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Mail Fraud

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VIII. Mail Fraud

A. Substantial Deception Test—*Lustigur v. United States*, 386 F.2d 132 (9th Cir. 1967).

The subject of consumer protection and truth in advertising has been a very lively topic in recent years.¹ Both federal and state governments have enacted legislation² designed to curb some of the more excessive practices of promoters and advertisers. The first official recognition of the need for consumer protection came in 1872 in the act establishing the Post Office as an executive department. Included in the act was a section making it a misdemeanor to utilize the mails in furtherance of a fraudulent scheme.³ This section, as amended, constitutes the current mail fraud statute.⁴

The cases which have been prosecuted under the statute run the gamut of human ingenuity. The items which have been promoted by mail range from cosmic generators to impotence cures,⁵ from

¹ *E.g.*, J. SELDIN, *THE GOLDEN FLEECE* (1963); R. SMITH, *THE BARGAIN HUCKSTERS* (1962); Note, *The Regulation of Advertising*, 56 COLUM. L. REV. 1018 (1956); *Developments in The Law—Deceptive Advertising*, 80 HARV. L. REV. 1008 (1967).

² For an excellent discussion of pertinent statutes, see *Developments in The Law—Deceptive Advertising*, 80 HARV. L. REV. 1008, 1119-39 (1967).

Before a promoter may market subdivided lands within California he must secure a public report from the Real Estate Commissioner. A copy of the public report must be provided to each purchaser before any contract is executed. CAL. BUS. & PROF. CODE § 11,018.1. In 1963 section 11,018.1 was amended to provide additional grounds for denial of the public report. Cal. Stats. 1963, ch. 335, § 301, at 17. The Attorney General, in an opinion discussing the amendment, 42 OPS. CAL. ATTY. GEN. 99, 101 (1963), stated: “[I]t can no longer be said that the prevention of fraud through mere disclosure is the sole purpose of subdivision laws. The commissioner now has the power not only to require full disclosure of defects and possible inability to comply with commitments but also to insure that the seller of subdivision parcels can produce his product precisely as he would represent it to the purchasing public.”

³ Act of June 8, 1872, ch. 335, § 301, 17 Stat. 323.

⁴ 18 U.S.C. § 1341 (1964). The statute provides: “Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises . . . for the purpose of executing such scheme or artifice or attempting so to do, places in any post office or authorized depository for mail matter, any matter or thing whatever to be sent or delivered by the Post Office Department . . . shall be fined not more than \$1,000 or imprisoned not more than five years, or both.”

⁵ M. GELLER, *ADVERTISING AT THE CROSSROADS* 227 (1952).

stock schemes⁶ to reducing plans.⁷ Some of the earlier schemes were quite crude and unprofessional when compared with the contemporary variety. The law, however, has kept pace with the schemes and the courts continue effectively to enforce the letter as well as the spirit of the mail fraud law.⁸

One of the most profitable schemes, from the promoter's standpoint, is the real estate swindle. Desert land is purchased at nominal cost, advertised as a planned retirement or recreational community and sold to the public for many times its actual value. In *Lustiger v. United States*,⁹ the Ninth Circuit was presented with a case that typifies the land swindle. The defendant was indicted for violation of the mail fraud statute and charged with using the mails in furtherance of a scheme to defraud. The scheme involved the promotion of certain Arizona lands, which were described in advertising materials as Lake Mead City. The brochure and fact sheets that were sent to prospective customers portrayed the area as a planned resort community with ample water supply and easy access to water sports. In fact, all units of the development were located in odd-numbered, widely scattered sections. The alternate even numbered sections were owned by the Government and used for grazing. In addition, the lands were rocky, access to some lots was inconvenient, and others were many miles from domestic water supply and other utility hookups.¹⁰ The brochure contained several pictures of lakes and ponds; while all were within the Lake Mead City area, none of the pictured bodies of water were on land owned or optioned by the defendant's company.

Sales and promotions for Lake Mead City were handled by the Lake Mead Land and Water Company, a company owned by Lustiger and his family. The company utilized the mails in sending out advertising materials and in receiving correspondence from prospective purchasers. After an individual had responded to the company's advertising, by submitting a ten dollar refundable deposit, he was mailed a purchase contract for execution. It was not anticipated that a purchaser would see the property before he executed the contract.

The district court found that the advertising materials were fraudulent and misleading.¹¹ Lustiger appealed the conviction. The

⁶ *Myrick v. United States*, 332 F.2d 279 (5th Cir.), *cert. denied*, *Bergman v. United States*, 377 U.S. 952 (1964).

⁷ *Reilly v. Pinkus*, 338 U.S. 269 (1949).

⁸ See text accompanying notes 16-18 *infra*.

⁹ 386 F.2d 132 (9th Cir. 1967), *cert. denied*, 390 U.S. 951 (1968).

¹⁰ The hookups could have been made, but only at a prohibitive cost. The existing electric power lines and telephone lines were from 20 to 38 miles from the subdivision units. *Id.* at 137.

¹¹ *Id.* at 135.

Ninth Circuit, in an opinion written by Judge Hamley, ruled that the defendant's advertising materials, when considered as a whole, were deceptive and misleading and exhibited an intent to defraud.¹²

Lustiger claimed that the representations contained in his advertising constituted puffing rather than fraud, but the court stated that "[w]hile it is true that exaggeration within reasonable bounds under the circumstances will not support a finding of a scheme to defraud, a substantial deception as evidenced here, is sufficient."¹³ It was immaterial whether or not the advertising had misrepresented an existing fact, for it created a false impression and showed an intent to defraud.

The defense that representations are not false or fraudulent, but constitute permissible puffing of the seller's wares, is frequently encountered in mail fraud cases. This leaves the courts with the problem of determining the amount of "trade talk" or exaggeration that is to be tolerated. The earlier decisions¹⁴ attempted to delineate between puffing and fraud by defining puffing. Any representation that was construed as "trade talk" would avoid the criminal sanctions of the statute. The court in *Lustiger* takes a different approach and defines an intent to defraud as an intent to substantially deceive. Rather than concentrating on definitions of puffing, the court now places its emphasis on examining the representations made by the defendant. To find an intent to substantially deceive, the court looks not only to the representations, but also to the audience to whom the representations are addressed. This constitutes a more realistic approach in that puffing can be judged solely from the character of the representations,¹⁵ whereas a substantial deception can be established only by considering the character of the representations in relation to the person or persons to whom they are made.

To appreciate the significance of *Lustiger*, it is important to view the decision within the context of the mail fraud statute. "The elements necessary for a conviction . . . are (1) the formation of a scheme with an intent to defraud, and (2) use of the mails in furtherance of that scheme."¹⁶ In order to prove the fraudulent scheme the prosecution need not show an actual misrepresentation of an existing fact,¹⁷

¹² *Id.* at 138.

¹³ *Id.*

¹⁴ *E.g.*, *Deaver v. United States*, 155 F.2d 740, 744 (D.C. Cir.), *cert. denied*, 329 U.S. 766 (1946); *Harrison v. United States*, 200 F. 662, 665-66 (6th Cir. 1912).

¹⁵ *See, e.g.*, *Holmes v. United States*, 134 F.2d 125, 133 (8th Cir.), *cert. denied*, 319 U.S. 776 (1943).

¹⁶ *Lemon v. United States*, 278 F.2d 369, 373 (9th Cir. 1960); *accord*, *Blachly v. United States*, 380 F.2d 665, 671 (5th Cir. 1967).

¹⁷ *Lustiger v. United States*, 386 F.2d 132, 138 (9th Cir. 1967); *Gregory*

reliance on any representation,¹⁸ or any loss suffered by the intended victim of the scheme.¹⁹ For the prohibition of the statute "is not limited to what would give rise to a common-law action for deceit."²⁰ The statute tends to be preventive²¹ as well as punitive, as the Government may bring an action before anyone has suffered loss because of the scheme.²²

According to *Lustiger* an intent to substantially deceive and to plan or scheme to carry out that intent constitutes fraud within the meaning of the statute. As suggested earlier, to determine the presence or absence of a scheme to deceive, both the representations and the audience to whom the representations were made should be considered. The first inquiry is to ask whether exaggerations of the capabilities and capacities of the product will be held to constitute a substantial deception. While the courts will grant the seller some latitude in extolling the merits of his product²³ they will not tolerate excessive claims.

The promoter's safe range of exaggeration was an issue in the leading case of *United States v. New South Farm and Home Co.*,²⁴ a mail fraud case involving the promotion of subdivided real estate. On its facts the case was quite similar to *Lustiger*. The defendants attempted to sell swampy, barren Florida land by representing it to be part of a planned community encompassing excellent farm lands. The district court held that the statute was not violated by puffing

v. *United States*, 253 F.2d 104, 109 (5th Cir. 1958); *Silverman v. United States*, 213 F.2d 405 (5th Cir.), *cert. denied*, 348 U.S. 828 (1954).

¹⁸ *Blue v. United States*, 138 F.2d 351, 359 (6th Cir. 1943), *cert. denied*, 322 U.S. 736 (1944).

¹⁹ *United States v. Sylvanus*, 192 F.2d 96, 105-06 (7th Cir. 1951), *cert. denied*, 342 U.S. 943 (1952); *United States v. McKay*, 45 F. Supp. 1007, 1012 (E.D. Mich. 1942).

²⁰ *Epstein v United States*, 174 F.2d 754, 766 (6th Cir. 1949); *accord*, *United States v. Groves*, 122 F.2d 87, 90 (2d Cir.), *cert. denied*, 314 U.S. 670 (1941). The *Groves* case stated, "[t]he statute is not limited to what would give rise to a civil action, in spite of what was said in another connection in [*Brown*] . . ." *Id.* at 90. In *Brown v. United States*, 79 F.2d 321 (2d Cir. 1935), Judge Learned Hand had equated the offense with the common law action for deceit.

²¹ The government has another statutory power which is exclusively preventive. The fraud order is an administrative proceeding under 39 U.S.C. § 4005 (1964). The Postmaster General is given authority to determine whether the mails are being used for schemes to defraud the public. He is then empowered to refuse to deliver mail to anyone found to be using the mails to defraud.

²² *Blue v. United States*, 138 F.2d 351, 359 (6th Cir. 1943), *cert. denied*, 322 U.S. 736 (1944).

²³ *Babson v. United States*, 330 F.2d 662, 664 (9th Cir.), *cert. denied*, 377 U.S. 993 (1964).

²⁴ 241 U.S. 64 (1916).

the qualities of the land in advertising it. In reversing the district court the Supreme Court said:

Mere puffing, indeed, might not be within its [the statute's] meaning (of this, however, no opinion need be expressed), that is, the mere exaggeration of the qualities which the article has; but when a proposed seller goes beyond that, assigns to the article qualities which it does not possess, does not simply magnify in opinion the advantages which it has but invents advantages and falsely asserts their existence, he transcends the limits of "puffing" and engages in false representations and pretenses.²⁵

The Court went on to indicate that exaggeration of the qualities the article possessed would be sufficient to constitute fraud since, "[a]n article alone is not necessarily the inducement and compensation for its purchase."²⁶ In other words, a substantial deception can be established even though the value of the article received by the purchaser is equal to the value with which he had been induced to part. When the defendant advertises desert land worth 20 dollars an acre as lush farm land and offers the land to the "victim" for 15 dollars an acre he can be prosecuted for mail fraud. The fraud lies in the disparity between what the purchaser was led to expect and what he in fact received.²⁷ The purchaser has been deceived as to the substantial identity of the item bargained for. The defendant has deprived him of his opportunity to bargain with the pertinent facts before him by concealing or coloring material facts.

It can be concluded that representations designed to deceive the purchaser as to the quality or quantity of the product or service are within the purview of the statute. The representations do not have to be false, but have to be purposely organized or worded so as to mislead the purchaser.²⁸ If the intent to mislead or deceive is proved, the defendant cannot escape the sanctions of the statute by claiming that his representations were just seller's talk or puffing.

The next inquiry is directed at the extent to which the class of persons addressed or any member of that class is to be considered in deciding whether the defendant devised a scheme to defraud. It is obvious that the type of individual to whom the defendant has directed his representations cannot be entirely overlooked, for an intent to deceive necessarily requires a subject or, more precisely, a "victim" that the defendant intends to influence with his false representations.

While a number of cases have held that the scheme must be one "calculated to deceive persons of ordinary prudence and comprehen-

²⁵ *Id.* at 71.

²⁶ *Id.*; *accord*, *Durland v. United States*, 161 U.S. 306, 313 (1896); *United States v. Bloom*, 237 F.2d 158, 162 (2d Cir. 1956).

²⁷ *United States v. Whitmore*, 97 F. Supp. 733, 736 (S.D. Cal. 1951)

²⁸ *Lustiger v. United States*, 386 F.2d 132, 138 (9th Cir. 1967).

sion,"²⁹ recent decisions of the Ninth Circuit have shown a tendency to afford protection to the more credulous members of society. "Section 1341 protects the naive as well as the worldlywise, and the former are more in need of protection than the latter."³⁰ This does not mean that if anyone is deceived there are grounds for prosecution. Rather, the defendant will not avoid the prohibition of the statute merely by proving that a person of normal intelligence and perception would not have been misled.

Although it is not necessary to prove that the scheme was reasonably certain of success, it is incumbent upon the prosecution to prove that the defendant devised his scheme with the intent to defraud.³¹ Direct proof is not necessary; the requisite intent can be inferred from the character of the representations and the surrounding circumstances.³² One of the relevant circumstances is the type of person whom the defendant is trying to influence. For example, advertising directed to the aged, the infirm, or any such class may be treated differently from the same advertising addressed to the general public.³³ The court will look beyond the material to the audience, for "the lack of guile on the part of those solicited may itself point with persuasion to the fraudulent character of the artifice."³⁴

The statute was designed to protect the public from frauds perpetrated through the mails.³⁵ It would not comport with the purpose of the statute to limit its protection to the discerning person of ordinary prudence and comprehension. The term defraud "must be construed broadly."³⁶ It cannot be defined accurately as an exaggeration which transcends puffing, for the amount of exaggeration permissible must vary from case to case. Given the proper circumstances, what would normally be tolerated as puffing will constitute fraud within the meaning of the mail fraud statute.³⁷

²⁹ *United States v. Baren*, 305 F.2d 527, 533 (2d Cir. 1962); *accord*, *Silverman v. United States*, 213 F.2d 405, 407 (5th Cir. 1954).

³⁰ *Lemon v. United States*, 278 F.2d 369, 373 (9th Cir. 1960); *accord*, *United States v. Sylvanus*, 192 F.2d 96, 105 (7th Cir. 1951); *United States v. Monjar*, 47 F. Supp. 421, 425 (D.C. Del. 1942), *aff'd*, 147 F.2d 916 (3d Cir. 1944), *cert. denied*, 325 U.S. 859 (1945).

³¹ *Holmes v. United States*, 134 F.2d 125, 133 (8th Cir. 1943).

³² *Blachly v. United States*, 380 F.2d 665, 676 (5th Cir. 1967).

³³ *See Lemon v. United States*, 278 F.2d 369, 373 (9th Cir. 1960).

³⁴ *Id.*

³⁵ *Parr v. United States*, 363 U.S. 370, 389 (1960). However, it is not necessary that the initial contact with the purchaser be made by mail. Any foreseeable use of the mails in execution of a fraudulent scheme constitutes a violation of section 1341. *Blue v. United States*, 138 F.2d 359 (6th Cir. 1943).

³⁶ *United States v. Buckner*, 108 F.2d 921, 926 (2d Cir.), *cert. denied*, 309 U.S. 669 (1940).

³⁷ *Cf. Epstein v. United States*, 174 F.2d 754, 767 (6th Cir. 1949).

Fraud is not a term that can be adequately defined. It applies to a wide range of human conduct, that which is dishonest, unfair, or cheating. The judicial value of the term is in its flexibility; and any exact definition is inherently inadequate since it limits the flexibility and tends "to reward subtle and ingenious circumvention"³⁸ It is submitted that the definition of fraud used in *Lustiger* has the advantage of being sufficiently flexible to avoid restricting the coverage of the statute and yet sufficiently certain to provide a workable criterion for determining the presence or absence of fraud in any given case.

The Ninth Circuit's decision in *Lustiger* strikes another blow at the already weakened maxim—*caveat emptor*. Use of the term "substantial deception" will encompass the blatantly dishonest and cheating enterprises as well as the more subtle and sophisticated schemes. The decision was not, however, a radical departure from the accepted construction of the statute. The courts have shown a general disposition to enlarge the coverage of the statute and to afford protection to those who are most often victimized. But the Ninth Circuit, by defining a scheme to defraud as an attempt to substantially deceive, gives additional recognition to the fact that the audience must be considered when evaluating the defendant's scheme. This approach will enable the court to deal effectively with the myriad schemes that fall within the general classification of mail fraud.

P. W. B.

³⁸ *Foshay v. United States*, 68 F.2d 205, 211 (1933).