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Skilling: Is it Really a Game-Changer for Mail and Wire Fraud Cases?

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On June 24 the U.S. Supreme Court issued its much-anticipated decision in *Skilling v. United States*,[1] holding that the honest-services statute, 18 U.S.C. § 1346, which prosecutors have long used to charge a broad range of misconduct, is limited to schemes involving kickbacks and bribes.[2] The decision has been widely touted as one with major ramifications for the prosecution of corruption and criminal fraud cases. But contrary to conventional wisdom, *Skilling* may have relatively little impact on the scope of cases that prosecutors can successfully bring. In the *Skilling* case itself, former Enron chief executive officer Jeffrey Skilling probably will not escape jail-time given that he was also convicted of multiple other offenses, including securities fraud and lying to auditors. Moreover, a review of the expansive body of honest-services case law since Section 1346 was enacted reveals that the great majority of honest-services prosecutions that have been brought either: (1) involved bribes or kickbacks and thus survive under *Skilling*; (2) could have been brought as traditional wire or mail fraud cases because they involved the deprivation of property or money; or (3) could have been brought under different criminal statutes that also encompassed the defendant's misconduct. Thus, the expectation that *Skilling* will meaningfully constrain prosecutors' ability to bring cases may prove illusory.

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Background on Honest-Services Fraud

Theft of honest services began as a judicially created doctrine. Prior to the Supreme Court's 1987 decision in *McNally v. United States*,[3] lower courts interpreted the federal mail and wire fraud statutes' prohibitions of ''any scheme or artifice to defraud'' to include deprivations not only of money or property, but also of the intangible right to ''honest services.'' The paradigmatic example of an honest-services case involved a public official who accepted a bribe in exchange for actions favorable to the bribe payer. Rather than showing that the public had been defrauded out of money or property, the government instead relied on the theory that the

[1] 78 U.S.L.W. 4735, 2010 WL 2518587 (U.S. June 24, 2010).

[2] Also on June 24, the court decided two other honest-services fraud cases—*Black v. United States*, 78 U.S.L.W. 4732, 2010 WL 2518593 (U.S. June 24, 2010) and *Weyhrauch v. United States*, 78 U.S.L.W. 4766, 2010 WL 2518696 (U.S. June 24, 2010)—similarly involving high-profile individuals convicted under the honest-services fraud statute. These cases were remanded to their respective lower appellate courts consistent with the court's holding in *Skilling*.

[3] 483 U.S. 350 (1987).

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public had been denied their right to the official's honest services.[4] Over time, the doctrine was expanded to reach not only public officials, but also private employees who breached a duty to their employer.[5] By 1982, all courts of appeals had embraced the honest-services theory of fraud.

The Supreme Court's decision in *McNally* brought an abrupt halt to the development of the honest-services fraud theory. In *McNally*, the court held that the mail fraud statute only protected property rights and not ''the intangible right of the citizenry to good government.''[6] ''If Congress desires to go further,'' the court stated, ''it must speak more clearly than it has.''[7]

Congress responded to the *McNally* decision the following year by enacting 18 U.S.C. § 1346, which specifically defines a ''scheme or artifice to defraud'' under the mail and wire fraud statutes to include ''a scheme or artifice to deprive another of the intangible right of honest services.'' However, Congress failed to define the phrase ''intangible right of honest services'' and the open-ended language was roundly criticized by defense lawyers and others, who argued that the statute invited prosecutors to bring charges for nearly any form of deceit. As Justice Antonin Scalia observed in a dissent from the court's decision not to grant certiorari in an honest-services case filed last year, ''Without some coherent limiting principle to define what 'the intangible right of honest services' is, whence it derives, and how it is violated, this expansive phrase invites abuse by headline-grabbing prosecutors in pursuit of local officials, state legislators, and corporate CEOs who engage in any manner of unappealing or ethically questionable conduct.''[8] In the more than two decades since Section 1346 was enacted, the courts of appeals authored numerous decisions attempting to define the limits of the statute, but its precise meaning remained elusive. Thus, it was not until the Supreme Court issued the *Skilling* opinion that the contours of the honest-services statute were definitively drawn.

Background on the *Skilling* Case

Following the collapse of Enron in December 2001, Skilling was indicted with two other top Enron executives on charges of conspiracy, securities fraud, insider trading, and making false representations to auditors. Count 1 of the indictment charged Skilling with conspiracy to commit honest-services wire fraud, traditional wire fraud, and securities fraud. The government's honest-services prosecution was concededly not ''prototypical.''[9] The theory was that Skilling ''placed his interests in conflict with that of the [Enron] shareholders, when, for his own financial benefit, he engaged in an undisclosed scheme to artificially inflate the stock's price by deceiving the shareholders and others about the company's true financial condition.''[10]

Skilling was tried before a jury in the U.S. District Court for the Southern District of Texas and, on May 25, 2006, convicted of 19 counts, including the conspiracy count. He was sentenced to 292 months in prison and ordered to pay $45 million in restitution. The U.S. Court of Appeals for the Fifth Circuit affirmed the conspiracy conviction, and held that the jury was entitled to convict Skilling for conspiracy to commit honest-services fraud based on ''a material breach of a fiduciary duty . . . that results in a detriment to the employer.''[11]

The *Skilling* Decision

The Supreme Court unanimously held that Skilling had not committed honest-services fraud. In an opinion written by Justice Ruth Bader Ginsburg and joined by Chief Justice John G. Roberts Jr. and Justices Samuel A. Alito Jr., Stephen G. Breyer, Sonia Sotomayor, and John Paul Stevens, the court interpreted Section 1346 to encompass only bribery and kickback schemes. Because Skilling's alleged misconduct entailed neither a bribe nor a kickback, the court vacated the Fifth Circuit's ruling on Skilling's conspiracy conviction and remanded the case for proceedings consistent with its opinion. Justice Scalia authored a concurrence, joined by Justices Clarence Thomas and Anthony M. Kennedy, concluding that Section 1346 was unconstitutionally vague and could not be saved by confining the statute to bribery and kickback schemes.

The court reached the conclusion that Section 1346 covers only bribery and kickback schemes by paring down the pre-*McNally* body of honest-services case law to its core, so as to ''preserve what Congress certainly intended the statute to cover.''[12] According to the court, the pre-*McNally* decisions were dispositive because it was clear that Congress intended to reinstate that body of case law when it enacted Section 1346. In reviewing the relevant decisions from the courts of appeals, the Supreme Court found that the ''vast majority of the honest-services cases involved offenders who, in violation of a fiduciary duty, participated in bribery or kickback schemes.''[13] Therefore, the court concluded that there could be no doubt that Congress intended for Section 1346 to reach at least bribes and kickbacks. Beyond this ''solid core,'' however, the court found ''considerable disarray'' in the application of the honest-services fraud doctrine and therefore declined to read Section 1346 more broadly.[14]

The government had pressed for a more expansive interpretation of Section 1346—one that reached not only bribes and kickbacks but also prohibited ''undisclosed self-dealing by a public official or private employee—*i.e.*, the taking of official action by the em-

[4] *Shushan v. United States*, 117 F. 2d 110, 115 (5th Cir.) *cert. denied,* 313 U.S. 574 (1941), is widely regarded as providing the foundation for the honest-services fraud theory. There, the court found that ''[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.''

[5] *See, e.g.*, *United States v. Lemire*, 720 F. 2d 1327, 1335-1336 (D.C. Cir. 1983).

[6] 483 U.S. at 356, 360.

[7] *Id.* at 360.

[8] *Sorich v. United States*, 129 S. Ct. 1308, 1310, 77 U.S.L.W. 3466 (2009) (Scalia, J., dissenting from denial of certiorari).

[9] *See* Brief for the United States, 2010 WL 302206, at *49 (Jan. 26, 2010).

[10] *Id.* at 50.

[11] 554 F. 3d 529, 547 (5th Cir. 2009), *cert. granted and decision vacated in part and aff'd on other grounds*, 78 U.S.L.W. 4735, 2010 WL 2518587 (U.S. June 24, 2010).

[12] 2010 WL 2518587, at *26.

[13] *Id.* at *27.

[14] *Id.* at *26-28.

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ployee that furthers his own undisclosed financial interests while purporting to act in the interests of those to whom he owes a fiduciary duty.''[15] But the court held that the pre-*McNally* case law did not support such a theory of liability: ''In light of the relative infrequency of conflict-of-interest prosecutions in comparison to bribery and kickback charges, and the intercircuit inconsistencies they produced, we conclude that a reasonable limiting construction of § 1346 must exclude this amorphous category of cases.''[16]

Assessing the Impact of *Skilling*

For Jeffrey Skilling, the Supreme Court's decision may make little difference. Even if the Fifth Circuit overturns the conspiracy conviction on remand (not a certainty given that the government also alleged conspiracy to commit traditional wire fraud and securities fraud in the same count), the numerous other convictions are likely to still stand.[17]

Skilling's situation illustrates the fact that prosecutors hardly ever have to rely on a non-bribery/kickback honest-services fraud theory to secure a conviction. Indeed, a review of the more than 600 published decisions involving the honest-services statute reveals that the overwhelming majority of such cases involved either allegations of a bribe or kickback, or conduct that was, or could have been, charged as a traditional wire/mail fraud or under other federal statutes, such as those prohibiting securities fraud, extortion, and bribery. For example, the *Skilling* decision is unlikely to affect the prosecution of political patronage cases. Many of those cases involve bribes or kickbacks and therefore can still be prosecuted under Section 1346.[18] In addition, prosecutors may be able to use traditional mail and wire fraud theories to successfully bring patronage cases. In *United States v. Sorich*,[19] for instance, the government asserted both a traditional theory of mail fraud and the honest-services theory in prosecuting members of Chicago Mayor Richard M. Daley's administration, who were accused of creating ''an illegitimate, shadow hiring scheme based on patronage and cronyism.''[20] In affirming the conviction, the Seventh Circuit held that both theories were legally sound. With respect to the traditional theory, the court found that ''[b]y setting up a false hiring bureaucracy the defendants arguably cheated the city out of hundreds of millions of dollars.''[21] In so holding, the court brushed aside the defendants' argument that the city would have filled the jobs and paid the salaries even without the patronage system.

Thus, it appears that only a small minority of the cases that have been brought under an ''honest-services'' theory would not be viable post-*Skilling*. Two notable exceptions are cases involving the nondisclosure of a conflicting financial interest and the nondisclosure of other material information, as discussed below.

Nondisclosure of Conflicting Financial Interests. In cases where the only offensive conduct was an individual's failure to disclose a conflicting financial interest, the government was forced to proceed solely on an honest-services theory that is no longer available after *Skilling*. The Third Circuit's decision in *United States v. Panarella* is illustrative.[22] In that case, the defendant paid a Pennsylvania state senator to act as a business consultant but the state senator failed to disclose his income from the defendant as required under Pennsylvania law. Although the state senator spoke and voted against legislation that was harmful to the defendant's business, the government did not allege that his conduct was actually influenced by his relationship with the defendant. Nevertheless, in affirming the conviction of the defendant as an accessory after the fact, the Third Circuit concluded that the state senator's nondisclosure of his conflict of interest rose to the level of honest-services fraud. According to the *Panarella* court, ''where a public official conceals a financial interest in violation of state criminal law and takes discretionary action in his official capacity that the official knows will directly benefit the concealed interest, the official has deprived the public of his honest services.''[23] (In a later opinion, the Third Circuit clarified that a state criminal law violation may not be necessary to prove honest-services fraud.)[24] Other courts of appeals have similarly held that the nondisclosure of a financial conflict of interest can constitute honest-services fraud.[25]

Nondisclosure of Other Material Information. The *Skilling* decision will also likely preclude the government from proceeding in the rare case in which it has charged individuals with honest-services fraud based on their nondisclosure of material information unrelated to their financial interests. An example is *United States v. Gray*,[26] where the Fifth Circuit affirmed the honest-services convictions of Baylor University basketball coaches who improperly helped recruits obtain academic eligibility and compete for scholarships by taking tests for them. The Fifth Circuit concluded that it was sufficient that ''the information withheld, i.e. the 'coaches' cheating scheme', was material because Baylor did not get the quality student it expected.''[27]

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[15] Brief for the United States, 2010 WL 302206, at **43-44.

[16] 2010 WL 2518587, at *29.

[17] Skilling contends that all of his other convictions hinged on the conspiracy count and thus must also be overturned.

[18] *See, e.g., United States v. Margiotta*, 688 F.2d 108 (2d Cir. 1982).

[19] 523 F.3d 702 (7th Cir. 2008), *cert. denied*, 77 U.S.L.W. 3466, 129 S. Ct. 1308 (U.S. 2009)

[20] *Id.* at 711.

[21] *Id.* at 712.

[22] 277 F.3d 678 (3d Cir. 2002).

[23] *Id.* at 680.

[24] *See United States. v. Carbo*, 572 F.3d 112, 118 n. 4, 78 U.S.L.W. 1051 (3d Cir. 2009).

[25] *See, e.g., United States v. Geddings*, No. 07-4544, 2008 WL 2095385, at *4 (4th Cir. May 19, 2008), *cert. denied*, 77 U.S.L.W. 3226, 129 S. Ct. 435 (U.S. 2008) (''Geddings [committed honest-services fraud] by concealing his conflict of interest with Scientific Games and acting for its benefit as a lottery commissioner.''); *United States v. Jennings*, 487 F.3d 564, 577-579 (8th Cir. 2007); *United States v. Hasner*, 340 F.3d 1261, 1272 (11th Cir. 2003) (upholding conviction of a local housing official who failed to disclose conflict of interest).

[26] 96 F.3d 769 (5th Cir. 1996).

[27] *Id.* at 775. The defendants in *Gray* arguably could have been charged exclusively with traditional mail and wire fraud because the government alleged a scheme to deprive Baylor of its use of scholarships. *See id.* at 776 (''An employee assisting ineligible students to obtain scholarships from his employer may constitute a scheme to defraud within the scope of the mail fraud and wire fraud statutes.'').

Conclusion

The *Skilling* decision will not stop prosecutors from bringing the vast majority of the cases they previously brought under Section 1346. Instead, the battle lines will be redrawn to focus on whether the facts of a particular case suggest a bribe or kickback, and if not, whether the government can proceed under a traditional mail/wire fraud theory through a liberal interpretation of what constitutes the deprivation of property and money. Despite the publicity surrounding the *Skilling* decision, there is little reason to believe that it will have a significant impact on the government's ability to combat fraud.

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