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The Supreme Court Limits the Scope of the Federal Criminal "Honest Services Fraud" Statute to Conduct Involving Bribes or Kickbacks

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The Supreme Court yesterday limited the scope of an important federal criminal statute that has been frequently relied upon by prosecutors in investigating and prosecuting business leaders, public officials and professionals. The Court held, in an opinion arising out of the case against former Enron CEO Jeffrey Skilling, and in related rulings in cases involving newspaper magnate Conrad Black and Alaska legislator Bruce Weyhrauch, that the federal "honest services fraud" statute, 18 U.S.C. § 1346, may only be used to prosecute breaches of fiduciary duty involving bribes or kickbacks.[1] The import of the holding is that the statute can no longer be used -- as it has been frequently -- to prosecute conduct such as self-dealing, undisclosed conflicts of interest, and breach of fiduciary duty that, while unethical and unsavory, is otherwise typically the subject of civil litigation. Going forward, in order to make out an honest services fraud violation, a prosecutor will need to establish that a defendant solicited or received a side payment from a third party in exchange for a fraudulent act or a breach of duty.

The Honest Services Fraud Statute

The federal mail and wire fraud statutes make it a crime to use the mail or interstate communications to "devise any scheme or artifice to defraud" or "[obtain] money or property" by means of fraud.[2] Title 18, Section 1346 provides that for purposes of the mail and wire fraud statutes, "the term 'scheme and artifice to defraud' includes a scheme or artifice to deprive another of the intangible right of honest services."

The meaning of the term "intangible right of honest services" has been hotly debated in the federal circuit courts and, in the cases decided yesterday, the defendants had argued that Section 1346 should be stricken as unconstitutionally vague. Indeed, Justice Scalia had previously signaled that he supported the defendants' position. In a dissent he filed in connection with the Court's refusal to hear a 2008 appeal of an honest services fraud conviction, Justice Scalia wrote that Section 1346: (a) fails to give "fair warning of the conduct that makes it a crime;" (b) is not clear in distinguishing what "separates the criminal breaches, conflicts and misstatements [by public officials] from the obnoxious but lawful ones;" and (c) is subject to a "serious argument" that it is "nothing more than an invitation for federal courts to develop a common law crime of unethical conduct … [but that it] is simply not fair to prosecute someone for a crime that has not been defined until the judicial decision that sends him to jail."[3]

Although Justice Scalia yesterday maintained this view by arguing in a separate concurrence (joined by Justices Thomas and Stevens) that Section 1346 is unconstitutionally vague, the Court refused to strike the statute. Instead, the Court held that Section 1346 is limited such that it only criminalizes bribery and kickback schemes and wrote, "reading the statute to proscribe a wider range of offensive conduct . . . would raise the due process concerns underlying the vagueness doctrine."[4] The Court went on to specify certain types of conduct that the statute does not reach, such as "mere failure to disclose a conflict of interest," "undisclosed self-dealing," and "concealment of material information." A review of the cases helps illustrate the effect of the Court's holding.

The Jeffrey Skilling Case

Former Enron CEO Jeffrey Skilling was convicted at trial of conspiracy and substantive counts of securities fraud, wire fraud, insider trading and making false statements to Enron's auditors. Count One, the conspiracy count, listed three objects of the conspiracy: honest services fraud, securities fraud and wire fraud. The government's theory of the case was that Skilling conspired to defraud Enron's shareholders by misrepresenting the company's fiscal health, thereby artificially inflating its stock price, and that he profited from the fraud by receiving a salary and bonuses and by receiving almost $90 million in profits through his sale of Enron stock.

After considering and rejecting Skilling's argument that he had not received a fair trial because of extensive pre-trial publicity and a tainted jury pool, the Supreme Court held that, because there was no evidence that Skilling "solicited or accepted side payments from a third party in exchange for making these misrepresentations," he did not commit honest services fraud.[5] The Court remanded the case to the Fifth Circuit to determine whether the conspiracy count and any of the substantive counts must be reversed in light of its holding. The issues for the Fifth Circuit will be whether the jury's verdict on the conspiracy count rested on the legally invalid theory of honest services fraud and whether any of the substantive counts "hinged" on the flawed conspiracy count.

The Conrad Black Case

Conrad Black was a senior executive in Hollinger, a publicly-held media company. The government's evidence at trial showed that, in connection with Hollinger's sale of a small California subsidiary that distributed a single local newspaper, Black and others caused the subsidiary to transfer $5.5 million to themselves, purportedly in exchange for promises not to compete. The government's theory at trial was that the non-compete fee was a sham and that Black looted Hollinger by arranging the fee and failing to disclose it to investors.

Based on the fact that there was no evidence that Black obtained or arranged a kickback or received a bribe, the Court held that Black's conduct did not violate Section 1346. The Court also ruled that the trial court's jury instructions were incorrect; the trial court had instructed the jury that Black could be found guilty if he "misused his position for private gain for himself and/or a co-schemer" and "knowingly and intentionally breached his duty of loyalty."[6] The Court remanded the case to the Seventh Circuit to determine whether the incorrect jury instruction was harmless error and whether the conviction could still stand based on the government's proof of traditional mail and wire fraud and the instructions on those counts.

The Bruce Weyhrauch Case

Bruce Weyhrauch was an Alaskan state legislator who had met with the CEO of an oil services company to discuss potential employment with the company while he and the Alaskan legislature were considering a special tax on oil production that would have impacted the company. During the meeting, Weyhrauch discussed the bill with the oil executive. The indictment alleged that

Weyhrauch's failure to disclose to the legislature his potential conflict of interest constituted a violation of Section 1346. In support of its case, the government sought to introduce evidence of legislative ethics publications requiring the disclosure of potential conflicts of interest. The trial court excluded the evidence and held that Section 1346 does not require proof of a violation of state law. Weyhrauch sought interlocutory review and, in the *per curiam* order issued this week, the Supreme Court remanded the case for further consideration in light of *Skilling*. It seems certain that unless the government can show on remand that Weyhrauch received (or agreed to receive) a bribe or kickback in exchange for his vote on the oil legislation, the government's honest services fraud case against him will be doomed.

Conclusion

The Supreme Court's opinion in *Skilling* dramatically alters the landscape of honest services fraud prosecutions and makes it clear that, unless the conduct involves a bribe or kickback paid by a third party, the government can no longer use Section 1346 to prosecute employees or executives for unethical or unsavory business practices, such as self-dealing, undisclosed conflicts of interest, or other breaches of duty.[7]

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[1] *See Skilling v. United States*, 561 U.S. ____, ____ WL ____, (U.S. Jun 24, 2010) (08-1394); *Black v. United States*, 561 U.S. ___, ___ WL ___, (U.S. Jun 24, 2010) (No. 08-876); *Weyhrauch v. United States*, 561 U.S. ___, ___ WL ___, (U.S. Jun 24, 2010) (No. 08-1196).

[2] 18 U.S.C. §§ 1341 and 1343.

[3] *Sorich v. United States*, 531 F.3d 501 (7th Cir. 2008), *cert denied*, 129 S.Ct. 1308, 1310 (No. 08-410) (Scalia, J., dissenting).

[4] *Skilling*, at *44.

[5] *Skilling*, at *49.

[6] *Black*, at *3.

[7] Section 1346 was enacted in 1987 in response to a Supreme Court decision restricting the prosecution of federal mail and wire fraud violations to those schemes designed to obtain money or tangible property. *McNally v. United States*, 483 U.S. 350 (1987) (mail fraud statute does not protect "the intangible right of the citizenry to good government"). It remains to be seen whether Congress will act once more, now that the Court in *Skilling* has again limited the scope of honest services fraud.