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## Honest Services Fraud And The Antitrust Division

*Law360, New York (September 17, 2009)* -- The Antitrust Division of the U.S. Department of Justice, although best known for prosecuting criminal violations of the Sherman Act, also regularly uses the fraud statutes to prosecute competition crimes.

One such non-Sherman Act tool is the honest services fraud statute (18 U.S.C. § 1346) used by the division to prosecute commercial bribery and kickback schemes.

These prosecutions usually target conduct arising out of a breach of an employees' duty owed to his employer. But the statute is not clear as to which such breaches are violations and the division has given little guidance.

Some guidance may come from the Supreme Court when it decides two cases pending this term, including Conrad Black's appeal. But until the DOJ clearly sets forth its enforcement intentions, businesses should proceed with caution.

### **Background on the Antitrust Division's Prosecution of Fraud**

The division is responsible for criminal enforcement of "the federal antitrust laws and other laws relating to the protection of competition ..." (28 C.F.R. §0.40) These "other laws" include mail and wire fraud, tax fraud, money-laundering and, with the Criminal Division, the Foreign Corrupt Practices Act.

The division has filed a significant number of fraud charges, often without accompanying antitrust charges. Between 2002 and 2008, its criminal antitrust caseload ranged from 23 to 26 cases each year, but the number of cases charging primarily non-Sherman Act crimes fluctuated from nine to 28. For the last four years, there has been a steady increase in the number of non-Sherman Act cases filed.

When the division files fraud charges, it is careful to do so within its mandate to protect competition. Its press releases typically explain the charges as a "corruption" or "subversion" or "cheating" of the competitive process.

The DOJ has recognized the division's expertise concerning competition fraud by regularly including the division on important department-wide white collar crime task forces.

With the division's recent establishment of its Economic Recovery Initiative designed to uncover collusion and fraud in connection with the funds from the Stimulus Bill, the division is poised to bring more competition fraud cases, including honest services fraud.

### **Honest Services Fraud**

The honest services fraud statute amends the mail and wire fraud statutes as follows: "the term 'scheme or artifice to defraud' includes a scheme or artifice to deprive another of the intangible right of honest services" (18 U.S.C. § 1346).

The mail and wire fraud statutes (18 U.S.C. §§ 1341 and 1343) prohibit schemes to deprive persons of money or property, but do not include in their texts schemes that seek to deprive persons of someone's "honest services."

Prior to 1987, the courts had often found honest services fraud to be within the reach of the fraud statutes. But the law changed with the 1987 Supreme Court ruling in *McNally v. United States*. McNally, a Kentucky state official, was convicted of mail fraud for his part in a kickback scheme.

The Supreme Court reversed the conviction because, although the fraud scheme may have deprived the public of its right to have their public official serve honestly, the scheme did not deprive anyone of money or property and, therefore, could not constitute mail fraud.

In 1988, Congress responded by passing the honest services fraud statute.

### **Application of Honest Services Fraud Statute to Private Conduct**

The honest services fraud statute has been used to prosecute both public and private corruption under the theory that, just as politicians owe a duty of honesty to their constituents, so employees owe a duty of honesty to their employers.

There are a slew of cases in which misuse of public office for private gain is prosecuted as a fraud under § 1346 including, for example, the cases brought against former Illinois Governor Rod Blagojevich and former Congressman William Jefferson.

But the Antitrust Division typically charges honest services fraud when an employee breaches a duty owed to his employer. For example, in June 2008, an individual pleaded guilty to bribing a manufacturing company to hire the defendant's freight forwarding business (*United States v. Granizo*).

In December 2008, a processed tomato products broker who bribed purchasing agents to buy from him was charged by the division and the U.S. Attorney's office with multiple crimes, including money laundering, using honest services fraud as one of the predicate offenses (*United States v. Rahal*).

And in a division prosecution earlier this year, Home Depot employees received prison sentences for directing business to vendors who paid them kickbacks (e.g., *United States v. Tesvich*).

In each of these prosecutions, an employee breached a duty to an employer by participating in a bribery or kickback scheme that deprived the employer of the benefits of competition among its suppliers.

### **Counseling Compliance with the Statute**

The broad wording of the honest services fraud statute has drawn a fair amount of criticism, including from Justice Scalia, who noted earlier this year in his dissent from denial of certiorari in *Sorich v. United States*, that, taken to its logical conclusion, the statute could criminalize “a state legislator’s decision to vote for a bill because he expects it will curry favor with a small minority essential to his reelection; a mayor’s attempt to use the prestige of his office to obtain a restaurant table without a reservation; a public employee’s recommendation of his incompetent friend for a public contract; and any self-dealing by a corporate officer. Indeed, it would seemingly cover a salaried employee’s phoning in sick to go to a ball game.”

The issues raised by Justice Scalia highlight the problems in counseling compliance with the statute. Consider *Granizo*: the defendant bribed a customer to use his freight forwarding services and was charged not with breaching a duty owed to his own company, but, rather, with conspiring to deprive his customer of the honest services of the executive *Granizo* had bribed.

*Granizo* made wire transfers to the executive totaling \$28,000; in exchange, the executive directed business to *Granizo*’s company. But suppose that, instead of bribing the executive with money, *Granizo* got the same result by taking the executive on a golf outing — is that a crime? Suppose that it had been an extravagant golf outing costing over \$28,000 — now is it a crime?

The golf outing hypothetical is not facetious — if the person being bribed by the golf outing had been a foreign government official, the Criminal Division would have to consider charging a violation of the FCPA.

The honest services fraud statute is, in some ways, a domestic version of the FCPA applied to private companies. The FCPA makes it a crime to bribe foreign government officials; the honest services fraud statute makes it a crime to bribe employees of private firms.

The DOJ routinely provides guidance regarding the scope of the FCPA, but there is no comparable guidance as to the scope of honest services fraud. And even with guidance from the DOJ, complying with the FCPA remains a challenge for companies doing business abroad.

With limited guidance from DOJ, companies are left on their own to assess the risks to themselves and their key employees. What is the range of “dishonest” conduct under the statute? Is the risk limited to individuals or could a company be charged under the statute?

Granizo, but not his company, was charged with conspiring to deprive his customer of the honest services of his customer’s employee. Could Granizo’s company have been charged as a co-conspirator in that scheme? Would the charging decision turn on whether Granizo’s conduct violated his employer’s corporate ethics policy?

Which leads to the question of where the “right” to honest services originates, i.e., what is the source of the employee’s duty to provide honest services? Is it conceivable that such a duty arises from the various corporate ethics policies in force at different companies?

The Antitrust Division has at least implied that a duty to provide honest services can arise from a company’s ethics policy. In charging a former Home Depot employee with honest services fraud, the division asserted in its charging document that the employee owed a “fiduciary duty” to the company.

The charging document further alleged that “Home Depot maintained corporate policies ... enacted to ensure that Home Depot employees acted honestly and faithfully ... [and included] a duty to make full and fair disclosure to Home Depot of any personal interest, profit or kickback ...”

If a duty arises from a corporation’s policies, then does the reach of the statute vary from one company to another? In the hypothetical golf outing, if the employer of the purchasing agent who was bribed by the golf outing had a corporate policy allowing employees to participate in such outings, would that policy be relevant to the Division’s charging decision?

The compliance challenges with honest services fraud are made more difficult by the lack of clear guidance from the courts. The courts of appeal have struggled to find ways to limit the broad language of the statute, so that not every breach of an employee’s fiduciary duty gives rise to a federal crime.

One limiting principle in private corruption cases is whether the government must show that the scheme could have harmed the employer. In other words, is it enough to show that the employee realized personal gain or must the government also show that the gain came at the expense of his employer?

The prevailing view of the appeals courts that have addressed the issue seems to be that the government must prove that harm to the employer was reasonably foreseeable.

In one notable case arising from the Enron prosecutions (United States v. Brown, et al.), the Fifth Circuit reversed the convictions of four individuals, holding that there is no honest services fraud when the scheme is designed to further rather than harm the corporation alleged to be the victim.

The issue of reasonably foreseeable harm to the employer is at the heart of Conrad Black's appeal to the Supreme Court (United States v. Black). The issue has also arisen in an appeal of an Antitrust Division conviction in United States v. Candelario.

### **Implications of the Conrad Black Challenge**

Conrad Black, the former CEO of media conglomerate Hollinger International, and the other defendants, caused a Hollinger subsidiary to pay the defendants \$5.5 million, ostensibly as part of an agreement not to compete against certain assets divested by the subsidiary.

The government contended that Black essentially stole this money from Hollinger; Black contended that the money represented management fees owed to him and that the payment was characterized as part of a noncompete agreement in order to receive favorable tax treatment in Canada.

Black was convicted of multiple counts, including honest services mail fraud, and was sentenced to 78 months in prison.

At issue in Black's appeal to the Seventh Circuit and to the Supreme Court is the instruction that allowed the jury to find a scheme to deprive Hollinger of the honest services of the defendants even in the absence of any foreseeable harm to Hollinger.

Black does not dispute that he received a "private gain," but maintains that he intended no harm to Hollinger and that there could not have been any harm to Hollinger, since the money paid to him was owed to him.

The Seventh Circuit dismissed Black's argument as merely seeking a "no harm, no foul" rule.

In his cert petition, however, Black makes the point that, without at least some link between the dishonesty and harm to the victim, the government is in a position to criminalize almost any violation of corporate policy. The Supreme Court is set to decide the issue this term.

### **Conclusion**

Whatever the Supreme Court decides in the cases before it, the division's ability to bring honest services prosecutions will be affected. At the extreme of the range of possibilities, the court could invalidate the statute as unconstitutionally vague.

That seems unlikely; a more likely outcome is for the court to limit the statute's reach by clarifying the elements of the offense.

For example, if the court requires proof of reasonably foreseeable harm to the victim of the honest services scheme, will future division prosecutions require evidence that, but for the bribery or kickback scheme, the victimized company would have paid a lower price for the products involved? Would the increased evidentiary burden lead to fewer honest services prosecutions?

Regardless of the Supreme Court's decisions, the business community would benefit from guidance from the division regarding its enforcement intentions.

In the absence of such guidance, businesses must strengthen their own compliance efforts, minimizing opportunities to run afoul of the honest services fraud statute when marketing to customers, suppliers and other business partners.

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