

Defenses to Discount Fraud Stripped



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Discount fraud is a crime that exploits the special discounts companies sometimes offer when market circumstances justify sacrificing revenue to win a particular piece of business. Most commonly, the customer provides a description of these market circumstances to the company. The customer must also pledge that any specially discounted products it acquires will be used only for the specified purpose, and will not be resold. While it can be highly profitable to obtain these specially discounted products for resale by making fraudulent misrepresentations, people engaging in such conduct may be subject to federal prosecution for mail fraud (18 U.S.C. §1341) and wire fraud (18 U.S.C. §1343).

The U.S. Supreme Court recently denied a petition for a writ of certiorari in the case of *United States v. Ali*, 10 C.D.O.S. 11104, which leaves standing a Ninth Circuit decision that eases the government's burden in prosecuting discount fraud cases. *Ali* is significant because it removes certain defenses

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that had often provided a barrier to discount fraud prosecutions. It also provides a clear method for determining the amount of a victim's loss, which is a salient factor in computing the amount of restitution that a defendant owes to the victim.

BACKGROUND FACT

Defendants Mirza Ali, Sameena Ali and Keith Griffen devised a scheme through which they exploited a Microsoft promotion that provided software to certain specified end-users at a special discount. Defendants procured about \$30 million in Microsoft products, on which they received about \$20 million in special discounts, by pretending to be a specified end-user to which Microsoft would normally approve sales of these discounted products.

Microsoft sold a special "academic edition" of its software, which, while being virtually identical to the normally marketed version, was sold at a much lower price. Microsoft would only sell this cheaper academic edition software to "authorized education resellers" that could then sell the discounted products only to "educational users," or to other AERs.

Defendants made false representations to Microsoft in order to obtain AER status for various companies they owned. Defendants also purchased companies that had been legitimate AERs, with the intent of using these acquired companies to fraudulently obtain the discounted academic edition software. Significantly, all of the specially discounted academic edition software defendants purchased came from other AERs — none of it was purchased directly from Microsoft. Defendants then resold this specially discounted software to 120 different entities, 90 percent of which were not

authorized to receive these discounted products.

Defendants were indicted in the U.S. District Court for the Northern District of California for various crimes, including mail fraud, wire fraud (discount fraud) and money laundering. After agreeing with the government to a set of stipulated facts, which are described above, a maximum sentencing exposure, and waiving their rights to a trial by jury, defendants were convicted. They were sentenced for terms of imprisonment that ranged between 33 and 60 months, with each defendant receiving the maximum punishment allowed by his or her stipulation. Defendants were also ordered to pay Microsoft \$20 million in restitution, which reflected the difference between the discounted price for the academic edition software defendants acquired and the full list price Microsoft would have charged for the normally marketed version of the software.

On appeal, defendants claimed they were wrongfully convicted of mail and wire fraud because there was no evidence that they took money or property from Microsoft. Relying upon the requirement that fraudulent schemes must seek to obtain money or property that is actually "in the hands of the victim" (*Cleveland v. United States*), defendants argued that their conduct was not criminal because: 1) discounts are only a "potential profit" and do not constitute an "actual loss" for the victim; and 2) any benefit defendants intended to receive was from the AERs, who did not suffer any loss. Defendants did not receive any benefit from the purported victim, Microsoft.

COURT HOLDINGS

The Ninth Circuit upheld the fraud convictions. The court found that discounts are "property" within the mean-

ing of the mail and wire fraud statutes because victims have a right to collect the full retail price for their products. The court also found that mail and wire fraud convictions can be upheld where a defendant procures the discounted products through an intermediary, such as a distributor, because the victim ultimately suffers a loss.

Relying upon well-established precedent that a fraud conviction will be upheld where the scheme sought to deprive a party of “an entitlement to collect money[,]” the Ninth Circuit determined that discounts obtained through fraud are such an entitlement, rather than “a potential loss,” which could not support a fraud conviction. Relying upon *Pasquantino v. United States*, the Ninth Circuit determined that a victim’s right to full payment for its products is among the types of property that are protected by the federal mail and wire fraud statutes. In *Pasquantino*, the Supreme Court ruled that a scheme that sought to avoid payment of Canadian excise tax constituted criminal fraud because “the defendants were attempting to deprive Canada of money legally due and Canada’s right to uncollected excise taxes is property in its hands.” The Ninth Circuit reasoned that this case is similar: A demand for payment of the full, retail price is not a mere potential loss because it is money legally due upon the sale. “Microsoft had a right to full payment for its software and was deprived of that right when defendants fraudulently obtained the software for less than full payment.”

In cases where discounts are procured through fraud, criminal convictions can be upheld on appeal regardless of whether the victim could have sold the same products at a higher price. Here, Microsoft suffered a loss because “defendants acquired the lower priced software when they should have paid the higher price,” the court reasoned. “It does not matter whether those who purchased the lower priced software from defendants would have paid the

higher price otherwise.” Further, the loss amount may be properly calculated by the difference between the discounted amount of the sales and the full retail price of the product.

The court was not persuaded by defendants’ argument that they were insulated from being convicted of fraud due to having procured products from third parties, who themselves purchased the products at discount and did not suffer any loss. It held that “depriving a victim of property rightfully due is enough” and the existence of intermediaries in the transaction did not shield Microsoft from its loss.

The court also found unpersuasive defendants’ argument that this was merely a breach of contract and not criminal fraud. It reasoned, “the simple fact that [a victim may bring] a civil contract claim against defendants does not immunize defendants’ conduct from criminal prosecution if that conduct meets the elements of the criminal statutes as well.” The court also concluded that defendants’ allegations that their conduct was in response to Microsoft’s own violations of antitrust and copyright laws were irrelevant. Illegal conduct by a victim “would not immunize defendants’ fraud.”

Defendants’ appeal did raise one valid legal defense. They could not be guilty of criminal fraud if their misrepresentations were directed to someone other than the victim because the law requires that a defendant’s intent be to obtain money or property from the one who is deceived. Defendants claimed that their misrepresentations were directed to the AERs, but not to the victim, Microsoft. The court disagreed — here, defendants made misrepresentations directly to Microsoft in their applications to become AERs. Because defendants were only able to procure discounted products because they operated AERs, and they would not have become AERs absent their misrepresentations to the victim Microsoft, the evidence was suf-

ficient to sustain their convictions.

CONCLUSION

There are misperceptions about discount fraud that sometimes cause victims and their counsel to regard it differently than traditional mail and wire fraud cases. Often, this is due to the mistaken belief that a victim is not really harmed because it received some measured profit, in spite of the scheme. In addition to whatever faulty assumptions may lie in such reasoning, it improperly shifts the focus away from the defendant’s criminal intent to analyze whether the victim received an incremental benefit. The better perspective to assess whether schemes to commit discount fraud should be prosecuted would be to ask: But for the defendant’s misrepresentations, would the victim have sacrificed its revenues for this defendant’s benefit?

Discount fraud provides a means for stealing a victim’s revenues in the same way as any other fraudulent scheme provides a means for such theft. The Ninth Circuit has made this clear in *Ali* by focusing upon the defendant’s intent. As *Ali* makes clear, where the defendant’s objective is to deprive the victim of money through a fraudulent scheme, that conduct is not immunized based upon some incremental profit that the victim is supposed to have made, and where a defendant engages in a fraudulent scheme through which he obtains special discounts not available to similarly situated honest actors, his bad acts are not shielded from prosecution merely because the scheme used intermediaries and shells. *Ali* simplifies loss calculations by removing a burden that had sometimes been imposed upon victims to project whether they could have otherwise sold the fraudulently procured products at normal retail prices. This case may prove to be significant because it removes defenses and claims that effectively caused discount fraud schemes to be treated differently from other fraudulent schemes and made them more difficult to prosecute.