

Supreme Court Limits “Honest Services” Fraud Prosecutions

by Mark R. Hellerer, Maria T. Galeno, and Danielle Grinblat

On June 24, 2010, the Supreme Court rendered a significant decision clarifying and limiting the reach of fraud prosecutions for deprivations of the intangible right to “honest services.” Construing a statute commonly used by prosecutors against both public officials and private corporate officers, the Supreme Court in Skilling v. United States, 561 U.S. ____ (2010) and Black v. United States, 561 U.S. ____ (2010) held that prosecutions under 18 U.S.C. § 1346 must be limited to cases involving bribery or kickbacks. The Court thus established a “national standard” for the definition of honest services and in so doing, severely restricted fraud prosecutions involving “schemes of nondisclosure and concealment of material information” where there may not have been a tangible loss to the victim.

Background

In federal white collar crime cases, prosecutors regularly charge violations of the federal mail and wire fraud statutes which cover corporate and financial misconduct, as well as corruption of public officials. Prior to 1987, courts had interpreted the mail and wire fraud statutes to prohibit not only schemes to defraud victims of money and property, but also those fraud cases involving certain intangible rights including “honest services.” Unlike cases of traditional fraud, in “honest services” cases, the victim may actually suffer no tangible loss. For example, if a public official accepts a bribe from a third party to gain a public contract, and yet the contract price is that same as what could otherwise have been obtained, the public suffers no tangible loss. Nevertheless, the public official has still violated the “honest services” provision by accepting the bribe and misusing his public office.

In 1987, in *McNally v. United States*, 483 U.S. 350 (1987), the Supreme Court limited the application of the statute drastically, holding that the statute did not protect intangible rights. Rather it only protected against deprivations of property rights. If Congress wanted the statute to go beyond that, the Supreme Court

stated that “it must speak more clearly.” Congress did exactly that a year after *McNally* when it enacted § 1346. It added a new, broadly worded fraud provision stating that “the term ‘scheme or artifice to defraud’ includes a scheme or artifice to deprive another of the intangible right of honest services.” Since its passage, § 1346 has been a favorite of prosecutors because the wording left much room for jury interpretation of what the right to honest services might include. Finally, in *Skilling*, the Court provided much needed guidance in construing the provision, capturing pre-*McNally* case law which had limited “honest services” prosecutions to those involving bribery and kickbacks.

The *Skilling* and *Black* Rulings

Jeffrey K. Skilling, the former chief executive of Enron, was convicted for, among other things, a violation of § 1346 because of his participation in a scheme to deceive the public about Enron’s deteriorating financial condition. Because his compensation was linked to the performance of Enron’s stock, these misrepresentations benefitted Skilling financially. The prosecutors charged that this constituted a violation of the shareholders’ rights to Skilling’s honest services. Skilling’s lawyers argued that § 1346 should be struck down and his conviction overturned because the law was unconstitutionally vague. Specifically, they argued that the term “intangible right of honest services” did not clearly define what conduct was actually prohibited, instead allowing jurors to impose their own understanding of the term.

Justice Ruth B. Ginsberg, writing for the majority of the Court, refused to strike down the law, and instead, construed it in the context of core “honest services” cases decided before *McNally*. (Three other justices would have ruled that the statute was unconstitutional altogether.) After an analysis of the case law, the Court held that the “honest-services” statute is restricted *only* to cases of bribery and kickbacks. Such an interpretation thus resolves the vagueness and notice problem. Because the government never alleged that Skilling’s misconduct involved bribery or kickbacks, his actions did not fall within the scope of the statute. Whether or not this error will jeopardize his conviction on other charges will be determined on remand by the lower court.

In another “honest-services” fraud decision released the same day against Conrad M. Black, the former chairman of the media company Hollinger International Inc., and several other executives, the Court re-affirmed the holding in *Skilling* that the statute only criminalizes schemes involving bribes or kickbacks. Black had been convicted of stealing millions of dollars from the company by paying himself fictitious fees, thereby depriving the company of his honest services as a manager. Finding that the instructions to the jury were erroneous, the Supreme Court remanded the case for reconsideration in light of *Skilling*.

Effect of the Court’s Decisions

The Court’s June 24th decisions call into question a number of other cases where defendants have been convicted under § 1346. When the Supreme Court interprets a statute, that interpretation must be given “full retroactive effect,” thus potentially affecting many other cases. It is expected that defendants convicted under the statute will seek to challenge their convictions based on *Skilling*.

The Supreme Court has also instructed the Court of Appeals for the 11th Circuit to review the convictions of Richard Scrushy, the former CEO of HealthSouth, and former Alabama Governor Don Siegelman based on the *Skilling* decision. Several pending high profile cases that may be affected by the decision include that of former Illinois Governor Rod Blagojevich, who was recently indicted under the statute and former New York State Senate majority leader, Joseph Bruno, who was convicted last year.

Going forward, the Court's decisions should resolve the longstanding controversy over the scope of federal criminal fraud provisions by defining exactly what conduct is illegal under § 1346. Unless there is proof of bribery or kickbacks, prosecutors can no longer rely on that provision to pursue corporate crime and public corruption.

If you have any questions about the content of this client alert, please contact the Pillsbury attorney with whom you regularly work or the authors below.

Mark R. Hellerer
New York
+1.212.858.1787
mark.hellerer@pillsburylaw.com

Maria T. Galeno
New York
+1.212.858.1833
maria.galeno@pillsburylaw.com

Danielle Grinblat
New York
+1.212.858.1683
danielle.grinblat@pillsburylaw.com

This publication is issued periodically to keep Pillsbury Winthrop Shaw Pittman LLP clients and other interested parties informed of current legal developments that may affect or otherwise be of interest to them. The information contained herein does not constitute legal opinion and should not be regarded as a substitute for legal advice.

© 2010 Pillsbury Winthrop Shaw Pittman LLP. All Rights Reserved.