

US Supreme Court Remands Blaszczak Insider Trading Case Back to the Second Circuit

The U.S. Supreme Court recently cast doubt on the criminal convictions of the one-time "King of Political Intelligence" David Blaszczak and three others for their role in an insider trading scheme. The Court's action could significantly affect the prosecution of criminal insider trading cases based on the use of confidential government information.

Background

In March 2018, the U.S. Department of Justice charged David Blaszczak, along with two hedge fund employees and a representative of the Centers for Medicare and Medicaid Services (CMS), with securities fraud. The charges were made in connection with several insider trading schemes to obtain confidential, non-public information regarding future CMS rule-making. Blaszczak, a former CMS employee who at the time operated a "political intelligence" consulting firm, leveraged his network of CMS insiders to obtain information pertaining to the timing and substance of proposed CMS rule changes that would affect the reimbursement rates for certain medical treatments. Blaszczak then passed this information to his hedge fund clients, who in turn traded on the information—typically by shorting the stock of healthcare companies that would be negatively affected by the changes in CMS reimbursement rates.

In addition to charging securities fraud under Title 15 enacted pursuant to the Securities Exchange Act of 1934, the widely used statute in insider trading cases, the DOJ also charged the defendants with violating the wire and securities fraud statutes added to Title 18 under Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley). After a four-day trial, the jury acquitted all the defendants on the Title 15 securities fraud counts, but found certain defendants guilty of the Title 18 fraud charges.

The Second Circuit Opinion

As discussed in a previous [client alert](#), the defendants argued on appeal before the U.S. Court of Appeals for the Second Circuit that, among other things, (1) the confidential CMS information at issue was not "property" for purposes of Title 18's wire and securities fraud statutes and (2) the district court failed to instruct the jury that, pursuant to *Dirks v. SEC*, a conviction on the Title 18 securities fraud statute required a finding that the CMS insider tipped confidential agency information in exchange for a "personal benefit." (The district court limited this personal benefit instruction to the Title 15 securities fraud charge.)

The Second Circuit rejected both arguments.[1] First, the court stated that the right of government agencies to exclude the public from its confidential information "squarely implicates the government's role as property holder." The court also cited the government's economic interest in its confidential information, noting the "time and resources" that agencies expend in generating and maintaining confidentiality. With respect to the inconsistency in the district court's "personal benefit" instruction between the Title 15 and Title 18 securities fraud charges, the court reasoned that, while the statutory provisions are both textually and substantively similar, the personal benefit test for the Title 15 statute, as required by *Dirks*, is a "judge-made doctrine premised on the

Exchange Act's statutory purpose." This, the court stated, is different from Title 18's securities fraud provision, which was implemented under Sarbanes-Oxley and underpinned by congressional intent to provide prosecutors with a "different—and broader—enforcement mechanism to address securities fraud" than that provided under Title 15.

Accordingly, the Second Circuit's decision in *Blaszczak* allowed prosecutors to by-pass Title 15 and to instead use Title 18 as a potential tool to prosecute criminal insider-trading without the additional burden of satisfying the personal benefit test.

The Supreme Court's Action

On January 11, 2021, the Supreme Court vacated and remanded the case back to the Second Circuit to reconsider its decision in light of the Supreme Court's recent holding in *Kelly v. United States* concerning the scope of the "property" requirement under Title 18's fraud statutes.[2]

In *Kelly*, the Supreme Court addressed the scope of the "property" requirement for purposes of Title 18's wire fraud statute, which makes it a crime to effect "any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations or promises." [3] The defendants in *Kelly* were charged with violating this statute for their alleged involvement in the "Bridgegate" scandal—a politically-motivated scheme to close certain lanes on the George Washington Bridge that were reserved for residents of Fort Lee, New Jersey, whose mayor had refused to support the reelection campaign for then-Governor Chris Christie.

The government contended that the defendants' scheme satisfied the property requirement because they sought to "commandeer" the bridge's physical access lanes, while depriving the government of "the costs of compensating traffic engineers and back-up toll collectors who performed work relating to the realignment." Rejecting these arguments, the Supreme Court construed the defendants' scheme as an "exercise of regulatory power" and found that such regulatory decision-making "cannot count as the taking of property" for purposes of Title 18's wire fraud statute. For the property at issue to fall within the purview of the statute, the Court stated, it must "play more than some bit part in a scheme: It must be an 'object of the fraud'" itself and not merely "an incidental byproduct of the scheme." In this case, the Court stated, the time and labor expended by port authority employees were merely the "implementation costs" of the defendants' plan to exact political retribution.

Implications for *Blaszczak* After *Kelly*

On remand, the Second Circuit must now address whether the confidential CMS information relating to reimbursement rates for medical treatments at issue in *Blaszczak* is "property" or merely invokes the government's regulatory power.

Blaszczak and his co-defendants may have a solid argument on remand. On the one hand, the confidential information and its transfer to the hedge fund traders was at the heart of the fraud. On the other, based on *Kelly*, and the Court's prior decision in *Cleveland v. United States*, [4] the Second Circuit may find that its prior decision extending the meaning of "property" for purposes of the criminal fraud and conversion statutes to include government regulatory information is contrary to the holding in *Kelly*. If so, this would be welcome news for political intelligence firms. The firms will have clarity on the extent to which they can be held criminally liable for the mining and use of government regulatory information where no personal benefit is involved, and the government will have to rely on more traditional insider trading theories, which are more difficult to prove.

Regardless, *Kelly* did not address whether the personal benefit test applies to Title 18 securities fraud statute. Therefore, even if the Second Circuit concludes that the CMS information is not property for Title 18 purposes, it need not reconsider the personal benefit issue. In that instance, prosecutors could still charge insider trading cases under Title 18 (provided they satisfy the property requirement per *Kelly*) while sidestepping the difficult burden of Title 15's personal benefit requirement.

As we noted in our previous client alert, the use of Title 18's fraud provisions to charge insider trading cases is limited to criminal cases and does not affect the prosecution of enforcement actions by civil agencies such as the SEC. These actions will still have to establish the personal benefit element.

Endnotes

1. *United States v. Blaszczyk*, 947 F.3d 19 (2d Cir. Dec. 30, 2019).
2. *Blaszczyk v. United States*, 2021 WL 78043 (Jan. 11, 2021).
3. *Kelly v. United States*, 140 S.Ct. 1565 (May 7, 2020).
4. *Cleveland v. United States*, 531 U.S. 12 (Nov. 7, 2000).

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