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Supreme Court and First Circuit Cut Back on Expansive Theories of Federal Fraud

Three Decisions Continue Appellate Trend of Rejecting Broad Interpretations of Federal Fraud Statutes

SUMMARY

Appellate courts rejected broad theories of white-collar fraud three times last week.

First, on May 10, 2023, in an opinion by Judge Lynch, the U.S. Court of Appeals for the First Circuit vacated the mail and wire fraud convictions of two parents who, as part of the "Varsity Blues" scandal, allegedly made payments to university accounts in exchange for employees' securing admission for their children. *United States* v. *Abdelaziz*, ___ F.4th ___, 2023 WL 3335870 (1st Cir. 2023). The court held that the defendants could not be prosecuted on an honest-services theory of fraud because their payments were not a cognizable form of bribery. It also held that the defendants could not be prosecuted on a property theory of fraud because, on the record before the court, admissions slots were not property within the meaning of the fraud statute.

The next day, in opinions by Justice Thomas and Justice Alito, respectively, the U.S. Supreme Court unanimously overturned federal fraud convictions in *Ciminelli* v. *United States*, 598 U.S. ___, 2023 WL 3356256 (2023), and *Percoco* v. *United States*, 598 U.S. ___, 2023 WL 3356257 (2023). In *Ciminelli*, the Court overturned Second Circuit precedent and held that "property" under the fraud statutes does not include the intangible right to control one's assets. In *Percoco*, the Court held that a private citizen does not owe the public a duty to provide honest services simply because he has strong influence over government decisions, again abrogating contrary Second Circuit precedent. These decisions continue a clear trend over the past 15 years of appellate courts, and especially the Supreme Court, rejecting aggressive interpretations of the federal mail and wire fraud statutes.

BACKGROUND

All three cases arose out of high-profile scandals that resulted in numerous federal criminal convictions.

Abdelaziz involved two defendants caught up in the Varsity Blues college admissions scandal. Mr. Abdelaziz and Mr. Wilson agreed to make payments to university accounts in exchange for university employees' securing admission for their children on athletic scholarships. The government indicted the defendants, along with dozens of other parents who had committed similar acts. Mr. Abdelaziz and Mr. Wilson were charged with multiple offenses, including conspiracy to commit two types of mail and wire fraud: honest-services fraud, by using their payments to deprive the universities of the honest services of university employees; and property fraud, by depriving the universities of property in the form of admissions slots. *See* 18 U.S.C. §§ 1343, 1346. Before trial, all co-defendants besides Mr. Abdelaziz and Mr. Wilson pleaded guilty. Mr. Abdelaziz and Mr. Wilson were tried jointly and convicted on all counts.

Ciminelli concerned a scheme to rig the bid process for state-funded development projects in Buffalo, New York, as part of the "Buffalo Billion" plan. Mr. Ciminelli and a board member of the nonprofit in charge of choosing state-funded contractors ensured that unique aspects of Mr. Ciminelli's construction company were treated as job prerequisites, guaranteeing his company's selection for a marquee $750-million project. The government charged Mr. Ciminelli with wire fraud and conspiracy to commit wire fraud. At trial, the government relied on the Second Circuit's "right to control" theory of property fraud, under which, a defendant defrauds the victim of property if he deprives the victim of potentially valuable economic information necessary to make discretionary economic decisions. Mr. Ciminelli was convicted on that theory, and the Second Circuit affirmed.[1]

Finally, the defendant in *Percoco* was an influential former adviser to New York Governor Andrew Cuomo. In 2014, he resigned from government service for eight months to manage the Governor's reelection campaign. During that time, Mr. Percoco accepted payments to assist a real-estate developer in dealing a state development agency. Mr. Percoco urged an official at that agency to drop a condition that was preventing the developer from receiving state funding, and the agency agreed to do so the next day. The government indicted Mr. Percoco, asserting that his dealings with the state agency amounted to conspiracy to commit honest-services fraud, even though he was not a public official at the time. The jury convicted Mr. Percoco. Applying circuit precedent regarding the application of the honest-services statute to private actors, *United States* v. *Margiotta*,[2] the Second Circuit affirmed.[3]

[1] *United States* v. *Percoco*, 13 F.4th 158 (2d Cir. 2021).

[2] 688 F.2d 108 (2d Cir. 1982).

[3] *United States* v. *Percoco*, 13 F.4th 180 (2d Cir. 2021).

THE FIRST CIRCUIT'S DECISION IN *ABDELAZIZ*

The First Circuit in *Abdelaziz* rejected both of the government's fraud theories and vacated the defendants' mail and wire fraud convictions. The First Circuit first rejected the honest-services theory. It explained that, under the Supreme Court's decision in *Skilling* v. *United States*,[4] which narrowly construed the concept of "honest services" to avoid constitutional vagueness concerns, the statue criminalizes only the classic crimes of bribery and kickbacks.[5] The government here did not allege any kickbacks. And the First Circuit rejected the government's argument that a "bribe" could include a payment "to the purportedly betrayed party" itself—here, the universities.[6] The court concluded that, following the logic of *Skilling*, an ordinary person would not be on notice that such a payment would be considered a bribe, and warned that accepting the government's theory would leave the statute's "outer boundaries ambiguous."[7]

The court also rejected the government's property-fraud theory. It held that the district court erred in instructing the jury that, "for purposes of the mail and wire fraud statutes, admission slots are the property of universities."[8] The First Circuit rejected the defendants' categorical arguments that admission slots can *never* be property. But it also rejected the government's equally categorical argument that admission slots are *always* property because they are both exclusive and economically valuable, finding that "highly general" test both too broad and too indeterminate.[9] The court left open the possibility that more "case-specific" factual arguments might demonstrate that admission slots can be treated as property, but saw nothing in the record here to support that conclusion.[10]

THE SUPREME COURT'S DECISIONS IN *CIMINELLI* AND *PERCOCO*

In both *Ciminelli* and *Percoco*, all nine Justices voted to overturn Second Circuit precedent and vacate the defendants' fraud convictions.

In *Ciminelli*, the Court made quick work of the Second Circuit's right-to-control theory of property fraud. Under the Court's precedents, Justice Thomas's unanimous opinion explained, "the wire fraud statute reaches only traditional property interests," and "the right to valuable economic information . . . is not a traditional property interest."[11] The Court also noted that the right-to-control theory "makes a federal crime

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[4] 561 U.S. 358 (2010).

[5] *Abdelaziz*, 2023 WL 3335870, at *16.

[6] *Id.* at *19.

[7] *Id*.

[8] *Id.* at *20 (alterations omitted).

[9] *Id.* at *22-23.

[10] *Id.* at *24-25.

[11] *Ciminelli*, 2023 WL 3356526, at *5.

of an almost limitless variety of deceptive actions traditionally left to state contract and tort law."[12] The government had conceded in the Supreme Court that the right-to-control theory is erroneous, and had attempted to defend the conviction on alternative grounds. But the Court did not consider the government's alternative (and potentially broader) theory that a fraud charge can be based on *any* property obtained from the misrepresentations—here, valuable government contracts. Justice Alito wrote a short concurrence, emphasizing that the Court's opinion did not address "fact-specific issues" regarding the government's ability to retry Mr. Ciminelli.[13]

The Court's analysis in *Percoco* was lengthier, but no less definitive. Writing for the Court, Justice Alito began by explaining that it is theoretically possible for private citizens to commit honest-services fraud if they are acting as an agent of the government.[14] But that was not the theory the lower courts applied here. The Court held that the jury instructions in this case, drawn from the Second Circuit's *Margiotta* decision, were "too vague."[15] Those instructions had stated that a private citizen owes a duty of honest services to the public if he "dominated and controlled any government business" and "people working in the government actually relied on him because of a special relationship he had with the government."[16] The Court considered that test too open-ended, as it could be applied to "lobbyists and political party officials" whenever their "clout exceeds some ill-defined threshold."[17] Again, the government did not defend the jury instructions in the Supreme Court, but rather argued harmless error. The Court disagreed, and remanded for further proceedings.[18]

Justice Gorsuch concurred only in the judgment, joined by Justice Thomas. Justice Gorsuch would have resolved the case on the broader ground that the honest-services fraud statute is unconstitutionally vague in all its applications.[19] He lamented that, in light of the Court's narrow opinion, although "we may now know a little bit more about when a duty of honest services *does not* arise . . . we still have no idea when it *does*."[20]

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[12] *Id.*

[13] *Id.* at *6 (Alito, J., concurring).

[14] *Percoco*, 2023 WL 3356527, at *6.

[15] *Id.* at *7.

[16] *Id.*

[17] *Id.*

[18] Justice Jackson did not join this portion of the Court's opinion, but did not explain her reasoning.

[19] *Percoco*, 2023 WL 3356527, at *11 (Gorsuch, J., concurring in the judgment).

[20] *Id.* at *10.

ANALYSIS

The results in *Ciminelli* and *Percoco* were expected by Supreme Court watchers. Over the past 13 years, the Court has granted review in four cases involving honest-services or property fraud—in *Skilling*, *Kelly* v. *United States*,[21] and now in *Ciminelli* and *Percoco*. Every Justice who participated in those cases voted to reverse the conviction at issue by rejecting the government's broad construction of the fraud statute. Also part of this trend is the Court's 2016 reversal of Virginia Governor Bob McDonnell's bribery conviction, in which the Court—again unanimously—adopted a narrowing construction of the federal bribery statute.[22] (Indeed, *Percoco* cited *McDonnell* in its analysis.[23]) *Skilling*, *Kelly*, and *McDonnell* were driven by common concerns: the defendant's due process right to fair notice of the criminal laws; the need for clear rules to avoid a chilling effect on legitimate political activity like lobbying; and the fear that broad, open-ended standards invite federal prosecutors into areas more appropriately left to state law. These concerns likewise mapped onto *Ciminelli* and *Percoco*. It is therefore not surprising that the United States all but conceded error in both cases, or that the Supreme Court agreed with the defendants.

Although handed down one day earlier, the First Circuit's decision in *Abdelaziz* anticipated the results and reasoning of *Ciminelli* and *Percoco*. Straightforwardly applying the logic of the Supreme Court's opinions, the First Circuit refused to accept the government's novel and expansive theories of property and honest-services fraud, which were "at best a stretch."[24]

The First Circuit's decision, however, may be cold comfort to the 47 parents, school officials, and others who have pleaded guilty in Varsity Blues cases, many to charges premised on similarly dubious theories. In this respect, *Abdelaziz* illustrates the downsides of the Supreme Court's approach to federal fraud cases since *Skilling*. The Court has tended to narrowly reject the governments' aggressive theory of the day while declining to provide broader interpretive guidance. Although the thrust of the Court's decisions is often clear enough, that has not deterred federal prosecutors from continuing to aggressively wield the federal fraud statutes, as they did in the Varsity Blues prosecutions. And most criminal defendants are unwilling to risk lengthy prison sentences by going to trial, despite having strong legal arguments for appeal. This dynamic lends credence to Justice Gorsuch's call in *Percoco* for greater clarity.

Of the three decisions, *Ciminelli* may prove to have the farthest-reaching consequences. In recent years, federal prosecutors have frequently based fraud prosecutions on the theory that victims were deprived of information that may have been relevant to decisions on how to conduct their affairs, even if those victims did not suffer any economic loss. For example, the Department of Justice has charged a number of foreign

[21] 140 S. Ct. 1565 (2020).

[22] *See McDonnell* v. *United States*, 579 U.S. 550 (2016).

[23] 2023 WL 3356257, at *7.

[24] *Abdelaziz*, 2023 WL 3335870, at *17.

banks and individuals not otherwise subject to U.S. money-laundering or trade-sanctions laws with bank and wire fraud for sending to their U.S. correspondent banks payments on behalf of suspicious or sanctioned parties, without disclosing information that would likely have caused the U.S. banks to reject those payments. The government's theory in those cases is that the U.S. banks were the victims of fraud even though they suffered no financial loss because they were deprived of sufficient information to determine whether to process those payments. It seems doubtful that such prosecutions are still viable following *Ciminelli*'s emphatic holding that the federal fraud statutes require a deprivation of money or property.

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