Honest Services Fraud After *Skilling v. United States*

*By Steven Wisotsky**

The mail fraud statute of 1872 may be regarded as the progenitor of what we now call white collar crimes. Originating with the Postmaster General's concern[1] that the mail system was being used to facilitate fraudulent schemes, the mail fraud statute has evolved into a powerful prosecutorial weapon. The core prohibition in the statute, first amended in 1909,[2] punishes "any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises."[3] Not only does the statute reach far and wide in its own right, it is also a predicate crime for RICO[4] and money laundering prosecutions.[5]

The classic violation of the statute is a case in which A defrauds B of money or property, as in a Ponzi scheme when it fails. But what if there is no victim in the traditional sense or the losses are abstract? Beginning in the 1940s, the courts developed a theory embracing generalized intangible losses. According to the Supreme Court in *Skilling v. United States*,[6] *Shushan v. United States*[7] originated the doctrine by affirming the mail fraud prosecution of a public official who allegedly accepted bribes from entrepreneurs in exchange for urging city action beneficial to the bribe payers. *Shushan* thus established the theory that the mail fraud statute covers a scheme to defraud the public, although the "loss" sustained by the public is not monetary but rather an intangible right to the honest administration of government. "A scheme to get a public contract on more favorable terms than would likely be got otherwise by bribing a public official would not only be a plan to commit the crime of bribery, but would also be a scheme to defraud the public."[8]

The court in *Shushan* further stated that no trustee has more sacred duties than a public official, and any scheme to obtain an advantage by corrupting such official must in the federal law be considered a scheme to defraud.[9] Nevertheless, subsequent cases extended the principle of fiduciary duty to a private employer-employee relationship. An employee who bought from vendors at reasonable rates but took a kickback from the vendor committed honest services fraud by using the mails in furtherance of the scheme.

Surveying public and private honest services fraud the Supreme Court in *Skilling* stated:

> "Most often these cases . . . involved bribery of public officials," *United States v. Bohonus*, 628 F.2d 1167, 1171 (C.A.9 1980), but courts also recognized private-sector honest-services fraud. In perhaps the earliest application of the theory to private actors, a District Court, reviewing a bribery scheme, explained:
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> "When one tampers with [the employer-employee] relationship for the purpose of causing the employee to breach his duty [to his employer,] he in effect is defrauding the employer of a lawful right. The actual deception that is practised is in the continued representation of the employee to the employer that he is honest and loyal to the employer's interests." *United States v. Proctor & Gamble Co.*, 47 F. Supp. 676, 678 (Mass. 1942).
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> Over time, "[a]n increasing number of courts" recognized that "a recreant employee"—public or private—"c[ould] be prosecuted under [the mail-fraud statute] if he breache[d] his allegiance to his employer by accepting bribes or kickbacks in the course of his employment," *United States v. McNeive*, 536 F.2d 1245, 1249 (CA8 1976); by 1982, all Courts of Appeals had embraced the honest-services theory of fraud, Hurson, Limiting the Federal Mail Fraud Statute—A Legislative Approach, 20 Am. Crim. L. Rev. 423, 456 (1983).[10]

In the 1970's prosecutors increasingly began to use the mail and wire fraud statutes in cases brought against political officials for failure to provide honest services.[11] In *United States v. States*,[12] the Eight Circuit affirmed the district court's ruling that the two phrases of section 1341 should be read separately and independently, thus proscribing two distinct offenses: 1) schemes to defraud and 2) schemes for obtaining money or property by means of fraudulent pretenses.[13] Without the requirement of a money or property scheme honest services became the "Stradivarius, the Colt 45, the Louisville Slugger[,] . . . and the true love of federal prosecutors."[14]

McNally

In 1987, the Supreme Court put an end to the expansion of the mail fraud statute in the case of *McNally v. United States*.[15] *McNally* involved the conviction of Gray, a former Kentucky public official, and McNally, a private individual, for participation in a self-dealing patronage and kickback scheme. The violation asserted by the Government was nondisclosure: the failure to disclose the defendants' sharing of insurance commissions, thus depriving the people of Kentucky of their right to have the commonwealth's affairs conducted honestly.[16] Footnote nine of *McNally* shows the broad reach that intangible rights doctrine had attained:

> [I]t was not charged that requiring the Wombell agency to share commissions violated state law. We should assume that it did not. For the same reason we should assume that it was not illegal under state law for Hunt and Gray to own one of the agencies sharing in the commissions and hence to profit from the arrangement, whether or not they disclosed it to others in the state government. It is worth observing as well that it was not alleged that the mail fraud statute would have been violated, had Hunt and Gray reported to state officials the fact of their

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financial gain. *The violation asserted is the failure to disclose their financial interest, even if state law did not require it, to other persons in the state government whose actions could have been affected by the disclosure.* It was in this way that the indictment charged that the people of Kentucky had been deprived of their right to have the Commonwealth's affairs conducted honestly.

It may well be that congress could criminalize using the mails to further a state officer's efforts to profit from governmental decisions he is empowered to make or over which he has some supervisory authority, even if there is no state law proscribing his profiteering or even if state law expressly authorized it. But if state law expressly permitted or did not forbid a state officer such as Gray to have an ownership interest in an insurance agency handling the State's insurance, it would take a much clearer indication than the mail fraud statute evidences to convince us that having and concealing such an interest defrauds the State and is forbidden under federal law.[17]

The Court in *McNally* held that the scheme did not qualify as mail fraud. "Rather than construing the statute in a manner that leaves its outer boundaries ambiguous and involves the Federal Government in setting standards of disclosure and good government for local and state officials, we read the statute as limited in scope to the protection of property rights."[18] The Court relied in part upon the rule of lenity in reaching its conclusion, and stated that "if Congress desires to go further, it must speak more clearly than it has."[19]

Congressional Reaction to *McNally*

It took Congress only a year to "speak more clearly." In 1988, Congress enacted 18 U.S.C. §1346 as part of the Drug Abuse Act. Some have called section 1346 the "stealth bill" because it was never referred to any committee of either the House or the Senate, and was never the subject of any floor debate.[20] The statute itself is only twenty-eight words long, has virtually no legislative history,[21] and fails to define the term honest services. Section 1346 reads: "For the purpose of this chapter, the term 'scheme or artifice to defraud' includes a scheme or artifice to deprive another of the intangible right of honest services." It is clear that Congress disapproved of *McNally* because of either its result or its rationale.

Skilling

It was not until *Skilling* in 2010 that the Supreme Court attempted to resolve the issues surrounding the honest services doctrine. Petitioner Jeffrey K. Skilling was the former chief executive officer of Enron, then an energy and commodities company, from February until August 2001. Less than four months later, Enron, the seventh-highest revenue-grossing company in America at the time, crashed into bankruptcy, and its stock plummeted in value.

Skilling was charged with engaging in a scheme to deceive investors about Enron's true finances by manipulating its publicly reported financial results and making false and misleading statements about Enron's financial performance. Count One of the indictment charged Skilling with conspiracy to commit honest services wire fraud by depriving Enron and its shareholders of the intangible right of his honest services.[22]

After a four-month trial, the jury found Skilling guilty of nineteen counts, including the honest services fraud conspiracy charge, and not guilty of nine insider trading counts. Skilling appealed, claiming his conviction was premised on an improper theory of honest services wire fraud.[23] Skilling maintained that section 1346 was unconstitutionally vague, and alternatively, that his conduct did not fall within the statute. The Fifth Circuit affirmed Skilling's convictions, and the Supreme Court granted certiorari.

The Court acknowledged that Skilling's vagueness challenge had force because honest services decisions preceding *McNally* were not models of clarity or consistency, but held that there is a definable core of honest services cases. Rather than invalidating section 1346, the Court in *Skilling* determined that the statute should be construed and pared down to the "core" of pre-*McNally* case law concerning honest services. The Court explained that its longstanding practice is to consider a limiting construction before striking a federal statute as impermissibly vague.[24] "Although some applications of the pre-*McNally* honest services doctrine occasioned disagreement among the Courts of Appeals, these cases do not cloud the doctrine's solid core: The vast majority of the honest services cases involved offenders who, in violation of a fiduciary duty, participated in bribery or kickback schemes."[25]

In view of the history of honest services cases, the Court determined that Congress intended section 1346 to reach "*at least"* bribes and kickbacks. The Court stated that the *McNally* case itself, which spurred Congress to enact section 1346, presented a paradigmatic kickback fact pattern. The Court acknowledged that reading the statute to proscribe a wider range of offensive conduct would raise the due process concerns underlying the vagueness doctrine.

The Government urged the Court in *Skilling* to include conflict-of interest cases, i.e., undisclosed self-dealing by a public official or private employee within the scope of section 1346.[26] The Government asserted that while pre-*McNally* cases involving undisclosed self-dealing were not as numerous as the bribery and kickback cases, they were abundant. The government argued that the theory of liability in *McNally* itself was nondisclosure, which is an accurate statement of the case in the lower courts. Although a kickback scheme was in fact involved in *McNally,* "the violation asserted is the failure to disclose their financial interest . . . ."[27] The Court in *Skilling* found that "[g]iven the relative infrequency of [conflict of interest] prosecutions [in comparison to bribery and kickback charges] and the intercircuit inconsistencies they produced, . . . that a reasonable limiting construction of §1346 must exclude this amorphous category of cases."[28] Echoing *McNally*, the Court in *Skilling* stated that "if Congress desires to go further, it must speak more clearly than it has." So far, Congress has not done so.

Regarding the due process issue, the Court concluded that vagueness is not a problem when section 1346 is limited to bribery and kickback schemes because there is fair notice of what the statute prohibits. "'[W]hatever the school of thought concerning the scope and meaning of' §1346, it has always been 'as plain as pikestaff that' bribes and kickbacks constitute honest-services fraud."[29] The Court did not perceive a significant risk of arbitrary prosecutions because section 1346 draws content on bribes and kickbacks from pre-*McNally* case law and from federal statues proscribing and defining similar crimes.[30] In short, a criminal defendant who participates in a bribery or kickback scheme cannot plausibly complain about prosecution on vagueness grounds.[31]

As to Skilling's conduct, the Court noted that the Government did not, at any time, allege that Skilling solicited, accepted, or offered payments to or from a third party in exchange for making these misrepresentations. Therefore, he did not commit honest services fraud.[32] But because the indictment alleged three objects of the conspiracy—honest services wire fraud, money or property fraud, and securities fraud—the Court remanded to determine if there was error and if it required reversal of the conspiracy conviction. On remand, the Fifth Circuit held that the error was harmless beyond a reasonable doubt and affirmed the conviction on all counts.[33]

Justices Scalia and Thomas concurred with the majority's judgment but not its honest services rationale. Scalia argued that the doctrine of honest services includes more than bribes and kickbacks. "Among all the pre-*McNally* smorgasbord offerings of varieties of honest services fraud, not one is limited to bribery and kickbacks. That is a dish the Court has cooked up all on its own."[34] Additionally, Scalia argued, there remains uncertainty as to when the fiduciary obligation arises and if it comes from state or federal law. The Court in *Skilling* briefly addressed this concern in a footnote stating that debates were rare regarding the source and scope of fiduciary duties in bribe and kickback cases. "The existence of a fiduciary relationship, under any definition of that term, was usually beyond dispute . . . ." Examples include public official-public, employee-employer, and union official-union members.[35] The Court then cited *Chiarella v. United States*[36] for the "established doctrine that [a fiduciary] duty arises from a specific relationship between two parties."[37]

In sum, a charge under section 1346 now requires that the defendant have a fiduciary duty, and the scheme to defraud of honest services is limited to bribery and kickback schemes.

Analysis of Post-*Skilling* Cases

A. Fiduciary Duty

The First Circuit analyzed fiduciary duty in an honest services charge after *Skilling* in *United States v. Urciuoli*.[38] Urciuoli, the chief executive officer of a medical center in Rhode Island, employed John Celona, then a Rhode Island state senator, to market a nursing home Urciuoli's medical center owned. But, in substance, the Senator was employed to use his office on behalf of the medical center to support or oppose bills and influence major insurance companies.[39] Urciuoli was convicted of multiple honest services fraud counts, including undisclosed conflict of interest and bribery. He appealed, and a new trial was ordered. On retrial, the government excluded any mention of conflict of interest, and he was again convicted.[40] Uriciuoli appealed again and, relying on language from *Skilling*, argued that as a private citizen he owed no fiduciary duty to the public and therefore the honest services charge could not stand.

The court held that nothing in *Skilling's* language or context suggests that the Court was distinguishing between the fiduciary who received the bribe and the non-fiduciary who gave it.[41] Indeed, the court stated that of the nine circuit court cases that *Skilling* cited as examples of core honest service fraud cases, two involved convictions of individuals who bribed another to violate his fiduciary duties.[42] The First Circuit affirmed, and held that this case is the core bribery offense preserved by *Skilling*.[43]

B. The Agreement Required for a Bribe or Kickback Scheme

In *United States v. Siegelman*,[44] then-Alabama Governor Don Siegelman was convicted of federal funds bribery, honest services fraud, conspiracy, and obstruction of justice. Siegelman's honest services mail fraud convictions were based on allegations that Richard Scrushy, founder and former chief executive officer of HealthSouth Corporation, made and executed a corrupt agreement with Siegelman. Scrushy allegedly gave Siegelman $500,000 in exchange for Siegelman appointing him to Alabama's Certificate of Need Review Board (the "CON Board"), and Scrushy used the CON Board seat to further HealthSouth's interests.[45]

Siegelman argued that counts six and seven of the honest services charges were not proper because there was no express quid pro quo for Siegelman's appointment of Scrushy to the CON Board. The district court stated that an express agreement or words of promise are not needed for honest services fraud; "the government need only show that a public official has obtained a payment to which he was not entitled, knowing that the payment was made in return for official acts."[46] Nor is there any requirement that an agreement be memorialized in writing. "Since the agreement is for some specific action or inaction, the agreement must be explicit, but there is no requirement that it be express."[47] The court found that testimony at trial was sufficient to prove that Siegelman and Scrushy had agreed to a deal in which Scrushy's donation would be rewarded with a seat on the CON Board.[48] This corrupt quid pro quo thereby proved counts six and seven. Siegelman petitioned for a writ of certiorari, and the Supreme Court vacated judgment and remanded the case for further consideration in light of *Skilling*.[49]

On January 19, 2011, the Eleventh Circuit heard oral arguments concerning Siegelman's case. Siegelman's attorney argued that the government did not prove an explicit quid pro quo bribe or kickback scheme to warrant a conviction on honest services fraud. The government took the position that it had proven Siegelman and Scrushy did have a quid pro quo arrangement and that the *Skilling* case had no bearing on their convictions, as the honest services charge involved bribery. The Eleventh Circuit has not ruled as of the date of this publication.

Unresolved Issues

The cycle of the Court imposing limits on the mail fraud statute and inviting Congress to speak "more clearly" may continue. On September 28, 2010, the Honest Services Restoration Act was introduced in the Senate by Senator Patrick J. Leahy.[50] The bill was sent to committee, but it was not passed before the session ended, thereby killing the bill. The bill included both undisclosed self-dealing for public officials and undisclosed private self-dealing for officers and directors.[51] The term "public official" was defined, but "officers" and "directors" were not. The bill also required a mens rea requirement; the individual must "knowingly falsify, conceal, cover up, or fail to disclose material information that is required to be disclosed regarding the financial interest in question by any Federal, State, or local statute, rule, regulation or charter applicable" to the individual.[52] It is unknown whether the bill will be re-introduced.

The *Skilling* decision did not address important questions regarding honest services and has also created some new ones. For example, it stated that the Court's definition of honest services fraud only reaches serious culpable conduct without defining the term "serious" or explaining whether "minor" frauds can be prosecuted under the honest services statute.[53] Other lacunae relate to the existence vel non of a fiduciary duty, public or private.

A recent article by Elizabeth R. Sheyn addresses these issues and provides recommendations for a new honest services statute.[54] Her major recommendations are to define or describe when a fiduciary duty arises, to add a mens rea requirement that a defendant act with specific intent to defraud, and to require proof of actual economic harm.[55]

Conclusion

To conclude, the mail fraud statute has undergone dramatic expansion over the years. The *Skilling* decision is the most recent, holding that honest services charges under section 1346 are limited to bribery or kickback schemes. The Court in *Skilling* also required that the scheme involve, as the defendant or an unindicted coconspirator, an individual with a fiduciary duty, even though it declined to define how or when the fiduciary duty arises. Post-*Skilling*, conflict of interest charges or undisclosed self dealing charges under section 1346 are not allowed. Perhaps in the near future Congress may "speak more clearly" in response to *Skilling* as it did after *McNally*.

Endnotes

1 Carrie A. Tendler, *An Indictment of Bright Line Tests for Honest Services Mail Fraud*, 72 Fordham L. Rev. 2729, 2731 (2004).

2 The Supreme Court first addressed the scope of the mail fraud statute in Durland v. United States, 161 U.S. 306, 314 (1896). The Court in *Durland* held that the mail fraud statute reached more broadly than the then-existing version of the common law crime of false pretenses. The statute "includes everything designed to defraud by representations as to the past or present, or suggestions and promises as to the future." *Id*. at 313. In 1909, Congress codified *Durland*.

3 18 U.S.C. §1341.

4 18 U.S.C. § 1961.

5 18 U.S.C. § 1956.

6 130 S. Ct. 2896 (2010).

7 117 F.2d 110, 113 (5th Cir. 1941).

8 *Id*. at 115.

9 *Id*.

10 *Skilling*, 130 S. Ct. at 2926-2927 (2010).

11 Jeffrey J. Dean & Doye E. Green, Jr., McNally v. United States *and Its Effect on the Federal Mail Fraud Statute: Will White Collar Criminals Get a Break?*, 39 Mercer L. Rev. 697, 703 (1988).

12 488 F.2d 761, 764 (1973).

13 *Id*.

14 Hon. Jed S. Rakoff, *The Federal Mail Fraud Statute* (Part 1), 18 Duq. L. Rev. 771, 771 (1980).

15 483 U.S. 350 (1987).

16 *Id*. at 361.

17 *Id*. (emphasis added).

18 *Id*. at 360.

19 *Id*.

20 The specific text of what has become 18 U.S.C. §1346 was inserted in the Omnibus Drug Bill for the first time on the very day that the Omnibus Drug Bill was finally passed by both the House and the Senate. The text of what is now §1346 was never included in any bill as filed in either the House of Representatives or the Senate. As a result, the text of §1346 was never referred to any committee of either the House or the Senate, was never the subject of any committee report from either the House or the Senate, and was never the subject of any floor debate reported in the Congressional Record. United States v. Brumley, 116 F.3d 728, 742 (5th Cir. 1997) (Jolly, J., dissenting).

21 A report submitted by the Senate Judiciary Committee after 18 U.S.C §1346 was enacted stated that the provision was designed to "overturn the decision in *McNally*" and "reinstate all of the pre-*McNally* case law pertaining to the mail and wire fraud statutes without change." Elizabeth R. Sheyn, *Criminalizing the Denial of Honest Services After Skilling*, 2011 Wisc. L. Rev. 27, 35 (2011) (citing 134 Cong. Rec. S17,360, S17,376 (daily ed. Nov. 10, 1988)).

22 Skilling was also charged with over twenty-five substantive counts of securities fraud, wire fraud, making false representations to Enron's auditors, and insider trading.

23 On appeal Skilling also contended that pretrial publicity and community prejudice prevented him from obtaining a fair trial. Both the Fifth Circuit and the Supreme Court concluded that Skilling's fair trial argument failed, and that he did not establish that a presumption of juror prejudice arose or that actual bias infected the jury that tried him. Skilling v. United States, 130 S. Ct. 2896, 2907 (2010).

24 *Id*. at 2930.

25 *Id*.

26 *Id.* at 2932.

27 McNally v. United States, 483 U.S. 350, 361 n.9 (1987).

28 *Skilling*, 130 S. Ct. at 2932.

29 *Id.* at 2933. The Court quoted its decision in *Broadrick v. Oklahoma*, 413 U.S. 601 (1973): "'Even if the outermost boundaries of a statute are imprecise, any such uncertainty has little relevance . . . where appellants' conduct falls squarely within the "hard core" of the statute's proscriptions.' *Skilling*, 130 S. Ct. at 2933 (quoting *Broadrick*, 413 U.S. at 608). And it stated, "Today's decision clarifies that no other misconduct falls within §1346's province." *Skilling*, 130 S. Ct. at 2933.

30 *Skilling* cites as examples 18 U.S.C. §§ 201(b), 666(a)(2), and 41 U.S.C. § 52(2). *Skilling*, 130 S. Ct. at 2933. A recent district court case, decided March 11, 2011, found that *Skilling* did not, as the defendant suggested, require simultaneous proof of § 201(b)(1) and (b)(2) in order to successfully prove honest services fraud. United States v. Ring, 2011 WL 833335 (D.D.C. 2011).

31 *Skilling*, 130 S. Ct. at 2934.

32 *Id.* at 2934.

33 United States v. Skilling, 2011 WL 1290805 (5th Cir. Apr. 6, 2011).

34 *Skilling*, 130 S. Ct. at 2939.

35 *Id.* at 2930 n.41.

36 445 U.S. 222 (1980).

37 *Skilling*, 130 S. Ct. at 2931 n.41 (quoting *Chiarella*, 445 U.S. at 233).

38 613 F.3d 11 (1st Cir. 2010).

39 *Id*. at 13.

40 The bribe to the Senator was not to press or oppose legislation directly through his votes; rather, the purchased use of official power was the implied threat of such action—and also the potential use of influence over legislation in committee—that the Senator conveyed largely by implication through the orchestrated meetings. But the distance between this and paying outright for legislative votes is not great: both involve the misuse of office. *Id.* at 17.

41 *Id*. at 18.

42 *Id*.

43 *Id*.

44 561 F.3d 1215 (11th Cir. 2009).

45 United States v. Siegelman, 561 F.3d 1215, 1219 (11th Cir. 2009).

46 *Id*. at 1225-1227, citing bribery decisions *Evans v. United States,* 112 S. Ct. 1881(1992) and *McCormick v. United States,* 111 S. Ct. 1807 (1991).

47 *Siegelman*, 561 F.3d at 1226.

48 Bailey, an associate of Siegelman, provided testimony that Siegelman showed him a check, said that it was from Scrushy, and that Scrushy was "halfway there." Bailey asked, "[W]hat in the world is he going to want for that?" Siegelman replied, "[T]he CON Board." Bailey then asked, "I wouldn't think that would be a problem, would it?" Siegelman responded, "I wouldn't think so." *Id.* at 1228.

49 Siegelman v. United States, 130 S. Ct. 3542 (2010).

50 Honest Services Restoration Act, S. 3854, 111th Cong. (2010).

51 *Id*.

52 *Id*.

53 *Id*. at 47.

54 Elizabeth R. Sheyn, *Criminalizing the Denial of Honest Services After* Skilling, 2011 Wisconsin L. Rev. 27, 35 (2011).

55 *Id*. at 55-58.