

**"Honest Services" Fraud – Strong Medicine for "Pay to Play"**

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This article provides brief guidance as to the manner in which courts have interpreted 18 U.S.C. § 1346, which generally provides that for purposes of federal mail and wire fraud statutes (18 U.S.C. §§ 1341 and 1343, respectively), a "scheme or artifice to defraud" includes a "scheme or artifice to deprive another of the intangible right to honest services." Specifically, this article examines the manner in which courts have interpreted the broad language of § 1346 in circumstances that do not involve the explicit bribery of public officials.

## **I. Background**

18 U.S.C. § 1346 was enacted in 1988, for purposes of reversing the Supreme Court's decision in McNally v. U.S., 483 U.S. 350 (1987). In McNally, the Supreme Court overruled a long line of lower court decisions by holding that the federal mail and wire fraud statutes did not encompass schemes to defraud citizens of an intangible right to honest government service from public officers. Id. at 355. 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 the public of "honest services" by a public official could be punished as mail or wire fraud (assuming, of course, that such an instrumentality was used as part of the scheme or artifice).

## **II. Judicial Interpretations of the "Honest Services" Fraud**

### **A. General Parameters of the Statute**

Not surprisingly, the majority of cases that have analyzed the "honest services" fraud set forth in 18 U.S.C. § 1346 have involved the bribery of public officials, where the charge under § 1346 is in addition to other charges. However, there have been numerous prosecutions under § 1346 against public officials (and those who have corrupted public officials) for transactions that do not involve outright bribery, but which nonetheless involve the provision of cash or gifts to a

public official in exchange for the public official's exercise of power on behalf of the individual or entity providing the gratuity.

Courts have recognized that the term "honest services," as used in § 1346, is incredibly broad, but the statute has survived repeated challenges asserting that it is unconstitutionally vague, with courts resorting to a "common sense" usage of the phrase "honest services." In rejecting a constitutional void-for-vagueness challenge to the statute's wording, one court opined that "[c]oncrete parameters outlining the duty of honest services should not be necessary. . . . The concept of the duty of honest services sufficiently conveys warning of the proscribed conduct when measured in terms of common understanding and practice." U.S. v. ReBrook, 837 F. Supp. 162, 171 (S.D. W. Va. 1993), aff'd, 58 F.3d 961 (4<sup>th</sup> Cir. 1995).

Another court demonstrated little patience for the defendant's void-for-vagueness challenge in the context of a kickback scheme, holding that "[i]t should be plain to ordinary people that offering and accepting large sums of money in exchange for a city councilman's vote is a type of conduct proscribed by the language of § 1346." U.S. v. Paradies, 98 F.3d 1266, 1283 (11<sup>th</sup> Cir. 1996).

Nonetheless, courts have refused to allow § 1346 to be used as a "catch-all" that subjects every unethical or illegal act to federal mail and wire fraud prosecution. See, e.g., U.S. v. Bloom, 149 F.3d 649, 654-56 (7<sup>th</sup> Cir. 1998) (noting, inter alia, that "not every breach of fiduciary duty works a criminal fraud"); U.S. v. Welch, 327 F.3d 1081, 1107 (10<sup>th</sup> Cir. 2003) ("the right to honest services is not violated by every breach of contract, breach of duty, conflict of interest, or misstatement made in the course of dealing").

Recognizing the difficulty of interpreting the undefined phrase "honest services," courts have attempted to establish general criteria that must be satisfied to successfully assert an "honest services" fraud claim. One of the leading circuits interpreting the scope of the honest services fraud is the First Circuit Court of Appeals, which held that:

First, . . . honest services convictions of public officials typically involve serious corruption, such as embezzlement of public funds, bribery of public officials, or the failure of public decision-makers to disclose conflicts of interest. Second, . . . the broad scope of the mail fraud statute . . . does not encompass every instance of official misconduct that results in the official's personal gain. Third, and most importantly, . . . the government must not merely indicate wrongdoing by a public official, but must also demonstrate that the wrongdoing at issue is intended to prevent or call into question the proper or impartial performance of the public servant's official duties.

U.S. v. Czubinski, 106 F.3d 1069, 1076 (1<sup>st</sup> Cir. 1997) (emphasis added) (internal citations and quotations omitted), (discussing the First Circuit's prior decision in U.S. v. Sawyer, 85 F.3d 713, 724 (1996)).

The Seventh Circuit has held that "[m]isuse of office (more broadly, misuse of position) for private gain is the line that separates run of the mill violations of state law fiduciary duty . . . from federal crime." U.S. v. Bloom, 149 F.3d 649, 655 (7<sup>th</sup> Cir. 1998). The court went on to note that "in almost all of the intangible rights cases decided . . . (before McNally or since § 1346), the defendant used his office for private gain, as by accepting a bribe in exchange for official action[.]" but also noted that "[s]ecret conversion of information received in a fiduciary capacity is a form of fraud against the owner of that information." Id. Accordingly, the Seventh Circuit summarized its test for an honest services fraud as follows: "[a]n employee deprives his employer of his honest services only if he misuses his position (or the information he obtained in it) for personal gain" (emphasis added). Id. at 656-57.

The Tenth Circuit has likewise held that cases involving § 1346 "must be read against the backdrop of the mail and wire fraud statutes, thereby requiring fraudulent intent and a showing of materiality." U.S. v. Welch, 327 F.3d 1081, 1107 (10<sup>th</sup> Cir. 2003). However, the Tenth Circuit unequivocally rejected the Seventh Circuit's position that a public official must seek "personal gain" to violate § 1346, stating that while it was unwilling to "define the exact contours of honest services fraud or the proof necessary to sustain it . . . to require an allegation of intent to personally gain would suggest that [a defendant is] justified in using whatever means necessary to achieve [his or her] goals . . .," which the Court was unwilling to do.

B. What Constitutes an Honest Services Fraud?

As noted above, the language of § 1346 is not helpful in categorizing what specific conduct by a public official is prohibited, and courts have been unwilling to set forth a litany of proscribed acts, instead setting forth general parameters that must be satisfied to successfully assert an honest services fraud. It should be noted, however, that Justice Stevens, in his dissent in McNally (vindicated by Congress' reversal of McNally), stated the following:

In the public sector, judges, State Governors, chairmen of political parties, state cabinet officers, city alderman, Congressmen, and many other state and federal officials have been convicted of defrauding citizens of their right to honest services of their governmental officials. In most of these cases, the officials have secretly made governmental decisions with the objective of benefiting themselves or promoting their own interests, instead of fulfilling their legal commitment to provide the citizens of the State or local government with their loyal service and honest government.

McNally, 483 U.S. at 362-63 (emphasis added).

The basic concept on an honest services fraud "is that the public is not getting what it expects and deserves: honest, faithful, disinterested service from a public official. This concept

applies whether the official is bribed or fails to disclose a conflict of interest." U.S. v. Mangiardi, 962 F. Supp. 49, 51 (M.D. Penn. 1997). Addressing what constitutes an honest services fraud in the context of a union officer's duty toward his union, a court held that "'honest services' contemplates that in rendering some particular service . . . , the defendant was conscious of the fact that his actions were something less than in the best interests of the employer—or that he consciously contemplated or intended such actions. For example, something close to bribery." U.S. v. Boyd, 309 F. Supp.2d 908, 913 (S.D. Tex. 2004).

Underlying § 1346 is the notion that "a public official acts as 'trustee for the citizens and the State . . . and thus owes the normal fiduciary duties of a trustee, *e.g.*, honesty and loyalty to them. Theft of honest services occurs when a public official strays from this duty.'" U.S. v. Sawyer, 239 F.3d 31, 39 (1<sup>st</sup> Cir. 2001).

When a government officer decides how to proceed in an official endeavor—as when a legislator decides how to vote on an issue—his constituents have a right to have their best interests form the basis of that decision. If the official instead secretly makes his decision based on his own personal interests—as when an official accepts a bribe or personally benefits from an undisclosed conflict of interest—the official has defrauded the public of his honest services.

U.S. v. Lopez-Lukis, 102 F.3d 1164, 1169 (11<sup>th</sup> Cir. 1999).

According to the First Circuit, a public official can steal honest services from his public employer in two ways: (1) the official can be influenced or otherwise improperly affected in the performance of his duties, or (2) the official can fail to disclose a conflict of interest, resulting in a personal gain. U.S. v. Woodward, 149 F.3d 46, 57 (1<sup>st</sup> Cir. 1998) (relying upon the court's earlier decision in U.S. v. Sawyer, 85 F.3d 713, 724 (1<sup>st</sup> Cir. 1996)).<sup>1</sup>

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<sup>1</sup> In contrast, an employee's failure to perform his job adequately, or his failure to adhere to the government's code of conduct concerning permissible work-related activities, is not sufficient to

C. Specific Instances Where Honest Services Fraud Has Been Found

Most of the honest services fraud cases brought pursuant to § 1346 have involved, not surprisingly, clear-cut cases of bribery or the payment of "kickbacks" to public officials who exercised their influence on behalf of the person or entity paying such gratuity. Considering that bribery cases tend to be "clear cut," in that there is, at a minimum, an exchange of something of value in return for an official action, the matters below involve less certain areas, where honest services fraud has been found (or alleged) notwithstanding the lack of a clear cut exchange of valuable consideration.

1. Recent—and Well-Publicized—Cases Involving Claims of Honest Services Fraud

(a) U.S. v. Abramoff

A recent case asserting honest services fraud involves disgraced Washington lobbyist Jack Abramoff. On January 3, 2006, Abramoff pleaded guilty to a three-count information charging him with conspiracy, honest services mail fraud, and tax evasion. The honest services fraud charges to which Abramoff pleaded guilty are extensive—but essentially boil down to his failure to honestly serve his clients, his employer, and his attempts to corrupt public officials.<sup>2</sup>

i. Honest Services With Respect to Abramoff's Clients

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establish an honest services fraud. See, e.g., U.S. v. Czubinski, 106 F.3d 1069, 1077 (1<sup>st</sup> Cir. 1997) (an IRS employee's unauthorized access of tax returns did not violate § 1346, since the employee's actions were motivated only by his (misguided) curiosity, and it could not be found that he received, or intended to receive, any tangible benefit from such action).

<sup>2</sup> Abramoff's plea agreement, entered in the U.S. District Court for the District of Columbia, is available at <http://news.findlaw.com/usatoday/docs/abramoff/usabrmff10306plea.pdf> (last visited January 16, 2006).

With respect to the honest services fraud against his clients, Abramoff admitted that he used his influence with Native American tribes that he represented on gaming matters to cause them to hire (at above-market prices) "grass roots" and "public relations" firms in which Abramoff had an undisclosed ownership interest, and from which he was being paid 50 percent of net profits, in addition to his lobbying fee from the tribes.

Moreover, Abramoff admitted that he provided lobbying services to a Native American tribe in Texas that was seeking to reopen its gaming operations, without revealing that he had been paid millions of dollars by a Louisiana tribe to oppose all gaming legislation under consideration by the Texas legislature. Abramoff avoided disclosing the clear conflict of interest to his law firm by telling the Texas tribe that he was providing his lobbying services free of charge, while he simultaneously engineered the tribe's retention of a "grass roots" firm in which Abramoff had an undisclosed financial interest, and which paid Abramoff \$1.8 million in fees as a result of the Texas tribe's retention.

ii. Honest Services Fraud With Respect to Abramoff's Employer

During the time that Abramoff was employed by a law firm, Abramoff agreed to represent a wireless company in securing a license to install wireless telephone infrastructure in the House of Representatives. Rather than entering into a retainer relationship with Abramoff's law firm, Ambramoff instructed the wireless company to pay his fee to a non-profit entity that Abramoff founded, and that he used as a vehicle to fund trips and gifts for the politically influential. Abramoff did not disclose this arrangement to his employer, thus depriving his employer of fees to which it was entitled, which Abramoff admitted was an honest services fraud against his employer.

iii. Honest Services Fraud—Corruption of Public Officials

The lengthiest portion of Abramoff's plea agreement concerns the allegations that Abramoff engaged in a conspiracy to commit honest services fraud by corrupting public officials by providing "a stream of things of value . . . in exchange for a series of official acts and influence and agreements to provide official actions and influence." (Abramoff Plea Agreement, ¶ 32). The things of value to which Abramoff pled guilty to providing included "foreign and domestic travel, golf fees, frequent meals, entertainment, election support for candidates for government office, employment for relatives of officials, and campaign contributions." (Id.).

Specifically, Abramoff pled guilty to providing "Representative #1" (since identified as Representative Bob Ney (R-OH)) and "Staffer #1" with such lavish items as all-expenses-paid trips to the Northern Marianas Islands, Scotland, and to Tampa, Florida (for the Super Bowl). Other things of value provided by Abramoff to Representative #1 and Staffer #1, however, were not so lavish—such as "comped" meals at Abramoff's Washington, DC restaurant—and included items that some may consider "normal" business expenses when it comes to politics, such as contributions to Representative #1's campaign committee and contributions to the Republican National Party. Abramoff's plea agreement states that he provided such things of value in exchange for public officials':

agreements to support and pass legislation, agreements to place statements in the Congressional Record, agreements to contact personnel in the United States Executive Branch agencies and offices to influence decisions of those agencies and offices, meetings with Abramoff's . . . clients, and awarding contracts for services with . . . Abramoff's law firms.

Id. at ¶ 33.

(b) San Diego Pension Fund

Another very recent case involving allegations of honest services fraud in the context of public officials concerns the indictment of the former top executive of the San Diego City Employees Retirement System, the Retirement System's lawyer, and three former trustees of the Retirement System. The indictment, announced on January 6, 2006, alleges that the Retirement System's executive, its lawyer, and its former trustees committed honest services fraud by conspiring to approve enhanced retirement benefits for City of San Diego workers—including themselves—in exchange for allowing the City to underfund the Retirement System.<sup>3</sup>

According to the indictment, by early 2002, the Retirement System's funding status was approaching only 82.3 percent, and, at such level, a "funding trigger" would have been tripped, requiring the City of San Diego to make a massive cash infusion to the Retirement System. As the funding trigger was about to tripped, the City negotiated a labor agreement that enhanced pension benefits for members of the municipal labor unions (including the indicted Retirement System employees), and the City advised the Board of the Retirement System that the increased pension benefits were "contingent upon" obtaining relief from the funding trigger that was about to be tripped. The indictment alleges that the indicted officials agreed to reduce the City's funding obligations with respect to the Retirement System, and that the vote to approve such relief was linked to the enhanced pension benefits that the officials would receive. According to the indictment, such conduct constitutes a conspiracy to deprive citizens of San Diego with their intangible right to honest services from public officials.

## 2. "Pay-to-Play" Schemes Involving Campaign Contributions

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<sup>3</sup>The indictment is available at: <http://www.signonsandiego.com/news/metro/pension/images/060106fedpensionindictment.pdf> (last visited January 16, 2006).

In U.S. v. Troutman, 814 F.2d 1428 (10<sup>th</sup> Cir. 1987), the Tenth Circuit addressed a "pay-to-play" scheme involving the payment of campaign contributions by a bank for consideration for state business, which the court held to be violative of the Hobbes Act, 18 U.S.C. § 1951 (extortion). (It should be noted that the defendant was not charged with committing an honest services fraud, even though such a claim was viable at the time of the defendant's arrest and trial).

At issue in Troutman was the Investment Officer of New Mexico, who advised a bank bidding for state business that it had to contribute to a fundraiser for the Governor of New Mexico. The United States successfully prosecuted the Investment Officer for extortion, and, on appeal, the Tenth Circuit affirmed the conviction, noting that "[a]n extortion effort made under the color of official right is described as a public official's attempt to obtain money not due him or his office." Id. at 1456. The court went on to cite several cases from various circuits, holding, *inter alia*, that "[t]he coercive solicitation of political contributions is within the realm of actions that are illegal under the Hobbes act." Id. (quoting U.S. v. Cerilli, 603 F.2d 415, 421 (3d Cir. 1979), and citing U.S. v. Dozier, 672 F.2d 531, 540 (5<sup>th</sup> Cir. 1982), and U.S. v. Williams, 621 F.2d 123, 124 (5<sup>th</sup> Cir. 1980)).

In U.S. v. Kemp, 379 F. Supp. 2d 690, 697 (E.D. Penn. 2005), the court upheld the conviction of the City Treasurer of Philadelphia, who was convicted of extortion and honest services fraud based upon his acceptance of bribes from people doing business with the City. In upholding Kemp's conviction for honest services fraud, the court noted that "there were specific intercepted communications where [a co-conspirator] and Kemp made agreements that because certain individuals did—or in some cases did not—make the requested contributions to either

political activities or charitable events, they were, or were not, going to receive City business."

Id.

Another case asserted an honest services fraud claim in the context of a "pay-to-play" scheme, although the scheme was not characterized as such. In Castro v. U.S., 248 F. Supp. 2d 1170 (S.D. Fla. 2003), the court addressed a "pay-to-play" kickback scheme in which judges serving on the Dade County (Florida) Circuit Court assigned criminal cases to selected defense attorneys who agreed to pay the assigning judges a percentage of the fees earned from each assigned case. The U.S. prosecuted the attorneys who participated in the scheme, alleging that the attorneys attempted to defraud the State of Florida of the judges' honest services. The court held that the defendants had committed an honest services fraud, noting that public officials have inherent fiduciary duties to the public, and that violations of such inherent fiduciary duty are proper predicates to convictions under § 1346, *even if* an underlying state law or regulation was not violated.

3. Cases Not Involving "Pay-to-Play," But In Which Corruption Was Established

Other cases in which honest services fraud has been successfully asserted include the following:

U.S. v. Sawyer, 239 F.3d 31 (1<sup>st</sup> Cir. 2001): an insurance company lobbyist who paid for numerous meals, rounds of golf, trips, and other entertainment expenses lavished upon legislators violated § 1346, since he intended to influence official actions by such expenditures, and by purposefully evading lobbying expenditure laws.

U.S. v. ReBrook, 837 F. Supp. 162 (S.D. W. Va. 1993), affd., 58 F.3d 961 (4<sup>th</sup> Cir. 1995): a former attorney for the West Virginia lottery commission who knew that the state was

about to award a lucrative contract to a video gambling company violated § 1346 when he acquired stocks of the gambling company prior to the announcement of the contract award.

U.S. v. Genova, 333 F.3d 750 (7<sup>th</sup> Cir. 2003): a Mayor's failure to disclose, on financial disclosure forms, kickbacks paid by a firm that was awarded city business was part of scheme to deprive citizens of the Mayor's honest services, and thus violated § 1346.

U.S. v. Blumeyer, 114 F.3d 758 (8<sup>th</sup> Cir. 1997): the owner of insurance company violated § 1346 when he paid the living expenses for a Missouri state representative who chaired the legislature's insurance commission, and paid him a salary that the representative did not report on his financial disclosure forms. The court noted that the conviction for honest services fraud could stand even though the legislator was acquitted of corruption charges stemming from his relationship with the insurance company, and despite the fact that actions taken by the legislator on the insurance company's behalf were not enacted into law. "[T]he public's right to the honest services of a public officer is violated when the officer uses a public position to pursue dishonest ends, not merely when the officer achieves a dishonest goal." Id. at 766 (emphasis added).

U.S. v. Welch, 327 F.3d 1081 (10<sup>th</sup> Cir. 2003): an indictment properly alleged that leaders of the Salt Lake City Olympic bid committee violated § 1346 by bribing and lavishing gifts upon members of the International Olympic Committee ("IOC"). The court further held that the accused were not required to obtain "personal gain" from their actions, but only that they intended to deprive the public of IOC members' honest services.

U.S. v. Paradies, 98 F.3d 1266 (11<sup>th</sup> Cir. 1996): a city commissioner violated § 1346 when he used his political position to reduce the rent of concessionaires at the Atlanta airport,

and was paid money by an airport concessionaire that purported to be consulting fees and dividends.

U.S. v. Kemp, 379 F. Supp. 2d 690 (E.D. Penn. 2005): the City Treasurer of Philadelphia was convicted of honest services fraud, based upon his acceptance of bribes from an attorney seeking business from the city, and his decision to award City contracts to individuals who had contributed to identified political or charitable events.

U.S. v. Frega, 933 F. Supp. 1536 (S.D. Cal. 1996): Judges' acceptance of gifts from plaintiffs' attorneys who appeared before them in civil cases constituted an honest services fraud, in violation of § 1346.

U.S. v. Bissell, 954 F. Supp. 841 (D.N.J. 1996): A county prosecutor's failure to disclose outside business interests that conflicted with his duties as a prosecutor violated a state ethics law applicable to local officers, and further violated § 1346.

The cases referenced herein are provided for purposes of demonstrating the scope of 18 U.S.C. § 1346, and to provide representative examples of the manner in which the statute has been employed by prosecutors in cases involving public officials. It is by no means an exhaustive treatment of the scenarios in which the honest services fraud may be applied by zealous (and, perhaps, at times, "creative") prosecutors.