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Honest Services after *Skilling*: Judicial, Prosecutorial, and Legislative Responses

BY IRIS E. BENNETT, JESSIE K. LIU, CYNTHIA J. ROBERTSON, AND GOVIND C. PERSAD

In *Skilling v. United States*, the U.S. Supreme Court substantially narrowed the reach of the “honest services fraud” statute, 18 U.S.C. § 1346, by holding that it applies only to “bribery and kickback schemes,” not to “undisclosed self-dealing by a public official or private employee.” *Skilling v. United States*, 130 S. Ct. 2896 (2010). Two companion cases also were decided the same day. See *Black v. United States*, 130 S. Ct. 2963 (2010); *Weybrauch v. United States*, 130 S. Ct. 2971 (2010). These decisions have major significance for federal fraud prosecutions.

Honest-Services-Fraud Law Before *Skilling*

Honest-services fraud began as an outgrowth of 18 U.S.C. §§ 1341 and 1343, which criminalize the use of the mails or wires to execute a “scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretense, representations, or promises.” About 60 years ago, federal prosecutors started successfully using the mail-and-wire-fraud statutes to charge fraud involving “intangible harms,” which they alleged included a deprivation of the “honest services” owed by the defendant to a particular group, such as by a public official to the public. The Supreme Court’s 1987 decision in *McNally v. United States*, 483 U.S. 350 (1987), temporarily halted these prosecutions by holding that the statutory term “property” did not encompass “honest services.”

In 1988, Congress enacted section 1346, which expressly overruled *McNally* by adding a provision to the mail-and-wire-fraud statutes prohibiting “a scheme or artifice to defraud another of the intangible right of honest services.” Congress left the term “honest services” undefined. Federal prosecutors took a broad view of the phrase and employed the statute to charge both public officials and private parties with a range of misdeeds that at their core involved self-dealing and

conflicts of interest. Thus, for example, in securities fraud and insider-trading cases, federal prosecutors often charged the defendant executive or employee with depriving the company and its shareholders of the honest services owed them. *Skilling* and *Black* exemplify this type of case. Section 1346’s breadth and flexibility made it extremely useful to prosecutors: It was the lead charge asserted against 79 defendants in 2007, up from 63 in 2005, and 28 in 2000. Lynne Marek, *DOJ may rein in use of “Honest Services” statute*, Natl. L.J., June 15, 2009, at 1, available at www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=1202431433581; see also Lisa L. Casey, *Twenty-Eight Words: Enforcing Corporate Fiduciary Duties Through Criminal Prosecution of Honest Services Fraud*, 35 Del. J. Corp. Law 1, 43 and n.244 (2010) (finding that at least 107 federal dockets referenced honest services fraud in 2008, up from 86 in 2007), available at <http://ssrn.com/abstract=1557351>.

During this period, defendants often argued that their conduct did not fall within the honest-services statute, or that the statute was so vague that it violated due process by failing to provide adequate notice as to what conduct it proscribed. The lower federal courts struggled to clarify the scope of the statute, resulting in varying and sometimes conflicting definitions of the concept of “honest services.”

What Did *Skilling* Decide?

Although presented with an opportunity to strike down the “honest services” fraud statute as unconstitutionally vague, the Supreme Court, with Justice Ginsburg writing for the majority, held that it could be preserved by limiting section 1346 to offenses involving bribery and kickbacks, which comprised the “heartland” of section 1346 violations under pre-*McNally* case law. *Skilling*, 130 S. Ct. at 2931 and n.44. The Court concluded that Congress, in passing section 1346, had intended to

restore the honest-services fraud doctrine recognized by the courts of appeals before *McNally*, and which primarily focused on bribery and kickbacks. *Id.* Justice Scalia, joined by Justices Thomas and Kennedy, concurred in the judgment but would have found the statute unconstitutionally vague.

Bribery and Kickbacks

Skilling did not define the precise scope of bribery and kickbacks encompassed by the statute, but noted that the “prohibition on bribes and kickbacks draws content not only from the pre-*McNally* case law, but also from federal statutes proscribing and defining similar crimes, [such as] 18 U.S.C. §§ 201(b), 666(a)(2); 41 U.S.C. § 52(2).” *Skilling*, 130 S. Ct. at 2931. Section 201(b) prohibits bribery of federal officials to influence an official act or to induce the official to do or omit to do anything that violates the official’s lawful duty; section 666 prohibits the acceptance of bribes by public officials; section 52(2) prohibits paying or accepting a kickback (essentially, something of value in exchange for favorable treatment) in connection with government contracts. *McNally* “involved a classic kickback scheme” in which a public official awarded a contract to a company in exchange for that company’s sharing its commissions with entities in which the official had an interest. *Id.* at 2932. Many state laws also penalize bribery and kickbacks.

Both bribery and kickbacks are punishable under the honest-services statute only where a fiduciary duty exists, but *Skilling* does not provide much guidance on the source or scope of this fiduciary duty. Prior to *Skilling*, some circuits had held that state law determines the existence of a fiduciary duty. *E.g.*, *United States v. Brumley*, 116 F.3d 728 (5th Cir. 1997); *United States v. Murphy*, 323 F.3d 102 (3d Cir. 2003). See generally Frank C. Razzano and Jeremy D. Frey, *U.S. Supreme Court’s Recent Decisions on “Honest Services” Fraud Raise*

Questions About Fiduciary Duty, Quid Pro Quo, Mens Rea, and Other Issues, 5 BNA Whitecollar 15 (2010). Other circuits had held that public officials always owe a fiduciary duty to the public. *E.g.*, *United States v. Sorich*, 523 F.3d 702, 712 (7th Cir. 2008); *United States v. Walker*, 490 F.3d 1282, 1297, 1299 (11th Cir. 2007); *United States v. Sawyer*, 239 F.3d 31, 41–42 (1st Cir. 2001). Potential ambiguity in the definition of fiduciary duty could lead to a variety of results in future cases. For instance, whether the alleged briber believed that the recipient was not authorized to receive the gift or had the intent to defraud, as well as whether the gratuity must be correlated with a specific action, may continue to be key issues in section 1346 bribery and kickback cases.

Even after *Skilling*, the honest-services statute affords federal prosecutors further avenues for prosecution beyond those provided by other bribery statutes. As Justice Ginsburg made clear, “[o]verlap with other federal statutes does not render § 1346 superfluous. The principal federal bribery statute, § 201, for example, generally applies only to federal public officials, so § 1346’s application to state and local corruption and to private-sector fraud reaches misconduct that might otherwise go unpunished.” *Skilling*, 130 S. Ct. at 2934 n.46. Additionally, 18 U.S.C. § 666 covers only bribes over \$5,000 in value, while the honest-services statute has no minimum.

Skilling’s Impact on Pending Cases

In *Skilling*, along with *Black* and *Weyhrauch*, the Supreme Court vacated the convictions and remanded the cases for further proceedings because in each case the defendant’s conduct lay outside the bribery and kickback “heartland.” Conrad Black, the former CEO and chair of Hollinger International, was convicted on three counts of depriving Hollinger of his honest services by granting himself purported “noncompetition” fees that he failed to disclose to Hollinger. *Black v. United States*, 130 S. Ct. 2963 (2010). Alaska state legislator Bruce Weyhrauch was charged with soliciting future employment from a company at a time when the legislature was considering a tax bill that would affect that company.

Weyhrauch v. United States, 130 S. Ct. 2971 (2010). *Skilling*’s misrepresentation of Enron’s financial health for personal profit, like Black’s and Weyhrauch’s conduct, did not constitute a bribe or kickback scheme. *Skilling*, 130 S. Ct. at 2934. But, because *Skilling*’s and Black’s indictments also alleged conspiracies to commit money-or-property fraud, the Court concluded that the appeals courts in each case would have to determine whether the error was harmless. *Id.*; *Black*, 130 S. Ct. at 2970.

Defendants across the country are successfully obtaining relief under the *Skilling* trio of cases. A few examples illustrate this trend. Five days after deciding *Skilling*, the Supreme Court vacated and remanded the convictions of former Alabama governor Don Siegelman and former HealthSouth CEO Richard Scrushy in connection with a scheme to bribe Siegelman. *Scrushy v. United States*, No. 09-167, 2010 WL 2571879 (U.S. June 29, 2010); *Siegelman v. United States*, No. 09-182, 2010 WL 2571880 (U.S. June 29, 2010). A New Jersey district court dismissed charges against Joseph A. Ferriero, the former Democratic Party chairman of Newark’s Bergen County, for not disclosing his ownership in a firm that solicited contracts in towns where he had political influence. *United States v. Ferriero*, Crim. A. No. 08-00616, Order (D.N.J. Aug. 2, 2010). Former New York state Senate leader Joseph Bruno, convicted of a long-standing and wide-ranging scheme to use his public office to pursue private business gain, was released on bail pending appeal because, a district court judge concluded, his appeal raises “a substantial question of law” regarding whether he received bribes or kickbacks. *United States v. Bruno*, 1:09-cr-00029, Text Order (N.D.N.Y. July 22, 2010). The impact has been felt in cases involving private individuals as well; for example, the U.S. District Court for the Middle District of Alabama recently ruled that the honest-services statute does not apply to a lawyer who drafted county gambling rules while failing to disclose that he represented a gambling business that would benefit from the rules. *Hope For Families & Community Svc., Inc. v. Warren*, No. 3:06-CV-1113-WKW, 2010 WL 2629408, at *31 (M.D.

Ala. June 30, 2010).

The government also preemptively has dropped several prosecutions in the wake of *Skilling*. For example, prosecutors have moved to dismiss an indictment of several public officials in Louisiana who were accused of using their official powers to increase the value of their private property on the ground that no bribery or kickbacks were alleged, and so no honest-services fraud prosecution could lie. Press Release, Dep’t of Justice, *United States Asks Court to Dismiss Charges in Poverty Point Reservoir Fraud Case* (July 6, 2010), available at www.justice.gov/usao/law/news/wd120100706.pdf.

Of course, many cases remain unaffected. In perhaps the most high-profile example, former Illinois governor Rod Blagojevich had sought to delay his trial in light of *Skilling*, but the court refused, noting that the allegations against him involved bribery and kickbacks. Ted Cox, *Judge Says “Honest Services” Charges Stick Against Blagojevich*, Chi. Daily Herald, June 30, 2010, available at www.dailyherald.com/story/?id=391152. Similarly, Robert Urciuoli, a Rhode Island CEO prosecuted for his role in a scheme to bribe a state senator, argued that his case should be dismissed because honest-services fraud covers only those who owe a fiduciary duty to the public (in his case, the state senator). The court ruled that “Urciuoli’s . . . attempt to use [*Skilling*] in his favor, although imaginative, is hopeless” because the case involved “the core bribery offense preserved by *Skilling*.” *United States v. Urciuoli*, No. 09-1504, 2010 WL 2814311, at *6–*7 (1st Cir. July 20, 2010). Similarly, where a defendant clearly has been convicted of an offense that survives *Skilling*, in addition to an honest-services charge, any relief will only be partial. For example, although honest-services allegations as part of an insider-trading prosecution were struck in light of *Skilling*’s limitation to “bribes or kickbacks,” other broader mail-and-wire-fraud charges were unaffected because “[m]oney and property fraud survives the Supreme Court’s recent decisions.” *United States v. Hatfield*, No. 06-CR-0550, 2010 WL 2710616, at *5 (E.D.N.Y. July 15, 2010).

No Longer Honest-Services Fraud	Still Honest-Services Fraud
<p>Self-dealing and conflicts of interest</p> <p><i>Example:</i> Officials or private individuals use their authority to secure personal benefits like employment for a relative.</p>	<p>Bribery and kickbacks</p> <p><i>Example:</i> Someone with business before a public official or employee offers a gratuity or something of value in exchange for favorable treatment.</p>
<p><i>Example:</i> An employee gives a lucrative public or private contract to a company in which he or she owns stock.</p>	<p><i>Example:</i> A contractor provides free services to an official or employee who gave that contractor a lucrative contract.</p>

How Might Prosecutors Respond?

The *Skilling* decision established that allegations of conflict of interest and self-dealing, such as those against Black and Skilling, no longer can support a prosecution under the honest-services-fraud statute. But prosecutors may still be able to reach conflicts of interest and self-dealing through other laws. Among the most obvious is the use of the “money or property,” rather than “honest services,” prong of the mail-and-wire-fraud statutes to prosecute breaches of fiduciary duty. When the Supreme Court repudiated honest-services fraud in *McNally*, Justice Stevens suggested in his dissent that prosecutors might argue that an employee who breaches a fiduciary duty in effect steals the salary he is paid, thus recasting a theft of honest services as a theft of property. Compare *United States v. Richerson*, 833 F.2d 1147, 1157 (5th Cir. 1987) (adopting theft-of-salary theory), with *United States v. Ochs*, 842 F.2d 515, 526–27 (1st Cir. 1988) (rejecting *Richerson* theory). Now that *Skilling* has limited section 1346 to bribes and kickbacks, prosecutors may revive this theory. See Peter M. Oxman, Note, *The Federal Mail Fraud Statute After McNally v. United States*, 107 S. Ct. 2875 (1987): *The Remains of the Intangible Rights Doctrine and its Proposed Congressional Restoration*, 25 Am. Crim. L. Rev. 743, 745–46 (1988) (discussing the theft-of-salary theory and other prosecutorial strategies adopted after *McNally*).

In addition, a number of state and federal statutes penalize self-dealing and undisclosed conflicts of interest. See, e.g.,

FAR 3.601 (prohibiting award of contract to business owned or controlled by a government employee); Ark. Code Ann. § 21-8-803 (2008); N.Y. Pub. Off. Law § 74 (2008). These laws can require that federal employees or officials refrain from representing parties adverse to the government before agencies and courts, 5 C.F.R. § 2635.805; 32 C.F.R. § 516.49, and from participating in matters in which they or their relatives have a financial interest, e.g., Ariz. Rev. Stat. § 38-503 (2008). But the federal conflict-of-interest and self-dealing statutes apply only to federal employees and officials, and state statutes vary widely as to what conduct they proscribe and how harshly they punish prohibited conduct. For example, some state statutes may provide for only civil penalties. E.g., N.C. Gen. Stat. Ann. § 138A-45(a) (“Except as specifically provided in this Chapter and for perjury under G.S. 138A-12 and G.S. 138A-24, no criminal penalty shall attach for any violation of this Chapter.”). Accordingly, prosecutors may not view these statutes as adequate substitutes for section 1346.

The Congressional Response

On September 28, 2010, Lanny Breuer, assistant attorney general for the Department of Justice’s Criminal Division, urged Congress to pass legislation to “restore our ability to use the mail and wire fraud statutes to prosecute state, local, and federal officials who engage in schemes that involve undisclosed self-dealing.” See Honest Services Fraud: Hearing Before the

S. Comm. on the Judiciary, 111th Cong. (statement of Lanny A. Breuer, Assistant Attorney General, Criminal Division, U.S. Department of Justice). Breuer suggested that the new statute “rely upon the mail and wire fraud statutes,” but “in order to define the scope of the financial interests that underlie improper self-dealing, the statute should draw content from the well-established federal conflict of interest statute, 18 U.S.C. § 208.” *Id.* In addition, he argued, the statute “should provide that no public official can be prosecuted unless he or she knowingly conceals, covers up, or fails to disclose material information that he or she is already required by law to disclose.” *Id.* Breuer also stated that the department was interested in working with the Judiciary Committee on legislation to address corrupt corporate officers. *Id.*

That same day, Senator Patrick Leahy (D-VT), Chairman of the Senate Judiciary Committee, introduced the Honest Services Restoration Act, S. 3854, which would amend the definition of “scheme or artifice to defraud” in 18 U.S.C. § 1346 to include a scheme or an artifice “by a public official to engage in undisclosed self-dealing,” or “by officers or directors to engage in undisclosed private self-dealing.” The bill defines “undisclosed self-dealing” as the performance of an official act for the purpose of benefiting or furthering a financial interest of the official or certain related or associated individuals or entities, where disclosure of that financial interest is required by federal, state, or local law. *Id.* The bill defines “undisclosed private

self-dealing” as the performance of an act that causes or is intended to cause harm to an officer or a director’s employer, and is undertaken to benefit the financial interest of the officer or director or a related or associated individual or entity, where disclosure is required by law. Leahy issued a press release explaining that the new statute “targets cases in which officials failed to disclose the interests they benefited in violation of federal, state and local disclosure laws.” Press Release, Sen. Patrick Leahy, Leahy Introduces Bill to Address Supreme Court’s *Skilling* Decision (Sept. 28, 2010), available at http://leahy.senate.gov/press/press_releases/release/?id=d8b2c597-548f-49cc-aaa9-9ac7cb8792a8 (last visited Nov. 8, 2010). The bill was referred to the Senate Judiciary Committee, which, as of press time, has not yet acted.

Conclusion

Contrary to many predictions that it would strike down the honest-services statute altogether, the Supreme Court, in *Skilling* and its companion cases, limited the law to bribes and kickbacks. Although many pending prosecutions will survive *Skilling*, a number of lower federal courts also are reconsidering the propriety of charges of honest-services fraud in pending cases, and some such cases have been dismissed altogether. It remains to be seen how federal prosecutors and Congress will respond. Clearly, though, the *Skilling* trio of cases will continue to affect white-collar criminal practice for many years to come. ■

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