Future Fraud Defendants Can Overcome 2nd Circ. FIFA Ruling

By **Ashwin Ram and Brittany Prelogar** (July 10, 2020)

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The U.S. Court of Appeals for the Second Circuit's latest opinion in the FIFA bribery investigation[1] wades into the murky waters of the extraterritorial reach of U.S. fraud statutes and the inherent ambiguity continuing to plague the so-called right to honest services.

The U.S. government's expansive interpretation of its jurisdiction under various fraud statutes in cases involving only minimal, attenuated, links to U.S. territory through U.S. electronic mail systems, cellular phone networks and bank wire transfers, coupled with the ubiquity of these facilities in modern commerce, substantially increases the risk that foreign entities and individuals may be forced into U.S. criminal investigations.

The Second Circuit's opinion in U.S. v. Napout, which was deferential to the U.S. District Court for the Eastern District of New York's findings, leaves room for future courts to reach a different outcome in similar cases.

Background of FIFA Investigation

The FIFA investigation was publicly announced in 2015 based on alleged "bribes and kickbacks paid in connection with the process by which FIFA and its regional associates [sold] broadcasting and marketing rights to their more popular tournaments."[2]

Ensuing indictments charged FIFA officials and executives with racketeering, honest services wire fraud and money laundering. The wire fraud counts were the predicate for the racketeering and money laundering counts, such that defeating the wire fraud allegation would have also defeated the racketeering and money laundering conspiracy charges.

On June 23, the Second Circuit issued an opinion in the FIFA investigation addressing (1) the extraterritorial application of the wire fraud statute to conduct that predominantly occured outside of the U.S.; and (2) a void-for-vagueness challenge concerning whether the honest services wire fraud statute "criminalizes a breach of the fiduciary duty that a foreign employee owes to his foreign employer."

What Is Honest Services Fraud?

Enacted in 1872, the original mail fraud statute — the predecessor of the modern-day mail and wire fraud statutes — focused on schemes to defraud designed to obtain money or property from a victim.[3]

But in the early-to-mid 1900s, courts began expanding the "scheme or artifice to defraud" framework to apply to deprivations not only of money or property, but also of various intangible rights, unrelated to any property interest. One of those rights was the so-called right to honest services from elected officials in the public sector and from other fiduciaries in the private sector.

In 1987, the U.S. Supreme Court invalidated the honest services doctrine in McNally v. U.S., holding that the mail fraud statute was limited to the protection of only property rights and invited Congress to speak more clearly if it wished to proscribe violations related to honest services.

Congress quickly responded to McNally by codifying an honest services theory of fraud in Title 18 of U.S. Code, Section 1346, which adds a gloss to the mail and wire fraud statutes to bar fraudulent schemes "to deprive another of the intangible right of honest services" regardless of whether the scheme seeks to divest a victim of any property.

In 2010, the Supreme Court adopted a limiting construction of honest services fraud, confining the statute to schemes involving bribes or kickbacks. That effectively decriminalized the amorphous category of conflict-of-interest and self-dealing cases for purposes of the honest services fraud statute. Even after Skilling, however, courts have grappled with several additional ambiguities inherent in the honest services fraud statute.[4]

The Napout Decision at a Glance

Napout's appellate brief opened with the question:

> This case raises one overarching question: by what authority does the United States purport to police the relationship between a Paraguayan employee and his Paraguayan employer, and an alleged scheme involving South Americans that took place almost entirely in South America.[5]

The Second Circuit responded that effectively any interstate wire transaction involving a U.S. facility gives the U.S. sufficient regulatory authority if the transaction was essential to a scheme to defraud.

The Napout defendants also argued that the honest services mail fraud statute did not provide them with fair notice that the fiduciary duty they, as foreign employees, purportedly owed to their foreign employers, FIFA and CONMEBOL, could qualify as a source of the fiduciary obligation, whose breach, if committed by a fraudulent scheme using American wires, would constitute honest services wire fraud.[6]

The Second Circuit did not address the question directly, but instead side-stepped the issue by focusing on the standard of review:

> Our decision here is determined by application of plain error's second requirement: that "[f]or an error to be plain, it must, at a minimum, be clear under current law," which means that "[w]e typically will not find such error where the operative legal question is unsettled, including where there is no binding precedent[.][7]

On the specific question of whether breach of foreign employees' fiduciary duty to their foreign employers, if committed by a use of American wires, is cognizable as honest services fraud, the court concluded that issue "remains unsettled, at best."

Thus, because it is not clear that Section 1346 is unconstitutionally vague — or, stated differently, because it is not clear whether the reach of Section 1346 to foreign defendants is unclear — as applied to defendants' conduct, the Second Circuit held that the district court did not commit plain error in upholding the convictions.

Implications

Napout raises more questions than it answers, and it is possible that another case with the same facts could be decided differently.

Focus of the Statute for Extraterritoriality Purposes

In addressing the extraterritorial application of the honest services wire fraud statute, the Second Circuit rejected defendants' argument that "'the statute's focus for [the] extraterritoriality analysis' is not the use of the wires but rather the 'bad-faith breach of a fiduciary duty owed to the scheme's victim.'"[8]

The Second Circuit explained that defendants' "argument mischaracterizes the nature of honest services wire fraud. It is not something different from wire fraud; it is a type of wire fraud that is explicitly prohibited by that statute."[9]

In support, the Second Circuit relied on its recent decision in Bascuñán v. Elsaca,[10] which was a civil RICO case that apparently "made clear that the conduct regulated by § 1343 — that is, the statute's 'focus' — was not merely a 'scheme to defraud,' but more precisely the use of the ... wires in furtherance of a scheme to defraud."[11]

The Second Circuit's analysis potentially rests on a faulty premise. Bascuñán itself recognized that the issue was one of first impression in the circuit. Additionally, the wholesale adoption of Bascuñán is problematic because Bascuñán did not involve any allegation of honest services fraud. Indeed, Bascuñán concerned civil litigation over an alleged misappropriation of funds, i.e., a classic deprivation of money or property.

This distinction is substantial. There are several key differences between these two types of cases under the federal fraud statutes.

First, honest services fraud requires the existence of a fiduciary duty, while a property theory of fraud does not.

Second, the victim under an honest services theory is the person owed the fiduciary duty (here, that would be FIFA). In contrast, under a property theory, the victim is the person who lost money.

Third, a victim of honest services fraud does not necessarily lose anything tangible; the essence of the fraud is that an intangible right to honest services of a fiduciary is violated.

Notwithstanding these important differences, the Second Circuit in Napout relied on a civil case alleging a property fraud theory to hold that the focus of the honest services wire fraud statute is a wire transaction. Given the gravamen and uniqueness of the honest services fraud statute, strong arguments exist that the "focus" of the statute, at least in part, should be the source and nature of the underlying fiduciary duty at issue.

The Essential Nature of a Mail or Wire Communication

Because the Second Circuit articulated a limiting principle to avoid wading into uniquely foreign conduct — namely, that "'the use of the … wires must be essential, rather than merely incidental, to the scheme to defraud'" — it is important to recognize the various formulations of this requirement and the varying interpretations of activities that are deemed essential.

For example, in Schmuck v. U.S., the Supreme Court affirmed a mail fraud conviction of a used car distributor who had purchased used cars, rolled back their odometers, and sold them to retail dealers at prices artificially inflated by the low-mileage readings.[12]

The at-issue mailings occurred when the unwitting retail dealers, who, relying on the altered readings, resold the cars to customers at inflated prices and, in the ordinary course of business, consummated the sales by mailing title-application forms to the state on behalf of the buyers.

Schmuck noted that mailings do not need to be an essential element of the scheme to defraud, but are sufficient so long as they are incident to an essential part of the scheme.[13] On this front, the court found that the scheme would collapse if unwitting retail dealers did not mail the title applications, because the affected cars could not otherwise be sold, and, if the cars were not sold, the distributor's scheme would not have been possible.

Based on this logic, the court found that a rational jury could have found that the title-registration mailings were part of the execution of the fraudulent scheme.

Several other circuits have explicitly held that a mailing or wiring does not need to serve an essential role in the underlying fraud scheme. Instead, "[m]ailings are considered to be in execution of a fraudulent scheme if they are 'sufficiently closely related.'"[14]

The U.S. Court of Appeals for the Ninth Circuit, for example, determined, in U.S. v. Lo, that a mailing that occurred after the alleged plot had been completed — according to the defendant — still met the necessary threshold, and emphasized the Schmuck language regarding a mailing only needing to be a "step" in the plot and "incident" to an essential part of the scheme.[15]

In contrast, other cases have drawn a distinction between mailings or wirings that were sufficiently incident to the execution of a scheme and those that were part of an after-the-fact transaction that, although foreseeable, were not in furtherance of a fraudulent scheme.

In Kaan v. U.S.,[16] for example, the Supreme Court found that after-the-fact mailings associated with a bank's check clearing process — even when the transaction effectuated the transfer of allegedly fraudulent proceeds — were not sufficient.

Although Kaan was decided in an era when the bank check clearing process relied on the actual shipment of deposited checks from the receiving bank to the check writer's bank — directly or through a clearing bank — for payment, this concept remains true for analogous electronic transmissions charged as wire fraud.

Similarly Situated Cases May Come Out Differently

Several parts of the Napout decision highlight strong arguments defendants in similar circumstances should make at the pretrial and trial stage to challenge the assertion of U.S. jurisdiction based on marginal or tangential uses of the U.S. financial system.

First, although it is relatively rare for run-of-the-mill domestic mail and wire fraud prosecutions to turn on the essentiality of a jurisdictional mailing or wiring, as the case may be, the issue can be dispositive.[17] In the extraterritoriality context, Napout counsels in favor of a renewed focus on whether a wire or mailing underlying an alleged scheme to defraud is truly essential.

If use of U.S. wires were merely coincidental or happenstance, or similarly had no meaningful nexus to the alleged fraud, defendants will have viable arguments that case should not trigger U.S. jurisdiction.

Along the same lines, if defendants were indifferent to the currency of an alleged bribe, even if money was wired from the U.S., it may be difficult for the government to prove beyond a reasonable doubt that a wire transaction was truly essential. Given that this issue poses a mixed question of fact and law, it will be relevant at both the pretrial and trial stages.

Defense opportunities also arise from portions of the Napout decision that were in tension with each other. For example, to satisfy the due process vagueness standard, criminal statutes must make it reasonably clear that a defendant's conduct constitutes a criminal violation of U.S. law.[18]

Given that the Napout court effectively conceded in step one of the extraterritoriality analysis that the language of the wire fraud statute was not "a clear, affirmative indication" of extraterritorially, there is an inherent tension with the assertion that the statute provides foreign defendants with fair notice that a purely foreign employment relationship entirely in another country could fall within the ambit of the same statute.

Finally, in another part of the Napout decision, the court found that the district court did not commit an abuse of discretion in keeping out evidence indicating that the underlying payment arrangements may not have violated local law where the conduct predominantly occurred.

Yet, importantly, an intent to defraud remains an element of the U.S. fraud statutes. The fact that the underlying conduct might have been legal where it substantially occurred — and defendants believed they were acting lawfully in their local jurisdictions — potentially carries the day on whether the defendants harbored the requisite intent for conviction.

Conclusion

Given these issues underlying the Napout decision, there are several grounds to argue that other cases with similar facts should reach a different result.

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[1] United States v. Napout (United States v. Napout, Nos. 18-2750 (L), 18-2820 (Con), __ F.3d__, 2020 WL 3406620 (2d Cir. June 22, 2020).

[2] Id.

[3] See McNally v. United States, 483 U. S. 350, 356 (1987), superseded by statute, 18

U.S.C. § 1346.)

[4] See Skilling v. United States, 561 U.S. 358, 417 (2010) ("None of the [pre-McNally] 'honest services' cases, neither those pertaining to public officials nor those pertaining to private employees, defined the nature and content of the fiduciary duty central to the 'fraud' offense."

[5] Napout, 2020 WL 3406620, at *1 (quoting Napout Br. at 1)

[6] Id. at *13.

[7] Id. at *14 (quoting United States v. Whab, 355 F.3d 155, 158 (2d Cir. 2004).

[8] Id. at *11.

[9] Id.

[10] 927 F.3d 108, 122 (2d. Cir. 2019).

[11] Napout, 2020 WL 3406620, at *11.

[12] Schmuck v. United States, (489 U.S. 705, 712 (1989).

[13] Id.

[14] United States v. Nguyen, 829 F.3d 907, 921 (8th Cir. 2016) (internal citations omitted).

[15] United States v. Lo, 231 F.3d 471, 478 (9th Cir. 2000) (emphasis in original).

[16] 323 U.S. 88 (1944).

[17] See, e.g., Schmuck, 489 U.S. at 712; Lo, 231 F.3d at 478; Pereira v. United States, 347 U.S. 1, 8-9 (1954); United States v. Maze, 414 U.S. 395, 402-03 (1974).

[18] Napout, 2020 WL 3406620, at *13.