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REASSESSING THE SECOND CIRCUIT'S EXPANSION OF CRIMINAL INSIDER TRADING LIABILITY IN *UNITED STATES V. BLASZCZAK*

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The Second Circuit's recent opinion in United States v. Blaszczak *has contributed to paving a less burdensome pathway for the government to successfully prosecute criminal insider trading. In* Blaszczak, *Centers for Medicare & Medicaid Services ("CMS") employees disclosed confidential agency information to the defendant, Blaszczak, principally including proposed CMS rule changes and other nonpublic information pertaining to the healthcare industry. Blaszczak was a hedge fund consultant and former CMS employee, who in turn tipped this information periodically over a span of five years to certain of the other defendants, employees of two separate hedge funds. Both of the employees' hedge funds then traded on the information, resulting in large profits. The court held that (1) the personal benefit test necessary to establish an insider trading charge under Section 10(b) does not apply when such a charge is brought under Title 18 securities fraud or wire fraud statute, and (2) that predecisional regulatory information constitutes property for the purposes of the aforementioned statutes. This article argues that the court erred in dispensing with the personal benefit requirement because the court failed to recognize that the personal benefit test cabins the fraud that is necessary to sustain a tipper-tippee criminal insider trading charge to fraudulent behavior in which the tipper stands to gain personally, not also to situations in which the agent is merely acting in bad faith. This Note further argues that such predecisional regulatory information is not property in this context and that the Second Circuit's holding runs afoul of Supreme Court precedent. This decision has the potential to disrupt the normal functioning of the markets by proscribing activity that market actors have long since relied on being lawful.*

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INTRODUCTION

The most ubiquitous federal statute and SEC Rule regulating insider trading is Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b–5. Section 10(b) of the statute punishes fraud, which requires deceit or material misrepresentations.[1] Although insider trading rarely involves affirmative misrepresentations, fraud is committed when the trader has a duty to disclose information and remains silent. In *Chiarella v. United States*, the Supreme Court held that, where one has a fiduciary duty to one of the transacting parties, silence constitutes fraud when someone is in possession of material nonpublic information and trades on that information, without first disclosing an intention to trade on the information.[2] The Court clarified that mere possession of material nonpublic information does not give rise to a duty to disclose or abstain from trading, but rather (1) the trader must inherit a fiduciary relationship, and (2) the trader used the information for the personal benefit of the fiduciary or the principal's agent, and not for the benefit of the principal.[3] In a subsequent Supreme Court case, *Dirks v. SEC*, the Court applied the standard established in *Chiarella* to the question of when a tippee, the recipient of material nonpublic information, is liable

1. *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976) (finding that liability only attaches under Section 10(b) and Rule 10b–5 to fraudulent acts performed with scienter).
2. 445 U.S. 222, 228 (1980).
3. *Id.* at 228–30.

for insider trading.[4] In keeping with *Chiarella*, *Dirks* held that tippees are liable when they trade on information from tippers whom they know are sharing that information in breach of a fiduciary duty for the tipper's own personal benefit.[5]

In a recent paradigm-shifting case *United States v. Blaszczak*, the United States Court of Appeals for the Second Circuit expanded criminal liability for insider trading.[6] Writing for the panel, Judge Sullivan's opinion eschews traditional tipper–tippee insider trading doctrine employed under a Section 10(b) and SEC Rule 10b–5 analysis, and held that the personal benefit test necessary to establish an insider trading charge under Section 10(b) does not apply when such a charge is brought under the Title 18 securities fraud or wire fraud provisions.[7] Further, the court held that "predecisional" information, or the agency's preliminary, deliberative information produced in contemplation of regulation, constitutes property for purposes of the federal wire fraud provisions, and by extension, Title 18 securities fraud.[8] In so holding, the court may have deviated from the precept that there must be a specific showing of fraud to sustain an insider trading charge by grounding tippee liability on an embezzlement theory. Further, the court's decision arguably mischaracterizes the legislative history of Title 15 securities fraud to justify jettisoning the personal benefit requirement in the context of Title 18 securities fraud.

In Part I of this note, the relevant doctrinal background on insider trading is summarized to properly frame the issues in *Blaszczak*. Parts II and III will argue that the Second Circuit may have erred in dispensing with the personal benefit requirement of insider trading liability for purposes of Title 18. Part IV of this note argues that the court's opinion dangerously expands insider trading criminal liability in contravention of 18 U.S.C. § 1348's text, and Congress's intent and purpose in enacting both the wire fraud statute and 18 U.S.C. § 1348. Part V of this note argues that the predecisional information at issue in *Blaszczak* should not constitute property for

4. 463 U.S. 646, 660–62 (1983).
5. *Id.* at 660.
6. 947 F.3d 19 (2d Cir. 2019).
7. *Id.* at 36–37.
8. *Id.* at 34.

purposes of wire fraud or for a Title 18 violation. Part V also argues that an expansive definition of property combined with a less burdensome legal pathway to insider trading liability overrides principles of due process in criminal proceedings and the policy norms on which the insider trading laws were based.

I.
Doctrinal Background

In *Chiarella v. United States*, the Court found that an employee of a financial printer company did not violate Section 10(b) when the employee used confidential information, the fact that his employer's client would soon acquire another corporation, to buy securities in the target company prior to the public takeover announcement. The Court reasoned that Chiarella did not have a fiduciary duty or similar relationship of trust and confidence to the sellers of the target company's securities, and absent such a duty, the duty to disclose or abstain from trading on material non–public information was not triggered.[9] Chiarella was not the sellers' "agent, he was not a fiduciary, he was not a person in whom the sellers had placed their trust and confidence. He was . . . a complete stranger who dealt with the sellers only through impersonal market transactions."[10] The Court emphasized that not every perceived "instance of financial unfairness" constitutes fraudulent activity under Section 10(b).[11] Moreover, rather than a duty to all participants in the marketplace, the duty to disclose material, nonpublic information in the Section 10(b) context only arises where there is a fiduciary or similar relationship between two parties.[12]

Three years later, the Supreme Court established the legal framework for finding a tippee of material nonpublic information guilty of violating Section 10(b). In *Dirks v. SEC*, the Court held that the defendant Dirks, a market analyst who provided investment advice to the insurance industry, did not violate Section 10(b) when he was provided nonpublic information from Secrist, a disgruntled employee who informed Dirks of

9. Chiarella v. United States, 445 U.S. 222, 232–33 (1980).
10. *Id.*
11. *Id.* at 232.
12. *Id.* at 228.

certain fraudulent practices by his former employer's subsidiary, who in turn aided and abetted trading on such information.[13] The Court reinforced its rejection of the SEC's view that anyone who receives material, nonpublic information has a fiduciary duty to disclose or abstain from trading, which the Court said was "rooted in the idea that the antifraud provisions require equal information among all traders."[14] The Court noted that imposing such a duty on all market traders would have an "inhibiting influence on the role of market analysts," and that the SEC conceded that such analysts are integral to the functioning of a healthy market.[15] Thus, the Court found that a tippee could only be held derivatively liable when the insider who provides the tip has breached a fiduciary duty.[16] The insider breaches his fiduciary duty when he discloses confidential information improperly for his personal benefit, and the tippee assumes insider trading liability when he knows or has reason to know the insider breached this fiduciary duty for the purpose of a direct or indirect personal benefit.[17]

Although not expressly adverted to in *Dirks*, the personal benefit requirement derives from agency law.[18] Personal benefit that solely redounds to the fiduciary-agent and not the principal distinguishes fraud on the principal and fraud on behalf of the principal. The law of imputation states that corporations are liable for their employees' acts of fraud when that fraud is even partly aligned with the corporation's interests, regardless of the agent's "selfish motive[s]."[19] There is a presumption that an agent will communicate all material information to its principal.[20] That presumption is only rebutted when an agent has "totally abandoned his principal's interests" and commits fraud solely to benefit his own interests that are "entirely opposed" to the principal's interests.[21] Where the agent seeks to act upon the principal's confidential information solely for his self-interest, a duty to disclose is triggered because acting in

13. Dirks v. SEC, 463 U.S. 646, 665 (1983).
14. *Id.* at 657.
15. *Id.* at 658.
16. *Id.* at 659.
17. *Id.* at 660.
18. Restatement (Third) of Agency § 8.05 (Am. L. Inst. 2006).
19. *See* Kirschner v. KPMG LLP, 938 N.E.2d 941, 951 (N.Y. 2010).
20. *Id.*
21. *Id.* at 952.

such a manner would be a breach of the agent's duty of loyalty.[22] Only when the agent receives consent from the principal to act would the agent remain loyal to the principal, foreclosing any claim of fraud upon the source of the information, the principal.[23] Therefore, an agent is not violating his duty of loyalty to the principal-corporation when he fails to disclose and receive consent before trading on nonpublic information if that trading is motivated, even in part, to benefit the corporation.[24] The corporation in this situation is not the victim of fraud, but the perpetrator.[25] Applying this principle to the facts of the case, the Court concluded that Secrist did not violate his fiduciary duties to the corporation's shareholders by providing information to Dirks; ergo Dirks could not be derivatively liable as a tippee that passed such information to others who traded on the basis of these secrets.[26] The Court reasoned that Secrist's disclosures "were motivated by a desire to expose the fraud," the tipper received no pecuniary or other personal benefits for proving the information, and there was no purpose to gift the information to Dirks.[27]

More recently, the Second Circuit and the Supreme Court had occasion to clarify and reaffirm the *Dirks* test regarding what constitutes a personal benefit in a tipper-tippee insider trading case. In *United States v. Newman*, the Government charged the defendant Newman et al. for trading on material nonpublic information that was tipped to them by a group of analysts at various hedge funds and investment firms.[28] The Second Circuit held that there was insufficient evidence to convict the defendant and the trial court erred in failing to instruct the jury that the government must prove that the tippee knew that he was trading on confidential information in violation of the insiders' fiduciary duties, and that the

22. Restatement (Third) of Agency § 8.05 (Am. L. Inst. 2006).

23. *Id.* at § 8.06

24. *See* United States v. Sun-Diamond Growers, 138 F.3d 961, 970 (D.C. Cir. 1998) (citing United States v. Automated Med. Labs, 770 F.2d 399, 407 (4th Cir. 1985), which held that an employee-agent acting for his own benefit and at least in part to benefit the principal-corporation does not insulate the corporation from criminal liability for the agent's actions even if those actions were detrimental to the corporation).

25. *See id.* at 970–71.

26. *See* Dirks v. SEC, 463 U.S. 646, 667 (1983).

27. *Id.*

28. *See* 773 F.3d 438, 443 (2d Cir. 2014).

tippee knew that the insider received a personal benefit in exchange for the tip.[29] The court found that a personal benefit exchanged between a tipper and tippee, who are engaged in a "meaningfully close personal relationship," "must be of some consequence."[30] Although *Dirks* and its progeny have declared that the tipper's benefit need not be "immediately pecuniary . . . something more than the ephemeral benefit" of the value of friendship must be received.[31] Two years later in *Salman v. United States*, the Supreme Court, on appeal from the Ninth Circuit, was presented with a situation in which the defendant received nonpublic information from Maher Kara, an investment bank employee who shared information with his brother Michael, who in turn gave the information to the defendant.[32] Salman argued that the evidence was insufficient to sustain a conviction under Section 10(b) tippee liability because a gift to a trading relative was not enough absent proof that the tip was for the benefit of the insider.[33]

At the appellate level in *Salman*, the Ninth Circuit refused to follow the approach of the Second Circuit in *Newman*, and found that "proof that the insider disclosed material nonpublic information with the intent to benefit a trading relative or friend [and the tippee knew as much] is sufficient to establish the breach of fiduciary duty element of insider trading."[34] The Supreme Court affirmed the Ninth Circuit's decision in *Salman* while holding that the *Dirks* test of personal benefit in a tipper-tippee insider trading paradigm governed the situation at bar. The Supreme Court clarified the tension between the Second Circuit and Ninth Circuits' approaches to the personal benefit test by saying that "[t]o the extent the Second Circuit held that the tipper must also receive something of a pecuniary or similarly valuable nature in exchange for a gift to family or friends . . . , we agree with the Ninth Circuit that this requirement is inconsistent with *Dirks*."[35] Moreover, the Court refused to adopt the government's arguments that (1) a gift of confidential information to anyone, regardless of their rela-

29. *See id.* at 442.
30. *Id.* at 452.
31. *Id.*
32. *See* 137 S. Ct. 420, 423–25 (2016).
33. *See id.* at 426.
34. United States v. Salman, 792 F.3d 1087, 1094 (9th Cir. 2015).
35. *Salman*, 137 S. Ct. at 428.

tionship, is enough to prove an insider trading violation, and that (2) a gift arises whenever the tipper discloses nonpublic trading information for "non-corporate purposes."[36]

Therefore, to be held liable as a tippee in an insider trading violation under Section 10(b), one must establish the following elements: (1) the tipper discloses material, nonpublic information in breach of his fiduciary duty; (2) the tipper discloses the information with the expectation that the tippee will trade on it; (3) the tipper receives a personal benefit in the form of pecuniary or something of similar value when disclosing to a stranger, or the tipper gifts the information to family or a "trading relative or friend;" (4) the tippee knows of the tipper's fiduciary relationship and that the tipper disclosed the information for a personal benefit (or at least should have known in a civil case) and the tipper expected trading to ensue.[37] Importantly, the Newman definition of "trading relative or friend" remains intact after *Salman*. In order to apply the Dirks' gifts to friends personal benefit analysis, there must be a "meaningfully close personal relationship."[38] Proving personal benefit "by the mere fact of friendship, particularly of a casual or social nature" will not suffice.[39] Short of a gift to a friend, the personal benefit to the insider who subsequently shares the information must be "objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature."[40]

II.
Not all Frauds are Created Equal

Stripped to its core proposition, *United States v. Blaszczak*[41] equates all forms of embezzlement and the fraud inherent

36. *Id.* at 426–27.

37. *See, e.g.*, Dirks v. SEC, 463 U.S. 646 (1983); United States v. Newman, 773 F.3d 438, 443 (2d Cir. 2014); *Salman*, 137 S. Ct. 420.

38. *Newman*, 773 F.3d at 452.

39. *Id.*

40. *Id.*

41. 947 F.3d 19 (2d Cir 2019). In *Blaszczak*, CMS employees disclosed confidential agency information to Blaszczak, principally including proposed CMS rule changes and other nonpublic information pertaining to the healthcare industry. Blaszczak was a hedge fund consultant and former CMS employee, who in turn tipped this information periodically over a span of five years to certain of the defendants, employees of two separate hedge

therefrom as consistent with the fraud inherent in current insider trading law under Section 10(b). The central analytical issue the court faces in *Blaszczak* is whether the Centers for Medicare & Medicaid Services ("CMS") employee who tipped confidential information to Blaszczak defrauded CMS by divulging this information contrary to corporate policy and seemingly without a corporate purpose, but not for any personal benefit.[42] Under Delaware corporate law, officers and key managerial employees, agents of a firm, and mere employees who have been entrusted with confidential information obtained through the scope of their employment all have a fiduciary duty to safeguard confidential information.[43] Further, both agents of a corporation and those entrusted with confidential information that assume the agent's fiduciary role owe the principal corporation duties of good faith, loyalty, and fair dealing.[44] Misappropriating confidential information is classified as fraud when an agent or employee breaches a duty.[45] Delaware courts have held that a "certain duty to disclose inheres in the duty of loyalty."[46] An agent's duty to disclose arises when they "have notice of facts which they should know may affect the decisions of their principals as to their conduct . . . [or has] or represents another who has, interests adverse to the principal concerning matters within the scope of the agency."[47] Upon this standard, it is evident that an agent has a duty to disclose material information to a firm when a conflict of interest arises.

Moreover, Delaware courts have found the duty to disclose triggered under circumstances in which the fiduciary director of a corporation engages in a transaction that is harmful to the corporation, but personally beneficial to the direc-

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funds. Both of the employees' hedge funds then traded on the information, resulting in large profits. *See id.* at 26–28.

42. *Id.* at 34–37.

43. *See, e.g.*, Triton Constr. Co. v. E. Shore Elec. Servs., No. CIV.A. 3290-VCP, 2009 WL 1387115, at *15 (Del. Ch. May 18, 2009) (citing RESTATEMENT (THIRD) OF AGENCY § 8.05 (AM. LAW INST. 2006)).

44. Estate of Eller v. Bartron, 31 A.3d 895, 898 (Del. 2011).

45. RESTATEMENT (THIRD) OF AGENCY § 8.01 (AM. LAW INST. 2006).

46. *See, e.g.*, Big Lots Stores, Inc. v. Bain Capital Fund VII, LLC, 922 A.2d 1169, 1184 (Del. Ch. 2006).

47. *Bartron*, 31 A.3d 895 at 899 n.10.

tor.[48] Thus, it is apparent that a duty to disclose is triggered in cases—at least under Delaware law—where a fiduciary violates the duty of loyalty due to conflicts of interest and self-dealing.[49] As agency and corporate law provides context, the duty to disclose or abstain from trading, the violation of which is the fraud underpinning a Section 10(b) insider trading violation, is properly viewed as inhering in a fiduciary's duty of loyalty. It follows that a fiduciary has a duty to disclose or abstain from trading on confidential information when doing so would present a conflict of interest or would be an act of self-dealing.

An interesting wrinkle is whether a fiduciary has a duty to disclose to the firm when they plan to use their confidential information in bad faith, meaning beyond authorized use but not for personal benefit. In the corporate director context, Delaware law has proclaimed that a corporate fiduciary violates the duty of good faith when "the fiduciary intentionally acts with a purpose other than that of advancing the best interests of the corporation."[50] Further, the duty of good faith is a "subsidiary element" or "condition" of the corporate fiduciary's duty of loyalty.[51] One can make the argument that "interests adverse" as quoted in the context of an agent's duty to disclose is a more stringent standard than "with a purpose other than . . . the best interests" in the corporate director context. Interests adverse to an agent's principal seems to connote a fiduciary acting for personal gain at the expense of the company, whereas acting with a purpose other than the best interests of a corporation invokes activity much broader in scope. Thus, a fiduciary agent's duty to disclose seems to imply conflict of interest and self-dealing scenarios. These are situations in which the fiduciary stands to gain personally. This is distinct from a corporate fiduciary's duty of good faith where the fiduciary does not necessarily act for personal benefit.

Therefore, the *Dirks* personal benefit test, indispensable to finding a fiduciary duty violation in insider trading, seems

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48. *See Big Lots*, 922 A.2d at 1184 (citing Hollinger Int'l v. Black, 844 A.2d 1022 (Del. Ch. 2004) as the "paradigmatic example" of such a duty to disclose claim).

49. *See also* RESTATEMENT (THIRD) OF AGENCY §§ 8.02, 8.03 (AM. L. INST. 2006).

50. *See, e.g.*, In re Walt Disney Co., 906 A.2d 27, 67 (Del. 2006).

51. Stone v. Ritter, 911 A.2d 362, 370 (Del. 2006).

to be consistent with the personal benefit element necessary to establish a fiduciary duty violation when an agent inherits a duty to disclose confidential information. On the other hand, the agent's duty as articulated above could be viewed as broad enough to capture the agent's duty of good faith as necessary to the agent's duty to disclose plans to use confidential information in a presumptively unauthorized manner. Further, using confidential information in this manner would appear to be a violation of the corporate director's duty of good faith. Therefore, it is ambiguous whether embezzling confidential information in bad faith would be a violation of the corporate agent's duty of loyalty underlying the agent's duty to disclose.

As will be discussed in more detail below, the Second Circuit in *Blaszczak* found the defendant-tippee derivatively liable for the CMS employee's tip of confidential information, in the absence of any claimed personal benefit redounding to the employee, because the court grounded the employee's fiduciary duty violation in an embezzlement theory of fraud.[52] In the court's view, a breach of duty is inherent in all forms of embezzlement, and there is no need to prove a breach of duty in a specific manner, much less through finding the tipper tipped in exchange for a personal benefit.[53] If one stipulates to the proposition that a fiduciary is embezzling information when they take property in violation of their duty of loyalty, although the court purports to be dispensing with the personal benefit test, the underlying fraud inherent in embezzlement could be consistent with the duty of loyalty that animates the fraudulent behavior violative of Section 10(b). If we exclude good faith as necessary to the duty to disclose, disclosing confidential information in violation of one's duty of loyalty subsumes the personal benefit to the fiduciary element, as one violates this duty of loyalty in situations where the fiduciary stands to gain a personal benefit. As discussed, however, *Blaszczak* seems to be implying that one embezzles information in violation of their duty of loyalty to the extent that the fiduciary acts in bad faith with the firm's confidential information.[54] *Dirks* did not address whether taking property in pure bad faith alone would be fraudulent, but its personal benefit test

52. United States v. Blaszczak, 947 F.3d 19, 35–36 (2d Cir. 2019).
53. *Id.* at 36.
54. *Id.*

appears to cabin the duty of loyalty to conflict of interest transactions and self-dealing, or breaches in which the fiduciary stands to gain a personal benefit.

Although the court is correct in saying that fraud is inherent in embezzlement, it cannot be correct to the extent it espouses the notion that proving embezzlement in any manner will suffice to prove the fraud with which Section 10(b) is concerned. Arguably, an agent acting in bad faith, such as one who uses confidential information with a purpose "other than the firm's best interests,"[55] triggers the duty to disclose, and an agent who embezzles confidential information has violated his duty of loyalty and defrauded his firm. Further, the *Dirks* personal benefit test says that to the extent an agent appropriates confidential information in violation of firm policy, this alone is not enough to find fraud under Section 10(b).[56] *Dirks* itself is illustrative of this proposition. There, Secrist divulged information to Dirks in contravention of firm policy. Under this assumption, Secrist arguably acted in bad faith because he acted in contravention of policy but not with the purpose of gaining a personal benefit. Secrist, however, would not be considered to have embezzled the information, or taking firm property in violation of a duty of loyalty, because he was serving a corporate purpose in exposing fraudulent behavior. By serving a legitimate purpose, Secrist is treated as acting on behalf of the firm. If Secrist was not exposing the firm's fraudulent practices, Secrist could be deemed to have embezzled information, defrauding his firm in the process. However, because this embezzlement was not for a personal benefit, this conduct was outside the scope of the *Dirks* test. On the other hand, if Secrist had brought this misconduct or any other confidential information to light in exchange for a personal benefit, he would have violated Section 10(b) as a tipper.

Moreover, it is important to examine in more detail whether the CMS employee was actually embezzling the agency's confidential information and defrauding his firm. The court defines embezzlement as "the fraudulent appropria-

55. *Walt Disney*, 906 A.2d at 67.

56. *See* Dirks v. SEC, 463 U.S. 646, 667 (1983) (finding no derivative violation of the duty of loyalty and concomitant fraud because Secrist provided confidential information to Dirks to expose corporate fraud, which was against firm policy, but was not motivated by a desire to reap any personal benefit).

tion to one's own use of the money or goods entrusted to one's care by another."[57] If the alleged appropriator is acting on behalf of the firm and is acting even somewhat in alignment with the firm's interests, he is not defrauding the firm nor embezzling. In *United States v. Sun-Diamond Growers of California*, the Court of Appeals for the D.C. Circuit pronounced when an agent's actions can be properly imputed to the firm in connection with wire fraud charges.[58] On appeal, Sun-Diamond argued that "Douglas's campaign contribution scheme [could not] be attributed" to the company because "Douglas was not acting with intent to benefit the corporation."[59] The court rejected this argument, holding that an agent's acts can be imputed to the firm in a criminal case if the agent, even if primarily motivated by self-interest, acts with some intent to benefit the firm.[60] The court reasoned that even though the facts showed that Douglas hid the scheme from the company and used company funds to accomplish the scheme, this did not prevent a finding that Douglas undertook the scheme, even if only in part, to benefit Sun-Diamond.[61] The court found that Douglas was acting on the request of Secretary Espy to help the Secretary's brother's congressional campaign, and that part of Douglas's job was to foster a relationship with Espy on behalf of the firm.[62] The court went on to say that Douglas could have been "acting out of pure friendship, but the jury was entitled to conclude that he was acting instead, or also, with an intent (however befuddled) to further the interests of

57. Blaszczak, 947 F.3d at 35 (citing United States v. Carpenter, 484 U.S. 19, 27 (1987)).

58. 138 F.3d 961, 969–70 (D.C. Cir. 1998). Sun-Diamond's employee Douglas caused Lake, an individual employed by a firm that handled Sun-Diamond's communications and public relations matters, to solicit congressional campaign donations for one of Douglas's clients. *Id.* at 969–70. Douglas promised these contributions would all be reimbursed by Sun-Diamond. *Id.* Federal law forbids corporations from making contributions "in connection with any election" for Congress. *Id.* at 969. In order to facilitate Sun-Diamond's reimbursement of these illegal contributions, Douglas had Lake submit invoices to the corporation that listed dinner tickets to an annual benefit dinner, which Lake and his company "had in the past routinely bought" on Sun-Diamond's behalf. *Id.*

59. *Id.* at 970.

60. *Id.* (citing United States v. Automated Medical Laboratories, Inc., 770 F.2d 399, 406–07 (4th Cir. 1985)).

61. *Sun-Diamond*, 138 F.3d at 970.

62. *Id.*

his employer."[63] Accordingly, Douglas, although not explicitly authorized to carry out this scheme, did not defraud the company nor embezzle Sun-Diamond's funds because he was acting on behalf of the firm in furthering the company's interests. Applying this principle to *Blaszczak*, it would be worth examining whether the CMS employee was furthering the agency's interests, in the absence of any evidence that the employee divulged confidential information with the purpose of receiving a personal benefit. If such a showing could be made, the court's embezzlement ground for convicting Blaszczak would collapse because the CMS employee would not have misappropriated the information nor violated a duty, subsequently extinguishing the derivative tippee liability.

III.
Practical Justifications for the Personal Benefit Test

The court in *Blaszczak* holds that the personal benefit test is not grounded in the embezzlement theory of fraud, but rather is entirely tethered to Title 15's statutory provisions.[64] The court claims that Congress enacted these provisions with the "limited purpose of . . . eliminat[ing] [the] use of inside information for personal advantage."[65] The court reasons that because the personal benefit is a judge-made doctrine entirely predicated on the statutory context surrounding the Title 15 securities fraud provisions, the personal benefit test has no bearing on charges brought under the wire fraud and Sarbanes-Oxley Act securities fraud provisions.[66] The court relies upon the Supreme Court's articulation of embezzlement theory in *Carpenter v. United States*. In that case, the Supreme Court upheld the defendants' convictions on Rule 10b-5 and wire and mail fraud charges for trading on the Wall Street Journal's, their employer's, prepublication confidential information.[67] The *Blaszczak* court posits that the misappropriation theory of insider trading liability is underpinned by the doctrine of embezzlement fraud.[68] In the court's view, because "it

63. *Id.*
64. United States v. Blaszczak, 947 F.3d 19, 36–37 (2d Cir. 2019).
65. *Id.* at 35.
66. *Id.* at 36.
67. 484 U.S. 19, 24 (1987).
68. *Blaszczak*, 947 F.3d at 35–36.

is impossible to embezzle the money of another without committing a fraud upon him," there is no additional requirement that an insider breach a duty to the owner of the property at issue.[69] Under this embezzlement paradigm, a breach of duty is inherent and it follows that there is no need to prove a breach of duty in any specific matter, much less through a showing that the tipper gained a personal benefit by tipping confidential information to the tippee, who in turn was aware of both the breach of the tipper's duty and that the "tipper disclosed the information for a personal benefit and that the tipper expected trading to ensue."[70] The court fails to acknowledge, however, that the traditional elements of misappropriation theory insider-trading liability were present in *Carpenter*, and the Court in that case gave no indication that it was dispensing with these requirements in the wire fraud context. In *Carpenter*, the employee of the Wall Street Journal clearly misappropriated confidential, material nonpublic information, thereby breaching his fiduciary duty to the Journal when he disclosed the information for a clear personal benefit: the agreement with the tippees to share in the ill-gotten gains of about $690,000.[71]

Further, in *United States v. O'Hagan*, the defendant was prosecuted under Section 10(b) on the theory that he misappropriated his employer's confidential information for his own personal pecuniary gain.[72] Although in *O'Hagan* the Court pronounced that the misappropriation theory of insider trading was "akin to embezzlement," nowhere in either *O'Hagan* or *Carpenter* did the Court, as the Second Circuit did in *Blaszczak*, intimate that in the absence of a clear personal benefit to the tipper or direct personal benefit to the misappropriater, a wire fraud charge could stand. The *Blaszczak* opinion ignores, moreover, that the Second Circuit has made it clear that the personal benefit test articulated in *Dirks* is integral to finding the underlying fraud necessary to establish a criminal insider trading violation under both the classical and misappropria-

69. *Id.* at 36.
70. United States v. Salman, 137 S. Ct. 420, 427 (9th Cir. 2015).
71. 484 U.S. at 23.
72. 521 U.S. 642, 647–48 (1997).

tion theories of insider trading liability.[73] While some might argue that this proposition was technically dictum, district courts within the Second Circuit have ruled that tippee liability in a misappropriation theory case requires the personal benefit element. For example, Judge Rakoff for the District Court for the Southern District of New York rejected the SEC's argument that a personal benefit was not necessary in such a case, and stated that "whatever the abstract merits of the argument," the Second Circuit said "unequivocally" that the personal benefit test is required under both misappropriation and classical insider trading cases.[74]

Further, the Eleventh Circuit issued perhaps the most thoughtful decision in defense of the personal benefit test in misappropriation cases in *SEC v. Yun*.[75] The court reasoned that an important reason for analyzing misappropriation cases under the personal benefit test paradigm was that "nearly all violations under the classical theory of insider trading can be alternatively characterized as misappropriations."[76] The relevant section of the cited treatise supporting this statement impugns the claimed distinctions between classical and misappropriation cases, explaining that "[t]here is no reason why insiders cannot deceptively 'feign loyalty' any less than outsiders to their sources."[77] Eschewing the personal benefit test in misappropriation cases empowers prosecutors to side-step *Dirks*'s requirements simply by re-labeling classical insider trading cases as misappropriation cases. In *Yun*'s view, such a result is unwarranted particularly given that *O'Hagan*'s principles are consistent with *Dirks*'s.[78] Also, the parties in the Supreme Court's most recent occasion to address criminal insider trading liability under Section 10(b) did not dispute that the *Dirks* personal benefit test applied in both classical and misappropriation cases, so the Court operated under the assumption that

73. *See* United States v. Newman, 773 F.3d 446 (2d Cir. 2014) ("The elements of tipping liability are the same, regardless of whether the tipper's duty arises under the 'classical' or the 'misappropriation' theory.").

74. S.E.C. v. Payton, 97 F. Supp. 3d 558, 562 (S.D.N.Y. 2015).

75. 327 F.3d 1263 (11th Cir. 2003).

76. *Id.* at 1279.

77. Donald C. Langevoort, Insider Trading Regulation, Enforcement, and Prevention § 6:13 n.14 (2020).

78. *Yun*, 327 F.3d at 1275–76.

it did.[79] It strains credulity to think that lower courts, let alone the Supreme Court, would have taken the trouble to articulate the elements of an insider trading charge, only to see their work rendered superfluous when a crafty prosecutor charges the same violation under a different statute. The wire fraud and Sarbanes-Oxley Act securities fraud provisions should not be employed as end-runs around the requirements of Section 10(b) because fraud is only established in a misappropriation theory insider trading case when the traditional *Dirks* personal benefit test is satisfied. Indeed, if such a prosecutorial workaround were upheld, an absurd and inequitable situation would result where prosecutors in subsequent cases could prosecute a defendant criminally under Title 18, without any personal benefit evidence, whereas the SEC could not proceed with civil charges under Title 15 due to the same lack of evidence.

The decision in *Blaszczak* to dispense with the personal benefit test is in accordance with two decisions in the Northern District of Georgia that faced the same issue. In *United States v. Melvin*, the court reviewed the defendants' motion to dismiss the indictment charging them under 18 U.S.C. § 1348 for an insider trading scheme.[80] The defendants argued that the government failed to allege a crime in their indictment because they failed to allege the elements required to prove an insider trading scheme in violation of Section 10(b) of the Exchange Act and Rule 10b-5.[81] The court rejected this argument, relying on a previous decision in the same district, *United States v. Slawson*, where the defendant there, as here, failed to support that proposition with any precedent.[82] The court noted that *Slawson* was especially persuasive because Congress's purpose in enacting § 1348 "was to broaden the range of conduct proscribed by existing federal securities law" and "the text and legislative history of 18 U.S.C. § 1348 clearly establish that it was modeled on the mail and wire fraud statutes."[83] In a footnote, the court cited the government's contention that traditional elements of Section 10(b) insider trad-

79. Salman v. United States, 137 S. Ct. 420, 425 n.2 (2016).

80. 143 F. Supp. 3d 1354 (N.D. Ga. 2015), *aff'd*, 2017 U.S. App. LEXIS 28077 (11th Cir. 2017).

81. *Id.* at 1374.

82. *Id.* at 1375.

83. *Id.*

ing liability have not been found to be required when charged under the mail and wire fraud statutes, so given the alleged parallels between the statutes, these elements are properly jettisoned under a § 1348 analysis.[84] The court cited *United States v. Bryan* as an example of a case indicating that an insider trading scheme can be properly charged under a wire fraud statute without required Section 10(b) evidence.[85] *Bryan*, however, involved a scheme to defraud the people of the defendant's honest services and was not merely an insider trading scheme.[86] The underlying fraud, deprivation of honest services, is separate and apart from the fraud required to prove an insider trading scheme. Where there is no fraud independent of that which is inherent in a pure insider trading scheme, the elements of which have been duly articulated by the courts, the government should not charge the defendant under a wire fraud statute to circumvent finding actionable fraud under the appropriate provision. Thus, *Melvin*'s reasoning that prosecutors can circumvent charging the appropriate provision and proving the necessary elements in a pure insider trading scheme is not supported by *Bryan*, as the defendant's wire fraud charge was undergirded by honest services fraud, not purely insider trading fraud.[87] Interestingly, the *Melvin* court made a point to note that even if the court incorporated the elements required to establish a criminal insider trading charge under Section 10(b) into § 1348, the defendants might have still been liable.[88] The court found that the Eleventh Circuit's expansive interpretation of the *Dirks* personal benefit test foreclosed the defendants' argument that the indictment did not sufficiently allege disclosure of inside information for personal benefit in violation of a duty to the source of the information.[89] Aside from the fact that these are only two decisions stemming from the same district, both courts do not propound persuasive arguments that wire fraud and § 1348 can be appropriately deployed to circumvent the fraud needed to establish an insider trading case.

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84. *See id.* at 1375 n.22.
85. *Id.*
86. United States v. Bryan, 58 F.3d 933, 942 (4th Cir. 1995).
87. *Id.*
88. *Melvin*, 143 F. Supp. 3d, at 1375.
89. *Id.* at 1376.

IV.
The Legislative History Arguments

The courts in *Blaszczak* and the two Northern District of Georgia cases propound unpersuasive and erroneous statutory arguments in support of their goal to eliminate traditional insider trading elements in such cases charged under Title 18. In *Blaszczak*, as noted above, the court argued that Congress enacted Title 15 with the "limited purpose of . . . eliminat[ing] [the] use of inside information for personal advantage."[90] The opinion notes that "*Dirks* effectuated this purpose by holding that an insider could not breach his fiduciary duties by tipping confidential information unless he did so in exchange for a personal benefit."[91] The *Dirks* opinion, however, has a notably different articulation of the purpose of the personal benefit test. The relevant language in *Dirks* says of the personal benefit test: "This standard was identified by the SEC itself in *Cady, Roberts*: a purpose of the securities laws was to eliminate 'use of inside information for personal advantage.' "[92] *Blaszczak*'s alteration of this sentence results in language that has entirely different implications than that of the language in *Dirks*. *Blaszczak*'s gloss on *Dirks* is that personal benefit is peculiar to Title 15 because the test's use depends entirely on the purpose of the Exchange Act, which in the court's view cabins the Title 15 fraud provision's purpose as limited to eliminating use of inside information for personal benefit. *Dirks*, however, does not explicitly say that it applied the personal benefit test to effectuate the "limited purpose" of the Title 15 provisions, but rather noted that the personal benefit test was in accordance with "a purpose of the securities laws."[93] This language suggests that the judge-made doctrine of the personal benefit test is far from peculiar to Title 15 fraud provisions, but rather is consistent with a purpose of the securities laws generally. Further, the court in *Blaszczak* omits the *Dirks* reference to *Cady, Roberts* and does not cite any legislative history to support its proposition that Congress's "limited purpose" is peculiar to Ti-

90. United States v. Blaszczak, 947 F.3d 19, 35 (2d Cir. 2019) (emphasis added) (internal quotation marks omitted).

91. *Id.*

92. Dirks v. SEC, 463 U.S. 646, 662 (1983) (quoting In re Cady, Roberts & Co., 40 S.E.C. 907, 912 n.15 (1961)).

93. *Id.* at 662 (emphasis added).

tle 15 fraud. In contrast, *Dirks* did quote *Cady, Roberts*, which in turn cites direct sources to substantiate the claim that a purpose of the securities laws was to "eliminate the idea that the use of inside information for personal advantage was a normal emolument of corporate office."[94]

One would be justified in suspecting that *Blaszczak*'s omission of the *Cady, Roberts* reference in *Dirks* was purposeful because nowhere in its decision does the court reference any legislative sources that corroborate that "Congress enacted the Title 15 fraud provisions for the limited purpose of eliminating the use of insider information for personal advantage."[95] In fact, *Cady, Roberts* cites legislative materials that speak to Section 16 of the Exchange Act, and those same materials discuss the fraud provisions of Title 15, but nowhere in those materials is there any support for *Blaszczak*'s "limited purpose" claim.[96] For example, rather than indicating limiting language, the materials explain that the purpose of banning "manipulative devices of all kinds" was to "[i]nsure to the multitude of investors the maintenance of fair and honest markets."[97] Taken together, the plain text and legislative history of the Title 15 fraud provisions indicate that the reach of the personal benefit test spans all securities fraud provisions to effectuate Congress's stated purpose. This belies *Blaszczak*'s argument that the elements delimiting fraud in insider trading cases do not extend to Title 18 fraud provisions.

Further, 18 U.S.C. § 1348 was enacted as part of the Sarbanes-Oxley Act to fill the perceived gap in statutes criminalizing securities fraud, but was not meant to disrupt the law of the existing securities fraud regime.[98] Contrary to *Melvin*'s assertion, the text and the legislative history of 18 U.S.C. § 1348 do not *clearly* establish the proposition that this statute

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94. *Cady, Roberts*, 40 S.E.C. at 912 n.15.

95. *Blaszczak*, 947 F.3d at 35 (internal quotation marks omitted).

96. *See* Brian Jacobs, *Title Fight: Blaszczak (18) v. Dirks (15),* FORBES (Jan. 21, 2020), https://www.forbes.com/sites/insider/2020/01/21/title-fight-blaszczak-18-v-dirks-15/?sh=342c19d97529 (last visited Nov. 17, 2020).

97. *Id.* (Citing H.R. REP. No. 73-1383, at 10. (*See also* SEC, TENTH ANNUAL REPORT OF THE SECURITIES AND EXCHANGE COMMISSION 16 (1944) (describing the Exchange Act's purpose of "insur[ing] the maintenance of fair and honest securities markets"))).

98. COMM. ON THE JUDICIARY, THE CORPORATE AND CRIMINAL FRAUD ACCOUNTABILITY ACT OF 2002, S. REP. No. 107-146, at 30 (2002).

was modeled off the mail and wire fraud statutes, but rather it establishes that § 1348 was modeled after the bank and health care fraud statutes.[99] Largely in response to the Enron fraudulent accounting scheme, Congress enacted § 1348 to ease the prosecutorial burden of charging such complex schemes under the existing regulatory framework.[100] Congress believed prosecuting Enron for their elaborate scheme under existing law was unnecessarily convoluted, and lamented that "unlike bank fraud, health care fraud, and bankruptcy fraud, there is no specific 'securities fraud' provision in the criminal code to outlaw the breadth of schemes and artifices to defraud investors in publicly traded companies."[101] The Senate Report explained that the decision to create a new securities fraud offense will "make it easier, in a limited number of cases, for prosecutors to prove securities fraud by eliminating, for example, the element that the mails or wires were used to further the scheme to defraud."[102] The Sarbanes-Oxley Act was designed to target schemes akin to the Enron scandal involving misleading statements to investors, not the species of securities fraud involving an insider leaking confidential information. Existing insider trading laws already contemplated and addressed this type of fraud. Congress made it abundantly clear that this new provision was not designed to overhaul existing securities laws, including the requirements to establish a Section 10(b) violation. Congress explained that "[t]he provision would supplement the patchwork of existing technical securities law violations with a more general and less technical provision, with elements and intent requirements comparable to current bank fraud and health care fraud statutes."[103] Congress further reiterated that:

> Like the bank and health care fraud statutes on which this provision is modeled, prosecutors must prove that a defendant knowingly engaged in a scheme or artifice to defraud, or knowingly made false statements or representations to obtain money in a securities transaction. This standard, which in-

99. *Id.*
100. *Id.* at 6.
101. *Id.*
102. *Id.* at 30.
103. *Id.* at 14.

> cludes knowledge and intent elements, is consistent with existing securities fraud statutes.[104]

Thus, it is evident from the legislative history that § 1348 was created as a mere "supplement" and was intended to be "consistent" with extant securities laws. The fact that the provision was modeled off the bank and health care fraud statutes, contradicting *Melvin*'s claim that is was modeled off the mail and wire statutes, reinforces the fact that existing securities law, namely the elements of an insider trading violation under Section 10(b), and § 1348 were meant to address different species of fraud.

While *Blaszczak* only briefly alludes to the textual similarities between § 1348 and Section 10(b), it is important to note that the relevant language is almost identical. Such a similarity in text hardly evinces a Congressional intent to jettison years of judge-made doctrine establishing fraudulent insider trading, but rather demonstrates a conscious Congressional effort to uphold the status quo when showing fraud in different contexts. Therefore, because § 1348, other Title 18 fraud statutes, and Section 10(b) all punish fraud in different contexts, there must first be a showing of fraud in the Section 10(b) context for such activity to also be fraudulent under Title 18 statutes. As there is no "general duty between all participants in market transactions to forgo actions based on material, nonpublic information,"[105] prosecutors must establish fraud that satisfies the *Dirks* personal benefit test before such a scheme can also be violative of Title 18 fraud statutes.

V.
Predecisional Regulatory Information Does Not Constitute Property

The Second Circuit held in *Blaszczak* that predecisional regulatory information constitutes property for purposes of wire fraud and Title 18 securities fraud.[106] Wire fraud criminalizes using the mail or wires in executing "scheme[s] to defraud" to obtain money or property, and Title 18 securities fraud prohibits schemes to obtain money or property in connection with securities transactions "by means of false or fraud-

104. *Id.* at 30.
105. Chiarella v. United States, 445 U.S. 222, 233 (1980).
106. United States v. Blaszczak, 947 F.3d 19, 34 (2d Cir. 2019).

ulent pretenses."[107] As alluded to below, however, there is a substantial possibility that the defendants' wire and securities fraud convictions will not stand given that the Supreme Court has intimated that *Blaszczak's* holding with respect to what constitutes property, at a minimum, contravenes an intervening Court decision.

A. *The Materiality Requirement*

Before addressing whether in fact confidential predecisional regulatory information should be treated as property within the meaning of these statutes, one should examine whether such information would be material to the investor. In *Basic v. Levinson*, the Supreme Court established the probability and magnitude test when analyzing whether preliminary merger discussions would be material to investors.[108] The Court explained that applying the materiality standard, defined in an earlier Supreme Court decision, is not so straightforward when the Court needs to determine whether a reasonable investor would deem preliminary negotiations important in the context of transactions that might not come to fruition.[109] Recognizing the difficulty in applying this standard to negotiations involving speculative events, the Court first rejected the Third Circuit's view that preliminary negotiations concerning a merger become material when an agreement-in-principle as to price and structure is reached.[110] Adhering to a broader view of materiality, the Court agreed with the Second Circuit's probability and magnitude test, which stated that materiality "will depend at any given time upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity."[111] The Court further agreed with the Second Circuit idea that materiality will be determined according to the specific facts of each case.[112] In assessing whether an event is probable, the Court said that the factfinder must "look to indicia of interest in the transaction" at the company's up-

107. 18 U.S.C. §§ 1343, 1348 (2018).
108. 485 U.S. 224, 238–39 (1988).
109. *Id.* at 232.
110. *Id.* at 232–36.
111. *Id.* at 238 (quoting SEC v. Tex. Gulf Sulphur Co., 401 F.2d 833, 849 (2d Cir. 1968)).
112. *Levinson*, 485 U.S. at 239.

per-management level.[113] As to magnitude in the context of a merger, the Court said the factfinder should look to facts regarding the size of the merging corporations and of the potential premiums above market value.[114]

The court in *Blaszczak* does not mention or analyze whether the preliminary regulatory information of CMS would be material to a reasonable investor. A fact-specific inquiry regarding whether information is material seems particularly appropriate in this case where the information derives from a government agency. Although the Supreme Court gives guidelines from *Basic* on how to analyze materiality in the context of speculative transactions, no court has given specific guidance on how to determine whether predecisional regulatory information is material.

Blaszczak tells us that the defendant tipped confidential CMS information "concerning both the timing and substance of an upcoming proposed CMS rule change that would reduce the reimbursement rate for certain radiation oncology treatments."[115] At another point during the years-long scheme, Blaszczak tipped information concerning his expectation that CMS would cut the reimbursement rate for end-stage renal disease by twelve percent.[116] Blaszczak assured his co-conspirators that this was coming from a reliable source and that the cut was "around the corner and thus less likely to change."[117] The Second Circuit, however, did not engage with its own analysis regarding how probable this rule change was at the time, nor the magnitude of such a rule change viewed in light of CMS's past practices and in light of the healthcare industry, respectively. Neither inquiry seems particularly daunting for the court. In terms of probability at the time a reasonable investor would have considered the information, the court could have looked to internal discussions with high-ranking CMS officials and any relevant documents germane to the decision to move forward with the proposed rule. With respect to magnitude to a reasonable investor, it might seem self-evident that this rule change was important, given the millions of dollars in profits

113. *Id.*
114. *Id.*
115. *Blaszczak*, 947 F.3d at 27.
116. *Id.*
117. *Id.* at 27–28.

the tippees earned from trading on the information. Even so, a post hoc assessment is not a proper substitute for assessing the magnitude of the confidential information at the time the investors received it. In all likelihood, the court would have found this proposed rule change to be material.

B. *Property Precedent*

The court relied upon the Supreme Court's decision in *Carpenter* in holding that confidential information concerning the CMS rule change was CMS's property. In *Carpenter*, the Supreme Court held that the publication schedule information regarding forthcoming articles of the Wall Street Journal were the publication's property because the Journal had a property right in making exclusive use of the contents of an upcoming publication prior to its publication.[118] The Court reasoned that "[n]ews matter . . . is [the Journal's] stock in trade" and further stated that "exclusivity is an important aspect of confidential information and most private property for that matter."[119] In finding that the defendants had the requisite specific intent to defraud the Journal of its property, the Court stressed two key pieces of evidence. The first piece was the Journal's employee manual that declared business information as the company's property, along with the stated expectation that employees keep such information confidential.[120] The second fact was that the defendant told his editors on two separate occasions about leaks of confidential information unrelated to the stock trading scheme at issue.[121] The Court found this probative of the defendant's knowledge that the Journal's nonpublic news information was its property, and probative of the defendant's feigned loyalty to the Journal.[122]

The *Blaszczak* court then proceeded to examine *Cleveland v. United States*, which remains good law.[123] In *Cleveland*, the Court held that the mail fraud statute does not apply to false statements made in an application for a state license to oper-

118. Carpenter v. United States, 484 U.S. 19, 26 (1987).

119. *Id.* at 26–27 (citing International News Service v. Associated Press, 248 U.S. 215, 316 (1918)).

120. *Id.* at 28.

121. *Id.*

122. *Id.*

123. United States v. Blaszczak, 947 F.3d 19, 32 (2d Cir. 2019).

ate video poker machines.[124] The Court reasoned that "such a license [was] not property in the government regulator's hands" because (1) the licenses had no economic value to the state of Louisiana while the licenses remained in the state's hands, and (2) Louisiana was not deprived the right to control its property because the state's prerogative in choosing to whom it issued its licenses implicated nothing more than the state's sovereign power to regulate.[125] The Court went on to address the government's argument comparing the state's interest in video poker licenses to a patent holder's interest in a patent not yet licensed.[126] In rejecting the analogy, the Court noted that Louisiana does not conduct gaming operations itself, it does not hold such licenses to reserve that right, it does not sell such licenses, and it does not have the ability to sell its licensing authority.[127] According to the Court, the more apt analogy would be the federal government's interest in an unissued patent because this interest, like Louisiana's interest in licensing video poker games, is relevant only to the government's role as a sovereign, not as a property holder.[128]

After considering both of these cases, the *Blaszczak* court made a point to cabin *Cleveland*'s holding by adverting to its purported narrowness. The court quoted a previous Second Circuit case in saying that *Cleveland* did "not establish 'rigid criteria for defining property but instead . . . provid[ed] permissible considerations.'"[129] The court deemed the "right to exclude" as the dispositive consideration in finding that predecisional regulatory information at issue is the agency's property, much like the Court in *Carpenter* found that the Journal had a property right in the exclusive use of the Journal's prepublication information.[130] The court found that CMS's right to exclude the public from its predecisional regulatory information implicated its role as a property holder, and not as a sovereign regulator.[131] The court claimed its view was con-

124. Cleveland v. United States, 531 U.S. 12, 20 (2000).
125. *Id.* at 23.
126. *Id.*
127. *Id.*
128. *Id.* at 23–24.
129. *Blaszczak*, 947 F.3d at 32–33 (quoting Fountain v. United States, 357 F.3d 250, 256 (2d Cir. 2004)).
130. *Id.* at 33.
131. *Id.*

sistent with *United States v. Girard* and *United States v. Czubinski*, Second and First Circuit decisions, respectively.[132] Further, the court stated that although *Cleveland* does not strictly require the property interest in question to be "economic in nature," CMS did have an economic interest in its predecisional regulatory information because it expended "time and resources into generating and maintaining" the secrecy of this information.[133] The court supported this proposition that predecisional regulatory information is valuable to the agency by citing *United States v. Middendorf*, where the District Court for Southern District of New York held that a non-profit's confidential audit inspection lists were property within the meaning of federal wire fraud.[134]

C. *Distinguishing Predecisional Regulatory Information from Property*

There are legitimate grounds for distinguishing predecisional regulatory information and the confidential news of a private business. First, confidential predecisional regulatory information is not an agency's "stock in trade" as confidential news matter is to The Wall Street Journal.[135] CMS is not in competition with other news publications that might value being ahead of the competition with respect to disseminating previously unreported information, and CMS will regulate regardless of whether its predecisional information remains confidential.[136] Second, while it might be conceded that agencies equally have an exclusive right to control their confidential information, an agency such as CMS does not have a property right in its confidential information regarding a proposed regulation because that information squarely implicates its power to regulate.

The court cited *United States v. Girard* in coming to its conclusion that CMS's confidential information is property.[137] In *Girard*, the Second Circuit held that the government had a property interest in confidential United States Drug Enforce-

132. *Id.*
133. *Id.*
134. United States v. Middendorf, No. 18-cr-36 (JPO), 2018 WL 3443117, at *9 (S.D.N.Y. July 17, 2018).
135. *See Blasczcak*, 947 F.3d, at 47 (Kearse, C.J., dissenting).
136. *Id.*
137. *Id.* at 33.

ment Agency ("DEA") records concerning persons who were DEA informants.[138] As Judge Kearse in his dissenting opinion in *Blaszczak* points out, however, the DEA has a much stronger property interest in information regarding confidential informants than does CMS in its predecisional regulatory information. Confidential information regarding DEA informants allows the DEA to conduct its mission as an agency, namely "collect evidence . . . obtain warrants for arrests, and commence prosecutions."[139] Confidentiality in this context allows the DEA to conduct its mission and to act upon such confidential information before it is leaked and investigation targets and potential witnesses for prosecutions alter their behavior to frustrate the core purpose of the DEA.[140] The confidentiality of predecisional information does not have commensurate value to CMS as the confidentiality of informants does to the DEA. As Judge Kearse notes, regardless of whether such information is leaked, CMS has the autonomy to either issue the proposed regulation exactly as planned, or not.[141] On the other hand, even if confidential information is not subjectively as valuable to CMS as it is to the DEA, it still has some objective value, however minimal, especially given the fact that there was trial evidence showing that CMS expends "time and resources" in establishing and preserving the confidentiality of its information.[142] But, as the Supreme Court has just recently held, CMS's employee resources must be the "object of the fraud" and a wire fraud conviction alleging property fraud "cannot stand when the loss to the victim is only an incidental byproduct of the scheme."[143] As the Court noted in *Kelly v. United States*, the fraud on Louisiana's licensing system in *Cleveland* cost the state its employees' time; but, because the object of the scheme was not to get the employees' labor but to get the gaming licenses, the labor costs were incidental and thus insufficient to maintain a property fraud conviction.[144] Here, the object of Blaszczak's scheme was not to divert or comman-

138. United States v. Girard, 601 F.2d 69, 70–71 (2d Cir. 1979).
139. *Blaszczak*, 947 F.3d at 47 (Kearse, C.J., dissenting).
140. *Id.*
141. *Id.*
142. *Id.*
143. United States v. Kelly, 140 S. Ct. 1565, 1573 (2020) (citations omitted).
144. *Id.*

deer the CMS employees' labor, but rather to obtain predecisional regulatory information, a byproduct of the employees' time that would have otherwise been expended in the ordinary course of their regulatory duties.[145] Moreover, unlike the taxpayer information at issue in *Czubinski*, which the court found to be property in the hands of the IRS, predecisional information regarding a proposed rule change does not have any value to CMS at this snapshot in time, as a proposed regulation does not have any value on the agency until it is effectuated, or not, at some point in the future.[146] In stark contrast, *Czubinski* accessed income tax return information of many individuals.[147] This information was tangible, official information that was not hypothetical or subject to change.

The *Blaszczak* opinion does not interpret *Cleveland* as requiring property in this context to have some economic element.[148] That is hard to square with the reasoning in *Cleveland*, however, and belies the attention the court paid to attempting to establish that CMS was indeed deprived of property that had independent economic value. Indeed, in rejecting the argument that a state's power to issue gaming licenses is a property right, *Cleveland* emphasized that the state may not sell its licensing authority nor sell its "licenses in the ordinary commercial sense."[149] In highlighting the non-economic aspect of Louisiana's power to issue video poker licenses, the Court noted that the state "did not decide to venture into the video poker business; it decided typically to permit, regulate, and tax private operators of the games."[150] Just like Louisiana had the right to control the issuance of the licenses, licenses which had no economic nor property status until issued, CMS had the right to issue regulations, which similarly had no economic effect until the regulation was actually implemented. CMS does

145. Indeed, this argument may yet prevail as the Supreme Court granted defendants Olan and Huber's Petition for a Writ of Certiorari and vacated the decision in *Blaszczak*, remanding the case to the Second Circuit "for further consideration in light of" the Court's decision in *Kelly*. *Blaszczak v. United States*, No. 20-5649, 2021 WL 78043, at *1 (U.S. Jan. 11, 2021).

146. United States v. Czubinski, 106 F.3d 1069, 1074 (1st Cir. 1997).

147. *Id.* at 1071–72.

148. *Blaszczak*, 947 F.3d at 33.

149. Cleveland v. United States, 531 U.S. 12, 23 (2000).

150. *Id.* at 24.

not venture into the private health care industry; it merely regulates the industry.

The *Blaszczak* opinion also cited *United States v. Middendorf* to support the proposition that the resources that CMS used to keep its predecisional information confidential conferred economic value upon the information. In *Middendorf*, the property at issue in the wire fraud scheme was confidential information concerning planned audit inspections conducted by the Public Company Accounting Oversight Board ("PCAOB"), a nonprofit organization.[151] The District Court for the Southern District of New York held that the inspection lists were property in the hands of PCAOB, and that neither *Carpenter* nor *Cleveland* directly controlled this finding.[152] *Middendorf* articulated the holding of *Cleveland* as "permission to engage in regulated conduct is a regulatory interest in the hands of the government which transmutes into a property interest in the hands of a private party."[153] The court noted that in *Cleveland*, the government didn't hold "any 'licenses' per se; rather, it [held] the power to issue licenses, which is a regulatory power."[154] The court continued its gloss on the opinion by stating that "[t]o borrow an analogy from physics, what is potential energy in the hands of the government becomes kinetic energy in the hands of a license-holder."[155] The court concluded, however, that the inspection lists were more like the confidential information at issue in *Carpenter*, and reasoned that such information that facilitates a regulatory function is no less property than confidential information in the hands of a private business.[156]

The confidential information at issue in *Middendorf*, as the court noted, is arguably more akin to that in *Carpenter* compared with the information in *Blaszczak*, which is more akin to the licenses at issue in *Cleveland*. Like the status that the licenses conferred upon its licensees, CMS regulations confer upon private parties the "permission to engage in regulated conduct," which only transforms into a property interest in the

151. United States v. Middendorf, No. 18-cr-36 (JPO), 2018 WL 3443117, at *1–2 (S.D.N.Y. July 17, 2018).
152. *Id.* at *9.
153. *Id.* at *8.
154. *Id.*
155. *Id.*
156. *Id.* at *9.

hands of health care service providers when the regulation is enacted. The power to issue regulations, like the power to issue licenses, is purely a regulatory power with no independent property value.[157] Further, potential energy in the form of proposed regulations becomes reified, or kinetic energy, in the form of a final CMS rule to which private parties must adhere and under which private parties must conduct their business. The PCAOB inspection lists, unlike the licenses in *Cleveland*, was confidential information that the court indicated was not subject to further revision.

It is telling that the *Middendorf* court used a bar exam question analogy to explain its reasoning. The court posited the scenario in which an employee of the National Conference of Board Examiners ("NCBE") tips a prospective bar exam taker, in exchange for a sum of money, six confidential bar exam questions one month in advance of the test.[158] The court explained that this employee would undoubtedly be defrauding the NCBE, the entity that administers the bar exam, because providing someone with these questions in advance would allow that person to "prepare perfect answers to the questions in advance and to unfairly ace the essay exam."[159] The court did not concern itself with whether the confidential questions leaked at the time would be, in fact, the same questions administered on exam day. Presumably the court operated under the assumption that this confidential information is official and written in stone. Such an analogy, which the court declared is closer to the facts of its case, is inapposite to the situation in *Blaszczak*. As discussed, although predecisional regulatory information might inform a future regulatory decision, the information was by no means final and comprehensive at the time the information was leaked, as the *Middendorf* court suggested the inspection lists were. Indeed, like the bar exam essay questions in the court's hypothetical, the audit inspection lists would not have value if the lists were merely grist for consideration in carrying out PCAOB's official regulatory mandate. The PCAOB is a nonprofit organization created by

157. *See* Cleveland v. United States, 531 U.S. at 23–24 (holding that the power to issue video poker licenses does not vest a state with a property interest, but rather implicates a state's regulatory and police powers).

158. *Middendorf*, 2018 WL 3443117 at *9.

159. *Id.*

the Sarbanes-Oxley Act of 2002.[160] It conducts inspections of auditors that have audited large public companies' financial statements in connection with registering financial securities with the SEC.[161] The six largest accounting firms in the United States are subject to the PCAOB's authority, and each year the PCAOB selects a list of audits subject to its inspection.[162] Contrary to rules promulgated by CMS, an administrative agency, PCAOB inspection lists do not carry the force of law nor are they subject to pre-rulemaking public notice and comment procedures. Under the Affordable Care Act of 2010, proposed CMS rule changes are issued in a notice of proposed rulemaking in the Federal Register.[163] Only after proposed rules have been through this process, subjecting proposed rules to revisions, will the ultimate regulation be issued. All this is to say that the speculative or indeterminate nature of proposed agency regulations makes rulemaking power much more like the sovereign power to issue video poker licenses at issue in *Cleveland* because the state and government agency holds the power to choose licenses and craft regulations, respectively, but that very power holds no actual property value until the license or regulation is effectuated.

Finally, the expansion of the definition of property to include predecisional regulatory information dangerously expands criminal liability without a clear Congressional statement speaking to the issue.[164] Allowing property to be defined this broadly in conjunction with the expansion of insider trading liability under Title 18 would subject traders to undue exposure to criminal liability. Not only does this unfavorable interpretation of an ambiguous word to the defendant in a criminal statute run afoul of the doctrine of lenity, but it also works to impede the flow of information that is so important to the healthy functioning of the market.[165] An efficient market depends on the law to clearly demarcate when trading on confi-

160. *Id.* at *1.
161. *Id.*
162. *Id.*
163. *See Pre-Rulemaking*, Centers for Medicare & Medicaid Services, https://www.cms.gov/Medicare/Quality-Initiatives-Patient-Assessment-Instruments/QualityMeasures/Pre-Rulemaking (last visited May 10, 2020).
164. Cleveland v. United States, 531 U.S. 12, 24 (2000).
165. Dirks v. SEC, 463 U.S. 646, 658 (1982).

dential information is illegal and when it is not.[166] As *Dirks* notes, unclear insider trading laws would disincentivize market analysts to perform their role in maintaining market efficiency by interviewing corporate insiders to "ferret out and analyze" information on pain of increased exposure to criminal liability.[167] Allowing analysts to seek out and trade on this information assists other investors in assessing the "market worth" of a corporation's stock.[168] The *Dirks* opinion notes that such information "cannot be made simultaneously available to all of the corporation's stockholders or the public generally."[169] As alluded to in *Chiarella* and reiterated in *Dirks*, insider trading law's purpose is not to mandate equality of information among all market actors. The *Dirks* court acknowledges that the question of whether an insider personally benefits from disclosing confidential information will "not always be easy for courts," but that a clear limiting principle and legal guidepost for those whose "daily activities" rely upon insider trading law is essential.[170] The *Blaszczak* decision advocates for a return to the SEC's position that was rejected in *Chiarella*, namely that federal securities laws were fashioned to provide equal access to information to all market participants to avoid informational asymmetries.[171] Dispensing with decades worth of insider trading doctrine in conjunction with an expansive interpretation of property in federal fraud statutes threatens to unnecessarily impede the efficiency of the market, along with exposing integral market actors to the enhanced prospect of criminal liability.

Conclusion

Prosecutors and courts should not attempt to eschew the personal benefit element integral to establishing fraud in the tipper-tippee paradigm for the purpose of establishing a convenient workaround that circumvents insider trading doctrine. The Second Circuit's opinion in *Blaszczak* fails to recognize that while fraud is inherent in embezzlement, years of prece-

166. *Id.* at 658 n.17.
167. *Id.* at 658.
168. *Id.* at 658–59.
169. *Id.* at 659.
170. *Id.* at 664.
171. Chiarella v. United States, 445 U.S. 222, 232–33 (1980).

dent regarding insider trading law only prohibits violations of the insider's duty of loyalty whereby the insider receives a personal benefit in exchange for disclosure of company confidential information. While it is arguable that a corporate agent's duty to disclose information is triggered when that agent is acting in bad faith, it seems clear that the personal benefit test articulated in *Dirks* limits that duty for purposes of the federal securities laws in scenarios whereby the agent stands to gain personally from disclosure of confidential information. Moreover, trying to shoehorn 18 U.S.C. § 1348 to find insider trading violations without proving the traditional elements of the crime is not consistent with the legislative history and purpose of this statute. Contrary to the court's opinion, "a purpose" of the securities laws generally was to limit the use of inside information for personal gain. This purpose was not solely tied to Section 10(b) of The Securities and Exchange Act of 1934.

Finally, reverting to a parity of information norm to inform courts' decisions regarding insider trading liability combined with an expansive interpretation of property under the federal securities laws threatens to over-deter behavior that has been lawful for quite some time. The predecisional regulatory information at issue in *Blaszczak* has no more property value than Louisiana's power to issue licenses in *Cleveland*. The object of the scheme was not to appropriate government property, but rather to take preliminary information that merely implicated CMS's sovereign power to issue regulations. The Second Circuit's dual expansive interpretations threatens market efficiency in a palpable manner, as analyst and other market activity will be arrested amid the confusion that this case has sowed, not to mention the activity that will continue to be unnecessarily deterred if this decision is not overruled. Courts might want to reconsider expanding criminal liability at the expense of undermining the functionality of the capital markets.