quickly.[300] Prosecutors did not allege that the adjusters paid more on the claims submitted by the defendants' clients, nor did they charge that the defendants themselves breached any duties. Nonetheless, the government indicted the two partners for honest services fraud on the theory that the defendants' bribes deprived the insurance companies of the honest services of their employee adjusters.[301] Affirming the defendants' convictions, the court attempted to synthesize the extant (especially pre-*McNally*) private honest services case law by dividing the earlier opinions into two categories: (1) bribes or kickbacks; and (2) self-dealing.[302]

The bribery/kickback cases included prosecutions in which "a defendant who has or seeks some sort of business relationship or transaction with the victim secretly pays the victim's employee (or causes such a payment to be made) in exchange for favored treatment."[303] For this group, the undisclosed bribery establishes the crime. By contrast, in self-dealing cases, "the defendant typically causes his or her employer to do business with a corporation or other enterprise in which the defendant has a secret interest, undisclosed to the employer."[304] The mere existence of a conflict of interest, by itself, is not sufficient to support conviction. Instead, the defendant's behavior also must harm or potentially harm the employer.

Regardless of whether the facts involve allegations of bribery/ kickbacks or self-dealing, the majority opinion described honest services fraud as

> a scheme or artifice to use the mails or wires to enable an officer or employee of a private entity (or *a person in a relationship that gives rise to a duty of loyalty* comparable to that owed by employees to employers) purporting to act for and in the interests of his or her employer (or of *the person to whom the duty of loyalty is owed*) secretly to act in his or her or the defendant's own interests instead, accompanied by a material misrepresentation made or omission of information disclosed to the employer or other person.[305]

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[300] *Rybicki II*, 354 F.3d at 127.

[301] *Id.*

[302] *Id.* at 139-41.

[303] *Id.* at 139.

[304] *Rybicki II*, 354 F.3d at 140.

[305] *Id.* at 141-42 (emphasis added) (footnote omitted). With self-dealing, unlike bribery/ kickback cases, there was also "a requirement of proof that the conflict caused, or at least was capable of causing, some detriment." *Id.* at 142.

Although the majority asserted that its interpretation did not leave "too much uncontrolled discretion to police or prosecutors,"[306] the dissenters sharply disagreed.[307] They criticized both the statute itself and the majority's construction of § 1346.[308] According to the dissent, § 1346 not only "flunks the test for facial vagueness," but its text provides "insufficient constraint on prosecutors, gives insufficient guidance to judges, and affords insufficient notice to defendants."[309] Specifically, the dissenters refuted the notion that § 1346 "has any settled or ascertainable meaning or that the offense it describes has known contours."[310] As for the majority's now-seminal opinion, the dissenters characterized it "as standardless as the statute itself."[311] Indeed, the dissent argued that the majority's interpretation effectively "criminaliz[ed] all material acts of dishonesty by employees or by persons who owe analogous duties."[312]

While the dissent may have exaggerated the realistic impact of the majority's construction, *Rybicki II* certainly muddied the doctrinal waters by grounding § 1346 violations in breaches of the duty of loyalty[313] without even confronting the foundational question of what relationships give rise to such a duty. In fact, the majority's analysis perpetuated (but, in fairness, did not create) at least three controversies that have vexed courts.

First, the court failed to designate the body of law to which prosecutors and subsequent courts should look for other "relationship[s] that give[] rise to a duty of loyalty comparable to that owed by employees to employers."[314] Since the rights and duties governing employer-employee relations generally arise under agency law, which is principally state law, it might follow that prosecutors and courts should consult state law for guidance on this question. But the *Rybicki II* majority left this question unanswered.

Second, determining whether a person is "in a relationship that gives rise to a duty of loyalty" is inherently fact-sensitive, creating imprecision and serious complications when it is used to support criminal charges. As Judge Winter emphasized before *McNally*, "The words fiduciary duty are no more than a legal conclusion and the legal obligations actually imposed under that

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[306] *Id.* at 137 n.10.
[307] *Id.* at 157-58 (Jacobs, J., dissenting).
[308] *Rybicki II*, 354 F.3d at 155-58.
[309] *Id.* at 156-57.
[310] *Id.* at 161-62.
[311] *Id.* at 161.
[312] *Rybicki II*, 354 F.3d at 164.
[313] *Id.* at 127 (majority opinion).
[314] *Id.*

label vary greatly from relationship to relationship. . . . Partners, employees, trustees and corporate directors are all fiduciaries, yet their legal obligations may be wholly dissimilar."[315] Yet, under current law, government prosecutors can invoke the same statutory language (which, again, makes no mention of fiduciaries or duties) to regulate not only relationships between public officials and their constituents but also the myriad private relationships that may give rise to a duty of loyalty.[316] The text of § 1346 does not differentiate between cases on the basis of their public or private context.

Finally, *Rybicki II* enlarged liability for honest services fraud in a third way. Without addressing the ramifications of doing so, the decision extended liability to persons who are not themselves fiduciaries to the fraud victim.[317] The *Rybicki II* defendants owed no fiduciary duties to the victim deprived of honest services, i.e., the insurance carrier; rather, it was the insurance adjuster employees who breached their duties by accepting the bribes. In essence, the defendants aided and abetted the fiduciaries' breach of loyalty.[318] That the Second Circuit implicitly sanctioned this theory of § 1346 liability is highly problematic. Liability could extend to any person who encouraged a fiduciary to breach her duties.

The Second Circuit's construction of § 1346 in *Rybicki II*, then, raises the possibility, at least in theory, that "every violation of a fiduciary duty becomes a federal crime."[319] Worst yet, even transactions or relationships with persons who violate their fiduciary duties can give rise to federal felonies.[320] To avoid this result, other federal appellate courts have attempted to cabin the statute's reach (and prosecutors' discretion) by devising "limiting principles" for application of § 1346.[321] For some jurists, the creation of limiting principles also was compelled by their inclination to

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[315]United States v. Margiotta, 688 F.2d 108, 142 (2d Cir. 1982) (Winter, J., concurring in part and dissenting in part).

[316]*See Rybicki II*, 354 F.3d at 161-62 (Jacobs, J., dissenting).

[317]*See id.*

[318]While not unheard of, there is little Delaware case law on this potential cause of action. *See* Globis Partners, L.P. v. Plumtree Software, Inc., No. 1577-VCP, 2007 WL 4292024, at *15 (Del. Ch. Nov. 30, 2007) (holding that a claim requires proof of: "(1) the existence of a fiduciary relationship; (2) the fiduciary breached its duty; (3) a defendant, who is not a fiduciary, knowingly participated in a breach; and (4) damages to the plaintiff that resulted from the concerted action of the fiduciary and the nonfiduciary").

[319]United States v. Sorich, 523 F.3d 702, 708 (7th Cir. 2008); *see also* United States v. Rybicki (*Rybicki I*), 287 F.3d 257, 264 (2d Cir. 2002) ("[B]ecause the statute does not define honest services, the potential reach of § 1346 is virtually limitless.").

[320]*See* United States v. Kincaid-Chauncey, 556 F.3d 923, 940 (9th Cir. 2009).

[321]*Id.* ("Without some kind of limiting principle, honest services wire fraud could potentially make relatively innocuous conduct subject to criminal sanctions."); *Sorich*, 523 F.3d at 707-08.

"avoid the constitutional question" engendered by the statute's vagueness.[322] Regardless of the motivation for their creation, all of the limiting principles announced by the lower federal courts over the past two decades have generated considerable criticism, and none have been accepted universally.

2. What Law Applies? Where Does the Fiduciary Duty Come From?

Rybicki II did not specify the law applicable to its analysis—federal, state, or some combination. Unfortunately, appellate courts have differed widely in framing and answering choice of law questions. Some courts have expressed the question as whether an independent violation of state law is necessary for an honest services fraud conviction. Several circuits have concluded that, at least when dealing with public honest services fraud, a government official must have violated some state law to be convicted for honest services fraud.[323] Most circuits, however, have decided that proving an independent violation of state law is not necessary for an honest services fraud conviction.[324] In fact, in other circumstances, the Supreme Court ruled that, "in the absence of a plain indication to the contrary, . . . Congress when it enacts a statute is not making the application of the federal act dependent on state law."[325]

This raises an antecedent question. Is state law even relevant to finding that the honest services fraud statute has been violated? While some courts have looked to state law to find the fiduciary duty whose breach is the

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[322] *See* United States v. Brown, 459 F.3d 509, 534 (5th Cir. 2006) (DeMoss, J., concurring in part and dissenting in part) ("Rather than address the larger constitutional problem with this statute, which would provide clarity to Congress, prosecutors, and the lower courts, the circuit courts have instead only clouded the meaning of § 1346 by repeatedly resolving the ambiguities of the statute's text via judicially created definitions and limitations.").

[323] *See, e.g.*, United States v. Brumley, 116 F.3d 728, 734-35 (5th Cir. 1997) (en banc). The Third Circuit's position is unclear. *See* United States v. Carbo, 527 F.3d 112, 117 n.4 (3d Cir. 2009) (concluding that its prior decisions had only held that an independent violation of state law was sufficient for an honest services fraud violation, but noting it had never expressly held it was necessary).

[324] *See* United States v. Weyhrauch, 548 F.3d 1237, 1245 (9th Cir. 2008), *cert. granted*, 129 S. Ct. 2863 (June 29, 2009) (No. 08-1196); *Sorich*, 523 F.3d at 712; United States v. Urciuoli, 513 F.3d 290, 294, 298-99 (1st Cir. 2008) (expressing concern that the statute might "embrace every kind of legal or ethical abuse remotely connected to the holding of a governmental position"); United States v. Walker, 490 F.3d 1282, 1299 (11th Cir. 2007), *cert. denied*, 128 S. Ct. 1649 (2008); United States v. Bryan, 58 F.3d 933, 942 (4th Cir. 1995), *abrogated by* United States v. O'Hagan, 521 U.S. 642 (1997).

[325] Jerome v. United States, 318 U.S. 101, 104 (1943) (construing the federal Bank Robbery Act). According to the Court, this "assumption is based on the fact that the application of federal legislation is nationwide . . . and at times on the fact that the federal program would be impaired if state law were to control." *Id.* Courts analyzing § 1346 have not applied *Jerome*, however.

basis for a violation, others have relied on federal fiduciary doctrine, or some unstated standard, instead. In many honest services fraud cases, the courts cite no state law as support for the defendant's conviction. The Seventh Circuit has justified such omissions, explaining:

> [W]e have never held that only state law can supply a fiduciary duty between public official and public or between employee and employer in honest services cases. Indeed, our case law, and the case law of the vast majority of circuits, shows that other sources can create a fiduciary obligation.[326]

Indeed, to support this assertion, the court of appeals cited other federal cases where employee handbooks or power of attorney agreements provided the sources of such obligations.[327]

This legal indeterminacy has important implications for public company managers. Since an employee handbook generally fails to create even a contractual relationship, the idea that it could create a fiduciary relationship supporting an honest services fraud conviction seems difficult to justify from reading the statutory language itself. Moreover, this theory certainly has no basis in Delaware fiduciary duty law. Nonetheless, the government has constructed other honest services fraud charges on violations of the purported fiduciary duty owed by corporate officers to the company's employees. Most notably, prosecutors repeatedly argued to the jury in closing argument that Jeff Skilling violated his duty of "loyalty to [Enron's] employees and to investors."[328] In addition, the prosecution maintained that Skilling committed honest services fraud by "expos[ing] Enron to an irresponsible amount of long-term risk in exchange for a short-term stock-price benefit" and even by violating his "duty to do [his] job . . . and do it appropriately."[329] Such claims would not give rise to civil liability under

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[326] *Sorich*, 523 F.3d at 712 (citations omitted); *see also* United States v. Martin, 195 F.3d 961, 966 (7th Cir. 1999).

> The fear that motivated the *Brumley* decision is that if federal courts are free to devise fiduciary duties the breach of which violates the mail fraud statute, the result will be the creation in effect of a class of federal common law crimes . . . . *Brumley*, however, is contrary to the law in this circuit.

Id.

[327] *Sorich*, 523 F.3d at 712 (citing United States v. Williams, 441 F.3d 716, 724 (9th Cir. 2006) (power of attorney agreement); United States v. George, 477 F.2d 508, 514 n.7 (7th Cir. 1973) (employee handbook)).

[328] Petition for Writ of Certiorari at 3, Skilling v. United States, No. 08-1394 (U.S. Oct. 13, 2009) [hereinafter Skilling Petition] (citing R. at 14784, 14799-800, 29610-11).

[329] *Id.* at 3-4 (citing R. at 21239, 22848, 22843, 37065).

state corporate law. Indeed, the Delaware Court of Chancery barred strikingly similar civil claims for breach of fiduciary duty from proceeding against Citigroup's executives.

Most concerning to corporate executives, federal prosecutors apparently can rely on fiduciary duties not found in state law (and, seemingly, also not heretofore recognized in federal law) to support § 1346 prosecutions. As the Ninth Circuit has explained, most circuits "have held that the meaning of 'honest services' is governed by a uniform federal standard inherent in § 1346, although they have not uniformly defined the contours of that standard."[330] Divining a uniform federal standard from the vague language of a statute that the federal courts have not construed uniformly hardly produces confidence in the development of coherent doctrine.

3. What Other Evidence Is Necessary for Conviction?

In addition to state law limiting principles, defendants have argued for, and some courts have adopted, additional statutory glosses restricting prosecutors' discretion and restraining the scope of § 1346.[331] Several courts focus on the result, or potential result, of the fiduciary breach, either from the victim's perspective or the defendant's perspective. Viewing the breach from the defendant's perspective, the Seventh Circuit has asked whether there was an improper gain to the defendant (or another person) from the breach. Viewing the breach from the victim's perspective, other courts have examined whether the fiduciary breach created a reasonably foreseeable economic harm to the victim.[332] On some level, these inquiries represent two sides of the same coin. In many instances of fraudulent conduct, the victim's loss is the defendant's gain. This symmetry is not found in every case of fiduciary breach, however. Sometimes, the defendant may gain without an obvious corresponding loss to the victim, or the victim may suffer a loss even though the defendant does not obtain an obvious gain. These asymmetric cases have generated more attention and controversy. A third gloss focuses not on the result of the fiduciary breach from the victim's perspective but instead on the victim's perception of that result, a materiality inquiry. Importantly, none of

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[330]United States v. Weyhrauch, 548 F.3d 1237, 1244 (9th Cir. 2008), *cert. granted*, 129 S. Ct. 2863 (June 29, 2009) (No. 08-1196).

[331]*See, e.g.*, United States v. Sun-Diamond Growers, 138 F.3d 961, 973 (D.C. Cir. 1998) (stating that "federal criminal liability could metastasize" under § 1346 without limiting principles).

[332]*See* United States v. Vinyard, 266 F.3d 320, 328 (4th Cir. 2001); *Sun-Diamond*, 138 F.3d at 974; United States v. Frost, 125 F.3d 346, 368 (6th Cir. 1997) (absent reasonably foreseeable economic harm, "[p]roof that the employer simply suffered only the loss of the loyalty and fidelity of the [employee] is insufficient to convict").

these limiting principles have any textual basis. Indeed, none of the restrictive rules appear to limit prosecutors' actual discretion or the scope of conduct that courts may deem criminal.

a. *Examining Improper Gain to Defendant (and Others) from Conduct*

The Seventh Circuit has used the improper gain that flows from the fiduciary breach as the litmus test for honest services fraud. According to that court, "Misuse of office (more broadly, misuse of position) for private gain is the line that separates run of the mill violations of state-law fiduciary duty . . . from federal crime."[333] However, the meaning of this distinction is not clear, and this limiting principle actually has evolved, expanding the scope of "private gain" over time. In earlier cases, the defendant herself had to receive some personal, financial gain because of the misuse of office or position.[334] Later, the Seventh Circuit recognized benefits from deprivations beyond simply the defendant's gain. This doctrinal enlargement occurred incrementally, beginning with the gain going to participants in the fraudulent scheme other than the defendant.[335]

Then, in *United States v. Sorich*,[336] the court broadened its interpretation of "other participants" to mean not simply others complicit in the fraud but third parties who appear to have known nothing about the defendants' activities. *Sorich* began as yet another honest services fraud indictment against a Chicago public official. Defendants included several officials from Mayor Richard Daley's Office of Intergovernmental Affairs who engaged in a "corrupt and far-reaching scheme" that "doled out thousands of city civil service jobs based on political patronage and nepotism."[337] Among other things, the defendants conducted sham interviews of potential job applicants, falsified interview forms to ensure that those with political con-nections received jobs, and ignored various merit evaluations. To hide the scheme, the defendants purportedly misrepresented to city attorneys that the hires were legitimate, and they attempted to destroy evidence to hide their involvement once a governmental investigation began. Defendants engaged in this behavior despite two federal consent decrees prohibiting the use of

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[333]United States v. Bloom, 149 F.3d 649, 655 (7th Cir. 1998).

[334]*See* United States v. Hausmann, 345 F.3d 952, 956 (7th Cir. 2003).

[335]*See* United States v. Spano, 421 F.3d 599, 603 (7th Cir. 2005) ("A participant in a scheme to defraud is guilty even if he is an altruist and all the benefits of the fraud accrue to other participants.").

[336]523 F.3d 702 (7th Cir. 2008).

[337]*Id.* at 705.

politics in hiring by the City of Chicago.[338] Following their convictions for honest services fraud (and mail fraud), defendants' principal argument on appeal was that their conduct did not violate § 1346 because they received no gain.[339]

Despite many indicia of inappropriate behavior, the defendants did not benefit financially, and there was no evidence that they harmed the entity to which they owed their fiduciary duties (the City of Chicago). Furthermore, prosecutors offered no proof that the "other participants" who received a benefit had conspired with the defendants; according to the evidence, they probably did not know that anything untoward had occurred. Nonetheless, the court of appeals sustained the convictions because third parties somewhere received jobs to which they otherwise may not have been entitled. Opining that the "amorphous and open-ended nature of § 1346" forced appellate courts to devise limiting principles,[340] the court explained that it had distinguished state law fiduciary breaches from federal crimes by requiring "'[m]isuse of office (more broadly, misuse of position) *for private gain*.'"[341] However, "private gain" encompassed more than a defendant's personal gain.[342] According to the court:

> These cases are the exception to a rule of human nature rather than of law: usually someone up to no good will be out to enrich himself, not others. . . . It is much less likely—but no less culpable—that fraudulent schemers will share the proceeds with third parties rather than amongst themselves.[343]

Nonetheless, provided that the scheme was somehow "illegitimate" and the gain from the scheme flowed to *someone*—in this case, thousands of unindicted city employees who received patronage jobs—it was sufficient to "cabin[] zealous prosecutors by insuring that not every violation of a fiduciary duty becomes a federal crime, [and] reduce[] the risk of creating federal common law crimes."[344] Indeed, a defendant could commit fraud "'even if

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[338] *Id.* at 706.

[339] *Id.* at 706-08.

[340] *Sorich*, 523 F.3d at 707.

[341] *Id.* (quoting United States v. Bloom, 149 F.3d 649, 655 (7th Cir. 1998)).

[342] *Id.* at 708-11.

[343] *Id.* at 709.

[344] *Sorich*, 523 A.2d at 707-08 (citing *Bloom*, 149 F.3d at 654-55); *see also Bloom*, 149 F.3d at 654 (noting that "it is frightening to contemplate the prospect that the federal mail fraud statute makes it a crime punishable by five years' imprisonment to misunderstand how a state court in future years will delineate the extent of impermissible conflicts[,]" in which case "we would have a federal common-law crime, a beastie that many decisions say cannot exist").

he is an altruist and all the benefits of the fraud accrue to other participants.'"[345]

According to the court of appeals in *Sorich*, the "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."[346] Yet, the boundary created by the private gain requirement is, itself, indistinct; indeed, the demarcation seems visible only with the benefit of hindsight. In the Seventh Circuit, for example, the line apparently falls somewhere between *Sorich* and *United States v. Thompson*.[347] In *Thompson*, the Justice Department prosecuted a state employee for circumventing the bidding process to award a government contract to a particular travel agency because she thought the grant would please her boss. In that case, however, the Seventh Circuit concluded that defendant's receipt of a bonus in the ordinary course of her employment, along with the goodwill she achieved with her boss, constituted insufficient personal gain to support her conviction for honest services fraud.[348]

Under the appellate courts' decisions, then, state officials responsible for rigging government contracts may or may not violate § 1346. Although the defendant who tinkers with the bidding process for one relatively small contract may appear less blameworthy than the defendant who creates a false paper trail to enable the employment of perhaps hundreds of party loyalists, the distinction between criminal bid rigging and non-criminal bid rigging certainly cannot be quantitative. Nonetheless, the courts have failed to adopt a uniform culpability standard providing public officials with reasonable notice, *ex ante*, of what conduct constitutes a crime. Judicial efforts to distinguish between legal and illegal conduct instead have produced conflicting outcomes, and the courts' decisions attempting to legislate the standard have raised more questions than they have resolved. Most fundamentally, how, if at all, does criminally culpable conduct differ substantively from any other breach by an employee of her fiduciary duty of loyalty?[349] If the government can satisfy the private gain requirement merely by pointing to any benefit received by any person, regardless of the person's participation in or knowledge of the scheme, all but the most isolated and self-contained loyalty

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[345] *Id.* at 709 (quoting United States v. Spano, 421 F.3d 599, 603 (7th Cir. 2005)). According to the court, "Robin Hood may be a noble criminal, but he is still a criminal." *Id.* at 710.

[346] *Id.* at 710.

[347] 484 F.3d 877 (7th Cir. 2007).

[348] *Id.* at 884.

[349] Other circuits have criticized this approach. *See, e.g.*, United States v. Welch, 327 F.3d 1081, 1107 (10th Cir. 2003); United States v. Panarella, 277 F.3d 678, 691-92 (3d Cir. 2002).

breaches become punishable as crimes under § 1346. For all of these reasons, the private gain rule seems ineffective as a limiting principle.

b. *Examining Conduct's Potential Impact on Victim*

Rather than adopting the Seventh Circuit's private gain requirement, other circuits have focused on the potential harms resulting from the fiduciary's breach. Some opinions evaluate the results from the victim's perspective, while others seem to appraise the outcomes objectively. Specifically, several appellate courts have engrafted onto § 1346 the requirement that the government prove that the defendant "'foresaw or reasonably should have foreseen that his employer might suffer an economic harm as a result of the breach.'"[350] As an initial matter, this limiting principle (if taken seriously) would merge § 1346 with §§ 1341 and 1343, provisions which similarly require some deprivation or threatened deprivation of money or property.[351]

In practice, however, courts do not require proof of actual economic loss or even proof of defendant's intent to cause economic loss. Instead, many courts simply require evidence that the agent/employee "reasonably fores[aw] that the breach would create 'an identifiable economic risk' for the employer," which might include the risk of foregone potential future business opportunities.[352] Conduct violative of § 1346 may extend beyond conduct in contravention of §§ 1341 or 1343 insofar as hypothetical economic risk could sustain a conviction for honest services fraud. If the "possibility of a suboptimal outcome was reasonably foreseeable," a conviction could stand under § 1346 regardless of whether the underlying business transactions were "objectively fair."[353]

Other courts endorsing the application of limiting principles based on evidence of economic harm have rejected the reasonable foreseeability standard in favor of a materiality rule. Under this competing test, the fact-finder must determine that the misrepresentation "'ha[d] the natural tendency to influence or is capable of influencing the employer to change his

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[350]United States v. Sun-Diamond Growers, 138 F.3d 961, 974 (D.C. Cir. 1998) (quoting United States v. Frost, 125 F.3d 346, 368 (6th Cir. 1997)) (holding that one need not intend to cause economic harm, just that it be a reasonably foreseeable consequence).

[351]*See* 18 U.S.C. §§ 1341, 1343 (2006). Engrafting this limiting principle onto § 1346 might even conflate traditional mail and wire fraud with § 1346 so much that one could argue that the conduct prosecuted in *McNally*, which spawned § 1346, might not be criminal under § 1346. However, since this limiting principle appears to be satisfied sometimes by theoretical economic harms, some distinction still remains.

[352]United States v. Vinyard, 266 F.3d 320, 329 (4th Cir. 2001) (quoting *Frost*, 125 F.3d at 369).

[353]*Id.* at 330.

behavior.'"[354] Although the inquiries are similar in many respects,[355] most courts maintain that the analyses are distinct. Advocates of the "reasonably foreseeable harm" test assert that their rule is more appropriate because it "keeps the focus of the analysis on employee intent rather than on employer response."[356] The test also purportedly avoids the possibility of criminal liability based on an employer's overreaction to an "insignificant fraud" or an employer's attempt to "avoid the mere appearance of impropriety."[357]

Proponents of the materiality standard assert that their rule overlaps with the reasonably foreseeable harm test insofar as misconduct giving rise to the likelihood of reasonably foreseeable economic or pecuniary harm presumably matters to victims.[358] However, the materiality test also extends liability further by "captur[ing] some cases of non-economic, yet serious, harm in the private sphere."[359] Moreover, courts adopting the materiality test deride the competing analysis as "something of an *ipse dixit* designed simply to limit the scope of [§] 1346."[360]

In the final analysis, both standards essentially restrict criminal liability for fiduciary breaches by examining the potential impact of the conduct on either the reasonable defendant or the reasonable victim. Both tests would preclude criminal liability under § 1346 where the harm caused by the breach of duty was not reasonably foreseeable, either by the defendant or the victim.[361] No appellate courts appear to have concluded that a breach of fiduciary duty would support a conviction under one analysis but not the other, so it remains to be seen whether this analytical distinction actually makes a practical difference.

c. *The Fifth Circuit's Contradictory Jurisprudence*

The jurisprudence of the Fifth Circuit illustrates the fluctuation of appellate honest services jurisprudence and the resulting uncertainty for corporate fiduciaries. The Fifth Circuit extended the reach of § 1346 in *United States v. Skilling*,[362] the decision that the Supreme Court agreed to

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[354]United States v. Rybicki (*Rybicki II*), 354 F.3d 124, 145 (2d Cir. 2003) (quoting *Vinyard*, 266 F.3d at 328).

[355]*Vinyard*, 266 F.3d at 328.

[356]*Id.*

[357]*Id.*

[358]*See Rybicki II*, 354 F.3d at 146.

[359]*Id.*

[360]*Id.*

[361]If it was not reasonably foreseeable to the victim that he could suffer harm from the fiduciary breach, presumably he would not change his behavior if he learned of the conduct.

[362]554 F.3d 529 (5th Cir. 2009), *cert. granted*, 130 S. Ct. 393 (U.S. Oct. 13, 2009) (No. 08-

review most recently. While the Fifth Circuit's honest services fraud jurisprudence seemed to be converging toward reasonable limits before Enron, the court of appeals vacillated about the scope of § 1346 in a series of three decisions arising from the government's indictments of Enron executives and the financial professionals who advised them. The resulting case law evidences both confusion and disagreement about the proper boundaries for prosecuting corporate fiduciaries under § 1346.

In the first case, *United States v. Brown*, the Fifth Circuit reversed the convictions of four former Merrill Lynch investment bankers retained in connection with Enron's sale of Nigerian power barges.[363] A federal jury found the bankers guilty of depriving Enron of its employees' honest services by causing Merrill Lynch to purchase the barges in order to inflate Enron's earnings artificially.[364] For its part, Merrill Lynch received an advisory fee and a 15% annual return on the barges' investment.[365] Prosecutors alleged—and the defendant bankers denied—that Enron promised to repurchase the barges if they could not find a third-party buyer for them in six months.[366] If Enron had made such a promise, the transaction would not have qualified as a true sale, and the revenue generated from the transaction was improperly accounted for as income to Enron.[367]

Although the government had no evidence of bribery, kickbacks, or classic self-dealing, prosecutors argued that the Enron executives who approved the transaction breached their fiduciary duties to disclose that the deal was not a "true sale."[368] Under Fifth Circuit precedent, a breach of fiduciary duty violated § 1346 only if there was evidence of "some detriment to the employer."[369] According to the government, the sufficient detriment to Enron was simply the failure to disclose the fact that the transaction was not a "true sale." In other words, the failure to disclose was essentially both the breach and the harm.[370]

The Fifth Circuit disagreed.[371] Concerned that the government's theory could "mak[e] every knowing fiduciary breach a federal crime,"[372] the *Brown* court opted for a more narrow interpretation of the honest services fraud statute. According to its decision, § 1346 is not violated "where an

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1394).

[363]United States v. Brown, 459 F.3d 509, 517 (5th Cir. 2006).

[364]*Id.* at 515-17.

[365]*Id.* at 516.

[366]*Id.* at 515.

[367]*Brown*, 459 F.3d at 515-16.

[368]*Id.* at 520.

[369]*Id.* at 519 (citing United States v. Ballard, 663 F.2d 534, 540 (5th Cir. 1981)).

[370]*Id.* at 519, 522.

[371]*Brown*, 459 F.3d at 522.

[372]*Id.*

employer intentionally aligns the interests of the employee with a specified corporate goal, where the employee perceives his pursuit of that goal as mutually benefiting him and his employer, and where the employee's conduct is consistent with that perception of mutual interest."[373] Based on the evidence presented at trial, the court determined that the Merrill Lynch defendants had not deprived Enron of its executives' honest services because the Enron deal-makers believed they were furthering Enron's corporate interests in addition to their own self-interests. Enron's incentive structure tied employee compensation to corporate earnings targets and rewarded employees for helping to attain those targets. Moreover, Enron's senior management (e.g., then-CFO Andrew Fastow) was aware of, and approved of, the transaction.[374] The court, therefore, concluded that the Enron employees should not have recognized that their failure to disclose (the purported breach) actually constituted a criminal breach of their fiduciary duty to Enron.[375]

Because the Enron employees' behavior did not violate the statute, the Merrill Lynch employees' conduct also did not violate the law. Thus, the Fifth Circuit reversed the investment bankers' convictions under § 1346.[376] Rather than incrementally expand the statute, a law that the court deemed "vague and amorphous on its face" and which "depends for its constitutionality on the clarity divined from a jumble of disparate cases," the court invoked the rule of lenity and interpreted § 1346 narrowly to exclude the conduct.[377]

The *Brown* court's interpretation of § 1346 raised the possibility that the Fifth Circuit also might reverse the conviction of former Enron CEO Jeffrey Skilling. A jury found Skilling guilty of honest services fraud and other crimes relating to his involvement in a number of allegedly fraudulent transactions, including the Nigerian barges deal.[378] Skilling had testified that he, too, had acted in what he believed were Enron's interests and to advance Enron's corporate goals. Skilling also claimed that he did not participate in the allegedly fraudulent transactions in secret.[379] Again, government

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[373] *Id.*

[374] *Id.* at 522 n.13.

[375] *Brown*, 459 F.3d at 522.

[376] *Id.*

[377] *Id.* at 523. The Fifth Circuit repeated this approach in *United States v. Howard*, 517 F.3d 731, 732, 735, 737 (5th Cir. 2008) (involving an Enron transaction similar to the Nigerian barge deal).

[378] United States v. Skilling, 554 F.3d 529, 539-40, 542 (5th Cir. 2009), *cert. granted*, 130 S. Ct. 393 (U.S. Oct. 13, 2009) (No. 08-1394).

[379] *Id.* at 545.

prosecutors did not present evidence that Skilling bribed anyone or received any kickbacks.[380] Before the Fifth Circuit's decision, then, some commentators predicted that the Fifth Circuit would follow *Brown*'s logic and, again, construe the honest services fraud statute narrowly.

However, another Fifth Circuit panel limited *Brown* instead, opting to expand the reach of § 1346. In *Skilling*, the court held that the analysis in *Brown* applied only when a corporation's upper management (e.g., CFO Fastow) expressly sanctioned lower-level employees' improper conduct to meet corporate objectives.[381] In other words, *Skilling* narrowed the holding in *Brown* to its facts, interpreting *Brown* to have created an "I was only following orders" exception to liability under § 1346. Skilling's conduct fell outside the exception because "no [superior to Skilling] at Enron sanctioned Skilling's improper conduct."[382] According to the court, "Skilling [did] not allege that the Board of Directors or any other decisionmaker specifically directed the improper means that he undertook to achieve his goals," and Skilling himself could not both sanction the scheme and then receive the benefit of *Brown*'s limited exception.[383] The fact that Enron's board of directors knew of, and approved, some of the wrongful transactions was irrelevant because the board did not "specifically direct" Skilling's "improper means" of achieving Enron's corporate goals.[384] According to the *Skilling* court, "[I]t makes no difference that the Board of Directors *knew* of Skilling's conduct if Enron (through the Board or its senior executives) did not actually *direct* Skilling to undertake the fraudulent means to achieve his goals."[385]

Lastly, and most significantly, the court summarized the elements of honest services wire fraud as "(1) a material breach of a fiduciary duty imposed under state law, including duties defined by the employer-employee relationship, (2) that results in a detriment to the employer."[386] The court then held that "it is a sufficient detriment for an employee, contrary to his duty of honesty, to withhold material information, i.e., information that he

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[380] *See Brown*, 459 F.3d at 522 (noting that the Nigerian barges case was "a situation in which the dishonest conduct is disassociated from bribery or self-dealing").

[381] *See Skilling*, 554 F.3d at 545 ("*Brown* created an exception for honest-services fraud where an employer not only aligns its interests with the interests of its employees but also sanctions the fraudulent conduct, i.e., where the corporate decisionmakers, who supervised the employees being prosecuted, specifically authorized the activity.").

[382] *Id.* at 546.

[383] *Id.* Requiring Skilling to "allege" the board's knowledge, rather than requiring that the prosecution demonstrate the board's lack of knowledge, is curious, particularly since the *Brown* exception was not established, much less discussed, by the Fifth Circuit until after Skilling's trial.

[384] *Id.* at 546-47.

[385] *Skilling*, 554 F.3d at 546-47.

[386] *Id.* at 547 (footnotes omitted).

had reason to believe would lead a reasonable employer to change its conduct."[387] The "detriment" to the employer, it would seem, is essentially the breach of the duty of honesty itself. A fiduciary's failure to be honest with his employer, then, can be both the material breach of a fiduciary duty under state law[388] and the detriment to the employer.[389] Whether the detriment element is simply a reformulation of the materiality standard, or something different, is unclear. Regardless, the Fifth Circuit's test seems to require little more than proof that the employee breached his duty to disclose material information to his employer. Indeed, it seems that the Fifth Circuit in *Skilling* has construed § 1346 as a "mandatory disclosure" statute, the pre-*McNally* outer limits of liability for honest services fraud.

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As the analysis in Part V.B has demonstrated, the courts' various extratextual limiting principles have done little to restrict prosecutors' discretion or the breadth of conduct criminalized by § 1346. What prosecutors must prove beyond a breach of fiduciary duty (as defined perhaps by state law, perhaps by something else) seems vestigial at best. In general, the government need not prove, or even allege, any benefit to the duty-breaching corporate executive or monetary harm to the corporation. Thus, if a corporate manager breaches a fiduciary duty (presumably including the duty of candor or "honesty" to the corporation) and then fails to disclose that breach, she could be convicted of honest services fraud. So while there may be no reason to believe that Congress enacted § 1346 in order "to grant carte blanche to federal prosecutors, judges and juries to define 'honest services' from case to case for themselves,"[390] the law, as currently interpreted, may allow precisely that result.

C. *The Supreme Court's Upcoming Review of § 1346*

In light of the doctrinal conflicts that have arisen in the lower courts since Congress enacted the statute, it is perhaps not surprising that the Supreme Court has decided to interpret § 1346. More remarkable is that the

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[387] *Id.*

[388] However, the court did not find specifically that Skilling breached his fiduciary duty to Enron under Oregon, Delaware, or any other state's law.

[389] As discussed previously, the government argued at closing that Skilling breached his "fiduciary duty" to Enron's employees and breached his duty to Enron and its investors to "do his job and do it appropriately." *See supra* notes 328-29 and accompanying text, Neither of these purported duties is cognizable under Oregon (or Delaware) law as a basis for a shareholder derivative claim. Indeed, recognition of such duties would expand corporate law dramatically in either jurisdiction.

[390] United States v. Rybicki (*Rybicki II*), 354 F.3d 124, 138 (2d Cir. 2003).

Court, having declined so many previous opportunities to construe § 1346, granted three petitions for writs of certiorari, raising multiple questions about the scope and constitutionality of the statute in the same Term. Justice Scalia's trenchant dissent in *Sorich* apparently paved the way for the Court's review of *Weyhrauch*, *Black*, and *Skilling*,[391] underscoring many of the most salient criticisms of the statute and its use by the Justice Department to prosecute corporate fraud.[392] Since Justice Scalia's opinion provides a road-map to the issues before the Court, several points about the *Sorich* dissent are worth noting.

1. Justice Scalia's Dissent in *Sorich*

First, Justice Scalia apparently found no guideposts for interpretation in the statutory text itself.[393] Instead, his dissent mentioned several of the limiting principles created by the lower federal courts of appeal. In particular, Justice Scalia referenced the Fifth Circuit's state law limiting principle and the Seventh Circuit's private gain limitation as two attempts by the lower courts to cabin the reach of the statute, conceding that each rule also had appellate court detractors. "Without some coherent limiting principle to define what 'the intangible right of honest services is' . . . and how it is violated," Justice Scalia expressed concern that the "expansive phrase invites abuse by headline-grabbing prosecutors in pursuit of local officials, state legislators, and corporate CEOs who engage in any manner of unappealing or ethically questionable conduct."[394]

Also significant is Justice Scalia's assertion that Congress's enactment of § 1346 failed to resolve two of the principal concerns animating the *McNally* Court's decision to abolish the "common law" of honest services. The first concern was respect for federalism. States' rights could be

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[391] *See* Sorich v. United States, 129 S. Ct. 1308 (2009) (Scalia, J., dissenting from denial of certiorari).

[392] The dissent from the Seventh Circuit's denial of rehearing en banc flagged several of these issues. *See* United States v. Sorich, 531 F.3d 501 (7th Cir. 2008) (Kanne, J., dissenting from denial of rehearing en banc). This dissent questioned whether: (1) a federal consent decree, rather than state law, could create a fiduciary duty which, if violated, could give rise to an honest services fraud prosecution, *id.* at 503-04, and (2) the Seventh Circuit's "private gain" requirement had been diluted out of existence. *Id.* at 503.

[393] *See Sorich*, 129 S. Ct. at 1310 (Scalia, J., dissenting from denial of certiorari) (remarking that "what principle it is that separates the criminal breaches, conflicts and misstatements from the obnoxious but lawful ones, remains entirely unspecified"). As a jurist who often applies a textualist approach to statutory interpretation, his agreement with those who find little meaning in the text itself should raise concerns for the statute's supporters.

[394] *Id.*

significantly impinged if the Court permitted federal prosecutors and courts to create ethical rules and disclosure obligations regulating state and local governmental officials.[395] The second concern was that the law provide constitutionally "fair warning of the conduct that it makes a crime."[396] According to Justice Scalia, § 1346, as written, is "nothing more than an invitation for federal courts to develop a common-law crime of unethical conduct."[397]

Finally, for Justice Scalia, the statutory construction problem implicates the constitutionality of § 1346. Describing the questions raised in *Sorich* as concerning "both the meaning and the constitutionality of § 1346," Justice Scalia urged the Court to decide (1) whether the crime of honest services fraud requires a "predicate violation of state law," (2) whether it requires "the defendant's acquisition of some sort of private gain," and (3) whether the void for vagueness and/or due process concerns undermined the constitutionality of the statute.[398] Justice Scalia apparently would vote to strike down the statute as unconstitutionally vague.

With this kind of blueprint, it is little wonder that within a few months of its publication, the Supreme Court received multiple petitions challenging honest services convictions and raising the same issues, each relying on Justice Scalia's dissent. Weyhrauch asked whether a state law violation was a mandatory predicate in the petition he filed scarcely a month later (March 25, 2009).[399] In his May 11 petition, Skilling asked the Court to decide the constitutionality of the statute and whether the government must prove that the defendant received an improper private gain.[400] And although Black's petition actually pre-dated Justice Scalia's dissent, Black wisely relied quite heavily on its reasoning in his April 27 reply brief.[401]

2. *Weyhrauch* and the State Law Limiting Doctrine

The Supreme Court granted certiorari in *Weyhrauch* to address the state law limiting doctrine.[402] Weyhrauch served as a state representative in

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[395] *Id.*

[396] *Id.* (quoting Bouie v. City of Columbia, 378 U.S. 347, 350 (1964)).

[397] *Sorich*, 129 S. Ct. at 1310.

[398] *Id.* at 1310-11.

[399] Petition for Writ of Certiorari, Weyhrauch v. United States, No. 08-1196 (U.S. filed Mar. 25, 2009) [hereinafter Weyhrauch Petition].

[400] Skilling Petition, *supra* note 328, at i.

[401] *See* Reply Brief of Petitioners at 2, Black v. United States, No. 08-876 (U.S. filed Apr. 27, 2009).

[402] The specific question presented in *Weyhrauch* is "whether a federal honest services mail fraud prosecution under 18 U.S.C. §§ 1341 and 1346 requires proof that the conduct at issue also violated an applicable state law." United States v. Weyhrauch, 548 F.3d 1237, 1239 (9th Cir. 2008),

Alaska as lawmakers considered legislation to alter the taxation of oil production. Having decided that he would not run for reelection, but before his term expired, Weyhrauch contacted an oil services company (VECO) to solicit legal work. Weyhrauch had multiple communications with VECO seeking new work while the Alaska legislature continued to draft and consider new statutes affecting VECO. VECO purportedly never compensated Weyhrauch, nor did VECO offer work to Weyhrauch. Nonetheless, federal prosecutors charged Weyhrauch with honest services fraud under the theory that his discussions with VECO constituted a conflict of interest, a conflict that Weyhrauch failed to disclose. Importantly, Alaska law did not require legislators to disclose their employment negotiations, and Alaska's Ethics Code mandated disclosure only if a legislator received more than $1,000 in compensation for personal services. Although the state's law made no mention of potential or future conflicts of interest, prosecutors argued that a state legislator commits honest services fraud by failing to disclose a potential conflict of interest contrary to federal standards of good government. Weyhrauch moved to dismiss the indictment, urging that federal common law cannot provide the requisite duty supporting a conviction for honest services fraud.[403]

The district court excluded evidence of various state ethics publications and ethics training that lacked the force of law which, the government claimed, supported its position that Weyhrauch's conduct was discouraged, if not somehow prohibited. According to prosecutors, the evidence supported the government's argument for a "uniform standard for 'honest services' that governs *every* public official," regardless of any independent violation of state law.[404] Following this evidentiary ruling, the trial court dismissed the indictment.

The government appealed, and the Ninth Circuit reversed. While acknowledging that states logically should have sole control over the ethical standards of their public officials (or, at a minimum, state law should establish the bounds of acceptable conduct), the appellate court declined to "adopt the state law limiting principle."[405] Part of the court's rationale is fairly weak and could as easily support the opposite conclusion. The court reasoned that its pre-*McNally* decisions did not derive their content solely

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cert. granted, 129 S. Ct. 2863, 2863 (U.S. June 29, 2009) (No. 08-1196). The Ninth Circuit distinguished *Weyhrauch*, a public honest services fraud case, and honest services fraud prosecutions in the *private* context, about which the court offered no opinion. *Id.* at 1245 n.5. Nonetheless, the Supreme Court's analysis in *Weyhrauch* likely will impact both public and private honest services fraud cases.

[403] *Id.* at 1239-40.

[404] *Id.* at 1248.

[405] *Id.* at 1245.

from state law (actually, the prior decisions did not address the issue either way), and that neither the text nor legislative history of § 1346 conditioned the meaning of the statute on state law (again, however, the statute and the legislative history are silent).[406]

The more persuasive rationale focused on the federal interest furthered by a federal, rather than state, standard. The criminality of an official's conduct under federal law, the court opined, should not depend on "geography."[407] Congress had a legitimate federal interest in ensuring that state action impacting federal priorities was not improperly influenced by state lawmakers nor state-specific policy, and that federal law did not vary on a state-by-state basis. The court concluded that, because Congress regulated industries having national and global scope, federal regulation—and even a federal standard—was appropriate. That such an approach "intrudes on state interests" is not improper, and indeed is permissible, under the Supremacy Clause.[408]

Thus, the Ninth Circuit rejected Weyhrauch's argument that his conduct must violate state law in order to run afoul of § 1346. The court instead held that § 1346 established "a uniform standard for 'honest services' that governs *every* public official" and, therefore, does not require proof of an independent violation of state law.[409] As alleged by prosecutors, Weyhrauch may have voted or taken official legislative actions at VECO's direction, potentially in return for future legal work. This conduct, at a minimum, constituted an undisclosed conflict of interest and might support a more serious vote-buying charge. The court, therefore, held that the prosecution could proceed.

The question for review in *Weyhrauch* logically should precede the question raised in *Black*. *Weyhrauch* asks

> [w]hether, to convict a state official for depriving the public of its right to the defendant's honest services through the nondisclosure of material information, in violation of the mail-fraud statute (18 U.S.C. § 1341 and § 1346), the government must prove that the defendant violated a disclosure duty imposed by state law.[410]

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[406] *Weyhrauch*, 548 F.3d at 1244-45.
[407] *Id.* at 1246.
[408] *Id.* (citing U.S. CONST. art. VI, cl. 2).
[409] *Id.* at 1248.
[410] Weyhrauch v. United States, 129 S. Ct. 2863, 2863 (2009).

The decision as to whether state law limits the scope of § 1346 will affect both the propriety of, and need for, additional limiting principles.

3. *Black* and the Economic Harm Doctrine

Black asks the Supreme Court to decide whether an honest services fraud conviction requires proof of a "'reasonably contemplated identifiable economic harm' to the party to whom honest services are owed."[411] During Black's trial in the Seventh Circuit, the trial judge refused to instruct the jury on this limiting principle. Instead, the district court instructed the jury to consider whether Black had received an improper private gain.[412] Black argues that, had the trial court instructed the jury on the "reasonably contemplated identifiable economic harm" standard, the jury would not have convicted him for violating § 1346.[413]

Like most financial fraud prosecutions, the essential facts in *Black* are complex. Black and several other persons owned a controlling interest in Hollinger, a newspaper conglomerate, through their controlling interest in a privately-held Canadian company called Ravelston. Rather than Black drawing a salary from Hollinger, Hollinger paid management fees to Ravelston for Black's services. Over time, as Hollinger sold many of its newspaper assets, Black orchestrated a scheme whereby management fees Hollinger owed Ravelston were recharacterized as payments by the various divested newspapers to Black in consideration for Black's agreement not to compete with the publications going forward. According to Black, the deals were structured to take advantage of Canadian law excluding from taxable income payments received pursuant non-compete agreements. Rather than Hollinger paying Ravelston management fees owing (taxable income), the newspapers instead paid Black not to compete with them (non-taxable income). However, Black failed to disclose to Hollinger's board of directors that these arrangements generated a significant benefit to him.[414]

Black asserted that Hollinger suffered no economic harm from the subject dealings because the monies he received were disclosed to, and even approved by, Hollinger's board of directors. He argued further that the private gain he received from the transaction was not extracted from Hollinger

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[411] Petition for Writ of Certiorari at 14, Black v. United States, No. 08-876 (U.S. filed Jan. 9, 2009) [hereinafter Black Petition].

[412] United States v. Black, 530 F.3d 596, 600 (7th Cir. 2008), *cert. granted*, 129 S. Ct. 2379 (U.S. May 18, 2009) (No. 08-876).

[413] *See* Black Petition, *supra* note 411, at 22.

[414] *Black*, 530 F.3d at 599.

but, rather, from Canada, in the form of a tax benefit.[415] On appeal, however, the Seventh Circuit rejected both arguments. Describing the question as whether Black received an improper private gain from Hollinger, not whether Hollinger suffered economic harm, the court analogized Black's receipt of an improper gain to the "straightforward" prosecution of a judge for accepting a bribe. Even if a third party paid the bribe, the judge still breached his fiduciary duty to the public and committed honest services fraud. Indeed, the judge would violate § 1346 even if he claimed not to benefit the third party. Similarly, even if Black received the private gain from a third party (Canada), he nonetheless deprived Hollinger of his honest services as well.[416] The court also held that Black's failure to disclose the Canadian tax benefit to Hollinger's board of directors harmed Hollinger, reasoning that an informed employer could reduce its compensation to Black in order to share in the economic rent created by the Canadian tax benefit.[417]

In his petition for writ of certiorari, Black argued to the Supreme Court that the Seventh Circuit erred by failing to require proof of some "reasonably contemplated identifiable economic harm." According to Black, the "only obstacle to converting every violation of corporate governance or company rules into federal crimes would seem to be the moment-to-moment whims of federal prosecutors."[418] Black's assertion that honest services fraud potentially criminalizes trivial breaches of fiduciary duty by corporate executives, rather than by public officials, distinguished his appeal from the appeal filed by Sorich with the Court just a few months earlier. Both cases otherwise raised substantially the same questions regarding the difference between the Seventh Circuit's private gain requirement and the economic harm rule adopted in other circuits. Yet, only Justice Scalia opted to hear the arguments when Sorich presented them.

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[415] *See* Black Petition, *supra* note 411, at 19 ("[I]n the Seventh Circuit a private individual who receives a *lawful* tax benefit but fails to disclose it to his employer may safely be compared with a state judge who takes bribes."); *see also Black*, 530 F.3d at 600-01.

[416] *Black*, 530 F.3d at 601.

[417] *Id.* at 602. Another theory, not addressed sufficiently in the appellate decision, is the impact of Black's failure to disclose on Hollinger's publicly-filed financial statements. The Seventh Circuit mentioned that Hollinger's characterization of the management fees it paid to Black as "payments for non-compete agreements" effectively resulted in the filing of a "false 10-K" with the SEC which may have given rise to an SEC investigation. *Id.* at 600, 602. This misrepresentation probably decreased the value of Hollinger's shares and increased Hollinger's cost of raising additional capital, both causing reasonably contemplated economic harm to Hollinger.

[418] Black Petition, *supra* note 411, at 22. Black's Petition also argued that the case merits Supreme Court review because it highlighted disagreements over "core issues" of federal criminal law, such as (1) "the balance between matters of state and federal concern"; (2) "the rule against a common law of federal crimes"; and (3) "the threat to due process posed by broadly and vaguely worded criminal statutes." *Id.* at 32.

4. *Skilling* and the Constitutionality of § 1346

Skilling's petition advanced the counterpoint to Black's petition. Skilling asked the Supreme Court to determine whether § 1346 "requires the government to prove that the defendant's conduct was intended to achieve 'private gain' rather than to advance the employer's interests."[419] Indeed, Skilling argued that he would not have been convicted of violating § 1346 in the Seventh Circuit under its private gain rule[420] because he received only compensation from his employer, not bribes or kickbacks from third parties. Given the similarity of the issues raised by Black and Skilling, however, the Court may have granted Skilling's petition because the former Enron CEO also included a direct challenge to the constitutionality of § 1346. Repeating many of the arguments raised by Justice Scalia in his *Sorich* dissent, Skilling argued on appeal that § 1346 is void for vagueness.[421] Skilling claimed, too, that § 1346 offends the prohibition against the creation of federal common law crimes, intrudes on areas of traditional state regulation, and fails to provide adequate notice to defendants.[422] Finally, Skilling's petition emphasized the Justice Department's increasing use of the honest services fraud statute, asserting that § 1346 criminalizes any fiduciary breaches that federal prosecutors seek to punish.[423]

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Having examined the questions before the Supreme Court, the final part of this article analyzes the discordant risks to corporate executives who breach their fiduciary duties under current law. The Supreme Court's upcoming decisions may help resolve some of the friction between state and federal liability standards, but the Court's decisions also could exacerbate the tensions that this paper has revealed. Whether or not the Justices strike down § 1346 as unconstitutional, Congress should take action to harmonize civil and criminal liability for executives who breach their fiduciary duties.

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[419]Skilling Petition, *supra* note 328, at i.

[420]*See id.* at 20-21. Skilling asserts that the Second Circuit (in *Rybicki II*) and the Sixth Circuit have also adopted a personal gain requirement. *Id.* at 19.

[421]*Id.* at 23.

[422]*Id.* at 23-24.

[423]Skilling Petition, *supra* note 328, at 22-23.

VI. FUTURE ENFORCEMENT OF FIDUCIARY DUTIES THROUGH CRIMINAL PROSECUTION OF HONEST SERVICES FRAUD

The litany of recent scandals—from financial reporting frauds to CEO looting scandals; from stock options backdating to the recent collapses and government rescues of "too-big-to-fail" financial institutions—has focused the public's attention once again on wrongdoing by corporate executives.[424] Fraud and other unlawful conduct by public company management damages not only the firm's stockholders; revelation of disloyal schemes perpetrated by senior officers also "erodes public confidence in the corporate community at large" and, "if left unchecked, ha[s] a negative impact on the stock markets and capital raising, which will in turn have a negative impact throughout the U.S. economy."[425] Insofar as executives may have breached their fiduciary duties to companies that received federal stimulus funding, monies from the country's taxpayers, the government has a heightened enforcement interest. In order to restore investor confidence, experts argue that two things must happen.[426] First, the public must see corporate wrongdoers punished for their illegal acts.[427] Second, investors must see changes in the system designed to preclude future bad behavior.[428] Like its constituents, Congress has come to expect that the Justice Department will prosecute even the most senior executives responsible for wrongdoing.[429]

A. *The Federal Interest in Prosecution*

Although the government's war on corporate crime seemed to lag during the final years of the Bush Administration, the financial meltdown of 2008, the election of a new president, and his installation of a new attorney general promised renewed enforcement efforts. Even without the recent turnover in the executive branch, the collapse of financial institutions, corresponding losses in the stock market, and diminished investor confidence revived congressional demand for aggressive criminal investigations of corporate activities. Public anger became more pronounced when it was

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[424] *See* JOHN NOFSINGER & KENNETH KIM, INFECTIOUS GREED: RESTORING CONFIDENCE IN AMERICA'S COMPANIES 1 (2003).

[425] FED. BUREAU OF INVESTIGATION, FBI STRATEGIC PLAN 2004-2009 § II.H (2009), *available at* http://www.fbi.gov/publications/strategicplan/stategicplantext.htm#message.

[426] *See* NOFSINGER & KIM, *supra* note 424, at 1.

[427] *Id.*

[428] *Id.*

[429] *Id.*

revealed that financial industry executives received and continued to be awarded oversized performance bonuses and other questionable compensation despite their firms' failures or near failures. Congress intensified its pressure on the DOJ and the SEC to prosecute corporate actors who have broken the law. On several occasions in late 2008 and in 2009, legislators called senior officials from these agencies, along with the FBI, to Capitol Hill to testify about their efforts to hold accountable those persons who, in the minds of many, caused the economic crisis.[430] For their part, lawmakers expressed bipartisan support for criminal prosecutions, urging that the "'full might of federal law enforcement [be brought] against the people who illegally profited or destroyed companies at the expense of our country.'"[431]

In the spring of 2009, federal lawmakers made good on their promises of support by passing new legislation, the Fraud Enforcement and Recovery Act of 2009 (FERA),[432] to encourage criminal prosecutions. FERA, like SOX, amended the mail and wire fraud laws to facilitate prosecutors' use of the statutes.[433] This time, Congress supplemented the definition of "financial institution" in 18 U.S.C., a term referenced in both the mail and wire fraud statutes, to expand the reach of the laws.[434] In addition, FERA designated $165 million in new funding for the DOJ to hire additional investigators and other necessary personnel.[435] And, unlike SOX, FERA created a separate investigatory body to conduct a full scale investigation of the financial crisis. FERA established the bipartisan Financial Crisis Inquiry Commission (FCIC) to conduct a fifteen-month investigation of the causes of the upheaval.[436] Congress appropriated $8 million for work of the ten-member Commission, an amount roughly equivalent to the yearly budget of a major congressional committee, but FCIC can seek additional appropriations if

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[430] *See, e.g., Testimony Concerning Investigations and Examinations by the Securities Exchange Commission and Issues Raised by the Bernard L. Madoff Investment Securities Matter: Hearing Before the S. Comm. on Banking, Housing and Urban Affairs*, 111th Cong. (2009) (statement of Linda Chatman Thomsen, Director, Division of Enforcement, SEC) (discussing the culpability of Bernard Madoff in connection with his alleged Ponzi scheme).

[431] Eric Lichtblau et al., *F.B.I. Struggling to Handle Wave of Finance Cases*, N.Y. TIMES, Oct. 19, 2008, at A1 (quoting FBI Director Robert S. Mueller III).

[432] Pub. L. No. 111-21, 123 Stat. 1617.

[433] *See id.* § 2(f) (amending portions of 18 U.S.C. § 1957).

[434] *Id.* § 2(a)-(b) (expanding the definition of "financial institution" to include "an organization which finances or refinances any debt secured by an interest in real estate, including private mortgage companies and any subsidiaries" whose activities affect interstate or foreign commerce). The definition also includes "any person or entity that makes in whole or in part a federally related mortgage loan as defined in section 3 of the Real Estate Settlement Procedures Act of 1974." *Id.* § 2(a)(3).

[435] *Id.* § 3(a)(1).

[436] Fraud Enforcement and Recovery Act § 5.

necessary.[437] Modeled (somewhat) after the 9/11 Commission, the FCIC's broad investigatory mandate directs it to consider twenty-two enumerated potential causes of the current financial and economic crisis in the United States, including, first and foremost, "fraud and abuse in the financial sector."[438] Congress specifically instructed FCIC to make referrals to the U.S. attorney general (and any appropriate state attorney general) of any person that it concludes may have violated federal laws in relation to the financial crisis.[439] For these reasons, too, it is reasonable to predict that the DOJ ultimately will institute criminal proceedings against executives of failed, or nearly-failed, financial institutions.[440]

Most recently, President Obama signed an executive order establishing an interagency Financial Fraud Enforcement Task Force, replacing the Bush Administration's Corporate Fraud Task Force.[441] Responding to pressure from Congress and mounting criticism that the Obama Administration had done little to prosecute significant financial crimes relating to the 2008 crisis, Attorney General Holder also reiterated the Justice Department's commitment to "wage an aggressive, coordinated, and proactive effort" to investigate corporate wrongdoing and "to bring charges, where appropriate, for criminal misconduct on the part of businesses and business executives."[442]

B. *Civil Law and Criminal Law Trending in Opposite Directions*

Fraud and wrongdoing by corporate executives probably did not cause or even contribute to the losses suffered by most investors during the recent economic crisis. More likely, lack of understanding, poor judgment, and inappropriate risk taking led to many of the bank failures over the past year. Unfortunately, as the financial crisis illustrates, reliance on management self-interest to protect shareholders has failed dismally. Under these circumstances, failure of the civil enforcement system to impose any liability on corporate executives—and, relatedly, the public's perception that there are no

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[437]FERA authorizes appropriations of "such sums as are necessary to cover the costs of the Commission." *Id.* § 5(j).

[438]*Id.* § 5(c)(1)(A).

[439]*Id.* § 5(c)(4).

[440]Besides enlarging executives' exposure to criminal liability, FCIC's investigation also could lead the SEC or other regulators to institute enforcement actions against them.

[441]*See* Exec. Order No. 13,519, 74 Fed. Reg. 60,123 (Nov. 17, 2009).

[442]Eric Holder, U.S. Attorney Gen., Remarks at the Financial Fraud Enforcement Task Force Press Conference (Nov. 17, 2009), *available at* http://www.justice.gov/ag/speeches/2009/ag-speech-091117.html.

consequences to corporate executives for malfeasance much less misfeasance—creates pressure on the federal government to "do something" to restore investor confidence.

Developments in Delaware corporate law and federal securities law have created an enforcement gap, a space in which many breaches of fiduciary duty by corporate executives and their advisors will go unremedied, and a space where executives who engage in significant wrongdoing are fairly insulated from potential liability, at least civilly. Corporate executives are not likely to pay damages for breaching their fiduciary duties. Worse yet for investor confidence, executives may leave the employ of failed companies with substantial assets, even judgment-proof wealth. Professor Fairfax said it well: "[O]ur [civil] legal system appears to lack the will to hold corporate executives personally liable for dereliction of their duties."[443]

But nature abhors a vacuum. Because of the strong federal interest in disciplining corporate fiduciaries—an interest repeatedly expressed by both the executive and legislative branches—criminal law is creeping into the regulatory space ceded by the civil law. With the enactment of SOX and the creation of the CFTF in 2002, criminal enforcement became the corporate fiduciary accountability mechanism of choice. Absent intervention by the Supreme Court, the trend in the law on the criminal side favors enforcement, and the prospect of criminal liability has increased significantly for public company executives.[444] Government lawyers have prosecuted and successfully convicted senior executives found to have breached their fiduciary duties, and honest services fraud has become a more important weapon in the DOJ's war against corporate fraud. Importantly, it is a crusade authorized and financed by Congress. Federal lawmakers made clear in 2002 and again in 2009 that fighting frauds perpetrated by public companies and their executives should be a high priority for the DOJ. Through its legislative efforts—SOX and, more recently, FERA—Congress has expressed a strong federal interest in prosecuting managers criminally in order to deter future wrongdoing and restore investor confidence in public companies and our financial system.

With liability under civil law and criminal law trending in opposite directions and the Supreme Court poised to construe § 1346, we have reached a defining moment in the enforcement of corporate executives' fiduciary duties. The DOJ has prosecuted and convicted corporate executives, as well as financial professionals and lawyers, for failing to disclose

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[443]Fairfax, *supra* note 224, at 440.

[444]*See supra* Part V.

that they breached their fiduciary duties or otherwise had conflicts of interest. Until now, the progression of the law has favored broad application of § 1346, as I demonstrated in Part V.[445] Despite lip service to the contrary, it seems that most breaches of fiduciary duty are—or at least can be—criminalized, and in many jurisdictions, federal prosecutors may indict public company executives for breaching duties not even recognized under state corporate law. Furthermore, it may well be easier for the government to convict miscreant corporate executives for acts that breach their fiduciary duties than it is for shareholders to obtain discovery about those acts, much less hold corporate executives accountable for them in civil litigation alleging the same illegal conduct.[446]

C. *Potential Ramifications of* Weyhrauch, Black, *and* Skilling

The Supreme Court's decisions in *Weyhrauch*, *Black*, and *Skilling* undoubtedly will influence whether honest services fraud prosecutions continue to play a role in filling the enforcement function ceded by civil law. By granting certiorari in all three cases, the Court can settle many of the thorniest interpretive issues concerning § 1346. Although the Court still could resolve the questions raised in the three cases separately, its determination to hear the cases together could signal its intention to eschew piecemeal construction of § 1346 in favor of a unified theory of interpretation.[447] Then, too, the Court's decision to hear *Skilling*, after granting certiorari in *Black* and *Weyhrauch*, suggests some likelihood that the justices will strike down the statute as unconstitutional.

Unless a majority concludes that the statute is unconstitutionally vague, the Supreme Court likely will decide whether state law is the only

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[445] *See supra* Part V.

[446] *See, e.g.*, *In re* Refco, Inc. Sec. Litig., 609 F. Supp. 2d 304, 318 n.15 (S.D.N.Y. 2009). The court stated that

> [i]t is perhaps dismaying that participants in a fraudulent scheme who may even have committed criminal acts are not answerable in damages to the victims of the fraud. However, as the Court noted in *Stoneridge*, the fact that the plaintiff-investors have no claim is the result of a policy choice by Congress. . . . This choice may be ripe for legislative re examination.

Id. Section 10(b) claims against attorneys who assisted Refco in perpetrating its fraud were dismissed even though they had been indicted for the same conduct (and subsequently convicted).

[447] The Court on occasion has handed down two opinions interpreting the same statute or federal rule on the same day. *See, e.g.*, Johnson v. De Grandy, 512 U.S. 997 (1994) (construing section 2 of the Voting Rights Act of 1965); Holder v. Hall, 512 U.S. 874 (1994) (same); Celotex Corp. v. Catrett, 477 U.S. 317 (1986) (construing FED. R. CIV. P. 56); Anderson v. Liberty Lobby, Inc., 477 U.S. 242 (1986) (same). Research has not, however, located situations in which three decisions construing the same statute were delivered on the same date.

source of the duties whose breach gives rise to criminal liability under § 1346, the question raised by *Weyhrauch*. Depending on the source or sources of fiduciary duties giving rise to the intangible right of honest services, the Court may or may not identify other elements necessary to sustain a conviction under § 1346. For example, if the Court decides that state fiduciary law exclusively governs the scope of the duties enforceable under the statute, it may not endorse any additional limiting principles. Conversely, if state law provides but one potential source for the duties that, if breached, could give rise to an honest services prosecution, the Court presumably would need to adopt some other limitation(s) on the potential breadth of the statute in order to save the law from constitutional challenge.

A decision by the Court rejecting any state law limiting principle and affirming *Weyhrauch*, while most consistent with the case law developed by the circuit courts over the past two decades, could exacerbate other tensions that this paper has revealed. A federal standard for honest services—essentially a federal set of fiduciary duties unmoored to any specific body of state law—invites prosecutorial enlargement, if not whole-cloth creation, of a defendant's legal duties, including the fiduciary duties owed by corporate executives to their firms. The extent to which federal law duties coincide with, conflict with, or even supplant, state law fiduciary duties are questions of considerable importance for corporate managers and, more broadly, for corporate governance.

Thus, while *Weyhrauch* concerns the prosecution of a former elected state representative rather than a corporate fiduciary, the outcome of his appeal is critically important to corporate executives. Should the government prevail against Weyhrauch, corporate executives could face criminal liability for breaches of fiduciary duty that simply do not exist under state law. At a minimum, executives of public companies would face substantial uncertainty were the Supreme Court to decide that their fiduciary duties include any duties recognized outside extant state corporate law at the urging of federal prosecutors.[448] Without a state law limiting principle, honest services fraud jurisprudence—and by extension, fiduciary duty jurisprudence—will develop nationwide through decisions issued in federal criminal cases, potentially subjecting corporate executives to an array of

[448]If the Supreme Court endorses the state law limiting principle, state fiduciary duty law arguably will continue to develop primarily in the state courts, especially given the federal courts' traditional reluctance to create, as opposed to simply interpret, state law. *See* Erie R.R. Co. v. Tompkins, 304 U.S. 64, 80 (1938). If, instead, the Court permits federal prosecutors and courts to disregard Delaware's corporate fiduciary doctrine, corporate law could be altered in ways that create tension with *Erie*.

varying and even conflicting fiduciary duties, including fiduciary duties not recognized under the law of the state of incorporation.[449] Federal fiduciary law could supplement, if not eventually supplant, Delaware and other states' corporate fiduciary doctrine. The Justice Department's more expansive use of § 1346 to prosecute defendants over the past decade suggests even greater confusion and controversy in the future should the Court reject the state law limiting principle.

A decision by the Court reversing *Weyhrauch* not only reduces the likelihood that corporate fiduciaries will become subject to conflicting obligations under state and federal law, but such a ruling also enables corporate managers to gauge the propriety of their behavior by reference to a single body of law, that is, the fiduciary duty law of the firm's state of incurporation.[450]

The counterweight to this rationale is the Supreme Court's 1943 decision in *Jerome v. United States*. *Jerome* created the presumption that Congress does not enact federal criminal legislation incorporating or relying upon state law without clearly expressing that intent.[451] The state-federal friction here is difficult to avoid. In enacting § 1346, Congress either impliedly federalized some portion of fiduciary or corporate law, which traditionally is regulated by the states, or it left the application and interpretation of federal criminal law to be governed by potentially inconsistent state laws. In either case, Congress usually makes its intent known.

Furthermore, unless the Supreme Court sanctions honest services fraud prosecutions based on some non-state law, its examination of other limiting principles, as urged by *Black* and *Skilling*, could become largely superfluous. In fact, it would be improper under Delaware law to engraft any additional limiting principles onto § 1346 if the statute truly is predicated on state law because such limiting principles are foreign to classical

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[449] *Skilling* provides one such example. In that case, prosecutors argued that Skilling breached his fiduciary duty to Enron's employees, a duty not recognized under either Delaware or Oregon state law. United States v. Skilling, 554 F.3d 529, 545 (5th Cir. 2009), *cert. granted*, 130 S. Ct. 393 (U.S. Oct. 13, 2009) (No. 08-1394).

[450] Most courts recognize the so-called "internal affairs" doctrine, which requires application of the state law of incorporation in adjudication of intracorporate claims, including claims against directors and officers for breach of their fiduciary duties.

[451] *See* Jerome v. United States, 318 U.S. 101, 104 (1943).

> [W]e must generally assume, in the absence of a plain indication to the contrary, that Congress when it enacts a statute is not making the application of the federal act dependent on state law. That assumption is based on the fact that the application of federal legislation is nationwide . . . and at times on the fact that the federal program would be impaired if state law were to control.

Id. (citations omitted).

fiduciary duty doctrine. Traditional fiduciary duty law resembles a strict liability regime. In the absence of consent, the fiduciary has the burden to justify her self-dealing transaction. Because the law entitles the principal to rely on its fiduciary's trustworthiness, the principal need not prove that she relied in fact on the fiduciary. A breaching fiduciary is liable to her principal regardless of whether the fiduciary received an improper personal gain, provided the principal suffered harm. The breaching fiduciary also is liable to her principal to disgorge any personal gain that she received, even if her principal suffered no harm. The types of limiting principles under review in *Black* and *Skilling*—requiring some manner of economic harm to the principal or gain to the fiduciary—generally are foreign to classical fiduciary jurisprudence; as a result, incorporating those requirements into Delaware's fiduciary duty regime runs afoul of state law principles. It would undermine any conclusion that state law alone provides the fiduciary principles defining honest services fraud.

If sources in addition to state law or wholly independent of state law supply the requisite fiduciary obligations, it becomes more likely that the Court will sanction some limiting principles already engrafted onto § 1346 by the lower courts. Without such limitations, the statute becomes completely untethered and, thus, more vulnerable to constitutional challenge.

1. Doctrinal Support for Construing § 1346 Narrowly

The Supreme Court's prior decisions provide doctrinal support for interpreting § 1346 narrowly. Insofar as a broad construction of the statute could penetrate Delaware's traditional corporate governance domain and, potentially, undermine it, the Court could construe § 1346 more narrowly by applying the extrastatutory principles that guided its prior decisions in *Santa Fe* and *Stoneridge*. In both cases, the Court focused on the impact that its statutory construction would have on the balance between federal and state interests, expressing concern that interpreting section 10(b) expansively (i.e., by reading a "federal fiduciary principle" into the statute or applying the statute to govern contractual relationships) would "federalize" the regulation of relationships already well-regulated under state law.[452] Characterizing

[452] *See* Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 479 (1977) (avoiding "federaliz[ing] the substantial portion of the law of corporations that deal with transactions in securities, particularly where established state policies of corporate regulation would be overridden"). In *Stoneridge*, the Court read section 10(b) narrowly to avoid the risk "that the federal power would be used to invite litigation beyond the immediate sphere of securities litigation and in areas already governed by functioning and effective state-law guarantees." Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc., 552 U.S. 148, 161 (2008).

corporations as "creatures of state law," the *Santa Fe* decision also presumed that "'state law will govern the internal affairs of the corporation'" unless federal law "'*expressly* requires'" otherwise.[453]

The Court's opinions interpreting section 10(b) also are grounded in the notion that separation of powers theory constrains the power of the courts to construe federal statutes. Because federal courts, not Congress, created section 10(b)'s private remedy, the Court declined to expand the scope of investors' remedies under the statute without express congressional action.[454] In the absence of express language in the statute evidencing congressional purpose, the Court usually has decided against the party proffering the more expansive interpretation of the right of action. This preference is evocative of the Court's admonition in *McNally* that "[i]f Congress desires to go further, it must speak more clearly than it has."[455]

In addition, the Supreme Court's *Santa Fe* and *Stoneridge* opinions considered the impact that its statutory interpretation could have on persons regulated by the law. In *Santa Fe*, for example, the Court noted that expanding federal law would impose potentially new and contradictory duties on corporate executives. By its very nature, any "federal fiduciary principle" would depart from state fiduciary standards to the extent necessary to "ensure uniformity within the federal system."[456] State law and federal law would provide overlapping—and, necessarily, confusing and contradictory—standards of conduct for corporate fiduciaries; indeed, federal law could "impose a stricter standard of fiduciary duty than that required by the law of some States."[457]

Lastly, the majority's opinions in *Santa Fe* and *Stoneridge* reflect concern for the practical ramifications of the Court's decisions. Both opinions reference the presence of other enforcement mechanisms and regimes capable of addressing the same misconduct without the need for federal intervention.[458] The *Santa Fe* majority opined that Delaware corporate law adequately protected shareholders, and the majority in *Stoneridge* determined that state contract law covered the disputed transaction. Thus, in both cases, the Supreme Court concluded not only that there was no need for

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[453] *Santa Fe*, 430 U.S. at 479 (quoting Cort v. Ash, 422 U.S. 66, 84 (1975) (emphasis in *Santa Fe*)).

[454] *See id.* at 477; *see also Stoneridge*, 552 U.S. at 164-65.

[455] McNally v. United States, 483 U.S. 350, 360 (1987).

[456] *Santa Fe*, 430 U.S. at 479.

[457] *Id.* at 479 n.16.

[458] *See id.* at 477; *see also Stoneridge*, 552 U.S. at 166 (noting that the SEC's "enforcement power is not toothless").

additional federal regulation but that to hold otherwise would unsettle the existing state law regime.

Borrowing these lenses from *Santa Fe* and *Stoneridge*, the Supreme Court could opt for a narrow (state law based) interpretation of the honest services statute. As in *Santa Fe*, expanding the predicate for honest services fraud prosecutions beyond extant state fiduciary duty law will lead, inevitably, to the federalization of relations traditionally governed by state law. In addition, this construction could run afoul of the principle that there is no "federal common law of crimes."[459] Permitting a parallel statutory regime that impinges on the state's corporate regulatory scheme will alter the current scheme, perhaps profoundly or in unforeseen ways.[460] Predictability and certainty is a hallmark, or at least the goal, of the current corporate regulatory regime.[461] Predictability promotes commerce. Subjecting public company executives to potentially conflicting substantive duties under state and federal law will likely be, at a minimum, expensive and confusing.

To be sure, federal law has made increasingly significant incursions into the regulation of corporate duties and relationships since the Court decided *Santa Fe* in 1977. After SOX, for example, federal law dictates the composition of public company audit committees and prohibits public companies from making loans to its officers and directors.[462] Yes, state law generally governs the fiduciary duties of corporate officers and directors. But even in that context, there is an exception. Federal law has regulated insider trading, a paradigmatic breach of a corporate employee's duty of loyalty, for decades, both civilly and criminally. So, although the recognition of federal fiduciary standards would represent a new incursion into state law's traditional territory, the invasion is hardly unique.

Still, the separation of powers constraint provokes concern. Neither a broad nor a narrow interpretation of § 1346 is well-anchored in the statute's opaque language. Other than simply overturning *McNally*, Congress's

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[459]Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164, 181 (1994).

[460]*See* CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69, 90 (1987) ("This beneficial free market system depends at its core upon the fact that a corporation—except in the rarest situations—is organized under, and governed by, the law of a single jurisdiction, traditionally the corporate law of the State of its incorporation.").

[461]Deborah A. DeMott, *Perspectives on Choice of Law for Corporate Internal Affairs*, 48 LAW & CONTEMP. PROBS. 161, 161 (1985) ("Convenience and predictability of application, it is said, dictate that one body of corporate law govern internal affairs, while the most plausible state to supply that law is the state of incorporation, to whose legislative grace the corporation owes its legal existence." (footnote omitted)).

[462]*See generally* Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521 (2005).

statutory purpose is not clear from the almost nonexistent legislative history, much less from the text. Nor has twenty years of post-enactment legislative neglect served to elucidate the statute's meaning. Congress has not spoken clearly about the source of the predicate fiduciary duty (or even said that that is the touchstone), and federal legislators have not considered any limiting principles.[463] Since § 1346 is a criminal statute, this indeterminacy also triggers fair notice problems,[464] potential constitutional infirmities sometimes avoided by invoking lenity principles, as Justice Scalia previously noted.

As for the presence of an alternative enforcement regime, the evidence is mixed. Certainly state law, particularly Delaware law, has developed an extensive, if not wholly coherent, fiduciary jurisprudence. This state law regime imposes duties on corporate executives that, in theory, should protect the corporation from their abuse and misuse of power. State law also 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, as I have demonstrated. For public company executives especially, the risk of liability for fiduciary breach is quite small. Liability for even blatant self-dealing has become uncertain. Even if more vigorously enforced, civil liability probably will not deter fiduciares' wrongdoing; they perceive a low risk of detection and view potential sanctions as a cost of doing business. Arguments that the mere threat of civil sanctions serves to effectively deter serious malfeasance for reputationally-conscious executives seems naïve, if not disingenuous, in light of the recurring frauds and scandals witnessed this decade. What is unquestionably true is that Congress and the executive branch perceive the need for aggressive criminal enforcement against public company executives in order to deter future wrongdoing, recover ill-gotten gains, restore investor confidence, and benefit the economy.

2. The Federal Interest in Enforcing Corporate Fiduciaries' Duties

Offsetting concerns about federalizing corporate fiduciary law is the federal government's interest in taking enforcement action against disloyal public company executives and other corporate fiduciaries who breach their duties to their firms. Grounding the reach of § 1346 in state law could

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[463] As Justice Scalia stated, whether § 1346 "qualifies as speaking 'more clearly' or in any way lessens the vagueness and federalism concerns that produced . . . *McNally* is another matter." Sorich v. United States, 129 S. Ct. 1308, 1309 (2009) (Scalia, J., dissenting from denial of certiorari).

[464] *See* United States v. Bass, 404 U.S. 336, 348 (1971).

neuter the statute's potential effectiveness as an enforcement weapon; Delaware (and other states') corporate law affords numerous protections for executives and other corporate fiduciaries, as I have shown. Is the federal government's interest sufficiently strong to override state sovereignty and federalism concerns? Nationwide uniformity of fiduciary regulation, at least with respect to public company executives, might be justified. Although incorporated in one state, many public companies transact business across the country, if not the world. Corporate managers' activities obviously impact their company's shareholders, who also are geographically dispersed. Likewise, managers' decisions, including their determinations to adhere to their fiduciary duties, can have profound financial and other consequences for investors throughout the nation and globally. It seems reasonable, therefore, to consider whether the incorporating state's local interest should monopolize the regulation of the firm's fiduciaries, much less thwart their conformity with national and international standards of honest and loyal behavior.

The events of the past year reinforce this view. The destruction of perhaps another $10 trillion of shareholder wealth created another crisis of investor confidence. Confidence is less likely to be restored without imposing some liability on corporate executives who filched secret profits, diverted assets through undisclosed self-dealing, and looted their corporations on their way out the door. As in 2002, Delaware has done nothing to revise the procedural rules and substantive doctrines that shield executives from civil liability. What has happened instead, as in the immediate post-Enron period, is that Congress and the executive branch have reacted to discipline corporate managers whose wrongdoing contributed to the demise of their firms and helped push the nation into the worst financial crisis since the Great Depression. By enacting FERA, Congress endorsed the DOJ's efforts to indict culpable executives under the mail and wire fraud statutes, as it did by enacting SOX. Congress's active encouragement of such enforcement provides some evidence of a strong federal interest prosecuting public company executives who breach their fiduciary duties. Whether this interest is strong enough may well be decided soon.

D. *The Civil Liability–Criminal Liability Paradigm Turned Upside Down*

Stepping back for a moment, it also makes sense to consider the impact of the enforcement anomaly that I have identified on our normative expectations about civil and criminal liability. The courts' concern with litigation costs has created a situation where it is easier to indict and convict a defendant of honest services fraud for "breaching" a fiduciary duty than it is

to successfully assert a civil claim for breach of fiduciary duty against that defendant. This development reverses our traditional notions about the relative culpability and blameworthiness of civil violations and criminal violations. Classically, conduct violative of the criminal law is a subset of the conduct that violates civil law. Again, however, as the enforcement anomaly has developed, conduct (breach of fiduciary duties by corporate executives) no longer violative of civil law nonetheless violates criminal law (if prosecuted as honest services fraud). This phenomenon represents a shift in the traditional civil liability–criminal liability paradigm, a change with potentially far-reaching and unanticipated ramifications. Among the consequences are the blurring of the distinction between civil and criminal law and the threat of overcriminalization.

1. Blurring the Civil-Criminal Distinction

A robust literature explores how the enlargement of federal criminal law, an expansion that began in the mid-twentieth century, if not earlier, has blurred the traditional distinctions between civil law and criminal law. Whereas the objective of civil tort law is to have the defendant internalize the social costs of her conduct, the objective of criminal law is to blame and punish the defendant.[465] Arguably, we should reserve criminal law to punish "the most damaging wrongs and the most culpable defendants"[466] for conduct that society believes lacks any social utility. For conduct that has positive social utility, but imposes externalities on others, civil damages and/or penalties should be used to deter (or "price") the behavior.[467] Almost twenty years ago, Professor Coffee pointed to honest services fraud as an example of the "collapsing" line between civil and criminal penalties, a reduction he found highly problematic for several reasons.[468] First, the lack of precision inherent in fiduciary doctrine makes the crime difficult to define with sufficient specificity *ex ante*. This lack of specificity conflicts with the bedrock principle that the legislature must define crimes with sufficient

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[465]Coffee, *supra* note 275, at 1878.

[466]Kenneth Mann, *Punitive Civil Sanctions: The Middleground Between Criminal and Civil Law*, 101 YALE L.J. 1795, 1863 (1992); *see also* Coffee, *supra* note 275, at 1890 ("[T]he criminal law should be confined 'to areas of clearly egregious behavior in which severely punitive civil monetary sanctions are ineffective.'" (quoting Mann, *supra*, at 1802)).

[467]Coffee, *supra* note 275, at 1876. Traditionally, criminal law is also legislatively created and publicly enforced, whereas civil law is principally judge-made and privately enforced. *Id.* at 1878.

[468]*See id.* at 1875.

specificity to satisfy due process notice concerns.[469] Second, criminalizing conduct proscribed under civil law can distort civil law. Courts may become increasingly cautious in their explications of fiduciary duties, lest their rhetoric become the basis for later criminal prosecutions. Courts also may hesitate to create new fiduciary duties to avoid subjecting additional conduct to potential criminal sanction.[470] Third, the difficulty in setting clear boundaries for criminal breaches of fiduciary duty creates risk that more citizens will unwittingly cross the line into criminal behavior in their ordinary professional lives.[471]

The three concerns Professor Coffee identified have the greatest force as directed to criminalizing breaches of the corporate fiduciaries' duty of care. Criminalizing vague aspirational standards which, by definition, "can never be fully realized," raises the specter of overcriminalization.[472] More specifically, the risk is that corporate fiduciaries will suffer criminal sanctions for making bad judgments, penalizing them for ordinary negligence—or, more appropriately, for gross negligence.[473] The lack of moral certainty, in many instances, makes civil regulation via pricing or taxing misbehavior more appropriate than harsh criminal sanctions, which are best reserved for conduct that society never tolerates and outright prohibits.[474] The policies supporting the business judgment rule seem relevant here, too. The law protects corporate fiduciaries from *ex post* judicial review of their business judgments to encourage optimal risk taking and service on corporate boards. Threatening more severe sanctions for careless judgments seems particularly unwise. Breach of the duty of care, without more, should not give rise to criminal liability.[475] To date, it appears that the DOJ agrees. As discussed earlier,[476] prosecutors have not used honest services fraud to enforce

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[469]*See, e.g.*, United States v. Santos, 128 S. Ct. 2020, 2025 (2008) ("[N]o citizen should be held accountable for a violation of a statute whose commands are uncertain, or subjected to punishment that is not clearly prescribed."). Justice Scalia has invoked this principle repeatedly when advocating that "[t]he rule of lenity requires ambiguous criminal laws to be interpreted in favor of the defendants subjected to them." *Id.*; *see also* Moskal v. United States, 498 U.S. 103, 131 (1990) (Scalia, J., dissenting) ("' [B]efore a man can be punished as a criminal under the federal law his case must be plainly and unmistakably within the provisions of some statute.'" (quoting United States v. Gradwell, 243 U.S. 476, 485 (1917))).

[470]*See* Coffee, *supra* note 275, at 1876 ("When the criminal law is used to enforce civil law norms that are aspirational in character and deliberately soft-edged, the result may distort the civil law.").

[471]*See id.* at 1881.

[472]*Id.* at 1879.

[473]*See id.*

[474]Coffee, *supra* note 275, at 1886-87.

[475]*Id.* at 1879.

[476]*See supra* Part IV.A.2.

corporate fiduciaries' duty of care (although the government did argue in closing that Skilling took inappropriate risks and failed to perform his job appropriately).

Imposing criminal sanctions for abuse of loyalty is comparatively easier to justify and enforce. These breaches are significantly more blameworthy and properly treated as serious crimes. Still, the lack of precision inherent in fiduciary doctrine makes the boundaries of the crime difficult to identify. Indeed, appellate courts have struggled for decades to define those perimeters, without success. Although the courts generally adhere to the duty limitation, I have shown that this principle generates a host of follow-on problems.[477] For private honest services fraud prosecutions in particular, the difficulty arises, in no small part, because fiduciary proscriptions remain supple and contextually-dependent.

Prosecutions of corporate executives for honest services fraud, assuming they continue, upset executives' enforcement expectations. These prosecutions, too, will generate some set of default standards delimiting their conduct. We can predict *that* default standards will develop because executives rationally will behave such that they avoid the vastly more severe penalties associated with honest services fraud. What we cannot predict is *what* default standards will take form. Among other factors, the development will depend on how frequently prosecutors charge executives and executives' advisors with honest services fraud and how closely government lawyers adhere to (and are made by the courts to respect) state fiduciary doctrine.[478] Also unknowable is the extent to which the default standards arising from honest services prosecutions will displace, as opposed to augment, state law fiduciary standards.

As government prosecutors employ the honest services statute more frequently over time, the risk of spill-over distorting civil standards becomes more acute, even though Delaware (and other states') courts rarely impose liability on corporate executives for breaching their duties. Why? Because the courts still exhort managers to carry out their duties, lest they be adjudged liable in the future. Whether these threats effectively deter executives is certainly dubious, but there is good evidence that the opinions establish influential social norms. The point is that Delaware judges have established aspirational standards—such as the directive from *Guth v. Loft* that "undivided and unselfish loyalty to the corporation demands that there shall

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[477] *See supra* Part V.B.1.

[478] Whether defendant executives plead guilty to honest services fraud and whether juries convict executives for honest services fraud will also impact the development of fiduciary standards under criminal law.

be no conflict between duty and self-interest"[479]—that public company fiduciaries come to know. They believe, too, that if they follow good process, they will not incur personal liability for violating the lofty standards. Potential criminal liability for failing to achieve these aspirational objectives changes that dynamic significantly.

2. The Threat of Overcriminalization

Commentators critical of the federal government's criminal enforcement policies argue that they threaten overcriminalization. Professor Ribstein, for example, has disapproved of the Enron prosecutions, arguing that the actions "criminaliz[e] agency costs."[480] In his view, prosecutors indicted Jeff Skilling and other Enron executives for "subtle" conduct that the board approved implicitly, if not explicitly—conduct that did not "deserve[] society's severest condemnation."[481] Using criminal law to discipline executives for governance failures "dissipates the moral force of the criminal law," creates the danger of selective prosecution, and even tempts prosecutors into misconduct as they search out wrongdoing to satisfy the public's demand for retribution and, perhaps, even to benefit their own career aspirations.[482]

The honest services fraud provision—and, indeed, the entire mail and wire fraud statutory scheme—has come under similar attack. Justice Scalia impliedly addressed one aspect of the concern in his *Sorich* dissent when he quipped that § 1346 "would seemingly cover a salaried employee's phoning in sick to go to a ball game."[483] Prosecutors and other supporters counter that the open-textured nature of § 1346 is both intentional and necessary. Indeed, fraud doctrine has "traditionally been understood to be one of the most open-ended concepts in law."[484] Were the law to proscribe fraud with too much specificity, the offender could structure her conduct in such a way

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[479]Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939); *see also* Coffee, *supra* note 275, at 1879 (referencing the "punctilio" language in *Meinhard v. Salmon*, 164 N.E. 545, 546 (N.Y. 1928) (Cardozo, C.J.)).

[480]Larry E. Ribstein, *The Perils of Criminalizing Agency Costs*, 2 J. BUS. & TECH. L. 59, 63-64 (2007).

[481]*Id.* at 59, 69 (arguing that prosecutors criminalized agency costs by charging Enron executives for engaging in complex transactions that "differed only marginally from what was generally considered at the time legal business behavior" and for making statements obscuring the company's financial health in a desperate attempt to keep it afloat).

[482]*Id.* at 60, 62.

[483]Sorich v. United States, 129 S. Ct. 1308, 1309 (2009) (Scalia, J., dissenting from denial of certiorari).

[484]Dan M. Kahan, *Lenity and Federal Common Law Crimes*, 1994 SUP. CT. REV. 345, 374.

as to "frustrate[] efforts to punish ex post what in substance is fraud (or, more precisely, what is just as blameworthy or undesirable as what the law previously has specified as fraud.)"[485] Furthermore, the imprecision of the fraud laws may enable the government to deter more conduct than its limited resources could punish.[486]

Analytically, overcriminalization takes several forms, and § 1346 arguably raises each of the various concerns.[487] First, overcriminalization can mean criminalizing behavior that should not be criminalized, either because the conduct is something that most of society does not deem sanction-worthy[488] or because the conduct is better left to the more nuanced "pricing" mechanism of tort law. Threatening the strongest possible sanction, imprisonment under the criminal law, is not justified simply because the community prefers that corporate fiduciaries abide by their duties.[489] Again, one could argue that criminalizing an executive's breach of the duty of care, without more, exemplifies this form of overcriminalization. In contrast, the public clearly does condemn many breaches of loyalty by corporate fiduciaries as morally wrong and blameworthy, particularly where the fiduciary has acted deceptively and there is a large financial benefit to the fiduciary or substantial harm to the firm. Although social norms do not support criminalizing all breaches of duty by corporate fiduciaries, it does not follow necessarily that civil liability adequately addresses the harms caused by their failures. Part of the tension arises from Delaware's lack of robust support for civil enforcement actions. On some level, the public's interest in criminal sanctions will persist so long as Delaware courts continue to dismiss most shareholder actions alleging breach by corporate executives.

A second form of overcriminalization describes the enforcement of vague laws that prohibit not only culpable wrongdoing but also similar conduct that is not morally blameworthy. The obvious danger with this form of overcriminalization is prosecutors' largely unchecked discretion to choose which individuals to prosecute among the many whose conduct could fall within the language of the statute.[490] Insofar as the honest services statute

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[485]Samuel W. Buell, *Novel Criminal Fraud*, 81 N.Y.U. L. REV. 1971, 1973-74 (2006).

[486]*See* Samuel W. Buell, *The Upside of Overbreadth*, 83 N.Y.U. L. REV. 1491, 1499 (2008).

[487]For a more complete discussion of the potential issues related to overcriminalization, see generally Sara Sun Beale, *The Many Faces of Overcriminalization: From Morals and Mattress Tags to Overfederalization*, 54 AM. U. L. REV. 747 (2005).

[488]*See* United States v. Thompson, 484 F.3d 877, 884 (7th Cir. 2007) (reversing conviction "of a civil servant for conduct that . . . was designed to pursue the public interest as the employee understood it").

[489]*See* Coffee, *supra* note 275, at 1879 (characterizing such a view as "simplistic").

[490]*See* Beale, *supra* note 487, at 766.

criminalizes both loyalty breaches involving significant self-dealing (like *Black*), and less blameworthy breaches, such as failures to disclose a conflict of interest (like *Bronston* or *Rybicki II*), this criticism of § 1346 seems well-taken.

Black, involving significant self-dealing and, according to the government, deceit, is an inferior case to raise this overcriminalization concern. If there is a heartland of § 1346, Black's conduct would seem to fall squarely within it. Indeed, the circumstances in *Black* seem closest to *McNally* insofar as government prosecutors in both cases alleged that the defendant received financial benefits without making disclosures to, much less obtaining the consent of, his principal. That Congress enacted § 1346 to criminalize (at least) such opportunistic behavior makes it more probable that, absent a wholesale invalidation of the statute, the Court would affirm Black's conviction. *Skilling* may raise this overcriminalization argument more persuasively, but even there, Skilling's convictions on numerous other counts (including securities fraud and insider trading) also make his case a poor example of the potential pitfalls associated with a criminal statute that sweeps too broadly.

Perhaps more applicable to Skilling's case is the final aspect of overcriminalization, redundancy. When indicting corporate executives for securities fraud, federal prosecutors have multiple potential charging options because the defendant's alleged conduct, if proven, will violate several criminal statutes requiring distinct proofs and providing various maximum punishments. Prosecutors may select the proof required and the punishment (at least the maximum punishment) by choosing among the options. This ability undoubtedly provides government lawyers with significant leverage over criminal defendants; for example, prosecutors can threaten to charge a defendant with a more serious crime if the defendant insists on putting the prosecutor to her proof at trial.

Section 1346, like many federal statutes, criminalizes conduct that already is made illegal by other criminal statutes (either federal or state).[491] For corporate fiduciaries, much of the conduct criminalized by § 1346 is also criminal under the securities fraud statutes.[492] Prosecutors appear to indict executives under § 1346 to trigger potential liability under other statutes with

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[491] *Id.* at 763-64 (arguing that most federal statutes largely duplicate state law but have much higher sentences); *see also* Sara Sun Beale, *Is Corporate Criminal Liability Unique*, 44 AM. CRIM. L. REV. 1503, 1509 (2007) (citing Sara Sun Beale, *Too Many and yet Too Few: New Principles to Define the Proper Limits for Federal Criminal Jurisdiction*, 46 HASTINGS L.J. 979, 996-1004 (1995)).

[492] *See, e.g.*, 15 U.S.C. § 78j(b) (2006); 17 C.F.R. § 240.10b-5 (2009).

even more excessive penalties, like RICO, and to threaten the defendant with asset forfeitures. Faced with these most severe of consequences, prosecutors can force executives into plea bargains.[493] Redundancy, then, elevates the risk of prosecutorial abuse. To be sure, evidence that government lawyers increasingly choose to indict corporate executives for honest services fraud does not prove that prosecutors are abusing their discretion. The potential for abuse, however, remains a valid concern.

E. *Criminalizing Breaches of the Duty of Candor to the Board*

The Supreme Court has an array of interpretive resolutions to choose among as it addresses the challenge of construing § 1346 this Term. The Court could take a cleaver to the extant case law and, perhaps, find the statute unconstitutionally vague. Alternatively, the Court could use a scalpel, tinkering around the edges by relying on traditional fiduciary law and possibly other sources as support for adopting limiting principles and carving some discernible outer boundary to the statute's reach. Or, the Court could approve the broadest interpretation of the statute (perhaps like the Fifth Circuit's construction in *Skilling*), affirm all three appellate court decisions, and criminalize, potentially, any breach of fiduciary duty. All of these resolutions, and more, are possible.

Of course, the Court might approach these questions more conservatively than Justice Scalia perhaps envisioned by interpreting § 1346 only to the extent necessary to decide the cases before it. A narrow, more case-specific approach could permit the Court to develop and refine its honest services fraud jurisprudence over time, adding nuances as required by the specific factual and legal circumstances presented. For instance, if the Court agrees with the Seventh Circuit that, whatever its outer limits, Black's conduct violated the federal wire fraud prohibition, it simply could affirm the judgments of conviction. In other words, the Court would approve the use of § 1346 to criminalize only *certain* breaches of fiduciary duty by corporate executives—specifically, the breaches committed by Black. Black's conviction for honest services wire fraud relates to the charge that he violated his duty of loyalty. The duty of loyalty is the most important fiduciary duty of corporate executives, "the one accepted constant," and the duty that functions distinctively to control managers' opportunism.[494]

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[493]Darryl K. Brown, *Prosecutors and Overcriminalization: Thoughts on Political Dynamics and a Doctrinal Response*, 6 OHIO ST. J. CRIM. L. 453, 453 (2009).

[494]Flannigan, *supra* note 31, at 428.

Such an approach offers several advantages. First, the Court would provide greater certainty for corporate fiduciaries that not every lapse will subject them to criminal prosecution; the relevant duty is a fiduciary duty, and specifically the duty of loyalty, rather than the duty of care. Second, the Justices would avoid (or at least defer) delineating the statute's outer boundaries, preserving the law enforcement advantages of § 1346 in fighting novel frauds by corporate executives. That Congress twice amended the mail and wire fraud laws to encourage their use in fighting corporate crime—and never amended them to restrict their application—demonstrates the federal interest in maintaining the laws' adaptability. By sanctioning the use of § 1346 to criminalize breaches such as Black's, § 1346 still may function as a foundation for a more expansive federal role in regulating corporate governance, as Congress has suggested, in order to instill greater investor confidence.

How the Court addresses *Skilling* likely will prove more complicated, since that case provides the only vehicle for the Justices to examine the statute's constitutional issues. Unlike *Black*, however, the Fifth Circuit's decision in *Skilling* did not rest on any perceived benefit received by Skilling from his fiduciary breach. This is not to say that the trial court record is devoid of evidence of such benefits; the jury also convicted Skilling of multiple counts of securities fraud and even insider trading. But absent some selective reexamination of the record, the Justices might perceive that the government's honest services charge in *Skilling* departs somewhat from the core conduct that Congress intended to criminalize by enacting § 1346.

Skilling also adds a further wrinkle to the Court's analysis insofar as the harm to Enron was not strictly economic or financial in nature; were the harm viewed so narrowly, the conduct charged presumably would fall within the scope of the traditional mail or wire fraud statutes. Instead, the Fifth Circuit perceived the harm to Enron as Skilling's failure to make adequate disclosures to Enron's board about the fraudulent nature of the transactions and not that those transactions, in and of themselves, harmed Enron financially.[495] Yet, because state law traditionally regulates the internal affairs of the corporation, construing § 1346 to police the communications between the corporate executive and his board would require the Court to engraft meaning onto the statute's text without even a basis in prior judge-made law. Although such an interpretation of § 1346 offers important public

[495]United States v. Skilling, 554 F.3d 529, 546-47 (5th Cir. 2009), *cert. granted*, 130 S. Ct. 393 (U.S. Oct. 13, 2009) (No. 08-1394).

policy benefits, congressional amendment of the statute is preferable, as discussed below.

An incrementalist approach also enables the Court to avoid the perilous prospect of either establishing a one-size-fits-all limiting principle or crafting distinguishing rules unsupported by the statute's language or legislative history. Considerations that give rise to well-reasoned limiting principles for public corruption cases do not apply to corporate crimes, and vice versa, but Congress did not distinguish between public sector frauds and private sector frauds when it enacted § 1346. The text of the statute simply provides no basis for the creation of distinct limiting principles.

Judicial interpretations cabining the scope of § 1346 are, in any event, a second-best solution. The best solution is to fix the enforcement problem legislatively. So long as public company fiduciaries cause or threaten to cause serious economic harm by breaching their duties but still remain protected from civil liability, there will be pressure for criminal law to fill that enforcement void. On the other hand, when criminal prosecutors respond to the need without sufficient statutory guidance, there is the danger of overcriminalization.

Regardless of how the Supreme Court decides the cases before it, Congress can and should address these competing concerns by amending the honest services fraud statute. (Of course, new legislation will become necessary if the Court invalidates § 1346 or restricts its scope to any significant degree.) To advance the federal enforcement interest that I have identified, while minimizing the harms associated with overcriminalization, Congress could specifically criminalize frauds (breaches of the duty of candor) perpetrated by senior officers and other executives on corporate boards of directors. The facts in *Black* and (especially) in *Skilling*—indeed, in most of the criminal prosecutions of top public company executives over the past decade—evidence such frauds. Black failed to disclose to Hollinger's board that substantial tax benefits motivated his self-dealing transactions. Skilling and his fellow officers deceived Enron's directors to gain the board's approval of the fraudulent transactions, including certain self-dealing transactions. Although these deceptions warrant criminal sanctions, "intra-firm frauds" are not necessarily actionable as criminal securities fraud if they do not involve the making of false disclosures to the public. Yet, current corporate governance theory and practice emphasize the importance of a monitoring board of directors, comprised primarily of vigilant, informed outside directors. In order to monitor management effectively, the board must receive full and accurate information about the financial condition of the corporation from executive management. Without candid disclosure by senior corporate managers to the firms' directors, boards simply cannot perform their essential functions. Criminalizing fraudulent misrepresentations

made by officers and their advisors to the firm's directors will increase attention on the potential for such deception, both in the boardroom and in the courtroom.

VII. CONCLUSION

Congress, federal prosecutors, and the courts (both Delaware and federal) all have contributed to the current controversy concerning criminal enforcement of corporate fiduciary duties, and each has a potential role to play in bringing more coherence to the law. Most obviously, Congress could amend § 1346 and clarify its intent. For its part, Delaware could reduce the procedural obstacles impeding effective private enforcement of corporate executives for breaching their duties of loyalty and candor. The Justice Department could act voluntarily to limit prosecutions of executives and other public company fiduciaries under § 1346, charging such violations only in cases involving serious breaches of loyalty (such as self-dealing transactions, usurping corporate opportunities, or misappropriating inside information) that also implicate the fiduciary's duty of candor.

However, it seems more likely that the Supreme Court will take the lead in attempting to rationalize the law by restricting, or even eliminating, the government's ability to use § 1346 as a weapon of enforcement. Should the Court so rule, Congress may have no choice but to enact a new criminal statute to advance the federal interest in prosecuting disloyal and dishonest corporate fiduciaries.