No. 02-320

In the Supreme Court of the United States

DEMETRIOS KARAMANOS AND RICHARD PEDRONI,
PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether the application of the wire fraud statute to petitioners' scheme to defraud the State of New Jersey out of motor fuel tax revenues violated the Tenth Amendment and principles of federalism.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases:

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OPINIONS BELOW

The opinions of the court of appeals (Pet. App. 3a-8a, 18a-29a) are not published in the Federal Reporter, but are reprinted at 38 Fed. Appx. 727 and 45 Fed. Appx. 103.

JURISDICTION

The judgments of the court of appeals were entered on April 18, 2002. Pet. App. 3a, 9a, 18a. A petition for rehearing filed by petitioner Karamanos was denied on June 4, 2002. Pet. App. 1a-2a. A petition for rehearing filed by petitioner Pedroni was denied on May 30, 2002. The petition for a writ of certiorari was filed on August

28, 2002. The jurisdiction of this Court is invoked under 28 U.S.C. 1254.

STATEMENT

Following a jury trial, petitioners were found guilty of conspiring to defraud the United States and to commit tax evasion (26 U.S.C. 7201), wire fraud (18 U.S.C. 1343), and money laundering (18 U.S.C. 1957), in violation of 18 U.S.C. 371. Petitioner Karamanos was also found guilty on eleven counts of attempting to evade federal motor fuel excise taxes, in violation of 26 U.S.C. 7201, five counts of wire fraud, in violation of 18 U.S.C. 1343, and two counts of money laundering, in violation of 18 U.S.C. 1957. Karamanos was sentenced to 135 months of imprisonment. Pedroni was sentenced to 37 months of imprisonment and was ordered to pay restitution in the amount of $500,000. Pet. App. 3a-4a, 18a-19a.

1. Petitioners and their co-conspirators participated in a "daisy chain" scheme to evade the payment of excise taxes on the sale of certain kinds of fuel, including diesel fuel and gasoline.[1] Petitioner Karamanos was director of marketing for Kings Motor Oils (Kings), and his duties included obtaining motor fuel product for Kings to sell. Petitioner Pedroni operated Pedroni Fuels, which was one of Kings's suppliers of fuel. Kings sold, or caused to be sold, diesel fuel to PetroPlus Oil (PetroPlus), a company that bought and sold motor fuel and that was owned by

[1] Petitioners' co-conspirators included Daniel Enright, who was tried with petitioners and was convicted of various offenses. Karamanos Gov't C.A. Br. 2 n.2. Enright's and petitioners' convictions were affirmed by the court of appeals, and Enright and Pedroni have filed their own petitions for a writ of certiorari (Nos. 02-240 and 02-228).

petitioners' co-conspirator Daniel Enright. Petitioners and their co-conspirators created paperwork that made it appear as if excise taxes owed on motor fuel bought by PetroPlus had been paid by other entities. Neither those entities nor PetroPlus in fact paid the taxes, however. Pet. App. 3a, 19a; Karamanos Gov't C.A. Br. 3-18; Pedroni Gov't C.A. Br. 3-4.

a. During the prosecution period, 1989 through 1995, the Internal Revenue Code imposed a tax on "the sale of any taxable fuel by the producer or the importer thereof or by any producer of a taxable fuel." 26 U.S.C. 4091(a) (1988). "Taxable fuel" included diesel fuel. 26 U.S.C. 4092(a)(1)(A) and (2) (1988). Diesel fuel is "number two oil," which can be used both as motor fuel and as home heating oil. The State of New Jersey imposed a state excise tax and a gross receipts tax on the sale of number two fuel to be used for a taxable purpose. During the prosecution period, neither the federal government nor the State of New Jersey imposed an excise tax on the sale of number two oil used as home heating oil. Karamanos Gov't C.A. Br. 4.

b. Enright entered into an agreement with representatives of Kings, including Karamanos, in a scheme to avoid payment of motor fuel excise taxes. Karamanos generally purchased, or caused a company Kings controlled to purchase, number two fuel as tax-free home heating oil. Kings or the Kings-controlled company then "sold" the fuel through a chain of companies, known as a daisy chain or line. At the bottom of the chain, PetroPlus purchased the number two fuel from a company that invoiced the fuel as diesel fuel on which the required motor fuel excise taxes purportedly had been paid. In reality, PetroPlus simply purchased the diesel fuel from Kings or the Kings-controlled company at the top of the chain

without the taxes having been paid. Karamanos Gov't C.A. Br. 6-7.

The daisy chains, which were used to avoid a direct connection between PetroPlus and Kings, involved an elaborate network of other companies (the middle companies) created by Kings. The middle companies never came into possession of the oil. Many of the middle companies were sham companies that existed for no purpose other than to create paperwork to make it appear that PetroPlus bought diesel fuel on which the federal excise tax had been paid, when in fact no taxes had been paid. Karamanos Gov't C.A. Br. 8-9.

In a typical chain, at least one company below Kings (or the other company at the top of the chain) invoiced the fuel to another middle company as home heating oil. Kings then instructed another middle company in the chain, known as the "burn company," to invoice the fuel as diesel fuel at a price that purportedly included an amount for federal excise taxes. The burn company then invoiced to at least one other company in the chain the fuel that apparently had been transformed from tax-free home heating oil into "tax-paid" diesel fuel (fuel on which excise taxes had already been paid). At that point, the fuel would be sold to PetroPlus as tax-paid diesel fuel. Karamanos Gov't C.A. Br. 9.

Pedroni Fuels was one of Kings's suppliers and, on a monthly basis, Pedroni Fuels was informed of the amount of fuel Kings was to provide to PetroPlus. Pedroni would call Kings in order to determine which company in the daisy chain should be invoiced for the fuel supplied by Pedroni Fuels to PetroPlus. Pedroni insisted that companies he invoiced have an IRS certification authorizing them to engage in tax-free sales, which would give the appearance that the conspirators were conducting legitimate transactions. If

Pedroni reviewed certifications for a company involved in one of his transactions and found the documents to be lacking, he contacted Kings, not the actual purchaser, and requested that Kings identify another company with adequate documentation. Although Pedroni Fuels nominally sold the fuel to Kings-controlled companies, Pedroni Fuels typically transferred the fuel directly from its account at a terminal to PetroPlus's account at the terminal. Thus, while Pedroni arranged to have companies in the daisy chain invoiced for the fuel, he knew that the real purchaser of the fuel was PetroPlus. Pedroni Gov't C.A. Br. 3-4, 6-9.

Kings often operated more than one chain at a time. Karamanos and Enright set up the chains, and Karamanos instructed Kings's bookkeeper and others on which companies would be used in the chains and the order of the companies in the chains. On occasion, Kings's bookkeeper simply prepared the invoices for the middle companies to send out. The invoices did not reflect actual sales of fuel, and were used only to conceal the fraud. PetroPlus was the only party in the chains that actually received oil. The other companies in the chains simply received and sent out paperwork in furtherance of the scheme to avoid payment of excise taxes. Karamanos Gov't C.A. Br. 9-11.

c. In the course of the conspiracy, the conspirators wired $596,255,927 through the middle companies. The conspiracy evaded federal taxes totaling $132,376,800. It also defrauded the State of New Jersey out of $11,892,297 in excise taxes and gross receipts taxes. In approximately 78 transactions between January 11, 1990, and June 24, 1992, Pedroni Fuels supplied PetroPlus with roughly 47 million gallons of fuel, on which more than $9 million in federal and state excise

taxes was not paid. Karamanos Gov't C.A. Br. 18; Pedroni Gov't C.A. Br. 9.

2. On August 3, 1995, a grand jury in the United States District Court for the District of New Jersey returned a 39-count indictment charging petitioners and 23 co-defendants with, *inter alia*, excise tax evasion, wire fraud, money laundering, and conspiracy to commit those offenses and to defraud the United States. On August 27, 1996, the grand jury returned a superseding indictment. The allegations of wire fraud, as well as the allegations that an object of the conspiracy was to commit wire fraud, were based on wire transfers used to carry out the fraudulent evasion of excise and gross receipts taxes owed to the State of New Jersey. C.A. App. 12-13, 43-44, 46-47, 53-54, 57-58, 61-62.

On June 19, 1998, following a nine-month trial, the jury found petitioner Karamanos guilty on counts alleging tax evasion, wire fraud, money laundering, and conspiracy. The jury also found petitioner Pedroni guilty on one count of conspiracy. Pet. App. 3a-4a, 18a-19a.

3. On appeal, Karamanos, on behalf of all of the co-defendants including Pedroni, asserted that the application of the wire fraud statute in this case—both as a stand-alone count and as one of the alleged objects of the conspiracy—violated principles of federalism and the Tenth Amendment by infringing on New Jersey's authority to enforce its own tax laws. The court of appeals rejected that argument. The court explained that this Court has "consistently maintained that Congress may constitutionally regulate the 'channels' and 'instrumentalities' of interstate commerce." Pet. App. 4a (citing *United States* v. *Morrison*, 529 U.S. 598, 609 (2000)). The court concluded that the "wire fraud

statute, as applied in this case, is in harmony with these Commerce Clause principles," and it cited a number of decisions that "reject[] the theory underlying [petitioners'] federalism argument." *Ibid.* The court therefore held that "the use of the wire fraud statute to prosecute [petitioners] did not offend constitutional principles regarding the proper division of powers between the individual states (such as New Jersey) and the federal government." *Ibid.*

ARGUMENT

Petitioners renew their contention (Pet. 4-18) that the application of the wire fraud statute in this case constituted an impermissible intrusion into state affairs barred by the Tenth Amendment and principles of federalism. That contention lacks merit and further review is unwarranted.

1. Petitioners contend (Pet. 4-14) that, according to principles of federalism, "there is no constitutional justification for * * * federal prosecutors to utilize the federal fraud and conspiracy statutes to prosecute state and local tax offenses." Pet. 4. That argument rests on the flawed premise that the wire fraud statute was applied in order to prosecute a state law offense. The wire fraud statute, 18 U.S.C. 1343, focuses "upon the misuse of the [interstate] wires, not the regulation of state affairs." *United States* v. *DeFiore*, 720 F.2d 757, 761 (2d Cir. 1983), cert. denied, 466 U.S. 906 (1984); accord *United States* v. *Mirabile*, 503 F.2d 1065, 1066-1067 (8th Cir. 1974) (mail fraud statute), cert. denied, 420 U.S. 973 (1975).

Petitioners' unlawful use of the interstate wires did occur in furtherance of a scheme to avoid payment of excise and gross receipts taxes owed under New Jersey law. As this Court has explained with respect to the

mail fraud statute, however, the "fact that a scheme may violate state laws does not exclude it from the proscriptions of the federal mail fraud statute, for Congress 'may forbid any . . . [mailings] . . . in furtherance of a scheme that it regards as contrary to public policy, whether it can forbid the scheme or not.'" *Parr* v. *United States*, 363 U.S. 370, 389 (1960) (quoting *Badders* v. *United States*, 240 U.S. 391, 393 (1916)). In particular, Congress can make "criminal any use of the mails 'for the purpose of executing [a] scheme' to defraud or to obtain money by false representations—leaving generally the matter of what conduct may constitute such a scheme for determination under other laws." *Ibid.* (quoting 18 U.S.C. 1341). The same conclusion applies to the wire fraud statute. See *DeFiore*, 720 F.2d at 761.

Contrary to petitioners' suggestion (Pet. 13), the application of the wire fraud statute in this case does not intrude on New Jersey's ability to enforce its own tax or criminal laws. See *United States* v. *Panarella*, 277 F.3d 678, 694 (3d Cir.) ("In this case, the intrusion into state autonomy is significantly muted, since the conduct that amounts to [mail] fraud is conduct that the state itself has chosen to criminalize."), cert. denied, 123 S. Ct. 95 (2002). New Jersey remains fully free to prosecute petitioners or to attempt to collect the unpaid taxes if it so chooses. And even if the penalty for violating the wire fraud statute exceeds the penalty under New Jersey law for evading state excise taxes (Pet. 11), such a "disparity in punishment * * * may occur whenever federal criminal law defines predicate

offenses by reference to state law." *Panarella*, 277 F.3d at 694.[2]

2. The court of appeals' opinion does not conflict with this Court's decision in *Cleveland* v. *United States*, 531 U.S. 12 (2000). See Pet. 4, 11-14. The Court held in *Cleveland* that video poker licenses issued by the State of Louisiana do not constitute "property" of the State under the mail fraud statute, 18 U.S.C. 1341, and that the mail fraud statute thus does not encompass fraud in connection with applications to the State for a video poker license. 531 U.S. at 20. Here, by contrast, petitioners' scheme to deprive the State of New Jersey of tax revenues unquestionably involved the obtaining of "money or property" within the meaning of the wire fraud statute, 18 U.S.C. 1343. See *United States* v. *Helmsley*, 941 F.2d 71, 94 (2d Cir. 1991), cert. denied, 502 U.S. 1091 (1992); *United States* v. *Bucey*, 876 F.2d 1297, 1309 (7th Cir.), cert. denied, 493 U.S. 1004 (1989); *United States* v. *Doe*, 867 F.2d 986, 989 (7th Cir. 1989); *United States* v. *Porcelli*, 865 F.2d 1352, 1359-1361 (2d Cir.), cert. denied, 493 U.S. 810 (1989). Although this

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[2] Petitioners emphasize (Pet. 10-11) that Pedroni was required to pay restitution of $500,000 to the United States and was not required to pay restitution to the State of New Jersey. Pedroni was found guilty of conspiracy to defraud the United States and to commit evasion of federal excise taxes, money laundering, and wire fraud. Pet. App. 18a-19a. Because the charged objects of the conspiracy included defrauding the United States and evading federal excise taxes, it was appropriate to order Pedroni to pay restitution to the United States. Whereas the conspiracy count encompassed evasion of both federal and state taxes, the wire fraud and money laundering counts (on which Pedroni was acquitted) only involved evasion of state taxes. Other defendants who were found guilty on those counts, such as Enright and Igor Erlikh, were ordered to pay restitution to the State of New Jersey as well as to the United States. See C.A. App. 129, 136.

Court observed in *Cleveland* that "[e]quating issuance of [video poker] licenses * * * with deprivation of property would subject to federal mail fraud prosecution a wide range of conduct traditionally regulated by state and local authorities," 531 U.S. at 24, that observation has no application where, as here, the scheme at issue plainly involves "money or property." See *id.* at 22 (noting that "the Government nowhere alleges that Cleveland defrauded the State of any money to which the State was entitled by law"); *United States* v. *Pasquantino*, 305 F.3d 291, 294-295 (4th Cir. 2002) (holding that *Cleveland* casts no doubt on the conclusion that a scheme to defraud Canada of tax revenues satisfies the "money or property" requirement of the wire fraud statute).

The court of appeals' decision also does not conflict with this Court's opinions in *United States* v. *Morrison*, 529 U.S. 598 (2000), and *United States* v. *Lopez*, 514 U.S. 549 (1995). See Pet. 4-5, 11-12. The statute at issue in *Morrison* prohibited gender-motived crimes of violence, 529 U.S. at 605, and the statute at issue in *Lopez* prohibited possession of a firearm within a school zone, 514 U.S. at 551. The Court held in both cases that the statutes fell outside Congress's power to regulate interstate commerce. Those decisions have no bearing on the constitutionality of the wire fraud statute or its application in this case.

Both *Morrison* and *Lopez* identify "three broad categories of activity that Congress may regulate under its commerce power." *Morrison*, 529 U.S. at 608; *Lopez*, 514 U.S. at 558. "First, Congress may regulate the use of the channels of interstate commerce." *Morrison*, 529 U.S. at 609; *Lopez*, 514 U.S. at 558. "Second, Congress is empowered to regulate and protect the instrumentalities of interstate commerce, or persons or things in

interstate commerce, even though the threat may come only from intrastate activities." *Morrison*, 529 U.S. at 609; *Lopez*, 514 U.S. at 558-559. "Finally, Congress' commerce authority includes the power to regulate those activities having a substantial relation to interstate commerce, . . . *i.e.*, those activities that substantially affect interstate commerce." *Morrison*, 529 U.S. at 609; *Lopez*, 514 U.S. at 558-559.

The wire fraud statute falls within the first two categories of Congress's commerce power because it regulates the channels and instrumentalities of interstate commerce—the interstate wires. The statutes in *Morrison* and *Lopez*, by contrast, were alleged to implicate the third category of Commerce Clause regulation, *Morrison*, 529 U.S. at 609; *Lopez*, 514 U.S. at 559, and the Court held in both cases that the effect on interstate commerce was not sufficient to fall within that category. Moreover, while the statutes in *Morrison* and *Lopez* were directed at non-economic activity, 529 U.S. at 610; 514 U.S. at 566-567, the wire fraud statute addresses schemes "to defraud" or "for obtaining money or property by means of false or fraudulent pretenses," 18 U.S.C. 1343. In addition, whereas the statutes in *Morrison* and *Lopez* contained no jurisdictional element concerning interstate commerce, 529 U.S. at 613; 514 U.S. at 561-562, the wire fraud statute contains an express jurisdictional element limiting its reach to uses of the wires connected to interstate commerce, 18 U.S.C. 1343 (prohibiting transmission "by means of wire * * * *in interstate or foreign commerce*, any writings, signs, signals, pictures, or sounds for the purpose of executing" fraudulent scheme) (emphasis added).

For those reasons, the wire fraud statute is within Congress's power to regulate the channels and instru-

mentalities of interstate and foreign commerce. See *Caminetti* v. *United States*, 242 U.S. 470, 491 (1917) ("the authority of Congress to keep the channels of interstate commerce free from immoral and injurious uses has been frequently sustained, and is no longer open to question"); see also *Badders* v. *United States*, 240 U.S. 391, 393 (1916) ("overt act of putting a letter into the postoffice of the United States is a matter that Congress may regulate").[3]

3. Petitioners assert (Pet. 6) that the court of appeals' decision adds to a conflict between the First Circuit's opinion in *United States* v. *Boots*, 80 F.3d 580, cert. denied, 519 U.S. 905 (1996), and the Second Circuit's opinion in *United States* v. *Trapilo*, 130 F.3d 547 (1997), cert. denied, 525 U.S. 812 (1998). That contention lacks merit. Both *Boots* and *Trapilo* involved schemes to deprive a *foreign* government of tax revenues and turned on considerations unique to that distinct context.

In *Boots*, the defendants had been involved in a scheme to transport tobacco into Canada without paying Canadian taxes and excise duties. 80 F.3d at 583-585. Relying on the common law "revenue rule," under which courts generally will not enforce foreign tax judgments, the First Circuit held that the wire fraud

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[3] Because Congress's power to regulate interstate commerce encompasses the application of the wire fraud statute in this case, there is no warrant for invoking the canon of constitutional doubt. See Pet. 14-16. As explained, moreover, the terms of the wire fraud statute, which cover any scheme to "obtain[] money or property" by fraud, 18 U.S.C. 1343, directly apply to petitioners' scheme to deprive the State of New Jersey of tax revenues. See *Pennsylvania Dep't of Corrs.* v. *Yeskey*, 524 U.S. 206, 212 (1998) (canon of constitutional doubt does not apply where statute is clear).

statute could not reach a scheme to defraud the Canadian government of tax revenue. *Id.* at 586-587. The court determined that the revenue rule applied based on its conclusion that it could not uphold the convictions without passing "on the validity and operation of the revenue laws of a foreign country." *Id.* at 587. The court expressed concern that the power of the political branches to make foreign policy might be undermined if "a foreign government's revenue laws [were] subjected to intrusive scrutiny by the courts of this country." *Id.* at 588.

In *Trapilo*, the Second Circuit disagreed with *Boots* and held that a scheme to defraud the Canadian government of tax revenue falls within the purview of the wire fraud statute. The court noted that the statute "unambiguously prohibits the use of interstate or foreign communication systems by anyone who 'intend[s] to devise *any* scheme or artifice to defraud.'" 130 F.3d at 551 (quoting 18 U.S.C. 1343). The court concluded that "the common law revenue rule * * * provides no justification for departing from the plain meaning of the statute." *Ibid.* According to the court, "[a]t the heart of [the] indictment [was] the misuse of the wires in furtherance of a scheme to defraud the Canadian government of tax revenue, not the validity of a foreign sovereign's revenue laws." *Id.* at 552. Because the defendants' "intent to defraud [did] not hinge on whether or not [they] were successful in violating Canadian revenue law," the court explained, "there is no obligation to pass on the validity of Canadian revenue law and the common law revenue rule is not properly implicated." *Id.* at 552-553. The Fourth Circuit, in a decision issued after the petition for a writ of certiorari was filed in this case, expressly

disagreed with *Trapilo* and followed *Boots*. *United States* v. *Pasquantino*, 305 F.3d 291 (2002).

The Third Circuit's decision in this case does not implicate the conflict between the Second Circuit's decision in *Trapilo* and the decisions of the First and Fourth Circuits in *Boots* and *Pasquantino*. Those cases address the scope of the "revenue rule," which is grounded in separation of powers concerns in the field of foreign relations and may apply only when courts are called upon to construe and enforce a *foreign* government's revenue laws. See *Pasquantino*, 305 F.3d at 295-296. In *Boots*, the First Circuit expressly refused to decide "whether a smuggling scheme structured like the instant one, if practiced upon, say, federal or other authorities within the United States, would be a fraudulent scheme within section 1343," and the court distinguished cases applying the wire fraud and mail fraud statutes against "schemes to evade domestic taxes" on the ground that none of those decisions involved a foreign government. 80 F.3d at 586. In *Pasquantino*, the Fourth Circuit likewise observed that, "[g]enerally, we would agree that the identity and location of the victim in a wire fraud case are irrelevant. However, when that victim is a foreign government, that identity takes on a new importance." 305 F.3d at 298.

This case does not involve a foreign government, and the Third Circuit's decision follows a long line of authority applying the mail and wire fraud statutes where a State is the victim of a scheme to defraud and where state law prohibited the underlying conduct. See *Parr*, 363 U.S. at 389. Every court of appeals that has considered the question has concluded that the mail and wire fraud statutes encompass schemes to defraud a State of tax revenues. See *Porcelli*, 865 F.2d at 1358

(New York State sales tax on gasoline sales); *DeFiore*, 720 F.2d at 761-762 (New York State and City cigarette tax); *Doe*, 867 F.2d at 989 (Cook county taxes); *United States* v. *Flaxman*, 495 F.2d 344 (7th Cir.) (Illinois occupation and gross receipts taxes), cert. denied, 419 U.S. 1031 (1974); *Mirabile*, 503 F.2d at 1066-1067 (Missouri gross receipts and sales tax). Those decisions expressly reject federalism arguments of the kind raised by petitioners in this case. See *DeFiore*, 720 F.2d at 761-762; *Porcelli*, 865 F.2d at 1358; *Mirabile*, 503 F.2d at 1067; see also *Panarella*, 277 F.3d at 693-694.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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