

PUBLICATION

Securities Insider Trading Cases Get a Prosecutorial Boost

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Because of the December 30, 2019 decision of the Second Circuit Court of Appeals in *United States v. Blaszcak*, prosecutors appear to have an easier task sustaining insider trading cases under alternatives to Title 15 requirements. 2019 WL 7289753 (2d Cir. Dec. 30, 2019). Whereas Title 15 insider trading cases require a personal benefit to the tipper (and knowledge thereof by the tippee), the Court ruled 2-1 that under the Sarbanes-Oxley securities fraud standards as well as Title 18 wire fraud elements, no proof of the tipper's personal benefit or knowledge of it by the tippee is necessary. Moreover, the Court held that confidential government information disclosed prior to decision by the agency constitutes property of the government protected under prosecution theories of embezzlement or misappropriation.

This approach avoids the muddy territory recently laid out in the *Newman* case in the Second Circuit and the *Salman* case in the Supreme Court. The Second Circuit in *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014), addressed the limits of the longstanding requirements in Title 15 insider trading cases that the tipper received a "personal benefit" from the wrongful disclosure of material non-public information (MNPI), and that the tippee be aware of that fact. The *Newman* Court vacated the insider trading convictions of two portfolio managers who received information up to three and four levels removed from corporate insiders. The government asserted that a "personal benefit" to the insiders could be inferred from their wrongful disclosure of MNPI to the first-level tippees based on family friendships and casual acquaintances. The Second Circuit rejected this argument and held that a "personal benefit" may only be inferred under this so-called "gift" theory if there exists a "meaningfully close personal relationship [between the tipper and first-level tippee] that generates an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature."

The U.S. Supreme Court in *Salman v. United States*, 137 S. Ct. 420 (2016), reined in *Newman* – issued just two years prior. The Supreme Court rejected *Newman's* "meaningfully close personal relationship" and held that a jury may infer a "personal benefit" in Title 15 insider trading cases where a tipper wrongfully provides MNPI to a "trading relative or friend." The Supreme Court reasoned that the tipper's provision of the MNPI equates to a "cash gift" to the tippee from which the tipper personally benefits "because giving a gift of trading information is the same thing as trading by the tipper followed by a gift of the proceeds." The Supreme Court also questioned *Newman's* holding that the tipper received something of a "pecuniary or similarly valuable nature" in exchange for the MNPI.

Briefly, the facts in *Blaszcak* are as follows: the indictment alleged that Centers for Medicare and Medicaid Services (CMS) employees disclosed the agency's confidential information to Blaszcak, himself a former CMS employee turned "political intelligence" consultant for hedge funds. The alleged confidential information concerned contemplated rule changes to reimbursement rates for certain medical procedures. The government asserted that Blaszcak provided the confidential information to two employees of a hedge fund, which shorted the stock of health care companies likely to be hurt by the rule changes. The government charged a CMS employee (the tipper), Blaszcak (the tippee), and the two hedge fund employees (downstream tippees) for the alleged insider trading scheme, including charges of conversion of government property, Title 15 securities fraud, Title 18 securities fraud, and wire fraud.

At trial, the district court instructed the jury that, to convict Blaszczak and the two hedge fund employees of securities fraud under Title 15, it must find that those defendants were aware that the CMS employee provided the MNPI information in exchange for a personal benefit. The defendants sought that same jury instruction for the charges of securities fraud under Title 18, as well as the wire fraud counts. The district court refused. The jury returned a split verdict that, among other things, found the defendants guilty of Title 18 securities fraud (except the CMS employee), conversion, and wire fraud, but not guilty of Title 15 securities fraud.

On appeal to the Second Circuit, the defendants asserted that the lower court erred in its refusal to apply the "personal benefit" test to the Title 18 securities fraud and wire fraud counts. The Second Circuit reasoned that Congress intended the Title 18 securities fraud statute – enacted in 2002 as part of the Sarbanes-Oxley Act – to provide a broader enforcement mechanism than the significantly older Title 15 securities fraud provisions. The Court thus "decline[d] to graft" the "personal-benefit test onto the elements of Title 18 securities fraud" or the wire fraud statute. The defendants also asserted that the predecisional CMS information concerning reimbursement rate changes did not constitute government "property" to support the Title 18 securities fraud and wire fraud convictions. The Second Circuit rejected this argument and reasoned that "CMS *does* have an economic interest in its confidential predecisional information[.]" The Court held that "in general, confidential government information may constitute government 'property' for purposes of" wire fraud and Title 18 securities fraud charges.

Thus, prosecutors now have, courtesy of this first court of appeals ruling on the issues, an easier way to bring insider trading cases. They no longer have to rely on Title 15 charges, with the personal benefit test, but can charge Sarbanes-Oxley and wire fraud violations without that extra burden of proof.