

Honest-Services Fraud - The Supreme Court Whittles away Prosecutors' Big Stick

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The Supreme Court has issued three opinions substantially limiting the breadth of "honest-services" fraud under 18 U.S.C. § 1346. In the lead case, *Skilling v. United States*, the Court ruled that honest-services fraud—which prosecutors had been using aggressively to criminalize corporate executives' and public officials' failure to disclose personal gains from corporate or government business—only prohibits bribes and kickbacks.

As a result of the Court's ruling, the statute can no longer be used to prosecute executives, fiduciaries and public officials merely for "undisclosed self-dealing," or taking official action to further their own interests while purporting to act in the interests of those owed a fiduciary duty. Courts have already begun to apply the *Skilling* ruling to overturn rulings in a variety of honest-services fraud cases. These decisions, involving defendants ranging from a self-dealing lottery commissioner to self-interested parties writing charitable bingo regulations, are an early indicator of the breadth of the *Skilling* ruling. Of course, this ruling does not go so far as to immunize business actions committed for personal gain from other legal consequences; it simply removes one tool from prosecutors' arsenal and clarifies the scope of an ill-defined criminal statute.

The honest-services fraud statute evolved from the traditional fraud statute, which generally prohibits a "scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises." 18 U.S.C. § 1341. Although the statute did not include the words "honest services," courts interpreted it to involve both property and intangible rights. As such, a number of courts had previously held that honest-services fraud occurred if a victim did not actually lose money or property to an

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offender through fraud, but instead lost the intangible right to an offender's honest services. Thus, for example, if a government official offered a contract to a contractor in which the official secretly owned a stake, that deal could have given rise to honest-services fraud, even if the general public paid no more for the contract than it would have paid if a different contractor were used.

Prosecutors traditionally enjoyed broad discretion under the honest-services wire fraud statute and brought charges against fiduciaries and public officials for a wide range of unethical actions for personal gain. The Supreme Court first limited this discretion in 1987, declaring that the wire fraud statute protected only property rights. See *McNally v. United States*, 483 U.S. 350.

In response, Congress quickly passed a statute clarifying that fraud explicitly could include "a scheme or artifice to deprive another of the intangible right of honest services." 18 U.S.C. § 1346. The new statute, however, offered no definition of "honest services" or guidance about what actions constituted a scheme to deprive others of such intangible rights. This enabled prosecutors to continue to bring charges under the honest-services fraud statute in a wide variety of cases, including bribery, kickbacks, conflicts of interest and other more amorphous misdeeds, such as concealment of material information. Courts have since struggled to determine the limits of the statute and came to diverging conclusions about what actions could be considered honest-services fraud.

Faced with such a potentially vague criminal statute, the Supreme Court ruled on June 24, 2010, that the statute only applied to narrow, well-defined circumstances. In *Skilling*, the government had charged the former CEO of Enron with conspiring to commit honest-services wire fraud by misrepresenting the company's financial health, which resulted in artificially inflated stock prices. At no time, however, did the defendant accept payments from third parties in conjunction with his misrepresentations. Skilling argued that the honest-services fraud statute under which he was charged was unconstitutionally vague because it could apply to an innumerable range of actions. Alternatively, he argued that his conduct did not fall under the statute.

The Supreme Court determined that the honest-services statute, as written, could only prohibit bribes and kickbacks. The Court declined, however, to deem the entire statute unconstitutionally vague. In coming to this conclusion, the Supreme Court examined the legal precedent prior to *McNally*, noting that the bulk of the honest-services fraud cases traditionally arose from bribes and kickbacks. The Court also found persuasive that Congress passed the honest-services statute in response to *McNally*, which was a kickback case. The Court concluded that because Skilling did not accept payments from third parties in conjunction with his actions, his actions did not constitute bribery or a kickback, and he did not violate the honest-services fraud statute.

In two other decisions issued simultaneously, the Court applied *Skilling* to vacate honest-services fraud convictions of corporate executives and an elected official. In *Black v. United States*, Conrad Black and other executives of Hollinger International, a publicly held company that owned newspapers, were charged with honest-services fraud for failing to disclose their receipt of bogus "noncompetition fees." The Hollinger executives had arranged for a Hollinger subsidiary to pay them millions of dollars not to compete with the subsidiary's small-town newspaper. Neither Hollinger's audit committee nor its board of directors was

informed about this transaction between the company and the executives, and the payments were backdated and never disclosed in securities filings. In *Weyhrauch v. United States*, a member of Alaska's House of Representatives, who also worked as a private attorney, submitted his resume to an oil company and offered to vote favorably on oil legislation in exchange for receiving future legal work from the company.

Lower courts have already begun to apply *Skilling*. In *Geddings v. United States*, Kevin Geddings was appointed to serve as a North Carolina lottery commissioner. After accepting the appointment, Geddings failed to acknowledge on a disclosure of economic interests that a company vying for a contract to run the North Carolina lottery had paid about \$160,000 to entities under his control. Geddings was convicted of honest-services fraud and was serving time in prison. After *Skilling*, the government acknowledged that Geddings' conviction should be vacated, and Geddings was released on recognizance. In *Hope for Families & Cmty. Svc., Inc. v. Warren*, the sheriff of Macon County was entrusted by the Alabama legislature to draft and enforce charitable bingo regulations. The sheriff's lawyer, who happened to be the son and law partner of the counsel and minority shareholder of a charitable bingo operator called VictoryLand, drafted the regulations. Subsequently, a single charitable bingo operator obtained licensure in Macon County: VictoryLand. In a civil suit, the sheriff, his lawyer and VictoryLand were accused of Racketeer Influenced and Corrupt Organizations Act (RICO) violations predicated on honest-services fraud for self-dealing, conflicts of interest and bribery. The court awarded summary judgment to the defendants on the charges of honest-service fraud for self-dealing and conflicts of interest under *Skilling*, then did the same for the honest-services fraud for bribery charge based on a theory unrelated to *Skilling*.

Despite these recent cases reining in honest-services fraud, the *Skilling* ruling should not be interpreted as a license for executives and government officials to engage freely in business activities that result in personal gain. First, there is significant overlap between the conduct that previously fell under honest-services fraud and conduct falling under other fraud statutes. Corporate executives and government contractors who engage in business for personal gain may still be violating securities laws, insider trading or conflict-of-interest regulations and other forms of fraud, plus face civil liability from shareholders. Even with his victory, Jeffrey Skilling, for example, may still face a jail sentence for his securities fraud charge. Likewise, public officials and those who deal with public officials (including government contractors) are still subject to a host of other criminal statutes that encompass conduct that may have previously been covered by the honest-services fraud statute, including, for example, statutes regarding conflicts of interest, bribery, gifts and gratuities, kickbacks, false statements, and fraud or false claims.

Second, Congress may respond to *Skilling* as it did to the decision in *McNally*, that is, by revising the statute to explicitly include conduct that the court found was not covered by the current law. Thus, while certain actions may no longer (at least for the present) be considered honest-services fraud, they may result in a host of other repercussions both now and in the future, meaning that those in positions with the government or as fiduciaries should still be extremely cautious about engaging in undisclosed business activities that result in personal gain.

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