

June 28, 2010

MEMORANDUM

RE: The U.S. Supreme Court Sharply Curtails Use of the "Honest Services Fraud" Statute

In a ruling with significant implications for public plan trustees and public officials generally, the U.S. Supreme Court has unanimously – and sharply – curtailed the use of a federal law that has been a favorite tool of prosecutors against public officials: the so-called "honest services fraud" statute, 18 U.S.C. § 1346. (*Skilling v. U.S.*, No. 08-1394 (June 24, 2010)). Specifically, the Court held that Section 1346, which defines fraudulent efforts to "deprive another of the intangible right of honest services," may *only* be applied to cases involving bribery and kickback schemes – and not in cases involving undisclosed conflicts of interest. This is an important decision for public plans because, until now, prosecutors were free to bring indictments (as in the San Diego pension fund case) against trustees and staff for any conduct that arguably violated fiduciary standards. By so significantly limiting the offenses that can be prosecuted under Section 1346, the Court has dramatically reduced concerns that public plan trustees and public officials (and even private actors) might be prosecuted for conduct that is not clearly unlawful.

I. Background

The Court's ruling arose in the context of former Enron CEO Jeffrey Skilling's appeal of his conviction on conspiracy and fraud convictions. Skilling was accused of conspiring to defraud Enron shareholders by misrepresenting the company's financial health. The government argued that Skilling benefited from the fraud in the form of salary and bonuses paid to him, and from proceeds received on the sale of his Enron stock, but it but never alleged that Skilling solicited or accepted side payments from a third-party in exchange for making representations about Enron's finances. Skilling alleged that adverse pretrial publicity had so seriously tainted the jury pool that his conviction had to be reversed, and that his conviction under § 1346 for honest services fraud had to be reversed due to the statute's unconstitutional vagueness.

The honest services fraud statute was enacted in 1988, in response to the Supreme Court ruling in *McNally v. United States*, 483 U.S. 350 (1987), which held that the federal mail fraud statute did *not* prohibit a scheme or artifice to defraud "citizens of their intangible rights to honest and impartial Government." By enacting 18 U.S.C. § 1346, Congress restored "honest services" within the ambit of the federal mail and wire fraud statutes, meaning that a scheme to deprive someone of "honest services" could be punished as mail or wire fraud assuming such an instrumentality was used as part of the scheme.

Congress, however, did not define what constitutes "honest services," or what actions constitute a scheme to "defraud" a person of the right to honest services. Since its passage, federal prosecutors have wielded Section 1346 as a powerful weapon in public corruption cases, and even in the prosecution of individuals in the private sector (like disgraced lobbyist Jack Abramoff) for failing to provide honest services to their employers. Section 1346 has also been used against the trustees and staff of public pension funds, where prosecutors have alleged that the trustees deprived the public of honest services by failing to disclose alleged conflicts-of-interest, or engaging in "pay-to-play" schemes that did not involve bribery or kickbacks.

II. The Court's Ruling in *Skilling*

One of the issues presented in *Skilling's* appeal was whether Section 1346 applies where the defendant's conduct was undertaken to further the economic interests of his employer (*i.e.*, Enron), as opposed to advancing the defendant's private interests at the expense of his employer's, and, if so, whether the statute was unconstitutionally vague.

The Court began its analysis by noting that "[t]here is no doubt that congress intended § 1346 to refer to and incorporate the honest-services doctrine recognized . . . before *McNally* derailed the intangible-rights theory of fraud." The Court acknowledged that *Skilling's* "void-for vagueness" argument had force, but found that because a survey of pre-*McNally* case law demonstrated that allegations of bribes and kickbacks were the basis for the prototypical cases alleging honest services fraud, "there is no doubt that Congress intended § 1346 to reach *at least* bribes and kickbacks." The Court, however, found no consensus about pre-*McNally* prosecutions that involved mere conflicts of interest. Accordingly, while "[r]eading the statute to proscribe a wider range of offensive conduct . . . would raise the due process concerns underlying the vagueness doctrine," the Court concluded that the statute was not unconstitutionally vague if it was limited to solely to bribes and kickbacks.

In so ruling, the Court unequivocally rejected the government's argument that Section 1346 should be read broadly to prohibit conflicts of interest in the form of "undisclosed self dealing by a public official or private employee." Specifically, the Court held that "[i]n 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." (Emphasis added).

Justice Ginsburg, joined by Justices Stevens, Breyer, Alito, and Sotomayor, wrote the majority decision limiting 18 U.S.C. § 1346 to the offenses of bribes and kickbacks. Justices Scalia, Thomas, and Kennedy concurred, stating that they would have gone further than the majority and struck down the law entirely. By a separate 6-to-3 vote, the Court rejected *Skilling's* argument that he had not received a fair trial in Houston in 2006 given the widespread prejudice there against Enron.

While the Court stopped short of invalidating Section 1346 in its entirety, the Court's narrow application of the statute to *only* bribery and kickback cases cuts back sharply back on the kinds of offenses that can be punished under the statute, and thus dramatically reduces concerns that public plan trustees and public officials might be prosecuted for conduct that is not clearly unlawful.

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Groom Law Group represents numerous public pension plans and we continue to track case law developments that may be of interest to our public plan clients. If you would like further information or have question about the *Skilling* case, please contact one of the following Groom attorneys:

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