

PUNISHING HOPE? MATERIALITY AND IMMATERIALITY IN FEDERAL MORTGAGE FRAUD CASES UNDER 18 U.S.C. § 1014

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ABSTRACT

Over 20 years ago, in *United States v. Wells*, the Supreme Court held that 18 U.S.C. § 1014, which criminalizes false statements to financial institutions, does not contain a materiality requirement. Justice Stevens issued a forceful dissent, arguing that the Court’s holding created the risk that foolish borrowers could be imprisoned for minor falsehoods or even mere flattery. This Article explores the enduring, and at times unexpected, effects and implications of *Wells*. In particular, this Article addresses the application of *Wells* to the wave of mortgage fraud cases following the 2007–2008 financial crisis and Great Recession. This Article uses Judge Posner’s decision for the Seventh Circuit in *United States v. Phillips* to illustrate doctrinal and public policy issues that persist under the current mortgage law regime. Almost two decades after *Wells*, Posner, the once hard-hearted leader of the law and economics movement, expressed sympathy for hapless mortgage fraud borrowers exploited by lenders and mortgage brokers. More than anything else, it is evident that the legal system has failed to distinguish adequately between borrowers who truly are deserving of criminal sanctions, and those for whom civil liability and other negative financial consequences would be sufficient punishment.

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INTRODUCTION

There is widespread agreement that a tremendous increase in various forms of fraud and white collar crime played a key role in causing or exacerbating the 2007–2008 financial crisis that led to the Great Recession.¹ This Article addresses one particular type of financial wrongdoing—knowingly misleading lenders into making mortgage loans based on false information, a criminal offense that has been referred to as “mortgage fraud.”² As the Seventh Circuit observed: “charges of mortgage fraud . . . mushroomed in the wake of the collapse of the housing and credit

1. See David O. Friedrichs, *Wall Street: Crime Never Sleeps*, in *HOW THEY GOT AWAY WITH IT: WHITE COLLAR CRIMINALS AND THE FINANCIAL MELTDOWN* 3, 7 (Susan Will, Stephen Handelman & David C. Brotherton eds., 2013) (“The term *crime* has been widely applied to the activities of individuals and institutions regarded as having played a central role in causing the financial crisis.”); but see Ellen S. Podgod, *White-Collar Crime and the Recession: Was the Chicken or Egg First?*, 2010 U. CHI. LEGAL F. 205, 222 (contending that “there is uncertainty about whether white-collar criminality caused the recession”).

2. The meaning of the term “mortgage fraud” and the connections between mortgage fraud and the Great Recession are examined in great detail in Matthew A. Edwards, *The Concept and Federal Crime of Mortgage Fraud*, 57 AM. CRIM. L. REV. 57 (2020) [hereinafter Edwards, *Mortgage Fraud*].

bubbles in the period 2006 to 2008.”³ In the absence of a federal criminal statute specifically barring mortgage fraud,⁴ federal prosecutors routinely charge borrowers, brokers and assorted white collar conspirators under the well-known federal criminal statutes that bar wire,⁵ mail,⁶ and bank fraud,⁷ as well as conspiracies to commit such frauds.⁸

There is, however, an alternative route to criminal liability for misrepresentations in loan applications: 18 U.S.C. § 1014,⁹ which criminalizes certain false statements to statutorily specified financial institutions.¹⁰ One treatise explains the vital importance of this provision to federal prosecutors:

Section 1014 has always been a popular statute with prosecutors

3. United States v. Phillips, 731 F.3d 649, 650 (7th Cir. 2013) (en banc); see also U.S. DEP’T OF JUSTICE, OFFICE OF THE INSPECTOR GEN., AUDIT OF THE DEPARTMENT OF JUSTICE’S EFFORTS TO ADDRESS MORTGAGE FRAUD 45 (2014) (asserting that “the number of mortgage fraud convictions more than doubled from FY 2009 to FY 2010, *i.e.*, from 555 to 1,087 convictions, and then increased further in FY 2011 to 1,118 convictions”). Not all of the cases to which Cole is referring may involve falsehoods on mortgage loan applications.

4. See Edwards, *Mortgage Fraud*, *supra* note 2, at 85 (“Although the federal code currently contains over 4,000 crimes and over 300 fraud and misrepresentation offenses, no federal law specifically defines mortgage fraud.”) (footnotes omitted).

5. 18 U.S.C. § 1343 (2018).

6. 18 U.S.C. § 1341 (2018).

7. 18 U.S.C. § 1344 (2018) provides:

Whoever knowingly executes, or attempts to execute, a scheme or artifice—

(1) to defraud a financial institution; or

(2) to obtain any of the moneys, funds, credits, assets, securities, or other property owned by, or under the custody or control of, a financial institution, by means of false or fraudulent pretenses, representations, or promises;

shall be fined not more than \$1,000,000 or imprisoned not more than 30 years, or both.

8. 18 U.S.C. § 1349 (2018) (covering conspiracy to commit mail, wire, or bank fraud). Mortgage fraud schemes can violate a wide range of additional federal criminal statutes. See Linda P. Marshall, *Making Choices: Charging and Plea Negotiations*, 58 U.S. ATT’YS’ BULL. 18, 18–21 (2010) (collecting statutes commonly applied to mortgage fraud schemes); see also Daniel B. Mestaz, *Building a Mortgage Fraud Defense*, ARIZ. ATT’Y, Jan. 2011, at 18, 21–22 (same); see also Holly A. Pierson, *Mortgage Fraud Boot Camp: Basic Training on Defending a Criminal Mortgage Fraud Case*, CHAMPION, Sept.–Oct. 2007, at 14, 15 n.3 (same).

9. See 18 U.S.C. § 1014 (2018) (“Whoever knowingly makes any false statement or report . . . for the purpose of influencing in any way the action of . . . any institution the accounts of which are insured by the Federal Deposit Insurance Corporation [and numerous other entities] . . . shall be fined not more than \$1,000,000 or imprisoned not more than 30 years, or both.”).

10. The current text of the statute lists numerous specific entities, including, *inter alia*, mortgage lending businesses, institutions insured by the Federal Deposit Insurance Corporation, and State-chartered credit unions. 18 U.S.C. § 1014 (2018).

because the elements of a Section 1014 violation are relatively simple for a jury to grasp and because the proof typically consists of documentary evidence that is difficult for the defendant to refute. As a consequence, Section 1014 prosecutions have been quite common and have resulted in a relatively high conviction rate.¹¹

This Article explores the origins and enduring implications of a key doctrinal distinction between the federal wire, mail, and bank fraud statutes and 18 U.S.C. § 1014: the Supreme Court has held that § 1014 does not contain a materiality requirement.¹² The lack of a materiality requirement under § 1014 permits (in theory at least) federal criminal prosecutions, and the possibility of rather severe penalties,¹³ for immaterial mortgage application misstatements. The Article proceeds as follows. Part I provides background on the two Supreme Court decisions, *United States v. Wells*,¹⁴ and *Neder v. United States*,¹⁵ which together establish that § 1014 does not require proof of materiality, while the federal mail, wire and bank fraud statutes all require materiality. In particular, Part I part focuses on Justice Stevens's dissent in *Wells*, and the specter Stevens raised of the possibility of borrowers being sent to prison for mere flattery.

The remainder of the Article discusses the interpretation and application of § 1014 in the more than 20 years since *Wells* was decided. Part II addresses the oddity of how federal prosecutors have continued to charge defendants with making “material” misstatements in § 1014 cases, even though proof of materiality is not required under existing Supreme Court case law. Part III explores one of the unusual, and likely unexpected, implications of *Wells*—its application to immigration cases involving the possible deportation of those who have been convicted of violating § 1014. Part IV investigates the application of § 1014's non-materiality rule to the wave of mortgage fraud cases following the 2007-2008 financial crisis and the Great Recession. In particular, the Article uses the Seventh Circuit's important *en banc* decision in *United States v. Phillips*¹⁶ to illustrate the doctrinal and public policy issues that persist under the current mortgage law regime. Finally, Part V of the Article concludes with possible lessons

11. 1 JOHN K. VILLA, BANKING CRIMES: FRAUD, MONEY LAUNDERING AND EMBEZZLEMENT § 4:3 (2019).

12. See *infra* Part I.A.

13. The current version of the statute carries a maximum fine of \$1,000,000 or 30 years in prison. 18 U.S.C. § 1014 (2018).

14. *United States v. Wells*, 519 U.S. 482 (1997).

15. *Neder v. United States*, 527 U.S. 1 (1999).

16. *United States v. Phillips*, 731 F.3d 649, 650 (7th Cir. 2013) (*en banc*).

that scholars, policymakers and practicing criminal law attorneys may take away regarding current judicial doctrine on mortgage fraud and § 1014.

I. SUPREME COURT DOCTRINE ON MATERIALITY UNDER 18
U.S.C. § 1014

A. Wells and Neder

Fraudulent misrepresentations can give rise to criminal liability,¹⁷ justify voiding a contract,¹⁸ and, of course, provide grounds for civil tort claims.¹⁹ As federal prosecutors and defense attorneys are well aware, however, the elements of fraud as a tort do not necessarily carry over to the criminal context.²⁰ Most important for this Article, in stark contrast to tort

17. See William J. Stuntz, *Commentary, O.J. Simpson, Bill Clinton, and the Transsubstantive Fourth Amendment*, 114 HARV. L. REV. 842, 863 (2001) (observing that there are over 300 federal criminal fraud and misrepresentation offenses).

18. See RESTATEMENT (SECOND) OF CONTRACTS § 164(1) (AM. LAW INST. 1981) (“If a party’s manifestation of assent is induced by either a fraudulent or a material misrepresentation by the other party upon which the recipient is justified in relying, the contract is voidable by the recipient.”). The Restatement § 164(2) seems to distinguish between fraudulent misrepresentations and material misrepresentations, which suggests that materiality may not be required for rescission due to fraud. See Emily Sherwin, *Nonmaterial Misrepresentation: Damages, Rescission, and the Possibility of Efficient Fraud*, 36 LOY. L.A. L. REV. 1017, 1018–19 (2003) (explaining that, under the black letter law, rescission does not require proof of materiality).

19. See RESTATEMENT (SECOND) OF TORTS § 525 (AM. LAW 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.”). Simply put, “[t]o establish fraud in tort, the victim must prove that the party who committed fraud made a false statement of material fact with knowledge of the falsity and intent to deceive, on which the victim justifiably relied, and which caused the victim injury.” Kathleen C. Engel & Thomas J. Fitzpatrick IV, *Complexity, Complicity, and Liability up the Securitization Food Chain: Investor and Arranger Exposure to Consumer Claims*, 2 HARV. BUS. L. REV. 345, 353 (2012); see also Douglas R. Richmond, *Fraud and Misrepresentation Claims Against Lawyers*, 16 NEV. L.J. 57, 64–65 (2015) (surveying different state approaches to fraud).

20. Nevertheless, even prominent federal law enforcement officials can exhibit confusion over the distinctions between civil and criminal fraud law. U.S. District Court Judge Jed Rakoff (S.D.N.Y.) notably criticized Lanny Breuer, then head of the DOJ’s Criminal Division, for publicly misstating that prosecutors had to prove reliance in criminal fraud cases. See JESSE EISINGER, *THE CHICKENSHIT CLUB: WHY THE JUSTICE DEPARTMENT FAILS TO PROSECUTE EXECUTIVES* 311 (2017) (noting that Rakoff “skewed Lanny Breuer for having mischaracterized the criminal law”); Rena Steinzor, *White-Collar Reset: The DOJ’s Yates Memo and Its Potential to Protect Health, Safety, and the Environment*, 7 WAKE FOREST J.L. & POL’Y 39, 62–63 (2017) (“As for erroneous interpretations of the law,

law,²¹ not every federal crime involving deceit or misrepresentation requires proof of materiality.²²

Two Supreme Court cases from the late 1990's form the essential bedrock for understanding materiality requirements in criminal prosecutions for so-called mortgage fraud.²³ First, in 1997, the Supreme Court held, in *United States v. Wells*, that 18 U.S.C. § 1014, which criminalizes the making of false statements to certain financial institutions,²⁴ did not contain a materiality requirement.²⁵ Just two years

Rakoff explains that when Breuer was head of the Criminal Division, he claimed erroneously that the legal standard for proving criminal culpability was not only that a defendant made a fraudulent claim but also that the other party to the transaction 'relied on' what the defendant had said." (citing Jed S. Rakoff, *The Financial Crisis: Why Have No High Level Executives Been Prosecuted?*, N.Y. REV. BOOKS (Jan. 9, 2014), <https://www.nybooks.com/articles/2014/01/09/financial-crisis-why-no-executive-prosecutions/> [<https://perma.cc/DPY6-PD7N>]).

21. Both the Restatement (Second) of Torts and the draft Restatement (Third) of Torts confirm the black-letter law principle that proof of materiality is required to establish a valid civil tort claim for fraud. See RESTATEMENT (SECOND) OF TORTS § 538(1) (AM. LAW INST. 1977) ("Reliance upon a fraudulent misrepresentation is not justifiable unless the matter misrepresented is material."); Michael D. Moritz, *The Advent of Scierterless Fraud? Applying Omnicare to Section 10(b) and Rule 10b-5 Claims*, 13 N.Y.U. J.L. & BUS. 595, 598 (2017) ("The draft *Restatement (Third) of Torts* lays out three elements of fraudulent conduct: a material misrepresentation, intent, and justifiable reliance.") (citing RESTATEMENT (THIRD) OF TORTS: LIAB. FOR ECON. HARM § 9 (AM. LAW INST., Tentative Draft No. 2, 2014)); Shannon M. Roesler, *Evaluating Corporate Speech About Science*, 106 GEO. L.J. 447, 473 (2018) (summarizing the new Restatement's fraud definition); *United States v. Rosby*, 454 F.3d 670, 674 (7th Cir. 2006) ("At common law, both materiality (in the sense of tendency to influence) and reliance (in the sense of actual influence) are essential in private civil suits for damages.").

22. At a general level, a matter is material if it is "[o]f such a nature that knowledge of the item would affect a person's decision-making." *Material*, BLACK'S LAW DICTIONARY (11th ed. 2019). According to the Restatement (Second) of Torts, 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. LAW INST. 1977), or "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.* at § 538(2)(b). I am not suggesting, of course, that federal criminal law definitions of materiality track traditional common law tort definitions.

23. There is no official federal mortgage fraud statute and the term "mortgage fraud" lacks a precise meaning in the legal lexicon. Edwards, *Mortgage Fraud*, *supra* note 2, at 83-90 (discussing federal statutes under which mortgage fraud is punished and FBI definitions of mortgage fraud). This Article uses the term mortgage fraud merely to mean intentional misrepresentations, with knowledge of falsity, in connection with mortgage loan applications. With this in mind, the remainder of this Article drops the "so called" qualifier from its discussions of mortgage fraud.

24. See *supra* note 10 (listing some of the financial institutions covered by § 1014).

later, however, in *Neder v. United States*, the Court unanimously held that the federal wire, mail and bank fraud statutes all required proof of a misrepresentation's materiality to sustain a criminal conviction.²⁶

How did the Supreme Court come to opposite conclusions in *Wells* and *Neder*? After all, none of the criminal statutes involved in either case specifically mentioned materiality.²⁷ Although the outcomes differed, both cases illustrate “[t]he age-old principle . . . that words undefined in a statute are to be interpreted and applied according to their common-law meanings.”²⁸ This brings us to the crucial textual point that undergirded the Court's decision in *Wells*: the applicable statute in that case, 18 U.S.C. § 1014, only prohibited “false statements,” not *fraud*.²⁹ In the Court's view, the defendants in *Wells* had not “come close to showing that at common law the term ‘false statement’ acquired any implication of materiality that came with it into § 1014.”³⁰

25. *United States v. Wells*, 519 U.S. 482 (1997).

26. *Neder v. United States*, 527 U.S. 1, 25 (1999) (holding “that materiality of falsehood is an element of the federal mail fraud, wire fraud, and bank fraud statutes”); see also Ellen S. Podgor, *Arthur Andersen, LLP and Martha Stewart: Should Materiality Be an Element of Obstruction of Justice?*, 44 WASHBURN L.J. 583, 597 (2005) (“[T]he *Neder* Court was unanimous in its finding that mail, wire, and bank fraud required the government to prove materiality as an element of the offense.”). Justice Scalia, joined by Justices Souter and Ginsburg, dissented on an unrelated point concerning whether the trial court's jury instruction error should be subjected to harmless error analysis. *Neder*, 527 U.S. at 30–40 (Scalia, J., dissenting).

27. See Alexa Briscoe, *Mail and Wire Fraud*, 50 AM. CRIM. L. REV. 1245, 1250 (2013) (explaining that “[i]n *Neder*, the Court acknowledged that the mail and wire fraud statutes make no mention of a materiality”) (citing *Neder*, 527 U.S. at 22–23); CHARLES DOYLE, CONG. RESEARCH SERV., MAIL AND WIRE FRAUD: A BRIEF OVERVIEW OF FEDERAL CRIMINAL LAW 7 (2011), <https://fas.org/sgp/crs/misc/R41930.pdf> [<https://perma.cc/9BLT-DAKN>] (“Neither the mail nor the wire fraud statute exhibits an explicit reference to materiality”).

28. ANTONIN SCALIA & BRYAN A. GARNER, *READING LAW: THE INTERPRETATION OF LEGAL TEXTS* 320 (2012) (“Even though federal law has no common-law criminal offenses—all federal offenses having been created by statute—the federal courts still look to common-law meaning.”).

29. See *Neder*, 527 U.S. at 23 n.7 (explaining that “the term ‘false statement’ does not imply a materiality requirement”) (citing *Wells*, 519 U.S. at 491); see also *United States v. Taylor*, 808 F.3d 1202, 1204 (9th Cir. 2015) (noting that “[t]he *Wells* Court relied on the plain text of § 1014, which contains no mention of materiality, as well as on the legislative history of the statute, to determine that there is no materiality requirement”); *United States v. Youssef*, 547 F.3d 1090, 1093 (9th Cir. 2008) (stating that the *Wells* Court “held there was no materiality requirement in § 1014 because the plain language of the statute did not expressly include the word ‘material’”).

30. *Wells*, 519 U.S. at 491. In *Williams v. United States*, 458 U.S. 279, 288 (1982), the Supreme Court explained that § 1014 was the product of the reduction, in 1948, of “13 existing statutes, which criminalized fraudulent practices directed at a variety of financial and credit institutions, to a single section.”

In contrast to *Wells*, the three federal criminal statutes at issue in *Neder* explicitly referred to “schemes or artifices to defraud.”³¹ 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”³² that “required a misrepresentation or concealment of *material* fact.”³³ In fact, the Court noted, “the common law could not have conceived of ‘fraud’ without proof of materiality.”³⁴ Accordingly, the Court stated:

[U]nder the rule that Congress intends to incorporate the well-settled meaning of the common-law terms it uses, we cannot infer from the absence of an express reference to materiality that Congress intended to drop that element from the fraud statutes. On the contrary, we must *presume* that Congress intended to incorporate materiality “unless the statute otherwise dictates.”³⁵

Therefore, Congress might have the power to create a federal false statement offense without a materiality requirement (and the Supreme Court held Congress did so with § 1014), but if Congress uses the term “fraud,” a rebuttable presumption has been created that materiality is to be included as an element of the offense.³⁶ The *Neder* Court was careful, however, to make clear that the same conclusion does not necessarily follow for justifiable reliance and damages.³⁷ In the view of the Supreme Court, such elements of common law fraud “plainly have no place in the federal fraud statutes.”³⁸

31. *Neder*, 527 U.S. at 20–21.

32. *Id.* at 22.

33. *Id.*

34. *Id.*

35. *Id.* at 23 (citing *Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. 318, 322 (1992)).

36. See James B. Helmer, Jr. & Julie Webster Popham, *Materiality and the False Claims Act*, 71 U. CIN. L. REV. 839, 842 (2003) (explaining that, under *Neder*, “a statutory provision using the word ‘fraud’ but lacking an express ‘materiality’ requirement would be presumed to have a materiality element, unless that presumption is rebutted by the language or structure of the statute”).

37. See *Neder*, 527 U.S. at 24–25 (“The common-law 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.”).

38. *Id.* at 25; see also *United States v. Rosby*, 454 F.3d 670, 674 (7th Cir. 2006) (“Reliance is not . . . an ordinary element of federal criminal statutes dealing with fraud.”).

B. Justice Stevens and Specter of Prison for Flattery

Not everyone on the Supreme Court was keen on the notion of extirpating materiality from § 1014.³⁹ Justice Souter's majority opinion in *Wells* inspired a vigorous solo dissent by Justice Stevens,⁴⁰ who saw little difference between the many federal false statement statutes containing express materiality requirements (by his count, about forty-two) and the many statutes that do not (he counted fifty-four).⁴¹ Justice Souter's rejoinder to this point was rather simple: the two categories of false statement crimes easily can be distinguished—some statutes have express materiality requirements whereas others do not.⁴² And Souter declined to assume that the inclusion of materiality in the first group of statutes was surplusage given the Court's "presumption that each term in a criminal statute carries meaning."⁴³

More important, Justice Stevens argued that the Court's decision not to require materiality in § 1014 cases created the possibility of criminal punishment for minor falsehoods. A recurring "prison for flattery" theme ran throughout Stevens's dissent:⁴⁴

As now construed, § 1014 covers false explanations for arriving

39. Prior to *Wells*, nine out of the ten federal circuit courts to address the issue had held that § 1014 required proof of materiality. *United States v. Wells*, 519 U.S. 482, 486 n.3 (1997) (citing cases); see *Neder v. United States*, 527 U.S. 1, 25 (1999) (holding "that materiality of falsehood is an element of the federal mail fraud, wire fraud, and bank fraud statutes"); see also Bradford R. Hise, *Federal False Statement Prosecutions: The Absurd Becomes Material*, 88 J. CRIM. L. & CRIMINOLOGY 877, 881 (1998) (noting that "virtually every circuit that examined § 1014 prior to *Wells* held that materiality is an implicit element of the offense"); see also Podgor, *supra* note 26, at 589 (explaining that "the *Neder* Court was unanimous in its finding that mail, wire, and bank fraud required the government to prove materiality as an element of the offense").

40. *Wells*, 519 U.S. at 500–13 (Stevens, J., dissenting).

41. *Id.* at 505–06 (Stevens, J., dissenting) ("[A]t least 100 federal false statement statutes may be found in the United States Code. About 42 of them contain an express materiality requirement; approximately 54 do not. The kinds of false statements found in the first category are, to my eyes at least, indistinguishable from those in the second category."); see also Christopher P. Guzelian, *False Speech: Quagmire?*, 51 SAN DIEGO L. REV. 19, 67 (2014) ("Justice Stevens . . . vehemently dissented in *United States v. Wells*, arguing that there was no distinction at common law between false statements, false representations, or misrepresentations and that the Court was creating an arbitrary, artificial, implicit standard.").

42. *Wells*, 519 U.S. at 493 n.14.

43. *Id.*

44. See *Wells*, 519 U.S. at 512 (Stevens, J., dissenting) ("Congress, the Court seems to recognize, could not have intended that someone spend up to 30 years in prison for falsely flattering a bank officer for the purpose of obtaining favorable treatment.").

late at a meeting, false assurances that an applicant does not mind if the loan officer lights up a cigar, false expressions of enthusiasm about the results of a football game or an election, as well as false compliments about the subject of a family photograph. So long as the false statement is made “for the purpose of influencing” a bank officer, it violates § 1014.⁴⁵

Stevens provided yet another amusing flattery example in a lengthy footnote,⁴⁶ constructing a hypothetical borrower lying about his “sartorial common ground” with a loan officer who (like Stevens) has a penchant for wearing bow ties.⁴⁷ Stevens wrapped up his prison for flattery argument with the following observation: “Unwarranted confidence in one’s own ability to ascertain the truth has prompted many a victim of deception to make the false statement that ‘flattery will get you nowhere.’ It now appears that flattery may get you into a federal prison.”⁴⁸

In response, Justice Souter, writing for the commanding 8-1 majority, disputed Stevens’s view that, by reading materiality out of § 1014, unimportant falsehoods now would (or is it *could*) be prosecuted as federal offenses. Two intriguing aspects of Justice Souter’s analysis are worthy of further discussion. First, Souter argues:

The language makes a false statement to one of the enumerated financial institutions a crime only if the speaker knows the falsity of what he says and intends it to influence the institution. A statement made “for the purpose of influencing” a bank will not usually be about something a banker would regard as trivial, and “it will be relatively rare that the Government will be able to prove that” a false statement “was . . . made with the subjective intent” of influencing a decision unless it could first prove that the statement has “the natural tendency to influence the decision.”⁴⁹

The *Wells* Court thus claimed that false statements a borrower knowingly makes with the goal of influencing a bank are unlikely to be

45. *Id.* at 502 (Stevens, J., dissenting).

46. *Id.* at 512, n.14 (Stevens, J., dissenting) (citations omitted). In the interests of space, the entire bow tie scenario, amusing as it is, is not quoted here.

47. Justice Stevens was quite well-known for this sartorial preference. See Sonja R. West, *Justice Stevens, the Writer*, 94 WASH. U. L. REV. 1417, 1417 (2017) (noting that one might hear Justice Stevens “described simply as a polite and humble Midwesterner, bow-tie aficionado and diehard Cubs fan”).

48. *Wells*, 519 U.S. at 513 (Stevens, J., dissenting).

49. *Wells*, 519 U.S. at 499 (quoting *Kungys v. United States*, 485 U.S. 759, 780–81 (1988)).

about matters that the lender thinks are unimportant.⁵⁰ After all, who really would try to influence a bank with immaterial information? It seems much more reasonable, according to Souter, to assume that, in most cases, a borrower will attempt to influence a lender with material misstatements. Accordingly, when Stevens claims that fools can get imprisoned for certain silly lies under the Court's interpretation of § 1014, Justice Souter did not deny this proposition.⁵¹ Instead, Souter's basic reply is that the existence of such lies is factually implausible.⁵²

Stevens recognized—and disputed—the Court's factual assumption in his dissent, challenging the Court's reliance on “an empirical judgment that false statements will not ‘usually’ be about a trivial matter.”⁵³ Stevens commented:

I am not at all sure, nor do I know how the Court determined, that attempted flattery is less common than false statements about material facts. Even if it were, the “unusual” nature of trivial statements provides scant justification for reaching the conclusion that Congress intended such peccadillos to constitute a felony.⁵⁴

The second fascinating issue raised by Souter's opinion in *Wells* concerns how courts should or do interpret and apply laws that punish morally blameless or innocent behavior. Souter writes that “an unqualified reading of § 1014 poses no risk of criminalizing so much conduct as to suggest that Congress meant something short of the straightforward

50. Generic terms like bank are used here to simplify the exposition. The recipient of the misstatement under § 1014 need not be, technically, a bank or even a lender. See *United States v. Wade*, 266 F.3d 574, 580 (6th Cir. 2001) (holding that “18 U.S.C. § 1014 is not limited to applications for loans or credit”); *United States v. Krilich*, 159 F.3d 1020, 1028 (7th Cir. 1998) (explaining that not all of the entities covered by § 1014 make loans).

51. *United States v. Phillips*, 688 F.3d 802, 805 (7th Cir. 2012) (Easterbrook, J.) (observing that the *Wells* majority did not deny the consequences posited by Justice Stevens), *reh'g en banc granted, vacated* (Dec. 7, 2012), *on reh'g en banc*, 731 F.3d 649 (7th Cir. 2013).

52. According to one treatise:

Somewhat more plausible scenarios include the case in which a defendant overstates his personal net worth in connection with an application for a bank loan to his corporation, which he is *not* expected to guarantee. Another example is the loan applicant who has apparently assumed a false identity and, therefore, fills out an application with false personal description.

1 JOHN K. VILLA, *BANKING CRIMES: FRAUD, MONEY LAUNDERING AND EMBEZZLEMENT* § 4:8 (2019) (citations and footnotes omitted).

53. *Wells*, 519 U.S. at 513 (Stevens, J., dissenting).

54. *Id.*

reading.”⁵⁵ This observation suggests that if the *Wells* Court’s materiality-free interpretation had indeed dragged too much innocent or morally blameless conduct into the purview of § 1014, then the Court might have had to rethink its conclusion about the proper interpretation of the statute.⁵⁶

In recent years, possible punishment of morally blameless defendants has attracted significant scholarly attention, specifically in connection with *mens rea* requirements in federal criminal statutes.⁵⁷ One prominent scholar even argues that recent Supreme Court case law plausibly can be read “as making a culpable mental state a prerequisite for punishment for all crimes, even regulatory offenses.”⁵⁸ Ultimately, the *Wells* Court, however, did not directly address whether there are substantive legal or constitutional limits on the legislative power to punish innocent or morally blameless behavior. By concluding that the materiality-free (but knowing and intending to influence) interpretation of § 1014 would not actually criminalize an excessive amount of possibly innocent conduct, the Supreme Court was able to skirt the specific issue of whether a misrepresentation made to influence a lender could ever truly be “innocent,”⁵⁹ and more general questions of how to interpret statutes that seem to punish morally blameless conduct.⁶⁰

55. *Wells*, 519 U.S. at 498–99.

56. For a discussion of moral culpability and *Wells*, see John Shepard Wiley Jr., *Not Guilty by Reason of Blamelessness: Culpability in Federal Criminal Interpretation*, 85 VA. L. REV. 1021, 1155–59 (1999).

57. See Susan R. Klein & Ingrid B. Grobey, *Debunking Claims of Over-Federalization of Criminal Law*, 62 EMORY L.J. 1, 69 (2012) (“Outside of the public welfare context, the Court has been surprisingly active in successfully moving beyond the reach of federal criminal law those classes of individual defendants who may not be morally blameworthy. This is accomplished almost exclusively through statutory interpretation by reading in a *mens rea* requirement when the statute is otherwise devoid of one.”); John F. Stinneford, *Punishment Without Culpability*, 102 J. CRIM. L. & CRIMINOLOGY 653, 698 (2012) (explaining that since the 1970s, the Supreme Court “has applied a presumption that federal criminal statutes require proof of *mens rea* even where they are silent as to this requirement”) (citing *Carter v. United States*, 530 U.S. 255, 268 (2000); *Staples v. United States*, 511 U.S. 600, 605 (1994); *Liparota v. United States*, 471 U.S. 419, 426 (1985); *United States v. U.S. Gypsum Co.*, 438 U.S. 422, 438 (1978)).

58. Stephen F. Smith, *Overcoming Overcriminalization*, 102 J. CRIM. L. & CRIMINOLOGY 537, 573 (2012) (emphasis added).

59. John Shepard Wiley argues that the existing elements in § 1014 are sufficient to ensure that every defendant convicted under § 1014 will be a “designing liar,” and that “[d]esigning liars seem morally culpable.” Wiley, *supra* note 56, at 1157; *id.* at 1159 (“Though the *Wells* majority did not use it, another reply to Justice Stevens’s dissent would be to maintain that white lies and flattery of bank officials are immoral and culpable conduct, even if only trivially so.”).

60. Joseph E. Kennedy, *Making the Crime Fit the Punishment*, 51 EMORY L.J. 753,

C. *Justice Stevens on Prosecutorial Discretion*

One final aspect of Justice Stevens's dissent in *Wells* is worth noting—he astutely noted something that was absent from the majority's arguments. Stevens observed that “the Court correctly avoids relying on prosecutors not to bring frivolous cases,”⁶¹ further explaining: “It is well settled that courts will not rely on ‘prosecutorial discretion’ to ensure that a statute does not ensnare those beyond its proper confines.”⁶² Put another way, the *Wells* majority, to its credit, resisted the urge to press an obvious, but problematic claim—that borrowers simply could count on professional, prudent federal prosecutors to refrain from bringing § 1014 cases involving immaterial misstatements. Prosecutorial discretion will be discussed further below.⁶³

D. *Justice Stevens's Coda on Wells in Neder*

In one small way, Justice Stevens had the final word on the materiality holding in *Wells*. As discussed earlier, the Supreme Court's decision in *Wells* was followed not too long after by *Neder*, in which the Court held that the federal bank, wire and mail fraud statutes all required proof of materiality.⁶⁴ Although Justice Stevens now agreed with the majority,⁶⁵ he used the opportunity in *Neder* to draw continued attention to the now plainly differential materiality standards:

In my dissent in *United States v. Wells*, I pointed out that the vast majority of judges who had confronted the question had placed the same construction on the federal statute criminalizing false statements to federally insured banks, 18 U.S.C. § 1014. I repeat this point to remind the Congress that an amendment to § 1014 would both harmonize these sections and avoid the potential injustice created by the Court's decision in *Wells*.⁶⁶

842–46 (2002) (providing several arguments against judicial enforcement of principles of mandatory moral culpability).

61. *United States v. Wells*, 519 U.S. 482, 512 (1997) (Stevens, J., dissenting).

62. *Id.* at 512 n.15.

63. *See infra* Part V.B.

64. *See supra* note 26 and accompanying text.

65. *Neder v. United States*, 527 U.S. 1, 29 (1999) (Stevens, J., concurring in part and concurring in the judgment) (stating that “[t]he Court's conclusion that materiality is an element of the offenses defined in 18 U.S.C. §§ 1341, 1343, and 1344 is obviously correct”).

66. *Neder*, 527 U.S. at 29–30 (Stevens, J., concurring in part and concurring in the judgment) (citation omitted).

Needless to say, Congress never took Justice Stevens up on his invitation in *Neder* to amend the federal criminal code to ameliorate any “potential injustice” wrought by *Wells*. The text of 18 U.S.C. § 1014 (with respect to materiality) remains the same today as it did when *Wells* and *Neder* were decided in the late 1990s.

II. CHARGING MATERIALITY POST-*WELLS*: A CURIOSITY

Approximately two decades after *Wells* was decided, it remains well-settled that proof of materiality is not required for § 1014 cases,⁶⁷ whereas proof of materiality is required for bank, wire and mail fraud cases.⁶⁸ Despite this state of affairs, somewhat strangely, there are numerous § 1014 cases that mention that defendants were charged, indicted or convicted for making *material* misstatements.⁶⁹ Many of these cases are unpublished

67. *United States v. Phillips*, 731 F.3d 649, 652 (7th Cir. 2013) (en banc) (Posner, J.) (“[I]f you make a knowingly false statement intending to influence a bank, it’s no defense that you didn’t succeed in influencing it or even that you couldn’t have succeeded. Materiality is not an element of the offense punished by section 1014.”); *United States v. Sandlin*, 589 F.3d 749, 754 (5th Cir. 2009) (“A false statement need not be material nor relied upon by the bank to violate Section 1014.”); *United States v. Kohler*, 87 F. App’x 530, 532 (6th Cir. 2004) (“Section 1014 does not contain a materiality requirement.”); *United States v. Lane*, 323 F.3d 568, 582 (7th Cir. 2003) (“Section 1014 does not require that a false statement must be material or even mention materiality.”); *United States v. Cornish*, 68 F. App’x 557, 560 (6th Cir. 2003) (using the exact same language as in *Kohler*); *United States v. Swanquist*, 161 F.3d 1064, 1075 (7th Cir. 1998) (“[M]ateriality is not, and never was, an element of the crime of knowingly making a false statement to a federally-insured bank under § 1014.”).

68. *See, e.g., United States v. Raza*, 876 F.3d 604, 614 (4th Cir. 2017) (stating that wire fraud prosecution requires proof of “a material statement or omission in furtherance of the scheme”), *cert. denied*, 138 S. Ct. 2679 (2018); *United States v. Williams*, 865 F.3d 1302, 1309 (10th Cir. 2017) (explaining that “[t]he misrepresentation or falsehood must be materially false” for a bank fraud prosecution under 18 U.S.C. § 1344(1)), *cert. denied*, 138 S. Ct. 567 (2017); *Williams v. Affinion Grp., LLC*, 889 F.3d 116, 124 (2d Cir. 2018) (stating that mail fraud and wire fraud both require proof of materiality); *United States v. Camick*, 796 F.3d 1206, 1214–18 (10th Cir. 2015) (same).

69. *See, e.g., United States v. Bennis*, 740 F.3d 370, 371–72 (5th Cir. 2014) (stating that the single-count indictment charging a violation of § 1014, alleged that the defendant “knowingly made a material false statement for the purpose of influencing” an FDIC-insured bank); *United States v. Rabhan*, 628 F.3d 200, 201 (5th Cir. 2010) (stating that the defendant was charged “for conspiracy to violate 18 U.S.C. § 1014 by making material false statements for the purpose of influencing a federally insured bank and a United States agency in connection with a loan to procure a catfish farm in Mississippi”); *United States v. Davis*, 397 F.3d 340, 342 (6th Cir. 2005) (featuring a defendant that was indicted, though ultimately not convicted, for allegedly making “materially false statements in connection with federally insured loans, in violation of 18 U.S.C. § 1014”).

opinions that merely are noting the allegations in § 1014 charging documents.⁷⁰ These courts are not holding that materiality is a required

70. *See, e.g.*, *United States v. Williams*, 785 F. App'x 692, 694 (11th Cir. 2019) (stating that the indictment charged the defendant with “making materially false statements to a financial institution in violation of 18 U.S.C. §§ 1014”); *United States v. Rogers*, 580 F. App'x 347, 349 (6th Cir. 2014) (explaining that the federal grand jury had charged the defendants with, among other crimes, “submission of materially false statements” to a bank, “in violation of 18 U.S.C. § 1014”); *United States v. Zehringer*, 489 F. App'x 980, 981 (8th Cir. 2012) (stating that the defendant “pleaded guilty to one count of making a material false statement in connection with a loan application in violation of 18 U.S.C. § 1014”); *United States v. Crook*, 479 F. App'x 568, 580 (5th Cir. 2012) (stating that the defendant allegedly “knowingly made a material false statement or report for the purpose of influencing the action of the Secretary of Agriculture,” acting through entities covered by § 1014); *United States v. Ciocchetti*, 422 F. App'x 695, 697 (10th Cir. 2011) (convicting the defendant of “making materially false statements in connection with a bank loan application, in violation of 18 U.S.C. § 1014”); *United States v. Ciocchetti*, 330 F. App'x 745, 746 (10th Cir. 2009) (stating that the defendant “was indicted and charged with four counts of making materially false statements in connection with bank loan applications in violation of 18 U.S.C. § 1014”); *United States v. Sankey*, 169 F. App'x 484, 485 (7th Cir. 2006) (stating that the defendant “was convicted of making a materially false statement to the Farm Service Agency . . . in connection with a loan” in violation of § 1014); *United States v. Gladhart*, 68 F. App'x 784, 785 (9th Cir. 2003) (showing that the defendants appealed “their convictions for making materially false statements” to a bank in violation of § 1014); *Blair v. United States*, No. 2:11-CR-3, 2018 WL 794846, at *2 (E.D. Tenn. Feb. 8, 2018) (stating that the federal grand jury charged defendants with the “submission of materially false statements . . . in violation of 18 U.S.C. § 1014”); *Holstein v. United States*, No. 2:12-CV-0214, 2015 WL 1514986, at *1 (N.D. Tex. Mar. 17, 2015) (quoting one-count information that alleged that the “defendant, knowingly made material false statements, reports and willfully overvalued property and security for the purpose of influencing the action” of the bank); *Joyce v. United States*, No. 2:09-CR-00256, 2014 WL 7160417, at *2 (S.D.W. Va. Dec. 15, 2014) (stating that the defendant “pled guilty to one count of knowingly making a material false statement to a financial institution, in violation of 18 U.S.C. § 1014”); *Powell v. United States*, No. 3:06-CR-189-RJC, 2014 WL 4793232, at *1 (W.D.N.C. Sept. 25, 2014) (stating that the petitioner seeking post-conviction relief, had been charged with, *inter alia*, “making materially false statements to a bank, in violation of 18 U.S.C. § 1014”); *United States v. Beltramea*, No. 13-CR-20-LRR, 2013 WL 5719501, at *2 (N.D. Iowa Oct. 21, 2013) (noting that several counts in the indictment charged the defendant “with knowingly making material false statements or reports for the purpose of influencing certain financial institutions in violation of 18 U.S.C. § 1014”); *Roggio v. United States*, No. 11-22847-CIV-MOORE/GOODMAN, 2013 WL 12177016, at *4 (S.D. Fla. Aug. 29, 2013) (stating that the grand jury indicted the defendant “on a charge of making and causing to be made materially false statements to a federally insured financial institution . . . in violation of 18 U.S.C. § 1014”); *United States v. Palma-Hernandez*, No. 8:13CR194, 2013 WL 3863933, at *1 (D. Neb. July 23, 2013) (indicting the defendant for violating § 1014 by “making a materially false statement on a loan application”); *United States v. Corbell*, No. 08-0075-01, 2012 WL 6098794, at *2 (W.D. La. Dec. 6, 2012) (featuring a defendant that was charged with and pleaded guilty to “making a materially false statement to a bank in violation of 18 U.S.C. § 1014”); *United States v. Meisinger*, No. EDCV 11-00896VAP

element under § 1014.⁷¹ In any case, it is odd that so many § 1014 charging documents would make explicit reference to materiality post-*Wells*.

In the end, this recurring prosecutorial charging decision presumably has no legal effect—merely stating that the defendant in a § 1014 action made a materially false statement need not compel the prosecutor to prove materiality. As the Supreme Court explained many years ago: “The insertion of surplus words in the indictment does not change the nature of the offense charged.”⁷² Thus, the required elements of the statutory offense remain unchanged.⁷³ Furthermore, § 1014 defendants who are offended at the mention of materiality in their charging documents conceivably could make a motion to strike any materiality language from the indictment.⁷⁴ To

(OPx), 2011 WL 13134959, at *1 (C.D. Cal. Oct. 19, 2011) (explaining how the government alleged that “by submitting a raft of deeds and bankruptcy petitions on behalf of unknowing parties,” the defendants “made materially false statements that were intended to deceive federally-insured financial institutions” in violation of § 1014); *United States v. Wilson*, No. 07-CR-0092-CVE, 2008 WL 4980895, at *1 (N.D. Okla. Nov. 21, 2008) (stating that the defendant was charged with violating § 1014 by “knowingly making materially false statements to a financial institution”); *United States v. Peer*, No. 4:06CR124-P-D, 2008 WL 4635388, at *1 (N.D. Miss. Oct. 17, 2008) (describing a conspiracy to violate § 1014 “involving the making of false material statements”); *United States v. Huffman*, No. S1-4:06-CR-352 CAS, 2007 WL 271379, at *3 (E.D. Mo. Jan. 25, 2007) (stating that the indictment alleged a conspiracy “to violate 18 U.S.C. § 1014, involving the making of false material statement”); *United States v. Byrd*, No. 01-20325-SHM, 2006 WL 3805666, at *1 (W.D. Tenn. Dec. 22, 2006) (indicting the defendant on “two counts of making a materially false statement for the purpose of influencing a financial institution, in violation of 18 U.S.C. § 1014”); *United States v. Kooistra*, No. 8:05CR81, 2006 WL 1888685, at *3 (D. Neb. July 7, 2006) (stating that the indictment alleged that the defendant made “material false statements in connection with a line of credit advance request . . . in violation of 18 U.S.C. § 1014”).

71. My research revealed only one post-*Wells* decision that explicitly and erroneously includes materiality as an element of § 1014. See *United States v. Robinson*, No. A-08-CR-001-SS, 2008 WL 11423911, at *3 (W.D. Tex. May 12, 2008) (citing *United States v. Williams*, 12 F.3d 452, 456 (5th Cir. 1994)). This unpublished district court opinion cites a pre-*Wells* circuit court precedent. The error is only in the recitation of the elements of § 1014—materiality is not directly at issue in the case.

72. *Bridges v. United States*, 346 U.S. 209, 223 (1953).

73. See *Jaben v. United States*, 349 F.2d 913, 915 (8th Cir. 1965) (explaining that “if the indictment . . . did actually require proof of an additional element not necessitated by the language of the statute, the appellant should not be heard to complain” because “[t]he requirement of proof beyond the wording of the statute would in fact be in appellant’s favor,” as “[i]t would force the government to establish something not necessitated by the language of the statute, thereby placing an additional burden on the government”).

74. See FED. R. CRIM. P. 7(d) (“Upon the defendant’s motion, the court may strike surplusage from the indictment or information.”); see also *United States v. Brooks*, 438 F.3d 1231, 1237 (10th Cir. 2006) (explaining that at trial court “may strike from an indictment allegations which are both independent of and unnecessary to the offense on which a

do so, however, the defendant would have to prove that the inclusion of the materiality surplusage in the indictment “is both irrelevant (or immaterial) and prejudicial.”⁷⁵ This would be a difficult hurdle to surmount. The conventional wisdom is that “[m]otions to strike surplusage are rarely granted,”⁷⁶ and given the relationship between § 1014’s intent to influence standard and materiality,⁷⁷ it might be challenging to convince a trial court that the use of the term materiality in a § 1014 indictment is an error at all, let alone erroneous enough to warrant judicial rectification.

In sum, the unnecessary inclusion of materiality in § 1014 charging documents is a curious trend. This routine charging decision has led to the state of affairs where federal appellate courts continue to reiterate, as required by *Wells*, that proof of materiality is not required under § 1014, while some federal prosecutors keep charging § 1014 defendants with making material misstatements. This might lead one to question whether these prosecutors are, in practice, treating § 1014 as if it does require materiality, even though the Supreme Court so clearly rejected such a mandate in *Wells*.

III. SECTION 1014 IN THE IMMIGRATION CONTEXT

As the Supreme Court decided *Wells*, it is unlikely that the justices considered how the decision might impact enforcement of the nation’s immigration laws. A recent Second Circuit case, however, was forced to grapple directly with the intersection of § 1014 and the Immigration and Nationality Act.⁷⁸ In *Sampathkumar v. Holder*,⁷⁹ the Second Circuit, in an

conviction ultimately rests”).

75. *United States v. Hedgepeth*, 434 F.3d 609, 612 (3d Cir. 2006); *United States v. Ferguson*, 676 F.3d 260, 290 n.34 (2d Cir. 2011) (“Motions to strike surplusage from an indictment are granted only when the challenged phrases are ‘not relevant to the crime charged and are inflammatory and prejudicial.’”) (quoting *United States v. Hernandez*, 85 F.3d 1023, 1030 (2d Cir. 1996)); *see also* 1944 Advisory Committee Note to FED. R. CRIM P. 7(d) (“This rule introduces a means of protecting the defendant against immaterial or irrelevant allegations in an indictment or information, which may, however, be prejudicial.”).

76. *United States v. Hedgepeth*, 434 F.3d 609, 611 (3d Cir. 2006); *see also* *United States v. Rezaq*, 134 F.3d 1121, 1134 (D.C. Cir. 1998) (explaining that “[t]he standard under Rule 7(d) has been strictly construed against striking surplusage”) (quoting *United States v. Jordan*, 626 F.2d 928, 930 n.1 (D.C. Cir. 1980)); Robert J. Anello & Richard F. Albert, *Keeping the Indictment Out of the Jury Room*, N.Y.L.J., Aug. 7, 2012 (explaining that “courts tend to be loath to grant motions strike surplusage,” and that such motions “rarely are granted”).

77. *See infra* notes 104–105 and accompanying text.

78. Immigration and Nationality Act of 1952, Pub. L. No. 82-414, 66 Stat. 163

unpublished disposition, addressed the question of whether § 1014 counted as an offense involving fraud or deceit, and thus constituted an “aggravated felony”⁸⁰ under the INA.⁸¹ If so, the petitioner faced removal from the United States following her conviction for violating § 1014.⁸² In fact, according to a recent Supreme Court decision, “removal is a virtual certainty for an alien found to have an aggravated felony conviction, no matter how long he has previously resided here.”⁸³ Thus, the stakes in this case were quite high.

Sampathkumar argued that § 1014 was not an offense that involved “deceit,” because the statute lacks a materiality requirement.⁸⁴ Sampathkumar relied on the Supreme Court’s decision in *Kawashima v. Holder*.⁸⁵ In that case, the Court held that violations of two applicable IRS Code provisions, both of which made specific reference to materiality,⁸⁶ were crimes involving “‘fraud or deceit’ under 8 U.S.C. § 1101(a)(43)(M)(i) and are therefore aggravated felonies as that term is defined in the Immigration and Nationality Act . . . when the loss to the Government

(codified as amended in scattered sections of 8 U.S.C.).

79. *Sampathkumar v. Holder*, 573 F. App’x 55 (2d Cir. 2014), *cert. denied sub nom. Sampathkumar v. Lynch*, 135 S. Ct. 2919 (2015).

80. One author notes: “The definition of aggravated felony for the purpose of removing individuals from the United States has been expanded so that now an aggravated felony need no longer be either aggravated or a felony.” Diana R. Podgorny, *Comment, Rethinking the Increased Focus on Penal Measures in Immigration Law as Reflected in the Expansion of the “Aggravated Felony” Concept*, 99 J. CRIM. L. & CRIMINOLOGY 287, 289 (2009).

81. *See Sampathkumar v. Holder*, 573 F. App’x 55, 57–58 (2d Cir. 2014) (citing 8 U.S.C. § 1101(a)(43)(M)(i)), *cert. denied sub nom. Sampathkumar v. Lynch*, 135 S. Ct. 2919 (2015).

82. *Sampathkumar*, 573 F. App’x at 57.

83. *Sessions v. Dimaya*, 138 S. Ct. 1204, 1211 (2018).

84. *Sampathkumar*, 573 F. App’x at 57.

85. *Id.* (“Sampathkumar relies heavily on *Kawashima*, which held that the statute at issue there . . . contained the elements that ‘necessarily entail[ed]’ deceitful conduct: a falsity, that was material, and knowingly and willfully made.”) (citing *Kawashima v. Holder*, 565 U.S. 478, 483–85 (2012)).

86. The Internal Revenue Code provides that a person is guilty of a felony if he “[w]illfully makes and subscribes any return, statement, or other document, which contains or is verified by a written declaration that it is made under the penalties of perjury, and which he does not believe to be true and correct as to every material matter,” 26 U.S.C. § 7206(1) (2018), or “[w]illfully aids or assists in, or procures, counsels, or advises the preparation or presentation under, or in connection with any matter arising under, the internal revenue laws, of a return, affidavit, claim, or other document, which is fraudulent or is false as to any material matter, whether or not such falsity or fraud is with the knowledge or consent of the person authorized or required to present such return, affidavit, claim, or document.” 26 U.S.C. § 7206(2) (2018).

exceeds \$10,000.”⁸⁷

The Second Circuit rejected Sampathkumar’s arguments regarding § 1014,⁸⁸ relying on the same dictionary definition of deceit that the Supreme Court had used in *Kawashima*.⁸⁹ Justice Thomas, writing for the *Kawashima* Court, had explained that when the relevant tax code section “was enacted, the term ‘deceit’ meant a ‘the act or process of deceiving (as by falsification, concealment, or cheating).’”⁹⁰ The question for the Second Circuit, then, was whether § 1014 satisfied this understanding of deceit. To answer this question, the Second Circuit applied the “categorical approach” dictated by the Supreme Court,⁹¹ “by looking to the statute defining the crime of conviction, rather than to the specific facts underlying the crime.”⁹² In other words, the Second Circuit was not interested in whether Sampathkumar herself had actually engaged in “deceit” in the underlying § 1014 criminal case. Instead the categorical approach requires “looking solely to the criminal statute and focusing on the minimum conduct for which there is a ‘realistic probability’ that a conviction will result.”⁹³ Thus,

87. *Kawashima*, 565 U.S. at 480.

88. The Second Circuit also addressed several additional issues that are not relevant to the discussion here, including whether the loss amount in the underlying case exceeded \$10,000 and whether § 1014 is a crime involving moral turpitude. See *Sampathkumar*, 573 F. App’x at 58–59.

89. *Id.* at 57.

90. *Kawashima*, 565 U.S. at 484 (citing *Deceit*, WEBSTER’S THIRD NEW INTERNATIONAL DICTIONARY 584 (1993)).

91. See *Esquivel-Quintana v. Sessions*, 137 S. Ct. 1562, 1567–68 (2017) (“[T]o determine whether an alien’s conviction qualifies as an aggravated felony . . . we ‘employ a categorical approach by looking to the statute . . . of conviction, rather than to the specific facts underlying the crime.’”) (quoting *Kawashima*, 565 U.S. at 483).

92. *Kawashima*, 565 U.S. at 483 (citing *Gonzales v. Duenas–Alvarez*, 549 U.S. 183, 186 (2007); *Taylor v. United States*, 495 U.S. 575, 599–600 (1990)); *Esquivel-Quintana v. Sessions*, 137 S. Ct. 1562, 1567–68 (2017) (quoting *Kawashima*, 565 U.S. at 483). Judicial application of the categorical approach has not been simple. See Christina M. Cabanillas, *The Times They Are A-Changin’: Sentencing in Illegal Reentry Cases and the November 2016 Amendment to U.S.S.G. § 2L1.2(b)(1)*, 65 U.S. ATT’YS’ BULL. 153, 157 (2017) (“During the over twenty-five years since *Taylor* was decided, federal appellate courts and district courts have found it difficult to apply the categorical approach and have often produced inconsistent results.”).

93. *Sampathkumar v. Holder*, 573 F. App’x 55, 57 (2d Cir. 2014). The Supreme Court has explained that a “modified categorical approach” is employed “[w]here a state statute contains several different crimes that are described separately.” *Esquivel-Quintana v. Sessions*, 137 S. Ct. 1562, 1568 n.1 (2017) (citing *Gonzales v. Duenas–Alvarez*, 549 U.S. 183, 187 (2007)). In such a case, “the court may review the charging documents, jury instructions, plea agreement, plea colloquy, and similar sources to determine the actual crime of which the alien was convicted.” *Id.* For a more recent Supreme Court case exploring the categorical approach and the “modified categorical approach,” see *Descamps*

the question became whether § 1014 typically requires deceit.

The Second Circuit proceeded by comparing the tax offense in *Kawashima* with the § 1014 violation in *Sampathkumar*. The court noted that the tax offense at issue in *Kawashima* “contained the elements that ‘necessarily entail[ed]’ deceitful conduct: a falsity, that was material, and knowingly and willfully made.”⁹⁴ The Court of Appeals then explained: “Nearly all of these elements are satisfied here: to sustain a conviction for violating § 1014, the government must demonstrate that a defendant acted with the knowledge that the information was false and with the purpose of influencing the action of the institution.”⁹⁵

The Second Circuit’s analysis, however, had put it in a bit of an analytical bind (though arguably an unnecessary one). The court had set the tax offense in *Kawashima* as the baseline for deceit, and that particular tax crime included materiality, which—as we know—is not a required element under § 1014. But the Second Circuit neatly extracted itself from its bind by explaining: “To be sure, materiality is not an element of the offense punished by § 1014. But the specific intent required by the statute—that is, the intent to influence the bank—approaches a materiality requirement.”⁹⁶ To drive home the point that the § 1014 standard is functionally equivalent to a materiality standard, the Second Circuit quoted at length from *Wells*, and concluded that “there is not a ‘realistic probability’ that a false statement sufficient for conviction under § 1014 would be trivial, notwithstanding the lack of a materiality requirement.”⁹⁷ Thus, the Second Circuit concluded that § 1014 is an offense that involves deceit.⁹⁸

The Second Circuit’s ultimate holding in *Sampathkumar* is sound.⁹⁹ As a district court stated in a later case upholding the Immigration Service’s determination that the plaintiff was ineligible for naturalization due to his conviction under § 1014, “making false statements to influence another party is the epitome of deceit.”¹⁰⁰ It is less clear, however, whether the Second Circuit in *Sampathkumar* had to rely on the near-equivalence of

v. *United States*, 570 U.S. 254 (2013).

94. *Sampathkumar*, 573 F. App’x at 57 (citing *Kawashima v. Holder*, 132 S. Ct. 1166, 1172–73 (2012)).

95. *Id.*

96. *Id.* (citing *United States v. Wells*, 519 U.S. 482, 484 (1997)).

97. *Id.* at 58.

98. *Id.*

99. I am only referring to the *Sampathkumar* opinion with respect to § 1014. I express no judgment as to the other issues in the case.

100. *Blank v. Johnson*, No. 16-60551-CIV-GAYLES, 2017 WL 4346874, at *2 (S.D. Fla. Sept. 29, 2017) (citing *Sampathkumar v. Holder*, 573 F. App’x 55, 57 (2d Cir. 2014)).

materiality and the § 1014 standard. Undoubtedly, the offenses in *Kawashima* included materiality,¹⁰¹ and the Supreme Court did explicitly mention materiality in its ultimate determinations in that case.¹⁰² It does not follow, however, that materiality is a necessary element of every crime of deceit. That would be a rather overbroad interpretation of *Kawashima*, as the Second Circuit implicitly recognized.¹⁰³ Perhaps the Second Circuit, even in an unpublished opinion, did not want to go on the record as stating that the legal concept of deceit does not necessarily require materiality. Instead, it was simpler to follow Souter's teachings in *Wells* and endorse the notion, as other courts have,¹⁰⁴ that the § 1014 standard is functionally the same as a materiality requirement.¹⁰⁵ Accepting the idea that a § 1014 violation invariably will involve material misstatements obviates the need to determine whether a non-material § 1014 misrepresentation could constitute deceit.

101. The Supreme Court noted that the U.S. Government had argued “that the Kawashimas’ convictions necessarily involved deceit because they required a showing that the Kawashimas willfully made materially false statements.” *Kawashima v. Holder*, 565 U.S. 478, 482–83 (2012).

102. See *Kawashima v. Holder*, 565 U.S. 478, 484 (2012) (“Mr. Kawashima’s conviction under § 7206(1) establishes that he knowingly and willfully submitted a tax return that was false as to a material matter. He therefore committed a felony that involved ‘deceit.’”); *Id.* (“We conclude that Mrs. Kawashima’s conviction establishes that, by knowingly and willfully assisting her husband’s filing of a materially false tax return, Mrs. Kawashima also committed a felony that involved ‘deceit.’”).

103. The Second Circuit explained: “With regard to any elements mentioned in *Kawashima* still lacking here, the Supreme Court did not hold that all those elements must be present” for the applicable statutory language to apply. *Sampathkumar*, 573 F. App’x at 57. The Second Circuit did not specify, however, which elements present in *Kawashima* were lacking in this case.

104. See *United States v. Mitchell*, 528 F.3d 1034, 1040 (8th Cir. 2008) (explaining that the *Wells* Court determined that “[t]he knowledge element and the term ‘for the purpose of influencing’ was enough to narrow the class of criminal conduct in the same manner as an implied materiality requirement.”); see also *United States v. Tierney*, 266 F.3d 37, 40 (1st Cir. 2001) (asserting that “it will be relatively rare that a statement made for the purpose of influencing a bank’s decision will not relate to a material matter”); see also *United States v. White*, 597 F. Supp. 2d 1269, 1272 (M.D. Ala. 2009) (stating, in dicta, that 18 U.S.C. § 1014 “essentially prohibits making materially false statements to a federally insured bank”).

105. *Sampathkumar*, 573 F. App’x at 57 (explaining that the intent required by § 1014 “approaches a materiality requirement”).

IV. SECTION 1014 AND THE GREAT RECESSION (AND BEYOND)

A. *Mortgage Fraud and the Great Recession*

As Justices Souter and Stevens debated the proper interpretation of § 1014 in the late 1990s, they could not have predicted the calamitous financial crisis in 2007 and 2008 that morphed into the Great Recession, and the role that various forms of financial malfeasance would play in the crisis.¹⁰⁶ As one author sums it up: “If the financial meltdown has multiple dimensions and involves a variety of causes, fraudulent misrepresentations in many different forms and on many different levels were clearly at the center of this catastrophe.”¹⁰⁷

A post-meltdown Seventh Circuit opinion, *United States v. Phillips*, illustrates some of *Wells*’s intriguing real-world implications in light of the events of the Great Recession. Judge Posner used the opportunity in *Phillips* to explore the connections between the early 2000s mortgage market and the financial crisis. Posner’s opinion inspired a heated dissent from Judge Easterbrook,¹⁰⁸ who disputed Posner’s take on § 1014’s application to so-called liar’s loans.¹⁰⁹ The debate between Posner and Easterbrook, who have well-documented differences on statutory interpretation,¹¹⁰ has implications that continue to resonate with respect to

106. The literature on the causes and effects of the financial crisis is truly immense. See Bernard S. Black, Charles K. Whitehead & Jennifer Mitchell Coupland, *The Nonprime Mortgage Crisis and Positive Feedback Lending*, 3 J.L. FIN. & ACCT. 1, 6 (2018) (stating that the literature is “too vast to usefully cite”). For the official U.S. government study of the crisis, see FIN. CRISIS INQUIRY COMMISSION, THE FINANCIAL CRISIS INQUIRY REPORT (2011). In the years since the FCIC report was published there have been many dozens of articles and books devoted to various aspects of the financial crisis.

107. David O. Friedrichs, *Wall Street: Crime Never Sleeps*, in HOW THEY GOT AWAY WITH IT: WHITE COLLAR CRIMINALS AND THE FINANCIAL MELTDOWN 3 (Susan Will, Stephen Handelman & David C. Brotherton eds., 2013); see also Edwards, *Mortgage Fraud*, *supra* note 2, at 73 (explaining that “prior to the Great Recession, the United States experienced . . . a toxic mix of wrongdoing related to the mortgage market”).

108. *United States v. Phillips*, 731 F.3d 649, 656 (7th Cir. 2013) (Easterbrook, J., dissenting).

109. Obviously, “liar’s loans” is not a precisely defined legal term. For more on the meaning of this concept, see Edwards, *Mortgage Fraud*, *supra* note 2, at 62–63.

110. See Daniel A. Farber, *Do Theories of Statutory Interpretation Matter? A Case Study*, 94 NW. U. L. REV. 1409, 1409 (2000) (“In terms of their theoretical writings about interpretation, Posner (a leading pragmatist) and Easterbrook (a leading textualist) are as far apart as two judges could be.”). But these differences do not necessarily lead to judicial disagreement. See *id.* at 1411 (noting “a resounding absence of evidence that these judges’ sharp theoretical difference has any substantial effects on their judicial votes”). It must be noted that Farber’s article was published in 2000, and it might be the case that Posner and

the application of § 1014 to mortgage origination fraud cases.

B. The Phillips Case

1. Background

In 2006, Erin Hall and Lacey Phillips, a “financially unsophisticated”¹¹¹ unmarried couple,¹¹² applied for a mortgage to purchase a house.¹¹³ Hall was a hairstylist and Phillips was a barber.¹¹⁴ Initially they were turned down because their joint income was not sufficient for the approximately \$200,000 that they needed to borrow for the \$250,000 home, and also because Hall had a prior bankruptcy.¹¹⁵ After their application was rejected, Hall connected up with an allegedly crooked mortgage broker named Brian Bowling,¹¹⁶ who “steered them to a federally insured bank of dubious ethics named Fremont Investment & Loan,”¹¹⁷ which specialized in making stated income or so-called liar’s loans.¹¹⁸ Bowling prepared the loan application,¹¹⁹ which Phillips alone signed.¹²⁰ Phillips also signed an employment verification form.¹²¹ As Judge Easterbrook’s dissent explains, the loan application materials: (1) omitted Hall’s name;¹²² (2) “attributed

Easterbrook drifted further apart in the later years of Posner’s tenure on the Seventh Circuit. (Posner retired in 2017.)

111. *United States v. Phillips*, 731 F.3d 649, 650 (7th Cir. 2013) (en banc) (explaining that “[t]hey had never owned a house,” and “had only a high-school education,” though “Hall had some college but no degree”).

112. Hall and Phillips married after the events discussed in this case. *Phillips*, 731 F.3d at 653.

113. *Id.* at 650.

114. *Id.* I am merely recounting the facts here; I do not mean to suggest that barbers cannot be well-educated or financially astute.

115. *Id.*

116. *Id.* (referring to Bowling as “a crook who brokered fraudulent loans”). In another § 1014 case, “Bowling admitted to submitting false loan applications, inflating applicants’ income, exaggerating assets, understating liabilities, falsifying job titles and employment histories, misrepresenting the sources of down payments, and engaging in silent second mortgages.” *United States v. Johnson*, 729 F.3d 710, 714 (7th Cir. 2013). Bowling was also impeached at trial in that case “with specific instances of untruthful conduct including forging signatures on loan documents.” *Id.*

117. *Phillips*, 731 F.3d at 650.

118. *Id.*

119. *Id.* at 655.

120. *Id.* at 656 (noting that Hall did not sign the application form). Phillips also signed an employment verification form. *Id.* at 657 (Easterbrook, J., dissenting).

121. *Id.* at 657 (Easterbrook, J., dissenting).

122. *Id.*

the combined income of Hall and Phillips to Phillips alone;”¹²³ (3) doubled the couples’ combined income;¹²⁴ (4) and “falsely claimed that Phillips was a sales manager at a satellite TV business.”¹²⁵ Thus, instead of a borrower who was hairstylist at J.C. Penney with an income of less than \$24,000, the loan application represented that Phillips was a satellite TV sales manager with \$90,000 in annual income.

At trial, the defendants wanted to introduce evidence to establish that the mortgage broker, Bowling, told them that the loan documents should be filled out with Hall’s income added to Phillips’s income on the loan application, even though he was not named on the application.¹²⁶ According to the defendants, Bowling told them that “this was proper in the case of a stated-income loan because what the bank was asking for was the *total* income from which the loan would be repaid rather than just the borrower’s income.”¹²⁷ The district court, however, excluded this evidence as irrelevant, as Judge Posner explained:

The district judge ruled erroneously that if mortgage applicants “sign something and they send it in, they’re attempting to influence the bank. . . . They didn’t sign these papers just to put them up on their wall. They signed these papers with the idea they would go in to whoever and they would get a mortgage. . . . [If defendant Phillips, who signed the mortgage application to Fremont] just took the papers and went home, we would not have a crime. But by sending them in to the mortgage company, she’s met the requirements of [section] 1014.”¹²⁸

Ultimately, Hall and Phillips were convicted of violating and conspiring to violate 18 U.S.C. § 1014.¹²⁹ The penalties for their transgressions were stiff: “The defendants were each sentenced to two months’ imprisonment plus three years of supervised release and they were ordered to pay . . . nearly \$90,000 in restitution.”¹³⁰ A panel of the Seventh Circuit affirmed,¹³¹ over Judge Posner’s dissent,¹³² but the Seventh Circuit agreed to rehear the case *en banc*, “to clarify the elements of the crime and their application to charges of mortgage fraud, which have mushroomed in

123. *Id.*

124. *Id.*

125. *Id.*

126. *Id.* at 653.

127. *Id.*

128. *Id.* at 652.

129. *Phillips*, 731 F.3d at 650.

130. *Id.*

131. *United States v. Phillips*, 688 F.3d 802 (7th Cir. 2012), *vacated*, 731 F.3d 649 (7th Cir. 2013) (*en banc*).

132. *Phillips*, 688 F.3d at 805–10 (Posner, J., dissenting)

the wake of the collapse of the housing and credit bubbles in the period 2006 to 2008.”¹³³

2. Judge Posner’s Critique of the District Court

a) *The Basics of § 1014*

Judge Posner attacked the district court’s reasoning on several fronts. But first Posner began with a reminder that it is not enough to demonstrate that a loan application has false statements to satisfy § 1014.¹³⁴ The false statements must be knowingly made by the defendant with the purpose of influencing the lender.¹³⁵ Both elements must be met for § 1014 liability—the defendant must have knowledge of falsity *and* the goal of influencing the lender. To illustrate the limits of § 1014, Posner used an example of a wealthy actress lying about her age on loan documents.¹³⁶ The actress’s motivation for lying might be to avoid age discrimination in future projects should her true age as stated in the documents become public.¹³⁷ Such a borrower is knowingly making a false statement, but she is doing so without any purpose of influencing the lender. Thus, she cannot be convicted under § 1014.

b) *Knowledge of Falsity*

According to Posner, the evidence that the defendants sought to introduce in *Phillips* was relevant to both of § 1014’s requirements. First, their testimony (if believed) could undermine the conclusion that the false statements regarding borrower’s income were made knowingly.¹³⁸ Phillips admittedly conceded that “Bowling had told them he would add Hall’s

133. *Phillips*, 731 F.3d at 650.

134. *Id.* at 651.

135. *Id.* at 651–52.

136. *Id.* at 652.

137. *Id.*

138. Because § 1014 requires that misstatements be made knowingly, Phillips could not be held liable merely for signing the mortgage application forms, as Posner explained: “The government does not argue that by signing the form Phillips adopted the false statements in it that she was unaware of. Nor would that be a plausible reading of a criminal statute that forbids only false statements made ‘knowingly.’ It is careless to sign a document without reading it, but it is a knowing adoption of its contents only if the signer is playing the ostrich game (‘willful blindness’), that is, not reading it *because* of what she knows or suspects is in it.” *Id.* at 656.

income to Phillipps's in the line for the borrower's income."¹³⁹ This admission, however, did not settle the issue for the Seventh Circuit. Although the plain meaning of "borrower's income," may have only included Phillipps's income, Posner pointed out that Phillipps and Hall could have believed, based on what Bowling told them, that borrower's income was a term that had different meaning in this context.¹⁴⁰ And if they believed in this different meaning of "borrower's income," then they were not knowingly making a false statement to the bank. They were making what they believed was a true statement given their alleged understanding of the meaning of borrower's income. One white collar criminal law expert, Solomon L. Wisenberg,¹⁴¹ explains:

If Phillipps and Hall believed that Borrower's Income meant (to Fremont) Combined Income of the People Repaying the Loan, then Phillipps and Hall were not making a statement to Fremont that they knew was false. Their state of mind on this point was directly at issue. Theirs may have been be an implausible story, but the jury was allowed to hear it.¹⁴²

Judge Posner similarly concluded: "It is for a jury to determine what the defendants understood to be the meaning that Bowling attached to 'borrower's income.' In finance as in law, words and phrases in everyday use often bear a specialized meaning of which ordinary people are ignorant."¹⁴³

c) Purpose of Influencing the Lender

Judge Posner went further, however, and also contended that the proffered evidence might be relevant with respect to the question of whether the defendants sought to influence the lender. This is a more

139. *Id.* Phillipps claimed, however, that Bowling did not mention that he planned on inflating the overall income amount and that neither she nor Hall had read or were aware of the other inaccuracies in the loan application. *Id.* at 655.

140. *Id.* at 653–54; *see also* Solomon L. Wisenberg, *18 U.S.C. Section 1014: Dick and Frank (Posner and Easterbrook to you) Duke It Out*, WHITE COLLAR CRIME PROF BLOG (Sept. 5, 2013), https://lawprofessors.typepad.com/whitecollarcrime_blog/2013/09/18-usc-section-1014-dick-and-frank-duke-it-out-.html [<https://perma.cc/7MC8-P6AR>] ("According to Phillipps and Hall, Bowling told them that, to Fremont Investment & Loan, Borrower's Income meant the total income from which the loan would be repaid. They were in essence informed that Borrower's Income was a term of art for Fremont.").

141. Wisenberg is a law firm partner and the author of SOLOMON L. WISENBERG, *WHITE COLLAR CRIME: SECURITIES FRAUD* (2016 ed.).

142. Wisenberg, *supra* note 140.

143. *Phillips*, 731 F.3d at 654.

radical argument with possibly profound implications. To simplify somewhat, if a borrower believes, because of what a mortgage broker tells her, that something that she has put on her loan application will have no effect on the bank's ultimate lending decision, then arguably she is not attempting to influence the bank with her falsehoods. Posner explained:

[A] jury could find that the defendants believed the bank had approved the loan to the couple, and was telling them through Bowling what to put on the loan application, or what he should put on it in their name, and that in complying with his directives the defendants were not trying to influence the bank because they knew the bank had already made up its mind to make the loan and were just following Bowling's directions, which they may not have understood. What if he told them that the bank wouldn't even read their application, that all it cared about was having a signed application? Then in authorizing Bowling to fill in the application the defendants would not have been trying to influence the bank.¹⁴⁴

Put a different way, Posner asked: "What can it mean to intend to influence a bank by telling it something you're confident won't influence it?"¹⁴⁵

In support of this "influencing the lender" point, Posner provided a primer on his view of the perilous relationship between liar's loans—which were Fremont's specialty¹⁴⁶—securitization, and the financial crisis.¹⁴⁷ According to Posner, liar's loans "were profitable despite the high risk of default because lenders sold them as soon as they'd made them. Many of the loans were repackaged by the buyers into ill-fated mortgage-backed securities whose holders lost their shirts."¹⁴⁸ "This was musical-chairs

144. *Id.* at 655.

145. *Id.* at 653.

146. *Phillips*, 731 F.3d at 651.

147. Posner asserted that the type of liar's loans Fremont made "played a significant role in the financial collapse of September 2008," *id.* at 651, and that the collapse of Fremont was "a harbinger of the worldwide financial collapse that occurred three months later when Lehman Brothers suddenly declared bankruptcy." *Id.* For more on the role that liar's loans and securitization played in the Great Recession, see Edwards, *Mortgage Fraud*, *supra* note 2, at 62–68.

148. *Phillips*, 731 F.3d at 651. Many lenders suffered no direct financial loss from the misrepresentations in mortgage loan applications. See Shaun P. Martin, *Legal Winners and Losers in the Mortgage Crisis*, 24 CONN. INS. L.J. 245, 245 (2018) ("Given the presence of widespread mortgage securitization during the relevant period, lenders rarely lost money from even blatantly fraudulent mortgages. Instead, these lenders originated the underlying mortgages and promptly sold them to other market participants.").

financing,”¹⁴⁹ as Posner explained:

[T]here was . . . evidence, consistent with Fremont’s business model, that the bank didn’t give a fig about the couple’s ability to repay the loan. It planned to sell the loan, which would then be folded with many other loans into a mortgage-backed security that would be sliced and the slices sold around the world, the premise being that the security would be safe because of diversification—the mortgages bundled into the security would be on properties scattered across the United States. A nationwide collapse of the housing market was not foreseen.¹⁵⁰

Posner’s argument demonstrates the vital relationship between materiality evidence and the “purpose of influencing” element of § 1014. Just because the government is not required to prove materiality (i.e., whether the misstatement has some probability of influencing the lender), this does not mean that the defendant’s subjective beliefs about whether the lender would or could be influenced by the borrower’s misstatements are never legally relevant.¹⁵¹ As such, in the Seventh Circuit’s view, although *Wells* forbids courts from requiring that the government prove materiality in a § 1014 case,¹⁵² it “allows immateriality to be used as evidence that the false statement was not intended to influence the bank.”¹⁵³

3. Judge Easterbrook’s Response

Judge Easterbrook, who wrote the initial panel opinion in *Phillips*,¹⁵⁴ attacked Posner’s suggestion that lenders did not care at all what was on stated income applications just because they eventually would be securitized. In Easterbrook’s view, that most certainly was not the case; rather, the evidence supported the conclusion that the defendants in *Phillips* knew that the lender cared very much that the income number placed on the application was high enough to meet the bank’s standards (regardless of whether the income amount was true) so that the loan could be approved and ultimately securitized and sold to investors.¹⁵⁵ Easterbrook explained:

149. *Phillips*, 731 F.3d at 651.

150. *Id.* at 655.

151. See *infra* Part V.C. for further discussion of this point.

152. *Phillips*, 731 F.3d at 652.

153. *Id.*; but see *United States v. Johnson*, 732 F. App’x 638, 656 (10th Cir. 2018) (declining to consider immateriality argument raised for the first time on appeal).

154. *United States v. Phillips*, 688 F.3d 802 (7th Cir. 2012), *vacated*, 731 F.3d 649, 653 (7th Cir. 2013) (en banc).

155. *Phillips*, 731 F.3d 649, 658 (Easterbrook, J., dissenting).

Banks that syndicate their loans do not lose if the borrowers default—that’s why some didn’t run credit checks on potential borrowers, and why the phrase “liars’ loans” developed—but they do care about the *representation* that the income is high enough. Without the representation that the income is sufficient, the loan can’t be syndicated, the original bank would remain on the hook, and the loan therefore would not be made.¹⁵⁶

Thus, Easterbrook contended that Bowling’s testimony only would have been relevant “[i]f Bowling told defendants that banks would make loans with the income line left blank . . . because it would have tended to show that the defendants did not have ‘the purpose of influencing’ the lender when they put a number, any number, in the income blank.”¹⁵⁷ But, according to Easterbrook, there was no evidence that the lender would have approved a loan application with the income left blank.¹⁵⁸ Easterbrook therefore argued:

[I]f Bowling told the defendants only that the bank did not care about the truth of the claimed income, that would not have aided the defense. To the contrary, it would have supported the prosecution by showing that defendants knew that the stated income was vital to the success of the application.¹⁵⁹

Easterbrook’s dissent concluded with a gibe at the judge and scholar who arguably is most associated with the law and economics movement (Posner) from a prominent law and economics scholar himself.¹⁶⁰ Easterbrook argued:

The upshot of [Posner’s conclusion] . . . is that crooked brokers such as Bowling can confer on clients a legal entitlement to obtain loans by deceit. *That’s bad economics as well as bad law.* It makes it harder to extirpate liars’ loans programs, and it raises

156. *Id.*

157. *Id.*

158. *Id.*

159. *Id.* (concluding that everything that happened in the district court was consistent with the understanding that the “defendants wanted to show that, although they knew that banks respond to the income stated on the form, they thought that banks don’t care whether the statements are true”).

160. See Randall S. Thomas & Harwell Wells, *James D. Cox: The Shareholders’ Best Advocate*, 66 DUKE L.J. 467, 473–74 (2016) (“Undoubtedly the most influential work applying law and economics to corporate law was that of Judge Frank Easterbrook and Professor Daniel Fischel. In a series of articles—and then their classic book . . . they effectively founded the contractarian school, blazing a trail for later law and economics scholars.”).

the rate of interest that will be charged to honest applicants.¹⁶¹

Before moving on, it is worth remembering that the ultimate question before the Court of Appeals in *Phillips* was whether the district court erred in excluding the defendants' proffered evidence,¹⁶² and not whether the government's evidence was legally insufficient to support a § 1014 conviction.¹⁶³ Thus, although the Seventh Circuit reversed, it only did so to mandate a new trial.¹⁶⁴ In the end, the jury might well have been dubious about the defendant's claims regarding what the mortgage broker told them and how it influenced both their knowledge and mental state.¹⁶⁵ According to the Seventh Circuit, however, this was relevant testimony that the jury deserved to hear.¹⁶⁶

V. HOPEFUL DREAMERS OR CRIMINALS? LESSONS LEARNED REGARDING § 1014 IN THE WAKE OF THE GREAT RECESSION

A. *Is Materiality the Answer?*

It would be tempting to conclude that cases like *Phillips* vindicate Justice Stevens's dissent in *Wells* by illustrating the value of a rigorously imposed materiality requirement in criminal prosecutions for mortgage fraud under § 1014. There is little doubt that materiality requirements serve valuable purposes. In the civil context, Emily Sherwin concisely explains the general benefit of materiality requirements:

Perhaps the most straightforward reading of the materiality

161. *Phillips*, 731 F.3d 649, 658 (Easterbrook, J., dissenting) (emphasis added).

162. In Posner's view, the district court's flawed interpretation of the law "warped the trial," and that "the judge may have been led by a misunderstanding of section 1014 to exclude evidence that if admitted might have exonerated the defendants." *Phillips*, 731 F.3d at 650, 652.

163. See *United States v. Cavallo*, 790 F.3d 1202, 1230–31 (11th Cir. 2015) (explaining that "*Phillips* did not concern a sufficiency of the evidence issue"). Cf. *United States v. Vargas*, 629 F. App'x 415, 418 (3d Cir. 2015) (distinguishing *Phillips* and upholding convictions for conspiracy to commit wire and bank fraud—as opposed to § 1014—based upon the sufficiency of the evidence).

164. *Phillips*, 731 F.3d at 657 (reversing and remanding for a new trial after holding that "[t]he erroneous exclusion of evidence favorable to the defendants could thus have been decisive in the jury's decision to convict").

165. Judge Easterbrook also argued that there was sufficient evidence before the jury to convict *Phillips* and *Hall*, even disregarding the evidence that the district court excluded. *Phillips*, 731 F.3d at 657–58 (Easterbrook, J., dissenting); see also JOHN KAPLAN, ROBERT WEISBERG & GUYORA BINDER, *CRIMINAL LAW: CASES AND MATERIALS* 1036 (8th ed. 2017) (discussing this evidentiary issue).

166. Ultimately, the government decided not to re-try *Phillips* and *Hall*.

requirement is that some fraudulent misrepresentations, even if deliberate, believed, believable, and acted on in fact, should not have legal consequences. In other words, materiality is a *de minimus* limitation, marking off a zone in which proven fraud is tolerated by law.¹⁶⁷

Materiality arguably is even more important in criminal cases.¹⁶⁸ One scholar, Timothy Todd, explains that “criminal statutes without robust materiality and specificity invite ‘abuse on the part of prosecuting officials, who are left free to harass any individuals or groups who may be the object of official displeasure.’”¹⁶⁹ He further observes:

The ability to stack (or multiply) charges, which compounds the potential sentence, “allows prosecutors to pressure defendants to settle rather than to fight, to enter a plea bargain that admits guilt (whether it truly existed or addressed conduct that was truly wrongful in any meaningful sense), and to take a small punishment.”¹⁷⁰

There is no doubt that materiality matters. But, as important as that point is, it might not be exactly the right lesson here. As the Supreme Court recently explained: “Under any understanding of the concept, materiality ‘look[s] to the effect on the likely or actual behavior of the recipient of the alleged misrepresentation.’”¹⁷¹ Thus, even if § 1014 required proof of materiality, it is likely that prosecutors would not have had much difficulty in proving in *Phillips* that doubling the borrower’s income on a loan application and changing one’s job from J.C. Penney hairdresser to a satellite TV business sales manager were both pretty

167. Emily Sherwin, *Nonmaterial Misrepresentation: Damages, Rescission, and the Possibility of Efficient Fraud*, 36 LOY. L.A. L. REV. 1017, 1021 (2003).

168. At the very least, “[w]hen materiality is included as an element of a statute, it serves to narrow the range of conduct that is subject to prosecution.” Podgor, *supra* note 26, at 594.

169. Timothy M. Todd, *The Pernicious Effect of Dubious Materiality*, 12 LIBERTY U. L. REV. 315, 323 (2018) (quoting *Parker v. Levy*, 417 U.S. 733, 775 (1974)).

170. *Id.* at 332 (quoting Ronald A. Cass, *Overcriminalization: Administrative Regulations, Prosecutorial Discretion, and the Rule of Law*, 15 ENGAGE: J. FEDERALIST SOC’Y PRAC. GROUPS 11, 23–24 (2014)). In the context of § 1014, prosecutors might use the threat of prosecution under § 1014 to pressure defendants who might not be the primary targets of a law enforcement investigation to provide information on co-conspirators. Another possibility is that § 1014 might be used to extract guilty pleas from defendants who are also under investigation for crimes that do require proof of materiality, such as bank, mail and wire fraud, and thus might be harder to prosecute successfully.

171. *Universal Health Servs., Inc. v. United States*, 136 S. Ct. 1989, 2002 (2016) (citing 26 RICHARD A. LORD, WILLISTON ON CONTRACTS § 69:12 (4th ed. 2003)).

material misstatements.¹⁷² This is not to say that misrepresentation statutes ought not have materiality requirements, but rather that *Phillips* and similar mortgage fraud cases are not ideal examples to demonstrate such a point. It is common for misstatements in mortgage fraud origination cases to involve significantly inflated income and assets claims and falsehoods regarding a buyer's intention to occupy the property securing the loan.¹⁷³ It is hard to imagine any court not finding such matters to be material, regardless of how we choose to define materiality or how rigorously the concept is applied in specific mortgage fraud cases. Accordingly, the lessons, if any, to be learned from prosecutions arising out of the mortgage fraud explosion is not simply that § 1014's knowledge and purpose standard needs to be supplemented with a materiality requirement.

B. Prosecutorial (In)Discretion

Although Justice Stevens argued that the *Wells* Court's interpretation of § 1014 allowed the prosecution of borrowers who did not deserve criminal punishment, he also praised the majority for avoiding arguments based on prosecutorial restraint.¹⁷⁴ In the years since *Wells* was decided, the Supreme Court repeatedly has addressed the important non-relationship between prosecutorial discretion and statutory interpretation.¹⁷⁵ Justice Breyer, writing for the Court in a recent opinion explained:

[T]o rely upon prosecutorial discretion to narrow the otherwise wide-ranging scope of a criminal statute's highly abstract general statutory language places great power in the hands of the prosecutor. Doing so risks allowing "policemen, prosecutors, and juries to pursue their personal predilections," . . . which

172. See *supra* notes 122–125 and accompanying text (discussing the specific misrepresentations in *Phillips*).

173. This is also known as "occupancy fraud." See Erwin J. Shustak, *Recent Developments and Issues in Mortgage Fraud Cases*, in *MORTGAGE AND FINANCE FRAUD LITIGATION STRATEGIES: LEADING LAWYERS ON MANAGING THE COMPLEXITIES OF FRAUD CASES, UNDERSTANDING GOVERNMENT REGULATIONS, AND STRUCTURING AN EFFECTIVE LITIGATION PLAN* 59, 66 (2015–2016 ed. 2015).

174. *United States v. Wells*, 519 U.S. 482, 512 (1997) (Stevens, J., dissenting); Hise, *supra* note 39, at 901 ("In dissent, Justice Stevens noted that the Court, quite correctly, did not rely upon the discretion of prosecutors to avoid frivolous prosecutions.")

175. See *Abuelhawa v. United States*, 556 U.S. 816, 823 n.3 (2009) ("Congress legislates against a background assumption of prosecutorial discretion, but this tells us nothing about the boundaries of punishment within which Congress intended the discretion to be exercised; prosecutorial discretion is not a reason for courts to give improbable breadth to criminal statutes.") (Souter, J. for the Court).

could result in the nonuniform execution of that power across time and geographic location. And insofar as the public fears arbitrary prosecution, it risks undermining necessary confidence in the criminal justice system. That is one reason why we have said that we “cannot construe a criminal statute on the assumption that the Government will ‘use it responsibly.’”¹⁷⁶

Scholars similarly contend that “resorting to prosecutorial discretion to curtail executive branch power rings hollow,”¹⁷⁷ given that “prosecutors simply have no incentive to ratchet down investigations or screen out undeserving defendants when liability for morally blameless conduct is so expansive and the pressure to obtain convictions is so great.”¹⁷⁸

The *Phillips* case provides a nice illustration of why courts and scholars believe that we cannot rely on prosecutorial discretion as a protection against overbroad criminal statutes.¹⁷⁹ Posner’s disgust about the prosecutor’s decision to prosecute Hall and Phillips is evident throughout his opinion for the en banc Seventh Circuit. In short, Judge Posner viewed Hall and Phillips as “hapless victims” of their broker¹⁸⁰—who ultimately “turned state’s evidence and was rewarded for helping to convict his victims by being given a big slice off his sentence.”¹⁸¹ Posner was also sure to note that, criminal sanctions aside, Hall and Phillips—like so many other borrowers in the halcyon days prior to the financial crisis—

176. *Marinello v. United States*, 138 S. Ct. 1101, 1108–09 (2018) (quoting *Smith v. Goguen*, 415 U.S. 566, 575 (1974), and *McDonnell v. United States*, 136 S. Ct. 2355, 2372–73 (2016)). See also Wiley, *supra* note 56, at 1058–68 (discussing the decline of prosecutorial discretion arguments in the Supreme Court).

177. Lisa Kern Griffin, *Compelled Cooperation and the New Corporate Criminal Procedure*, 82 N.Y.U. L. REV. 311, 380 (2007).

178. *Id.*

179. This point would not hold for readers who view borrowers such as Hall and Phillips as morally culpable and deserving of punishment.

180. *United States v. Phillips*, 731 F.3d 649, 651 (7th Cir. 2013); see also KAPLAN, WEISBERG & BINDER, *supra* note 165, at 1036 (“Judge Posner clearly regards Phillips and Hall as victims, who were tricked into accepting a loan that would become unaffordable after two years, after the introductory rate went up.”); Daniel Colbert, *Victims or Fraudsters?: Telling Them Apart in the Wake of the Subprime Mortgage Crisis*, AM. CRIM. L. REV. (Oct. 26, 2013, 4:04 PM), <https://web.archive.org/web/20140302152844/http://www.americancriminallawreview.com/Drupal/blogs/blog-entry/victims-or-fraudsters-telling-them-apart-wake-subprime-mortgage-crisis-10-26-2013> [https://perma.cc/QG3A-AZTN] (“In his original dissent, Posner points out that Bowling and Fremont were among the ‘unscrupulous’ actors who helped cause the financial crisis by lending money to ‘impecunious suckers.’”) (citing *United States v. Phillips*, 688 F.3d 802, 808 (7th Cir. 2012)).

181. *Phillips*, 731 F.3d at 651.

suffered dearly for their folly.¹⁸² After all, the couple ultimately “lost their home, being unable—despite valiant efforts to keep up their mortgage payments by working second jobs—to make the monthly payments of principal and interest required by the terms of the mortgage.”¹⁸³ The entire affair led one commentator to opine that “it is appalling and embarrassing that any self-respecting U.S. Attorney’s Office would prosecute a case like this.”¹⁸⁴

In contrast, Judge Easterbrook’s dissent in *Phillips* did not evidence any discomfort with the government’s decision to prosecute the borrowers in this case. Whereas the majority views the defendants as gullible dreamers duped by a sleazy mortgage broker, “Judge Easterbrook . . . saw Phillips and Hall as liars and willing collaborators in a scam”¹⁸⁵—the type of ne’er do wells who make it harder for honest borrowers to obtain credit.¹⁸⁶ As Easterbrook summed up the facts: “Had defendants told the truth, they wouldn’t have received the loan.”¹⁸⁷

The more pertinent question raised by *Phillips*, might be not whom prosecutors decided to prosecute in the wake of the financial crisis, but who federal prosecutors failed to prosecute. The point has almost become banal by now, but it is “commonplace to observe that no top bankers from the top financial firms went to prison for the widespread malfeasance that led to the 2008 financial crisis.”¹⁸⁸ Viewed this way, cases like *Phillips* provide ammunition for critics who believe that far too much prosecutorial focus is placed on minor white-collar crime players, while Wall Street muckety-mucks routinely evade prosecution and punishment.¹⁸⁹

182. See KAPLAN, WEISBERG & BINDER, *supra* note 165, at 1036 (“Judge Posner suggests that it is unjust that Phillips and Hall, after losing their house and their down payment, should be required to pay restitution to the bank that tricked them into this.”).

183. *Phillips*, 731 F.3d at 651.

184. Wisenberg, *supra* note 140.

185. KAPLAN, WEISBERG & BINDER, *supra* note 165, at 1037; Colbert, *supra* note 180 (“Easterbrook’s logic assumes that the borrowers are crooks, or at least sophisticated financial actors.”).

186. *Phillips*, 731 F.3d 649, 658 (Easterbrook, J., dissenting) (arguing that Posner’s lenity towards borrowers like Hall and Phillips “makes it harder to extirpate liars’ loans programs, and . . . raises the rate of interest that will be charged to honest applicants”).

187. *Phillips*, 731 F.3d at 659 (Easterbrook, J., dissenting).

188. JESSE EISINGER, *THE CHICKENSHIT CLUB: WHY THE JUSTICE DEPARTMENT FAILS TO PROSECUTE EXECUTIVES* xvii (2017).

189. The classic statement of this position is Jed S. Rakoff, *The Financial Crisis: Why Have No High Level Executives Been Prosecuted?*, N.Y. REV. BOOKS (Jan. 9, 2014), <https://www.nybooks.com/articles/2014/01/09/financial-crisis-why-no-executive-prosecutions/> [https://perma.cc/Y3W3-93DE]. For a contrary view that is more skeptical of the calls for prosecutions related to the financial crisis, see Daniel C. Richman, *Corporate*

This need not have been the case with respect to financial malfeasance in connection with the Great Recession. Adam Levitin, a prominent financial regulation scholar, surmises that “[b]etween federal bully statutes like wire fraud and mail fraud and the immense power federal prosecutors have to coerce plea bargains, it is hard to believe that a determined federal prosecutor could not have brought a criminal case against either a bank or its executives.”¹⁹⁰ At the same time, Levitin concedes that it “it is hard to second-guess” prosecutors who have “direct access” to information about specific cases.¹⁹¹ In other words, we might have the intuition that many powerful, wealthy and well-connected bankers engaged in criminal behavior prior to and during the Great Recession, but that does not mean that prosecutors who declined to prosecute such parties did not have legitimate reasons for keeping their powder dry in specific cases.¹⁹² Nevertheless, it may be upsetting to some members of the public that prosecutors used their wide discretion to hold off on prosecuting top Wall Street bankers, while going after borrowers like Hall and Phillips.¹⁹³

C. Immateriality and Materiality

The Seventh Circuit’s opinion in *Phillips* highlighted an important tension in § 1014 doctrine regarding materiality and immateriality evidence in federal mortgage fraud cases. Four related points must be reiterated to understand the problem. First, as discussed throughout this Article, a successful § 1014 prosecution does not require proof that the borrower’s false statements were material. Whether or not a borrower’s misstatements would be likely to influence a bank or lender need not be established by prosecutors in a § 1014 case. Second, a defendant may violate § 1014 even if the bank does not rely on the misstatements and the lender suffers no financial harm.¹⁹⁴ Proof of harm or reliance are just not required under §

Headhunting, 8 HARV. L. & POL’Y REV. 265, 265 (2014) (arguing that “a focus on headhunting will only distract from, and reduce the pressure for, efforts to explain the collapse and prevent its recurrence”).

190. Adam J. Levitin, *The Politics of Financial Regulation and the Regulation of Financial Politics: A Review Essay*, 127 HARV. L. REV. 1991, 2028 (2014).

191. *Id.*

192. See Richman, *supra* note 189, at 275 (discussing the challenges of identifying specific responsible individuals to prosecute under existing federal criminal law).

193. See Colbert, *supra* note 180 (“One would hope that prosecutors would consider the sophistication of the borrowers before prosecuting.”)

194. See *United States v. Sandlin*, 589 F.3d 749, 754 (5th Cir. 2009) (“A false statement need not be material nor relied upon by the bank to violate Section 1014.”).

1014, though defendants often try to make such arguments.¹⁹⁵ Third, and related to the first two points, a borrower may violate § 1014 even if the lender itself is involved in the mortgage fraud scheme or bank employees conspired with the borrowers.¹⁹⁶ The Fifth Circuit has explained the public policy behind this position:

While it is undoubtedly true that 18 U.S.C. § 1014 benefits various financial institutions, the law's ultimate beneficiary is the United States. False statements given to insured banks have the potential to mislead the auditors charged with maintaining the federal standards. The government's interest in maintaining the vitality of its insurance programs mandates that all material false statements violate § 1014, even when the false statements are given with the knowledge, consent or duplicity of a bank officer.¹⁹⁷

Fourth, despite the three points summarized above, § 1014 does require proof that the borrower had the subjective intent to influence the lender. Knowingly making a false statement to the lender alone does not violate § 1014. Thus, borrowers may want to introduce evidence, as odd and counterintuitive as this might seem, that they knew or believed that the lender would not be influenced by their misstatements. Such proof might show that the *borrower* did not have the subjective intention of influencing the lender.¹⁹⁸ As one treatise explains: "A defendant who knew, or

195. See 1 JOHN K. VILLA, *BANKING CRIMES: FRAUD, MONEY LAUNDERING AND EMBEZZLEMENT* § 4:18 (2019) (explaining that lack of bank reliance is a "popular but unsuccessful argument advanced by many defendants" in § 1014 cases).

196. See 1 JOHN K. VILLA, *BANKING CRIMES: FRAUD, MONEY LAUNDERING AND EMBEZZLEMENT* § 4:17 (2019) (explaining that "complicity" of bank officers is not a valid defense in a § 1014 case, even where "the bank officer encouraged the defendant to submit the false statement") (collecting cases); see also Colbert, *supra* note 180 ("Because the statute does not require that the borrower intend to harm the bank, but only that he intend to influence it, it does not 'immunize a party from criminal liability because an officer of the bank was involved in the fraudulent scheme.'") (quoting *United States v. Braverman*, 522 F.2d 218, 223 (7th Cir. 1975)).

197. *United States v. Bush*, 599 F.2d 72, 75 (5th Cir. 1979); Colbert, *supra* note 180 ("Though one of the effects of the statute is that banks are protected from false statements, its central goal was the vitality of the government's deposit insurance programs, which is only served if the statute also bans statements that the bank knows are false.") (citing *Bush*, 599 F.2d at 75).

198. One criminal defense attorney makes this point on his firm's blog: If your client's loan was a "liar's loan" (i.e. stated income loan, where the lender did not verify the borrower's income), what was your client told by the mortgage broker or lender representative? If your client was told it doesn't matter what his or her income really was, then the false part of your client's statement was not made to influence the bank. Carl Gunn, *Materiality and Intent to Influence in 18 U.S.C. § 1014 Prosecutions*, KMBL

believed, at the time he submitted the false statement that the bank would not rely upon it would have a good jury argument that his knowledge or belief negates an element of the offense: the intent on his part to influence the bank.”¹⁹⁹ Accordingly, as Judge Posner explained in *Phillips*,²⁰⁰ *immateriality* evidence, which may involve proof regarding the lender’s own wrongdoing, may be used for the purpose of showing that the defendant lacked the subjective intent to violate § 1014.²⁰¹

Prosecutors naturally will recoil at the prospect of defendants introducing proof regarding a lender’s dubious business practices, such as routine disregard of troubling information contained in borrowers’ mortgage applications,²⁰² or even a bank’s employees’ active participation in generating falsehoods found in such documents.²⁰³ Prosecutors, and perhaps even federal court judges,²⁰⁴ will view this as a sneaky way of

LAW (Nov. 6, 2012), <https://www.kmblaw.com/materiality-and-intent-to-influence-in-18-u-s-c-%c2%a7-1014-prosecutions/> [<https://perma.cc/AEW6-3S6T>].

199. 1 JOHN K. VILLA, *BANKING CRIMES: FRAUD, MONEY LAUNDERING AND EMBEZZLEMENT* § 4:18 (2019). As noted earlier, Posner asked, rhetorically: “What can it mean to intend to influence a bank by telling it something you’re confident won’t influence it?” *United States v. Phillips*, 731 F.3d 649, 653 (7th Cir. 2013).

200. *Phillips*, 731 F.3d at 652 (stating that *Wells* “allows immateriality to be used as evidence that the statement was not intended to influence the bank” in § 1014 cases).

201. See KAPLAN, WEISBERG & BINDER, *supra* note 165, at 1036 (explaining that “materiality to a decision would provide some evidence of an intention to influence” a bank decision, and that “the absence of materiality would provide some evidence against intention to influence”).

202. One recent article uses the term “willful blindness” to capture this phenomenon. See Bernard S. Black, Charles K. Whitehead & Jennifer Mitchell Coupland, *The Nonprime Mortgage Crisis and Positive Feedback Lending*, 3 J.L. FIN. & ACCT. 1, 37 (2018) (arguing “that market participants were willfully blind at all stages of the lending, structuring, and purchase chain” for mortgage-backed securities).

203. The conventional wisdom is that borrowers, brokers and lenders all bore some responsibility for the pervasive falsehoods found in so-called liar’s loans applications prior to the Great Recession, though “there are numerous examples where mortgage brokers or originators may have falsified income information by borrowers without the borrowers’ knowledge.” Atif Mian & Amir Sufi, *Fraudulent Income Overstatement on Mortgage Applications During the Credit Expansion of 2002 to 2005*, 30 REV. FIN. STUD. 1831, 1863 (2017). This issue is discussed in Edwards, *Mortgage Fraud*, *supra* note 2, at 64–66; see also KAPLAN, WEISBERG & BINDER, *supra* note 165, at 1031 (“During the mortgage bubble preceding [the Great Recession of 2008], banks often encouraged borrowers to make false statements either because rising real estate prices lulled them into underestimating the cost of bad loans, or because they intended to pass these costs on to other institutions—who may have been deceived or who may also have been eager to pass the hot potato of fraudulent loans on to someone else.”).

204. Judge Easterbrook’s initial panel opinion in *Phillips* is an example of judicial skepticism on this score. *United States v. Phillips*, 688 F.3d 802, 805 (7th Cir. 2012) (“*Phillips* and Hall are not the first defendants to argue that they should be acquitted

trying to evade the first three propositions above, that in § 1014 cases: (1) prosecutors do not need to prove materiality;²⁰⁵ (2) prosecutors need not prove reliance or damages; and (3) a lender or bank's own culpability is not a defense.²⁰⁶ Undoubtedly, one real concern—legal doctrine aside—is that jurors who believe that lenders and brokers are the true villains in a mortgage fraud case (or just generally villainous) might be inclined towards acquittal, even if as a matter of law banker wrongdoing is not a defense for borrowers. In one case involving mortgage loan misrepresentations brought under the federal wire fraud statute (as opposed to § 1014), the Ninth Circuit stated:

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.²⁰⁷

The essential point, though, is that evidence of the lender's practices (whether foolish or criminal) could in some cases undermine the conclusion that the borrower believed that her misstatements would influence the lender's decisions. And, ultimately, the borrower's subjective intent to influence the bank is a question for the jury to decide.

because, although they lied to a bank, they thought that the bank cared only about paperwork and not about the truth of their representations.”)

205. For example, in *United States v. McDonnell*, No. 3:14-CR-12, 2014 WL 3545206 (E.D. Va. July 16, 2014), the district court explicitly distinguished *Phillips* and granted the government's motion to exclude evidence related to materiality, explaining that there was “no evidence in the record that Defendants had any inkling of the materiality of their allegedly false statements at the time they were made.” *Id.* at *1. The court further precluded the defendants from “testifying as to their opinion of the allegedly false statements' materiality because their opinions as to materiality are irrelevant.” *Id.* On the other hand, the court held that the defendants could “testify that they did not intend to influence the financial institutions.” *Id.* (citations omitted).

206. In upholding convictions for conspiracy to commit wire and bank fraud, the Third Circuit contended that “asserted lender recklessness . . . has no bearing on the defendants' awareness of misrepresentations on the loan applications. That is, whether the lenders were reckless in approving loans simply does not make the defendants' knowledge any more or less probable.” *United States v. Vargas*, 629 F. App'x 415, 419 (3d Cir. 2015). Although *Vargas* did not involve § 1014, it does reflect judicial skepticism for such arguments.

207. *United States v. Lindsey*, 850 F.3d 1009, 1014 (9th Cir. 2017) (citations and footnotes omitted).

D. Differentiating Fraud for Housing

There is a final lesson to be considered regarding the application of § 1014 to federal mortgage fraud cases: it may be problematic that federal law does not recognize in any formal way the distinction between fraud for housing and fraud for profit.²⁰⁸ Both types of mortgage fraud may violate § 1014.²⁰⁹ As the FBI explains: “Fraud for profit aims not to secure housing, but rather to misuse the mortgage lending process to steal cash and equity from lenders or homeowners.”²¹⁰ Fraud for housing, by contrast, occurs when mortgage loan applicants

commit fraud . . . in order to acquire property that they intend to maintain as a homeowner, and often carry out the fraud by making misrepresentations about their income and other information relevant to their credit rating, in order to obtain a loan that they intend to—and often do—fully repay.²¹¹

Although they do not have the force of law, the FBI’s two categories of mortgage fraud usefully draw attention to the question of which forms of mortgage origination fraud truly are the most pernicious and deserving of criminal punishment.²¹² The FBI, for its part, always has contended that mortgage fraud for profit schemes are far more harmful and deserving of

208. The FBI’s two-category classification of mortgage fraud into fraud for profit and fraud for housing is “referenced in almost every book and article on the topic.” Edwards, *Mortgage Fraud*, *supra* note 2, at 88 (collecting numerous sources).

209. Depending on the particular facts, misrepresentations to banks or lenders may also violate the federal wire, mail and bank fraud statutes.

210. *Financial Institution/Mortgage Fraud*, FBI, <https://www.fbi.gov/investigate/white-collar-crime/mortgage-fraud> (last visited on Jan. 24, 2019).

211. Gabrielle A. Bernstein, *The Role of Expectations in Assessing Intended Loss in Mortgage-Fraud Schemes*, 2010 U. CHI. LEGAL F. 337, 341; *see also* FBI, 2008 MORTGAGE FRAUD REPORT: “YEAR IN REVIEW” (2008), <http://www.fbi.gov/stats-services/publications/mortgage-fraud-2008> [<https://perma.cc/86XB-3B9D>] (“Fraud for property/housing entails misrepresentations by the applicant for the purpose of purchasing a property for a primary residence. This scheme usually involves a single loan. Although applicants may embellish income and conceal debt, their intent is to repay the loan.”).

212. Arguably, the Seventh Circuit in *Phillips* implicitly recognized the distinction between fraud for housing and fraud for profit, though some might think that Posner’s majority opinion twisted the law to reach what the Court of Appeals believed was an equitable result. *See* Colbert, *supra* note 180 (“[W]hen an overzealous prosecutor brings a case against borrowers, allowing the jury to consider the possibility that the borrowers were unwitting victims can adapt § 1014 to fit the realities of the subprime market.”); *id.* (“Posner’s approach – allowing the jury to hear evidence that a mortgage broker misled the borrowers – may not fit well with existing precedent, but it offers a way to distinguish fraudsters from their victims.”).

law enforcement attention than fraud for housing.²¹³ Nevertheless, this is merely a professed law enforcement priority, not a statutory limit on prosecutorial power.

New York's relatively new criminal mortgage fraud statute provides an interesting example of how criminal law may differentiate fraud for housing from fraud for profit. First, the New York statute explicitly includes a materiality requirement,²¹⁴ thus avoiding vexing questions of whether immaterial misrepresentations can give rise to criminal liability. Second, and of even more import, New York has an interesting wrinkle—an explicit exception from criminal liability for borrowers who take out a residential mortgage loan for a property that they intended to occupy,²¹⁵ though they can be held liable as accessories in some cases.²¹⁶ Thus, to use FBI terminology, New York has decided that criminal liability for borrowers is improper in some cases involving fraud for housing. At the same time, New York's mortgage fraud statute still permits criminal liability in cases of fraud for profit, where the borrower has no plan to reside in the property secured by the mortgage or intent to repay the loan. Furthermore, New York's approach obviously does not protect brokers and lenders who play an active role in generating the misrepresentations in loan applications. Thus, there are ways for criminal laws that govern mortgage-related misrepresentations to show leniency for (arguably) less morally blameworthy borrowers.

213. See *supra* note 210 (asserting that “[t]he FBI prioritizes fraud for profit cases”).

214. N.Y. PENAL LAW § 187.00(4) (McKinney 2009).

215. The statute reads as follows: “No individual who applies for a residential mortgage loan and intends to occupy such residential property which such mortgage secures shall be held liable under this article provided, however, any such individual who acts as an accessory to an individual or entity in committing any crime defined in this article may be charged as an accessory to such crime.” N.Y. PENAL LAW § 187.01 (McKinney 2009); David E. Zukher, *2009-2010 Survey of New York Law: Criminal Law*, 61 SYRACUSE L. REV. 681, 715 (2011) (explaining that the statute provides “an exemption from mortgage fraud for an individual person who applies for a loan and who intends to occupy the mortgaged property, other than as part of a criminal conspiracy”) (citing N.Y. PENAL LAW § 187.01 (McKinney 2010)).

216. See William C. Donnino, Practice Commentary, McKinney's Consolidated Laws of New York, Book 39, Penal Law § 187.00 (explaining that “exclusion of the ordinary home buyer does not, however, apply if the buyer is acting as ‘an accessory to an individual or entity in committing’ a ‘residential mortgage fraud’ crime”).

CONCLUSION

Phillips is an ideal denouement to the Souter-Stevens debate in *Wells* more than 20 years ago over the proper interpretation of 18 U.S.C. § 1014. In *Wells*, Stevens voiced concern regarding the imposition of severe criminal liability upon foolish bank borrowers. At the same time, Stevens recognized judicial skepticism about reliance on prosecutorial discretion as an institutional protection for overbroad federal criminal laws. Two decades later, in *Phillips*, Richard Posner, the once hard-hearted leader of the law and economics movement,²¹⁷ in the twilight of his illustrious judicial career, expresses great sympathy for hapless mortgage fraud borrowers exploited by mortgage brokers who end up facing federal criminal charges for their folly.

Justice Gorsuch recently wrote: “History shows that governments sometimes seek to regulate our lives finely, acutely, thoroughly, and exhaustively. In our own time and place, criminal laws have grown so exuberantly and come to cover so much previously innocent conduct that almost anyone can be arrested for something.”²¹⁸ Given the perils of over-criminalization to which Justice Gorsuch is alluding, we need to ask whether the legal system adequately has distinguished between borrowers who truly are deserving of criminal sanctions, and those for whom civil liability and other negative financial consequences would be sufficient punishment. That is one of the key issues that Justice Stevens homed in on in *Wells* over 20 years ago, and the importance of such matters was magnified by the subsequent mortgage meltdown and the Great Recession. As long as politicians, journalists and public policy wonks pound away on the countless virtues of home ownership, we will have borrowers who are tempted (or even lured) to get in on what has been touted as a low-risk, wealth-creating dream machine.²¹⁹ Whether or when such borrowers truly deserve criminal punishment is a question well worth asking.

217. Judge Posner has confessed “that for the first 25 or even 30 years of being a federal judge [he] did not feel empathy for many litigants.” RICHARD A. POSNER, IMPROVING THE FEDERAL JUDICIARY: STAFF ATTORNEY PROGRAMS, THE PLIGHT OF THE PRO SE’S, AND THE TELEVISIONING OF ORAL ARGUMENTS 253 (2d ed. 2017). Posner goes on to discuss his softening over time. *Id.* at 253–54.

218. *Nieves v. Bartlett*, 139 S. Ct. 1715, 1730 (2019) (Gorsuch, J., concurring and dissenting in part).

219. For more skeptical views on the benefits of home ownership, see A. Mechele Dickerson, *The Myth of Home Ownership and Why Home Ownership Is Not Always a Good Thing*, 84 IND. L.J. 189 (2009); Georgette Chapman Phillips, *An Urban Slice of Apple Pie: Rethinking Homeownership in U.S. Cities*, 24 NOTRE DAME J.L. ETHICS & PUB. POL’Y 187 (2010).