White Collar Counseling and Defense Alert

July 2010

GODFREY & KAHN S.C.
ATTORNEYS AT LAW

Dan Flaherty
(920) 831-6341
dflaherty@gklaw.com

Sean Bosack
414) 287-9431
sbosack@gklaw.com

Eric J. Wilson
(608) 284-2603
ewilson@gklaw.com

Anthony J. Gaughan
(608) 284-2238
agaughan@gklaw.com

The Supreme Court Narrows the Definition of Honest Services Fraud

On June 24, 2010, the Supreme Court significantly narrowed the scope of criminal liability for corporate officers and employees under the "honest services" law of the federal wire and mail fraud statutes. Federal law makes it a felony to "deprive another of the intangible right of honest services," a crime known as honest services fraud. In *Skilling v. United States*, and its companion case of *Black v. United States*, the Supreme Court held that individuals can be convicted of honest services fraud only if they have committed bribery or received kickbacks. Prior to the ruling, prosecutors had used the honest services statute to convict corporate executives and other employees for a broad range of activity, including non-disclosure of conflicts of interest. However, *Skilling* and *Black* effectively put the brakes on prosecutors' more ambitious theories of criminal liability. Going forward, prosecutors can bring cases for honest services fraud only where they have evidence of bribery or kickbacks.

The Supreme Court Decision

Honest services law is predicated on the notion that corporate officials and employees owe a duty of honest services to the corporation and its shareholders. Few would disagree with that notion. However, in recent years, federal prosecutors have aggressively used the honest services law to prosecute activity by corporate officers and employees that was not obviously criminal in nature. The law's vague nature provided little guidance to corporate officers and employees regarding precisely what types of conduct ran afoul of the law.

In a welcome development for boardrooms across the country, the Supreme Court's rulings in *Skilling* and *Black* finally bring some clarity to honest services law. Corporate officers and employees now have a much clearer sense of the types of conduct that are illegal under the honest services statute.

In the *Skilling* and *Black* cases, prosecutors charged two prominent corporate executives – former Enron CEO Jeff Skilling and former Hollinger newspaper syndicate head Conrad Black – with honest services fraud. Skilling faced charges for allegedly orchestrating a scheme to prop up Enron's stock prices by overstating the company's financial well-being. Prosecutors charged Black with failing to disclose to his board of directors that he had described management fees as non-compete fees for tax purposes, a characterization from which he personally benefitted. According to the Justice Department, Skilling and Black violated the honest services statute by breaching their fiduciary duty to their respective corporations.

The Supreme Court disagreed. The Court held that the honest services statute only outlaws bribery and kickback schemes, not murkier "breaches" of fiduciary duty such as those alleged against Skilling and Black. The Supreme Court ruled that unless prosecutors could show evidence that Skilling and Black had received bribes or kickbacks from third parties, the defendants' convictions under the honest services statute could not be sustained. Both cases have now been remanded for further proceedings consistent with the Supreme Court's opinion.

The Practical Impact

The *Skilling* and *Black* rulings clarify for corporate officers and employees what types of behavior are considered criminal. Limiting honest services fraud to bribes and kickbacks likely means that prosecutors can bring charges only when an officer or employee has taken money, or other types of gifts, from a third party. Absent evidence of bribery or kickbacks, failure to disclose conflicts of interest will no longer be grounds for prosecution under the honest services statute.

GODFREY & KAHN S.C.
ATTORNEYS AT LAW

However, there are important questions left unanswered. For example, in the future will prosecutors be able to shoehorn self-dealing and conflict-of-interest cases into the bribery/kickback framework? Also, to secure a conviction for honest services fraud, must prosecutors show that corporate workers held a fiduciary position? It is possible that prosecutors may be able to pursue self-dealing and other breach of fiduciary duty cases by framing them as bribery or kickback schemes.

Finally, the possibility remains that sometime in the future Congress may pass laws that expand the definition of corporate "crimes." In fact, in its ruling in *Skilling*, the Supreme Court expressly invited Congress to pass clearer laws if it intends to permit the prosecution of self-dealing by corporate officers and employees.

Conclusion

For now, the one thing that is clear is that the *Skilling* decision restricts the flexibility of prosecutors in white collar prosecutions. They will no longer be able to bring open-ended honest services fraud charges against corporate officers and employees. To bring a case under the honest services statute, prosecutors most show evidence of bribes or kickbacks. But, at the same rate, corporate officers and employees must nevertheless remain on guard to other potential white collar law violations. The federal mail and wire fraud statutes have broad reach even apart from the honest services law. The Supreme Court's decision does not prevent prosecutors from pursuing other white collar crimes. Therefore, companies must maintain vigilance to ensure compliance with all state and federal laws.

White Collar Counseling and Defense Team Members

Appleton office:
Daniel Flaherty
(dflaherty@gklaw.com)

Madison office:
Eric Wilson
(ewilson@gklaw.com)
Anthony Gaughan
(agaughan@gklaw.com)
Monica Santa Maria
(msantamaria@gklaw.com)
Frank Tuerkheimer
(ftuerkheimer@gklaw.com)

Milwaukee office:
Daniel Blinka
(dblinka@gklaw.com)
Sean Bosack
(sbosack@gklaw.com)
Nelson Phillips III
(nphillips@gklaw.com)

The following is based on a summary of legal principles. It is not to be construed as legal advice. Individuals should consult with legal counsel before taking any action based on these principles to ensure their applicability in a given situation.

©2010 Godfrey & Kahn, S.C.