

White Collar Defense and Investigations Client Service Group

To: Our Clients and Friends

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Supreme Court Restricts “Honest Services” Fraud to Cases Involving Bribery or Kickbacks

In a recent decision involving a former Enron CEO’s criminal conviction, the U.S. Supreme Court limited, but did not altogether cut off, the government’s ability to prosecute corporate crime under the federal statute that bars theft of “honest services.” The case had been closely followed because of the widespread use of the statute to prosecute fraudulent corporate schemes.

While neither side won everything it sought, the effect of the decision is to prevent the government from using a theory of “undisclosed self-dealing” that had been a linchpin of many leading corporate and political corruption prosecutions.

At issue was 18 USC §1346, the statute that proscribes honest services fraud. Former Enron CEO Skilling had argued that the statute is so vague that it violated the Due Process Clause of the Fifth Amendment.

The Supreme Court rejected that argument. Instead it saved the statute by limiting its reach to cases “involving fraudulent schemes to deprive another of honest services through bribes or kickback supplied to a third party who had not been deceived.” *Skilling v. United States*, 561 U.S. ____ (2010). In other words, where a third party pays a bribe to a corporate officer, the government can still bring a case alleging that the corporation was illegally deprived of that officer’s honest services.

But the Court also expressly rejected the government’s broader theory, used in many corporate and government corruption cases: that the statute also encompasses situations where the officer has not received a bribe, but is alleged merely to have been acting to benefit himself rather than the corporation to whom he owed a fiduciary duty. The Court’s opinion held that the language of the statute did not support interpreting it to make it a crime to engage in such “undisclosed self-dealing.”

The Court’s majority opinion was written by Justice Ginsburg, who was joined by five other justices. The three-member minority would have gone further and struck down the entire statute.

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Skilling's case is not finally resolved by the decision. Rather than overturn his conviction, the Supreme Court sent the case back to the trial court for further proceedings.

The use of the honest services statute in the Skilling case illustrates the broad interpretation of the law the government had been employing in corporate criminal cases. The indictment alleged that Skilling and his co-conspirators had engaged in a scheme to deceive the investing public, including Enron's shareholders, about Enron's true performance by manipulating the company's financial results and by making false and misleading representations about its performance and results. According to the indictment, the co-conspirators enriched themselves through salary, bonuses, grants of stocks and options, other profits and prestige.

Skilling was charged with conspiracy to commit securities and wire fraud by depriving Enron and its shareholders of their right to receive his honest services. There was, however, no allegation that he received a bribe or a kickback from a third party.

The Court traced the history of the honest services theory of fraud under the mail and wire fraud statutes, which it noted was "stopped...in its tracks" in 1987 by *McNally v. United States*, 483 U.S. 350 (1987). *McNally* involved a state officer who, in selecting Kentucky's insurance agent, arranged to procure a share of the agent's commissions via kickbacks paid to companies the official partially controlled. The prosecutor did not charge that in the absence of the scheme the state would have paid lower commissions or secured better insurance, but rather that the kickback scheme defrauded the citizens and government of Kentucky of their right to have Kentucky's affairs conducted honestly. Slip. Op at 37. The Court held that this scheme did not qualify as mail fraud and limited mail fraud to the protection of property rights. The Court suggested that if Congress desired to go further, "it must speak more clearly." *Id.*

Congress reacted swiftly by enacting 18 USC §1346, which provides that for purposes of §1341 (mail fraud) and §1343 (wire fraud) "the term 'scheme or artifice to defraud' includes a scheme or artifice to deprive another of the intangible right of honest services." §1346.

In *Skilling*, the Court agreed with Skilling's argument that Congress reacted quickly but not clearly. Deciding that in §1346 Congress meant to reinstate the body of pre-*McNally* honest-services law, the Court surveyed those cases; it concluded that they involved fraudulent schemes to deprive another of honest services through bribes or kickbacks supplied to the defendant by a third party. Relying on its jurisprudence that stressed the strong presumptive validity of Congressional enactments, the Court decided to construe rather than invalidate §1346. It therefore held that the statute was confined to cases involving fraudulent schemes through bribes or kickbacks, but that it was not unconstitutionally vague.

Given the importance of this statute to criminal prosecutors, it is quite possible that Congress will consider legislation that would cover undisclosed self-dealing cases. It is unclear whether Congress will enact such a law, and if it does whether such a statute would be clear enough to satisfy the concerns raised by the Supreme Court.

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