Second Circuit Set To Revisit Insider Trading Decision Post-Bridgegate

On January 11, 2021, the Supreme Court vacated the U.S. Court of Appeals for the Second Circuit's controversial decision in *United States v. Blaszczak*, 947 F. 3d 19 (2d Cir. 2019), remanding the case for the circuit court to reconsider whether the insider trading convictions of four men who traded on government secrets can survive in light of *Kelly v. United States*, 140 S. Ct. 1565 (2020)—the Supreme Court's so-called "Bridgegate" decision. In *Blaszczak*, the Second Circuit held that confidential government information about proposed regulations constitutes "property" under Title 18 of the U.S. Code, meaning that those who use that information for their own trading purposes are liable for defrauding the government under Title 18's securities fraud and mail fraud provisions, even if their conduct does not meet the traditional elements of insider trading. But in *Kelly*, the Supreme Court ruled that "a scheme to alter [] a regulatory choice"—there, to realign traffic lanes leading to the George Washington Bridge—"is not one to appropriate the government's property." 140 S. Ct. at 1572. Given the Supreme Court's construction of "property" under Title 18 in *Kelly*, the Second Circuit must revisit the government's winning theory of insider trading "fraud" in *Blaszczak*, and it is likely that the theory cannot survive the *Kelly* analysis. It also means that the defendants may get a second bite of the apple on another key issue: whether the government must prove that a tipper received a "personal benefit" to convict for insider trading under Title 18. Both of these issues will impact what tools prosecutors will have at their disposal to prosecute insider trading schemes.

UNITED STATES V. BLASZCZAK

In *Blaszczak*, employees from the Centers for Medicare and Medicaid Services ("CMS") provided a "political intelligence" consultant with confidential "predecisional" agency information concerning both the timing and substance of upcoming CMS rule changes. The consultant then tipped the information to two traders who traded on it.

Among other counts, the defendants were charged with violating Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder, 15 U.S.C. §§ 78(b) & 78ff, 17 C.F.R. § 240.10b-5—the conventional statutory framework under

which suspects in insider trading schemes are routinely prosecuted. However, the government also charged the defendants with Title 18 securities fraud and wire fraud, 18 U.S.C. §§ 1343 & 1348, two statutes under which insider trading is far less frequently prosecuted. In so doing, the government took the position that information about prospective CMS regulations constituted a form of property of which the defendants fraudulently deprived the agency under Title 18. It further contended that a conviction for securities fraud under Title 18 (unlike under Rule 10b-5) did not require proof that the defendants knew that the confidential CMS information came from a CMS insider, in violation of a duty of confidentiality, and in exchange for a personal benefit.[1] Those contentions proved decisive—the jury acquitted the defendants of all Title 15 securities fraud counts but convicted the defendants on all counts arising under Title 18.

The defendants appealed, challenging both the government's theory of a "property" deprivation and the district court's decision not to require proof of a personal benefit to convict for fraud under Title 18. A split panel of the Second Circuit disagreed on both counts.

As for the government's "property" theory, the Second Circuit panel emphasized that CMS invested time and resources into generating and maintaining the confidentiality of its proposed regulations—an investment that rendered the information cognizable under Title 18. The panel reconciled the case with *Carpenter v. United States*, 484 U.S. 19 (1987) and *Cleveland v. United States*, 531 U.S. 12 (2000), two seminal decisions exploring the bounds of "property" in the context of misappropriating a *Wall Street Journal* column (property) and state video poker licenses (not property), respectively. On this score, Judge Kearse dissented, writing that a business, unlike a government regulator, has an economic interest in selling information, distinguishing the case from *Carpenter*. The panel also held that Title 18 securities fraud does not require proof of a personal benefit. Focusing on the different legislative histories of the two titles, it reasoned that Title 15 is specifically intended to "'eliminat[e] [the] use of inside information for personal advantage,'"[2] whereas Title 18 contains no such limiting principle.

UNITED STATES V. KELLY

The Bridgegate saga bears little resemblance to the facts of *Blaszczak*, but the two share a core legal issue—the meaning of "property" under Title 18.

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1 *See Dirks v. SEC*, 463 U.S. 646 (1983); *United States v. Newman*, 773 F.3d 438, 450 (2d Cir. 2014), *abrogated on other grounds*, *Salman v. United States*, 137 S. Ct. 420, 423 (2016); *United States v. Martoma*, 894 F.3d 64, 76 (2d Cir. 2017).

2 *Blaszczak*, 947 F.3d at 35 (quoting *Dirks*, 463 U.S. at 662).

In *Kelly*, prosecutors charged officials from the Port Authority of New York and New Jersey and officials in former New Jersey Governor Chris Christie's office with hatching a political retribution scheme by closing traffic lanes leading to the George Washington Bridge during rush hour. The government argued that depriving the Port Authority of the use of traffic lanes was a taking of "property" in violation of Title 18's wire fraud and federal program fraud provisions. But the Supreme Court saw it otherwise. Looking to *Cleveland*, the Court characterized the defendant's scheme as mere interference in the Port Authority's intangible rights of "allocation, exclusion, and control" in its regulatory affairs, which "do not create a property interest."[3]

The Supreme Court also held that the government failed to adequately prove that the defendants deprived the Port Authority of something more tangible. Although "a government's right to its employees' time and labor, by contrast, can undergird a property fraud prosecution," those items were not "an 'object of the fraud'" in *Kelly*; at most, they played "some bit part in [the] scheme."[4] The Supreme Court handed the government a unanimous defeat.

FALLOUT FROM *KELLY*

In early September 2020, three of the defendants in *Blaszczak* petitioned the Supreme Court for a *writ of certiorari*, challenging both key elements of the Second Circuit's decision in *Blaszczak*. The U.S. Solicitor General's response requested that the Supreme Court grant the petitions, vacate the decision below, and remand to allow the Second Circuit to consider the impact of *Kelly*.

The petitioners strongly objected on reply. Pressing the Court to either summarily reverse or grant certiorari to consider the issue itself, they feared that merely vacating the case and remanding it to the Second Circuit would allow the court to potentially sidestep consideration of the personal benefit issue. "If the Second Circuit reverses itself on the 'property' issue, it may choose to go no further (because that ruling would invalidate all counts), or to discuss the personal-benefit issue in a way that might be considered only dicta."[5] The Supreme Court rejected petitioners' arguments in adopting the government's proposed course of action, vacated the judgment, and remanded the case for further consideration in light of *Kelly*.

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[3] *Kelly*, 140 S. Ct. at 1572.

[4] *Id.* at 1573.

[5] Reply Brief for Petitioners, *Olan v. United States*, 2020 WL 7345516 (Dec. 8, 2020).

KEY TAKEAWAYS

All eyes turn once again to the Second Circuit and whether that court will find a way to reconcile its earlier opinion with *Kelly*—especially since *Carpenter*, the case on which it primarily relied in its earlier opinion, was not mentioned in *Kelly*—or whether the court will retreat from its earlier analysis. Among other things, the Second Circuit will need to square its earlier decision that using confidential agency information constitutes a "property" deprivation with the Supreme Court's conclusion in *Kelly* that a "run-of-the-mine exercise of regulatory power cannot count as the taking of property."[6]

But even if the Second Circuit reverses itself, it may leave undisturbed its personal benefit holding, paving the way for prosecutors to continue charging securities fraud under Title 18 with greater ease than would be the case under traditional Section 10(b)-based actions. Complicating matters further is the fact that one of the judges who comprised the majority of the Second Circuit's panel in *Blaszczak* retired last year.

For these reasons, *Blaszczak* remains a case worth watching—especially as other insider trading cases premised on the same legal theories weave their way through the courts.[7]

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Please do not hesitate to contact us with any questions.

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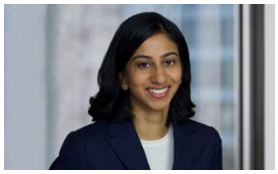
[6] *Kelly*, 140 S. Ct. at 1573.

[7] *See, e.g.*, *United States v. Middendorf*, 2018 WL 3443117, at *8–9 (S.D.N.Y. July 17, 2018), appeal pending (2d Cir. Nos. 19-2983, 19-3374); *United States v. Blakstad*, 2020 WL 5992347 (S.D.N.Y. Oct. 9, 2020).

NEW YORK


Andrew J. Ceresney
aceresney@debevoise.com


Matthew E. Kaplan
mekaplan@debevoise.com

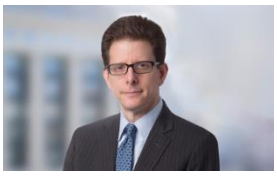

Charu A. Chandrasekhar
cchandrasekhar@debevoise.com


Eric W. Silverberg
ewsilverberg@debevoise.com


David Wang (Law Clerk)
dwang@debevoise.com

WASHINGTON, D.C.


Arian M. June
ajune@debevoise.com


Robert B. Kaplan
rbkaplan@debevoise.com


Julie M. Riewe
jriewe@debevoise.com


Jonathan R. Tuttle
jrtuttle@debevoise.com


Ada Fernandez Johnson
afjohnson@debevoise.com