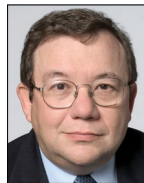


SECOND CIRCUIT REVIEW

Expert Analysis

Constraints on Insider Trading Liability

In *United States v. Blaszcak*, the U.S. Court of Appeals for the Second Circuit reviewed the government's decision to seek dismissal of certain of defendant's insider trading convictions in light of the U.S. Supreme Court's 2020 decision in *Kelly v. United States*, 140 S. Ct. 1565 (2020), which narrowed the definition of "property" for purposes of certain federal criminal statutes. Circuit Judges Amalya Kearse and John Walker Jr. concluded, based on *Kelly*, that certain insider trading statutes are not violated by a scheme to misappropriate confidential government information that is regulatory in nature because the government has no property interest in



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that information. Circuit Judge Richard Sullivan issued a dissenting opinion.

Deciding 'Blaszcak I'

United States v. Blaszcak concerns two insider trading schemes. Both schemes stemmed from a Centers for Medicare & Medicaid Services (CMS) employee's disclosure to hedge fund consultants of contemplated rulemaking lowering certain Medicare reimbursement rates. The hedge fund consultants then used the information to successfully short companies negatively affected by the contemplated rulemaking. See *United States v. Blaszcak*, 947 F.3d 19, 27-28 (2d Cir.

2019) (*Blaszcak I*). Defendants were charged with violating 18 U.S.C. §§641 (conversion), 1343 (federal wire fraud), 1348 (securities fraud), and Section 10(b) of the Securities and Exchange Act (Exchange Act), 15 U.S.C. §78j(b), and accompanying Securities and Exchange Commission (SEC) Rule 10b-5. After a four week-long trial before the U.S. District Court for the Southern District of New York, Defendants were found guilty of conversion, wire fraud, and (excepting one Defendant) securities fraud. Defendants were acquitted of the Section 10(b) and Rule 10b-5 charges.

On appeal to the Second Circuit, Defendants challenged their convictions for conversion under §641 and wire fraud under §1343 on grounds that they had not engaged in a scheme to defraud CMS of "property" because the agency had a "purely regulatory" interest in

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its confidential information, as opposed to a property interest. The Second Circuit disagreed and affirmed the convictions. *Blaszczak I*, 947 F.3d, at 34. In doing so, the court determined that “property” (afforded the same meaning under both statutes) should be interpreted in line with its ordinary meaning—“something of value”—and the contemplated rulemaking was something of value to CMS. *Id.* at 31, 33.

The Second Circuit distinguished the Supreme Court’s decision in *Cleveland v. United States*, 531 U.S. 12 (2000), which found that the government had only a sovereign interest in licenses to operate video poker machines because the licenses themselves had no economic value and the state’s right to issue them did not implicate its rights as a property holder. *Cleveland*, 531 U.S., at 22-23. The Second Circuit noted that “courts have consistently rejected attempts ... to apply [*Cleveland*] expansively,” and determined that “*Cleveland*’s ‘particular selection of factors’ did not establish ‘rigid criteria for defining property’” *Blaszczak I*, 947 F.3d, at 32 (quoting *Fountain v. United States*, 357 F.3d 250, 256 (2d Cir. 2004)). Finding it a “significant” factor

that CMS possessed the “right to exclude” others from the confidential information it had invested “time and resources into generating” and keeping confidential, the court determined that the information was “property.” *Id.* at 33.

The Defendants petitioned the Supreme Court for review in the fall of 2020. In January 2021, the Supreme Court granted cert,

Circuit Judge Richard Sullivan dissented from the majority opinion, arguing that ‘Kelly’ did not necessitate such an outcome because the present scheme aimed to misappropriate confidential information, unlike the schemes in ‘Kelly’ and ‘Cleveland,’ which aimed to influence government decision-making.

vacated the judgment, and remanded the case for further consideration in light of *Kelly v. United States*, which had been decided on May 7, 2020.

The Supreme Court’s Decision in ‘Kelly’

In *Kelly*, the Supreme Court evaluated charges against public officials accused of committing a “scheme[] to deprive [the government of] money or property” under §1343. *Kelly*, 140 S. Ct., at

1571. The defendants were convicted of engaging in a scheme designed to punish the mayor of Fort Lee for refusing to support the New Jersey Governor’s reelection bid by ostensibly closing three New Jersey Port Authority traffic lanes for four days—causing standstill traffic during rush hour—as part of a “traffic study.” *Id.* at 1568. The Court reversed judgment, finding that the object of defendants’ scheme could not have been to deprive the government of “property” because the realignment of traffic lanes “was a quintessential exercise of *regulatory* power,” implicating the government’s role as sovereign, not as a property holder. *Id.* at 1572 (emphasis added). The Court concluded that, consistent with *Cleveland*, “a scheme to alter such a regulatory choice is not one to appropriate the government’s property.” *Id.* (citing *Cleveland*, 531 U.S. at 23). The Court held that such a conviction could “not stand when the [economic] loss to the victim is only an incidental byproduct of the scheme.” *Id.* at 1573.

‘Blaszczak’ on Remand

On remand, the government conceded that, after *Kelly*, “[confidential government] information typically must have

economic value in the hands of the relevant government entity to constitute ‘property’ for purposes of 18 U.S.C. §§1343 and 1348 ... [and a] related, though not necessarily identical, analysis applies when determining what confidential information is a ‘thing of value’ under 18 U.S.C. §641,” which was not met in the present case. Circuit Judges Amalya Kearse and John Walker Jr. concluded that “[n]o greater property interest was involved in the CMS information in the present case” than was at issue in *Kelly*. *United States v. Blaszcak*, 56 F.4th 230, 2022 WL 17926047, at *11 (*Blaszcak II*). The court explained that, although CMS expends effort to maintain confidentiality, rulemaking is an exercise of *regulatory power* that “remains within the exclusive control of CMS.” *Id.* Even if the confidential information is “prematurely disclosed to others, the disclosure has no direct impact on the government’s fisc, although it might well impact CMS’s subsequent *regulatory choices*.” *Id.* (emphasis added).

The majority acknowledged that there are limitations on the government’s ability to successfully bring insider trading cases under §1343 and §641. As noted by amicus curiae in the

case, “[*Blaszcak*] was a case about insider trading—an act already understood to be wrongful under [the Title 15 Securities Laws].” *Id.* at *10. In this case, the government had brought charges under Title 15 (Section 10(b) and Rule 10b-5), but at trial Defendants were acquitted on those counts, in part, because “the actual and intended victims of the alleged frauds would have been investors in the market for securities of the companies” affected by the rulemaking—not the government. *Id.*

Circuit Judge Richard Sullivan dissented from the majority opinion, arguing that *Kelly* did not necessitate such an outcome because the present scheme aimed to misappropriate confidential information, unlike the schemes in *Kelly* and *Cleveland*, which aimed to influence government decision-making. *Id.* at *18 (Sullivan, J., dissenting). Judge Sullivan reasoned that a scheme to misappropriate the government’s confidential information implicated a property interest, noting that “[n]owhere in *Cleveland* did the Supreme Court suggest that government entities are incapable of having property interest in such confidential information; the Court merely held that the government’s *decision*

whether to issue licenses – the object of the defendants’ fraudulent scheme there—was not itself *property*. In the end, *Cleveland* has little to say about this case.” *Id.*

Conclusion

Taken together, the Supreme Court’s decision in *Kelly* and the Second Circuit’s decision in *Blaszcak II* make it clear that the government is constrained when prosecuting insider trading cases where individuals have misappropriated government information that, although confidential, has no direct economic value to the government.