BUSINESS LAW TODAY

Honest Services Fraud: You May Already Be Guilty!

Neil Abbott, K. B. Battaglini

About the Authors:

Abbott is a partner at the Toronto office of Gowling Lafleur Henderson LLP, and Battaglini is a partner at the Houston office of Greenberg Traurig LLP. Their respective emails are neil.abbott@gowlings.com and battaglinik@gtlaw.com. The opinions expressed in this article are those of the authors and do not reflect a position or endorsement by Gowling Lafleur Henderson LLP or Greenberg Traurig LLP, or any other partner or associate of either firm. The writers gratefully acknowledge the assistance of law students David Campbell, Michelle McBride, and Nohayia Javed in the preparation of this article.

All criminal acts contain a component of dishonesty. But do all dishonest acts contain a component of criminality? A brief digression if you please.

A university student schemed with his professor to turn in plagiarized work. He should have been kicked out of school, but instead found himself with a criminal conviction.

A New York lawyer traded side payments to insurance adjusters in exchange for the accelerated processing of his clients' awaiting claims. He made a visit to the state penitentiary when he should have been disbarred.

A prominent Mississippi trial lawyer legally donated money to the state's Democratic Party and then appeared as a lawyer before the judicial candidates who received his donations. All he got for his hard-earned money was a damp prison cell.

BUSINESS LAW TODAY HOME

DOWNLOAD A PDF OF THIS ARTICLE

DOWNLOAD A PDF OF THIS ISSUE

BUSINESS LAW SECTION

IN THE NEXT ISSUE

The September issue of *Business Law Today* will feature topics and advice for business lawyers such as smart contracts, what structured negotiation can offer business attorneys, shareholder activism, and more.

WE'D LIKE YOUR FEEDBACK!

Do you have a great idea for a *BLT* article? Would you like to see more of a featured column? Let us know how we can make

You must be wondering: What law did these random private individuals violate? Drum roll please: they were all convicted of violating 18 U.S.C. § 1346—commonly referred to as "honest services fraud." The honest services provision is 28 open-ended words that have created a buzz in the legal community:

> For the purposes of this chapter, the term "scheme or artifice to defraud" includes a scheme or artifice to deprive another of the intangible right of honest services.

The situations discussed above are just some recent examples of the harmless acts of dishonesty that have branded a growing number of unfortunate people forevermore as criminals. It might seem hard to imagine, but similar dishonest conduct could land you in handcuffs.

Sound a little crazy? Well, it certainly is! Prosecutors across America are using honest services fraud to combat a wide array of dishonest acts. But is it really their job to get in the sandbox and play mom? Should ordinary people be held criminally responsible for everyday acts of dishonesty—especially when they are not violating any other law?

Scalia's Scrutiny

Supreme Court Justice Antonin Scalia does not seem to think so. In his recent scathing dissent from the majority opinion in *Sorich v. United States*, 129 U.S. 1308 (2009), he called for a review of honest services fraud. He cited various examples to show the unfairness and utter preposterousness of the honest services provision and stated that "[i]t is simply not fair to prosecute someone for a crime that has not been defined until the judicial decision that sends him to jail."

Justice Scalia listed numerous examples to illustrate why the provision is just too broad. He argued that a state senator who voted for a bill only to appease a small minority essential to her reelection, a mayor who used the prestige of his office to obtain a table at a restaurant, a public employee who recommended an incompetent friend for a public contract, and a self-dealing corporate officer would all be in violation of this criminal law. What Justice Scalia is attempting to demonstrate is how easily an individual can unknowingly fall within the scope of the honest services provision.

Business Law Today the best resource for you and your clients. We welcome any suggestions. Please send us your feedback here.

SECTION NEWS

New Legal Analytics Committee!
Basics of Accounting for Lawyers: Free CLE 6/29
When Good Lawyers Make Bad Decisions
FREE CLE: 6/15
Free non-CLE webinar on 6/8: The Tax Implications Of Managing An Immigration Workforce
Business Law Breaking News - Midland Funding LLC v. Johnson

All News

SECTION EVENTS

Business Law Section Annual Meeting
September 14-16, 2017
Chicago, IL

COMMITTEE NEWSLETTERS

Business Bankruptcy
August 2017

Consumer Financial Services
June 2017

Corporate Governance
July 2017

Cyberspace Law
August 2017

Legal Opinions
Spring 2017

Nonprofit Organizations
Second Quarter, 2017

OTHER NEWSLETTERS

Running a quick Google search reveals why the blogosphere has been buzzing for months. Every commentator and his dog have weighed in on the issue and breadth of honest services fraud. Some applaud the law's ability to criminalize a wide range of unethical behavior, while others share Justice Scalia's perspective and view the law as overreaching. However, most are deeply troubled by the politically motivated uses of the honest services provision. The controversy surrounds the use of the law to punish a wide range of seemingly immoral and unethical behavior.

The problem with the honest services provision is that the outer boundary of the law is unclear. It is impossible for individuals, like the increasing number of private citizens convicted under the statute, to know when dishonest acts become criminal. The fine line between criminality and dishonesty is ultimately determined not by the wording of the law, but by the discretion of individual prosecutors.

Justice Scalia recognized this dilemma in *Sorich* and called for an immediate review of the law. Although his colleagues disagreed with him at that time, the Supreme Court has the opportunity once more to review honest services fraud in the appeal, which was recently granted certiorari from the Seventh Circuit, of Canadian media tycoon Conrad Black.

The Supreme Court should take this opportunity to restrict the use of honest services fraud to its original purpose: prohibiting dishonest acts by public officials. Given the range of civil remedies available in the United States, there is no need to use honest services fraud to prosecute private actors.

History of Honest Services Fraud

The provisions for both wire and telephone fraud require a "scheme or artifice to defraud." Up until 1987, courts were expanding the fraud provisions to prohibit any conduct by a public official that deprived citizens of their intangible rights to honest services and impartial government. The Supreme Court rejected this interpretation of the provisions in *McNally v. United States*, 483 U.S. 350 (1987). The court held that this form of official corruption and misconduct did not constitute fraud under the wording of the provisions. *McNally* overturned a line of appellate court decisions, as the Supreme Court clearly said: "If Congress desires to go further, it must speak more clearly."

One year later, in an attempt to reverse the Supreme Court's decision, Congress enacted the honest services provision.

Miscellaneous IT Related Legal News (MIRLN) 6 - 26 August 2017 (v20.12)

Congress failed in its attempt to restore the law to its pre-*McNally* state, and these 28 words have wreaked havoc ever since. For two decades, courts struggled to define the intangible right of honest services and to determine to whom the right is owed. Prosecutors artfully seized the opportunity created by this uncertainty and have used the provision to police an assortment of private conduct.

The "terse amendment," as Justice Scalia states, created broader prosecutorial freedom than under the pre-*McNally* law. Although the amendment's original use was to prosecute people in the public realm, the stories above demonstrate how its use has expanded over the past 21 years. Prosecutors now use it as a powerful tool when policing the private realm. What was intended to be a criminal offense applicable only to public officials has evolved into a device to criminalize otherwise legal activities.

In the private sector, the appellate courts are split on the requirements for honest services fraud. Some courts recognized the need to restrain the law's scope, while others have allowed prosecutors to run wild. As Justice Scalia stated in *Sorich*, "without some coherent limiting principle to define what 'the intangible right of honest services' is, when it derives, and how it is violated, this expansive phrase invites abuse by headline-grabbing prosecutors in pursuit of local officials, state legislators, and corporate CEOs who engage in any manner of unappealing or ethically questionable conduct."

Some courts have narrowed the law's scope by requiring a breach of a fiduciary duty or the violation of a state law. Other limitations, like intent requirements or proof of actual economic harm, have been used to narrow the scope of the honest services provision. Although these additional requirements are not apparent on the face of the provision, they are effective at reducing the provision's utility as a prosecutorial tool.

It is other courts, which have adopted fewer requirements, that have produced the examples discussed above. These courts need only a dishonest act, whether lawful or unlawful, to obtain a conviction. These courts are concerned only with dishonest conduct, and have convicted without the presence of economic harm or on the basis of a reasonable foreseeability of the economic harm.

These divergences in the law can be handled with ease. Conrad Black's appeal provides the Supreme Court with the ideal

opportunity to restore honest services fraud to its original purpose: punishing public officials for acts of dishonesty. Given the range of civil remedies available to the remainder of the populace, honest services fraud is not needed in the private realm.

A Canadian Clarifying American Law?

Even if you have not heard of honest services fraud, you are certainly familiar with it. It was used in several high-profile cases including the prosecution of Enron's Jeffrey Skilling, former Washington lobbyist Jack Abramoff, and impeached Illinois Governor Rob Blagojevich. The law is so far-reaching that even Conrad Black, one of Canada's most well-known corporate criminals, could not escape its grasp.

Ironically, 20 years of uncertainty in American law will be clarified by the appeal of a former Canadian who was never criminally charged in Canada. Conrad Black was a household name north of the border long before the controversy surrounding his company (Hollinger International, Inc.) came south into the U.S. courts. He was an aristocrat who, after a public argument with then Prime Minister Jean Chretien, denounced his Canadian citizenship to become a member of the British House of Lords.

Lord Black, as he is now known, built Hollinger into a world-class organization with market capitalization in excess of $1 billion. It owned and operated several large newspapers, including the *Jerusalem Post*, the *Chicago Sun Times*, the London *Daily Telegraph*, and the *National Post* in Canada.

Lord Black's run-in with the law stemmed from Hollinger's divestment of several smaller newspapers. As part of the sale, Lord Black received noncompetition payments directly from the acquiring parties. The prosecutors proved these payments to be bogus and showed the money rightfully belonged to Hollinger. The court convicted Lord Black under honest services fraud because he denied Hollinger of its right to honest services by accepting the noncompetition payments.

The Supreme Court decided to hear Lord Black's appeal on the basis that his conviction may have been unwarranted. Many hope that the Court will finally clarify the vague and ambiguous language of the 1988 honest services amendment.

Public Law: The Uninvited Guest

The use of honest services fraud to prosecute elected public officials is less offensive than the application of the law in the

private sphere. For many, the idea of public office is a noble one, with historic roots and a deep-seeded obligation to fulfill the ultimate unselfish act: public service. This underlying rationale does not support the use of honest services fraud to prosecute private behavior.

The private sector relationship between shareholders and officers of a corporation is generally financial in nature. When conflicts arise, the harms complained of are often financial, and it follows that the remedy sought should be defined in monetary terms and not in years of a prison sentence. Importing the noble idea underlying public service into an economic relationship is inappropriate, as private disputes are properly resolved in civil courts. Numerous remedies are available in tort, contract, and corporate law to individuals wronged in the private realm.

Let's not kid ourselves; the role of corporate officer does not carry the weight, historic significance, or integrity that flows from public service. At its core, the disputes between these private parties are not about the deprivation of honest services. They are about money. The courts that require proof of economic harm to make out a charge of honest services fraud seem to agree.

While easier to justify, it should be noted that public sector honest services fraud is not without its complications. For instance, whatever happened to the idea that politicians should be held accountable by political means? In the absence of honest services fraud, unscrupulous politicians would be held accountable by the same means by which they were empowered: the people.

Journalists would play the role of prosecutors by uncovering the less-than-honest behavior and exposing it to the public. A trial would take place, not in a courtroom, but in the media circus. Each voter would get to participate in the jury, a verdict would be delivered, and the ultimate punishment would be doled out to the tune of public disgrace and no reelection. Given recent incidents involving public officials, the political remedies lack the teeth necessary to protect the integrity of public office. Nevertheless, the current uses of honest services fraud must be reigned in and returned to its original public purpose.

Overzealous criminalization of borderline political dishonesty, while well intended, has been hijacked into kitchen-sink, grab-bag-style prosecutions against nonpolitical officials. The indeterminacy of the statute combined with prosecutorial discretion results in an environment of uncertainty with the potential to criminalize

business-as-usual. Recent corporate scandals, coupled with an economic environment that cannot sustain them, scream for increased accountability of corporate officials. But there remains significant debate regarding the best means to achieve this end.

Chaos Finally Controlled?

The honest services provision is a legitimate provision designed to combat legitimate corruption. In the absence of clearly defined limits, the broad wording of the statute invites abuse by prosecutors. The examples above illustrate the danger inherent in a broadly worded criminal statute. Critics and supporters of honest services fraud agree that when liberty is at stake, the outer limits of criminalized behavior must be more clearly defined. Over the past 20 years, defining this outer limit has been a challenge for the courts. This challenge will be resolved if the Supreme Court restricts honest services fraud to its original use of policing public officials.

The remedies for behavior currently captured by private sector honest services fraud can and should remain a matter for the civil courts. It is appropriate to seek a financial remedy for a financial harm that results from a purely financial relationship. Prior to honest services fraud, this type of corporate behavior was held accountable in the civil courts. The corporate behavior captured by private sector honest services fraud is adequately addressed by the existing corporate law concept of breach of fiduciary duty and the judicial award of civil remedies.

Corporate corruption is a problem we all agree merits judicial intervention. The question regarding private sector honest services fraud remains: Is the remedy worse than the disease? The stigma of a criminal record most certainly outweighs the harm that individuals cause others by depriving them of their right to honest services. The law has simply gone too far. The vague requirements of honest services fraud are too broad to allow those who aspire to be law-abiding citizens to actually follow the law.

The proper role of honest services fraud as it relates to adjudicating private sector disputes remains to be defined. Commentators north and south of the border will certainly be following Lord Black's appeal with interest and trepidation. Hopefully the Supreme Court will do its part and finally take up Justice Scalia on his offer to define the law. After all, his dissent in *Sorich* perfectly hones in on the issue: "Indeed, it seems . . . quite irresponsible to let the current chaos prevail."

Additional Resources

Other examples of the uses of the honest services provision

In Los Angeles, federal prosecutors are investigating whether the largest Roman Catholic archdiocese in the United States violated the law when its top officials allegedly covered up sexual abuse of minors by the church's priests.

At Baylor University in Texas, three basketball coaches violated the law when the prosecutor successfully argued that the coaches deprived the school of its right to honest service by violating NCAA recruitment rules.

Additional Resources

For more reading on a similar topic, you can retrieve the following article on the *Business Law Today* website at www.abanet.org/buslaw/blt. All issues since 1998 may be accessed under the "Past Issues" heading at the bottom of the web page.

Prosecution of Private Corporate Conduct
The Uncertainty Surrounding Honest Services Fraud
By Frank C. Razzano and Kristin H. Jones
Business Law Today
January/February 2009
Volume 18, Number 3