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## High Court Ready To Rein In Honest Services Fraud

By **Christine Caulfield**

Law360, New York (October 26, 2009) -- It has bitten the likes of one-time Illinois Gov. Rod Blagojevich, media magnate Conrad Black, Senate Majority Leader Joseph Bruno and former Enron Corp. CEO Jeffrey Skilling. Now the honest services provision of the mail fraud statute, that long-held weapon of prosecutors, looks set to finally lose its teeth.

Just what conduct is outlawed under the provision — which explicitly prohibits any scheme or artifice to deprive another of the intangible right to “honest services” — has been guessed at by the federal appeals courts for 20 years. Now the U.S. Supreme Court has agreed to step in to clarify the murky law and greatly narrow its reach.

With its Oct. 13 decision to hear Skilling's appeal of his convictions stemming from the massive fraud that led to Enron's collapse, the high court has signed up this term to hear three cases centering on the sweeping 28-word statute.

In May the justices agreed to take up the appeal of media baron Conrad Black, who is serving six years in prison after being convicted under the honest services statute of swindling Hollinger International Inc. out of millions of dollars. The question for the court in that case is whether the statute applies to private enterprise and not just the public sphere as originally intended.

In June the court agreed to weigh in on the case of former Alaska Rep. Bruce Weyhrauch, who is awaiting trial on public corruption charges premised on the statute. The justices will consider Weyhrauch's argument that the government must prove an underlying violation of a state law.

In the case of Skilling — who was convicted of depriving Enron of honest services by engaging in a conspiracy to mislead investors about the financial health of the energy giant — the court will address whether the statute implicitly requires a defendant to have

personally gained from the fraud and, if not, whether the statute is unconstitutionally vague, as Skilling's lawyer contends.

While rulings on constitutional grounds typically are rendered by the Supreme Court only as a last resort, its decision to hear Skilling's case in addition to those of Black and Weyhrauch may portend a significant intervention by the justices, said Denis King, a former prosecutor, now a partner at Goulston & Storrs LLP.

"The fact that [the justices] have accepted three cases involving the statute tells me that they are likely to decide at least one of them on a constitutional basis. I can't imagine that these three cases will be decided without some discussion of the vagueness issue," King said.

"If the words aren't clear on their face as to what the statute means, the court will look at the legislative history or any definition provided by the Legislature. But Congress provided no definition whatsoever, and I think you'll find the legislative history very sparse, too," he added.

Congress enacted the 1998 honest services amendment to the mail and wire fraud statutes, known as Section 1346, in direct response to the Supreme Court's 1987 ruling in *McNally v. United States*, which held that the statutes did not extend to a scheme to deprive people of the intangible right to honest politicians, but only to property or money.

This provision of the statute, which carries a maximum prison term of 20 years, initially was intended to criminalize public corruption by officials, under the theory that such officials were depriving their constituents of the good governance, or honest services, owed them.

But prosecutors began to use it to shore up other criminal fraud charges against private corporate executives who breached their fiduciary duties, and that's when things got messy, lawyers say.

"As a theory it got traction with the courts in the context of public servants, so if a congressman or a mayor used his office to line his pockets, the courts were fairly comfortable applying the statute," said Chris Steskal, a partner in Fenwick & West LLP's securities litigation group.

"But then it started being applied in the context of private employees, particularly executives in white collar crime cases, and the problem with that is that it's difficult to

define in the private context. That's where the courts have had concerns," Steskal said.

The federal circuit courts now are clearly split on the scope of the provision as it applies to the private sector and have articulated three competing tests in an effort to sketch the limits of the law, said Sally Blinken, a partner at Venable LLP.

The U.S. Court of Appeals for the Fourth Circuit, in its 2001 *U.S. v. Vineyard* ruling, applied the "reasonably foreseeable harm" test, which requires evidence only that an employee foresaw, or should reasonably have foreseen, that his employer might suffer economic harm as a result of a breach of fiduciary duty.

In contrast, the U.S. Court of Appeals for the Fifth Circuit — in its 1996 *U.S. v. Gray* ruling — applied the so-called materiality test, which requires a showing of fraudulent intent and proof that an employee's actions likely would influence his employer — the victim — to change her behavior to prevent further misconduct.

The U.S. Court of Appeals for the Tenth Circuit also applied the materiality test in its 1997 decision in *U.S. v. Cochran*, as did the U.S. Court of Appeals for the Second Circuit in *U.S. v. Rybicki* in 2002.

Applying the "personal gain" test is the U.S. Court of Appeals for the Seventh Circuit, which ruled in *U.S. v. Hausmann* in 2003 that honest services fraud requires evidence that a private-sector defendant misused his position for personal gain.

The circuit courts also are divided on the reach of the law as it pertains to public officials, with the U.S. Court of Appeals for the Fifth Circuit in its 1997 *U.S. v. Brumley* decision limiting the statute to conduct already forbidden under state law, and the First, Fourth, Eleventh and Ninth Circuits — which decided against *Weyhrauch* — all holding broader interpretations.

"The state of play in the circuit courts is such a mess that as a defendant you don't know how to defend yourself. It's so unclear," Blinken said. "It would seem easy to limit it, but the courts are so far apart on what it means."

The Supreme Court's decision to finally step in and clarify the statute in light of widening circuit court division followed Justice Antonin Scalia's scathing dissenting opinion in *Sorich v. United States*, which was denied certiorari in February.

Like the Weyhrauch case, Sorich centered on whether prosecutors could use the statute to prosecute public figures, in this case three Chicago city officials, absent any proof of bribery or kickbacks.

Justice Scalia said the loosely worded statute could be used against "a salaried employee's phoning in sick to go to a ballgame" and criticized his colleagues for irresponsibly letting "the current chaos prevail" by not accepting the Sorich appeal.

"Scalia essentially lamented the fact that it was so broad that no one has notice as to how they should comport themselves," said Richard B. Roper, a white collar crime partner at Thompson & Knight LLP and former U.S. attorney for the Northern District of Texas.

The statute's expansive application has raised two main issues for the Supreme Court to consider, King said. The first is the principle of federalism, specifically the power of the federal government to define the fiduciary duties of state government officials and private employees. The second is the issue of "basic fairness," he said.

"There is a basic principle that a criminal statute has to give fair warning of the conduct that makes it a crime," King said.

Skilling's lawyers will argue to the court that the honest services statute provides so little notice as to breach the due process clause of the Fifth Amendment.

The argument has had sway with the Supreme Court before — memorably in its 1971 *Coates v. Cincinnati* decision, when it ruled unconstitutionally vague a Cincinnati ordinance that made it a crime for three or more people to assemble in a manner "annoying" to passers-by. But whether the court will dispense with the honest services statute in quite the same swift manner is debatable.

"I think Justice Scalia will have a long way to go to get a majority to find the statute wholly unconstitutional, but he might be able to persuade enough of his colleagues to limit it in a specific fashion," said Bill Moran, a former prosecutor and now partner at McCarter & English LLP.

One way in which the court might narrow the statute's reach is to confine it to public servants, as it was initially intended, Steskal said.

"I would think they [the justices] would push back on the broadest interpretation, and might

go as far as to say it can only be applied in the public service context. I wouldn't be surprised if the court went in that direction," Steskal said.

Barring that, he said, the court might at least require that private sector employees charged under the statute be found to have personally gained from the fraud.

As for public officials such as Weyhrauch, the court might also clarify that there must be an underlying state law violation for the charge to stick, Blinken added.

Lawyers agree that turning back the clock to McNally and striking down the honest services provision was an unlikely move by the high court. Reining it in, however, was necessary.

"The Supreme Court said in McNally that if Congress wanted to go further it must speak clearly. But I would say that while Congress spoke in passing the honest services statute, it hardly spoke clearly," King said. "Right now, the statute doesn't give a clue as to what conduct it is applying to."

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