

## HONEST SERVICES FRAUD: CONSTRUING THE CONTOURS OF SECTION 1346 IN THE CORPORATE REALM

### ABSTRACT

*The honest services fraud statute, 18 U.S.C. § 1346, makes it a crime to engage in a scheme to "deprive another of the intangible right to honest services." Congress enacted the statute in an effort to fight fraudulent activity, but it has received disparate treatment among the courts since its inception in 1988. For instance, it is not clear how the statute should be applied in a private context as opposed to a case involving a publically elected official. Moreover, section 1346 has been criticized of being "void for vagueness," because it does not clearly define what behavior is prohibited.*

*In 2010, after several years of inconsistent application of section 1346 by lower courts, the United States Supreme Court attempted to more clearly define the outer limits of the statute's reach in *Skilling v. United States*. The decision simply limited the use of section 1346 to cases involving bribes and kickbacks.*

*Despite the Court's attempt to provide guidance on the reach of section 1346, *Skilling* left many questions unanswered. For instance, the Court failed to define precisely what behavior constitutes a "bribe" or a "kickback." Additionally, though the Court explained that honest services fraud cases almost always involve breaches of fiduciary duties, it neglected to indicate the source of these duties. Finally, the Court failed to illustrate how the statute should properly be enforced in the private sector—for example, in a case involving claims against corporate officers and directors—where relationships are undeniably vastly different than those in the public sector, between elected officials and the public.*

*The honest services fraud statute has potentially unanticipated implications for corporate relationships, particularly corporate relationships in Delaware. This Note analyzes the potential reach of the statute in a corporate context and illustrates the need to bifurcate the statute in a way that differentiates between public and private honest services fraud violations.*

*Presently, the contours of section 1346 are poorly defined and subject to broad interpretation. The circuit courts have come to differing conclusions on the source of the duty that invokes an honest services fraud violation. Additionally, the courts are unable to agree on a uniform definition of either bribes or kickbacks. Congress should be charged with addressing these gaps in the current legislation as well as enacting separate legislation to address purely private honest services fraud violations.*

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## I. INTRODUCTION

Imagine you are a corporate director who is wining and dining a prospective client, a practice that is generally accepted in your profession, with the hope that this prospective client will engage in business with your company. To your satisfaction, your efforts result in gaining a new client—but that is not all. You have also been indicted for a violation of honest services mail fraud under 18 U.S.C. §§ 1341 and 1346,<sup>1</sup> a conviction that former Enron CEO Jeffrey Skilling managed to evade,<sup>2</sup> but you cannot seem to escape.

The above example is a dramatic, but not an overly implausible illustration of the potential reach of section 1346, the honest services fraud

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<sup>1</sup>18 U.S.C. §§ 1341, 1346 (2006).

<sup>2</sup>*Skilling v. United States*, 130 S. Ct. 2896, 2934-35 (2010) (holding that Jeffrey Skilling's conduct did not fall within the reach of section 1346).

statute. This statute, which was designed to fight fraudulent activity,<sup>3</sup> has received disparate treatment among the courts.<sup>4</sup> The honest services fraud statute has potentially unanticipated implications for corporate relationships, particularly corporate relationships in Delaware.<sup>5</sup>

Part II of this Note explores the evolution of honest services fraud, including the United States Supreme Court's 2010 decision in *Skilling v. United States*.<sup>6</sup> Part III enumerates the elements of an honest services mail fraud conviction, analyzing the disparate treatment the honest services fraud statute has received among lower courts.<sup>7</sup> Specifically, Part III considers the inconsistent approaches used by lower courts to establish the existence of a duty in a business-entity context<sup>8</sup> and examines the definitions of the terms "bribes" and "kickbacks" in pre-*McNally*<sup>9</sup> case law and other federal statutes.<sup>10</sup> Part IV stresses the need to bifurcate section 1346 in a way that differentiates between honest services fraud in the scenarios of public officials and business entities.<sup>11</sup> Part IV also addresses conflicts that may be of particular concern for Delaware business entities.<sup>12</sup> Finally, Part V proposes that Congress create a carve-out in section 1346 to specifically address honest services fraud in the context of private business entities.<sup>13</sup>

## II. BACKGROUND

The federal mail and wire fraud statutes, found in 18 U.S.C. §§ 1341 and 1343,<sup>14</sup> criminalize the use of mails<sup>15</sup> or wires<sup>16</sup> to implement "any

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<sup>3</sup>See, e.g., *United States v. Sawyer*, 239 F.3d 31, 39 (1st Cir. 2001) (referring to the legislative history behind the enactment of §§ 1341 and 1346).

<sup>4</sup>See *infra* note 61 and accompanying text.

<sup>5</sup>See *infra* Part IV.D.

<sup>6</sup>130 S. Ct. 2896; see *infra* Part II.

<sup>7</sup>See *infra* Part III.

<sup>8</sup>See *infra* Part III.A.

<sup>9</sup>*McNally v. United States*, 483 U.S. 350 (1987).

<sup>10</sup>See *infra* Part III.B.

<sup>11</sup>See *infra* Part IV.

<sup>12</sup>See *infra* Part IV.D.

<sup>13</sup>See *infra* Part V.

<sup>14</sup>18 U.S.C. §§ 1341, 1343 (2006).

<sup>15</sup>Within the meaning of the statute, "use of mails" refers to a situation when a person acts "with knowledge that the use of the mails will follow in the ordinary course of business, or where such use can reasonably be foreseen." *Pereira v. United States*, 347 U.S. 358, 363 (1954). "Mails" refers to the Postal Service or any private or commercial interstate carrier. 18 U.S.C. § 1341 (2006).

<sup>16</sup>Use of "wires" includes "traditional land-line telephone calls, . . . cell phone calls, faxes, e-mails, text messages, and Internet transmissions (wired or wireless)." Randall D. Eliason, *Surgery with a Meat Axe: Using Honest Services Fraud to Prosecute Federal Corruption*, 99 J. CRIM. L. & CRIMINOLOGY 929, 954 (2009).

scheme or artifice to defraud."<sup>17</sup> Pursuant to these statutes, the federal government traditionally prosecuted individuals for depriving others of money or property.<sup>18</sup> Eventually, however, courts began upholding mail fraud convictions<sup>19</sup> even where the victim's loss was not material.<sup>20</sup>

After the Watergate scandal in the 1970s, protection against public corruption became a top priority for Congress and the courts.<sup>21</sup> In turn, courts began utilizing the language, "any scheme or artifice to defraud"<sup>22</sup> to uphold the prosecution of elected public officials who were allegedly denying the public of its "intangible right" to honest services.<sup>23</sup> The notion that "[a] public official's betrayal of trust overcomes the need for both a tangible loss *and* an actual misrepresentation" advanced these prosecutions.<sup>24</sup> The legality of the act in question was irrelevant.<sup>25</sup> Instead, the mere fact that a public official betrayed the public's trust served as a sufficient basis for the mail fraud conviction.<sup>26</sup> This broad interpretation incited a vast range of prosecutions for offenses that, under a narrow construction of section 1341, would not have previously constituted mail fraud violations.<sup>27</sup>

Prosecutions under this broad application of the mail fraud statute lasted for over a decade until the Supreme Court's 1987 decision, *McNally v.*

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<sup>17</sup>18 U.S.C. § 1341. The mail fraud statute originated in 1872. See Jennifer I. Rowe, *The Future of Honest Services Fraud*, 74 ALB. L. REV. 421, 422 (2010-11).

<sup>18</sup>See *Skilling v. United States*, 130 S. Ct. 2896, 2926 (2010) (referring to traditional cases of fraud where the victim's loss became the mirror image of the defendant's gain).

<sup>19</sup>Sections 1341 and 1343 are virtually the same other than the fact that the former refers to mail and the later to wire communication. See *United States v. Griffith*, 17 F.3d 865, 874 (6th Cir. 1994). As a result, for simplicity's sake, this Note refers only to § 1341, the mail fraud statute, though this Note's discussion is equally relevant to § 1343.

<sup>20</sup>See, e.g., *Shushan v. United States*, 117 F.2d 110, 121 (5th Cir. 1941) (commonly acknowledged as the first case in which the "intangible rights" theory was litigated, upholding a mail fraud conviction when defendant betrayed the confidence of a board of commissioners even though the board was not deprived of any money or property); *United States v. George*, 477 F.2d 508, 512 (7th Cir. 1973) (explaining that the victim need not actually experience a tangible loss to be convicted under the mail fraud statute).

<sup>21</sup>See Paul Taylor, *In Watergate's Wake: Scandal, Cynicism and Redemption*, WASH. POST, June 14, 1992, at c3.

<sup>22</sup>18 U.S.C. § 1341.

<sup>23</sup>See Taylor, *supra* note 21; see, e.g., *United States v. Isaacs*, 493 F.2d 1124, 1150 (7th Cir. 1974) (upholding a mail fraud conviction of a governor who defrauded the state's citizens of "honest and faithful services" when he failed to administer state laws in an impartial manner and obtained secret profits through a bribery scheme concerning horse racing).

<sup>24</sup>Joshua A. Kobrin, *Betraying Honest Services: Theories of Trust and Betrayal Applied to the Mail Fraud Statute and § 1346*, 61 N.Y.U. ANN. SURV. AM. L. 779, 794 (2005-06).

<sup>25</sup>*Id.*

<sup>26</sup>*Id.*

<sup>27</sup>See, e.g., *United States v. Tarnopol*, 561 F.2d 466, 475 (3d Cir. 1977) (involving a wire fraud claim against a disc jockey who allegedly deprived the public of "loyal services of disc jockeys").

*United States*, restricting the mail fraud statute.<sup>28</sup> In *McNally*, the Supreme Court held that the mail fraud statute serves only to protect property rights and "does not refer to the intangible right of the citizenry to good government."<sup>29</sup> The Court expressed that it was not willing to interpret the statute "in a manner that leaves its outer boundaries ambiguous"<sup>30</sup> and indicated that if Congress was not satisfied with this approach, it was up to Congress to clearly indicate where it intended the boundaries to lie.<sup>31</sup>

Congress responded promptly to *McNally* by enacting section 1346<sup>32</sup>—referred to as the "honest services fraud" statute.<sup>33</sup> Section 1346 provides, "the term 'scheme or artifice to defraud' includes a scheme or artifice to deprive another of the intangible right of honest services."<sup>34</sup> Ostensibly, this amendment represents Congress' intent that the mail fraud statutes are to protect against more than just property rights.<sup>35</sup> Despite Congress' attempt to more-clearly delineate the parameters of the mail fraud statute, the added language resulted in a more-flexible interpretation of the statute.<sup>36</sup> To be sure, some circuits began applying section 1346 so that state-fiduciary-duties law defined "honest services."<sup>37</sup> Other circuits rejected this approach, applying the statute under circumstances in which there was no state law violation.<sup>38</sup> The enactment of section 1346 has "jumbled some pieces of the honest services puzzle."<sup>39</sup>

In 2010, the United States Supreme Court seized the opportunity to yet again constrict the outer limits of the application of honest services fraud in *Skilling v. United States*.<sup>40</sup> Former CEO of Enron Corporation ("Enron"), Jeffrey Skilling, was indicted after a federal investigation revealed that he was involved in a conspiracy to increase Enron's stock prices by overstating

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<sup>28</sup>483 U.S. 350 (1987).

<sup>29</sup>*Id.* at 356.

<sup>30</sup>*Id.* at 360.

<sup>31</sup>*Id.*

<sup>32</sup>18 U.S.C. § 1346 (2006).

<sup>33</sup>*See, e.g.*, *United States v. Bryant*, 655 F.3d 232, 236 (3d Cir. 2011).

<sup>34</sup>18 U.S.C. § 1346.

<sup>35</sup>*See Rowe, supra* note 17, at 430 (arguing that the statute is meaningless without such additional protections).

<sup>36</sup>*See Kobrin, supra* note 24, at 782 (noting flexibility in mail fraud statute borders on impermissible vagueness).

<sup>37</sup>*See, e.g.*, *United States v. Brumley*, 116 F.3d 728, 734 (5th Cir. 1997) (applying a state law limiting principle in honest services fraud cases).

<sup>38</sup>*See, e.g.*, *United States v. Woodward*, 149 F.3d 46, 66 (1st Cir. 1998); *see also United States v. Sawyer*, 239 F.3d 31, 47 (1st Cir. 2001) (declining to apply a state law limiting principle in honest services fraud cases).

<sup>39</sup>Lisa L. Casey, *Twenty-Eight Words: Enforcing Corporate Fiduciary Duties Through Criminal Prosecution of Honest Services Fraud*, 35 DEL. J. CORP. L. 1, 51 (2010).

<sup>40</sup>130 S. Ct. 2896 (2010).

the company's fiscal health.<sup>41</sup> Immediately after Skilling resigned, Enron filed for bankruptcy relief. An investigation ensued which led to the indictment alleging that Skilling had deprived Enron's shareholders of honest services when he misrepresented the corporation's financial stability.<sup>42</sup> The jury found Skilling guilty on nineteen counts, including the section 1346 honest services fraud charge.<sup>43</sup> Skilling appealed his conviction, arguing that section 1346 was void for vagueness because it did "not adequately define what behavior it bars" and therefore facilitated arbitrary prosecutions.<sup>44</sup> In its decision, the Court limited the meaning of the statute to include "only bribery and kickback schemes[.]"<sup>45</sup> Under this interpretation, the Court held that section 1346 "is not unconstitutionally vague."<sup>46</sup> Because the government alleged neither a bribe nor kickbacks, the Court found that Skilling did not commit honest services fraud.<sup>47</sup>

### III. DUTIES, BRIBES, & KICKBACKS

Under the broad language of section 1346, honest services mail fraud is used as a basis to prosecute in both the public and private sectors.<sup>48</sup> A conviction of honest services mail fraud relies on the government's ability to establish three elements: (1) the defendant used the mails,<sup>49</sup> (2) with the intent to employ a scheme or artifice to defraud,<sup>50</sup> and (3) the scheme to defraud was for the purpose of depriving another of the intangible right of honest services.<sup>51</sup>

The first element is easily satisfied in most cases, as it merely requires the defendant use the "mails or wires" (*e.g.*, e-mail) in some way

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<sup>41</sup>*Id.* at 2907.

<sup>42</sup>*Id.* at 2907-08.

<sup>43</sup>*Id.* at 2911.

<sup>44</sup>*Skilling*, 130 S. Ct. at 2928.

<sup>45</sup>*Id.* at 2933.

<sup>46</sup>*Id.*

<sup>47</sup>*Id.* at 2934.

<sup>48</sup>*See* United States v. Sovich, 523 F.3d 702, 707 (7th Cir. 2008) (explaining that honest services fraud cases come in two types: private and public); United States v. Williams, 441 F.3d 716, 723 (9th Cir. 2006) ("[T]he 'intangible rights' theory of fraud, as codified by § 1346, can apply to private individuals as well as to public figures."); *see also Skilling*, 130 S. Ct. at 2907 (applying section 1346 to the private sector).

<sup>49</sup>18 U.S.C. § 1341 (2006). This element is generally very easy to satisfy and requires little analysis.

<sup>50</sup>*Id.* ("[I]ntending to devise any scheme or artifice to defraud . . .").

<sup>51</sup>18 U.S.C. § 1346 (2006) ("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.").

during the course of the allegedly unlawful conduct.<sup>52</sup> In light of the fact that use of the mails and or wires is so widespread, the first element under section 1346 is often referred to as a sort of "jurisdictional hook," pulling honest services fraud cases into federal court.<sup>53</sup> Notably, federal jurisdiction under the honest services fraud statute remains, even if the use of mail or wires is confined to the territorial limits of one state.<sup>54</sup> Although the analysis of the first element is relatively simple—inquiring whether the defendant used mails or wires—the latter two elements are quite complicated. Accordingly, the remainder of this Note focuses primarily on judicial analysis of the latter elements.

The United States Supreme Court in *Skilling* rendered the intent to employ a scheme or artifice to defraud applicable to only bribes and kickbacks.<sup>55</sup> In the public sector, this interpretation clearly indicates that cases prosecuted under the honest services fraud statute are limited to those involving situations in which a public official either partook in some official act in exchange for a bribe, or received kickbacks.<sup>56</sup> Although the facts of *Skilling* involved honest services fraud in the context of a private corporation context, the Court's decision left many questions unanswered as to how the statute should properly be enforced in the private sector.<sup>57</sup> For example, while the *Skilling* Court explained that honest services fraud cases almost always involve breaches of fiduciary duties,<sup>58</sup> the Court neglected to indicate the source of these duties.<sup>59</sup> Additionally, the Court failed to define precisely

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<sup>52</sup>See *United States v. Hickok*, 77 F.3d 992, 1004 (7th Cir. 1996) ("The 'use of the mails' element is satisfied if a defendant 'knowingly cause[s] the mails to be used in furtherance of a scheme to defraud.'" (quoting *United States v. Brocksmith*, 991 F.2d 1363, 1367 (7th Cir. 1993))).

<sup>53</sup>*Schmuck v. United States*, 489 U.S. 705, 722-23 (1989) (Scalia, J., dissenting) ("[U]se of the mails [is] the jurisdictional hook . . .").

<sup>54</sup>See *United States v. Reid*, 533 F.2d 1255, 1260 n.19 (D.C. Cir. 1976) (noting that the "in furtherance" requirement appears to only serve jurisdictional purposes); *United States v. Sawyer*, 85 F.3d 713, 723 n.5 (1st Cir. 1996) ("Some have observed . . . that the use of the mails or wires is merely a 'jurisdictional hook' . . .").

<sup>55</sup>*Skilling v. United States*, 130 S. Ct. 2896, 2933 (2010).

<sup>56</sup>*Id.* at 2929.

<sup>57</sup>See Anita Cava & Brian M. Stewart, *Quid Pro Quo Corruption is "So Yesterday": Restoring Honest Services Fraud After Skilling and Black*, 12 U.C. DAVIS BUS. L.J. 1, 12 (2011) ("Although the Skilling decision effectively defined the outer boundaries of honest services fraud, questions remain regarding how to properly apply § 1346 to private sector actors."); Charion L. Vaughn, *Power Corrupts: Honest Services Fraud and Fiduciary Duties*, 50 WASHBURN L.J. 713, 713 (2011) ("The Court . . . failed to clarify the source of . . . a duty."); Anna Stolley Persky, *Honest Services Fraud: What's Left of This Blunted Weapon Against Corruption?*, WASH. LAWYER, Dec. 2010, at 25, 30 ("Even though it is clear that the Supreme Court narrowed the scope of honest-services fraud, it left room for debate, interpretation, and, inevitably, litigation.").

<sup>58</sup>*Skilling*, 130 S. Ct. at 2930 ("The 'vast majority' of the honest-services cases involved offenders who, in violation of a fiduciary duty, participated in bribes or kickback schemes.").

<sup>59</sup>Vaughn, *supra* note 57, at 713 ("The Court . . . failed to clarify the source of such a

what behavior constitutes a "bribe" or a "kickback."<sup>60</sup> Unsurprisingly, the statute continues to receive disparate treatment among lower courts due to these ambiguities.<sup>61</sup>

### A. *Analyzing the Source of Duty*

In the public sector, understanding the source of the duty owed is relatively simple and straightforward: public officials are either elected or appointed for the purpose of acting in the best interest of the public.<sup>62</sup> Thus, public officials owe an inherent duty to the public and breach that duty by engaging in conduct that is prohibited by the honest services fraud statute, such as accepting bribes or kickbacks.<sup>63</sup> The analysis of the statute's application and subsequent implications in a purely private context (such as a business-entity context) is not as straightforward.<sup>64</sup>

It is not clear where the duties relating to honest services fraud originate,<sup>65</sup> nor is it clear that the duties are necessarily fiduciary in nature.<sup>66</sup> Defining the source of the fiduciary duty in the private sector has been described as the "most fundamental indeterminacy."<sup>67</sup> Justice Scalia illustrates this point in his concurring opinion in *Skilling*, highlighting that "[n]one of the 'honest services' cases . . . pertaining to private employees[] defined the nature and content of the fiduciary duty . . ."<sup>68</sup> He points to *Blachly v. United States*,<sup>69</sup> where the Fifth Circuit did not expressly discuss fiduciary duties as they related to the director of a corporation, but merely

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duty.").

<sup>60</sup>See Persky, *supra* note 57, at 31 ("[T]he Court never defined either bribe or kickback.").

<sup>61</sup>See *United States v. Weyhrauch*, 548 F.3d 1237, 1245 n.5 (9th Cir. 2008) (declining to look to state law to find fiduciary duties); *United States v. Murphy*, 323 F.3d 102, 115-16 (3d Cir. 2003) (finding that fiduciary duties come from state law).

<sup>62</sup>See, e.g., *United States v. deVegeter*, 198 F.3d 1324, 1328 (11th Cir. 1999) ("Public officials inherently owe a fiduciary duty to the public to make governmental decisions in the public's best interest.").

<sup>63</sup>See *United States v. Lopez-Lukis*, 102 F.3d 1164, 1169 (11th Cir. 1997) ("[W]hen a political official uses his office for personal gain, he deprives his constituents of their right to have him perform his official duties in their best interest.").

<sup>64</sup>See Lori A. McMillan, *Honest Services Update: Directors' Liability Concerns After Skilling and Black*, 18 TEX. WESLEYAN L. REV. 149, 174 (2011) ("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 . . .").

<sup>65</sup>Lisa L. Casey, *Class Action Criminality*, 34 J. CORP. L. 153, 190 (2008) (questioning which fiduciary duties give rise to the right to honest services).

<sup>66</sup>See *United States v. Sancho*, 157 F.3d 918, 920 (2d Cir. 1998) ("Nothing in either § 1343 or § 1346 indicates that the existence of an actual fiduciary duty is a necessary element of the crime.").

<sup>67</sup>*Skilling v. United States*, 130 S. Ct. 2896, 2938 (2010).

<sup>68</sup>*Id.* at 2936 (Scalia J., concurring in part and concurring in judgment).

<sup>69</sup>380 F.2d 665 (5th Cir. 1967).

explained that the law disfavors "conduct which fails to match the 'reflection of moral uprightness, of fundamental honesty, fair play and right dealing in the general and business life of members of society.'"<sup>70</sup> The Fifth Circuit's language is incredibly broad, far-reaching, and likely to be subject to unequal treatment.<sup>71</sup>

Most of the circuit courts agree that it is unnecessary to find a state law violation in order to convict for honest services mail fraud.<sup>72</sup> In contrast, the Fifth Circuit in *United States v. Brown*<sup>73</sup> found that "[h]onest services' are services owed to an employer under state law," including fiduciary duties defined by the employer-employee relationship.<sup>74</sup> Conversely, the Seventh Circuit, rather than relying on state law, once consulted an employee handbook to find the existence of the same duty.<sup>75</sup> The dissimilarities in the circuit courts' analyses when considering these similar relationships is disconcerting and reveals the contrasting treatment this statute has received in different jurisdictions. The varying approaches to finding a duty in honest services mail fraud cases are discussed below.

In *United States v. Sancho*,<sup>76</sup> when considering whether a real estate developer owed a duty to a construction company, the Second Circuit held that it was unnecessary to find a fiduciary duty when considering honest services fraud cases.<sup>77</sup> In using a statutory constructionist perspective, the court simply looked to the language of the honest services fraud statute,<sup>78</sup> noting that there is no indication that the existence of a fiduciary relationship is an element of the crime.<sup>79</sup> The court did find that a duty existed, but declined to accept defendant's argument that the duty owed must be classified as a *fiduciary* duty.<sup>80</sup>

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<sup>70</sup>*Id.* at 671 (quoting *Gregory v. United States*, 253 F.2d 104, 109 (5th Cir. 1958)).

<sup>71</sup>*See, e.g.*, *United States v. Curry*, 681 F.2d 406, 410 (5th Cir. 1982) ("The definition of a scheme to defraud is quite broad.").

<sup>72</sup>*Casey, supra* note 39, at 56 ("Most circuits . . . have decided that proving an independent violation of state law is not necessary for an honest services fraud conviction.").

<sup>73</sup>459 F.3d 509 (5th Cir. 2006).

<sup>74</sup>*Id.* at 519 (quoting *United States v. Caldwell*, 302 F.3d 399, 409 (5th Cir. 2002)).

<sup>75</sup>*United States v. George*, 477 F.2d 508, 514 (7th Cir. 1973).

<sup>76</sup>157 F.3d 918 (2d Cir. 1998).

<sup>77</sup>*Id.* at 921-22.

<sup>78</sup>*Id.*; 18 U.S.C. § 1346 (2006) ("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.").

<sup>79</sup>*United States v. Sancho*, 157 F.3d 918, 920 (2d Cir. 1998) ("Nothing in either § 1343 or § 1346 indicates that the existence of an actual fiduciary duty is a necessary element of the crime.").

<sup>80</sup>*Id.* at 921 ("We do not accept his argument. Section 1346 does not require the existence of a fiduciary relationship.").

In *United States v. Lemire*,<sup>81</sup> the D.C. Circuit Court found that the manager of a subsidiary company who provided advance information to a freight-forwarding corporation had breached his duty to the parent company.<sup>82</sup> In drawing this conclusion, the D.C. Circuit, similar to the Second Circuit in *Sancho*, noted that the government does not necessarily need to establish the existence of a fiduciary duty to convict for honest services mail fraud.<sup>83</sup> Further, the court rejected the notion that the duty may be found in either state or federal law.<sup>84</sup> Instead, the court suggested that the duty owed might stem from an employment, or similar, relationship where comparable duties of loyalty exist.<sup>85</sup>

According to the Eleventh Circuit, the duty of loyalty, as it is understood in the public sector, does not have an equivalent counterpart in the private realm.<sup>86</sup> For this reason, in *United States v. deVegter*,<sup>87</sup> the court held that the government must establish that a fiduciary duty existed, but declined to recognize that the breach of a duty of loyalty is enough to invoke criminal sanctions.<sup>88</sup> In *deVegter*, the court found that because the defendant, an investment banker, was "vested with a position of dominance, authority, trust, and de facto control[,] a fiduciary duty did exist."<sup>89</sup>

In *United States v. Frost*,<sup>90</sup> the Sixth Circuit was afforded the opportunity to specifically consider whether, and by what means, section 1346 extends to employer-employee relationships.<sup>91</sup> Here, defendants—professors at a university—were charged with depriving the university of the honest services of its employees.<sup>92</sup> The Sixth Circuit held that "federal law governs the existence of fiduciary dut[ies]" under sections 1341 and 1346 and that it is "axiomatic" to find a fiduciary duty in an employer-employee relationship.<sup>93</sup> The court based this assertion on the principle of agency,<sup>94</sup> citing the Restatement (Second) of Agency § 1, which defines agency as "the fiduciary relation which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his

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<sup>81</sup>720 F.2d 1327 (D.C. Cir. 1983).

<sup>82</sup>*Id.* at 1351-52.

<sup>83</sup>*Id.* at 1335-36.

<sup>84</sup>*Id.* ("The duty breached need not arise from state or federal law . . .").

<sup>85</sup>*Lemire*, 720 F.2d at 1336.

<sup>86</sup>*See* *United States v. deVegter*, 198 F.3d 1324, 1328 (11th Cir. 1999).

<sup>87</sup>*Id.* at 1324.

<sup>88</sup>*Id.* at 1329.

<sup>89</sup>*Id.* at 1331.

<sup>90</sup>125 F.3d 346 (6th Cir. 1997).

<sup>91</sup>*Id.* at 365.

<sup>92</sup>*Id.* at 352.

<sup>93</sup>*Id.* at 366.

<sup>94</sup>*Frost*, 125 F.3d at 366.

control, and consent by the other so to act."<sup>95</sup>

Most recently, the Ninth Circuit addressed whether merely a "trust" relationship, without any formal fiduciary duties, was sufficient for honest services fraud.<sup>96</sup> In *United States v. Milovanovic*,<sup>97</sup> the defendants allegedly accepted bribes to help unqualified applicants obtain commercial drivers' licenses.<sup>98</sup> The defendants were both independent contractors and had neither an agency relationship, nor an employment relationship with the licensing department.<sup>99</sup> The court agreed that it is necessary to establish a fiduciary relationship, but held that the relationship need not be a formal or traditional fiduciary relationship.<sup>100</sup> According to the court, the meaning of "fiduciary duty" in *this* context "extends to a trusting relationship in which one party acts for the benefit of another and induces the trusting party to relax the care and vigilance which it would ordinarily exercise."<sup>101</sup> Such a definition included the defendants—independent contractors.<sup>102</sup>

Because *Skilling* neglected to precisely define who could be found liable of an honest services fraud violation,<sup>103</sup> courts have looked to different cases and have attempted to answer the question in different ways.<sup>104</sup> Though the circuits are split on what sort of duty must be established in order for an honest services fraud conviction to attach,<sup>105</sup> it is most widely asserted by prosecutors that the "duty of loyalty" has been breached.<sup>106</sup> Most courts disagree with the Eleventh Circuit's approach that the "duty of loyalty" found in the private sector is not appropriate to use as a basis for honest services fraud convictions.<sup>107</sup>

### B. *What are "Bribes" and "Kickbacks"?*

When the courts first began using the mail fraud statutes in the context of "intangible rights," the word "bribe" was occasionally used but

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<sup>95</sup>RESTATEMENT (SECOND) OF AGENCY § 1 (1958).

<sup>96</sup>*United States v. Milovanovic*, 678 F.3d 713, 716 (9th Cir. 2012) (en banc).

<sup>97</sup>*Id.* at 713.

<sup>98</sup>*Id.* at 716-17.

<sup>99</sup>*Id.* at 719.

<sup>100</sup>*Milovanovic*, 678 F.3d at 724.

<sup>101</sup>*Id.*

<sup>102</sup>*Id.*

<sup>103</sup>*See Skilling v. United States*, 130 S. Ct. 2896 (2010).

<sup>104</sup>*See supra* notes 62-102 and accompanying text.

<sup>105</sup>*See supra* notes 62-102 and accompanying text.

<sup>106</sup>*See Casey, supra* note 39, at 43.

<sup>107</sup>*See id.* (noting that prosecutors often identify breaches of the duty of loyalty in charging documents; logic dictates that they would not do so if courts did not accept such a breach as a basis for honest services fraud).

did not require the showing of a strict *quid pro quo*.<sup>108</sup> Today, however, the courts sometimes treat honest services fraud bribery as a *quid pro quo*.<sup>109</sup> Notably, the language of sections 1341 and 1346 supports a finding that bribery, does not actually require a *quid pro quo* when considered in the context of honest services mail fraud.<sup>110</sup> In the following sections, this Note discusses the limited guidance offered by *Skilling* in terms of defining bribery and the courts subsequent application of the now-articulated requirement to establish bribery or kickbacks when indicting under section 1346.

### 1. Skilling

The United States Supreme Court's sixty-eight-page decision in *Skilling* offers just one sentence to assist with the otherwise unguided task of defining "bribes" and "kickbacks."<sup>111</sup> Justice Ginsburg, writing for the majority, notes "[the statute's] prohibition on bribes and kickbacks draws content not only from the pre-*McNally* case law, but also from federal statutes proscribing—and defining—similar crimes."<sup>112</sup> In this single sentence, the Court confirms that pre-*McNally* cases properly applied the terms "bribes" and "kickbacks" in circumstances involving honest services mail fraud.<sup>113</sup> Additionally, the Court cites to three statutes as suggestions of other federal statutes from which a definition could be lifted: 18 U.S.C. § 201(b) (2006), 18 U.S.C. § 666(a)(2) (2006), and 41 U.S.C. § 8701 (2006).<sup>114</sup>

#### a. *Pre-McNally Case Law*<sup>115</sup>

*McNally* is a "classic kickback" case.<sup>116</sup> A public official and a third-party, unrelated to the duty relationship, conspired in a way that they would

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<sup>108</sup>See Persky, *supra* note 57, at 27 ("A strict *quid pro quo* was not required . . .").

<sup>109</sup>United States v. Arthur, 544 F.2d 730, 734 (4th Cir. 1976).

<sup>110</sup>Compare 18 U.S.C. § 1341 (2006), and 18 U.S.C. § 1346 (2006), with 18 U.S.C. § 201(b)(2) ("Whoever . . . receives . . . anything of value . . . in return for . . . being influenced in the performance of any official act . . .") (emphasis added).

<sup>111</sup>*Skilling v. United States*, 130 S. Ct. 2896, 2933 (2010).

<sup>112</sup>*Id.*

<sup>113</sup>*Id.*

<sup>114</sup>*Id.* at 2933-34. 41 U.S.C. § 8701 was formerly cited as 41 U.S.C. § 52.

<sup>115</sup>Because the decision in *Skilling* does not distinguish between honest services fraud in the public and private context, I will draw from cases in both sectors.

<sup>116</sup>*Skilling*, 130 S. Ct. at 2932.

each profit from wealth generated by public contracts.<sup>117</sup> The Court distinguishes this conduct from mere undisclosed self-dealing<sup>118</sup> and failure to disclose a conflict of interest,<sup>119</sup> and warns that the constitutionality of section 1346 may again be examined if Congress chooses to extend the reach of the statute to include such behavior.<sup>120</sup>

The *Skilling* decision, however, does not cite to any pre-*McNally* cases that serve as a model or "classic" bribery case.<sup>121</sup> In one pre-*McNally* bribery case, *United States v. Proctor & Gamble*,<sup>122</sup> a federal district court found bribery existed where the defendant's agents made payments of gratuity to employees of another company in exchange for various formulas and facts.<sup>123</sup> The court noted that acceptance of unsolicited gifts of gratuities is not recognized as a bribe.<sup>124</sup> Some courts required that the government show a *quid pro quo* to establish bribery,<sup>125</sup> while other courts were not prepared to hold that an actual *quid pro quo* is a necessary element.<sup>126</sup> Interestingly, ascertaining what weight these decisions actually carry is difficult because none of the pre-*McNally* cases have limited the analysis of mail fraud to only bribery and kickbacks.<sup>127</sup>

b. *Sections 201(b)(2), 666(a)(2), & 8701(2)*

As noted above, the *Skilling* court pointed to sections 201,<sup>128</sup> 666,<sup>129</sup> and 8701<sup>130</sup> for additional guidance on defining "bribes" and "kickbacks."<sup>131</sup>

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<sup>117</sup>*McNally v. United States*, 483 U.S. 350, 352 (1987).

<sup>118</sup>*Skilling*, 130 S. Ct. at 2932. Self-dealing occurs when the fiduciary is negotiating on both sides of the transaction. *See id.* Self-dealing is defined as "[p]articipation in a transaction that benefits oneself instead of another who is owed a fiduciary duty." BLACK'S LAW DICTIONARY (9th ed. 2009).

<sup>119</sup>*Skilling*, 130 S. Ct. at 2932.

<sup>120</sup>*Id.* at 2933 n.44.

<sup>121</sup>*See Skilling*, 130 S. Ct. 2896 (2010).

<sup>122</sup>47 F. Supp. 676 (D. Mass. 1942).

<sup>123</sup>*Id.* at 678.

<sup>124</sup>*United States v. McNeive*, 536 F.2d 1245, 1251 (8th Cir. 1976) ("The acceptance of small unsolicited gratuities or tips is not a bribe . . . or a 'scheme or artifice to defraud' under the facts of this case.").

<sup>125</sup>*See, e.g., United States v. Arthur*, 544 F.2d 730, 734 (4th Cir. 1976).

<sup>126</sup>*See, e.g., United States v. L'Hoste*, 609 F.2d 796, 808 (5th Cir. 1980).

<sup>127</sup>*Skilling v. United States*, 130 S. Ct. 2896, 2939 (2010) (Scalia, J., concurring) ("Among all the pre-*McNally* smorgasbord-offerings of varieties of honest-services fraud, *not one* is limited to bribery and kickbacks. That is a dish the Court has cooked up all on its own.").

<sup>128</sup>18 U.S.C. § 201 (2006).

<sup>129</sup>18 U.S.C. § 666(a)(2) (2006).

<sup>130</sup>41 U.S.C. § 8701 (2006).

<sup>131</sup>*See supra* text accompanying notes 111-14.

Section 201(b)(2) criminalizes bribery, defined as the acceptance of anything of value in return for: (1) being influenced in the performance of an official act; (2) being influenced to commit fraud on the United States; or (3) being induced to do or omit to do any act in violation of an official duty.<sup>132</sup> A conviction under section 201 may result in a maximum sentence of fifteen years imprisonment.<sup>133</sup> Conversely, under section 666(a)(2), bribery in the context of programs receiving federal funding carries a maximum sentence of ten years imprisonment.<sup>134</sup>

41 U.S.C. § 8701(2) governs only public contracts and defines a kickback as "any . . . thing of value, or compensation of any kind which is provided [to another to] . . . improperly obtain[] or reward[] favorable treatment in connection with a prime contract . . . ."<sup>135</sup>

## 2. Post-Skilling Interpretation

The Seventh Circuit recently reaffirmed that gifts are not bribes.<sup>136</sup> Instead the court defined bribes as "private payment[s] for official services rendered, where the payment was designed to influence those official acts . . . ."<sup>137</sup> A strict showing of a *quid pro quo*, however, was not required.<sup>138</sup> The Second Circuit, while neglecting to actually define either "bribery" or "kickback," indicated that a jury instruction describing the honest services fraud statute as "a kind of anti kickback or anti bribery law" is insufficient.<sup>139</sup>

## IV. EVALUATION

Delaware has retained its preeminence as the forum of choice for business formations in large part due to its predictability in the area of business-entity law.<sup>140</sup> As discussed above, section 1346 of the federal code has not experienced the same certainty in its application.<sup>141</sup> This lack of predictability is primarily due to courts' inconsistent applications of section

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<sup>132</sup>18 U.S.C. § 201(b)(2).

<sup>133</sup>18 U.S.C. § 201(b)(4).

<sup>134</sup>18 U.S.C. § 666(a)(2).

<sup>135</sup>41 U.S.C. § 8701(2).

<sup>136</sup>*See* Ryan v. United States, 688 F.3d 845, 849 (7th Cir. 2012) (distinguishing bribes from gifts).

<sup>137</sup>*Id.*

<sup>138</sup>*Id.* at 850.

<sup>139</sup>United States v. Mahaffy, 693 F.3d 113, 136 (2d Cir. 2012).

<sup>140</sup>Casey, *supra* note 39, at 83-84.

<sup>141</sup>*See supra* Part III (discussing the disparate treatment of section 1346 among the federal courts).

1346, which undeniably leads to results that are as confounding as they are expensive.<sup>142</sup> As a consequence of such irregularity, individuals in the private sector, such as corporate directors and officers, are left with uncertainty as to whether their conduct will subject them to criminal liability.<sup>143</sup> To be sure, the concept of "right to honest services," although relatively consistently applied in the public sector, has experienced disparate treatment in the private realm.<sup>144</sup> Accordingly, this author submits that Congress, as opposed to the federal courts,<sup>145</sup> should be charged with enacting separate legislation for such private-sector mail and wire fraud causes of action.

It is well settled that the civil punishments for duty breach have not sufficiently addressed the goals of honest services fraud: punishment and deterrence.<sup>146</sup> Particularly in the private sector, civil sanctions have become a "cost of doing business."<sup>147</sup> The Department of Justice is concerned that imposing too many restrictions on the use of section 1346 will thwart one of the goals of the statute in the private sector: fighting corporate crime.<sup>148</sup> Another concern is that punishable conduct will slip through the cracks if use of the statute becomes too limited.<sup>149</sup> These concerns highlight some of the reasons that Congress must amend section 1346 to ensure that the statute's goals are effectively fulfilled.

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<sup>142</sup>See Casey, *supra* note 39, at 84 ("Predictability . . . is a hallmark, or at least the goal, of the current corporate regulatory regime. Predictability promotes commerce. Subjecting public company executives to potentially conflicting substantive duties under state and federal law will likely be . . . expensive and confusing.").

<sup>143</sup>See discussion *supra* Part III.A.

<sup>144</sup>See *United States v. deVegter*, 198 F.3d 1324, 1328 (11th Cir. 1999).

<sup>145</sup>See, e.g., *United States v. Frost*, 125 F.3d 346, 369 (6th Cir. 1997) ("[W]e stress that we are not reviewing the standard applicable to defendants accused of depriving the public of the honest services of public officials."); *United States v. Lemire*, 720 F.2d 1327, 1337 n.13 (D.C. Cir. 1983) ("Our holding does not address whether an undisclosed conflict of interest, by itself, can support the wire fraud conviction of a public official.").

<sup>146</sup>See Casey, *supra* note 39, at 85 ("State law . . . provides a host of potential sanctions available to the corporation whose executives breached their duties. Yet, enforcement of those fiduciary duties is infrequent at best . . ."); Cava & Stewart, *supra* note 57, at 21 ("The events of the past decade have made glaringly clear that the civil justice and administrative regulatory systems cannot effectively harness the imaginations of determined fraudsters.").

<sup>147</sup>See Casey, *supra* note 39, at 85 ("[Fiduciaries] . . . view potential sanctions as a cost of doing business.").

<sup>148</sup>See Persky, *supra* note 57, at 30.

<sup>149</sup>See *id.* at 31.

### A. *The Need to Bifurcate Section 1346*

Despite arguments in support of distinguishing between public and private honest services fraud,<sup>150</sup> the decision in *Skilling* neglected to do so. In a footnote, the *Skilling* court indicates that section 1346 must remain on the books so that there is still a vehicle by which private conduct involving bribery can be prosecuted without being curtailed by section 201, which relates only to public officials.<sup>151</sup> The need to differentiate between public and private honest services fraud stems from the fact that relationships between elected officials and the public are vastly different from purely private relationships, which are built around interests "less ethereal and more economic than the abstract satisfaction of receiving 'honest services' for their own sake."<sup>152</sup> Rather, public confidence in such private-sector relationships, as with corporate directors and officers, is grounded in agency and tort law, particularly in fiduciary duties.<sup>153</sup>

### B. *Origin of the Duty Owed in Honest Services Cases*

Black's Law Dictionary defines a fiduciary as "[a] person who is required to act for the benefit of another person on all matters within the scope of their relationship; one who owes to another the duties of good faith, trust, confidence, and candor . . . ."<sup>154</sup> As evidenced by the following discussion, *Skilling* likely intended to require that the breached duty be a fiduciary duty. In attempting to reach the "core" of section 1346, the Court commented: "The 'vast majority' of the honest-services cases involved offenders who, *in violation of their fiduciary duty*, participated in bribery or kickback schemes."<sup>155</sup> Similarly, in his concurring opinion, Justice Scalia notes, "'the intangible right of honest services' means the right not to have *one's fiduciaries* accept 'bribes or kickbacks.'"<sup>156</sup> Because the Court

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<sup>150</sup>See, e.g., John C. Coffee, Jr., *Modern Mail Fraud: The Restoration of the Public/Private Distinction*, 35 AM. CRIM. L. REV. 427, 459-63 (1998) (arguing that the mail and wire fraud statutes should distinguish between public and private fiduciaries).

<sup>151</sup>See *Skilling v. United States*, 130 S. Ct. 2896, 2934 n.45 (2010) ("The principal federal bribery statute, § 201 . . . applies only to federal public officials, so § 1346's application to . . . private-sector fraud reaches misconduct that might otherwise go unpunished.").

<sup>152</sup>*United States v. Frost*, 125 F.3d 346, 365 (6th Cir. 1997) (citing *United States v. Jain*, 93 F.3d 436, 442 (8th Cir. 1996)).

<sup>153</sup>See Kobrin, *supra* note 24, at 797.

<sup>154</sup>BLACK'S LAW DICTIONARY 702 (9th ed. 2009).

<sup>155</sup>*Skilling*, 130 S. Ct. at 2930 (emphasis added) (quoting *United States v. Runnels*, 833 F.2d 1183, 1187 (6th Cir. 1987)).

<sup>156</sup>*Id.* at 2935 (Scalia, J., concurring) (emphasis added).

repeatedly referred to fiduciary duties when discussing the duty element of honest services mail fraud, it logically follows that it intended to require the finding of a fiduciary duty before upholding a conviction of honest services fraud.

Post-*Skilling*, many of the lower courts' attempts to define the nature of the fiduciary duties required by section 1346 are flawed.<sup>157</sup> Suggesting that the fiduciary duties to which section 1346 refers are borne out of federal common law fiduciary duties is futile due to the disparate treatment the statute has received among federal courts.<sup>158</sup> To posit that the duties are derived from state law is also problematic because the obligations of fiduciaries vary from state-to-state.<sup>159</sup> Most unsound is the suggestion that the existence of a fiduciary duty may be found in something like an employee handbook—a writing that does not even create a contractual relationship.<sup>160</sup>

Fiduciary obligations differ by the nature of the relationship.<sup>161</sup> The purpose of fiduciary law in the corporate context is civil, not criminal.<sup>162</sup> Civil law and criminal law are "trending in opposite directions."<sup>163</sup> Thus, it is inappropriate to make these duties the basis of criminal prosecution.<sup>164</sup>

### C. *The Problem with Public Bribes*

The Court's failure to adequately define the specific acts proscribed by section 1346 has resulted in prosecutors sculpting a definition that fits their immediate needs. Without denoting a difference between honest services fraud in the public and private sectors, the Court proposed that the contours of honest services fraud bribery be drawn from other federal statutes.<sup>165</sup> Two of these statutes are 18 U.S.C. §§ 201(b) & 666(a)(2).<sup>166</sup> Remarkably, these statutes apply only to bribery as it relates to public

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<sup>157</sup>See *supra* Part III.A.

<sup>158</sup>See *Skilling*, 130 S. Ct. at 2937 (Scalia, J., concurring).

<sup>159</sup>See Paul M. Kessimian, *Business Fiduciary Relationships and Honest Services Fraud: A Defense of the Statute*, 2004 COLUM. BUS. L. REV. 197, 211 (2004).

<sup>160</sup>See Casey, *supra* note 39, at 57.

<sup>161</sup>See *United States v. Margiotta*, 688 F.2d 108, 142 (2d Cir. 1982).

<sup>162</sup>See generally Peter R. Ezersky, *Intra-Corporate Mail and Wire Fraud: Criminal Liability for Fiduciary Breach*, 94 YALE L.J. 1427, 1436-40 (1985) (discussing corporate fiduciaries' duties and how they apply in civil law).

<sup>163</sup>Casey, *supra* note 39, at 8.

<sup>164</sup>See Ezersky, *supra* note 162, at 1436-40.

<sup>165</sup>See *Skilling v. United States*, 130 S. Ct. 2896, 2933 (2010).

<sup>166</sup>*Id.*

officers and programs receiving federal funds, not to private conduct.<sup>167</sup>

There is nothing intuitive about applying the language of these statutes—designed to target bribery as it relates to public acts—to honest services fraud, which relates to both public and private acts, without distinguishing the two. In order to emphasize how unfitting it is to use these statutes in the private sector, it is helpful to understand that applying sections 201 and 666 to honest services fraud cases is problematic in the public sector as well. First, with regard to deterrence in the public sector, if we adopt the language of sections 201 and 666 to fill the gap in section 1346, then section 1346 is superfluous and adds nothing further to the inquiry of the proscribed behavior. Thus, if one were to engage in the prohibited conduct under sections 201 and 666, that conduct would almost automatically fall under section 1346 as well and no additional behavior will have successfully been deterred. In terms of punishment, sections 201 and 666 carry a maximum sentence of fifteen and ten years, respectively.<sup>168</sup> A conviction under section 1346 carries a prison sentence of up to twenty years.<sup>169</sup> It is excessive to potentially add twenty years to a defendant's prison sentence for an act that is virtually the same and already carries a sentence of ten to fifteen years.

While section 1346 seeks to both punish and deter in the public and private context, the use of the statute in these two dissimilar arenas causes contrasting results.<sup>170</sup> For instance, in the private sector, unlike the public sector, it is sometimes difficult to distinguish between a corporate director who has criminal intent, and one who is making an aggressive business decision, hoping to "turn the most profit possible"—the exact duty with which he is charged under corporate fiduciary law.<sup>171</sup> Additionally, by using the language of public federal bribery statutes in a private context, simple "corporate hospitality" could become the basis of criminal prosecution.<sup>172</sup> It is outlandish to suggest that it would be appropriate to prosecute a corporation who takes a potential client to a fancy dinner simply because that

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<sup>167</sup>See 18 U.S.C. § 201 (2006) ("Bribery of *public officials* and witnesses") (emphasis added); 18 U.S.C. § 666 (2006) ("Theft or bribery *concerning programs receiving Federal funds*") (emphasis added).

<sup>168</sup>18 U.S.C. §§ 201(b)(4), 666(a)(2).

<sup>169</sup>See Casey, *supra* note 39, at 6 (noting that each conviction of honest services mail-fraud carries a maximum sentence of twenty years).

<sup>170</sup>See United States v. deVegter, 198 F.3d 1324, 1328 (11th Cir. 1999).

<sup>171</sup>See Cava & Stewart, *supra* note 57, at 14; *see also* United States v. L'Hoste, 609 F.2d 796, 808 (5th Cir. 1980) ("[C]ertain practices designed to promote business in the private sector may very well be intended as a *quid pro quo* for that business. Yet, in the public sector, the same practices may run counter to a bribery statute."); *c.f.* DEL. CODE ANN. tit. 8, § 141 (2006) (vesting authority to manage the affairs of the corporation in the corporation's board of directors).

<sup>172</sup>See Persky, *supra* note 57, at 31.

potential client ends up giving the company business.<sup>173</sup>

#### D. *Implications on Delaware Business Entities*

Corporate directors in Delaware, while exercising their vested authority to manage the corporation's affairs,<sup>174</sup> must do so while fulfilling their fiduciary duties of loyalty and care.<sup>175</sup> Although it is unclear whether members and managers under Delaware LLC law owe such fiduciary duties by default,<sup>176</sup> it is clear that such duties, to the extent they exist, can be contracted away.<sup>177</sup> Notwithstanding the fact that Delaware's fiduciary duty law is considered "extensive, if not wholly coherent,"<sup>178</sup> applying state-fiduciary duty law to establish whether a duty, and ultimate breach of that duty, exists under section 1346 is nonsensical for a myriad of reasons.

##### 1. State Law Varies With Respect to Fiduciary Duty Law Resulting in Inconsistent Decisions

The internal affairs doctrine holds that the laws of the state of incorporation (or formation in the case of unincorporated entities) govern matters concerning a business's internal affairs.<sup>179</sup> Accordingly, since Delaware is the forum of choice for 59 percent of the Fortune 500 and 85 percent of corporations that are not incorporated in the founder's home state,<sup>180</sup> Delaware fiduciary law will likely govern most business-entity disputes. Notwithstanding the fact that Delaware fiduciary law will likely govern in the case of private-sector convictions,<sup>181</sup> it is unclear whether federal prosecutors will apply Delaware fiduciary law when prosecuting

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<sup>173</sup>*Id.*

<sup>174</sup>See DEL. CODE ANN. tit. 8, § 141.

<sup>175</sup>See Nicole M. Sciotto, *Opt-In vs. Opt-Out: Settling the Debate Over Default Fiduciary Duties in Delaware LLCs* 37 DEL. J. CORP. L. 531, 539-40 (2012).

<sup>176</sup>See generally *id.*; see also Ann E. Conaway & Peter I. Tsoflias, *The Delaware Series LLC: Sophisticated and Flexible Business Planning*, 2 MICH. J. PRIV. EQUITY & VENTURE CAP. L. 97, 127-30 (2012).

<sup>177</sup>See DEL. CODE ANN. tit. 6, § 18-1101(c); *but see* *Meinhard v. Salmon*, 164 N.E. 545, 549 (N.Y. 1928) (articulating the duty of finest loyalty in the partnership context).

<sup>178</sup>See Casey, *supra* note 39, at 85.

<sup>179</sup>See, e.g., *Edgar v. MITE Corp.*, 457 U.S. 624, 645 (1982) ("The internal affairs doctrine is a conflict of law principle which recognizes that only one State should have the authority to regulate a corporation's internal affairs—matters peculiar to the relationships among or between the corporation and its current officers, directors, and shareholders . . .").

<sup>180</sup>See Lucian Arye Bebchuk & Assaf Hamdani, *Vigorous Race or Leisurely Walk: Reconsidering the Competition Over Corporate Charters*, 112 YALE L.J. 553, 578 (2002).

<sup>181</sup>A notion this Author supports by the doctrine of comity.

pursuant to section 1346. In the same vein, parties will certainly argue for the application of the state fiduciary law most favorable to their case, resulting in inconsistent outcomes.

For example, in Delaware, unlike other states, parties to an LLC agreement are statutorily granted with the authority to eliminate fiduciary duties.<sup>182</sup> Consider a hypothetical manager of a Delaware LLC, who owes no fiduciary duties pursuant to the LLC operating agreement. If this manager then bribes another business-entity formed and located in the state of Minnesota, the prosecution will argue that Minnesota LLC law applies. The defendant, meanwhile, will argue that Delaware LLC law applies, and the LLC agreement governs: there would be no fiduciary duties owed to serve as the basis of an honest services fraud conviction. As noted above, it is unclear how a federal court will rule. This lack of clarity is compounded by the District Court's holding in *Butler v. Adoption Media, LLC*,<sup>183</sup> where the court refused (albeit unconstitutionally) to apply the laws of the state of formation.<sup>184</sup>

In the same vein, many states recognize business entities that do not exist in other jurisdictions, thus it is unclear whether a court will apply fiduciary duties where a particular entity has not been adopted by a designated forum. For example, Delaware's LLC Act provides for the creation of a "Series LLC."<sup>185</sup> A Series LLC simply allows for the separation of assets and interests into separate cells or units.<sup>186</sup> This separation creates certain "internal shields" of liability.<sup>187</sup> Despite this separation, it is unclear whether a manager of one series owes any fiduciary duties to the members and or members of another series.<sup>188</sup> In light of this lack of clarity, and the fact that a Series LLC is not universally adopted by all jurisdictions,<sup>189</sup> it is unclear how a federal court will prosecute a manager of such a business form.

Finally, even if a federal court overcomes the obstacle of deciding

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<sup>182</sup>DEL. CODE ANN. tit. 6, § 18-1101(c) (2011) ("[T]he member's or manager's or other person's duties may be expanded or restricted or eliminated by provisions in the limited liability company agreement; provided, that the limited liability company agreement may not eliminate the implied contractual covenant of good faith and fair dealing.").

<sup>183</sup>2005 WL 2077484, at \*1 (N.D. Cal. Aug. 26, 2005).

<sup>184</sup>*See id.* at 3.

<sup>185</sup>*See* DEL. CODE ANN. tit. 6, § 18-215.

<sup>186</sup>*See, e.g.,* Daniel S. Kleinberger & Carter G. Bishop, *The Next Generation: The Revised Uniform Limited Liability Company Act*, 62 BUS. LAW. 515, 541 (2007) (stating that the series LLC allows an LLC to "compartmentalize its operations and create 'internal' shields to protect assets").

<sup>187</sup>*See id.*

<sup>188</sup>Conaway, *supra* note 176, at 127-30.

<sup>189</sup>*See id.* at 102-03 ("[S]ince its creation, nine other jurisdictions have followed Delaware and adopted 'series' legislation . . .").

which state's law will apply when determining whether a duty existed, a question still remains: what duty do we apply? Specifically, it is unclear whether courts will apply fiduciary duties principles grounded in agency law, trust law, or tort law.<sup>190</sup>

## 2. Pleading Standard in Federal Criminal Law is Lower Than Civil Law

The pleading standard in federal criminal court is much lower than that in Delaware courts. A number of procedural obstacles exist in Delaware courts that make it particularly difficult for shareholders to enforce fiduciary duties in derivative suits.<sup>191</sup> In fact, due to the heightened pleading standard—the need to allege particularized facts—these cases rarely make it past the pleading stage.<sup>192</sup>

In federal criminal court, the indictment does not need to contain particularized facts.<sup>193</sup> With such a low pleading standard, indictments generally survive motions to dismiss with ease.<sup>194</sup> The standard for indicting someone is so low that it is said, "prosecutors could convince a grand jury to indict a ham sandwich."<sup>195</sup>

Similarly, Delaware has its own standards of review to resolve business-entity internal affairs disputes, which sharply differ from the standards used in honest services fraud convictions. In particular, Delaware courts often invoke the business judgment rule to the majority of business transactions.<sup>196</sup> Delaware courts also apply entire fairness review to "interested" transactions.<sup>197</sup> Thus, a Delaware fiduciary (*i.e.*, a corporate director) might clearly bribe another individual to gain his or her business, but a Delaware court of equity might uphold this transaction under the deferential business judgment rule. On the other hand, the same Delaware fiduciary might be involved in an interested transaction and, during that transaction, may provide a "kickback" to the other contracting entity, resulting in civil liability under the strict entire fairness review and, consequently, criminal liability under section 1346.

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<sup>190</sup>See *supra* Part III.A.

<sup>191</sup>See Casey, *supra* note 39, at 18.

<sup>192</sup>See *id.* at 25.

<sup>193</sup>FED. R. CRIM. P. 7(c)(1).

<sup>194</sup>See Casey, *supra* note 39, at 45.

<sup>195</sup>*Id.*

<sup>196</sup>See, e.g., Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 360 (Del. 1993) (applying the business judgment rule as a way "to preclude [the] court from imposing itself unreasonably on the business and affairs of [the] corporation").

<sup>197</sup>See, e.g., Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983) (explaining one's requirement to establish entire fairness when standing on both sides of the transaction).

## V. SOLUTION

Criminal statutes must be worded with sufficient definiteness so that laypeople, lawyers, and judges all understand what the prohibited conduct is and who will be punished under the statute.<sup>198</sup> Presently, the honest services mail fraud statute fails to sufficiently define the contours of the conduct it prohibits.<sup>199</sup> This author proposes: (1) section 1346 should address public and private honest services violations separately; (2) violations of honest services fraud should be based on a criminal law duty akin to that found in agency law ("criminal agency duty"); and (3) section 1346 should explicitly define the bribery and kickbacks that are proscribed by the statute.

First, section 1346 should be amended to incorporate a carve-out that addresses honest services fraud convictions that occur specifically in purely private settings, such as corporate or alternative business entities. By bifurcating the statute in such a manner, the statute—which was originally applied to only public cases<sup>200</sup>—will be structured in a way that the idiosyncrasies of private business relationships can be properly addressed.

Next, the duty on which the statute relies should be based on criminal agency duty. Agency is the fiduciary duty that arises between two parties, where one party (the "agent") must act for the benefit of the other party (the "principal").<sup>201</sup> While it is sometimes possible to contract away civil duties of agency,<sup>202</sup> the criminal agency duty cannot be eliminated. Basing honest services fraud violations on a criminal agency duty will accomplish two objectives: (1) courts will consistently base convictions of honest services fraud on the same duty, and (2) potential violators of honest services fraud will not be able to preemptively contractually exculpate themselves from the criminal liability associated with section 1346.

Finally, the statute should statutorily define bribery and kickbacks so that courts are no longer required to embark upon the onerous task of analyzing a myriad of conflicting pre-*McNally* decisions to find a suitable

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<sup>198</sup>See *Skilling v. United States*, 130 S.Ct. 2896, 2904 (2010).

<sup>199</sup>See, e.g., *United States v. Mahaffy*, 693 F.3d 113, 136 (2d Cir. 2012) (explaining that a jury requested a "plain English" definition of honest services fraud).

<sup>200</sup>See *supra* text accompanying notes 63-64.

<sup>201</sup>RESTATEMENT (THIRD) OF AGENCY § 101 (2006) ("Agency is the fiduciary relation which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and consent by the other so to act 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 that the agent manifests assent or otherwise consents so to act.").

<sup>202</sup>See *supra* Part IV.D.

definition.<sup>203</sup> Section 1346 should define bribery as "the knowing solicitation or acceptance of a benefit in exchange for violating a criminal agency duty." Kickback should be defined as "a return of a portion of a monetary sum received as a result of coercion or a secret agreement in violation of criminal agency duty."

## VI. CONCLUSION

Section 1346 must be amended in order to effectively prosecute honest services fraud violations in the private sector. Presently, the contours of section 1346 are poorly defined and subject to broad interpretation. The circuit courts have come to differing conclusions on the source of the duty that invokes an honest services fraud violation. Additionally, the courts are unable to agree on a uniform definition of either bribes or kickbacks.<sup>204</sup> For these reasons, it is necessary that section 1346 indicate the precise source of the duty in honest services fraud cases and statutorily define bribes and kickbacks. Until section 1346 is amended to specifically target violators of honest services fraud in the private context, the idiosyncrasies of corporate law and alternative business entity law will allow violators to evade criminal prosecution under the statute.

*Michelle V. Barone*

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<sup>203</sup>See *supra* Part III.A.

<sup>204</sup>See *supra* Part III.B.