The Honorable John C. Coughenour

UNITED STATES DISTRICT COURT FOR THE
WESTERN DISTRICT OF WASHINGTON
AT SEATTLE

UNITED STATES OF AMERICA, Plaintiff, v. ERIC SHIBLEY, Defendant.	NO. CR20-174JCC **GOVERNMENT'S MOTION *IN LIMINE* TO PRECLUDE EVIDENCE AND ARGUMENTS CONCERNING VICTIM NEGLIGENCE AND PROFITS**

The government files this motion *in limine* to preclude the defense from introducing evidence and arguments concerning alleged negligence by the victim lenders and loan processors or the SBA and as well as from introducing evidence and arguments concerning any profit by the victim lenders.[1]

I. BACKGROUND

On October 15, 2020, the Defendant was indicted by a grand jury with seven counts of Title 18, United States Code, Section 1343 (Wire Fraud); three counts of Title 18, United States Code, Section 1344(2) (Bank Fraud); and five counts of Title 18,

[1] Undersigned counsel and counsel for defendant, Michael Nance, met and conferred about this motion by phone on October 26, 2021.

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United States Code, Section 1957 (Money Laundering) related to a scheme to submit false and fraudulent applications for Paycheck Protection Program (PPP) loans and Economic Injury Disaster Loans (EIDL). Dkt. #31. During the scheme, the Defendant sought multiple PPP and EIDL funds by submitting applications in the name of fake businesses that he falsely stated had dozens of employees for which the businesses paid salaries and payroll taxes and thousands of dollars in payroll as of February 15, 2020.

II. ARGUMENT

The Court should exclude any evidence relating to alleged negligence by the lenders and loan processors responsible for administering the loans that Defendant fraudulently obtained. As explained below, these lenders and loan processors, along with the SBA itself, are the victims of Defendant's fraud and conspiracy. Any evidence relating to victim negligence is irrelevant to the question of Defendant's guilt and inadmissible as a defense.

A. Background of the PPP

Following the enactment of the CARES Act, the SBA issued interim final rules establishing and regulating the PPP. See SBA, Interim Final Rules, 85 Fed. Reg. 20811 (April 15, 2020) (the "First Rule") and 85 Fed. Reg. 33010 (June 1, 2020) (the "Lender Rule"). The SBA recognized that speed was of the essence in distributing COVID-19-related economic relief. "The intent of the [CARES] Act is that SBA provide relief to America's small businesses expeditiously, which is expressed in the Act by giving all lenders delegated authority and streamlining the requirements of the [SBA's] regular 7(a) loan program." Lender Rule, 85 Fed. Reg. 33011. If borrowers used PPP loans used for eligible expenses, such as payroll, the repayment of the borrowed funds used for those expenses could be forgiven, and the SBA guaranteed repayment to PPP lenders for the full amount of the loan. See First Rule, 85 Fed. Reg. 20816 and SBA, Interim Final Rule, 85 Fed. Reg. 33004 (June 1, 2020) (the "Forgiveness Rule").

Given the need for expeditious distribution of PPP funds, the SBA emphasized that "lenders may rely on borrower representations" and, to the extent the application

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contained errors or needed further support, "the lender should work with the borrower to remedy the issue." Lender Rule, 85 Fed. Reg. 33013; see also First Rule, 85 Fed. Reg. 20815-20816. However, since "loans and loan forgiveness are provided based on the borrower's certifications and documentation provided by the borrower," the SBA has the authority to review individual PPP loans to determine if the borrower was ineligible and require additional documentation from PPP lenders. Lender Rule, 85 Fed. Reg. 33012.

The SBA further warned that it would seek repayment of lender processing fees associated with an ineligible loan, and clawback such fees if it determined a lender had not fulfilled its obligations under PPP regulations. *Id.* Although the SBA assured PPP lenders that borrower ineligibility would not affect the SBA's guarantee of a PPP loan, the availability of that guarantee was subject to lender compliance with, among other things, the SBA's First Rule. Lender Rule, 85 Fed. Reg. 33014. The SBA expected lenders to abide by the due diligence and anti-money laundering program requirements of the Bank Secrecy Act, including but not limited to practices such as establishing a customer identification program, and were expected to "understand the nature and purpose of their PPP customer relationships to develop customer risk profiles." First Rule, 85 Fed. Reg. 20815.

B. Courts Routinely Find Evidence of Lender Negligence is Inadmissible

The Ninth Circuit has held that evidence of a victim's alleged negligence is not relevant and is properly excluded at trial. *United States v. Lindsey*, 850 F.3d 1009, 1015 (9th Cir. 2017) ("We join several of our sister circuits in holding that a victim's negligence is not a defense to wire fraud."); *United States v. Ellison*, 704 F. App'x 616, 620 (9th Cir. 2017) ("a victim's negligence is not a defense" to securities fraud); *United States v. Palamarchuk*, 791 F. App'x 658, 660 (9th Cir. 2019) ("neither individual victim lender negligence nor an individual victim lender's intentional disregard of relevant information is a defense to mail fraud"). "[I]t is no defense to wire fraud or bank fraud that the victim of the fraud was negligent, gullible, or incompetent." *United States v. Maximov*, No. CR10-822-PHX-DGC, 2011 WL 4915162, at *2 (D. Ariz. Oct. 17, 2011)

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(*citing United States v. Blixt*, 548 F.3d 882, 889 (9th Cir. 2008) ("[A] misrepresentation may be material without inducing any actual reliance. What is important is the intent of the person making the statement that it be in furtherance of some fraudulent purpose.")).

In *United States v. Palamarchuk*, 791 F. App'x 658, 660 (9th Cir. 2019), the Ninth Circuit approved the district court's exclusion of certain evidence related to "the conduct and motives of the victim lenders", noting that "neither individual victim lender negligence nor an individual victim lender's intentional disregard of relevant information is a defense to mail fraud."

Other circuits have reached similar conclusions. See *United States v. Powell*, 509 F. App'x 958, 967 (11th Cir. 2013) ("Likewise, whether the lenders negligently created an environment of lax lending standards is irrelevant. Contributory negligence is not a defense to the crime of fraud."); *United States v. Coyle*, 63 F.3d 1239, 1244 (3d Cir. 1995) ("[T]he negligence of the victim in failing to discover a fraudulent scheme is not a defense to criminal conduct."); *United States v. Moore*, 923 F.2d 910, 917 (1st Cir. 1991) ("[I]t is not a defense that the bank might have prevented its losses had it better internal controls or procedures."); *United States v. Winkle*, 477 F.3d 407, 418 (6th Cir. 2007) (approving the exclusion of an FDIC report that criticized the bank fraud victim's failure to detect a fraud scheme); *United States v. Rennert*, 374 F.3d 206, 213 (3d Cir. 2004) ("fraud victim's negligence or lack of diligence in uncovering the fraud is not a defense"); *United States v. Thomas*, 377 F.3d 232, 243-44 (2d Cir. 2004) (affirming restrictions on cross of victim; rejecting defendant's argument that victim's foolishness vitiated defendant's fraudulent intent); *United States v. Frenkel*, 682 F. App'x 20, 22 (2d Cir. 2017) ("A victim's negligence is not a defense under the federal fraud statutes.") (*citations omitted*).

C. Whether a Victim is Sophisticated or Not is Immaterial to the Intent to Defraud

In the Ninth Circuit, as in other circuits, the government need not prove that a fraud scheme was calculated to deceive only persons of ordinary prudence and

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comprehension, as fraud statutes protect the naïve as well as the sophisticated, and it is immaterial whether only the most gullible victims would have been deceived. *United States v. Ciccone,* 219 F.3d 1078, 1083 (9th Cir. 2000) ("the wire-fraud statute protects the naive as well as the worldly-wise, and the former are more in need of protection than the latter. As a matter of fact, ... the lack of guile on the part of those solicited may itself point with persuasion to the fraudulent character of the artifice. . . . Thus, we reject Ciccone's argument that the government had to prove that the scheme was calculated to deceive persons of ordinary prudence and comprehension.").

The susceptibility of a victim to a fraud scheme, including a victim financial institution, is irrelevant to a defendant's guilt or innocence. As explained by the Fourth Circuit in *United States v. Colton*, 231 F.3d 890, 903 (4th Cir. 2000): "The susceptibility of the victim of the fraud, in this case, a financial institution, is irrelevant to the analysis: If a scheme to defraud has been or is intended to be devised, it makes no difference whether the persons the schemers intended to defraud are gullible or skeptical, dull or bright. These are criminal statutes, not tort concepts." Whether the institutional victim's internal controls or personnel were sufficient to detect and prevent fraud is irrelevant to the crimes charged in this case, and inadmissible as a defense. *See Lindsey,* 850 F.3d at 1014 ("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.").

D. Victim Negligence is Irrelevant for Assessing the Materiality of a False Statement

The federal mail fraud, wire fraud, and bank fraud statutes generally require a misrepresentation or concealment of material fact. *See Neder v. United States*, 527 U.S. 1, 22-25 (1999). In assessing whether a misrepresentation of fact was material, the Ninth Circuit has time and time again rejected the argument, commonly made by defendants in

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fraud cases, that victim negligence is somehow relevant to materiality. The materiality requirement does not permit defendants to backdoor victim negligence into a case because materiality is an objective, rather than subjective, test. *See United States v. Lindsey*, 850 F.3d 1009, 1014 (9th Cir. 2017) ("[T]he government does not have to prove actual reliance upon the defendant's misrepresentations to satisfy materiality.") (internal citations and quotation marks omitted); *see also United States v. Farrace,* 805 Fed.App'x. 470, 474 (9th Cir. 2020) ("The excluded evidence [defendant] identifies pertains to the individual lenders' specific behavior and actual reliance on [defendant's] statements, which are irrelevant to the materiality inquiry."); *United States v. Kuzmenko,* 777 Fed.App'x. 186, F.N. 3 (9th Cir. 2019) ("Materiality is evaluated objectively; the government need not prove actual reliance upon the misrepresentations."); *United States v. Chang,* 2020 WL 5702131 at *3 (N.D. Cal. 2020) ("The Ninth Circuit has squarely held that materiality 'is an objective test, which looks at the intrinsic capabilities of the false statement itself, rather than the possibility of the actual attainment of its end.' . . . To be material a statement need only have the propensity or capacity to influence or affect [the relevant] decision . . . Thus, 'the government does not have to prove actual reliance upon the defendant's misrepresentations' in order to satisfy materiality' . . . After all, wire fraud does not require a showing 'that the scheme was successful or that the intended victim suffered a loss or that the defendants secured a gain.'") (internal citations omitted).

The materiality requirement is not concerned with whether a decisionmaker relied on a false statement, but instead materiality focuses on whether a false statement "has a tendency to influence or is capable of influencing a decision." *United States v. Neder*, 197 F.3d 1122, 1128 (11th Cir. 1999); *see also Lindsey*, 850 F.3d at 1015 ("A false statement is material if it objectively had a tendency to influence, or was capable of influencing, a lender to approve a loan."); *United States v. Hussain,* 2018 WL 3619797 at *27 (N.D. Cal. 2018) ("The misrepresentation need only have an objective propensity to influence its intended target."); *United States v. Kuzmenko,* 2014 WL 7140640 at *5 (E.D. Cal. 2014) ("The Government must prove a defendant's falsehoods were material

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in order to sustain a conviction for wire fraud or mail fraud . . . Satisfying the materiality requirement does not require the Government to prove actual reliance or damages . . . False statements are material where they have 'natural tendency to influence, or [are] capable of influencing' a lender.") (Citations omitted).

Along similar lines, the Ninth Circuit has held that actual reliance is not a requirement for materiality. *See United States v. Norby,* 44 Fed.App'x. 208, 210 (9th Cir. 2002) ("The government need not prove actual reliance on the defendant's misrepresentation."); *United States v. Kuzmenko,* 777 Fed.App'x. 186, F.N. 3 (9th Cir. 2019) ("Materiality is evaluated objectively; the government need not prove actual reliance upon the misrepresentations."); *Neder*, 197 F.3d at 1129 ("[T]he issue is whether a statement has a tendency to influence or is capable of influencing a decision, and not whether the statement exerted actual influence, a false statement can be material even if the decision maker did not actually rely on the statement.")

E. The SBA's Guarantees to PPP Lenders Is Also Irrelevant

In the instant case, the relevant inquiry is whether: (i) Defendant submitted fraudulent PPP applications; (ii) whether Defendant had the requisite intent to defraud the SBA, PPP lenders and processors, and financial institutions holding the accounts into and through which fraudulent loan proceeds were deposited or transferred; and (iii) for the purpose of certain counts, whether the information that Defendant submitted and the half-truth he told to the SBA, PPP lenders and processors, and financial institutions had the natural tendency to influence or was capable of influencing them. Hindsight challenges to any of these institutional victims' internal controls are irrelevant, a waste of time, and create the risk of jury confusion. *See* Fed. R. Evid.403.

For similar reasons, the Court should exclude any evidence or arguments concerning the SBA's guarantees to PPP lenders as a defense to the alleged fraud and conspiracies. The government does not know on what basis the defense would try to introduce evidence or make arguments concerning this guarantee, but any such evidence or argument would be irrelevant to the case, a waste of time, and tend to confuse and

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mislead the jury, and as such it should be excluded. Even in civil cases, where a victim's negligence might be relevant to damages, evidence of financial compensation (insurance) is inadmissible to prove negligence or wrongdoing. Fed. R. Evid. 411. This is even more true in the criminal context of the instant case, where victim negligence is irrelevant, and should therefore be excluded.

F. Evidence Concerning Profit by the Victim Lenders is Irrelevant

Evidence of any profit by the victims should also be excluded because it would suggest that the victims intentionally disregarded information from defendant for their own benefit. "Intentional disregard of relevant information is not a defense to wire fraud, and evidence of intentional disregard by lenders is not admissible as a defense to mortgage fraud." *Lindsey,* 850 F.3d at 1019. This is consistent with other circuits, which have also held that evidence of victim profits is immaterial. *See United States v. Powell,* 509 F. App'x 958, 967 (11th Cir. 2013) ("[w]hether the lenders were motivated by profit or did, in fact, profit from [defendant's] efforts is equally immaterial."). Any evidence concerning the profit by the victims is immaterial because person can be convicted of mail or wire fraud regardless of a victim's reliance – all that matters is whether the defendant created a scheme to defraud and used mail or wire services to execute the scheme. *See United States v. Goldberg,* 455 F. 2d. 479, 480-81 (9th Cir. 1972) ("The essential elements of mail fraud under 18 U.S.C. § 1341 are (1) a scheme to defraud and (2) a knowing use of the mail to execute the scheme. . . It is not necessary to show that reliance of the victim was induced by misrepresentation of the defendant, nor is it necessary to show that the victim was misled."); *Kuzmenko,* 775 Fed.App'x. at 275 ("Actual reliance is not an element of mail fraud or wire fraud."); *United States v. Stewart,* 728 Fed.App'x. 651, 653 (9th Cir. 2018) ("[C]riminal fraud statutes do not require the government to prove reliance."). Therefore, the Court should exclude any

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evidence or arguments concerning any profits the victim lenders may have made as a result of the loans that are at issue in this conspiracy.

III. CONCLUSION

For the reasons stated above, the government respectfully requests that the Court preclude the defense from introducing evidence and arguments concerning alleged negligence by the victim lenders and loan processors or the SBA and as well as from introducing evidence and arguments concerning any profit by the victim lenders.

DATED this 1st day of November, 2021.

Respectfully submitted,

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