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The Supreme Court Holds That The “Honest-Services” Fraud Statute Covers Only Bribery and Kickback Schemes

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Yesterday, in *Skilling v. United States*, No. 08-1394, the United States Supreme Court held that prosecutors can only use the federal “honest-services” fraud statute, 18 U.S.C. § 1346, to prosecute cases involving bribery and kickbacks. The Court’s decision, arising out of the prosecution of former Enron CEO Jeffrey Skilling, significantly narrows the application of § 1346, which has heretofore been heavily criticized as being impermissibly vague and susceptible to overly broad constructions.¹ Although the Supreme Court’s decision may not be enough to overturn Skilling’s conviction on remand – he was convicted of 19 counts, including securities fraud and lying to auditors – it will curtail prosecutors’ increasingly creative uses of § 1346 in other circumstances, such as in the context of nondisclosure of conflicts of interest and self-dealing.

BACKGROUND ON HONEST-SERVICES FRAUD

Prior to 1987, 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 intangible rights. Not all honest-services fraud cases, however, concerned public officials. Over time, the doctrine was expanded to reach private employees who breached a duty to their employer. *See, e.g. United States v. Lemire*, 720 F. 2d 1327, 1335-1336 (D.C. Cir. 1983). By 1982, all Courts of Appeals had embraced the honest-services theory of fraud.

The development of the honest-services fraud theory came to an abrupt halt in 1987, when the Supreme Court held in *McNally v. United States* that the federal mail fraud was “limited in scope to the protection of property rights.” 483 U.S. 350, 360 (1987). As the Court explained in that case, “to defraud commonly refer[s] to wronging one in his property rights by dishonest methods or schemes, and usually signif[ies] the deprivation of something of value by trick, deceit, chicane or overreaching.” *Id.* at 358 (internal quotation marks and citation omitted). If Congress wanted to expand the doctrine beyond the deprivation of property rights, the Court held, “it must speak more clearly than it has.” *Id.*

Congress responded to the *McNally* decision the following year by enacting § 1346, which specifically defines a “scheme or artifice to defraud” under the mail and wire fraud

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¹ The decision directly affects two other cases the Court decided this term – *Black v. U.S.* (08-876) and *Weyhrauch v. U.S.* (08-1196) – involving other high-profile individuals convicted under the honest-services fraud statute. These cases were similarly remanded to lower courts consistent with the Court’s holding in *Skilling*.

statutes to include "a scheme or artifice to deprive another of the intangible right of honest services." However, Congress did not define "honest services," and without any guidance from the Supreme Court since the enactment of the statute, lower courts have resorted to interpreting pre-*McNally* decisions to determine what qualifies as a deprivation of the "intangible right of honest services."

BACKGROUND ON THE SKILLING CASE

Following the collapse of Enron in December 2001, Skilling was indicted with two other top Enron executives and charged with over 25 substantive counts of securities fraud, wire fraud, making false representations to Enron's auditors, and insider trading. Count 1 of the indictment charged Skilling with, among other things, conspiracy to commit honest-services fraud. The Government's honest-services prosecution was not "prototypical." 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." Brief for United States 50. The Government did not allege that Skilling solicited or accepted any side payments from a third party in exchange for making any misrepresentations.

After a contentious venue and jury selection process, which was also the subject of his appeal, Skilling was tried before a jury in the United States District Court for the Southern District of Texas and, on May 25, 2006, was convicted of 19 counts, including the conspiracy count. He was sentenced to 292 months in prison and ordered to pay \$45 million in fines and restitution. On appeal to the United States Court of Appeals for the Fifth Circuit, Skilling argued that he did not conspire to commit honest-services fraud because his actions were taken with the intent of advancing his employer's corporate interest: "[W]hen an employee is actually working to advance his employer's stated goals and interests, he has not defrauded his employer, even if the act is wrongful or dishonest or unlawful in some other respect." See Brief of Defendant-Appellant Jeffrey K. Skilling in No. 06-20885 (5th Cir.). The Fifth Circuit rejected Skilling's argument, holding 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." 554 F. 3d 529, 547 (2009). The Fifth Circuit held that "it is a sufficient detriment for an employee, contrary to his duty of honesty, to withhold material information, i.e., information that he had reason to believe would lead a reasonable employer to change its conduct."

At oral argument before the Supreme Court on March 1, 2010, Skilling argued that the honest-services fraud statute was unconstitutionally vague and overbroad. Specifically, Skilling contended that the scope of the statute could not be ascertained by reviewing the pre-*McNally* case law because it was a "hodgepodge of oft-conflicting holdings" that are "hopelessly unclear." Brief for Petitioner 39. The Government responded to the vagueness challenge by asserting that there is "solid consensus" in the pre-*McNally* case law that honest-services fraud proscribes: (1) bribes and kickbacks and (2) undisclosed self-dealing by a public official or private employee - i.e., the taking of official action by the employee that furthers his own undisclosed financial interests while purporting to act in the interests of those to whom he owes a fiduciary duty. Brief for United States 43-44.

"Holding that honest-services fraud does not encompass conduct more wide-ranging than the paradigmatic cases of bribes and kickbacks, we resist the Government's less constrained construction absent Congress' clear instruction otherwise."

OPINION OF THE COURT

SUMMARY OF THE DECISION

In its opinion, written by Justice Ginsburg and joined by Chief Justice Roberts and Justices Alito, Breyer, Sotomayor, and Stevens, the Supreme Court held that the honest-services statute covers only bribery and kickback schemes. Because Skilling's alleged misconduct entailed no bribe or kickback, the Court vacated the Fifth Circuit's ruling on Skilling's conspiracy conviction and remanded the case for proceedings consistent with its opinion.² Justice Scalia authored an opinion joined by Justices Thomas and Kennedy that concurred in the Court's judgment that Skilling did not commit honest-services fraud, but disagreed with the majority's decision to salvage the statute by confining its scope to bribery and kickbacks. In Justice Scalia, Thomas, and Kennedy's view, § 1346 is unconstitutionally vague in its entirety.

The Court conducted a two step analysis to reach its decision. First, as lower courts have done, the Court considered the pre-*McNally* body of case law to interpret § 1346's critical phrase, "the intangible right to honest services." According to the Court, it was the pre-*McNally* case law which Congress meant to reinstate when it enacted the honest-services fraud statute. In reviewing the relevant decisions from the Courts of Appeal, the 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." Therefore, the Court concluded that there could be no doubt that Congress intended for § 1346 to reach at least bribes and kickbacks. Beyond that "solid core", however, the Court acknowledged that the pre-*McNally* case law was in "considerable disarray."

In the second step of its analysis, the Court considered whether the inconsistency and ambiguity in honest-services decisions outside the bribery and kickback context required § 1346 to be invalidated *in toto* or whether the statute could be salvaged by confining its scope to bribery and kickbacks. The Court held that under its longstanding practice of constitutional avoidance – pursuant to which statutes are to be construed in a way that saves them from unconstitutionality when such a construction is reasonable – a limited construction of § 1346 was proper. "To preserve the statute without transgressing constitutional limitations, we now hold that § 1346 criminalizes *only* the bribe-and-kickback core of the pre-*McNally* case law."

In reaching its decision that § 1346 only proscribes bribes and kickbacks, the Court specifically rejected the Government's argument that the statute extends to "undisclosed self-dealing by a public official or private employee." The Court reasoned that such conduct was not part of the core pre-*McNally* case law. "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." In a footnote, the Court issued a stern warning to Congress about extending the statute to capture self-dealing through new legislation: "If Congress were to take up the enterprise of criminalizing 'undisclosed self-dealing by a public official or private

² In a separate part of the opinion, the Court rejected Skilling's argument that pretrial publicity and community prejudice prevented him from receiving a fair trial. That aspect of the opinion is not discussed herein.

"Among all the pre-McNally smörgåsbord-offerings of varieties of honest-services fraud, not one is limited to bribery and kickbacks. That is a dish the Court has cooked up all on its own."

JUSTICE SCALIA, concurring

employee' it would have to employ standards of sufficient definiteness and specificity to overcome due process concerns."

Justices Scalia's concurrence undertakes the same analysis as the majority opinion but concludes that § 1346's vagueness cannot be remedied. First, Justice Scalia disputes the Court's finding that bribery and kickback schemes are the essence of the honest-services fraud doctrine as reflected by the pre-McNally case law. To the contrary, in reviewing that body of law, Justice Scalia found there to be "no clear indication of what constitutes a denial of honest services." Second, according to Justice Scalia, even if § 1346 is limited to bribery and kickbacks, there remains the "fundamental indeterminacy" of who falls within the statute's ambit - public officials, private individuals who contract with the public, or everyone. To this question, Justice Scalia contends, the pre-McNally case law does not provide an answer. (Justice Ginsburg's majority opinion indicates that the statute catches private sector fraud.). Third, in Justice Scalia's view, the Court does not have the authority to limit the statute to only bribes and kickbacks. "I know of no precedent for such 'paring down,' and it seems to me clearly beyond judicial power." According to Justice Scalia, "Congress enacted the entirety of the pre-McNally honest-services law, the content of which is (to put it mildly) unclear. In prior vagueness cases, we have resisted the temptation to make all things right with the stroke of our pen. I would show the same restraint today, and reverse Skilling's conviction on the basis that § 1346 provides 'no ascertainable standard' for the conduct it condemns."

IMPLICATIONS

The Court remanded Skilling's case to the Fifth Circuit, holding that his conspiracy conviction could still be affirmed if the flawed honest-services component was found to be "harmless-error." (The indictment alleged three objects of the conspiracy - honest-services wire fraud, money-or-property wire fraud, and securities fraud). Moreover, the Court held that "[w]hether potential reversal on the conspiracy count touches any of Skilling's other convictions is also an open question." Thus, the Court's decision could have little or no practical impact on Skilling's conviction.

More generally, in cases like Skilling's, where the underlying conduct triggers numerous criminal statutes, the Court's paring down of § 1346 is unlikely to have a dramatic impact. In eliminating certain conduct from the reach of the statute, however, the Government may not be able to prosecute more novel and aggressive honest-services cases. An example of the type of case where the Skilling decision could make a significant difference is *United States v. Gray*, 96 F.3d 769 (5th Cir. 1996). There, the Fifth Circuit upheld the conviction of Baylor University basketball coaches under § 1346 based on their scheme to establish academic eligibility for five transfer students to play basketball at Baylor. The coaches had provided the students with written course work or answers to correspondence exams, which were then sent to the sponsoring schools as the students' work. *Id.* at 772. In affirming the conviction, the Fifth Circuit held that it was sufficient that the coaches did not disclose their alleged scheme to their employer and the subject of the nondisclosure was material - Baylor did not get the quality student it expected. *Id.* at 775. After Skilling, such facts plainly would be insufficient to secure a conviction under the honest-services fraud statute because of the absence of any bribes or kickbacks.

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