LOS ANGELES & SAN FRANCISCO
Daily Journal
www.dailyjournal.com
THURSDAY, FEBRUARY 18, 2021

PERSPECTIVE

A setback for the broadening of insider trading liability

By Michael M. Farhang

The U.S. Supreme Court's recent decision to summarily vacate the 2nd U.S. Circuit Court of Appeals' ruling in *United States v. Blaszczak* has generated new questions about the permissible scope of DOJ enforcement of insider trading laws. In its *Blaszczak* decision, the 2nd Circuit expanded the scope of potentially actionable insider trading conduct by holding that the confidential "predecisional" information of government agencies constituted a property interest sufficient to make out an insider trading offense, and holding that a tipper need gain no personal benefit to be convicted of insider trading under Title 18's securities fraud statute. The Supreme Court, in vacating the 2nd Circuit's decision in light of its recent opinion in *Kelly v. United States*, appeared to limit and possibly undo those key components of the 2nd Circuit's ruling. But depending on how the 2nd Circuit handles the issues on remand, the most significant expansions of insider trading law in its original decision could potentially remain intact, creating new avenues for prosecutors to broaden the criminalization of insider trading schemes.

Blaszczak concerned an alleged insider trading ring based on disclosures of confidential information regarding planned changes to Center for Medicare & Medicaid Services reimbursement rates. According to the government's indictment, Blaszczak, who had previously worked at CMS and later became a consultant to a healthcare-focused hedge fund, passed nonpublic information regarding the timing and substance of upcoming CMS rule changes covering reimbursement rates for radiation oncology treatments to partners at the hedge fund, who then used the information to short trade in securities of various companies, including a radiation device manufacturer, that would be hurt by the proposed CMS rule changes. Blaszczak allegedly gained access to the confidential information through sources at his former employer, CMS. After a trial, Blaszczak and several other defendants were convicted on conversion, wire fraud, and Title 18 securities fraud charges, and were acquitted on other charges, including Title 15 securities fraud.

On appeal, the 2nd Circuit upheld the convictions, and its December 2019 decision articulated two important expansions of existing insider trading law that could affect how prosecutors view the scope of such laws. First, the 2nd Circuit held that the confidential governmental information at issue, the planned agency reductions of Medicare and Medicaid reimbursements for certain radiation oncology treatments, was akin to the government's "property," sufficient to create an offense where misappropriated under the federal criminal fraud statutes, including Title 18 securities fraud. Second, the court held that, unlike with respect to Title 15 securities fraud offenses, no personal benefit to the tipper was required for a Title 18 securities fraud offense. Various defendants thereafter petitioned the Supreme Court for review of the decision. On Jan. 11, the Supreme Court vacated the 2nd Circuit's decision and remanded for further consideration in light of its recent 2020 decision in *Kelly v. United States*.

Both expansions in the 2nd Circuit's ruling discussed above were significant in that they clarified a greater potential scope for insider trading offenses than was recently understood. Regarding the first component, the *Blaszczak* court's holding suggests that misappropriation of confidential information about upcoming government agency decisions could potentially implicate the same type of property interests as confidential business information for purposes of the criminal fraud statutes, and in their petition to the Supreme Court the defendants argued that this would mean that the government could now seek to prosecute government whistleblowers, journalists and publishers involved in leaks of such information under the fraud and conversion statutes. Regarding the second component, the court's holding regarding lack of a personal benefit requirement for Title 18 securities fraud meant that the government had an easy option to avoid that rigorous requirement inherent in Title 15 insider trading prosecutions by resort to the analog securities fraud statute in Title 18 instead. The petitioners decried this as a "sweeping and amorphous" expansion that removed the clear guiding principle of a personal benefit standard established in the Supreme Court's earlier *Dirks v. SEC* decision that they claimed had enabled a clear differentiation between legal and illegal conduct regarding trades on material nonpublic information.

By vacating and remanding in light of *Kelly*, the Supreme

Court signaled that that decision, which came five months after the 2nd Circuit's decision in *Blaszczak*, impacted the 2nd Circuit's holding regarding property interests under the federal fraud statutes. In *Kelly*, the Supreme Court reversed the conviction of the New Jersey governor's former deputy chief of staff in connection with an alleged conspiracy with Port Authority officials involving limitations of access lanes to the George Washington Bridge in order to retaliate against the mayor of Fort Lee, New Jersey for refusing to endorse the governor's reelection bid. The court held that the Port Authority's decision to realign access lanes was an exercise of regulatory power that could not be construed as a taking of property — despite the alleged use of government agency employees' paid labor to facilitate the access lane alignment — thus making the fraud statutes inapplicable. *Kelly* thus raises the question of whether the "predecisional" information at issue in *Blaszczak*, i.e., the timing and substance of changes to Medicare and Medicaid reimbursement levels, fell within the *Kelly* court's definition of regulatory power and thus could not constitute a basis for an insider trading conviction under Title 18.

By refraining from following the petitioners' request to summarily reverse the 2nd Circuit's decision, the Supreme Court left open the possibility that the 2nd Circuit could preserve the impact of its holding in a couple of ways. First, the 2nd Circuit might still ultimately hold that confidential information about CMS reimbursement decisions falls outside of *Kelly*'s formulation and constitutes "property" subject to misappropriation under federal insider trading laws. For example, the *Kelly* court clarified that in order to constitute "property," the interest at stake must be the object of the fraud and not merely an incidental byproduct of the scheme, which the *Kelly* court concluded the government employees' labor was in that case. In *Blaszczak*, the 2nd Circuit might ultimately conclude that the confidential CMS information was the very object of the scheme and not merely an incident casualty of it. Second, the Supreme Court's decision left unaddressed whether the 2nd Circuit's disavowal of a personal benefit requirement under the Title 18 securities fraud statute might reappear in a post-remand decision, potentially cementing an exception under that statute to the court's earlier holding in *Dirks* that a personal benefit to the tipper is a requirement for insider trading offenses.

Although the circuit court decision in *Blaszczak* has prompted some rethinking of the limits to enforcement of the insider trading laws, its immediate application has been short lived. Now that the impact of *Blaszczak*'s holding is effectively up in the air given the Supreme Court's vacatur, it remains to be seen whether some of the most significant aspects of that holding, regarding application of the fraud statutes to confidential government information and the lack of a personal benefit requirement for certain insider trading offenses, will survive in a post-remand decision. ■

Michael M. Farhang *is a partner at Gibson, Dunn & Crutcher LLP.*