Bank Scheme Ruling Spotlights Clash Over Limits Of Fraud

By Eddie Jauregui, Dan Small and Gary Klubok (November 3, 2021)

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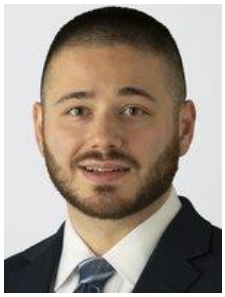

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Last month, the U.S. Court of Appeals for the Ninth Circuit published its decision in U.S. v. Yates, an unusual bank fraud case with broad implications.[1]

The crux of Yates was that neither depriving a bank of accurate information, nor deceiving a bank to draw an existing salary from the bank, can support convictions for bank fraud. The Ninth Circuit held that these two things are not cognizable property interests under the bank fraud statute, and vacated all convictions.

The government's theories in Yates and the reasons why the Ninth Circuit rejected them are instructive for future cases, as they help clarify what is not bank fraud in the Ninth Circuit and beyond. Further, Yates is the latest round in an ongoing tug of war between prosecutors trying to broaden the reach of key federal fraud statutes, and courts trying to narrow and define them.

Background

In 2017, the government charged Dan Heine and Diana Yates, both former executives at Bank of Oswego, with conspiracy to commit bank fraud and making false bank entries.

The indictment alleged that through the following three schemes, Heine and Yates conspired to conceal the bank's true financial condition in order to create a better financial depiction of the bank:

- "[R]ecruiting a bank employee ... to make an undisclosed straw purchase of a property ... using [the] bank's funds";
- "[A]rranging for third parties to make payments on delinquent customer loans to bring them current and then omitting those loans as delinquent on the bank's ... reports"; and
- "[I]ncorrectly accounting for two properties after selling them to a customer ... and approving a loan to reconcile the error without disclosing that purpose to the internal loan committee."[2]

The false-bank-entry counts alleged that Heine and Yates concealed and omitted material information about loans.[3]

The federal bank fraud statute, Title 18 of the U.S. Code, Section 1344(1), requires that a defendant "knowingly execut[e] ... a scheme or artifice ... to defraud a financial institution." Scheme or artifice requires that the defendant deceive a bank and deprive it of something of value, i.e., money or property.[4]

At trial, the government alleged that Heine and Yates conspired to deprive the bank of three

property interests: (1) accurate financial information in the bank's books; (2) Heine and Yates' regular salaries and bonuses; and (3) the use of bank funds.[5]

The jury found Heine and Yates guilty of conspiracy and of 12 counts of making false bank entries.[6] The U.S. District Court for the District of Oregon sentenced both defendants to prison terms.[7]

On appeal, the Ninth Circuit held that the accurate-information and salary-maintenance theories were legally insufficient.[8] Because the government's reliance on these two theories was not harmless, the Ninth Circuit dismissed the remaining bank-funds theory and overturned all convictions.[9]

Takeaways

The Ninth Circuit rejected the accurate-information and salary-maintenance theories because these theories overly broaden federal fraud statutes.

In rejecting the accurate-information theory, for instance, the court held that "there is no cognizable property interest in the ethereal right to accurate information"[10] and observed that, by definition, every deceptive act deprives the victim of accurate information.

Thus, under the government's theory, all deception would automatically become fraud. Notably, the government abandoned this argument on appeal.[11]

The court likewise rejected the government's salary-maintenance theory. The court noted that Heine and Yates lied only to continue to draw their existing salaries and avoid being fired.

Thus, if the government were correct that this conduct was fraudulent, then any bank employee's lie to her boss — including, for example, a lie about how much time she spent on surfing the web — could subject her to federal prosecution for fraud.[12]

The court noted:

> Extending the fraud statutes in that way would raise serious concerns about whether the offense is defined "with sufficient definiteness that ordinary people can understand what conduct is prohibited and ... in a manner that does not encourage arbitrary and discriminatory enforcement."[13]

Notably, however, the court drew a fine line here: Lying to obtain a higher salary or bonus could deprive employers of something of value, but lying to maintain the status quo ordinarily does not.[14] To hold otherwise, the court held, would criminalize too wide a range of commonplace conduct.[15]

The principal takeaway from Yates is that the government's theories pushed the definition of fraud too far.[16] The government should have focused on its one valid theory: The defendants' use of the bank's funds deprived the bank of valuable property, i.e., money.

This theory likely would have been more successful, as the defendants allegedly used bank funds to complete a straw purchase. But in relying on the two additional theories — accurate information and salary maintenance — the government tainted the well, leading to a dismissal of all charges.

In the future, the government will have to be more tightly focused on evidence that shows a deprivation of traditional and tangible forms of property, and advancing legal theories based on that conduct.[17]

Another takeaway is that the Ninth Circuit does not believe it has limited the scope of the bank fraud statute in any way.[18] The court noted that it did not vacate the convictions because Heine and Yates' conduct was legal. It vacated them because the government's presentation of Heine and Yates' conduct to the jury focused on two legally insufficient theories, which resulted in harmful error that tainted all the charges.

Heine and Yates could have been found guilty if the government presented only valid theories — e.g., Heine and Yates misled the bank to receive the bank's funds and continue their conspiracy.[19]

Trends

Yates is the latest case in a line of decisions in which courts have rejected attempts by the government to extend the definitions of fraud and corruption statutes.

In 2010, the U.S. Supreme Court issued its decision in Skilling v. U.S., which narrowed the federal honest services fraud statute.[20]

There, the government's theory was that Jeffrey Skilling committed honest services fraud for undisclosed self-dealing because he allegedly misrepresented Enron's fiscal health to artificially inflate its stock price, which resulted in Skilling receiving his normal salary, bonus and $200 million through the sale of Enron stock.

However, the Supreme Court did not believe that self-dealing, without more, was criminal conduct, and held that honest services fraud criminalizes only bribery and kickback schemes, because it is "seriously culpable conduct."[21] If fraud statutes penalized any culpable conduct, they could be unconstitutionally vague.[22]

Similarly, in 2016, the Supreme Court issued a unanimous ruling in McDonnell v. U.S., which limited the scope of the statute governing federal bribery of public officials.[23] This statute forbids public officials from "committing or agreeing to commit an 'official act'" in exchange for anything of value.[24]

The issue in McDonnell was whether the term "official act" encompassed arranging meetings, hosting and attending events, contacting other government officials, and facilitating relationships for third parties.[25] The Supreme Court did not think so, and vacated McDonnell's convictions.[26]

It reasoned that the government's definition of official act would raise serious concerns:

> Conscientious public officials arrange meetings for constituents, contact other officials on their behalf, and include them in events all the time. Representative government assumes that public officials will hear from their constituents and act appropriately on their concerns. The Government's position could cast a pall of potential prosecution over these relationships.[27]

The government's definition of official act was too broad for the Supreme Court, just like the government's definition of honest services fraud in Skilling.[28]

The conduct in both cases was not serious enough to constitute a criminal act, even if they may have been deceitful acts.

And in 2020, the Supreme Court issued a unanimous ruling in Kelly v. U.S., the Bridgegate case, which narrowed the federal wire fraud and federal program fraud statutes.[29]

The wire fraud statute prohibits deceptive schemes that deprive the victim of money or property, and the federal program fraud statute prohibits obtaining by fraud the money or property of a federally funded program or entity.[30] Both statutes additionally require that money or property be the object of the fraud.[31]

The Supreme Court held that taking control of the George Washington Bridge, which received federal funds, by closing lanes was a typical exercise of regulatory power that cannot encompass the legal definition of taking property; otherwise, any closures from road construction could border on a federal crime.[32]

Furthermore, the court reasoned that money paid to Port Authority of New York and New Jersey engineers and toll collectors was an incidental byproduct to the defendants' scheme, not the object of the defendants' scheme, as the law requires.[33]

Although closing lanes on the George Washington Bridge seemed devious, not every devious act by state or local officials is a federal crime. The act must target money or property. Otherwise, the government would have almost unlimited power to prosecute anyone, which would likely make fraud statutes void for vagueness.

The throughline in Yates, Skilling, McDonnell and Kelly is that the courts disapprove of efforts by federal prosecutors to push the bounds of federal white collar crime statutes.

In these cases, the courts have made clear that only the most serious misconduct involving core property interests — or in the case of McDonnell, core official acts — come within the ambit of the statutes. This is so because there must be some definiteness to these statutes; the public and the courts need to understand when your everyday bad acts cross over into federal crimes.

In the future, defense attorneys should analyze whether their clients' allegedly fraudulent conduct falls within the heartland of traditional federal fraud crimes. And the government should be careful to focus on only its strongest arguments, because one or two invalid arguments can vacate all convictions, which was the flaw in Yates.

Finally, with regard to Yates, the Supreme Court may grant certiorari to clear up the law. The dissent cites opinions from the U.S. Courts of Appeals for the Fourth, Seventh, Eighth and Tenth Circuits that it believes diverge from the Ninth Circuit's view.[34]

For example, the dissent quotes a 2009 decision in U.S. Severson, writing that the U.S. Court of Appeals for the Seventh Circuit

> [upheld a] bank fraud conviction when the defendant participated with the bank's president in a scheme to "mask the bank's dilapidating condition and to present the illusion of a financially sound bank."[35]

And, the dissent notes, the U.S. Court of Appeals for the Fourth Circuit in 2015 in U.S. v. Fields

> affirm[ed] convictions of bank executives when "[t]he indictment alleged that the objectives of the conspiracy were to hide the true financial condition of the Bank and to benefit the conspirators at the Bank's expense."[36]

Given the split between the circuits, this will definitely be an area to watch.

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[1] United States v. Yates, 18-30183, 2021 WL 4699251, at *1 (9th Cir. Oct. 8, 2021).

[2] Id. at 4.

[3] Id.

[4] Id. at 4.

[5] Id. at 4.

[6] Id. at 1.

[7] Id. at 4.

[8] Id. at 4-7.

[9] Id. at 8-9.

[10] See id. at 5.

[11] Id. at 8-9.

[12] Id. at 7.

[13] Id. at 9 (internal quotations and citations omitted).

[14] Id.

[15] Id. at 7.

[16] Id.

[17] The Court noted that certain information (e.g., trade secrets or confidential business information) can constitute "something of value." That makes sense. A trade secret itself is can be commercially valuable. But under Supreme Court and Ninth Circuit precedent, neither the "right to make an informed decision," nor the "intangible right to make an informed lending decision" is a thing of value.

[18] The court wrote that "[b]ank executives considering engaging in fraud should take no comfort from [the Yates decision]."

[19] See id.

[20] Skilling v. U.S., 561 U.S. 358, 413-14 (2010).

[21] Id. at 409-11 (internal quotations and citations omitted).

[22] Id.

[23] McDonnell v. United States, 136 S. Ct. 2355 (2016).

[24] 18 U.S.C. § 201.

[25] McDonnell, 136 S. Ct. at 2365.

[26] Id. at 2357-58.

[27] Id. at 2372.

[28] See Skilling, 561 U.S. at 409-11.

[29] Kelly v. United States, 140 S. Ct. 1565 (2020).

[30] Id. at 1571-72.

[31] Id.

[32] Id. at 1573-74.

[33] Id.

[34] United States v. Yates, 18-30183, 2021 WL 4699251, at *22-25. (9th Cir. Oct. 8, 2021).

[35] Id. at 22-23 (internal quotations and citations omitted).

[36] Id. (internal quotations and citations omitted).