

## Supreme Court Relies on “Bridgegate” Case to Vacate Second Circuit Insider Trading Decision

January 26, 2021

**On January 11, 2021, the Supreme Court vacated the Second Circuit’s controversial decision in *United States v. Blaszczak*, which held that proof of a benefit to the tipper is not a required element for criminal insider trading claims brought under Title 18 of the U.S. Code. Although the Supreme Court ordered reconsideration on other grounds—whether certain government information may be considered “property” for the purpose of a scheme to defraud—the impact on the insider trading decision may be the more significant consequence.**

### ***The Second Circuit’s Decision in United States v. Blaszczak***

As we discussed in a past [client memorandum](#), in 2019 the Second Circuit in *United States v. Blaszczak* expanded insider trading liability by affirming the convictions of four individuals of wire fraud, securities fraud, and conversion charges under Title 18. The government charged the defendants—a government employee, a consultant, and two hedge fund analysts—with violating both Title 15 and Title 18 of the U.S. Code. The jury acquitted the defendants under Title 15, which is the traditional basis to charge insider trading, but convicted on certain Title 18 counts.<sup>1</sup> On appeal, one of the defendants’ arguments was that the District Court wrongly instructed the jury that an element that applied under Title 15 did not apply under Title 18: that the tipper disclosed information for a “personal benefit” that was known to the recipients of the tip.

The Second Circuit reached two significant holdings in *Blaszczak*: (i) that prosecutors need not prove that the defendant sought a “personal benefit” in order to prove criminal insider trading under Title 18 of the U.S. Code, and (ii) that confidential government information held by an agency may constitute government property for the purposes of a scheme to defraud.

### *The Personal Benefit Test*

The Second Circuit in *Blaszczak* was the first court to consider whether the benefit test applies to Title 18 securities fraud cases. The Second Circuit held that the personal benefit test does not apply because it is “not grounded” in the embezzlement theories that are central to Title 18.<sup>2</sup> In comparison, Title 15 was enacted with the “limited purpose” of eliminating use of insider information for “personal advantage.”

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<sup>1</sup> 18 U.S.C. § 1348, enacted in 2002 as part of the Sarbanes-Oxley Act, tracks the federal wire fraud statute and criminalizes any scheme or artifice to defraud, or to obtain money or property by means of false or fraudulent pretenses, representations, or promises, in connection with the purchase or sale of any commodity or security.

<sup>2</sup> *United States v. Blaszczak*, 947 F.3d 19, 35–36 (2d Cir. 2019).

The *Blaszczak* decision increased the risk of prosecution for traders and created the odd possibility, in cases lacking evidence of a personal benefit, that it could be easier for DOJ to obtain a criminal conviction under Title 18 than it would be for the SEC to obtain a civil verdict under Title 15 (the SEC has authority only to enforce Title 15, not Title 18).

### Government Information as Property

The Second Circuit's decision in *Blaszczak* also expanded liability by holding that certain information held by government agencies can constitute government property for the purpose of a scheme to defraud. The court reasoned that the agency had a property right in the "right to exclude" outsiders from the information.<sup>3</sup> This increased the risk of liability if the government could prove that it had invested efforts to maintain the confidentiality of its information.

### ***The Supreme Court's Decision in Kelly v. United States***

In May 2020, five months after the Second Circuit's decision in *Blaszczak*, the Supreme Court addressed the government property issue in the context of the "Bridgegate" scandal in *Kelly v. United States* (discussed in a previous [client memorandum](#)). In *Kelly*, the Court reversed the wire fraud convictions of two New Jersey officials who had been convicted of colluding to alter traffic patterns on the George Washington Bridge as a means of political retaliation against a mayor who refused to support the then-governor's re-election campaign.

The Court took a narrow view of what constitutes "property" for the purposes of the federal wire fraud statute, holding that obtaining the property must be the "object" of the scheme and not merely an "incidental byproduct."<sup>4</sup> It also held that a state does not have a cognizable property interest in its "intangible" rights of regulatory control.<sup>5</sup> The Court concluded that the issue of traffic pattern re-routing was an exercise of "police powers" and not an exercise of the state in its role as a property holder.<sup>6</sup>

In September 2020, the *Blaszczak* defendants petitioned the Supreme Court for certiorari, arguing the Second Circuit erred in both the personal benefit and government property aspects of the decision. The Solicitor General took the position that the Supreme Court should remand the case for reconsideration in light of the Court's decision in *Kelly*. The Petitioners objected, warning that the Second Circuit could reverse itself on the government property issue but leave its judgment on the "personal benefit" test in place.

### ***Remand of Blaszczak and Open Issues***

On January 11, the Supreme Court vacated the judgment in *Blaszczak* and remanded the case in full for the Second Circuit's "further consideration in light of" the decision in *Kelly*.<sup>7</sup>

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<sup>3</sup> *Id.* at 38.

<sup>4</sup> *Kelly v. United States*, 140 S.Ct. at 1565, 1569 (2020).

<sup>5</sup> *Id.* at 1572.

<sup>6</sup> *Id.* Numerous district courts have since relied on *Kelly* to dismiss fraud charges premised on overbroad "property" theories. See, e.g. *United States v. Palma*, No. 2:19-cr-2026-NGE, 2020 WL 6743144 (E.D. Mich. Nov. 17, 2020) (dismissing wire fraud counts where the purported purpose was "regulatory approvals"); *U.S. v. Ernst et al*, No. 1:19-cr-10081 (D. Mass., Nov. 23, 2020) (dismissing fraud counts based on the obtaining of college admissions slots).

<sup>7</sup> *Blaszczak v. United States*, No. 20-5649, 2021 WL 78043 (Jan. 11, 2021).

On remand, the Second Circuit may well reverse its decision regarding government property in light of the decision in *Kelly*. If that happens, presumably the Second Circuit would have no occasion to re-reach the personal benefit question, and its prior holding on the issue, having been vacated by the Supreme Court, would have no precedential effect. In such circumstance, it would be an open question as to whether prosecutors would take the risk of pursuing Title 18 insider trading cases absent evidence of personal benefit, or revert to treating Title 18 and Title 15 cases in parity going forward. In any event, one can expect the personal benefit question to remain an active one for time to come.

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