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Expert Analysis

The 'Right to Control' Theory in Mail And Wire Fraud Prosecutions

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The federal mail and wire fraud statutes have been described as a "Louisville Slugger," a powerful tool used by prosecutors to combat dishonest behavior in private and public life. Jed S. Rakoff, "The Federal Mail Fraud Statute (Part I)," 18 Duq. L. Rev. 771, 771 (1980). These laws seek to punish the use of false or misleading statements to deprive someone of money or property. Over time, the range of activity to which these statutes have been applied has grown to include schemes that do not contemplate direct financial injury.

A "right to control" theory has been formulated to account for unlawful schemes that do not cause a tangible monetary loss, but merely deprive the victim of "information necessary to make discretionary economic decisions." *United States v. Rossomando*, 144 F.3d 197, 201 n.5 (2d Cir. 1998). Given the doctrine's potential breadth, the Second Circuit has sought to limit "right to control" schemes to those involving misrepresentations of "an essential element of the bargain," as distinct from other deceit that might occur in an economic transaction. *United States v. Davis*, No. 13-CR-923 (LAP), 2017 WL 3328240, at *8 (S.D.N.Y. Aug. 3, 2017).

In this article, we discuss SDNY Judge Loretta A. Preska's recent decision in *United States v. Davis*, in which Judge Preska analyzed the Second Circuit's "right to control" decisions and concluded that a guilty verdict should be set aside. We then address practical steps defense counsel can take when facing a mail or wire fraud prosecution premised on this sometimes elusive doctrine.

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Prosecution of Larry Davis

Larry Davis owned and operated DCM Erectors, a structural steel contractor. The Port Authority of New York and New Jersey chose DCM to do substantial work after the 9/11 attacks. DCM was awarded a contract for metal decking on Tower 1 of the new World Trade Center (the Trade Center) and on the World Trade Center PATH Transportation Hub (the Hub). Id. at *1-2.

> In 'Davis,' Judge Preska analyzed the Second Circuit's "right to control" decisions and concluded that a guilty verdict should be set aside.

The contracts between DCM and the Port Authority included provisions that related to participation by minority-owned and woman-owned business enterprises (MWBEs). The contracts said that DCM's MWBE plan should meet or exceed 12 percent participation for MBEs and five

percent participation for WBEs. The language of the contract referred to goals, not requirements, for MWBE participation. Throughout the project, based on DCM's statements of payment and certified payrolls, the Port Authority assigned MWBE "credit" to DCM, which was a non-pecuniary evaluative figure determined by the Port Authority and used for its own internal tracking purposes. Id. at *2-3.

DCM had a joint venture agreement with Solera Construction, an MBE owned by Johnny Garcia, on both projects. DCM also subcontracted to GLS Enterprises, a certified WBE owned and managed by Gale D'Aloia, for payroll services on both projects. Both Garcia and D'Aloia pled guilty and became cooperating witnesses for the government. Their testimony was central to the trial. Id. at *3, 5-6.

A grand jury returned an indictment that charged Davis and DCM with a scheme (and conspiracy) to commit wire fraud on the theory that in order to be awarded contracts and be paid under those contracts, they had misrepresented to the Port Authority that Solera and GLS were performing work as MWBEs when, in reality, Solera and GLS did not do genuine work on the projects and served merely as "pass-through" entities for non-minority companies. Id. at *22.

Government's Theories of Fraud

The gravamen of the charges was that DCM and Davis deprived the Port Authority of a "right to control" its assets by causing decisions—namely, to award the contracts to DCM and also to make payments to DCM—to be made on the basis of false and misleading statements about MWBE work on the Trade Center and Hub projects. In its opening statement, the government added an additional theory of economic harm: that misrepresentations caused substantial payments on top of the original contracts, related to change orders, to be made to the defendants. Id. at *17, 32.

At trial, Garcia had problems as a government witness. On direct examination, he testified that he did "basically nothing" on both projects, but on cross-examination conceded that for both projects he had managed Solera and DCM employees and had traveled outside the country to oversee steel and glass procurement. The other government cooperator, D'Aloia, gave similar contradictory testimony. On direct examination D'Aloia testified that she "committed fraud," but conceded on cross-examination that she had performed payroll-related tasks on both projects. Trial testimony also showed that additional payments for change orders were made to DCM not based on statements about MWBE work but as a result of logistical problems, bad weather and design changes. Id. at *5-6.

The government shifted prosecution theories again in summation, arguing that specific payments to Garcia—falsely reported on a few certified payrolls—caused direct financial harm to the Port Authority, because Garcia did no meaningful work on the projects, causing the Port Authority to make payments for work that did not occur.

Finally, in post-trial briefing, the government, apparently acknowledging that Garcia had worked on the projects, changed its theory once more, arguing that false statements on a few certified payroll records caused direct financial harm to the Port Authority because Garcia did not do construction-related work, and the Port Authority made payments for work falsely represented as related to construction. Id. at *17.

Deceit and Fraud in Context

Judge Preska focused on the "fine line" in the Second Circuit between cases in which deceit does not go to the essence of the parties' bargain and thus does not amount to mail or wire fraud, and cases in which dishonesty goes to a key element of the bargain and constitutes fraud. Ultimately, Judge Preska concluded that the false statements alleged in the *Davis* case could at most have influenced the Port Authority to enter into contracts with DCM it would not have otherwise entered into, but did not amount to a fraud because the deceit did not relate to an essential element of the bargain between them. Id. at *8-15.

For example, in *United States v. Shellef*, 507 F.3d 82 (2d Cir. 2007), in which defendants falsely represented that they would not resell industrial chemicals domestically and thereby acquired them at a lower price by avoiding an excise tax adjustment, the Second Circuit held (after conviction at trial) that the indictment was insufficient because it failed to allege that the misrepresentations affected essential elements of the bargain between the seller of the product and defendants. The court rejected the government's "no-sale," or right to control, theory because the misrepresentations lacked relevance to the object of the contract; they were not directed to the quality, adequacy, or price of goods to be sold, or otherwise to the nature of the bargain—and were simply made to gain access to the contracting party's products. Id. at 108-09.

Carefully exploring this distinction between deceit and fraud, Judge Preska held that the alleged misrepresentations in *Davis* did not go to an essential element of the bargain—like the misrepresentations in *Shellef* and another leading Second Circuit decision, *United States v. Regent Office Supply Co.*, 421 F.2d 1174 (2d Cir. 1970). The court found that the MWBE sections of the contracts were merely "aspirational," did not concern the quality or nature of the goods or services being provided to the Port Authority, and were only collateral aspects of the building contracts. In reaching this conclusion, Judge Preska carefully parsed the language of the lengthy contacts between DCM and the Port Authority, which specified in detail the bargain between the parties, including the non-mandatory nature of the MWBE goals, and the discretionary and prospective nature of the sanctions if DCM did not meet those goals. *Davis*, 2017 WL 3328240, at *16.

Reinforcing the conclusion that the defendants' conduct amounted at worse to deceit, not fraud, Judge Preska went on to explore the contours of the "right to control" theory and explain why the government's charges and proof did not fall within that theory of prosecution. In the Second Circuit's "right to control" cases, Judge Preska found a common thread in the case law: Convictions under this theory have been upheld when "the deceit had the potential to cause economic harm to the victim or where it involved a violation of the law," whereas, convictions in which these factors were not present had been reversed. Id. at *9. The court then analyzed cases that tracked these two types of "right to control" prosecutions, those involving risk of economic harm, and those involving violations of law.

As to the risk of economic harm, in *Unites States v. Dinome*, 86 F.3d 277 (2d Cir. 1996), the defendant made false statements about his income and employment as part of a residential mortgage loan application, which resulted in undisclosed economic risk for the bank. The Second Circuit upheld the defendant's conviction for wire fraud, explaining that even if default did not ensue, the false information created economic risk for the bank as the mortgage loan was more exposed to default. Id. at 284.

As to violations of law, in *United States v. Frank*, 156 F.3d 332 (2d Cir. 1998), the defendants contracted with their customer to transport raw sewage sludge for disposal at sea. The defendants represented to their customer that they would dispose of the customer's hazardous waste at least 106 miles from shore as required by federal regulations, while they routinely dumped the hazardous waste in waters short of the 106-mile site. Explaining that the defendants' misrepresentation, which went to the heart of the bargain between the parties, could have subjected the customer to fines and the loss of its environmental permit, the Second Circuit affirmed the defendants' convictions. Id. at 335.

Judge Preska explained why the defendants' alleged misrepresentations in *Davis* did not expose the Port Authority to potential or actual economic harm under any of the government's theories, and did not implicate violations of the law. The court found that Garcia and D'Aloia worked on the projects, but even

if the government had proven that they did not, the Port Authority would not have been exposed to actual or potential economic harm because the contract prices were fixed, and additional payments were due to extra work, not false statements. The parties had also stipulated that a breach of the MWBE section of the contracts was not in itself a violation of the law, so that basis for sustaining a "right to control" theory of prosecution was not in the case. *Davis*, 2017 WL 3328240, at *16-22.

Practical Implications

Judge Preska's application of the *Regent Office Supply* and "right to control" lines of cases in the *Davis* case suggests several implications for defense counsel. Above all, it is vital to analyze the government's theory of prosecution. If the theory of fraud is not clear on the face of the indictment, defense counsel should consider seeking from the government a bill of particulars, and if that is unsuccessful, consider motion practice on the premise that particulars are necessary to understand the charges and defend the case. The defense might also consider making a motion to dismiss the indictment once the theory of fraud is clear. Such motions are rarely granted, but they might at least succeed in highlighting issues for the court and clarifying the government's theory of fraud.

Second, it is important for counsel to be vigilant in detecting shifts in the government's theory—for example, in regard to the specific injury alleged by the government, and how the defendant's actions and statements caused or at least contemplated such harm. These issues are accentuated when the government proceeds under a "right to control" theory of prosecution, often giving rise to questions as to the precise harms and culpable acts and intentions underlying the government's case. As Judge Preska observed in her decision, shifts in the government's theory of prosecution prevented the defense from marshalling certain evidence before trial, and required defense counsel to formulate defenses hastily during trial. Id. at *34-35.

At the same time, certain features of the *Davis* case may limit its applicability to other fraud cases. In considering sufficiency of the evidence, Judge Preska made the unusual finding that cooperator testimony was "patently incredible" as to whether the MWBEs worked on the projects and concluded that, absent this testimony, "the jury probably would have acquitted Defendants." Id. at *26. In addition, Judge Preska interpreted highly detailed and specific contracts between DCM and the Port Authority, which used aspirational rather than mandatory language in relation to MWBE participation. The language supported Judge Preska's conclusion that any misrepresentations did not go to the essential elements of the parties' bargain. Most fraud prosecutions do not turn on such detailed contracts.

Conclusion

Judge Preska's decision in *Davis* explains one of the most challenging doctrines in the law of mail and wire fraud—the "right to control" theory—and serves to remind defense counsel, and prosecutors, of the importance of clarity in articulating the government's theory of prosecution. Given the breadth and flexibility of the mail and wire fraud statutes, no one decision can provide definitive answers to enduring questions. But it remains vital for courts to be clear and emphatic, as Judge Preska was in *Davis*, when a prosecution is seen as going too far.

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