

Supreme Court Decision Could Galvanize Prosecutions of Government Contractors

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The U.S. Supreme Court's May 22 decision in *Kousisis v. United States* could have wide-ranging implications for criminal and civil fraud cases against government contractors going forward. The Court ruled that a government contractor can commit criminal wire fraud by fraudulently misrepresenting its eligibility for an award and thereby inducing the government to award a contract – even if the contractor ultimately performs the work according to the contract specifications. Coming on the heels of the U.S. Department of Justice (DOJ) announcement that procurement fraud was the top “high-impact” enforcement area under the Trump Administration, the decision clears a path for prosecutors to aggressively pursue fraud cases against contractors that knowingly make false statements in contract bids. Nevertheless, the Justices cautioned that the rigorous materiality requirement in federal fraud statutes will continue to limit prosecutions and help distinguish “everyday misstatements from actionable fraud.”

The Court's Decision

The case involved multimillion-dollar bridge repair contracts issued by the Pennsylvania Department of Transportation (PennDOT) to Stamatis Kousisis and Alpha Painting & Construction Co. (Alpha). The contracts were federally funded and conditioned on compliance with disadvantaged business enterprise (DBE) participation requirements. As a result, PennDOT required contractors to subcontract a certain percentage of the contract value to a disadvantaged business. In Alpha's bid, Kousisis falsely represented that Alpha would procure paint supplies from a certified DBE, Markias, Inc., to satisfy this requirement. In reality, Markias was a pass-through entity, performing no commercially useful function. Alpha arranged for third-party paint companies to submit invoices to

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Markias, which simply tacked on a markup and passed on the paint supplies to Alpha.

Kousisis and Alpha were convicted on multiple counts of wire fraud and conspiracy. On appeal, they argued that even if Alpha had not used a DBE subcontractor, PennDOT received the bargained-for bridge repair services and had suffered no “net pecuniary loss.” As a result, they argued, there was no deprivation of “money or property” as required by the wire fraud statute, 18 U.S.C. § 1343.

The Supreme Court held that Section 1343 does not require the victim to suffer a net economic loss to sustain a conviction, as “economic loss” is not an element found in the statute’s text. Instead, it requires only a scheme to obtain money or property through materially false representations. It does not matter if the defendant provides something of equal value in return. The Court reaffirmed that the object of the scheme must be money or property – not merely regulatory interference or intangible rights. But the Court concluded that using false statements to induce the government to award a lucrative government contract was a scheme to obtain money or property. In doing so, the Court reiterated the viability of a “fraudulent inducement” theory of wire fraud.

Despite finding in favor of the government, both Justice Barrett’s majority opinion and Justice Thomas’s concurrence went out of their way to reinforce that the element of materiality was a “limit” on federal fraud statutes – even though these defendants had not contested materiality in their appeal. Both opinions cited favorably to the civil False Claims Act standard for materiality, a “rigorous” and “demanding” element that requires that the misrepresentation induce action by the government and go to the “very essence of the bargain.” *Universal Health Services v. United States ex rel. Escobar*, 579 U.S. 176, 193 (2016). Justice Thomas in particular used the materiality framework to question how minority subcontracting requirements could ever be material to bridge repair contracts. Justice Thomas’s concurrence went so far as to doubt the government could have proven materiality in this case.

Takeaways

Given the government’s penchant for bringing fraud-in-the-inducement actions against contractors, *Kousisis* will likely be a landmark case for both criminal and civil enforcement actions involving procurement fraud. On one level, the decision makes it easier for the government to allege fraud merely for misrepresenting eligibility for an award or compliance with social policies, even if the contractor ultimately performs the contract according to the government’s specifications. The government no longer has a burden of proving economic loss as an element of wire fraud. At the same time, the decision provides a roadmap for defendants to challenge fraud actions for lack of materiality if the alleged misrepresentation does not go to the “very essence of the bargain.”

Now that DOJ has reaffirmed its commitment to prosecuting procurement fraud, contractors could see a resurgence in DOJ criminal investigations and prosecutions premised on a “fraudulent inducement theory.” Indeed, *Kousisis*’s holding can extend far beyond minority contracting requirements. For example, DOJ may try to use such a theory to pursue a contractor for perceived false certifications or representations about diversity, equity, and inclusion (DEI) policies and practices. This is especially true given DOJ’s recent Civil Rights Fraud

Initiative announcement strongly encouraging whistleblowers to come forward with evidence that recipients of federal funds were engaging in such practices.

Despite this ruling, economic loss arguments will remain relevant for sentencing calculations under the U.S. Sentencing Guidelines. Courts have recognized that in procurement fraud cases, “loss” under Section 2B1.1(b) (1) of the Sentencing Guidelines means “the contract price less the fair market value of the services that the defendant rendered,” not “the total contract value.” *United States v. Crummy*, 249 F. Supp. 3d 475 (D.D.C. 2017). This argument can dissuade the government from pursuing a prosecution on the front end or reduce the possible sentence of a defendant on the back end.

With the potential rise in procurement fraud prosecutions in the wake of *Koussis* and recently announced DOJ priorities, companies doing business with the government should ensure they have a robust compliance program to limit potential exposure. If companies do learn of possible issues, they should work with counsel to promptly review and address those concerns to mitigate the risk of becoming the target of a criminal fraud investigation.

Wiley’s White Collar Defense & Government Investigations and Government Contracts practices are well-positioned to help businesses and government contractors navigate the evolving enforcement and compliance landscapes. If you have any questions, please contact one of the authors listed on this alert.