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Ninth Circuit vacates convictions premised on improper fraud theory

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In a recent decision, *United States v. Yates*, 16 F.4th 256 (9th Cir. 2021), the 9th U.S. Circuit Court of Appeals overturned the convictions of two bank executives for bank fraud on the grounds that the prosecutors argued an improper fraud theory to the jury. On appeal, the Court held that the executives' withholding of "accurate information" from the bank's directors was insufficient to create a property interest necessary for upholding a conviction.

Yates is a continuation of a long pattern of cases leading back to the Supreme Court's 1987 decision in *McNally v. United States* that has reinforced that a federal fraud conviction cannot stand absent some proof by the government that obtaining property or money was the "object" of the alleged scheme.

Ninth Circuit's decision in *Yates*

In *Yates*, the Ninth Circuit vacated the convictions of two bank executives from a small bank in Lake Oswego, Ore., who were charged with one count of conspiracy to commit bank fraud under 18 U.S.C. § 1349 and 12 counts of making false bank entries. Under 18 U.S.C. § 1344, bank fraud requires that a scheme must be aimed at obtaining any "moneys . . . or other property owned by, or under the custody or control of, a financial institution."

According to the indictment, the executives concealed the bank's true financial condition through a series of false and misleading statements, unauthorized bank transfers, and failure to disclose material facts to the bank's directors.

Based on this conduct, the prosecutors put forth three main theories of fraud. First, the government argued that the executives had deprived the bank of accurate information by making false bank entries and diverting bank funds.

Second, the government alleged that the defendants had fraudulently obtained their salaries and employment benefits by misleading the bank's board about the financial health of the bank in order to remain employed and continue to draw their salaries.

Third, the government contended that the defendants misled the bank and its board of directors in order to improperly use bank funds to continue the conspiracy, specifically by (1) recruiting a bank employee to make an undisclosed straw purchase of a property using bank funds; (2) arranging for third parties to make payments on delinquent loans to bring them current; and (3) incorrectly accounting for two properties after selling them to a customer and approving a loan to reconcile the error without properly disclosing it.

On appeal, the Ninth Circuit rejected the first two theories. First, the court held that there is no "cognizable property interest" in the right to accurate information because recognizing accurate information as property would "transform all deception into fraud."

Courts have long held that "intangible rights" do not constitute property and cannot support a fraud conviction. Yates' *rejection of the "accurate information" theory is a natural continuation of this line of reasoning.*

Second, while the court agreed that salaries and employment benefits are both forms of "money" for fraud purposes, it rejected the notion that drawing an *existing* salary can form the basis of a fraud conviction. The court reasoned in part that the government's salary-maintenance theory would criminalize a "wide range of commonplace conduct," such as situations where an employee wastes time on the job and falsely claims to have been productive in order to avoid being fired.

As for the government's third theory, while the court agreed that the bank has a property interest in its funds, and that the fraudulent diversion of the bank's funds could indeed be the basis of a fraud conviction, it stopped short of fully endorsing this theory. Rather, the court held that the government's reliance on two legally insufficient theories was not harmless and necessitated overturning the convictions.

The court reasoned that the evidence of guilt was not "so overwhelming as to ensure that the jury could not have found in favor of the defendants in the absence of the errors," and therefore could not conclude that the invalid legal theories did not contribute to the jury's verdict beyond a reasonable doubt.

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While the dissent agreed (and the government ultimately conceded at oral argument before the Ninth Circuit) that accurate information could not constitute property under the bank fraud statute, it disagreed with the majority's rejection of the salary-maintenance theory, and asserted that the government's presentation of improper theories at trial did not warrant reversal given the overwhelming weight of the evidence that the executives had misled the bank and regulators about the financial health of the bank.

But according to the majority, even though the trial court administered jury instructions that were technically correct, those instructions did nothing to "preclude conviction under the government's invalid theories."

Property as the 'object' of fraud

Yates' rejection of the "accurate information" theory is consistent with a long line of decisions that has narrowly construed federal fraud statutes to criminalize only behavior that has ill-gotten money or property as the "object" of a fraudulent scheme. This trend began with the Supreme Court's landmark decision in *McNally v. United States*, 483 U.S. 350 (1987).

In *McNally*, the Court was evaluating a scheme in which Kentucky awarded its state's insurance business to a private agency in return for kickbacks that were ultimately placed in an investment firm run by a front man for state officials.

The appellants, a public official (the Secretary of Public Protection and Regulation) and a private individual, were accused of conspiring to use the official's supervisory authority over the government process for awarding insurance contracts to benefit the private individual's company without disclosing the official's ownership interest in the company. Because the scheme only implicated an intangible right to honest government, the conduct could not support a mail fraud conviction, as the statute was "limited in scope to the protection of property rights."

The Court reached a similar conclusion in *Cleveland v. United States*, 531 U.S. 12 (2000), when it reversed a wire fraud conviction related to the defendant's fraudulent scheme surrounding the awarding of state gaming licenses. The Court held that the issuance of licenses was an "intangible" regulatory right of "allocation, exclusion, and control," which did not constitute an interest in property or money as required for fraud.

Subsequently, in *Skilling v. United States*, 561 U.S. 358 (2010), the Supreme Court reversed the fraud conviction of the CEO of Enron, who was charged with "honest-services" fraud for making misrepresentations that inflated the financial health of the company, because Skilling did not receive kickbacks or bribes from a third party in exchange for making the misrepresentations.

The past year has seen two additional cases reinforcing the Court's stance that a conviction cannot stand absent property or money being the "object" of the fraudulent scheme. In *Kelly v. United States*, 140 S. Ct. 1565 (2020), the Supreme Court reversed wire fraud and federal program fraud convictions that arose from a political payback scheme by allies of former New Jersey Governor Chris Christie to limit access to bridge lanes across the George Washington Bridge into Manhattan.

The Court reasoned that, although the scheme had deprived the city of Fort Lee, N.J., of property in the form of overtime wages paid to toll workers on the bridge, the lane access scheme was regulatory in nature and thus not property, and the wages (which were property) were an "incidental byproduct" and not the object of the scheme.

Earlier this year, the Supreme Court also vacated the insider trading conviction of an employee of the Centers for Medicare and Medicaid Services (CMS) and a former CMS employee-turned-hedge fund consultant in *Blaszczak v. United States*, 141 S. Ct. 1040 (2021), for further consideration in light of *Kelly*. In *Blaszczak*, the government convicted a CMS employee who provided confidential information to a health care hedge fund related to the timing and details of planned reimbursement rate changes.

On remand to the 2nd U.S. Circuit Court of Appeals, the government asked the court to reverse the property fraud convictions pursuant to the Justice Department's post-*Kelly* policy that, "in a case involving confidential government information, that information typically must have economic value in the hands of the relevant government entity to constitute 'property'." Brief on Remand for the United States of America at 7-8, No. 18-2811 (L), ECF No. 453 (Apr. 2, 2021).

Yates going forward

As demonstrated above, courts have long held that "intangible rights" do not constitute property and cannot support a fraud conviction. *Yates*' rejection of the "accurate information" theory is a natural continuation of this line of reasoning.

The difference between *Yates* and cases such as *Cleveland* or *Kelly* is that, while in *Kelly* and *Cleveland* there was no viable property fraud theory, in *Yates* the majority hints (and the dissent strongly declares) that a viable fraud theory existed based on the facts and the prosecutors raised that theory at trial.

According to the majority, however, context matters: The presentation of a valid theory in connection with an invalid one, even if the valid theory is supported by facts in evidence, could result in a conviction based on invalid grounds. Going forward, defense counsel should pay close attention to the various theories argued by prosecutors and raise concerns with the trial court to ensure that the matter is preserved for appeal.

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