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WHITE-COLLAR CRIME

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Issues Ripe for U.S. Supreme Court Review

WE TYPICALLY devote this column to a review of the criminal cases of particular import to white-collar practitioners decided by the Supreme Court during the previous term. In a departure from that tradition (motivated in large measure by the dearth of white-collar cases on the Court's 2002-2003 docket), we identify and discuss white-collar crime issues on which the circuits are split and which are likely to recur in the current prosecutorial climate. Such conflicts are often the bellwether of important Supreme Court decisions, and defense counsel should be alert to those issues on which the U.S. Court of Appeals for the Second Circuit may already have spoken, but on which there is no consensus among the appellate courts.

Bank Fraud

Courts have taken varying approaches to the question of how much of a nexus there must be between a federally insured bank and a fraudulent scheme to sustain a prosecution under the federal bank fraud statute, 18 USC §1344. The U.S. Court of Appeals for the Third Circuit recently held in *United States v. Thomas*,[1] that the "sine qua non of a bank fraud violation … is the intent to defraud the bank," not some other party. The defendant in *Thomas*, a home health worker, had conned her employer into signing checks payable to the defendant with various false representations, some of which were repeated to bank employees. Because the checks were legitimate on their face, the court held that the defendant's scheme did not constitute bank fraud, as only the employer and not the bank faced any risk of loss from this scheme.


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The Second Circuit also stresses the risk of loss to the bank as a determinative factor. It has drawn a sharp distinction between frauds that involve misrepresentations to the bank, and those in which a misrepresentation is made only to a third party and which result in wrongful payment of funds held at a bank. Thus, in *United States v. Laljie*,[2] the court upheld the conviction of a defendant who had altered the amounts on some checks, rendering them fraudulent on their face, but reversed her conviction on those bank fraud counts where the defendant had improperly inserted the name of her family business on the payee line of blank checks pre-signed by her employer. The bank received the latter checks as a holder in due course, and thus was not exposed to any risk of loss.

Similarly focusing on whether the bank faced a risk of loss from the defendant's scheme, the U.S. Court of Appeals for the Seventh Circuit reversed a mail fraud conviction in *United States v. Davis*,[3] where the defendant had duped a homeless man into depositing a fraudulently obtained tax refund check in his name into a bank account from which the defendant was authorized to make withdrawals. The court held that the bank fraud statute was not designed "to protect people who write checks to con artists but to protect the federal government's interest as an insurer of financial institutions." Even though the defendant had made certain misrepresentations to the bank in opening the account, because his fraud did not put the bank's funds at risk, the defendant's deceptions were not covered by the bank fraud statute.

Earlier this year, in *United States v. McNeil*,[4] the U.S. Court of Appeals for the Ninth Circuit expressly disagreed with the Seventh Circuit's reasoning in *Davis*, finding that a defendant's efforts to deposit a similarly fraudulent refund check did constitute

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bank fraud based solely on the defendant's deception of the bank in opening up the account. The Ninth Circuit rejected the notion that the bank must face an actual or potential loss in order for a scheme to fall within the bank fraud statute. The court concluded that "Congress reasonably could have determined that it was appropriate to criminalize schemes to obtain money or property from a bank whether or not such schemes expose the bank to actual or potential loss…"

Federal Program Funds Bribery

Concerns over federal intrusion into local law enforcement figure prominently in the debate over the proper scope of 18 USC §666, which makes it a crime to offer or receive corrupt payments intended as an influence or reward in connection with any transaction of an organization, government or agency involving anything of value of $5,000 or more, if that organization, government or agency receives $10,000 or more under a federal program in any given year. Some early decisions interpreting §666 required that the government show that the bribe affected the federal funds — a position rejected by the Supreme Court in *Salinas v. United States*.[5] But in holding that the broad language of §666 did not confine its reach to transactions that affect federal funds, the Court specifically left open the question of "whether some other kind of connection between a bribe and the expenditure of federal funds" was required. Subsequently, the Second Circuit in *United States v. Santopietro*,[6] held that even after *Salinas*, there must be some connection between the bribe and the integrity of the federally funded program, explaining that the government could not, for example, use §666 "to prosecute a bribe paid to a city's meat inspector in connection with a substantial transaction just because the city's parks department had received a federal grant of $10,000." The U.S. Court of Appeals for the Third Circuit has also required the prosecution to demonstrate some nexus between the offense conduct prosecuted under §666 and the federal funds, warning that without a demonstrable federal interest implicated by the bribery, the statute would raise significant federalism concerns by transforming §666 into a general federal anti-corruption statute targeting traditionally local conduct.[7]

The Second and Third circuits are in the minority in requiring a connection between the offense conduct prosecuted under §666 and the federal funds specified in the statute. The Fifth, Sixth, Seventh and Eighth circuits have all held that §666 requires no such nexus.[8] The most recent of these decisions was issued by a divided panel of the U.S. Court of Appeals for the Eighth Circuit in *United States v. Sabri*,[9] rejecting the contention that some nexus between the bribery and the federal funds provided the requisite "jurisdictional hook" to make the statute a legitimate exercise of Congress's legislative power. Expressly disagreeing with the Second and Third circuits, the *Sabri* court found that the statute unambiguously omitted any requirement that the bribery have some connection to the federal funds, noting that by enacting §666 Congress intended to "change the enforcement paradigm from one that monitored federal funds to one that monitored the integrity of the recipient agencies." The court found that even without any nexus between the federal funds and the bribery penalized under the statute, §666 was nonetheless constitutional, reversing the district court's dismissal of the indictment on that basis. It reasoned that the statute did not fall within Congress's Spending Clause authority because it regulates the conduct of third-parties and not the recipient of the federal funds. Rather, in reliance on *M'Culloch v. Maryland*, the court held that §666 was a legitimate exercise of legislative authority under the Necessary and Proper Clause of Article I, because it was rationally related to the efficacious disbursement of federal funds to local governments and agencies. The dissenting judge in *Sabri* noted that as interpreted by the majority, §666 "punishes a broad swath of conduct bearing little relationship to any federal interest," and as such "swims against the tide of governing law" emphasizing "Congress' limited ability to federalize criminal conduct … and to interfere in matters traditionally left to state governance."

Although the Supreme Court has denied certiorari on most issues raised by these cases in the past, it is not unusual for the Court to allow the circuits to remain in conflict for a time before addressing a question.

Perjury in a Civil Deposition

Determining what constitutes criminal perjury in a civil deposition poses an interesting question that has yielded varying responses from the circuits. The uncertainty stems from establishing materiality, a necessary element of a perjury prosecution under 18 USC §1623, in the context of statements made in a deposition. Materiality is generally defined as a declaration that "has a natural tendency to influence, or is capable of influencing, the decision-making body to which it was addressed." In contrast to a trial or a grand jury proceeding, "given that a deponent's testimony is not actually addressed to a decision-making body, [the materiality] standard does not apply neatly when … the defendant is charged with committing perjury in a civil deposition."[10]

The U.S. Court of Appeals for the Fifth Circuit has adopted the broadest definition of materiality in the civil deposition context, holding that any matter properly the subject of and material to deposition under Rule 26 of the Federal Rules of Civil Procedure is material for the purposes of a §1623 prosecution.[11] In *United States v. Kross*,[12] the Second

Circuit adopted a similar formulation, holding that a false statement given in a deposition would be material where "a truthful answer might reasonably be calculated to lead to discovery of evidence admissible at the trial of the underlying suit." The *Kross* court was careful to limit that broad definition to the facts of that case — a government deposition in a civil forfeiture action. It noted that while civil in form, the proceeding in which the deposition was given was predicated on a nexus between property and criminal activity, warranting adoption of a materiality standard similar to that employed in the context of grand jury proceedings, where a material statement is one that has the tendency to influence, impede or dissuade the grand jury from pursuing its investigation. Given that qualification, the Second Circuit might be inclined towards a narrower definition of materiality for statements made in the context of a deposition in a standard civil case.

The Sixth and Ninth circuits have articulated the narrowest standard, holding that a statement is material not simply if it relates to matter discoverable under the Federal Rules of Civil Procedure, but only if it would also have a tendency to affect the outcome of the underlying proceeding in which the deposition was given.[13] Most recently, in *United States v. McKenna*,[14] the Ninth Circuit reiterated that standard, in a prosecution based in part on false statements made by the defendant in a civil deposition in a personal injury action she had brought against the United States. The court held that the Magistrate Judge who presided over the civil trial was the relevant decision-maker for purposes of §1623, rejecting the government's remarkable contention that the prosecutor defending the civil action should be viewed as the decision-maker because she had to evaluate the evidence in that case for trial and settlement purposes. The court determined that the defendant's false statements during the deposition were evidence of her credibility and were thus "capable — at least to some degree — of affecting the magistrate's decision-making process in the civil trial, because they would have been admissible" as impeachment evidence.

RICO, Forfeiture

Another area of disagreement among the circuits is in determining the amount subject to forfeiture under 18 USC §1963(a)(3), which requires forfeiture of "any property constituting, or derived from, any proceeds which the [RICO defendant] obtained, directly or indirectly, from racketeering activity." As the Seventh Circuit observed in its decision in *United States v. Genova*,[15] "[r]estitution is loss based, while forfeiture is gain based." Following its decision in *United States v. Masters*,[16] the *Genova* court found that RICO proceeds subject to forfeiture included only the defendant's profits, net of the costs of their criminal business. In that case the defendants were convicted for their participation in a scheme in which one defendant, the mayor of an Illinois city, directed most of the city's legal business to the law firm of another defendant in exchange for substantial kickbacks. In ordering that the RICO forfeiture amount be recalculated, the Seventh Circuit held that the lawyer defendant was entitled to deduct from the illegally obtained fees the ordinary and necessary costs for generating them, such as salaries and other costs of maintaining his law office. This approach is in stark contrast to that taken by every other circuit to address this issue. A number of circuits interpret "proceeds" subject to forfeiture to encompass gross revenues obtained from the illegal activity.[17] The Second Circuit[18] and a district court in the Third Circuit[19] have charted a middle course, requiring forfeiture of gross profits, permitting deduction of certain direct or marginal costs of the illegal business, but not its fixed costs such as labor and taxes.

Although the Supreme Court has denied certiorari on most of the issues raised by these cases in the past, it is not unusual for the Court to allow the circuits to remain in conflict for some time before addressing a particular question. As these conflicts are particularly topical and do not appear headed for resolution at the circuit level, some of them may now be ripe for Supreme Court intervention. Lawyers should make their records accordingly.

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(1) 315 F3d 190 (3rd Cir. 2002).

(2) 184 F3d 180 (2d Cir. 1999).

(3) 989 F2d 244 (7th Cir. 1993).

(4) 320 F3d 1034 (9th Cir. 2003), petition for cert. filed, (May 22, 2003).

(5) 522 US 52 (1997).

(6) 166 F3d 88 (2d Cir. 1999).

(7) *United States v. Zwick,* 199 F3d 672 (3d Cir. 1999).

(8) See, *United States v. Dakota,* 197 F3d 821 (6th Cir. 1999); *United States v. Grossi,* 143 F3d 348 (7th Cir.), cert. denied, 525 US 879 (1998); *United States v. Westmoreland,* 841 F2d 572 (5th Cir.), cert. denied, 488 US 820 (1988). But see *United States v. Suarez,* 263 F3d 468 (6th Cir. 2001) (noting that if it were writing on a clean slate it might well require a minimal nexus between the offense conduct and the federal funding), cert. denied, 535 US 991 (2002).

(9) 326 F3d 937 (8th Cir. 2003), mandate stayed, (April 30, 2003), petition for cert. filed, (July 2, 2003).

(10) *United States v. Wilkinson,* 137 F3d 214 (4th Cir.), cert. denied, 525 US 873 (1998).

(11) *United States v. Holley,* 942 F2d 916 (5th Cir. 1991), cert. denied, 510 US 821 (1993).

(12) 14 F3d 751 (2d Cir.), cert. denied, 513 US 828 (1994).

(13) See *United States v. Clark,* 918 F2d 843 (9th Cir. 1990); *United States v. Adams,* 870 F2d 1140 (6th Cir. 1989).

(14) 327 F3d 830 (9th Cir. 2003).

(15) 333 F3d 750 (7th Cir. 2003).

(16) 924 F2d 1362 (7th Cir.), cert. denied, 500 U.S. 919 (1991).

(17) See, e.g., *United States v. Simmons,* 154 F3d 765 (8th Cir. 1998); *United States v. DeFries,* 129 F3d 1293 (D.C. Cir.1997); *United States v. McHan,* 101 F3d 1027 (4th Cir.1996), cert. denied, 520 US 1281 (1997); *United States v. Hurley,* 63 F3d 1 (1st Cir.1995), cert. denied, 517 US 1105 (1996).

(18) *United States v. Lizza Industries, Inc.,* 775 F2d 492 (2d Cir. 1985), cert. denied, 475 US 1082 (1986).

(19) *United States v. Milicia,* 769 FSupp 877 (E.D. Pa. 1991).