cir. 2019), vacated and remanded, 141 S. Ct. 1040 (2021).

[6] Kelly v. United States, 140 S. Ct. 1565 (2020).

In *Kelly*, the Supreme Court held that charges of wire fraud require that the defendant's fraudulent scheme seek to obtain "money or property." Since the conduct at issue was an exercise of regulatory power and did not actually take anything that had value in the hands of the government, notwithstanding loss of employee time and labor on the bogus study (an "incidental byproduct" to the scheme), the Supreme Court concluded that the convictions could not stand.[7]

Taking note, the Blaszczak defendants filed petitions for certiorari with the Supreme Court. With the government's agreement, the Supreme Court granted the petitions for certiorari, vacated the Second Circuit's decision and remanded the case for reconsideration in light of Kelly.[8]

The Appeals – *Blaszczak II*

On remand, the *Blaszczak* defendants argued that in light of the Supreme Court's decision in Kelly, the CMS information at issue did not constitute "property" or a "thing of value."[9] The government, in an unusual move, agreed with that conclusion and confessed error as to the substantive counts and as to the conspiracy count premised on crimes concerning "property," arguing that those counts should be reversed or remanded to the district court for dismissal.[10] However, the government sought an affirmance on the remaining conspiracy counts on which certain defendants were convicted that were not premised exclusively on the government information being considered "property."

In another 2-1 decision, the Second Circuit, agreeing with the parties, reversed course in *Blaszczak II* and overturned defendants' convictions on those charges that required information to constitute "property" under the federal statutes (§ 1343 and § 1348) or a "thing of value" (§ 641).[11] Flipping their roles from *Blaszczak I*, Judge Amayla L. Kearse (who wrote the dissent in *Blaszczak I*) issued the opinion for the panel, and Judge Richard J. Sullivan (who wrote the majority opinion in *Blaszczak I*) dissented. Judge John M. Walker (who had not sat on the *Blaszczak I* panel) joined Judge Kearse's opinion.

The court determined that the government's decision to seek dismissal of the counts under §§ 1343, 1348 and 641 was to be granted deference based on its power to prosecute.[12] However, the court was clear to note that the "government's confession of error does not automatically govern an appellate court's disposition of an appeal."[13] Nonetheless, the court engaged in an independent review and "confirm[ed] that the dismissals requested by the government are required following Kelly" on the basis that CMS's predecisional regulatory information was not "property" or a "thing of value" to CMS and, therefore, could not be the basis for a charge under the criminal statutes at issue.[14]

As to defendants' conspiracy convictions, the court further determined that because "the jury was not given questions to answer that would reveal which one or more of the alleged conspiratorial goals it found proven," reversal was required because the jury could have made its determination

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[7] *Id*. at 1573-74.
[8] Olan v. United States, 141 S. Ct. 1040 (2021); Blaszczak v. United States, 141 S. Ct. 1040 (2021).
[9] Blaszczak II, 56 F.4th at 236.
[10] *Id*. at 236-37.
[11] *Id*. at 237.
[12] *Id*. at 242.
[13] *Id*. (internal quotation and citation omitted).
[14] *Id*. at 245.

based on its belief that the Blaszczak defendants conspired to commit a property crime.[15] By the same token, however, because the jury likewise could have found the defendants guilty for conspiring to commit a non-property crime (Title 15 securities fraud or conspiracy to defraud the United States), the court rejected the Blaszczak defendants' argument that those convictions should simply be reversed.[16] Those charges were remanded for further proceedings, which may include a new trial.[17]

These holdings are limited to material nonpublic information from government sources. The holdings in this case do not affect insider trading liability in the context where material nonpublic information has been allegedly misappropriated from a private enterprise. Federal property fraud statutes still apply to intangible property rights, such as in Carpenter v. United States, where the Supreme Court upheld convictions based on misappropriation of confidential business information.[18] Likewise, the decision does not affect the scope of either criminal or civil liability under § 10(b) of the Exchange Act, which federal prosecutors and the SEC continue to primarily use to bring insider trading cases.

Notably, based on the posture of the case, the court did not need to address the issue of whether a tipper needs to receive a "personal benefit." That did not stop one panel member from addressing it anyway.

Specifically, Judge Walker wrote a concurring opinion to "highlight an anomaly" in *Blaszczak I*, namely, that a criminal conviction for tipper-tippee insider trading prosecuted under § 1348 does not require proof that the tipper received a personal benefit, whereas liability for the same conduct under § 10(b)—whether prosecuted criminally or civilly — *does* require proof of a personal benefit.[19] This struck Judge Walker as "odd" and as offensive to "traditional notions of fair play."[20] "It should not," he wrote, "require fewer elements to prove a criminal conviction than to impose civil penalties for the same conduct."[21] Judge Walker also expressed concern that *Blaszczak I*'s broad reading of § 1348 insider trading would inhibit lawful market activity and posed a challenge to "the lawyer advising the security analyst who has no desire to run afoul of the law but wants to be able to do his job effectively."[22]

In contrast, Judge Sullivan remained convinced that the convictions should be affirmed based on the reasons set forth in *Blaszczak I* and because he thought the "majority opinion effectively permits sophisticated insiders to leverage their access to confidential government information and sell it to the highest bidders."[23] Likewise, Judge Sullivan took issue with the concurrence because the "personal benefit" issue was not properly before the court.[24]

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[15] *Id*.
[16] Id. at 246.
[17] *Id.*
[18] *Carpenter v. United States*, 484 U.S. 19 (1987).
[19] *Blaszczak II* (Walker, J. concurring) at 246.
[20] *Id*.
[21] *Id.*
[22] *Id*. at 250.
[23] *Blaszczak II* (Sullivan, R. dissenting) at 250.
[24] *Id*. at 261-63.

Going Forward

As it stands, the *Blaszczak* defendants will return to the district court, potentially for a new trial on the conspiracy charges — some five years after their first trial. No matter what ultimately happens with the remaining charges, *Blaszczak* will influence insider trading prosecutions going forward.

The effects will be most strongly felt in situations dealing with nonpublic information from the government and governmental agencies. To the extent prosecutors want to bring cases involving government sources of nonpublic information, they will be hard-pressed to bring claims requiring a showing that such information is "property" or a "thing of value."

For insider trading cases more broadly, Judge Walker's concurrence and Judge Sullivan's dissent further highlight the fickle judge-made nature of insider trading law. Prosecutors may continue to get creative as to how they bring insider trading cases, but at least some members of the Second Circuit are willing to question whether a "personal benefit" is required in a tipper-tippee case under § 1348. Since *Blaszczak I* was vacated, it no longer has binding precedential effect[25] and the "personal benefit" issue is again a live one in the Second Circuit.

[25] *See Los Angeles Cnty. v. Davis*, 440 U.S. 625, 634 n.6 (1979) (noting that a Supreme Court decision "vacating the judgment of the Court of Appeals deprives that opinion of precedential effect") (citation omitted).