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## **FRIENDS WITHOUT BENEFITS: CRIMINAL INSIDER TRADING LIABILITY AND THE “PERSONAL BENEFIT” TEST AFTER *BLASZCZAK***

Curtis A. French\*

*The U.S. Supreme Court established the “personal benefit” test in Dirks v. SEC to determine whether a tippee assumed a fiduciary duty to not trade based on or disclose inside information when a tipper breached his or her fiduciary duty by improperly disclosing such information to the tippee. Under the personal benefit test, a tipper breaches his or her fiduciary duty if the tipper derives a personal benefit, either directly or indirectly, from disclosing the inside information to a tippee. The Supreme Court provided examples as to what constitutes a personal benefit, such as the tipper’s expectation of reputational benefits that will lead to future profits, receiving a quid pro quo from the tippee, or providing inside information as a gift to a relative or friend. However, the examples provided in Dirks were too broad and left other courts without a definitive answer as to how to identify a personal benefit. The Second Circuit and the Supreme Court attempted to refine the application of the Dirks personal benefit test in United States v. Newman, Salman v. United States, and United States v. Martoma. This line of cases culminated in the Second Circuit’s recent decision in United States v. Blaszcak in which the Second Circuit declined to apply the Dirks personal benefit test to securities fraud and insider trading claims brought under Title 18 of the federal criminal code. This Comment discusses the origins of insider trading law in the United States and the subsequent development of the Dirks personal benefit test, examines the effects of the Second Circuit’s decision in Blaszcak on insider trading law, and recommends how the body of insider trading law can move forward following Blaszcak.*

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## INTRODUCTION

Federal courts and prosecutors have struggled to apply federal insider trading law within the United States ever since the Securities and Exchange Commission (SEC) brought its first insider trading enforcement action in *In re Cady, Roberts & Co. (Cady, Roberts)* in 1961.<sup>1</sup> Insider trading is a form of securities fraud prohibited under the general anti-fraud provisions of Section 10(b) of the Securities Exchange Act of 1934.<sup>2</sup> Insider trading occurs when an individual who owes a duty to not disclose or trade upon material non-public information subsequently trades a security upon the basis of such information or shares such information with a third party in exchange for profit.<sup>3</sup> Tipping, a particular form of insider trading, involves an insider (the

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<sup>1</sup> See generally *In re Cady, Roberts & Co.*, 40 S.E.C. 907 (1961); Russell G. Ryan, Opinion, *Insider Trading Law is Irreparably Broken*, WASH. POST (Jan. 27, 2020), <https://www.washingtonpost.com/opinions/2020/01/27/insider-trading-law-is-irreparably-broken/> [<https://perma.cc/5M7Q-U5GD>] (arguing that “there has never been an actual law that defines and prohibits insider trading” and that “the SEC bypassed the legislative branch entirely” through its actions in *Cady, Roberts*).

<sup>2</sup> Andrew N. Vollmer, *A Rule of Construction for the Personal Benefit Requirement in Tipping Cases*, 11 N.Y.U. J.L. & LIBERTY 331, 333 (2017).

<sup>3</sup> *Id.* at 333–34.

tipper) who shares material non-public information with a third party (the tippee) who subsequently trades securities based upon the information or shares the information with another third party.<sup>4</sup>

In response to such trading and information sharing practices, the SEC sought “to promote fair trading markets for all investors,” beginning with its insider trading enforcement action in *Cady, Roberts*.<sup>5</sup> For a time, the federal courts maintained a somewhat predictable body of law to impose insider trading liability upon corporate insiders—those who breached their fiduciary duty by trading upon material non-public information without first disclosing that information—and upon corporate outsiders—those who received material non-public information and subsequently breached their duty by trading upon such information without disclosure.<sup>6</sup> In *Dirks v. SEC*, the U.S. Supreme Court introduced the “personal benefit” test to further clarify that an insider’s disclosure of material non-public information would constitute a breach of fiduciary duty if the insider will benefit from the disclosure.<sup>7</sup> However, recent cases in the U.S. Supreme Court and the U.S. Court of Appeals for the Second Circuit “have blurred the lines of liability for insider trading.”<sup>8</sup>

On December 30, 2019, the Second Circuit issued its opinion in *United States v. Blaszczak*,<sup>9</sup> igniting criticisms that “insider-trading law [was] irreparably broken.”<sup>10</sup> In *Blaszczak*, the Second Circuit declined to apply the “personal benefit” test from *Dirks*<sup>11</sup> to securities fraud and insider trading claims brought under Title 18, Section 1348 of the federal criminal code.<sup>12</sup> The Second Circuit held that it would be improper to extend the personal benefit test from Title 15 securities fraud to Title 18 securities fraud because the underlying statutory purposes of the fraud provisions under Title 15 and

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<sup>4</sup> See *id.* at 334.

<sup>5</sup> Stephen J. Crimmins, *Insider Trading: Where Is the Line?*, 2013 COLUM. BUS. L. REV. 330, 367 (2013).

<sup>6</sup> See *id.* at 335.

<sup>7</sup> *Dirks v. SEC*, 463 U.S. 646, 662 (1983).

<sup>8</sup> Crimmins, *supra* note 5, at 330.

<sup>9</sup> 947 F.3d 19 (2d Cir. 2019).

<sup>10</sup> Ryan, *supra* note 1.

<sup>11</sup> See *Dirks*, 463 U.S. at 662 (1983) (holding that a corporate insider breaches his or her duty by disclosing material non-public information in exchange for a personal benefit and is therefore subject to insider trading liability pursuant to Section 10(b) of the Securities Exchange Act of 1934).

<sup>12</sup> *Blaszczak*, 947 F.3d at 36–37.

Title 18 are markedly different.<sup>13</sup> The Second Circuit’s decision in *Blaszczak* effectively “seized on a snippet . . . [of] legislative history . . . to overthrow more than 50 years of insider trading jurisprudence.”<sup>14</sup>

Part I of this Comment discusses the statutory basis for federal insider trading jurisprudence in the United States. Part II examines how the elements of insider trading law and tipping scheme liability developed in the common law. Part III identifies recent insider trading cases demonstrating how federal courts struggle to apply insider trading law consistently. Part IV analyzes the Second Circuit’s recent decision in *Blaszczak*. Part V recommends how *Blaszczak* should be addressed.

## I. THE STATUTORY ORIGINS OF INSIDER TRADING LAW

Legal academics and practitioners describe United States insider trading law as “seriously flawed,”<sup>15</sup> a “theoretical mess,”<sup>16</sup> “irreparably broken,”<sup>17</sup> and “extraordinarily vague and ill-formed.”<sup>18</sup> Such criticisms stem from the lack of a federal statute that “directly prohibits the offense of insider trading”<sup>19</sup> or defines the elements constituting insider trading offenses.<sup>20</sup> Absent explicit statutory language prohibiting insider trading activity, prosecutors typically bring insider trading cases under both the general anti-fraud provisions of Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5.<sup>21</sup> Section 10(b) provides:

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<sup>13</sup> See *id.* at 34–37 (“Section 1348 [of Title 18] and the [Securities] Exchange Act do not share the same statutory purpose . . . [and] because the personal-benefit test . . . depends entirely on the purpose of the [Securities] Exchange Act, we decline to extend *Dirks* beyond the context of that statute.”).

<sup>14</sup> Adam Pritchard, *2nd Circ. Ruling Makes Messy Insider Trading Law Worse*, LAW360 (Jan. 27, 2020, 4:10 PM), <https://www.law360.com/articles/1237586> [<https://perma.cc/C69P-UY5P>].

<sup>15</sup> Jill E. Fisch, *Start Making Sense: An Analysis and Proposal for Insider Trading Regulation*, 26 GA. L. REV. 179, 184 (1991).

<sup>16</sup> Alan Strudler & Eric W. Orts, *Moral Principle in the Law of Insider Trading*, 78 TEX. L. REV. 375, 379 (1999).

<sup>17</sup> Ryan, *supra* note 1.

<sup>18</sup> Kimberly D. Krawiec, *Fairness, Efficiency, and Insider Trading: Deconstructing the Coin of the Realm in the Information Age*, 95 NW. U. L. REV. 443, 443 (2001).

<sup>19</sup> Donna M. Nagy, *Insider Trading and the Gradual Demise of Fiduciary Principles*, 94 IOWA L. REV. 1315, 1322 (2009).

<sup>20</sup> Peter J. Henning, *What’s So Bad About Insider Trading Law?*, 70 BUS. LAW. 751, 753 (2015).

<sup>21</sup> Mark D. Cahn, Elizabeth L. Mitchell, Theresa Titolo & Brett Atanasio, *Insider Trading Law Alert: The Second Circuit Clears the Path for Insider Trading Convictions Absent a Dirks Personal Benefit*, WILMERHALE (Jan. 7, 2020), <https://www.wilmerhale.com/en/>

It shall be unlawful for any person . . . (b) To use or employ, *in connection with the purchase or sale of any security* registered on a national securities exchange or any security not so registered, or any securities-based swap agreement[,] *any manipulative or deceptive device or contrivance in contravention of such rules and regulations* as the Commission may prescribe as necessary or appropriate *in the public interest or for the protection of investors.*<sup>22</sup>

An examination of this language reveals that Congress likely intended to prohibit a broad range of actions in cases where the act of trading of securities would defraud investors. Indeed, the U.S. Supreme Court held that “Section 10(b) is aptly described as a catchall provision, but what it catches must be fraud.”<sup>23</sup> More recently, the Supreme Court stated that “Congress enacted the Title 15 fraud provisions with the limited ‘purpose of . . . eliminat[ing] [the] use of inside information for *personal advantage.*’”<sup>24</sup> Consistent with these intentions, Congress expressly provided for administrative interpretations of Section 10(b) by authorizing the SEC to issue rules to further define which schemes or behaviors may constitute the deceptions and contraventions of public interest.

The SEC exercised its authority under Section 10(b) by promulgating Rule 10b-5 to provide examples of prohibited actions. Rule 10b-5 establishes both “civil and criminal liability for securities fraud” that can be pursued by the SEC and Department of Justice respectively.<sup>25</sup> Rule 10b-5 provides:

It shall be unlawful for any person . . . (a) To *employ any device, scheme, or artifice to defraud*, (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) To *engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.*<sup>26</sup>

While Rule 10b-5 explicitly prohibits schemes to defraud, misstatements and omissions of material fact, and deceptive or fraudulent business practices, this language essentially mirrors the “catchall” language used in Section 10(b) of the Securities Exchange Act.<sup>27</sup> This catchall

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insights/client-alerts/20200107-the-second-circuit-clears-the-path-for-insider-trading-convictions-absent-a-dirks-personal-benefit [https://perma.cc/H6HU-W7W7].

<sup>22</sup> 15 U.S.C. § 78j (emphasis added) (footnote omitted).

<sup>23</sup> *Chiarella v. United States*, 445 U.S. 222, 234–35 (1980).

<sup>24</sup> *United States v. Blaszczyk*, 947 F.3d 19, 35 (2d Cir. 2019) (quoting *Dirks v. SEC*, 463 U.S. 646, 662 (1983)).

<sup>25</sup> Karen E. Woody, *The New Insider Trading*, 52 ARIZ. ST. L.J. 594, 615 (2020).

<sup>26</sup> 17 C.F.R. § 240.10b-5 (2020) (emphasis added).

<sup>27</sup> *Chiarella*, 445 U.S. at 234–35.

language is ripe for judicial interpretation and contributes to the ever-evolving “common-law-like” body of federal insider trading law.<sup>28</sup>

As part of the Sarbanes-Oxley Act of 2002,<sup>29</sup> Congress enacted a new securities fraud statute, Section 1348, under the federal criminal code of Title 18, which provides:

Whoever knowingly executes . . . a scheme . . . (1) to defraud any person in connection with . . . any security of an issuer with a class of securities registered under . . . the Securities Exchange Act of 1934 . . . or (2) to obtain, by means of false or fraudulent pretenses, representations, or promises, any money or property in connection with the purchase or sale of . . . any security of an issuer with a class of securities registered under . . . the Securities Exchange Act of 1934 . . . shall be fined under this title, or imprisoned not more than 25 years, or both.<sup>30</sup>

The legislative history of Section 1348 reveals that Congress intended to “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.”<sup>31</sup> Specifically, Congress used Section 1348 to overcome the “technical legal requirements”<sup>32</sup> of the existing “shortcomings in current law” at a time when “Enron and [Arthur] Andersen were taking advantage of a system that allowed them to behave in an apparently fraudulent manner . . . [and] the regulators . . . were faced with daunting challenges to punish the wrongdoers and protect the victims’ rights.”<sup>33</sup>

Despite Congress’s intent for Section 1348 to be more general than previous securities fraud provisions, the language of Section 1348 is similar to the language in Section 10(b) and Rule 10b-5. However, Section 1348 is markedly different from Section 10(b) and Rule 10b-5 in one regard: Section 1348 may only be used to bring criminal securities fraud enforcement actions while Section 10(b) and Rule 10b-5 can be used for both civil and criminal securities fraud enforcement actions. Invoking Section 1348 in conjunction with Section 10(b) and Rule 10b-5 can lead to confusing results at trial, as evidenced by the Second Circuit’s recent decision in *Blaszczak*.<sup>34</sup>

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<sup>28</sup> Edward Greene & Olivia Schmid, *Duty-Free Insider Trading?*, 2013 COLUM. BUS. L. REV. 369, 384 (2013).

<sup>29</sup> See 15 U.S.C. § 7201. See also Pritchard, *supra* note 14 (explaining that Sarbanes-Oxley was passed in response to accounting scandals at Enron and WorldCom).

<sup>30</sup> 18 U.S.C. § 1348 (emphasis added).

<sup>31</sup> S. REP. NO. 107-146, at 14 (2002).

<sup>32</sup> *Id.* at 6.

<sup>33</sup> *Id.* at 5-6.

<sup>34</sup> See *United States v. Blaszczak*, 947 F.3d 19, 36-37 (2d Cir. 2019) (holding that the “personal benefit” test, as applied in *Dirks* to securities fraud enforcement actions under Title

## II. THE COMMON LAW DEVELOPMENT OF INSIDER TRADING LAW

Before discussing the impact *Blaszczak* will likely have on criminal insider trading enforcement, it is necessary to examine how federal insider trading law evolved by reviewing three notable insider trading cases: *Cady, Roberts*,<sup>35</sup> *Chiarella v. United States*,<sup>36</sup> and *Dirks v. SEC*.<sup>37</sup> Together, these cases constitute some of the earliest instances of insider trading prohibition enforcement and lay the foundation for the common law development of insider trading.<sup>38</sup> *Chiarella* clarifies when the duty to disclose or abstain from trading upon confidential information, as introduced in *Cady, Roberts*, arises.<sup>39</sup> *Dirks* establishes the personal benefit test “to determine whether [an] insider’s ‘tip’ constitute[s] a breach of the insider’s fiduciary duty,” which became a primary issue in *Blaszczak*.<sup>40</sup>

### A. THE PROHIBITION OF INSIDER TRADING: *CADY, ROBERTS*

Following the passage of the Securities Exchange Act of 1934, insider trading law went untouched for twenty-seven years until the SEC commenced its first insider trading administrative proceeding in *Cady, Roberts*.<sup>41</sup> In *Cady, Roberts*, a director of an SEC registrant corporation informed a securities broker of non-public plans to reduce the amount of the next dividend payment before the corporation had announced such reduction to the public.<sup>42</sup> After learning this confidential information and prior to the public announcement, the securities broker sold shares in the corporation to avoid any potential losses associated with a decline in share price.<sup>43</sup> The actions of the corporate director and securities broker in *Cady, Roberts* exemplify a classic tipping scheme where the director (the tipper) shared non-public information with the broker (the tippee) for the broker’s benefit.

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15, Section 10(b), was *not* applicable to securities fraud enforcement actions under Title 18, Section 1348).

<sup>35</sup> 40 S.E.C. 907 (1961).

<sup>36</sup> 445 U.S. 222 (1980).

<sup>37</sup> 463 U.S. 646 (1983).

<sup>38</sup> See Woody, *supra* note 25, at 603.

<sup>39</sup> *Chiarella*, 445 U.S. at 232.

<sup>40</sup> *Dirks*, 463 U.S. at 661; *United States v. Blaszczak*, 947 F.3d 19, 26 (2d Cir. 2019) (“[T]he ‘personal benefit’ test established in *Dirks v. SEC* . . . does not apply to these Title 18 fraud statutes.”).

<sup>41</sup> See Crimmins, *supra* note 5, at 349.

<sup>42</sup> *In re Cady, Roberts & Co.*, 40 S.E.C. 907, 908–09 (1961).

<sup>43</sup> *Id.*



In response, the SEC commenced proceedings to determine whether the director's sharing of non-public information and the broker's trading activities violated Section 10(b) of the Securities Exchange Act of 1934, Rule 10b-5, and Section 17(a) of the Securities Act of 1933.<sup>44</sup> SEC Chairman Cary began his analysis by stating that a primary purpose of both the Securities Act of 1933 and the Securities Exchange Act of 1934 "is the prevention of fraud, manipulation or deception in connection with securities transactions."<sup>45</sup> Chairman Cary stated that each act contains "broad remedial provisions aimed at reaching . . . deceptive activities, whether or not they are . . . sufficient to sustain a common law action for fraud and deceit."<sup>46</sup> Such "anti-fraud provisions are not intended as a specification of particular acts or practices which constitute fraud, but rather are designed to encompass the infinite variety of devices by which undue advantage may be taken of investors and others."<sup>47</sup>

The SEC ultimately found that the securities broker violated Rule 10b-5, holding that an insider possessing material non-public information has an affirmative duty to either disclose such information or abstain from entering into transactions upon the basis of such information.<sup>48</sup> While *Cady, Roberts* was not a criminal case, it plays a significant role in the history of U.S. insider trading law as "one of the first cases cementing the prohibition against insider trading."<sup>49</sup> Furthermore, the tipper-tippee relationship present in *Cady, Roberts* would eventually inspire a redefinition of the element of duty within insider trading law during the 1980s.

#### B. THE DUTY TO DISCLOSE: *CHIARELLA V. UNITED STATES*

During the two decades following the SEC's decision in *Cady, Roberts*, Congress did not enact any additional statutes prohibiting or defining the elements of insider trading or tipping schemes associated with securities transactions.<sup>50</sup> However, in *Chiarella*, the Supreme Court attempted to clarify when an individual owes a duty to disclose material non-public information to the investing public or abstain from trading upon material non-public information.<sup>51</sup> The defendant-petitioner in *Chiarella* had access to

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<sup>44</sup> *Id.* at 907–08.

<sup>45</sup> *Id.* at 909.

<sup>46</sup> *Id.* at 910.

<sup>47</sup> *Id.* at 911.

<sup>48</sup> *Id.*

<sup>49</sup> Woody, *supra* note 25, at 603.

<sup>50</sup> See Vollmer, *supra* note 2, at 338–39.

<sup>51</sup> See *Chiarella v. United States*, 445 U.S. 222, 224 (1980).

corporate takeover press release drafts through his position as a printer at a financial press company.<sup>52</sup> After discovering the identities of each target corporation, and prior to any public announcement of such takeover attempts, the defendant-petitioner purchased shares in each target and subsequently sold those shares for a profit after the takeover attempts were publicly announced.<sup>53</sup> The defendant-petitioner was indicted and convicted on seventeen counts of violating Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5.<sup>54</sup> On appeal, the Circuit Court of Appeals for the Second Circuit affirmed all seventeen convictions.<sup>55</sup>

However, the Supreme Court reversed the Circuit Court on the basis that “[t]he Court of Appeals, like the trial court, failed to identify a relationship between petitioner and the sellers that could give rise to a duty.”<sup>56</sup> The Supreme Court argued that “[t]he party charged with failing to disclose market information must be under a duty to disclose it”<sup>57</sup> and that “[n]o duty could arise from petitioner’s relationship with the sellers of the target company’s securities, for petitioner had no prior dealings with them.”<sup>58</sup> The defendant-petitioner “dealt with the sellers . . . through impersonal market transactions” and was not an agent, a fiduciary, or a trusted party of the sellers.<sup>59</sup> *Chiarella* is significant to the evolution of insider trading law because it establishes common law precedent incorporating the SEC’s original emphasis on duty in *Cady, Roberts*. *Chiarella* effectively provides a template for how various relationships may trigger a duty to disclose material non-public information to the investment public or abstain from trading upon this information.

### C. THE PERSONAL BENEFIT TEST: *DIRKS V. SEC*

In the two years following *Chiarella*, the Supreme Court’s new fiduciary relationship requirement precedent “created analytical difficulties for the SEC and courts in policing tippees who trade on inside information”<sup>60</sup>

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<sup>52</sup> *Id.*

<sup>53</sup> *Id.*

<sup>54</sup> *Id.* at 225.

<sup>55</sup> *Id.*

<sup>56</sup> *Id.* at 231–32.

<sup>57</sup> *Id.* at 229 (quoting *Frigitemp Corp. v. Fin. Dynamics Fund, Inc.*, 524 F.2d 275, 282 (2d Cir. 1975)).

<sup>58</sup> *Id.* at 232.

<sup>59</sup> *Id.* at 232–33.

<sup>60</sup> *Dirks v. SEC*, 463 U.S. 646, 655 (1983) (footnote omitted).

when “the typical tippee has no such relationships.”<sup>61</sup> Therefore, in *Dirks*, the Supreme Court attempted to resolve the issue of whether a tippee with no fiduciary relationship violated Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5 by trading on non-public information.<sup>62</sup>

The defendant in *Dirks* worked for a brokerage firm and received a tip that a corporation had fraudulently overstated the value of its assets.<sup>63</sup> After confirming the existence of fraud, the defendant shared this information with numerous clients and other investors who subsequently sold their shares in the corporation before the fraud was publicly known.<sup>64</sup> After an investigation and administrative proceeding, the SEC found that the petitioner aided and abetted violations of Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5.<sup>65</sup> The SEC argued that “[w]here ‘tippees’—regardless of their motivation or occupation—come into possession of material ‘corporate information that they know is confidential and know or should know came from a corporate insider,’ they must either publicly disclose that information or refrain from trading.”<sup>66</sup> The Court of Appeals for the District of Columbia affirmed the SEC’s decision, stating that “the obligations of corporate fiduciaries pass to all those to whom they disclose their information before it has been disseminated to the public at large.”<sup>67</sup>

However, the Supreme Court reversed the Circuit Court’s decision on the basis that the SEC’s theories of tippee fiduciary duty and liability conflicted with the principles of *Chiarella*.<sup>68</sup> The SEC’s position that any tippee “who knowingly receives nonpublic material information from an insider has a fiduciary duty to disclose”<sup>69</sup> is inconsistent “with the principle set forth in *Chiarella* that only some persons, under some circumstances” would be subject to a fiduciary duty to disclose or abstain.<sup>70</sup> While rejecting the SEC’s position of what would essentially constitute strict liability for tippees, the Supreme Court acknowledged that “[t]he need for a ban on some tippee trading is clear” in order to prevent insiders from recruiting tippees to

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<sup>61</sup> *Id.*

<sup>62</sup> *Id.* at 650–52.

<sup>63</sup> *Id.* at 648–49.

<sup>64</sup> *Id.* at 649.

<sup>65</sup> *Id.* at 650–51.

<sup>66</sup> *Id.* at 651.

<sup>67</sup> *Id.* at 652 (quoting *Dirks v. SEC*, 681 F.2d 824, 839 (D.C. Cir. 1982)).

<sup>68</sup> *Id.* at 657.

<sup>69</sup> *Id.* at 656.

<sup>70</sup> *Id.* at 657.

trade securities on their behalf.<sup>71</sup> The Supreme Court established that a tippee's duty should be derivative from the tipper's duty, the tippee assumes a fiduciary duty "only when the insider has breached his fiduciary duty . . . by disclosing the information to the tippee and the tippee knows or should know that there has been a breach."<sup>72</sup>

To determine when an insider breaches his or her duty, the Supreme Court adopted a test under which an insider's disclosure of material non-public information will constitute a breach of fiduciary duty when the insider will benefit, directly or indirectly, from the disclosure.<sup>73</sup> The Supreme Court based this so-called personal benefit test on *Cady, Roberts*, in which the SEC argued that one of the purposes of the Securities Act of 1933 and the Securities Exchange Act of 1934 was to prevent the "use of inside information for personal advantage."<sup>74</sup> Rather than define what constitutes a personal benefit to the tipper, the Supreme Court provided general examples such as the tipper's receipt of cash, reciprocal information, reputational gain, or some other *quid pro quo* from the tippee.<sup>75</sup> The Supreme Court acknowledged that to determine "whether an insider personally benefits from a particular disclosure [is] a question of fact, [which] will not always be easy for courts."<sup>76</sup> By applying the personal benefit test, the Supreme Court reasoned that the insiders in *Dirks* did not breach their fiduciary duty by providing information to the defendant because the insiders did not receive "monetary or personal benefit" in exchange for the information.<sup>77</sup> With no insider breach of fiduciary duty, the Supreme Court held that there could be no derivative breach of duty by the defendant.<sup>78</sup>

### III. RECENT APPLICATIONS OF THE PERSONAL BENEFIT TEST

The personal benefit test in *Dirks* altered insider trading law by creating a new category of would-be defendants, but the Supreme Court's vague description of a personal benefit ultimately left courts confused.<sup>79</sup> How could a court find the existence of a personal benefit without a clear definition of

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<sup>71</sup> *Id.* at 659.

<sup>72</sup> *Id.* at 660.

<sup>73</sup> *Id.* at 662.

<sup>74</sup> *Id.* (citation omitted).

<sup>75</sup> *Id.* at 663–64.

<sup>76</sup> *Id.* at 664.

<sup>77</sup> *Id.* at 666–67.

<sup>78</sup> *Id.* at 667.

<sup>79</sup> Sari Rosenfeld, *The Ever-Changing Scope of Insider Trading Liability for Tippees in the Second Circuit*, 8 MICH. BUS. & ENTREPRENEURIAL L. REV. 403, 407 (2019).

what constitutes a personal benefit? For this reason, legal academics criticize *Dirks* and the personal benefit test as being “a complete invention of the Supreme Court with only a distant tie to Section 10(b) and Rule 10b-5.”<sup>80</sup> Academics also maintain that *Dirks* was “far more legislative than the normal outcome of a court using traditional tools of statutory or regulatory construction to determine the meaning of a law,”<sup>81</sup> in spite of the largely common law evolution of insider trading law. Other academics argue that the personal benefit test was merely an attempt to create an exception to insider trading liability that would allow tippers to disclose inside information in whistleblowing contexts where the tipper is motivated by exposing fraud rather than seeking personal gain.<sup>82</sup> In the aftermath of *Dirks*, a series of recent cases emphasized the difficulties courts continue to face in applying the personal benefit test,<sup>83</sup> culminating in the Second Circuit’s controversial decision in *Blaszczak*.<sup>84</sup>

#### A. UNITED STATES V. NEWMAN

The defendants-appellants in *United States v. Newman* were hedge fund managers who obtained and traded upon earnings results for Dell and NVIDIA prior to each company’s respective public earnings announcement.<sup>85</sup> The defendants-appellants received the non-public earnings results through tipping chains that consisted of numerous financial analysts who had received the information directly from various company insiders at Dell and NVIDIA.<sup>86</sup> Regarding the Dell tipping chain, the defendants-appellants were “three and four levels removed from the inside tipper, respectively.”<sup>87</sup> Regarding the NVIDIA tipping chain, the defendants-appellants were “four levels removed from the insider tippers.”<sup>88</sup> The defendants-appellants were criminally charged with violating Section 10(b) of the Securities Exchange Act and SEC Rule 10b-5.<sup>89</sup>

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<sup>80</sup> Vollmer, *supra* note 2, at 341.

<sup>81</sup> *Id.* at 340.

<sup>82</sup> Woody, *supra* note 25, at 608.

<sup>83</sup> See generally *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014), *abrogated* by *Salman v. United States*, 137 S. Ct. 420 (2016); see also *United States v. Martoma*, 894 F.3d 64 (2d Cir. 2018).

<sup>84</sup> *United States v. Blaszczak*, 947 F.3d 19 (2d Cir. 2019).

<sup>85</sup> *Newman*, 773 F.3d at 443.

<sup>86</sup> *Id.*

<sup>87</sup> *Id.*

<sup>88</sup> *Id.*

<sup>89</sup> *Id.*

At trial in the U.S. District Court for the Southern District of New York, the defendants-appellants argued that they had no knowledge of whether the tippers received any personal benefit for sharing the non-public earnings results information and therefore could not have known about the insiders' breaches of duty.<sup>90</sup> However, the jury found the defendants-appellants guilty on all counts.<sup>91</sup> On appeal, the Court of Appeals for the Second Circuit reversed the defendants-appellants' convictions on the basis that the Government failed "to prove beyond a reasonable doubt that [defendants-appellants] knew that the insiders received a personal benefit in exchange for disclosing confidential information."<sup>92</sup> The Second Circuit reasoned that "[t]o the extent *Dirks* suggests that a personal benefit may be inferred from a personal relationship between the tipper and tippee . . . such an inference is impermissible in the absence of proof of a meaningfully close personal relationship."<sup>93</sup> The Second Circuit added that such a relationship must also "generate[] an exchange that is objective, consequential, and represent[] at least a potential gain of a pecuniary or similarly valuable nature."<sup>94</sup>

Ultimately, the Second Circuit maintained that the government's evidence that the defendants-appellants had formerly worked with, attended school with, and were family with some of the tippers was "simply too thin to warrant the inference that the corporate insiders received any personal benefit in exchange for their tips."<sup>95</sup> The Second Circuit's "meaningfully close personal relationship"<sup>96</sup> requirement in *Newman* tipped the scales of insider trading law in favor of would-be defendants by making it more difficult for the government to infer that the tipper received the personal benefit needed to establish tipper liability under *Dirks*. However, two years later in *Salman v. United States*,<sup>97</sup> the Supreme Court heard an appeal from the Ninth Circuit concerning *Newman*'s requirement that a close personal relationship must be accompanied by a pecuniary gain to satisfy the personal benefit test established in *Dirks*.

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<sup>90</sup> *Id.* at 444.

<sup>91</sup> *Id.*

<sup>92</sup> *Id.* at 453.

<sup>93</sup> *Id.* at 452.

<sup>94</sup> *Id.*

<sup>95</sup> *Id.* at 451–52.

<sup>96</sup> *Id.* at 452.

<sup>97</sup> *Salman v. United States*, 137 S. Ct. 420 (2016).

B. *SALMAN V. UNITED STATES*

The defendant in *Salman* received inside information from his friend and brother-in-law, Michael Kara, who received the inside information from his brother, Maher Kara, who worked as an investment banker at Citigroup.<sup>98</sup> The petitioner was indicted, and ultimately convicted, in the Northern District of California for violating Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5.<sup>99</sup> Evidence presented at trial established that Maher initially shared inside information to assist Michael financially, but Michael subsequently shared this information with others, including the defendant, without Maher's knowledge.<sup>100</sup> Michael also informed the defendant that Maher was the source of the information.<sup>101</sup>

On appeal, the defendant argued that, pursuant to *Newman*, his conviction should be reversed because there was no evidence that Maher received a pecuniary benefit in exchange for sharing the information or that the defendant had any knowledge of such benefit.<sup>102</sup> In response, the Ninth Circuit reasoned that a "tipper benefits personally by making a gift of confidential information to a trading relative or friend" and therefore such a tipping scheme satisfies the personal benefit test under *Dirks*.<sup>103</sup> The Ninth Circuit ultimately affirmed the defendant's convictions by declining to follow any additional requirements *Newman* imposed on tipping schemes involving friends or family.<sup>104</sup>

On appeal to the Supreme Court, the defendant argued that "an insider's 'gift of confidential information to a trading relative or friend,' is not enough to establish securities fraud"<sup>105</sup> because "a tipper does not personally benefit unless the tipper's goal in disclosing inside information is to obtain money . . . or something of tangible value."<sup>106</sup> The Supreme Court rejected this argument, maintaining that "*Dirks* specifies that when a tipper gives inside information to 'a trading relative or friend,' the jury can infer that the tipper meant to provide the equivalent of a cash gift"<sup>107</sup> and therefore "the tipper benefits personally because giving a gift of trading information is the

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<sup>98</sup> *Id.* at 424.

<sup>99</sup> *Id.* at 425.

<sup>100</sup> *Id.* at 424.

<sup>101</sup> *Id.* at 425.

<sup>102</sup> *Id.*

<sup>103</sup> *Id.*

<sup>104</sup> *Id.*

<sup>105</sup> *Id.* at 426 (quoting *Dirks v. SEC*, 463 U.S. 646, 664 (1983)).

<sup>106</sup> *Id.*

<sup>107</sup> *Id.* at 428.

same thing as trading by the tipper followed by a gift of the proceeds.”<sup>108</sup> The Supreme Court reasoned that such a situation occurred in the present case, in which Maher breached his fiduciary duty to Citigroup by disclosing confidential information to Michael with the expectation that Michael would trade upon such information.<sup>109</sup> As recipients of the confidential information, Michael and the defendant therefore each assumed—and subsequently breached—Maher’s duty by trading upon the information.<sup>110</sup> Ultimately, the Supreme Court affirmed the Ninth Circuit’s decision on the basis that “*Dirks* makes clear that a tipper breaches a fiduciary duty by making a gift of confidential information to ‘a trading relative.’”<sup>111</sup>

The Supreme Court next took aim at the Second Circuit’s decision in *Newman*, stating that *Newman*’s requirement “that the tipper must also receive something of a ‘pecuniary or similarly valuable nature’ in exchange for a gift to family or friends” was inconsistent with *Dirks*.<sup>112</sup> Specifically, the Supreme Court maintained that *Newman*’s pecuniary gain requirement for close relationships contradicted *Dirks*’ language that “the elements of fiduciary duty and exploitation of nonpublic information also exist when an insider makes a gift of confidential information to a trading relative or friend.”<sup>113</sup> Aside from rejecting the Second Circuit’s attempt to raise the government’s hurdle in insider trading cases involving friends and relatives, the Supreme Court’s decision in *Salman* was essentially a modern-day affirmation of *Dirks* rather than a radical change in the existing body of insider trading law.<sup>114</sup>

### C. UNITED STATES V. MARTOMA

Less than one year after *Salman*, the Second Circuit reentered the fold in *United States v. Martoma* to grapple with the “meaningfully close personal relationship” requirement the Second Circuit imposed in *Newman* only three years prior.<sup>115</sup> The defendant-appellant in *Martoma* worked as a portfolio manager for a hedge fund and was also responsible for recommending

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<sup>108</sup> *Id.*

<sup>109</sup> *Id.*

<sup>110</sup> *Id.*

<sup>111</sup> *Id.* at 427.

<sup>112</sup> *Id.* at 428.

<sup>113</sup> *Id.* at 427 (emphasis omitted).

<sup>114</sup> See Woody, *supra* note 25, at 611 (“*Salman* was an open-and-shut case that fell squarely within the definition of personal benefit as laid out in *Dirks*”).

<sup>115</sup> *United States v. Martoma*, 869 F.3d 58 (2d Cir. 2017) (*Martoma I*), *opinion amended and superseded*, *United States v. Martoma*, 894 F.3d 64 (2d Cir. 2018) (*Martoma II*).



investments to other fund managers.<sup>116</sup> The defendant-appellant began trading and recommending the shares of two pharmaceutical companies based on non-public information concerning the progress of various clinical trials that the defendant-appellant received from paid consulting sessions with clinical researchers.<sup>117</sup> The defendant-appellant met with one researcher approximately forty-three different times at a rate of \$1,000 per hour and paid another researcher a rate of \$1,500 per hour for similar sessions.<sup>118</sup>

The District Court for the Southern District of New York convicted the defendant on two counts of securities fraud in connection with insider trading.<sup>119</sup> On appeal, he argued that there was insufficient evidence that he maintained a “meaningfully close personal relationship” with either tipper.<sup>120</sup> Alternatively, the defendant-appellant argued that even if the evidence was sufficient to support his conviction, the district court’s jury instructions were inadequate in light of *Newman* because they did not inform the jury about the limitations on a personal benefit.<sup>121</sup> The defendant-appellant maintained that *Newman*’s “meaningfully close personal relationship” requirement survived the Supreme Court’s decision in *Salman*, and therefore the district court should have instructed the jury that the existence of such a relationship was a prerequisite for finding a personal benefit.<sup>122</sup>

The Second Circuit ultimately affirmed the district court’s decision, rejecting each of the defendant-appellant’s arguments in turn.<sup>123</sup> The Second Circuit rejected the defendant-appellant’s insufficient evidence argument on the basis that any *quid pro quo* relationship between a tipper and tippee could “yield future pecuniary gain” and therefore “constitute[s] a personal benefit giving rise to insider trading liability.”<sup>124</sup> The Second Circuit reasoned that in light of the defendant-appellant’s relationships with both researchers who “regularly disclosed confidential information in exchange for fees,”<sup>125</sup> “a rational trier of fact could have found the essential elements of the crime [of insider trading] beyond a reasonable doubt.”<sup>126</sup> Next, the Second Circuit

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<sup>116</sup> *Martoma I*, 869 F.3d at 61.

<sup>117</sup> *Id.* at 61–62.

<sup>118</sup> *Id.*

<sup>119</sup> *Id.* at 61.

<sup>120</sup> *Id.* at 64–65.

<sup>121</sup> *Id.* at 65.

<sup>122</sup> *Id.* at 67.

<sup>123</sup> *Id.* at 73.

<sup>124</sup> *Id.* at 67 (citation omitted).

<sup>125</sup> *Id.*

<sup>126</sup> *Id.* (quoting *United States v. Coplan*, 703 F.3d 46, 62 (2d Cir. 2012)).

rejected the defendant-appellant's jury instruction argument on the basis that "*Salman* fundamentally altered the analysis underlying *Newman*[] . . . such that the 'meaningfully close personal relationship' requirement is no longer good law."<sup>127</sup> The Second Circuit maintained that while *Salman* did not expressly overrule the "meaningfully close personal relationship" requirement, "the effect of a Supreme Court decision . . . may nonetheless alter the relevant analysis fundamentally enough to require overruling prior, 'inconsistent' precedent."<sup>128</sup>

*Martoma* was immediately controversial, raising concerns that now "nearly any relationship would meet the standard of tipper-tippee for insider trading liability"<sup>129</sup> within the Second Circuit. The New York Council of Defense Lawyers and a group of law professors filed amici briefs, claiming that *Martoma* was an "over-extension of insider trading liability beyond the *Dirks* standard."<sup>130</sup> In response to such criticisms, the Second Circuit issued an amended opinion<sup>131</sup> that shied away from its prior denouncement of *Newman*'s "meaningfully close personal relationship" requirement.<sup>132</sup> The Second Circuit still affirmed the district court's decision, but this time on the basis that there was "compelling evidence" in the form of approximately \$70,000 of consulting fees that the tippers received a personal benefit in exchange for sharing confidential information.<sup>133</sup> The Second Circuit maintained that since the evidence established a personal benefit, it need not decide whether *Newman*'s additional requirements to establish a personal benefit were inconsistent with *Salman* in the present case.<sup>134</sup> By amending *Martoma*, the Second Circuit quelled its critics for the moment. However, the Second Circuit had also managed to kick the *Newman* can further down the road by not actually deciding how the "meaningfully close personal relationship" requirement should fit within the Second Circuit's modern insider trading jurisprudence, if at all.

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<sup>127</sup> *Id.* at 69.

<sup>128</sup> *Id.* (quoting *Doscher v. Sea Port Grp. Sec., LLC*, 832 F.3d 372, 378 (2d Cir. 2016)).

<sup>129</sup> Woody, *supra* note 25, at 612.

<sup>130</sup> Woody, *supra* note 25, at 613; *see also* Brief for Law Professors as *Amici Curiae* in Support of Petitioner at 1, *Martoma I*, 894 F.3d 64 (2d Cir. 2017) (No. 18-972); *see also* Brief for the New York Council of Defense Lawyers & National Association of Criminal Defense Lawyers as *Amici Curiae* in Support of Defendant-Appellant's Petition for Rehearing *En Banc* at 1, *Martoma I*, 894 F.3d 64 (2d Cir. 2017) (No. 14-3599).

<sup>131</sup> *Martoma II*, 894 F.3d 64 (2d Cir. 2018).

<sup>132</sup> *Id.* at 71 (quoting *United States v. Newman*, 773 F.3d 438, 452 (2d Cir. 2014)).

<sup>133</sup> *Id.*

<sup>134</sup> *Id.*

IV. *UNITED STATES V. BLASZCZAK*

## A. BACKGROUND

Prior to *Blaszczak*,<sup>135</sup> the Second Circuit's analysis of the *Dirks* personal benefit test generally pertained to civil and criminal insider trading actions brought under Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5. However, *Blaszczak* required the Second Circuit to determine, for the very first time, the extent to which the *Dirks* personal benefit test applied to criminal insider trading actions brought under Section 1348.<sup>136</sup> In *Blaszczak*, defendants Olan and Huber worked for a healthcare-focused hedge fund and ultimately traded upon non-public information from the Centers for Medicare and Medicaid (CMS).<sup>137</sup> From 2009 to 2014, Olan and Huber received information concerning CMS's potential rules and regulations from defendant Blaszczak, a former CMS employee and current hedge fund consultant.<sup>138</sup> Blaszczak in turn obtained non-public CMS information from defendant Worrall, a current CMS employee.<sup>139</sup> The defendants were charged with eighteen counts, including securities fraud under Section 10(b), Rule 10b-5, and Section 1348.<sup>140</sup>

At trial, the District Court for the Southern District of New York instructed the jury that in order to convict Worrall of securities fraud under Section 10(b) and Rule 10b-5, the jury must “find that he tipped confidential CMS information in exchange for a ‘personal benefit[.]’”<sup>141</sup> To convict Blaszczak under the same provisions, the jury must find that “he knew that Worrall disclosed the information in exchange for a personal benefit.”<sup>142</sup> To convict Huber or Olan under the same provisions, the jury must find that Huber or Olan “knew that a CMS insider tipped the information in exchange for a personal benefit.”<sup>143</sup> Unsurprisingly, each of the district court's instructions concerning securities fraud under Section 10(b) and Rule 10b-5

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<sup>135</sup> 947 F.3d 19 (2d Cir. 2019).

<sup>136</sup> Antonia M. Apps & Katherine R. Goldstein, ‘*United States v. Blaszczak*’: Can the Government Circumvent ‘Newman’ Personal Benefit Test?, LAW.COM (Nov. 27, 2019, 11:00 AM), <https://www.law.com/newyorklawjournal/2019/11/27/united-states-v-blaszczak-can-the-government-circumvent-newman-personal-benefit-test/?slreturn=20210811233359> [https://perma.cc/AX9F-CFUS].

<sup>137</sup> *Blaszczak*, 947 F.3d at 26.

<sup>138</sup> *Id.* at 26–27.

<sup>139</sup> *Id.* at 27.

<sup>140</sup> *Id.* at 28–29.

<sup>141</sup> *Id.* at 29.

<sup>142</sup> *Id.*

<sup>143</sup> *Id.*

required that the personal benefit test be satisfied pursuant to *Dirks*. However, the court did not require the jury to satisfy the personal benefit test when considering each defendant's securities fraud charges under Section 1348.<sup>144</sup> Rather, the court instructed that the jury could find the existence of a scheme to defraud under Section 1348 if the defendants merely "participated in a scheme to embezzle or convert confidential information from CMS" for his or another's own use.<sup>145</sup> The court further instructed that the jury "could only convict if it found that the defendant . . . knowingly and willfully participated in the fraudulent scheme."<sup>146</sup> The jury ultimately convicted Olan, Huber, and Blaszcak of securities fraud under Section 1348 and acquitted all defendants of the securities fraud charges under Section 10(b) and Rule 10b-5.<sup>147</sup>

On appeal, the defendants argued that the lower court erred by not instructing the jury that the *Dirks* personal benefit test also applied to securities fraud under Section 1348, and therefore the personal benefit test must be satisfied in order to convict.<sup>148</sup> The defendants maintained that the court should construe the term "defraud" to have the same meaning under Section 1348 and Rule 10b-5 so as to make the elements of insider trading fraud the same under each provision.<sup>149</sup> Alternatively, the defendants argued that declining to extend the *Dirks* personal benefit test beyond the securities fraud provisions of Section 10(b) and Rule 10b-5 would allow the government to circumvent the personal benefit test altogether by merely pursuing criminal insider trading actions under the lower hurdle of Section 1348.<sup>150</sup>

The Second Circuit rejected the defendants' argument that the district court erred in its jury instructions on the basis that it would be improper to extend the personal benefit test to Section 1348 because the statutory purpose of each securities fraud provision is fundamentally different.<sup>151</sup> Beginning with Section 10(b), the Second Circuit maintained that the personal benefit test "is a judge-made doctrine premised on the [Securities] Exchange Act's statutory purpose."<sup>152</sup> The Second Circuit reasoned that Congress enacted the

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<sup>144</sup> *Id.* at 29.

<sup>145</sup> *Id.*

<sup>146</sup> *Id.*

<sup>147</sup> *Id.* at 29–30.

<sup>148</sup> *Id.* at 30.

<sup>149</sup> *Id.* at 35.

<sup>150</sup> *Id.* at 37.

<sup>151</sup> *Blaszcak*, 947 F.3d at 36.

<sup>152</sup> *Id.* at 35.

securities fraud provisions under the Securities Exchange Act of 1934 “to protect the free flow of information into the securities markets” by “eliminat[ing] [the] use of inside information for personal advantage.”<sup>153</sup> Further, it reasoned that since the *Dirks* “personal benefit” test was intended to be consistent with the purpose of the securities fraud provisions, the purpose of the personal benefit test must be to prevent the use of inside information for personal advantage.<sup>154</sup> In contrast, the Second Circuit maintained that “Congress intended for Section 1348 to ‘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.’”<sup>155</sup> The Second Circuit ultimately held that since Congress intended for the securities fraud provisions of Section 1348 to be more broad than the existing provisions under Section 10(b) and Rule 10b-5, applying the *Dirks* personal benefit test would undermine the intent of Section 1348.<sup>156</sup> Additionally, the Second Circuit rejected the defendant’s alternative argument that failing to apply the personal benefit test to securities fraud actions under Section 1348 would undermine Section 10(b) on the basis that “Congress was certainly authorized to enact a broader securities fraud provision, and it is not the place of courts to check that decision on policy grounds.”<sup>157</sup>

#### B. RESPONSES TO *BLASZCZAK*

In response to the Second Circuit’s decision in *Blaszczak*, defendants Olan and Huber filed a joint petition for a rehearing *en banc*.<sup>158</sup> Olan and Huber argued that the Second Circuit “upended insider trading law by eliminating the personal-benefit requirement for cases brought under Title 18.”<sup>159</sup> They maintained that “[c]ourts, prosecutors, and market participants” recognize the personal benefit test as “the boundary between innocent and fraudulent trading, no matter which fraud statute prosecutors charge.”<sup>160</sup> They also claimed that the Second Circuit’s distinction between the statutory purpose of Section 10(b) and Section 1348 ignores not only the text of each

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<sup>153</sup> *Id.* (emphasis omitted) (quoting *Dirks*, 463 U.S. at 662).

<sup>154</sup> *Id.* at 35–36.

<sup>155</sup> *Id.* at 36 (quoting S. REP. NO. 107-146, at 14 (2002)).

<sup>156</sup> *Id.* at 36–37.

<sup>157</sup> *Id.* at 37.

<sup>158</sup> See Joint Petition for Rehearing or Rehearing *En Banc*, *United States v. Blaszczak*, 947 F.3d 19 (2d Cir. 2019) (No. 18-2811).

<sup>159</sup> *Id.* at 2.

<sup>160</sup> *Id.*

provision, but also *Dirks* and other binding authorities providing “that personal benefit is essential to proving insider-trading fraud.”<sup>161</sup> However, the Second Circuit denied the petition.<sup>162</sup>

Legal academics and practitioners echoed the defendants’ criticisms of the Second Circuit’s reasoning in *Blaszczak*, maintaining that allowing prosecutors to establish insider trading liability without first establishing a personal benefit will place “careless employees, guilty of no more than over-sharing,” at the mercy of an “over-zealous prosecutor.”<sup>163</sup> These consequences are not limited to employees, but would also likely apply to “traders who stumble upon nonconfidential information . . . if they do not track down its source.”<sup>164</sup>

From a policy standpoint, allowing the Department of Justice to prosecute insider trading violations under Section 1348 that the SEC, using the same facts, is unable to levy civil penalties against under Section 10(b) “can hardly be what Congress intended when it adopted Section 1348.”<sup>165</sup> The Second Circuit should have realized that allowing criminal charges to proceed when civil liabilities cannot is absurd, especially given the different burdens of proof required for criminal and civil liability.<sup>166</sup> For example, how can the same evidence establish criminal insider trading liability beyond a reasonable doubt, yet fail to establish a more likely than not civil insider trading liability? Such a possibility raises additional policy questions regarding the respective roles that criminal and civil insider trading liability each play in deterring certain behaviors.

Would-be defendants should be particularly concerned that *Blaszczak* effectively provides “a potentially simpler path to conviction for prosecutors in tipping cases where the evidence of a personal benefit is thin.”<sup>167</sup> By increasing the likelihood of bringing successful criminal insider trading charges, *Blaszczak* essentially places the SEC’s regulatory oversight to pursue civil insider trading charges under Section 10(b) into the hands of

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<sup>161</sup> *Id.*

<sup>162</sup> *Second Circuit Denies Rehearing in Key Insider Trading Case*, PAUL WEISS (Apr. 13, 2020), <https://www.paulweiss.com/practices/litigation/litigation/publications/second-circuit-denies-rehearing-in-key-insider-trading-case?id=32632> [https://perma.cc/2QZ5-E5KF].

<sup>163</sup> Pritchard, *supra* note 14.

<sup>164</sup> *Id.*

<sup>165</sup> *Id.*; see also Cahn, Mitchell, Titolo & Atanasio, *supra* note 21.

<sup>166</sup> Cahn, Mitchell, Titolo & Atanasio, *supra* note 21.

<sup>167</sup> *Id.* (footnote omitted).

federal prosecutors who now have a lower hurdle to bring criminal insider trading charges under Section 1348.<sup>168</sup>

Legal practitioners also suggest that, since the non-public information at issue in *Blaszczak* originated within a government agency,<sup>169</sup> the Second Circuit's holding may extend criminal insider trading liability "to those who may be privy to and act on a regulator's deliberations or other agency information that has not yet been publicly released."<sup>170</sup> Specifically, *Blaszczak* "could have significant implications for hedge funds, investment advisers, healthcare systems and pharmaceutical companies, as well as consulting firms handling health, financial, environmental and transportation issues—any entity or individual receiving information originating from a government agency that may be nonpublic."<sup>171</sup> In other words, the loosened criminal insider trading liability rules could place government employees at risk of committing criminal insider trading activities if the personal benefit test no longer has to be satisfied when non-public government information is communicated to another individual.<sup>172</sup>

This situation raises another policy concern: government employees who may regularly have to share confidential information with agencies or other government officials as part of their employment could now be found criminally liable under *Blaszczak* if the recipient of such information trades upon that information.<sup>173</sup> Does it make sense to hold government employees criminally liable for sharing confidential information with other government employees, when the sharer of the information had no knowledge that recipient was going to use the information for their own personal benefit? Surely the Second Circuit would acknowledge that such a result is an

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<sup>168</sup> *Id.*; see also Robert J. Anello & Richard F. Albert, *Days Seem Numbered for Circuit's Controversial Insider Trading Decision*, LAW.COM (Dec. 9, 2020, 12:15 PM), <https://www.law.com/newyorklawjournal/2020/12/09/days-seem-numbered-for-circuits-controversial-insider-trading-decision/> [<https://perma.cc/VHR8-4E4R>].

<sup>169</sup> See *United States v. Blaszczak*, 947 F.3d 19, 26–27 (2d Cir. 2019) (establishing that the non-public information in question originated from within the Centers for Medicare and Medicaid Services).

<sup>170</sup> Jonathan N. Halpern, *Second Circuit Paves Easier Route to Prosecute Disclosure of Agency Information, Insider Trading*, HOLLAND & KNIGHT (Feb. 5, 2020), <https://www.hkllaw.com/en/insights/publications/2020/02/second-circuit-paves-easier-route-to-prosecute-disclosure-of-agency> [<https://perma.cc/JZG5-EW2Q>]; see also Cahn, Mitchell, Titolo & Atanasio, *supra* note 21.

<sup>171</sup> Halpern, *supra* note 170.

<sup>172</sup> *Id.*; see also Cahn, Mitchell, Titolo & Atanasio, *supra* note 21.

<sup>173</sup> Halpern, *supra* note 170.

unintended, absurd result of striking down the personal benefit test under *Blaszczak*?

Or perhaps the Second Circuit willfully disregards policy considerations altogether. The Second Circuit indicated as much in *Blaszczak* while stating that “it is not the place of courts to check that decision on policy grounds.”<sup>174</sup> The Second Circuit may also be trying to distance itself from policy-focused holdings to avoid encroaching on the legislative authority of Congress to consider policy issues when drafting and adopting legislation. However, given that current insider trading has evolved beyond its statutory origins into a mostly common law body of law, the Second Circuit should not ignore policy concerns, especially given that Congress has yet to enact a revised, exclusive statute codifying the elements of criminal insider trading liability.

### C. SUBSEQUENT DEVELOPMENTS

On September 4, 2020, defendants Olan and Huber petitioned the Supreme Court for certiorari regarding the Second Circuit’s decision in *Blaszczak*.<sup>175</sup> *Blaszczak* filed his own petition for certiorari containing similar arguments.<sup>176</sup> The Office of the Solicitor General then filed a memorandum with the Supreme Court stating that “[a] remand is appropriate under the circumstances, because it would allow the court of appeals to consider the issue in a different posture and to provide a written decision that addresses”<sup>177</sup> the Supreme Court’s recent decision in *Kelly v. United States*.<sup>178</sup> In December 2020, Olan and Huber filed a brief in response requesting that the Supreme Court either grant a summary reversal of the Second Circuit’s decision in *Blaszczak* or grant certiorari to allow the case to be heard before the Supreme Court.<sup>179</sup> Olan and Huber argued remanding *Blaszczak* based on *Kelly* was insufficient because regardless of whether the Second Circuit reached a different conclusion based on the property issues in *Kelly*, the “court’s radical

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<sup>174</sup> *Blaszczak*, 947 F.3d at 37.

<sup>175</sup> See Petition for a Writ of Certiorari, *United States v. Blaszczak*, 141 S. Ct. 1040 (2021) (No. 20-306).

<sup>176</sup> See Petition for a Writ of Certiorari, *United States v. Blaszczak*, 141 S. Ct. 1040 (2021) (No. 20-5649).

<sup>177</sup> Memorandum for the United States at 2, *United States v. Blaszczak*, 141 S. Ct. 1040 (2021) (No. 20-5649).

<sup>178</sup> *Kelly v. United States*, 140 S. Ct. 1565, 1571–73 (2020) (holding that in order to prove property fraud, “the Government had to show not only that . . . [defendants] engaged in deception, but that an ‘object of the[ir] fraud [was] property’” and “that run-of-the-mine exercise[s] of regulatory power cannot count as the taking of property.”).

<sup>179</sup> Reply Brief for Petitioners at 3–11, *Blaszczak v. United States*, 141 S. Ct. 1040 (2021) (No. 20-306).



change to insider-trading law would remain unaddressed.”<sup>180</sup> Olan and Huber argued further that the Second Circuit may merely choose “to discuss the personal-benefit [test] in a way that might be considered only dicta.”<sup>181</sup> On January 11, 2021, the Supreme Court, consistent with the Solicitor General’s prior recommendations, vacated the judgement in *Blaszczak* and remanded the case to the Second Circuit “for further consideration in light of *Kelly*.”<sup>182</sup>

#### V. RECOMMENDATIONS

On remand, the Second Circuit should deliver a new holding in *Blaszczak* that applies the *Dirks* personal benefit test to criminal insider trading charges brought under Section 1348. In keeping with four decades of insider trading law precedent, the Second Circuit’s original decision in *Blaszczak* acknowledges that the personal benefit test is appropriate when determining criminal and civil insider trading activity under Section 10(b) and SEC Rule 10b-5.<sup>183</sup> By failing to apply the personal benefit test to criminal insider trading activities under Section 1348, the Second Circuit incentivizes prosecutors to pursue criminal insider trading charges exclusively under Section 1348.<sup>184</sup> If prosecutors do not have to introduce evidence establishing that a tipper knew that sharing confidential information with a tippee would result in a personal benefit under Section 1348, why would prosecutors bother to do so under Section 10(b) and SEC Rule 10b-5?<sup>185</sup>

By requiring a higher hurdle for criminal charges under Section 10(b) and SEC Rule 10b-5 than under Section 1348, the Second Circuit’s original decision in *Blaszczak* essentially rendered Section 10(b) and SEC Rule 10b-5 ineffectual by “clear[ing] a path for the government to circumvent the *Dirks* personal benefit test by charging [insider trading] tipping schemes exclusively under Title 18’s securities fraud provision.”<sup>186</sup> However, similar arguments from the defendants were rejected in *Blaszczak* on the basis of the Second Circuit’s reasoning that the personal benefit test would undermine

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<sup>180</sup> *Id.* at 2.

<sup>181</sup> *Id.*

<sup>182</sup> *Blaszczak v. United States*, 141 S. Ct. 1040, 1040 (2021).

<sup>183</sup> Greg Andres, Angela Burgess & Neil MacBride, *Lower Bar for Criminal Insider Trading Charges*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Jan. 23, 2020), <https://corpgov.law.harvard.edu/2020/01/23/lower-bar-for-criminal-insider-trading-charges/> [<https://perma.cc/7GDT-987B>].

<sup>184</sup> Cahn, Mitchell, Titolo & Atanasio, *supra* note 21.

<sup>185</sup> *Id.*

<sup>186</sup> *Id.*

Congress's intention that Section 1348 provide a broader anti-fraud provision than Section 10(b) and SEC Rule 10b-5.<sup>187</sup> While Congress may have intended for Section 1348 to be a broader anti-fraud provision, it is unlikely that Congress intended to prevent the application of Section 10(b) and SEC Rule 10b-5 in criminal insider trading cases altogether. For example, Congress did not include language identifying Section 1348 as the exclusive statute governing insider trading activity. The Second Circuit also fails to elaborate on what broader types of activities Section 1348 intends to address.<sup>188</sup> *Blaszczak* appears to rely upon the notion that the personal benefit test should not apply to Section 1348 because Congress did not expressly indicate that the personal benefit test should apply.<sup>189</sup> The Second Circuit could use the same reasoning to conclude that the personal benefit test *should* apply to Section 1348 because Congress did not expressly indicate that the personal benefit test should *not* apply.

The Second Circuit also held that the personal benefit test as applied to Section 10(b) insider trading activity should not be extended to Section 1348 because Section 10(b) and Section 1348 have fundamentally different purposes.<sup>190</sup> The Second Circuit stated that the personal benefit test is a judge-made doctrine designed to serve the purpose of Section 10(b), which was to eliminate the use of inside information for personal benefit.<sup>191</sup> From this reasoning, it could also be inferred that the purpose of the personal benefit test itself is to eliminate the use of inside information for personal benefit by determining when knowledge of such personal benefit exists. Therefore, it is likely that the Second Circuit failed to recognize that applying the personal benefit test to Section 1348 insider trading activity would align with the general anti-fraud purpose.

The Supreme Court's decision to vacate *Blaszczak* and remand the case to the Second Circuit indicates that the Second Circuit's original reasoning was flawed. Further, the decision in *Blaszczak* was the result of a 2-1 ruling,

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<sup>187</sup> United States v. *Blaszczak*, 947 F.3d 19, 36–37 (2d Cir. 2019).

<sup>188</sup> *See id.* (the Second Circuit states “that Section 1348 was intended to provide prosecutors with a different—and broader—enforcement mechanism to address securities fraud than what had been . . . provided in the Title 15 fraud provisions” but provides no explicit guidance regarding the scope or limitations of Section 1348).

<sup>189</sup> *Id.* at 35 (“We begin by noting what the Title 18 fraud statutes and Title 15 fraud provisions have in common: their text does not mention a ‘personal benefit’ test. Rather, these provisions prohibit . . . schemes to defraud” and “[w]hile the Title 18 fraud statutes and Title 15 fraud provisions . . . share similar text and proscribe similar theories of fraud, these common features have little to do with the personal-benefit test.”).

<sup>190</sup> *Id.* at 36.

<sup>191</sup> *Id.* at 35.

and one of those judges—Judge Christopher Droney—who joined in the majority opinion has since retired.<sup>192</sup> Perhaps “the [Second Circuit] judges should take the opportunity to restore insider trading law to the limits imposed by the Supreme Court, unless and until Congress changes those limits.”<sup>193</sup> Interestingly, the Supreme Court’s decision to vacate and remand the Second Circuit’s original decision in *Blaszczak* still provides an opportunity for the losing party to appeal the Second Circuit’s new decision to the Supreme Court.<sup>194</sup> Thus, the Second Circuit’s new decision upon remand may not immediately clarify the confusion caused by the original *Blaszczak* decision.<sup>195</sup>

If the Second Circuit fails to reach a different decision regarding the personal benefit test, then the most viable solution would be for Congress to enact additional insider trading legislation. This legislation must either explicitly define the elements of criminal insider trading liability or identify an exclusive governing statute to eliminate the confusion surrounding which statute applies. Additional legislation could also shift the prohibition of insider trading away from its administrative origins to law “written by actual lawmakers.”<sup>196</sup> Fortunately, the U.S. House of Representatives passed H.R. 2534, the Insider Trading Prohibition Act, on December 5, 2019 with “an overwhelming bipartisan majority of . . . 410 to 13.”<sup>197</sup> Legal practitioners criticize the language in H.R. 2534 as being too broad, granting prosecutors too much discretion, and expressly replacing the existing common law insider trading framework.<sup>198</sup> However, “any legislative definition of insider trading would beat the prevailing muddle.”<sup>199</sup> The Insider Trading Prohibition Act currently sits with the Senate Committee on Banking, Housing, and Urban Affairs.<sup>200</sup>

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<sup>192</sup> See Reed Brodsky, Barry R. Goldsmith & M. Jonathan Seibald, *Supreme Court Vacates Second Circuit Ruling Expanding Insider Trading Liability*, GIBSON DUNN (Jan. 13, 2021), <https://www.gibsondunn.com/supreme-court-vacates-second-circuit-ruling-expanding-insider-trading-liability/> [https://perma.cc/YS3Q-SJGV].

<sup>193</sup> Pritchard, *supra* note 14.

<sup>194</sup> Brodsky, Goldsmith & Seibald, *supra* note 192.

<sup>195</sup> *Id.*

<sup>196</sup> Ryan, *supra* note 1.

<sup>197</sup> *Id.*; H.R. 2534, 116th Cong. (2019).

<sup>198</sup> Ryan, *supra* note 1.

<sup>199</sup> *Id.*

<sup>200</sup> See H.R. 2534, 116th Cong. (2019).

## CONCLUSION

The Second Circuit's decision in *Blaszczak* to not extend the personal benefit test to Section 1348 insider trading actions remains controversial and in need of remedy. Further, the Second Circuit's original decision renders insider trading charges under Section 10(b) and SEC Rule 10b-5 obsolete. *Blaszczak* underscores that insider trading law within United States desperately needs clarification by Congress. The Supreme Court's decision to vacate the *Blaszczak* decision and remand the case to the Second Circuit does not immediately solve the problems created by the original decision in *Blaszczak*. However, the decision to remand provides a new opportunity for the Second Circuit to reach a different decision.

While the Second Circuit's pending new decision in *Blaszczak* may result in a more consistent application of the *Dirks* personal benefit test, such a result is far from certain. Fortunately, a piece of new insider trading legislation has cleared the U.S House of Representatives and currently sits with the U.S. Senate awaiting further discussion in committee. Given ongoing Senate negotiations regarding COVID-19 financial relief packages and continued confirmation hearings for officials appointed by the Biden Administration, it is unclear when new insider trading legislation will arrive. However, it is possible that calls for insider trading legislation and enforcement may increase as the transition from the Trump Administration to the Biden Administration continues.<sup>201</sup> For example, “[t]he number of white-collar defendants charged per year declined an estimated 26% to 30% from the Obama to the Trump era.”<sup>202</sup> While this trend alone is not indicative of how the Biden Administration will proceed, “[t]he new administration is unlikely to share the same enforcement priorities and relatively business-friendly orientation of Trump’s.”<sup>203</sup> Therefore, white-collar enforcement activity—including insider trading enforcement—and the prosecution of corporate executives is likely to increase under the Biden Administration.<sup>204</sup> However, given the unknown, precise legislative priorities of the Biden Administration, the most expedient course of action would be for the Second

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<sup>201</sup> Zach Terwilliger, Branden Stein & John Greil, *White-Collar Enforcement in the Biden Area: Where We Were, Where We're Going*, VINSON & ELKINS (Mar. 12, 2021), <https://www.velaw.com/insights/white-collar-enforcement-in-the-biden-era-where-we-were-where-were-going/> [<https://perma.cc/BM2E-7LQC>]; see also Patricia Hurtado & Christopher Yasejko, *White-Collar Crime Probes Likely to Intensify Under Biden's DOJ*, BLOOMBERG (Nov. 11, 2020, 1:00 AM), <https://www.bloomberg.com/news/articles/2020-11-11/white-collar-crime-probes-likely-to-intensify-under-biden-s-doj> [<https://perma.cc/P5T9-TMYP>].

<sup>202</sup> Terwilliger, Stein & Greil, *supra* note 201.

<sup>203</sup> *Id.*

<sup>204</sup> *Id.*

Circuit to deliver a new decision in *Blaszczak* that applies the *Dirks* personal benefit test to criminal insider trading proceedings under the anti-fraud provisions of Section 1348.