Simpson Thacher

Regulatory and Enforcement Alert

DOJ Reverses Course on Definition of "Property" for Fraud on *Blaszczak* Remand, Leaving Statutory Action the Only Likely Hope for Insider Trading Reform—For Now

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Overview

On January 11, 2021, based on the consent—and indeed, at the request of the Department of Justice ("DOJ")—the Supreme Court vacated and remanded the Second Circuit's decision in *United States v. Blaszczak*. *Blaszczak* was the controversial 2-1 decision that arguably heightened (some say unfairly) the risk of criminal insider trading prosecution by upholding the multi-count convictions of the defendants for, at bottom, illegally trading while in possession of information stolen from the government. The Supreme Court agreed, remanding to the Second Circuit to reconsider its decision in light of the Court's intervening decision in *Kelly v. United States*. *Kelly* overturned the convictions that had stemmed from New Jersey's infamous BridgeGate scandal by finding that, in that case, the government information at issue was not "property" as would have been required to sustain a conviction under the wire fraud theory, and that while "allocating lanes" on the bridge required "the time and labor of Port Authority employees," those expenditures were "incidental" to "run-of-the-mine exercise of regulatory power," rather than a misappropriation of government property.[1]

Following the remand on consent, defense counsel and commentators alike speculated that, on remand, the Second Circuit would reconsider not only the issue of whether the CMS "predecisional" information stolen by the defendants constituted property to sustain an insider trading conviction under a wire fraud theory, but the controversial holding that affirmed the elements required to prove insider trading under Title 18. Specifically, the controversy around the Second Circuit's decision related to the fact that at trial, the defendants were convicted on a wire fraud theory of insider trading, under Title 18, and acquitted on the traditional insider trading counts charged under Title 15. This was significant because, in doing so, the Second Circuit affirmed the lower court's decision that Title 18 did not require the government to prove the "personal benefit" element of the crime as is now required when bringing criminal and civil insider trading cases under the Securities Exchange Act. As a result, criminal insider trading charges can be proven more easily under a theory of "wrongfully obtained" information than in an SEC civil enforcement action, which would still require proof of the arduous "personal benefit" test—including the tippee's knowledge of the benefit, engrafted by decades of case law under Title 15.

[1] The federal wire fraud statute targets fraudulent schemes for obtaining property. *See* 18 U.S.C. §1343 (crime to effect (with the use of the wires) "any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises.").

When the defendants in *Blaszczak* filed for certiorari, some hoped that the Supreme Court would step in and clarify the law. That hope was perpetuated when the Government consented to remand, and argument, which would involve a new panel member, was scheduled for April 21, 2021.[2]

In a significant turn of events, on April 2, 2021, the DOJ filed a remand brief where it confessed error—in light of the Supreme Court's subsequent holding in *Kelly*—at the direction of the Office of the Solicitor General and argued that all but two counts of its *Blaszczak* conviction should be reversed. This submission wholly alters the DOJ's previous position on the scope of "property" under 18 U.S.C. §§ 1343 and 1348 and a "thing of value" under 18 U.S.C. § 641. In its filing, the DOJ asserts that, "[i]n light of the Supreme Court's holding in *Kelly*, it is now the position of the DOJ that in a case involving confidential government information, that 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," that property must be "the object of the fraud" and that "a related, though not necessarily identical, analysis applies when determining what confidential information is a 'thing of value' under 18 U.S.C. § 641." The DOJ wrote that, "[t]he Department has determined that the confidential information at issue in this case does not constitute 'property' or a 'thing of value' under the relevant statutes after *Kelly*" and that although "CMS does have an economic interest in its confidential predecisional information because the agency invests time and resources into generating and maintaining the confidentiality of that information, and leaks affect the efficient use of its limited time and resources . . . the CMS employee time at issue in this case did not constitute 'an object of the fraud,' and thus the associated labor costs could not sustain the convictions here." This changed position is particularly notable, given that the Second Circuit's recent post-*Kelly* precedent in *United States v. Gatto* (which declined to adopt *Kelly*'s narrow definition of Title 18 property), indicated it might largely maintain the Circuit's more expansive definition of "property," especially given the facts of *Blaszczak*.

The Implications of the DOJ's Change in Position

The DOJ's new position and broad view of *Kelly* on remand significantly narrows the definition of government property and curtails Title 18's application in insider trading cases—but arguably only with respect to those cases involving government property. Those cases—which may include trading on predecisional information about budgetary decisions, tax policies or economic stimulus plans—will have to be brought under Title 15, and are subject to the morass of confusing case law that the courts have developed over the course of many years. Indeed, some could argue that the DOJ's decision to go this route in *Blaszczak* will only contribute to the confusion, as the Second Circuit is unlikely to take up issues that will not affect the outcome of the case before it—but we'll have to wait to see what happens when the panel hears the matter on April 21.

While this holding likely makes it impossible to prosecute insider trading based on *government information* under Title 18 going forward, it also likely limits the Circuit's interest in revisiting the other elements required to prove insider trading under a wire fraud theory. Thus, the *Blaszczak* remand will likely neither affect nor clarify the state of the law with respect to the elements of insider trading under Title 18 overall, but rather simply force

[2] Judge Christopher Droney, who voted in favor of the majority decision, is now retired.

prosecutors to follow the more traditional theory under Title 15 in cases where the defendants trade while in possession of government information. For clarity, we'll likely have to wait to see if Congress will act to create a uniform legislative definition of insider trading, and if so, if they'll get it right.

For further information about this Alert, please contact one of the following members of the Firm's Litigation Department.

NEW YORK CITY

Brooke E. Cucinella
+1-212-455-3070
brooke.cucinella@stblaw.com

Stephen M. Cutler
+1-212-455-2773
stephen.cutler@stblaw.com

Sarah L. Eichenberger
+1-212-455-3712
sarah.eichenberger@stblaw.com

Nicholas S. Goldin
+1-212-455-3685
ngoldin@stblaw.com

Joshua A. Levine
+1-212-455-7694
jlevine@stblaw.com

Michael J. Osnato, Jr.
+1-212-455-3252
michael.osnato@stblaw.com

Jonathan S. Kaplan
+1-212-455-3028
jonathan.kaplan@stblaw.com

WASHINGTON, D.C.

Meaghan A. Kelly
+1-202-636-5542
mkelly@stblaw.com

Jeffrey H. Knox
+1-202-636-5532
jeffrey.knox@stblaw.com

Cheryl J. Scarboro
+1-202-636-5529
cscarboro@stblaw.com

PALO ALTO

Stephen P. Blake
+1-650-251-5153
sblake@stblaw.com