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## Litigation Update

# Supreme Court Poised to Narrow Materiality

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The materiality standard in fraud cases may soon shift dramatically if the comments of Supreme Court justices during a recent oral argument are any indication. A rollback of the materiality standard would be the latest in a series of Supreme Court cases that make it more difficult to prosecute white-collar cases. Any change in the materiality standard could also impact noncriminal cases, including regulatory enforcement actions and civil lawsuits, depending on the precise language of the Supreme Court's decision.

### Background: *Kousisis v. United States*

The defendants in *Kousisis v. United States* were convicted of a wire fraud scheme in which they lied about hiring disadvantaged business enterprises, which the state agency required under the contract. Instead of hiring a DBE, the defendants reported payments to a DBE that then sent invoices, with a small markup, to non-DBEs that actually performed the work. The government alleged and proved that the defendants made it appear that a DBE performed the work in order to mislead the state.

But the defendants argued that the DBE requirement was not a material term of the contract, and "materiality" is an element of fraud. The contract was completed, and the state did not suffer any economic harm because of the defendant's scheme. So according to the defense: no harm, no foul, and certainly no wire fraud.

The government disagreed, noting that the wire fraud statute does not contain an economic harm requirement. The government argued that the defendants only received the contract because they lied about using DBEs. And, even if the state suffered no financial harm, states can have material noneconomic interests. One potential issue, not raised in this case but lingering in the background, is whether a state can have a valid interest in promoting hiring of certain races, given the Supreme Court's recent Equal Protection Clause jurisprudence.

### Oral Arguments at the Supreme Court: Skepticism Toward Both Sides

Throughout oral arguments, the Justices grappled with how to define materiality, pressing both sides on their competing views.

The defense argued that materiality inherently requires a financial loss by the victim. Otherwise, under the government's theory, any false statement could be wire fraud — white lies, puffery, and other everyday tactics used to entice people into a transaction. The defense explained that while such behavior may be grounds for a breach of contract claim, it is not criminal fraud.

Justice Ketanji Brown Jackson asked the defense whether it would be fraud if a babysitter lied about being Christian, knowing that the parents only wanted a Christian babysitter. The defense responded that it would not be fraud if the babysitter was otherwise qualified and performed the contract. The parents' religious preference was not material to whether the child was properly cared for. The family could seek civil remedies, but the government could not bring criminal fraud charges.

In contrast, the government argued that deception regarding *any* clause could be material and therefore serve as a basis for a fraud suit. As part of its argument, the government also proposed a higher standard for materiality, suggesting that only statements which go to the "essence of the bargain" are material. Currently, any statements capable of influencing the other party are deemed material.

Some Justices seemed skeptical of the defense's theory, while others expressed concern about the government's potentially limitless interpretation of wire fraud. Justice Neil Gorsuch changed the babysitter hypothetical: Is it criminal fraud if a babysitter told the family she worked for that she was going to use the money to pay for college, but instead vacationed in Cancun? The government begrudgingly conceded that she *would* be guilty of criminal fraud under its theory.

### Implications

If the Court narrows what can be considered material to a contract, it could create ripple effects in contexts beyond the wire fraud statute at issue in *Kousisis*. Materiality is a core element of many regulatory enforcement actions, civil fraud claims and similar lawsuits, and a higher standard would make bringing such actions more difficult. Defendants facing any claims for which materiality is an element should look out for the Supreme Court's decision to determine if they can use *Kousisis* as part of their defense.



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