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FRAUD

The Prosecutor's Pistol: The Genesis and State of Honest-Services Fraud



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The labyrinth of doctrine surrounding the federal honest-services fraud statute, 18 U.S.C. § 1346, is a constant source of confusion to both white collar criminal practitioners and corporate regulators. Although a series of federal appellate decisions from 2010

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to the present sought to provide definitive guidance on the substance of honest-services fraud, judicial intervention has only camouflaged the confusion and driven the constitutionality of the law deeper into doubt.

In what quickly became federal prosecutors' preferred weapon against public corruption, Section 1346 punishes mail and wire fraud that involves "a scheme or artifice to deprive another of the intangible right of honest services." With its passage, Congress authorized a regulatory mechanism that provided almost boundless prosecutorial discretion and statutorily eliminated the government's burden to prove more concrete crimes, such as fraud or bribery. A barrage of legal challenges significantly reduced the scope of the honest-services fraud statute, but substantial uncer-

tainty remains, and the constitutional legitimacy of the statute's surviving elements is tenuous.

A Brief History Of Honest-Services Fraud

In *McNally v United States*, 483 U.S. 350 (1987), the U.S. Supreme Court rejected the concept that the federal wire fraud statute, 18 U.S.C. § 1343, or the mail fraud statute, 18 U.S.C. § 1341, proscribed violations of the “intangible right to honest services.” Essentially, the court held that those statutes were “limited in scope to the protection of property rights” and that they did not extend to “a scheme or artifice to deprive another of the intangible right of honest services.”

As a response, in 1988, Congress passed Section 1346—the current honest-services fraud statute. No longer did the government have to actually prove that a defendant deprived a victim of tangible property, such as money or securities; now, the prosecution was required to prove only that some intangible right was violated. The problem faced by defendants, and largely ignored by prosecutors, was that Congress created a risk statute. What exactly constituted an “intangible right”? No one knew, but many unfortunate defendants would spend years fighting for their freedom as this small detail was clarified.

In 1997, the U.S. Court of Appeals for the Fifth Circuit held in *United States v. Brumley*, 116 F.3d 728 (5th Cir. 1997), that for a state employee to be convicted of honest-services fraud, the government was required to prove that the employee breached a state statute defining a duty that the employee owed the state. This narrowed the scope of Section 1346 considerably because it represented the first time the federal courts acknowledged that Congress had no intent to “impose upon states a federal vision of appropriate services—to establish, in other words, an ethical regime for state employees.” The Fifth Circuit further noted that “such a power would sorely tax separation of powers and erode our federalist structure.”

Concerned with more than the cryptic notion of a deprivation of honest services, the court turned its attention to federalism; nevertheless, the First, Fourth, Ninth, and Eleventh circuits all held that the language of Section 1346 does not narrow the scope of violations to infractions of state law. In *United States v. Weyhrauch*, 548 F.3d 1237, 84 CrL 284 (9th Cir. 2008), the Ninth Circuit held:

Because laws governing official conduct differ from state to state, conditioning mail fraud convictions on state law means that conduct in one state might violate the mail fraud statute, whereas identical conduct in a neighboring state would not. Congress has given no indication it intended the criminality of official conduct under federal law to depend on geography.

The *Weyhrauch* decision, however, provided no clarity as to what constituted a violation of the federal statute. Given the split among the circuits, the Supreme Court would eventually need to intervene.

In *United States v. Czubinski*, 106 F.3d 1069 (1st Cir. 1997), the First Circuit established another important limitation, holding that mere violations of workplace rules are insufficient to trigger liability for honest-services fraud because such an infraction does not nec-

essarily deprive the employer of some tangible property. In *Czubinski*, an Internal Revenue Service employee used his computer to perform non-job-related searches of IRS databases. He was convicted of computer and wire fraud, and the latter count was buttressed by the allegation that he defrauded the IRS of property and the public of his honest services. In overturning the conviction for mail fraud, the First Circuit held:

Czubinski was not bribed or otherwise influenced in any public decision-making capacity. Nor did he embezzle funds. He did not receive, nor can it be found that he intended to receive, any tangible benefit . . . The conclusive consideration is that the government simply did not prove that Czubinski deprived, or intended to deprive, the public or his employer of their right to his honest services. Although he clearly committed wrongdoing in searching confidential information, there is no suggestion that he failed to carry out his official tasks adequately, or intended to do so.

In the end, Czubinski's convictions were all overturned, but the First Circuit's refusal to expand the amorphous meaning of honest-services fraud was significant.

For the next decade, federal courts would struggle to corral the efforts of prosecutors who would use honest-services fraud as a basis to prosecute defendants for whom they would otherwise be unable to secure indictments under traditional criminal statutes.

The 2010 Troika And a Failure of Judicial Review

In 2010, in a series of related appeals, the Supreme Court was given the opportunity to clarify the meaning of honest-services fraud and determine whether the language of Section 1346 was too broad to pass constitutional muster.

In *Skilling v. United States*, 87 CrL 511 (U.S. 2010), the Supreme Court limited Section 1346's reach to those deprivations of honest services involving “fraud” or “kickbacks.” Relying exclusively upon the questionable pillar of congressional intent, Justice Ruth Bader Ginsburg's majority decision, joined by most of the court, found that fraud and kickbacks constitute “core” violations of the statute and that criminal indictments predicated upon the statute not involving fraud or kickbacks are unconstitutional. Looking to save the statute from a fate akin to that of the Violence Against Women Act, which was condemned in *United States v. Morrison*, 529 U.S. 598, 67 CrL 232 (2000), the court donned its legislative cloak and sought to define the ever-expanding police powers of the federal government.

In *Skilling*, former Enron Chief Executive Officer Jeffrey Skilling was charged with conspiracy to commit securities and wire fraud in connection with his alleged attempt to deprive Enron's shareholders of their right to his “honest services.” Skilling attacked the statute as unconstitutionally vague, arguing that a criminal statute must be clear enough to allow an ordinary person to understand the nature and scope of the prohibited conduct. Skilling maintained that Section 1346 did not clearly indicate what conduct was proscribed and that the congressional record was not helpful in providing insight into the legislative intent behind the statute.

Rather than reject the statute, the Supreme Court narrowed its reach, recognizing that the long, winding precedents advanced by previous lower courts had left the meaning of the statute in “considerable disarray.” Using *McNally* as a basis, the court opined that an “intangible right to honest services” must incorporate bribes or kickbacks.

Thus, the court sought to use federal common-law precedents established in *McNally* to determine the foundation of the statute’s supposed core intent. Although the government advanced the position that an “intangible right to honest services” included undisclosed self-dealing by employees or government officials, the court rejected this view. Justice Antonin Scalia noted that prosecutors are “all over the place” with regard to their interpretation of the statute, and he said that if the Department of Justice is unable to provide a consistent understanding of its scope, “I don’t know how you can expect the average citizen to figure it out.”

In *Black v. United States*, 87 CrL 511 (U.S. 2010), senior executives of media conglomerate Hollinger International Inc. were convicted of, inter alia, Section 1346 violations for allegedly failing to inform Hollinger’s audit board that they received substantial payments as part of noncompetition agreements.

The defendants, including Hollinger’s CEO Conrad Black, maintained that the payments were management fees due to them and that the noncompete agreements were drafted as a legal strategy to avoid the payment of costly taxes that would otherwise be levied by the Canadian government. The Seventh Circuit upheld the defendants’ convictions under the theory that they had violated a duty of candor and had misused their positions for personal gain. The Supreme Court ultimately found that the district court’s instructions to the jury were flawed, and it held that the Section 1346 conviction was questionable in light of *Skilling*. Black established that the government must prove that a defendant knew that his actions would cause economic harm.

Finally, as briefly mentioned above, in *Weyhrauch v. United States*, 87 CrL 511 (U.S. 2010), a former Alaska state representative was accused of trading votes and legislative actions for a promised job with an oil-services company that possessed an interest in tax legislation pending before the state senate. Having failed to disclose the possible conflict to his legislative colleagues or constituents, Weyhrauch was indicted under Section 1346 even though Alaska law did not require legislators to disclose ongoing negotiations for employment. The district court suppressed much of the evidence advanced by the government, but the Ninth Circuit reversed, holding that Section 1346 incorporated a single standard for honest services that applies to every public official and that the government need not prove an independent violation of state law to secure a conviction. Consistent with *Skilling*, the Supreme Court vacated the Ninth Circuit’s judgment and remanded the case to the district court.¹

Pandora’s Box

In deciding to construe rather than abandon the honest-services fraud language of Section 1346, the Su-

¹ Weyhrauch eventually pleaded guilty to a state misdemeanor offense as part of an agreement to dismiss federal corruption charges.

preme Court opened a Pandora’s box. The court’s insistence that it could unilaterally divine the intent of Congress with regard to the “core” purposes of the statute is troubling in many respects, not the least of which concerns the proper role of courts in the federal system. The majority’s attempt to avoid confusion or vagueness only exacerbated the dilemma, because the thrust of Section 1346 remains premised upon fiduciary duty.

Although the court attempted to tie the criminal standards of pre-*McNally* caselaw and several federal statutes to the meaning of Section 1346, it did not clarify the source of the statute’s fiduciary duties or provide any indication as to whom these duties are owed. The court’s decision to construe Section 1346 places the judiciary in the unenviable position of establishing a quasi-code of practice—a federal common law—with regard to fiduciary duties in the context of criminal fraud. In effect, the Supreme Court passed the buck to lower courts, and the only possible result will be a stream of inconsistent opinions and technical holdings. The supposed clarity provided by the Supreme Court only made matters worse.

It was not long before circuit courts began issuing various tests and standards defining such activity, and, again, the law is in flux. Maybe Scalia was correct in characterizing the court’s holding as an invention, rather than an interpretation, of criminal law.

Did *Skilling* and Its Progeny Have Any Substantial Repercussions?

While the Supreme Court sought to narrow the meaning of honest-services fraud under Section 1346, it may not have succeeded, and the clause remains a dangerous shell of its former self. Defendants can still be indicted for honest-services fraud in connection with conspiracy, wire fraud, mail fraud, and other crimes, and Section 1346 remains a powerful tool in the government’s possession. Imaginative prosecutors, reaching into their magician’s kettle, can add honest-service fraud charges to other, more concrete charges in an effort to maximize penalties, increase pressure, and heighten the stakes for a defendant. In effect, criminal defendants are more likely to work toward a deal with prosecutors if some charges, including ancillary charges under Section 1346, are dropped as part of a plea bargain. It is a way for the government to artificially stack the deck.

In the end, the Supreme Court’s holdings in *Skilling*, *Black*, and *Weyhrauch* effected negligible, almost meaningless changes to the honest-services fraud doctrine. Although prosecutions under Section 1346 must now be connected to bribery or fraud, the court’s willingness to create a criminal law code premised upon Congress’s alleged intent is troubling. Instead of striking down the law and allowing Congress to reshape the legislation so that it conforms to constitutional norms, the court revised the statute so that it survives as a relic of its former self.

In deciding to construe rather than abandon the honest-services fraud language of Section 1346, the Supreme Court opened a Pandora's box.

The substantial problem raised by the court's revision of Section 1346 is twofold: (1) separation of powers is imperiled whenever the judiciary undertakes to rewrite a statute instead of declaring it null and letting the political process sort out the matter; and (2) the novel interpretation leaves widespread confusion and differing standards among the circuits. No prosecutor, never mind the general public, has any concrete idea of what duties are owed to public and private enterprises, how those duties are defined, or from whence those duties arise in connection with Section 1346. The law remains a disastrous mess, and the line between illicit conduct and permissible behavior is blurred more than ever. While Congress and the courts fail to confront the problems raised by Section 1346 directly, innocent people sit in prison, fortunes are lost, and reputations are destroyed. The imprisonment of Conrad Black is merely one prominent example.

The Supreme Court's willingness to engage in the speculative endeavor of determining Congress's intent leads to the larger issue of what some commentators have called "Washington's biggest crime problem," namely, using criminal law as a means of hyper-regulation. Congress, and now the Supreme Court, both engage in an unprecedented expansion of the criminal code, eroding powers originally delegated to the states and adding confusion to an already bloated body of regulations. Congress has found a willing partner in its march toward ever-expanding control over corporate transactions and private enterprise. Nevertheless, Congress and the courts must not let hysteria over corporate and political corruption drive them into creating long-term policies that fail to achieve any true reform while simultaneously endangering economic growth and the freedom of law-abiding citizens.

Conclusion

The honest-services fraud doctrine, codified by federal statute and defined by the courts, illustrates such a knee-jerk reaction. Section 1346's failure to pass constitutional muster in full, and the widespread confusion generated by the courts in its wake, should encourage policymakers to confront the possibility that the passage of new criminal laws to confront every ethical issue may not be an advisable, prudent enterprise.