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WHITE-COLLAR CRIME

BY ELKAN ABRAMOWITZ AND BARRY A. BOHRER

The Meaning of 'Property' Under Federal Mail, Wire Fraud Statutes

MAIL FRAUD AND wire fraud are among the most frequently charged federal crimes. Each qualifies as a predicate offense for RICO (Racketeer Influenced and Corrupt Organizations Act) prosecutions and as an underlying offense for the federal money laundering statute. The scope of the mail and wire fraud statutes thus plays a critical role in determining how aggressive the government can be in investigating and bringing charges.

In this regard, courts have long grappled with the issue of what constitutes "property" under the federal mail and wire fraud statutes. On Jan. 26, the U.S. Court of Appeals for the Second Circuit issued a significant opinion in this area. In *Fountain v. United States*,[1] the Court of Appeals held that taxes owed to a government can constitute property within the meaning of the federal mail and wire fraud statutes.

Background

The mail and wire fraud statutes, 18 USC §§1341 and 1343, prohibit "any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses." In 1988, in response to the Supreme Court's call in *McNally v. United States*[2] for Congress to "speak more clearly than it ha[d]" on the subject of whether the mail fraud statute was meant to protect more than property rights, Congress expanded the mail and wire fraud statutes to protect "the intangible right of honest services." The new statute, 18 USC §1346, was intended to cover kickbacks and other forms of corruption.[3]

Elkan Abramowitz *Barry A. Bohrer*

Twelve years later, in *Cleveland v. United States*,[4] the Supreme Court made clear that the scope of the mail and wire fraud statutes was not without limits. The defendant in *Cleveland* was indicted for making false statements in his application to the Louisiana State Police for a license to operate video poker machines in violation of the mail fraud statute. The Court held that state and municipal licenses do not qualify as "property" for purposes of the mail fraud statute.

In language much quoted subsequently by lower courts, the Court stated that, "[i]t does not suffice … that the object of the fraud may become property in the recipient's hands; for purposes of the mail fraud statute, the thing obtained must be property in the hands of the victim." The *Cleveland* Court reasoned that, although, "[w]ithout doubt, Louisiana ha[d] a substantial economic stake in the video poker industry," its "core concern [was] regulatory" as opposed to revenue-collecting. The Court pointed out that the government had "nowhere allege[d] that [the defendant] defrauded the State of any money to which the State was entitled by law."

The Court also noted that the state's authority to select licensees rested "upon the State's sovereign right to exclude applicants" and that a "right to exclude in that governing capacity is not one appropriately labeled 'property.' " In addition, the Court expressed reluctance to "subject to federal mail fraud prosecution a wide range of conduct traditionally regulated by state and local authorities."

Three courts have considered *Cleveland's* application in a tax context in the past year. In *United States v. Pasquantino*,[5] a case with facts similar to those in *Fountain*, the U.S. Court of Appeals for the Fourth Circuit held that tax revenues owed by reason of the defendants' fraudulent conduct constituted property for purposes of the federal wire fraud statute. The defendants in *Pasquantino* were convicted of wire fraud for the purpose of executing a scheme to defraud Canada and the Province of Ontario of excise duties and tax revenues relating to the importation and sale of liquor. The court distinguished *Cleveland*, stating that, while in that case "an unissued video poker license did not constitute property that was valuable in the hands of the State of Louisiana," the tax revenues owed Canada were property "because a government has a property right in tax revenues when they accrue."

The U.S. Court of Appeals for the Fifth Circuit faced a slightly different tax issue last year: whether unissued federal low-income housing tax credits were property under the mail fraud statute. In *United States v. Griffin*,[6] a defendant argued that "tax credits are like licenses in that they do not exist until they are issued" and therefore should not be considered property for purposes of the mail fraud statute. The government contended that the tax credits were a valuable commodity and an economic incentive, unlike the more regulatory licenses at issue in *Cleveland*. After a lengthy discussion of *Cleveland*, the Fifth Circuit held that unissued tax credits, which had zero intrinsic value, were not property when they were in the possession of the state housing agency; the "only property interest the State ha[d] in the tax credits [was] purely abstract or theoretical."

In *United States v. 1,920,000 Cigarettes*,[7] an in rem forfeiture action, the government alleged that the defendant cigarettes were subject to forfeiture because they represented property that was the proceeds of a wire fraud scheme designed to deprive states of cigarette

Elkan Abramowitz *is a member of Morvillo, Abramowitz, Grand, Iason & Silberberg. He is a former chief of the criminal division in the U.S. Attorney's Office for the Southern District of New York.* **Barry A. Bohrer** *is also a member of Morvillo, Abramowitz and was formerly chief appellate attorney and chief of the major crimes unit in the U.S. Attorney's Office for the Southern District of New York.* **Elizabeth J. Carroll,** *an attorney, assisted in the preparation of this article.*

excise tax revenue. The claimants argued that, under *Cleveland*, New York State's right to collect taxes was not a property right for purposes of the wire fraud statute. The U.S. District Court for the Western District of New York, "adopt[ing] the reasoning and result in *Pasquantino*," held that a government's right to collect taxes was a sufficient property right for wire fraud purposes and dismissed the claimants' motion to dismiss.

Although, prior to *Fountain*, the Second Circuit had not considered *Cleveland's* application in a tax context, in *Porcelli v. United States*,[8] it did address whether a mail fraud conviction should be vacated because a New York Court of Appeals opinion had established that uncollected and unremitted sales taxes were not the property of the state.[9] The defendant in *Porcelli* had been convicted of mail fraud for underreporting gasoline sales on his tax return in order to reduce his payment of state sales taxes. While the Second Circuit did not dispute the holding of the state court, it distinguished that case from the defendant's. In the state case, the defendants had been charged with larceny; the defendant in *Porcelli* "was not charged with theft of the State's property." Citing *McNally*, but not *Cleveland*, the Second Circuit upheld the conviction because the defendant "used fraud to conceal from the State its claim for sales taxes and thus effectively deprived the State of its property right in its chose in action."

'Fountain'

It was not until *Fountain* that the Second Circuit addressed the issue of whether, after *Cleveland*, taxes owed to a government can constitute property in its hands within the meaning of the federal mail and wire fraud statutes. The defendant there, John Fountain, exchanged Canadian for United States currency in conjunction with a scheme to transport cigarettes from Canada into a Mohawk reservation in New York and then back to Canada in order to circumvent Canadian cigarette taxes. He was convicted of conspiracy to launder the proceeds of a wire fraud. In his habeas petition, Mr. Fountain argued that the Canadian government did not possess "property" in its hands at the time of the alleged fraud.

The Court of Appeals at the outset clarified that it did not find *Cleveland* to have effected a sea change in mail and wire fraud law, stating: "The modest extent to which we understand the *Cleveland* decision to have reconfigured the existing landscape dictates our resolution of [Mr. Fountain's] claim that, after *Cleveland*, taxes can no longer be considered property under the mail and wire fraud statutes."

The court went on to observe that the Supreme Court in *Cleveland* had "examined a number of factors" but had "emphasized the regulatory as opposed to revenue-collecting nature of Louisiana's video poker licenses and the fact that the State could not alienate its licensing authority" while "downplaying the significance of the right to exclude … a right that other cases deemed crucial in defining property."[10] Again keeping its distance from *Cleveland*, the court read the factors not "as establishing rigid criteria" but as "providing permissible considerations."

After observing that the *Cleveland* Court appeared to have placed the most weight on the regulatory versus revenue-enhancing factor, the *Fountain* court noted that, in the tax context, "the attempt to discern whether particular laws are aimed more at generating revenue or at regulating may not be easily accomplished." The *Fountain* court therefore chose to "place weight upon the [Supreme] Court's observation that monetary loss was not involved at all in the offense underlying the conviction in *Cleveland*."

In 'Fountain,' the Second Circuit addressed whether, after 'Cleveland,' owed taxes can constitute government property within … statutes' aims.

The Second Circuit in *Fountain* concluded that "[t]he mere fact that the government is authorized to collect revenue under the provisions of a licensing law is not determinative; the relevant inquiry is, rather, whether the scheme prosecuted under the mail or wire fraud statute is designed to defraud the government of its revenues or of its licenses." The court distinguished licenses from taxes: "[w]hile a liquor license might not constitute property in the hands of the state, the sales taxes that the government can anticipate collecting from transactions in alcohol are property under the mail and wire fraud statutes."

The *Fountain* court examined pre-*Cleveland* mail and wire fraud cases involving taxes and licenses, concluding that "[t]axes were … much more firmly identified as property pre-*Cleveland* than permits and licenses." After further reviewing post-*Cleveland* tax and licenses cases such as *Pasquantino* and *Porcelli* — and distinguishing *Griffin* because it did not involve sales or income tax — the court reached its conclusion, again playing down the impact of *Cleveland*: "Because we interpret the Supreme Court's decision in *Cleveland* as effecting a limited alteration in the course of interpretation of the mail and wire fraud statutes rather than as completely redirecting the stream, we continue to deem taxes owed to governments … 'property' within the meaning of the mail and wire fraud statutes."

Conclusion

The government continues to strive to find new ways to broaden the type of conduct that can be prosecuted under the federal mail and wire fraud statutes. *Fountain*, while also perhaps not "redirecting the stream," does clarify that prosecutors may use the mail and wire fraud statutes to prosecute tax fraud cases post-*Cleveland*. Fortified by *Fountain*, prosecutors will continue to rely on these statutes as their "Colt .45" because of their "simplicity, adaptability, and comfortable familiarity."[11]

(1) No. 03-2188, 2004 WL 113491 (2d Cir. Jan. 26, 2004).

(2) 483 US 350 (1987).

(3) Section 1346 was the subject of another recent important and long-anticipated Second Circuit decision concerning the definition of property under the mail and wire fraud statutes. In *United States v. Rybicki*, 354 F3d 124 (2d Cir. 2003) (in banc), the court held on Dec. 29 that 18 USC §1346, which permits mail and wire fraud prosecutions for the "deprivation of the intangible right to honest services" was not unconstitutionally vague. For more on Rybicki, see Daniel Richman & Alan Vinegrad, " 'Rybicki': The Intangible Rights Theory of Criminal Fraud," NYLJ, Jan. 12, 2004; Mark Hamblett, "Sharply Split In Banc Panel Upholds Constitutionality of Mail Fraud Statute," NYLJ, Dec. 31, 2003.

(4) 531 U.S. 12 (2000).

(5) 336 F.3d 321 (4th Cir. 2003) (en banc).

(6) 324 F.3d 330 (5th Cir. 2003).

(7) No. 02-CV-437A, 2003 WL 21730528 (W.D.N.Y. Mar. 31, 2003).

(8) 303 F.3d 452 (2d Cir. 2002), cert. denied, 537 U.S. 1113 (2003).

(9) *People v. Nappo*, 729 N.E.2d 698 (2000).

(10) See *Carpenter v. United States*, 484 US 19 (1987) (cited by *Fountain* court as case that emphasized exclusivity); see also *United States v. Henry*, 29 F.3d 112 (3d Cir. 1994).

(11) Jed S. Rakoff, "The Federal Mail Statute (Part I)," 18 Duq. L. Rev. 771 (1980).