New York Law Journal

Web address: http://www.law.com/ny

VOLUME 28—NO. 87 TUESDAY, NOVEMBER 5, 2002

WHITE-COLLAR CRIME

BY ELKAN ABRAMOWITZ AND BARRY A. BOHRER

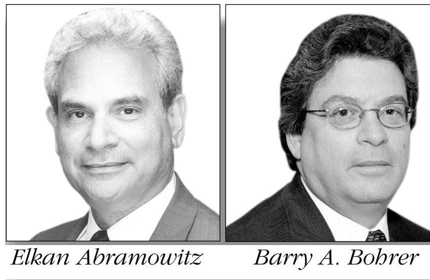
Exploring the Contours of the Federal Mail and Wire Fraud Statutes

THE FEDERAL mail fraud and wire fraud statutes are the subject of an almost perpetual tug of war between prosecutors seeking to broaden the type of conduct that can be prosecuted within the statutes' extremely elastic boundaries and defense attorneys striving to protect their clients from an over-zealous or, at least overly creative, prosecution.

Case Law Is Key

The courts play an increasingly important role as arbiters of those disputes, and their willingness to call the government to task when it casts too wide a net with the federal fraud statutes may give prosecutors pause before embarking on a novel prosecutorial approach. Criminal practitioners and scholars are currently awaiting the U.S. Court of Appeals for the Second Circuit's en banc opinion in *United States v. Rybicki*, addressing the constitutionality of the "honest services" provision of the fraud statutes. But, in the meantime, there remain other aspects of the statutes that are open to divergent interpretation and on which the Second Circuit has not yet spoken.

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 and a Fellow of the American College of Trial Lawyers.* **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.* **Judith L. Mogul** *assisted in the preparation of this article.*



Elkan Abramowitz *Barry A. Bohrer*

One such unsettled question in this circuit is whether, in establishing the existence of a scheme to defraud, the government must show that a reasonably prudent person would have been taken in by the scheme. Some circuits have required that a fraudulent scheme be "reasonably calculated to deceive a person of ordinary prudence and comprehension," while others have expressly rejected such a standard, holding that the fraud statutes protect the gullible as well as the astute.

The clearest articulation of the reasonable person standard is found in the U.S. Court of Appeals for the Eleventh Circuit's decision in *United States v. Brown.*[1] There, the court reversed the convictions of executives in a real estate development company who were convicted of fraud for their role orchestrating a scheme under which they misrepresented the value of homes they were marketing in Florida. The government showed at trial that the developers were selling the property at inflated prices and had taken steps to prevent people visiting Florida, on junkets arranged by the developers, from seeing lower-priced homes offered by competitors. Among other tactics employed by the developers, they limited their visitors' access to phones, other real estate literature and newspapers in which real estate was advertised, and steered potential purchasers away from third-party lenders, providing their own financing, sometimes for amounts greater than the property's actual worth.

In reversing the convictions, the Eleventh Circuit held that even accepting that the defendants lied about the value of the properties, "no reasonable jury could find that [they] prevented, in a way that would make reliance on [the developer's] value representations reasonable, people of ordinary prudence from discovering what houses in Florida sold and rented for and how the price of [the] homes compared to comparable properties in Florida." The court held that a scheme to defraud cannot be proved where the "representation is about something which the customer should, and could, easily confirm — if they wished to do so — from readily available external sources." Finding that the home buyers could have determined the market price of comparable homes, the court concluded that the fraudulent

scheme in this case fell short of the Eleventh Circuit's requirement that the government prove that a reasonable person would have acted on the defendants' representations to obtain a mail or wire fraud conviction. The court explained that this standard was necessary to prevent "puffing" or "sellers talk" from becoming actionable under the federal criminal fraud statutes.[2]

'Ordinary Prudence and Comprehension'

The standard employed by the Eleventh Circuit in *Brown* — that a scheme to defraud must be one that is "reasonably calculated to deceive persons of ordinary prudence and comprehension," has led some defendants to argue that schemes targeting the naive or gullible fall outside the scope of the mail fraud statute. Such arguments have been consistently rejected, even by those circuits adhering to the reasonable person standard. For example, the U.S. Court of Appeals for the Ninth Circuit has held that specific intent to defraud can only be shown by proof that the scheme was "reasonably calculated to deceive persons of ordinary prudence and comprehension."[3] Yet it has also held, repeatedly, that this standard does not exclude schemes that take advantage of those who do not exercise ordinary prudence, finding that the fraud statutes "protect the naive as well as the worldly-wise."[4] Indeed, the fact that the sentencing guidelines provide harsher punishments for those convicted of defrauding vulnerable victims clearly undermines any argument that victim vulnerability is a viable defense.

At least one court, noting the apparent inconsistency between the reasonable person standard and the need to protect the naive from fraudulent schemes has questioned whether the reasonable person language "is intended to be understood literally" and suggested that that standard has two purposes, "neither of which has anything to do with declaring open season on the people most likely to be targets of fraud." Writing for the U.S. Court of Appeals for the Seventh Circuit in *United States v. Coffman*,[5] Judge Richard A. Posner posited that the first reason is to assist in evaluating evidence of fraudulent intent and the second is to help in distinguishing between real fraud and "sharp dealing." In that case, the defendants argued that their misrepresentations were so outrageous that a person of ordinary prudence would not have credited them. In finding that the reasonable person standard presented no bar to their conviction, the *Coffman* court noted that there are small lies that are discounted as part of the language of business, but that the safe harbor extended for such harmless lies does not extend to the "biggest whoppers," which the sophisticated might see through, but which are not part of normal business discourse.

The Second Circuit

The U.S. Court of Appeals for the Second Circuit has not addressed this issue directly, although dicta in two recent cases suggests that it may be inclined, in the right circumstances, toward incorporating a reasonable person standard that actually has some teeth. In *United States v. Brennan*,[6] the court reversed, on venue grounds, the mail fraud convictions of defendants who were charged with having managed litigation and settlement of claims arising out of an airplane accident while under a conflict of interest. The court cautioned against re-prosecution based on its perception of serious problems in the substantive charges leveled against the defendants. One of those concerns was whether there the defendants' failure to disclose their conflict of interest was sufficient evidence of misrepresentation to the alleged victims of the scheme. In support of that proposition, the court did not invoke the general "reasonable person" language that has led to so much confusion, but instead relied on that portion of the *Brown* opinion that found no fraudulent scheme where the alleged victim "should, and could easily confirm" the representation from available external sources.

Subsequently, in a summary order issued in *United States v. Boyd*,[7] the court rejected the defendant's contention that the government had not proved that the victims were objectively reasonable. Noting the disagreement between the circuits concerning the requirement that objective reasonableness be shown, the court assumed arguendo that such a standard applied, and held that it had been satisfied in that case.

Notwithstanding the Second Circuit's apparent openness to applying some sort of reasonable person standard to a mail or wire fraud conviction, Southern District Judge Victor Marrero recently issued a decision in *United States v. Falkowitz*,[8] finding that the target of a fraudulent scheme should not be held to a reasonable person standard. *Falkowitz* involved a scheme in which the defendants were alleged to have induced people with AIDS or who had tested HIV positive to apply for life insurance, falsely representing that they were in good health. The defendants then marketed those insurance policies to investors through a mechanism known as a viatical settlement whereby the investor provides an immediate payment to the insured and then receives the life insurance policy proceeds when the insured dies. The defendants received a portion of the policy proceeds as payment for their services. They were alleged to have exploited an apparently common insurance company practice of not requiring applicants for policies with a value of less than $100,000 to undergo a medical examination, although the companies did reserve the right to conduct such examinations and required applicants to provide authorizations for release of their medical records.

On a motion to dismiss, the defendants challenged the sufficiency of the indict-

ment arguing that if the insurance companies had chosen to investigate, they would have had access to information that would have disclosed the applicants' misrepresentations about their health. They argued, based on *Brown*, and the Second Circuit's citation to it in *Brennan*, that as a matter of law this took the scheme outside the purview of the mail fraud statute.

Conflicting Decisions

In a lengthy opinion, Judge Marrero assessed "apparent disarray" from conflicting decisions between and within the other circuits as to whether criminal fraud prosecutions should turn on the reasonableness of the victim. He concluded that those cases that incorporate such a standard have improperly imported the concept of reasonable reliance from the civil fraud and civil RICO contexts. Noting, in reliance on *United States v. Neder*,[9] that not all common-law fraud concepts are applicable to the federal criminal fraud statutes, he stressed that unlike civil fraud, a criminal fraud prosecution does not require that the victim suffer any damage or that there even be a victim at all. In that context, he reasoned that the civil law concept of justifiable reliance "loses its meaning and purpose." He attempted to distinguish *Brennan's* citation to *Brown*, suggesting that the *Brennan* court was really concerned with the sufficiency of defendants' specific intent in that case, rather than a standard that turned on the objective prudence of the victims. Of course the *Brown* decision itself related directly to the victims' lack of prudence, in a context where the information that would have alerted them to the scam was publicly available, and there is nothing in the Second Circuit's dicta in *Brennan* or *Boyd* to suggest that the court was citing the *Brown* standard for a purpose different than that employed by the *Brown* court itself.

The 'Falkowitz' Case

While the *Falkowitz* decision is sweeping in its rejection of any sort of standard that examines the victim's reasonableness, that decision should not deter defense counsel from pursuing a reasonable-person defense in the appropriate circumstances. The *Falkowitz* defendants raised their objections to the government's theory of the case on a motion to dismiss — where, to prevail they would have had to show that there was no set of facts the government could prove that would have established their participation in a fraudulent scheme. Judge Victor Marrero recognized that their arguments turned more on the sufficiency of the government's proof rather than on the indictment's facial validity, and found that consideration of defendants' challenge would be an invasion of the jury's province.

One question in the Second Circuit is whether the government must show that a reasonably prudent person would have been taken in.

More significantly, *Falkowitz* was simply the wrong vehicle for raising this defense at all. The defendants' argument was that it was unreasonably imprudent to rely on a life insurance applicant's representations concerning his or her health status. Such representations are a far cry from a developer's statements inflating the value of real property at issue in *Brown*. The law assumes and accepts a certain amount of such "puffery" in a way that it has never tolerated patently false statements on an insurance application. Moreover, the court found that the victims in *Brown* had ready access to public information concerning home values that they should have, and could have consulted, and that would have alerted them to the defendants' false representations concerning the home values. It is an enormous stretch of the reasoning in *Brown* to equate the *Falkowitz* insurance companies' possession of a medical release, entitling them to medical records, to the type of publicly available information concerning real estate prices. As Judge Marrero noted, medical records are by their very nature confidential and are in no way akin to any source of easily accessible public information found in other cases to have put reasonable people on notice of a misrepresentation.

Conclusion

The reasonable-person standard is unlikely to provide a viable defense to defendants accused in more common fraudulent schemes. But, in circumstances where prosecutors reach to bring behavior at the border between "sharp dealing" and true fraud within the scope of the fraud statutes, it may prove useful to the defense, particularly when narrowed to circumstances where public information would put a reasonable person on notice of the defendant's alleged misrepresentation.

(1) 79 F3d 1550 (11th Cir. 1996).

(2) See also *United States v. Goodman*, 984 F2d 235 (9th Cir. 1993).

(3) *United States v. Mason*, 902 F2d 1434 (9th Cir. 1990).

(4) See, e.g., *United States v. Ciccone*, 219 F3d 1078 (9th Cir. 2000). See also *United States v. Davis*, 226 F3d 346 (5th Cir. 2000) (victim's reliance need not be objectively reasonable), cert. denied, 531 US 1181 (2001); *United States v. Maxwell*, 920 F2d 1028 (D.C.Cir. 1990); *United States v. Brien*, 617 F2d 299 (1st Cir.), cert. denied, 446 US 919 (1980).

(5) *United States v. Coffman*, 94 F3d 330 (7th Cir. 1996), cert. denied, 520 US 1165 (1997).

(6) 183 F3d 139 (2d Cir. 1999).

(7) 2001 WL 40781 (2d Cir. 2001).

(8) 214 FSupp2d 365 (S.D.N.Y. 2002).

(9) 527 US 1 (1999).

This article is reprinted with permission from the November 5, 2002 edition of the NEW YORK LAW JOURNAL. © 2002 NLP IP Company. All rights reserved. Further duplication without permission is prohibited. For information contact, American Lawyer Media, Reprint Department at 800-888-8300 x6111. #070-11-02-0015