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Supreme Court Tackles Honest Services Fraud: How Might Its Decision Affect Government Contractors?

In its current term, which ends in June, the Supreme Court ("Court") is poised to hand down opinions in three cases involving challenges to convictions under the Honest Services Fraud corollary to the mail and wire fraud statutes. The breadth of conduct which might be found to constitute an act of Honest Services Fraud has caused concern among some Justices on the Court. Depending upon the Court's treatment of these cases, government contractors could gain valuable insight into what conduct might be deemed a violation of the Act.

If you are wondering what Honest Services Fraud is, you are not alone. There has been considerable disagreement among the federal courts of appeals ("Circuits") over what constitutes an act of honest services fraud. Presumably, the Court accepted these cases in order to provide some clarity and resolve what appear to be irreconcilable differences in interpretation among the Circuits.

Background

Passed in 1988, the Honest Services Fraud Statute was enacted as a Congressional response to a 1987 Supreme Court opinion, *McNally v. United States.* In *McNally*, the Court reversed the mail fraud convictions of a Kentucky state official who had taken part in a kickback scheme. The Court held that mail fraud was limited to schemes to deprive persons of money or property, not honest services. The Honest Services Fraud Statute Congress passed in response states simply, "the term 'scheme or artifice to defraud' includes a scheme or artifice to deprive another of the intangible right of honest services,"—whatever that means.

Before the Court accepted *certiorari* to consider the current cases, honest services fraud became a popular tool for prosecutors and inspectors general in their efforts to combat fraud and corruption. It was alleged in the prosecutions of high profile cases involving lobbyist Jack Abramoff, former Congressmen William Jefferson and Duke Cunningham, Enron executives, and former Illinois Governor Rod Blagojevich. The point of the statute, and what has made it so popular among government attorneys and investigators, is that it made the amorphous concept of "deprivation of honest services" a crime, presumably even where the government could prove no actual economic harm.

The Honest Services Fraud Statute has been used to prosecute conduct by public officials alleged to have deprived the public of their honest services by their involvement in corruption. It has also been used to prosecute corporate officers who allegedly deprived their companies or shareholders of their honest service; and in conspiracy cases, persons have been prosecuted for conspiring with an employee of a separate company (often a vendor) to deprive the separate employee's company of honest service.

In cases examining honest services fraud, the Circuits have attempted to fashion tests to avoid the conclusion that the law is overbroad. As each Circuit created its own analysis, often driven by the facts of the case before it, the legal analyses underlying the Circuits' decisions created a confused and, in some ways, irreconcilable case law.

Three Cases Before the Court

The three cases currently before the Court demonstrate the inconsistency in analyses and results among the Circuits.

- In *United States v. Black*, newspaper magnate Conrad Black is challenging his honest services fraud conviction. He and fellow executives devised a scheme to mischaracterize certain payments in order to avoid Canadian taxation of the transactions. Black claims that an honest services conviction is inappropriate because his personal gains were not at the expense of his employer, but rather the Canadian government. The Seventh Circuit decision which *Black* challenges held that where an executive seeks personal gain, the lack of harm to his employer is irrelevant. The Circuit employed the "personal gain" test.
- In *United States v. Skilling*, former Enron executive Jeffrey Skilling also challenges his honest services fraud conviction. Skilling, however, is asking the Court to apply the personal gain test, claiming that he did not engage in self-dealing and did not personally gain from his scheme to manipulate Enron's corporate earnings by fraudulently representing Enron's financial status. The Fifth Circuit, in convicting Skilling, ignored the personal gain test, instead applying the "materiality" test. Under the materiality test, honest services fraud occurs whenever the defendant's

misrepresentation has the natural tendency to influence, or is capable of influencing, the employer to change his behavior.

- In *Weyhrauch v. United States*, a former member of Alaska's House of Representatives challenges his honest services fraud conviction. As part of the same public corruption investigation that involved former Alaska Senator Ted Stevens, Weyhrauch was found to have accepted payments from an Alaskan oil services company in exchange for his votes on legislation affecting the company. Weyhrauch's honest services fraud conviction was based upon his failure to disclose his conflict of interest. He challenges the conviction by saying that Alaska law provides no affirmative duty to disclose conflicts of interest.

As demonstrated by the *Black* and *Skilling* cases, the current honest service fraud case law leads to inconsistent enforcement. It is possible if Messrs. Black and Skilling switched circuits that neither could have been convicted of honest services fraud. Further, *Weyhrauch* raises the question of whether the violation of the federal Honest Services Fraud Statute varies from state to state based upon state ethics laws.

A third test known as the "reasonably foreseeable harm test" is not at issue in the cases currently before the Court, but has been applied to cases arising in the Fourth Circuit, which includes Virginia and Maryland. Under that test, honest services fraud occurs where an employee intended to breach a fiduciary duty, and the employee foresaw or reasonably should have foreseen that his employer might suffer an economic harm.

Mandatory Reporting of Fraud

Since November of 2008, the FAR has required that government contractors report to the appropriate Inspector General whenever they have credible evidence of a violation of Title 18 of the U.S. Code (*i.e.* criminal laws) involving fraud. At least one representative of the Justice Department has asserted that the FAR requirement may include honest services fraud. Given the differing tests among the Circuits and pending before the Court, government attorneys and investigators may reach differing conclusions about what constitutes credible evidence of honest services fraud. The determination of whether or not credible evidence of honest services fraud exists might even vary based upon where conduct occurred, or may be prosecuted.

One possible outcome in *Wehyrauch*, is that public officials' duty to disclose conflicts of interest will be found to vary depending upon state law. If that were the case, could honest services fraud liability vary based upon the terms of a company's ethical guidelines? Absent a clarifying decision from the Supreme Court, it is difficult for anyone to say with certainty what constitutes honest services fraud.

In 2009, when the Court decided not to hear an honest service fraud case, Justice Scalia took the rare step of authoring a written dissent from the denial of certiorari:

> 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 office. Indeed, it would seemingly cover a salaried employee's phoning in sick to go to a ball game.

Sorich v. United States, 129 S. Ct. 1308 (2009), (Scalia, J.)(dissenting)

Practitioner's Tips

The Supreme Court's upcoming decisions will likely provide important guidance to attorneys who advise government contractors. Attorneys should analyze the upcoming decisions and change, as appropriate, reporting guidelines to conform with the applicable law.

Further Information

Venable and the Federal Bar Association are hosting a discussion of Honest Services Fraud entitled, "Honest Services Fraud: What government contractors, government attorneys, and the private bar need to know." The program will be held at Venable's Washington D.C. offices on June 29th, 2010 from 12:00-1:30 pm. Speakers will include government contracts and white collar practitioners, including a representative from the Department of Justice. For more information, please click here.

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