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Closing The Skilling Gap

Law360, New York (October 26, 2010) -- Consider two hypotheticals: 1) A mayor secretly creates his own company and uses the power of his office to funnel city contracts to that company; and 2) a corporate executive with an interest in an undisclosed side business diverts lucrative contracts from his corporation to the side business for his own personal financial gain.

Steven Fagell

Did the mayor and the executive both commit a federal crime, punishable by up to 20 years in prison?

A few months ago, the answer might have been "yes." But then along came Skilling — specifically, Skilling v. United States, a landmark 2010 case in which the U.S. Supreme Court held that the federal honest services fraud statute, 18 U.S.C. § 1346, can apply only to schemes involving bribery or kickbacks and cannot be applied, as drafted, to mere allegations of undisclosed self-dealing.[1]

The court explained that "[i]f Congress desires to go further ... it must speak more clearly than it has."[2] Congress recently began the process of doing just that.

On Sept. 28, the Senate Judiciary Committee convened a hearing to consider a possible legislative response to Skilling.[3] Four witnesses provided written and oral testimony: Lanny A. Breuer, assistant attorney general, Criminal Division, U.S. Department of Justice; Samuel Buell, professor, Duke University School of Law; Michael Seigel, professor, University of Florida College of Law; and George Terwilliger III, partner, White & Case LLP.

The witnesses generally highlighted a gap created by Skilling — one that left some types of obviously fraudulent conduct beyond the reach of federal criminal law. The hypothetical mayor referenced at the outset of this guest column came straight from Breuer; as he said, the mayor's conduct, obviously corrupt and a crime under pre-Skilling honest services law, would now be beyond the reach of federal criminal law.[4]

Seigel, in similar fashion, offered the separate examples of a judge who failed to disclose that he was negotiating for a future job with a party appearing before him in a major case, and a U.S. Department of Homeland Security employee who exaggerated a threat for no reason other than to cause panic.

In Seigel's view, these individuals should — but, post-Skilling, could not — be prosecuted for deprivation of honest services.[5]

The witnesses generally agreed that a revised honest services statute should focus on undisclosed self-dealing, similar to the mayor's conduct in Breuer's hypothetical.

They also suggested that a revised statute should include some combination of the following elements: 1) the existence of a pre-existing disclosure obligation grounded in federal, state or local law; 2) that the defendant knowingly concealed the financial interest; 3) that the defendant acted with a specific intent to defraud; 4) that the defendant had a fiduciary or other trust relationship with the individual(s) deprived of the defendant's honest services; and 5) a minimum amount of intended or caused benefit (to the defendant) or harm (to the victim).[6]

Notwithstanding the prevailing view that a revised statute is needed,[7] vexing problems remain — especially with respect to applying a new honest services statute to the private sector. Consider the Honest Services Restoration Act, a bill introduced after the hearing by Sen. Patrick Leahy, D-Vt., and co-sponsored by Sens. Sheldon Whitehouse, D-R.I., and Ted Kaufman, D-Del.[8]

The bill is intended to "prevent public officials and corporate executives from acting in their own self-interest at the expense of the people they serve."[9] As applied to the private sector, the bill would make it a crime — punishable by up to 20 years in prison — for a corporate officer or director "to engage in undisclosed private self-dealing."[10]

Undisclosed private self-dealing, in turn, occurs when "an officer or director performs an act which causes or is intended to cause harm to the officer's or director's employer, and which is undertaken in whole or in part to benefit or further by an actual or intended value of $5,000 or more a financial interest of," inter alia, the officer or director or the officer or director's spouse, minor child or general partner.[11]

Moreover, criminal liability can be imposed only if "the officer or director knowingly falsifies, conceals, or covers up material information that is required to be disclosed regarding that financial interest by any federal, state or local statute, rule, regulation or charter applicable to the officer or director, or knowingly fails to disclose material information regarding that financial interest in a manner that is required by any federal, state or local statute, rule, regulation or charter applicable to the officer or director."[12]

This bill has several important implications for the private sector, starting with the issue of mens rea. By defining self-dealing as an act "which causes or is intended to cause harm," the statute goes well beyond requiring an intent to defraud, and reaches even those acts done for some nonfraudulent purpose.

This expansive definition of "self-dealing" is notable for (at least) three reasons. First, it conflicts with the hearing testimony of Breuer, Seigel and Buell — all of whom advocated for a specific intent requirement.[13]

Second, it represents a departure from the government's argument in Skilling that the court should construe Section 1346 as applicable to undisclosed self-dealing "so long as the employee acts with a specific intent to deceive ..."[14]

And finally, it is in some tension with the Supreme Court's long-standing view that "the requirement of a specific intent to do a prohibited act may avoid those consequences to the accused which may otherwise render a vague or indefinite statute invalid."[15]

The mens rea issue does not arise only with respect to harm, however. The bill would require that a defendant knowingly fail to make a required disclosure. But the bill does not appear to require proof that the defendant knew of the disclosure obligation.

Given the myriad "federal, state or local statute[s], rule[s], regulation[s] or charter[s]" that may be applicable in a given situation, it is easy to imagine a scenario in which a corporate officer or director intentionally conceals some information (for example, to avoid personal or family embarrassment) without also knowing that disclosure was required.

Leaving the mens rea issue aside, it is not obvious that the bill is necessary to ensure adequate prosecution of fraud in the private sector. As Breuer himself explained, "The existing mail and wire fraud statutes can often be used effectively to reach

the improper conduct" in the private sector "because undisclosed self-dealing in the private sector usually involves a loss of money or property."[16]

Even Seigel — who appears to be a strong proponent of new honest services legislation — seems to agree; he concedes that some of his own examples of conduct that would fall outside the post-Skilling honest services law "[p]erhaps ... violate other federal laws ..."[17]

As discussed at the hearing, there are persuasive reasons why federal criminal law should reach public officials who use their official positions for personal gain; in so doing, they violate the public trust and undermine the most fundamental principles of our system of representative government.

Likewise, there are valid arguments as to why federal criminal law should reach those corporate officers and directors who abuse their positions to enrich themselves at the expense of employees, shareholders and investors.

But to extend criminal liability to undisclosed self-dealing in corporate America — especially without the strict specific intent requirement for which the DOJ and others have advocated — may prove to be an awkward fit. The federal government already has myriad tools to prosecute corporate wrongdoing, and shareholders can seek redress through an extant and robust body of civil corporate law.

These issues merit close attention before passage of a private sector fix to the Supreme Court's ruling in Skilling.

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[1] 130 S. Ct. 2896, 2931 (2010).

[2] Id. at 2933 (internal quotation marks omitted).

[3] See Restoring Key Tools to Combat Fraud and Corruption After the Supreme Court's Skilling Decision, 111th Cong. (2010) (hereinafter, "Honest Services Hearing").

[4] Honest Services Hearing, Statement of Lanny A. Breuer, Assistant Att'y Gen., Criminal Div., Dep't of Justice, at 6 (Sept. 28, 2010) (hereinafter, "Breuer Statement").

[5] Honest Services Hearing, Statement of Michael L. Seigel, Univ. of Fla. Research Foundation Professor of Law, at 2 (Sept. 28, 2010) (hereinafter, "Seigel Statement").

[6] Breuer Statement at 6-7; Seigel Statement at 3; Honest Services Hearing, Statement of Samuel W. Buell, Duke Univ. Sch. of Law, at 4-5 (Sept. 28, 2010) (hereinafter, "Buell Statement").

[7] Sen. Jeff Sessions, R-Ala., and Terwilliger expressed some unease with proceeding too quickly, or at all, in revising § 1346.

[8] S. 3854, 111th Cong. (2010).

[9] Id.

[10] Id. § 1346A(a)(2).

[11] Id. § 1346A(b)(2)(A)(i)(I)-(V).

[12] Id. § 1346A(b)(2)(A)(ii).

[13] See Breuer Statement at 7 ("By requiring the government to prove both knowing concealment and a specific intent to defraud, there is no risk that a person could be convicted for a mistake or unwitting conflict of interest."); Seigel Statement at 3 (advocating for a bill that would "spell out in clear terms high levels of specific intent — for example, intent to defraud and knowing conduct — that the prosecution must prove before the statute is breached"); Buell Statement at 4 (suggesting that a revised statute "have [a] demanding requirement[] with regard to mental state," such as "proof beyond a reasonable doubt of the defendant's specific intent to defraud").

[14] Skilling, 130 S. Ct. at 2933 n.44.

[15] Colautti v. Franklin, 439 U.S. 379, 395 n.13 (1979) (quoting Screws v. United States, 325 U.S. 91, 101 (1945) (plurality opinion)); see also Skilling, 130 S. Ct. at 2933 (citing Screws and explaining that the mens rea requirement of § 1346 "further blunts any ... concern" that the statute is unconstitutionally vague as to bribery and kickbacks).

[16] Breuer Statement at 8.

[17] Seigel Statement at 2.

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