Texas Wesleyan Law Review

Volume 18 | Issue 2 Article 2

12-1-2011

Honest Services Update: Directors' Liability Concerns After Skilling and Black

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ARTICLES

HONEST SERVICES UPDATE: DIRECTORS' LIABILITY CONCERNS AFTER *SKILLING* AND *BLACK*

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While corporations may have "no soul to damn, no body to kick,"[2] corporate officers and directors who do not meet their fiduciary obligations do. These officers and directors are the captains who helm the

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2. "Did you ever expect a corporation to have a conscience, when it has no soul to be damned, and nobody to be kicked?" Attributed to Lord Chancellor Edward, First Baron Thurlow (1731-1806); *quoted in* John C. Coffee, *"No Soul to Damn: No Body to Kick": An Unscandalized Inquiry into the Problem of Corporate Punishment,* 79 MICH. L. REV. 386, 386 (1981); *see also* Mullins v. Venable, 297 S.E.2d 866, 870 (W. Va. 1982); MERVYN KING, PUBLIC POLICY AND THE CORPORATION 1 (1977).

DOI: https://doi.org/10.37419/TWLR.V18.I2.1

corporate ship, set the direction, and make the major decisions that move a business forward. There are heavy responsibilities resting on these people, and there are penalties when the directors do not meet the standards of behavior appropriate for the duty to the corporation for which they act and to the shareholders thereof. Punishments for breaching their fiduciary obligations are found in both the criminal and civil areas of law. "Honest services fraud" has been an important tool used to criminalize the fiduciary malfeasance of corporate officers and directors, while personal financial responsibility may also attach in the civil context when their behavior is below a standard appropriate for a fiduciary. Recent Supreme Court decisions have drastically narrowed the scope of "honest services law" as a federal prosecutorial weapon, while state-specific civil standards have remained relatively constant for a period of time.

This Article will set out the current law in the honest services area after a quick historical review for context. Then, civil standards and penalties for breach of a corporate officer or director's fiduciary obligations will be outlined to give a more complete picture of what hazards officers and directors face when discharging their duties in a manner less than sufficient.

I. INTRODUCTION

"Honest services fraud," found in 18 U.S.C. § 1341, is a particular subset of mail and wire fraud, rather than a separate substantive offense.[3] Mail and wire fraud have "historically been powerful weapons used by prosecutors to charge a huge range of fraudulent conduct that might otherwise escape more specific criminal statutes. One sitting federal judge has called it "the prosecutor's 'Colt .45.'"[4] A regular mail fraud conviction requires devising or intending to devise a scheme to intentionally defraud or to commit certain specified intentionally fraudulent acts and using the mails to execute or attempt to execute these acts. The mails need not actually be used,[5] but a reasonable person need only foresee the use of the mails or that the defendant acted with the knowledge that use of the mails would follow in

3. Douglas Zolkind, Note, *The Case of the Missing Shareholders: A New Restriction on Honest Services Fraud in* United States v. Brown, 93 CORNELL L. REV. 437, 442 (2008).

4. Frank C. Razzano & Kristin H. Jones, *Prosecution of Private Corporate Conduct: The Uncertainty Surrounding Honest Services Fraud*, BUS. L. TODAY, Feb. 18, 2009, at 37, 38, *available at* http://apps.americanbar.org/buslaw/blt/2009-01-02/razzano.shtml.

5. Schmuck v. United States, 489 U.S. 705, 710–11 (1989) ("To be part of the execution of the fraud, however, the use of mails need not be an essential element of the scheme. It is sufficient for mailing to be 'incident to essential part of the scheme', or 'a step in the plot.'"); *see also* Joseph E. Edwards, Annotation, *What Constitutes "Causing" Mail To Be Delivered for Purpose of Executing Scheme Prohibited by Mail Fraud Statute (18 USC § 1341)*, 9 A.L.R. FED. 893 (2010).

the ordinary course of business.[6] The specifics of honest services fraud are found in 18 U.S.C. § 1346, which states: "For the purposes of [mail and wire fraud], the term 'scheme or artifice to defraud' includes a scheme or artifice to deprive another of the intangible right of honest services."[7] The brief language of § 1346 has been widely interpreted by lower courts as they grappled with its broad and vague language. One court interpreted § 1346 as follows:

> The phrase "scheme or artifice [to defraud] by depriv[ing] another of the intangible right of honest services" in the private sector context, means a scheme or artifice to use the mails or wires to enable an officer or employee of a private entity (or a person in a relationship that gives rise to a duty of loyalty comparable to that owed by employees to employers) purporting to act for and in the interests of his or her employer . . . secretly to act in his or her or the defendant's own interests instead, accompanied by a material misrepresentation made or omission of information disclosed to the employer or other person.[8]

Prosecutions for honest services fraud were dealt a serious blow on June 24, 2010, with the Supreme Court's rulings in *Skilling*,[9] *Black*,[10] and *Weyhrauch*[11] drastically narrowing the scope of honest services prosecutions to situations only involving bribes and kickbacks. Honest services law, not only under 18 U.S.C. § 1346 but also under previous non-statutory law, has meant that the breach of the fiduciary duties attaching to corporate officers and directors has criminal sanctions attached, in addition to the civil remedies that are available to corporate shareholders. From 1988 until the Court's decisions in 2010, prosecutorial discretion cast a wide wake,[12] criminalizing the breach of corporate fiduciary duties and allowing fraud prosecutions without the onerous requirements of regular fraud prosecutions.[13] Post-*Skill-*

6. United States v. Maze, 414 U.S. 395, 399 (1974) ("[O]ne 'causes' the mails to be used where he 'does an act with knowledge that the use of the mails will follow in the ordinary course of business, or where such use can reasonably be foreseen, even though not actually intended . . . .'" (quoting Pereira v. United States, 347 U.S. 1, 8–9 (1954))).

7. 18 U.S.C. § 1346.

8. United States v. Rybicki, 354 F.3d 124, 146–47 (2d Cir. 2003).

9. Skilling v. United States, 130 S. Ct. 2896 (2010).

10. *See generally* Black v. United States, 130 S. Ct. 2963 (2010).

11. Weyhrauch v. United States, 130 S. Ct. 2971 (2010) (per curiam).

12. Razzano & Jones, *supra* note 3, at 41 ("The lack of a clear and uniform standard for what constitutes honest services fraud puts tremendous discretion into the hands of the thousands of assistant U.S. attorneys in the 93 districts of this country. Prosecutors have the discretion to interpret the standard as they see fit to essentially create crimes. A federal criminal standard based on theft of honest services is in reality no standard at all as the baseline for what constitutes illegal behavior is not only far from uniform across the country, but a hodgepodge of conflicting rules and elements.").

13. *See generally* PRACTICING LAW INST., "BET THE COMPANY" LITIGATION 2010: BEST PRACTICES FOR COMPLEX CASES (PLI Litig. & Admin. Practice, Course Handbook Ser. No. 23276, 2010) (discussing the traditional elements of fraud).

ing and *Black*, however, the civil penalties for much of what passed as "honest services" breaches are all that remains for many of the lapses of fiduciary duties, which were previously criminalized. Otherwise, prosecutors must now rely on standard fraud statutes for criminal convictions when fiduciary duties are breached, but the breach is no longer enough—the prosecutor must now prove the traditional elements of the crime.

II. BACKGROUND

The initial purpose of both wire and mail fraud statutes was to secure the integrity of the United States Postal Service.[14] Originally enacted in 1872[15] and later amended by Congress in 1909, § 1341 of the mail fraud statute prohibited then, as it does today, "any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises."[16] As technology advanced over the decades, the wire and mail fraud statutes naturally expanded to include other modes of communication such as telephones, computer modems, and the Internet.[17] By 1994, the mail statute had expanded beyond the United States Postal Service, and Congress had amended the mail fraud statute to include mailings delivered by private interstate commercial carriers such as UPS and FedEx.[18] Originally, as well as today, the statute provides federal jurisdiction for a wide range of crimes including "consumer frauds, stock frauds, land frauds, bank frauds, insurance frauds, and commodity frauds, but [also] . . . such areas as blackmail, counterfeiting, election fraud, and bribery."[19] The Supreme Court has stated that

14. *See, e.g.*, Durland v. United States, 161 U.S. 306, 314 (1896) (stating that the statute was passed "with the purpose of protecting the public against all such intentional efforts to despoil, and to prevent the post office from being used to carry them into effect. . . ."); *see also* Elizabeth Wagner Pittman, *Mail and Wire Fraud*, 47 AM. CRIM. L. REV. 797, 798 (2010).

15. Act of June 8, 1872, ch. 335, § 301, 17 Stat. 283 (current version at 18 U.S.C § 1341 (2006)).

16. Skilling v. United States, 130 S. Ct. 2896, 2926 (2010).

17. 18 U.S.C. § 1343 explicitly applies to the use of television, radio, and wire communications. However, the statute has been applied to modes not explicit in the statute. *See* United States v. Ross, 210 F.3d 916, 920 (8th Cir. 2000) (upholding conviction for wire fraud when defendant used facsimile to defraud potential borrowers); United States v. Morrison, 153 F.3d 34, 57 (2d Cir. 1998) (affirming conviction for wire fraud scheme involving telephone calls); United States v. Carrington, 96 F.3d 1, 7–8 (1st Cir. 1996) (upholding conviction for wire fraud scheme involving fax transmissions and computer modem transmissions); *see also* Pittman, *supra* note 14, at 798–99.

18. 18 U.S.C.A. § 1341 (West Supp. 2011); *see* SCAMS Act, Pub. L. No. 103-322, Title XXV, § 250006, 108 Stat. 1796, 2087 (1994); *see also* 18 U.S.C. § 2326 (2006) (expanding application of the statute to "any matter or thing whatever to be sent or delivered by any private or commercial interstate carrier").

19. *See* Pittman, *supra* note 14, at 799 n.11–12 (citing United States v. Goldin Indus., 219 F.3d 1271, 1274 (11th Cir. 2000) (defining racketeering activity as the commission of certain federal crimes, including crime of mail fraud, pursuant to 18 U.S.C.

because the wire and mail fraud statutes share the same language in the relevant parts, the same legal analysis and case law can be applied to both.[20]

Although wire and mail fraud statutes have historically been used to criminalize schemes to defraud victims of tangible property, such as money, application of the statute has been expanded to those who defraud victims of intangible rights known as "honest services." Prosecution for honest services fraud does not need a victim who suffers financial loss but rather a harm, which is the denial of a victim's right to enjoy the honest services of a person who owes them a fiduciary duty.[21] The statute does not identify the persons to whom the right of honest services might be owed nor does it provide guidance on what fiduciary duties need be breached, such as those under state law or federal common law. The source of the duty that must be breached was not outlined.[22] Honest services fraud does not require reliance or damages the way regular fraud prosecutions do, as the provision prohibits the "scheme to defraud" rather than an actual fraud.[23] In a recent decision, the Supreme Court said:

> The mail- and wire-fraud statutes criminalize the use of the mails or wires in furtherance of "any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises." 18 U.S.C. § 1341 (mail fraud); § 1343 (wire fraud). The honest-services statute, § 1346, defines "the term 'scheme or artifice to defraud'" in these provisions to include "a scheme or artifice to deprive another of the intangible right of honest services."[24]

In order to convict the defendant of wire fraud,[25] the courts generally agree that the government must show beyond a reasonable doubt

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§ 1341); Monterey Plaza Hotel Ltd. P'ship v. Local 483 of the Hotel Empl. & Rest. Empl. Union, 215 F.3d 923, 928 (9th Cir. 2000) (affirming dismissal of RICO case where plaintiff failed to state requisite predicate acts of mail and wire fraud); United States v. Zichettello, 208 F.3d 72, 99–100 (2d Cir. 2000) (affirming multi-defendant convictions on counts including: (i) mail fraud in connection with bribery and (ii) wire fraud in connection with campaign finance scheme); United States v. Collins, 209 F.3d 1, 3 (1st Cir. 1999) (upholding restitution order where defendant was convicted of bank fraud, mail fraud, and conspiracy in connection with check-cashing scheme); United States v. Martin, 195 F.3d 961, 966 (7th Cir. 1999) (affirming conviction for bribery and mail fraud in connection with Medicaid fraud scheme); Jed S. Rakoff, *The Federal Mail Fraud Statute (Part I)*, 18 DUQ. L. REV. 771, 772 (1980)).

20. *See* United States v. Mills, 199 F.3d 184, 188 (5th Cir. 1999) (citing Carpenter v. United States, 484 U.S. 19, 25 n.6 (1987)); *see also, e.g.*, United States v. Reifler, 446 F.3d 65, 95 (2d Cir. 2006) (holding that cases involving § 1341 shall be used to help interpret § 1343).

21. United States v. Dixon, 536 F.2d 1388, 1400 (2d Cir. 1976).

22. Skilling v. United States, 130 S. Ct. 2896, 2935–38, (2010) (Scalia, J., concurring) (describing the uncertainty of where the duty must arise from); *see infra* notes 46–52.

23. *See* United States v. Inzunza, 638 F.3d 1006, 1018 (9th Cir. 2011).

24. *Skilling*, 130 S. Ct. at 2908 n.1.

25. 18 U.S.C.A. § 1343 (West Supp. 2011).

that the defendant met three distinct elements: (1) proof of a scheme to defraud (entailing a material misrepresentation); (2) use of the mails or wires to further the fraudulent scheme; and (3) specific intent to defraud.[26] In *Neder v. United States*,[27] the Court concluded that there is an element of materiality that must necessarily be included in the definition: "We hold that materiality of falsehood is an element of the federal mail fraud, wire fraud, and bank fraud statutes."[28]

As early as 1924, the United States Supreme Court interpreted "scheme to defraud," found within the mail and wire fraud statutes, to include the *intangible* right to honest services.[29] Prosecutors gradually used this interpretation to their advantage in prosecuting both public corruption and, eventually, breaches of fiduciary duties in the private arena.[30] Other courts' interpretation of "intangible honest services" also gradually expanded during this time.[31] In 1987, however, the Supreme Court ended the inclusion of "intangible" rights in this definition by ruling in *McNally v. United States* that the wire and mail fraud statutes did not include intangible honest services: "The mail fraud statute clearly protects property rights, but does not refer to the intangible right of the citizenry to good government."[32] The Court suggested Congress draft its intention so that it might be clear rather than allow the courts to interpret the language with broad discretion.[33]

A few months after the *McNally* ruling that severely limited the scope of honest services and excluded intangible rights from the defi-

26. *See Inzunza*, 638 F.3d at 1017 (quoting United States v. Sullivan, 522 F.3d 967, 974 (9th Cir. 2008)); United States v. Sorich, 523 F.3d 702, 707 (7th Cir. 2008), *cert. denied*, 129 S. Ct. 1308 (2009) (mem.).

27. Neder v. United States, 527 U.S. 1, 25 (1999).

28. *Id.*

29. Hammerschmidt v. United States, 265 U.S. 182, 188 (1924); *see also* Paul M. Kessimian, Note, *Business Fiduciary Relationships and Honest Services Fraud: A Defense of the Statute*, 2004 COLUM. BUS. L. REV. 197, 204 (2004).

30. Skilling v. United States, 130 S. Ct. 2896, 2927 n.35 (2010) ("In addition to upholding honest-services prosecutions, courts also increasingly approved use of the mail-fraud statute to attack corruption that deprived victims of other kinds of intangible rights, including election fraud and privacy violations. *See, e.g.,* Cleveland v. United States, 531 U.S. 12, 18, n. 2, (2000); McNally v. United States, 483 U.S. 350, 362–364, n.1–4 (1987) (Stevens, J., dissenting)."); *see also id.* at 2929. Although verbal formulations varied slightly, the words employed by the Courts of Appeals prior to *McNally* described the same concept. *See e.g.,* United States v. Bruno, 809 F.2d 1097, 1105 (5th Cir. 1987) ("honest services"); United States v. Diggs, 613 F.2d 988, 998 (D.C. Cir. 1979) ("faithful and honest services"); United States v. Brown, 540 F.2d 364, 374 (8th Cir. 1976) ("honest and faithful services"), *abrogated by* McNally v. United States 483 U.S. 350 (1987), *superseded by statute*, Pub. L. No. 100-690, Title VII, § 7603(a), 102 Stat. 4508 (1988) (codified at 18 U.S.C. § 1346), *limited on constitutional grounds by Skilling*, 130 S. Ct. at 2931.

31. Skilling v. United States, 130 S. Ct. 2896, 2927 (2010) ("[B]y 1982, all Courts of Appeals had embraced the honest-services theory of fraud.").

32. McNally v. United States, 483 U.S. 350, 356 (1987), *superseded by statute*, Pub. L. No. 100-690, Title VII, § 7603(a), 102 Stat. 4508 (1988) (codified at 18 U.S.C. § 1346), *limited on constitutional grounds by Skilling*, 130 S. Ct. at 2931.

33. *Id.* at 359–60.

nition of honest services, the Court began its expansive interpretation once again. In *Carpenter v. United States*, a writer for the Wall Street Journal investment advice column entered into a scheme with a stockbroker to exchange advance information for a portion of the profits made from trading based on this information. Eventually, their dealings were discovered and, *inter alia*, the convictions for mail and wire fraud under §§ 1341 and 1343 were affirmed. The Court held that "[c]onfidential business information has long been recognized as property."[34] Unlike in *McNally*, in which the Court refused to recognize an *intangible* right to honest services, in *Carpenter*, the Court held that the statute did cover instances of defrauding one of an *intangible property* right. The Court also noted that "even in the absence of a written contract, an employee has a fiduciary obligation to protect confidential information obtained during the course of his employment."[35] Also consistent with pre-*McNally* decisions, the Court recognized that a breach of a fiduciary duty did constitute fraud under § 1341 and § 1343. Reacting to the *McNally* definition of "scheme or artifice to defraud" in § 1341 and § 1343 so as to exclude the intangible right to honest services, Congress passed 18 U.S.C. § 1346 the following year, which included the undefined, yet explicit phrase, "intangible right to honest service."[36] The phrase "honest services" implies an intangible right, such as the right citizens have to good government free from corrupt government officials working for their own

34. Carpenter v. United States, 484 U.S. 19, 26 (1987) ("Confidential information acquired or compiled by a corporation in the course and conduct of its business is a species of property to which the corporation has the exclusive right and benefit, and which a court of equity will protect through the injunctive process or other appropriate remedy." 3 W. Fletcher, Cyclopedia of Law of Private Corporations § 857.1, p. 260 (rev. ed. 1986) (footnote omitted). The Journal had a property right in keeping confidential and making exclusive use, prior to publication, of the schedule and contents of the "Heard" column."); *see also* Ruckelshaus v. Monsanto Co., 467 U.S. 986, 1001–04 (1984); Dirks v. SEC, 463 U.S. 646, 653 n.10 (1983); Bd. of Trade of Chicago v. Christie Grain & Stock Co., 198 U.S. 236, 250 (1905); *cf.* 5 U.S.C. § 552(b)(4) (2006) (recognizing that certain types of information may be classified as company property).

35. *Carpenter*, 484 U.S. at 27–28 ("'[E]ven in the absence of a written contract, an employee has a fiduciary obligation to protect confidential information obtained during the course of employment' [because,] as the New York courts have recognized: 'It is well established, as a general proposition, that a person who acquires special knowledge or information by virtue of a confidential or fiduciary relationship with another is not free to exploit that knowledge or information for his own personal benefit but must account to his principal for any profits derived therefrom." (quoting Snepp v. United States, 444 U.S. 507, 515 n.11 (1980); Diamond v. Oreamuno, 248 N.E.2d 910, 912 (N.Y. 1969))).

36. Roger Parloff, *The Catchall Fraud Law That Catches Too Much*, FORTUNE, Jan. 18, 2010, at 86, 90–91 ("[O]n the last day of the congressional session in October 1988, the terse language of today's honest-services fraud law was tacked onto a mammoth drug bill, and it passed a couple of hours later without debate.").

interest at the public's expense. A public official has an intangible duty to provide honest services to the public.[37]

Since 1988, prosecutors have primarily used 18 U.S.C. § 1346 to prosecute in two situations: (1) public corruption; and (2) private individuals who breached a fiduciary duty to another.[38] Circuit courts varied widely on their interpretation of the statute and rarely agree with other circuit court opinions on key issues relating to § 1346's language of "a scheme or artifice to deprive another of the intangible right to honest services."[39] From 1988 to the recent *Skilling* case, there was a lack of agreement among the circuits regarding the application of § 1346. This Article will briefly outline the various circuits' treatment of each area before *Skilling* as well as the impact of that Supreme Court decision. I will briefly examine honest services, first in the context of public officials where the fiduciary duty owed is to the public, and then fiduciary duties owed to private persons will be explored in greater detail.

III. HONEST SERVICES FRAUD AND THE PUBLIC SECTOR

The United States' federal system does not allow the national government to pass bribery and conflict of interest laws pertaining to state and local officials. Traditionally, the power to criminalize acts such as fraud has been left to the states.[40] The honest services fraud statute has, however, been a tool for federal prosecutors to apply the federal government's standard of good and honest government at

37. Skilling v. United States, 130 S. Ct. 2896, 2936 (2010) ("It [McNally] described prior case law as holding that 'a public official owes a fiduciary duty to the public, and misuse of his office for private gain is a fraud.'") (quoting *McNally*, 483 U.S. at 355).

38. United States v. Sorich, 523 F.3d 702, 707 (7th Cir. 2008) ("Broadly speaking, honest services fraud cases come in two types. In the first, an employer is defrauded of its employee's honest services by the employee or by another. In *United States v. George*, 477 F.2d 508, 509–10 (7th Cir. 1973), for example, an employee of television manufacturer Zenith granted a contract to another company to supply television cabinets in exchange for kickbacks. The Zenith employee, the worker at the cabinet factory, and a middleman all were convicted of depriving Zenith of its employee's honest services. In the second and more common type of case, the citizenry is defrauded of its right to the honest services of a public servant, again, by that servant or by someone else. For instance, in *United States v. Warner*, 498 F.3d 666 (7th Cir.2007), the Illinois Secretary of State channeled state contracts and leases to a friend in return for paid vacations."), *cert. denied*, 129 S. Ct. 1308 (2009) (mem.).

39. *See* Thomas Rybarcyzk, Comment, *Preserving a More Perfect Union: Melding Two Circuits' Approaches to Save a Valuable Weapon in the Fight Against Political Corruption*, 2010 WIS. L. REV. 1119, 1134 (2010) (analyzing the four dominant circuit approaches to interpreting § 1346); *see also* United States v. Weyhrauch, 548 F.3d 1237, 1243–44 (9th Cir. 2008) (the court notes the various circuits' treatment of § 1346 in comparison to its own interpretation) (per curiam), *vacated and remanded by* 130 S. Ct. 2971 (2010) (per curiam).

40. Nicholas J. Wagoner, Comment, *Honest-Services Fraud: The Supreme Court Defuses the Government's Weapon of Mass Discretion in* Skilling v. United States, 51 S. TEX. L. REV. 1087, 1114, n.135 (2010).

both the state and local level.[41] The underlying idea is that a public official involved in bribery or a conflict of interest is defrauding the people of their intangible right to that public official's honest services. The Supreme Court recognized that, despite the divisions in the appellate courts addressing the source and scope of fiduciary duties, there is indeed a fiduciary relationship—under any definition of the word—between the public and the public official.[42]

A pervasive issue on which circuit courts have divided is whether the fiduciary duty breached by the accused state employee must originate in *state* law in order to commit honest services fraud. The Fifth Circuit held in *U.S. v. Brumley* that a state official must violate a state statute in order to commit honest services fraud.[43] Mr. Brumley was a state employee working for the Industrial Accident Board ("IAB"), and his position enabled him to know certain conduct of specific lawyers and certain unrepresented claimants. He conspired with a lawyer to use his position at the IAB to assist the lawyer's interactions with the state agency. Mr. Brumley contended, among other things, that the federal statute does not address duties owed to a state employer, nor did an ethical lapse or state misdemeanor constitute a deprivation of honest services such as to commit a federal crime.[44] The court agreed with Brumley and reasoned that "the official must act or fail to act contrary to the requirements of his job under state law. This means that if the official does all that is required under state law, al-

41. Razzano & Jones, *supra* note 3, at 38 ("Public honest services is the instrument used by federal prosecutors to impose the federal government's view of good government on state and local officials."); *see also* United States v. Brumley, 116 F.3d 728, 734 (5th Cir. 1997) (expressing concern that honest services fraud prosecutions would unduly interfere with state politics); United States v. Sawyer, 85 F.3d 713, 722–23 (1st Cir. 1996) (noting that Congress has the power to use the mail fraud statute to prohibit schemes to defraud a state and its citizens through § 1346); Randall D. Eliason, *Surgery with a Meat Axe: Using Honest Services Fraud to Prosecute Federal Corruption*, 99 J. CRIM. L. & CRIMINOLOGY 929, 932, 969 (2009) ("Court decisions discussing honest services fraud routinely refer to it as a vehicle for prosecuting state and local corruption.").

42. *Skilling*, 130 S. Ct. at 2930–31 n.41 (giving three examples of fiduciary relationships that are generally beyond dispute. First, between the public and the public official; second, between an employee and employer; third, between a union official and a union member.).

43. *Brumley*, 116 F.3d at 734.

44. *Id.* at 730 ("As we will explain, Brumley's primary contention is that the government has misused federal criminal statutes to prosecute a state employee for ethical lapses. Along the way to review by the en banc court the issues on appeal have narrowed to four. First, Brumley urges that neither the plain language of § 1346 nor its legislative history expands the types of victims protected by the statute to include a state employer. Second, he insists that an ethical lapse, or at worst a state misdemeanor, is not a deprivation of honest services. Third, he argues that the Commerce Clause does not support § 1346. Finally, he contends that the money laundering statute does not reach his conduct. Brumley also challenged the statute and the indictment on vagueness grounds in the district court, but he did not pursue these contentions on appeal. We reject each of these contentions and affirm the convictions.").

leging that the services were not otherwise done 'honestly' does not charge a violation of the mail fraud statute."[45] The court continued by saying, "[t]he statute contemplates that there must first be a breach of a state-owed duty. It follows that a violation of state law that prohibits only appearances of corruption will not alone support a violation of §§ 1343 and 1346."[46] The Third Circuit agreed with and expanded upon the Fifth Circuit's holding when the Third Circuit used state law as a limiting principle, but not the only one, to determine when an official's failure to disclose a conflict of interest amounts to honest services fraud.[47]

In *United States v. Murphy*, the court noted that, "[t]he Third Circuit has adopted a similar rule requiring the government to prove the public official violated a fiduciary duty specifically established by state *or* federal law."[48] Similarly, the Eighth Circuit has also held that state *or* federal law can provide the source of fiduciary duty that a public official can breach with certain activities.[49] Four other circuits also do not limit a conviction of honest services based on state sovereignty; the First,[50] Fourth,[51] Ninth,[52] and Eleventh[53] Circuits have addressed the issue and found that a violation of § 1346 is not limited to a violation of state law.[54] These courts reasoned that federal law cre-

45. *Brumley*, 116 F.3d at 734.

46. *Id.* at 734.

47. United States v. Panarella, 277 F.3d 678, 692–93 (3d Cir. 2002) ("We believe that state law offers a better limiting principle for purposes of determining when an official's failure to disclose a conflict of interest amounts to honest services fraud.").

48. United States v. Weyhrauch, 548 F.3d 1237, 1244 (9th Cir. 2008) (citing United States v. Murphy, 323 F.3d 102, 117 (3d Cir. 2003)), *vacated and remanded*, 130 S. Ct. 2971 (2010) (per curiam).

49. United States v. Jennings, 487 F.3d 564, 577–78 (8th Cir. 2007) (accepting a state law limitation but not ruling that it is the only means available to prove honest-services fraud); *see also* Rybarczyk, *supra* note 37, at 1136.

50. United States v. Urciuoli, 513 F.3d 290, 298–99 (1st Cir. 2008) (declining to read honest services fraud statute to require violation of state law).

51. United States v. Bryan, 58 F.3d 933, 942 (4th Cir. 1995) (holding that the duty of honesty is defined irrespective of the existence of state law), *abrogated by* United States v. O'Hagan, 521 U.S. 642 (1997).

52. *Weyhrauch*, 548 F.3d at 1245 (federal honest services mail fraud prosecution against public official did not require independent state law violation).

53. United States v. Walker, 490 F.3d 1282, 1299 (11th Cir. 2007) (holding that an honest services fraud conviction "does not require proof of a state law violation").

54. *See Weyhrauch*, 548 F.3d at 1247. Several circuits, however, have held that the meaning of "honest services" is governed by a uniform federal standard inherent in § 1346, although they have not uniformly defined the contours of that standard. *See* United States v. Sorich, 523 F.3d 702, 712 (7th Cir. 2008) (holding that sources other than state law can establish a duty to provide honest services), *cert. denied*, 129 S. Ct. 1308 (2009) (mem.). United States v. Weyhrauch, 548 F.3d 1237, 1247 (9th Cir. 2008) (The majority of circuits, however, have held that the meaning of "honest services" is governed by a uniform federal standard inherent in § 1346, although they have not uniformly defined the contours of that standard. *See Sorich,* 523 F.3d at 712 (holding that sources other than state law can establish a duty to provide honest services)).

ated an actionable fiduciary duty.[55] The Seventh Circuit went one step further and has read § 1346 to require public officials to breach a fiduciary duty with an intent to reap private gain in order to support an honest services mail fraud conviction.[56] Finally, the Tenth and Eighth Circuits have read into § 1346 a requirement that a public official's actions go beyond a mere breach of duty, but the actions must be material and accompanied by fraudulent intent.[57] Rather than settling the inconsistency between the circuits in *United States v. Weyhrauch*,[58] the Supreme Court did not issue a detailed opinion but vacated the judgment and remanded the case back to the Court of Appeals for the Ninth Circuit on other grounds pursuant to their holding in *Skilling* that honest services fraud encompasses only schemes involving bribery and kickbacks.[59] With this development, it remains unsettled whether the underlying fiduciary relationship that is offended by the bribery or kickback must originate in state or federal law.

IV. HONEST SERVICES FRAUD AND THE PRIVATE SECTOR

While honest services fraud prosecutions are most often pursued against public officials, several federal courts have convicted individuals who breach a private fiduciary duty. Perhaps the earliest application of honest-services-type fraud to private actors was in 1942.[60] Often cited to demonstrate private sector application is the 1997 case *United States v. Frost*,[61] where the defendants, two college professors, owned a private atmospheric science research firm that received government contracts and research grants. Several graduate students, who were employed by various governmental agencies, were improperly provided materials from the professors for their dissertations. The scheme was to obtain federal contracts from the agencies that employed these students. Despite the professors' argument that

55. *See also Weyhrauch*, 548 F.3d at 1247; Rybarczyk, *supra* note 37, at 1136; *see generally* United States v. deVegter, 198 F.3d 1324, 1329 (11th Cir. 1999) (noting federal law governs mail fraud's fiduciary duty sources).

56. United States v. Bloom, 149 F.3d 649, 655 (7th Cir. 1998); *see also* Sorich v. United States, 129 S. Ct. 1308, 1309 (mem.) (Scalia, J., dissenting).

57. *See* United States v. Cochran, 109 F.3d 660, 667 (10th Cir. 1997); United States v. Jain, 93 F.3d 436, 442 (8th Cir. 1996).

58. Weyhrauch v. United States, 130 S. Ct. 2971 (2010) (per curiam).

59. United States v. Weyhrauch, 623 F.3d 707, 708 (9th Cir. 2010) (affirming the district court's denial of the government's motion in limine and remanding the case back to the district court).

60. Skilling v. United States, 130 S. Ct. 2896, 2926–27 (2010) (stating that, "[w]hen one tampers with [the employer-employee] relationship for the purpose of causing the employee to breach his duty [to his employer,] he in effect is defrauding the employer of a lawful right. The actual deception that is practiced is in the continued representation of the employee to the employer that he is honest and loyal to the employer's interests." (quoting United States v. Procter & Gamble Co., 47 F. Supp. 676, 678 (D. Mass. 1942))).

61. United States v. Frost, 125 F.3d 346, 352 (6th Cir. 1997).

§ 1346 did not apply because they were not public officials, the court held that private individuals can be convicted of honest services fraud. The court held "that private individuals, such as Frost and Turner, may commit mail fraud by breaching a fiduciary duty and thereby depriving the person or entity to which the duty is owed of the intangible right to the honest services of that individual."[62]

Following the *Frost* decision, two tests developed to determine when a private individual has committed honest services fraud.[63] The first test is a *reasonably foreseeable economic harm test*, which requires the defendant to intentionally breach his fiduciary duty and foresee that it would result in economic harm. The second test is a *materiality test*, which requires the defendant to have a fraudulent intent and make "any misrepresentation that has the natural tendency to influence or is capable of influencing" the victim to change his behavior.[64] The two tests are briefly discussed below.

A. *Reasonably Foreseeable Economic Harm Test*

The duties owed by a public official and a private individual are inherently different. The Eleventh Circuit expressed it as follows: "The meaning of the 'intangible right of honest services' has different implications, however, when applied to public official malfeasance and private sector misconduct. Public officials inherently owe a fiduciary duty to the public to make governmental decisions in the public's best interest."[65] However, the theory underpinning § 1346 still applies to private-sector defendants if the case involves a breach of fiduciary duty and reasonably foreseeable economic harm.[66] Several circuits have adopted the *reasonably foreseeable economic harm test* in one form or another.[67] The Fourth Circuit recognizes the existence of the two tests but concludes that the *reasonably foreseeable economic harm test* is the superior test.[68] "Actual harm" is not necessary, only that it be foreseeably harmful:

> Under this test, the employee need only intend to breach his fiduciary duty and reasonably foresee that the breach would create "an identifiable economic risk" for the employer. ("There must be a failure to disclose something which in the knowledge or contemplation of the employee poses an independent business risk to the em-

62. *Id.* at 366.

63. United States v. Vinyard, 266 F.3d 320, 328 (4th Cir. 2001) ("The two tests (the reasonably foreseeable harm test and the materiality test) are similar in many respects. We are persuaded, however, that the reasonably foreseeable harm test, as adopted and explained by the Sixth Circuit in its *Frost* decision, is the better approach").

64. *Id.* at 327–28.

65. United States v. deVegter, 198 F.3d 1324, 1328 (11th Cir. 1999).

66. *Id.* at 1330.

67. *Vinyard*, 266 F.3d at 328.

68. *See id.*

> ployer."). Thus, the reasonably foreseeable harm test is met whenever, at the time of the fraud scheme, the employee could foresee that the scheme potentially might be detrimental to the employer's economic well-being. Furthermore, the concept of "economic risk" embraces the idea of risk to future opportunities for savings or profit; the focus on the employer's well-being encompasses both the long-term and the short-term health of the business. *See Frost,* 125 F.3d at 369; *Lemire,* 720 F.2d at 1338. Whether the risk materializes or not is irrelevant; the point is that the employee has no right to endanger the employer's financial health or jeopardize the employer's long-term prospects through self-dealing. Therefore, so long as the employee could have reasonably foreseen the risk to which he was exposing the employer, the requirements of § 1346 will have been met.[69]

B. *A Test Based on Materiality*

Some circuits use a *materiality test* to determine when a private individual has breached his fiduciary duty sufficiently to warrant an honest services fraud conviction.[70] In *United States v. Gray*, Baylor University's basketball coaching staff helped players obtain certain academic credits required for eligibility to play by providing them with schoolwork to submit that was not the student's own. The coaches were found to have made *material* misrepresentations. "Materiality exists whenever 'an employee has reason to believe the information would lead a reasonable employer to change its business conduct.'"[71] The same circuit had previously held in *Ballard* and repeated in *Gray* that:

> [A] breach of fiduciary duty of honesty or loyalty involving a violation of the duty to disclose could only result in criminal mail fraud where the information withheld from the employer was material and that, where the employer was in the private sector, information should be deemed material if the employee had reason to believe the information would lead a reasonable employer to change its business conduct.[72]

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69. *Id.* at 329 (internal citations omitted).

70. *Id.* at 327 ("We [acknowledge] . . . that § 1346 must be read against a backdrop of the mail and wire fraud statutes, thereby requiring fraudulent intent and a showing of materiality." (quoting United States v. Cochran, 109 F.3d 660, 667 (10th Cir. 1997))); *see also* United States v. Gray, 96 F.3d 769, 774–75 (5th Cir. 1996) (construing the honest services doctrine to merely require a showing that the employee possessed a fraudulent intent and that the misrepresentation at issue was material (the "materiality test")). Courts that prefer the materiality test have defined a misrepresentation as material "if it has a natural tendency to influence or is capable of influencing" the employer to change his behavior. Cochran, 109 F.3d at 668 n.3; *see also Gray*, 96 F.3d at 775 ("Materiality exists whenever 'an employee has reason to believe that the information would lead a reasonable employer to change its business conduct.'").

71. *Gray*, 96 F.3d at 775.

72. United States v. Ballard, 680 F.2d 352, 353 (Former 5th Cir. 1982).

The Second Circuit also noted the two tests but opted to employ the *materiality test* in *United States v. Rybicki.*[73]

V. WHERE THE LAW IS NOW

The use of honest services law as a prosecutorial weapon was tightened considerably in June of 2010 with the release of the *Skilling*, *Black,* and *Weyhrauch* judgments. *Skilling* and *Black* dealt with private individuals and actions taken by corporate executives, while *Weyhrauch* addressed actions of an elected public official. The Supreme Court essentially eliminated much of the prosecutorial discretion that had typified honest services prosecutions and handed down a strict mandate that honest services prosecutions are only available in circumstances involving bribes and kickbacks.[74]

A. *Three Supreme Court Cases*

Prior to *Skilling*, *Black*, and *Weyhrauch*, Justice Scalia foreshadowed the Court's involvement in the honest services controversy in his 2009 dissent in *Sorich v. United States.*[75] There, the Supreme Court denied a petition for certiorari in *Sorich*, and Scalia recognized the array of issues within the honest services debate, stating that it was "quite irresponsible to let the current chaos prevail."[76] He acknowledged the "conflicts among the Circuits" in dealing with the "confusion over the scope of the statute" and opined that the petition for certiorari should have been granted for the Court to "squarely confront both the meaning and the constitutionality of § 1346."[77] In its next term, the Court granted certiorari to hear *Skilling v. United States* to try to resolve the controversy that had been growing since the *McNally v. United States* decision twenty-three years earlier.

During the 2009–10 term, three appeals from honest services convictions made it to the Supreme Court, as the Court granted petitions for certiorari in *United States v. Skilling*, *United States v. Black*, and *United States v. Weyhrauch.* After the Court heard *Skilling*, both *Black* and *Weyhrauch* were vacated and remanded back to their original appellate courts for consideration in light of the *Skilling* holding.

1. *Skilling v. United States*

Much has been written about Enron and its corporate officers, from the company's dramatic rise in the 1990s to its shocking bankruptcy

73. United States v. Rybicki, 354 F.3d 124, 146–47 (2d Cir. 2003).
74. Skilling v. United States, 130 S. Ct. 2896 (2010).
75. Sorich v. United States, 129 S. Ct. 1308, 1311 (2009) (mem.) (Scalia, J., dissenting).
76. *Id.*
77. *Id.*

filing in 2001.[78] Jeffrey Skilling, the former CEO of Enron, was at the center of the corporation's collapse and was convicted of various crimes in the wake of the fallen Enron empire. While there were many charges against Skilling,[79] the Supreme Court dealt with just the two issues Skilling had appealed—only one of which addressed honest services—in addition to considering the constitutionality of the provision.[80] "The Government charged Skilling with conspiring to defraud Enron's shareholders by misrepresenting the company's fiscal health, thereby artificially inflating its stock price."[81] The Government's position was that Skilling had "profited from the fraudulent scheme . . . through the receipt of salary and bonus . . . and through the sale of approximately $200 million in Enron stock, which netted him $89 million."[82]

The Supreme Court decided to distill the provision to its "solid core" and stated that the honest services statute covers only bribery and kickback schemes.[83] As a result of this statutory reading, the Court refused to strike down the law as unconstitutionally vague, reasoning that "[i]nterpreted to encompass only bribery and kickback schemes, § 1346 is not unconstitutionally vague."[84] Justice Scalia disagreed with this reasoning and wrote separately to express his opinion that the statute "is vague, and therefore violates the Due Process Clause of the Fifth Amendment."[85] He stated that nowhere in the text of the statute was the definition of "honest services fraud" limited to bribes and kickbacks, and an unconstitutionally vague statute cannot be saved by judicial construction that writes in specific criteria not included in its text.[86] Scalia emphatically noted that the pre-*McNally* cases do not include *bribery* or *kickbacks* in the description of the cases' opinions.[87] Scalia argued that Congress intended for the statute to include more than *bribery* or *kickbacks*, writing: "Among all the pre-*McNally* smorgasbord-offerings of varieties of honest-services

78. BETHANY MCLEAN & PETER ELKIND, THE SMARTEST GUYS IN THE ROOM: THE AMAZING RISE AND SCANDALOUS FALL OF ENRON (2003); C. William Thomas, *The Rise and Fall of Enron*, 4-02 J. ACCT. 41 (2002), *available at* http://www.journalofaccountancy.com/Issues/2002/Apr/TheRiseAndFallOfEnron.htm.

79. *Skilling*, 130 S. Ct. at 2900 ("Skilling was also charged with over 25 substantive counts of securities fraud, wire fraud, making false representations to Enron's auditors, and insider trading.").

80. *Id.* at 2907 (addressing two issues: (1) whether pretrial publicity and community prejudice prevent Skilling from obtaining a fair trial, and (2) whether the jury improperly convicted Skilling of conspiracy to commit "honest-services" wire fraud).

81. *Id.* at 2934.

82. *Id.*; *see also* Brief for the United States at 51, *Skilling*, 130 S. Ct. 2896 (No. 08-1394), 2010 WL 302206, at *51.

83. *Skilling*, 130 S. Ct. at 2930–31.

84. *Id.* at 2933.

85. *Id.* at 2935 (Scalia, J., concurring).

86. *Id.* (citing Lanzetta v. New Jersey, 306 U.S. 451, 453 (1939); United States v. Reese, 92 U.S. 214, 219–21 (1876)).

87. *Id.* at 2936 ("In fact, they do not. *Not at all.*").

fraud, *not one* is limited to bribery and kickbacks. That is a dish the Court has cooked up all on its own."[88] In the previous year, Scalia had voiced these same concerns, in more detail, in his *Sorich* certiorari dissent, where he articulated the danger in allowing a vaguely worded statute to exist.[89] Most striking is his assertion that any salaried employee, who leaves work early to attend a baseball game or any other afternoon amusement, would be committing honest services fraud under that interpretation of the law. Many people who could hardly be considered criminals could be prosecuted for such behavior, even if it were for isolated incidents—myself included.

The majority, in a 6-3 split, disagreed with Scalia and voted not to strike the statute down as unconstitutionally vague.[90] The majority reasoned that case law requires the Court, if it can, "to construe, not condemn, Congress's enactments."[91] In limiting the statute to "fraudulent schemes to deprive another of honest services through bribes or kickbacks supplied by a third party who had not been deceived," as the Court held, "§ 1346 presents no vagueness problem."[92] The evidence did not show that Skilling solicited or accepted side payments from a third party in exchange for the financial misrepresentations, and therefore the Court found that the honest services statute did not apply.[93]

Skilling was remanded back to the Fifth Circuit to decide, in light of the narrowly construed statute, whether Skilling had committed honest services fraud.[94] "[T]he *Skilling* decision removed a category of deceptive, fraudulent, and corrupt conduct from the scope of the honest services fraud statute and placed that conduct beyond the reach of

88. *Id.* at 2939.

89. Sorich v. United States, 129 S. Ct. 1308, 1309 (2009) (mem.) (Scalia, J., dissenting) ("If the 'honest services' theory—broadly stated, that officeholders and employees owe a duty to act only in the best interests of their constituents and employers—is taken seriously and carried to its logical conclusion, presumably the statute also renders criminal a state legislator's decision to vote for a bill because he expects it will curry favor with a small minority essential to his reelection; a mayor's attempt to use the prestige of his office to obtain a restaurant table without a reservation; a public employee's recommendation of his incompetent friend for a public contract; and any self-dealing by a corporate officer. Indeed, it would seemingly cover a salaried employee's phoning in sick to go to a ball game. In many cases, moreover, the maximum penalty for violating this statute will be added to the maximum penalty for violating 18 U.S.C. § 666, a federal bribery statute, since violation of the latter requires the additional factor of the employer's receipt of federal funds, while violation of the 'honest services' provision requires use of mail or wire services, §§ 1341, 1343. Quite a potent federal prosecutorial tool.").

90. *See Skilling*, 130 S. Ct. at 2928 ("We agree that § 1346 should be construed rather than invalidated.").

91. *Id.*

92. *Id.*

93. *Id.* at 2934.

94. *Id.* at 2935.

federal criminal law."[95] This decision, the most important and detailed of the three Supreme Court cases in the honest services trilogy, has effectively disarmed a potent prosecutorial weapon and has had considerable impact on honest services law.

2. *United States v. Black*

United States v. Black, the second case in this trilogy, dealt with whether private citizens with a fiduciary duty must know that their actions would cause economic harm to the entity to which they owed the fiduciary duty. Lord Conrad Black, a publicist and media executive, was the CEO of Hollinger International ("Hollinger"), which through various subsidiaries owned a number of newspapers in the United States and abroad. Hollinger sold certain publishing assets and Black diverted some of the funds as "noncompete fees" for personal benefit. Ravelston, a Canadian holding company, controlled Hollinger, and Black in turn owned 65% of the shares in Ravelston.[96] While Black directly owned some stock in Hollinger, it was through his majority stake in Ravelston that he effectively controlled Hollinger, which caused Hollinger to pay large management fees to Ravelston.

In 2001, APC, a subsidiary of Hollinger, had a newspaper in the small town of Mammoth Lake, California. When APC sold this newspaper, it paid Hollinger executives, including Black, $5.5 million in exchange for their covenants not to compete with APC for three years after they stopped working for Hollinger.[97] Black argued that the purpose behind characterizing the fees in such a manner was to get favorable tax treatment in Canada where he was a resident. The payments had been made to the defendants personally rather than to Ravelston, and there was no evidence that either the corporation's board or audit committee approved the $5.5 million.[98] There was also a failure to credit this transaction to the management-fees account on Ravelston's books as well as a failure to disclose the $5.5 million in payments in the 10-K reports. All this, combined with the fact that the payments came from the proceeds of a newspaper sale, decreased

95. *Restoring Key Tools to Combat Fraud and Corruption After the Supreme Courts Skilling Decision: Hearing Before the S. Comm. on the Judiciary*, 111th Cong. 32 (2010) (statement of Lanny A. Breuer, Assistant Att'y Gen., Criminal Division, United States Department of Justice).

96. There was a holding company in between Hollinger and Ravelston, it is not important for discussion purposes and can be ignored.

97. United States v. Black, 530 F.3d 596, 599 (7th Cir. 2008), *vacated* 130 S. Ct. 2963 (2010) (The court was skeptical about the unusual nature of this transaction: "That Black and the others would start a newspaper in Mammoth Lake to compete with APC's tiny newspaper was ridiculous. The defendants argued that the $5.5 million actually represented management fees owed Ravelston.").

98. *Id.*

the likelihood that these payments were a means of discharging a debt owed these executives by Hollinger.

The evidence established a traditional fraud scenario, which violated 18 U.S.C. § 1341. The jury had also been instructed that it could convict the defendants upon proof that they had schemed to deprive Hollinger and its shareholders of their intangible right to the honest services of the corporate officers, provided the objective of the scheme was *private gain.*[99] The jury reached a verdict to convict the defendants, and after the conviction, they quickly appealed. The jury instruction with regard to the honest service fraud was the issue on appeal. During the appeal, Black and the other defendants argued that, although he did seek private gain, it was at the expense of the Canadian government and not at the expense of those persons to whom he owed his honest services, and hence the honest services fraud charge should not remain. Also, since a general verdict was requested, rather than a special verdict, Black argued that it became very difficult to separate the conviction of traditional fraud from honest services fraud. The Seventh Circuit Court of Appeals affirmed the convictions. The defendants then petitioned for certiorari from the Supreme Court to hear their appeal, and the Court granted the petition in May of 2009.[100]

After Black and the other defendants appealed to the Supreme Court, the Court ruled that in light of the recently decided *Skilling* case, the definition of honest services fraud used in the trial judge's charge to the jury was too broad.[101] As outlined in *Skilling*, honest services fraud could only be found where there was bribery and kickbacks.[102] *Black* was remanded back to the Seventh Circuit Court of Appeals to review the convictions. On October 28, 2010, the Seventh Circuit Court of Appeals overturned two of Black's three mail fraud convictions and left his conviction on one count of obstruction of justice. On December 17, 2010, Black lost his appeal to overturn these remaining convictions and was resentenced on June 24, 2011, to three and a half years in prison; he has already served two years.

3. *Weyhrauch v. United States*

The question asked in *Weyhrauch v. United States* was whether a public official has a duty of disclosure and can be charged with honest services fraud if his behavior is legal under the law of his home state. Federal prosecutors accused Bruce Weyhrauch, a former Alaska state legislator, of having criminally deprived his constituents of his honest

99. *Id.* at 600.

100. Black v. United States, 129 S. Ct. 2379, 2379 (2009).

101. Black v. United States, 130 S. Ct. 2963, 2966 (2010).

102. Skilling v. United States, 130 S. Ct. 2896, 2907 (2010).

services while acting as a public official.[103] The government argued that Weyhrauch should have disclosed his attempts to procure future employment from VECO, an oil company, to the public *before* he voted for legislation that benefited the oil company. Weyhrauch demonstrated that he had not secured future employment with VECO, he had not taken any explicit bribe, nor had an agreement been reached between VECO and Weyhrauch as to his future within or without the company. Hence, Weyhrauch argued that he could not be convicted of honest services fraud because Alaska only required the disclosure of actual conflicts of interest, not possible ones.[104]

The government alleged that Weyhrauch had spoken to VECO executives about voting on a more favorable tax position for the company with the tacit expectation to be employed by VECO after his term in office expired. The parties disputed whether or not Weyhrauch had an *affirmative duty* to disclose the conflict of interest stemming from his dealings with VECO. Since Alaska state law did not require Weyhrauch to "disclose his negotiations for future employment with a company affected by pending legislation, the district court found it would be inappropriate to admit evidence that would support the United States' contention that Weyhrauch should be federally liable for concealing his conflict of interest."[105]

The Ninth Circuit reversed the district court's decision and held that § 1346 "establishes a uniform standard for 'honest services' that governs every public official and that the government does not need to prove an independent violation of state law to sustain an honest services fraud conviction."[106] Weyhrauch subsequently petitioned the Supreme Court for certiorari, which was granted in July 2009. Weyhrauch asked the Court to determine whether the government must first prove that the defendant violated a duty to disclose under state law before the court can convict a state official for non-disclosure of material information in violation of the mail-fraud statutes under 18 U.S.C. §§ 1341 and 1346.[107] Because the Court had decided the *Skilling* case, judgment was vacated, and *Weyhrauch* was remanded back to the Ninth Circuit for reconsideration in light of the statutory reading-down of honest services law in *Skilling*. On March 14, 2011, Weyhrauch pled guilty to engaging with unregistered lobby-

103. United States v. Weyhrauch, 548 F.3d 1237, 1244 (9th Cir. 2008), *vacated and remanded*, 130 S. Ct. 2971 (2010) (per curiam).

104. *See* LEGAL INFO. INST., *Weyhrauch v. United States, (08-1196)*, CORNELL U.L. SCH., http://www.law.cornell.edu/supct/cert/08-1196 (last visited Oct. 1, 2011).

105. *Id.*

106. *Weyhrauch*, 548 F.3d at 1240, 1248.

107. LEGAL INFO. INST., *supra* note 101.

ists, and in return, prosecutors dropped, *inter alia*, the honest services fraud charges.[108]

B. *After* Skilling

It is too early to tell what every implication of *Skilling* will be. Some defendants "convicted for honest-services fraud based on the now defunct theory—that nondisclosure of self-dealing violates § 1346—may use *Skilling* to challenge their convictions or ask for shortened sentences by arguing that they were convicted under an unconstitutional application of the statute."[109] *Skilling* had an immediate impact on some honest services fraud convictions—for example, five days after *Skilling* was decided, the first convicted felon was released from prison and his conviction vacated in light of the new Supreme Court decision.[110] Some cases have been dismissed, such as the ones against two former Westar executives, David Wittig and Douglas Lake.[111] Numerous other defendants, who had been convicted for self-dealing, have had their petitions for writ of certiorari granted, and with their lower court judgments vacated, they are awaiting consideration on remand.[112] As mentioned earlier, Conrad Black had two of his three fraud convictions thrown out. It remains to be seen whether prosecutors will use the honest services statute as a backup to regular fraud statutes, as they often had in past, or if honest services fraud will fall into disuse except in very narrow circumstances. After all, if bribery or kickbacks are involved, there are state criminal statutes that address the behavior directly and other federal statutes that deal with corporate misbehavior, such as Sarbanes Oxley. What is clear is that honest services fraud will no longer be used as just a threat to get

108. *See* Klas Stolpe, *Weyhrauch Pleads Guilty to Working with Unregistered Lobbyists*, JUNEAUEMPIRE.COM (March 15, 2011), http://juneauempire.com/stories/031511/sta_799763825.shtml.

109. Wagoner, *supra* note 38, at 1130.

110. *Id.*; *see also* Geddings v. United States, No. 5:06-CR-136-D, No. 5:08-CV-425-D, 2010 WL 2639920, at *2 (E.D.N.C. June 29, 2010) (granting the government's motion to release Geddings and directing the penitentiary to release him from imprisonment immediately).

111. *See* Peter Lattman, *Fraud Ruling is Reshaping Federal Cases*, N.Y. TIMES, Aug. 25, 2010, at B1, *available at* http://www.nytimes.com/2010/08/26/business/26energy.html?pagewanted=print.

112. Harris v. United States, 130 S. Ct. 3542, 3542 (2010) (mem.) (reversed and remanded in light of *Skilling*); United States v. Hargrove, 412 F. App'x 869, 870 (7th Cir. 2011) ("[No] reasonable jury could have acquitted Hargrove of money fraud but convicted him of honest services fraud . . . . The judgment and sentence is reinstated and affirmed."), *petition for cert. filed*, 79 U.S.L.W. 3712 (U.S. June 2, 2011) (No. 10-1477); *but see* United States v. Redzic, 627 F.3d 683 (8th Cir. 2010), *cert. denied*, 131 S. Ct. 2126 (2011); United States v. Hereimi, 396 F. App'x 433, 434 (9th Cir. 2010) (reversed and remanded in light of *Skilling*).

defendants to plea bargain when the government might not be able to prove the elements of actual fraud in court.[113]

With the amount of attention being paid to corporate malfeasance in recent years, such as the debacles of WorldCom,[114] Enron,[115] and Tyco,[116] it is unlikely that Congress will leave the state of honest services law as it currently exists. It is likely Congress will attempt to craft legislation, which addresses the Supreme Court's concerns about vagueness, while still criminalizing the more serious breaches of state or federally-rooted fiduciary duties. After the Supreme Court released its decisions in the summer of 2010, a new bill was introduced to replace § 1346—*The Honest Services Restoration Act.* The bill addressed undisclosed self-dealing in both the public and private sectors. Needless to say, the bill was substantially longer than the twenty-eight-word sentence regarding honest service fraud found in § 1346. Self-dealing was the definitional focus, and particular attention was paid to ensure that the bill covered breaches of the fiduciary duty of loyalty. "Scheme or artifice to defraud," for purposes of fraud offenses, was defined to include:

1) A scheme or artifice by a public officer to engage in undisclosed self-dealing; or
2) A scheme or artifice by officers and directors to engage in undisclosed private self-dealing.[117]

Undisclosed self-dealing was defined as:

1) Performing an official act to benefit or further a financial interest of the public official, a spouse or minor child, a general partner, a business or organization in which the public official is negotiating for, or has any arrangement concerning, prospective employment or financial compensation; and
2) Knowingly falsifying, concealing, covering up, or failing to disclose material information regarding a financial interest as required by law.[118]

Undisclosed private self-dealing was defined as:

1) Performing an act which causes or is intended to cause harm to the employer of the officer or director, and which is undertaken to benefit or further by an actual or intended value of $5,000 or more a financial interest of the officer or director, a spouse or

113. *See* Eliason, *supra* note 39, at 932 (noting the increased use of honest services fraud theory to prosecute corruption in the wake of court decisions that have made prosecutions under statute or traditional bribery or gratuities more and more difficult).

114. United States v. Ebbers, 458 F.3d 110, 112–13 (2d Cir. 2006).

115. United States v. Skilling, 554 F.3d 529, 534 (5th Cir. 2009), *aff'd in part, vacated in part*, 130 S. Ct. 2896 (2010).

116. People v. Kozlowski, 898 N.E.2d 891, 895 (N.Y. 2008).

117. Honest Services Restoration Act, S. 3854, 112th Cong. § 1346A(a)(1)–(2) (2010), *available at* www.opencongress.org/bill/111-s3854/show.

118. *Id.* at § 1346A(b)(1)(A)(i)–(ii).

minor child, a general partner, another business or organization in which the officer or director is serving as an employee, officer, director, trustee, or general partner, or an individual, business, or organization with whom the officer or director is negotiating for, or has an arrangement concerning, prospective employment or financial compensation; and

2) Knowingly falsifying, concealing, covering up, or failing to disclose material information regarding a financial interest as required by law.[119]

This bill did not move through committee and died a natural death when cleared from the books at the end of the session. Despite this, it does give an idea of the clarification that politicians are considering to address the vagueness issue, while attempting to attach liability to certain types of undesirable behaviors.

VI. CORPORATE FIDUCIARY DUTIES OF OFFICERS AND DIRECTORS

Corporate officers and directors owe two key fiduciary duties to the corporations and shareholders that they serve: the duty of loyalty and the duty of care. While a duty of good faith has also been recognized,[120] it has been clarified to be a subset of the duty of loyalty.[121] The duty of loyalty is the broadest, aimed at curbing opportunistic self-dealing. This ensures that the beneficiary of the fiduciary relationship is the corporation and its shareholders. The source of these fiduciary obligations is private in nature, arising from individuals entering into voluntary relationships and stemming from state corporate law and jurisprudence.

A. *Introduction, Fiduciary Duties*

Historically, corporate directors had a duty of care and a duty of loyalty. The business judgment rule ("BJR") protected directors from personal liability for breaches of their duty of care by preventing judicial inquiry into a director's decision and whether that decision met that duty of care. This is why some consider the BJR to be an abstention doctrine.[122] Typically, absent self-dealing, if the BJR was inapplicable, liability was not immediate, but instead the inquiry then focused on whether the director met her duty of care. Alleged breaches of the duty of loyalty were traditionally reviewed under the "*entire fairness test*," and it was violations of the duty of loyalty that

119. *Id.*

120. *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 967 (Del. Ch. 1996).

121. Stone *ex rel.* AmSouth Bancorporation v. Ritter, 911 A.2d 362, 370 (Del. 2006).

122. *See* Stephen M. Bainbridge, *The Business Judgment Rule As Abstention Doctrine*, 57 VAND. L. REV. 83, 88 (2004).

commonly led to personal liability for a corporate director.[123] This changed in 1985 in the unusual holding in *Smith v. Van Gorkom,* in which the Delaware Supreme Court held directors liable for breaching the duty of care.[124] This landmark decision was a shift from traditional outcomes and occurred in a time of significant corporate law development. Within the next decade, the Court introduced a number of intermediate standards of review for situations in which neither the BJR nor the *entire fairness test* seemed adequate to deal with the circumstances.[125]

In 1993, the Delaware Supreme Court announced a third branch of fiduciary duties that include "good faith" along with the duties of care and loyalty.[126] In *Cede & Co. v. Technicolor, Inc.*, the court said the enforcement of fiduciary duties would be subject to a unified test in every case, which would include the BJR and a fairness inquiry.[127] Numerous other decisions added to the complexity of the law addressing corporate governance and fiduciary duties. For example, the court decided in 1999 that a charter provision exculpating a director should be interpreted as an affirmative defense rather than as a bar to liability,[128] and in the 2005 decision *In re The Walt Disney Co.*, the court gave new life to the definition of "good faith."[129] Coming full circle, and adding to the complexity and confusion, is the 2006 *Stone ex rel. AmSouth Bancorporation v. Ritter* decision, which the court bifurcated the fiduciary duties once again into the two traditional branches of duty: the duty of care and the duty of loyalty.[130]

Courts are continually forced to evaluate an ever-increasing variety of directors' behavior and corporate governance decisions made in the

123. Julian Velasco, *How Many Fiduciary Duties Are There in Corporate Law?*, 83 S. CAL. L. REV. 1231, 1233 (2010).

124. Smith v. Van Gorkom, 488 A.2d 858, 872, 893 (Del. 1985) (holding directors liable for breach of the duty of care), *overruled on other grounds by* Gantler v. Stephens, 965 A.2d 695, 713 n.54 (Del. 2009).

125. Velasco, *supra* note 120, at 1233 n.3 (citing Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985) (holding that directors' actions to resist a hostile takeover will be upheld only if there are reasonable grounds to believe that the offer poses a threat and the response is reasonable in relation to the threat); Zapata Corp. v. Maldonado, 430 A.2d 779, 788-89 (Del. 1981) (holding that a motion to dismiss shareholder litigation made by a committee of the board of directors will be upheld only if the independence and good faith of the committee are established and the motion comports to the court's independent business judgment)).

126. Cede & Co. v. Technicolor, Inc., 634 A.2d 345 (Del. 1993).

127. Velasco, *supra* note 120, at 1233 (referencing *Cede & Co.*, 634 A.2d 345).

128. *See* Emerald Partners v. Berlin, 726 A.2d 1215, 1223–24 (Del. 1999).

129. *In re* The Walt Disney Co. Derivative Litig., 906 A.2d 27, 62–68 (Del. 2006) (outlining the concept of good faith); *In re* The Walt Disney Co. Derivative Litig., 907 A.2d 693, 755–56 (Del. Ch. 2005) (holding that the plaintiff can establish lack of good faith on the part of a director by proving "intentional dereliction of duty" or "conscious disregard for one's responsibilities"), *aff'd*, *Disney*, 906 A.2d at 36; *see also* Velasco, *supra* note 120, at 1233.

130. Stone *ex rel.* AmSouth Bancorporation v. Ritter, 911 A.2d 362, 369–70 (Del. 2006).

context of increasingly complex transactions and deals. To repeat the metaphor used at the beginning of this Article, corporate officers and directors are at the helm of these large and sophisticated corporate ships, and because of the reach of influence and potential harm these corporate ships are capable of on the high seas of capitalism, it is necessary to effectively ensure accountability. This is accomplished through the establishment of fiduciary duties with strong civil and criminal penalties for breaching those duties. Corporations are key players in the United States and world economies, and they can and do touch the lives of stakeholders far removed from the actual shareholders.[131] Fiduciary duties have been, and still are, a major topic of concern for the courts and legislatures.

It is through linking corporate actions to fiduciary duties that the courts and legislatures have attempted to prevent deliberate malfeasance and other behaviors that might result in major financial disruptions in the economy, such as that seen in 2008, while still allowing those directing corporations to take risks and make mistakes, which can also result in the innovations and growth we are accustomed to seeing in the American economic system.

B. *The Duty of Care and the Duty of Loyalty*

The duty of care is governed by statute in most states and by judicial decision in other states, like Delaware. The duty of care generally requires directors perform their duties in good faith and with the care that an ordinarily prudent person in a like position would exercise under similar circumstances and in a manner the director reasonably believes to be in the best interests of the corporation.[132] This objective standard ensures that directors have an obligation to do a good job as determined by an "ordinarily prudent person," while not requiring perfection or that the directors act as guarantors for all the decision they might make in their directorial capacity.

The duty of loyalty generally requires directors to act on behalf of the corporation and its shareholders, and they must refrain from self-dealing, usurpation of corporate opportunities, and any acts that would permit them to receive an improper personal benefit or injure their constituencies.[133] The duty of loyalty is breached if an executive consciously causes the corporation to violate the law, knowingly exposes the corporation to penalties from criminal and civil regulators,

131. This was aptly demonstrated by the ripple effect felt by the demise of Enron, for example.

132. *See* Graham v. Allis-Chalmers Mfg. Co., 188 A.2d 125, 130 (Del. 1963); *see also* MODEL BUS. CORP. ACT § 8.30(b) (2011) ("The members of the board of directors . . . shall discharge their duties with the care that a person in a like position would reasonably believe appropriate under similar circumstances.").

133. *See, e.g.*, Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939).

and finally, if an executive consciously causes the corporation to act unlawfully.[134]

The BJR is a shield that prevents judicial inquiry into the substance of directorial decisions, which rests on the presumption that in making business decisions directors acted on an informed basis, in good faith, and in the honest belief that the action was taken in the best interests of the corporation.[135] This rule exists in order to restrain judicial over-reaching that would likely result in chilling corporate initiative and provides directors with significant protection from personal liability as they exercise good faith business decisions. As powerful as the protections of the BJR are, however, it is inapplicable in cases where a director had a personal financial interest in a transaction such as self-dealing, lacked independence in making the decision, did not make the effort to become informed with available information, failed to exercise the requisite level of care, the decision involved illegality, or the director stood on both sides of the transaction. Under certain of these circumstances, the director is obligated to show his conduct met the stricter standard of "entire fairness" to the corporation, which includes both fair dealing and fair price.[136] In other situations not involving self-dealing, when the BJR is inapplicable, liability for a director's decision is not automatic. Rather, an inquiry into whether the director met her duty of care must be made; only if it has not will personal liability attach to a director's action.

C. *Fiduciary Duties Owed to Corporations and Shareholders*

As early as 1862, the courts recognized that "[directors] hold a place of trust, and by accepting the trust are obliged to execute it with fidelity, not for their own benefit, but for the common benefit of the stockholders of the corporation."[137] In a financially healthy and solvent corporation, the directors owe fiduciary duties to both the corporation itself and the shareholders of the corporation.[138] In contrast, the courts have generally held that directors of such corporations do not owe fiduciary duties to other constituencies, such as creditors, because

134. Desimone v. Barrows, 924 A.2d 908, 934–35 (Del. Ch. 2007).

135. Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) (holding that to invoke the protection of the "business judgment rule," directors have a duty to inform themselves of all material information reasonably available to them), *overruled on other grounds by* Brehm v. Eisner, 746 A.2d 244 (Del. 2000).

136. Weinberger v. UOP, Inc., 457 A.2d 701, 710–11 (Del. 1983). In establishing the "entire fairness" of the transaction sufficient to pass the test of careful scrutiny by the courts, directors are required to demonstrate their utmost good faith and the most scrupulous inherent fairness of the bargain. The concept of fairness has two basic aspects: fair dealing and fair price. *See id.* (explaining that fair dealing examines timing, structure, initiation, disclosure and approval of the transaction, while fair price focuses on economic and financial considerations).

137. Koehler v. Black River Falls Iron Co., 67 U.S. 715, 720–21 (1862).

138. *See, e.g.*, Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 179 (Del. 1986).

those rights are contractual in nature.[139] When a corporation becomes insolvent, however, directors may then owe a fiduciary duty to creditors.[140] Some states have enacted legislation, often called "other constituencies statutes," which allow directors to consider the interests of non-shareholder constituencies, such as creditors, in making corporate decisions.[141] It should be understood, however, that, while these statutes are permissive in nature, they do not appear to create new fiduciary obligations for directors. The purpose behind these statutes is to allow directors to consider other constituencies as a factor in determining the best interests of the shareholders.

D. *Civil Consequences of Breaching a Fiduciary Duty*

Although the fiduciary duty owed by a public official to those whom he represents is clear and widely accepted, the fiduciary duties owed by a private individual acting as a corporate director are often less unambiguous but tantamount in importance. While there is an abundance of court opinions and academic papers exploring the various boundaries of the issue, the fiduciary obligations of corporate officers remain unsettled in many respects. This is partly the result of the difficulty in adequately assigning legal remedies to a business world that is constantly changing. The law addressing fiduciaries, which has been referred to as the "most mandatory inner core" of the corporate doctrine, remains the key means by which corporate directors' and officers' conduct is regulated.[142] The purpose underlying the binding of a breach of fiduciary duty to both criminal and civil penalties is to not only punish past wrongdoings by opportunistic corporate executives but also provide adequate incentives to deter future wrongdoing,[143] and past judicial remedies are inadequate for current circumstances. "Shareholder litigation, once the principal judicial device for addressing fiduciary corruption, no longer disciplines most directors and officers who have breached their fiduciary duties to the corporation."[144]

139. *See, e.g.*, Katz v. Oak Indus., 508 A.2d 873, 879 (Del. Ch. 1986).

140. *See, e.g.*, Geyer v. Ingersoll Publ'ns Co., 621 A.2d 784, 787–90 (Del. Ch. 1992). One rationale proposed for this is the "Trust Fund Doctrine" which posits that upon insolvency the directors effectively become trustees of the corporate assets which should be held first for the creditors' benefit and then for that of the shareholders. *See, e.g.*, Am. Nat'l Bank of Austin v. MortgageAmerica Corp. (*In re* MortgageAmerica Corp.), 714 F.2d 1266, 1268–69 (5th. Cir. 1983); *see also* FDIC v. Sea Pines Co., 692 F.2d 973, 977 (4th Cir. 1982) (when a corporation becomes insolvent, or in a failing condition, the officers and directors no longer represent the stockholders, but become trustees for the creditors), *cert. denied*, 461 U.S. 928 (1983).

141. *See* OR. REV. STAT. § 60.357(5) (2009) (Oregon has enacted permissive non-shareholder constituency statues); *see also* CONN. GEN. STAT. ANN. § 33-756 (West 2000 & Supp. 2010) (requiring consideration of other constituents).

142. Lisa L. Casey, *Twenty-Eight Words: Enforcing Corporate Fiduciary Duties Through Criminal Prosecution of Honest Services Fraud*, 35 DEL. J. CORP. L. 1, 10 (2010).

143. *Id.*

144. *Id.* at 10.

The law has attempted to adapt to the evolving circumstances in the corporate world: "As the civil law has developed over time, private enforcement has become exceptionally expensive, and the resulting benefits are questionable. Public enforcement of fiduciary duties—specifically, criminal prosecutions charging honest services fraud—may better punish serious infidelity while providing superior deterrence."[145]

In theory, civil suits and the penalties and remedies that arise from them provide a threat of personal liability for a breach of fiduciary duty that ought to deter executives from self-dealing or diverting corporate profits and properties to illegal or ill-conceived endeavors. Again, in theory, the risk of personal liability under a civil penalty ought to move a director to genuinely put the interests of the corporation before his own. In practice, however, "directors and officers seldom face civil liability for breaching their fiduciary duties, regardless of the forum in which shareholders bring suit and despite corporate law rhetoric emphasizing the importance of executives' fiduciary responsibilities."[146] Boards of directors are likely reluctant to pursue any remedies for such breaches in such a public forum, for whatever reason. There is a relative paucity of private litigation when it comes to public company officers, as opposed to directors, who had breached their fiduciary duties.[147] "When shareholders sue corporate fiduciaries for breach, the defendants usually win early dismissal of the litigation, and the defendants very rarely are adjudicated liable, much less pay monies to resolve the lawsuits."[148] According to research, from 1980 through 2005, "only five derivative suits against outside directors of public companies went to trial," and the plaintiffs won only two of those.[149] "Empirical research demonstrates that shareholders rarely obtain judgments holding executives liable for fiduciary duty violations."[150] Hence, civil law and procedures fall short of establishing adequate remedies for misconduct by corporate directors and insufficient incentives to deter future fiduciary breaches.

Significant procedural and substantive obstacles exist before a shareholder is able to bring a derivative suit to enforce an executive's fiduciary duties. The first obstacle is the difficulty in obtaining and maintaining standing to sue and qualifying as a fair and adequate rep-

145. *Id.* at 10–11.

146. *Id.* at 17.

147. Lyman P.Q. Johnson & David Millon, *Recalling Why Corporate Officers Are Fiduciaries*, 46 WM. & MARY L. REV. 1597, 1611 (2005) ("[A]lthough officers and directors occupy distinctive roles in corporate governance, most corporate law authority uncritically obliterates that distinction when it comes to fiduciary duties.").

148. Casey, *supra*, note 139, at 17.

149. *Id.* at 35 (citing Bernard Black et al., *Outsider Director Liability*, 58 STAN. L. REV. 1055, 1064–66 (2006)).

150. *Id.*

resentation of the interests of the other shareholders.[151] The next major obstacle is the demand rule and demand futility, where the shareholder seeking to initiate the derivative suit must serve demand on the board. If the shareholder does not serve demand, she must allege with particularity the efforts, if any, made to obtain the desired action from the board and the reasons why such demand would be futile.[152] If demand is made, directors are properly able to make a decision that is protected by the BJR. The directors are then shielded from personal liability, and they are able to kill the lawsuit if they so choose, preventing the corporation from pursuing liability for the alleged breach prompting the lawsuit. Directors are insulated "from civil liability through resolute enforcement of the business judgment rule, exculpatory charter provisions exonerating directors from monetary damages, and generous indemnification rights. Shareholders do not fare much better when they sue executives in federal court."[153] With these obstacles in place, civil liability rules work far below optimal levels to constrain fiduciary opportunism.[154] If creating liability for breaches of fiduciary duties does not effectively create accountability through civil penalties, with an underlying purpose of punishing past wrongdoings by opportunistic corporate executives to provide adequate incentive to deter future wrongdoing,[155] then one must ask if criminal charges could sufficiently fill the gap.

E. *Criminal Consequences of Breaching a Fiduciary Duty*

In the 1990s, § 1346 was primarily used to prosecute public corruption rather than corporate fraud.[156] In the new millennium this changed, as Congress and the President declared "war" on corporate corruption.[157] Federal prosecutors dramatically increased criminal indictments of public company executives, which inevitably included increases in charges of honest services fraud.[158]

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151. *See* FED. R. CIV. P. 23.1.

152. *Id.*

153. Casey, *supra* note 139, at 37.

154. *Id.*

155. *Id.* at 38.

156. *Id.* at 38 n.205 (explaining that "[r]esearch revealed few reported decisions charging corporate officers with honest services fraud in the late 1990s.") (citing United States v. Skeddle, 940 F. Supp. 1146, 1148 (N.D. Ohio 1996) (charging senior officers of Libbey-Owens-Ford Co. with alleged undisclosed self-dealing); United States v. Brennan, 938 F. Supp. 1111, 1115, 1125 (E.D.N.Y. 1996) (prosecuting former president and CEO of United States Aviation Underwriters, Inc. for mail fraud), *rev'd*, 183 F.3d 139 (2d Cir. 1999)).

157. *See Bush and Big Business: The Unlikeliest Scourge*, ECONOMIST, July 11, 2002, at 22, 26, *available at* http://www.economist.com/node/1224109.

158. Kathleen F. Brickey, *From Enron to WorldCom and Beyond: Life and Crime After Sarbanes-Oxley*, 81 WASH. U. L.Q. 357, 357–59 (2003); *see also* Eliason, *supra* note 39, at 985 n.7 ("Other commentators have noted the increased use of honest services fraud: '[Honest services fraud] was the lead charge lodged by U.S. attorney offices against 79 suspects in fiscal year 2007, up from 63 in 2005 and 28 in 2000.'

The discovery of financial fraud in Enron was only the beginning of widespread corporate financial misconduct that has come to light in recent years. Like dominos, one company after another—including Adelphia, Xerox, Global Crossing, Lucent, Qwest, and Rite Aid—discovered misstatements in their prior financial reports, which covered up misconduct including executive self-dealing, abusive executive loans, and conflict-of-interest transactions. The announcement of WorldCom's bankruptcy, which came just six months after Enron's collapse, resulted in a drain of capital in the stock market. Already decreasing stock prices continued to plummet, and Fortune magazine's cover at the time read, "They lie, they cheat, they steal and they've been getting away with it for too long."[159] In July 2002, with the mid-term elections fast approaching, Democrats and Republicans ramped up the anti-corruption rhetoric, as President George W. Bush established the Corporate Fraud Task Force ("CFTF") by executive order.[160] Two weeks after the president signed the executive order, Congress passed the Sarbanes-Oxley Act of 2002 ("SOX"). Congress also quadrupled the maximum prison term for mail and wire fraud to twenty years,[161] and it doubled the maximum prison term for securities fraud from ten years to twenty years. To address the impression that white-collar criminals have light sentences in country-club like jails, Congress directed the U.S. Sentencing Commission to revise sentencing guidelines and lengthen the sentences for corporate officers and directors convicted of fraud.[162]

During this time, Congress did not create any substantial new civil rules or remedies to deal with the corporate executives and officers who had breached fiduciary duties.[163]

> Public company fiduciaries still faced little risk of civil liability, regardless of their culpability or harm to the corporations they man-

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Lynne Marck, Fitzgeral and 'Honest Services', Nat'l L.J. June 15, 2009, at 1. The statistics maintained by the Department of Justice do not distinguish among federal officials, state and local officials, and private individuals charged with honest services fraud. As another rough indication of the charge's increasing popularity, a Westlaw search for all federal district court and circuit court opinions containing the terms 'honest services' and '18 U.S.C. 13465' from the years 1998–2001 found an average of twelve cases per year. From 2002–2005, the average was eighteen cases per year. From 2006–2009, the average was thirty-five cases per year.").

159. *See generally* Clifton Leaf, *Enough Is Enough White-Collar Criminals: They Lie They Cheat They Steal and They've Been Getting Away With It for Too Long*, FORTUNE, Mar. 18, 2002, *available at* http://money.cnn.com/magazines/fortune/fortune_archive/2002/03/18/319921/.

160. *See* Casey, *supra* note 139, at 39–40 & n.212 (citing Exec. Order No. 13,271, 67 Fed. Reg. 46,091 (July 9, 2002)).

161. *Id.* at 40 & n.221 (citing Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 903, 116 Stat. 745 (codified as 18 U.S.C. § 1341)).

162. *Id.* at 40 & n.222 (citing *Bosses Behind Bars*, ECONOMIST, June 12, 2004, *available at* 2004 WLNR 6533778).

163. *See* Lisa M. Fairfax, *Spare the Rod, Spoil the Director? Revitalizing Directors' Fiduciary Duty Through Legal Liability*, 42 HOUS. L. REV. 393, 395, 405–07 (2005).

> aged. Despite the recognized need to punish corrupt acts and hold responsible executives more accountable, shareholder litigation remained politically disfavored as a deterrent. In contrast, even the head of the U.S. Chamber of Commerce endorsed criminal enforcement.[164]

The article that this quote was taken from revealed that of 1,300 corporate fraud convictions from 2002 to January 2009, more than 200 chief executive officers and presidents, 120 corporate vice presidents, and 50 chief financial officers were convicted of felonies; federal prosecutors charged executives with a host of criminal violations most of which included mail and wire fraud; many of these included charges of honest services fraud;[165] and two of these cases were against Jeffrey Skilling of Enron and Conrad Black of Hollinger International.

If viewed in this perspective, and noting the trend to use criminal charges rather than civil proceedings to curtail shameful corporate behavior, it is no surprise that judicial interpretation of the honest services statute has incrementally broadened from 1988 to the present. In some ways, it makes the Supreme Court's decision in *Skilling* almost surprising. The trend to move away from civil proceedings as a mechanism to constrain corporate and executive behavior, the move toward criminal punishment as a more aggressive and persuasive instrument in punishing past wrongdoings, and the creation of sufficient incentives to deter future wrongdoing has gained momentum with time. This is not only true in the area addressing fiduciary obligations—like mail and wire fraud, securities law has the Foreign Corrupt Practices Act that includes criminal charges with penalties of heavy fines and imprisonment.[166]

VII. Policy Discussion

Liability rules usually have a two-fold purpose. The first is to deter people from committing the acts that attract liability; the second is to impose punishment on those who have committed the prohibited act. Liability rules are supposed to change behavior, and while it is unlikely that *no one* will do the behaviors that attract liability, the numbers who do are likely far fewer as a result. As a society, we like liability to attach only in situations where the rules are clear and unambiguous, and this is especially true when criminal sanctions result.

Directors occupy a privileged and important position in our society. They are responsible for making key decisions that set economic and

164. Casey, *supra* note 139, at 41.

165. *Id.* at 41–43.

166. Foreign Corrupt Practices Act of 1977, Pub. L. No. 95-213, 91 Stat. 1494 (codified as amended at 15 U.S.C. §§ 78a, 78dd-1, 78dd-2, 78ff, 78m, 78o (2006)), amended by Foreign Corrupt Practices Act Amendments of 1988, 15 U.S.C. §§ 78dd-1 to -3, 78ff (2006) and International Anti-Bribery and Fair Competition Act of 1998, 15 U.S.C. §§ 78dd-1 to -3, 78ff (2006).

fiscal policy for corporations, which are by far the biggest actors in the U.S. economy.[167] Because the potential exists for these corporations to have a significant negative impact on the overall economy, there is a social interest in rationally constraining those who run them and in aligning their interests with those of the corporations they serve. Thus, corporate directors owe a fiduciary duty, which recognizes the huge potential for harm to the corporation and its shareholders resulting from a director's action.[168] Many other fiduciary relationships exist, notably principal-to-agent and partner-to-partner, and liability attaches in these relationships if the fiduciary breaches the standards of behavior established for their type of fiduciary relationship. For example, if an agent breaches her fiduciary duty of loyalty,[169] which requires her to act loyally for the principal's benefit in all matters connected with the agency relationship,[170] or her duty of care, where she must act with the care, competence, and diligence normally exercised by agents in similar circumstances,[171] she will be liable to her principal. There is no secondary rule that says "no liability shall attach to this type of fiduciary unless certain preconditions are met"; in short, there is no business judgment rule type of protection afforded an agent. Breach equals liability. This is a source of some frustration and confusion when trying to establish thresholds of liability for directors. The aspirational establishment of a fiduciary duty evokes all the gravity that is associated with the word "fiduciary," while in essence watering down its application by interposing the BJR. Directors still owe fiduciary obligations, but unlike other fiduciaries, failing to meet these obligations does not necessarily trigger automatic liability, mostly as a result of the burden of proof. The rule is a presumption that must be rebutted by the plaintiff, so a plaintiff has the job of clearing this hurdle with proof and proper pleadings before the court will inquire into whether, for example, the duty of care has been met.[172] The BJR is a hurdle, which keeps judges from actually asking whether a fiduciary duty has been breached, unless a plaintiff can prove certain irregularities. This burden of proof cannot always be met as plaintiffs may find the information they need to establish these

167. *See* Donald J. Smythe, *The Rise of the Corporation, the Birth of Public Relations, and the Foundations of Modern Political Economy*, 50 WASHBURN L.J. 635 at 636–38 (2011).

168. *See* Edwin W. Hecker, Jr., *Fiduciary Duties in Business Entities*, 54 U. KAN. L. REV. 975 at 975–76 (2006).

169. RESTATEMENT (THIRD) OF AGENCY § 1.01 (2006) (defining agency as "the fiduciary relationship that arises when one person (a 'principal') manifests assent to another person (an 'agent') that the agent shall act on the principal's behalf and subject to the principal's control, and the agent manifests assent or otherwise consents so to act").

170. *Id.* §§ 8.01–.02.

171. *Id.* § 8.08.

172. Shlensky v. Wrigley, 237 N.E.2d 776, 781 (Ill. App. Ct. 1968).

irregularities difficult to gather, especially since information asymmetries exist.

Comparing directors to regular agents is like comparing apples to oranges. Directors usually have a highly developed skill set, which makes them attractive to their corporations, and the level of complexity inherent in running a large, possibly multinational, corporation is mind-boggling to the average person. A regular principal has control over her agent, and at the very least, has the power to direct the desired outcome; this makes the actions that trigger liability more certain for the agents involved. Directors have much more discretion than do agents; they not only direct the desired outcome for the corporation to pursue, they also have the potential liability when things go wrong. A director's relationship with the corporation is far more complicated than the average fiduciary.

Perhaps the BJR should not be looked to as a shield against liability but rather as a statement by which a director's fiduciary duties might be interpreted. In order for the business judgment rule to shield a director from liability, there can be no fraud, illegality, self-dealing, waste, egregious negligence, or breach of good faith, and a decision must have actually been made. If you examine these "preconditions" for the judicial abstention, you will see that each of them might be associated with a fiduciary duty. Fraud, illegality, self-dealing, and breach of good faith all accord with the duty of loyalty, while waste, egregious negligence, and requiring the directors to actually make a decision accord with the duty of care. These obviously are not the sum total of all the elements that would comprise the fiduciary duties of loyalty and care. In the context of director liability, however, these are the behaviors that can cause the BJR to be inapplicable, which can then result in an in-depth evaluation of whether the director met her fiduciary obligations taking place. Therefore, it might be helpful to view the business judgment rule as a sort of filter by which certain fiduciary duties are elevated to "let's look at now" status, with the rest to be examined if and only if a BJR analysis results in the BJR not applying. This recognizes the special type of fiduciary that is a corporate director and is a judicial tweaking meant to balance competing interests. While we do want accountability for directors, we do not want to have a hair-trigger mechanism to establish liability or a liability rule that uses hindsight to penalize mistakes. Most agents are not responsible for mistakes they make in fulfilling the duties of their agency relationship, and the worst thing that usually happens is they get fired. The stakes are significantly higher for directors as opposed to pizza delivery guys, and the harm that can be caused to the corporation is likely much higher than the harm a single pizza delivery guy can do. A liability rule that scares quality directors away from being directors, however, does no one any good and likely does more harm than the behaviors of a few bad directors. A good pizza delivery guy

is easier to find than a good director, so we must compromise on director liability in ways that we do not need to in other fiduciary relationships to make sure that the best possible candidates accept the director jobs.

VIII. CONCLUSION

The current state of the law on director liability is this: civil standards for liability are hard to trigger and are much more nuanced than just liability based on breach of a fiduciary duty. After *Skilling* and *Black*, criminal liability for breaching fiduciary duties is much less likely now, absent a breach that actually rises to the level of a crime, such as bribery or kickbacks. Honest services law, as it now stands, is duplicative in the sense that the behaviors that trigger application are also criminal in other statutes. But do we really want to impose criminal liability for breaches of fiduciary duty *qua* fiduciary duty? If an activity is not criminal, should we be looking to criminalize it just to satisfy an annoyed public who has been exposed to the malfeasance of a handful of directors, when the vast majority of directors have respected the nature of their duties? It is important to pinpoint with laser accuracy the behavior that causes liability when enacting a criminal statute, and criminalizing the mere breach of a fiduciary duty by a director is far too low of a standard. Skipping work to go to a baseball game is a breach of the fiduciary duty of a salaried employee but should not be criminalized. Tightening civil standards would be more appropriate and better reflect the private nature of the relationship between corporations and their directors, while acknowledging the wider societal interests in constraining director malfeasance. The revised civil standards, whatever they may be, must still allow directors the freedom to make mistakes and resist the urge to make directors the guarantors of all their decisions. Directors are special fiduciaries and must be treated as such to balance accountability with the understanding that no talent, especially at higher echelons, can do an effective job while looking over their shoulders and being overly concerned about liability.