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Fraud Against Financial Institutions: Judging Materiality Post-Escobar

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FRAUD AGAINST FINANCIAL INSTITUTIONS: JUDGING MATERIALITY POST-*ESCOBAR*

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ABSTRACT

In Neder v. United States*, 527 U.S. 1 (1999), the Supreme Court held that proof of materiality is required for convictions under the federal mail, wire and bank fraud statutes. During the past 20 years, the federal courts have endeavored to apply the complex common law concept of materiality to the federal criminal law context. The Supreme Court's recent decision in* Universal Health Services, Inc. v. United States *ex rel.* Escobar*, 136 S. Ct. 1989 (2016), a civil case involving the False Claims Act, provided the federal appellate courts with an ideal opportunity to reconsider materiality standards in federal fraud cases. In particular, criminal fraud defendants have argued that* Escobar*'s "subjective" materiality standard should be applied in mail, wire and bank fraud cases involving financial institutions. Thus far, these arguments have failed. Instead, the Courts of Appeals have endorsed an objective materiality standard tethered to what a reasonable bank would do—not the behavior of renegade lenders. This Article explores judicial treatment of materiality in federal criminal fraud cases, and investigates the many challenges that criminal fraud defendants face when they try to undermine the government's proof of materiality by attacking the imprudent or reckless actions of banks and other lenders.*

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INTRODUCTION

In 2016, the United States Court of Appeals for the Ninth Circuit issued a rather curious decision regarding a mortgage fraud scheme engineered by a mortgage loan officer and real estate broker named Nicholas Lindsey.[1] In a criminal prosecution under the federal wire fraud statute, the Ninth Circuit explicitly held "as a matter of law, that when a lender requests specific information in its loan applications, false responses to those specific requests are objectively material for purposes of proving fraud."[2] This holding was deeply problematic. The very fact that a lender requests information cannot simply render that information material as a matter of law. Such an approach eviscerates the very notion of materiality and, furthermore, deprives the jury of its essential fact finder's role in criminal trials.[3]

Fortunately, the Supreme Court's opinion in *Universal Health Services, Inc. v. United States ex rel. Escobar*,[4] came to the rescue. Although *Escobar* is a civil case involving the False Claims Act, the Supreme Court's extensive discussion of materiality in *Escobar* provided the Ninth Circuit with a justification for reconsidering *Lindsey I*.[5] Eventually, the panel opinion in *Lindsey I* was withdrawn,[6] and was replaced by an opinion containing more extensive and thoughtful analysis about materiality in federal

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[1] United States v. Lindsey (*Lindsey I*), 827 F.3d 865 (9th Cir. 2016), *reh'g granted*, *opinion withdrawn,* United States v. Lindsey, 854 F.3d 1047 (9th Cir. 2017), *on reh'g*, United States v. Lindsey (*Lindsey II*), 850 F.3d 1009 (2017).

[2] *Lindsey I*, 827 F.3d at 871.

[3] *See* Washington v. Recuenco, 548 U.S. 212, 219 (2006) (stating that "materiality is an element of the mail fraud, wire fraud, and bank fraud statutes, and thus must be submitted to the jury to support conviction of those crimes" (citing Neder v. United States, 527 U.S. 1, 20 (1999))); Youngjae Lee, *Reasonable Doubt and Moral Elements*, 104 J. CRIM. L. & CRIMINOLOGY 1, 3 (2015) ("The law is axiomatic. In order to convict a defendant, the Constitution requires a jury to determine that he is 'guilty of every element of the crime with which he is charged, beyond a reasonable doubt.'" (quoting Apprendi v. New Jersey, 530 U.S. 466, 477 (2000) (quoting United States v. Gaudin, 515 U.S. 506, 510 (1995)))).

[4] Universal Health Servs., Inc. v. United States *ex rel.* Escobar, 136 S. Ct. 1989 (2016). This Article will refer to this Supreme Court case as *Escobar*; some sources use *Universal Health Services* instead.

[5] *See infra* notes 103–11 and accompanying text (discussing *Escobar*'s treatment of materiality).

[6] *See* United States v. Lindsey, 854 F.3d 1047 (9th Cir. 2017) (granting petition for rehearing and withdrawing prior opinion).

fraud prosecutions.[7] What remained the same in *Lindsey II*, however, was the presence of deep judicial skepticism towards defendants who challenge the government's proof of materiality in mail, wire and bank fraud cases by attacking the behavior of lenders.[8] Put bluntly, the Ninth Circuit did not want federal fraud trials to become a forum for adjudicating the incompetence or malfeasance of mortgage lenders who may have helped to trigger the Great Recession.[9] An observation that survived from *Lindsey I* to *Lindsey II* is particularly telling:

> We understand the desire to see lenders shoulder responsibility for their role in the mortgage crisis of the last decade .... However, that does not mean that lenders can be victimized by intentional fraudulent conduct with impunity merely because the lenders were negligent, or even because the lenders intentionally disregarded the information in a loan application. Two wrongs do not make a right, and lenders' negligence, or even intentional disregard, cannot excuse another's criminal fraud.[10]

This Article examines materiality standards in fraud cases involving financial institutions and, in particular, considers whether *Escobar* signals a change in the treatment of materiality for criminal cases brought under the federal mail, wire and bank fraud statutes. The Article proceeds as follows: Part I briefly surveys the three primary anti-fraud laws that are used to fight schemes directed at financial institutions: the federal mail, wire and bank fraud statutes.[11] In particular, Part I examines the meaning of the materiality requirement established over 20 years ago by the

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[7] Judge Graber replaced Judge Noonan on the *Lindsey II* panel. *See Lindsey II*, 850 F.3d at 1011 n.*. A separate memorandum opinion vacated Lindsey's sentence and the amount of restitution ordered for reasons unrelated to the topic of this Article. *See* United States v. Lindsey, 680 F. App'x 563, 567–68 (9th Cir. 2017).

[8] *See Lindsey II*, 850 F.3d at 1011–13.

[9] *See id.* A discussion of the meaning of mortgage fraud and its role in causing the Great Recession can be found in Matthew A. Edwards, *The Concept and Federal Crime of Mortgage Fraud*, 57 AM. CRIM. L. REV. 57 (2020).

[10] *Lindsey II*, 850 F.3d at 1014 (footnote omitted). The same language appears in *Lindsey I,* 827 F.3d, 865, 869–70 (9th Cir. 2016). The Ninth Circuit explains it used "the words 'victimized' and 'victim' in this context to describe the original lenders, while acknowledging that the entities that actually lost money in this scheme at the time of foreclosure—the victims in this case for the purposes of restitution—were those financial institutions that purchased the loans and/or collateral from the original lenders." *Lindsey II*, 850 F.3d at 1014 n.3.

[11] *See infra* Part I.

Supreme Court in *Neder v. United States*.[12] Part II summarizes key aspects of the Supreme Court's decision in *Escobar* with respect to materiality under the False Claims Act.[13] As we will see, criminal defendants have argued that *Escobar*'s subjective materiality standard should be applied to wire, mail and bank fraud cases involving financial institutions.[14] These fraud defendants have argued that they should be permitted, under *Escobar*, to introduce evidence about the actual decision-making processes of banks to challenge the materiality of their misstatements to financial institutions.[15] Part III of the Article uses *Lindsey II* and another recent federal circuit court decision, *United States v. Raza*,[16] to illustrate judicial treatment of materiality in federal criminal fraud cases in light of *Escobar*.[17] In both cases, the courts rejected the defendants' efforts to graft *Escobar*'s subjective materiality standard on to mail, wire and bank fraud cases.[18] Instead, both circuits endorsed an objective conception of materiality, which focuses on how a reasonable lender—not a renegade bank—might respond to a defendant's misrepresentations.[19]

Despite general agreement as to objective materiality standards post-*Escobar*, Part IV of the Article analyzes how the federal appellate courts have diverged in terms of their treatment of materiality evidence in criminal fraud cases.[20] To be specific, the Ninth Circuit in *Lindsey II* adopted bright-line prophylactic rules against the introduction of materiality evidence of individual lender behavior in financial fraud cases, while the Fourth Circuit in *Raza* declined to do so.[21] Finally, Part V of the Article dispels any lingering confusion over whether objective or subjective materiality standards apply in federal criminal fraud cases involving financial institutions.[22] The upshot is that the endorsement of

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[12] 527 U.S. 1, 1 (1999).

[13] *See infra* Part II.

[14] *See infra* notes 109–10 and accompanying text.

[15] *See infra* text accompanying notes 95–96.

[16] 876 F.3d 604 (4th Cir. 2017).

[17] *See infra* Part III.

[18] *See infra* notes 167–85 and accompanying text (discussing *Lindsey II*); *infra* notes 250–60 and accompanying text (discussing *Raza*).

[19] See *infra* Section III.E (summarizing the key lessons of *Lindsey II* and *Raza*).

[20] *See infra* Part IV.

[21] *See infra* Section IV.A.

[22] *See infra* Part V.

objective materiality in the federal appellate courts post-*Escobar* does not necessarily mean that the government is precluded from establishing materiality with subjective materiality evidence. On the other hand, defendants who seek to attack financial institutions for their foolish or imprudent lending practices will find that they face hostile legal terrain, which limits the viability of such arguments.

I. FRAUD AGAINST FINANCIAL INSTITUTIONS: A PRIMER

A. The Wire, Mail and Bank Fraud Statutes

Frauds against financial institutions can be prosecuted under a variety of federal laws, including, most importantly, the federal wire, mail and bank fraud statutes.[23] The wire and mail fraud statutes,[24] with their long histories and extraordinary flexibility,[25] are widely touted as "the workhorses of federal white-collar prosecution."[26] Although they may be beloved by federal

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[23] *See* Steven M. Biskupic, *Fine Tuning the Bank Fraud Statute: A Prosecutor's Perspective*, 82 MARQ. L. REV. 381, 381 (1999) (stating that the bank fraud statute's "broadness and flexibility have made it the lead charge for prosecutors indicting hundreds of white-collar crimes that affect financial institutions each year"); Thomas M. DiBiagio, *Reaching a Sense of Justice: Understanding How the Facilitation Theory of Prosecution Under Federal Criminal Law Can Be Used to Hold Hard Targets Accountable for Financial Crimes and Corporate Corruption*, 74 WASH. & LEE L. REV. ONLINE 256, 266 (2018) (asserting that "[t]he primary federal criminal laws used to address financial crimes and corporate misconduct are the federal mail and wire fraud statutes").

[24] 18 U.S.C. § 1343 (wire fraud); 18 U.S.C. § 1341 (mail fraud); 18 U.S.C. § 1344 (bank fraud).

[25] The federal mail fraud statute was first enacted in 1872. *See* Act of June 8, 1872, ch. 335, § 302, 17 Stat. 323 (1872). The wire fraud statute followed in 1952. *See* Act of July 16, 1952, ch. 879, § 18(a), 66 Stat. 722 (1952).

[26] Frank O. Bowman, III, *Pour Encourager Les Autres? The Curious History and Distressing Implications of the Criminal Provisions of the Sarbanes-Oxley Act and the Sentencing Guidelines Amendments That Followed*, 1 OHIO ST. J. CRIM. L. 373, 384 (2004). Numerous sources use the exact term "workhorse" to describe the mail and wire fraud statutes. *See, e.g.*, Eric Alden, *Blocking the Ax: Shielding Corporate Counsel from Retaliation As an Alternative to White Collar Hypercriminalization*, 36 U. HAW. L. REV. 95, 108 (2014) (stating that "the mail and wire fraud provisions are workhorses of the federal prosecutorial bar") (citing Jack E. Robinson, *The Federal Mail and Wire Fraud Statutes: Correct Standards for Determining Jurisdiction and Venue*, 44 WILLAMETTE L. REV.

prosecutors,[27] the seemingly boundless application of these two statutes has generated scholarly and judicial consternation.[28] The Seventh Circuit recently warned: "The mail and wire fraud statutes have 'been invoked to impose criminal penalties upon a staggeringly broad swath of behavior,' creating uncertainty in business negotiations and challenges to due process and federalism. We must take care not to stretch the long arms of the fraud statutes too far."[29]

The federal bank fraud statute is of relatively recent vintage in comparison to the mail and wire fraud statutes.[30] Congress enacted the federal bank fraud statute in 1984,[31] in response to various concerns about the sufficiency of then-existing federal anti-fraud laws,[32] and to counter Supreme Court case law that

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479, 479 (2008)); Geraldine Szott Moohr, *Playing with the Rules: An Effort to Strengthen the Mens Rea Standards of Federal Criminal Laws*, 7 J.L. ECON. & POL'Y 685, 694 (2011); Julie Rose O'Sullivan, *The Federal Criminal "Code": Return of Overfederalization*, 37 HARV. J.L. & PUB. POL'Y 57, 63 (2014).

[27] Perhaps the most famous quote on this matter comes from District Judge Jed Rakoff (S.D.N.Y.), then a federal prosecutor, who wrote 40 years ago: "To federal prosecutors of white collar crime, the mail fraud statute is our Stradivarius, our Colt 45, our Louisville Slugger, our Cuisinart—and our true love." Jed S. Rakoff, *The Federal Mail Fraud Statute (Part I)*, 18 DUQ. L. REV. 771, 771 (1980).

[28] *See* CHARLES DOYLE, CONG. RSCH. SERV., R41930, MAIL AND WIRE FRAUD: A BRIEF OVERVIEW OF FEDERAL CRIMINAL LAW 1 (2019) ("Commentators have argued that the statutes 'have long provided prosecutors with a means by which to salvage a modest, but dubious, victory from investigations that essentially proved unfruitful.'" (citing John C. Coffee, Jr. & Charles K. Whitehead, *The Federalization of Fraud: Mail and Wire Fraud Statutes*, in WHITE COLLAR CRIME: BUSINESS AND REGULATORY OFFENSES § 9.05, at 9-73 (1990))).

[29] United States v. Weimert, 819 F.3d 351, 356 (7th Cir. 2016) (quoting Sorich v. United States, 555 U.S. 1204 (2009) (Scalia, J., dissenting from denial of certiorari)).

[30] For the history of the federal bank fraud statute, see Biskupic, *supra* note 23, at 382–83; Mehul Madia, *The Bank Fraud Act: A Risk of Loss Requirement?*, 72 U. CHI. L. REV. 1445, 1446–49 (2005); 1 JOHN K. VILLA, BANKING CRIMES: FRAUD, MONEY LAUNDERING AND EMBEZZLEMENT § 7:1 (Nov. 2019 Update) (providing legislative history of the bank fraud statute).

[31] *See* Pub. L. No. 98-473, § 1108(a), 98 Stat. 2147 (Oct. 12, 1984) (codified at 18 U.S.C. § 1344).

[32] *See* Michael McGregor, *Bank Fraud*, in 1 ENCYCLOPEDIA OF WHITE-COLLAR & CORPORATE CRIME 73–74 (2005) (Lawrence M. Salinger, ed.) ("The enactment of Section 1344 of the law was the product of growing concern over the inability of federal prosecutors to reach sophisticated financial criminals with antiquated

members of Congress believed impeded prosecutions of frauds involving financial institutions.[33] Since 1984, the bank fraud statute has been applied to myriad forms of financial malfeasance involving financial institutions, as one article explains:

> Section 1344 is broadly written and criminalizes a variety of offenses against financial institutions, including check-kiting, check forging, false statements and nondisclosures on loan applications, stolen checks, the unauthorized use of automated teller machines ("ATMs"), credit card fraud, student loan fraud, sham transactions between offshore "shell" banks and domestic banks, automobile title fraud, diversion of funds by bank employees, submission of fraudulent credit card receipts, false statements intended to induce cashing checks, and mortgage fraud.[34]

During the past three decades, the statutory penalties for bank fraud have increased substantially, and Congress has

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statutes, many of which were enacted more than 50 years ago."); VILLA, *supra* note 30, § 7:1 (noting "the long-standing complaint of federal prosecutors that they were forced to stretch outmoded statutes to combat sophisticated fraudulent schemes" and stating that "[t]he enactment of the first federal bank fraud statute ... was the product of a growing concern over the inability of federal prosecutors to reach sophisticated financial crime with antiquated statutes").

[33] Numerous sources credit *Williams v. United States*, 458 U.S. 279 (1982), as one of the main inspirations for the bank fraud statute. *See, e.g.*, Madia, *supra* note 30, at 1446–47 (explaining that "Congress passed the bank fraud statute partly in response to the Supreme Court's 1982 decision in *Williams*," in which "the Supreme Court held that persons who engage in fraudulent schemes, such as check-kiting, could not be prosecuted under 18 U.S.C. § 1014, the federal provision that criminalized false statements to financial institutions") (footnotes omitted). Another line of Supreme Court cases had limited the reach of the federal mail fraud statute to the dismay of some observers. *See* Loughrin v. United States, 573 U.S. 351, 360 (2014) (stating that *United States v. Maze*, 414 U.S. 395 (1974), was "[o]ne of the decisions prompting enactment of the bank fraud law"); VILLA, *supra* note 30, § 7.1 (explaining that the *Maze* Court had "held that the mail fraud statute must be construed to apply only where the mails are used for the purpose of executing the scheme or artifice to defraud, and is not applicable to every case where the mails are utilized at some point in the scheme"); S. Rep. No. 225, 98th Cong., 1st Sess. 379 (1983) ("Recent Supreme Court decisions have underscored the fact that serious gaps now exist in Federal jurisdiction over frauds against banks and other credit institutions which are organized or operating under Federal law or whose deposits are federally insured.").

[34] Troy Nichols, *Financial Institutions Fraud*, 56 AM. CRIM. L. REV. 931, 933–35 (2019) (citations and footnotes omitted).

amended both the mail and wire fraud statutes to provide for increased criminal penalties in wire and mail fraud cases involving financial institutions.[35] As it stands now, in addition to substantial civil penalties,[36] all three anti-fraud statutes carry a maximum criminal penalty of $1 million in fines and 30 years imprisonment in cases involving financial institutions.[37] These three anti-fraud laws thus give prosecutors a powerful set of tools to attack fraud involving banks and other financial institutions.[38]

B. Materiality, Reliance and Damages

The federal bank fraud statute was modeled on the mail and wire fraud statutes,[39] and the Supreme Court reads the mail and

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[35] *See* Financial Institutions Reform, Recovery and Enforcement Act, Pub. L. No. 101-73, § 961(k) (1989) (increasing maximum penalties under § 1344 from $10,000 in fines and five years' imprisonment to $1 million in fines and 20 years in prison); *Id.* § 961(i)–(j) (increasing penalties for mail and wire fraud offenses that affect a financial institution); 1990 Crime Control Act, Pub. L. No. 101-647, 104 Stat. 4861, § 2504(h)–(j) (1990) (increasing the maximum period of imprisonment for bank fraud violations, as well as cases of mail and wire fraud affecting a financial institution, to 30 years).

[36] *See* 12 U.S.C. § 1833a. In the interests of space, this Article will not specifically address civil penalties for financial fraud involving financial institutions.

[37] *See* 18 U.S.C. §§ 1341, 1343, 1344.

[38] *See* 18 U.S.C. § 20 (defining "financial institution"). In addition to federally insured banks and credit unions, foreign bank branches, and holding companies, mortgage lending businesses were added to the statute after the 2007–2008 financial crisis as part of the Fraud Enforcement and Recovery Act ("FERA"). *See* Pub. L. No. 111-21, § 2(a), 123 Stat. 1617 (May 20, 2009); *see also* United States v. Banyan, 933 F.3d 548, 553 (6th Cir. 2019) (declining to apply the bank fraud statute to an alleged fraud scheme involving a mortgage lending business that occurred prior to FERA's amendment of 18 U.S.C. § 20).

[39] *See* Wendy Gerwick Couture, *Criminal Securities Fraud and the Lower Materiality Standard*, 41 SEC. REG. L.J. 77, 79 (2013) (explaining that "[t]he bank fraud statute ... was modeled on the mail and wire fraud statutes"); Madia, *supra* note 30, at 1458 (discussing background of the bank fraud statute). A House Judiciary Committee Report on the proposed Bank Fraud Act acknowledged that the text of § 1344 paralleled the language of the mail fraud and wire fraud statutes and that the bank fraud statute was intended to incorporate case law interpretations of those provisions. *See* Financial Bribery and Fraud Amendments Act of 1984, H.R. REP. NO. 98-901, 2, 4 (1984). Nevertheless, the Committee evidenced mixed feelings about the potential scope of these anti-fraud laws, stating that it was "concerned by the history of expansive interpretations of that language by the courts," given that the scope of wire and mail fraud offenses

wire fraud statutes *in pari materia*.[40] Thus, these three anti-fraud statutes share important legal commonalities, two of which are crucial for the discussion here.[41] First, in *Neder v. United States*, the United States Supreme Court unanimously held that the federal bank, wire and mail fraud statutes all require proof of materiality.[42] The Second Circuit recently explained: "The wire and bank fraud statutes do not criminalize every deceitful act, however trivial .... to sustain a conviction under these statutes, the Government must prove that the defendant in question engaged in a deceptive course of conduct by making *material* misrepresentations."[43] Second, unlike fraud in tort law,[44] the mail, wire and bank fraud statutes do not require proof of justifiable reliance or damages. In *Neder,* the Supreme Court stated: "The common-law

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was "clearly greater than that intended by Congress." *Id.* Despite this show of concern, the House Judiciary Committee explicitly endorsed then-current interpretations of the language, with the final caveat that the Committee "does not anticipate any further expansions." *Id.*

[40] *See* Pasquantino v. United States, 544 U.S. 349, 355 n.2 (2005); *see also* United States v. Bradley, 644 F.3d 1213, 1238 (11th Cir. 2011) ("Mail and wire fraud are analytically identical save for the method of execution.") (footnotes omitted); CHARLES DOYLE, CONG. RSCH. SERV., R41931, MAIL AND WIRE FRAUD: A BRIEF OVERVIEW OF FEDERAL CRIMINAL LAW 2 (2019) ("The mail and wire fraud statutes are essentially the same, except for the medium associated with the offense—the mail in the case of mail fraud and wire communication in the case of wire fraud.").

[41] In fact, courts often use precedents from one federal fraud statute to interpret another. *See Lindsey II*, 850 F.3d at 1016, n.4 (2017) (noting that "[t]he Supreme Court has used cases on materiality in one context as precedent for materiality in another"); United States v. Saks, 964 F.2d 1514, 1520 (5th Cir. 1992) ("It is well settled that Congress modeled § 1344 on the mail and wire fraud statutes, and that the usual practice is to look to precedents under those statutes to determine its scope and proper interpretation."); United States v. Williams, 865 F.3d 1302, 1310 n.10 (10th Cir. 2017) ("The bank fraud materiality analysis is identical to the materiality analysis required for convictions of making a false statement under 18 U.S.C. § 1001, mail fraud under 18 U.S.C. § 1341, and wire fraud under 18 U.S.C. § 1341.").

[42] Neder v. United States, 527 U.S. 1, 25 (1999).

[43] United States v. Calderon, 944 F.3d 72, 85 (2d Cir. 2019).

[44] *See* RESTATEMENT (SECOND) OF TORTS § 525 (AM. L. INST. 1977) ("One who fraudulently makes a misrepresentation of fact, opinion, intention or law for the purpose of inducing another to act or refrain from action in reliance upon it, is subject to liability to the other in deceit for pecuniary loss caused to him by his justifiable reliance upon the misrepresentation.").

requirements of 'justifiable reliance' and 'damages,' ... plainly have no place in the federal fraud statutes .... By prohibiting the 'scheme to defraud,' rather than the completed fraud, the elements of reliance and damage would clearly be inconsistent with the statutes Congress enacted."[45] By definition, then, criminal fraud offenses are "inchoate" crimes, as Sam Buell explains: "A criminal fraud case, of course, requires no proof of reliance or damages: the crime of fraud would be inchoate even if there were not also readily available attempt and conspiracy doctrines in federal and state criminal law."[46]

The Supreme Court steadfastly has adhered to the principle that proof of actual harm is not required in federal criminal fraud cases involving financial institutions.[47] For example, in *Shaw v. United States*, a recent § 1344(1) bank fraud case,[48] the Court stated

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[45] *Neder*, 527 U.S. at 24–25. In stark contrast, *Neder* stated that "the common law could not have conceived of 'fraud' without proof of materiality." *Id.* at 22.

[46] *See* Samuel W. Buell, *Fraud*, *in* THE PALGRAVE HANDBOOK OF APPLIED ETHICS AND CRIMINAL LAW 265, 267 (Larry Alexander & Kimberly K. Ferzan eds. 2019).

[47] Shaw v. United States, 137 S. Ct. 462, 467 (2016).

[48] To understand this discussion, a little background on the bank fraud statute is helpful. The bank fraud statute, 18 U.S.C. § 1344, has two separate subsections. Section 1344(1) covers frauds squarely aimed at financial institutions. *See* Loughrin v. United States, 573 U.S. 351, 357 (2014) ("The *first* clause of § 1344 ... includes the requirement that a defendant intend to 'defraud a financial institution'; indeed, that is § 1344(1)'s whole sum and substance."). Section 1344(2), on the other hand, makes it a crime to fraudulently obtain not only a financial institution's own funds but also those assets under its custody or control. For many years, the relationship between the two clauses of § 1344 was the subject of judicial debate and uncertainty. *See* United States v. Nkansah, 699 F.3d 743, 762 (2d Cir. 2012) (Lynch, J., concurring in part and concurring in the judgment in part) ("Although § 1344 has produced much litigation in the Circuits and many separate opinions by learned appellate judges, federal courts do not agree on the mental state necessary to support a conviction under § 1344, nor on the relationship between the statute's two subsections.") (collecting cases). Eventually, the Supreme Court weighed in on the relationship between the two subsections of § 1344 and explained that the two subsections of § 1344 "overlap substantially but not completely." *Shaw*, 137 S. Ct. at 468. Thus, under current Supreme Court doctrine, many fraud schemes are amenable to prosecution under either subsection of § 1344. *See* VILLA, *supra* note 30, § 7:7 (explaining that "[i]n many instances, a fraudulent scheme will constitute a violation of both Subsections (1) and (2)").

The Supreme Court specifically declined to read the bank fraud statute to eliminate this partial superfluity, noting: "No doubt, the overlap between the two that it had "found no case from this Court interpreting the bank fraud statute as requiring that the victim bank ultimately suffer financial harm, or that the defendant intend that the victim bank suffer such harm."[49] The *Shaw* Court concluded: "the statute, while insisting upon 'a scheme to defraud,' demands neither a showing of ultimate financial loss nor a showing of intent to cause financial loss."[50] Numerous federal circuit court opinions have reiterated the principle in criminal fraud cases that "there is no requirement that the misrepresentations must have actually influenced the decision-maker or that the decision-maker in fact relied on the misrepresentations,"[51] though some courts have held that a financial institution must, at least, be exposed to a risk of loss for a scheme to count as fraudulent.[52] Accordingly, criminal fraud can

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clauses is substantial on our reading, but that is not uncommon in criminal statutes." *Loughrin*, 573 U.S. at 358 n.4. The superfluity conceded by the Supreme Court is not complete because there may be some fraud schemes that can be prosecuted only under § 1344(1), and not § 1344(2). *See Loughrin*, 573 U.S. at 353 ("The Courts of Appeals ... have unanimously agreed that the Government can prosecute check kiting (i.e., writing checks against an account with insufficient funds in a way designed to keep them from bouncing) only under Clause (1), because such schemes do not involve any false representations.").

[49] *Shaw*, 137 S. Ct. at 467; *see also Loughrin*, 573 U.S. at 364 (explaining that "failure is irrelevant in a bank fraud case, because § 1344 punishes not 'completed frauds,' but instead fraudulent 'scheme[s]'" (quoting *Neder*, 527 U.S. at 25)).

[50] *Shaw*, 137 S. Ct. at 467.

[51] United States v. O'Brien, 953 F.3d 449, 460 (7th Cir. 2020); *see also* United States v. Prieto, 812 F.3d 6, 13 (1st Cir. 2016) (stating that the government "'need not prove that the decisionmaker actually relied on the falsehood or that the falsehood led to actual damages'" (quoting United States v. Appolon, 715 F.3d 362, 368 (1st Cir. 2013))); *Lindsey II*, 850 F.3d 1009, 1014 (2017) (explaining that the government need not prove actual reliance); United States v. Pizano, 421 F.3d 707, 722 (8th Cir. 2005) ("Under the bank fraud statute, the Government need not prove that the financial institution actually relied on the defendant's misrepresentations.").

[52] In a post-*Shaw* opinion, the Tenth Circuit stated:

> To satisfy the first element of bank fraud under § 1344(1)— "that the defendant knowingly executed or attempted to execute a scheme or artifice to defraud a financial institution"—our case law states that the government must show, in addition to materiality, that the financial institution was put at "risk," "potential risk," or suffered a "risk of loss."

United States v. Williams, 865 F.3d 1302, 1310 (10th Cir. 2017) (quoting United States v. Bowling, 619 F.3d 1175, 1181 (10th Cir. 2010)); *see also* United States v. Calderon, 944 F.3d 72, 85 (2d Cir. 2019) (stating that "both wire fraud and still occur even if a bank discovers a borrower's misrepresentations prior to extending credit or ultimately rejects the borrower's loan application.[53] In fact, one might conceivably argue that the crime of fraud could still occur even if the bank employees misplace and fail to review the borrower's loan application documents altogether.[54] What would merely be an unsuccessful attempt at a civil fraud is a prosecutable criminal fraud.

C. Neder*'s Materiality Standards*

With one judicial oddity noted below,[55] it seems beyond dispute that *Neder* and its progeny require proof of materiality

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bank fraud require the Government to prove that the defendant had an intent to deprive the victim of money or property"); United States v. Bogucki, 316 F. Supp. 3d 1177, 1189 (N.D. Cal. 2018) ("[T]he government need not show that the bank actually lost money, but rather only that the bank was exposed to a risk of loss.") (emphasis in original) (citing United States v. Stargell, 738 F.3d 1018, 1022 (9th Cir. 2013)); United States v. Serpico, 320 F.3d 691, 694 (7th Cir. 2003). The extent to which the risk of loss requirement survives *Shaw* is beyond the scope of my discussion here.

[53] *See supra* note 51 and accompanying text.

[54] *See id.*

[55] As explained earlier, § 1344 has two separate subsections, see *supra* note 48, and most circuit courts that have considered the question have held that the materiality element applies to *both* prongs of 1344. *See* United States v. Omer, 395 F.3d 1087, 1089 (9th Cir. 2005) ("[P]ursuant to *Neder*, materiality of the scheme is an essential element of bank fraud in violation of 18 U.S.C. § 1344(1). As such, materiality must be alleged in the indictment."); *see also* United States v. Williams, 865 F.3d 1302, 1309 (10th Cir. 2017) (stating, in § 1344(1) case, that "[t]he misrepresentation or falsehood must be materially false"); United States v. Gordon, 493 F. App'x 617, 629 (6th Cir. 2012) ("Consistent with the common law definition of 'fraud,' § 1344(1) requires 'a misrepresentation or concealment of material fact.'" (quoting Neder v. United States, 527 U.S. 1, 22 (1999))); United States v. Del Campo, 695 F. App'x 453, 455–56 (11th Cir. 2017) (in case brought under both sections of § 1344, observing that "the Supreme Court has held that a conviction for federal bank fraud requires that the scheme to defraud employ not simply falsehoods, but *material* falsehoods, even though materiality is not expressly mentioned in the bank-fraud statute") (emphasis in original).

Nevertheless, one outlier must be noted. In *United States v. LeBeau*, 949 F.3d 334, 341 (7th Cir. 2020), the defendant was convicted, after a jury trial, of multiple counts of bank fraud under § 1344(1). On appeal, LeBeau argued that the omission of materiality from the instruction in his trial "impermissibly relieved the government of part of its evidentiary burden and prejudiced him." *Id.* at 341. Chief Judge Wood, writing for the Seventh Circuit, conceded in federal wire, mail and bank fraud cases and that materiality is a question for the jury to consider.[56] The question is, of course, what does *Neder*'s materiality requirement entail? The answer to this question is not as simple as it first appears. This section will briefly review what *Neder* itself states with respect to materiality, as well as several issues that *Neder*'s treatment of materiality raises.

1. *What* Neder *Actually Says About Materiality*

To understand mail, wire and bank fraud materiality, it is helpful to start with the text of the *Neder* opinion itself. The

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that the defendant in *LeBeau* had raised a serious point, in light of *Neder*'s holding, Seventh Circuit precedent, and the Committee Comments to the Seventh Circuit's Pattern Criminal Jury Instructions. *See LeBeau*, 949 F.3d at 341; *see also* United States v. Freed, 921 F.3d 716, 721 (7th Cir. 2019) ("Pattern instructions are presumed to accurately state the law.") (citing United States v. Marr, 760 F.3d 733, 744 (7th Cir. 2014)). Chief Judge Wood acknowledged, however, that there was recent circuit precedent stating that proof of materiality was only required in bank fraud cases brought under § 1344(2), and not in cases brought under § 1344(1). *See LeBeau*, 949 F.3d at 341 (citing United States v. Ajayi, 808 F.3d 1113, 1119 (7th Cir. 2015)). Without stating directly that the prior panel opinion in *Ajayi* (on which Chief Judge Wood also sat) was incorrect, *LeBeau* provided this guidance:

> The better course, consistent with *Neder*, is to require the materiality instruction on all bank-fraud charges, whether brought under section 1344(1) or (2). The government has informed us that this is its current practice, and we encourage that practice to continue until such time as we receive greater clarity from the Supreme Court about what is required.

LeBeau, 949 F.3d at 341. *See also* United States v. Cross, 962 F.3d 892, 901 (7th Cir. 2020) (explaining that "[t]he government assured the panel in *LeBeau* that its current practice is to include the materiality element in all section 1344 cases," which is "a prudent policy").

Unfortunately for LeBeau, nothing that Chief Judge Wood wrote regarding materiality in bank fraud jury instructions was of any help to his appeal. The Court of Appeals held that because LeBeau's lawyer had explicitly consented to the instruction without the materiality element, the argument was waived and could not be reviewed on appeal even for plain error. *LeBeau*, 949 F.3d at 341–43.

[56] *See* Washington v. Recuenco, 548 U.S. 212, 219 (2006) (stating that "materiality is an element of the mail fraud, wire fraud, and bank fraud statutes, and thus must be submitted to the jury to support conviction of those crimes") (citing Neder v. United States, 527 U.S. 1, 20 (1999)); United States v. Rigas, 490 F.3d 208, 231 n.29 (2d Cir. 2007) (explaining that "a criminal defendant is entitled to have a jury determine his guilt on every element of his alleged crime and the jury must pass on the materiality of a defendant's misrepresentations") (citing United States v. Gaudin, 515 U.S. 506, 522–23 (1995)).

defendant in *Neder* was convicted of multiple counts of mail, wire and bank fraud, and two counts of filing a false income tax return (also known as tax fraud).[57] The specific offenses are important because Justice Rehnquist's majority opinion in *Neder* contains two different formulations of materiality.[58] In the portion of the opinion dealing with tax fraud,[59] the *Neder* Court uses the following definition of materiality: "In general, a false statement is material if it has a natural tendency to influence, or is capable of influencing, the decision of the decision-making body to which it was addressed."[60] It is of interest and importance that the two cases that *Neder* quotes in the tax fraud materiality part of the opinion, *United States v. Gaudin*,[61] and *Kungys v. United States*,[62] both concerned misrepresentations made to United States Government officials.[63] *Gaudin* involved 18 U.S.C. § 1001,[64] an extraordinarily broad statutory provision that covers innumerable false statements to federal government officials.[65] Specifically, Gaudin was prosecuted under § 1001 for making false statements on Federal

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[57] *Neder*, 527 U.S. at 6.

[58] *See* Wendy Gerwick Couture, *White Collar Crime's Gray Area: The Anomaly of Criminalizing Conduct Not Civilly Actionable*, 72 ALB. L. REV. 1, 8 (2009) (observing that *Neder* has two different materiality definitions); United States v. Raza, 876 F.3d 604, 616 (4th Cir. 2017) (asserting that *Neder* "identified different standards of materiality for those two categories of fraud") (citing *Neder*, 527 U.S. at 16, 22 n.5).

[59] *Neder*, 527 U.S. at 16 ("To obtain a conviction on the tax offense at issue, the Government must prove that the defendant filed a tax return 'which he does not believe to be true and correct as to every material matter.'" (quoting 26 U.S.C. § 7206(1))).

[60] To make the *Neder* language easier to process, I have removed any alterations and internal quotes. Readers should know, however, that *Neder*, 527 U.S. at 16, is quoting *United States v. Gaudin*, 515 U.S. 506, 509 (1995), which, in turn, is quoting *Kungys v. United States*, 485 U.S. 759, 770 (1988). This Article will refer to this as the *Gaudin/Kungys* materiality definition.

[61] 515 U.S. 506 (1995).

[62] 485 U.S. 759 (1988).

[63] *See* United States v. Raza, 876 F.3d 604, 616–17 (4th Cir. 2017) ("The *Neder* materiality standard—emphasizing that the false statement must be capable of influencing the decisionmaking body to which it is addressed—is derived from earlier decisions assessing materiality issues in fraud schemes that targeted the federal government.") (discussing *Kungys*, 485 U.S. at 769–70).

[64] *See* 18 U.S.C. § 1001.

[65] For an overview of 18 U.S.C. § 1001, see Daniel D. Duhaime, *False Statements and False Claims*, 56 AM. CRIM. L. REV. 875, 877–92 (2019).

Housing Administration and Department of Housing and Urban Development loan documents.[66] At issue in *Kungys* was a provision of the Immigration and Nationality Act,[67] under which the Government can bring an action to cancel a certificate of naturalization due to its procurement "by concealment of a material fact or by willful misrepresentation."[68] Accordingly, like *Gaudin, Kungys* also involved falsehoods aimed at the U.S. government officials—in the latter case, the Immigration and Naturalization Service.[69]

The section of the *Neder* opinion dealing with wire, mail and bank fraud, however, does not repeat the *Gaudin*/*Kungys* materiality formulation,[70] but instead quotes the influential materiality definition from the *Restatement (Second) of Torts*.[71] The *Restatement (Second) of Torts* provides two alternative definitions of materiality: (1) a matter is material if "a reasonable man would attach importance to its existence or nonexistence in determining his choice of action in the transaction in question,"[72] or (2) a matter is material if "the maker of the representation knows or has reason to know that its recipient regards or is likely to regard the matter as important in determining his choice of action, although a reasonable man would not so regard it."[73] The comments to the *Restatement (Second) of Torts* explain the justification for permitting subjective materiality, in addition to objective materiality:

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66 *Gaudin*, 515 U.S. at 508.

67 *Kungys*, 485 U.S. at 763 (stating that the first issue presented in the case was "whether certain misrepresentations or concealments made by Kungys in connection with his naturalization proceeding were material within the meaning of the Immigration and Nationality Act of 1952").

68 *See* 8 U.S.C. § 1451(a) (setting forth duty of U.S. attorneys to bring actions "for the purpose of revoking and setting aside the order admitting such person to citizenship and canceling the certificate of naturalization on the ground that such order and certificate of naturalization were ... procured by concealment of a material fact or by willful misrepresentation").

69 *Kungys*, 485 U.S. at 772 (holding that "the test of whether Kungys' concealments or misrepresentations were material is whether they had a natural tendency to influence the decisions of the Immigration and Naturalization Service").

70 It is entirely possible that the *Neder* Court felt that repeating the first materiality standard was not necessary.

71 Neder v. United States, 527 U.S. 1, 22 n.5. (1999) (quoting RESTATEMENT (SECOND) OF TORTS § 538 (AM. L. INST. 1977)).

72 RESTATEMENT (SECOND) OF TORTS § 538(2)(a) (AM. L. INST. 1977).

73 *Id.* § 538(2)(b).

> Even though the matter misrepresented is one to which a reasonable man would not attach any importance in determining his course of action in the transaction in hand, it is nevertheless material if the maker knows that the recipient, because of his own peculiarities, is likely to attach importance to it. There are many persons whose judgment, even in important transactions, is likely to be determined by considerations that the normal man would regard as altogether trivial or even ridiculous. One who practices upon another's known idiosyncracies cannot complain if he is held liable when he is successful in what he is endeavoring to accomplish.[74]

Thus, the *Restatement (Second) of Torts* accepts either an objective standard of materiality, based upon a reasonable person, or a subjective standard of materiality based upon what the maker knows about the particular recipient of the misrepresentation; either suffices. The *Restatement (Second) of Contracts* similarly permits either an objective or a subjective standard of materiality in the context of misrepresentations,[75] for reasons that mirror those provided in the *Restatement (Second) of Torts*.[76]

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[74] *Id.* § 538 cmt. f.

[75] *See* RESTATEMENT (SECOND) OF CONTRACTS § 162 (AM. L. INST. 1981) ("A misrepresentation is material if it would be likely to induce a reasonable person to manifest his assent, or if the maker knows that it would be likely to induce the recipient to do so."); *see also id.* § 162 cmt. c ("The requirement of materiality may be met in either of two ways. First, a misrepresentation is material if it would be likely to induce a reasonable person to manifest his assent. Second, it is material if the maker knows that for some special reason it is likely to induce the particular recipient to manifest his assent."). This is not to say that materiality necessarily is required to rescind or disaffirm a contract. That is a separate issue.

[76] A comment to the *Restatement (Second) of Contracts,* like the comments to the *Restatement (Second) of Torts*, explains the justification for permitting subjective materiality, in addition to objective materiality.

> There may be personal considerations that the recipient regards as important even though they would not be expected to affect others in his situation, and if the maker is aware of this, the misrepresentation may be material even though it would not be expected to induce a reasonable person to make the proposed contract. One who preys upon another's known idiosyncrasies cannot complain if the contract is held voidable when he succeeds in what he is endeavoring to accomplish.

RESTATEMENT (SECOND) OF CONTRACTS § 162 cmt. c (AM. L. INST. 1981). *See also* Stephanie R. Hoffer, *Misrepresentation: The Restatement's Second Mistake*, 2014 U. ILL. L. REV. 115, 129 n.89 (2014) ("The Restatement's use of the word

2. *Issues Concerning* Neder*'s Materiality Standards*

As we have seen, *Neder* requires proof of materiality in fraud cases brought under the federal, mail, wire and bank fraud statutes.[77] According to the Supreme Court: "It is a settled principle of interpretation that, absent other indication, 'Congress intends to incorporate the well-settled meaning of the common-law terms it uses.'"[78] But what does materiality really mean? As Emily Sherwin aptly observes, "[t]he precise meaning of materiality is somewhat elusive."[79] David Kwok, who concludes that materiality is not a simple element,[80] further contends: "Not only is analysis of materiality itself complex, but the element of materiality is likely related to existing elements of fraud. Evaluating materiality likely requires reconsideration of these other factors, and a failure to understand the interaction may create vagueness and uncertainty."[81] In short, transplanting a slippery, ever-evolving common law term, like materiality, to the criminal law context, as mandated by *Neder*, is bound to be a challenging task.

The following related questions regarding the meaning of materiality recur in this Article.[82] First, are the two materiality

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'preys' is particularly interesting since the maker of a material misrepresentation does not have to know with certainty that the statement is false.") (citing RESTATEMENT (SECOND) OF CONTRACTS § 162 cmt. b (AM. L. INST. 1981)).

[77] *See supra* notes 57–76 and accompanying text (discussing *Neder*).

[78] Sekhar v. United States, 570 U.S. 729, 732 (2013).

[79] Emily Sherwin, *Nonmaterial Misrepresentation: Damages, Rescission, and the Possibility of Efficient Fraud*, 36 LOY. L.A. L. REV. 1017, 1020 (2003).

[80] David Kwok, *Is Vagueness Choking the White-Collar Statute?*, 53 GA. L. REV. 495, 528 (2019).

[81] *Id.* at 532. In particular, proof of mens rea or fraudulent intent is closely related to the element of materiality. *See id.* at 532–37 (discussing the relationship in fraud between materiality and mens rea, and between materiality and harm); United States v. Weaver, 860 F.3d 90, 94 (2d Cir. 2017) (per curiam) (noting "the connection between the materiality element and the additional requirement that the government prove fraudulent intent"); United States v. Svete, 556 F.3d 1157, 1165 (11th Cir. 2009) (en banc) ("Because the focus of the mail fraud statute, like any criminal statute, is on the violator, the purpose of the element of materiality is to ensure that a defendant actually intended to create a scheme to defraud.").

[82] Exactly how much of an effect (hypothetical or otherwise) is required to satisfy the criminal fraud materiality standard is a question beyond this Article's scope. *See* United States v. Rigas, 490 F.3d 208, 234 (2d Cir. 2007) (distinguishing

standards discussed in *Neder* in tension or are they simply different ways of expressing the same basic legal principle? Second, do *Neder*'s two materiality standards apply in different types of fraud cases?[83] (Of course, if the two materiality standards are consonant, then this question would not be of much import). Third, is the materiality standard in federal criminal fraud cases objective or subjective?[84] Or can materiality be either objective or subjective?[85]

"relevance" from "materiality"). There are innumerable formulations of materiality in judicial opinions, though, as the Second Circuit opines: "All of these specifications of the materiality inquiry target the same question: would the misrepresentation actually matter in a meaningful way to a rational decision-maker?" United States v. Calderon, 944 F.3d 72, 85 (2d Cir. 2019) (emphasis in original); *see also* United States v. Tum, 707 F.3d 68, 72 (1st Cir. 2013) (wire fraud requires proof of "false or omitted statements that a reasonable person would consider important in deciding what to do"), *cert. denied*, 569 U.S. 1025 (2013); United States v. Weaver, 860 F.3d 90, 94 (2d Cir. 2017) (per curiam) ("A statement is material if the misinformation or omission would naturally tend to lead or is capable of leading a reasonable person to change his conduct.").

[83] More specifically, it could be asked whether the *Gaudin/Kungys* materiality definition applies in mail, wire and bank fraud cases even though that definition appears in the portion of *Neder* discussing tax fraud. In *Escobar,* Justice Thomas asserts, in passing, that *Neder* uses the *Gaudin/Kungys* materiality definition "to interpret the mail, bank, and wire fraud statutes." *Escobar*, 136 S. Ct. at 2002 (citing *Neder*, 527 U.S. at 16). Moreover, since *Neder* was decided, many courts have cited the *Gaudin/Kungys* materiality definition in federal mail, wire or bank fraud cases. *See, e.g.*, United States v. Prieto, 812 F.3d 6, 13 (1st Cir. 2016); United States v. Appolon, 715 F.3d 362, 368 (1st Cir. 2013); United States v. Calderon, 944 F.3d 72, 85 (2d Cir. 2019); United States v. Plany, 711 F. App'x 392, 394 (9th Cir. 2017); United States v. Hames, 185 F. App'x 318, 325 (5th Cir. 2006); United States v. Rigas, 490 F.3d 208, 231 (2d Cir. 2007); United States v. Betts-Gaston, 860 F.3d 525, 532 (7th Cir. 2017); *see also* Couture, *supra* note 58, at 7–8 (stating that most courts apply the *Gaudin* definition in mail and wire fraud cases); William K.S. Wang, *Application of the Federal Mail and Wire Fraud Statutes to Criminal Liability For Stock Market Insider Trading and Tipping*, 70 U. MIAMI L. REV. 220, 279 n.191 (2015) (collecting cases using the *Gaudin/Kungys* materiality definition).

[84] *See generally* Lauren D. Lunsford, *Fraud, Fools, and Phishing: Mail Fraud and the Person of Ordinary Prudence in the Internet Age*, 99 KY. L. J. 379, 387–94 (2010–2011) (addressing whether an objective or subjective conception of materiality applies in criminal fraud cases). For a discussion of judicial conflicts over objective and subjective fraud materiality standards pre-*Neder*, see Mark Zingale, Note, *Fashioning a Victim Standard in Mail and Wire Fraud: Ordinarily Prudent Person or Monumentally Credulous Gull?*, 99 COLUM. L. REV. 795 (1999).

[85] *See infra* Section V.A.

The fourth, and final question is whether *Neder*'s citation to the *Restatement (Second) of Torts*'s definition of materiality truly counts as an endorsement of this definition by the Supreme Court for use in the criminal fraud context. Not everyone believes that it does.[86] In *United States v. Svete*,[87] Judge Tjoflat criticized the Eleventh Circuit's en banc opinion for using modern sources, such as the *Restatement (Second) of Torts*, to explicate the meaning of materiality under the mail fraud statute.[88] In Judge Tjoflat's view, the Eleventh Circuit ought to have relied only upon materiality sources that were contemporaneous with enactment of the mail fraud statute in 1872.[89] Moreover, Judge Tjoflat rejected the idea that *Neder* commanded such a result, arguing that the Supreme Court was not endorsing the *Restatement (Second) of Torts*'s materiality definition in *Neder* but was merely "regurgitating" Neder's arguments.[90]

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[86] *See* United States v. Svete, 556 F.3d 1157, 1172 (11th Cir. 2009) (en banc) (Tjoflat, J., specially concurring).

[87] *Id.* In *Svete*, the Eleventh Circuit held that the mail fraud statute does not require "proof of a scheme calculated to deceive a person of ordinary prudence." *Id.* at 1166, *overruling* United States v. Brown, 79 F.3d 1550 (11th Cir. 1996).

[88] *Id.* at 1171–72 ("I am troubled by the court's reliance on contemporary sources to define materiality, rather than using the meaning of the word as it was understood in 1872, the year of the enactment of the mail fraud statute.") (Tjoflat, J., specially concurring).

[89] *Id.* at 1172–73. Judge Tjoflat specifically recommends JOSEPH STORY, COMMENTARIES ON EQUITY JURISPRUDENCE (10th ed. 1870), because it "was written at nearly the same time as the enactment of the mail fraud statute, that source provides a better understanding of the settled meaning of materiality under the common law as it existed in 1872." *Id.* at 1173; *see also id.* at 1170 ("This case is a statutory construction case involving an old statute. In defining the acts that the statute declares to be criminal, we must put aside our modern perceptions and preoccupations. Our job is to determine what Congress intended at the time the statute was made law.") (Edmondson, C.J., concurring in the result).

[90] Judge Tjoflat explains:

> As I read *Neder,* the Court only cited the *Restatement (Second) of Torts* because Neder, himself, relied on it to support his argument that materiality is an element of the mail fraud statute. Specifically, the Court cited the *Restatement (Second) of Torts* in a footnote appended to the following statement: "Neder contends that 'defraud' is just such a term, and that Congress implicitly incorporated its common-law meaning, including its requirement of materiality, into the statutes at issue." The Court's citation

Judge Tjoflat, therefore, argues that courts should not use the *Restatement (Second) of Torts* "to define the contours of the mail fraud statute's materiality requirement."[91] Whether or not Judge Tjoflat is ultimately correct regarding his reading of *Neder*, undoubtedly the *Neder* Court was more concerned with determining whether the mail, wire and bank fraud statutes required materiality at all, and the justices likely were less focused on what the materiality standards ought to entail and whether it was ideal to apply the *Restatement (Second) of Torts* to the criminal context.[92] For now it is sufficient to recognize that *Neder* provides

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> to the *Restatement (Second) of Torts* has limited precedential value because it was merely a regurgitation of Neder's argument. Thus, a more straightforward reading of *Neder* suggests that the Court did not cite the *Restatement (Second) of Torts* for the proposition that the meaning of words in a statute enacted in 1872 can be identified by reference to a modern restatement of the law.

Svete, 556 F.3d at 1172 (Tjoflat, J., specially concurring) (quoting Neder v. United States, 527 U.S. 1, 22 (1999) (footnotes omitted)). *See also* Lunsford, *supra* note 84, at 387 ("It is entirely possible that this standard was merely what Neder was arguing for at the time, rather than the Court's endorsement of the 'reasonable man' objective standard.").

[91] *Id.* at 1172–73.

[92] A little history is helpful here. Just two years before *Neder* was decided, the Supreme Court held that 18 U.S.C. § 1014, which bars false statements to certain specified financial institutions, did not have a materiality requirement. *See* United States v. Wells, 519 U.S. 482 (1997). Given that the wire, mail and bank fraud statutes, like 18 U.S.C. § 1014, make no explicit mention of materiality, the big question before the Supreme Court in *Neder* was whether the Court would imply a materiality requirement into these federal fraud statutes at all, not what the materiality standard might entail. Ultimately, *Neder* distinguished *Wells* as follows:

> In contrast to *Wells*, the three federal criminal statutes at issue in *Neder* explicitly referred to "schemes or artifices to defraud." This textual distinction altered the Court's analysis. The *Neder* Court explained that "both at the time of the mail fraud statute's original enactment in 1872, and later when Congress enacted the wire fraud and bank fraud statutes, actionable 'fraud' had a well-settled meaning at common law" that "required a misrepresentation or concealment of *material* fact." In fact, the Court noted, "the common law could not have conceived of 'fraud' without proof of materiality."

Matthew A. Edwards, *Punishing Hope? Materiality and Immateriality in Federal Mortgage Fraud Cases under 18 U.S.C. § 1014*, 22 U. PENN. J. BUS. L. 492, 499 (2020) (quoting *Neder*, 527 U.S. at 20–21, 22) (footnotes omitted).

two materiality standards—the *Gaudin/Kungys* materiality definition and the *Restatement (Second) of Torts*'s materiality definition—and that the application of these materiality standards to criminal fraud cases raises several important questions.[93]

II. *ESCOBAR* AND THE FALSE CLAIMS ACT

In *Universal Health Services, Inc. v. United States ex rel. Escobar*, the Supreme Court considered the validity of "implied false certification" claims brought under the False Claims Act (FCA).[94] Justice Thomas explained the nature of such claims:

> According to this theory, when a defendant submits a claim, it impliedly certifies compliance with all conditions of payment. But if that claim fails to disclose the defendant's violation of a material statutory, regulatory, or contractual requirement, so the theory goes, the defendant has made a misrepresentation that renders the claim "false or fraudulent" under § 3729(a)(1)(A).[95]

Escobar ultimately held that implied false certification claims could be a basis of False Claims Act liability when "the claim does not merely request payment, but also makes specific representations about the goods or services provided,"[96] and "the defendant's failure to disclose noncompliance with material statutory, regulatory, or contractual requirements makes those representations misleading half-truths."[97]

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[93] *See supra* notes 82–86 and accompanying text; text accompanying notes 93–94.

[94] Universal Health Servs., Inc. v. United States *ex rel.* Escobar, 136 S. Ct. 1989, 1993 (2016); *see also* Deborah R. Farringer, *From Guns that Do Not Shoot to Foreign Staplers: Has the Supreme Court's Materiality Standard Under* Escobar *Provided Clarity for the Health Care Industry About Fraud Under the False Claims Act?*, 83 BROOK. L. REV. 1227, 1228 (2018) (explaining that the False Claims Act "permits both private individuals and the federal government (through the U.S. district attorneys' offices) to file an action in court on behalf of the United States against a government contractor believed to have knowingly submitted false claims to the federal government for payment").

[95] *Escobar*, 136 S. Ct. at 1995; 31 U.S.C. § 3729(a)(1)(A) (providing for civil liability for one who "knowingly presents, or causes to be presented, a false or fraudulent claim for payment or approval" to the government).

[96] *Escobar*, 136 S. Ct. at 2001.

[97] *Id.* Since *Escobar* was decided there has been some debate as to whether these two requirements are both absolutely necessary in all implied false certification claims or whether the Supreme Court was merely stating that satisfying

At the same time, however, the Court also endorsed what it described as a "demanding" and "rigorous" materiality standard for implied false certification claims under the FCA.[98] A tough materiality standard was essential because, in the view of the Supreme Court: "The False Claims Act is not 'an all-purpose antifraud statute,' or a vehicle for punishing garden-variety breaches of contract or regulatory violations."[99] Justice Thomas further explained:

> A misrepresentation cannot be deemed material merely because the Government designates compliance with a particular statutory, regulatory, or contractual requirement as a condition of payment. Nor is it sufficient for a finding of materiality that the Government would have the option to decline to pay if it knew of the defendant's noncompliance. Materiality, in addition, cannot be found where noncompliance is minor or insubstantial.[100]

Justice Thomas declined to specify whether the materiality standard that applied to implied false certification claims came from the common law or the text of the FCA itself.[101] Instead, he

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these two requirements could be one suitable method of proving an implied false certification claim under the FCA. *See* United States *ex rel.* Rose v. Stephens Inst., 909 F.3d 1012, 1018 (9th Cir. 2018) (observing that the *Escobar* "Court did not state that its two conditions were the only way to establish liability under an implied false certification theory," but nevertheless explaining that Ninth Circuit post-*Escobar* precedent requires proof of both conditions until a contrary en banc determination occurs); Farringer, *supra* note 94, at 1250–53 (discussing this issue).

[98] *Escobar*, 136 S. Ct. at 2003 ("The materiality standard is demanding."); *id.* at 1996, 2002 ("rigorous"); *see also Stephens Inst.*, 909 F.3d at 1024 (Smith, J. dissenting in part) (noting that "[t]he Supreme Court stated four times that the materiality test was 'rigorous' or 'demanding'"), *cert. denied sub nom.* Stephens Inst. v. U.S. *ex rel.* Rose, 139 S. Ct. 1464 (2019); United States v. Sanford-Brown, Ltd., 840 F.3d 445, 447 (7th Cir. 2016) (stating that the FCA's "materiality requirement is 'rigorous' and 'demanding'" (citing *Escobar*, 136 S. Ct. at 2002–03, 2004 n.6)); United States *ex rel.* Marsteller v. Tilton, 880 F.3d 1302, 1312 (11th Cir. 2018) ("The materiality standard is 'demanding,' and 'rigorous.'" (citing *Escobar*, 136 S. Ct. at 1996, 2002)).

[99] *Escobar*, 136 S. Ct. at 2003 (quoting Allison Engine Co. v. United States *ex rel.* Sanders, 553 U.S. 662, 672 (2008)).

[100] *Id.*

[101] *Id.* at 2002 ("We need not decide whether § 3729(a)(1)(A)'s materiality requirement is governed by § 3729(b)(4) or derived directly from the common law."). *See also* Farringer, *supra* note 94, at 1255 (contending that "[t]he *Escobar* Court's decision not to address the relationship between the statutory definition of 'material' found in Section 3729(b)(4) and the guidance it set forth regarding

asserted: "Under *any* understanding of the concept, materiality 'look[s] to the effect on the likely behavior of the recipient of the alleged misrepresentation."[102] As such, the *Escobar* Court explained that courts adjudicating FCA claims should consider not only whether the government had designated compliance with contract terms and applicable regulations as a precondition to payment, but also how the Government actually had responded to noncompliance in the past.[103] The Court wrote:

> [P]roof of materiality can include, but is not necessarily limited to, evidence that the defendant knows that the Government consistently refuses to pay claims in the mine run of cases based on noncompliance with the particular statutory, regulatory, or contractual requirement. Conversely, if the Government pays a particular claim in full despite its actual knowledge that certain requirements were violated, that is very strong evidence that those requirements are not material. Or, if the Government regularly pays a particular type of claim in full despite actual knowledge that certain requirements were violated, and has signaled no change in position, that is strong evidence that the requirements are not material.[104]

Escobar establishes that, in the FCA context, the Government's actual behavior is crucial to the question of materiality.[105] Proving materiality therefore requires that juries be provided with a real-world understanding of how the Government typically acts in the face of noncompliance with statutory, regulatory, or contractual requirements. Does the Government usually pay or not? The Tenth Circuit explains: "[R]ather than directing courts to focus exclusively on a reasonable person—as they would under a

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how to assess materiality has caused confusion among the lower courts about how to square these two standards").

[102] *Escobar*, 136 S. Ct. at 2003 (quoting RICHARD A. LORD, WILLISTON ON CONTRACTS § 69:12, at 549 (4th ed. 2003) (emphasis added)). *Escobar* then cited the *Restatement (Second) of Torts* § 538 (1977), and the *Restatement (Second) of Contracts* § 162(2) (1981).

[103] *Escobar*, 136 S. Ct. at 2003 ("In sum, when evaluating materiality under the False Claims Act, the Government's decision to expressly identify a provision as a condition of payment is relevant, but not automatically dispositive.").

[104] *Id.* at 2003–04.

[105] *See* Farringer, *supra* note 94, at 1258 (explaining that "the thrust of the *Escobar* opinion ... is the newly established focus on the government's behavior and the defendant's knowledge of such behavior").

purely objective analysis—or exclusively on the mindset of the misrepresenter—as they would under a purely subjective analysis—*Escobar* focuses the materiality inquiry on the likely reaction of the recipient."[106]

Although *Escobar's* materiality reasoning has been subjected to criticism,[107] there is no doubt that the Court's opinion has had a profound impact.[108] Not surprisingly, criminal defense attorneys have found the doctrinal development in *Escobar* rather intriguing and they have argued that *Escobar*'s treatment of materiality under the False Claims Act should be extended to federal criminal fraud cases.[109] After all, the argument proceeds, if the Government's actual conduct is relevant to determine materiality in the False Claims Act context, then perhaps the actions of banks and other lenders is relevant in mail, wire and bank fraud cases involving financial institutions.[110] As we will see, however, such arguments have been thus far unsuccessful in the federal

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[106] United States *ex rel.* Janssen v. Lawrence Mem'l Hosp., 949 F.3d 533, 541 (10th Cir. 2020).

[107] *See* Joan H. Krause, *Reflections on Certification, Interpretation, and the Quest for Fraud That "Counts" Under the False Claims Act*, 2017 U. ILL. L. REV. 1811, 1833 (2017) (asserting that "[t]he single biggest weakness in the *Escobar* opinion is the failure to clearly define materiality"); *see also* Latoya C. Dawkins, *Not So Fast: Proving Implied False Certification Theory Post-*Escobar, 42 SETON HALL LEGIS. J. 163, 179–80 (2017) ("*Escobar* should have done more to delineate what is needed to show that the misrepresentation would have affected the government's decision to pay."); Kwok, *supra* note 80, at 538 (arguing that *Escobar* "adopts an unusual materiality standard that conflates criminal and civil law principles" and "imposes a materiality standard for civil fraud that does not reflect existing civil contract principles, and it counterintuitively makes imposition of civil fraud liability more difficult than criminal fraud liability").

[108] *See* Alexander Kristofcak, *FCA v. FDA: The Case Against the Presumption of Immateriality from Agency Inaction*, 95 N.Y.U. L. REV. 235, 246 (2020) ("Judging from the sheer number of opinions citing *Escobar*, the impact of the case is undeniable, even if the exact nature of the impact is difficult to pin down.") (footnote omitted); *see also id.* at 246 n.54 (stating that "[i]n the two and a half years since its publication, *Escobar* has been cited over five hundred times, including nearly one hundred times at the court of appeals level").

[109] *See* Craig Margolis & Christina Ferma, *The False Claims Act: Why Should a Civil Statute Matter to Criminal Lawyers?*, 31 CRIM. JUST. 26, 28 (Winter 2017) (noting that "[c]riminal practitioners have already begun to cite *Escobar* in their briefing on materiality").

[110] *See id.*

appellate courts.[111] The next section uses two recent, important mortgage fraud cases, *United States v. Lindsey*, and *United States v. Raza*, to explore the criminal fraud implications of *Escobar*.

III. POST-*ESCOBAR* CASE STUDIES IN MATERIALITY

A. Lindsey's Mortgage Fraud Scheme and Trial

Nicholas Lindsey, a mortgage loan officer and real estate broker,[112] perpetrated a classic mortgage fraud scheme using straw buyers or straw borrowers for numerous residential properties.[113] In order to obtain approval for the straw buyers' loan applications, Lindsey made the borrowers appear more creditworthy by depositing money into their bank accounts and falsely stating their incomes on their loan applications.[114] For example, Lindsey recruited Madelon Bridges, flew her to Las Vegas, paid off her debts, and gave her $10,000 for her role in his mortgage fraud scheme.[115] Lindsey then had Bridges "sign a loan application that falsely represented, *inter alia*, that she intended to live at the property she was applying for a loan to purchase, paid $3,300 a month in rent, was gainfully employed, and had a sizeable bank account."[116] In the end, Bridges was the named buyer of a Las Vegas house worth $720,000, even though she actually lived in Louisiana and only had "$50 to her name."[117] For good measure, Lindsey also used Bridges's personal information to take out another mortgage loan without her knowledge.[118] Bridges was only one of Lindsey's straw

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[111] *See infra* Section III.A.

[112] *Lindsey II*, 850 F.3d 1009, 1011 (9th Cir. 2017).

[113] *Id.* at 1012. In a related appeal, the Ninth Circuit summed up Lindsey's actions as follows:

> Lindsey ran an elaborate mortgage fraud scheme that targeted vulnerable and impoverished individuals and convinced them to act as straw buyers for properties in Las Vegas. He also stole their identities and purchased other properties without their knowledge. When the scheme caused foreclosures on the properties, Lindsey profited while lenders lost money and the straw buyers were left with ruined credit.

United States v. Lindsey, 680 F. App'x 563, 567–68 (9th Cir. 2017).

[114] *Lindsey II*, 850 F.3d at 1011.

[115] *Id.* at 1012.

[116] *Id.*

[117] *Id.*

[118] *Id.*

buyers; he "perpetrated similar frauds with five straw buyers—including his sister—on nine home loans and eight different properties."[119] As the Ninth Circuit explained: "The properties secured through this scheme were destined for foreclosure, creating large losses for financial institutions while Lindsey benefitted financially from commissions, rent payments, and diverted escrow monies."[120]

The government charged Lindsey with nine counts of wire fraud and one count of aggravated identity theft.[121] Prior to trial, the government moved to prevent Lindsey from introducing evidence of lender negligence at trial.[122] The district court reserved judgment on the matter,[123] but the battle lines were drawn—the government was going to do all that it could to prevent Lindsey from putting the lenders on trial. As the government expected, during the trial, Lindsey's attorney repeatedly sought to draw attention to the lenders' behavior.[124] This became a point of contention between Lindsey's lawyer, the government, and the trial judge. For example, during opening statements, District Judge Lloyd "warned Lindsey's attorney to 'stay away' from the issue of lender negligence."[125] Lindsey's lawyer persisted, however, as the Ninth Circuit explains:

> Nevertheless, Lindsey's counsel described 2006 to 2007 as "a wild time" of mortgage lending, one that he had once referred to as the "Wild West." It was a period, counsel said, when "there were mortgages being offered that had never been offered before and perhaps may never be offered again." These mortgages included "stated income" and "no income, no assets" loans. The Government objected to defense counsel's description of the loan products, arguing that it was evidence of lender negligence. The district court allowed the description of the loans, but warned

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[119] *Id.*

[120] *Id.* at 1011; *see also id.* at 1012 (noting that "Lindsey profited by receiving significant commissions, rent payments, and diverted escrow monies" from one of his schemes).

[121] *Id.* at 1012.

[122] *Id.*

[123] *Id.* (explaining that "[t]he district court declined to rule on the issue, concluding that a final ruling 'would be more appropriately made in the context of the development of the evidence at trial'").

[124] *Id.*

[125] *Id.*

> counsel again to "stay away" from suggesting negligence. The district court subsequently told the parties that it was "inclined" to exclude evidence of lender negligence from the rest of trial.[126]

Of course, an "inclination" is not a final ruling, and the issue of lender negligence arose again during cross-examination of government witnesses.[127] The court allowed cross-examination testimony about the general state of the mortgage industry, as well as stated income and no document loans at the time of Lindsey's alleged fraud.[128] The district court, however, sustained the Government's objection when Lindsey's attorney asked a lender's employee specifically about "previous bad loans that her employer, a lender, had provided."[129] In a similar vein, the court prevented Lindsey's counsel from eliciting testimony from a lender's former employee of how the employee would have responded to particular inaccuracies regarding the applicant's bank accounts in a loan application.[130] On the other hand, the district judge gave Lindsey's lawyer some latitude during closing arguments, permitting the lawyer to make several comments, over the Government's objection, about the frenzied state of the mortgage lending market prior to the 2008 financial crisis and the Great Recession.[131] Finally, although the district court instructed the jury that "[l]oose

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[126] *Id.* at 1012–13 (footnote omitted).

[127] *Id.* at 1013.

[128] *Id.* at 1013, 1018.

[129] *Id.* at 1013. The district court apparently accepted the prosecutor's argument that the "the district court had already ruled on the issue of lender negligence, and so defense counsel's question was irrelevant." *Id.*

[130] *Id.*

[131] The opinion reads:

> During closing arguments, Lindsey's counsel again hit on the lending standards previously commonplace in the mortgage market. He explained that "[i]n 2006 and 2007 America was on a mortgage loan high." As a result of "[e]asy lending practices" and "100 percent financing of a mortgage on stated income and stated assets," lenders made bad loans to "people [who] bought houses they could not afford." The Government objected to these statements, but the district court overruled the objection. Defense counsel also told the jury that buyers and sellers of real estate were "extremely busy," making money very quickly, and would sometimes make mistakes or "do things on purpose just to close a deal."

Id. at 1018.

lending practices do not constitute a defense to wire fraud,"[132] the judge also stated that "the lending standards applied by the financial institutions that lent the money in this case are relevant to the question of materiality."[133] In the end, the jury convicted Lindsey of wire fraud and identity theft, and he was sentenced to 132 months in prison and ordered to pay over $2 million in restitution.[134]

B. Lindsey I*'s Per Se Materiality Rule*

On appeal, Lindsey argued that the district court prevented him from presenting a complete defense in violation of his constitutional rights.[135] In particular, Lindsey claimed "that the district court erred by preventing him from presenting evidence about the 'stated income/no doc' loans, thus barring him 'from challenging the materiality of false statements on a loan type that invites the applicant to state their income without justification or support.'"[136] The *Lindsey I* panel began by observing that the First Circuit had recently created a "bright-line" approach to materiality, which it found persuasive.[137] *Lindsey I* then explicitly adopted the First Circuit's bright-line test,[138] and held "as a matter of law, that when a lender requests specific information in its loan applications, false responses to those specific requests are objectively material for purposes of proving fraud."[139] Thus, any of Lindsey's arguments regarding materiality were unavailing since, most assuredly, he had provided inaccurate information on the many loan applications involved in the case.[140]

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[132] *Id.* at 1013, 1018.

[133] *Id.*

[134] *Id.* at 1011, 1013. Lindsey was sentenced to 108 months on the wire fraud counts and 24 months for identity theft. *Id.* at 1013.

[135] *Id.* at 1014; *Lindsey I*, 827 F.3d 865, 869 (9th Cir. 2016).

[136] *Lindsey I*, 827 F.3d at 869.

[137] *Id.* at 871 (citing United States v. Appolon, 715 F.3d 362, 368 (1st Cir. 2013); United States v. Prieto, 812 F.3d 6, 14 (1st Cir. 2016)).

[138] *Lindsey I*, 827 F.3d at 871.

[139] *Id.*

[140] *Id.* ("The government introduced evidence that the lenders specifically requested information about, *inter alia*, employment, income, and assets, and that Lindsey provided false information with the intent to fraudulently secure loans.").

Lindsey I's adoption of the First's Circuit's per se materiality rule was deeply misguided for a three reasons. First, an argument can be made that neither *Appolon* nor *Prieto* actually created a per se materiality rule in the first instance.[141] Second, even if the First Circuit has adopted a per se materiality rule, the First Circuit's rule is arguably narrower than the materiality rule enunciated by *Lindsey I*.[142] Third, putting aside the First Circuit's approach altogether, the per se materiality rule stated by *Lindsey I* is without merit.[143] This part of the Article will briefly discuss each of these three arguments.

Undoubtedly, there is broad and incautious language in *Appolon* and *Prieto* suggesting that materiality can be established simply by a borrower providing incorrect information on a loan application.[144] Nevertheless, a close reading of *Appolon* and *Prieto* calls into question whether those are the First Circuit's actual holdings in those two cases.[145] Most important, in both *Appolon*

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[141] *See infra* text accompanying notes 139–50.

[142] *See infra* text accompanying notes 151–53.

[143] *See infra* text accompanying notes 154–56.

[144] For example, in *Appolon*, the court asserted that because the application forms for one of the transactions "specifically sought information regarding the purchaser's income, assets, and intent to reside in the property, all of which were designed to assess the borrower's creditworthiness," United States v. Appolon, 715 F.3d 362, 368 (1st Cir. 2013), this indicated that the "responses were capable of influencing its decision." *Id.* In addition, in *Prieto*, the First Circuit asserts that:

> [I]t is ... fair to presume that a loan applicant's stated income level and plans for using the property in question would have a "natural tendency" to influence a lender's decision. Why else, after all, did the lender demand the information and Prieto take the risk of providing false information?

United States v. Prieto, 812 F.3d 6, 14 (1st Cir. 2016). This rhetorical question is particularly unfortunate. That is exactly what a criminal fraud prosecution must establish—that the defendant provided false information as part of a scheme to defraud someone and that the information is material. One cannot elide the question by simply proclaiming that a lie must be legally significant because, well, why would one party ask for information and why would someone lie in response to the request?

[145] The line between a holding and dicta can be frustrating to discern here. In *Prieto*, the First Circuit describes *Appolon* as follows: "In that case, the government's evidence that the victim lender had 'explicitly sought' information from the fraudulent applicant and had received false information in return satisfied the government's burden on that element." *Prieto*, 812 F.3d at 13 (quoting *Appolon*, 715 F.3d at 368). *Prieto* then states: "We ruled that

and *Prieto* there was witness testimony before the jury that went to the question of materiality.[146] Neither case relied solely on the fact that the lenders requested the information as conclusive proof that the information provided was material.[147] For example, in *Appolon*, although the government had not presented any witness testimony regarding the loan evaluation process for one of the transactions involved in the fraud scheme,[148] the First Circuit contended that the jury reasonably could rely on witness testimony regarding the lending protocols for another lender involved in the case to consider the materiality of the defendant's misrepresentations—especially given the substantial similarities in the lenders' applications.[149] Thus, in *Appolon*, there was some witness testimony about loan procedures relevant to the question of materiality.[150]

Similarly, in *Prieto*, the jury heard lay witness testimony from "a mortgage broker with a decade of experience in the industry and a cooperating witness who had submitted numerous loan applications on Prieto's behalf."[151] Although the defendant argued that the witness "did not have insight into the particular underwriting practices of the victim institutions during the relevant time period,"[152] the First Circuit determined that his testimony was relevant to the question of materiality.[153] Regardless of whether the materiality evidence ought to have been deemed sufficient in either *Prieto* or *Appolon*, the important point here is that both cases involved witness testimony in addition to the proof that the loan documents contained false statements.[154]

'[t]he fact that [the lender's] loan application explicitly sought [certain] information from the applicant indicates that [the defendant's] responses were capable of influencing its decision.'" *Id.* (quoting *Appolon*, 715 F.3d at 368–69). At the same time, however, *Prieto* explicitly acknowledges that the evidence in *Appolon* "was helpfully accompanied by testimony from an officer of a different mortgage lender about the range of criteria relevant to that lender's loan processing procedures." *Prieto*, 812 F.3d at 13 (citing *Appolon*, 715 F.3d at 368–69).

146 *See Appolon*, 715 F.3d at 368–69; *Prieto*, 812 F.3d at 13–14.

147 *See Appolon*, 715 F.3d at 369; *Prieto*, 812 F.3d at 14.

148 *Appolon*, 715 F.3d at 368.

149 *Id.* at 369.

150 *See id.* at 368–69.

151 *Prieto*, 812 F.3d at 14.

152 *Id.*

153 *Id.*

154 *Appolon*, 715 F.3d 362, 368–69 (1st Cir. 2013); *Prieto*, 812 F.3d at 14.

Neither case relied solely on loan document falsehoods alone to establish materiality.[155]

Second, to the extent that *Appolon* and *Prieto* did create a bright-line materiality test, the *Lindsey I* panel's holding arguably was even broader than in those two cases. In *Prieto*, the First Circuit states that "it is ... fair to presume that a loan applicant's stated income level and plans for using the property in question would have a 'natural tendency' to influence a lender's decision."[156] The exact language is important. It is one thing to have a judicially created materiality presumption in mortgage loan applications for false statements about the borrower's income and their plans to reside in the property—these are undeniably two of the most important items on any mortgage loan application—but it is quite another to hold, as *Lindsey I* did, that *any* false responses in a loan application with respect to any matter are, as a matter of law, material.[157] That is a much broader, and more dubious, proposition.[158]

This leads to the third and ultimate flaw in *Lindsey I*'s materiality holding. Even if *Lindsey I* had been correct that to conclude that the First Circuit has a true bright-line per se materiality rule, following this rule was inadvisable on the merits. The simplicity of such a per se materiality rule is only matched by its vacuity. Think about the implications of this reasoning—that any time a party to a contract, such as a mortgage loan agreement, requests information from another party, by definition, the request alone proves that the information is material, independent of any evidence about its potential significance to any decision-making processes.[159] Such an approach eviscerates

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[155] *See Appolon*, 715 F.3d at 368–69; *Prieto*, 812 F.3d at 14.

[156] *Prieto*, 812 F.3d at 14; *see also Appolon*, 715 F.3d at 368 (noting that the loan file for one of the transactions "included application forms that specifically sought information regarding the purchaser's income, assets, and intent to reside in the property, all of which were designed to assess the borrower's creditworthiness").

[157] *Lindsey I*, 827 F.3d at 871.

[158] Even a presumption regarding income overstatement might still be inadvisable, but at least it is relatively narrow. *See Prieto*, 812 F.3d at 14 (because "residential mortgage lenders were devoting scant resources to the verification of applicants' income levels, it is nevertheless fair to presume that a loan applicant's stated income level and plans for using the property in question would have a 'natural tendency' to influence a lender's decision").

[159] Conversely, the Second Circuit has held "that contractual disclaimers of reliance on prior misrepresentations do not render those misrepresentations

the very nature of materiality. Why have materiality as a separate element of a criminal offense, if we presume materiality when the falsity of the statement in response to an inquiry has been established?[160] In order to understand why this is a misguided approach, we now will turn to *Lindsey II*, which discarded the bright-line rule from *Lindsey I*, and even more tellingly, did not even cite the First Circuit's opinions in *Prieto* and *Appolon*.[161] The excision of these First Circuit precedents in *Lindsey II* is an implicit concession of the flawed reasoning in *Lindsey I*, and a repudiation of the First Circuit's alleged per se materiality rule.

C. Lindsey II*: Distinguishing* Escobar *and Adopting Rigid Evidentiary Rules*

Escobar, provided the Ninth Circuit with a justification for granting rehearing in *Lindsey*.[162] Ultimately, the Ninth Circuit once again rejected Lindsey's claim that he had been prevented from presenting a complete defense.[163] To get to that point, though, the Ninth Circuit in *Lindsey II* was compelled to address *Escobar*.[164] As Judge Gould explained: "According to Lindsey, *Escobar* directs that factfinders in a mortgage fraud prosecution be free to consider any evidence of lender behavior, including how an individual lender treats a particular false statement on its loan applications."[165]

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immaterial under the criminal mail and wire fraud statutes." United States v. Weaver, 860 F.3d 90, 95 (2d Cir. 2017); *see also* United States v. Ghilarducci, 480 F.3d 542, 547 (7th Cir. 2007) (rejecting the argument that contracts should have put fraud victims on notice that oral representations would not be honored and thus were "immaterial or without tendency to influence").

[160] *See* United States v. Rigas, 490 F.3d 208, 231 (2d Cir. 2007) ("The simple fact that the Co-Borrowing Agreements required information does not make any misstatement of that information *per se* material.") (citing United States v. Rodriguez, 140 F.3d 163, 168 (2d Cir. 1998)).

[161] *Lindsey II*, 850 F.3d 1009, 1019 (9th Cir. 2017).

[162] *See* Shin v. United States, No. CR 04-00150 SOM, 2017 WL 2802866, at *1 (D. Haw. June 28, 2017) (explaining that *Escobar* led to the Ninth Circuit's rehearing of *Lindsey I*), *aff'd*, 782 F. App'x 595 (9th Cir. 2019)).

[163] *Lindsey II*, 850 F.3d at 1019. In fact, the Ninth Circuit suggested that the district court had been too generous, by allowing Lindsey to introduce evidence that would not be admissible according to the *Lindsey* court's reasoning. *Id.* at 1018–19.

[164] *Id.* at 1016–17.

[165] *Id.* at 1017.

Put another way, Lindsey argued that *Escobar* requires trial courts to allow criminal fraud defendants to introduce proof about the subjective decision-making processes of those who are the recipients of a falsehood in a fraud scheme—such as banks and other financial institutions.[166]

Lindsey II rejected this reading of *Escobar*.[167] As opposed to *Lindsey I*, with its ill-advised adoption of a per se materiality rule borrowed from the First Circuit, Judge Gould thoughtfully and carefully worked to explicate and reconcile several principles and precedents regarding federal fraud law.[168] Most important for its analysis, the Court of Appeals contended that materiality under the wire fraud statute is evaluated under an *objective* test.[169] As the court explained: "This standard is not concerned with a statement's subjective effect on the victim, but only the 'the intrinsic capabilities of the false statement itself.'"[170] The idea of objective materiality undergirds the Ninth Circuit's analysis in *Lindsey II*. Connected to this point, the Ninth Circuit stated that so-called "lender negligence in verifying loan application information, or even intentional disregard of the information, is not a defense to fraud."[171] After all, the thinking goes, if we care only about the intrinsic capabilities of a false statement and its actual effects (successful or otherwise), then the actions of the lender, whether negligent or otherwise, should have no

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[166] *Id.*

[167] *Id.* at 1017–18.

[168] *Lindsey II* begins with the two basic principles that are beyond dispute: materiality is an element of the wire fraud offense, *id.* at 1013, but proof of reliance or actual damages is not required. *Id.* at 1014–15.

[169] *Id.* at 1014 ("The element of materiality is evaluated under an objective test, in which we must examine 'the intrinsic capabilities of the false statement itself, rather than the possibility of the actual attainment of its end.'" (quoting United States v. Peterson, 538 F.3d 1064, 1072 (9th Cir. 2008))); *see also id.* at 1015 ("A false statement is material if it *objectively* had a tendency to influence, or was capable of influencing, a lender to approve a loan.").

[170] *Id.* at 1015 (quoting United States v. Peterson, 538 F.3d 1064, 1072 (9th Cir. 2008)).

[171] *Id.* at 1011–12 ("[W]e hold that lender negligence in verifying loan application information, or even intentional disregard of the information, is not a defense to fraud, and so evidence of such negligence or intentional disregard by particular lenders is inadmissible as a defense against charges of mortgage fraud.").

bearing on the question of materiality.[172] As Judge Easterbrook explained in an earlier mail fraud case, "Once the Supreme Court excludes reliance as a separate element of the mail-fraud offense, it will not do for appellate judges to roll reliance into materiality; that would add through the back door an element barred from the front."[173] To do so would threaten the very nature of criminal fraud as an inchoate offense.[174]

Judge Gould was unconvinced that *Escobar* disturbed this basic understanding of federal criminal fraud law.[175] He distinguished *Escobar* by drawing a distinction between the context of the False Claims Act, which protects the United States Government, and federal anti-fraud laws, which cover an entire marketplace of lenders:

> [Lindsey's] interpretation misses that the Federal Government in an FCA case is in a far different position than is an individual lender in a mortgage fraud prosecution. A single lender represents only some small part of the market for issuing mortgages. The Federal Government, by contrast, represents the entire market for issuing federal government contracts. The weight the Government gives to a particular statutory, regulatory, or contractual requirement is analogous not to the weight an individual lender gives to a statement on its loan application, but rather the weight the entire mortgage industry gives to that type of statement.
>
> This difference matters because materiality measures natural capacity to influence, not whether the statement actually influenced any decision .... The way the entire market has historically treated a statement or requirement says a lot about that statement or requirement's natural capacity to influence a decision by market participants. But the way one market participant of many has previously treated a statement says little or nothing about that statement's inherent ability to affect decision making.[176]

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[172] *See* United States v. Svete, 556 F.3d 1157, 1165 (11th Cir. 2009) (en banc) ("A perpetrator of fraud is no less guilty of fraud because his victim is also guilty of negligence.").

[173] United States v. Rosby, 454 F.3d 670, 674 (7th Cir. 2006).

[174] *See* Buell, *supra* note 46 (explaining the inchoate nature of fraud as a criminal offense).

[175] *Lindsey II*, 850 F.3d at 1017.

[176] *Id.* (citation omitted).

Lindsey II thus theorizes that subjective and objective materiality standards essentially merge in the *Escobar* context of the False Claims Act—how the Federal Government hypothetically would respond to explicit or implicit misrepresentations is basically the same as how the Government routinely *does* respond to such misstatements.[177] The same cannot be said for fraud against financial institutions where, according to the Ninth Circuit, "the way one market participant of many has previously treated a statement says little or nothing about that statement's inherent ability to affect decision making."[178]

Ultimately, based upon its objective understanding of materiality and its reading of *Escobar*, the Court of Appeals in *Lindsey II* determined that "the district court did not deny Lindsey the opportunity to present a complete defense."[179] If anything, Ninth Circuit opined that the district court had been a bit too generous "by allowing the jury to consider ... evidence of particular lenders' standards that might have squeaked its way into the record."[180] Just to make sure that the principles enunciated by *Lindsey II* were not misinterpreted by the district courts, the Ninth Circuit laid out its four holdings as follows:

> In conclusion, we hold the following: (1) negligence is not a defense to wire fraud, and evidence of lender negligence is not admissible as a defense to mortgage fraud; (2) intentional disregard of relevant information is not a defense to wire fraud, and evidence of intentional disregard by lenders is not admissible as a defense to mortgage fraud; (3) evidence of individual lender behavior is not admissible to disprove materiality, but evidence of general lending standards in the mortgage industry is admissible to disprove materiality; and (4) the district court did not deny Lindsey the opportunity to present a complete defense.[181]

The Ninth Circuit thus drew a clear line: criminal mortgage fraud defendants can challenge the materiality of false statements

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[177] A similar point is made by the Fourth Circuit in *Raza*. *See infra* notes 207–08 and accompanying text.

[178] *Lindsey II*, 850 F.3d at 1017.

[179] *Id.* at 1019 (explaining that throughout the trial, "the district court allowed Lindsey to argue and present evidence that his false statements were not material in light of general industry lending standards").

[180] *Id.*

[181] *Id.*

with evidence about industry practices,[182] but are forbidden from introducing or relying on evidence about individual lenders.[183] In Judge Gould's view, "[t]his line between evidence of industry practice and the practice of particular lenders is subtle,"[184] but it reflects the best way to respect both *Escobar* and the objective conception of materiality in federal criminal fraud cases.[185]

D. United States v. Raza

1. Background

In *United States v. Raza*, the Fourth Circuit also addressed the implications of *Escobar* on criminal fraud cases involving financial institutions.[186] The *Raza* panel had the benefit not only of Justice Thomas's opinion in *Escobar*, but also the Ninth Circuit's opinion in *Lindsey II*. The fraud scheme in *Raza* involved four employees of the SunTrust Mortgage branch in Annandale, Virginia:[187] Mohsin Raza managed the branch; Raza's wife, Humaira Iqbal, worked as his personal assistant; and Farukh Iqbal and Mohammad Ali Haider, both of whom are Humaira's brothers, worked as loan officers in the same SunTrust office.[188] Raza and Humaira also acted as loan officers at the branch.[189] The fraud scheme was extensive:[190] it involved twenty-five mortgage loans made on thirteen properties in Virginia.[191] As the Fourth Circuit exhaustively detailed, the four

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[182] *Id.* at 1016. As an example, Judge Gould explained that "defendants can offer testimony about the types of information, such as household income or assets, that lenders typically consider, as well as evidence of how much weight the industry generally gives to statements about such information." *Id.*

[183] *Id.* ("As long as defendants do not stray into evidence of the behavior of individual lenders—for instance, evidence of specific prior bad loans or particular mistakes by underwriters—defendants may attack materiality though industry practice.").

[184] *Id.*

[185] *Id.* at 1016–17.

[186] United States v. Raza, 876 F.3d 604, 619–21 (4th Cir. 2017).

[187] *Id.* at 607. The Fourth Circuit explained that the fraud scheme affected both parent and subsidiary banking entities, but that the distinctions between the entities were immaterial for the purpose of the discussion. *Id.* at 606 n.1.

[188] *Id.* at 608.

[189] *Id.*

[190] *See id.* at 607 n.6 (describing key elements of the indictment).

[191] *Id.* at 607.

defendants helped to originate numerous mortgage loan applications containing inaccurate borrower information—especially with respect to job titles, income, and bank savings on deposit.[192] These mortgage applications often were supported by false tax and payroll documents obtained or prepared by the defendants.[193] Many of the false tax documents were produced by Ranjit Singh, a tax preparer who cooperated with the prosecution.[194]

It is vitally important to note that the jury was apprised not only of the facts of these mortgage loan application misrepresentations, but also that the jurors heard testimony as to why such

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[192] Astonishingly enough, the four defendants in *Raza* claimed to have worked at SunTrust for only a year, during the pre–Great Recession mortgage lending boom, and that the government waited nine years to indict them for their crimes. *See* Petition for Writ of Certiorari, United States v. Raza, 876 F.3d 604 (4th Cir. 2017), *cert. denied*, 138 S. Ct. 2679 (2018) (No. 17-1314), *available on* Westlaw at 2018 WL 1394194, at 3–4 [hereinafter *Raza* Cert. Petition].

[193] *Raza*, 876 F.3d at 609–10. They even had a branch employee impersonate a tenant's landlord to confirm rental information with SunTrust's underwriters. *Id.* at 609.

[194] *Id.* Seven vivid examples will give the reader a sense of the types of misrepresentations involved in the *Raza* mortgage fraud scheme: (1) Reynaldo Valdez, obtained a home mortgage loan for $414,000 from SunTrust. *Id.* at 610. His application indicated that he was a dentist who earned over $100,000 per year and that he had almost $70,000 in the bank. *Id.* In reality, he worked in his sister's medical office doing clerical and maintenance work for far less income. *Id.* (2) Harwinder Singh, obtained $470,000 in SunTrust mortgage loans in his wife's name. *Id.* The loan application stated that Mrs. Singh worked as a systems engineer and that she made almost $15,000 per month and had $45,000 on deposit at Wachovia Bank. *Id.* In fact, she earned only $25,000 per year and did not have a bank account with Wachovia. *Id.* (3) Santos Valdez-Mejia, who worked as a cook and a manual laborer, obtained $405,000 in mortgage loans from SunTrust. *Id.* at 610–11. His loan file indicated that he earned almost $10,000 per month and that he worked as an area manager for a restaurant chain. *Id.* at 610. (4) Francy Castillo's loan application falsely stated that she "was president of a company called NGDC, earned a monthly salary of $17,000, and had $100,000 in a Wachovia bank." *Id.* at 611. In reality, Castillo worked "two hourly jobs—as a waitress and as a caretaker," and "she never had $100,000 in any bank." *Id.* (5) Khalid Yousaf, a cab driver, who also operated a Dollar Store. *Id.* Yousaf earned about $3,000 per month, but his mortgage refinancing application falsely stated that he was a vice president of a business and that he earned $13,000 per month. *Id.* (6) Juan Pablo Yanez's loan application "reflected that he was president of a construction company and earned more than $11,000 per month," but he "was actually a laborer earning hourly wages." *Id.* (7) Finally, Jagtar Dhanoa worked as a cab driver and at Pizza Hut as a cook, but his loan application "falsely indicated he was a senior analyst at Ikon Solutions." *Id.*

information was significant in the lending process.[195] In particular, "Barbara Daloia, a vice-president of SunTrust's national underwriting team in North Carolina, explained the potential consequences to SunTrust of loan applicants failing to submit accurate information on mortgage loan applications."[196] Daloia also "emphasized the significance to SunTrust of the information required on its loan applications,"[197] and "stressed that supporting documents were similarly important to SunTrust's loan process—such as those required for full document loans and stated income, stated asset loans—because those documents authenticate the information on the loan application."[198]

Just as important, the defendants in *Raza* were permitted to have their own witnesses testify about SunTrust's "originate-to-sell" mortgage business model[199] and the firm's purportedly reckless lending policies during the period of the alleged mortgage fraud scheme.[200] According to a former SunTrust underwriter, Terri Dougherty:

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[195] *Id.* at 611–12.

[196] *Id.* at 611.

[197] *Id.* at 612.

[198] *Id.*

[199] *Id.*; *see also* FINANCIAL CRISIS INQUIRY COMM'N, FINANCIAL CRISIS INQUIRY REPORT: FINAL REPORT OF THE NATIONAL COMMISSION ON THE CAUSES OF THE FINANCIAL AND ECONOMIC CRISIS IN THE UNITED STATES 542 (2011), https://www.govinfo.gov/content/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf [https://perma.cc/V6AQ-NBAJ] (defining "originate-to-distribute" as "[w]hen lenders make loans with the intention of selling them to other financial institutions or investors, as opposed to holding the loans through maturity"). One scholar explains:

> A more sophisticated secondary market for mortgages developed in the 1970s. Banks, aided by the GSEs, began to securitize mortgages, selling pools of mortgage loans to intermediaries who sold securities backed by those loans to investors. Investors in the securitized mortgages then bore the interest rate, prepayment, and default risk associated with the underlying loans apart from a small residual interest typically maintained by the originator. Many banks thus moved from an originate-to-hold model to an originate-to-distribute model, transferring most of their mortgage loans to special purpose vehicles that issued and sold securities to investors.

Paul G. Mahoney, *Deregulation and the Subprime Crisis*, 104 VA. L. REV. 235, 243 (2018) (footnote omitted).

[200] *Raza*, 876 F.3d at 612–13.

> SunTrust aggressively sought to originate mortgage loans in order to sell them on the secondary mortgage market. SunTrust attempted to sell loans immediately after origination, before the SunTrust borrowers could default and undermine the loans' marketability. Dougherty believed this business model encouraged SunTrust employees to prioritize economic metrics that attracted secondary loan purchasers—such as good credit scores of borrowers—and to disregard other information on the SunTrust loan applications. For example, Dougherty asserted that SunTrust discouraged its mortgage loan underwriters from raising red flags when loan applications contained questionable information concerning income, employment, and assets, so long as the borrowers' credit scores were adequate. Dougherty also maintained that SunTrust supervisors would sometimes override her decisions to defer action on loan applications and to request additional supporting documents.[201]

Another expert witness for the defense, Robert MacLaverty opined that:

> SunTrust's mid-Atlantic region had engaged in reckless lending practices and approved more than ninety-eight percent of its residential mortgage loan applications during the period of the fraud scheme .... In contrast, SunTrust's competitors approved about eighty percent of similar loan applications during that period .... MacLaverty believed that secondary market purchasers deemed credit scores of borrowers to be one of the most important economic metrics in their evaluations of loan acquisitions .... MacLaverty further opined that SunTrust's pattern of expeditiously selling originated loans to secondary market purchasers minimized SunTrust's exposure to the risk of borrowers defaulting on SunTrust loans.[202]

Thus, the defendants in *Raza* were quite successful at getting their "reckless lender" story in front of the jury, even if they were unable to obtain the jury charge on materiality that they wanted from the district court.[203]

After a jury trial, all four defendants were convicted of wire fraud involving a financial institution and conspiracy to

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[201] *Id.* at 612.

[202] *Id.* at 612–13

[203] *Id.* at 615 (noting that the defendants' witnesses were able to testify "that SunTrust had engaged in reckless lending practices and disregarded false information in loan applications").

commit wire fraud.[204] On appeal, the defendants argued that the trial court's instruction as to materiality was defective because "the court erroneously gave the jury an objective—or 'reasonable lender'—standard of materiality,"[205] where it should have advised "the jury that it had to find ... that the defendants' misrepresentations and false statements were subjectively material to the fraud's victim."[206] As in *Lindsey II*, the defendants in *Raza* specifically invoked *Escobar*.[207] The Fourth Circuit explained: "The defendants' contention of error on the materiality element apparently comes to this: They want us to utilize [*Escobar*] to rule that the Supreme Court has clarified its earlier cases to say that materiality—in any criminal fraud context—requires proof that the false statements and misrepresentations were subjectively material."[208]

2. The Raza *Decision*

In the end, the Fourth Circuit rejected the defendants' arguments regarding materiality.[209] The *Raza* court arrived at two related legal conclusions similar to *Lindsey II*: first, an objective standard of materiality applies in cases involving fraud against private lenders; and second, nothing in *Escobar* changes that principle or warrants the application of a subjective materiality standard in criminal fraud cases involving financial institutions.[210] As for the first point, the *Raza* court relied heavily on *Neder*,[211] in addition to a recent Fourth Circuit bank fraud case, *United States v. Wolf*.[212] According to the Court of Appeals, in *Neder*, "the Supreme Court endorsed an objective, reasonable person

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[204] *Id.* at 607.

[205] *Id.* at 614. The defendants raised two other arguments on appeal, which will not be addressed here. *Id.* at 613. This Article will limit its focus to the materiality issue.

[206] *Id.* at 614.

[207] *Id.* at 615.

[208] *Id.* at 620.

[209] *Id.* at 621.

[210] *Id.* at 620–21.

[211] *Id.* at 616–18.

[212] United States v. Wolf, 860 F.3d 175, 193 (4th Cir. 2017). Even though *Wolf* was decided more than a year after *Escobar*, the panel in *Wolf* did not address the implications of *Escobar*. *See Raza*, 876 F.3d at 619 n.8.

standard for materiality in the context of wire fraud against private lending institutions."[213] Moreover, in *Wolf*, the Court of Appeals plainly stated that "the test for whether a false statement to a bank is material is an objective one; it does not change from bank to bank."[214] Instead, as *Raza* explained, "frauds perpetrated on private lending institutions are judged according to an objective, 'reasonable financial institution' standard."[215] Although the Fourth Circuit's endorsement of an objective materiality test in *Raza* was accompanied by additional discussion, the combination of *Raza*'s reading of *Neder* and the recent circuit precedent in *Wolf* pretty much settled the issue for the Court of Appeals.[216]

The only question, then, for the Fourth Circuit was whether *Escobar* somehow dictated a contrary outcome and thus, perhaps, whether *Wolf* was erroneously decided.[217] The answer was no. The Court of Appeals determined that *Escobar*'s more subjective materiality standard does not apply in criminal fraud cases involving financial institutions,[218] contending that it was unlikely

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[213] *Raza*, 876 F.3d at 618 ("In determining that Congress intended to incorporate common law materiality principles into those offenses, the *Neder* Court relied on the objective materiality test spelled out in the Second Restatement of Torts.") (citing Neder v. United States, 527 U.S. 1, 22 n.5 (1999)). Oddly, as *Raza* cites *Neder* citing the Restatement (Second) of Torts here, the second subpart of the Restatement's materiality test (the subjective prong) seems to vanish. *Id.*

[214] *Wolf*, 860 F.3d at 193; *Raza*, 876 F.3d at 618 (discussing *Wolf*).

[215] *See Raza*, 876 F.3d at 618 ("More than fifteen years prior to *Wolf*—and post-*Neder*—our Court explained that frauds perpetrated on private lending institutions are judged according to an objective, 'reasonable financial institution' standard." (citing United States v. Colton, 231 F.3d 890, 903 n.5 (4th Cir. 2000))).

[216] *Id.* at 618.

[217] *Id.* at 619 (explaining that the defendants specifically argued that *Wolf* was wrongly decided in light of *Escobar*).

[218] One argument proffered by the panel in *Raza* against the extension of *Escobar* will not be explored in depth here. The Fourth Circuit noted that Justice Thomas actually cited both objective and subjective materiality tests in *Escobar*, and then opined that there is no true tension between the objective and subjective materiality tests in this context. *See id.* at 621 ("The Court's juxtaposition of those two standards suggests that they are not in tension. Put another way, an objective test of materiality does in fact 'look to the effect on the likely or actual behavior of the recipient.'" (quoting *Escobar*, 136 S. Ct. at 2002)). *Raza* then concluded that both standards lead to the conclusion that "the jury should assess in its materiality inquiry is a reasonable lender in SunTrust's position—not necessarily SunTrust itself." *Id.* Regardless of whether the ultimate conclusion

that *Escobar* extended past qui tam actions that protect the federal government.[219] In support of this point, *Raza* cited a recent case, *United States v. Palin*,[220] in which the Fourth Circuit had declined to apply *Escobar* in the context of health care fraud, stating: "We do not believe the Supreme Court intended to broadly 'overrule' materiality standards that had previously applied in the context of criminal fraud."[221] The Fourth Circuit then distinguished cases like *Escobar*, which "involved a civil fraud scheme that had targeted the federal government," from cases involving private lenders.[222] As the Fourth Circuit explained, "when the victim is the government, the prosecution must prove materiality by reference to the particular government agency or public officials that were targeted,"[223] therefore "[i]n such a circumstance, the applicable materiality test verges toward a subjective standard."[224] Accordingly, in cases involving false statements made to government agencies or public decision-making bodies, subjective materiality evidence (i.e., how the targeted decision-maker would respond or actually has responded in the past to such misrepresentations) is relevant.[225] In fact, not only would such evidence be admissible for the defense, the prosecution might need to proffer such subjective materiality evidence to establish its case-in-chief.

Although subjective materiality evidence might be relevant in a case involving fraud against the government, according to *Raza*, the same is not true for cases involving fraud against

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is correct (which it very well may be) the reasoning leading there in this paragraph of *Raza* is rather opaque. It is not evident how *Escobar*'s citation of both materiality standards, without more, leads to the conclusion that the two standards are not in tension, nor why this means that a reasonable lender standard necessarily applies in all cases. Once again, the conclusion may be correct, but the reasoning requires further elaboration.

[219] *See id.* at 620.

[220] *Id.* (citing United States v. Palin, 874 F.3d 418, 420 (4th Cir. 2017)).

[221] *Palin*, 874 F.3d at 423.

[222] *Raza*, 876 F.3d at 621.

[223] *Id.* at 617.

[224] *Id.* at 621; *see also id.* at 616 ("Pursuant to *Neder*, the test for materiality in a fraud scheme targeting the federal government verges toward the subjective.") (citing Neder v. United States, 527 U.S. 1, 16 (2019)).

[225] *Id.* at 617 (citing cases involving false statements to public decision-making bodies, including *United States v. Camick*, 796 F.3d 1206, 1217–19 (10th Cir. 2015); *United States v. Litvak*, 808 F.3d 160, 174 (2d Cir. 2015); and *United States v. Ismail*, 97 F.3d 50 (4th Cir. 1996)).

financial institutions.[226] To support this point, *Raza* quoted *Lindsey II*, to illuminate why a single private lender in the mortgage market is not analogous to the federal government:

> A single lender represents only some small part of the market for issuing mortgages. The Federal Government, by contrast, represents the entire market for issuing federal government contracts. The weight the Government gives to a particular statutory, regulatory, or contractual requirement is analogous not to the weight an individual lender gives to a statement on its loan application, but rather the weight the entire mortgage industry gives to that type of statement.[227]

In sum, like the Ninth Circuit in *Lindsey II*, the Fourth Circuit in *Raza* declined to extend the *Escobar* Court's subjective materiality standard to cases involving criminal frauds perpetrated against private lenders or financial institutions.[228] Thus, the Fourth Circuit held that the district court did not err by refusing to give the materiality instruction requested by the defendants.[229]

E. Summary: The Key Lesson of Lindsey II *and* Raza

There is one key lesson that can be drawn from *Lindsey II* and *Raza*: the federal courts of appeals thus far have rejected defendants' arguments that the "subjective"[230] materiality standard enunciated by the United States Supreme Court in *Escobar* should be applied to criminal fraud cases involving financial institutions.[231] This has been a losing argument. Instead, the circuit

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[226] *Id.* at 616.

[227] *Id.* at 621 (quoting *Lindsey II*, 850 F.3d 1009, 1017 (9th Cir. 2017)).

[228] *Id.* at 620.

[229] *Id.* at 621.

[230] The characterization of the *Escobar* standard as "subjective" could be debated. *See* Dawkins, *supra* note 107, at 178 (asserting that "[u]nder *Escobar*, the government and relators must meet both the objective and subjective standards when judging if a misrepresentation was material to the decision to its pay") (footnotes omitted). But this is the argument pressed by criminal fraud defendants, so it is suitable for the purposes of this discussion. *Raza*, 876 F.3d at 620.

[231] *See* United States v. Robertson, 760 F. App'x 214, 219–20 (4th Cir. 2019) (quoting *Raza*, 876 F.3d at 620) (explaining that *Raza* "noted that the subjective materiality standard articulated by the Supreme Court in [*Escobar*] ... a False Claims Act case—likely does not extend 'beyond the context of qui tam actions,' which are 'civil proceeding[s] that protect[ ] the federal government'").

courts to consider the issue in *Escobar*'s wake steadfastly have maintained that an objective materiality standard applies in mail, wire and bank fraud cases.[232] As the Fourth Circuit stated in *Raza*: "[T]he correct test for materiality ... is an objective one, which measures a misrepresentation's capacity to influence an objective 'reasonable lender,' not a renegade lender with a demonstrated habit of disregarding materially false information."[233]

IV. MATERIALITY EVIDENCE IN FEDERAL FRAUD CASES

A. Lindsey II*'s Prophylactic Rules*

Although *Lindsey II* and *Raza* arrived at basically the same conclusion with respect to post-*Escobar* materiality standards in federal fraud cases involving financial institutions, the Ninth and Fourth Circuits differed in one fundamental manner: how to treat the admission of evidence regarding lending practices. As discussed earlier, in *Lindsey II*, the Ninth Circuit specifically held that neither evidence of lender negligence nor evidence of intentional regard of relevant information could be admissible as a defense in a criminal mortgage fraud case.[234] The Ninth Circuit went further, however, holding that "evidence of individual lender behavior is not admissible to disprove materiality, but evidence

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[232] *See Lindsey II*, 850 F.3d at 1014–17; United States v. Betts-Gaston, 860 F.3d 525, 532 (7th Cir. 2017) ("[W]hether a statement is material depends on its effect on 'a reasonable person'—or, in this case, a reasonable lender."); *Raza*, 876 F.3d at 620–21; *see also* United States v. Lucas, 709 F. App'x. 119, 123 (3d Cir. 2017) ("[M]ateriality is an objective test, and requires showing that a defendant's misrepresentations would have been important to a reasonable person deciding whether to take the requested action, not that the victim actually relied on those misrepresentations."); United States v. Mazumder, 800 F. App'x 392, 396 (6th Cir. 2020) (explaining that "the concept of materiality ... involves the *tendency* or *capacity* to influence a reasonable person's decision and does not require actual reliance on the part of the victim"); Shin v. United States, No. CR 04-00150 SOM, 2017 WL 2802866, at *22 (D. Haw. June 28, 2017) ("*Escobar* does not alter the applicable objective materiality standard. Rather, *Escobar* clarifies what types of evidence may be relevant in proving materiality depending on the facts of a particular case. *Lindsey II* clearly emphasizes that materiality continues to be evaluated under an objective standard and applies that standard in the wire fraud context.").

[233] *Raza*, 876 F.3d at 621.

[234] *Lindsey II*, 850 F.3d at 1019.

of general lending standards in the mortgage industry is admissible to disprove materiality."[235] Thus, the Ninth Circuit went from a per se materiality rule in *Lindsey I*, which would have made virtually all evidence about materiality outside of the loan application itself and any supporting documents irrelevant and inadmissible,[236] to a prophylactic "bright-line rule against evidence of individual lender behavior"[237] in *Lindsey II*.

Needless to say, the Ninth Circuit did not have to bake its conclusions about materiality into rigid evidentiary rules in *Lindsey II*. The *Lindsey II* panel itself acknowledged that it was making an explicit policy judgment that a prophylactic evidentiary rule was superior to the alternatives.[238] In fact, the Court of Appeals identified one possible option as follows: "We recognize that an alternative possible rule would be to allow evidence of past behavior by individual lenders, but require a jury instruction that the evidence be considered only for the purpose of evaluating materiality, and not negligence, intentional disregard, or lack of reliance."[239] Nevertheless, the Ninth Circuit rejected other such approaches, asserting that because "individual lender behavior can easily touch on lender negligence, intentional disregard, or lack of reliance—none of which is a defense to mortgage fraud,"[240] permitting "evidence of prior non-reliance by lenders would still lead factfinders to consider whether the victims themselves relied on the defendant's false statements."[241] The *Lindsey II* panel thus concluded that "[a] prophylactic rule against all evidence of individual lender behavior best avoids" the court's concerns about jury confusion.[242]

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[235] *Id.*

[236] *See supra* notes 135–61 and accompanying text (discussing the per se materiality rule established by *Lindsey I*).

[237] *Lindsey II*, 850 F.3d at 1017.

[238] *Id.* at 1018.

[239] *Id.* at 1017 (citations omitted).

[240] *Id.*

[241] *Id.* at 1018. *Lindsey II* also cites FED. R. EVID. 403, which states: "The court may exclude relevant evidence if its probative value is substantially outweighed by a danger of one or more of the following: unfair prejudice, confusing the issues, misleading the jury, undue delay, wasting time, or needlessly presenting cumulative evidence."

[242] *Lindsey II*, 850 F.3d at 1018.

B. Supervisory Powers

Lindsey II does not explain the source of its authority to establish these prophylactic evidentiary rules for future criminal fraud cases. This is not to say that the Ninth Circuit acted outside of its authority, but merely to note that it is not addressed in Judge Gould's opinion. It could be claimed, perhaps, that the Ninth Circuit was acting pursuant to what are sometimes called supervisory authority or supervisory powers.[243] The sources and scope of the federal courts' supervisory powers have been the subject of significant scholarly attention.[244] Questions about the limits of supervisory powers run even deeper when it is the federal courts of appeals, as opposed to the Supreme Court,[245] that are exercising these implicit powers.[246] Nevertheless, in *Thomas v. Arn*, the Supreme Court asserted: "It cannot be doubted that the courts of appeals have supervisory powers that permit, at the least, the promulgation of procedural rules governing the management of litigation."[247] Thus, there is plausible authority for the Ninth Circuit's action here.[248]

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[243] *See* Amy Coney Barrett, *The Supervisory Power of the Supreme Court*, 106 COLUM. L. REV. 324, 330 (2006) ("In some instances, courts use the term 'supervisory authority' to refer to the power of an appellate court to supervise lower courts by prescribing procedures for them above and beyond those required by statutory and constitutional provisions.").

[244] *See, e.g.*, Sara Sun Beale, *Reconsidering Supervisory Power in Criminal Cases: Constitutional and Statutory Limits on the Authority of the Federal Courts*, 84 COLUM. L. REV. 1433 (1984); Barrett, *supra* note 243.

[245] *See* Dickerson v. United States, 530 U.S. 428, 437 (2000) ("The law in this area is clear. This Court has supervisory authority over the federal courts, and we may use that authority to prescribe rules of evidence and procedure that are binding in those tribunals.") (citing Carlisle v. United States, 517 U.S. 416, 426 (1996)).

[246] *See* 15A C. WRIGHT, A. MILLER & E. COOPER, FEDERAL PRACTICE & PROCEDURE: JURISDICTION § 3901 (2d ed. 1984) (referring to the courts' of appeals' supervisory powers as "scantily defined"); *see also* United States v. Strothers, 77 F.3d 1389, 1398 (D.C. Cir. 1996) (Sentelle, J., concurring) (asserting that "unclear ... where the courts of appeals derive the power to control the practice of the district courts when it is not constitutionally mandated").

[247] Thomas v. Arn, 474 U.S. 140, 146 (1985).

[248] Given the uncertain boundaries of the federal appellate courts' supervisory powers, an argument could be made that the Ninth Circuit went too far in *Lindsey II*. But resolving that question would require a deep dive into the

Of course, it could be argued instead that the *Lindsey II* court was not truly engaged in rulemaking or policymaking at all, but merely was stating the holdings for the case in front of it and thus observing what existing federal law would require or forbid in similar financial fraud cases. To accept this view, we would need to believe that the particular evidentiary rules established by the Ninth Circuit in *Lindsey II* are compelled by applicable precedents, statutory language and the Federal Rules of Evidence. In other words, we would have to accept that these prophylactic evidentiary rules are mandated by existing law, not just within the exercise of the court's discretion. If we accept this view, then other courts of appeals that do not arrive at the same conclusion and do not implement such rules would be committing legal error. This seems like a dubious proposition given that nothing in either the federal wire fraud statute or Supreme Court precedents mandated such expansive bright-line evidentiary rules.[249] It seems more likely that the Ninth Circuit was exercising some form of discretion to establish these rules.

C. Alternative Evidentiary Approaches

Thus far, no other federal appellate court has adopted *Lindsey II*'s prophylactic materiality evidence rules. In *Raza*, the Fourth Circuit specifically declined to follow the Ninth Circuit's lead, stating:

> The Ninth Circuit appears to have barred the evidentiary use of a lender's past lending practices on the materiality issue. In explaining that step, it related that "lending standards applied by an individual lender are poor evidence of a false statement's intrinsic ability to affect decision making" .... Although we need not go so far, we understand the rationale for the *Lindsey* court's wholesale rejection of such evidence.[250]

Given the ultimate outcome in *Raza*, one can see why the Fourth Circuit may not have felt compelled to go down *Lindsey*

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federal appellate courts' supervisory powers in matters covered by the Federal Rules of Evidence—a matter that is far beyond this Article's scope.

[249] *See generally* 18 U.S.C. § 1343 (wire fraud).

[250] *See* United States v. Raza, 876 F.3d 604, 621 (4th Cir. 2017) (quoting *Lindsey II*, 850 F.3d at 1018).

II's path. After all, as noted above, the jury in *Raza* was presented with evidence of uninspiring if not outright reckless lender behavior, as well as information about the lender's potentially perilous originate-to-distribute mortgage lending model.[251] Despite this evidence, the jury still convicted all four defendants in *Raza* for their respective roles in the mortgage fraud scheme.[252] Hence, the Fourth Circuit may not have seen any urgent need for prophylactic evidentiary rules, given the ease with which materiality can be established in many mortgage fraud cases, and the apparent absence of juror confusion in the *Raza* case itself.[253]

Even without adopting *Lindsey II*'s prophylactic materiality rules, other courts have accepted the Ninth Circuit's assertion in *Lindsey II* that "the lending standards applied by an individual lender are poor evidence of a false statement's intrinsic ability to affect decision making."[254] The Seventh Circuit's opinion in *Betts-Gaston* illustrates this point.[255] The defendant Betts-Gaston argued that mortgage applications at issue "were not materially false because the lenders did not care about the information the applications requested, such as the borrower's income."[256] The district court excluded Betts-Gaston's evidence including expert testimony "that the lenders' business model depended on generating large volumes of mortgage loans without regard for the borrower's ability to pay."[257] The court concluded that such testimony would be irrelevant and confusing to the jury.[258] Moreover, the district court sustained the government's objections to proposed defense cross-examination "on whether the lenders cared about or tried to verify loan application claims."[259] The Seventh Circuit found no error, explaining:

> Betts-Gaston argues that those rulings were errors because the expert's testimony and the cross-examination questions were relevant to the materiality of the loan applications' false statements.

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[251] *See supra* text accompanying notes 209–29.
[252] *Raza*, 876 F.3d at 606.
[253] *Id.* at 624.
[254] *Lindsey II*, 850 F.3d at 1018.
[255] United States v. Betts-Gaston, 860 F.3d 525, 532 (7th Cir. 2017).
[256] *Id.*
[257] *Id.*
[258] *Id.*
[259] *Id.*

> We disagree. Betts-Gaston wanted to convince the jury that the lenders involved here routinely behaved unreasonably—that, as a matter of policy, they ignored information that a reasonable lender would consider, like the borrower's income .... But whether a statement is material depends on its effect on "a reasonable person"—or, in this case, a reasonable lender .... Whether a particular lender or group of lenders was in fact reasonable is irrelevant to that question.[260]

Thus, even though the Seventh Circuit has not adopted *Lindsey II*'s evidentiary rules, it did accept one motivating rationale underlying these rules: that how a target financial institution actually responded to misstatements is not probative as to how a reasonable decision-maker would have responded to such falsehoods.[261] The factual assumption underlying *Lindsey II* and *Betts-Gaston* could, of course, be challenged in a particular case. One could imagine a defendant arguing that a particular bank's employees are eminently reasonable agents of a prudent financial institution. If so, their lending practices might be representative of industry norms (or the norms of a significant sector of the industry) and understanding the specific bank's approach to lending decisions might be useful to a jury.[262] Nevertheless, under *Lindsey II*, the proffer of such evidence by the defendant is forbidden,[263] and under *Betts-Gaston* and *Raza*, the exclusion of such evidence almost certainly would not be an abuse of the trial judge's discretion.[264]

D. A Gate that Swings One Way?

A recent federal district court case illustrates an additional challenge that defendants face under *Lindsey II*'s evidentiary

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[260] *Id.*

[261] *Id.* at 522–23.

[262] Prior to *Lindsey II*, a federal district court in California noted in an unpublished decision: "Whether, and to what extent, a jury must know about the lenders' decision-making process in a mortgage fraud prosecution would appear to be an issue over which reasonable minds might disagree." United States v. Kuzmenko, No. 2:11-CR-0210 JAM, 2014 WL 7140640, at *6 n.5 (E.D. Cal. Dec. 12, 2014) (collecting cases).

[263] *Lindsey II*, 850 F.3d 1009, 1011 (9th Cir. 2017).

[264] *Betts-Gaston*, 860 F.3d at 532–33; *Raza*, 876 F.3d 604, 614, 625 (4th Cir. 2017).

regime. In *United States v. Casher*, the defendant, an employee of Rocky Mountain Bank (RMB), argued that the government should not have been permitted to introduce evidence of RMB's "lending practices and whether RMB relied on the alleged misrepresentations."[265] Casher argued that "RMB's behavior—the behavior of an individual bank—is inadmissible because whether or not RMB did or did not rely on the alleged misrepresentations is not an element of bank fraud or relevant to the materiality inquiry."[266] In other words, the defendant claimed that the ruling in *Lindsey II* is "a gate that swings both ways,"[267] barring both the defendant *and* the government from introducing evidence related to a specific lender's practices.

The district court rejected this argument.[268] First, the district court explained that the government "must establish that the allegedly false statements were, in fact, false," which requires providing the jury with necessary context related to the bank's loan consideration process.[269] Furthermore, the defendant, Casher, was a loan officer and market president for RMB who approved the loans at issue in the case,[270] so evidence of his role was "relevant to the Government's case at a fundamental level."[271]

Second, the district court explained that although *Lindsey II* "limits a defendant from admitting evidence of lender behavior to avoid confusing the jury into believing actual reliance on a defendant's false statements is an element of fraud,"[272] on the other hand, "[t]he Government … is free to introduce this evidence when it attempts to demonstrate that the defendant's statements were false and material."[273] In fact, the court noted

[265] United States v. Casher, No. CR 19-65-BLG-SPW, 2020 WL 2557849, at *1–2 (D. Mont. May 20, 2020).

[266] *Id.* at *2.

[267] *Id.*

[268] *Id.*

[269] *Id.* at *2.

[270] According to the superseding indictment, the defendant, Casher, made private loans to Larry Price, "while simultaneously approving loans, in Casher's capacity as a loan officer and market president of RMB, to entities controlled by Price and for which Price was a guarantor—all without disclosing the private loans to RMB." *Id.* at *1.

[271] *Id.* at *2.

[272] *Id.*

[273] *Id.*

that Casher had been "unable to provide any cases where a court prevented the Government from admitting evidence of a victim bank's loan process regarding the loans at issue or of actual reliance on a defendant's misrepresentations."[274] The district court's reasoning boiled down to one key conclusion: "[E]vidence of non-reliance is highly prejudicial to the Government, but evidence of reliance is not highly prejudicial to the defense."[275] Why is this the case? Why does *Lindsey II*'s evidentiary gate only swing one way? The district court explained:

> If a defendant submits evidence of negligent reliance or evidence of other bad loan practices, the evidence is highly prejudicial and misleading because it implies the Government must prove an additional element: actual reliance. The Court would most likely find the probative value of the lender's past behavior (if any probative value existed) was substantially outweighed by the danger of unfair prejudice, confusing the issues, and misleading the jury.[276]

According to *Casher*, the same conclusion does follow, however, if it is the government, and not the defendant, who seeks to introduce such reliance evidence:

> On the other hand, if the Government introduces evidence of actual reliance, the evidence is not highly prejudicial to the defendant because it does not, for example, reduce the number of elements the Government must prove. *Rather, actual reliance can be highly probative of whether the allegedly false statements were material.* The jury is then left to decide whether the victim bank's subjective reliance on the false statements indicates the false statements were objectively material. If necessary, the Court could accept a limiting instruction explaining as much.[277]

The emphasized part of the quote above is essential. According the district court in *Casher*, evidence of actual reliance tends to prove materiality, but even if evidence of non-reliance could tend to prove *immateriality* such evidence is highly prejudicial and misleading.[278] Thus, in the case at hand, the district

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[274] *Id.*
[275] *Id.* at *3.
[276] *Id.*
[277] *Id.* (emphasis added).
[278] *Id.*

court ruled that the government "might elicit testimony from RMB employees about the importance of the information contained in the loan documents,"[279] and "may also elicit testimony that RMB did rely on the false statements and likely would not have approved the loans at issue had it known of the misrepresentations."[280]

The district court did make two concessions to Casher.[281] First, the court acknowledged that if the government opens the door by soliciting testimony regarding the bank's actual reliance on the alleged misrepresentations to establish materiality, "the defendant may cross-examine and submit evidence of his own to cast doubt on whether the lenders did rely on the false statements and whether the information was capable of influencing their decision-making."[282] The court cautioned: "However, the defendant could only submit contrasting evidence for this limited purpose (e.g., he could not then submit evidence of *other* bad loans that the bank approved)."[283] Second, the district court pointed out that under *Lindsey II*, the defendant "is free to rebut the Government's evidence by testimony of industry practices."[284] Thus, "Casher may attempt to show RMB acted unreasonably and that a reasonable bank would not have relied on the defendant's false statements—i.e., the misrepresentations were immaterial. Again, the jury would be left to decide, when comparing both parties' evidence, whether the false statements were material."[285]

Casher thus illustrates an advantage that the government possesses in criminal fraud cases under *Lindsey II*: the government may introduce evidence regarding a financial institution's actual reliance to prove materiality, while the defendant may not touch on a bank's lack of reliance (except to rebut the government's reliance evidence).[286] Defendants must steer clear of

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[279] *Id.* at *2.

[280] *Id.* (citing United States v. Ovist, 2012 WL 5830296, at *7 (D. Or. Nov. 16, 2012)) ("[T]o decide whether the false statements had a natural tendency to influence, or were capable of influencing, the decisions of the lenders, the jury must know something about the lenders' decision-making process.").

[281] *See infra* notes 282–85 and accompanying text.

[282] *Casher*, No. CR 19-65-BLG-SPW, 2020 WL 2557849, at *2 n.1.

[283] *Id.*

[284] *Id.* at *3 (citing *Lindsey II*, 850 F.3d 1009, 1016 (9th Cir. 2017)).

[285] *Id.*

[286] *See Lindsey II*, 850 F.3d at 1017.

evidence regarding the target financial institution's lack of actual reliance and, instead, focus on proof that a hypothetical reasonable lender would not have been sufficiently influenced—to whatever extent demanded by the law—by the defendant's misrepresentations. As sensible as this might seem, it may not be easy for fraud defendants to explore the question of what a hypothetical financial institution might do without either entering forbidden reliance territory or, even worse, suggesting that the victim was somehow at fault for the defendant's fraud, which is also problematic. The next and final part of this Article explores these complications.

V. OBJECTIVE AND SUBJECTIVE MATERIALITY RECONSIDERED

A. Two Materiality Paths?

Throughout this Article, we have explored an issue that has concerned courts and lawyers since *Neder* was decided more than 20 years ago: whether an objective or subjective materiality test applies in mail, wire, and bank fraud cases involving financial institutions. The two case studies in this Article, *Lindsey II* and *Raza*, suggest that the answer to the question is simple: materiality in federal criminal fraud cases is judged under an objective standard.[287] To paraphrase *Raza,* materiality requires that we focus on reasonable lenders and not renegade banks.[288] Unfortunately, this answer may be misleading insofar as it suggests that there is only one way to prove materiality.[289] It is true

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[287] *See supra* notes 232–33 and accompanying text.

[288] *See* United States v. Raza, 876 F.3d at 621 (4th Cir. 2017) ("[T]he correct test for materiality ... is an objective one, which measures a misrepresentation's capacity to influence an objective 'reasonable lender,' not a renegade lender with a demonstrated habit of disregarding materially false information.").

[289] Thus far, criminal fraud defendants have been unsuccessful in their efforts to get the Supreme Court to wade in further on this issue, despite their claims that a circuit split exists on materiality standards. *See Raza* Cert. Petition, *supra* note 192; Petition for Writ of Certiorari, United States v. Betts-Gaston, 860 F.3d 525 (7th Cir. 2017), *cert. denied*, 138 S. Ct. 689 (2018) (No. 17-705), available on Westlaw at 2017 WL 5433144. For example, Raza's unsuccessful petition for a writ of certiorari argued:

> The circuits are intractably divided over the standard for proving *materiality* in federal fraud prosecutions involving a private, as opposed to a government, victim. For private victims, some

that the government can establish a criminal fraud case with *objective* materiality evidence based upon a reasonable lender.[290] Numerous federal appellate court cases, including *Lindsey II* and *Raza*, make this clear.[291] For example, if mortgage loan applicants accused of fraud lied about their family income and provided falsified tax documents in support of their false income claims, the government would introduce evidence that prudent lenders care very much about a borrower's income to establish the required element of materiality. The earlier discussion of *Raza* provided a myriad of examples of income, employment and savings misrepresentations in the context of mortgage fraud.[292]

> circuits have held that a misrepresentation is *material* only if it could influence the decision of the actual decisionmaker to which the misrepresentation was addressed. Other circuits, by contrast, have held that a misrepresentation is *material* as long as it could influence the decision of a hypothetical "reasonable person."

Raza Cert. Petition, *supra* note 192, at 2 (asserting that "the circuits are deeply divided on a fundamental question: the standard for determining the materiality of a misrepresentation made to a private victim"); Petition for Writ of Certiorari, Shin v. United States, No. CR 04-00150 SOM, 2017 WL 2802866 (D. Haw. June 28, 2017), *aff'd*, 782 F. App'x. 595 (9th Cir. 2019), *cert. denied*, 140 S. Ct. 1123 (2020) (No.19-848), available online at 2020 WL 93924 ("The Circuits disagree over the standard for proof of materiality in federal fraud prosecutions and disagree as to whether the 'demanding' materiality requirement that necessitated clarification in [*Escobar*] altered how rigorously that standard must be imposed.") (case involving False Statements prosecution under 18 U.S.C. § 1001(a)(3)).

In contrast, the United States Solicitor General's Office has taken the view that no true circuit split exists on the materiality standards in criminal fraud cases. Brief for the United States in Opposition, United States v. Raza, 876 F.3d 604 (4th Cir. 2017), *cert. denied*, 138 S. Ct. 2679 (2018) (No. 17-1314), available online at 2018 WL 2299235, at 16–17 (collecting cases). Instead, the U.S. Government has asserted that "every court of appeals has stated that a false statement or omission is material if it is capable of influencing a reasonable decisionmaker." *Id.* at 17; *see also id.* at 18–19 ("Petitioners cite no court of appeals decision holding that a misstatement or omission cannot be material if it is capable of influencing a reasonable decisionmaker, but not the intended victim."); *id.* at 20 (asserting that no cases "turned on the difference between the fraud's effect on the intended victim, as opposed to its effect on a reasonable decisionmaker").

[290] *Raza*, 876 F.3d at 621.

[291] *See id.*; *see also Lindsey II*, 850 F.3d 1009, 1014 (9th Cir. 2017).

[292] *See supra* text accompanying notes 194–96 (discussing *Raza*, 876 F.3d at 609–11).

Furthermore, if the government establishes its case with objective materiality evidence, to disprove materiality, the defendants could argue that a hypothetical reasonable lender would not have cared enough about the misrepresentations, thus rendering them immaterial. Obviously, that would be difficult to prove with respect to misstated job titles, income, and assets. On the other hand, it might be possible to establish a lack of materiality if the particular information requested by the lender typically is unimportant in lending decisions according to accepted industry norms. In *Lindsey II*, Judge Gould provided the following example:

> To illustrate, suppose a defendant is charged with wire fraud for falsely stating on a loan application that he was married. In such a case, it would be admissible for a defense expert to testify that, while mortgage applications usually ask about marital status, the general practice in the industry is to ignore marital status when making lending decisions. The defendant could then argue in closing that his false statement about marriage was immaterial, and so the elements of wire fraud have not been proven. By contrast, a district court could properly exclude evidence that (a) the particular lender to whom the defendant lied did not generally give weight to marital status when deciding whether to lend, or (b) there were prior instances in which that lender did not consider marital status in making loans.[293]

Nevertheless, the fact that the government may (and typically will) establish its case with objective materiality evidence does not necessarily mean that the government is precluded from establishing a criminal fraud case with *subjective* materiality evidence instead.[294] Thus, we can see why the plain answer above gleaned from *Lindsey II* and *Raza*—that materiality is judged according to an objective test—may be misleading. As the Eleventh Circuit observed in *Svete*: "The objective reliability of a misrepresentation is sufficient to establish its materiality, but proof of

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[293] *Lindsey II*, 850 F.3d at 1016.

[294] The Eleventh Circuit asserted that "[a]ll the sources cited by the Supreme Court" in *Neder* "support the proposition that materiality may be proved without establishing that the misrepresentation was objectively reliable." United States v. Svete, 556 F.3d 1157, 1164 (11th Cir. 2009) (en banc); *see also* Couture, *supra* note 58, at 8 (noting that "[b]oth definitions of materiality cited in *Neder* include within their reach statements that an objectively reasonable person would not regard as important").

objective reliability is not necessary to establish materiality if the defendant knows or should know that the victim is likely to regard the misrepresented facts as important."[295] Thus, under *Svete*, materiality can be established with either proof that a reasonable person would have been sufficiently influenced by the defendant's misrepresentations (objective materiality evidence) or proof that the defendant knew that the specific target or intended recipient was likely to be influenced by the defendant's misrepresentations, regardless of whether a reasonable person would have been so influenced (subjective materiality evidence).[296] There are two alternative materiality paths.[297]

In practice, however, one can assume it will be relatively rare for a federal criminal fraud case involving a financial institution

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[295] *Svete*, 556 F.3d at 1165.

[296] Several authors have advocated in favor of a subjective materiality standard in federal fraud cases. *See* Couture, *supra* note 58, at 7 (asserting that "[i]n the wire and mail fraud context ... materiality is a subjective standard"); Lunsford, *supra* note 84, at 386 ("Based on the text, history, and current interpretations of the mail and wire fraud statutes, it is both the intent of Congress and the interpretation of the Supreme Court that the objective standard for materiality has no place in the federal statutory scheme for fraud crimes."). A fair reading suggests that the argument being advanced in such scholarly works is that an objective materiality should not be applied to the exclusion of subjective materiality—not that subjective materiality alone should be the only path to proving fraud. This is the approach of the Eleventh Circuit in *Svete*, 556 F.3d at 1164–65.

[297] Recall the *Restatement (Second) of Torts* alternative definitions of materiality and the *Gaudin/Kungys* materiality definition. *See supra* Section I.C.1. The first prong of the Restatement test embodies objective materiality: a matter is material if "a reasonable man would attach importance to its existence or nonexistence in determining his choice of action in the transaction in question." RESTATEMENT (SECOND) OF TORTS § 538(2)(a) (AM. L. INST. 1977). The second prong of the *Restatement* materiality definition embodies subjective materiality: a matter is material if "the maker of the representation knows or has reason to know that its recipient regards or is likely to regard the matter as important in determining his choice of action, although a reasonable man would not so regard it." *Id.* § 538(2)(b). As discussed earlier, there is debate as to whether *Neder* intended that the *Restatement (Second) of Torts* materiality standards would apply in federal criminal fraud cases. *See supra* notes 88–92 and accompanying text. The two prongs of the Restatement's materiality standard are being used here for illustration only. The *Gaudin/Kungys* materiality definition similarly includes a subjective component. *See* Couture, *supra* note 39, at 80 (explaining that both materiality standards in *Neder* include a subjective component).

to be predicated upon purely subjective materiality evidence. In civil contract and torts cases involving individuals there may be occasions where a fraudster preys on a person's known idiosyncrasies,[298] thus satisfying subjective materiality but not the objective materiality test. Charlie Brown might want to buy a used car once owned by his childhood baseball hero, Joe Shlabotnik,[299] even if this fact of prior ownership would be of little interest to most reasonable auto consumers. Charlie Brown's preference (if known) could be exploited by a sleazy used car salesperson. It seems less likely, however, that a bank or other financial institution would have idiosyncratic preferences, much less that a borrower would be aware of these unique preferences and then lie to a bank to exploit them. It is not impossible, of course, just not very likely. Thus, while theoretically, the government can establish materiality with either objective or subjective materiality evidence in mail, wire and bank fraud cases, the use of objective materiality evidence is more likely in cases involving financial institutions.[300]

B. Gullible Banks

Alleged fraudsters may wish to argue that a financial institution or its staff was incompetent, unreasonable, or even complicit in the fraud scheme.[301] Putting aside the law, we can see why a

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[298] *See supra* notes 74–76 and accompanying text.

[299] *See Peanuts Wiki: Joe Shlabotnik*, FANDOM, https://peanuts.fandom.com/wiki/Joe_Shlabotnik [https://perma.cc/E5U6-7XDR].

[300] There are some unusual cases that might appear difficult to characterize on the objective/subjective divide. In one "rather unusual bank fraud case," *United States v. Rigas*, 490 F.3d 208, 234 (2d Cir. 2007), the Second Circuit explained: "If a bank's discretion is limited by an agreement, we must look to the agreement to determine what factors are relevant, and when a misstatement becomes material." *Id.* at 235. This evidence might seem "subjective" in a sense in that the court is considering what the particular bank involved in the case might have done under the circumstances. *Id.* But this materiality evidence can also be viewed as "objective," as the court is considering what a reasonable decision-maker, cabined by the applicable contractual agreements would have done under the circumstances. *Id.* (explaining that "[t]he only 'decisions' that the bank could make, in the case the government presented to the jury, involved how much interest would be charged—an objective decision cabined by the ranges set in the Co-Borrowing Agreements").

[301] It must also be pointed out that the victim under federal fraud statutes is the financial institution itself, not its duplicitous or incompetent staff. *See*

criminal defense attorney would like the jury to hear about a lender's culpability. Whether phrased in terms of a defendant's lack of fraudulent intent or an absence of materiality in the defendant's misstatements, blaming the lender is likely to be a losing argument.[302] Numerous federal appellate court opinions have held that it is no defense to criminal fraud that the victims were negligent or gullible.[303] According to the Fourth Circuit, this principle applies with equal force to banks and other financial institutions:

> The susceptibility of the victim of the fraud, in this case a financial institution, is irrelevant to the analysis: "If a scheme to defraud has been or is intended to be devised, it makes no difference whether the persons the schemers intended to defraud are

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Scott Mah et al., *Financial Institutions Fraud*, 57 AM. CRIM. L. REV. 787, 800 (2020) ("[K]nowledge of the scheme or even participation in the scheme by the defrauded bank's officers adds no support to a 'good faith' defense because it is the financial institution itself, and not one of its officers, that is being defrauded.") (citing United States v. Hamaker, 455 F.3d 1316, 1325 (11th Cir. 2006); United States v. Rackley, 986 F.2d 1357, 1361 (10th Cir. 1993); United States v. Saks, 964 F.2d 1514, 1518–19 (5th Cir. 1992)); *see also* United States v. Jimenez, 513 F.3d 62, 74 (3d Cir. 2008) (citing United States v. Waldroop, 431 F.3d 736, 742 (10th Cir. 2005)) (explaining that the financial institution, not its officers or agents, is the victim of a bank fraud scheme).

[302] *See* United States v. Gaver, No. 19-4026, 2020 WL 2770600, at *2 (4th Cir. May 28, 2020) (concluding that the district court did not abuse its discretion in excluding "certain evidence relating to the victims' alleged negligence, complicity, or actual knowledge of [the defendant's] fraudulent scheme").

[303] United States v. Svete, 556 F.3d 1157, 1165 (11th Cir. 2009) (en banc) (stating that "a defendant who intends to deceive the ignorant or gullible by preying on their infirmities is no less guilty" of mail fraud); United States v. Weaver, 860 F.3d 90, 95 (2d Cir. 2017) ("[T]he unreasonableness of a fraud victim in relying (or not) on a misrepresentation does not bear on a defendant's criminal intent in designing the fraudulent scheme, whereas the materiality of the false statement does."). As the Second Circuit explains:

> The "unreasonable victim" argument misapprehends the function of the ordinary prudence standard. To establish a violation of the federal fraud statutes, the government must prove a scheme to defraud. Critical to this showing is evidence that the defendant "possessed a fraudulent intent." The role of the ordinary prudence and comprehension standard is to assure that the defendant's conduct was calculated to deceive, not to grant permission to take advantage of the stupid or careless.

United States v. Thomas, 377 F.3d 232, 242 (2d Cir. 2004) (footnote and citations omitted).

> gullible or skeptical, dull or bright. These are criminal statutes, not tort concepts."[304]

Still, it must be acknowledged that there are some authorities—a minority view to be sure—that suggest that a criminal fraud conviction requires proof that that reasonable person would have been fooled by the defendant's scheme.[305] For example, the Sixth Circuit has asserted that "[a] fraudulent scheme must include a material misrepresentation, which is a misrepresentation that could influence the decision of a 'person[ ] of ordinary prudence and comprehension.'"[306] The Tenth Circuit has made similar claims.[307] Despite such statements of law, it is hard to find appellate court decisions that have overturned federal fraud convictions because a fraud scheme that succeeded against a gullible target would not have fooled a reasonably prudent person.[308] The trend in the law is clear:

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[304] United States v. Colton, 231 F.3d 890, 903 (4th Cir. 2000) (quoting United States v. Brien, 617 F.2d 299, 311 (1st Cir. 1980)). As Judge Posner once wrote for the Seventh Circuit: "It would be very odd for the law to protect only those who, being able to protect themselves, do not need the law's protection. In fact picking on the vulnerable normally makes your conduct more rather than less culpable, earning you a heavier sentence." United States v. Coffman, 94 F.3d 330, 334 (7th Cir.1996).

[305] In *Svete*, Chief Judge Edmonson argued that the common law of fraud and the federal mail fraud statute require "the government ordinarily to show that the pertinent scheme or misrepresentation was *capable* of inducing reliance on the part of a reasonable person exercising ordinary prudence for the protection of his own interests." *Svete*, 556 F.3d at 1170 (Edmondson, C.J., concurring in the result) (footnote omitted).

[306] United States v. Petlechkov, 922 F.3d 762, 766 (6th Cir. 2019) (quoting United States v. Jamieson, 427 F.3d 394, 415–16 (6th Cir. 2005)); *Jamieson*, 427 F.3d at 415 ("It is well-established in this circuit that a scheme to defraud, as prohibited by the mail fraud statute, 'must involve misrepresentations or omissions reasonably calculated to deceive persons of ordinary prudence and comprehension.'" (quoting Berent v. Kemper Corp., 973 F.2d 1291, 1294 (6th Cir. 1992) (quoting Walters v. First Tennessee Bank, 855 F.2d 267, 273 (6th Cir. 1988)))).

[307] United States v. Fredette, 315 F.3d 1235, 1241 (10th Cir. 2003) (stating that "in order to prove a scheme to defraud, 'the government must show conduct intended or reasonably calculated to deceive persons of ordinary prudence or comprehension'" (quoting United States v. Janusz, 135 F.3d 1319, 1323 (10th Cir. 1998))).

[308] In *Svete*, the Eleventh Circuit overruled what may have been one such rare case, *United States v. Brown*, 79 F.3d 1550 (11th Cir.1996). *See Svete*,

> A few circuits have, without connecting their pronouncements to the materiality standard, stated that a fraudulent scheme must be credible enough to influence a reasonable person in order to be actionable as wire or mail fraud. The trend, however, is away from this minority rule and toward using the credibility of the scheme merely as an indicator of whether the defendant possessed the requisite intent to defraud.[309]

What if a defendant instead argues that any reasonable financial institution would be too savvy or sophisticated to be fooled by a particular scheme? In one interesting case, bank fraud defendants argued that proof of materiality was not satisfied because the $15 million cashier's check involved in the case "was so obviously fraudulent that no bank official could have been influenced to take any action in reliance on it."[310] In essence, the fraudsters were not saying that the victim was too gullible for their actions to count as fraud, rather they were arguing that their scheme was too dumb to count as criminal fraud.[311] The Eighth Circuit rejected that argument, once again distinguishing materiality from reliance:

> Here, the nature of the item itself was evidence of materiality. The evidence showed that defendants presented bank employees with a fraudulent Bank of America cashier's check and made false statements about the check in order to influence the bank to negotiate it. The fact that the cashier's check was obviously fraudulent (apparently the check was the wrong size and printed on the wrong type of paper, the check was made out to bearer

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556 F.3d at 1168 ("According to one treatise, *Brown* 'is the only major criminal case where the court absolved the defendants by finding unreasonable reliance by the alleged victim of fraud.'" (citing 1 JOEL ANDROPHY, WHITE COLLAR CRIME § 8:2.70 (2d ed. 2006))).

[309] Couture, *supra* note 58, at 8–9 (footnotes omitted); *see also* Wang, *supra* note 83, at 277–78 (stating that "some circuits *may* endorse the 'reasonable person' or 'person of ordinary prudence' definition: mail/wire fraud is material only if a 'reasonable person' would attach importance to the misstatement or nondisclosure," whereas "[o]ther circuits have abandoned the 'reasonable person' standard of *materiality* in favor of the broader formulation: capable of influencing the intended victim").

[310] United States v. Rashid, 383 F.3d 769, 778 (8th Cir. 2004), *cert. granted, judgment vacated on other grounds sub nom.* Abu Nahia v. United States, 546 U.S. 803 (2005).

[311] *See Rashid*, 383 F.3d at 772–73. The unsuccessful fraud scheme was discovered quite easily by bank personnel. *See id.*

> only, the bank logo was wrong, and the perforation was in the wrong place) does not mean that it was not material, that is, that it did not have a natural tendency to influence the bank or was not capable of influencing the bank. The fact that the bank was not actually influenced or actually deceived does not mean that the check and defendants' false statements about the check were not material.[312]

The outcome in Rashid seems tough to dispute given the defendant's obvious fraudulent intent and the undisputed falsity of the $15 million check.[313] But there is something curious in the Eighth Circuit's materiality reasoning. *Rashid* implies that an "obviously fraudulent" check could have the natural tendency to influence or could be capable of influencing a bank.[314] There is no explanation, however, as to why this is the case. If someone tries to deposit a suitcase full of Monopoly™ money at a bank and informs the teller that it is legal currency, would that be a material misrepresentation? Under *Rashid*, the falsehood could be material, though there seems to be something odd about that outcome given that no reasonable bank would or could be fooled in such a manner.[315] How does a suitcase full of Monopoly™ money differ from a crudely created cashier's check for $15 million? The distinction is unclear. Perhaps the simple answer is that the Monopoly™ money scam could indeed land someone in federal prison, as absurd as that seems.

C. Endemic Irrationality

The foregoing discussion leads to the ultimate materiality conundrum. What if an entire industry is, in some sense, unreasonable? This is essentially what scholars have argued about a vast part of the mortgage lending industry in the years preceding the

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[312] *Id.* at 778–79.

[313] *See id.* at 772.

[314] The Eighth Circuit did not actually say this—what the court stated was that "[t]he fact that the cashier's check was obviously fraudulent ... does not mean that it was not material, that is, that it did not have a natural tendency to influence the bank or was not capable of influencing the bank." *Id.* at 778–79. It would have been more direct for the *Rashid* court to have stated that the obviously fake cashier's check in the case was material, though the Court of Appeals chose not to do so.

[315] Nor does this seem to be a case of exploiting the gullible, as just discussed.

Great Recession.[316] When few lenders are sleazy or incompetent renegades and the vast majority of financial institutions are prudent, the application of an objective materiality standard seems sensible and easy to administer. What if, instead, a lack of due diligence is endemic? What if innumerable lenders continually and regularly act in a foolish, suboptimal or otherwise improper manner? The role of materiality as a required element of criminal fraud is unclear if such behavior becomes the norm. In an effort to adhere to an "objective" materiality standard, courts may end up holding criminal defendants to a normative materiality standard based on what *should* theoretically affect relevant bank decision-makers, even though we as a society know that financial institutions may be disregarding these principles systematically.[317] If the purpose of requiring proof of materiality is connected somehow to establishing the defendant's *mens rea* or fraudulent intent,[318] applying a fictional materiality standard unconnected to actual bank behavior might be an undesirable outcome.

CONCLUSION

The Supreme Court has made it clear that proof of materiality is required for convictions under the federal mail, wire and bank fraud statutes.[319] During the past twenty years, the federal courts have endeavored to apply materiality to federal fraud cases involving financial institutions.[320] This task is easier said than done. Transplanting an elusive common law concept to the federal criminal law context has proven quite challenging.[321]

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[316] *See generally* KATHLEEN C. ENGEL & PATRICIA A. MCCOY, THE SUBPRIME VIRUS: RECKLESS CREDIT, REGULATORY FAILURE, AND NEXT STEPS (2011); Edwards, *supra* note 9, at 60–68 (discussing the rise of non-prime lending, a decline in home loan underwriting standards, and increased securitization of mortgage debt prior to the Great Recession).

[317] David Kwok raises a similar point in his discussion of normative and descriptive conceptions of materiality in the False Claims Act context. *See* Kwok, *supra* note 80, at 532 (explaining that "courts may conflate the normative and descriptive approaches to causation, as it is unclear whether a juror should apply her judgment as to what lies should influence the government as opposed to which lies actually influence the government").

[318] *See supra* note 82; *supra* text accompanying note 83.

[319] *See supra* Section I.C.

[320] *See supra* Section I.C.2.

[321] *See supra* Section I.C.2.

The Supreme Court's decision in *Escobar* provided the federal appellate courts with an opportunity to reconsider the role of materiality in criminal fraud cases.[322] Thus far, the federal appellate courts have rejected the application of *Escobar*'s "subjective" materiality standard to the criminal fraud context.[323] Instead, the courts of appeals have endorsed an objective materiality standard tethered to what a reasonable lender would do—not the behavior of renegade lenders.[324]

Although limiting *Escobar* to the False Claims Act context may be correct,[325] the manner in which courts have interpreted and applied *Escobar* shows deep judicial skepticism towards criminal defendants who try to challenge the government's materiality evidence.[326] Courts must remember, however, that materiality is a required element for the government to establish beyond a reasonable doubt—immateriality is not an affirmative defense that criminal defendants must prove.[327] Materiality may not be hard to prove—especially in mortgage fraud cases—but it is still the government's burden to do so.[328] Furthermore, if an entire industry's decision-making processes become deeply flawed, as it did prior to the Great Recession, we must ask what it means for false statements to be material and, ultimately, what role materiality plays in our conception of criminal fraud.[329]

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[322] *See supra* Part II.

[323] *See supra* Part III.

[324] *See supra* Part IV.

[325] As the *Escobar* Court explained, "The False Claims Act is not 'an all-purpose antifraud statute.'" Universal Health Servs., Inc. v. United States *ex rel.* Escobar, 136 S. Ct. 1989, 2003 (2016) (quoting Allison Engine Co. v. United States *ex rel.* Sanders, 553 U.S. 662, 672 (2008)). This is in stark contrast to the mail, wire and bank fraud statutes, which are designed as capacious, broad-reaching anti-fraud laws.

[326] *See supra* Part III.

[327] *See supra* Part IV.

[328] *See supra* Part V.

[329] *See supra* Section V.C.