# 2. FRAUD

To one who marveled what should be the reason that acts and statutes are continually made at every Parliament without intermission, and without end, a wise man made a good and short answer, both which are well composed in verse. 'If you ask why there are so many laws, the answer is that fraud ever increases on this earth.' – Lord Coke, *Twyne's Case*, 76 Eng. Rep. 809 (K.B.) (1601)

Crimes of deception give rise to a majority of the investigations pursued, and offenses charged, in the field of corporate crime. Fraud is thus the most important legal concept to understand in order to develop a firm grasp of the "substantive criminal law" that applies in corporate crime practice. Fraud's conceptual structure, and often its doctrinal particulars, lie at the core of business crimes in sectors ranging from securities dealing to health care services to consumer product manufacturing.

Fraud is both intuitive—rooted in the simple concept of deception—and endlessly complex—turning heavily on contextual particulars. The truth in the modern world is that deceptive statements and conduct are sometimes expected and permissible—think about used car sales, many kinds of negotiations, poker, or campaign promises—and sometimes forbidden—consider doctors and lawyers talking to patients and clients, securities brokers dealing with customers, and corporate executives speaking to shareholders.

Conceptually, fraud is a general problem with common features. Doctrinally, it varies somewhat with statutory particulars. This chapter will move from the concept to the doctrine, introducing fraud primarily through the broad, flexible, and frequently deployed federal mail and wire fraud statutes. The objective of this chapter is that students leave it with the ability to read the facts of the next scandal about deception in a setting and form a solid opinion about whether the conduct amounted to criminal fraud.

The chapter is organized as follows: Part A introduces the concept of fraud through three examples. Part B deals briefly with (1) the jurisdictional component of the federal mail and wire fraud statutes and (2) the essential element of "materiality" in the crime of fraud. Part C introduces some potential limiting principles on the reach of the mail and wire fraud statutes. Part D explores the question of what kinds of interests might count as "property" in a mail or wire fraud prosecution. Part E covers the law of "honest services" mail and wire fraud—a concept that had broadened the potential reach of these statutes, but that the Supreme Court then curtailed.

## A. The Concept of Fraud

Before taking up the particulars of statutes and doctrine, it will help to develop an idea of the basic concept of fraud. What is fraud, and what isn't? Consider the three examples that follow. What do these examples tell us about what is involved in the social concept of fraud, both generally and particularly in financial markets? To work towards answering this question, pay at least as much attention to the facts in these examples as what is said about the law.

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Note that the first case is a *civil lawsuit*, not a criminal prosecution. The court's discussion of fraud is nonetheless useful. To generalize, civil fraud claims differ from the crime of fraud mostly on two dimensions: (1) mens rea (more is required for criminal liability, of course), and (2) burden of proof (a preponderance of the evidence versus beyond a reasonable doubt). Additionally, civil fraud plaintiffs must prove damages because they seek to recover money. Prosecutors do not have to prove damages and, as elsewhere in criminal law, attempt and conspiracy are available theories even when a fraud does not come to fruition or succeed.

**GOMEZ-JIMENEZ v. NEW YORK LAW SCHOOL, 103 A.D.3d 13 (N.Y. Sup. Ct. App. Div. 2012)**

ACOSTA, J.

This appeal involves the propriety of the disclosures of postgraduate employment and salary data by defendant New York Law School to prospective students during the period August 11, 2005 to the present. Plaintiffs allege that the disclosures caused them to enroll in school to obtain, at a very high price, a law degree that proved less valuable in the marketplace than they were led to expect. We hold that defendant's disclosures, though unquestionably incomplete, were not false or misleading. We thus affirm the dismissal of the complaint.

Plaintiffs are graduates of the law school who attended the school between 2004 and 2011. They assert, individually and on behalf of all others similarly situated, a claim for deceptive acts and practices in violation of General Business Law § 349 and claims for common-law fraud and negligent misrepresentation. These claims are based on allegations that the employment and salary information published by defendant during the relevant time period concealed, or failed to disclose, that the employment data included temporary and part-time positions and that the reported mean salaries were calculated based on the salary information submitted by a deliberately small, specifically selected, subset of graduates. In addition, plaintiffs allege that defendant enhanced its numbers by, among other things, hiring unemployed graduates as short-term research assistants so that they could be classified as employed. Plaintiffs assert that defendant engaged in this fraud to increase its class size and use the high tuition demanded of its students to lavish perks and exorbitant salaries on its administration and large faculty. The complaint seeks damages and equitable relief, including the refund and reimbursement of plaintiffs' tuition.

Defendant moved to dismiss the complaint pursuant to CPLR 3211(a)(1) and (7), arguing, among other things, that its employment reports were not materially misleading because they (1) complied with the then applicable disclosure rules of the American Bar Association (ABA); (2) made no representation or implication that they included only full-time, permanent employment that required or preferred a law degree; and (3) explicitly revealed that the reported salary ranges were based on a small sample of graduates. . . .

To state a cause of action for fraudulent misrepresentation, "a plaintiff must allege a misrepresentation or a material omission of fact which was false and known to be false by defendant, made for the purpose of inducing the other party to rely upon it, justifiable reliance of the other party on the misrepresentation or material omission, and injury" (*Mandarin Trading Ltd. v Wildenstein*, 16 N.Y. 3d 173, 178 [2011] [internal quotation marks omitted]). "A cause of action for fraudulent concealment requires, in addition to the four foregoing elements, an allegation that the defendant had a duty to disclose material information and that it failed to do so" (*P.T. Bank Cent. Asia, N.Y. Branch v ABN AMRO Bank N.V.*, 301 A.D. 2d 373, 376 [1st Dept 2003]). "In addition, in any action based upon fraud, the circumstances constituting the wrong shall be stated in detail" (*id*. [internal quotation marks omitted], citing CPLR 3016 [b]). To state a cause of action for negligent misrepresentation, in turn, the plaintiff must allege "(1) the existence of a special or privity-like relationship imposing a duty on the defendant to impart correct information to the plaintiff; (2) that the information was incorrect; and (3) reasonable reliance on the information" (*Mandarin Trading*, 16 N.Y. 3d at 180 [internal quotation marks omitted]).

Plaintiffs argue that they stated causes of action for common law fraud and negligent misrepresentation based on their allegations that defendant knowingly published misrepresentations about its graduates' employment rates and salaries, and fraudulently concealed the fact that the employment rates included temporary, part-time, voluntary or non-JD-required/preferred employment. However, . . . the employment and salary data disclosed by defendant was not actually false (even if it was incomplete). Thus, the fraud claim fails insofar as it is based on fraudulent misrepresentations (*see Pappas v Harrow Stores*, 140 A.D. 2d 501, 504 [2d Dept. 1988]; *see also MacDonald v Thomas M. Cooley Law Sch.*, 880 F. Supp. 2d 785, 794 [W.D. Mich. 2012] [dismissing a lawsuit against a law school on the grounds that plaintiff's "subjective misunderstanding of information that is not objectively false or misleading cannot mean that (defendant) has committed the tort of (fraud)"]). Furthermore, because plaintiffs have not alleged any special relationship or fiduciary obligation requiring a duty of full and complete disclosure from defendant to its prospective students, we dismiss plaintiff's claim to the extent that it is based on fraudulent and negligent misrepresentation.

We are not unsympathetic to plaintiffs' concerns. We recognize that students may be susceptible to misrepresentations by law schools. As such, "[t]his Court does not necessarily agree [with Supreme Court] that [all] college graduates are particularly sophisticated in making career or business decisions" (*MacDonald*, 880 F. Supp. 2d at 797). As a result, prospective students can make decisions to yoke themselves and their spouses and/or their children to a crushing burden of student loan debt, sometimes because the schools have made less than complete representations giving the impression that a full-time job is easily obtainable, when, in fact, it is not.

Given this reality, it is important to remember that the practice of law is a noble profession that takes pride in its high ethical standards. Indeed, in order to join and continue to enjoy the privilege of being an active member of the legal profession, every prospective and active member of the profession is called upon to demonstrate candor and honesty in their practice. This requirement is not a trivial one. For the profession to continue to ensure that its members remain candid and honest public servants, all segments of the profession must work in concert to instill the importance of those values. "In the last analysis, the law is what the lawyers are. And the law and lawyers are what the law schools make them." Defendant and its peers owe prospective students more than just barebones compliance with their legal obligations. Defendant and its peers are educational not-for-profit institutions. They should be dedicated to advancing the public welfare. In that vein, defendant and its peers have at least an ethical obligation of absolute candor to their prospective students.

Accordingly, the order of the Supreme Court, New York County (Melvin L. Schweitzer, J.), entered March 21, 2012, which granted defendant New York Law School's motion to dismiss the complaint, should be affirmed, without costs.

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The next case further explores the question of what makes a particular business practice fraudulent or not. The case also includes a very useful explanation of futures trading which is, in its essence, similar to many of the securities derivative trading activities you will read about throughout these materials. The explanation here introduces the concepts involved in derivatives trading.

**UNITED STATES v. DIAL, 757 F.2d 163 (7th Cir. 1985)**

POSNER, Circuit Judge:

Donald Dial and Horace Salmon were found guilty by a jury of mail and wire fraud (18 U.S.C. §§ 1341 and 1343) in connection with the trading of silver futures on the Chicago Board of Trade. Dial was sentenced to 18 months in prison to be followed by 5 years on probation, and was fined $16,000. Salmon was sentenced to 5 years on probation with 30 days of this period to be spent in work release (meaning that he will work during the day but sleep in jail), and was fined $15,000 and ordered to do 500 hours of community service.

The main argument of the appeals is that the conduct in which the defendants engaged was not fraudulent. To understand this argument you must know something about commodity futures. . . . A futures contract is a contract for the sale of a commodity at a future date; but unlike a forward contract, which it otherwise resembles, a futures contract rarely results in actual delivery of the commodity. Suppose that today, a day in March, the price of silver for delivery in June is $4 an ounce, but you think the price will go up to $5 by the time June rolls around. You would then buy June silver at $4. The person on the other side of the contract, the seller, presumably thinks differently—that the price in June will be $4 or lower. You are "long" on the contract; you expect the price to rise. He is "short"; he expects it to fall. As the months go by, the price of June silver will change as more and more information becomes available on the likely demand and supply of silver in June. Suppose in May the price hits $5 and you want to take your profit. All you have to do is sell the contract for $5; you don't have to worry about ending up with a pile of silver to dispose of. Nor need the person who sold you the silver for $4, and who probably never had any silver, have to worry about getting some and delivering it in June to the person to whom you sold your contract. All he has to do in order to take his loss and get out of the market is buy (at $5) the same amount of June silver that he had agreed to sell; the two contracts cancel, and he is out of the market.

What we have described is speculation but not, as the defendants contend, gambling. Commodity futures trading serves a social function other than to gratify the taste for taking risks—two other social functions in fact. It increases the amount of information that the actual consumers of the commodity (mainly, in the case of silver, manufacturers of film, electronics, and jewelry) have about future price trends, by creating incentives for investors and their advisers to study and forecast demand and supply conditions in the commodity. And it enables the risk-averse to hedge against future uncertainties. Suppose a jewelry manufacturer knows that it will need a certain amount of silver in June and is worried that the price might be very high by then. By buying June silver futures at $4 it can place a ceiling on what the silver will cost it (sellers can hedge similarly, by selling futures). Suppose that by June the price has risen to $5. When the manufacturer buys silver then, it will have to pay $5; but by selling its futures contract (to someone who had gone short on June silver) just before delivery is due, for $5, which is to say at a profit of $1, the manufacturer ends up paying a net of only $4 for the silver. The manufacturer could have hedged by means of a forward instead of a futures contract, that is, by signing a contract with a silver company for delivery in June at $4. But then it would have to locate and negotiate with a particular seller in advance, rather than wait till June when it will actually want the silver and buy then at the current price ($5). Since futures contracts are standard contracts—for example, the Chicago Board of Trade's silver futures contract in the period relevant to this case was a contract for 5,000 troy ounces of silver of a specified grade and quality—there is no negotiation over terms; and since the transaction is guaranteed by the clearing members of the exchange, *see Bernstein v. Lind-Waldock & Co.*, 738 F.2d 179, 181 (7th Cir. 1984), the buyer does not have to worry about whom he is dealing with.

Traders on a commodity futures exchange will, however, want some assurance that there are no people in the market who have preferential access to information. If there are known to be such people, the other traders will tend to leave the exchange for other exchanges that do not have such people—and several commodity exchanges besides the Board of Trade offer trading in silver futures contracts. If trading is "rigged" on all commodity futures exchanges, there will be less commodity futures trading, period, and the social benefits of such trading, outlined above, will be reduced. The greatest danger of preferential access comes from the brokers, who often trade on their own account as well as for their customers. Brokers have more information than any of their customers because they know all their customers' orders. Suppose a customer directs his broker to buy a large number of silver futures contracts. The broker knows that when he puts this order in for execution the price will rise, and he can make it rise further if he waits to execute the order until he can combine it with other buy orders from his customers into a "block" order that will be perceived in the market as a big surge in silver demand. If, hoping to profit from this knowledge, the broker buys silver futures on his own account just before putting in the block order and then sells at the higher price that the block order generates, he will hurt his customers. His purchase (if substantial) will have caused the market price to rise just before the block order went in, and thus the price that his customers pay will be higher than otherwise; and his sale will cause the price to fall, and thus reduce the value of his customers' contracts. So if "trading ahead"—as the practice of a broker's putting in his own orders for execution ahead of his customers' orders is called—became widespread, customers would realize that the market was rigged against them. And trading ahead serves no social function at all. The broker obtains a profit from information that he has not invested in producing but that comes to him automatically in his capacity as a broker. It is like a lawyer's discovering that his client is about to make a takeover bid for another company and rushing out and buying some of that company's stock before the bid is made public.

Against this background we consider the facts as the jury could reasonably have found them in the government's favor. Dial, an experienced silver trader, was the manager of a branch office of the Clayton Brokerage Company. Salmon was the company's president. In 1978 Dial was looking for a very large investor to make a multi-million dollar purchase of silver futures through Clayton Brokerage. In preparation for the appearance of such an investor Salmon arranged for Dial to control a trading account at Clayton Brokerage in the name of Multi-Projects (Cayman), Ltd., a Cayman Islands corporation. An "equity raiser" named Kirst located on Dial's behalf the putative grand investor in the person of Nasrullah Khan, who said he represented a group of investors organized as the International Monetary Corporation (IMC). While negotiations between Khan and Dial's son were proceeding, Dial began buying silver futures for the Multi-Projects account. But he put up no cash or cash equivalent for these purchases. To understand the significance of this omission, recall that a futures contract commits each of the contracting parties to buy or sell the underlying commodity at a date in the future at whatever the market price then is. Since the brokerage house (here, Clayton Brokerage) is responsible for the undertakings in its customers' futures contracts, it wants to be sure that each customer has the financial wherewithal to make good on his obligation under his futures contract should the price move in the opposite direction from his expectations. To this end, the brokerage house requires each of its customers to put up "margin"—cash or a cash equivalent such as a Treasury bill—as a guarantee of solvency. The required margin is a (small) percentage of the contract price and fluctuates as the price fluctuates.

Brokerage houses naturally keep very close tabs on their margin accounts, insisting that as the price of the futures contracts bought on margin fluctuates the buyer increase his margin (if necessary—it will be necessary for the long if the market price of the futures contract falls, and for the short if the price rises) so that the brokerage house will always have a cushion under its guarantee of its customers' transactions. Therefore when Dial bought silver futures for the Multi-Projects account without putting up any cash or cash equivalent—bought a lot of silver futures, 200 in all, worth $5 million—Clayton Brokerage Company's computer department notified its margin department that margin calls amounting to $100,000 should be issued to Multi-Projects, and they were. But Salmon instructed the director of the computer department to delete the Multi-Projects account from its computer programs and as a result the margin calls (which were never met) stopped.

On the weekend of November 10, 1978, at a time when Dial's personal trading account was in a perilous position (he had put up $1 million in Treasury bills against margin calls and all but $6,000 had been debited to meet them), negotiations with Khan were successfully concluded and Kirst was dispatched to London to pick up IMC's check for $25 million. On the same weekend Dial engaged in intensive solicitation of his regular customers to create a block order for silver futures to put in for execution on Monday, November 13. Kirst as directed deposited IMC's check—drawn on the Oxford International Bank in the Turks and Caicos Islands, and not certified—on Monday morning in Clayton Brokerage Company's account in a Chicago bank. Between 8:43 a.m. and 12:15 p.m. Salmon transmitted to the floor of the Board of Trade an order to buy 12 February (1979) silver futures contracts, and Dial transmitted orders on behalf of Multi-Projects, himself, his son, and Kirst and other associates, including two secretaries, for a total of 262 February futures. During this period the price of February silver fluctuated between $5.83 and $5.86 an ounce. At 12:40 p.m. Dial put in the block order, which was to buy 583 February futures, at higher prices—between $5.88 and $5.90. At 12:59 (two minutes after having bought 2,000 December futures for IMC), Dial bought 1,192 February futures for IMC at $5.92. Later that afternoon Salmon sold 10 of his 12 February futures at $5.91, seven cents more than he had bought them for that morning. The price kept on rising as the afternoon wore on, until it reached its limit—a 20 cent rise from the opening price. (Exchanges impose daily limits on price fluctuations; no trading is allowed at prices outside of the limits.)

At some point during the day, Dial and Salmon learned that Khan's check had not been certified. Yet Dial, authorized by Salmon, continued in the following days to buy silver futures heavily for IMC's account, even as it became increasingly likely from communications with the Oxford Bank that the check would never clear. On November 28 Dial decided the price of silver was now too high. He placed an order to sell 200 February silver futures contracts for the Multi-Projects account at $6.13. He had again assembled a block order (also to sell) from his customers, which he placed ten minutes after the Multi-Projects order and which was executed at lower prices than all but eight of the Multi-Projects contracts. The IMC check never did clear, and eventually the account was liquidated—at a profit. However, we were told at argument that in subsequent silver trading Dial was wiped out.

The surge of buy orders on November 13 caught the attention of Board of Trade officials and the Commodity Futures Trading Commission. Only 1,587 February silver futures contracts had been traded on the most recent trading day, November 10; 4,756 were traded on November 13. The closing price for February silver futures on the Board of Trade on November 13 had been 13 cents higher than the closing price on the New York Commodity Exchange, where a similar futures contract is traded—an unusual discrepancy between such close substitutes. The Board and the Commission began an investigation of Clayton Brokerage Company's trading of the IMC account. Dial and Salmon lied (under oath) a number of times in the course of this investigation—Dial saying for example that he had not learned that IMC's check was not certified until the week of November 28 (and later admitting that he had known this on November 13), Salmon for example denying his interest in Multi-Projects.

The question for decision is whether the conduct we have described amounts to a fraud; if so, the defendants are guilty of federal wire and mail fraud, as there is no dispute that the telephone and the mails were used extensively. Although stiff federal criminal penalties for commodity dealers who defraud or attempt to defraud their customers were added to the Commodity Futures Trading Act on October 1, 1978, see 7 U.S.C. §§ 6b(A), 13(b), about six weeks before the defendants' scheme fructified in the trading on November 13, 1978, the defendants were not charged under these sections (they were, however, charged with and acquitted of filing a false report under another section), perhaps because the ambiguous wording of section 6b, on which *see* 1 Bromberg & Lowenfels, Securities Fraud & Commodities Fraud § 4.6(452) (1984), makes it an uncertain vehicle for a criminal prosecution.

The defendants do not argue that the Commodity Futures Trading Act supersedes the federal mail or wire fraud statutes, and are wise not to make the argument. *See e.g., United States v. Brien,* 617 F.2d 299, 309–11 (1st Cir. 1980). But they emphasize that none of the defendants' customers, or the defendants' employer, Clayton Brokerage Company, lost money as a result of their acts and that there is no statute, regulations, or Board of Trade rule that specifically forbids insider trading in commodity futures (as in securities), or block trading, or trading ahead (other than by floor brokers—the brokers who actually execute the trades on the floor of the exchange—which the defendants were not). Rule 150(b) of the Board of Trade, forbidding "trad[ing] systematically against the orders or position of his customers," may implicitly forbid trading ahead by any broker; but the only specific rule the defendants violated was the Board of Trade's Rule 210, which requires that accounts be margined. Neither the Multi-Projects account nor the IMC account was margined—the latter not only because IMC's check was no good but because margin must be in cash or a cash equivalent, such as a certified check.

But we think there was a scheme to defraud in a rather classic sense, which is obscured only because commodity futures trading is an arcane business—though not to these defendants. Fraud in the common law sense of deceit is committed by deliberately misleading another by words, by acts, or, in some instances—notably where there is a fiduciary relationship, which creates a duty to disclose all material facts—by silence.

*See* Prosser and Keeton on the Law of Torts §§ 105–06 (5th ed. 1984). Liability is narrower for nondisclosure than for active misrepresentation, since the former sometimes serves a social purpose; for example, someone who bought land from another thinking that it had oil under it would not be required to disclose the fact to the owner, because society wants to encourage people to find out the true value of things, and it does this by allowing them to profit from their knowledge. But if someone asks you to break a $10 bill, and you give him two $1 bills instead of two $5's because you know he cannot read and won't know the difference, that is fraud. Even more clearly is it fraud to fail to "level" with one to whom one owes fiduciary duties. The essence of a fiduciary relationship is that the fiduciary agrees to act as his principal's alter ego rather than to assume the standard arm's length stance of traders in a market. Hence the principal is not armed with the usual wariness that one has in dealing with strangers; he trusts the fiduciary to deal with him as frankly as he would deal with himself—he has bought candor.

As a broker, and therefore, the defendants concede (as they must, *see, e.g.*, *Marchese v. Shearson Hayden Stone, Inc.*, 734 F.2d 414, 418 (9th Cir. 1984)), a fiduciary of his customers, Dial, when he solicited his customers to participate in block orders, implicitly represented to them that he would try to get the best possible price. He could have gotten a better price by putting their orders in ahead of the orders he placed for his own accounts and those of his friends. In trading ahead of his customers without telling them what he was doing, he was misleading them for his own profit, and conduct of this type has long been considered fraudulent. *See SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 183, 194–95, 84 S. Ct. 275, 278, 284, 11 L. Ed. 2d 237 (1963).

Although the defendants' expert witness testified to the effect that trading ahead does not violate the ethical standards of commodity futures trading, the jury did not have to believe this improbable testimony—by a witness who was a personal friend of Dial. (And the government presented its own expert, who gave contrary testimony.) It is true that the Board of Trade has no express rule against trading ahead of a customer (other than by a floor broker) and that there is no other specific prohibition (relevant to this case) of insider trading on commodity futures exchanges. But it is apparent that such a practice, when done without disclosure to the customer, is both contrary to a broker's fiduciary obligations and harmful to commodity futures trading, because it means that a person wanting to engage in such trading can trade only through an agent who has a conflict of interest.

The federal mail and wire fraud statutes have often been used to plug loopholes in statutes prohibiting specific frauds, a pertinent example being the application of the mail fraud statute to insider trading in securities before the promulgation of the SEC's Rule 10b–5. Although some scholars question the appropriateness of prohibiting insider trading by corporate officers, pointing out for example that (at least if short selling by insiders is prohibited) it gives officers a greater incentive to take risks that may benefit the shareholders, we would be surprised to find anyone saying a good word for insider trading by a broker; the only information he exploits is his knowledge of his customers' intentions.

The fraud was not only Dial's, but Salmon's, who was Dial's boss, knew what was going on, furthered the scheme by arranging for Dial to use the Multi-Projects account, and profited personally from the fraud along with Dial (indeed, more directly than Dial, who did not sell silver on his own account, as Salmon did, on November 13). Dial and Salmon not only defrauded their own customers; they also defrauded the people from whom they bought silver futures contracts, and their employer, the Clayton Brokerage Company, by trading, without margin, the Multi-Projects and IMC accounts. Trading without margin gives a misleading signal, because a signal not backed by any cash. If you had no assets at all, and could buy futures contracts at will (say $25 million worth), you could have a powerful influence on futures prices. Yet you might be totally irresponsible and incompetent in forecasting such prices, and might therefore reduce the accuracy of the market as a device for forecasting price; for you would lack the stimulus to sober reflection that comes from having to put one's money where one's mouth is. Trading without margin also shifts risk from the trader to the broker, in this case from Dial and Salmon to their employer, the Clayton Brokerage Company, which would have had to make good any losses on the Multi-Projects and IMC accounts. This risk was not disclosed to Clayton Brokerage any more than trading ahead was disclosed to the defendants' customers or the lack of cash backing for the enormous buying by Multi-Projects and IMC was disclosed to those who sold futures contracts to the defendants and their associates. Far from disclosing what they were doing, Dial and Salmon actively concealed it by using an account with an uninformative name (Multi-Projects) and by Salmon's ordering the deletion of the Multi-Projects account from Clayton Brokerage Company's computer records. The defendants' failure to disclose to their employer what was going on was the breach of the defendants' fiduciary duty as employees. Although they owed no similar duty to people on the other side of their silver futures transactions, their trading an unmargined account was an active misrepresentation and hence actionable even without a breach of fiduciary duty.

It is true that no one "lost money," because silver prices were rising for reasons other than the defendants' unmargined trading. If that trading had been the only thing jacking up the price, the price would have collapsed when the IMC account was liquidated—and it did not; between November 1978 and February 1980, the average monthly price of silver rose to $38.27 per ounce. But the analysis is incomplete. The defendants' customers did lose money—the additional profit they would have made if the defendants had placed their customers' orders ahead of rather than behind their own orders. And Clayton was subjected to the risk of having to make good what might have been $25 million in trading losses in the IMC account. The risk did not materialize, but just as it is embezzlement if an employee takes money from his employer and replaces it before it is missed, so it is fraud to impose an enormous risk of loss on one's employer through deliberate misrepresentation even if the risk does not materialize. Finally, the defendants confused the market by signaling the presence of big buyers who had not in fact put up any money (IMC and Multi-Projects); and to undermine the confidence on which successful futures trading depends is to harm the exchanges, and the society at large.

The evidence that the defendants' misrepresentations were deliberate was overwhelming, beginning with the establishment of an offshore trading operation in an uninformative name; continuing with the timing of the defendants' purchases for their own and their friends' accounts ahead of the block order and the IMC orders, all carefully orchestrated over the preceding weekend; culminating in the defendants' repeated lies to the investigating authorities; and including the violation of the margin requirements (Rule 210 of the Board of Trade) and the concealment of the defendants' interests in the Multi-Projects account. It is inessential whether the defendants also violated Rule 150(b).

Concern has been expressed with the possible abuse of the mail and wire fraud statutes to punish criminally any departure from the highest ethical standards. When the broad language of the statutes ("Whoever, having devised or intending to devise any scheme or artifice to defraud ..."), which punishes the scheme to defraud rather than the completed fraud itself, is read by the light of the broad concept of fraud that has evolved in civil cases and the precept that the mail and wire fraud statutes are not confined to common law fraud, concern naturally arises that the criminal law will be used to hold businessmen to the maximum, rather than minimum, standards of ethical behavior. It is not allayed by such popular formulations of the test for mail or wire fraud as the Fifth Circuit's in *Gregory v. United States*, 253 F.2d 104, 109 (5th Cir. 1958), which continues to be repeated with approval, *see, e.g.*, *United States v. Bohonus*, 628 F.2d 1167, 1171 (9th Cir. 1980): fraud is whatever is not a "reflection of moral uprightness, of fundamental honesty, fair play and right dealing in the general and business life of members of society." Courts have been more concerned with making sure that no fraud escapes punishment than with drawing a bright line between fraudulent, and merely sharp, business practices, even though the universality of telephone service has brought virtually the whole commercial world within the reach of the wire-fraud statute. But we need not explore the outer bounds of mail and wire fraud in this case. The defendants' elaborate efforts at concealment provide powerful evidence of their own consciousness of wrongdoing, making it unnecessary for us to decide whether the same conduct, done without active efforts at concealment, would have been criminal.

**UNITED STATES v. FINNERTY, 533 F.3d 143 (2d Cir. 2008)**

DENNIS JACOBS, Chief Judge:

In this securities fraud case, the government appeals from a judgment of acquittal entered by the district judge following a jury's guilty verdict. Defendant–Appellee David Finnerty was a specialist at the New York Stock Exchange ("NYSE") who engaged in the practice of "interpositioning"—the arbitrage of the gap between customers' orders to buy and sell stock—to the benefit of his firm's account and (via compensation) himself. The sole issue on appeal is whether the government proved that Finnerty's conduct was deceptive.

This case is one of several arising from an investigation into the practices of specialists on the NYSE trading floor. The NYSE operates as an auction market with specialists fielding competing bids and offers for stock in the 2,800 listed companies. We recently described the role of the specialist firms as follows:

> Each security listed for trading on the NYSE is assigned to a particular [specialist] Firm. To execute purchases and sales of a particular security, buyers and sellers must present their bids to buy and offers to sell to the specific Specialist Firm assigned to that security. The primary method of trading on the Exchange occurs through the NYSE's Super Designated Order Turnaround System, which transmits orders to buy and sell to the Specialist Firm electronically. The orders appear on a special electronic workstation often referred to as the "display book." Each Specialist Firm has a computerized "display book" at its trading post that permits the Firm to execute orders for the market.

In addition to executing trades for NYSE customers, specialists trade for the "proprietary" or "principal" account of their own firm.

In 2002, the NYSE opened an investigation into improper trading by specialists. The investigation focused on two practices: "interpositioning" and "trading ahead." A specialist engages in interpositioning when he "prevent[s] the normal agency trade between matching public orders and instead interpose[s]" himself "between the matching orders in order to generate profits" for the principal account-in other words, when the specialist acts as an arbitrager by taking a profit on the spread between the bid price and the ask price of customers' orders. A specialist trades ahead when he trades for his own "account before undertaking trades for public investors." These practices implicate two NYSE rules.

NYSE Rule 104 allows for a proprietary trade when it is "reasonably necessary to permit [a] specialist to maintain a fair and orderly market," and otherwise prohibits "such dealings." NYSE Rule 92(a) prohibits a proprietary trade when the specialist "has knowledge of any particular unexecuted customer's order to buy (sell) such security which could be executed at the same price."

In 2006, Finnerty was charged with three counts of securities fraud. The superseding indictment alleged that while he was employed by Fleet Specialists, Inc. between 1999 and 2003, Finnerty "caused approximately 26,300 instances of interpositioning, resulting in illegal profits to his dealer account of approximately $4,500,000, and approximately 15,000 instances of trading ahead, resulting in approximately $5,000,000 in customer harm." The indictment charged that Finnerty thus engaged in a fraudulent and deceptive course of conduct, in violation of 15 U.S.C. §§ 78j(b) and 78ff and 17 C.F.R. § 240.10b–5. . . .

At trial, the government narrowed its case. It did not undertake to prove trading ahead; it focused exclusively on interpositioning. It did not try to prove that Finnerty owed a fiduciary duty to public customers. . . .

The government called three former NYSE clerks, who testified that Finnerty directed them to execute interpositioning trades for the principal account ahead of (and to the detriment of) existing public orders. One of the clerks, Philip Finale, testified that just before he was scheduled to testify before the NYSE investigation, Finnerty pulled him aside and whispered: "don't say anything to incriminate [me], because it's going to incriminate [you] also."

The government displayed graphics showing the sequence of keystrokes that compose an interpositioning trade. An NYSE managing director testified about the computer codes used to generate "exception reports," which identify instances of interpositioning and trading ahead. Several summary charts of that data showed 26,283 instances of interpositioning trades under Finnerty's watch. In 95% of those instances, Fleet's principal account profited—yielding a total of $4.5 million.

Joseph DiPrisco, who served as Fleet's CFO during the relevant period, testified that individual "profitability" was one factor that determined a specialist's bonus. Fleet generally paid a specialist 15 to 20% of his profits.

Finally, the government introduced into evidence Finnerty's testimony before the NYSE, in which Finnerty admitted that he and his clerks could trade for the principal account only when necessary to maintain a fair and orderly market, and only when the public customers subsequently received the same or a better price than the principal account received.

Finnerty called Dr. Patrick Conroy, who testified that Finnerty's 26,283 alleged acts of interpositioning represented only .94% of the total trades executed by Finnerty during the relevant time period. . . .

Section 10(b) of the 1934 Act prohibits the use of any "manipulative or deceptive device or contrivance" in connection with the purchase or sale of securities. "The language of § 10(b) gives no indication that Congress meant to prohibit any conduct not involving manipulation or deception." *Santa Fe Indus. Inc. v. Green,* 430 U.S. 462, 473, 97 S. Ct. 1292, 51 L. Ed. 2d 480 (1977). The government has abandoned on appeal any claim of market manipulation. So the question is, what did Finnerty say or do that was deceptive?

The government admits that Finnerty made no misstatement. The government told the jury that the "real issue" in the case was "whether David Finnerty directed" the interpositioning trades and whether he did it "intentionally and with the intent to defraud." This was, in essence, a theory of non-verbal deceptive conduct.

"Conduct itself can be deceptive," and so liability under § 10(b) or Rule 10b–5 does not require "a specific oral or written statement." *Stoneridge Inv. Partners, LLC v. Scientific–Atlanta,* ––– U.S. ––––, 128 S. Ct. 761, 769, 169 L. Ed. 2d 627 (2008). Broad as the concept of "deception" may be, it irreducibly entails some act that gives the victim a false impression. "Theft not accomplished by deception (*e.g.,* physically taking and carrying away another's property) is not fraud absent a fiduciary duty." *In re Refco*

*Capital Markets, Ltd. Brokerage Customer Sec. Litig.*, 2007 WL 2694469, at *8 (S.D.N.Y. Sept. 13, 2007) (Lynch, J.) (internal citation omitted).

The government has identified no way in which Finnerty communicated anything to his customers, let alone anything false. Rather, viewing the evidence in the light most favorable to the government, the government undertook to prove no more than garden variety conversion. As the government put it during summation, "David Finnerty stole from his public customers tens of times a day, sometimes over a hundred times in one day . . ." The government later analogized Finnerty's conduct to a bank teller who

> takes in hundreds of deposits a day and he gives out hundreds of withdrawals, and just once, once every day takes he takes one of those deposits, instead of putting it in the till, he puts it in his pocket. He committed a crime probably less than 1 percent of the time in that example, but does that make it right to steal? Of course it doesn't.

Like a thieving bank teller, the government argued, Finnerty had the motive and the means to profit from interpositioning. But there is no evidence that Finnerty conveyed an impression that was misleading, whether or not it could have a bearing on a victim's investment decision in connection with a security. We need not decide whether some form of communication by the defendant is always required to prove deception (although that is the template of virtually every case). To impose securities fraud liability here, absent proof that Finnerty conveyed a misleading impression to customers, would pose "a risk that the federal power would be used to invite litigation beyond the immediate sphere of securities litigation and in areas already governed by functioning and effective state-law guarantees." *Stoneridge*, 128 S. Ct. at 771. . . .

The evidence shows (in the words of the government's brief) that "Finnerty, while holding himself out as a specialist obligated to follow NYSE rules and refrain from interpositioning, interpositioned on a massive scale under the guise of maintaining a fair and orderly market." Accordingly, the government argues, a reasonable jury could find that at least some customers were aware of the NYSE rules, would have expected Finnerty to comply with the rules, and were therefore deceived when Finnerty violated them. The government relies on the following chain of premises and inferences: (1) brokerage houses are "members" of the NYSE; (2) as members, brokerage houses know about (and are subject to) the NYSE rules against interpositioning; (3) brokerage houses were customers of Finnerty; so (4) Finnerty's violation of the NYSE rules deceived the brokerage houses. In essence, the government seeks to impose criminal liability based on a background assumption of compliance with NYSE rules. . . .

Some customers may have understood that the NYSE rules prohibit specialists from interpositioning, and that the rules amount to an assurance (by somebody) that interpositioning will not occur. As a consequence, some customers may have expected that Finnerty would not engage in the practice. But unless their understanding was based on a statement or conduct by Finnerty, he did not commit a primary violation of § 10(b)—the only offense with which he was charged. . . .

Taking a slightly different tack, the government argues that Finnerty's scheme was "self-evidently deceptive" because he had "two critical advantages" over his customers: he could see all pending orders to buy and sell a particular stock, and he determined the price ultimately paid.

It may be that Finnerty unfairly profited from superior information. But "not every instance of financial unfairness constitutes fraudulent activity under § 10(b)." *Chiarella v. United States*, 445 U.S. 222, 232, 100 S. Ct. 1108, 63 L. Ed. 2d 348 (1980). And characterizing Finnerty's conduct as "self-evidently deceptive" is conclusory; there must be some proof of manipulation or a false statement, breach of a duty to disclose, or deceptive communicative conduct. "Section 10(b) is aptly described as a catchall provision, but what it catches must be fraud." *Id.* at 234–35, 100 S. Ct. 1108.

The government points to evidence showing Finnerty's consciousness of guilt: (1) Finnerty testified before the NYSE that he traded ahead of customers only when the public received the same or a better price than his principal account did (testimony that was countered by the government's demonstrative chart, which showed that the customer was disadvantaged 95% of the time); (2) clerk Philip Finale testified that Finnerty pressured him to lie about being instructed to execute interpositioning trades; and (3) shortly after Finnerty learned about the NYSE investigation, his rate of interpositioning declined almost to zero.

Viewed in the light most favorable to the government, this evidence shows that Finnerty knew he had violated an NYSE rule, and tried to cover it up. But violation of an NYSE rule does not establish securities fraud in the civil context, let alone in a criminal prosecution. Finnerty may have known that interpositioning was wrong within the context of his employment, and that it put him at risk professionally; but an awareness of peril, a guilty conscience or an impulse to cover one's tracks does not bespeak criminally fraudulent conduct within the context of the securities laws. . . .

**Problem 2-1**

(a) What is Judge Posner's point in the final sentence of his opinion in *Dial*? How does the point relate to his theory of when nondisclosure of facts may constitute fraud?

(b) Was *Dial* correctly decided? *Finnerty*? Can the two opinions be reconciled or is this a sort of circuit split (though, technically, one case involved the wire fraud statute and the other the securities fraud statutes)?

| Problem 2-2 |
|---|
| Should the following be called fraud? Explain.<br><br>(a) An antique dealer is invited to tea at the house of an elderly woman who attends his church. In the living room, he spots a desk he knows is worth a great deal of money. He says, "I just adore that cute little desk." She says, "I wish I could get it out of here. I keep banging into it." He offers her $100 for the desk, which she accepts. He sells the desk later that day to a professional auctioneer for $10,000.<br><br>(b) A parent with young children tells a spouse that she needs to go back to the office for a few hours and cannot help with the kids that evening. On the way, she stops at a bar and stays for a couple of hours, enjoying beers and a basketball game.<br><br>(c) Accounting rules say that companies should maintain "reserve" accounts for large expected liabilities, such as litigation costs. As reported in its disclosures to its shareholders, PharmCo establishes a $500 million reserve account, representing its "best estimate" of how much it will cost to litigate a wave of products liability lawsuits relating to a drug that caused unanticipated side effects. Six months later, PharmCo reduces the reserve account to $200 million because it needs an additional $300 million in earnings in order to reach its earnings-per-share goal for the quarter. The week before, outside counsel had told the PharmCo General Counsel that "the litigation is going somewhat better than we expected." |

As a final entrée into the concepts underlying criminal fraud, the following case is about the meaning of cheating and dishonesty in English law, not the law of fraud itself. But this English court's discussion of cheating in gambling provides much insight into the problem of how to determine whether deception in a particular context is wrongful. The case involved a contract dispute turning on a criminal law definition. The unusual factual setting is both vivid and illustrative. (The opinion, while heavily edited here, is still long—British judges sometimes appear to believe they are paid by the page.)

**IVEY v. GENTING CASINOS (UK) LTD, [2017] UKSC 67 (UK Supreme Court 2017)**

LORD HUGHES:

This case, in which a professional gambler sues a casino for winnings at Punto Banco Baccarat, raises questions about (1) the meaning of the concept of cheating at gambling, (2) the relevance to it of dishonesty, and (3) the proper test for dishonesty if such is an essential element of cheating.

Over two days in August 2012 Mr. Ivey, the claimant in this case, deployed a highly specialist technique called edge-sorting which had the effect of greatly improving his chances of winning. He had the help of another professional gambler, Cheung Yin Sun ("Ms. Sun"). First they set up the conditions which enabled him to win. Then, later that evening and the following day, over the course of some hours, he won approximately £7.7m. The casino declined to pay, taking the view that what he had done amounted to cheating. His case is that it was not cheating, but deployment of a perfectly legitimate advantage. . . .

Punto Banco is a variant of Baccarat. It is not normally, to any extent, a game of skill. Six or eight decks or, in English nomenclature, packs of 52 cards are dealt from a shoe, face down by a croupier. Because the cards are delivered one by one from the shoe, she has only to extract them; no deviation is permitted in their sequence. She places them face down in two positions on the table in front of her, marked "player", the "Punto" in the name, and "Banker", "Banco". Those descriptions label the positions marked on the table; there need be no person as "player" and ordinarily there is not. She slides the cards from the shoe, face down, one card to player, one to banker; a second to player and a second to banker. . . .

The basic object of the game is to achieve, on one of the two positions, a combination of two or three cards which, when added together, is nearer to 9 in total than the combination on the other position. Aces to 9 count at face value, 10 to King inclusive count as nothing. Any pair or trio of cards adding up to more than 10 requires 10 to be deducted before arriving at the counting total. Thus 4 plus 5 equals 9, but 6 plus 5 (which equals 11) counts as only 1.

Punters (of whom there need only be one) play the house. They bet before any card is dealt and can bet on either the player or banker position. The cards are revealed by the croupier after a full hand (or "coup"), usually of four cards, two to each position, has been dealt. Winning bets are paid at evens on player, and at 19 to 20 on banker. It is possible to bet on a tie. In the event of a tie, all bets on player or banker are annulled; in other words, the punter keeps his stake and the only bet paid out on is the tie at odds set by the casino of either eight to one or, at Crockfords, nine to one. It is possible to place other types of bet, but this case does not concern them and they need not be described. The different odds mean that the casino, or house, enjoys a small advantage, taken over all the play. That is standard and well known to all; casinos publish the percentage "house edge" which they operate. In Punto Banco at Crockfords it was 1.24% if player wins and 1.06% if banker wins.

A pack of 52 playing cards is manufactured so as to present a uniform appearance on the back and a unique appearance on the face. . . . In casino games in which the orientation of the back of the card may matter, cards are used which are in principle indistinguishable whichever way round they are when presented in a shoe. . . .

"Edge-sorting" becomes possible when the manufacturing process causes tiny differences to appear on the edges of the cards so that, for example, the edge of one long side is marginally different from the edge of the other. Some cards printed by Angel Co Ltd for the Genting Group (which owns Crockfords) have this characteristic, apparently within the narrow tolerances specified for manufacture. The pattern is not precisely symmetrical on the back of the cards. The machine which cuts the card leaves very slightly more of the pattern, a white circle broken by two curved lines, visible on one long edge than on the other. The difference is sub-millimetric, but the pattern is, to that very limited extent, closer to one long edge of the card than it is to the other. Before a card is dealt from a shoe, it sits face down at the bottom of the shoe, displaying one of its two long edges. It is possible for a sharp-eyed person sitting close to the shoe to see which long edge it is.

Being able thus to see which long edge is displayed is by itself of no help to the gambler. All the cards have the same tiny difference between their right and left long edges, so knowing which edge is displayed tells the gambler nothing about the value of the next card in the shoe. The information becomes significant only if things can be so arranged that the cards which the gambler is most interested in are all presented with long edge type A facing the table, whilst all the less interesting cards present long edge type B. Then the gambler knows which kind of card is next out of the shoe.

In Punto Banco cards with a face value of 7, 8 and 9 are high value cards. If one such card is dealt to player or to banker, it will give that position a better chance of winning than the other. Thus a punter who knows that when the first card dealt (always to the "player" position) is a 7, 8 or 9, he will know that it is more likely than not that player will win. If he knows that the card is not a 7, 8 or 9, he will know that it is more likely than not that banker will win. Such knowledge, it is agreed, will give the punter a long-term edge of about 6.5% over the house if played perfectly accurately.

What is therefore necessary for edge-sorting to work is for the cards in the shoe to be sorted so that all the 7s, 8s and 9s display edge type A, whilst the rest display edge type B. That means rotating the high value cards so that they display edge type A. If the punter were to touch the cards, the invariable practice at most casinos, including at Crockfords, would be that those cards would not be used again. The only person who touches the cards is the croupier. So what had to happen was to get the cards sorted (i.e. differentially rotated) by type A and type B by the croupier and then to get them re-used in the next shoe, now distinctively sorted.

For edge-sorting to work at Crockfords it is therefore essential that the croupier is persuaded to rotate the relevant cards without her realising why she is being asked to do so. Casinos routinely play on quirky and superstitious behaviour by punters. It is in the casino's interests that punters should believe, erroneously, that a lucky charm or practice will improve their chance of winning and so modify or defeat the house edge. Consequently a wide variety of requests by punters, particularly those willing to wager large sums on games which they must, if they play long enough, lose in the long run, are accommodated by casinos without demur or surprise.

All of the games of Punto Banco played by the claimant and Ms. Sun on 20 and 21 August 2012 were captured on CCTV, mostly with contemporaneous audio recording as well. The moment at which they persuaded the croupier, Kathy Yau, to rotate the cards was at 9 pm on 20 August. The video shows it and the words spoken have been transcribed. Before then, the claimant and Ms. Sun had played part of four shoes, the first two plain backed, and the second two Angel cards but with no asymmetry on the back.

The claimant is a high stakes gambler. He began, by his standards, modestly: bets placed on those four shoes ranged from £4,000 to £75,000 per coup. He was losing. At 8.56 pm he requested a new shoe of cards. A new shoe was produced. The cards were blue Angel cards with the rounded pattern described on the back. At 8.57 the claimant asked Jeremy Hillier, the senior croupier overseeing the game: "If I win, can I say I want the same cards again?" to which Mr. Hillier replied he could, "because [he was] not bending them". The claimant had in fact avoided touching the cards from either the first or second shoe onwards.

The croupier, Kathy Yau, then put the cards face down in blocks on the table to make the cut, as is conventional. She cut the cards so as to exclude about one deck from play. The claimant asked about the cut: "Why so big?" Ms. Sun said: "They don't cut the seven cards", a reference to the traditional cut of 7 cards from the end. Ms. Yau asked if he wanted her to cut 7 cards, to which he replied "yes", he wanted to play 90 hands, slightly more than the maximum likely to be possible with an eight-deck shoe with a seven-card cut. She complied, after checking with the supervisor on duty in the room. That had the effect of maximising the number of coups which would be possible with those packs, and of exposing the maximum number of cards to the sorting (rotation) process.

Ms. Yau then dealt the first coup. After the bet was made, and all the cards then dealt, the next stage was for the croupier to turn the cards face up to reveal whether Player or Banker had won. Ms. Sun then asked Ms. Yau in Cantonese to do it, in other words to turn the cards over so that the face showed, slowly. Ms. Yau said "yes." Ms. Sun then asked her again in Cantonese to turn the cards in a particular and differential way as they were being exposed and before they were put on the pile of used cards. "If I say it is good, you turn it this way, good, yes? Um, no good." (A slightly different sounding um). Ms. Yau did not immediately understand what was required. She asked, "so you want me to leave it?" To which Ms. Sun replied, "change, yeah, yeah, change luck." Ms. Yau: "what do you mean?" Ms. Sun gestured how to turn it. "Turn it this way." Ms. Yau: "what, just open it? Yeah." Ms. Sun: "um," signifying good in Cantonese.

The claimant then chipped in, "yeah, change the luck, that's good. Anything to change the luck, it is okay with me." Ms. Sun reiterated her request in Cantonese, "If I say it is not good, you turn it this way. If it is good, turn it this way, okay?" To which Ms. Yau said "okay." When she turned over the cards of the second coup, Ms. Sun said of four of them, "good," and of one, "not good," in Cantonese. Ms. Yau did as requested. What she was being asked to do, and did, was to turn the cards which Ms. Sun called as "good" end to end, and the "not good" cards side to side. In consequence, the long edge of the "not good" card was oriented in a different way from the long edge of the "good" cards.

The judge found that she had been "wholly ignorant" of the significance of what she was doing, card by card, at the call of Ms. Sun.

This procedure was followed for each of the next 79 coups dealt from this shoe. The maximum amount staked by the claimant on the coups towards the end of the shoe reached £100,000. Self-evidently, at no time during the play of this shoe did he derive any advantage from the rotation of the cards requested by Ms. Sun because that rotation occurred at the end, not at the beginning, of each coup. This was all preparation.

At 10.03 pm, when the shoe was exhausted, the claimant said that he had won with that deck (i.e. shoe), and that he would keep it. The senior croupier, who had brought in a new collection of cards, was told by the claimant he did not want them, as he "had won £40,000 with that deck"; that was agreed to. The original cards were reused. The defendant has not been able to calculate retrospectively whether that assertion of winnings to that point was true.

Before the shoe was reused it had to be reshuffled. The claimant had earlier asked Ms. Yau's predecessor as croupier for a shuffling machine to shuffle the cards. The cards were reshuffled by a machine. For a punter using the edge-sorting technique this ensured that the shuffle would be effected without rotating any of the cards unless the croupier did so before they were put into the machine. Ms. Yau did not do so. Manual shuffling would have carried a much higher risk of re-rotation as it was done.

Play with the reshuffled shoe recommenced at 10.12 pm and continued until Ms. Yau went for a half hour break at 10.31 pm. The claimant did not play during her break but resumed when she returned until 3.57 am on 21 August. Ms. Yau was the croupier throughout. The claimant's stake increased to £95,000 and then to £149,000 per coup. He won approximately £2m.

The accuracy of his bets on player increased sharply. In the first two shoes in which Angel cards were used, those without an asymmetric pattern on the back, he placed respectively 11 bets and then 1 bet on player and a 7, 8 or 9 only occurred once in that 12 times. On the shoe in which the edge-sorting was done in the manner described, he placed 23 bets on player of which eight were 7s, 8s or 9s. On the succeeding shoes, those at least that were completed on that night, shoes four to eight, the record was as follows. Shoe four, 23 accurate bets out of 27; shoe five, 22 accurate bets out of 25; shoe six, 20 accurate bets out of 26; shoe 7, 23 accurate bets out of 30; shoe 8, 17 accurate bets out of 19. A similar but slightly less pronounced pattern occurred on the following day.

At the end of play on the early morning of the 21st the claimant asked if he could keep the same shoe, which he referred to as a deck, if he returned on the following day. He was told he could. Ms. Yau returned to duty at 2 pm on 21 August. The claimant resumed play with the same cards at 3 pm and played until 6.41 pm. His average stake was never less than £149,000. For the last three shoes it was £150,000, the maximum that he was allowed to bet each time. In the middle of play of the last shoe, the senior croupier told the claimant that the shoe would be replaced when it was exhausted. When it was, the claimant and Ms Sun left. By then he had won just over £7.7m.

Crockfords' practice after a large win such as this is to conduct an ex post facto investigation to work out how it occurred. After quite lengthy review of the CCTV footage and examination of the cards, the investigators succeeded in spotting what had been done. Nobody at Crockfords had heard of edge-sorting before.

Nine days after the play, on 30 August, the claimant spoke to Mr. Pearce, Managing Director of the London casinos of Genting UK, who told him that Crockfords would not be paying his winnings because the game had been compromised. The claimant said he had not touched the cards, but did not state that which at the trial he freely admitted, that he had used edge-sorting. Arrangements were made to refund his deposited stake, £1m, on 31 August. . . .

Section 42 [of the Gambling Act 2005] is in the following terms: (1) A person commits an offence if he - (a) cheats at gambling, or (b) does anything for the purpose of enabling or assisting another person to cheat at gambling. (2) For the purposes of subsection (1) it is immaterial whether a person who cheats- (a) improves his chances of winning anything, or (b) wins anything. . . .

It has been common ground throughout this litigation that the (now in principle enforceable) contract for betting into which these parties entered is subject to an implied term that neither of them will cheat. . . .

The section leaves open what is and what is not cheating, as is inevitable given the extraordinary range of activities to which the concept may apply. Plainly, what is cheating in one form of game may be legitimate competition in another. . . .

To the extent that defrauding someone may take the form of depriving him of something which is his, or to which he might otherwise be entitled, it is plain, and wholly unsurprising, that a criminal offence of defrauding must contain in addition an element which demonstrates that the means adopted are illegitimate and wrong. Otherwise much perfectly proper business competition would be at risk of being labelled fraud, since such competition frequently involves strategies to divert business from A to B. Hence it is entirely unsurprising that conspiracy to defraud was held to require in addition the proof of dishonest means. Dishonesty, in this context, supplies the essential element of illegitimacy and wrongfulness. . . .

Although the great majority of cheating will involve something which the ordinary person (or juror) would describe as dishonest, this is not invariably so. When, as it often will, the cheating involves deception of the other party, it will usually be easy to describe what was done as dishonest. . . . The runner who trips up one of his opponents is unquestionably cheating, but it is doubtful that such misbehaviour would ordinarily attract the epithet "dishonest". The stable lad who starves the favourite of water for a day and then gives him two buckets of water to drink just before the race, so that he is much slower than normal, is also cheating, but there is no deception unless one manufactures an altogether artificial representation to the world at large that the horse has been prepared to run at his fastest, and by themselves it is by no means clear that these actions would be termed dishonesty. Similar questions could no doubt be asked about the taking of performance-enhancing drugs, about the overt application of a magnet to a fruit machine, deliberate time wasting in many forms of game, or about upsetting the card table to force a re-deal when loss seems unavoidable, never mind sneaking a look at one's opponent's cards.

Conversely, there may be situations in which there is deception of the other player but what is done does not amount to cheating. The so-called "three card trick," much practised upon travellers on Victorian and Edwardian trains especially to and from racecourses, commonly involved a deception of the target traveller by a group of associates pretending to be unconnected to one another. The idea was to lure the target into playing the game. But once he was ensnared, the game was often played genuinely; the target lost not because of any cheating but because the shuffler of the cards had sufficient speed of hand to deceive the eye. No doubt other exponents of the three card trick had less genuine methods, such as a fourth (concealed) card, which would indeed be cheating. Sometimes the game admits of a level of legitimate deception. The unorthodox lead or discard at bridge is designed to give the opponent a misleading impression of one's hand, but it is part of the game and not cheating. Pretending to be stupid at the poker table, so that one's opponent does not take one seriously, and takes risks which he otherwise might not, may or may not be another example.

These far from sophisticated examples demonstrate the inevitable truth that there will be room for debate at the fringes as to what does and does not constitute cheating. To label an activity "advantage play," as Mr. Ivey and others did, is of no help at all. It asks, rather than answers, the question whether it is legitimate or cheating. It would be very unwise to attempt a definition of cheating. No doubt its essentials normally involve a deliberate (and not an accidental) act designed to gain an advantage in the play which is objectively improper, given the nature, parameters and rules (formal or informal) of the game under examination. The question in the present case, however, does not depend on the near impossible task of formulating a definition of cheating, but on whether cheating necessarily requires dishonesty as one of its legal elements. . . .

There is no occasion to add to the value judgment whether conduct was cheating a similar, but perhaps not identical, value judgment whether it was dishonest. Some might say that all cheating is by definition dishonest. In that event, the addition of a legal element of dishonesty would add nothing. Others might say that some forms of cheating, such as deliberate interference with the game without deception, are wrong and cheating, but not dishonest. In that event, the addition of the legal element of dishonesty would subtract from the essentials of cheating, and legitimise the illegitimate. Either way, the addition would unnecessarily complicate the question whether what is proved amounts to cheating.

The judge's conclusion, that Mr. Ivey's actions amounted to cheating, is unassailable. It is an essential element of Punto Banco that the game is one of pure chance, with cards delivered entirely at random and unknowable by the punters or the house. What Mr. Ivey did was to stage a carefully planned and executed sting. The key factor was the arranging of the several packs of cards in the shoe, differentially sorted so that this particular punter did know whether the next card was a high value or low value one. If he had surreptitiously gained access to the shoe and re-arranged the cards physically himself, no one would begin to doubt that he was cheating. He accomplished exactly the same result through the unwitting but directed actions of the croupier, tricking her into thinking that what she did was irrelevant. As soon as the decision to change the cards was announced, thus restoring the game to the matter of chance which it is supposed to be, he first covered his tracks by asking for cards to be rotated at random, and then abandoned play.

It may be that it would not be cheating if a player spotted that some cards had a detectably different back from others, and took advantage of that observation, but Mr. Ivey did much more than observe; he took positive steps to fix the deck. That, in a game which depends on random delivery of unknown cards, is inevitably cheating. That it was clever and skilful, and must have involved remarkably sharp eyes, cannot alter that truth.

Although the judge did not think it necessary to make a finding on the topic, and it is unnecessary to the resolution of this appeal, it would also seem that the facts which he found amounted in any event to a deception of the croupier. Certainly, the judge found (para 40) that pretending to be superstitious did not *by itself* cross the line from legitimate play to cheating, comparing it to the skilled poker player who pretends to be a fool. He also found, contrary to one of Crockfords' submissions, that what occurred did not amount to such deception as altogether to negate the existence of any contract for the game. But that was not a finding that there was no deception at all, and on the facts found there clearly was deception of the croupier into doing something which appeared innocuous or irrelevant, but was in fact highly significant and enabled Mr. Ivey to win when he should not have done. . . .

A significant refinement to the test for dishonesty was introduced by *R v Ghosh* [1982] QB 1053. Since then, in criminal cases, the judge has been required to direct the jury, if the point arises, to apply a two-stage test. Firstly, it must ask whether in its judgment the conduct complained of was dishonest by the lay objective standards of ordinary reasonable and honest people. If the answer is no, that disposes of the case in favour of the defendant. But if the answer is yes, it must ask, secondly, whether the defendant must have realised that ordinary honest people would so regard his behaviour, and he is to be convicted only if the answer to that second question is yes. . . .

The principal objection to the second leg of the *Ghosh* test is that the less the defendant's standards conform to what society in general expects, the less likely he is to be held criminally responsible for his behaviour. It is true that *Ghosh* attempted to reconcile what it regarded as the dichotomy between a "subjective" and an "objective" approach by a mixed test. The court addressed the present objection in this way, at p 1064:

> "There remains the objection that to adopt a subjective test is to abandon all standards but that of the accused himself, and to bring about a state of affairs in which 'Robin Hood would be no robber': *R v Greenstein* [1975] 1 WLR 1353. This objection misunderstands the nature of the subjective test. It is no defence for a man to say 'I knew that what I was doing is generally regarded as dishonest; but I do not regard it as dishonest myself. Therefore I am not guilty'. What he is however entitled to say is 'I did not know that anybody would regard what I was doing as dishonest'. He may not be believed; just as he may not be believed if he sets up 'a claim of right' under section 2(1) of the Theft Act 1968, or asserts that he believed in the truth of a misrepresentation under section 15 of the Act of 1968. But if he is believed, or raises a real doubt about the matter, the jury cannot be sure that he was dishonest."

And a little later the court added that upon the test which it was setting:

> "In most cases, where the actions are obviously dishonest by ordinary standards, there will be no doubt about it. It will be obvious that the defendant himself knew that he was acting dishonestly. It is dishonest for a defendant to act in a way which he knows ordinary people consider to be dishonest, even if he asserts or genuinely believes that he is morally justified in acting as he did. For example, Robin Hood or those ardent anti-vivisectionists who remove animals from vivisection laboratories are acting dishonestly, even though they may consider themselves to be morally justified in doing what they do, because they know that ordinary people would consider these actions to be dishonest."

Even if this were correct, it would still mean that the defendant who thinks that stealing from a bookmaker is not dishonest is entitled to be acquitted. It is no answer to say that he will be convicted if he realised that ordinary honest people would think that stealing from a bookmaker is dishonest, for by definition he does not realise this. Moreover, the court's proposition was not correct, because it is not in the least unusual for the accused not to share the standards which ordinary honest people set for society as a whole. The acquisitive offender may, it is true, be the cheerful character who frankly acknowledges that he is a crook, but very often he is not, but, rather, justifies his behaviour to himself. Just as convincing himself is frequently the stock in trade of the confidence trickster, so the capacity of all of us to persuade ourselves that what we do is excusable knows few bounds. It cannot by any means be assumed that the appropriators of animals from laboratories, to whom the court referred in *Ghosh*, know that ordinary people would consider their actions to be dishonest; it is just as likely that they are so convinced, however perversely, of the justification for what they do that they persuade themselves that no one could call it dishonest. There is no reason why the law should excuse those who make a mistake about what contemporary standards of honesty are, whether in the context of insurance claims, high finance, market manipulation or tax evasion. The law does not, in principle, excuse those whose standards are criminal by the benchmarks set by society, nor ought it to do so. On the contrary, it is an important, even crucial, function of the criminal law to determine what is criminal and what is not; its purpose is to set the standards of behaviour which are acceptable. As it was put in *Smith's Law of Theft* 9th ed (2007), para 2.296: ". . . the second limb allows the accused to escape liability where he has made a mistake of fact as to the contemporary standards of honesty. But why should that be an excuse?"

It is plain that in *Ghosh* the court concluded that its compromise second leg test was necessary in order to preserve the principle that criminal responsibility for dishonesty must depend on the actual state of mind of the defendant. It asked the question whether "dishonestly", where that word appears in the Theft Act, was intended to characterise a course of conduct or to describe a state of mind. The court gave the following example, which was clearly central to its reasoning:

> "Take for example a man who comes from a country where public transport is free. On his first day here he travels on a bus. He gets off without paying. He never had any intention of paying. His mind is clearly honest; but his conduct, judged objectively by what he has done, is dishonest. It seems to us that in using the word 'dishonestly' in the Theft Act 1968, Parliament cannot have intended to catch dishonest conduct in that sense, that is to say conduct to which no moral obloquy could possibly attach."

But the man in this example would inevitably escape conviction by the application of the (objective) first leg of the *Ghosh* test. That is because, in order to determine the honesty or otherwise of a person's conduct, one must ask what he knew or believed about the facts affecting the area of activity in which he was engaging. In order to decide whether this visitor was dishonest by the standards of ordinary people, it would be necessary to establish his own actual state of knowledge of how public transport works. Because he genuinely believes that public transport is free, there is nothing objectively dishonest about his not paying on the bus. The same would be true of a child who did not know the rules, or of a person who had innocently misread the bus pass sent to him and did not realise that it did not operate until after 10.00 in the morning.

The answer to the court's question is that "dishonestly", where it appears, is indeed intended to characterise what the defendant did, but in characterising it one must first ascertain his actual state of mind as to the facts in which he did it. It was not correct to postulate that the conventional objective test of dishonesty involves judging only the actions and not the state of knowledge or belief as to the facts in which they were performed. What is objectively judged is the standard of behaviour, given any known actual state of mind of the actor as to the facts. . . .

These several considerations provide convincing grounds for holding that the second leg of the test propounded in *Ghosh* does not correctly represent the law and that directions based upon it ought no longer to be given. . . . When dishonesty is in question the fact-finding tribunal must first ascertain (subjectively) the actual state of the individual's knowledge or belief as to the facts. The reasonableness or otherwise of his belief is a matter of evidence (often in practice determinative) going to whether he held the belief, but it is not an additional requirement that his belief must be reasonable; the question is whether it is genuinely held. When once his actual state of mind as to knowledge or belief as to facts is established, the question whether his conduct was honest or dishonest is to be determined by the fact-finder by applying the (objective) standards of ordinary decent people. There is no requirement that the defendant must appreciate that what he has done is, by those standards, dishonest.

Therefore in the present case, if, contrary to the conclusions arrived at above, there were in cheating at gambling an additional legal element of dishonesty, it would be satisfied by the application of the test as set out above. The judge did not get to the question of dishonesty and did not need to do so. But it is a fallacy to suggest that his finding that Mr. Ivey was truthful when he said that *he* did not regard what he did as cheating amounted to a finding that his behaviour was honest. It was not. It was a finding that he was, in that respect, truthful. Truthfulness is indeed one characteristic of honesty, and untruthfulness is often a powerful indicator of dishonesty, but a dishonest person may sometimes be truthful about his dishonest opinions, as indeed was the defendant in *Gilks*. For the same reasons which show that Mr. Ivey's conduct was, contrary to his own opinion, cheating, the better view would be, if the question arose, that his conduct was, contrary to his own opinion, also dishonest.

| **Problem 2-3** |
|---|
| How does the problem of what constitutes "cheating" in *Ivey*, and especially the English law concept of "dishonesty," help our understanding of the law of fraud might work in the U.S.? How do these ideas in *Ivey* relate to Judge Posner's idea in the last sentence of his opinion in *Dial*? |

## B. Mail and Wire Fraud: Jurisdiction and Materiality

Most practitioners of federal criminal law will agree that the mail and wire fraud statutes are the broadest, most flexible, and most commonly employed tools in prosecuting white collar crime in federal court. First, consider the text of the statutes. Do the normal criminal law drill and figure out their elements. Where is the actus reus? Where is the mens rea? What attendant circumstances must be proved in addition? Is there more than one theory on which a prosecutor can proceed under these statutes? How do the jurisdictional provisions appear to work?

**18 U.S.C. § 1341. Frauds and swindles**

Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, . . . for the purpose of executing such scheme or artifice or attempting so to do, places in any post office or authorized depository for mail matter, any matter or thing whatever to be sent or delivered by the Postal Service, or deposits or causes to be deposited any matter or thing whatever to be sent or delivered by any private or commercial interstate carrier, or takes or receives therefrom, any such matter or thing, or knowingly causes to be delivered by mail or such carrier according to the direction thereon, or at the place at which it is directed to be delivered by the person to whom it is addressed, any such matter or thing, shall be fined under this title or imprisoned not more than 20 years, or both. . . .

**18 U.S.C. § 1343. Fraud by wire, radio, or television**

Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, transmits or causes to be transmitted by means of wire, radio, or television communication in interstate or foreign commerce, any writings, signs, signals, pictures, or sounds for the purpose of executing such scheme or artifice, shall be fined under this title or imprisoned not more than 20 years, or both. . . .

**1. Jurisdiction**

As you can see, the mail and wire fraud statutes are written with fairly broad jurisdictional elements. Just how far do these provisions reach? The following case provides the applicable framework for litigating questions of jurisdiction in mail and wire fraud.

**SCHMUCK v. UNITED STATES, 489 U.S. 705 (1989)**

Justice BLACKMUN delivered the opinion of the Court.

In August 1983, petitioner Wayne T. Schmuck, a used-car distributor . . . was indicted on 12 counts of mail fraud, in violation of 18 U.S.C. §§ 1341 and 1342.

The alleged fraud was a common and straightforward one. Schmuck purchased used cars, rolled back their odometers, and then sold the automobiles to Wisconsin retail dealers for prices artificially inflated because of the low-mileage readings. These unwitting car dealers, relying on the altered odometer figures, then resold the cars to customers, who in turn paid prices reflecting Schmuck's fraud. To complete the resale of each automobile, the dealer who purchased it from Schmuck would submit a title-application form to the Wisconsin Department of Transportation on behalf of his retail customer. The receipt of a Wisconsin title was a prerequisite for completing the resale; without it, the dealer could not transfer title to the customer and the customer could not obtain Wisconsin tags. The submission of the title-application form supplied the mailing element of each of the alleged mail frauds.

Before trial, Schmuck moved to dismiss the indictment on the ground that the mailings at issue-the submissions of the title-application forms by the automobile dealers-were not in furtherance of the fraudulent scheme and, thus, did not satisfy the mailing element of the crime of mail fraud. . . .

"The federal mail fraud statute does not purport to reach all frauds, but only those limited instances in which the use of the mails is a part of the execution of the fraud, leaving all other cases to be dealt with by appropriate state law." *Kann v. United States*, 323 U.S. 88 (1944). To be part of the execution of the fraud, however, the use of the mails need not be an essential element of the scheme. . . . It is sufficient for the mailing to be "incident to an essential part of the scheme," or "a step in [the] plot." . . .

Schmuck . . . argues that mail fraud can be predicated only on a mailing that affirmatively assists the perpetrator in carrying out his fraudulent scheme. The mailing element of the offense, he contends, cannot be satisfied by a mailing, such as those at issue here, that is routine and innocent in and of itself, and that, far from furthering the execution of the fraud, occurs after the fraud has come to fruition, is merely tangentially related to the fraud, and is counterproductive in that it creates a "paper trail" from which the fraud may be discovered. We disagree both with this characterization of the mailings in the present case and with this description of the applicable law. . . .

We begin by considering the scope of Schmuck's fraudulent scheme. Schmuck was charged with devising and executing a scheme to defraud Wisconsin retail automobile customers who based their decisions to purchase certain automobiles at least in part on the low-mileage readings provided by the tampered odometers. This was a fairly large-scale operation. Evidence at trial indicated that Schmuck had employed a man known only as "Fred" to turn back the odometers on about 150 different cars. Schmuck then marketed these cars to a number of dealers, several of whom he dealt with on a consistent basis over a period of about 15 years. . . . Thus, Schmuck's was not a "one-shot" operation in which he sold a single car to an isolated dealer. His was an ongoing fraudulent venture. A rational jury could have concluded that the success of Schmuck's venture depended upon his continued harmonious relations with, and good reputation among, retail dealers, which in turn required the smooth flow of cars from the dealers to their Wisconsin customers.

Under these circumstances, we believe that a rational jury could have found that the title-registration mailings were part of the execution of the fraudulent scheme, a scheme which did not reach fruition until the retail dealers resold the cars and effected transfers of title. Schmuck's scheme would have come to an abrupt halt if the dealers either had lost faith in Schmuck or had not been able to resell the cars obtained from him. These resales and Schmuck's relationships with the retail dealers naturally depended on the successful passage of title among the various parties. Thus, although the registration-form mailings may not have contributed directly to the duping of either the retail dealers or the customers, they were necessary to the passage of title, which in turn was essential to the perpetuation of Schmuck's scheme. As noted earlier, a mailing that is "incident to an essential part of the scheme," *Pereira*, 347 U.S., at 8, 74 S. Ct., at 363, satisfies the mailing element of the mail fraud offense. The mailings here fit this description. . . .

Once the full flavor of Schmuck's scheme is appreciated, the critical distinctions between this case and the three cases in which this Court has delimited the reach of the mail fraud statute-*Kann, Parr,* and *Maze*-are readily apparent. The defendants in *Kann* were corporate officers and directors accused of setting up a dummy corporation through which to divert profits into their own pockets. As part of this fraudulent scheme, the defendants caused the corporation to issue two checks payable to them. The defendants cashed these checks at local banks, which then mailed the checks to the drawee banks for collection. This Court held that the mailing of the cashed checks to the drawee banks could not supply the mailing element of the mail fraud charges. The defendants' fraudulent scheme had reached fruition. "It was immaterial to them, or to any consummation of the scheme, how the bank which paid or credited the check would collect from the drawee bank."

In *Parr,* several defendants were charged, *inter alia,* with having fraudulently obtained gasoline and a variety of other products and services through the unauthorized use of a credit card issued to the school district which employed them. The mailing element of the mail fraud charges in *Parr* was purportedly satisfied when the oil company which issued the credit card mailed invoices to the school district for payment, and when the district mailed payment in the form of a check. Relying on *Kann,* this Court held that these mailings were not in execution of the scheme as required by the statute because it was immaterial to the defendants how the oil company went about collecting its payment. 363 U.S., at 393.

Later, in *Maze,* the defendant allegedly stole his roommate's credit card, headed south on a winter jaunt, and obtained food and lodging at motels along the route by placing the charges on the stolen card. The mailing element of the mail fraud charge was supplied by the fact that the defendant knew that each motel proprietor would mail an invoice to the bank that had issued the credit card, which in turn would mail a bill to the card owner for payment. The Court found that these mailings could not support mail fraud charges because the defendant's scheme had reached fruition when he checked out of each motel. The success of his scheme in no way depended on the mailings; they merely determined which of his victims would ultimately bear the loss. . . .

The title-registration mailings at issue here served a function different from the mailings in *Kann, Parr,* and *Maze*. The intrabank mailings in *Kann* and the credit card invoice mailings in *Parr* and *Maze* involved little more than post-fraud accounting among the potential victims of the various schemes, and the long-term success of the fraud did not turn on which of the potential victims bore the ultimate loss. Here, in contrast, [t]he mailing of the title-registration forms was an essential step in the successful passage of title to the retail purchasers. Moreover, a failure of this passage of title would have jeopardized Schmuck's relationship of trust and goodwill with the retail dealers upon whose unwitting cooperation his scheme depended. Schmuck's reliance on our prior cases limiting the reach of the mail fraud statute is simply misplaced.

To the extent that Schmuck would draw from these previous cases a general rule that routine mailings that are innocent in themselves cannot supply the mailing element of the mail fraud offense, he misapprehends this Court's precedents. In *Parr* the Court specifically acknowledged that "innocent" mailings—ones that contain no false information—may supply the mailing element. In other cases, the Court has found the elements of mail fraud to be satisfied where the mailings have been routine.

We also reject Schmuck's contention that mailings that someday may contribute to the uncovering of a fraudulent scheme cannot supply the mailing element of the mail fraud offense. The relevant question at all times is whether the mailing is part of the execution of the scheme as conceived by the perpetrator at the time, regardless of whether the mailing later, through hindsight, may prove to have been counterproductive and return to haunt the perpetrator of the fraud. The mail fraud statute includes no guarantee that the use of the mails for the purpose of executing a fraudulent scheme will be risk free. Those who use the mails to defraud proceed at their peril.

Justice SCALIA, with whom Justice BRENNAN, Justice MARSHALL, and Justice O'CONNOR join, dissenting.

The purpose of the mail fraud statute is "to prevent the post office from being used to carry [fraudulent schemes] into effect." *Durland v. United States,* 161 U.S. 306 (1896). The law does not establish a general federal remedy against fraudulent conduct, with use of the mails as the jurisdictional hook, but reaches only "those limited instances in which the use of the mails is *a part of the execution of the fraud,* leaving all other cases to be dealt with by appropriate state law." *Kann v. United States*, 323 U.S. 88 (1944) (emphasis added). In other words, it is mail fraud, not mail and fraud, that incurs liability. This federal statute is not violated by a fraudulent scheme in which, at some point, a mailing happens to occur-nor even by one in which a mailing predictably and necessarily occurs. The mailing must be in furtherance of the fraud. . . .

For though the Government chose to charge a defrauding of retail customers (to whom the innocent dealers resold the cars), it is obvious that, regardless of who the ultimate victim of the fraud may have been, the fraud was complete with respect to each car when petitioner pocketed the dealer's money. As far as each particular transaction was concerned, it was as inconsequential to him whether the dealer resold the car as it was inconsequential to the defendant in *Maze* whether the defrauded merchant ever forwarded the charges to the credit card company. . . .

And I think it particularly significant that in *Kann* the Government proposed a theory *identical* to that which the Court today uses. Since the scheme was ongoing, the Government urged, the fact that the mailing of the two checks had occurred after the defendants had pocketed the fraudulently obtained cash made no difference. "[T]he defendants expected to receive further bonuses and profits," and therefore "the clearing of these checks in the ordinary course was essential to [the scheme's] further prosecution." The dissenters in *Kann* agreed. "[T]his," they said, "was not the last step in the fraudulent scheme. It was a continuing venture. Smooth clearances of the checks were essential lest these intermediate dividends be interrupted and the conspirators be called upon to disgorge." (Douglas, J., dissenting). The Court rejected this argument, concluding that "the subsequent banking transactions between the banks concerned were merely incidental and collateral to the scheme and not a part of it." I think the mailing of the title application forms equivalently incidental here. . . .

## 2. Materiality

Materiality is one of those multi-purpose legal concepts, like reasonableness or duty, that are very important to understand because they arise in so many areas of law. Materiality's application varies with legal context, of course, but the central concept is a universal one in law. After you read the cases in this section, see if you can articulate the concept of materiality as a general legal concept in the form of a single sentence or phrase.

**NEDER v. UNITED STATES, 527 U.S. 1 (1999)**

Chief Justice REHNQUIST delivered the opinion of the Court.

In the mid-1980's, petitioner Ellis E. Neder, Jr., an attorney and real estate developer in Jacksonville, Florida, engaged in a number of real estate transactions financed by fraudulently obtained bank loans. Between 1984 and 1986, Neder purchased 12 parcels of land using shell corporations set up by his attorneys and then immediately resold the land at much higher prices to limited partnerships that he controlled. Using inflated appraisals, Neder secured bank loans that typically amounted to 70% to 75% of the inflated resale price of the land. In so doing, he concealed from lenders that he controlled the shell corporations, that he had purchased the land at prices substantially lower than the inflated resale prices, and that the limited partnerships had not made substantial down payments as represented. In several cases, Neder agreed to sign affidavits falsely stating that he had no relationship to the shell corporations and that he was not sharing in the profits from the inflated land sales. By keeping for himself the amount by which the loan proceeds exceeded the original purchase price of the land, Neder was able to obtain more than $7 million. . . .

We . . . granted certiorari in this case to decide whether materiality is an element of a "scheme or artifice to defraud" under the federal mail fraud (18 U.S.C. § 1341), wire fraud (§ 1343), and bank fraud (§ 1344) statutes. The Court of Appeals concluded that the failure to submit materiality to the jury was not error because the fraud statutes do not require that a "scheme to defraud" employ *material* falsehoods. We disagree.

Under the framework set forth in *United States v. Wells*, 519 U.S. 482 (1997), we first look to the text of the statutes at issue to discern whether they require a showing of materiality. In this case, we need not dwell long on the text because, as the parties agree, none of the fraud statutes defines the phrase "scheme or artifice to defraud," or even mentions materiality. Although the mail fraud and wire fraud statutes contain different jurisdictional elements (§ 1341 requires use of the mails while § 1343 requires use of interstate wire facilities), they both prohibit, in pertinent part, "any scheme or artifice to defraud" or to obtain money or property "by means of false or fraudulent pretenses, representations, or promises." The bank fraud statute, which was modeled on the mail and wire fraud statutes, similarly prohibits any "scheme or artifice to defraud a financial institution" or to obtain any property of a financial institution "by false or fraudulent pretenses, representations, or promises." Thus, based solely on a "natural reading of the full text," materiality would not be an element of the fraud statutes.

That does not end our inquiry, however, because in interpreting statutory language there is a necessary second step. It is a well-established rule of construction that "'[w]here Congress uses terms that have accumulated settled meaning under . . . the common law, a court must infer, unless the statute otherwise dictates, that Congress means to incorporate the established meaning of these terms.'. . ." Neder contends that "defraud" is just such a term, and that Congress implicitly incorporated its common-law meaning, including its requirement of materiality, into the statutes at issue.

The Government does not dispute that both at the time of the mail fraud statute's original enactment in 1872, and later when Congress enacted the wire fraud and bank fraud statutes, actionable "fraud" had a well-settled meaning at common law. Nor does it dispute that the well-settled meaning of "fraud" required a misrepresentation or concealment of *material* fact. Indeed, as the sources we are aware of demonstrate, the common law could not have conceived of "fraud" without proof of materiality. *See BMW of North America, Inc. v. Gore,* 517 U.S. 559 (1996). Thus, under the rule that Congress intends to incorporate the well-settled meaning of the common-law terms it uses, we cannot infer from the absence of an express reference to materiality that Congress intended to drop that element from the fraud statutes. On the contrary, we must *presume* that Congress intended to incorporate materiality "'unless the statute otherwise dictates.'" *Nationwide Mut. Ins., supra,* at 322, 112 S. Ct. 1344. . . .

The Government relies heavily on *Durland v. United States,* 161 U.S. 306 (1896), our first decision construing the mail fraud statute, to support its argument that the fraud statutes sweep more broadly than common-law fraud. But *Durland* was different from this case. There, the defendant, who had used the mails to sell bonds he did not intend to honor, argued that he could not be held criminally liable because his conduct did not fall within the scope of the common-law crime of "false pretenses." We rejected the argument that "the statute reaches only such cases as, at common law, would come within the definition of 'false pretenses,' in order to make out which there must be a misrepresentation as to some existing fact and not a mere promise as to the future." Instead, we construed the statute to "includ[e] everything designed to defraud by representations as to the past or present, or suggestions and promises as to the future." Although *Durland* held that the mail fraud statute reaches conduct that would not have constituted "false pretenses" at common law, it did not hold, as the Government argues, that the statute encompasses more than common-law fraud.

In one sense, the Government is correct that the fraud statutes did not incorporate *all* the elements of common-law fraud. . . . By prohibiting the "scheme to defraud," rather than the completed fraud, the elements of reliance and damage would clearly be inconsistent with the statutes Congress enacted. But while the language of the fraud statutes is incompatible with these requirements, the Government has failed to show that this language is inconsistent with a materiality requirement. Accordingly, we hold that materiality of falsehood is an element of the federal mail fraud, wire fraud, and bank fraud statutes.

**UNITED STATES v. BOGUCKI, 2019 WL 1024959 (N.D. Cal. 2019)**

CHARLES R. BREYER, United States District Judge:

Defendant is charged with one count of conspiracy to commit wire fraud affecting a financial institution, in violation of 18 U.S.C. § 1349, and six counts of wire fraud affecting a financial institution, in violation of 18 U.S.C. §§ 1343 and 2, and associated forfeiture allegations. [The defendant Robert Bogucki was the head of Barclays' foreign currency exchange trading desk in New York. The government alleged that he committed fraud in connection with his negotiation of the unwinding of a deal in options for British currency (pounds) with the Hewlett Packard corporation (HP), which acquired a large position in pounds to complete its purchase of a British company. The core of the government's theory was that Bogucki caused Barclays to trade ahead of HP's planned unwind transaction in the market for pounds, in order to profit Barclays' own positions in that market.]

The parties agree that the charge[] of wire fraud affecting a financial institution requires the Government to prove five elements. First, the defendant must have knowingly participated in, devised, or intended to devise a scheme or plan to defraud, or a scheme or plan for obtaining money or property by means of false or fraudulent pretenses, representations, or promises or omitted facts; second, the statements made or facts omitted as part of the scheme were material; third, the defendant acted with the intent to defraud, that is, the intent to deceive or cheat; fourth, the defendant used, or caused to be used, an interstate or foreign wire communication to carry out or attempt to carry out an essential part of the scheme; fifth, the scheme affected a financial institution.

The parties stipulated prior to trial that the alleged scheme affected a financial institution. Nor is there any dispute that the alleged scheme involved the use of an interstate wire communication. The parties do dispute the other elements of Defendant's wire fraud and conspiracy to commit wire fraud charges. Specifically, Defendant has argued that there is insufficient evidence to permit a reasonable jury to find that the Government has met its burden on the first, second, or third elements. . . . The Court is primarily concerned with the Defendant's argument that the government has not satisfied the second element of wire fraud, which requires the Government to prove that the statements Defendant made [to HP] were "material.". . .

Here, there are two pieces of evidence that are crucial to understand the context in which the allegedly materially false statements that Defendant provided to HP occurred: an International Swaps Dealers Association agreement between HP and Barclays, also known as an "ISDA," and the generally-understood industry practice of "pre-positioning."

The ISDA between HP and Barclays expressly stated that both HP and Barclays entered into "each Transaction as principal (and not as agent or in another capacity, fiduciary or otherwise)." It further stated that:

> This agreement and each transaction have been entered into by each party in reliance only upon its judgment in order to accomplish legitimate business needs. Neither party holds itself out as advising, or any of its employees or agents as having any authority to advise, the other party as to whether or not it should enter into this agreement or any transaction. Neither party is receiving any compensation from the other party for providing advice in respect of this agreement or any transaction, and any such advice provided to such other party will not form the primary basis for the investment decision of such other party.

Put simply, the ISDA establishes that the backdrop of the unwind was that HP and Barclays were engaged as principals at opposite sides of an arms-length transaction.

In his testimony, Zac Nesper, an HP employee who during the relevant period was the manager of HP's foreign exchange team and was the primary point of contact between HP and Barclays, reinforced this understanding. He agreed that the ISDA was the "master agreement" governing transactions between HP and Barclays. Nesper also stated that he was aware that the ISDA governed HP's relationship with Barclays in 2011 when the events at issue in this trial occurred. Most relevantly, he confirmed that the ISDA "accurately describe[d] [his] own thinking about [his] relationship with Barclays when it came to the unwind," stating that he "was making [his] own decision about what was best for HP." Indeed, Nesper acknowledged that he "bluffed" or was "BS-ing" Barclays during the parties' interactions—that is, he was not entirely truthful with Barclays—about the prices Nesper was seeing from other banks. He also indicated that he understood some of what Barclays told him to be "posturing," rather than entirely honest.

The ISDA, HP's corresponding understanding of the relationship between HP and Barclays and HP's own dishonesty are not the only background conditions in place at the time that are necessary to understand whether Defendant's allegedly false statements were capable of influencing an entity in HP's position to part with money or property. As the Ninth Circuit has instructed, the "standards generally applied in the lending industry at the time" are relevant to the materiality inquiry. Green, 698 F. App'x at 880.

Here, the Government's expert testified that banks like Barclays engage in "pre-positioning," also known as "hedging," wherein the bank changes its position prior to taking on an asset. Such "pre-positioning" could "[p]otentially" mean that "the bank would act in advance of a transaction," that is, "place trades in advance of that transaction." Indeed, Barclays' compliance manual expressly distinguishes between impermissible "frontrunning" and permissible "bona fide hedges." That compliance goes on to state that "[p]ositions may be established that are bona fide hedges (opposite side of the market) of either proprietary positions or the risk that is assumed or agree to be assumed in facilitating the execution of a related transaction." The parties agree that there are no rules or regulations, beyond banks' internal policies and any agreement that may be formed between two particular parties, that regulate pre-positioning, pre-hedging, or front-running of the type at issue here. So, evening assuming that FX options trading falls within the gambit of conduct prohibited by the rule against frontrunning—and the Government has offered no evidence for its intent-based reading of "bona fide," there are undisputedly some types of pre-positioning that are permitted.

All of this matters because someone in Nesper's position would evaluate the statements Bogucki made to him against this backdrop. And so the statements the Government argues satisfy the materiality element must also be evaluated in this context. The Court must thus determine whether, taking the facts in the light most favorable to the Government, a reasonable jury could conclude beyond a reasonable doubt that the statements the Government alleges were false or misleading would have been objectively capable of influencing someone in Nesper's position to part with money or property. . . .

None of the five pieces of evidence the Government has produced in its case in chief can sustain a finding that a reasonable jury could conclude beyond a reasonable doubt that Defendant made false statements or material omissions that were capable of influencing a person in Nesper or HP's position to part with money or property. None of these facts, thus, can satisfy the materiality requirement for the charges of wire fraud and conspiracy to commit wire fraud. . . .

Viewing the evidence in the light most favorable to the Government, there is simply no evidence in the record that, in the context of an arms-length transaction in which the parties bluffed and "BS-[ed]" each other, operated as principals, looked out for their own interests, and understood the other party to be "posturing," rather than providing strictly true information, someone in HP's position could, objectively, be induced by the statements in this case to part with money or property.

Nor does Nesper's subjective belief alter this conclusion. As the Government has repeatedly pointed out to the Court . . . the standard for materiality is objective. Whether Nesper or HP were gullible, guileless, naïve, or actually took Defendant to be representing that Barclays would not take action that undermined the value of HP's options, in light of the relationship of the parties, the agreement governing their interactions, industry practice, HP's own dishonesty, and Nesper's expectations as to Barclays' dishonesty, no reasonable jury could conclude beyond a reasonable doubt that it was objectively reasonable for HP to be influenced by the statements the Government has identified. . . .

A touchstone of our criminal law is that no person "shall be held criminally responsible for conduct which he could not reasonably [have] understand to be proscribed." United States v. Lanier, 520 U.S. 259, 265 (1997). Here, the Government has pursued a criminal prosecution on the basis of conduct that violated no clear rule or regulation, was not prohibited by the agreements between the parties, and indeed was consistent with the parties' understanding of the arms-length relationship in which they operated. The Court cannot permit this case to go to the jury on such a basis.

### C. Mail and Wire Fraud: Limiting Principles

As many cases in this chapter illustrate, the federal courts give fairly standard recitations of the elements of mail and wire fraud. Unfortunately, because fraud is such a malleable and contextual concept, those "black letter" statements don't get you far enough, at least not in any debatable case. Setting aside the statutes for the moment, we might say—with refinement to follow—that a viable criminal fraud claim has to fulfill something like the following working definition (my words, not those of the statutes or the courts):

(1) some deception (attempted or completed, by affirmative misrepresentation or nondisclosure)

(2) about a material matter

(3) with the intent to deceive

(4) and with the object of obtaining something (what we might call the "corpus" or "object" of the fraud)

(5) from an identifiable victim (or class of victims)

With that framework in mind, let's start looking at what principles might limit the exceedingly broad law of criminal fraud. It has been hard for the federal courts to fashion workable sub-doctrine to limit the scope of the mail and wire fraud statutes. What might explain the courts' difficulty? (Consider, in this connection, the English court's discussion of cheating and honesty in *Ivey*.)

Two things are going on in the next case. First, the facts allow further exploration of the concept of materiality. Why shouldn't lies used to "get a foot in the door" be eligible to count as fraud? Second, the appellate court is grasping for concepts that might limit the mail fraud statute. What's the limiting concept here? Does it work? Does the more recent Second Circuit case that follows *Regent Office Supply* help explain further the function of this limiting concept?

**UNITED STATES v. REGENT OFFICE SUPPLY CO., 421 F.2d 1174 (2d Cir. 1970)**

MOORE, Circuit Judge:

The appellants are in the business of selling stationery supplies through salesmen (called 'agents') who solicit orders for their merchandise by telephone. . . . Accordingly they stipulated in writing that their agents 'secured sales' by making false representations to potential customers that:

(a) the agent had been referred to the customer by a friend of the customer.

(b) the agent had been referred to customer firms by officers of such firms.

(c) the agent was a doctor, or other professional person, who had stationery to be disposed of.

(d) stationery of friends of the agent had to be disposed of because of a death and that the customer would help to relieve this difficult situation by purchasing it. . .

For its defense, the accused corporations called the president of Regent, Harold Hartwig, who testified that the firms sell well-known, nationally advertised brands of stationery, such as Swingline staples, Faber pencils, Perma-Write pens, etc., and some paper to large users among which are corporations such as Goodyear, General Electric and Rexall; that many of these customers provide a large volume of reorder business; that the Regent-Oxford enterprise has over 20,000 customers; that sales are made exclusively through their customers' purchasing agents; that the false representations listed in the stipulation were made as a preliminary part of the salesmen's solicitation; that price and quality of the merchandise are always discussed honestly; that the price offered has been lower than the purchasing agent is or was paying at the time of the solicitation; that the goods could be returned if found to be unsatisfactory; and that when a complaint is made an additional discount is offered to induce the customer to keep the goods.

Cross-examination elicited that visits to the Regent-Oxford offices had been made by the Better Business Bureau and by a Post Office Inspector; that the 'lies' were to 'get by' secretaries on the telephone and to get 'the purchasing agent to listen to our agent'; and that for business reasons various fictitious names were used both for their companies in different localities and for individuals. . . .

The important substantive question on this appeal is: Does solicitation of a purchase by means of false representations not directed to the quality, adequacy or price of goods to be sold, or otherwise to the nature of the bargain, constitute a 'scheme to defraud' or 'obtaining money by false pretenses' within the prohibition of 18 U.S.C. § 1341? We hold that, as here presented, it does not and the convictions should be reversed. We do not, however, condone the deceitfulness such business practices represent nor do we approve the cynical view advanced in defendants' rhetorical flourishes that such blatant dishonesty should be encouraged by reason of its 'social utility' and 'social necessity . . . in keeping with the most praiseworthy standards of business morality and worthy competitive enterprise.' We do not find the practices defended by counsel to be 'innocuous' or conduct 'which at worst may evoke in the breast of the perfectionistic moral idealist a sense of reproach towards the imperfections of man's soul during the mortal span.' On the contrary, we find these 'white lies' repugnant to 'standards of business morality.' Nevertheless, the facts as stipulated in the case before us do not, in our view, constitute a scheme to defraud or to obtain money by false pretenses punishable under section 1341. But this is not to say that we could not, on different facts or more specific proof, arrive at a different conclusion. . . .

It is generally stated that there are two elements to the offense of mail fraud: use of the mails and a scheme to defraud. Since only a 'scheme to defraud' and not actual fraud is required for conviction, we have said that 'it is not essential that the Government allege or prove that purchasers were in fact defrauded. . . .' But this does not mean that the government can escape the burden of showing that some actual harm or injury was contemplated by the schemer. Proof that someone was actually defrauded is unnecessary simply because the critical element in a 'scheme to defraud' is 'fraudulent intent,' . . . and therefore the accused need not have succeeded in his scheme to be guilty of the crime. . . . But the purpose of the scheme 'must be to injure, which doubtless may be inferred when the scheme has such effect as a necessary result of carrying it out.' *Horman v. United States*, 116 F. 350 (6th Cir. 1902).

The government has offered no direct proof that any customer was actually defrauded by the Regent-Oxford selling campaign. Instead it offers a stipulation which shows that false representations were made, and that they were made by defendants' agents with knowledge of their falsehood. As a result of the transactions of which the untrue statements were a part, money and property changed hands. With no further proof, the government urges upon us the inference that customers were induced to part with their money because of the false representations, and that such calculated inducement amounted to fraud in the terminology of section 1341. The defendants helped the government over the difficult hurdle of proving that the false representations were 'reasonably calculated' to induce purchasing agents of 'ordinary prudence,' to buy their wares by admitting in writing that the representations were made to secure sales. On this stipulation an intent to deceive, and even to induce, may have been shown; but this does not, without more, constitute the 'fraudulent intent' required by the statute.

If there is no proof that the defendants expected to get 'something for nothing,' *Harrison v. United States*, 200 F. 662 (6th Cir. 1912), or that they intended to get more for their merchandise than it was worth to the average customer, it is difficult to see any intent to injure or to defraud in the defendants' falsehoods. Instead of offering proof of some tangible injury to the objects of the Regent-Oxford promotion, the government argues in the negative that 'it is not essential (to) prove that purchasers were in fact defrauded,' and therefore that 'pecuniary loss' need not be shown for fraud to exist. It may be true, as Judge Learned Hand stated in *United States v. Rowe*, 56 F.2d 747 (2d Cir. 1932), that:

> . . . (a) man is none the less cheated out of his property, when he is induced to part with it by fraud, because he gets a quid pro quo of equal value. It may be impossible to measure his loss by the gross scales available to a court, but he has suffered a wrong; he has lost his chance to bargain with the facts before him.

Nevertheless, neither the Rowe case nor the language quoted will support the conclusion that no definable harm need be contemplated by the accused to find him guilty of mail fraud. For that is what the government is arguing: that these false representations, in the context of a commercial transaction, are per se fraudulent despite the absence of any proof of actual injury to any customer. . . .

[W]e have found no case in which an intent to deceive has been equated with an 'intent to defraud' where the deceit did not go to the nature of the bargain itself. Where the false representations are directed to the quality, adequacy or price of the goods themselves, the fraudulent intent is apparent because the victim is made to bargain without facts obviously essential in deciding whether to enter the bargain. In closer cases, where the representations do not mislead as to the quality, adequacy of inherent worth of the goods themselves, fraud in the bargaining may be inferable from facts indicating a discrepancy between benefits reasonably anticipated because of the misleading representations and the actual benefits which the defendant delivered, or intended to deliver. In either instance, the intent of the schemer is to injure another to his own advantage by withholding or misrepresenting material facts. Although proof that the injury was accomplished is not required to convict under 1341, we believe the statute does require evidence from which it may be inferred that some actual injury to the victim, however slight, is a reasonably probable result of the deceitful representations if they are successful. . . .

The government asks us to infer some injury from the mere fact of the falseness of the representations and their connection with a commercial transaction. On the evidence before us, consisting principally of the stipulated falsehoods and the testimony of the defendants' president, we conclude that the defendants intended to deceive their customers but they did not intend to defraud them, because the falsity of their representations was not shown to be capable of affecting the customer's understanding of the bargain nor of influencing his assessment of the value of the bargain to him, and thus no injury was shown to flow from the deception. . . .

**UNITED STATES v. JABAR, 19 F.4th 66 (2d Cir. 2021)**

WALKER JR., Circuit Judge:

The United States appeals from a post-verdict judgment of acquittal entered by the District Court for the Western District of New York (Lawrence J. Vilardo, *J.*) with respect to the convictions of defendants Steve S. Jabar and Deborah Bowers for wire fraud, in violation of 18 U.S.C. § 1343, and conspiracy to commit wire fraud, in violation of 18 U.S.C. § 371. The government argues that a reasonable jury could infer that the defendants had an intent to defraud the United Nations (UN) when they diverted for personal use more than $65,000 of grant money awarded to their non-profit organization. Viewing the evidence in the light most favorable to the government, we conclude that there was sufficient evidence for the jury to convict on the wire fraud and related counts. . . .

This case arises from defendants' personal use of grant money that the UN awarded to their non-profit organization, Opportunities for Kids International, Inc. (OKI). Jabar and Bowers applied for and obtained a grant in the amount of $500,000 ($150,000 of which was later withheld) for the sole purpose of establishing a radio station in Iraq dedicated to women's programming. Instead, the defendants siphoned off more than $65,000 of the grant to pay personal debts, bills, and taxes. . . .

The elements of wire fraud are: "(1) a scheme to defraud, (2) money or property as the object of the scheme, and (3) use of the wires to further the scheme." *United States v. Binday*, 804 F.3d 558, 569 (2d Cir. 2015); *see* 18 U.S.C. § 1343. Conspiracy to commit wire fraud requires merely the agreement between defendants to engage in the foregoing and an overt act by one of the conspirators in furtherance of the conspiracy. 18 U.S.C. § 371.

"Essential to a scheme to defraud is fraudulent intent." *D'Amato*, 39 F.3d at 1257. Fraudulent intent may be inferred "[w]hen the 'necessary result' of the actor's scheme is to injure others." *Id.* (quoting *United States v. Regent Office Supply Co.*, 421 F.2d 1174, 1181 (2d Cir. 1970). Intent may also be proven "through circumstantial evidence, including by showing that defendant made misrepresentations to the victim(s) with knowledge that the statements were false." *Guadagna*, 183 F.3d at 129. Because an intent to deceive alone is insufficient to sustain a wire fraud conviction, "[m]isrepresentations amounting only to a deceit ... must be coupled with a contemplated harm to the victim." *United States v. Starr*, 816 F.2d 94, 98 (2d Cir. 1987). "Such harm is apparent where there exists a discrepancy between benefits reasonably anticipated because of the misleading representations and the actual benefits which the defendant delivered, or intended to deliver." *Id.* (quotation marks omitted). Proof of actual injury to the victim is not required because the scheme need not have been successful or completed. *United States v. Dinome*, 86 F.3d 277, 283 (2d Cir. 1996).

Comparing two of our previous decisions clarifies that the misrepresentations must be central, not just collateral, to the bargain between the defendant and the victim. In *United States v. Starr*, owners of a bulk mailing company schemed to conceal higher rate mailings from customers in lower rate bulk mailings without paying the additional postage to the postal service or refunding their customers' excess postage payments. Defendants "represented that funds deposited with them would be used only to pay for their customers' postage fees," but upon defrauding the postal service, defendants sent fraudulent receipts to their customers and appropriated the remainder of the funds for their own use. We concluded that because the customers' mail was delivered on time to the correct location, whatever harm there was did not "affect the very nature of the bargain itself." At most, the government's evidence showed defendants' intent to deceive or induce customers into the transaction but not a fraudulent intent.

In *United States v. Schwartz* the defendants schemed to purchase U.S.-manufactured military equipment for their international clients. One producer, Litton Industries, "expressly demanded assurances" that its devices would not be exported unlawfully, including that: the condition be incorporated into the sales agreement, the defendants disclose the customer's identity, and the customer obtain the requisite export certificates. Rather than comply, the defendants fed Litton false information and fabricated documents to secure the purchase. On appeal, we concluded that evidence of the defendants' deceitful acts supported a finding of fraudulent intent and thus upheld the wire fraud convictions. We distinguished these facts from the false representations in *Starr*, which "did not cause any discrepancy between benefits reasonably anticipated and actual benefits received" and, therefore, "did not go to an essential element of the bargain." The scheme in *Starr* "only defeated [defendants'] customers' expectation that the money they paid to the defendants would be fully used to pay for postage, an expectation *that was not the basis of the bargain*." To the contrary, the defendants' misrepresentations in *Schwartz* were not "simply fraudulent inducements," but went to an essential element of the bargain: the *lawful* export of military equipment. The defendants made "*explicit* promises ... in response to Litton's demands" and evidence showed that the deceived party "would not have sold its product" to defendants if they "had not been able to guarantee these conditions." Therefore, even though it received payment, Litton was deprived of "the right to define the terms for the sale of its property" and "good will because equipment [that] Litton, a government contractor, sold was exported illegally." The wire fraud statute captured these non-pecuniary harms. . . .

The district court ultimately concluded that the evidence was insufficient to prove that the defendants had the intent to defraud the UN because ultimately, they built "$350,000 worth of a radio station." In reaching this decision, the district court rejected the notion that a reasonable jury could find Jabar and Bowers's use of grant funds for personal expenses was itself a harm to the UN. We do not agree that the evidence compels a finding that the benefit of the bargain to UNIFEM was confined to a brick-and-mortar radio station. The evidence was sufficient for the jury to determine reasonably that OKI's representation in the Cooperation Agreement that it would spend the grant funds pursuant to UNIFEM's specifications was equally essential to the issuance of the grant.

The Cooperation Agreement required compliance with numerous spending provisions that controlled OKI's use of the $500,000. OKI agreed to "utilize the funds ... provided by UNIFEM in strict accordance with the Project Document." Although the government failed to offer the Project Document and Project Budget into evidence, a reasonable jury could rely on other evidence that *was* offered to infer that a restriction on the use of grant funds was part of the basis of the bargain. The defendants' own budget proposal, received in evidence, unsurprisingly stated that every dollar of the grant proceeds would be allocated to a VOW-related expense. And a UNIFEM official testified that the agency as a matter of course demands assurances from grant recipients that they will devote the awarded money exclusively towards the project. The Cooperation Agreement also required that Jabar and Bowers return to UNIFEM any funds not spent on the project. UNIFEM mandated the return of all unused funds precisely because the proper use and management of funds was central to the bargain.

The Cooperation Agreement contained exhaustive accounting requirements that also demonstrate that OKI's proper spending of the grant was essential to the bargain. The agreement required OKI to "keep accurate and up-to-date records and documents in respect of all expenditures" and maintain "original invoices, bills, and receipts. UNIFEM explained the purpose of the records clearly: so that UNIFEM could "ensure that all expenditures are in conformity with the provisions of the Project Work Plan and Project Budgets." Moreover, OKI was required to disclose all income and expenditures in financial reports, "[t]he purpose of [which was] to request a quarterly advance of funds." UNIFEM would disburse each subsequent grant installment only upon determining that the report "show[ed] satisfactory management and proper use of UNIFEM resources." As in *Schwartz*, UNIFEM "made explicit" these requirements by "expressly demand[ing] assurances from" the defendants in the terms of the Cooperation Agreement. . . .

In sum, the government's theory at trial was that the construction of the radio station was only part of the bargain and that it served to conceal defendants' fraudulent acts with respect to the rest of the bargain—OKI's agreement to spend the entirety of the grant exclusively pursuant to the terms of the Cooperation Agreement. To the extent defendants insisted that the contractual bargain was confined to building the radio station, the jury was free to reject that claim based on its assessment of the weight of the evidence and reasonable inferences it could draw from that evidence. . . .

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**What should we do with "intent to injure"?** The Second Circuit's use of intent to injure or harm as a limiting device in application of the mail and wire fraud statutes is perhaps useful, but also tends to be confusing. Much of the confusion involves the relationship between this requirement and the elements of materiality and intent to defraud. The court related the requirement to fraudulent intent, but the element also seems to function in an overlapping way with the requirement of materiality. It thus remains unclear whether the requirement is really adding anything to the basic elements of mail/wire fraud, and whether it does any real limiting work.

Perhaps it is most helpful to focus on the court's discussions of, so to speak, what "the bargain really was" in these cases. After all, the court does not really mean that the fraud perpetrator must want the victim to suffer harm—the fraudster is interested in profit, not spite. *See United States v. Miller*, 953 F.3d 1095, 1101–03 (9th Cir. 2020) (Rakoff, J., sitting by designation) (explaining the distinction as between (1) a mere intent to deceive and (2) an intent to deceive the victim coupled with an intent to cheat the victim out of something). In the next case, the Supreme Court rejects a requirement of intent to injure in interpreting the highly similar bank fraud statute, perhaps calling into question the Second Circuit's approach to the mail and wire fraud statutes. Note that several circuits have said that proof of an intent to injure is not required even under the mail and wire fraud statutes. *See, e.g.*, *United States v. Kenrick*, 221 F.3d 19, 27–29 (1st Cir. 2000); *United States v. Segal*, 644 F.3d 364, 367 (7th Cir. 2011); *United States v. Welch*, 327 F.3d 1081, 1104 (10th Cir. 2003); *see also* Joseph Lanuti, *Mail and Wire Fraud*, 56 AM.

CRIM. L. REV. 1151, 1155 (2019).

**SHAW v. UNITED STATES, 137 S. Ct. 462 (2016)**

Justice BREYER delivered the opinion of the Court.

The relevant criminal statute [18 U.S.C. § 1344] makes it a crime:

> "knowingly [to] execut[e] a scheme . . .
>
> "(1) to defraud a financial institution; or
>
> "(2) to obtain any of the moneys, funds, credits, assets, securities, or other property owned by, or under the custody or control of, a financial institution, by means of false or fraudulent pretenses, representations, or promises."

Shaw obtained the identifying numbers of a Bank of America account belonging to a bank customer, Stanley Hsu. Shaw used those numbers (and other related information) to transfer funds from Hsu's account to other accounts at other institutions from which Shaw could obtain (and eventually did obtain) Hsu's funds. Shaw was convicted of violating the first clause of the statute, namely, the prohibition against "defraud[ing] a financial institution." . . .

Shaw says he did not intend to cause the bank financial harm. Indeed, the parties appear to agree that, due to standard banking practices in place at the time of the fraud, no bank involved in the scheme ultimately suffered any monetary loss. But the statute, while insisting upon "a scheme to defraud," demands neither a showing of ultimate financial loss nor a showing of intent to cause financial loss. Many years ago Judge Learned Hand pointed out that "[a] man is none the less cheated out of his property, when he is induced to part with it by fraud," even if "he gets a quid pro quo of equal value." *United States v. Rowe*, 56 F.2d 747, 749 (C.A.2 1932). That is because "[i]t may be impossible to measure his loss by the gross scales available to a court, but he has suffered a wrong; he has lost," for example, "his chance to bargain with the facts before him." *Ibid. Cf.* O. Holmes, The Common Law 132 (1881) ("[A] man is liable to an action for deceit if he makes a false representation to another, knowing it to be false, but intending that the other should believe and act upon it").

It is consequently not surprising that, when interpreting the analogous mail fraud statute, we have held it "sufficient" that the victim (here, the bank) be "deprived of its right" to use of the property, even if it ultimately did not suffer unreimbursed loss. *Carpenter v. United States*, 484 U.S. 19, 26–27, 108 S. Ct. 316, 98 L. Ed. 2d 275 (1987). Lower courts have explained that, where cash is taken from a bank "but the bank [is] fully insured[,] [t]he theft [is] complete when the cash [i]s taken; the fact that the bank ha[s] a contract with an insurance company enabling it to shift the loss to that company [is] immaterial." *United States v. Kucik*, 844 F.2d 493, 495 (C.A.7 1988). And commentators have made clear that "on the criminal side, it is generally held that the lack of financial loss is no defense to false pretenses." 2 W. LaFave & A. Scott, Substantive Criminal Law § 8.7(i)(3), p. 404 (1986). We have found no case from this Court interpreting the bank fraud statute as requiring that the victim bank ultimately suffer financial harm, or that the defendant intend that the victim bank suffer such harm. . . .

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The next case, dealing with the line between permissible deception in negotiations and fraud, is another example of a federal circuit court seeking limitations on the breadth of criminal fraud liability. How would you state the limitation on wire fraud liability that underlies the Seventh Circuit's reversal of the convictions in this case?

**UNITED STATES v. WEIMERT, 819 F.3d 351 (7th Cir. 2016)**

HAMILTON, Circuit Judge:

In the midst of the 2008–09 financial crisis, a Wisconsin bank called AnchorBank was struggling to stay above water. Under pressure to find cash to pay its own lenders, the bank's president told vice president David Weimert to try to sell the bank's share in a commercial real estate development in Texas. Weimert, who is the defendant and appellant in this criminal wire fraud case, successfully arranged a sale that exceeded the bank's target price by about one third. The deal also relieved the bank of a liability of twice the sale price.

Given the version of the facts we must accept for this appeal, however, Weimert saw an opportunity to insert himself into the deal personally. He persuaded two potential buyers that he would be a useful partner for them. Both buyers included in their offer letters a term having Weimert buy a minority interest in the property. The bank agreed. It also agreed to pay Weimert an unusual bonus to enable him to buy the minority interest. We must also assume that the successful buyer, at least, would have been willing to go forward without Weimert as a partner, and that Weimert deliberately misled his board and bank officials to believe that the successful buyer would not close the deal if he were not included as a minority partner. The government prosecuted Weimert for wire fraud on the theory that his actions added up to a scheme to obtain money or property by fraud, and the jury convicted him on five of six counts of wire fraud under 18 U.S.C. § 1343.

We reverse and order judgment of acquittal. Federal wire fraud is an expansive tool, but as best we can tell, no previous case at the appellate level has treated as criminal a person's lack of candor about the negotiating positions of parties to a business deal. In commercial negotiations, it is not unusual for parties to conceal from others their true goals, values, priorities, or reserve prices in a proposed transaction. When we look closely at the evidence, the only ways in which Weimert misled anyone concerned such negotiating positions. He led the successful buyer to believe the seller wanted him to have a piece of the deal. He led the seller to believe the buyer insisted he have a piece of the deal. All the actual terms of the deal, however, were fully disclosed and subject to negotiation. There is no evidence that Weimert misled anyone about any material facts or about promises of future actions. While one can understand the bank's later decision to fire Weimert when the deception about negotiating positions came to light, his actions did not add up to federal wire fraud. Weimert is entitled to judgment of acquittal. We order his prompt release from federal prison, on the stated terms of supervised release in his sentence, pending issuance of our mandate. . . .

Before giving a detailed account of the evidence, we explain the legal standards we apply. The wire fraud statute prohibits schemes to defraud or to obtain money or property by means of "false or fraudulent pretenses, representations, or promises" if interstate wire or electronic communications are used to execute the scheme. 18 U.S.C. § 1343. To convict a person under § 1343, the government must prove that he "(1) was involved in a scheme to defraud; (2) had an intent to defraud; and (3) used the wires in furtherance of that scheme." *United States v. Faruki,* 803 F.3d 847, 852 (7th Cir. 2015), quoting *Durham,* 766 F.3d at 678.

To prove a scheme to defraud, the government must show that Weimert made a material false statement, misrepresentation, or promise, or concealed a material fact. *United States v. Powell,* 576 F.3d 482, 490 (7th Cir. 2009); *see also Neder v. United States,* 527 U.S. 1, 25, 119 S. Ct. 1827, 144 L. Ed. 2d 35 (1999) (holding "materiality of falsehood" is an element of federal mail and wire fraud statutes). Intent to defraud requires proof that the defendant acted willfully "with the specific intent to deceive or cheat, usually for the purpose of getting financial gain for one's self or causing financial loss to another." *Faruki,* 803 F.3d at 853, quoting *United States v. Howard,* 619 F.3d 723, 727 (7th Cir. 2010).

Like its cousin mail fraud, the wire fraud statute has been interpreted to reach a broad range of activity. Courts have taken an expansive approach to what counts as a material misrepresentation or concealment in a scheme to defraud. As we will see, it is possible to put together broad language from courts' opinions on several different points so as to stretch the reach of the mail and wire fraud statutes far beyond where they should go.

First, for example, materiality has been defined in broad and general terms as having a tendency to influence or to be capable of influencing the decision-maker.

Second, the concept of a misrepresentation is also broad, reaching not only false statements of fact but also misleading half-truths and knowingly false promises. It can also include the omission or concealment of material information, even absent an affirmative duty to disclose, if the omission was intended to induce a false belief and action to the advantage of the schemer and the disadvantage of the victim.

Third, wire fraud does not require the false statement to be made directly to the victim of the scheme. Deception of someone else can suffice if it carries out the scheme.

Fourth, it is no defense that the intended victim of wire fraud was too trusting and gullible or, on the other hand, was too smart or sophisticated to be taken in by the deception.

These and other expansive glosses on the mail and wire fraud statutes have led to their liberal use by federal prosecutors. As one future federal judge put it during his tenure as a prosecutor, these statutes are "our Stradivarius, our Colt 45, our Louisville Slugger, our Cuisinart—and our true love." Jed S. Rakoff, *The Federal Mail Fraud Statute (Part I),* 18 Duq. L. Rev. 771, 771 (1980). Mail and wire fraud statutes "have long provided prosecutors with a means by which to salvage a modest, but dubious, victory from investigations that essentially proved unfruitful." John C. Coffee, Jr. & Charles K. Whitehead, *The Federalization of Fraud: Mail and Wire Fraud Statutes,* in White Collar Crime: Business and Regulatory Offenses § 9.05, at 9–73 (1990). . . .

This case presents a test of how far the mail and wire fraud statutes reach when parties negotiate a substantial commercial transaction that involves, as almost all will, the use of the mails or interstate wire communications. Some deceptions in commercial negotiations certainly can support a mail or wire fraud prosecution. A party may not misrepresent material facts about an asset during a negotiation to sell it. For example, a seller or his agent may not falsely tell potential buyers or investors that a piece of property has no history of environmental problems if soil and groundwater contamination on the property was discovered the year before. The buyer would be led to purchase a property worth far less than she was led to believe, given the looming remediation costs. Similarly, a company may not inform a potential investor that it expects patent protection for its key intellectual property if its patent application was recently rejected as barred by prior art. The investor would be led to believe that he was investing in a valuable asset that was actually worthless. The misrepresentations materially alter one party's understanding of the subject of the deal. . . .

From strands of case law, it is true, one can piece together a mail or wire fraud case based on such deception about negotiating positions. To track the specific rules we discussed above: First, information about a party's negotiating position is surely material in the sense that it is capable of influencing another party's decisions. Second, actionable deception can include false statements of fact, misleading half-truths, deceptive omissions, and false promises of future action. All of these descriptions may fit deceptions about negotiating positions, at least if a negotiator's present state of mind is treated as a fact. Third, the false statement may be made to someone other than the owner or holder of the money or property targeted by the scheme. And fourth, it is no defense that the intended victim either trusted the defendant too much or was too savvy to be fooled.

But Congress could not have meant to criminalize deceptive misstatements or omissions about a buyer's or seller's negotiating positions. *See United States v. Coffman,* 94 F.3d 330, 334 (7th Cir. 1996) ("it would not do to criminalize business conduct that is customary rather than exceptional and is relatively harmless"). Buyers and sellers negotiate prices and other terms. To state the obvious, they will often try to mislead the other party about the prices and terms they are willing to accept. Such deceptions are not criminal.

To take a simple example based on price, suppose a seller is willing to accept $28,000 for a new car listed for sale at $32,000. A buyer is actually willing to pay $32,000, but he first offers $28,000. When that offer is rejected and the seller demands $32,000, the buyer responds: "I won't pay more than $29,000." The seller replies: "I'll take $31,000 but not a penny less." After another round of offers and demands, each one falsely labeled "my final offer," the parties ultimately agree on a price of $30,000. Each side has gained from deliberately false misrepresentations about its negotiating position. Each has affected the other side's decisions. If the transaction involves interstate wires, has each committed wire fraud, each defrauding the other of $2,000? Of course not. But *why* not?

The government's answer at oral argument was the absence of "intent to defraud." That answer begs the question. How do we recognize "intent to defraud" if a party has gained a better deal by misleading the other party about its negotiating position? If a party's negotiation position is material for purposes of the mail and wire fraud statutes, each has obtained a financial gain by deliberately misleading the other.

The better answer is that negotiating parties, and certainly the sophisticated businessmen in this case, do not expect complete candor about negotiating positions, as distinct from facts and promises of future behavior. Deception about negotiating positions—about reserve prices and other terms and their relative importance—should not be considered material for purposes of mail and wire fraud statutes. . . .

About February 16, Weimert asked Richard Petershack, an outside lawyer for IDI, to draft a proposed "template" letter of intent for potential buyers of the Chandler Creek interest. Petershack testified that Weimert told him to use $8.5 million as the purchase price, with financing of $6.5 million available through AnchorBank. Weimert also told Petershack to include a term that Weimert said buyers were requiring: that Weimert himself "stay in the deal because of my institutional knowledge of the project." Petershack also testified that Weimert told him that IDI had agreed to compensate him for his efforts in "facilitating the deal and finding potential investors" by paying him a fee of four percent of the purchase price. On this record, we must assume that Weimert was lying to Petershack at that time about the buyers requiring that he participate and IDI agreeing to the four percent fee. . . .

On February 22, 2009, Weimert called Kalka and his investment partner. Both Weimert and the partner agreed that Weimert's involvement as a buyer would be beneficial; Weimert knew the property and had worked with the Burkes for several years. (Kalka's testimony was unclear as to whether his partner or Weimert first proposed that Weimert participate as a buyer.) In a follow-up email to Weimert, Kalka later confirmed "it is imperative that you David Weimert be involved personally in the Chandler Creek transaction." Weimert's involvement needed to be "economic" to assure Kalka of Weimert's services in overseeing the investment. Kalka wrote that Weimert "might show this," presumably the email, "to your Board to make sure that this is happening."

The following day, February 23, Weimert sent the IDI board of directors a memorandum on the Chandler Creek negotiations. He summarized key points from his conversations with Kalka and his partner. Kalka was to serve as a "stalking horse" in the investment and had ample funds to make the investment. In exchange, Kalka would receive $75,000 as a break-up fee if his offer was not selected. Finally, Weimert added: "It is imperative that Mr. Weimert be involved economically to assure his management—and investment liaison involvement in perpetuity while Mr. Kalka and or his investors are involved." Weimert went on to note as a "bottom line ... [that] Kalka will not do this without me being a Manager of the Investment and Liaison to his Group and the Burke's. . . ." As best we can tell from the record, this statement to the board about Kalka and his partner was true. . . .

By late February 2009, then, Weimert had secured two offers that exceeded Timmerman's target price for Chandler Creek by at least $2 million. But both offers also posed what all IDI directors and other bank officials recognized as a conflict of interest: Weimert was both a buyer and an officer of the seller. Weimert submitted both letters of intent to the IDI board of directors along with two memoranda that were central to the government's case.

The first, called "A Personal Note," was a short summary of the evolution of the deal. Weimert wrote falsely that he had "had no intention of being involved in this Project." But the deal had evolved, he said, so that "The Kalka's Group required [Weimert's involvement], . . . and Bill Burke actually felt that [Weimert] would continue to 'Add a Positive Dimension' to the Management of Chandler Creek." In addition to describing his involvement falsely as "inadvertent," Weimert said he needed to participate to close the deal.

Weimert's second document, called "Evolution of This Deal," also reported on his negotiations with Kalka and the Burkes. As part of the Kalka offer, Kalka had "insisted" that Weimert "run this investment" and "have money in the deal so 'I don't run away.'" As for the Burkes, Weimert falsely told the board that they continued to "be especially focused on my continued involvement." Weimert concluded by recommending selling to The Burke Group. Although it was offering a lower purchase price, the Burke deal would also release IDI from its potential $15 million liability to Bank of America on the Chandler Creek mortgage. . . .

[An] attorney advised the board that Weimert's involvement was not illegal. He asked the board two questions: first, whether the transaction could be completed without Weimert's involvement; and second, whether the transaction was necessary and in the best interest of the company. The board members said they understood that Weimert "had to be involved or the Burkes were not going to be a purchaser," and that the deal was good for the company, especially with the need to raise cash to make the looming payment due to U.S. Bank at the end of March. The attorney advised the board to waive the conflict and go forward with the sale. On this advice, the board waived the conflict, accepted The Burke Group's purchase offer, and approved the four percent fee for Weimert in the amount of $311,000. . . .

All terms of the transaction, including Weimert's participation as a buyer, were disclosed to all interested parties. The government's evidence of deception—all of it—addressed not material facts or promises but rather parties' negotiating positions, which are not material for purposes of mail and wire fraud. . . .

IDI was not misled as to the nature of the asset it was selling or the consideration it received…. At bottom, even the centerpiece of the government's case—Weimert falsely told the IDI board and Omanchinski that the Burkes required his participation—amounted to no more and no less than a false prediction about how the Burkes would respond to a counteroffer to exclude Weimert's participation. In other words, it was deception about a party's negotiating position. Weimert's false story about who had first come up with the idea to have him participate would have been material only for what it signaled about how important his participation was to the parties. In other words, it was important only in predicting how various parties were likely to respond to a counteroffer proposing to reduce or eliminate his role. . . .

The government's strongest argument is that Weimert's actions amounted to a scheme to defraud IDI because, even if an outsider might be permitted to mislead it about negotiating positions, Weimert could not do so about his own role in the transaction. Based on the testimony of IDI directors, we must assume that they trusted Weimert on all aspects of the Chandler Creek deal, including what he told them about the buyer insisting that he participate in the deal. . . .

Since Weimert had such a substantial financial interest in the deal that was disclosed to the board, it is helpful to view the role of Weimert's fiduciary duty as if this were a transaction involving Weimert's own compensation. If Weimert's role as a corporate officer with fiduciary duties were to play a decisive role here, it would be because he would have owed a duty to the corporation to be completely honest regarding the Chandler Creek sale, including how his participation in the deal came about and what he knew about how the Burkes were likely to have responded to a counteroffer excluding Weimert. So, to the extent that fiduciary standards are relevant to this criminal case, the best guidance concerns the extent of a corporate officer's fiduciary duty toward the corporation in negotiating his own compensation. . . .

Taken literally, such a broad fiduciary duty could require a corporate officer negotiating with the corporation about his own compensation to reveal the weaknesses in his own negotiating position as part of his duty of good faith. He might be required, for example, to disclose that he would be willing to take less compensation than he is asking for. And under that reasoning, Weimert would have been obliged to tell the directors that the Burkes probably would have been willing to go forward with the purchase even without his participation. That is not the law with corporate fiduciary duties or with other fiduciary duties, however, or at the very least it is not so clearly the law as to support a criminal conviction. . . .

FLAUM, Circuit Judge, dissenting.

I respectfully disagree with the analysis and conclusion of the majority. At the outset, I do not believe that the scenario presented in this case can be viewed as an arms-length, three-party transaction. Weimert, as president of IDI, was acting on behalf of IDI in negotiating the deal. Unlike a situation involving three independent parties, in the transaction at hand, the IDI board had every reason to expect that Weimert would fairly and honestly represent its interests. The record does not reflect an expectation at the start of negotiations that Weimert would be entitled to equity or any sort of bonus arising out of the Chandler Creek deal. Thus, I cannot accept the majority's conclusion that this situation amounts to hard bargaining among disinterested parties, and that the IDI board received what it agreed to and expected in the Chandler Creek sale. In fact, IDI likely would have received a higher purchase price had Weimert not taken a bite out of the deal. IDI received roughly 96 percent, rather than 100 percent, of the purchase price due to Weimert's creation of equity for himself.

I also do not agree that this case is similar to a routine negotiation among buyers and sellers in which the parties benefit from deliberately false misrepresentations about their negotiating positions. Such situations, which the majority contends are customary and relatively harmless, entail actual arms-length transactions among independent parties. By contrast, Weimert, the president of IDI, was not at arms-length with the IDI board. Moreover, in the typical negotiation involving a buyer and seller, the parties are aware that they are solely bargaining with one another; in the case at hand, the IDI board had no reason to believe that it was also negotiating with Weimert, in addition to the potential buyers.

Although the final contract terms were disclosed when the IDI board considered and approved the deal, the evidence suggests that the IDI board only approved the deal because Weimert represented that it would not get done without his involvement. All of the board members later testified that they would not have voted to waive the conflict of interest and pay Weimert's fee if they had known that the Burkes did not require his involvement. This evidence undermines the notion that the IDI board simply agreed to the terms that were in plain view and received what it expected. Rather, the deal the board approved was based on misrepresentations by its own representative and the board would not have approved the deal if it had known the truth. Further, I find the majority's assertion that the final contract terms were "in fact discussed and negotiated by the interested parties" to be an incomplete portrayal of the facts, since the only parties to negotiate the letter of intent that the IDI board approved were Weimert, as IDI's representative, and the Burkes. Although the final contract terms were slightly different than those initially approved by the board, that letter of intent formed the basis for a transaction in which the parties assumed and ultimately mandated Weimert's participation.

If one focuses on Weimert's misrepresentations to the IDI board while he was supposedly acting on its behalf, the materiality inquiry is different than the majority proffers. Even if Weimert's statements to Kalka and the Burkes—parties at arms-length—were closer to puffery, Weimert's deception of the IDI board and his ABCW/AnchorBank supervisors was more insidious than mere bluffing. Furthermore, even assuming Weimert's participation was a non-core term of the deal, IDI was misled as to the amount it could receive for the property as well as Weimert's interest in seeing the deal completed. Weimert's misrepresentations induced the IDI board to approve the deal and were, therefore, material to the board's decision. . . .

## D. Mail and Wire Fraud: Property

Next, we explore the part of criminal fraud law that deals with the thing the perpetrator is after, what we might call the "corpus" or "object" of the fraud. As you will see, that thing can range from clearly tangible property (like cash) to things that are far less tangible (like legal rights). The next series of cases deals, in different ways, with the general question of what kinds of property—or perhaps better, property *rights*—count as valid objects of fraud under the mail and wire fraud statutes.

**UNITED STATES v. SIEGEL, 717 F.2d 9 (2d Cir. 1983)**

GEORGE C. PRATT, Circuit Judge:

Leonard S. Siegel and Martin B. Abrams appeal from judgments of conviction... after a jury trial. Both defendants were found guilty of fifteen counts of wire fraud, in violation of 18 U.S.C. §§ 1343 and 2. . . .

During the period covered by the indictment, Mego Int'l was a publicly held international manufacturer and distributor of toys and games. Mego was one of its wholly owned subsidiaries. Abrams was chairman of the board of Mego Int'l and its president until 1980. Siegel was secretary of Mego Int'l and executive vice president of Mego.

The fraudulent scheme underlying defendants' convictions involved unrecorded cash sales of Mego merchandise which had either been closed out and marked down for clearance or returned because of damage or defect. The evidence presented at trial showed that the scheme had been furthered in various ways. Abrams conducted some cash transactions himself. Siegel also dealt in cash transactions, supervising cash sales through a retail store of imported shirts worth over $30,000. Other cash transactions were conducted with the aid of William Stuckey, who was manager of Mego's Long Island warehouse and who became a principal witness for the government. At the direction of Abrams and Siegel, Stuckey sold Mego merchandise to various street peddlers and merchants for cash. The "off the books" sales together generated in excess of $100,000 in cash. . . .

Even though . . . the cash sales were not recorded on Mego's books, Siegel and Abrams told Mego's auditors that there were no unrecorded assets. In addition, no information about the cash sales was divulged to Mego's stockholders. The jury was thus entitled to find that Siegel and Abrams, top executives in Mego, generated a secret fund of over $100,000 from cash sales of company assets without disclosing their activities to their stockholders, that they used the cash in part for private benefit, in part for illegal payments to buyers, and in part for illegal payoffs to labor unions, and that they did not account for any sum that may have remained in the fund. . . .

The government charged that Abrams and Siegel engaged in a scheme to defraud Mego and Mego stockholders by violating their fiduciary duties to act honestly and faithfully in the best interest of the corporation and to account for the sale of all Mego property entrusted to them. . . .

[W]e have held that the [mail fraud] statute is violated when a fiduciary fails to disclose material information "which he is under a duty to disclose to another under circumstances where the non-disclosure could or does result in harm to the other." While the prosecution must show that some harm or injury was contemplated by the scheme, it need not show that direct, tangible economic loss resulted to the scheme's intended victims. . . . In this record there is sufficient evidence from which the jury could reasonably have concluded that defendants received the cash proceeds and used them for non-corporate purposes in breach of their fiduciary duties to act in the best interest of the corporation and to disclose material information to Mego and its stockholders. . . .

Abrams argues that because the sums involved were insignificant when compared with Mego's overall sales volume, there was no affirmative duty to report the cash sales to the stockholders of Mego. While he is correct that, to prove a violation of the wire fraud statute, the government must show that the corporate officer or employee failed to disclose material information, we cannot accept as "immaterial" a failure to disclose unrecorded cash sales exceeding $100,000 over a period of nine years. Moreover, the jury was instructed, without defense objection, that "a material fact is one which would be important to a reasonable person in deciding whether to engage in a particular transaction or to engage in certain conduct", and certainly on this record the jury could reasonably have concluded that the failure to disclose the misappropriation of more than $100,000 was a fact which would be important to a Mego stockholder or corporate officer in his decision-making. Thus, failure to reveal the misappropriation violated defendants' fiduciary duty to disclose material information.

Defendants do not seriously contend that the wire fraud statute is not violated when a corporate officer or employee breaches his fiduciary duty to the corporation by taking the proceeds from unrecorded cash sales and using them for his own benefit. Rather, they argue that even if they did participate in the unrecorded cash sales, the record is devoid of any evidence that the money was used for other than corporate purposes and thus fails to support a finding of a breach of fiduciary duty. Defendants claim that at best the evidence merely shows that Abrams and Siegel received the proceeds from the cash sales and that Siegel periodically placed the money in the corporate safe deposit box. While neither Abrams nor Siegel testified, they argue that they received none of it for personal use and that any use of the proceeds for labor payoffs served a legitimate corporate purpose and was not in violation of any fiduciary duty. . . .

[W]e conclude that the record as a whole does support the determination that Abrams and Siegel used the money for their own enrichment . . . [T]here was testimony which showed that Abrams and Siegel personally received the proceeds from the cash sales and either pocketed them or placed them in the corporate safe deposit box. Further, although the cash sales generated in excess of $100,000, the testimony concerning the use to which the money was put accounted for approximately $31,000, used mainly for illicit payoffs. The reasonable mind can think of several destinations for the more than $69,000 that was missing, and, since we have rejected the view that a jury may not rely upon an inference to support an essential allegation unless no opposite inference may be drawn from the proof, we conclude that the jury could have inferred that Abrams and Siegel used some or all of the remainder of the proceeds for their own benefit. . . .

WINTER, Circuit Judge, dissenting in part and concurring in part:

. . . Today we read the wire fraud statute to create a federal law of fiduciary obligations imposed on corporate directors and officers, thereby setting the stage for the development of an expandable body of criminal law regulating intra-corporate affairs.

The majority's legal theory is that wire fraud occurred because some of Mego's funds were diverted "for noncorporate purposes in breach of [the defendants'] fiduciary duties to act in the best interest of the corporation and to disclose material information to Mego and its stockholders." The evidence is that Mego, a corporation with sales ranging between $30 million and $109 million, during the relevant period, had off-book transactions engineered by the defendants averaging slightly over $11,000 per year. There is no evidence—*none* —that any of the money was diverted to the personal use of either Siegel or Abrams. The government's *prima facie* case is thus made out solely by a showing of improper corporate record keeping.

State corporate laws universally impose upon corporate directors and officers certain obligations labelled fiduciary duties which are implied from the corporate relationship. These duties are of a contractual nature. However, because of the high transaction costs of organizing numerous parties and the difficulty of spelling out precise rules to govern future transactions, fiduciary obligations are developed and applied on a case by case basis by state courts.

There is nothing in the language or legislative history of the wire fraud statute remotely suggesting that it was intended as a vehicle for the enforcement of fiduciary duties imposed upon corporate directors or officers by state law. To allow it to be so used would thus be a grave error. However, what the majority does is infinitely worse, for it holds that the wire fraud statute creates a *federal* law of fiduciary obligations. There is no pretense that the source of the fiduciary duty at issue in this case was anything but federal law. There is no reference in the majority opinion to state law or even to Mego's state of incorporation. The jury simply was told that it was up to it to decide whether, as part of the obligation "to act in the best interest of the corporation," the defendants were under a duty to disclose the off-book transactions to shareholders.

The creation of this federal fiduciary duty is no minor step. The relationship of federal and state law in the governance of corporations is a matter of great debate, in which the proponents of federal regulation have strenuously argued that state law governing the conduct of corporate directors and officers is too lax. Over the years, Congress has responded by mandating disclosure through the various securities laws, 15 U.S.C. §§ 77a–78kk (1976), but has generally declined to enact substantive regulation of corporate transactions. . . .

| **Problem 2-4** |
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| As to *Regent Office Supply*, *Weimert*, and *Siegel*, what, if any, of these facts was missing in each fraud prosecution and why?<br>(a) proof of materiality;<br>(b) proof of intent to defraud;<br>(c) proof of a deceptive statement, conduct, or omission;<br>(d) proof of an identifiable property-like interest (or "corpus") sought by the perpetrator. |

The next case involves a matter of insider trading. Here is an important note to refer back to when Chapter 4 takes up insider trading law in earnest: This case was decided before the Supreme Court, in *United States v. O'Hagan,* validated the "misappropriation" theory of insider trading (the Court split 4-4 on the insider trading question in this case and that part of the discussion has been omitted here). When reviewing the course materials later, take note of how the government was able to win this case on a mail fraud theory instead of the misappropriation theory of insider trading that you will read about in Chapter 4.

**CARPENTER v. UNITED STATES, 484 U.S. 19 (1987)**

Justice WHITE delivered the opinion of the Court.

In 1981, [Foster] Winans became a reporter for the Wall Street Journal (the Journal) and in the summer of 1982 became one of the two writers of a daily column, "Heard on the Street." That column discussed selected stocks or groups of stocks, giving positive and negative information about those stocks and taking "a point of view with respect to investment in the stocks that it reviews." Winans regularly interviewed corporate executives to put together interesting perspectives on the stocks that would be highlighted in upcoming columns. . . . Because of the "Heard" column's perceived quality and integrity, it had the potential of affecting the price of the stocks which it examined. The District Court concluded on the basis of testimony presented at trial that the "Heard" column "does have an impact on the market, difficult though it may be to quantify in any particular case."

The official policy and practice at the Journal was that prior to publication, the contents of the column were the Journal's confidential information. Despite the rule, with which Winans was familiar, he entered into a scheme in October 1983 with Peter Brant and petitioner Felis, both connected with the Kidder Peabody brokerage firm in New York City, to give them advance information as to the timing and contents of the "Heard" column. This permitted Brant and Felis and another conspirator, David Clark, a client of Brant, to buy or sell based on the probable impact of the column on the market. Profits were to be shared. The conspirators agreed that the scheme would not affect the journalistic purity of the "Heard" column. . . . Over a 4-month period, the brokers made prepublication trades on the basis of information given them by Winans about the contents of some 27 "Heard" columns. . . .

In affirming the mail and wire fraud convictions, the Court of Appeals ruled that Winans had fraudulently misappropriated "property" within the meaning of the mail and wire fraud statutes and that its revelation had harmed the Journal. It was held as well that the use of the mail and wire services had a sufficient nexus with the scheme to satisfy §§ 1341 and 1343. The petition for certiorari challenged these conclusions. . . .

We held in *McNally* that the mail fraud statute does not reach "schemes to defraud citizens of their intangible rights to honest and impartial government," and that the statute is "limited in scope to the protection of property rights." Petitioners argue that the Journal's interest in prepublication confidentiality for the "Heard" columns is no more than an intangible consideration outside the reach of § 1341. . . . This is not a case like *McNally,* however. The Journal, as Winans' employer, was defrauded of much more than its contractual right to his honest and faithful service, an interest too ethereal in itself to fall within the protection of the mail fraud statute, which "had its origin in the desire to protect individual property rights." *McNally, supra,* at 359, n.8, 107 S. Ct., at 2881, n.8. Here, the object of the scheme was to take the Journal's confidential business information-the publication schedule and contents of the "Heard" column-and its intangible nature does not make it any less "property" protected by the mail and wire fraud statutes. *McNally* did not limit the scope of § 1341 to tangible as distinguished from intangible property rights.

Both courts below expressly referred to the Journal's interest in the confidentiality of the contents and timing of the "Heard" column as a property right and we agree with that conclusion. Confidential business information has long been recognized as property. . . . The Journal had a property right in keeping confidential and making exclusive use, prior to publication, of the schedule and contents of the "Heard" column.

Petitioners' arguments that they did not interfere with the Journal's use of the information or did not publicize it and deprive the Journal of the first public use of it. . . . miss the point. The confidential information was generated from the business, and the business had a right to decide how to use it prior to disclosing it to the public. Petitioners cannot successfully contend . . . that a scheme to defraud requires a monetary loss, such as giving the information to a competitor; it is sufficient that the Journal has been deprived of its right to exclusive use of the information, for exclusivity is an important aspect of confidential business information and most private property for that matter.

We cannot accept petitioners' further argument that Winans' conduct in revealing prepublication information was no more than a violation of workplace rules and did not amount to fraudulent activity that is proscribed by the mail fraud statute. Sections 1341 and 1343 reach any scheme to deprive another of money or property by means of false or fraudulent pretenses, representations, or promises. . . . The concept of "fraud" includes the act of embezzlement, which is "'the fraudulent appropriation to one's own use of the money or goods entrusted to one's care by another.'" *Grin v. Shine,* 187 U.S. 181 (1902).

The District Court found that Winans' undertaking at the Journal was not to reveal prepublication information about his column, [but] we noted the similar prohibitions of the common law, that "even in the absence of a written contract, an employee has a fiduciary obligation to protect confidential information obtained during the course of his employment." As the New York courts have recognized: "It is well established, as a general proposition, that a person who acquires special knowledge or information by virtue of a confidential or fiduciary relationship with another is not free to exploit that knowledge or information for his own personal benefit but must account to his principal for any profits derived therefrom."

We have little trouble in holding that the conspiracy here to trade on the Journal's confidential information is not outside the reach of the mail and wire fraud statutes, provided the other elements of the offenses are satisfied. The Journal's business information that it intended to be kept confidential was its property; the declaration to that effect in the employee manual merely removed any doubts on that score and made the finding of specific intent to defraud that much easier. . . .

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**Government functions and powers as the objects of fraud?** In *Cleveland v. United States*, 531 U.S. 12 (2000), the defendants deceived the state of Louisiana in applications for licenses to operate video poker machines. The Supreme Court held that such a state license cannot constitute property for purposes of the mail and wire fraud statutes. The Court reasoned that licenses have value to applicants, but that they are not property in the hands of the state (the alleged victim in *Cleveland*) because they involve only a power to regulate, not a property-like interest or right. The Court was also concerned about the potential federalism implications of allowing federal prosecutors to use the mail and wire fraud statutes to respond to misconduct in people's dealings with state and local authorities. The next case is a recent and broader effort by the Court to articulate the limits of federal prosecutors' ability to use the mail and wire fraud statutes to attack corruption within government based on creative theories of what can constitute property.

**KELLY v. UNITED STATES, 140 S. Ct. 1565 (2020)**

KAGAN, J., delivered the opinion of the Court.

For four days in September 2013, traffic ground to a halt in Fort Lee, New Jersey. The cause was an unannounced realignment of 12 toll lanes leading to the George Washington Bridge, an entryway into Manhattan administered by the Port Authority of New York and New Jersey. For decades, three of those access lanes had been reserved during morning rush hour for commuters coming from the streets of Fort Lee. But on these four days—with predictable consequences—only a single lane was set aside. The public officials who ordered that change claimed they were reducing the number of dedicated lanes to conduct a traffic study. In fact, they did so for a political reason—to punish the mayor of Fort Lee for refusing to support the New Jersey Governor's reelection bid.

Exposure of their behavior led to the criminal convictions we review here. The Government charged the responsible officials under the federal statutes prohibiting wire fraud and fraud on a federally funded program or entity. *See* 18 U. S. C. §§1343, 666(a)(1)(A). Both those laws target fraudulent schemes for obtaining property. *See* §1343 (barring fraudulent schemes "for obtaining money or property"); §666(a)(1)(A) (making it a crime to "obtain[] by fraud . . . property"). The jury convicted the defendants, and the lower courts upheld the verdicts.

The question presented is whether the defendants committed property fraud. The evidence the jury heard no doubt shows wrongdoing—deception, corruption, abuse of power. But the federal fraud statutes at issue do not criminalize all such conduct. Under settled precedent, the officials could violate those laws only if an object of their dishonesty was to obtain the Port Authority's money or property. The Government contends it was, because the officials sought both to "commandeer" the Bridge's access lanes and to divert the wage labor of the Port Authority employees used in that effort. We disagree. The realignment of the toll lanes was an exercise of regulatory power—something this Court has already held fails to meet the statutes' property requirement. And the employees' labor was just the incidental cost of that regulation, rather than itself an object of the officials' scheme. We therefore reverse the convictions.

The setting of this case is the George Washington Bridge. Running between Fort Lee and Manhattan, it is the busiest motor-vehicle bridge in the world. Twelve lanes with tollbooths feed onto the Bridge's upper level from the Fort Lee side. Decades ago, the then-Governor of New Jersey committed to a set allocation of those lanes for the morning commute. And (save for the four days soon described) his plan has lasted to this day. Under the arrangement, nine of the lanes carry traffic coming from nearby highways. The three remaining lanes, designated by a long line of traffic cones laid down each morning, serve only cars coming from Fort Lee.

The case's cast of characters are public officials who worked at or with the Port Authority and had political ties to New Jersey's then-Governor Chris Christie. The Port

Authority is a bi-state agency that manages bridges, tunnels, airports, and other transportation facilities in New York and New Jersey. At the time relevant here, William Baroni was its Deputy Executive Director, an appointee of Governor Christie and the highest ranking New Jersey official in the agency. Together with the Executive Director (a New York appointee), he oversaw "all aspects of the Port Authority's business," including operation of the George Washington Bridge. David Wildstein (who became the Government's star witness) functioned as Baroni's chief of staff. And Bridget Anne Kelly was a Deputy Chief of Staff to Governor Christie with special responsibility for managing his relations with local officials. She often worked hand-in-hand with Baroni and Wildstein to deploy the Port Authority's resources in ways that would encourage mayors and other local figures to support the Governor.

The fateful lane change arose out of one mayor's resistance to such blandishments. In 2013, Governor Christie was up for reelection, and he wanted to notch a large, bipartisan victory as he ramped up for a presidential campaign. On his behalf, Kelly avidly courted Democratic mayors for their endorsements—among them, Mark Sokolich of Fort Lee. As a result, that town received some valuable benefits from the Port Authority, including an expensive shuttle-bus service. But that summer, Mayor Sokolich informed Kelly's office that he would not back the Governor's campaign. A frustrated Kelly reached out to Wildstein for ideas on how to respond. He suggested that getting rid of the dedicated Fort Lee lanes on the Bridge's toll plaza would cause rush-hour traffic to back up onto local streets, leading to gridlock there. Kelly agreed to the idea in an admirably concise e-mail: "Time for some traffic problems in Fort Lee." In a later phone conversation, Kelly confirmed to Wildstein that she wanted to "creat[e] a traffic jam that would punish" Mayor Sokolich and "send him a message." And after Wildstein relayed those communications, Baroni gave the needed sign-off.

To complete the scheme, Wildstein then devised "a cover story"—that the lane change was part of a traffic study, intended to assess whether to retain the dedicated Fort Lee lanes in the future. Wildstein, Baroni, and Kelly all agreed to use that "public policy" justification when speaking with the media, local officials, and the Port Authority's own employees. And to give their story credibility, Wildstein in fact told the Port Authority's engineers to collect "some numbers on how[] far back the traffic was delayed." That inquiry bore little resemblance to the Port Authority's usual traffic studies. According to one engineer's trial testimony, the Port Authority never closes lanes to study traffic patterns, because "computer-generated model[ing]" can itself predict the effect of such actions. And the information that the Port Authority's engineers collected on this singular occasion was mostly "not useful" and "discarded." Nor did Wildstein or Baroni show any interest in the data. They never asked to review what the engineers had found; indeed, they learned of the results only weeks later, after a journalist filed a public-records request. So although the engineers spent valuable time assessing the lane change, their work was to no practical effect.

Baroni, Wildstein, and Kelly also agreed to incur another cost—for extra toll collectors—in pursuit of their object. Wildstein's initial thought was to eliminate all three dedicated lanes by not laying down any traffic cones, thus turning the whole toll plaza into a free-for-all. But the Port Authority's chief engineer told him that without the cones "there would be a substantial risk of sideswipe crashes" involving cars coming into the area from different directions. So Wildstein went back to Baroni and Kelly and got their approval to keep one lane reserved for Fort Lee traffic. That solution, though, raised another complication. Ordinarily, if a toll collector on a Fort Lee lane has to take a break, he closes his booth, and drivers use one of the other two lanes. Under the one-lane plan, of course, that would be impossible. So the Bridge manager told Wildstein that to make the scheme work, "an extra toll collector" would always have to be "on call" to relieve the regular collector when he went on break. Once again, Wildstein took the news to Baroni and Kelly. Baroni thought it was "funny," remarking that "only at the Port Authority would [you] have to pay a toll collector to just sit there and wait." Still, he and Kelly gave the okay.

The plan was now ready, and on September 9 it went into effect. Without advance notice and on the (traffic-heavy) first day of school, Port Authority employees placed traffic cones two lanes further to the right than usual, restricting cars from Fort Lee to a single lane. Almost immediately, the town's streets came to a standstill. According to the Fort Lee Chief of Police, the traffic rivaled that of 9/11, when the George Washington Bridge had shut down. School buses stood in place for hours. An ambulance struggled to reach the victim of a heart attack; police had trouble responding to a report of a missing child. Mayor Sokolich tried to reach Baroni, leaving a message that the call was about an "urgent matter of public safety." Yet Baroni failed to return that call or any other: He had agreed with Wildstein and Kelly that they should all maintain "radio silence." A text from the Mayor to Baroni about the locked-in school buses—also unanswered—went around the horn to Wildstein and Kelly. The last replied: "Is it wrong that I am smiling?" The three merrily kept the lane realignment in place for another three days. It ended only when the Port Authority's Executive Director found out what had happened and reversed what he called their "abusive decision." (e-mail of Patrick Foye). . . .

The Government in this case needed to prove *property* fraud. The federal wire fraud statute makes it a crime to effect (with use of the wires) "any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises." 18 U.S.C. § 1343. Construing that disjunctive language as a unitary whole, this Court has held that "the money-or-property requirement of the latter phrase" also limits the former. *McNally v. United States*, 483 U.S. 350, 358 (1987). The wire fraud statute thus prohibits only deceptive "schemes to deprive [the victim of] money or property." *Id.*, at 356. Similarly, the federal-program fraud statute bars "obtain[ing] by fraud" the "property" (including money) of a federally funded program or entity like the Port Authority. § 666(a)(1)(A). So under either provision, the Government had to show not only that Baroni and Kelly engaged in deception, but that an "object of the[ir] fraud [was] 'property.'" *Cleveland v. United States*, 531 U.S. 12, 26 (2000).

That requirement, this Court has made clear, prevents these statutes from criminalizing all acts of dishonesty by state and local officials. . . .

According to the Government's theory of the case, Baroni and Kelly "used a lie about a fictional traffic study" to achieve their goal of reallocating the Bridge's toll lanes. The Government accepts that the lie itself—*i.e.*, that the lane change was part of a traffic study, rather than political payback—could not get the prosecution all the way home. As the Government recognizes, the deceit must also have had the "object" of obtaining the Port Authority's money or property. The scheme met that requirement, the Government argues, in two ways. First, the Government claims that Baroni and Kelly sought to "commandeer[]" part of the Bridge itself—to "take control" of its "physical lanes." Second, the Government asserts that the two defendants aimed to deprive the Port Authority of the costs of compensating the traffic engineers and back-up toll collectors who performed work relating to the lane realignment. On either theory, the Government insists, Baroni's and Kelly's scheme targeted "a 'species of valuable right [or] interest' that constitutes 'property' under the fraud statutes."

We cannot agree. As we explain below, the Government could not have proved—on either of its theories, though for different reasons—that Baroni's and Kelly's scheme was "directed at the [Port Authority's] property." Baroni and Kelly indeed "plotted to reduce [Fort Lee's] lanes." But that realignment was a quintessential exercise of regulatory power. And this Court has already held that a scheme to alter such a regulatory choice is not one to appropriate the government's property. *See Cleveland*, 531 U. S., at 23. By contrast, a scheme to usurp a public employee's paid time is one to take the government's property. But Baroni's and Kelly's plan never had that as an object. The use of Port Authority employees was incidental to—the mere cost of implementing—the sought-after regulation of the Bridge's toll lanes. . . .

Contrary to the Government's view, the two defendants did not "commandeer" the Bridge's access lanes (supposing that word bears its normal meaning). They (of course) did not walk away with the lanes; nor did they take the lanes from the Government by converting them to a non-public use. Rather, Baroni and Kelly regulated use of the lanes, as officials responsible for roadways so often do—allocating lanes as between different groups of drivers. To borrow *Cleveland*'s words, Baroni and Kelly exercised the regulatory rights of "allocation, exclusion, and control"—deciding that drivers from Fort Lee should get two fewer lanes while drivers from nearby highways should get two more. They did so, according to all the Government's evidence, for bad reasons; and they did so by resorting to lies. But still, *what* they did was alter a regulatory decision about the toll plaza's use—in effect, about which drivers had a "license" to use which lanes. And under *Cleveland*, that run-of-the-mine exercise of regulatory power cannot count as the taking of property.

A government's right to its employees' time and labor, by contrast, can undergird a property fraud prosecution. Suppose that a mayor uses deception to get "on-the-clock city workers" to renovate his daughter's new home. *United States v. Pabey*, 664 F.3d 1084, 1089 (CA7 2011). Or imagine that a city parks commissioner induces his employees into doing gardening work for political contributors. *See United States v. Delano*, 55 F.3d 720, 723 (CA2 1995). As both defendants agree, the cost of those employees' services would qualify as an economic loss to a city, sufficient to meet the federal fraud statutes' property requirement. No less than if the official took cash out of the city's bank account would he have deprived the city of a "valuable entitlement." *Pasquantino*, 544 U.S., at 357.

But that property must play more than some bit part in a scheme: It must be an "object of the fraud." Or put differently, a property fraud conviction cannot stand when the loss to the victim is only an incidental byproduct of the scheme.[1] In the home-and-garden examples cited above, that constraint raised no problem: The entire point of the fraudsters' plans was to obtain the employees' services. But now consider the difficulty if the prosecution in *Cleveland* had raised a similar employee-labor argument. As the Government noted at oral argument here, the fraud on Louisiana's licensing system doubtless imposed costs calculable in employee time: If nothing else, some state worker had to process each of the fraudster's falsified applications. But still, the Government acknowledged, those costs were "[i]ncidental." The object of the scheme was never to get the employees' labor: It was to get gaming licenses. So the labor costs could not sustain the conviction for property fraud.

This case is no different. The time and labor of Port Authority employees were just the implementation costs of the defendants' scheme to reallocate the Bridge's access lanes. Or said another way, the labor costs were an incidental (even if foreseen) byproduct of Baroni's and Kelly's regulatory object. Neither defendant sought to obtain the services that the employees provided. The back-up toll collectors—whom Baroni joked would just "sit there and wait"—did nothing he or Kelly thought useful. Indeed, those workers came onto the scene only because the Port Authority's chief engineer managed to restore one of Fort Lee's lanes to reduce the risk of traffic accidents. In the defendants' original plan, which scrapped all reserved lanes, there was no reason for extra toll collectors. And similarly, Baroni and Kelly did not hope to obtain the data that the traffic engineers spent their time collecting. By the Government's own account, the traffic study the defendants used for a cover story was a "sham," and they never asked to see its results. Maybe, as the Government contends, all of this work was "needed" to realize the final plan—"to accomplish what [Baroni and Kelly] were trying to do with the [B]ridge." Even if so, it would make no difference. Every regulatory decision (think again of *Cleveland*) requires the use of some employee labor. But that does not mean every scheme to alter a regulation has that labor as its object. Baroni's and Kelly's plan aimed to impede access from Fort Lee to the George Washington Bridge. The cost of the employee hours spent

[1] Without that rule, as Judge Easterbrook has elaborated, even a practical joke could be a federal felony. *See United States v. Walters*, 997 F.2d 1219, 1224 (CA7 1993). His example goes: "A [e-mails] B an invitation to a surprise party for their mutual friend C. B drives his car to the place named in the invitation," thus expending the cost of gasoline. *Ibid*. "But there is no party; the address is a vacant lot; B is the butt of a joke." *Ibid*. Wire fraud? No. And for the reason Judge Easterbrook gave: "[T]he victim's loss must be an objective of the [deceitful] scheme rather than a byproduct of it." *Id.*, at 1226.

on implementing that plan was its incidental byproduct.

To rule otherwise would undercut this Court's oft-repeated instruction: Federal prosecutors may not use property fraud statutes to "set[] standards of disclosure and good government for local and state officials." *McNally*, 483 U.S., at 360; *see supra*, at 7. Much of governance involves (as it did here) regulatory choice. If U.S. Attorneys could prosecute as property fraud every lie a state or local official tells in making such a decision, the result would be—as *Cleveland* recognized—"a sweeping expansion of federal criminal jurisdiction." 531 U.S., at 24. And if those prosecutors could end-run *Cleveland* just by pointing to the regulation's incidental costs, the same ballooning of federal power would follow. In effect, the Federal Government could use the criminal law to enforce (its view of) integrity in broad swaths of state and local policymaking. The property fraud statutes do not countenance that outcome. They do not "proscribe[] schemes to defraud citizens of their in- tangible rights to honest and impartial government." *McNally*, 483 U.S., at 355; *see supra*, at 7. They bar only schemes for obtaining property. . . .

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The Court's *Kelly* decision is supporting further arguments by defense counsel to curtail prosecutors' theories about property and what kinds of objects are covered under federal fraud statutes. The next case, involving the bank fraud statute, illustrates, through an argument between a majority and a dissent in the Ninth Circuit, where the argument space will lie in post-*Kelly* litigation. Note also the dissent's description of a recent Second Circuit case involving a similar post-*Kelly* issue.

**UNITED STATES v. YATES, 16 F.4th 256 (9th Cir. 2021)**

MILLER, Circuit Judge:

Dan Heine and Diana Yates were executives at the Bank of Oswego in Lake Oswego, Oregon. After a 29-day trial, a jury found Heine and Yates guilty of one count of conspiracy to commit bank fraud and 12 counts of making a false bank entry. But as the district court explained at sentencing, unlike "your typical white-collar fraud case ... neither defendant directly tried to line their pockets as a result of their fraud." Indeed, the novelty of some of the government's legal theories led the district court to predict that the case could result in "a really interesting appellate or Supreme Court decision."

We leave that judgment to the reader. On the issues we do need to decide, we agree with the defendants that two of the government's three theories of bank fraud were legally inadequate and that presenting those theories was not harmless. We therefore set aside the conspiracy conviction. Without a conspiracy, the false-entry counts cannot stand because the jury may have based its verdict on those counts on a theory of co-conspirator liability. . . .

Heine founded the Bank of Oswego in 2004. Over the next decade, he served as the bank's president and chief executive officer and as a member of the board of directors.

Yates also joined the bank at its founding, serving as its executive vice president and chief financial officer until her resignation in 2012. Over the years, Yates also served as the bank's chief operating officer and chief credit officer. Unlike Heine, Yates was not a member of the board. Both Heine and Yates served on the bank's internal loan committee, which met weekly to discuss the bank's outstanding loans and to decide whether to approve new loans. Particularly large loans required the approval of the board of directors.

As a new bank, the Bank of Oswego was closely scrutinized by the Federal Deposit Insurance Corporation. The FDIC requires banks to submit quarterly "call reports," public documents that include a bank's balance sheet, its income statement, and detailed information about its assets and liabilities. While the bank's controller was responsible for preparing the call reports, Yates had to approve the reports before they were submitted to the FDIC.

In January 2009, the bank hired a vice president of lending, Geoff Walsh. Walsh was a highly productive employee. In a 2011 performance review, Heine described him as a "rock star," adding that his "personality, contacts and intelligence" enabled the bank "to attract and serve many professionals of high net worth and influence in the Portland-metro area." At the same time, Heine noted "growing concern" with Walsh's "apparent breach of internal controls" and his failure to "follow[ ] sound lending policy, procedures and practices." Heine's concern would prove to be well-founded—Walsh's conduct set in motion the chain of events that would eventually lead to the defendants' convictions.

The bank's troubles began at the end of 2009 when the FDIC reported disappointing results after an on-site examination. Concluding that the bank's overall financial condition was "less than satisfactory," the FDIC identified "emerging weaknesses" in the bank's asset quality and loan portfolio. The agency also criticized the bank's management structure, expressing particular concern over its concentration of responsibilities in Yates. The FDIC warned that "[a] single individual's ability to perform effectively in all of these roles is questionable" and that "[s]uch a concentration of responsibilities in one person ... represents a weakness in the bank's internal control structure." In 2010, the bank entered into a memorandum of understanding with the FDIC to address the agency's concerns. But when the FDIC returned to examine the bank early in 2011, it again found the bank's condition "less than satisfactory," downgrading its management score and concluding that "CFO Diana Yates' split attention is contributing to risks."

In January 2012, an independent auditor discovered that Walsh had received personal loans from one of his clients, Martin Kehoe. Kehoe was a "hard money lender" who made non-bank loans to individuals at high interest rates. The auditor immediately forwarded her findings to Heine and Yates. Yates contacted Kehoe, who denied that Walsh had ever borrowed money from him. Heine was unconvinced. In his opinion, this was "a major issue" that had to be reported to the board. Yates responded that Heine was overreacting. Kehoe followed up with an email directly to Heine stating that Walsh had not received any loans through Kehoe's business and had never been paid a fee for any customer referrals.

Meanwhile, the FDIC continued to criticize the bank's performance. When the agency completed its 2012 examination, it informed Heine and Yates that it planned to downgrade the bank's management score yet again. According to Chris Shepanek, the chairman of the board of directors, Yates became “extremely upset about the whole situation,” was overwhelmed by the bank's problems, and felt that Heine failed to support her in meetings with the FDIC. She resigned shortly thereafter.

After Yates's departure, Heine began reviewing Walsh's emails, forwarding items that concerned him to the board. Eventually, Heine concluded that Walsh was involved in a hard-money lending scheme funded by a $1.7 million loan the bank had issued to Kehoe. Heine fired Walsh four days later.

In July 2013, Walsh was arrested and charged with offenses unrelated to his work at the bank; he eventually pleaded guilty to wire fraud and conspiracy to commit wire fraud. But he also pleaded guilty to one count of conspiracy to make a false bank entry in the course of his work at the bank. Walsh cooperated with the government and provided extensive testimony at Heine and Yates's trial. . . .

Count 1 of the indictment charged the defendants with violating 18 U.S.C. § 1349, which makes it a crime to “conspire[ ] to commit any offense under this chapter”—here, bank fraud. Bank fraud entails “knowingly execut[ing] ... a scheme or artifice ... to defraud a financial institution.” *Id.* § 1344. A scheme to defraud “must be one to deceive the bank *and* deprive it of something of value,” that is, money or property. *Shaw v. United States*, ––– U.S. ––––, 137 S. Ct. 462, 469, 196 L.Ed.2d 373 (2016); *see id.* at 466; *see also Kelly v. United States*, ––– U.S. ––––, 140 S. Ct. 1565, 1571–72, 206 L.Ed.2d 882 (2020); *Neder v. United States*, 527 U.S. 1, 20–21, 119 S.Ct. 1827, 144 L.Ed.2d 35 (1999) (construing “scheme or artifice to defraud” identically for the mail, wire, and bank fraud statutes). And that property deprivation “must play more than some bit part in a scheme”—the loss to the victim “must be an ‘object of the fraud,’” not a mere “implementation cost[ ]” or “incidental byproduct of the scheme.” *Kelly*, 140 S. Ct. at 1573–74 (quoting *Pasquantino v. United States*, 544 U.S. 349, 355, 125 S.Ct. 1766, 161 L.Ed.2d 619 (2005)).

The government told the jury that Heine and Yates conspired to deprive the bank of three property interests: (1) “accurate financial information in the bank's books and records,” (2) “the defendants’ salaries [and] bonuses,” and (3) “the use of bank funds.”. . .

[W]e hold that the government's accurate-information and salary-maintenance theories are legally insufficient, *see United States v. Barona*, 56 F.3d 1087, 1097–98 (9th Cir. 1995), and that presenting those theories to the jury was not harmless. . . .

The accurate-information theory was the cornerstone of the government's case. The indictment alleged that “[o]ne of the purposes of the conspiracy”—and it specified only one—“was to conceal the true financial condition of the Bank and to create a better financial picture of the Bank” for the board and regulators. In pretrial proceedings, the government reiterated that “the primary purpose of the conspiracy ... was to conceal the information.”

That theory was also the first one the government advanced in closing argument. In discussing the “something of value” requirement, the government told the jury that the defendants “sought to deprive” the bank and the board of directors of “accurate financial information in the bank's books and records.” Without that information, the government argued, the board could not properly “analyze the risks posed by the various borrowers who are late.” To drive home the point, the government displayed a PowerPoint slide entitled “Something of Value,” which asserted that the defendants “sought to deprive [the] Bank and [the board of directors] of accurate financial information ... to make the Bank's books and records look better.” The slide underscored that the information was valuable because the board “relies on the accuracy of financial records to perform its duties.”

After the government's closing argument, Heine requested a curative instruction to the effect that “something of value cannot be the accuracy of the information that was the subject of the representation.” The government opposed the instruction, saying, “We have always been clear that [accurate information] is something that we think is something of value.” The district court declined to give the requested instruction or otherwise to instruct the jury on the meaning of “something of value.” In posttrial proceedings, the government continued to defend its position that “depriving the bank of information” is “something of value.”

The accurate-information theory is legally insufficient. There is no cognizable property interest in “the ethereal right to accurate information.” *United States v. Sadler*, 750 F.3d 585, 591 (6th Cir. 2014). Although a property right in trade secrets or confidential business information can constitute “something of value,” *Carpenter v. United States*, 484 U.S. 19, 26, 108 S.Ct. 316, 98 L.Ed.2d 275 (1987), “the right to make an informed business decision” and the “intangible right to make an informed lending decision” cannot, *United States v. Lewis*, 67 F.3d 225, 233 (9th Cir. 1995).

Recognizing accurate information as property would transform all deception into fraud. By definition, deception entails depriving the victim of accurate information about the subject of the deception. But “[i]ntent to deceive and intent to defraud are not synonymous.” *United States v. Yermian*, 468 U.S. 63, 73 n.12, 104 S.Ct. 2936, 82 L.Ed.2d 53 (1984) (quoting *United States v. Godwin*, 566 F.2d 975, 976 (5th Cir. 1978) (per curiam)). Rather, “the scheme must be one to deceive the bank *and* deprive it of something of value.” *Shaw*, 137 S. Ct. at 469. . . .

The government also argued that Heine and Yates sought to deprive the bank of their salaries and bonuses. Although the indictment did not reference the theory, the government raised it early in pretrial proceedings, arguing “that the continuation of the benefits of employment . . . was a purpose of the conspiracy.”

The government led with the theory in its opening statement at trial, inviting the jury to ask, "Why would Dan Heine and Diana Yates misrepresent the condition of the bank?" The government's answer: to receive their salaries and other financial compensation. The government reiterated the theory at closing argument, emphasizing that Heine and Yates "sought to ensure" their salaries and other financial compensation in light of their personal financial difficulties.

When Heine requested a curative instruction on the accurate-information theory after the government's closing argument, the government told the court that the defendants "desired for the financial condition of the bank to look better than it was so that they could get their own salaries and compensation" because "they were in a dire cash situation." And in posttrial proceedings, the government again explained that "[w]ith respect to something of value," its "theory is the salary piece."

Of course, salaries and "other financial employment benefits" are both forms of "money." *United States v. Ratcliff*, 488 F.3d 639, 644 (5th Cir. 2007); *accord United States v. Del Valle*, 674 F.3d 696, 704 (7th Cir. 2012). If obtaining a new job or a higher salary is the object of a defendant's fraudulent scheme, then the deprivation of that salary can in some circumstances support a fraud conviction. *See, e.g.*, *United States v. Granberry*, 908 F.2d 278, 280 (8th Cir. 1990) (new job and salary from fraudulent job application); *United States v. Doherty*, 867 F.2d 47, 55–56 (1st Cir. 1989) (Breyer, J.) (higher salary from a promotion obtained under false pretenses).

But there is a difference between a scheme whose object is to obtain a new or higher salary and a scheme whose object is to deceive an employer while continuing to draw an existing salary—essentially, avoiding being fired. The history of the Supreme Court's treatment of fraud in the employment context demonstrates why that distinction matters. . . .

In *Skilling*, for example, the government's theory was that Skilling had "conspir[ed] to defraud Enron's shareholders by misrepresenting the company's fiscal health, thereby artificially inflating its stock price," and that he had "profited from the fraudulent scheme ... through the receipt of salary and bonuses, ... and through the sale of approximately $200 million in Enron stock." 561 U.S. at 413, 130 S.Ct. 2896 (ellipses in original). But because there was no allegation "that Skilling solicited or accepted side payments from a third party in exchange for making these misrepresentations," the Court thought it "clear" that he had not committed honest-services fraud. *Id.*

*Skilling*'s rejection of the salary-maintenance theory is persuasive here. To be sure, the government charged Heine and Yates with conspiring to commit property fraud, not honest-services fraud. But we do not believe the Court intended "to let in through the back door the very prosecution theory that [it] tossed out the front." *United States v. Ochs*, 842 F.2d 515, 527 (1st Cir. 1988). Permitting the government to recharacterize schemes to defraud an employer of one's honest services—thereby profiting "through the receipt of salary and bonuses," *Skilling*, 561 U.S. at 413, 130 S.Ct. 2896—as schemes to deprive the employer of a property interest in the employee's continued receipt of a salary would work an impermissible “end-run” around the Court's holding in *Skilling*. *Kelly*, 140 S. Ct. at 1574.

[Ed: the *Skilling* discussion referenced in the preceding passage is covered in the next section of this Chapter.]

It also would criminalize a wide range of commonplace conduct. *See McDonnell v. United States*, ––– U.S. ––––, 136 S. Ct. 2355, 2373, 195 L.Ed.2d 639 (2016) (noting a due-process concern with the prospect of “prosecution, without fair notice, for the most prosaic interactions”). Consider an employee who wastes time on the Internet but then, to avoid being fired, falsely claims to have been working productively. Presented with that scenario at oral argument, the government declined to say whether the employee would be guilty of federal fraud on a salary-maintenance theory. The government's hesitation is understandable. Extending the fraud statutes in that way would raise serious concerns about whether the offense is defined “with sufficient definiteness that ordinary people can understand what conduct is prohibited and ... in a manner that does not encourage arbitrary and discriminatory enforcement.” *Skilling*, 561 U.S. at 402–03, 130 S.Ct. 2896 (quoting *Kolender v. Lawson*, 461 U.S. 352, 357, 103 S.Ct. 1855, 75 L.Ed.2d 903 (1983)). . . .

We agree that if an employer offers a raise or a bonus tied to some specific performance metric, an employee who lies about having achieved that metric has deprived the employer of something of value. But the evidence at trial showed that the defendants were interested in receiving standard annual raises and end-of-year bonuses that were based on the bank's overall financial condition, not on any specific metric they falsified to obtain additional compensation. . . .  As the government presented the case, it was effectively an honest-services case dressed in the garb of salary deprivation. . . .

BRESS, Circuit Judge, dissenting:

The defendants in this case, two bank executives, fraudulently transferred money from their bank and then surreptitiously re-routed it back in to disguise the bank's faltering finances. In doing so, they failed to disclose to the bank's Board and the FDIC the nature of their transactions. The defendants’ conduct was not merely unsavory—it was plainly unlawful. . . .

The defendants did not include in FDIC reports as “past due” certain loans in which payments were made on behalf of the borrowers. The problem was that the money used to pay most of these loans had come from the bank itself—money defendants fraudulently loaned out to a trusted “hard money lender” who then paid the delinquent loans of the otherwise “past due” borrowers, without these borrowers even knowing. The defendants were using bank money to cure “past due” loans, thereby masking the risk associated with the bank's loan practices. In holding that no rational jury could convict defendants of making false bank entries under these circumstances, the majority opinion again departs from precedent while unduly limiting Congress's prohibition on false bank entries. . . .

As an initial matter, and quite obviously, the jury could conclude that defendants engaged in a scheme to deceive the bank. The majority opinion does not suggest otherwise. Defendants repeatedly misled the bank's Board and bank employees about A Avenue and the loans to Martin Kehoe and Randall Coleman. Defendants improperly used bank funds to complete an unlawful straw purchase of A Avenue; made an unauthorized $675,000 wire transfer to Kehoe; misled the Board about the purpose of the $1.7 million Kehoe loan; misleadingly used the Kehoe loan to pay off delinquent loans of other customers without their knowledge; took money out of Dudley's political account and improperly used it to pay off his personal loan without telling him; failed to obtain required down payments from Coleman; and misled the Board about the purpose of Coleman's later $100,000 bank loan.

This was deception upon deception. Each of defendants' wrongs was independently deceptive and subject to the bank fraud statute.

These individual wrongs were bad enough. But as pieces of a collective effort to deceive the bank and regulators about the financial health of the institution, they were deceptive beyond that. This is quite plainly a permissible theory of deception under the bank fraud statute. *See, e.g.*, *United States v. Molinaro*, 11 F.3d 853, 857–58 (9th Cir. 1993) (upholding conviction under § 1344 when bank owner concealed facts that would have made regulators "frown" and that "would excite the Board's interest and invite closer scrutiny of [the bank's] solvency"); *United States v. Severson*, 569 F.3d 683, 685–86 (7th Cir. 2009) (upholding bank fraud conviction when the defendant participated with bank's president in scheme to "mask the bank's dilapidating condition and to present the illusion of a financially sound bank"); *United States v. Fields*, 614 F. App'x 101, 102 (4th Cir. 2015) (affirming convictions of bank executives when "[t]he indictment alleged that the objectives of the conspiracy were to hide the true financial condition of the Bank and to benefit the conspirators at the Bank's expense").

Defendants also deprived the bank of money or property as part of this deceptive scheme. *See Shaw*, 137 S. Ct. at 469. How? Because *they literally took from the bank millions of dollars and repurposed it.* Defendants diverted from bank funds: $267,727 to Danny Williams to do a straw purchase of A Avenue; $675,000 for Kehoe's initial unauthorized wire transfer; another $1.7 million to Kehoe to cover up the initial $675,000 outlay and surreptitiously pay off other people's loans; $23,326.66 out of Dudley's political account; and $100,000 to Coleman to pay back the down payments defendants falsely represented Coleman had already made, to say nothing of the initial amounts loaned to Coleman to finance the Bishop and Mesick purchases and get them out of OREO. All of this was money defendants took from bank funds as part of their fraudulent scheme.

Under Supreme Court precedent, it is irrelevant whether the bank suffered an "ultimate financial loss" or whether defendants had an "intent to cause financial loss." *Shaw*, 137 S. Ct. at 467. The bank had "the right to use [its] funds." *Id.* at 466. Defendants misappropriated those funds. It is hard to imagine a clearer deprivation of money or property than actually diverting millions of dollars from the bank. *See id.* at 467 (explaining that it is "'sufficient' that the victim (here, the bank) be 'deprived of its right to use of the property, even if it ultimately did not suffer unreimbursed loss") (quoting *Carpenter v. United States*, 484 U.S. 19, 26–27, 108 S.Ct. 316, 98 L.Ed.2d 275 (1987)). . . .

Properly considered, this case bears no meaningful resemblance to *Kelly*. Defendants' fraudulent diversion of *millions of dollars in bank funds* was not somehow a mere "bit part," "implementation cost," or "incidental byproduct" of their fraudulent scheme. Even if defendants misguidedly believed that all the bank's books would eventually balance out, using bank funds was *central* to their fraud.

*Kelly* was concerned with federal prosecutors misusing the wire fraud statute to turn "every corrupt act by state or local officials ... [into] a federal crime." *Id.* at 1574. Defendants' misconduct at their bank, in sharp contrast, lies at the foundation of the bank fraud statute. Defendants *took the bank's money*, diverted it to trusted third parties (Williams, Kehoe, Coleman), and then used these third parties to re-route the money back to the bank to wipe away troublesome bank records that would otherwise attract the scrutiny of the bank's Board and regulators. Diverting the bank's funds was necessary, central, and critical to the entire scheme. Under any reasonable sense of the phrase—both linguistically and conceptually—depriving the bank of this money was "*an* object" of defendants' fraud. *Id.* at 1571 (emphasis added) (quotations omitted).

The Second Circuit in *United States v. Gatto*, 986 F.3d 104 (2d Cir. 2021), rejected the same argument under *Kelly* that defendants raise here. In *Gatto*, the defendants were employees at a sports apparel company that had sponsorship agreements with university sports programs. The defendants illicitly paid money to basketball recruits' families to entice the recruits to join these programs, which would have made the students ineligible under NCAA rules. Defendants were prosecuted for wire fraud, and the Second Circuit upheld the convictions on the government's theory that defendants had deprived the universities of money used for financial aid given to the student athletes.

In so holding, the Second Circuit rejected the defendants' reliance on *Kelly*. The Second Circuit explained that "[d]efendants may have had multiple objectives, but property need only be '*an* object' of their scheme, not the sole or primary goal." *Id.* (quoting *Kelly*, 140 S. Ct. at 1572) (citation omitted). Depriving the universities of funds was not merely an "implementation cost[ ]" or "incidental byproduct" of defendants' scheme but was rather "at the heart" of the scheme, because "the scheme depended on the Universities awarding ineligible student-athletes athletic-based aid." That was so even though depriving the universities of financial aid monies was part of defendants' *broader scheme* to pay recruits' families to ensure that recruits went to schools where defendants' apparel company had lucrative sponsorship relationships.

As in *Gatto*, diverting money from the bank may not have been Heine and Yates's "sole or primary goal." But it was "at the *center* of the plan" because the larger scheme to conceal the bank's poor financial standing integrally depended on using the bank's own funds for that purpose. This case involves a scheme broader than simply depriving the bank of money outright, just as in *Gatto* the scheme was broader than just depriving the universities of money. But that made no difference to the Second Circuit, and it should make no difference here. Defendants in this case did not somehow remove millions of dollars from the bank "incidentally."

The central role of the monetary deprivation here in relation to the fraud is thus fundamentally different from what occurred in *Kelly*, where the deprivation of toll collectors' wages was merely a bit byproduct of the political payback scheme. That Heine and Yates taking money from the bank was part of their broader effort to mislead the bank and the FDIC should not somehow take their misconduct outside the bank fraud statute. That would create nothing less than a license to misuse bank funds. . . .

| **Problem 2-5** |
| --- |
| Tough question: Having read all the materials in this section, how would you now articulate what prosecutors must prove about the "corpus" or "object" of a defendant's deceptive scheme in order to succeed under the primary federal fraud statutes? Consider whether it is clearer to articulate a rule about what the object of the fraud can be, what it cannot be, or both. |

## E. Mail and Wire Fraud: Honest Services Fraud

What if the "corpus" of the fraud is not property or even property rights, but something even less tangible like legal rights? This problem tends to arise in triangular relationships. In a basic fraud, A deceives B to get B to give A something of value. We might call that a two-party or linear fraud. But sometimes, A will deceive B to get C to give A something of value (and C may well be in on the plan with A). B has not given A anything of value, but B has still been cheated by A. We might call this a triangular fraud.

For example, suppose Anna is Burt's and Cathy's teacher. Cathy pays Anna to give Burt a lower grade so that Cathy's grade will end up being the highest in the class. Anna and Cathy conceal this from Burt so that Burt will have no basis to seek recourse or to have Anna sanctioned by the school.

If criminal fraud required a scheme to deprive of tangible property, there would be no way to hold Anna liable for defrauding (essentially, cheating) Burt because Anna did not deprive Burt of any property: Anna and Cathy have schemed to deprive Burt of Burt's right to Anna's honest grading as Burt's teacher. (Unless we try to construct a strained theory about Burt having a property right in fair grading in exchange for having paid tuition to the school, but that could be difficult for a prosecutor to sell, especially given some of the courts' discussions about *Kelly* above.)

There are many examples like this: a disloyal and conflicted lawyer harming one client's interests for the benefit of another client; an elected official favoring one bidder over another in the awarding of a contract; a corporate officer steering the company to certain deals that benefit insiders, violating duties of loyalty to the company's shareholders; and so on.

Starting in the 1950s, the federal courts developed a theory to cover these "triangle" cases, holding in a series of rulings that the mail and wire fraud statutes covered not just schemes to defraud individuals of property but also schemes to defraud others of "the right to the honest services [of people they have hired, voted for, etc.]." In the example above, teacher Anna has deprived student Burt of his right to the honest services of teacher Anna—a right that comes, arguably, along with the nature of the contractual relationships among the school, the teachers, and the students.

In *McNally v. United States*, 483 U.S. 350 (1987), the Supreme Court held that the text of the mail and wire fraud statutes (which you read at the outset of this chapter) covered no such thing. The very next year, Congress said, "Yes it did" (or, at least, "now it does") by enacting the following statute:

> **18 U.S.C. § 1346. Definition of "scheme or artifice to defraud"**
>
> For the purposes of this chapter, the term "scheme or artifice to defraud" includes a scheme or artifice to deprive another of the intangible right of honest services.

Congress's new statute—as clear an example as you will see of a statute designed to reinstitute overruled case law—left unaddressed the difficulties with the "honest services" theory of mail and wire fraud. Even as the courts had been constructing that theory under the statutes, they (or some judges at least) were raising worries about the vagueness and potential overbreadth of the theory of defrauding a person of an "intangible right."

In the case below, the Supreme Court finally addressed those worries, by narrowing the scope of Congress's anti-*McNally* statute. (The defendant Jeffrey Skilling, former CEO of Enron—who will be discussed in Chapter 3—won here but lost on remand because there was plenty of evidence against him of securities fraud too, so the problem with the mail and wire fraud theory in his case didn't turn out to matter to his conviction and sentence.)

To recap, the sequence goes like this: (1) Congress enacts the mail and wire fraud statutes; (2) the federal courts, over decades, interpret them as covering the honest services theory of fraud; (3) the Supreme Court holds in *McNally* that the statutes don't cover that theory; (4) Congress enacts 18 U.S.C. § 1346, which states that deprivations of honest services are included within mail and wire fraud; (5) the Supreme Court, in the *Skilling* decision below, narrows the meaning of honest services fraud in order, it says, to save 18 U.S.C. § 1346 from constitutional difficulty.

**SKILLING v. UNITED STATES, 561 U.S. 358 (2010)**

Justice GINSBURG delivered the opinion of the Court.

In 2001, Enron Corporation, then the seventh highest-revenue-grossing company in America, crashed into bankruptcy. We consider in this opinion . . . questions arising from the prosecution of Jeffrey Skilling, a longtime Enron executive, for crimes committed before the corporation's collapse.

Founded in 1985, Enron Corporation grew from its headquarters in Houston, Texas, into one of the world's leading energy companies. Skilling launched his career there in 1990 when Kenneth Lay, the company's founder, hired him to head an Enron subsidiary. Skilling steadily rose through the corporation's ranks, serving as president and chief operating officer, and then, beginning in February 2001, as chief executive officer. Six months later, on August 14, 2001, Skilling resigned from Enron.

Less than four months after Skilling's departure, Enron spiraled into bankruptcy. The company's stock, which had traded at $90 per share in August 2000, plummeted to pennies per share in late 2001. Attempting to comprehend what caused the corporation's collapse, the U.S. Department of Justice formed an Enron Task Force, comprising prosecutors and FBI agents from around the Nation. The Government's investigation uncovered an elaborate conspiracy to prop up Enron's short-run stock prices by overstating the company's financial well-being. In the years following Enron's bankruptcy, the Government prosecuted dozens of Enron employees who participated in the scheme. In time, the Government worked its way up the corporation's chain of command: On July 7, 2004, a grand jury indicted Skilling, Lay, and Richard Causey, Enron's former chief accounting officer.

These three defendants, the indictment alleged,

> "engaged in a wide-ranging scheme to deceive the investing public, including Enron's shareholders, . . . about the true performance of Enron's businesses by: (a) manipulating Enron's publicly reported financial results; and (b) making public statements and representations about Enron's financial performance and results that were false and misleading."

Skilling and his co-conspirators, the indictment continued, "enriched themselves as a result of the scheme through salary, bonuses, grants of stock and stock options, other profits, and prestige."

Count 1 of the indictment charged Skilling with conspiracy to commit securities and wire fraud; in particular, it alleged that Skilling had sought to "depriv[e] Enron and its shareholders of the intangible right of [his] honest services." The indictment further charged Skilling with more than 25 substantive counts of securities fraud, wire fraud, making false representations to Enron's auditors, and insider trading. . . .

We . . . consider whether Skilling's conspiracy conviction was premised on an improper theory of honest-services wire fraud. The honest-services statute, § 1346, Skilling maintains, is unconstitutionally vague. Alternatively, he contends that his conduct does not fall within the statute's compass.

To place Skilling's constitutional challenge in context, we first review the origin and subsequent application of the honest-services doctrine.

Enacted in 1872, the original mail-fraud provision, the predecessor of the modern-day mail- and wire-fraud laws, proscribed, without further elaboration, use of the mails to advance "any scheme or artifice to defraud." *See McNally v. United States,* 483 U.S. 350 (1987). In 1909, Congress amended the statute to prohibit, as it does today, "any scheme or artifice to defraud, *or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises*." § 1341 (emphasis added); *see id.,* at 357–58, 107 S. Ct. 2875. Emphasizing Congress' disjunctive phrasing, the Courts of Appeals, one after the other, interpreted the term "scheme or artifice to defraud" to include deprivations not only of money or property, but also of intangible rights.

In an opinion credited with first presenting the intangible-rights theory, *Shushan v. United States,* 117 F.2d 110 (1941), the Fifth Circuit reviewed the mail-fraud prosecution of a public official who allegedly accepted bribes from entrepreneurs in exchange for urging city action beneficial to the bribe payers. "It is not true that because the [city] was to make and did make a saving by the operations there could not have been an intent to defraud," the Court of Appeals maintained. *Id.,* at 119. "A scheme to get a public contract on more favorable terms than would likely be got otherwise by bribing a public official," the court observed, "would not only be a plan to commit the crime of bribery, but would also be a scheme to defraud the public." *Id.,* at 115.

The Fifth Circuit's opinion in *Shushan* stimulated the development of an "honest-services" doctrine. Unlike fraud in which the victim's loss of money or property supplied the defendant's gain, with one the mirror image of the other, the honest-services theory targeted corruption that lacked similar symmetry. While the offender profited, the betrayed party suffered no deprivation of money or property; instead, a third party, who had not been deceived, provided the enrichment. For example, if a city mayor (the offender) accepted a bribe from a third party in exchange for awarding that party a city contract, yet the contract terms were the same as any that could have been negotiated at arm's length, the city (the betrayed party) would suffer no tangible loss. Even if the scheme occasioned a money or property *gain* for the betrayed party, courts reasoned, actionable harm lay in the denial of that party's right to the offender's "honest services."

"Most often these cases . . . involved bribery of public officials," *United States v. Bohonus,* 628 F.2d 1167 (C.A.9 1980), but courts also recognized private-sector honest-services fraud. In perhaps the earliest application of the theory to private actors, a District Court, reviewing a bribery scheme, explained:

> "When one tampers with [the employer-employee] relationship for the

> purpose of causing the employee to breach his duty [to his employer,] he in effect is defrauding the employer of a lawful right. The actual deception that is practised is in the continued representation of the employee to the employer that he is honest and loyal to the employer's interests." *United States v. Procter & Gamble Co.,* 47 F. Supp. 676 (D. Mass. 1942).

Over time, "[a]n increasing number of courts" recognized that "a recreant employee"—public or private—"c[ould] be prosecuted under [the mail-fraud statute] if he breache[d] his allegiance to his employer by accepting bribes or kickbacks in the course of his employment," *United States v. McNeive,* 536 F.2d 1245 (C.A.8 1976); by 1982, all Courts of Appeals had embraced the honest-services theory of fraud.

In 1987, this Court, in *McNally v. United States,* stopped the development of the intangible-rights doctrine in its tracks. *McNally* involved a state officer who, in selecting Kentucky's insurance agent, arranged to procure a share of the agent's commissions via kickbacks paid to companies the official partially controlled. 483 U.S., at 360. The prosecutor did not charge that, "in the absence of the alleged scheme[,] the Commonwealth would have paid a lower premium or secured better insurance." Instead, the prosecutor maintained that the kickback scheme "defraud [ed] the citizens and government of Kentucky of their right to have the Commonwealth's affairs conducted honestly."

We held that the scheme did not qualify as mail fraud. "Rather than constru[ing] the statute in a manner that leaves its outer boundaries ambiguous and involves the Federal Government in setting standards of disclosure and good government for local and state officials," we read the statute "as limited in scope to the protection of property rights." "If Congress desires to go further," we stated, "it must speak more clearly."

Congress responded swiftly. The following year, it enacted a new statute "specifically to cover one of the 'intangible rights' that lower courts had protected . . . prior to *McNally:* 'the intangible right of honest services.'" *Cleveland v. United States,* 531 U.S. 12 (2000). In full, the honest-services statute stated:

> "For the purposes of th[e] chapter [of the United States Code that prohibits, *inter alia,* mail fraud, § 1341, and wire fraud, § 1343], the term 'scheme or artifice to defraud' includes a scheme or artifice to deprive another of the intangible right of honest services." § 1346.

Congress, Skilling charges, reacted quickly but not clearly: He asserts that § 1346 is unconstitutionally vague.

According to Skilling, § 1346 meets neither of the two due process essentials. First, the phrase "the intangible right of honest services," he contends, does not adequately define what behavior it bars. Second, he alleges, § 1346's "standardless sweep allows policemen, prosecutors, and juries to pursue their personal predilections," thereby "facilitat[ing] opportunistic and arbitrary prosecutions.". . .

In urging invalidation of § 1346, Skilling swims against our case law's current, which requires us, if we can, to construe, not condemn, Congress' enactments.

We agree that § 1346 should be construed rather than invalidated. First, we look to the doctrine developed in pre-*McNally* cases in an endeavor to ascertain the meaning of the phrase "the intangible right of honest services." Second, to preserve what Congress certainly intended the statute to cover, we pare that body of precedent down to its core: In the main, the pre-*McNally* cases involved fraudulent schemes to deprive another of honest services through bribes or kickbacks supplied by a third party who had not been deceived. Confined to these paramount applications, § 1346 presents no vagueness problem.

There is no doubt that Congress intended § 1346 to refer to and incorporate the honest-services doctrine recognized in Court of Appeals' decisions before *McNally* derailed the intangible-rights theory of fraud. . . .

> "The definite article 'the' suggests that 'intangible right of honest services' had a specific meaning to Congress when it enacted the statute—Congress was recriminalizing mail- and wire-fraud schemes to deprive others of *that* 'intangible right of honest services,' which had been protected before *McNally,* not *all* intangible rights of honest services whatever they might be thought to be. . . ." *United States v. Rybicki,* 354 F.3d 124 (2003).

In parsing the Courts of Appeals decisions, we acknowledge that Skilling's vagueness challenge has force, for honest-services decisions preceding *McNally* were not models of clarity or consistency. While the honest-services cases preceding *McNally* dominantly and consistently applied the fraud statute to bribery and kickback schemes—schemes that were the basis of most honest-services prosecutions—there was considerable disarray over the statute's application to conduct outside that core category. In light of this disarray, Skilling urges us, as he urged the Fifth Circuit, to invalidate the statute *in toto*. . . .

It has long been our practice, however, before striking a federal statute as impermissibly vague, to consider whether the prescription is amenable to a limiting construction. . . .

Although some applications of the pre-*McNally* honest-services doctrine occasioned disagreement among the Courts of Appeals, these cases do not cloud the doctrine's solid core: The "vast majority" of the honest-services cases involved offenders who, in violation of a fiduciary duty, participated in bribery or kickback schemes. . . . Indeed, the *McNally* case itself, which spurred Congress to enact § 1346, presented a paradigmatic kickback fact pattern. . . .

In view of this history, there is no doubt that Congress intended § 1346 to reach *at least* bribes and kickbacks. Reading the statute to proscribe a wider range of offensive conduct, we acknowledge, would raise the due process concerns underlying the vagueness doctrine. To preserve the statute without transgressing constitutional limitations, we now hold that § 1346 criminalizes *only* the bribe-and-kickback core of the pre-*McNally* case law.

The Government urges us to go further by locating within § 1346's compass another category of proscribed conduct: "undisclosed self-dealing by a public official or private employee—*i.e.,* the taking of official action by the employee that furthers his own undisclosed financial interests while purporting to act in the interests of those to whom he owes a fiduciary duty." "[T]he theory of liability in *McNally* itself was nondisclosure of a conflicting financial interest," the Government observes, and "Congress clearly intended to revive th[at] nondisclosure theory." Moreover, "[a]lthough not as numerous as the bribery and kickback cases," the Government asserts, "the pre-*McNally* cases involving undisclosed self-dealing were abundant. . . ."

Although the Courts of Appeals upheld honest-services convictions for "some schemes of non-disclosure and concealment of material information," *Mandel,* 591 F.2d, at 1361, they reached no consensus on which schemes qualified. In light of the relative infrequency of conflict-of-interest prosecutions in comparison to bribery and kickback charges, and the intercircuit inconsistencies they produced, we conclude that a reasonable limiting construction of § 1346 must exclude this amorphous category of cases. . . .

In sum, our construction of § 1346 "establish[es] a uniform national standard, define[s] honest services with clarity, reach[es] only seriously culpable conduct, and accomplish[es] Congress's goal of 'overruling' *McNally*." "If Congress desires to go further," we reiterate, "it must speak more clearly than it has. . . ."

It remains to determine whether Skilling's conduct violated § 1346. Skilling's honest-services prosecution, the Government concedes, was not "prototypical." The Government charged Skilling with conspiring to defraud Enron's shareholders by misrepresenting the company's fiscal health, thereby artificially inflating its stock price. It was the Government's theory at trial that Skilling "profited from the fraudulent scheme . . . through the receipt of salary and bonuses, . . . and through the sale of approximately $200 million in Enron stock, which netted him $89 million."

The Government did not, at any time, allege that Skilling solicited or accepted side payments from a third party in exchange for making these misrepresentations. . . . It is therefore clear that, as we read § 1346, Skilling did not commit honest-services fraud. . . .

Justice SCALIA, with whom Justice THOMAS joins, and with whom Justice KENNEDY joins except as to Part III, concurring in part and concurring in the judgment.

In my view, the specification in 18 U.S.C. § 1346 (2006 ed., Supp. II) that "scheme or artifice to defraud" in the mail-fraud and wire-fraud statutes, §§ 1341 and 1343 (2006 ed.), includes "a scheme or artifice to deprive another of the intangible right of honest services," is vague, and therefore violates the Due Process Clause of the Fifth Amendment. The Court strikes a pose of judicial humility in proclaiming that our task is "not to destroy the Act . . . but to construe it," *ante,* at 2930 (internal quotation marks omitted). But in transforming the prohibition of "honest-services fraud" into a prohibition of "bribery and kick-backs" it is wielding a power we long ago abjured: the power to define new federal crime. . . .

I agree that Congress used the novel phrase to adopt the lower-court case law that had been disapproved by *McNally*—what the Court calls "the pre-*McNally* honest-services doctrine," *ante,* at 2930. The problem is that that doctrine provides no "ascertainable standard of guilt," and certainly is not limited to "bribes or kickbacks . . . ."

The Court is aware of all this. It knows that adopting by reference "the pre-*McNally* honest-services doctrine" is adopting by reference nothing more precise than the referring term itself ("the intangible right of honest services"). Hence the *deus ex machina:* "[W]e pare that body of precedent down to its core." Since the honest-services doctrine "had its genesis" in bribery prosecutions, and since several cases and counsel for Skilling referred to bribery and kickback schemes as "core" or "paradigm" or "typical" examples, or "[t]he most obvious form," of honest-services fraud, *ante,* at 2930–31 (internal quotation marks omitted), and since two cases and counsel for the Government say that they formed the "vast majority," or "most" or at least "[t]he bulk" of honest-services cases, *ante,* at 2930–31 (internal quotation marks omitted), THEREFORE it must be the case that they are *all* Congress meant by its reference to the honest-services doctrine.

Even if that conclusion followed from its premises, it would not suffice to eliminate the vagueness of the statute. It would solve (perhaps) the indeterminacy of what acts constitute a breach of the "honest services" obligation under the pre-*McNally* law. But it would not solve the most fundamental indeterminacy: the character of the "fiduciary capacity" to which the bribery and kickback restriction applies. Does it apply only to public officials? Or in addition to private individuals who contract with the public? Or to everyone, including the corporate officer here? The pre-*McNally* case law does not provide an answer. Thus, even with the bribery and kickback limitation the statute does not answer the question "What is the criterion of guilt?"

But that is perhaps beside the point, because it is obvious that mere prohibition of bribery and kickbacks was not the intent of the statute. To say that bribery and kickbacks represented "the core" of the doctrine, or that most cases applying the doctrine involved those offenses, is not to say that they *are* the doctrine. . . . Among all the pre-*McNally* smorgasbord-offerings of varieties of honest-services fraud, *not one* is limited to bribery and kickbacks. . . . Perhaps it is true that "Congress intended § 1346 to reach *at least* bribes and kickbacks". That simply does not mean, as the Court now holds, that "§ 1346 criminalizes *only*" bribery and kickbacks. . . .

I certainly agree with the Court that we must, "if we can," uphold, rather than "condemn," Congress's enactments. But I do not believe we have the power, in order to uphold an enactment, to rewrite it.

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As Justice Scalia warned, the *Skilling* decision left work for the courts. In the bigger picture, the question is the extent to which prosecutors will be able to refashion what used to be honest services fraud cases as property fraud cases, using creative theories about property, as attempted in *Kelly*. Meanwhile, in honest services fraud prosecutions, several questions persist:

(1) what is a bribe for purposes of section 1346?

(2) what is a kickback for purposes of section 1346?

(3) if a fiduciary relationship is required, what kind(s) of relationships qualify?

The following cases indicate how this unfolding story is developing in the federal courts of appeals. Note that it has always been the case that the honest services theory covers both "public" (political corruption) and "private" (business) cases. *Skilling* affects both kinds of cases. But the decision undoubtedly cut back more on what prosecutors can do with the statute in the private context—or at least it will force them back to the drawing board for new theories to cover corporate frauds with the mail and wire fraud statutes.

It is entirely predictable, maybe even certain, that circuit splits will develop on these and other issues. The following cases are a sample, not a survey. In an introduction to the field, you should expect to understand the current issues under the statute, not know what each of the circuits has said about them. The latter is a matter for legal research.

**<u>1. "Bribe"</u>**

**UNITED STATES v. HAWKINS, 777 F.3d 880 (7th Cir. 2015)**

EASTERBROOK, Circuit Judge:

Thomas Hawkins and John Racasi were employed as analysts on the staff of Larry Rogers, a member of the Cook County Board of Review, when they accepted money from Ali Haleem, a corrupt Chicago police officer acting as an undercover agent in order to reduce the penalties for his own crimes. The Board of Review hears complaints by property owners who believe that the assessed valuation (which affects real-estate taxes) is excessive. Haleem paid Hawkins and Racasi to arrange for lower assessments. They took his money, and the assessments were reduced, except for one parcel about which the protest was untimely. A jury found that Hawkins and Racasi had violated 18 U.S.C. § 666 (theft or bribery concerning programs receiving federal funds) and § 1341 (mail fraud), plus corresponding prohibitions of conspiracy. Hawkins and Racasi contend that they committed a different offense—they assert that they took the money with the intent to deceive Haleem and did nothing in exchange for the cash—and that the jury convicted them of the indictment's charges only because it was improperly instructed. . . .

The mail-fraud statute . . . prohibits schemes to defraud that use the mails but does not elaborate. Hawkins and Racasi may have defrauded Haleem out of his money (this was their defense!), but that was not the prosecutor's theory. The United States relied on 18 U.S.C. § 1346, which defines scheme to defraud as including "a scheme or artifice to deprive another of the intangible right of honest services." The idea is that the employer has a right to loyalty from agents and employees, and the prosecutor contended that Hawkins and Racasi deprived Cook County of their loyal services by taking Haleem's money secretly. But "honest services" is open-ended, and in *Skilling v. United States*, 561 U.S. 358, 130 S. Ct. 2896, 177 L. Ed. 2d 619 (2010), the Justices deflected a contention that it is so open-ended as to be unconstitutionally vague. They did this by holding that § 1346 covers only bribery and kickbacks. This means that an agent's secret receipt of a gratuity (a "reward" in the language of § 666) does not violate § 1341, for a payment that does not entail a plan to change how the employee or agent does his job is neither a bribe nor a kickback.

The district court instructed the jury that it could convict defendants under § 1341 only if they "intended to deprive another of the intangible right to honest services through bribery." So far, so good. (The instructions did not mention kickbacks, because the prosecutor did not allege any.) But the instructions then defined bribery this way:

> A defendant commits bribery when he, while acting as an agent of government, or any agency of that government, such as Cook County, solicits, demands, accepts, or agrees to accept, anything of value from another person corruptly intending to be influenced or rewarded in connection with some business, transaction or series of transactions of the government or government agency.

Under this instruction, defendants committed "bribery" if they took Haleem's money "intending to be . . . rewarded" for their official positions, even if they did not plan to lift a finger to reduce the properties' assessed valuations. Treating a gratuity as a bribe transgresses *Skilling*. The word "corruptly" in this instruction does not save it, given the way a different instruction defined "corruptly" (a subject we discussed above). . . .

The United States now defends the district judge's instruction despite its use of "reward." It contends that treating a gratuity as a bribe is consistent with *Skilling* because, in the course of a lengthy opinion, the Supreme Court cited 18 U.S.C. § 201(b), the principal bribery statute for federal employees, *see* 561 U.S. at 412 & n. 45, 130 S.Ct. 2896, and § 201(b) permits conviction on proof that the defendant accepted a reward. But that's not what *Skilling* says. It reversed Skilling's conviction because he did not accept anything of value "in exchange for" making misrepresentations to Enron's investors. If accepting some reward were enough, then Skilling's conviction would have been affirmed—for the theory in Skilling's own mail-fraud prosecution was that he had been rewarded (by his salary) for his services during a time when Enron violated the securities laws. The Justices thought that bribery entails a quid pro quo (planned or realized), not just a receipt of money. . . .

The United States maintains that proof of a completed exchange is not essential, and that's right. A plan to take money in exchange for an official act constitutes a scheme to defraud, whether or not the plan succeeds. We agree with this aspect of decisions such as *United States v. McDonough*, 727 F.3d 143, 159–60 (1st Cir. 2013); *United States v. Rosen*, 716 F.3d 691, 700–02 (2d Cir. 2013); and *United States v. Bryant*, 655 F.3d 232, 244–45 (3d Cir. 2011), on which the prosecutor relies. But none of these opinions holds that accepting a "reward" without doing anything in exchange—or ever planning to—is "bribery" that can support a mail-fraud conviction after *Skilling*. That's the problem in this instruction.

The United States weakly argues that any error was harmless, but that contention relies entirely on the undisputed fact that the defendants told Haleem that payments would induce them to lower the assessments. Yet defendants contend that they were lying. If they were indeed lying, then they can't be convicted under § 1341, even though the convictions under § 666 are valid. The definition of "bribery" in the instructions allowed the jury to bypass the question whether Hawkins and Racasi were scamming Haleem rather than Cook County. The error therefore cannot be called harmless, and defendants are entitled to a new trial of the mail-fraud charges. . . .

### 2. "Kickback"

**UNITED STATES v. DEMIZIO, 741 F.3d 373 (2d Cir. 2014)**

KEARSE, Circuit Judge:

In the securities industry, financial institutions and their customers sometimes participate in transactions such as "short sales"—i.e., sales of stock not then owned by the seller—that require them to borrow securities from other financial institutions. The present prosecution charged [Defendant Darin DeMizio] principally with conspiracy to commit securities fraud and wire fraud by causing his employer, Morgan Stanley & Co. Inc. ("Morgan Stanley"), to conduct stock-loan transactions through intermediary firms in a manner that, at Morgan Stanley's expense, caused large sums of money to be paid to DeMizio's brother and father for little or no work. . . .

On appeal, DeMizio contends principally that he is entitled to a judgment of acquittal on Count One, arguing that the evidence at trial was insufficient to prove an honest-services fraud conspiracy. He contends that (a) a payment in the private sector qualifies as a kickback only when the recipient does not perform any work other than the conferral of business in connection with the payment, and [his brother and father] did perform work; (b) a payment in the private sector qualifies as a kickback only when it is the employee who receives the payment, and [DeMizio] never received any money from the alleged schemes; and (c) there is no violation of § 1346 without nondisclosure of material information to the employer by the employee, and [his father's] involvement . . . was fully disclosed. . . .

In *Skilling*, addressing a contention that § 1346 was void for vagueness, the Supreme

Court concluded that the section is not unconstitutionally vague to the extent that it covers schemes involving bribery and kickbacks. The Court reasoned that fraudulent schemes involving bribery and kickbacks had long been held to be within the scope of §§ 1341 and 1343, and that in enacting § 1346 in the wake of *McNally* to proscribe fraudulent schemes for deprivation of the intangible right of honest services, Congress "no doubt . . . intended § 1346 to reach at least " schemes to defraud involving "bribes and kickbacks." 130 S. Ct. at 2931 (emphasis in original). The *Skilling* Court concluded that § 1346 cannot be interpreted to reach an "amorphous category" such as "conflict-of-interest" cases, 130 S. Ct. at 2932, and that the section "criminalizes only the bribe-and-kickback core of the pre-*McNally* case law," *id.* at 2931 (emphasis in original).

A kickback scheme typically involves an employee's steering business of his employer to a third party in exchange for a share of the third party's profits on that business. *See, e.g.*, Black's Law Dictionary 948 (9th ed. 2009) (defining "kickback" as the "return of a portion of a monetary sum received, esp. as a result of coercion or a secret agreement"). We reject at the outset DeMizio's suggestion that, in determining whether the evidence against him was sufficient under § 1346, we should ignore cases involving public officials. The *Skilling* Court noted that although honest-services cases most often involved bribery of public officials, private sector honest-services fraud had been recognized at least as early as 1942. The Court analyzed cases involving public officials as well as cases involving employees in the private sector in deciding the appeal brought by Skilling himself, a private-sector employee; and it noted that while the principal federal bribery statute, 18 U.S.C. § 201, "generally applies only to federal public officials, . . . § 1346's application to . . . private-sector fraud reaches misconduct that might otherwise go unpunished."

We also reject DeMizio's argument that kickbacks (a) do not include payments made to entities other than the employee who steers his employer's business to a third party in exchange for those payments, and (b) do not include payments of large sums of money to those recipients so long as they perform some minimal amount of work. Although the kickback amount frequently is paid directly to the employee who steered the contract, the scheme is no less a kickback scheme when the employee directs the third party to share its profits with an entity designated by the employee in which the employee has an interest. For example, as noted in *Skilling, see* 130 S. Ct. at 2933–34, a statute prohibiting kickbacks with respect to federal contracts defined "kickback," in part, to include "any money, . . . thing of value, or compensation of any kind which is provided, directly or indirectly," to a prime contractor or its employee "for the purpose of . . . rewarding favorable treatment in connection with . . . a subcontract relating to a prime contract," 41 U.S.C. § 52(2) (2006). . . .

In this vein, payoff schemes have been viewed as involving kickbacks when the defendant has directed that the contracting party's profit be shared with family, friends, or others loyal to the defendant.

In light of these authorities, and the failure of DeMizio to cite any authority to support his constrained conception of kickbacks, we reject his contention that a payment in a private-sector scheme does not qualify as a kickback unless the defendant employee himself or herself receives the payoff. The evidence overwhelmingly established that DeMizio directed Morgan Stanley stock-loan business to companies that agreed to pay commissions to his father and/or brother, in whom DeMizio plainly had an interest.

Further, there was evidence from which it could be inferred that the payoffs benefited DeMizio himself financially. For example, [a witness] testified DeMizio asked him to pay commissions to DeMizio's brother Craig because DeMizio said Craig "wasn't making a lot of money . . . and he needed help." (Tr. 98.) [The witness] also testified that he formed [his company] in 1999 at the suggestion of DeMizio, who asked him to hire DeMizio's father . . . in 2000. [Another witness] testified that around that time DeMizio was complaining . . . that [his father] was "hurting for money" and was requesting money from DeMizio.

As the district court reasoned, "the jury could have reasonably concluded that DeMizio benefited indirectly from the payments to his father and brother because he would otherwise have had to support them financially. By instead arranging for them to obtain substantial payments for little or no work, he relieved himself of the obligation to assist the individuals using his own wealth." . . .

We agree with the district court's post-*Skilling* view that the rule advocated by DeMizio—i.e., that so long as "any" work at all is done by the recipient of a share of the contracting party's profits, that payoff is not a kickback—"would be untenable," allowing "[p]otential fraudsters [to] shield themselves from criminal liability merely by performing some token labor in exchange for what would otherwise be an illegal kickback." And we agree with the district court that

> there was ample evidence from which a reasonable jury could have inferred that the payments to [the father and brother] were kickbacks. They performed work on no more than 10 to 20 percent of the transactions for which they were paid. The work they did perform was of minimal quality and difficulty, and there was even evidence that they were not competent to perform work as finders. In exchange for this "work," they received in excess of $1.5 million in payments. While DeMizio was free to argue to the jury that these payments were in exchange for legitimate work, the jury reasonably found otherwise.

Finally, we reject DeMizio's contention that the government's evidence was insufficient to show fraud, i.e., that Morgan Stanley was unaware of his kickback schemes. [A witness] testified to the existence of "a code that [DeMizio] would use with [him] to discuss these transactions"; that DeMizio said he wanted to use code "because he didn't want the people seated next to him to hear" him "instruct[ing the witness to] . . . put his brother in" on stock-loan tickets, . . . [b]ecause Morgan Stanley did not want him to deal with his brother." (Tr. 98–99.) [Another witness] testified that he and DeMizio did not discuss the arrangement . . . "to pay his brother Craig in front of other people," and [the witness] "did . . . not tell the other traders" at Freeman about the arrangement because "it was illegal" and "Darin didn't want anybody else to know about it." (Id. at 338.) Evangelista also testified that DeMizio told him that if anyone found out about the arrangement "[DeMizio] would deny the whole thing." (*Id.* at 339.) . . .

**3. "Fiduciary Duty"**

**UNITED STATES v. MILOVANOVIC, 678 F.3d 713 (9th Cir. 2012) (en banc)**

TALLMAN, Circuit Judge:

The State of Washington outsources the testing of applicants for commercial truck drivers' licenses to entities and individuals who administer the test and certify the results. The government alleges that a scheme to solicit bribes corrupted the process and caused the State to issue licenses to unqualified non-residents. A federal grand jury returned an indictment for mail and wire fraud on a theory that the State was deprived of the delivery of honest services by those involved. The district court held that the existence of a formal fiduciary duty to the State and resulting economic harm were required, and the court dismissed all charges. The United States brought an appeal to reinstate the case. 18 U.S.C. § 3731. . . .

Defendants Brano Milovanovic ("Milovanovic"), Tony Lamb ("Lamb"), Ismail Hot ("Hot"), Muhamed Kovacic ("Kovacic"), Elvedin Bilanovic ("Bilanovic"), and Aleksandar Djordjevic ("Djordjevic") were charged with conspiracy and with devising a scheme and artifice to defraud and deceive the Washington State Department of Licensing ("DOL"). The government alleged that defendants solicited and were paid bribes to help unqualified, non-resident applicants obtain commercial drivers' licenses ("CDLs") through materially false and fraudulent misrepresentations and omissions on CDL applications achieved by cheating on the exams, by false certifications that skills tests were completed successfully when no such tests were successfully performed, and by use of in-state addresses in Spokane, Washington, when the applicants actually resided out of state. . . .

In light of the Supreme Court's decision in *Skilling,* the parties agree that a breach of fiduciary duty is a required element of honest services fraud under §§ 1341 and 1346. Where they disagree, however, is whether the Supreme Court intended to require a formal, or classic, fiduciary duty or whether the statute also reaches those who assume a comparable duty of loyalty, trust, or confidence. Defendants argue that because Lamb was an independent contractor and Milovanovic did not contract with the State directly, there was no recognized fiduciary relationship between them and the State of Washington. Although we agree that a breach of fiduciary duty is an element of honest services mail fraud, our agreement with the defendants' argument stops there. . . .

A fiduciary is generally defined as "[a] person who is required to act for the benefit of another person on all matters within the scope of their relationship; one who owes to another the duties of good faith, trust, confidence, and candor. . . ." Black's Law

Dictionary (9th ed.). And courts have held that "fiduciary" encompasses informal fiduciaries. *See, e.g., In re Monnig's Dep't Stores, Inc. v. Azad Oriental Rugs, Inc.,* 929 F.2d 197, 201 (5th Cir. 1991) ("Confidential relationships arise not only from technical fiduciary relationships, but also from partnerships, joint ventures, and other informal relationships."); *United States v. Pappert*, 112 F.3d 1073, 1080 (10th Cir. 1997) ("[T]here is not a bright line between formal or informal fiduciary relationships, and run-of-the-mill commercial relationships. . . . [Courts] must carefully distinguish between those arms-length commercial relationships where trust is created by the defendant's personality or the victim's credulity, and relationships in which the victim's trust is based on defendant's position in the transaction.") (internal quotation marks omitted); *Advocare Int'l, LP v. Horizon Labs., Inc.,* 524 F.3d 679, 695–98 (5th Cir. 2008) (discussing formal and informal fiduciaries under Texas law). This definition is broad, but intentionally so. The existence of a fiduciary duty in a criminal prosecution is a fact-based determination that must ultimately be determined by a jury properly instructed on this issue.

In *Skilling,* 130 S.Ct. at 2931 n.41, the Supreme Court's reliance on *Chiarella v. United States,* a securities case that found "the duty to disclose arises when one party has information that the other [party] is entitled to know because of a fiduciary *or other similar relation of trust and confidence* between them," suggests that the Supreme Court interpreted the Mail Fraud Statute to mean that both formal—"fiduciary"—and informal fiduciaries—"other similar relation of trust and confidence"—are susceptible to prosecution. 445 U.S. 222, 228, 100 S. Ct. 1108, 63 L. Ed. 2d 348 (1980) (first alteration in original) (emphasis added) (citation and internal quotation marks omitted); *see also Rybicki*, 354 F.3d at 126–27 ("Based upon a review of the case law extant at the time that Congress enacted section 1346, we conclude that the statute clearly prohibits a scheme or artifice to use the mails or wires to enable an officer or employee of a private entity (*or a person in a relationship that gives rise to a duty of loyalty comparable to that owed by employees to employers* ) purporting to act for and in the interests of his or her employer (*or of the person to whom the duty of loyalty is owed* ) secretly to act in his or her or the defendant's own interests instead, accompanied by a material misrepresentation made or omission of information disclosed to the employer." (emphasis added)).

As we noted in *Williams,* we agree with the Second Circuit that, "'[a]lthough the bulk of the pre-*McNally* honest-services cases involved employees, we see no reason the principle they establish would not apply to other persons who assume a legal duty of loyalty comparable to that owed by an officer or employee to a private entity.'"

We therefore hold that a fiduciary duty for the purposes of the Mail Fraud Statute is not limited to a formal "fiduciary" relationship well-known in the law, but also extends to a trusting relationship in which one party acts for the benefit of another and induces the trusting party to relax the care and vigilance which it would ordinarily exercise. *See Moon v. Phipps,* 67 Wash. 2d 948, 411 P.2d 157, 160 (1966). In the case *sub judice,* the contractual term purporting to establish the testers as "independent contractors" for avoiding state vicarious civil liability does not foreclose the legal determination that an agency relationship or a relationship of trust existed between the State of Washington and Milovanovic and Lamb. The definition of "fiduciary" is certainly flexible enough to encompass the situation here. The State entrusted Milovanovic and Lamb to honestly and truthfully administer the written and skills tests and to interpret and certify the results. The defendants well knew that the State relied on their fidelity in administering and translating the tests in order to grant CDLs to applicants. . . .

Our reading of § 1341 in conjunction with § 1346 suggests that there are six limitations to the conduct susceptible to prosecution under the otherwise broad reach of the Mail Fraud Statute. First, there must be a legally based, recognized "enforceable right to the services at issue." Second, "[w]hat distinguishes 'honest services' from the general provision of labor, skill, or advice is that the value of the particular services at issue largely depends on their being performed honestly, that is, without fraud or deception." *Id.* The Mail Fraud Statute, therefore, reaches those who deprive another of services, the value of which depends on them being performed honestly. Third, deprivation of those services must be in breach of a formal or informal fiduciary duty. Fourth, under the plain text of the statute, the defendant must have a specific intent to defraud. Fifth, the defendant must "misrepresent or conceal a material fact." And, finally, "mails or wires must be used to further the scheme."

We therefore hold that the "intangible right to honest services" in § 1346, as devised by Congress, encompasses situations such as the conduct alleged here. . . .

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Note that at the end of the *Milovanovic* opinion, the court lists only six elements of honest services fraud. What element did the court forget to include?

| **Problem 2-6** | |
|---|---|
| (a) | Can the following case be charged as mail/wire fraud: Albert, a professor of engineering at the University of Texas, grants PhDs to three students who fail the examination in a required course on statistical methods; the three students obtain jobs with NASA in Houston and later recommend that Albert be hired as a consultant on a project for which NASA pays Albert $10,000 for his work. (Many wire communications across state lines occur in the course of the matter.) |
| (b) | Can the following case be charged as mail/wire fraud: Lucy, a partner at a large New York law firm, is asked to represent Corp B, a Delaware corporation, in a bid for a very large construction contract with the City of New York. During the "conflicts check," Lucy's partners tell her she can't represent Corp B because another partner at the firm is representing Corp A, a New Jersey corporation, which is bidding for the same construction contract. Lucy continues to represent Corp B, and collects a fee for doing so, while hiding her representation of Corp B from her partners. |
| (c) | Under what circumstances do you think a senior officer (the CEO, for example) of a large publicly held corporation could be charged with honest services fraud after *Skilling*? |