9th Circ. Ruling Shows Lies Must Go To Nature Of Bargain

By **Charles Kreindler and Krista Landis** (June 11, 2024)

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A recent U.S. Court of Appeals for the Ninth Circuit opinion instills the importance of raising an often overlooked defense in federal fraud cases: that the defendant's misrepresentation did not affect the "nature of the bargain."

In U.S. v. Milheiser, the panel vacated six defendants' convictions for mail fraud, holding that merely lying to influence a transaction does not rise to the level of fraud.[1] Instead a "lie must instead go to the nature of the bargain" to support a conviction.

The Milheiser decision joins several federal opinions where the courts appear to be narrowing the scope of behavior that constitutes criminal fraud. And in 2023, the U.S. Supreme Court's decision in Ciminelli v. U.S. also narrowed the scope of fraud statutes to only schemes that harm a victim's traditional property right.

This developing legal landscape requires defense counsel to rethink strategies on how to best defend against federal criminal fraud allegations.

The scheme charged in Milheiser surrounded the defendants' sales of printer toner. The "[d]efendants each owned or managed a sales company that telemarketed printer toner." Their sales company's representatives "would call a business, falsely imply that the sales company was [that] business's regular supplier of toner, and falsely state that the price of toner had increased." The sales representatives would then promise the old price if the business ordered more toner that day.

When the businesses ordered toner from the defendants after these misrepresentations, the defendants would deliver the product at the agreed-upon price.

Based on these facts, several defendants pled guilty before the case even went to trial.

During trial, many witnesses testified that they would not have bought toner from defendants if not for the sales representatives' lies. The government argued that if the defendants made any material representation that induced a victim to part with money, which is often cited as the common law definition of fraud, they should be found guilty.

The U.S. District Court for the Central District of California allowed jury instructions and closing arguments that described "mail fraud as making a misrepresentation that would be expected to and does cause a person to part with money."

In closing, the government stated, "When you lie to somebody on an important fact that causes them to give you money, you have defrauded them. That is mail fraud in a nutshell."

Based on that theory, all six defendants in Milheiser were convicted of mail fraud and conspiracy to commit mail fraud. But on April 9, after considering the appeal, the Ninth Circuit vacated all six convictions, and rejected that broad understanding of fraud for federal

criminal cases. It held that though the sales tactics the defendants employed did deceive their customers, they did not misrepresent or lie about the nature of the bargain.

This decision could be a signal of a shift in federal courts away from overly broad interpretations of fraudulent business activity.

In its decision, the Ninth Circuit cited precedent from the U.S. Courts of Appeals for the Second, Eleventh and District of Columbia Circuits. These circuits have also held that, to commit fraud, a lie "must go to the nature of the bargain," like price, quality or other essential aspects of the transaction.

The Ninth Circuit cited three cases: the U.S. Court of Appeals for the Second Circuit's 1970 decision in U.S. v. Regent Office Supply Co.;[2] the U.S. Court of Appeals for the Eleventh Circuit's 2016 decision in U.S. v. Takhalov;[3] and the U.S. Court of Appeals for the District of Columbia Circuit's decision last year in U.S. v. Guertin.[4]

These decisions all agree that not every false representation that leads someone to part with money rises to the level of federal fraud — specifically in situations where, regardless of the misrepresentation, the alleged "victims 'received exactly what they paid for,'" as noted in the Takhalov opinion.[5]

But it should be noted that not every federal court has adopted this standard for deciding when lies show fraudulent intent. Just this year, the U.S. District Court for the District of Columbia declined to follow the "nature of the bargain" standard in U.S. v. Venkata. The court indicated that it saw "a circuit split (and perhaps an intra-circuit split) on what is required to prove an intent to defraud."[6]

Whether a circuit split develops or not, the Milheiser decision shows that it is now essential to raise the argument that a lie did not go to the nature of the bargain in defense of relevant federal fraud cases in any circuit.

The difference between a material misrepresentation and a lie that goes to the nature of the bargain may seem like a small distinction, but in practice, this change can have an influential impact.

In Milheiser, the defendants certainly lied to their potential customers. The government also showed that these lies were what induced the customers to part with their money to purchase toner, making those material misrepresentations.

However, with this ruling, the court established that the real question is not whether lies were told, but what they were told about. Here, the defendants offered toner and then provided it at the agreed-upon price. Any facts beyond this were extraneous and did not go to the nature of this simple transaction.

When charges involve complex facts and broadly alleged schemes, it will be vital for defense counsel to separate alleged misrepresentations that may seem material from those that actually reach the ultimate terms of the bargain. The Ninth Circuit warned that the nature of the bargain will be very context-specific based on the type of transaction, but it is not yet clear where the line will be.

The Ninth Circuit panel specifically rejected the idea that only direct misrepresentations about price or quality will constitute fraud. For example, if a transaction is dealing with investments, giving false impressions about the size or the health of the investment would

be relevant to the nature of the bargain. But at the same time, the panel decided that lying about who you are doing business with is not necessarily essential to the bargain.

This means that the facts surrounding any alleged fraud need to be properly investigated, the implications of any alleged false statements determined, and the exact nature of the transaction defined.

Most federal fraud prosecutions are not as simple as the printer toner scheme in Milheiser. They can involve multiple parties, many allegedly fraudulent representations and unusual transaction types. In this evolving landscape, it is essential that defense attorneys probe all aspects of the bargain at issue in a case.

After a thorough investigation of the circumstances, defense counsel should seriously consider the merits of filing a motion to dismiss based on these developing legal theories.

Dismissals in district courts are rare in criminal matters, but if there is any indication that the alleged misrepresentations do not go to the nature of the bargain or do not involve traditional property interests, a motion to dismiss is now an essential. The Milheiser decision makes it abundantly clear that this can be a case-winning argument for clients.

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[1] https://law.justia.com/cases/federal/appellate-courts/ca9/21-50162/21-50162-2024-04-09.html.

[2] United States v. Regent Office Supply Co., 421 F.2d 1174 (2d Cir. 1970).

[3] United States v. Takhalov, 827 F.3d 1307 (11th Cir.), as revised (Oct. 3, 2016), opinion modified on denial of reh'g, 838 F.3d 1168 (11th Cir. 2016).

[4] United States v. Guertin, 67 F.4th 445 (D.C. Cir. 2023).

[5] Takhalov at 1314.

[6] United States v. Venkata, --- F.Supp.3d ---- (2024).