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SECOND CIRCUIT REVIEW

Expert Analysis

Personal Benefit in Title 18 Insider Trading Cases

In *United States v. Blaszczak*, No. 18-2811, 2019 WL 7289753 (2d Cir. Dec. 30, 2019), the Second Circuit significantly expanded insider trading enforcement authority. In an opinion written by Circuit Judge Richard Sullivan and joined by Circuit Judge Christopher Droney, the Second Circuit held that (1) certain confidential government information may constitute "property" in the hands of the government for purposes of the wire fraud and Title 18 securities fraud statutes, and (2) the "personal-benefit" requirement of *Dirks v. SEC*, 463 U.S. 646 (1983) does not apply to insider trading cases prosecuted as Title 18 securities fraud and wire fraud. Circuit Judge Amalya Kearse dissented from the court's threshold determination that confidential government information may constitute government "property" for purposes of 18 U.S.C. §§1343 and 1348, the wire fraud and securities fraud provisions of Title 18.

By **Martin Flumenbaum** | And **Brad S. Karp**

Background

David Blaszczak was a "political intelligence" consultant for hedge funds and had previously worked at the Centers for Medicare & Medicaid Services (CMS). Between 2009 and 2014, Blaszczak obtained non-public information from his former colleagues at CMS—including defendant Christopher Worrall—and passed that information to hedge funds. In one instance, for example, Blaszczak learned from Worrall that CMS was planning on reducing the reimbursement rate for certain radiation oncology treatments, and shared this information with Theodore Huber, Robert Olan, and Jordan Fogel of the hedge fund Deerfield Management Company, L.P. (Deerfield). Deerfield then placed orders shorting approximately $33 million of stock in radiation-device manufacturer Varian Medical Systems (Varian). As expected, Varian's stock fell when the rate change was announced, and Deerfield made $2.76 million in profits on its Varian trade.

On March 15, 2018, in an 18-count superseding indictment, the government charged Blaszczak, Worrall, and the Deerfield partners with conversion of U.S. property, Title 15 securities fraud, Title 18 securities fraud, wire fraud, and conspiracy. In April 2018, a one-month trial was held before Judge Lewis Kaplan in the Southern District of New York. At the conclusion of the evidence, the district court instructed the jury pursuant to *Dirks v. SEC* that, in order to convict Worrall of Title 15 securities fraud, it needed to find that he tipped confidential information in exchange for a "personal benefit" and, in order to convict the other defendants of Title 15 securities fraud, it needed to find that those defendants *knew* that the information had been tipped in exchange for a "personal benefit." The district court declined, however, to give a "personal benefit" instruction on the wire fraud and Title 18 securities fraud counts. After four days of deliberation, the jury found all defendants guilty of wire fraud, conversion, and, with the exception of Worrall, Title 18 securities fraud

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and conspiracy. The jury acquitted all defendants on the Title 15 securities fraud counts.

On appeal, the defendants challenged their convictions on various grounds, including misjoinder and insufficiency of the evidence. Of particular interest, the defendants argued that confidential government information does not constitute "property" within the meaning of the Title 18 fraud statutes, and that the district court erred in refusing to give a "personal-benefit" instruction in connection with the Title 18 securities fraud and wire fraud counts.

Title 15 and Title 18 Securities Fraud and Wire Fraud

The Title 15 securities fraud provision, and Rule 10b-5 promulgated thereunder, provide that it shall be unlawful for any person to use any "manipulative or deceptive device or contrivance," in connection with the purchase or sale of a security, including "any device, scheme, or artifice to defraud." 15 U.S.C. §78j(b); 17 C.F.R. §240.10b-5(a). The Title 18 securities fraud statute was added to the criminal code by the Sarbanes-Oxley Act of 2002. It proscribes any "scheme or artifice" to "defraud any person" in connection with a security, or to "obtain, by means of false or fraudulent pretenses, representations, or promises, any money or property" in connection with the purchase or sale of a security. 18 U.S.C. §1348. Finally, the wire fraud statute, like the Title 18 securities fraud statute, prohibits any "scheme or artifice to defraud" to "obtain[] money or property by means of false or fraudulent pretenses, representations, or promises" using the wires. 18 U.S.C. §1343. Each of these fraud provisions, the Supreme Court and the Second Circuit have held, embraces "the act of embezzlement, which is the fraudulent appropriation to one's own use" of the property entrusted to one's care by another. *Carpenter v. United States*, 484 U.S. 19, 27 (1987).

Government 'Property'

As a threshold matter, the Second Circuit considered whether the confidential CMS information at issue constituted "property" within the meaning of the Title 18 securities fraud and wire fraud statutes. Relying heavily on the Supreme Court's decision in *Carpenter*, the court held that, "in general, confidential government information may constitute government 'property' for purposes of 18 U.S.C. §§1343 and 1348 … ." *Blaszczak*, 2019 WL 7289753, at *8. Thus, because confidential government information is "property" within the meaning of the Title 18 fraud statutes, misappropriation of that property through insider trading is punishable under those provisions under the "embezzlement" theory, as well as under the Title 15 securities fraud provisions.

As a threshold matter, the Second Circuit considered whether the confidential CMS information at issue constituted "property" within the meaning of the Title 18 securities fraud and wire fraud statutes.

In *Carpenter*, the defendant had disclosed the Wall Street Journal's pre-publication information to a stockbroker who then traded on that information. The Supreme Court held that the information was the Journal's "property" because "[t]he Journal had a property right in keeping confidential and making exclusive use" of the information prior to publication. *Carpenter*, 484 U.S. at 26. Here, the Second Circuit explained, CMS possessed a "right to exclude" that was similar to the Wall Street Journal's property right recognized in *Carpenter*. Though not necessary to its holding that the CMS information constitutes "property," the court also observed that CMS has an "economic" interest in confidential pre-decisional information because, among other things, it expends significant time and resources to keep its information confidential.

Judge Kearse dissented from this holding, observing that "CMS is not a business" and thus, unlike the Wall Street Journal, confidential information is not its "stock in trade." Judge Kearse argued that the disclosure of confidential pre-decisional information does not prevent CMS from issuing a regulation that adheres to or differs from its original inclination, and thus the disclosure of that information does not deprive it of anything that could be considered "property." Relying on *Cleveland v. United States*, 531 U.S. 12 (2000), Judge Kearse explained that CMS's interest in confidential pre-decisional information is regulatory, not economic.

The 'Personal-Benefit' Requirement

The Second Circuit next considered whether Title 18 securities fraud and wire fraud charges in an insider trading case, like Title 15 securities fraud, require that the tipper receive a "personal benefit."

In *Dirks v. SEC*, the Supreme Court held that an insider may not be

convicted of Title 15 securities fraud unless the government proves that he breached a duty of trust and confidence by disclosing material, nonpublic information in exchange for a "personal benefit." 463 U.S. at 662. The personal-benefit requirement for Title 15 securities fraud was recently unanimously reaffirmed by the Supreme Court in *Salman v. United States*, 137 S. Ct. 420 (2016), which abrogated the Second Circuit's decision in *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014). (We have recently written about the evolution of insider trading enforcement in the Second Circuit. See Martin Flumenbaum & Brad S. Karp, "Civil Penalties for Insider Trading," NYLJ (March 25, 2019).)

As the Second Circuit recognized, the Title 15 and Title 18 fraud provisions "share similar text and proscribe similar theories of fraud." *Blaszczak*, 2019 WL 7289753, at *8. Despite the similarities between these provisions, the court declined to interpret them in pari materia and import the *Dirks* test from Title 15 into Title 18.

Instead, the court emphasized that although 18 U.S.C. §1348 and 15 U.S.C. §78(j) both address "securities" fraud, they do not share the same statutory purpose. The court observed that §1348 was added to the criminal code in 2002 to "overcome the technical legal requirements of the Title 15 fraud provisions" and thus to "provide prosecutors with a different—and broader—enforcement mechanism to address securities fraud" than Title 15. *Blaszczak*, 2019 WL 7289753, at *8. Title 15, by contrast, was enacted "with the "limited purpose" of eliminating the use of inside information for personal advantage "in order to protect the free flow of information into the securities markets." Id. (citing *Dirks*, 463 U.S. at 662) (internal quotation marks omitted). The *Dirks* personal-benefit test is a judge-made doctrine that "effectuated" Title 15's unique purpose "by holding that an insider could not breach his fiduciary duties by tipping confidential information unless he did so in exchange for a personal benefit." Id. Once "untethered" from this statutory context, the court reasoned, "the personal-benefit test finds no support in the embezzlement theory of fraud … ." Id. at *9.

In the context of embezzlement, which is the basis for the Title 18 fraud charges at issue in *Blaszczak*, "there is no additional requirement that an insider breach a duty to the owner of the property, since it is impossible for a person to embezzle the money of another without committing a fraud upon him." Id. In other words, because a breach of duty is "inherent" in the crime of embezzlement, there is "no additional requirement that the government prove a breach of duty in a specific manner, let alone through evidence that an insider tipped confidential information in exchange for a personal benefit." Id.

Only three years after the Supreme Court unanimously breathed new life into the personal-benefit requirement, 'Blaszczak' may well have rendered the Title 15 securities fraud statute—and with it, the personal-benefit test—obsolete. Such an outcome may never come to pass, however.

Conclusion

Blaszczak offers prosecutors a powerful new tool in insider trading cases. Prosecutors in the Second Circuit and elsewhere may increasingly charge insider trading cases as Title 18 frauds in order to avoid the personal-benefit test. Indeed, the court recognized that this could be the import of its decision. The defendants in *Blaszczak* argued strenuously that failing to extend the *Dirks* test to Title 18 fraud would allow the government to avoid that requirement altogether by prosecuting insider trading as Title 18 fraud. "[W]hatever the force of this argument as a policy matter," the court wrote, "we may not rest our interpretation of the Title 18 fraud provisions on such enforcement policy considerations." Id. at *9 (citing *United States v. O'Hagan*, 521 U.S. 642, 678 n.25 (1997)). Only three years after the Supreme Court unanimously breathed new life into the personal-benefit requirement, *Blaszczak* may well have rendered the Title 15 securities fraud statute—and with it, the personal-benefit test—obsolete.

Such an outcome may never come to pass, however. The *Blaszczak* opinion relies on its separate holding that confidential government information is "property" in the hands of the government and thus subject to the "embezzlement" theory of Title 18 fraud. Judge Kearse dissented from this holding as it pertains to confidential government information, and a petition for rehearing en banc may be forthcoming.