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WHITE-COLLAR CRIME

Supreme Court Agrees To Decide Another Mail/Wire Fraud Question

By Elkan Abramowitz and Jonathan Sack

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The Supreme Court has taken pains in recent years to mark the boundaries of the federal mail/wire fraud statutes. Of particular importance has been the outer limits of "property" in the context of a deprivation of "money or property." In *Kelly v. United States*, 140 S.Ct. 1565, 1573 (2020), the court held that "money or property" fraud does not encompass a misuse of government regulatory powers, or a monetary loss that was "incidental" to a fraud scheme. In *Ciminelli v. United States*, 598 U.S. 306, 316 (2023), the court held that property does not encompass a "right to control" property because the "right to valuable economic information needed to make discretionary economic decisions is not a traditional property interest."

The "right to control" theory of liability was formulated chiefly for acts of deception which may not cause a tangible loss of money or property. Following *Ciminelli*, attention has

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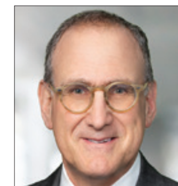

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now turned to a closely related question that has divided the circuit courts: whether false or misleading statements that "induce" a transaction amount to mail/wire fraud when the alleged victim gets the essential benefit of the bargain that was struck.

The Supreme Court agreed to address the question of fraudulent inducement several weeks ago when it granted a petition for certiorari in *United States v. Kousisis*, 82 F.4th 230 (3d Cir. 2023), *cert. granted*, No. 23-909, 2024 WL 3014475 (U.S. June 17, 2024).

In that case, the U.S. Court of Appeals for the Third Circuit affirmed a conviction based on a contractor's false statements concerning compliance with disadvantaged business enterprise (DBE) participation rules. The contractor argued that by providing good work at a fair price, it did not have the necessary intent to deprive the

other party to the contract, a state agency, of money or property.

In this article, we describe the different approaches taken to a "fraudulent inducement" theory of liability by contrasting the Third Circuit's decision in *Kousisis* with the U.S. Court of Appeals for the Second Circuit's different approach, as reflected in *United States v. Regent Off. Supply Co.,* 421 F.2d 1174 (2d Cir. 1970) and other cases. We conclude with observations on the potential significance of a Supreme Court ruling that further limits the scope of mail/wire fraud.

'Kousisis'

The prosecution of Stamatios Kousisis and his co-defendants arose from contracts with the Pennsylvania Department of Transcription (PennDOT) to paint and repair a bridge and Amtrak station in Philadelphia. The defendants were awarded contracts after submitting the lowest bids. The U.S. Department of Transportation (USDOT) provided funding for the two projects. Federal regulations require that states that receive such funds set "aspirational" goals to promote the participation of DBEs in transportation construction projects. When states agencies seek bids for USDOT-financed projects, the agencies must state specific DBE participation goals, and bids must explain how the contractor will meet those goals.

The defendants submitted bids for the two projects which committed to engaging a DBE-certified paint supplier. The government alleged that the supplier served as a pass-through entity: the listed supplier did not actually supply the materials or perform other work but only issued invoices, with a 2.25% fee for acting as a pass-through. The defendants in turn submitted those invoices to PennDOT to establish DBE participation.

The government charged the defendants with wire fraud in violation of 18 U.S.C. §1343; false statements in documentation to PennDOT concerning the DBE's role, in violation of 18 U.S.C. §1001; and conspiracy to violate these laws by misrepresenting that the DBE would, and did, perform a specified sum of the qualifying DBE work. Kousisis and his company were convicted of wire fraud conspiracy, three counts of wire fraud, and false statements.

On appeal, the defendants challenged the government's theory of "money or property" fraud. They argued that the misrepresentation concerning DBE participation did not implicate a property interest for several reasons.

First, they contended that any loses by PennDOT "cannot be classified as pecuniary" since it "received the repairs it paid for," and thus the full benefit of the bargain, and *Kelly* and *Cleveland* v. *United States*, 531 U.S. 12 (2000), "instruct that when the victim's damages are incidental to the object of the fraudulent scheme…there is an insufficient property interest to sustain a wire fraud conviction." *Kousisis*, 82 F.4th at 239-240.

Second, they contended that the jury instructions did not require the economic harm that "characterizes a property deprivation"; or "proof that the scheme contemplated obtaining property of which the victim was deprived." In the defense view, under *Kelly*, a sovereign's regulatory and policy interests in DBE participation are not property.

The Third Circuit acknowledged that "for the government to establish wire fraud, the property involved must play more than some bit part in a scheme: It must be an 'object of the fraud" (quoting *Kelly*, 140 S. Ct. at 1571). The court explained that this "must be evaluated from the victim's perspective," and thus, "the victim's loss must have been an *objective* of the fraudulent

scheme; it is insufficient if that loss is merely an incidental byproduct of the scheme" (citing *Kelly*, 140 S. Ct. at 1573 n.2.).

However, the court placed emphasis on different language in *Kelly*: the Supreme Court "has unambiguously held that there could have been no fraud in those cases unless 'an object of the[ ] dishonesty was *to obtain the [government]'s money or property*" (quoting *Kelly*, 140 S. Ct. at 1568) (emphasis added). Applying that concept here, the Third Circuit held that "obtaining the government's money or property was *precisely* the object of [the defendants'] fraudulent scheme" (emphasis in original).

According to the Third Circuit, Kousisis and his company "set out to obtain millions of dollars that they would not have received but for their fraudulent misrepresentations." While the scheme "could not have been consummated without falsely certifying the DBE participation, those false certifications were merely incidental to the true purpose of the fraudulent agreement—obtaining millions of dollars from PennDOT." "PennDOT's dollars establish the requisite property interest here," not PennDOT's interest in ensuring DBE participation.

Further, the court held that the DBE supplier's "2.25% fee constitutes economic harm sufficient to sustain wire fraud convictions[,]" which was "true even though the government does not allege economic *net* loss."

In sum, "DBE participation was an essential component of the contract[,]" and sufficient evidence was introduced to "support a federal fraud conviction given all of the circumstances surrounding that misrepresentation and the millions of dollars it fraudulently caused PennDOT to pay" the defendants.

The Third Circuit also concluded that the disputed contracts constituted property because under the law "the privilege of contracting is a property right." The court rejected concerns that its holding would criminalize essentially every "purposeful breach of contract." In the court's view, such concerns are "with the text of the statute and the Supreme Court's interpretation of it" because Congress criminalized "any" scheme to defraud, and "if 'any' is to be read out of the statute…that must be by congressional initiative, not by this court."

The Second Circuit

The Second Circuit is one of the circuit courts that has rejected a fraudulent inducement theory of liability. The Second Circuit looks to the "essential element of the bargain" to determine whether false representations made in connection with an economic transaction constitute mail/wire fraud. This approach relies on a distinction between mere deceit and fraud. The case law seeks to distinguish deceit that goes to the essence of the parties' bargain, which gives rise to mail/wire fraud, from deceit that does not materially affect the bargain and does not amount to a crime.

The leading case for this distinction is *Regent Office Supply*, in which the Second Circuit rejected a broad reading of Judge Learned Hand's statement in *United States v. Rowe*, 56 F.2d 747, 749 (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."

The Second Circuit rejected the government's theory that "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." *Regent Office Supply*, 421 F.2d 1174 at 1181. Instead, false representations must go to the essence of the bargain—that is, they must be "directed

to the quality, adequacy or price of the goods themselves."

Subsequent Second Circuit decisions have struggled at times to apply *Regent Office Supply* consistently, but, broadly speaking, they have sought to maintain this distinction between non-criminal deceit that may induce a financial decision and criminal fraud that deprives a victim of an essential part of a bargain. *Compare*, *e.g.*, *United States v. Shellef*, 507 F.3d 82, 108-109 (2d Cir. 2007) (vacating a wire fraud conviction because defendants' misrepresentations did not affect essential elements of the bargain between the seller and defendants, but were simply made to gain access to the seller's products) *with United States v. Frank*, 156 F.3d 332, 335 (2d Cir. 1998) (affirming a wire fraud conviction where defendants' misrepresentation went to the heart of the bargain between the parties).

Of note in light of the grant of *certiorari* in the *Kousisis* case is Judge Loretta Preska's decision in *United States v. Davis*, No. 13-CR-923 (LAP), 2017 WL 332824 (S.D.N.Y. Aug. 3, 2017), in which the court set aside a wire fraud conviction arising from a DBE scheme. As in *Kousisis*, the defendant was charged with a fraud scheme based on misrepresentations that two certified minority/women owned business enterprises were performing work when, in fact, they served as "pass through" entities for non-minority companies.

Though the case was charged under a "right to control" theory of liability, which was rejected last year in *Ciminelli*, Preska's conclusion—that the misrepresentations did not go to an essential element of the bargain—highlights an important feature of Second Circuit law and the present split in the circuits that will be taken up by the Supreme Court.

Conclusion

In *Kousisis*, the petitioners asked the Supreme Court to address three questions: (1) whether deception to induce a commercial exchange can constitute mail or wire fraud, even if inflicting economic harm on the alleged victim was not the object the scheme; (2) whether a sovereign's statutory, regulatory, or policy interest is a property interest when compliance is a material term of payment for goods or services; and (3) whether all contract rights are "property."

The petition for certiorari seeks to extend the decisions in *Kelly* and *Ciminelli*, which held that "money or property" mail/wire fraud prosecutions must be limited to deprivations of "traditional" property interests.

Of particular interest will be whether the Supreme Court regards the fraudulent inducement theory as raising the same basic question as the "right to control theory," or rather sees it as distinct because the ultimate aim of the misrepresentations was to obtain "money or property," as the Third Circuit emphasized. If the Supreme Court sides with petitioner and rejects fraudulent inducement as a theory of liability, it would create space between civil liability, which recognizes such a claim, and federal criminal liability. That would be a notable exception to a trend that we have seen over many years of collapsing distinctions between civil and criminal liability.

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