



White Paper

Undisclosed Self-Dealing by Public Officials and the Need for a Legislative Response to Skilling v. United States¹

More than 20 years ago, Congress broadened the scope of the federal mail and wire fraud statutes to reach “a scheme or artifice to deprive another of the intangible right of honest services.” 18 U.S.C. § 1346 (1988).² Section 1346 — likely because of its expansive scope — quickly became a favorite of federal prosecutors in their efforts to prosecute public officials and others whose fraudulent conduct did not fit neatly into the purview of the existing mail and wire fraud statutes. In particular, Section 1346 became an attractive vehicle for prosecuting a kind of fraud known as “undisclosed self-dealing” — *e.g.*, a city legislator votes on a matter affecting his financial interest without disclosing the existence and nature of that interest. For years, under the prevailing view of Section 1346, such undisclosed self-dealing was itself a crime, regardless of whether bribes or kickbacks were paid or whether the city’s financial interests were otherwise harmed by the legislator’s conduct.

The Supreme Court, however, has now rejected that expansive view of honest-services fraud. In *Skilling v. United States*, the Court held that Section 1346 can apply only to schemes involving bribery and kickbacks, and not to any other conduct, including undisclosed self-dealing.³ The Court’s holding thus saved an otherwise vague statute from being deemed unconstitutional, but it also left a gap in the federal criminal law.

This White Paper analyzes the effect of *Skilling* on the prosecution of honest-services fraud and evaluates whether Congress should pass a statute that would criminalize undisclosed self-dealing, as Congress came close to doing in March 2012. Ultimately, we conclude that Congress should address undisclosed self-dealing in the public sector, but that a statute covering undisclosed self-dealing in the private sector is unnecessary.

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² 18 U.S.C. § 1346 provides in full: “For the purposes of this chapter, the term ‘scheme or artifice to defraud’ includes a scheme or artifice to deprive another of the intangible right of honest services.”

³ 130 S. Ct. 2896, 2931 (2010).

I. Executive Summary

The federal mail and wire fraud statutes, 18 U.S.C. §§ 1341 and 1343, make it a crime to use the mails and the wires in an effort to “devise[] or intend[] to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises. . . .” Prior to 1987, prosecutors used Sections 1341 and 1343 expansively to reach conduct that deprived another of, *inter alia*, the intangible right to honest services. In *McNally v. United States*, however, the Supreme Court reigned in these efforts, holding that Sections 1341 and 1343 apply only to acts that deprived another of money or property — and not merely honest services.⁴

Congress responded the next year by passing 18 U.S.C. § 1346, which overruled *McNally* by specifically providing that “the term ‘scheme or artifice to defraud’ [as used in Sections 1341 and 1343] includes a scheme or artifice to deprive another of the intangible right of honest services.” The text of the statute is not self-defining, and the legislative history sheds little light on its meaning. Not surprisingly, prosecutors took a broad view of the statute’s reach, while many defense lawyers, commentators, and judges were critical of the statute’s breadth and vagueness.

The Supreme Court entered the debate in *Skilling*, where the Court limited the application of Section 1346 to “honest services fraud” involving bribery and kickbacks and held that the statute was unconstitutionally vague as applied to any other conduct.⁵ That holding saved Section 1346 from being struck down, but it also left a gap in the federal criminal law; as the law currently stands, undisclosed self-dealing in the public sector (absent the presence of a bribe, kickback, or some other money or property harm) is likely outside the reach of federal criminal law.

Public-sector undisclosed self-dealing typically refers to a public official who undertakes official action in furtherance of his own undisclosed interests while purporting to act in the interests of those to whom he owes a fiduciary duty. For example, the following conduct constitutes public-sector undisclosed self-dealing (which, after *Skilling*, lies outside the scope of the federal criminal law):

- A city official votes to approve a consulting contract without disclosing that he stood to benefit financially as a result.⁶
- An elected insurance commissioner steers insurance companies to hire a law firm in which he held an undisclosed financial interest.⁷

⁴ 483 U.S. 350, 359–60 (1987).

⁵ 130 S. Ct. at 2931.

⁶ See, e.g., *United States v. Hasner*, 340 F.3d 1261, 1271 (11th Cir. 2003).

- A city official uses his official position to direct city business to the mother of his children in lieu of paying her child support.⁸

These cases illustrate that the problem of undisclosed self-dealing in the public sector is a real one. In each of these cases, the harm is not necessarily economic, but instead lies in the deception itself. Indeed, public-sector undisclosed self-dealing imposes a grave harm. Public officials who misuse their official positions for private benefit violate the public trust and erode fundamental principles of representative government. Transparency is undermined, and the public is deprived of its right to the disinterested decisionmaking of its officials or, at the least, to be made aware of their actual motivations. And as we explain more fully below, the detrimental effects of public-sector undisclosed self-dealing are magnified by the inherent limitations on the citizenry's ability to vindicate its interest in public government free of corruption.

But despite these harms, existing federal criminal law will not necessarily reach public-sector undisclosed self-dealing. Such misconduct may not cause a money or property harm (as contemplated by the mail and wire fraud statutes) or involve a bribe or kickback — and therefore will not always be covered by Sections 1341/1343 and 1346, respectively. Nor does any other federal criminal statute reliably reach this type of corrupt conduct.

It is true that in some instances state and local prosecutors will prosecute such misconduct actively and aggressively under state and local law. But that will sometimes — or perhaps even often — not be the case. States and localities may lack the resources or the will to prosecute local acts of public-sector undisclosed self-dealing. Moreover, the federal system offers certain prosecutorial advantages over state systems, often including greater investigative resources and a more stringent criminal justice system. And federal prosecutors are comparatively less likely than state or local prosecutors to be connected to or impacted by state and local public corruption. Federal criminal law, therefore, would serve as an important backstop in this area of the law.

For these reasons, Congress should pass a new statute specifically to proscribe undisclosed self-dealing in the public sector. But the new statute should be carefully tailored. As explained in more detail below, a new statute should require proof that the defendant used the mails or the wires in furtherance of a scheme to defraud and that (1) the defendant acted with the specific intent to defraud; (2) the defendant knowingly failed to disclose his private interest in advance of taking the relevant action; (3) the defendant's nondisclosure violated an independent local, state, or federal law requiring disclosure; (4) the defendant's nondisclosure was material, *i.e.*, it would cause a

⁷ *United States v. O'Malley*, 707 F.2d 1240, 1246–48 (11th Cir. 1983).

⁸ *United States v. Antico*, 275 F.3d 245, 263 (3d Cir. 2001), abrogated by *Skilling* as recognized in *United States v. Riley*, 621 F.3d 312, 323 (3d Cir. 2010).

reasonable person to conclude that the defendant was acting in some interest other than the public's best interest; and (5) the defendant misused his public office to generate a private gain that inures to his benefit or to the benefit of another. A statute with these elements would be broad enough to capture truly criminal conduct while not converting every breach of fiduciary duty into a federal crime.

To be sure, undisclosed self-dealing also occurs in the private sector. Such acts can — but do not necessarily — impose a money or property harm. For example, consider a CEO who causes his corporation to buy a product from a side business in which he holds an undisclosed financial interest. If the price paid by the corporation *exceeds* what the corporation otherwise would have paid for the same or greater quality, timeliness, and performance, then the CEO's undisclosed self-dealing caused a money or property harm on the corporation and its shareholders and a federal criminal action would likely be an option under Sections 1341 and/or 1343. But if the corporation paid *the same or less* than it otherwise would have paid — and assuming no diminution in such intangibles as quality, timeliness, or performance — then it seems clear that no money or property harm resulted or was intended.

Either way, *Skilling* does not meaningfully impede the federal government's ability to prosecute private-sector undisclosed self-dealing, and Congress should not pass a new statute aimed at such conduct. Existing law (principally Sections 1341 and 1343) will almost always apply to schemes that impose a money or property harm. And schemes that *do not* intentionally impose a money or property harm are not sufficiently immoral or harmful to justify the imposition of federal criminal process and all that it entails. The more appropriate remedy for such conduct continues to be found in state law, and in particular civil laws governing the breach of fiduciary duties and similar violations.

II. Overview of Honest Services Fraud

A. Pre-Skilling

The modern mail and wire fraud statutes, 18 U.S.C. §§ 1341 and 1343, have their genesis in an 1872 statute that “proscribed, without further elaboration, use of the mails to advance any scheme or artifice to defraud.”⁹ Congress amended the statute in 1909 to add the phrase, “or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises.”¹⁰ The statutes therefore now read in relevant part: “Whoever, having devised or intending to devise any scheme or artifice

⁹ *Skilling*, 130 S. Ct. at 2926 (internal quotation marks omitted).

¹⁰ *Id.*

to defraud, *or* for obtaining money or property by means of false or fraudulent pretenses, representations, or promises”¹¹

Seizing on the disjunctive “or” in the statutes (emphasized above), courts beginning in 1941 allowed the use of Sections 1341 and 1343 to prosecute public and private actors accused of what became known as “honest services fraud.” In contrast to traditional money or property fraud “in which the victim’s loss . . . supplied the defendant’s gain,” in honest services fraud “the offender profited, [but] the betrayed party suffered no deprivation of money or property; instead, a third party, who had not been deceived, provided the enrichment.”¹² “[B]y 1982, all Courts of Appeals had embraced the honest-services theory of fraud”¹³

In 1987, however, the Supreme Court’s decision in *McNally v. United States* put a (temporary) end to the honest services doctrine when the Court held that Sections 1341 and 1343 apply only to cases in which the fraud involved a money or property harm.¹⁴ Although *McNally* was a case of statutory interpretation, the Court was clearly concerned about the vague outer limits of a statute that would criminalize “schemes to . . . deprive individuals, the people, or the government of intangible rights, such as the right to have public officials perform their duties honestly”: “Rather than construe the statute in a manner that leaves its outer boundaries ambiguous and involves the Federal Government in setting standards of disclosure and good government for local and state officials, we read § 1341 as limited in scope to the protection of property rights. If Congress desires to go further, it must speak more clearly than it has.”¹⁵

Congress did just that when, in 1988, it passed 18 U.S.C. § 1346. The statute provides: “For purposes of [the mail and wire fraud statutes], the term ‘scheme or artifice to defraud’ includes a scheme or artifice to deprive another of the intangible right of honest services.” Although the legislative history of the statute is “scant,”¹⁶ it is clear that the statute was meant to overturn *McNally* and thereby reinstate the honest services doctrine.¹⁷

In the years following the passage of Section 1346, prosecutors used the statute expansively to reach a wide array of dishonest conduct in the public and private

¹¹ 18 U.S.C. §§ 1341, 1343 (emphasis added).

¹² *Skilling*, 130 S. Ct. at 2926.

¹³ *Id.* at 2927.

¹⁴ 483 U.S. at 359.

¹⁵ *Id.* at 358, 359.

¹⁶ *United States v. Urciuoli*, 513 F.3d 290, 293 (1st Cir. 2008).

¹⁷ *See, e.g., United States v. Brown*, 459 F.3d 509, 519 (5th Cir. 2006).

sectors.¹⁸ But this broad use led to vexing questions about the nature and meaning of the statutory phrase “intangible right of honest services.” Courts were generally reluctant to make every lie, half-truth, or dishonest act into a federal crime, but the text of the statute offered no obvious limit, and the legislative history suggested none.¹⁹ As the First Circuit framed the issue at the time:

The central problem [with Section 1346] is that the concept of “honest services” is vague and undefined by the statute. So, as one moves beyond core misconduct covered by the statute (*e.g.*, taking a bribe for a legislative vote), difficult questions arise in giving coherent content to the phrase through judicial glosses. Closely related concerns are assuring fair notice to those governed by the statute and cabining the statute — a serious crime with severe penalties — lest it embrace every kind of legal or ethical abuse remotely connected to the holding of a governmental position.²⁰

In one of the starkest examples of this problem, the Second Circuit reversed an honest services conviction that was premised on a simple breach of contract. “Even someone fully familiar with §§ 1341 and 1346, and our cases, would lack any comprehensible notice that federal law has criminalized breaches of contract. Accordingly, application of those criminal statutes to [the defendant] violates the due process guarantee of fair notice.”²¹

The inherent vagueness in Section 1346 “induced court after court” before *Skilling* “to undertake a rescue operation by fashioning something that (if enacted)

¹⁸ See, *e.g.*, *Skilling*, 130 S. Ct. at 2908 (CEO misrepresented financial health of the company); *United States v. Handakas*, 286 F.3d 92, 96 (2d Cir. 2002) (private-sector defendant breached contract with city); *Antico*, 275 F.3d at 253–54 (public official funneled city business to mother of his child in lieu of paying child support); *United States v. Czubinski*, 106 F.3d 1069, 1071–72 (1st Cir. 1997) (reversing honest services conviction of IRS customer service worker who accessed private files without any business purpose).

¹⁹ See, *e.g.*, *Sorich v. United States*, 129 S. Ct. 1308, 1310 (2009) (Scalia, J., dissenting from the denial of certiorari) (“It is practically gospel in the lower courts that [Section 1346] does not encompass every instance of official misconduct . . . [or] every . . . conflict of interest But why that is so, and what principle it is that separates the criminal . . . conflicts . . . from the obnoxious but lawful ones, remains entirely unspecified.”) (internal quotation marks and citations omitted).

²⁰ *Urciuoli*, 513 F.3d at 294 (internal citations omitted).

²¹ *Handakas*, 286 F.3d at 107.

would withstand a vagueness challenge. . . . [T]he result of all these efforts . . . [was] to create different prohibitions and offenses in different circuits”²²

B. Skilling v. United States

In 2004, Jeffrey Skilling and two other senior executives at Enron were charged under Section 1346 (and other statutes) for “engag[ing] in a wide-ranging scheme to deceive the investing public, including Enron’s shareholders, . . . about the true performance of Enron’s businesses by: (a) manipulating Enron’s publicly reported financial results; and (b) making public statements and representations about Enron’s financial performance and results that were false and misleading.”²³ The government charged Skilling with, *inter alia*, conspiracy to commit honest services fraud, money-or-property wire fraud, and securities fraud.²⁴

The jury returned a general verdict convicting Skilling of conspiracy (among other crimes), and the Fifth Circuit affirmed.²⁵

The Supreme Court vacated the conspiracy conviction after holding that one of the possible purposes of the conspiracy — to commit honest services fraud — was unconstitutional as applied to Skilling.²⁶ The Court began its analysis with the premise that “Congress intended § 1346 to refer to and incorporate the honest-services doctrine recognized in Court of Appeals’ decisions before *McNally* derailed the intangible-rights theory of fraud.”²⁷ And “[w]hile the honest services cases preceding *McNally* dominantly and consistently applied the fraud statute to bribery and kickback schemes — schemes that were the basis of most honest-services prosecutions — there was considerable disarray over the statute’s application to conduct outside that core category.”²⁸

Seeking to “salvage[]” rather than invalidate the statute, the Court narrowed the reach of Section 1346 to “the core pre-*McNally* applications” — “honest-services cases involv[ing] offenders who, in violation of a fiduciary duty, participated in bribery or

²² *United States v. Rybicki*, 354 F.3d 124, 163–64 (2d Cir. 2003) (en banc) (Jacobs, J., dissenting); see also *Skilling*, 130 S. Ct. at 2928 (“Alert to § 1346’s potential breadth, the Courts of Appeals have divided on how best to interpret the statute.”).

²³ *Skilling*, 130 S. Ct. at 2908 (internal quotation marks omitted).

²⁴ *Id.* at 2934.

²⁵ *United States v. Skilling*, 554 F.3d 529, 542, 547 (5th Cir. 2009) (direct appeal).

²⁶ *Skilling*, 130 S. Ct. at 2934.

²⁷ *Id.* at 2928.

²⁸ *Id.* at 2929.

kickback schemes.”²⁹ In so holding, the Court rejected Skilling’s argument that Section 1346 should be invalidated *in toto*: although some pre-*McNally* decisions upheld honest services convictions premised on undisclosed self-dealing, those courts “reached no consensus on which schemes qualified. In light of the relative infrequency of conflict-of-interest prosecutions in comparison to bribery and kickback charges, and the intercircuit inconsistencies they produced, we conclude that a reasonable limiting construction of § 1346 must exclude this amorphous category of cases.”³⁰

The Court also rejected the government’s argument that Section 1346 is constitutional as applied to undisclosed self-dealing because such cases were “abundant” before *McNally*: *McNally* “involved a classic kickback scheme” and therefore gave no support to the government’s position.³¹

Having stated the rule, the Court then applied it to Skilling. Because he was not charged with a scheme involving bribes or kickbacks, the Court held that “Skilling did not commit honest services fraud.”³² But honest services was only one of three objects of the conspiracy that the government had argued to the jury. The Court therefore remanded the case to the Fifth Circuit for consideration of whether the honest services error was harmless, *i.e.*, whether the government could prove beyond a reasonable doubt that Skilling would have been convicted even without the honest services error.³³ On remand, the Fifth Circuit affirmed, holding that the honest services error was harmless in light of the “overwhelming evidence that Skilling conspired to commit securities fraud[.]”³⁴

III. The Impact of *Skilling*: Evaluating the Need for a Legislative Response

In *Skilling*, the Supreme Court reiterated its command from *McNally* that if Congress “desires to go further” — *i.e.*, to criminalize undisclosed self-dealing that

²⁹ *Id.* at 2930–31; *see also id.* at 2931 (“[T]here is no doubt that Congress intended § 1346 to reach *at least* bribes and kickbacks. Reading the statute to proscribe a wider range of offensive conduct, we acknowledge, would raise the due process concerns underlying the vagueness doctrine. To preserve the statute without transgressing constitutional limitations, we now hold that § 1346 criminalizes *only* the bribe-and-kickback core of the pre-*McNally* case law.”).

³⁰ *Id.* at 2929–30, 2932.

³¹ *Id.* at 2932.

³² *Id.* at 2934.

³³ *Id.*

³⁴ *United States v. Skilling*, 638 F.3d 480, 483–84 (5th Cir. 2011).

does not involve bribes or kickbacks — “it must speak more clearly than it has.”³⁵ Congress has since taken substantial steps in that direction.

On September 28, 2010, the Senate Judiciary Committee held a hearing on *Skilling* (hereinafter, “Senate Honest Services Hearing”); the House held a similar hearing on July 26, 2011.³⁶ Moreover, Republican and Democratic legislators have sponsored bills in both houses of the 112th Congress that would cover undisclosed self-dealing by public officials.³⁷

Most recently, on January 26, 2012, Senator Joseph Lieberman introduced the Stop Trading on Congressional Knowledge (“STOCK”) Act, which imposes restrictions on the ability of members of Congress, their staffs, and certain executive branch officials to engage in insider trading. Senators Patrick Leahy and John Cornyn sponsored an amendment to the STOCK Act that would have criminalized undisclosed self-dealing by federal, state, and local officials.

On February 2, the Senate passed the STOCK Act by a vote of 96-3 and passed the Leahy/Cornyn amendment by a voice vote. On February 9, the House passed the core provisions of the STOCK Act by a vote of 417-2. Unfortunately, however, House leadership stripped the bill of the Leahy/Cornyn amendment before voting, and the Senate ultimately decided to pass the House version. As a result, an honest services fix to *Skilling* will likely have to wait at least until the next session of Congress.

Transparency International-USA (“TI-USA”) believes that Congress should pass legislation similar to the Leahy/Cornyn amendment.³⁸ Such legislation would ensure that undisclosed self-dealing by public officials is again subject to federal criminal prosecution, thereby preserving and protecting a fundamental interest of all citizens:

³⁵ 130 S. Ct. at 2933 (quoting *McNally*, 483 U.S. at 360).

³⁶ Committee on the Judiciary, Subcommittee on Crime, Terrorism and Homeland Security, Hearing on H.R. 2572, the “Clean Up Government Act of 2011” (July 26, 2011) (hereinafter, “House Hearing”).

³⁷ See, e.g., Clean Up Government Act of 2011, H.R. 2572 (Rep. Sensenbrenner (R-WI), Rep. Quigley (D-IL), and Rep. Cohen (D-TN)) (unanimously voted out of committee on December 1, 2011); Public Corruption Prosecution Improvements Act, S. 401 (Sen. Leahy (D-VT), Sen. Blumenthal (D-CT), Sen. Cornyn (R-TX), Sen. Feinstein (D-CA), Sen. Kirk (R-IL), Sen. Klobuchar (D-MN), and Sen. Whitehouse (D-RI)) (voted out of committee, in a bipartisan vote, on July 28, 2011). H.R. 2572 — the subject of the July 26 House Hearing — has been endorsed by the DOJ. See House Hearing, Statement of Mary Patrice Brown, Deputy Assistant Attorney General, at 8.

³⁸ On February 24, 2012, TI-USA published a statement urging Congress to pass the Leahy/Cornyn amendment. See TI-USA Calls for Congress to Pass the Leahy/Cornyn Amendment to Criminalize Undisclosed Self-Dealing by Public Officials, available at <http://www.transparency-usa.org>.

ensuring that public officials avoid the sort of hidden dealings that threaten the integrity of representative government.

In the sections that follow, we (i) distinguish the nature of the problem as it impacts the public and private sectors and (ii) set forth the contours of a proposed statute that would offer a narrowly tailored but effective solution to the current gap that exists in the federal criminal law.

A. Undisclosed Self-Dealing in the Public Sector

Undisclosed self-dealing in the public sector refers to a public official who “secretly makes [a] decision based on his own personal interests” rather than “in the public’s best interest.”³⁹ For example, a public official who funnels official business to her own facility without first disclosing her ownership of that facility engages in undisclosed self-dealing,⁴⁰ as does a city legislator who votes on matters affecting his financial interest without first disclosing the existence and nature of that interest.⁴¹

As the federal courts have repeatedly recognized, public-sector undisclosed self-dealing gravely undermines our most fundamental principles of representative government. “In a democracy, citizens elect public officials to act for the common good.”⁴² But “when an official acting with the intent to defraud . . . fails to disclose a personal interest in a matter over which he or she has decision-making power, the public is deprived of its right to honest services because it is deprived of its right either to disinterested decision making itself or full disclosure as to the official’s motivation behind an official act.”⁴³

In contrast to undisclosed self-dealing in the private sector, *see* Section III.B below, undisclosed self-dealing in the public sector imposes a serious harm *regardless* of whether the defendant intended to cause a money or property harm.⁴⁴ Because “[p]ublic officials may be held to a higher standard of public trust . . . conflicts of interest may harm the public *merely by giving the illusion of unfairness.*”⁴⁵

³⁹ *United States v. deVegter*, 198 F.3d 1324, 1328 (11th Cir. 1999) (internal quotation marks omitted).

⁴⁰ *United States v. Davidson*, 399 F. App’x 525, 526–27 (11th Cir. 2010) (per curiam).

⁴¹ *See, e.g., United States v. Hasner*, 340 F.3d 1261, 1271 (11th Cir. 2003).

⁴² *United States v. Jain*, 93 F.3d 436, 442 (8th Cir. 1996).

⁴³ *United States v. Kincaid-Chauncey*, 556 F.3d 923, 944–45 (9th Cir. 2009) (internal quotation marks omitted) (quoting district court’s jury instruction and holding that the instruction was lawful).

⁴⁴ *See, e.g., Antico*, 275 F.3d at 264.

⁴⁵ *United States v. Lemire*, 720 F.2d 1327, 1337 n.13 (D.C. Cir. 1983) (emphasis added).

The federal criminal law has a critical role to play in deterring undisclosed self-dealing by public officials. In the *private* sector, undisclosed self-dealing is policed through a number of mechanisms: internal compliance programs and controls; shareholder lawsuits for breach of fiduciary duty and other civil causes of action; whistleblower incentives; and public disclosure obligations under the federal securities laws. In addition, shareholders in a public company can always quickly “opt out” by selling their shares in the company if they lose faith in management. Although not a perfect solution, these controls and remedies in the private sector help to moderate the power imbalance that exists between shareholders and company management. And, of course, the existing federal criminal law reaches most corporate self-dealing because such improper actions tend to have a monetary or property impact.⁴⁶

By contrast, the citizenry has less reliable means for ensuring that undisclosed self-dealing by *public* officials, without a clear monetary or property impact, will be adequately deterred, detected, and remediated. Even when a public watchdog successfully detects undisclosed self-dealing by public officials, the citizenry may have to wait years to vindicate its interests at the polls. And even if certain mechanisms such as a recall election or impeachment may be possible, those remedies are inherently political, cumbersome, and slow. As a result, there is a real risk that public officials will be under-deterred from engaging in acts of undisclosed self-dealing.

The gap first left by *McNally* and now left by *Skilling* is not imagined. As several cases illustrate, public-sector undisclosed self-dealing will not always impose a money or property harm or involve a bribe or kickback — and therefore will not always be covered by Sections 1341/1343 and 1346, respectively. For example, in *United States v. Davidson*, the defendant — an employee of the Department of Veterans Affairs responsible for placing needy veterans in privately owned assisted living facilities — used a home she had rented as a place for these veterans to live, and she in turn profited from the rental income (which was paid solely with federal funds).⁴⁷ She was convicted on four counts of honest services fraud, but the Eleventh Circuit reversed in light of *Skilling* because the defendant “was charged with and convicted of undisclosed self-dealing instead of bribery and kickbacks”⁴⁸

⁴⁶ For example, consider that after the Supreme Court’s decision in *Skilling*, two recent high-profile honest services fraud defendants — Jeffrey Skilling and Conrad Black — had, respectively, all and most of their convictions upheld on grounds other than Section 1346. See *United States v. Skilling*, 638 F.3d 480 (5th Cir. 2011); *United States v. Black*, 625 F.3d 386 (7th Cir. 2010).

⁴⁷ *United States v. Davidson*, Br. for the United States, 2010 WL 5650256, at *3-5 (11th Cir. Mar. 19, 2010).

⁴⁸ *Davidson*, 399 F. App’x at 526; see also, e.g., *United States v. Siegelman*, 640 F.3d 1159, 1176–77 (11th Cir. 2011) (on remand from *Skilling*, court reversed some of co-defendant Richard Scrushy’s convictions because “the self-dealing theory articulated in the indictment” was barred by *Skilling*, (continued...))

These cases also are unlikely to be addressed by other federal criminal statutes. As Lanny A. Breuer, Assistant Attorney General for the Criminal Division at the U.S. Department of Justice, testified at the Senate Honest Services Hearing, public-sector undisclosed self-dealing:

is corrupt, and undermines public confidence in the integrity of [our] government, [but] it is not bribery. Accordingly, after *Skilling*, it is no longer covered by the honest services fraud statute or any other federal statute.⁴⁹

This gap in federal criminal law is important. Although state and local officials may in certain instances have the ability to prosecute such misconduct, there are two fundamental reasons for ensuring that the federal criminal law serves as a backstop to such efforts.

First, state and local prosecutors may lack the resources to prosecute public-sector undisclosed self-dealing effectively. Dating back to the legislative debates in response to *McNally*, the resources and expertise of the states to prosecute these cases have been at issue:

State prosecutive jurisdiction is sometimes unequal to the task. Many State Attorneys General have very limited investigative and prosecutive authority. District Attorneys, who do possess the requisite legal authority, are geographically confined; they have the power to handle only offenses within their districts, whereas the most serious public corruption schemes may span multiple districts or encompass an entire State. . . . States and localities do not possess the effective instrumentalities and resources available to the Federal Government to investigate complex, concealed white collar offenses such as public corruption. . . . [M]ost States and local authorities have no investigative establishment,

and the evidence that he committed bribery was legally insufficient). Other illustrative cases include *Hasner*, 340 F.3d at 1271; *Antico*, 275 F.3d at 263; *United States v. Silvano*, 812 F.2d 754, 759–60 (1st Cir. 1987); and *O'Malley*, 707 F.2d at 1246–48.

⁴⁹ Breuer Testimony at 6; *see also id.* at 5 (“I can assure you that the impact of *Skilling* is real, and that there is conduct that would have been prosecuted under the honest services fraud statute before *Skilling* that can no longer be prosecuted under the federal criminal law.”). Mary Patrice Brown, a Deputy Assistant Attorney General in the Criminal Division, made this same point in her July 26, 2011 testimony at the House Hearing. *See* House Hearing, Brown Testimony at 7.

Other leading experts agree. *See, e.g.,* Senate Honest Services Hearing, Michael L. Seigel Testimony at 2 (“Unless Congress acts, . . . cases involving a public employee or official who receives a non-monetary benefit as a result of an undisclosed conflict of interest . . . will likewise go unaddressed.”).

comparable to the Federal Bureau of Investigation, Internal Revenue Service and other agencies at the federal level, with vast experience and expertise in investigating public corruption cases.⁵⁰

In addition to the resource advantage that the federal government maintains over the states, the federal system also contains several legal and systemic advantages, including more extensive use of grand juries, a more far-reaching law of conspiracy, and lengthier sentences.⁵¹

Second, state and local law enforcement officials may also lack the will to undertake such prosecutions.⁵² These officials are often elected or otherwise closely connected to local political forces; “federal prosecutors,” in contrast, “are less likely to be linked to state and local politicians and are generally more independent of local political forces that might try to protect high officials from aggressive state enforcement.”⁵³ As a result, “[f]ederal officials might be less corruptible than state and local officials.”⁵⁴ In other words, “[f]ederal criminal prosecutions of corrupt local government officials exploit the relative incorruptibility of federal officials . . . in order to reduce corruption at the local level.”⁵⁵ Similarly, state and local officials “themselves may be under investigation or be so corrupted as to undermine their effectiveness.”⁵⁶ These premises are broadly accepted, as “even analysts with widely differing views on the scope of federal law agree that prosecutions of state and local officials for corruption belong within federal jurisdiction.”⁵⁷

⁵⁰ 134 Cong. Rec. S8054, S8055 (daily ed. June 17, 1988) (statement of Sen. McConnell).

⁵¹ See Richard Posner, *Economic Analysis of the Law* 701 (7th ed. 2007) (“[F]ederal criminal law is more favorable to the prosecution than state criminal law. The ‘feds’ make more use of pretrial detention; there is broader authority to wiretap; federal judges run criminal trials with a stricter hand; grand juries [provide] potent investigatory tools [and] are used more in the federal system; conspiracy doctrine is more expansive in federal criminal law; and sentences are longer and parole has been abolished.”); see also Steven D. Clymer, *Unequal Justice: The Federalization of Criminal Law*, 70 S. Cal. L. Rev. 643, 668–74 (2007).

⁵² See, e.g., Geraldine S. Moohr, *The Federal Interest in Criminal Law*, 47 Syracuse L. Rev. 1127, 1173–74 (1997).

⁵³ *United States v. Lipscomb*, 299 F.3d 303, 334 (5th Cir. 2002) (op. of Wiener, J.).

⁵⁴ *Id.*

⁵⁵ Posner, *supra* n.50, at 701.

⁵⁶ 134 Cong. Rec. S8054, S8055.

⁵⁷ George D. Brown, *Should Federalism Shield Corruption? — Mail Fraud, State Law & Post-Lopez Analysis*, 82 Cornell L. Rev. 225, 234 (1997); see also, e.g., *Silvano*, 812 F.2d at 758–59 (rejecting argument that the federal criminal law cannot extend to state and local political matters).

In any event, to the extent state or local law enforcement *is* capable and willing to prosecute, nothing in Sections 1341, 1343, 1346, or our recommended new statute would prevent such an effort.⁵⁸ There may well be instances in which federal prosecutors will defer to vigorous prosecution by state and local officials. But where such prosecutions do not transpire (for whatever reason), the federal criminal law can serve as an important backstop.

It is therefore left to Congress to respond to *Skilling* by passing a new statute criminalizing undisclosed self-dealing in the public sector. When Congress recently had the chance, however, it failed to act. Opponents of the measure (including legislators and commentators) contended, *inter alia*, that the amendment was vague, symbolized the overcriminalization of federal law, and was in any event unnecessary.⁵⁹ But these objections are misplaced. The amendment was sufficiently specific to survive vagueness concerns; overcriminalization (to the extent it is a problem at all) is hardly unique to this context;⁶⁰ and, in any event, the Leahy/Cornyn amendment *is not* symptomatic of overcriminalization because the statute would have covered conduct that (i) is not now covered by the federal law and (ii) will not always be reliably policed at the state and local levels.

In *Skilling*, the Court warned that if Congress “were to take up the enterprise of criminalizing ‘undisclosed self-dealing by a public official or private employee,’ . . . it would have to employ standards of sufficient definiteness and specificity to overcome due process concerns.”⁶¹ The Court identified several specific questions: “How direct or significant does the conflicting financial interest have to be? To what extent does the official action have to further that interest in order to amount to fraud? To whom should the disclosure be made and what information should it convey?”⁶²

⁵⁸ *Accord*, e.g., 134 Cong. Rec. S8054, S8055 (statement of Sen. McConnell) (advocating for a legislative response to *McNally* that would provide “concurrent federal cognizance over [state and local] corruption schemes”).

⁵⁹ Opponents also criticized other aspects of the amendment that are unrelated to public-sector undisclosed self-dealing.

⁶⁰ There is, of course, nothing unusual about a federal criminal law applying to conduct that is also proscribed by state law. *See, e.g.*, Lisa L. Miller & James Eisenstein, *The Federal/State Criminal Prosecution Nexus: A Case Study in Cooperation & Discretion*, 30 Law & Soc. Inquiry 239, 244 (2005) (“In 1997, only about 5% of all federal criminal cases involved federal statutes with no local or state counterpart.”); Peter J. Henning, *Misguided Federalism*, 68 Mo. L. Rev. 389, 394 (2003) (“The Founders certainly envisioned that federal crimes could encompass conduct also subject to state prosecution.”).

⁶¹ 130 S. Ct. at 2933 n.44.

⁶² *Id.*

To avoid the same vagueness problems that plagued Section 1346 from its inception, and mindful of the Court’s warning in *Skilling*, Congress should ensure that any new statute explicitly identify the proscribed conduct and clearly set forth the required state of mind.⁶³ Toward this end, a new statute should require proof that the defendant used the mails or the wires in furtherance of a scheme to defraud and that (1) the defendant acted with the specific intent to defraud; (2) the defendant knowingly failed to disclose his private interest in advance of taking the relevant act; (3) the defendant’s nondisclosure violated an independent local, state, or federal law requiring disclosure; (4) the defendant’s nondisclosure was material; and (5) the defendant misused his office with the intent to generate a private gain.⁶⁴

1. *Specific Intent to Defraud*

Like Sections 1341, 1343, and 1346, a new statute should require proof that the defendant acted with the specific intent to defraud.⁶⁵ As AAG Breuer and the courts have explicitly recognized, requiring proof of specific intent helps ensure that comparatively innocuous, non-blameworthy conduct will not result in federal criminal exposure.⁶⁶

A specific intent requirement is also useful to help fortify the statute against a vagueness challenge. “[T]he requirement of a specific intent to do a prohibited act may avoid those consequences to the accused which may otherwise render a vague or

⁶³ It is not enough to assume that prosecutors will exercise their discretion to apply an overly vague or broad statute only to conduct that is obviously proscribed. *See, e.g., United States v. Stevens*, 130 S. Ct. 1577, 1591 (2010) (“We would not uphold an unconstitutional statute merely because the Government promised to use it responsibly.”).

⁶⁴ Collectively, these elements are responsive to the questions that the Supreme Court posed in *Skilling*. *See supra* n.61 and accompanying text. TI-USA’s proposed statute is similar, but not identical, to the Leahy/Cornyn amendment. For example, our statute would apply if the public official acted to benefit *anyone*; the Leahy/Cornyn amendment set forth a defined list of persons for whose benefit the public official must have acted. And our proposed bill would address how disclosure should be made; the Leahy/Cornyn amendment did not. Nonetheless, TI-USA continues to support passage of the Leahy/Cornyn amendment, in the event that sufficient legislative support cannot be garnered for the form of the statute proposed in this White Paper.

⁶⁵ The government may prove the requisite specific intent by various means, including by adducing evidence that the defendant’s nondisclosure was intentional. *See, e.g., United States v. Pennington*, 168 F.3d 1060, 1065 (8th Cir. 1999).

⁶⁶ *See* Senate Honest Services Hearing, Breuer Testimony at 7 (specific intent requirement will mitigate the “risk that a person could be convicted for a mistake or unwitting conflict of interest”); *see also, e.g., Carter v. United States*, 530 U.S. 255, 269 (2000) (specific intent requirements are often necessary to avoid “the risk of punishing seemingly innocent conduct” and “to protect the innocent actor”).

indefinite statute invalid. . . . [I]t . . . relieve[s] the statute of the objection that it punishes without warning an offense of which the accused was unaware.”⁶⁷

These considerations are especially important in contexts, such as this one, in which it can be difficult to distinguish lawful from unlawful conduct. “[C]riminal law should clearly separate conduct that is criminal from conduct that is legal. This is not only because of the dire consequences of a conviction . . . but also because criminal law represents the community’s sense of the type of behavior that merits the moral condemnation of society.”⁶⁸ As it relates to undisclosed self-dealing: “[S]ome conflicts of interest are tolerable, and not every violation of a fiduciary duty should be criminal. . . . [T]he broad nature of § 1346 has left courts to search for a limiting principle, one that would separate illicit behavior from more innocuous behavior that Congress did not intend to make a federal crime.”⁶⁹

2. *Failure to Disclose Before Action*

A new statute should require proof that the defendant knowingly failed to disclose the conflict in advance of taking the relevant action, *i.e.*, before voting on a bill that would favor a company in which he holds a financial interest or before awarding city business to a family member. This requirement recognizes that, for purposes of undisclosed self-dealing in the public sector, the harm inheres in the nondisclosure itself,⁷⁰ and pre-action disclosure fully negates this harm.

Disclosure should be made by any means consistent with federal, state, or local law or, if no such specific law exists, by any means reasonably calculated to inform the persons to whom the defendant owes fiduciary duties, *e.g.*, the citizens he represents or for whom he works.⁷¹ In the case of an elected official, disclosure should be made to the

⁶⁷ *Colautti v. Franklin*, 439 U.S. 379, 395 n.13 (1979) (quoting *Screws v. United States*, 325 U.S. 91, 101–02 (1945) (plurality op.)); *see also Skilling*, 130 S. Ct. at 2933 (citing *Screws* and explaining that the “*mens rea* requirement” of Section 1346 “further blunts any . . . concern” that the statute is unconstitutionally vague as applied to bribery and kickbacks).

⁶⁸ *United States v. Goyal*, 629 F.3d 912, 922 (9th Cir. 2010) (Kozinski, J., concurring).

⁶⁹ *Kincaid-Chauncey*, 556 F.3d at 947 (Berzon, J., concurring) (internal quotation marks and citations omitted); *see also Sorich*, 129 S. Ct. at 1310 (Scalia, J., dissenting from the denial of certiorari).

⁷⁰ *See deVegter*, 198 F.3d at 1328.

⁷¹ “A public official is a fiduciary toward the public, and if he deliberately conceals material information from them he is guilty of fraud.” *United States v. Panarella*, 277 F.3d 678, 696 (3d Cir. 2002) (internal quotation marks and ellipsis omitted). In other words, public officials “act[] as ‘trustee[s] for the citizens and the State and thus owe the normal fiduciary duties of a trustee, *e.g.*, honesty and loyalty to them.” *Kincaid-Chauncey*, 556 F.3d at 939 (internal ellipsis omitted) (continued...)

citizens (for example, by a posting on the official's website, in a letter to the local newspaper, or by holding a press conference). In the case of a public employee, disclosure should be made to the employee's supervisor.

3. *Nondisclosure in Violation of Local, State, or Federal Law*

The new statute should require proof that the defendant knowingly failed to disclose his private interest in violation of a local, state, or federal law requiring disclosure.⁷² This requirement is important; "it is often not readily apparent whether a problematic conflict of interest exists and therefore whether an official's failure to disclose such information should or should not give rise to criminal liability."⁷³

As *Skilling* teaches, this kind of ambiguity is unacceptable.⁷⁴ Thus, a new statute should not allow a conviction based on the fact that the defendant's nondisclosure violated, for example, a "duty . . . [that] may arise from the employment relationship,"⁷⁵ from local police regulations,⁷⁶ or from the ill-defined "common law."⁷⁷

There is little doubt that, because states and localities will differ in their assessment of what must be disclosed, conduct in one state may violate the statute while the same conduct in another state may not. Whatever theoretical problems that disparity may raise, it poses no *actual* problems for the statute's enforcement. If anything, the disparity advances the goals of federalism by allowing states and localities to determine for themselves what disclosures should be required.⁷⁸

(quoting *Silvano*, 812 F.2d at 759); see also *Panarella*, 277 F.3d at 695 (quoting *United States v. Holzer*, 816 F.2d 304, 307 (7th Cir. 1987)) ("Fraud in its elementary common law sense of deceit includes the deliberate concealment of material information in a setting of fiduciary obligation.") (internal ellipses omitted).

⁷² *Accord*, e.g., Senate Honest Services Hearing, Breuer Testimony at 7 (new statute should require proof of nondisclosure of material information that the defendant was "already required by law or regulation to disclose").

⁷³ *Kincaid-Chauncey*, 556 F.3d at 948 (Berzon, J., concurring).

⁷⁴ 130 S. Ct. at 2927 ("To satisfy due process, a penal statute must define the criminal offense . . . with sufficient definiteness that ordinary people can understand what conduct is prohibited.").

⁷⁵ *United States v. Ballard*, 663 F.2d 534, 541 (5th Cir. 1981).

⁷⁶ *United States v. Woodard*, 459 F.3d 1078, 1087 n.8 (11th Cir. 2006).

⁷⁷ *United States v. Sawyer*, 239 F.3d 31, 41 (1st Cir. 2001).

⁷⁸ See, e.g., *Panarella*, 277 F.3d at 693–94 ("We are mindful that the prosecution of state public officials for honest services fraud raises federalism concerns about the appropriateness of the federal government's interference with the operation of state and local governments. In our view, use of (continued...)

4. *Materiality*

The new statute should require proof that the defendant's nondisclosure was material. In the context of public-sector undisclosed self-dealing, a nondisclosure should be considered material if disclosure would have led a reasonable person to whom the defendant owed fiduciary duties to conclude that the defendant was acting in some interest other than the public's best interest.⁷⁹ This standard recognizes that the harm inheres in the nondisclosure itself, which effectively dupes the public into thinking that the defendant was acting in its best interests.

This definition of materiality will except only *de minimis* nondisclosures from the statute's ambit. But that is as it should be. The public's right to the disinterested decisionmaking of public officials and public employees is a fragile one that can be severely undermined by even relatively minor nondisclosures. Thus, only nondisclosures of *no* objective import should fall outside the scope of the statute.⁸⁰

5. *Misuse of Office to Generate a Private Gain*

Congress also should require proof that the defendant misused his office to generate a private gain.⁸¹ The requisite private gain may, but need not, inure to the benefit of the defendant.⁸² It suffices that the defendant misused his office for the

state law as a limiting principle defining the scope of honest services fraud in close cases better addresses these federalism concerns than does the limiting principle of misuse of office for personal gain, which [the defendant] urges upon us.” (internal citation omitted).

⁷⁹ In its brief to the Supreme Court in *Skilling*, the government articulated a similar formulation: “In many public sector cases, such as those involving legislators, a deception will be material if it makes a difference in the way the public or other officials assess whether the office-holder has placed his self-interest above that of the public.” *Skilling v. United States*, Br. for the United States, 2010 WL 302206, at *42 (Jan. 26, 2010).

⁸⁰ TI-USA's proposed definition of materiality differs slightly from definitions offered by the courts, which tend to focus on whether an act or representation “could have influenced the victims' decisions.” See, e.g., *United States v. Locke*, 643 F.3d 235, 241 (7th Cir. 2011). This is by design; what matters in the context of public-sector undisclosed self-dealing is whether the defendant acted in some interest other than the public's best interest. Our proposed materiality standard captures this inquiry while freeing prosecutors from having to prove that the *victim* of public-sector undisclosed self-dealing — *i.e.*, the citizens — would have acted differently (perhaps by not having voted for the official) had disclosure been properly made.

⁸¹ See *United States v. Bloom*, 149 F.3d 649, 655 (7th Cir. 1998).

⁸² See *United States v. Sorich*, 523 F.3d 702, 709 (7th Cir. 2008); see also *United States v. Silvano*, 812 F.2d 754, 760 (1st Cir. 1987) (“It is immaterial whether [the official] personally profited from the scheme or whether the City suffered a financial loss from it. The loss to the City of [the official's] good faith services alone establishes the breach.”) (internal citations omitted).

purpose of bestowing an illegitimate gain on *someone*. This principle reflects the general notion that “[i]n the case of a successful scheme [to defraud], the public is deprived of its servants’ honest services no matter who receives the proceeds.”⁸³

Although it is broad, this element will appropriately exclude certain conduct from the reach of the statute. “[T]he true purpose of the private gain requirement — and one that does not depend on who gets the spoils — is to prevent the conviction of individuals who have breached a fiduciary duty to an employer or the public, but have not done so for illegitimate gain.”⁸⁴ In *United States v. Czubinski*, the defendant, a customer service representative for the IRS, was convicted of honest services fraud for violating IRS policy by repeatedly accessing individuals’ income tax return information.⁸⁵ The First Circuit reversed, holding that “the government has failed to prove that Czubinski intended to use the IRS files he browsed for any private purposes” and that allowing a conviction on these facts would improperly “transform[] governmental workplace violations into felonies” and disregard the fact that “Congress [did not] intend[] to create what amounts to a draconian personnel regulation.”⁸⁶

B. Undisclosed Self-Dealing in the Private Sector

In contrast to its impact in the public sector, *Skilling* does *not* materially impede the federal government’s ability to prosecute undisclosed self-dealing in the private sector. Congress should not pass a new statute aimed at private-sector undisclosed self-dealing.

Private-sector undisclosed self-dealing may — but does not necessarily — impose a money or property harm. For example, consider a CEO who causes his corporation to buy a product from a side business in which he holds an undisclosed financial interest. If the price paid by the corporation *exceeds* what the corporation otherwise would have paid, then the CEO’s undisclosed self-dealing caused a money or property harm on the corporation and its shareholders, and a federal criminal action would probably lie. But if the corporation paid *the same or less* than it otherwise would have paid — and assuming no diminution in such intangibles as quality, timeliness, or performance — then one can fairly conclude that no money or property harm was intended (or resulted).⁸⁷

⁸³ *United States v. Spano*, 421 F.3d 599, 603 (7th Cir. 2005).

⁸⁴ *Sorich*, 523 F.3d at 710.

⁸⁵ 106 F.3d 1069, 1071–72 (1st Cir. 1997).

⁸⁶ *Id.* at 1077.

⁸⁷ Our conclusion in this regard is unaffected by whether the defendant’s conduct violated company conflict of interest rules. Absent any actual or intended money or property harm, company (continued...)

For different reasons, neither circumstance calls for a legislative response to *Skilling*.

1. *Extant Federal Law Already Proscribes Private-Sector Undisclosed Self-Dealing that Intentionally Caused or was Intended to Cause a Money or Property Harm*

As AAG Breuer explained at the Senate Honest Services Hearing, Sections 1341 and 1343 will cover most instances of private-sector undisclosed self-dealing (which generally involves a money or property harm).⁸⁸ And when the scheme involves a bribe or kickback, Section 1346 will apply.⁸⁹ Finally, still other federal laws will often reach conduct that can fairly be described as undisclosed self-dealing.⁹⁰

It is therefore unsurprising that “a review of the more than 600 published decisions involving the honest-services statute reveals that the overwhelming majority of such cases involved either allegations of a bribe or kickback, or conduct that was, or could have been, charged as traditional wire/mail fraud or under other federal statutes, such as those prohibiting securities fraud, extortion, and bribery.”⁹¹

Accordingly, because federal law already covers private-sector undisclosed self-dealing that implicates a money or property harm, no new legislation is warranted.

disciplinary procedures and the civil law — especially the law of fiduciary duty — should be sufficient to address the CEO’s conduct.

⁸⁸ See Breuer Testimony at 8 (“[B]ecause undisclosed self-dealing in the private sector usually involves a loss of money or property, the existing mail and wire fraud statutes can often be used effectively to reach the improper conduct.”). Cf. *United States v. McGeehan*, 584 F.3d 560, 569 (3d Cir. 2009) (“[E]nforcement of an intangible right to honest services in the private sector arguably has a weaker justification because relationships in the private sector generally rest upon concerns and expectations less ethereal and more economic than the abstract satisfaction of receiving ‘honest services’ for their own sake.”) (internal quotation marks omitted), *vacated on other grounds*, 625 F.3d 159 (3d Cir. 2010).

⁸⁹ *Skilling*, 130 S. Ct. at 2931.

⁹⁰ See, e.g., *Skilling*, 638 F.3d at 488 (on remand from the Supreme Court, affirming all of Skilling’s convictions on bases other than Section 1346); *In re Tyco Int’l, Ltd. Multidistrict Litig.*, 535 F. Supp. 2d 249 (D.N.H. 2007) (approving settlement of private suit); *SEC Sues Former Tyco CEO Kozlowski, Two Others for Fraud*, Aug. 6, 2002, available at <http://www.sec.gov/news/press/2002-135.htm>. (civil enforcement action).

⁹¹ Mark J. Stein & Joshua A. Levine, *Skilling: Is it Really a Game-Changer for Mail and Wire Fraud Cases?*, 1832 PLI/Corp 933, 938–39 (2010).

2. *Private-Sector Undisclosed Self-Dealing that was not Intended to Cause a Money or Property Harm does not Warrant Imposition of the Federal Criminal Law*

Private-sector undisclosed self-dealing that was not intended to cause a money or property harm is not and should not be prosecutable under the federal criminal law.

After *McNally*, Sections 1341 and 1343 apply only to schemes involving a money or property deprivation, and therefore do not apply to undisclosed self-dealing that was not intended to cause such an injury.⁹² That is as it should be. The principal goals of federal criminal law are deterrence, punishment, and rehabilitation.⁹³ Private-sector undisclosed self-dealing that was not intended to impose a money or property harm is not sufficiently serious, harmful, or immoral to advance these goals.⁹⁴

Federal criminal prosecution and conviction impose weighty consequences, including, among other things, a loss of liberty, a loss of rights (such as the right to vote), and the severe moral stigma that inheres in being a convicted federal felon.⁹⁵ As a result, application of the federal criminal law should be reserved for those whose acts are truly serious enough to warrant these consequences.

Moreover, private-sector undisclosed self-dealing that does not implicate a money or property harm is essentially a breach of fiduciary duty that can be adequately policed by state civil law,⁹⁶ corporate compliance programs, whistleblower statutes, and other similar mechanisms.⁹⁷ Congress should be especially reluctant to criminalize conduct that has traditionally been regulated by civil law⁹⁸ and should do so only when

⁹² *McNally*, 483 U.S. at 360.

⁹³ See, e.g., Principles of Federal Prosecution of Business Organizations, Comment to Chapter 9-28.1100.

⁹⁴ See generally John C. Coffee, Jr., *Does “Unlawful” Mean “Criminal”? Reflections on the Disappearing Tort/Crime Distinction in American Law*, 71 B.U. L. Rev. 193, 193–94 (1991). Similar conduct in the public sector, however, undermines our very system of representative government, and it is principally for this reason that we suggest criminalizing public-sector undisclosed self-dealing *regardless* of whether the conduct resulted (or was intended to result) in a money or property harm.

⁹⁵ See generally *Spencer v. Kemna*, 523 U.S. 1, 7–8 (1998); Michael Pinard, *Collateral Consequences of Criminal Convictions: Confronting Issues of Race & Dignity*, 85 N.Y.U. L. Rev. 457, 490–94 (2010).

⁹⁶ See, e.g., *Brown*, 459 F.3d at 519.

⁹⁷ See *supra* pages 10–11.

⁹⁸ *Coffee, supra* n.93, at 193 (“[B]lurring . . . the border between tort and crime predictably will result in injustice, and ultimately will weaken the efficacy of the criminal law.”).

the need is clear. Otherwise, even those who act in relatively harmless, non-blameworthy, and unintentional ways may find themselves in the crosshairs of federal criminal law.

Finally, in contrast to the public sector — where undisclosed self-dealing (like bribes and kickbacks) undermines “the essence of the political contract” — such conduct in the private sector is inherently less harmful because “in the private sector, most relationships are limited to more concrete matters. When there is no tangible harm to the victim of a private scheme, it is hard to discern what intangible ‘rights’ have been violated.”⁹⁹ In other words, while dealings in the private sector revolve principally around economics, interactions in the public sector necessarily implicate more intangible notions of trust, transparency, and ethics. As one court aptly described the difference:

[A] strict duty of loyalty ordinarily is not part of private sector relationships. Most private sector interactions do not involve duties of, or rights to, the “honest services” of either party. . . . An employee’s undisclosed conflict of interest does not by itself necessarily pose the threat of economic harm to the employer. A public official’s undisclosed conflict of interest, in contrast, does by itself harm the constituents’ interest in the end for which the official serves — honest government in the public’s best interest.¹⁰⁰

For this reason, as well, absent intentional money or property harm the federal criminal law should not apply to undisclosed self-dealing in the private sector.

IV. Conclusion

The Supreme Court’s decision in *Skilling* provides the same opportunity for Congress that was presented to it in 1987 when the Court decided *McNally*. In both instances, the Court concluded that existing fraud statutes did not allow public or private officials to be prosecuted merely for undisclosed self-dealing. After *McNally*, Congress took action and enacted Section 1346. Now that the Court has narrowed the reach of that statute, the question is whether Congress will take action again. Congress came close in March 2012, but legislators ultimately failed to act.

TI-USA continues to believe that a legislative response to *Skilling* is needed. Indeed, if Congress declines to step in, undisclosed self-dealing by public officials will remain outside the reach of federal prosecution, thus compromising a fundamental interest of all citizens: ensuring that public officials act at every turn in the public’s

⁹⁹ *Jain*, 93 F.3d at 442.

¹⁰⁰ *deVegter*, 198 F.3d at 1328 (internal quotation marks omitted).

best interest. As it did in 1987, Congress should once again take steps to ensure that the public's interests are vindicated. New legislation should be passed that will clearly but carefully proscribe this pernicious form of corruption.