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PERSPECTIVE

Fraud ruling stresses mens rea

By E. Martin Estrada and Mark R. Yohalem

On the heels of unanimously endorsing the 9th U.S. Circuit Court of Appeals' broad reading of securities fraud liability in *Salman v. United States*, 2016 DJDAR 12012 (Dec. 6, 2016), the U.S. Supreme Court has again unanimously affirmed a 9th Circuit decision expansively construing a criminal fraud statute. In *Shaw v. United States*, 2016 DJDAR 12142 (Dec. 12, 2016), the court held that a defendant can violate subsection (1) of the bank fraud statute, 18 U.S.C. Section 1344, even when a bank customer, rather than the bank itself, is the ultimate target of a defendant's fraudulent scheme. The court's decision underscores that proof of knowing or intentional deceit is the centerpiece of any fraud prosecution.

Shaw involved an increasingly common identity-theft/fraud scheme. The victim was a Taiwanese businessperson — Stanley Hsu — who, after returning to Taiwan, arranged for his mail to be sent to the home of the daughter of his employee so that the mail could be forwarded to him in Taiwan. Unfortunately for Hsu, Shaw was living with the daughter at this time. Managing to enshrine himself in the annals of horrible houseguests, Shaw began stealing Hsu's mail, including Hsu's bank account statements. Then, using Hsu's personal information, Shaw opened an email account and a PayPal account in Hsu's name, linked the PayPal account to Hsu's bank account, and obtained online access to that bank account. Shaw also opened two accounts under his father's name, without his father's knowledge or permission, one of which Shaw linked to the PayPal account (allaying PayPal's concerns about suspicious activity through the fake email account). With this web of false accounts in place, Shaw then began fraudulently transferring money from Hsu's bank account and into the PayPal account, and used the accounts in Shaw's father's name to launder the proceeds. Over the course of four months, Shaw stole approximately $307,000 from Hsu's account, until Hsu's son finally discovered the theft.

After being convicted of 14 counts of bank fraud under Section 1344(1), Shaw unsuccessfully appealed his convictions to the 9th Circuit, and then sought and obtained certiorari. Before the Supreme Court, Shaw asserted that Section 1344(1) does not criminalize fraudulent schemes to deprive third-party bank customers of their deposits. Section 1344(1) imposes criminal sanctions on anyone who "knowingly executes ... a scheme or artifice ... to defraud a financial institution." Shaw argued that because his scheme sought to obtain only Hsu's property, and not the bank's property, Section 1344(1) was inapplicable to his particular brand of misconduct.

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The Supreme Court disagreed. "The basic flaw in this argument," the court stated, "lies in the fact that the bank, too, had property rights in Hsu's bank account." When a customer deposits funds into a bank, the court explained, the bank becomes the owner of the funds or, at the very least, a bailee with "the right to possess the deposited funds against all the world but for the bailor (or, say, the bailor's authorized agent)." Shaw's actions, therefore, constituted not just a scheme to cheat Hsu's of his property but also "a scheme to deprive the bank of certain bank property rights." The court was unmoved by Shaw's argument that he was unaware of the bank's property rights in Hsu's money: To require knowledge of "bank-related property-law niceties" would "free (or convict) equally culpable defendants depending upon their property-law expertise — an arbitrary result."

The Supreme Court found immaterial Shaw's claims that he did not intend to harm the bank and that harm to the bank was not the "purpose" of his scheme. In line with its holding that subsection (2) of Section 1344 does not require an intent to defraud a bank, *see Loughrin v. United States*, 134 S. Ct. 2384, 2387 (2014), the court stated that Section 1344(1) "demands neither a showing of ultimate financial loss nor a showing of intent to cause financial loss." Relying on the common-law principle that a person is cheated, "even if he gets a quid pro quo of equal value," where he is induced to part with the property through fraud, the court held that Section 1344(1) requires neither "that the victim bank ultimately suffer financial harm, [n]or that the defendant intended that the victim bank suffer such harm." (Internal quotation marks omitted). All that Section 1344(1) requires is "knowledge" in executing the scheme.

The Supreme Court also rejected Shaw's textual argument that a broad reading of Section 1344(1) would subsume Section 1344(2). Section 1344(2) makes it a crime to "knowingly execute ... a scheme or artifice ... to obtain any of the moneys ... or other property owned by, or under the custody or control of, a financial institution, by means of false or fraudulent pretenses, representations, or promises." Essentially conceding that his scheme would have fallen within the ambit of Section 1344(2) (which certainly appears to be the case), Shaw asserted that "efforts such as his" should not be prosecuted under Section 1344(1). But the court did not find the overlap between the subsections problematic and noted that

Section 1344(2) also covered situations where the false statement was made to a party other than a bank (giving the example of a false statement to a "department store cashier").

As cases like *McDonnell v. United States*, 136 S. Ct. 2355 (2016), and *Bond v. United States*, 134 S. Ct. 2077 (2014), have shown, the Supreme Court is not always willing to interpret criminal statutes as broadly as the Department of Justice. But the decision in *Shaw* underscores the court's greater willingness to broadly interpret the fraud statutes, adhering to its previous observation that Congress passed the bank fraud statute to "expand federal criminal law's scope." *Loughrin*, 134 S. Ct. at 2391. Indeed, in affirming Shaw's convictions, the court did not hesitate to read Section 1344(1) in a way that meant that subsections (1) and (2) would "overlap substantially." In reaching this result, the court recognized that a deceit, even without harm, loss or purposefulness, is wrong in itself. For this, the court drew heavily on the common law notion that a person's mere loss of "his chance to bargain with the facts before him," is worthy of proscription (quoting *United States v. Rowe*, 56 F. 2d 747, 749 (2d. Cir. 1932)). Following *Shaw*, prosecutors are left with broad tools to prosecute identity-theft/ fraud schemes such as the one perpetrated by Shaw, tools that are given extra strength through the Aggravated Identity Theft statute, 18 U.S.C. Section 1028A, which could add a mandatory, consecutive, two-year sentence to any punishment otherwise imposed under Section 1344.

At the same time, *Shaw* stresses the fact that *mens rea* — proof of knowledge or intent — will always be the key element of any fraud prosecution. Whether or not there is an intent to cause harm or knowledge of a bank's property rights in deposited funds or a purpose to deprive a bank of money or a false statement to a third-party rather than the bank to obtain funds under the bank's control, the *sin qua non* of a Section 1344 conviction is knowing or intentional deceit. Thus, in affirming his convictions, the Supreme Court emphasized that Shaw "did know ... that the bank possessed [the victim's] account," "did make [knowingly] false statements to the bank" and "did correctly believe that those false statements would lead the bank to release from that account funds that ultimately and wrongfully ended up in Shaw's pocket," which were facts "sufficient to show that Shaw knew he was entering into a scheme to defraud the bank."

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With more flagrant fraud schemes such as Shaw's, the focus will be more on identifying the perpetrator, rather than demonstrating knowledge or intent — once you're caught with your hand in the cookie jar, there's really no excuse for opening up a slew of accounts in other people's names. In other cases, however, with differing levels of proof or sophistication, the question of knowledge or intent can be murky, and cases will turn on the age-old conundrum of just what exactly was going on inside the defendant's mind.

E. Martin Estrada *is a Los Angeles-based partner with Munger, Tolles & Olson LLP. Mr. Estrada is a former deputy chief at the U.S. Attorney's Office for the Central District of California, who focuses his practice on trials, complex litigation, internal investigations and appeals.*

Mark R. Yohalem, *also based in Los Angeles, is of counsel with Munger, Tolles & Olson. Mr. Yohalem is the former deputy chief of appeals at the U.S. Attorney's Office for the Central District of California. His practice focuses on complex litigation and appeals.*


MARTIN ESTRADA


MARK YOHALEM