The Case of the Missing Shareholders: A New Restriction on Honest Services Fraud in United States v. Brown

Douglas Zolkind

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NOTE

THE CASE OF THE MISSING SHAREHOLDERS: A NEW RESTRICTION ON HONEST SERVICES FRAUD IN UNITED STATES V. BROWN

Douglas Zolkindt†

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INTRODUCTION

18 U.S.C. § 1346 criminalizes mail and wire fraud schemes whose object—rather than stealing money or property—is to deprive the victim of "honest services."¹ Under this statute, the U.S. government prosecuted several former Enron Corp. (Enron) executives and their investment bankers for executing a sham transaction and falsely reporting to shareholders that Enron had met its financial targets.² But in a split decision, the United States Court of Appeals for the Fifth Circuit reversed the convictions, holding that the defendants' fraudulent conduct did not deprive Enron of its right to honest services.³ Unfortunately, the majority's analysis completely overlooked one key corporate constituency: Enron's shareholders. This Note argues that a proper analysis of "honest services fraud" in the context of a public corporation must take shareholders into account. Although there may be cases in which overzealous prosecutors bring inappropriate honest services charges, this was no such case. Rather, here a federal court seized the opportunity to limit the reach of a vague statute and, in so doing—intentionally or not—sanctioned inexcusable fraudulent conduct.

In 1999, Enron was struggling to meet its forecasted earnings.⁴ To boost its year-end financial statements, Enron sought to sell an equity interest in three power-generating barges moored off the coast of Nigeria.⁵ Several Enron executives and bankers at Merrill Lynch & Co., Inc. (Merrill) devised a scheme in which Merrill agreed to purchase equity in the barges, allowing Enron to record $12 million in earnings, but in which Enron also promised to buy back the barges at

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¹ 18 U.S.C. § 1346 (2000) ("For the purposes of this chapter, the term 'scheme or artifice to defraud' includes a scheme or artifice to deprive another of the intangible right of honest services."). Before the enactment of § 1346, mail and wire fraud included only schemes to deprive victims of money or property. See McNally v. United States, 483 U.S. 350 (1987); see also infra Part I (analyzing the progression of § 1346).
³ United States v. Brown, 459 F.3d 509 (5th Cir. 2006).
⁴ Id. at 514.
⁵ Id. at 513.
a premium six months later.\textsuperscript{6} As the Government proved at trial, the buy-back agreement made this a loan, not a sale. In failing to disclose the truth about the transaction, the executives committed fraud—particularly because Enron paid its executives handsome bonuses and paid Merrill a $250,000 fee for completing the deal.\textsuperscript{7} The jury convicted the defendants on all counts, agreeing that they had deprived Enron of their honest services.\textsuperscript{8}

In \textit{United States v. Brown}, the Fifth Circuit reversed and vacated the convictions.\textsuperscript{9} The court held that the alleged facts fell outside the scope of honest services fraud because Enron itself sanctioned the fraudulent transaction and intended to benefit from it.\textsuperscript{10} This Note argues that the court erred by equating “Enron” with Enron’s top-level executives. Although certain executives sanctioned the transaction and stood to benefit from it, the corporation as a whole—an entity consisting of top-level executives, employees, and shareholders—did not.

\textit{Brown} is the latest in a long line of appellate cases interpreting § 1346 as applied in the private sector.\textsuperscript{11} In the public sector, the general public has a right to the honest services of its public officials.\textsuperscript{12} This Note focuses on the private sector, where employees owe the right of honest services to their employers.\textsuperscript{13} \textit{Brown} raises questions that are of central importance to private sector honest services fraud. Unfortunately, the court’s answers to these questions are unclear and unpersuasive.

\textsuperscript{6} Id. at 514–16.
\textsuperscript{7} Id. at 516–17.
\textsuperscript{8} Id. at 517. The Government also charged the defendants with traditional “money or property” wire fraud under 18 U.S.C. § 1343. Id. at 516. However, because the jury convicted on all counts and was not asked to provide a special verdict, the Government had to prove both theories on appeal. Id. at 518; see 18 U.S.C. § 1343 (2000 & Supp. IV 2004).
\textsuperscript{9} 459 F.3d at 531.
\textsuperscript{10} Id. at 522; see infra note 127 and accompanying text.
\textsuperscript{11} See 18 U.S.C. § 1346 (2000); see, e.g., United States v. Rybicki, 354 F.3d 124 (2d Cir. 2003) (en banc); United States v. Vinyard, 266 F.3d 320, 326 (4th Cir. 2001); United States v. deVegter, 198 F.3d 1324, 1330 (11th Cir. 1999); United States v. Frost, 125 F.3d 346, 366 (6th Cir. 1997).
\textsuperscript{12} See, e.g., McNally v. United States, 483 U.S. 350, 358 (1987) (describing “schemes to defraud . . . designed to deprive individuals, the people, or the government of intangible rights, such as the right to have public officials perform their duties honestly”); United States v. Brumley, 116 F.3d 728, 734 (5th Cir. 1997) (en banc); United States v. Sawyer, 85 F.3d 713, 732 (1st Cir. 1996); United States v. Margiotta, 688 F.2d 108, 121 (2d Cir. 1982); see generally John C. Coffee, Jr., \textit{Modern Mail Fraud: The Restoration of the Public/Private Distinction}, 35 AM. CRIM. L. REV. 427, 444–48 (1998) [hereinafter \textit{Modern Mail Fraud}] (describing the application of § 1346 to the public sector).
\textsuperscript{13} See Rybicki, 354 F.3d at 141–42 (defining “honest services” in the private sector to mean services owed by “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)” to the employer or to “[a]nother person to whom the duty of loyalty is owed”).
Brown first raises the question of who exactly is the "employer" in the context of a public corporation, and thus, to whom do employees owe their honest services. Do employees owe honest services to the managers (officers and directors), the owners (shareholders), or the entity as a whole? Critics frequently argue that § 1346 is too vague to afford potential defendants constitutionally adequate notice that their conduct amounts to a federal crime. To stay within the bounds of the law, potential defendants need to know the persons to whom they owe their honest services. A coherent answer to this question will help solidify the constitutional footing of this statute. The court in Brown implicitly concluded that "employer" refers only to the managers. This Note will argue that a better analysis reveals that employees owe honest services to the corporation as a whole, including the shareholders.

The second question that Brown raises is what legal effect should be given to an employee who breaches a fiduciary duty to an employer, but who does so pursuant to a corporate policy. Unlike the first issue, which is concerned with who owes honest services to whom, this issue is concerned with the content of those services. Answering this question will help resolve a second ambiguity in § 1346, which is how to define the meaning of "honest services." This issue is of

14 See, e.g., Brown, 459 F.3d at 534 (DeMoss, J., dissenting in part) ("Section 1346's text is undeniably vague and ambiguous and is subject to wide variation in application by the lower courts."); Rybicki, 354 F.3d at 156-58 (2d Cir. 2003) (Jacobs, J., dissenting) ("[S]ection 1346 is so vague that there is 'no set of circumstances' in which it is clear enough to be applicable . . . . [T]his Circuit's long experience with section 1346 is . . . telling evidence that most lawyers and judges, not to speak of ordinary laymen or prospective defendants, cannot be expected to understand the statute." (quoting United States v. Salerno, 481 U.S. 739, 745 (1987))); Julie R. O'Sullivan, The Federal Criminal "Code" Is A Disgrace: Obstruction Statutes as Case Study, 96 J. CRIM. L. & CRIMINOLOGY 643, 660-66 (2006) (describing in detail the vagueness of § 1346); Alex Hortis, Note, Valuing Honest Services: The Common Law Evolution of Section 1346, 74 N.Y.U. L. REV. 1099, 1110 (1999) ("[Section] 1346 is so vague that it forces federal courts to define the statute's terms and legislate the offense from the bench."); Kelly Thornton, Vagueness of Statute on Corruption Stirs Dispute, SAN DIEGO UNION-TRIBUNE, Jan. 12, 2006, at A1 ("[I]t is a catchall statute that is ill-defined . . . . and is a way for prosecutors to convert almost any kind of behavior into a felony. . . . The language in the 28-word statute is so vague that it can be applied to conduct that doesn't fit into a specific category such as bribery.").

15 See, e.g., Richard M. Strassberg & Roberto M. Braceras, Circuit Grapples with "Honest Services" Fraud, N.Y. L.J., July 8, 2002, at 9 (describing a scenario in which "[a] client in the midst of a nasty contract dispute braces herself for litigation, . . . . but . . . . instead of a summons and complaint, the client is arrested on an indictment brought by federal prosecutors who accuse her of mail and wire fraud for breaching the honest services she owed under the contract").

16 Brown, 459 F.3d at 522; see infra Part III.

17 See, e.g., United States v. Handakas, 286 F.3d 92, 104 (2d Cir. 2002) ("The plain meaning of 'honest services' in the text of § 1346 simply provides no clue to the public or the courts as to what conduct is prohibited under the statute."); overruled by Rybicki, 354 F.3d 124; Brumley, 116 F.3d at 736 (Jolly and DeMoss, J., dissenting) (criticizing the majority for first acknowledging that the "meaning of 'honest services'" . . . is ambiguous and
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great practical importance to the everyday lives of corporate employees. When a corporate policy sanctions fraudulent conduct, do employees have a duty to disclose or frustrate the policy, or a duty to comply with it? Does the answer to this question depend on whether the employee is a low-level clerk or a top-level executive? Unfortunately, the Brown court devotes scant analysis to this issue and instead simply concludes that the defendants are shielded from honest services liability because their actions furthered a corporate policy.\(^{18}\) This Note will argue that, although compliance with a corporate policy should bar honest services liability in certain circumstances, those circumstances are absent in Brown.\(^{19}\)

Brown may have far-reaching implications, particularly if other circuit courts adopt its analysis. For one, it is likely to deter the government from bringing honest services fraud charges, even when it would be appropriate to do so.\(^{20}\) Moreover, when prosecutors do bring honest services charges, defendants will argue that Brown should extend to new factual circumstances that the Fifth Circuit likely did not foresee when it rendered its decision. This has already begun to happen in several options-backdating prosecutions.\(^{21}\) Most problematically, Brown adds to the confusion inherent in § 1346 by creating yet another way that federal courts will apply the same criminal statute differently. Thus, although the Fifth Circuit vacated the defendants’ convictions in Brown, it is incorrect to label the court’s holding “defense-friendly.”\(^{22}\) Potential defendants benefit from clarity in the law undefined by Congress” and then “assum[ing] a role somewhere between a philosopher king and a legislator to create its own definitions of the terms of (§ 1346)); Sawyer, 85 F.3d at 724 (noting that the definition of honest services “eludes easy definition”); David A. Skeel, Jr. & William J. Stuntz, Christianity and the (Modest) Rule of Law, 8 U. Pa. J. Const. L. 809, 822 (2006) (“No one knows what a ‘scheme or artifice to deprive another of the intangible right of honest services’ is, but thousands of people sit in federal prison convicted of intangible-rights mail fraud.”); Robert G. Morvillo & Robert J. Anello, Outer Limits of Federal Mail, Wire Fraud Prosecutions, 237 N.Y. L.J., Apr. 3, 2007, at 3 (“In creating the statute, Congress failed to provide a clear definition of ‘the intangible right of honest services,’ leaving courts to delineate the limits of the statute.”).

\(^{18}\) Brown, 459 F.3d at 522.

\(^{19}\) See infra Part IV.C.

\(^{20}\) Indeed, this is likely why federal prosecutors recently filed a motion to strike language alleging honest services fraud from the indictment of three former British investment bankers. See United States’ Motion to Strike the Honest Services Fraud Allegations from the Indictment, United States v. Bermingham, No. CR-H-02-0597 (S.D. Tex. Dec. 4, 2006).

\(^{21}\) See, e.g., Gregory L. Reyes’s Notice of Motion and Motion to Dismiss Counts One Through Seven of the Indictment Because They Are Permed By an Invalid Theory of Honest Services Fraud, United States v. Reyes, No. CR 06 0556 CRB (N.D. Cal. Jan. 9, 2007) 2007 WL 261401.

\(^{22}\) In fact, prosecutors recently announced that they will retry the defendants whose convictions were vacated in Brown. See Kristen Hays, Barge Case Could Sail Again: Enron-Merrill Retrial Likely in 2008 Unless There’s a Deal, Attorneys Say, Hous. Chron., Apr. 4, 2007, at D1.
so that they can be certain whether their conduct is lawful or not. Not only should the circuit courts stop defining the contours of § 1346 ad hoc, but Congress should finally amend the statute by defining its terms and delineating the circumstances in which it applies.

Part I of this Note discusses the evolution of honest services fraud from the development of the judge-made doctrine of “intangible rights” in mail and wire fraud cases, to the invalidation of this approach by the Supreme Court in McNally v. United States, to Congress’s response with § 1346. Part II discusses the use of § 1346 to prosecute fraud in the private sector and analyzes the various restrictions that circuit courts apply to limit the scope of private-sector honest services fraud. Part III describes the facts and opinions in Brown, and explains the rule that the court invented to hold that the defendants’ conduct was outside the scope of honest services fraud. Part IV analyzes the Brown rule and argues that it is premised on flawed assumptions which, if corrected, reveal that the court’s analysis lacks justification. This Part also suggests a way to modify the rule into a more reasonable approach.

I
THE EVOLUTION OF § 1346

Section 1346 states: “For the purposes of [mail and wire fraud], the term ‘scheme or artifice to defraud’ includes a scheme or artifice to deprive another of the intangible right of honest services.” Thus, honest services fraud is not a substantive offense, but a way of committing mail and wire fraud.

A. Mail Fraud and Wire Fraud

Congress passed the mail fraud statute in 1872 to curb the use of the mails to perpetrate frauds. The statute’s sponsor stated that it was needed “to prevent the frauds which are mostly gotten up in the large cities . . . by thieves, forgers, and rapscallions generally, for the purpose of deceiving and fleecing the innocent people in the country.” The first real test of the statute’s scope came in 1896 when the Supreme Court faced the question of whether a “scheme to defraud”

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24 Section 1346 also applies to bank fraud (18 U.S.C. § 1344) and health care fraud (18 U.S.C. § 1347). See 18 U.S.C. § 1346. Because it is used much more frequently for mail fraud and wire fraud, this Note focuses on these two offenses.
25 The original mail fraud statute provided that “any person having devised or intending to devise any scheme or artifice to defraud . . . by means of the post-office . . . shall be guilty of a misdemeanor.” Act of June 8, 1872, ch. 335, § 301, 17 Stat. 323 (current version at 18 U.S.C. § 1341 (2000 & Supp. IV 2004)).
should be interpreted narrowly—restricted by the common law definition of fraud—or read more expansively. In *Durland v. United States*, the Court adopted the expansive definition that fraud "includes everything designed to defraud by representations as to the past or present, or suggestions and promises as to the future."

Today, the most striking feature of the mail fraud statute—and the wire fraud statute, which was enacted in 1952 and closely parallels the mail fraud statute—is its breadth. As one former federal prosecutor put it, "the mail fraud statute is our Stradivarius, our Colt 45, our Louisville Slugger, our Cuisinart—our true love." The offenses are simple, requiring the government to prove only that the defendant devised a scheme to defraud and used the mails or wires to execute the scheme. This flexibility has enabled prosecutors to use the

27 See Paul M. Kessimian, Note, *Business Fiduciary Relationships and Honest Services Fraud: A Defense of the Statute*, 2004 COLUM. BUS. L. REV. 197, 202 (2004) ("The real question became whether or not the definition of fraud in the statute was limited by the common law definition.").


29 Id. at 313; see also Brian C. Behrens, Note and Comment, 18 U.S.C. § 1341 and § 1346: Deciphering the Confusing Letters of the Mail Fraud Statute, 13 ST. LOUIS U. PUB. L. REV. 489, 494-95 (1993) (explaining that "[t]he Court went beyond the meaning attributed to common law fraud," which included only misrepresentations or false pretenses concerning past or present facts).


31 Jed S. Rakoff, *The Federal Mail Fraud Statute (Part I)*, 18 DUQ. L. REV. 771, 771 (1980); see also Peter W. Low & Joseph L. Hoffman, *Federal Criminal Law* 161 (1997) ("Mail fraud continues to be the 'true love' of the federal prosecutor, a broad, self-defining statute that can be used to get crooks whose behavior falls between the cracks of other statutes."); Ralph K. Winter, *Paying Lawyers, Empowering Prosecutors, and Protecting Managers: Raising the Cost of Capital in America*, 42 DUKE L.J. 945, 954 (1993) ("With regard to the statutory weapons available to prosecutors, [mail and wire fraud] rank by analogy with hydrogen bombs on stealth aircraft."); Behrens, *supra* note 29, at 526 ("[I]n a society where an alarming number of ever-increasing crimes are occurring, the prosecutors need at least one secret weapon. This 'catch-all' [mail fraud] statute may be the most important tool for apprehending the new breed of crime—white collar crime.").

32 See Pereira v. United States, 347 U.S. 1, 8 (1954) (regarding mail fraud); Skye Lynn Perryman, *Mail and Wire Fraud*, 43 AM. CRIM. L. REV. 715, 718 (2006) ("[T]o be convicted of a mail or wire fraud offense the government has to show beyo[n]d a reasonable doubt that the defendant [perpetrated]: (i) a scheme to defraud that includes a material deception; (ii) with the intent to defraud; (iii) while using the mails, private commercial carriers, and/or wires in furtherance of that scheme; (iv) that did result or would have resulted in the loss of money or property, or in the deprivation of honest services."); see generally id. at 717-34 (explaining each element of the offense). The jurisdictional element of both statutes is met by a mere showing of any mailing or interstate wiring that is "incidental" to an essential part of the fraudulent scheme. See Schmuck v. United States, 489 U.S. 705, 710-11 (1989); John C. Coffee, Jr. & Charles K. Whitehead, *The Federalization of Fraud: Mail and Wire Fraud Statutes*, in Otto G. Obermaier & Robert G. Morvillo, *1 White Collar Crime: Business and Regulatory Offenses* § 9.01 (Robert J. Anello et al. eds., 2007); see also United States v. Wingate, 128 F.3d 1157, 1161-62 (7th Cir. 1997) ("[T]he element of the mailing being in furtherance of the scheme to defraud] is fairly easy to satisfy."); *supra* 77 F.3d 992, 1004 (7th Cir. 1996) (second alteration in original)); Roger J. Miner, *Federal Courts, Federal Crimes, and Federalism*, 10 HARV. J.L. & PUB.
statutes to combat "not only the full range of consumer frauds, stock frauds, land frauds, bank frauds, insurance frauds, and commodity frauds, but . . . even . . . blackmail, counterfeiting, election fraud, and bribery."Prosecutors also use mail and wire fraud to prosecute money-laundering and Racketeer Influenced and Corrupt Organizations Act (RICO) violations. Recent congressional action has broadened the scope of mail fraud to include mailings via private carriers, broadened the scope of wire fraud to include telemarketing fraud, and quadrupled the maximum punishment for both offenses from five to twenty years' imprisonment.

B. "Intangible Rights" Theory

In the 1970s and 1980s, federal prosecutors persuaded lower federal courts to expand mail and wire fraud to include as the object of the fraud certain "intangible rights" in addition to money and property. Initially, prosecutors used this new theory of mail and wire fraud to combat public corruption at the state and local levels. For...
example, a federal prosecutor may charge a public official who re-
ceives undisclosed kickbacks with depriving citizens of their right to
the official’s honest and faithful services.40

The intangible rights theory has also entered the private sector,
with prosecutors claiming that employers and principals have the
right to the honest services of their employees and agents.41 Accord-
ing to one commentator, this development became an “exotic flower
that quickly overgrew the legal landscape in the manner of the kudzu
twine until by the mid-1980s few ethical or fiduciary breaches seemed
beyond its potential reach.”42 For example, in United States v. Bron-
ston,43 an attorney was convicted of mail fraud for secretly represent-
ing a client who was competing for a franchise; the competitor was
another client represented by the attorney’s firm.44 Although the at-
torney neither reaped profits through self-dealing nor misappropri-
ated a client’s confidential information, the Second Circuit affirmed
the conviction based on an intangible rights theory because the attor-
ney failed to disclose his conflict of interest to the firm’s client.45
Prosecutions of this sort traditionally received little resistance from
the courts—until McNally.46

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(“Prosecutors indicted and convicted public officials pursuant to the intangible rights doc-
trine with a finding that they had deprived the citizenry of the right to good govern-
ment.”); see also McNally, 483 U.S. at 362 (Stevens, J., dissenting) (“In the public sector,
judges, State Governors, chairmen of state political parties, state cabinet officers, city alder-
men, Congressmen and many other state and federal officials have been convicted of de-
frauding citizens of their right to the honest services of their governmental officials.”); id.
at 362 n.1 (citing cases).
41 See Tendler, supra note 39, at 2734 & n.35 (citing United States v. Silvano, 812 F.2d
754 (1st Cir. 1987); United States v. Weiss, 752 F.2d 777 (2d Cir. 1985)).
42 Modern Mail Fraud, supra note 12, at 427.
43 658 F.2d 920 (2d Cir. 1981).
44 Id. at 922–23.
45 Id. at 926–30. Many commentators view Bronston as a high-water mark case in the
development of pre-§ 1346 honest services fraud in the private sector. See Modern Mail
Fraud, supra note 12, at 434 (“Bronston thus crossed a critical threshold: before it, cases in
which there was only a conflict of interests, but neither a transaction between the fiduciary
and the client nor any misappropriation of information or property by the fiduciary from
the client, had been considered merely ‘constructive fraud,’ which did not amount to the
type of ‘actual fraud’ that transgressed the federal mail and wire fraud statutes.”); Tendler,
supra note 39, at 2736 (“The facts of Bronston indicate that any lack of candor or good faith
to a former client . . . violates the mail fraud statute.”); Daniel Richman & Alan Vinegrad,
‘honest services’ theory flourished in the Second Circuit, and indeed reached what some
consider its disturbing high-water mark there.” (citing Bronston, 658 F.2d at 920)).
46 But see United States v. Margiotta, 688 F.2d 108, 140–43 (2d Cir. 1982) (Winters, J.,
dissenting) (“[N]o amount of rhetoric . . . can conceal that there is no end to the common
political practices which may now be swept within the ambit of mail fraud. . . . [W]hat
profoundly troubles me is the potential for abuse through selective prosecution and the
degree of raw political power the freewheeling club of mail fraud affords federal
prosecutors.”).
C. McNally v. United States

In McNally, the Supreme Court invalidated the intangible rights doctrine, leading Congress to respond by enacting § 1346. McNally involved three defendants: the chairman of the Kentucky Democratic Party, who was responsible for selecting an insurance company to provide the state’s workers’-compensation policies; a former Kentucky state official; and McNally, a private individual. The defendants devised a scheme in which the selected company, Wombwell Insurance, shared its commissions in exchange for having its contract renewed. The defendants were convicted of mail fraud and conspiracy to commit mail fraud with the object of depriving the citizens of Kentucky of their right to good government.

The Supreme Court reversed, holding that the “mail fraud statute clearly protects property rights, but does not refer to the intangible right of the citizenry to good government.” The majority found insufficient evidence that Congress intended to depart from the traditional conception of fraud, which required a deprivation of money or property. The majority did not suggest that it was implausible to read the statute to include deprivations of intangible rights, but it applied the principle of lenity to choose the less harsh interpretation. The Court invited Congress to “speak more clearly than it has” if it desired to expand mail fraud to intangible rights.

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48 Id. at 352-53.
49 Id.
50 Id.
51 The indictment charged that “petitioners had devised a scheme . . . to defraud the citizens and government of Kentucky of their right to have the Commonwealth’s affairs conducted honestly.” Id. at 353–54.
52 See id. (“[T]he sparse legislative history . . . indicates that the original impetus behind the mail fraud statute was to protect the people from schemes to deprive them of their money or property.”); id. at 357 (“Congress codified the holding of [Durland v. United States, 161 U.S. 306 (1896)] in 1909, and in doing so gave further indication that the statute’s purpose is protecting property rights.”); id. at 358 (“[T]he words ‘to defraud’ commonly refer ‘to wronging one in his property rights by dishonest methods or schemes,’ and ‘usually signify the deprivation of something of value by trick, deceit, chicane or overreaching.’” (quoting Hammerschmidt v. United States, 265 U.S. 182, 188 (1924))).
53 Id. at 359–60 (“The Court has often stated that when there are two rational readings of a criminal statute, one harsher than the other, we are to choose the harsher only when Congress has spoken in clear and definite language. . . . Rather than construe the statute in a manner that leaves its outer boundaries ambiguous and involves the Federal Government in setting standards of disclosure and good government for local and state officials, we read § 1341 as limited in scope to the protection of property rights.” (citations omitted)).
54 Id. at 360.
In Carpenter v. United States, the Court explained that McNally had not invalidated all intangible rights. It held that the mail fraud statute protects both tangible and intangible property rights. Other intangible rights, such as the right to honest services, remained outside the scope of mail fraud. As criticism of McNally mounted, Congress accepted the invitation to speak more clearly.

D. Congress Responds with § 1346

In 1988, Congress enacted 18 U.S.C. § 1346. Most agree that the purpose of this statute was to overturn McNally. This may be the only aspect of § 1346 on which courts agree—and even here, they agree to differing extents. Some circuit courts hold that § 1346 reinstated the pre-McNally case law; others hold that it did not; and still

56 Carpenter involved a Wall Street Journal columnist who shared confidential financial information with two stockbrokers, for the purpose of trading on it for a profit, prior to the information being published. Id. at 23–24. The Court held that the defendant deprived the Journal not of his honest services, but of its intangible property right to the confidential information. Id. at 25.
57 Id. at 27–28.
58 Id. at 25.
59 See Tendler, supra note 39, at 2737 (“[T]he McNally decision endured criticism.”); see, e.g., Jeffrey J. Dean & Doye E. Green, Jr., Note, McNally v. United States and Its Effect on the Federal Mail Fraud Statute: Will White Collar Criminals Get a Break?, 39 MERCER L. REV. 697, 712 (1988) (“Regardless of the ultimate results of McNally, the opinion itself is unreasonable and poorly supported.”); Donna Metcalfe Ducey, Note, McNally v. United States: The Demise of the Intangible Rights Doctrine, 66 N.C. L. REV. 1035, 1050 (1988) (“Congress should supply language that recaptures the protections provided by the broad interpretation of section 1341. . . . By eliminating an essential source of protection for victims of fraud, the Court has immunized an entire group of criminals from prosecution.”).
61 Representative Conyers, speaking on the floor of the House, remarked, “This amendment restores the mail fraud provision to where that provision was before the McNally decision. . . . Thus, it is no longer necessary to determine whether or not the scheme or artifice to defraud involved money or property. This amendment is intended merely to overturn the McNally decision.” 134 CONG. REC. H11251 (daily ed. Oct. 21, 1988) (statement of Rep. Conyers) (italics added). Several weeks after the passage of the provision, the Senate Judiciary Committee entered into the Congressional Record a report stating, “[Section 1346] overturns the decision of McNally v. United States . . . .” 134 CONG. REC. S17376 (daily ed. Nov. 10, 1988) [hereinafter Senate Judiciary Committee Report]. See generally United States v. Brumley, 116 F.3d 728, 742–45 (5th Cir. 1997) (en banc) (Jolly and DeMoss, JJ., dissenting) (describing the legislative history of § 1346).
62 See, e.g., United States v. Frost, 125 F.3d 346, 364 (6th Cir. 1997) (“[Section] 1346 has restored the mail fraud statute to its pre-McNally scope . . . .”); Senate Judiciary Committee Report, supra note 61, at S17376 (“The intent is to reinstate all of the pre-McNally case law pertaining to the mail and wire fraud statutes without change.”).
63 See, e.g., United States v. Sancho, 157 F.3d 918, 922 (2d Cir. 1998) (“What the government must prove to satisfy this element of the offense is defined by Section 1346—not by judicial decisions that sought to interpret the mail and wire fraud statutes prior to the passage of § 1346.”), overruled by United States v. Rybicki, 354 F.3d 124 (2d Cir. 2003) (en banc); Brumley, 116 F.3d at 733 (“Congress could not have intended to bless each and every
others hold that, although Congress did not reinstate the law, courts may refer to it when interpreting § 1346. 64

Section 1346 created other ambiguities, the most prominent being what Congress meant by “honest services.” 65 This ambiguity has led many scholars and dissenting judges to argue that § 1346 is unconstitutionally vague. 66 So far, no circuit court has agreed.

Another source of potential ambiguity was whether Congress intended to restrict § 1346 to public victim cases; that is, did Congress seek only to respond to the specific facts of McNally, or did Congress also intend to prohibit honest services fraud in the private sector? 67 Courts and prosecutors have settled on the latter interpretation, but not without generating significant confusion.

pre-McNally lower court ‘honest services’ opinion . . . Congress, then, has set us back on a course of defining ‘honest services’ . . . .”).

64 See, e.g., Rybicki, 354 F.3d at 145 (“[W]e look to cases decided before the enactment of section 1346 only in order to determine what section 1346 meant to Congress when it enacted the statute. We do not think that that earlier case law is, after the intervening occurrences of McNally and section 1346, ‘precedent’ in the sense that it sets forth rules of law that we are bound to follow.”).

65 See J U L I E R. O’ Sullivan, F E D E R A L W H I T E C O L L A R C R I M E 545 (2d ed. 2003) (suggesting that “honest services” could be interpreted as a short-hand for all the intangible rights recognized by the courts of appeals prior to McNally, including the right to privacy); see also supra notes 14 and 17 (citing relevant sources).

66 See United States v. Brown, 459 F.3d 509, 534 (5th Cir. 2006) (DeMoss, J., concurring in part) (“[T]he constitutionality of § 1346 may well be in serious doubt. . . . Section 1346’s text is undeniably vague and ambiguous and is subject to wide variation in application by the lower courts. . . . Congress should repair this statute that . . . fails to provide the requisite ‘minimal guidelines to govern law enforcement.’” (quoting Kolender v. Lawson, 461 U.S. 352, 358 (1983))); Rybicki, 354 F.3d at 158 (Jacobs, J., dissenting) (“The plain meaning of “honest services” in the text of § 1346 simply provides no clue to the public or the courts as to what conduct is prohibited under the statute.”) (citation omitted); Brumley, 116 F.3d at 736-46 (Jolly, J., dissenting) (The majority opinion “holds that general, undefined, vague, and ambiguous words constitute a clear statement that Congress intended for federal prosecutors and grand juries to police the conduct of state officers acting in their official state capacities. . . . The majority’s attempt to define ‘honest services’ demonstrates why such ad hoc definitions cannot possibly satisfy the requirements of ‘fair notice’ . . . .”).

67 A panel of the Second Circuit found § 1346 unconstitutionally vague as applied to a bid contractor working for a state school authority. United States v. Handakas, 286 F.3d 92, 96-112 (2d Cir. 2002). But the Second Circuit, sitting en banc, reversed this holding in Rybicki, 354 F.3d at 144. See United States v. Williams, 441 F.3d 716, 724-25 (9th Cir. 2006) (rejecting a claim that § 1346 is unconstitutionally vague); United States v. Hausmann, 345 F.3d 992, 958-59 (7th Cir. 2003) (rejecting a constitutional challenge to § 1346); Brumley, 116 F.3d at 733 (conceding that some defendants “on the outer reaches of the [wire fraud] statute” may be without adequate notice); see also Geraldine Scott Moomr, Mail Fraud and the Intangible Rights Doctrine: Someone to Watch Over Us, 31 HARV. J. ON LEGIS., 153, 190-97 (1994) (discussing vagueness in honest services fraud). But see United States v. Czubinski, 106 F.3d 1069, 1077 (1st Cir. 1997) (noting that the defendant could not be guilty of honest services fraud because he lacked notice that his actions were criminal).

68 See O’Sullivan, supra note 65, at 545.
II
SECTION 1346 IN THE PRIVATE SECTOR

As one court stated, "[T]he literal terms [of § 1346] suggest that dishonesty by an employee, standing alone, is a crime." Thus, based on "a need to avoid the over-criminalization of private relationships," courts have sought to prevent § 1346 from being applied "to its logical extreme" in the private sector. The result has been a patchwork of judicially created restrictions on honest services fraud, applied without even the semblance of uniformity throughout the circuit courts. For example, one commentator has found that circuits are split over what mens rea the prosecution must prove, whether the defendant must have caused tangible harm, what duty

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69 United States v. Frost, 125 F.3d 346, 368 (6th Cir. 1997).
70 Id. Commentators have also noted that different policy concerns are present in the private sector than in the public sector. For example, public officials know that they work for the public good, whereas privately employed individuals are more likely to be motivated by their own economic interest. In addition, duties of loyalty are more common and broader in the public sector than in the private sector. See Tendler, supra note 39, at 2741; see also United States v. deVegter, 198 F.3d 1324, 1328 (11th Cir. 1999) ([F]or a private sector defendant to have violated the victim's right to honest services, it is not enough to prove the defendant's breach of loyalty alone. Rather, as is always true in a breach of loyalty by a public official, the breach of loyalty by a private sector defendant must in each case contravene . . . the purpose of the parties' relationship.); United States v. Lemire, 720 F.2d 1327, 1336 (D.C. Cir. 1983) ("Employee loyalty is not an end in itself, it is a means to obtain and preserve pecuniary benefits for the employer.").
71 Frost, 125 F.3d at 368.
72 See Lemire, 720 F.2d at 1336 n.11 ("[I]f merely depriving the victim of the loyalty and faithful service of his fiduciary constitutes criminal fraud, the ends/means distinction is lost. Once the ends/means distinction is abolished and disloyalty alone becomes the crime, little remains before every civil wrong is potentially indictable." (quoting John C. Coffee, Jr., From Tort to Crime: Some Reflections on the Criminalization of Fiduciary Breaches and the Problematic Line Between Law and Ethics, 19 Am. CRIM. L. Rev. 117, 167 (1981))).
73 See United States v. Vinyard, 266 F.3d 320, 327 (4th Cir. 2001) ("[C]ourts construing and applying § 1346 have consistently utilized certain principles to limit its scope in the private employment context." (citations omitted)); O'Sullivan, supra note 14, at 663 ("Federal courts are now split every which way from Sunday on construction of this statute.").
75 Compare United States v. Pennington, 168 F.3d 1060, 1065 (8th Cir. 1999) (requiring an intent to cause actual harm and, in most business contexts, financial or economic harm), with Frost, 125 F.3d at 368 (requiring an intent to breach a fiduciary duty).
76 Compare United States v. Rybicki, 354 F.3d 124, 145–46 (2d Cir. 2003) (en banc) (requiring proof that the misrepresentation or omission at issue was "material," such that the misinformation or omission would naturally tend to lead or is capable of leading a reasonable employer to change its conduct), with Vinyard, 266 F.3d at 327–28 (adopting the reasonably foreseeable harm test), and Frost, 125 F.3d at 368 (requiring proof that the employee foresaw or reasonably should have foreseen that the employee's employer might suffer an economic harm as a result of the misrepresentation or omission).
the defendant must have breached, and the source of such duty. Generally, courts have narrowed the statute's reach by limiting the type of relationships that can give rise to an honest services conviction and by restricting the type of dishonest conduct that can trigger such a conviction.

A. Restrictions Based on the Type of Relationship

In an honest services fraud case, all courts require that a relationship exist in which the defendant owes honest services to the victim. Most frequently, courts look for the existence of a fiduciary relationship between the employer and employee. In the Seventh Circuit, any fiduciary breach coupled with personal gain constitutes a deprivation of honest services. But most courts additionally require an act of deception—usually a failure to disclose the fiduciary breach. Some courts do not require proof of a fiduciary relationship, noting that § 1346 does not, by its terms, require one. However, they do require proof of a comparable relationship giving rise to a duty of loyalty. In the absence of a fiduciary relationship—or a comparable relationship giving rise to a duty to disclose—courts find a mere failure to disclose insufficient to establish a deprivation of honest services. Rather, in such cases, they require proof of an affirmative, material misrepresentation.

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77 Compare United States v. Ervasti, 201 F.3d 1029, 1036 (8th Cir. 2000) ("We reject the [defendant's] contention that § 1346 requires the breach of a fiduciary duty."), with United States v. Czubinski, 106 F.3d 1069, 1077 (1st Cir. 1997) (discussing that in "honest services convictions involving private fraud victims[,] ... there must be a breach of a fiduciary duty to an employer").

78 Compare United States v. Brumley, 116 F.3d 728, 734 (5th Cir. 1997) (finding that violation of § 1346 requires breach of duties owed under state law), with Frost, 125 F.3d at 366 (ruling that breach of fiduciary duty is defined according to federal law).

79 See United States v. Szur, 289 F.3d 200, 211 (2d Cir. 2002).

80 See United States v. Caldwell, 302 F.3d 399, 409 (5th Cir. 2002).

81 See United States v. Hausmann, 345 F.3d 952, 956 (7th Cir. 2003) (holding that the jury need only find that the defendant used the interstate mails or wires "in furtherance of a scheme to misuse his fiduciary relationship for gain at the expense of the party to whom the fiduciary duty was owed").

82 See Geraldine Szott Moohr, Mail Fraud Meets Criminal Theory, 67 U. Cin. L. Rev. 1, 19 (1998) ("In honest services frauds, the deception lies in failing to disclose a breach of fiduciary duty to the principal." (citing United States v. Silvano, 812 F.2d 754, 756 (1st Cir. 1987))).

83 United States v. Ervasti, 201 F.3d 1029, 1036 (8th Cir. 2000) ("[W]hile we do not doubt that a defendant's breach of a fiduciary duty in proper circumstances may be a powerful indication that he also has deprived another of the right of honest services ... the breach of a fiduciary duty is not a necessary element of § 1346."); United States v. Sancho, 157 F.3d 918, 921 (2nd Cir. 1998) ("Section 1346 does not require the existence of a fiduciary relationship."); overruled on other grounds by United States v. Rybicki, 354 F.3d 124 (2d Cir. 2003) (en banc).

84 Id., 354 F.3d at 146.

85 Tendler, supra note 39, at 2756.

86 Id.
B. Restrictions Based on the Type of Conduct

In considering the type of dishonest conduct sufficient to give rise to an honest services violation, several circuits have decided between the "reasonably foreseeable harm" test and the "materiality" test.\textsuperscript{87} The reasonably foreseeable harm test requires that the employee foresaw, or reasonably should have foreseen, that the employer might suffer an economic harm as a result of the employee's misrepresentation or omission.\textsuperscript{88} The materiality test requires proof that the employee's fraud had the natural tendency to influence, or was capable of influencing, the employer to change its behavior.\textsuperscript{89} Courts also look to whether the defendant's conduct harmed the victim and whether it resulted in a personal benefit to the defendant—with some courts requiring one or the other,\textsuperscript{90} and other courts requiring only one.\textsuperscript{91}

In \textit{United States v. Rybicki}, "the leading opinion on honest-services fraud,"\textsuperscript{92} the Second Circuit found that "private-sector honest services cases fall into two general groups, cases involving bribes or kickbacks, and cases involving self-dealing."\textsuperscript{93} In the bribery or kickback cases, a defendant (e.g., a prospective supplier) who has or seeks some sort of business relationship or transaction with the victim (e.g., a manufacturer of goods) secretly pays, or causes to be paid, the victim's employee (e.g., a person responsible for choosing a supplier) in exchange for favored treatment (e.g., a supply contract).\textsuperscript{94} In the self-dealing cases, the defendant employee typically causes the employer

\textsuperscript{87} See \textit{United States v. Vinyard}, 266 F.3d 320, 327-28 (4th Cir. 2001).
\textsuperscript{88} \textit{Id.} at 328-29 (adopting the reasonably foreseeable harm test "because it both keeps the focus on employee intent and because it limits the scope of § 1346 to serious harms"). This test has also been adopted in the First Circuit, \textit{United States v. Martin}, 228 F.3d 1, 17 (1st Cir. 2000); the Eleventh Circuit, \textit{United States v. deVegter}, 198 F.3d 1324, 1328-30 (11th Cir. 1999); the D.C. Circuit, \textit{United States v. Sun-Diamond Growers of Cal.}, 138 F.3d 961, 973-74 (D.C. Cir. 1998); and the Sixth Circuit, \textit{United States v. Frost}, 125 F.3d 346, 368-69 (6th Cir. 1997).
\textsuperscript{89} See \textit{Rybicki}, 354 F.3d at 146 (adopting the materiality test "because it has the virtue of arising out of fundamental principles of the law of fraud: A material misrepresentation is an element of the crime"). This test has also been adopted by the Tenth Circuit, \textit{United States v. Cochran}, 109 F.3d 660, 665 (10th Cir. 1997); the Fifth Circuit, \textit{United States v. Gray}, 96 F.3d 769, 774-75 (5th Cir. 1996); and the Eighth Circuit, \textit{United States v. Jain}, 93 F.3d 436, 441-42 (8th Cir. 1996).
\textsuperscript{90} See, e.g., \textit{United States v. Jordan}, 112 F.3d 14, 19 (1st Cir. 1997) (requiring harm to the victim or "gainful use . . . intended by the [defendant], whether or not this use is profitable in the economic sense" (alteration in original) (quoting \textit{United States v. Czubinski}, 106 F.3d 1069, 1074-75 (1st Cir. 1997))).
\textsuperscript{91} See, e.g., \textit{United States v. Bloom}, 149 F.3d 649, 656-57 (7th Cir. 1998) (requiring a personal benefit to the duty-breaching employee); \textit{United States v. Ballard}, 663 F.2d 534, 540 (5th Cir. 1981) (requiring a detriment to the employer).
\textsuperscript{92} \textit{United States v. Brown}, 459 F.3d 509, 521 (5th Cir. 2006).
\textsuperscript{93} \textit{Rybicki}, 354 F.3d at 139.
\textsuperscript{94} \textit{Id.}
to do business with an enterprise in which the defendant has a secret interest.\textsuperscript{95} The court in \textit{Rybicki} concluded that in bribery or kickback cases, the undisclosed bribery itself suffices to constitute an honest services violation; but in self-dealing cases, the defendant's behavior must cause, or be capable of causing, some detriment to the employer.\textsuperscript{96} The court proceeded to formulate a single rule encompassing the restrictions on both the type of relationships and the type of dishonest conduct that may violate §1346:

The phrase "scheme of artifice [to defraud] by depriv[ing] another of the intangible right of honest services," in the private sector context, means 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 other 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.\textsuperscript{97}

If the Fifth Circuit in \textit{Brown} had applied existing federal law—in any of its various formulations—it would have concluded that the defendants were guilty of honest services fraud. Instead, the court crafted yet another restriction on the type of conduct that may give rise to an honest services violation. This restriction would be unjustified regardless of the case, and it is particularly incongruous in \textit{Brown} because its result is to sanction a fraud on an obviously innocent party: the shareholders.

\section*{III}
\textit{UNITED STATES V. BROWN}

\subsection*{A. The Facts}

This case derives from the so-called "Enron Nigerian Barge Transaction."\textsuperscript{98} This transaction involved two key participants from inside Enron: Andrew Fastow, Enron's Chief Financial Officer (CFO);
and Daniel Boyle, Enron’s Vice President in Global Finance. The indictment named four defendants from inside Merrill. The first three were managing directors: Daniel Bayly, head of Global Investment Banking; James Brown, head of Strategic Asset Lease and Finance; and William Fuhs, who worked under Brown. The fourth defendant, Robert Furst, was Merrill’s Enron relationship manager.

In 1999, Enron found itself struggling to meet forecasted earnings for the year’s final quarter. Executives, including Fastow, began pressuring Enron’s Asia/Pacific/Africa/China Division (APACHI) to monetize or sell assets in order to show a gain. To comply, APACHI attempted to sell an interest in its primary asset, electricity-generating power barges moored off the Nigerian coast. By December, these prospective deals had collapsed, and Enron executives discussed the need for an “emergency alternative.” Fastow turned to Merrill, hoping that as a “friend of Enron,” the bank would “help Enron out.” Boyle took the lead in negotiating with Furst to have Merrill buy the barges. Fastow orally promised to buy back the barge investment within six months, guaranteeing Merrill at least a 15 percent return. Within Merrill, both Brown and Fuhs expressed concerns about manipulating Enron’s income statement. Bayly, evidently more concerned about whether Enron would indeed buy back the interest, asked for written assurance of Enron’s promise. However, Enron executives told Bayly that such a written statement was not possible because it “would prevent Enron from receiving the accounting treatment it sought with the deal.” Nonetheless, the terms of the deal were clear. As Boyle explained in an e-mail, “[Merrill’s] decision to purchase the equity was based solely on personal assurances by

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99 Although the indictment listed Fastow as a coconspirator, he was not named as a defendant in Brown. See Superseding Indictment at 1, United States v. Brown, Cr. No. H-03-363 (S.D. Tex. Oct. 14, 2003) [hereinafter Indictment], aff’d in part, rev’d in part, and vacated in part, 459 F.3d 509 (5th Cir. 2006). Instead, he was charged separately on an indictment that listed ninety-eight criminal counts; he pleaded guilty and received a six-year prison sentence. See Kristen Hays et al., Fastow Shown Mercy: Sentence Cut to 6 Years; The Judge: Cites Cooperation, Family’s Suffering; Tearful Defendant: “I Wish I Could Undo What I Did,” Hous. CHRON., Sept. 27, 2006, at Al. In addition to Boyle, Sheila Kahanek, an Enron accountant, was named as a defendant in Brown, but she was acquitted of all charges. See Brown, 459 F.3d at 513.
100 See Indictment, supra note 99, at 437.
101 See Brown, 459 F.3d at 514.
102 Id.
103 Id.
104 Id. at 515.
105 Brown expressed his concerns to both Furst and Fuhs, and Fuhs communicated the risk of “income manipulation” to a Merrill analyst. Id. at 514.
106 Id. at 515.
Enron senior management to [Merrill] that the transaction would not go beyond June 30, 2000.”

At the end of 1999, Enron recorded the barge deal and the resulting $12,563,000 in earnings. This was a misrepresentation. Because of the buy-back agreement, Merrill’s investment carried no risk and was thus a loan, not a sale. In exchange for its participation, Merrill received a $250,000 “advisory fee” from Enron. And six months later, Enron caused an entity called “LJM2”—operated and controlled by Fastow—to pay Merrill $7,525,000 for its interest in the barges, a figure that represented exactly six-months’ return at an annual rate of fifteen percent. The Enron employees who helped effectuate the deal received compensation bonuses as a reward.

The defendants were charged with wire fraud and conspiracy to commit wire fraud in violation of 18 U.S.C. §§ 1343 (depriving Enron of money or property) and 1346 (depriving Enron of its intangible right to honest services). Boyle was convicted on all counts and did not appeal. The four Merrill defendants were convicted and appealed.

B. The Opinions

Circuit Judge Jolly, writing for the majority, began by noting that the Government proved all of the elements that are generally required for an honest services conviction. The Enron executives, Fastow and Boyle, owed fiduciary duties to Enron. The executives breached these duties, and thus the Merrill defendants were guilty of causing them to be breached or conspiring with the Enron executives to breach them by “the failure to disclose the full truth about the barge transaction.” The undisclosed information was material and

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107 Id. (alteration in original). Further evidence of Fastow’s involvement came from an e-mail written by Brown in 2001. Referring to the Nigerian Barge Transaction, Brown wrote, “[W]e had Fastow get on the phone with Bayly and lawyers and promise to pay us back no matter what.” Id.

108 Id. at 515–16.

109 Id. at 516.

110 The Merrill defendants Bayly, Brown, and Furst were also individual investors in LJM2. As such, they continued to bear an interest in the barges. Id. at 516 n.2.

111 Id. at 520.

112 Id. at 518. Brown was also charged with perjury before a Grand Jury in violation of 18 U.S.C. §§ 1623 and 3551, and with obstruction of a Grand Jury investigation in violation of 18 U.S.C. §§ 1503 and 3551. He was convicted, and the Fifth Circuit affirmed. Id. at 516.

113 The court only evaluated the honest-services theory on appeal. It did so because the trial court had not asked the jury to indicate the basis for its verdict, and thus the Government was required to prove all its theories for the court of appeals to affirm. Id. at 518 (citing Yates v. United States, 354 U.S. 298 (1957)).

114 Id. at 520.
thus constituted an "inherent" harm to Enron.\textsuperscript{115} Finally, the duty-breaching employees garnered a personal benefit in the form of compensation bonuses.\textsuperscript{116} These facts alone would suffice for an honest services conviction in any other circuit. Indeed, Judge Jolly conceded that "the Government present[ed] a very plausible, even strong, case for a criminal deprivation of honest services."\textsuperscript{117}

Judge Jolly proceeded to announce that the restrictions placed thus far on honest services fraud represented "only minimal distinctions we have had occasion to declare" and that further "constraints . . . [may be] appropriate to recognize."\textsuperscript{118} Turning to "a study of the case law to understand what behavior justifies criminal liability," Judge Jolly began with the \textit{Rybicki} rule.\textsuperscript{119} Here, he found that the defendants' "dishonest conduct [was] disassociated from bribery or self-dealing and indeed associated with and concomitant to the employer's own immediate interest."\textsuperscript{120} Judge Jolly emphasized the financial bonuses that motivated the defendants to complete the barge deal, stating that Enron's "incentive structure tying employee compensation to the attainment of corporate earnings targets" led the employees to believe that Enron's interest would "be furthered by a scheme involving a fiduciary breach."\textsuperscript{121} The opinion did not mention that the means of furthering Enron's interests involved falsely reporting that Enron had met earnings targets.\textsuperscript{122} In Judge Jolly's view, the important point was that the defendants "were driven by the concern that Enron would suffer absent the scheme."\textsuperscript{123} However, Judge Jolly did not consider whether "Enron" might encompass more than just the top-level executives who implemented the incentives policy. It is doubtful, for example, that Judge Jolly intended to suggest that the defendants were concerned that Enron's shareholders would suffer absent the scheme. Moreover, Judge Jolly's language seems to suggest that the court believed that the defendants did not intend to defraud Enron and therefore lacked the requisite mens rea. But he never actually drew this

\textsuperscript{115} \textit{Id.} The court also noted that the payment of fees to Merrill and compensation bonuses to Enron employees harmed Enron concretely. \textit{Id.} Moreover, in response to the defendants' argument that the barge transaction led to an increase in Enron's stock price and thus immediately benefited Enron and its shareholders, the court stated that it would "assume for purposes of this opinion that the alleged detriment [to Enron] satisfies that element of honest-services fraud." \textit{Id.} at 520 n.8.

\textsuperscript{116} \textit{Id.} at 520.

\textsuperscript{117} \textit{Id.}

\textsuperscript{118} \textit{Id.; see also id.} ("[B]etween the core of cases affirming honest-services fraud convictions and the shell of cases reversing them, there is a gap, a lacuna, a vacuum, a no-man's land, a demilitarized zone, in which this case awkwardly sits alone.").

\textsuperscript{119} \textit{Id.} at 520; \textit{see supra} notes 92-97 and accompanying text.

\textsuperscript{120} \textit{Brown}, 459 F.3d at 522.

\textsuperscript{121} \textit{Id.}

\textsuperscript{122} \textit{See supra} text accompanying notes 99-108.

\textsuperscript{123} \textit{Brown}, 459 F.3d at 522.
conclusion. Instead, he noted his concern with turning every fiduciary breach into a federal crime\textsuperscript{124} and proceeded to suggest that the defendants may not have "recognized, based on the nature of . . . past case law, that the 'employee services' taken to achieve [Enron's] corporate goals constituted a criminal breach of duty to Enron."\textsuperscript{125} This language, by contrast, suggests that the court was unwilling to hold the defendants guilty of honest services fraud because they lacked constitutionally adequate notice. But rather than draw this conclusion specifically, the court cryptically declared that "the scheme as alleged falls outside the scope of honest-services fraud."\textsuperscript{126}

Thus, erecting a new restriction on honest services fraud, Judge Jolly and the majority held:

[W]here an 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 the mutual interest, such conduct is beyond the reach of the honest-services theory of fraud . . . .\textsuperscript{127}

Because it is unclear where this rule derives from—does it redefine an element of § 1346? add an additional element? create an affirmative defense?—it is impossible to know how to apply it in the future. Indeed, Judge Jolly did not even explain how he applied it in this case.\textsuperscript{128}

Circuit Judge DeMoss, concurring in part, wrote separately to "reach the Defendants' constitutional challenge" and argued that § 1346 is unconstitutionally vague.\textsuperscript{129} Judge DeMoss criticized the circuit courts for "repeatedly resolving the ambiguities of the statute's text via judicially created definitions and limitations" and argued that Congress needs to repair the statute.\textsuperscript{130}

\textsuperscript{124} Id. at 519 ("[N]ot every breach of fiduciary duty owed by an employee to an employer constitute[s] an illegal fraud . . . ."); id. at 521 ("'[N]ot every breach of fiduciary duty works a criminal fraud . . . ." (citation omitted)); id. at 522 ("[W]e meet again our oft-mentioned chariness of making every knowing fiduciary breach a federal crime.").

\textsuperscript{125} Id. at 522.

\textsuperscript{126} Id.

\textsuperscript{127} Id.

\textsuperscript{128} Adding to the perplexity of this opinion, the court sought to bolster its ruling by applying the rule of lenity. Id. at 523. This doctrine holds that, when construing an ambiguous statute, the ambiguity should be resolved in favor of the more lenient punishment. See BLACK'S LAW DICTIONARY 1359 (8th ed. 2004). But here the court does not choose the more lenient of two interpretations of § 1346. Rather, the court adopts a wholly new restriction and applies it to find conduct outside the scope of the statute that would otherwise be plainly within its scope. In Part IV, this Note explores possible rationales for this rule, criticizes its flaws, and proposes a way to modify the rule into a more justifiable one.

\textsuperscript{129} Brown, 459 F.3d at 534 (DeMoss, J., concurring in part).

\textsuperscript{130} Id.
Circuit Judge Reavley, writing in dissent, argued that the convictions should have been affirmed because § 1346 "applies to the behavior in this case." He argued that the Enron executives owed fiduciary obligations to Enron and its shareholders, and that they breached those "duties by 'cooking' Enron's books and engaging in the fraudulent 'sale' of barges to Merrill Lynch ...." This, Judge Reavley asserted, "should [have] end[ed] the matter."

This Note agrees with the dissent that the defendants should have been convicted under established federal law and that the majority's justification for adopting a new restriction is unpersuasive. However, reaching this conclusion requires a deeper analysis than the dissent offered. This Note seeks to prove the dissent correct.

IV
Analysis

A. The Brown Rule

Despite the Brown court's claim that it was applying existing law, the court in fact created a new rule. Although possible rationales for the rule exist, the rationale on which the court relied is flawed because it overlooks the interests of shareholders, who must be included in the analysis of honest services fraud in the context of a public corporation.

1. A New Rule

The new rule in Brown is not easy to explain. An initial source of confusion is the court's suggestion that it applied existing law. After reciting the Rybicki rule and noting that Rybicki groups honest services cases into two categories, bribery/kickbacks and self-dealing, the court argued that the facts in Brown were distinguishable because "the only personal benefit or incentive originated with Enron itself—not from a third party as in the case of bribery or kickbacks, nor from one's own business affairs outside the fiduciary relationship as in the case of self-dealing." It proceeded to find that the defendants' "conduct [was] beyond the reach of the honest-services theory of fraud as it ha[d] hitherto been applied."

The court's conclusion, that Brown falls outside the categories that Rybicki listed merely because the benefit that accrued to the de-
fendants originated with the employer itself, is unconvincing. In United States v. Gray, the Fifth Circuit found an honest services violation where university basketball coaches fraudulently established the academic eligibility of transfer students recruited to play on the team. In that case, the only benefit that accrued to the defendants originated with the employer, and the defendant's actions benefited the employer by improving the quality of the team. To distinguish Gray, the Brown court noted that the university offered "nothing akin to Enron's corporate incentive policy coupled with senior executive support for the deal." The problem with this argument is that it overlooks the underlying similarity between Gray and Brown. In both cases, the employer itself was the source of the defendants' benefit, and the defendants' conduct furthered the employer's interests. Moreover, the court placed undue emphasis on the categories identified in Rybicki. Even if the defendants' conduct cannot be described neatly as involving bribery, kickbacks, or self-dealing, that should not be dispositive because those categories are not meant to be exhaustive.

2. Searching for a Rationale

Assuming that Brown created a new restriction on honest services fraud, the next difficulty is explaining the rationale guiding the new rule and how it operates. Two appealing options are that the rule exculpates defendants who lack the requisite mens rea, or that the

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136 A simple hypothetical reveals the speciousness of the court's reasoning. Imagine Bob, a clothing salesperson employed by Ernon. Ernon's policy is that each salesperson should sell as much clothing as possible. To encourage the salespeople, Ernon pays each a 10 percent commission. Bob needs $500 to repay a looming debt. Jane, Bob's friend, enters the store and buys a $5000 suit, thereby earning Bob a $500 commission which he uses to pay off his debt. Jane then returns the suit. To reclaim the commission it previously paid, Ernon withholds $500 from Bob's next paycheck. Bob pays Jane a fee for her efforts. The result: Ernon has not been permanently deprived of money or property, Jane has made some money, and Bob has paid off his debt. Is there truly no harm? No, it seems clear that Ernon has been deprived of Bob's honest services and that Bob or Jane or both should be guilty of honest services fraud (assuming the mails or wires were used in furtherance of the scheme). The mere fact that the benefit that accrued to Bob originated with his employer changes nothing. Nor is it of any import that Bob's actions were nominally in furtherance of Ernon's policy that each salesperson should sell as much clothing as possible. Although this hypothetical does not perfectly mirror the facts in Brown, it does suggest that the reasons given by the court to distinguish Brown from other honest services cases are unpersuasive.

137 96 F.3d 769 (5th Cir. 1996).
138 Id. at 774–75.
139 Id. at 775.
140 Brown, 459 F.3d at 523 n.13.
141 See id. at 532 n.1 (Reavley, J., concurring in part) ("[H]onest services fraud is not limited to those categories, and any implication otherwise is unjustified."); United States v. Rybicki, 354 F.3d 124, 154 (2d Cir. 2003) (en banc) (Raggi, J., concurring) ("I do not understand the court to be limiting the statute's reach to the identified categories.").
rule exculpates defendants whose fraud is necessarily immaterial. But the court appeared to reject these rationales. Instead, it reasoned that the rule exculpates defendants whose interests do not sufficiently conflict with the employer’s own interests. This rationale completely overlooks the interests of the shareholders.

a. **Lacking Mens Rea?**

One possibility is that the rule is really a sufficiency of the evidence restriction on mens rea. This would mean that whenever an employee breaches a fiduciary duty, but does so to further a corporate policy, the employee lacks the mens rea necessary to be guilty of honest services fraud—in other words, such an employee is not morally culpable. The problem with this is that honest services fraud is not a distinct crime, but a way of committing mail or wire fraud. The mens rea required for mail and wire fraud is simply the intent to defraud.142 Courts widely agree that when a defendant breaches a fiduciary duty, the defendant’s failure to disclose that breach constitutes a fraud because the fiduciary relationship imposes a duty to disclose material facts.143 In Brown, the court conceded that the defendants committed “a fiduciary breach—the failure to disclose the full truth about the barge transaction.”144 Thus, the requisite mens rea existed.

b. **Lacking Materiality?**

Another possibility is that the Brown rule is based on the materiality element of honest services fraud.145 Such a rule would mean that when a defendant breaches a fiduciary duty, but does so to further a corporate policy, the breach is necessarily not material. Although this makes some intrinsic sense, the court explicitly rejected this rationale by conceding the materiality of the defendants’ fraud. The court agreed with the Government that the defendants failed “to disclose material information—that the barge transaction presented no risk to

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142 United States v. Stephens, 421 F.3d 503, 509 (7th Cir. 2005) (citing United States v. Owens, 301 F.3d 521, 528 (7th Cir. 2002)); Perryman, supra note 32, at 721–22. The government does not need to prove that an actual injury occurred. See United States v. Naiman, 211 F.3d 40, 49 (2d Cir. 2000); United States v. Jain, 93 F.3d 436, 441 (8th Cir. 1996).


144 Brown, 459 F.3d at 520.

145 See Perryman, supra note 32, at 718.
Merrill because of the oral side deal."\textsuperscript{146} Thus, the \textit{Brown} rule does not establish that fiduciary breaches which further corporate policies are necessarily immaterial.

With respect to both mens rea and materiality, the court’s conclusion is correct. The defendants in \textit{Brown} had the requisite mens rea to be guilty of honest services fraud, and their fraudulent conduct was material. But the court missed the main reason why the defendants’ conduct satisfied these elements. As this Note argues below, the defendants intended to defraud Enron’s shareholders, as to whom the nondisclosed information was material.

c. \textit{Lacking a Corporate Conflict?}

The thrust of Judge Jolly’s opinion reveals that his concern in crafting a new rule was with the element of honest services fraud that requires a conflict between the interests of the duty-breaching employee and the employer. Judge Jolly began by citing the \textit{Rybicki} rule requiring “an officer or employee of a private entity . . . purporting to act for and in the interests of his or her employer . . . secretly to act in his or her or the defendant’s own interests instead . . . .”\textsuperscript{147} He then noted that the Fifth Circuit “ha[d] couch[ed] [its] language more broadly in terms of an understood \textit{divergence}, rather than a secret \textit{conflict}, of interests”\textsuperscript{148} and proceeded to explain that “‘honest services fraud’ contemplates that in rendering some particular service or services, the defendant was conscious of the fact that his actions were something less than in the best interests of the employer.”\textsuperscript{149} Moving to the facts in \textit{Brown}, the court found that “Enron’s legitimate interests were not so clearly distinguishable from the corporate goals communicated to the [d]efendants.”\textsuperscript{150} From here, the court found that each defendant “perceive[d] his pursuit of that goal as mutually benefiting him and his employer,” and thus concluded that the conduct did not constitute honest services fraud.\textsuperscript{151} Thus, it appears that the court viewed its rule as foreclosing honest services fraud liability when a defendant’s fiduciary breach furthers a corporate policy because, in such cases, any divergence of interests between the employee and the employer is per se insufficient.

\textsuperscript{146} \textit{Brown}, 459 F.3d at 520. It is clear that the court accepted the Government’s allegations regarding materiality because the court later concluded “that the scheme \textit{as alleged} falls outside the scope of honest-services fraud.” \textit{Id.} at 522 (emphasis added).

\textsuperscript{147} \textit{Id.} at 521 (omissions in original) (quoting United States v. Rybicki, 354 F.3d 124, 141–42 (2d Cir. 2003) (en banc)).

\textsuperscript{148} \textit{Id.}

\textsuperscript{149} \textit{Id.} (quoting United States v. Brumley, 116 F.3d 728, 734 (5th Cir. 1997) (en banc)).

\textsuperscript{150} \textit{Id.} at 522.

\textsuperscript{151} \textit{Id.}
The fundamental flaw in this view is that it conceives of “the employer”—the entity to whom honest services are owed—as consisting solely of the corporate managers. The court first assumed that the defendants breached their fiduciary duties to their employer. It next assumed that they were doing so pursuant to a corporate policy. From these premises, the court concluded that, despite the fiduciary breach, the defendant employees’ interests did not diverge sufficiently from the employer’s interests because they were furthering a corporate policy. But in order to draw that conclusion, it is necessary to additionally assume that the employer’s interests were identical to the interests of the persons who promulgated the given corporate policy. This is where the argument collapses. The defendants in Brown owed honest services to Enron as an entity, not merely to the corporate managers, and even if they did not commit honest services fraud vis-à-vis the Enron managers, they did commit honest services fraud vis-à-vis the shareholders.

B. Bringing Shareholders Back into the Picture

The defendants in Brown owed their honest services to Enron as a whole, including its shareholders. This argument proceeds in two steps. First, the core basis for honest services liability is a fiduciary relationship, and the defendants here were fiduciaries of Enron’s shareholders. Second, this conceptualization of honest services fraud accords with Congress’s intent in enacting § 1346.

1. Executives as Fiduciaries of Shareholders

Although the meaning of “honest services” is a matter of some debate, it is clear that it encompasses fiduciary duties. It is a fundamental principle of agency law that agents owe fiduciary duties to their principals. In the context of corporations, officers and directors are fiduciaries of the corporation and its shareholders. The

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152 See id. at 519 (""Honest services" are services owed to an employer under state law; including fiduciary duties defined by the employer-employee relationship." (internal citations omitted)); United States v. deVegter, 198 F.3d 1324, 1330 n.7 (11th Cir. 1999) ("It is clear that a breach of a fiduciary duty . . . is sufficient to state a private sector violation of § 1346. Most private sector § 1346 honest services fraud cases decided in the other Circuits . . . have involved breaches of fiduciary duties."); United States v. Frost, 125 F.3d 346, 368 (6th Cir. 1997) ("The prosecution must prove that the employee intended to breach a fiduciary duty . . . .").
153 See RESTATEMENT (THIRD) OF AGENCY § 8.01 (2006) ("An agent has a fiduciary duty to act loyally for the principal’s benefit in all matters connected with the agency relationship.").
Enron employees who executed the Nigerian Barge Transaction were Fastow (the CFO) and Boyle (the Vice President in Global Finance), both top executives. As fiduciaries of Enron, they owed Enron their honest services. This, in turn, meant that they owed honest services not only to the top corporate managers, such as the president, the chief executive officer, and the board of directors, but rather to the entire corporation, including its owners—the shareholders.

In the corporate context, a complete analysis of whether a defendant employee has deprived the employer of honest services must include an evaluation of the defendant's actions with respect to the shareholders. In many cases, it may be unnecessary to reach this second analytical step because a dishonest employee is generally harmful to all constituents of a corporation, managers and shareholders alike. But this will not always be the case, and it certainly was not the case in Brown. If a defendant has defrauded or otherwise harmed the shareholders, the mere fact that the defendant was furthering a managerially set policy does not mean that the defendant has complied with the defendant's obligation to provide honest services to the corporation. By harming shareholders, the defendant subjects the corporation to the significant risk of shareholder litigation. This risk constitutes a detriment to the employer. Especially when combined with the personal benefit to the duty-breaching defendant, this suffices to establish honest services fraud.

2. Shareholders as Private Sector "Citizens"

The above argument assumes that a fiduciary duty is sufficient to create a duty to provide honest services. To bolster the argument that the defendants in Brown owed honest services to Enron's shareholders, this section argues that such a conclusion comports with the purpose of § 1346.

In the typical case, it may be unnecessary to analyze whether an employee has committed honest services fraud vis-à-vis the shareholders as opposed to the managers because generally managers and shareholders share the same interest in ridding the corporation of dishonest employees. But the Brown court recognized that its facts were "exceptional" because the employees who breached their fiduciary duties did so pursuant to a corporate policy. Yet, by overlooking the interests of shareholders and concluding that the defendants' con-

("Directors and officers have a fiduciary duty to the corporation and its stockholders." (citations omitted)).


156 Brown, 459 F.3d at 522.
duct fell “outside the scope of honest-services fraud,” the court exculpated dishonest employees because the corporate fraud ran to the top. This result is ironic because in cases of large-scale corporate fraud, shareholders cannot rely on management to take appropriate action and thus are in particular need of federal regulatory oversight. Yet it is only in these cases that the Brown court found the conduct outside the scope of honest services fraud.

This result is not only unfair, but it also contravenes the purpose of § 1346. Congress enacted § 1346 in response to McNally, a case involving public-sector honest services fraud. Through this statute, Congress intended to enable the federal government to prosecute state and local corruption—the theory being that such federal oversight was necessary to adequately protect individual citizens from frauds perpetrated by public officials. Section 1346 has been applied by analogy to the private sector. In the private sector, shareholders, more than any other constituency, most closely resemble individual citizens from the public sector. Individual citizens have a vital interest in their government but have little power to control it other than by voting. Similarly, in a corporation, shareholders are keenly affected by corporate governance, but usually have no power to exert control other than by voting. Just as public officials owe a fiduciary duty to citizens, so too do corporate officers and directors owe fiduciary duties to shareholders. And in both cases, § 1346 exists to permit the federal government to prosecute those persons

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157 Id.
158 McNally v. United States, 483 U.S. 350, 356 (1987); see supra Part I.D.
159 Peter J. Henning, Federalism and the Federal Prosecution of State and Local Corruption, 92 Ky. L.J. 75, 145 (2003) (“The federal interest includes the prosecution of public corruption, and § 1346 is a clear congressional mandate that federal authority can be used to police misconduct by state and local officials.”); Roderick M. Hills, Jr., Corruption and Federalism: (When) Do Federal Criminal Prosecutions Improve Non-Federal Democracy?, 6 THEORETICAL INQUIRIES L. 113, 137 (2005) (“It is well-established that [§ 1346] was intended to criminalize at least some forms of ‘corrupt’ behavior by non-federal officials.”).
160 See United States v. deVegter, 198 F.3d 1324, 1327–28 (11th Cir. 1999) (noting that the “paradigm case of honest services fraud is the bribery of a public official,” but that § 1346 has been “extend[ed] to the defrauding of some private sector duties of loyalty”); Modern Mail Fraud, supra note 12, at 428 (explaining the evolution and differentiation of honest services fraud in public and private contexts); Perryman, supra note 32, at 733 (“Outside of the public-sector context, courts have struggled to apply the concept of ‘honest services’ to private employment situations . . . .”).
161 See deVegter, 198 F.3d at 1328 (“'[I]n a democracy, citizens elect public officials to act for the common good. When official action is corrupted . . . the essence of the political contract is violated.'” (quoting United States v. Jain, 93 F.3d 436, 442 (8th Cir. 1996))).
162 See 18A AM. JUR. 2D Corporations § 622 (2004) (noting that shareholders exercise their right to share in the management of the company by voting).
163 See United States v. Woodard, 459 F.3d 1078, 1086 (11th Cir. 2006) (“[A]s a public official, [the defendant] owed a fiduciary duty to the public to make governmental decisions in the public’s best interest . . . .” (footnote omitted)).
164 See supra notes 152–54 and accompanying text.
who abuse their positions of trust and breach their fiduciary duties. The prosecution of the Enron executives who devised and perpetrated the Nigerian Barge Transaction, and the Merrill executives who facilitated them, was a legitimate and justifiable exercise of this federal power.

3. Defrauding Shareholders, Depriving Enron of Honest Services

The defendants in Brown perpetrated a fraud on Enron's shareholders and therefore deprived Enron of their honest services. Fraud may be established by either the nondisclosure of material facts when a duty to disclose exists or by an affirmative misrepresentation of material facts. As the Brown court conceded, the defendants failed to disclose material information about the barge transaction, specifically, that Enron orally promised to buy the assets back from Merrill within six months at a fifteen percent annual rate of return. In addition to this nondisclosure, the defendants also made, or caused to be made, an affirmative misrepresentation. At the end of 1999, Enron recorded in its financial statements that the barge deal was a sale from which it booked $12,563,000 in earnings. Because of the buy-back agreement, the deal was risk-free for Merrill and was therefore a loan, not a sale, which made the entry an affirmative misrepresentation. Finally, these nondisclosures and misrepresentations were material as to the shareholders. The very purpose of a financial statement is to communicate information about a firm's financial condition to the general public; reliance is its raison d'être. Because a reasonable shareholder may have decided to sell Enron stock rather than retaining it or buying more had the shareholder known that the barge transaction

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165 See Basic Inc. v. Levinson, 485 U.S. 224, 231 (1988) (explaining that a fact is material when there is a "substantial likelihood that a reasonable shareholder would consider it important" (quoting TSC Indus. v. Northway, Inc., 426 U.S. 438, 449 (1976))); United States v. Rybicki, 554 F.3d 124, 145 (2d Cir. 2009) (en banc) (explaining that a material fact is one that "would naturally tend to lead or is capable of leading a reasonable employer to change its conduct"); Robert G. Vaughn, America's First Comprehensive Statute Protecting Corporate Whistleblowers, 57 ADMIN. L. REV. 1, 24 (2005) ("[M]aterial facts are ones that have the tendency or capability of influencing the decisions of the person or entity to whom statements containing the facts are addressed.").

166 See Neder v. United States, 527 U.S. 1, 16 (1999) (holding that defendants' false statements and failure to make disclosures constituted fraud); Rybicki, 554 F.3d at 146-47 (defining honest services fraud to include "a material misrepresentation made or omission of information disclosed"); Vaughn, supra note 165, at 24.

167 United States v. Brown, 459 F.3d 515, 520 (5th Cir. 2006).

168 Id. at 515-16.

169 See id. at 516 (recognizing this as the Government's argument).

170 The conduct would also satisfy the reasonably foreseeable harm test in courts that apply that test. See supra note 88 (listing cases). Undoubtedly, it was reasonably foreseeable to the defendants that their conduct might harm shareholders if, for example, shareholders who would have sold their stock decided instead to keep it, only to later see the stock price plummet when news of the sham transaction became public.
was a sham or that Enron had not, in fact, met earnings targets, the defendants’ omissions and misrepresentations were material.\textsuperscript{171} Thus, by defrauding Enron’s shareholders,\textsuperscript{172} profiting personally through bonuses and fees, and thereby harming Enron by subjecting it to shareholder liability risk and unnecessary fee and bonus payments, the defendants were guilty of depriving Enron of honest services.

Returning to the Brown court’s apparent rationale for its rule, once shareholders are in the picture, the rationale’s logic disappears. The element of honest services fraud that the Brown court found lacking because the defendants’ actions furthered a corporate policy was the requirement that the employee’s actions be “something less than in the best interests of the employer”\textsuperscript{173} or that the employee’s interests and the employer’s interests sufficiently diverge.\textsuperscript{174} Although Fastow and Boyle’s interests may have aligned with the interests of Enron’s top corporate managers, their scheme was certainly not in the best interests of Enron’s shareholders. At a minimum, the defendants’ interests—earning bonuses and meeting earnings targets—“sufficiently diverge[d]” from the shareholders’ interest in obtaining accurate information from Enron’s financial statements.\textsuperscript{175} Because shareholders are as much a part of the “employer” as are the corporate managers, this conflict of interests between the duty-breaching employees and the shareholders establishes the very element of honest services fraud that the Brown court deemed per se insufficient.

C. The Rule as an Affirmative Defense?

The Brown court’s justification for its rule is unpersuasive because the divergence of interests that it claimed were insufficient were in

\textsuperscript{171} The importance of this materiality requirement should not be underestimated. Facts that may be material to a corporate manager may not be material to shareholders. Indeed, most dishonest statements and actions by average employees of a corporation will not perpetrate a fraud on shareholders because it will not be material to them. Brown is different because the employees were high-level executives and their statements were of a type on which shareholders typically rely.

\textsuperscript{172} There need not be actual proof of harm to, or reliance by, shareholders, so long as the conduct was capable of producing harm or reliance. See Neder v. United States, 527 U.S. 1, 24–25 (1999) (“The common-law requirement[ ] of ‘justifiable reliance’ . . . plainly ha[s] no place in the federal fraud statutes.”); United States v. Weiss, 752 F.2d 777, 784 (2d Cir. 1985) (holding that the government does not need to prove that the scheme resulted in a direct, tangible loss to the victims).

\textsuperscript{173} Brown, 459 F.3d at 521 (quoting United States v. Brumley, 116 F.3d 728, 734 (5th Cir. 1997)) (en banc).

\textsuperscript{174} Id.

\textsuperscript{175} Judge Jolly notes that the defendants’ “breach . . . resulted in an increase in Enron’s stock price, an immediate benefit Enron specifically sought.” Id. at 520 n.8. But as the dissent correctly responds, “[T]he barge transaction did not serve the purpose of Enron’s shareholders . . . . [F]alsifying Enron’s books does not serve a legitimate corporate purpose, even if it temporarily made Enron’s finances appear more attractive to the investing public in the short term.” Id. at 533 (Reavley, J., dissenting in part).
fact more than sufficient once shareholders are considered. However, the rule may have more solid grounding as an affirmative defense.\footnote{As an affirmative defense, the Brown rule shares something in common with the defense of "superior orders" in the military context. See \textit{Model Penal Code} § 10.2 ("It is an affirmative defense that the actor, in engaging in the conduct charged to constitute an offense, does no more than execute an order of his superior in the armed services that he does not know to be unlawful.")). \footnote{See \textit{Del. Code Ann.} tit. 8, § 102(a)(3) (2005) ("It shall be sufficient to state . . . [in the certificate of incorporation] that the purpose of the corporation is to engage in any \textit{lawful} act or activity for which corporations may be organized . . . ." (emphasis added)); \textit{Jones Apparel Group v. Maxwell Shoe}, 883 A.2d 837, 845–46 (Del. Ch. 2004) (interpreting when a charter provision is contrary to law). I refer here to Delaware law because it is the most widely used body of corporate law and because Enron was incorporated in Delaware. \textit{See Bylaws of Enron Corp.}, (Feb. 13, 1996), http://contracts.corporate.findlaw.com/agreements/enron/bylaws.1996.02.13.html.}

First, this subpart explores the difficulty of justifying the \textit{Brown} rule, in its current form, as an affirmative defense. Second, it suggests a way to modify the rule to make it more supportable.

1. \textit{Problem: When the Policy is Unlawful}

As an affirmative defense, the \textit{Brown} rule would mean that because employees are justified in following corporate policies, even if all the elements of honest services fraud are established, a defendant may avoid liability by proving that the fiduciary breach furthered a corporate policy. The appeal of viewing this rule as an affirmative defense is that it avoids the doctrinal difficulty of redefining elements of honest services fraud to find that one element or another is not satisfied when an employee who breaches a fiduciary duty does so in furtherance of a corporate policy. However, the key problem with this view is that it is wrong to assume that all employees, under all circumstances, are justified in following corporate policies.

Corporations cannot exist for an unlawful purpose,\footnote{See \textit{In re Caremark Int'l Inc. Derivative Litig.}, 698 A.2d 959, 970 (Del. Ch. 1996) (requiring the board of directors to establish an information and reporting system to ensure employees are acting lawfully); \textit{Principles of Corporate Governance: Analysis and Recommendations} § 2.01(b)(1) (1992) ("Even if corporate profit and shareholder gain are not thereby enhanced, the corporation, in the conduct of its business . . . [i]s obliged . . . to act within the boundaries set by law . . . ").} cannot conduct their business in an unlawful manner, and certainly cannot have an official policy that sanctions illegal or fraudulent acts.\footnote{See \textit{18B Am. Jur. 2d Corporations} § 1166 (2004).} Thus, because corporations must act within the bounds of the law and in fact act through their agents, it follows that corporate agents—officers and employees—have a duty to further the corporation's goals exclusively through lawful means.\footnote{See \textit{Jones Apparel Group v. Maxwell Shoe}, 883 A.2d 837, 845–46 (Del. Ch. 2004) (interpreting when a charter provision is contrary to law). \textit{PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS} § 2.01(b) (1992) ("Even if corporate profit and shareholder gain are not thereby enhanced, the corporation, in the conduct of its business . . . [i]s obliged . . . to act within the boundaries set by law . . . ").}
The court in Brown relied heavily on the premise that the defendants were furthering a corporate policy. But what, exactly, was the policy? Specifically, did the policy sanction, implicitly or explicitly, fraudulent or illegal activity? The inescapable conclusion is that it did. According to the court's own rendering of the facts, when Enron encountered difficulties selling its barges, Fastow sought an "emergency alternative" solution which led him to enlist Merrill by guaranteeing that Enron would buy back the barges at a fifteen percent annual rate of return within six months.

It is clear, both from Fastow's experience as a financial expert and from his refusal to put Enron's buy-back guarantee in writing, that he knew the deal was fraudulent. Thus, the official Enron policy was not simply, "Do your best to meet our quarterly earnings targets." Rather, the policy, which the court called "benighted," was more like, "Meet earnings targets through whatever means necessary, even if fraudulent." This was not a legitimate corporate policy. Because corporate agents owe a duty to further the corporation's goals only through lawful means, the mere fact that the defendants' actions furthered Enron's policy cannot shield them from criminal liability because the policy itself was illegal. Put another way, it is illogical to allow the Enron and Merrill executives who committed honest services fraud to escape liability by proving that they were furthering a corporate policy because, under the circumstances, their affirmative obligation was to disclose the policy or to halt it.

2. Solution: A Rebuttable Presumption

To become a more reasonable affirmative defense, the Brown rule must take into account whether an employee who breaches a fiduciary duty in furtherance of a corporate policy has, under the circumstances, a duty to comply with the policy or a duty to desist. It may be that, in the majority of cases, a corporation's official policy will not intentionally sanction fraudulent behavior. Cases may also arise in which, even if the corporate policy is unlawful, the employees who further it will not know that the policy is unlawful or will not be in a position to challenge it.

Therefore, the Brown rule should be converted into a rebuttable presumption. Thus, if defendants can prove that they were furthering a corporate policy, a legal presumption against honest services fraud

180 See Brown, 459 F.3d at 522 (referring to Enron's "incentive structure tying employee compensation to the attainment of corporate earnings targets"); id. at 522 n.15 (referring to "Enron's corporate incentive policy").
181 Id. at 514-15.
182 Id. at 515.
183 Id. at 522.
184 See supra notes 177-79 and accompanying text.
liability should arise. The court must then permit the government to rebut this presumption by proving that the policy was fraudulent or illegal, that the defendants knew it was fraudulent or illegal, and that the defendants were in a position to disclose or otherwise frustrate the policy. The virtue of this rule is that it mollifies the *Brown* court's concern about turning every fiduciary breach into a crime while still imposing criminal liability on those who are aware of the fraudulent nature of their actions, have the power to take corrective action, and instead willingly perpetuate the fraud. Under this rule, the defendants in *Brown* would be guilty of honest services fraud because, as high-level executives of Enron and Merrill, they were well aware that the Nigerian Barge Transaction was fraudulent and they therefore had a duty to disclose it, halt it, or, at a minimum, abstain from executing it.

**Conclusion**

In *Brown*, the Fifth Circuit crafted yet another restriction on honest services fraud, holding that an employee who breaches a fiduciary duty escapes liability if the employee's goal—in addition to profiting personally—was to further a corporate policy. First, this Note has sought to identify and explain the court's rationale for this rule. Second, it has argued that the court's rationale is premised on flawed assumptions, and that if those assumptions are corrected, the rule loses all justification.

The rationale that the court seems to adopt is that if an employee's actions further a corporate policy, then, notwithstanding a fiduciary breach, the employee's and employer's interests do not diverge sufficiently to establish an honest services violation. The flawed assumption here is that "employer" refers only to the corporate managers who implement the policy. Rather, the "employer" is the corporation as a whole, including its shareholders. A duty-breaching employee may perpetrate a fraud on shareholders even when furthering a policy that the corporate managers set. This fraud results in concrete detriments to the corporation as a whole, such as by subject-

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185 Although the Supreme Court has held that presumptions in criminal cases are unconstitutional when they relieve the prosecution of its burden of proof, this rule would not apply to the rebuttable presumption here. See Francis v. Franklin, 471 U.S. 307, 317 (1985); Sandstrom v. Montana, 442 U.S. 510, 523–24 (1979) (holding that a rebuttable presumption is unconstitutional). Here, the prosecution would still need to prove all the elements of honest services fraud beyond a reasonable doubt. The defendant would then have the burden of proving, as an affirmative defense, that the defendant was furthering a corporate policy. This would then create a rebuttable presumption in favor of the defendant. Unconstitutional presumptions, by contrast, burden the defendant. See Walker v. Butterworth, 599 F.2d 1074, 1079 (1st Cir. 1979).

186 See supra note 124 and accompanying text.
ing the corporation to the risk of shareholder litigation. Thus, the
element of honest services fraud requiring divergent interests is
satisfied.

A more persuasive, but also problematic, rationale may be that
because employees are justified in complying with official policies, an
employee can escape honest-services-fraud liability if the employee
can prove, as an affirmative defense, that the conduct furthered such
a policy. The flawed assumption here is that employees are always
justified in complying with official policies. When a corporate policy
sanctions fraudulent or unlawful conduct and the employee knows
this and is in a position to disclose or frustrate the policy, the em-
ployee has an affirmative obligation to do so. The rule becomes more
sensible if it is modified to create a rebuttable presumption that an
employee acting pursuant to a corporate policy is complying with the
obligation to provide honest services.

Section 1346 is, as many have argued, hopelessly ambiguous on
its face.¹⁸⁷ Judge Jolly, the Brown author, pointed out many of these
ambiguities in his Brumley dissent.¹⁸⁸ In Brown, he instead sought to
restrict the reach of the statute by crafting a new rule. Although the
extensive reach of § 1346 has certain costly consequences, the costs of
the Brown rule are far greater. For one, the rule comes at the expense
of consistency and predictability throughout the circuit courts. Doc-
trinal rationality also suffers because accepting the rule requires mak-
ing the flawed assumptions discussed above. The rule’s final cost is
justice itself because, at least in this case, its effect is to exculpate indi-
viduals who committed outright fraud. A better solution would be for
courts to apply honest services law honestly and leave it to Congress to
amend the “facially vague”¹⁸⁹ statute if Congress dislikes the result.

¹⁸⁷ See supra notes 14 and 17.
¹⁸⁸ United States v. Brumley, 116 F.3d 728, 736–48 (5th Cir. 1997) (en banc) (Jolly and
DeMoss, JJ., dissenting).
¹⁸⁹ United States v. Brown, 459 F.3d 509, 520 (5th Cir. 2006).