Twenty-Eight Words: Enforcing Corporate Fiduciary Duties Through Criminal Prosecution of Honest Services Fraud

Lisa L. Casey
Notre Dame Law School

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TWENTY-EIGHT WORDS:
ENFORCING CORPORATE FIDUCIARY DUTIES
THROUGH CRIMINAL PROSECUTION
OF HONEST SERVICES FRAUD

BY LISA L. CASEY

ABSTRACT

This article examines the federal government's growing use of 18 U.S.C. § 1346 to prosecute public company executives for breaching their fiduciary duties. Section 1346 is a controversial but under-examined statute making it a felony to engage in a scheme "to deprive another of the intangible right of honest services." Although enacted by Congress over twenty years ago, the Supreme Court repeatedly declined to review the statute, until now. In 2009, Justice Antonin Scalia pointed to the numerous interpretive questions dividing the federal appellate courts and proclaimed that it was "quite irresponsible" to let the "current chaos prevail." Since then, the Court has granted certiorari in no fewer than three separate cases construing the honest services law.

The questions before the Supreme Court are of particular interest to public company executives and their professional advisors. Following revelations of massive fraud and management wrongdoing at Enron and other public companies, the Justice Department employed § 1346 to indict executives accused of breaching their fiduciary duties. Former Enron CEO Jeffrey Skilling and former Hollinger CEO Conrad Black are just two of the corporate fiduciaries found guilty of breaching their duties and convicted under the statute. Traditionally, Delaware law has governed the content and enforcement of executives' legal duties, largely protecting public company fiduciaries from civil liability. Now, with the emergence of honest services fraud as a weapon against corporate wrongdoing, and pressure from Congress for more prosecutions, civil and criminal law are trending in opposite directions. Corporate fiduciaries may become criminally liable for conduct that would not subject them to civil sanctions. Furthermore,
because these fiduciaries look to state law for the standards governing their conduct, this anomalous development has profound implications for public company governance.

This article analyzes the issues before the Supreme Court in light of these contradictory enforcement trends. Spill-over from federal criminal jurisprudence to state fiduciary duty doctrine is one concern, but over-criminalization and prosecutorial abuse also must be considered. I conclude this article by proposing a statutory amendment that may advance Congress’s interest in prosecuting public company executives for serious fraud while limiting federal interference with potentially conflicting fiduciary obligations arising under state law.

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I. INTRODUCTION

If lawyers for the notorious corporate kleptocrat Lord Conrad Black can persuade the United States Supreme Court to reverse their client's convictions for honest services mail fraud, the former media executive may have Justice Antonin Scalia to thank for his good fortune. Over the past two decades, the Court refused persistent appeals imploring the Justices to invalidate the federal honest services statute—§ 1346—which criminalizes fraudulent schemes "to deprive another of the intangible right of honest services." Notwithstanding sharp disagreements among the circuit courts over its proper scope, the Supreme Court had declined every opportunity to construe the twenty-eight-word statute. Indeed, just one month after Black filed his petition, the Court denied certiorari in Sorich v. United States, an honest services challenge from the Seventh Circuit (the same appellate court that had affirmed Black's convictions) raising very similar questions about the statute's reach. The Court's denial in Sorich, however, prompted a surprising dissent from Justice Scalia. Adding his voice to a chorus of other jurists and scholars, Justice Scalia complained that honest services fraud had become a "potent federal prosecutorial tool," "invoked to impose criminal penalties upon a staggeringly broad swath of behavior, including misconduct not only by public officials and employees but also by private employees and corporate fiduciaries." After all, what is the "intangible right of honest services"?

Read literally, § 1346 criminalizes conduct ranging from a mayor using his influence to get a restaurant table without a reservation to a public servant recommending an unqualified friend for a public contract. In the private sphere, the statute could prohibit "any self-dealing by a corporate officer" as well as "a salaried employee's phoning in sick to go to a ball game."
game." Justice Scalia urged the Court to review both the meaning of the statute and its constitutionality, admonishing his colleagues that it was "quite irresponsible to let the current chaos prevail." Still, legal prognosticators anticipated that the Court would reject Black's petition as it had rejected every other challenge to § 1346, leaving Black, a sixty-five-year-old British baron, to complete the remaining five and a half years of his prison sentence at a Florida minimum security camp located not far from his former Palm Beach mansion.

The pundits were wrong. Apparently persuaded by Justice Scalia's entreaty, the Supreme Court granted Black's petition and then, just a month later, also accepted a second petition to construe the scope of § 1346. In the latter case, the Court agreed to review a Ninth Circuit decision applying the statute to prosecute an elected state legislator. The petitioner, former Alaska Representative Bruce Weyhrauch, allegedly deprived the state of his honest services by voting on legislation while concealing a material conflict of interest. Although neither Black nor Weyhrauch attacked the honest services statute on constitutional grounds, the Court waited just a week after beginning the new Term before granting yet a third petition—this one filed by former Enron CEO Jeffrey Skilling—directly challenging the constitutionality of § 1346. In an unexpected about-face, then, the Supreme Court now is likely to resolve not only long-standing controversies about the government's application of § 1346 to convict public and private officials, but the Court also will hear arguments that the compact law lacks the specificity necessary to survive constitutional scrutiny.

The Supreme Court's decision to examine the honest services statute for the first time comes as criticism of the law—and, more broadly, criticism of the discretion the statute gives federal prosecutors—is mounting. Over...
the past several years, judges and scholars have expressed growing concern that the ambiguous language in § 1346 has enabled the Department of Justice (DOJ) to prosecute public corruption cases for political purposes. Although Congress may not have intended to "grant carte blanche" to federal prosecutors to define "honest services' from case to case for themselves," the federal courts of appeals have allowed precisely that result. Commentators recognize, too, that the Supreme Court's decisions in Black, Weyhrauch, and Skilling could defuse or even eliminate a powerful weapon often employed by the DOJ to attack public corruption.

Less studied, but also significant, is how the outcomes of these appeals might weaken the federal government's reinvigorated war on corporate corruption. In the past decade, Justice Department prosecutors have employed the honest services statute increasingly to charge, convict, and sentence corporate fraudsters, including not only notorious CEOs like Conrad Black, Enron's Skilling and Kenneth Lay, and Adelphia's John Rigas, but also scores of other lesser-known senior executives and their professional advisors. In many cases, § 1346 has been a stealth count, operating as a backup charge that won guilty verdicts and jailed corporate executives when proof of other allegations fell short. Each conviction for honest services fraud carries a maximum sentence of twenty years in prison.

If the Supreme Court upholds the convictions of Black and Skilling, honest services fraud charges are certain to appear in forthcoming indictments of corporate executives for wrongdoing connected to last year's financial crisis. The Obama Administration has made prosecuting corporate fraud a top priority for the DOJ under new Attorney General Eric Holder. Federal law enforcement authorities already have devoted vast resources to investigating allegations of senior management's deception and self-dealing

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14United States v. Rybicki (Rybicki II), 354 F.3d 124, 138 (2d Cir. 2003) (en banc).


16I refer to officers and directors collectively as "executives," "managers," or "management."

17See Marek, supra note 15, at 1 (noting that § 1346 was the "lead charge" asserted against 79 defendants in 2007, up from 63 in 2005, and 28 in 2000); infra Part IV.A.

18In recent testimony before Congress, the DOJ committed to "prosecute the wrongdoers, seek to put them in jail, work tirelessly to recover assets and criminally derived proceeds, and strive to make whole the victims of such crimes." Federal and State Enforcement of Financial Consumer and Investor Protection Laws: Hearing Before the H. Comm. on Fin. Servs., 111th Cong. 2 (2009) (statement of Rita Glavin, Acting Assistant Att'y Gen., Criminal Division, United States Department of Justice).
at some of the nation's largest (or formerly largest) financial institutions. Government lawyers also have launched criminal investigations to determine whether representations by CEOs about their firms' financial condition were deceptive in light of the companies' subsequent failures or near failures.\(^9\)

Understandably focused on restoring public confidence in the capital markets, Congress, too, has demanded prosecution of corporate officers and directors for any crimes that contributed to the economic downfall. But will the honest services fraud statute still be available to prosecute corporate executives for fraud and related wrongdoing?

Assuming that the Court dispenses with Skilling's constitutional challenge, the answer will depend on how the Justices interpret the twenty-eight seemingly unobjectionable words that Congress added to the mail fraud statute in 1988. Paradoxically, the potency of § 1346 derives from its innocuous language. The statute simply defines a "scheme to defraud" under the mail and wire fraud statutes to include conduct that "deprive[s] another of the intangible right of honest services."\(^{20}\) The government, then, may prosecute mail and wire frauds without proof that victims lost money or property. Yet, read literally, § 1346 reaches most dishonesty, as Justice Scalia illustrated in his dissent.

Courts have attempted to cabin the reach of honest services fraud by construing the statute more restrictively. In order to "deprive another of the intangible right of honest services," the courts reason, the defendant must owe some duty to provide honest services to some person who has the intangible right to receive the honest services.\(^{21}\) Such rights and duties generally obtain from special relations, such as those between fiduciaries and their beneficiaries.\(^{22}\) Whether the requisite rights and duties arise under state law, federal law, or both is just one of the many questions that have divided the federal circuit courts.\(^{23}\) By linking criminal liability to proof of a

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\(^{20}\) 18 U.S.C. § 1346 (2006); see infra Part V.

\(^{21}\) See United States v. Williams, 441 F.3d 716, 723 (9th Cir. 2006) ("The undifferentiated term 'another' has led a number of circuits to question whether Congress really meant to give § 1346 unlimited breadth.").

\(^{22}\) Id. ("At a minimum, we and other circuits have recognized the viability of the 'intangible rights' theory when the private defendant stands in a fiduciary or trust relationship with the victim of the fraud.").

fiduciary breach—a finding that, in and of itself, requires fact-sensitive boundary drawing—the analysis becomes more complex and less reliable. The courts, *ex post*, must define and interpret fiduciary principles; in some cases, federal courts have gone so far as to recognize original duties, creating novel fiduciary theories. The variation and even contradiction evident in the case law also exposes the considerable discretion vested in federal prosecutors to determine the line between unethical behavior and criminal conduct.

Prosecutors' reliance on, and possible expansion of, fiduciary duties as the basis for honest services fraud has potentially far-reaching consequences for persons already recognized as fiduciaries under state law, particularly for corporate executives facing prospective liability in the wake of the economic crisis. My thesis is that the government's increased use of § 1346 to criminalize fiduciary breaches contrasts sharply with the decline in fiduciaries' accountability under civil law for the same conduct. The threshold for indicting corporate executives for honest services fraud seems at least as low, if not lower, than either the threshold for enforcing breach of fiduciary duty claims under Delaware law or the threshold for pursuing civil securities fraud claims. In fact, civil law and criminal law are trending in opposite directions: as it has become more difficult to hold a corporate executive civilly liable for breaching her fiduciary duties, it has become easier to hold her criminally liable for the same conduct. Fiduciary betrayals—which, before Enron, likely would have exposed corporate managers to a slight risk of civil liability—have become the foundation upon which the government prosecutes the same individuals criminally, charging them with the felony of honest services fraud. This developing anomaly, while largely unrecognized in the literature, upsets our traditional expectation that criminal charges are more serious, and more difficult to prove, than civil claims.

I also contend that greater use of criminal sanctions is driven, at least in part, by the growing perception that civil law does not adequately deter, let alone punish, wrongdoing by corporate executives. Criminal enforcement responds to the perceived need for greater punishment and deterrence of corporate malfeasance. Disloyal and dishonest behavior by corporate fiduciaries injures not only the company that employed the corrupt executive, damaging its shareholders and employees, but these breaches harm the economy more broadly. As we have repeatedly witnessed this decade, executives may engage in deceitful conduct of such a magnitude that its revelation not only destroys their firms but also jeopardizes investors' confidence in public companies, financial institutions, and the securities markets. This fallout leads to even greater demand for effective law enforcement. That demand, however, cannot be met by civil law because as the
civil doctrine has developed over the past several decades, corporate executives have become increasingly insulated from liability. Since the Supreme Court's forthcoming decisions likely will limit the continuing availability of honest services fraud as a weapon to deter executives, this article also examines the questions before the Court and how the Court's rulings might impact directors and officers of public companies. While the Supreme Court's construction may provide some order to prosecutions under § 1346, the decision also could create further chaos.

My analysis, then, is organized as follows. Part II briefly considers why directors and officers are fiduciaries and describes their duties as fiduciaries. The next two sections compare and contrast civil enforcement of executives' fiduciary duties with their criminal enforcement under § 1346. Part III examines private enforcement of executives' fiduciary duties. This part identifies the significant legal obstacles preventing shareholders from enforcing management's fiduciary duties in state court or federal court, whether shareholders bring their claims derivatively or as class actions. As verified empirically, public company executives rarely incur liability for breaching their fiduciary duties.

Part IV chronicles the government's use of § 1346 to prosecute corporate executives and provides original evidence of the Justice Department's increasing use of the statute as a weapon against corporate crime. As this account shows, Congress and the White House strongly encouraged criminal prosecutions of culpable executives following the collapses of Enron and WorldCom. Part IV concludes by explaining how federal criminal law empowers prosecutors to indict and convict corporate executives using § 1346.

Part V analyzes the questions raised by the honest services fraud cases before the Supreme Court in the October 2009 Term. As background for this analysis, the section begins by examining the evolution of the intangible rights doctrine and Congress's enactment of § 1346. Most of Part V

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24 Executives of most public companies look to Delaware law for the content and enforcement of their fiduciary duties. Since this article examines civil and criminal enforcement actions brought against executives of large public companies, it will review and analyze Delaware corporate and fiduciary law. Other states also rely on Delaware decisions because of the large number of companies incorporated there and the special expertise of Delaware courts.

25 Indeed, even academics who favor state competition for charters concede that public companies incorporate in Delaware to minimize directors' and officers' exposure to personal liability for breaching their fiduciary obligations. See, e.g., Roberta Romano, Law as a Product: Some Pieces of the Incorporation Puzzle, 1 J. L. ECON. & ORG. 225 (1985).

26 See United States v. Brown, 459 F.3d 509, 519 (5th Cir. 2006) ("[Section 1346] can be understood only in the light of the long history of the mail- and wire-fraud statutes, which were intentionally written broadly to protect the mail and, later, the wires from being used to initiate fraudulent schemes.").
considers the important interpretive problems that have bedeviled the appellate courts, focusing particular attention on those issues that the Supreme Court may resolve presently.

Part VI explores how the Supreme Court's decisions in *Black*, *Weyhrauch*, and *Skilling* could impact the government's reinvigorated efforts to fight corporate fraud following the recent financial crisis. I conclude by offering a specific suggestion as to how Congress might promote the federal interest in prosecuting dishonest public company fiduciaries while curbing the threats of overcriminalization, prosecutorial abuse, and spill-over from federal criminal jurisprudence to Delaware's corporate doctrine.

II. CORPORATE EXECUTIVES' FIDUCIARY DUTIES, ACCORDING TO DELAWARE

Executives who engage in serious misconduct are subject to discipline under multiple, overlapping liability regimes—civil and criminal, private and public, state and federal. Because these legal rules apply simultaneously, the same misconduct exposes accused managers to concurrent enforcement actions, and adjudicated wrongdoers face a range of potential sanctions, from monetary damages to regulatory penalties such as debarment to imprisonment. For example, opportunistic misconduct by corporate executives may give rise to liability for breach of a fiduciary duty, fraud (both statutory and common law), other intentional torts, and violations of various criminal laws. Effective disciplinary rules not only punish past wrongdoing but also provide appropriate incentives to deter future wrongdoing.

Fiduciary law, the "most mandatory inner core" of corporate doctrine, regulates the conduct of corporate directors and officers. Yet, the fusion of substantive tenets deferential to public company management with procedural rules devised to dispose of shareholder lawsuits as cheaply as possible has produced a system of fiduciary duties practically incapable of civil enforcement. Shareholder litigation, once the principal judicial device for addressing fiduciary corruption, no longer disciplines most directors and officers who have breached their fiduciary duties to the corporation. As the

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27 Of course, non-legal mechanisms also serve disciplinary functions. For example, the firm may terminate the wrongdoer (or request that she resign her position) rather than pursue the company's rights in litigation; and the firm's stockholders may choose to sell their shares rather than initiate litigation.

civil law has developed over time, private enforcement has become exceptionally expensive, and the resulting benefits are questionable. Public enforcement of fiduciary duties—specifically, criminal prosecutions charging honest services fraud—may better punish serious infidelity while providing superior deterrence.

Before analyzing criminal liability, however, it is important to review the fiduciary duties of corporate executives and the predominant legal reasons that public company managers rarely incur civil liability for breaching those obligations. Part II synopsizes managers' fiduciary duties under state law. Then, Part III identifies the important procedural rules and substantive doctrines that make civil enforcement so complicated, burdensome, and ineffective, regardless of whether the action is brought in state or federal court. Part III concludes by briefly surveying empirical evidence on corporate executives' civil liability for fiduciary breach.

It is well-settled that corporate executives are bound by fiduciary principles. Classic fiduciary law regulates self-serving behavior in relationships where one party undertakes to serve another party's interests and requires access or control over the other party's assets in order to perform the undertaking. Like trustees of trusts (the archetypal fiduciary), corporate executives are entrusted by statute with power over assets to be used in the interest of others; specifically, general corporation laws enacted by state legislatures invest corporate directors and their officer-delegates with full discretion to manage their company's business. Recognizing that managers may divert company assets or take firm benefits for themselves without authorization, the law seeks to deter such opportunism. For seventy years, the Delaware Supreme Court has stated that

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29 The public enforcement actions considered in this article are criminal proceedings instituted by the DOJ. The Securities and Exchange Commission (SEC) institutes civil enforcement actions against public company managers which also discipline executives in important ways. However, because the SEC's authority is limited to the securities laws, and it cannot directly enforce state fiduciary law, SEC enforcement actions are not considered here.

30 See Koehler v. Black River Falls Iron Co., 67 U.S. 715, 720-21 (1862) ("[Directors] hold a place of trust, and by accepting the trust are obliged to execute it with fidelity, not for their own benefit, but for the common benefit of the stockholders of the corporation.").

31 See Robert Flannigan, The Economics of Fiduciary Accountability, 32 Del. J. Corp. L. 393, 393-95, 399 (2007) (explaining conventional fiduciary accountability as a general form of default civil liability concerned with opportunism, the specific mischief that arises in limited access arrangements).

32 See, e.g., Del. Code Ann. tit. 8, § 141(a) (2006) ("The business and affairs of every corporation . . . shall be managed by or under the direction of a board of directors.").
[w]hile technically not trustees, [directors and officers] stand in a fiduciary relation to the corporation and its stockholders. A public policy, existing through the years, and derived from a profound knowledge of human characteristics and motives, has established a rule that demands of a corporate officer or director, peremptorily and inexorably, the most scrupulous observance of his duty . . . [in order] to protect the interests of the corporation committed to his charge. . . . The rule that requires an undivided and unselfish loyalty to the corporation demands that there shall be no conflict between duty and self-interest.33

Universally, as in Delaware, directors and officers owe fiduciary duties to their firms in order to discipline managers' self-interested conduct.34

Corporate law further delineates that executives bear two principal duties as fiduciaries: loyalty and care.35 The duty of loyalty, described as "the most important fiduciary duty of corporate officers and directors"36 and "the one accepted constant in the various corporate law debates,"37 functions especially to control managers' opportunism. Loyal executives may not use their positions to further their private interests, and they must refrain from doing anything to benefit themselves that would injure their firm.38 Furthermore, executives may not stand on both sides of a company transaction nor

34Black's Law Dictionary defines the phrase "fiduciary duty" as:
A duty of utmost good faith, trust, confidence, and candor owed by a fiduciary (such as a lawyer or corporate officer) to the beneficiary (such as a lawyer's client or a shareholder); a duty to act with the highest degree of honesty and loyalty toward another person and in the best interests of the other person (such as the duty that one partner owes to another).
BLACK'S LAW DICTIONARY 581 (9th ed. 2009).
35Gantler v. Stephens, 965 A.2d 695, 708-09 (Del. 2009) (holding explicitly, for the first time, that "officers of Delaware corporations, like directors, owe fiduciary duties of care and loyalty, and . . . the fiduciary duties of officers are the same as those of directors."). Few Delaware decisions distinguish between directors and non-director officers.
37Flannigan, supra note 31, at 428 ("We have made a choice to reduce the costs of opportunism by incurring the costs of fiduciary regulation. . . . [T]he universal assumption appears to be that the conventional duty of loyalty is an efficient mechanism to control opportunism in limited access arrangements.").
38Guth, 5 A.2d at 510 (explaining, in prose regularly quoted, that "undivided and unselfish loyalty to the corporation demands that there shall be no conflict between duty and self-interest"); see also Schoon, 953 A.2d at 206 (quoting Guth for the enduring proposition that "corporate executives cannot use their positions of trust and confidence to further their private interests").
derive any personal benefit through self-dealing. Simply put, managers may not engage their self-interest without consent from the corporation. In contrast to the duty of loyalty, the duty of care requires corporate executives to make lawful decisions, employing well-informed, deliberate processes. The duty of care compels executives to be adequately informed and diligent when making corporate decisions and to protect the interests of the firm. In order to exercise informed business judgment, each director must devote adequate time to board activities, review materials prepared for board meetings in advance of those meetings, and, with due consideration, candidly and deliberately decide matters brought before the board.

Although the fiduciary duties of corporate executives generally organize into two broad classes, loyalty and care, Delaware courts have identified another duty as well, a duty of good faith. In the controversial 1996 decision in In re Caremark International Inc. Derivative Litigation, Chancellor William Allen instructed that corporate directors could incur liability if they failed to exercise appropriate attention to the firm's on-going operations and employees in good faith. However, Chancellor Allen also noted in dicta that

[g]enerally where a claim of directorial liability for corporate loss is predicated upon ignorance of liability creating activities within the corporation . . . only a sustained or systematic failure of the board to exercise oversight—such as an utter failure to attempt to assure a reasonable information and reporting system exists—will establish the lack of good faith that is a necessary condition to liability.

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40 Non-director officers, as agents of the corporation, are obligated by agency law and corporate law to act loyally for the benefit of the firm in matters connected with their agency. See RESTATEMENT (THIRD) OF AGENCY § 8.01 (2006).
42 See Paramount Commc'ns Inc. v. QVC Network Inc., 637 A.2d 34, 44 (Del. 1994).
44 In 1993, the Delaware Supreme Court stated, in dictum, that corporate directors incur a "triad[ ]" of fiduciary duties, including the traditional duties of loyalty and care as well as a third duty of "good faith." Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993).
45 698 A.2d 959 (Del. Ch. 1996).
46 Id. at 967-70.
47 Id. at 971. For over a decade, the corporate law academy parsed Caremark and other relevant judicial opinions and debated the potential boundaries of this good faith duty to monitor. See, e.g., Melvin A. Eisenberg, The Duty of Good Faith in Corporate Law, 31 DEL. J. CORP. L. 1
Relying on this dicta, courts came to recognize so-called "Caremark claims," actions addressed to directors' "utter failure" and "systematic failure" to take minimal steps to monitor legal compliance. Chancellor Chandler's 2003 decision denying the Walt Disney directors' motion to dismiss suggested that Delaware courts might advance management's duty of good faith as a discrete fiduciary obligation, potentially exposing outside directors to greater risk of liability for oversight failures. This development generated considerable commentary, especially in light of revelations in 2002 that the directors managing Enron and WorldCom may "have willfully shut their eyes" to executives' wrongdoing until it was too late and the firms failed.

Then, in 2006, the Delaware Supreme Court in Stone v. Ritter clarified that the duty of good faith is an aspect of the duty of loyalty rather than a distinct fiduciary duty or an obligation arising under the duty of care. As Professor Bainbridge and his co-authors recently argued, "Acknowleging good faith to be an independent fiduciary duty risked tipping that balance too far toward director accountability." Nonetheless, the court in Stone did acknowledge that corporate executives may incur liability for failing to exercise oversight, and it established the elements of such claims. As Justice Holland explained:

We hold that Caremark articulates the necessary conditions predicate for director oversight liability: (a) the directors utterly failed to implement any reporting or information system or controls; or (b) having implemented such a system or controls, consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention. In either case, imposition of liability requires a showing that the directors knew that they were not discharging their fiduciary obligations. Where directors fail to


49 See In re Walt Disney Co. Deriv. Litig., 825 A.2d 275, 278 (Del. Ch. 2003) (holding that facts as alleged raised sufficient doubt that directors' actions were taken in good faith).
52 Stone v. Ritter, 911 A.2d 362, 369-70 (Del. 2006). Thus, corporations cannot exonerate their directors from liability for Caremark claims pursuant to Delaware's exculpation statute. See infra Part III.A.4.
act in the face of a known duty to act, thereby demonstrating a conscious disregard for their responsibilities, they breach their duty of loyalty by failing to discharge that fiduciary obligation in good faith.\textsuperscript{54}

Although the obligation to act in good faith is not an independent fiduciary duty, a director could be liable for bad faith conduct nonetheless, because failure to act in good faith would breach the director's duty of loyalty. \textit{Stone} also clarified that a corporate fiduciary acts in bad faith when she:

"intentionally acts with a purpose other than that of advancing the best interests of the corporation, where . . . [she] acts with the intent to violate applicable positive law, or where . . . [she] intentionally fails to act in the face of a known duty to act, demonstrating a conscious disregard for his duties."\textsuperscript{55}

Furthermore, executives breach their duty of loyalty by knowingly causing the corporation to use illegal means in the pursuit of profit, by exposing the corporation to penalties from criminal and civil regulators, or by consciously causing the corporation to act unlawfully.\textsuperscript{56}

Candor is closely associated with good faith and the duty of loyalty as well. The obligation of candor applies to communications among the firm's executives.\textsuperscript{57} As agents of the corporation, officers must use their reasonable efforts to provide the board of directors with information relevant to affairs entrusted to them and which the officers have notice that the directors would want.\textsuperscript{58} Without receipt of truthful and complete information material to its decisions, the board cannot manage the firm profitably. As fiduciaries of the firm, all executives also have an "unremitting obligation" to deal candidly with the corporation and their fellow executives when advancing their own

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\textsuperscript{54} \textit{Stone}, 911 A.2d at 370 (footnotes omitted).
\textsuperscript{55} \textit{Id.} at 369 (quoting \textit{In re Walt Disney Co. Deriv. Litig.}, 906 A.2d 27, 67 (Del. 2006)).
\textsuperscript{56} Desimone v. Barrows, 924 A.2d 908, 934-35 (Del. Ch. 2007).
\textsuperscript{57} Some Delaware decisions use the term "duty of candor" to describe the obligation of corporate executives to provide full and fair disclosure to shareholders (the duty of disclosure), although the Delaware Supreme Court has urged the Court of Chancery to avoid such imprecision. See \textit{Stroud v. Grace}, 606 A.2d 75, 84 (Del. 1992).
\textsuperscript{58} \textit{See RESTATEMENT (SECOND) OF AGENCY § 381 (1958).}

Unless otherwise agreed, an agent is subject to a duty to use reasonable efforts to give his principal information which is relevant to affairs entrusted to him and which, as the agent has notice, the principal would desire to have and which can be communicated without violating a superior duty to a third person.

\textit{Id.}
interests (i.e., self-dealing transactions). While classic doctrine strictly prohibits fiduciaries from acting in conflict with their beneficiaries and proscribes the receipt of personal benefits, traditional principles do provide a defense: opportunism is not actionable as breach if the fiduciary obtained consent to enjoy the benefit or act despite the conflict. To be effective, however, consent must be fully informed. The inquiry, then, is whether the company—typically acting through fully informed and disinterested independent directors—validly approved the executive's conflict or benefit. To obtain operative consent, the conflicted executive must fully disclose (1) the existence of a conflict of interest, and (2) material facts concerning the subject transaction that may not be known to the company (i.e., the directors qualified to make the decision).

The duty of candor should not be confused with managers' duty of disclosure. The latter obligation requires corporate executives to disclose all material information when communicating publicly or directly with shareholders about the firm's affairs. Regardless of whether the communication seeks shareholders' approval or ratification of some action, "[c]orporate fiduciaries can breach their duty of disclosure . . . by making a materially false statement, by omitting a material fact, or by making a partial disclosure that is materially misleading." The Delaware Supreme Court recently clarified that the duty of disclosure also is not an independent duty; rather, it is part of the duty of loyalty owed by directors to the corporation.

Having summarized the fiduciary duties of corporate executives under state law, I turn to the legal rules impeding effective enforcement of those duties in civil proceedings.

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60 See 1 AM. LAW INST., PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 5.02, at 215 (1994) (stating that an interested director must "affirmatively . . . disclose the material facts known to the director" and "explain the implications of a transaction"); see also RESTATEMENT (THIRD) OF AGENCY § 8.06(1)(a) (2006) (stating that an agent's conduct does not constitute breach if principal consents to conduct and, in obtaining consent, agent acts in good faith and discloses all material facts, and otherwise deals fairly with principal).

61 See infra Part III.B.6; see also STEPHEN B. PRESSER, AN INTRODUCTION TO THE LAW OF BUSINESS ORGANIZATIONS 242 (2005) (quoting IOWA CODE § 496A.34 (2005)).

62 See Malone v. Bristow, 722 A.2d 5, 10 (Del. 1998) ("Whenever directors communicate publicly or directly with shareholders about the corporation's affairs, with or without a request for shareholder action, directors have a fiduciary duty to shareholders to exercise due care, good faith and loyalty.").


64 Id. at 690.

65 This high-level account of Delaware's corporate fiduciary doctrine necessarily glosses over
III. OBSTACLES TO ENFORCING EXECUTIVES’ FIDUCIARY DUTIES UNDER CIVIL LAW

In theory, the threat of personal liability for a fiduciary breach has two important functions. First, the threat deters managers from exploiting their position through, among other disloyal acts, insider transactions and diversion of corporate profits, property, and opportunities. Second, the risk of personal liability encourages outside directors to exercise their authority and oversight capabilities to detect, and even prevent, self-interested misconduct by inside executives.

In practice, however, directors and officers seldom face civil liability for breaching their fiduciary duties, regardless of the forum in which shareholders bring suit and despite corporate law rhetoric emphasizing the importance of executives’ fiduciary responsibilities. For one thing, corporate boards seldom choose to pursue the firms’ claims against executive malefactors for breaches of fiduciary duty, at least not publicly.66 Professors Johnson and Millon have focused attention on the relative paucity of private litigation claiming that public company officers (as opposed to directors) breached their fiduciary duties.67 When shareholders sue corporate fiduciaries for breach, the defendants usually win early dismissal of the litigation, and the defendants very rarely are adjudicated liable, much less pay monies to resolve the lawsuits. The following sections identify the legal obstacles that thwart shareholders’ efforts to hold executives accountable as fiduciaries.

A. Obstacles to Civil Enforcement in State Court

A fiduciary’s dereliction of her duties generally gives rise to one or more causes of action.68 Although the board of directors must authorize any

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66One explanation for non-enforcement is structural bias. Another is directors’ concern about negative publicity and risk that the corporation’s public pursuit of claims against the executive will give rise to shareholder litigation. A third possibility, however, is that the board disciplines the executive by demanding her resignation or by terminating her. If the board cannot reach agreement with the executive on the appropriate severance arrangement, the parties likely will arbitrate the dispute—including, perhaps, the firm’s claims that the executive breached her fiduciary duties—in the confidential forum agreed to under the executive’s employment contract.

67See Lyman P.Q. Johnson & David Millon, Recalling Why Corporate Officers Are Fiduciaries, 46 WM. & MARY L. REV. 1597, 1611 (2005) (“[A]lthough officers and directors occupy distinctive roles in corporate governance, most corporate law authority uncritically obliterates that distinction when it comes to fiduciary duties.”).

68See Tooley v. Donaldson, Lufkin, & Jenrette, Inc., 845 A.2d 1031, 1035 (Del. 2004) (explaining that the distinction between derivative and direct claims rests solely on who suffered alleged harm and who would receive benefit of the recovery).
claim filed on behalf of the corporation, courts of equity recognize that
directors would not vote to sue themselves. Nor, in the main, would direc-
tors sue their own colleagues or even non-director members of the senior
management team. Therefore, corporate law allows one or more of the
corporation's shareholders to assume "the legal managerial power to maintain
a derivative action to enforce the corporation's claim." Still, Delaware's
legislature and its courts have installed significant procedural and
substantive obstacles, derailing shareholders' efforts to enforce executives'
fiduciary duties through derivative litigation. A large literature examines
these legal rules. For our purposes, a brief summary suffices to explain why
civil actions holding corporate executives liable are so uncommon.

1. Standing to Enforce

Although an executive's fiduciary breach may affect the corporation's
employees, bondholders, and other creditors, only shareholders have stand-
ing in most cases to assert derivative claims on the company's behalf.70
Plaintiffs not only must own stock when they initiate their derivative com-
plaint, but their complaint also must aver that they owned stock in the
corporation at the time of the subject transaction.71 Additionally, plaintiffs
must hold their shares throughout the litigation.72 Even involuntary dispo-
sitions of shares, such as through a merger, can deprive the plaintiff of
standing to continue prosecuting the lawsuit.73

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v. Maldonado, 430 A.2d 779, 784 (Del. 1981) (holding that derivative suits allow shareholders to
sue on behalf of the corporation when "it is apparent that material corporate rights would not
otherwise be protected" (quoting Sohland v. Baker, 141 A. 277, 282 (Del. 1927))).
70The principal exception to this rule is that creditors of insolvent corporations may assert
derivative claims, though not direct claims, on behalf of the corporation for breach of fiduciary duty.
2007) ("When a corporation is insolvent . . . creditors take the place of shareholders as the residual
beneficiaries of any increase in value." (emphasis omitted)).
71DEI. CODE ANN. tit. 8, § 327 (2006). For criticism of the contemporaneous ownership
requirement, see generally J. Travis Laster, Goodbye to the Contemporaneous Ownership Require-
ment, 33 DEL. J. CORP. L. 673 (2008) (arguing that the rule is unnecessary and incoherent, and
proposing that an alternative standard be adopted).
not only be a stockholder at the time of the alleged wrong and at time [sic] of commencement of suit
but he must also maintain shareholder status throughout the litigation.").
73See id.
2. The Demand Rule and Pleading Demand Futility

According to Delaware law, before shareholders can initiate a derivative action, they either must make a demand on the board that the corporation pursue its claims against the executives, or they must plead facts sufficient to demonstrate that demand on the board would have been futile. Whether demand is made or not, derivative suit pleadings must comply with "stringent requirements" and allege "particularized factual statements that are essential to the claim." In practice, plaintiffs plead demand futility rather than make a demand on the company's board. The corporation, acting through a special litigation committee (SLC) of disinterested directors, if necessary, will respond by moving to dismiss the plaintiff's complaint for its failure to make a demand. In most cases, defendants will prevail. Not only are Delaware courts loath to excuse demand, but plaintiffs must satisfy an onerous pleading standard. To establish demand futility, plaintiffs must allege particularized factual allegations which raise reasonable doubt that: "(1) the directors are disinterested and independent [or] (2) the challenged transaction was otherwise the product of a valid exercise of business judgment." In practice, Delaware courts rarely find that plaintiffs have

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74Although shareholders are plaintiffs, they prosecute derivative claims on behalf of the corporation. Zapata, 430 A.2d at 784-86. Disinterested directors—non-defendant directors who are not otherwise disabled from exercising independent business judgment—maintain their authority to control the litigation. See Aronson v. Lewis, 473 A.2d 805, 811 (Del. 1984).
75Stone v. Ritter, 911 A.2d 362, 366-67 (Del. 2006). If the reviewing court determines that demand would have been futile, the court will excuse demand. Zapata, 430 A.2d at 784.
76Brehm v. Eisner, 746 A.2d 244, 254 (Del. 2000).
77Plaintiffs who make demand on the board are deemed to have conceded the directors' independence and disinterestedness for purposes of the lawsuit. E.g., Levine v. Smith, 591 A.2d 194, 212 (Del. 1991), overruled on other grounds by Brehm, 746 A.2d at 253.
78See ARTHUR R. PINTO & DOUGLAS M. BRANSON, UNDERSTANDING CORPORATE LAW 465 (2d ed. 2004) ("[N]o SLC has ever recommended that derivative litigation continue against sitting officers, as opposed to former directors or senior executive officers."); see also Robert B. Thompson & Randall S. Thomas, The Public and Private Faces of Derivative Lawsuits, 57 VAND. L. REV. 1747, 1776, 1783 (2004) (reviewing all corporate litigation filed in Delaware in 1999 and 2000, authors found that courts dismissed 60% of derivative actions against public corporations and plaintiffs obtained no relief; further, the courts excused demand in only one of eight cases where the parties litigated demand futility). "The limited data that has been collected on [SLC behavior] supports the view that the appointment of a special litigation committee almost always leads to dismissal of the case." Id. at 1791 n.147.
79Aronson, 473 A.2d at 814. This requirement "exists to preserve the primacy of board decisionmaking regarding legal claims belonging to the corporation." In re Am. Int'l Group, Inc. Deriv. Litig., 965 A.2d 763, 808 (Del. Ch. 2009). When the case involves the board's failure to take action, the second prong is inapplicable and the court only asks whether the plaintiff has alleged with particularity facts which "create a reasonable doubt that . . . the board of directors could have properly exercised its independent and disinterested business judgment in responding to a demand."
satisfied this heightened pleading standard, and the courts' published decisions sometimes display an aversion toward shareholder litigation. The upshot is that the board's decision not to sue is protected by the business judgment rule and "will be respected unless it is wrongful."

3. The Business Judgment Rule

Claims for breach of the duty of care generally are subject to the business judgment rule. This central corporate law doctrine establishes "a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company." To promote risk taking, the business judgment rule protects directors from civil liability for their decisions in all but the most extreme circumstances. Furthermore, the rule, when applicable, also creates a presumption against judicial review of most claims that executives breached their duty of care. Simply put, courts


Delaware presumes that directors are independent and disinterested until shown otherwise, and "[i]ndependence is a fact-specific determination made in the context of a particular case." Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart, 845 A.2d 1040, 1049 (Del. 2004). Specifically, the court considers not only "whether the director is disinterested in the underlying transaction" but also, "even if disinterested, whether the director is otherwise independent." Id. Commentators have criticized this presumption and the limited nature of judicial inquiries testing it. See, e.g., Antony Page, Unconscious Bias and the Limits of Director Independence, 2009 U. ILL. L. REV. 237, 242-46.

See, e.g., Brehm, 746 A.2d at 255 (holding that higher pleading standards are needed to prevent shareholders from causing "the corporation to expend money and resources in discovery and trial in the stockholder's quixotic pursuit of a purported corporate claim based solely on conclusions, opinions or speculation").

Zapata Corp. v. Maldonado, 430 A.2d 779, 784 & n.10 (Del. 1981).

Aronson, 473 A.2d at 812; see also id. at 815-16 (holding that despite chairman's ownership of controlling interest in corporation and his selection of each director, the presumption of independence will stand unless plaintiffs allege facts demonstrating "that through personal or other relationships the directors are beholden to the controlling person").

See Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985) ("The business judgment rule exists to protect and promote the full and free exercise of the managerial power granted to Delaware directors."); see also Joy v. North, 692 F.2d 880, 885 (2d Cir. 1982) ("Whereas an automobile driver who makes a mistake in judgment . . . injuring a pedestrian will likely be called upon to respond in damages, a corporate officer who makes a mistake in judgment . . . will rarely, if ever, be found liable for damages suffered by the corporation.").

The business judgment rule does not apply if the directors have not exercised judgment (i.e., made no decision). See, e.g., Van Gorkom, 488 A.2d at 873. Nor will the business judgment rule protect decisions by conflicted directors. See, e.g., Lewis v. S.L. & E., Inc., 629 F.2d 764, 769 (2d Cir. 1980) ("[T]he business judgment rule presupposes that the directors have no conflict of interest.").

will not hear complaints challenging management's business decisions provided that the decisions are based on any rational business purpose. The business judgment rule imposes a nearly insurmountable barrier to executives' liability in order to "prevent[] judicial second guessing of the decision if the directors employed a rational process and considered all material information reasonably available—a standard measured by concepts of gross negligence." But even if plaintiffs somehow rebut the business judgment rule with facts sufficient to demonstrate gross negligence, courts nonetheless dismiss duty of care claims without reviewing their merits, provided that the directors did not act in bad faith and that the corporation's charter includes an exculpatory provision.


Public corporations generally agree to indemnify their executives to the fullest extent permitted by law. Usually, indemnity agreements cover the directors' litigation expenses and attorneys' fees, as well as judgments, fines, and settlement amounts. Delaware companies also may have charter

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87 See Brehm v. Eisner, 746 A.2d 244, 264 (Del. 2000) ("Irrationality is the outer limit of the business judgment rule. Irrationality may be the functional equivalent of the waste test or it may tend to show that the decision is not made in good faith, which is a key ingredient of the business judgment rule."). (footnote omitted); see also In re Caremark Int'l Inc. Deriv. Litig., 698 A.2d 959, 967 (Del. Ch. 1996) ("[W]ether a ... decision [is] substantively wrong, or degrees of wrong extending through 'stupid' to 'egregious' or 'irrational,' provides no sound for director liability, so long as the court determines that the process employed was either rational or employed in a good faith effort to advance the corporate interests." (emphasis omitted)).

88 In re Citigroup Inc. Shareholder Deriv. Litig., 964 A.2d 106, 122 (Del. Ch. 2009). The Citigroup court reasoned that the fiduciary duty of care and business judgment rule "properly focus on the decision-making process rather than on a substantive evaluation of the merits of the decision." Id. at 124.

89 The Delaware Supreme Court has described gross negligence as reckless indifferennt to or a deliberate disregard for stockholders, or actions outside the bounds of reason. Van Gorkom, 488 A.2d at 873 & n.B.

90 Even without an exculpatory provision, proof of gross negligence is not necessarily determinative of liability. Although defendants will not be shielded from liability by the business judgment rule, they will not be liable for breaching their duty of care if they can demonstrate the entire fairness of their decision. See McMullin v. Beran, 765 A.2d 910, 917 (Del. 2000).

91 State indemnification statutes, such as section 145 of the Delaware General Corporation Law, typically permit corporations to indemnify their executives for expenses, judgments, and the like that are reasonably incurred in actions against them because they are executives, but only if the executives act in "good faith" and in a manner they reasonably believe to be "in or not opposed to the best interests of the corporation." Del. Code Ann. tit. 8, § 145 (2006). These statutes also authorize corporations to advance the litigation expenses their directors and officers (D&Os) incur in such actions. Id. In practice, corporations routinely advance such expenses. Companies also routinely purchase D&O liability insurance to cover the corporation's obligation to indemnify its
provisions exculpating their directors from personal liability for monetary damages arising from a breach of the duty of care.92 Importantly, section 102(b)(7) does not permit corporations to absolve directors for breaches of their duty of loyalty.93 Nor may corporations release directors from liability for breaching their fiduciary duties intentionally, knowingly, or in bad faith. Nevertheless, because most public companies have adopted exculpatory provisions in their certificates of incorporation,94 directors are protected from claims for monetary damages based solely on their lack of care.95

Accordingly, even if plaintiffs rebut the business judgment rule and successfully allege a duty of care violation, the director defendants need not prove entire fairness provided that the company's charter exculpates its directors.96 Instead, plaintiffs must establish that the director defendants wasted corporate assets—an extremely rare claim that is nearly impossible to prove.97 For executives to incur liability, then, plaintiffs must state a claim that, by law, cannot be exculpated, i.e., a duty of loyalty breach or a claim of bad faith oversight. However, public company executives do not risk substantial personal liability for even non-exculpated claims.

5. Pleading Non-exculpated Claims with Particularity

To plead a cognizable, non-exculpated claim against corporate executives—for example, a Caremark-type claim for bad faith failure of oversight—shareholders must allege particularized facts giving rise to a serious
threat of liability. Plaintiffs must plead specific facts (for example, that defendants ignored explicit "red flags") demonstrating that defendants' behavior exhibited more than gross negligence; typically, that defendants' conduct was so egregious as to establish bad faith. Essentially, shareholders must plead particularized facts proving, among other things, the defendants' unlawful state of mind.

6. Approval by Disinterested Board Members and Shareholders

The duty of loyalty is implicated when a fiduciary has engaged in self-dealing or takes for herself some asset or opportunity that properly belongs to the firm. While the corporation cannot exculpate directors for such claims, Delaware courts nonetheless have extended considerable deference to independent and disinterested board members in duty of loyalty cases, arguably as much deference as in duty of care cases.

Furthermore, Delaware courts have relaxed their oversight of executives' conflicts of interest considerably over the past several decades. At one time, courts scrutinized self-dealing and other conflict of interest transactions using the entire fairness test, a standard that is far more rigorous than the business judgment rule. Under the entire fairness test, it is the defendant fiduciary's burden, rather than the plaintiffs' burden, to prove that the challenged transaction was entirely fair to the corporation. To satisfy this


99See Desimone v. Barrows, 924 A.2d 908, 935 (Del. Ch. 2007) (holding that to plead failure-of-oversight liability sufficiently, plaintiffs must show "that the directors acted with the state of mind traditionally used to define the mindset of a disloyal director").

100See Stone v. Ritter, 911 A.2d 362, 369 (Del. 2006); see also In re Am. Int'l Group, Inc. Deriv. Litig., 965 A.2d 763, 800-01 (Del. Ch. 2009) (holding that the plaintiffs had sufficiently pleaded particularized facts to show that defendants knew about material, non-public information to support plaintiffs' insider trading claims).

101See In re Walt Disney Co., 907 A.2d at 751 ("The classic example... is when a fiduciary either appears on both sides of a transaction or receives a personal benefit not shared by all shareholders.").

102Historically, courts treated conflicted transactions as voidable, irrespective of fairness to the corporation. However, "[o]ver time, that approach gave way to a more workable rule requiring that the transaction be fair." J. Robert Brown, Jr., Disloyalty Without Limits: "Independent" Directors and the Elimination of the Duty of Loyalty, 95 Ky. L.J. 53, 54 (2006).

103See Seligman, supra note 36, at 8 (noting that executives "very rarely lose lawsuits" when courts apply the business judgment rule, but "[t]he odds are considerably less favorable" when the executives themselves must prove the fairness of self-dealing transactions).

104See Nixon v. Blackwell, 626 A.2d 1366, 1375-76 (Del. 1993) ("[T]he defendants are on both sides of the transaction. For that reason... defendants have the burden of showing the entire fairness of those transactions.").
evidentiary burden, the fiduciary must demonstrate both the substantive and procedural fairness of the bargain.105

Although the entire fairness test appears to create a difficult burden of proof for fiduciaries, well-counseled corporate managers can, and do, avoid its application. Executives shield self-dealing transactions by utilizing statutory procedures that, if followed, may obviate the need for judicial examination under the entire fairness test. Relying on these state safe harbor statutes, executives generally direct decisions or transactions involving conflicts of interest to disinterested directors or shareholders for their approval.106 Assuming that fully-informed, disinterested directors or shareholders sanctioned the transaction, Delaware courts may apply the business judgment rule.107 The courts then limit their review of the decisions authorizing such transactions; the shareholders attacking the transaction will have the burden to prove that the transaction amounted to a gift or waste.108 Commentators have criticized this approach:

The courts have never provided an adequate justification for applying the business judgment rule to a conflict of interest transaction approved by a board that contains a majority of independent directors. Section 144(a) does not, as some courts have suggested, compel applying the outcome. Nor does it result from expungement of the conflict. In fact, the approach makes no effort to ensure that a decision-making process is free of the conflict of interest.109

Not only do the Delaware courts generally refuse to consider how structural bias and social relationships disqualify purportedly "independent"

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105 Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983) ("When directors of a Delaware corporation are on both sides of a transaction, they are required to demonstrate their utmost good faith and the most scrupulous inherent fairness of the bargain.").

106 See, e.g., DEL. CODE ANN. tit. 8, § 144(a)(1)-(2) (2006) (providing business judgment protections to interested transactions approved by either a fully-informed disinterested board or the disinterested shareholders).

107 See Oberly v. Kirby, 592 A.2d 445, 466 (Del. 1991) ("Section 144 allows a committee of disinterested directors to approve a transaction and bring it within the scope of the business judgment rule.").

108 See Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 366 n.34 (Del. 1993) ("Under this statute, approval of an interested transaction by either a fully-informed disinterested board of directors or the disinterested shareholders provides business judgment protection." (citation omitted)), modified in part, 636 A.2d 956 (Del. 1994).

109 Brown, supra note 102, at 69.
directors, but because plaintiffs must satisfy heightened pleading standards without access to any discovery, the courts have no way to determine whether the "independent" directors were fully informed and what influence, if any, the interested executive had on their decisions. In light of disturbing revelations that interested executives withheld material information and even intentionally deceived the outside directors at Enron, WorldCom, and many other public companies, relaxed judicial oversight of insiders' conflict-of-interest transactions is especially troubling. I will return to this point later.

Given the gauntlet of procedural and substantive obstacles plaintiffs must navigate under Delaware law, it is not surprising that shareholders' suits against directors and officers rarely proceed past the pleading stage. Courts dismiss many civil actions filed against corporate executives early in the litigation. Shareholder plaintiffs cannot enforce fiduciary duties through derivative litigation because they cannot sufficiently plead, without discovery, facts that excuse board demand (i.e., facts showing that a majority of the board was not truly independent or was interested in the decision). Nor can shareholders establish, without discovery, a cognizable claim that the defendant executives breached their fiduciary duties and did so in such a way (intentionally or at least in bad faith) that they can be held liable to the corporation.

Thus, as the ultimate outcome of the Disney litigation made clear, corporate executives will not incur fiduciary liability under Delaware law even where their conduct "fall[s] far short of what shareholders expect and demand from those entrusted with a fiduciary position" and "does not comport with how fiduciaries of Delaware corporations are expected to act."

Illustrative of such judicial opinions is the recent decision by Delaware Chancellor William Chandler dismissing all but one of the state law claims asserted against Citigroup's management in In re Citigroup Inc. Shareholder Derivative Litigation.

B. Enforcing Fiduciary Duties in Delaware: The Citigroup Example

Many large financial institutions engaged in excessive risk taking in the years preceding the subprime mortgage crisis and the bursting of the real

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111See infra Part VI.E.
113964 A.2d 106 (Del. Ch. 2009).
estate bubble. Despite long odds against success, shareholders have filed derivative lawsuits against the directors and officers of financial institutions that failed or nearly failed in 2008, alleging that the companies' executives breached their fiduciary duties. For example, shareholders sued the executives of Citigroup, one of "the poster children for the excesses that created [the financial] crisis," after massive investments in subprime mortgages and complex debt instruments imperiled the giant bank and threatened its survival. Citigroup posted a $27 billion loss—and its stock price fell some 77%—before the federal government rescued it in 2008. Having determined that the bank was too big to fail, the Treasury Department bailed out the firm, spending approximately $45 billion of taxpayers' money to infuse Citigroup with capital under the controversial Troubled Asset Relief Program (TARP).

Before the government came to Citigroup's rescue, several shareholders sued the responsible executives, seeking to recover some of the more than $25 billion in losses incurred by the company in subprime mortgages and related assets. Alleging that demand on Citigroup's board was excused, plaintiffs instituted a derivative action in the Delaware Court of Chancery against the thirteen then-current members of Citigroup's board, several former directors, and certain current and former officers and senior managers. The complaint alleged that the defendants breached their fiduciary duties by failing to oversee and manage Citigroup's massive subprime mortgage investments, assets that ultimately comprised some 43% of Citigroup's equity. Despite many red flags warning them that the real estate and credit markets were collapsing, the defendants' alleged failures to monitor Citigroup's subprime portfolio exposed the firm to enormous losses and resulted in billions of write-downs. The complaint also asserted that the defendants failed to ensure the accuracy of Citigroup's financial reporting

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117 See id. (explaining that the Department of Treasury gave Citigroup $20 billion in addition to the $25 billion previously provided).
119 See id. at 7-14 (listing the defendants).
120 See id. at 1-3.
121 Id. at 114.
and other disclosures. Finally, plaintiffs maintained that certain defendants wasted Citigroup's assets by approving a controversial, multimillion dollar exit package for the company's outgoing chairman and CEO, Charles Prince. The board ultimately forced Prince to resign after he recommended to them that Citigroup write down billions of dollars in bad subprime investments.

The defendants moved to dismiss the complaint in its entirety, arguing that the plaintiffs failed to plead demand futility with the particularity required under Delaware law. Plaintiffs countered that the court should excuse demand because a majority of Citigroup's board members faced a substantial likelihood of liability. According to plaintiffs, the defendants faced a substantial likelihood of liability for violating their duty of loyalty in failing to discharge their oversight obligation in good faith by consciously ignoring Citigroup's enormous exposure to risky subprime investments.

Chancellor Chandler disagreed. While acknowledging Citigroup's "staggering" losses, the court refused to excuse demand and granted the defendants' motion to dismiss all but one of the shareholders' claims. Significantly, the court determined that plaintiffs' allegations against the Citigroup executives did not even give rise to Caremark-type claims for oversight failure. The court purposely distinguished the allegations in Caremark (that the defendant-directors' failure to monitor allowed illegal activity to transpire) from the allegations pled against the Citigroup defendants (that the defendant-directors failed to monitor Citigroup's business risk adequately, resulting in the firm's overexposure to risk from subprime mortgage investments):

While it may be tempting to say that directors have the same duties to monitor and oversee business risk, imposing

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122 In re Citigroup, 964 A.2d at 114.
123 Under Prince's leadership, Citigroup overinvested in risky subprime assets, refusing to liquidate or hedge against the risks. Several months before the board demanded his resignation, Prince famously justified the strategy, explaining to reporters, "When the music stops, in terms of liquidity, things will be complicated. But as long as the music is playing, you've got to get up and dance. We're still dancing." Michiyo Nakamoto & David Wighton, Bullish Citigroup Is "Still Dancing" to the Beat of the Buy-Out Boom, FIN. TIMES (London), July 10, 2007, at 1.
125 In re Citigroup, 964 A.2d at 112.
126 Id. at 121.
127 Id.
128 Id. at 139-40.
129 In re Citigroup, 964 A.2d at 123 ("Plaintiffs' theory of how the director defendants will face personal liability is a bit of a twist on the traditional Caremark claim.").
Caremark-type duties on directors to monitor business risk is fundamentally different. . . . Oversight duties under Delaware law are not designed to subject directors . . . to personal liability for failure to . . . properly evaluate business risk.130

Chancellor Chandler characterized the complaint as "essentially amount[ing] to a claim that the director defendants should be personally liable to the Company [for breach of fiduciary duty] because they failed to fully recognize the risk posed by subprime securities."131 The court sharply criticized this attempt to hold the Citigroup executives personally liable.132

By rejecting plaintiffs' theory and applying the business judgment rule to their failure-of-oversight claims, the court protected Citigroup's directors. How did the court rationalize its novel approach? According to Chancellor Chandler, to allow plaintiffs' claims to go forward would be to "abandon . . . bedrock principles of Delaware fiduciary duty law" and engage in the "kind of judicial second guessing" about the firm's investments that "the business judgment rule was designed to prevent."133 As the court emphasized, "Oversight duties under Delaware law are not designed to subject directors, even expert directors, to personal liability for failure to predict the future and to properly evaluate business risk."134 Although the business community praised Chancellor Chandler's decision, the result in Citigroup sends the message that state law immunizes corporate executives from liability. Indeed, shareholders' claims will not even get a hearing.135

What allegations are sufficient to withstand early dismissal? Allegations of criminal wrongdoing, as Vice Chancellor Leo Strine decided shortly before Citigroup came down. Vice Chancellor Strine denied the motions to dismiss filed by certain former executives of AIG, including its deposed former-CEO Hank Greenberg.136 Explaining his unusual decision to allow the suit to go forward, Strine remarked that the "diversity, pervasiveness, and materiality of the alleged financial wrongdoing at AIG is extraordinary."137 Indeed, the court described AIG as a "criminal organization"138

130 Id. at 131.
131 Id. at 124.
132 See id. at 126 ("To impose liability on directors for making a 'wrong' business decision would cripple their ability to earn returns for investors by taking business risks.").
133 In re Citigroup, 964 A.2d at 126.
134 Id. at 131.
137 Id. at 799.
and underscored that the alleged corruption within the company was not confined to certain business areas but, rather, permeated the entire firm.\textsuperscript{139} Moreover, the complaint alleged that Greenberg and his executive co-defendants were, themselves, directly responsible for the business units engaged in the alleged misconduct.\textsuperscript{140} Thus, Strine emphasized, the complaint included sufficient facts to support plaintiffs' claim that AIG's executives had personal knowledge of the wrongdoing.\textsuperscript{141}

Read both separately and together, the decisions in \textit{Citigroup} and \textit{AIG} illustrate the exceptionally high threshold that shareholders must surpass merely to advance a Delaware derivative suit past the pleadings stage. Unless public company executives managed a firm engaged in pervasive wrongdoing, or they appear to have committed some grievously dishonest and disloyal act themselves, the defendant directors and officers will not be adjudicated liable for breaching their state law fiduciary duties.\textsuperscript{142}

\textbf{C. Obstacles to Civil Enforcement in Federal Court}

Shareholders of public companies also may attempt to remedy management's fiduciary duty breaches by litigating civil claims in federal court. Before Congress imposed substantial limits on private securities enforcement, plaintiffs sometimes included state law claims in their putative class action complaints filed in federal court.\textsuperscript{143} Specifically, shareholders alleged that the defendant executives violated one or more federal antifraud statutes (typically, section 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934\textsuperscript{144}) and that one or more of the defendant executives breached their fiduciary duties under applicable state law.\textsuperscript{145} While Congress enacted the federal antifraud statutes to protect shareholders rather than the corporation, harm to the corporation's shareholders usually, if not inevitably, results in injury to the corporation. Rarely is harming the corporation beneficial to its

\textsuperscript{138}Id.
\textsuperscript{139}Id. at 774-75.
\textsuperscript{140}See \textit{In re AIG}, 965 A.2d at 780-81.
\textsuperscript{141}Id. at 799.
\textsuperscript{142}See id.; \textit{In re Citigroup Inc. S'holder Deriv. Litig.}, 964 A.2d 106, 125 (Del. Ch. 2009).
\textsuperscript{143}See, e.g., \textit{In re Donald J. Trump Casino Sec. Litig. (Taj Mahal Litig.)}, 7 F.3d 357 (3d Cir. 1993).
\textsuperscript{145}See, e.g., \textit{Taj Mahal Litig.}, 7 F.3d at 366 (relying on 28 U.S.C. § 1367(a) (2006) to assert jurisdiction over state law breach of fiduciary duty claim). Federal courts have supplemental jurisdiction over state law claims brought in connection with, and forming the same case or controversy as, claims over which the courts have original jurisdiction, like federal securities claims. \textit{See id.; cf. 28 U.S.C. § 1367(c) (2006) (permitting district courts to dismiss pendent state law claims where there are novel or complex issues of state law or when the court has dismissed all federal claims).}
shareholders, nor is defrauding the shareholders beneficial to the corporation. In fact, one wrong often begets the other. A fiduciary-duty-breaching executive will injure the firm and then mislead the firm's shareholders about the damage, thereby directly harming the shareholders as well.

While analytically distinct, executives' breaches of fiduciary duty to the corporation and their misrepresentations or omissions to investors often occur in tandem. Before 1998, shareholders could invoke the federal courts' supplemental jurisdiction over pendent state law claims in order to bypass the burdensome procedural obstructions associated with derivative litigation, such as the demand requirement. But Congress cut off this detour in the late 1990s when it passed two laws designed to curb the filing of "abusive and meritless" securities litigation. The first, the Private Securities Litigation Reform Act of 1995 (PSLRA), limited the rights of shareholders to file federal class action lawsuits and proceed with discovery. The PSLRA also reduced the civil liability of companies, as well as their directors, officers, and advisors, under the federal securities laws. As a result, it became more difficult, expensive, and risky for shareholders to sue corporate officers and directors in federal court for violating the federal antifraud provisions.

Less than three years later, public company executives returned to Capitol Hill, seeking additional protections from shareholder lawsuits. They testified that plaintiffs' lawyers were evading federal reforms by filing their securities fraud complaints in state courts. When successful, this tactic enabled shareholders to obtain discovery from defendants in state court, frustrating Congress's intent. Congress reacted by enacting a second statute, the Securities Litigation Uniform Standards Act of 1998 (SLUSA).

SLUSA stopped shareholders' attempts to end-run the PSLRA, but the law also effectively halted shareholders' ability to obtain redress for

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securities fraud under state law and through the state courts.\textsuperscript{150} With limited exceptions, SLUSA preempts shareholders' state law breaches of fiduciary duty if plaintiffs assert such causes of action as independent claims and the alleged breaches are in connection with the purchase or sale of a "covered security."\textsuperscript{151} By preemitting their state law claims, SLUSA substantially disabled shareholders from prosecuting fiduciary duty claims in federal court.\textsuperscript{152} When a claim for breach of fiduciary duty against a public company is rooted in misrepresentations or omissions, SLUSA may preempt its prosecution as a stand-alone claim.\textsuperscript{153} In fact, SLUSA actually sweeps more broadly than section 10(b).\textsuperscript{154} If the fiduciary's alleged breach "coincide[s]" with a securities transaction—\textit{whether by the plaintiff or by someone else,}\textsuperscript{155} that coincidence is enough to preempt the state law claim. As a result, even if the plaintiff shareholder is a "holder" and did not actually purchase or sell the company's security, that plaintiff would have no claim under federal law.\textsuperscript{156} SLUSA even "pre-empts state-law class-action claims for which federal law provides no private remedy."\textsuperscript{157}

Shareholders still may attempt to hold corporate fiduciaries liable under the antifraud provisions of the federal securities laws—typically, section 10(b) and Rule 10b-5.\textsuperscript{158} Although conduct violating the antifraud

\textsuperscript{150}See Casey, supra note 148, at 142.

\textsuperscript{151}See 15 U.S.C. § 78bb(f) (2006). Specifically, SLUSA provides that [n]o covered class action based upon the statutory or common law of any State or subdivision thereof may be maintained in any State or Federal court by any private party alleging—(A) a misrepresentation or omission of a material fact in connection with the purchase or sale of a covered security; or (B) that the defendant used or employed any manipulative or deceptive device or contrivance in connection with the purchase or sale of a covered security.


\textsuperscript{153}See 15 U.S.C. § 78j(b).

\textsuperscript{154}See Dabit, 547 U.S. at 84-86.

\textsuperscript{155}See id. at 85 (emphasis added).

\textsuperscript{156}See id.

\textsuperscript{157}Id. at 74. In Dabit, "holders" of various securities asserted breach of fiduciary duty claims in connection with the dissemination of misleading research. Id. at 75. Even though the class consisted of shareholders who had not purchased during the relevant time period, their claims also were preempted. Id. at 88-89.

\textsuperscript{158}See 15 U.S.C. § 78j(b) (2006); 17 C.F.R. § 240.10b-5 (2009). The prototype class action complaint alleges that the defendant issuer, through its senior management and/or advisors, misrepresented or fraudulently failed to disclose material information about the company to the market,
statutes is only a subset of the conduct that offends the duties of care and loyalty, Professors Thompson and Sale have demonstrated empirically that plaintiffs can reformulate fiduciary breach allegations as actionable securities fraud claims.\textsuperscript{159} Either way, the law favors early dismissal of plaintiffs' claims. Federal courts dismiss many civil securities fraud complaints on the pleadings, before discovery.\textsuperscript{160} Indeed, because the PSLRA established the most stringent pleading standards in civil litigation,\textsuperscript{161} its 1995 enactment practically guaranteed that defendants would move to dismiss, rather than answer, shareholders' complaints. The PSLRA mandates that plaintiffs plead with particularity facts giving rise to a strong inference of the defendants' required state of mind; for actions under section 10(b) and Rule 10b-5, this means knowledge or recklessness.\textsuperscript{162} In addition, plaintiffs must specify "each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed."\textsuperscript{163} Finally, plaintiffs must plead loss causation adequately.\textsuperscript{164} Again, plaintiffs must satisfy this extraordinary pleading standard without the benefit of any discovery from the firm or the individual defendants.\textsuperscript{165} Major decisions from the Supreme Court over the past 35 years also make federal civil liability unlikely. First and foremost, the Court has interpreted the federal securities laws narrowly, precluding federal liability for inflating the company's stock price artificially. When truthful information about the company is revealed to the market, the price of the securities corrects to its "proper" level, damaging investors who traded in the interim.

\textsuperscript{159}See Robert B. Thompson & Hillary A. Sale, Securities Fraud as Corporate Governance: Reflections upon Federalism, 56 VAND. L. REV. 859 (2003) (comparing class actions alleging Rule 10b-5 violations with shareholder actions filed in Delaware).


\textsuperscript{162}See 15 U.S.C. § 78u-4(b)(2) (2006); see Tellabs, 551 U.S. at 314 (construing scienter requirement). In order to survive a defendant's motion to dismiss after Tellabs, the pleadings of both the plaintiff and the defendant when read together must set forth a "cogent and compelling" inference that it is at least equally as likely that a knowing or reckless misrepresentation was committed as not. \textit{Id.} at 324.


\textsuperscript{164}See \textit{id.} § 78u-4(b)(4) ("[T]he plaintiff shall have the burden of proving that the act or omission of the defendant alleged to violate [the Securities Exchange Act] caused the loss for which the plaintiff seeks to recover damages."); Dura Pharm., Inc. v. Broido, 544 U.S. 336, 341-42 (2005) (holding that a plaintiff must allege facts demonstrating that defendants' material misrepresentation caused plaintiff's actual economic loss, not simply purchase price inflation).

\textsuperscript{165}Practically, plaintiffs' firms must engage in costly private investigators and rely on confidential informants to uncover enough non-public information about the defendants' wrongdoing to satisfy the threshold pleading standards.
conduct regulated by well-established state law. In *Santa Fe Industries, Inc. v. Green,* the Court held that mere breaches of fiduciary duty are not cognizable claims under section 10(b) and Rule 10b-5. In so deciding, the Court expressed concern that applying federal law to claims of fiduciary breaches by corporate management, an area traditionally governed by state law, would create problems. According to the Court, the logic that would permit such a result "could not be easily contained." Allowing a breach of fiduciary duty to satisfy section 10(b)'s "manipulative or deceptive device or contrivance" language would expand the scope of the prohibited conduct impermissibly. According to the Court, it would be difficult to distinguish that conduct from "other types of fiduciary self-dealing involving transactions in securities" and, as a result, "bring within ... [Rule 10b-5] a wide variety of corporate conduct traditionally left to state regulation." 

The Court also asserted that allowing federal courts to create and apply a "federal fiduciary principle" via the securities laws would "overlap and quite possibly interfere" with "established" state corporate law. Overarching federalism concerns, substantive questions about the scope of corporate managers' fiduciary duties, and basic notice concerns all supported the Court's decision to restrict the implied private right of action under section 10(b) to complaints alleging misrepresentations or omissions. Reading *Santa Fe* and *Dabit* together, executives' fiduciary duty breaches that coincide with securities transactions seem to be insulated from liability.

The Court's 2008 decision in *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.* followed a similar analysis. The majority again interpreted section 10(b) narrowly to restrict expansion of private antifraud enforcement to disputed contractual transactions, another area traditionally

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167 Id. at 471-75.
168 Id. at 478-79.
169 Id. at 478.
170 *Santa Fe*, 430 U.S. at 478.
171 Id. at 478-79. The Court worried that Rule 10b-5 could be interpreted to "impose a stricter standard of fiduciary duty than that required by the law of some States." Id. at 479 n.16.
172 Id. at 479.
173 This is a substantive difference, not simply a semantic distinction. Plaintiffs cannot "bootstrap" a claim of breach of fiduciary duty into a federal securities claim by alleging that [a defendant] failed to disclose that breach of fiduciary duty." Kas v. Fin. Gen. Bankshares, Inc., 796 F.2d 508, 513 (D.C. Cir. 1986).
regulated by state law. \footnote{According to the Court, section 10(b) "does not reach all commercial transactions that are fraudulent and affect the price of a security in some attenuated way." \textit{Id.} (citing \textit{SEC v. Zandford}, 535 U.S. 813, 820 (2002), in which the Court stated that section 10(b) "must not be construed so broadly as to convert every common-law fraud that happens to involve securities into a violation").} As in \textit{Santa Fe}, the Court considered extra-statutory principles counseling against extending the statute to reach the conduct alleged. \footnote{\textit{Id. at 161.}} Writing for the majority, Justice Kennedy first examined federalism concerns and respect for state law. \footnote{\textit{Id.}} The Court declined to apply section 10(b) to ordinary business transactions because such a reading would risk "that the federal power would be used to invite litigation beyond the immediate sphere of securities litigation and in areas already governed by functioning and effective state-law guarantees." \footnote{\textit{Id. at 164-65.}} Second, Justice Kennedy wrote that separation of powers concerns constrained the Court. \footnote{\textit{Id. at 165.}} The decision to extend the reach of a judicially-created, implied right of action "beyond its present boundaries" belonged to Congress, not the Court. \footnote{\textit{Id. at 166.}} Third, the Court found that the existence of other enforcement vehicles addressing the secondary actors' alleged misconduct—namely, criminal securities fraud, SEC enforcement, and sometimes express private rights of action—counseled against section 10(b) liability. \footnote{\textit{Stoneridge}, 552 U.S. at 157-58, 162.} Finally, the Court noted that after \textit{Central Bank}, Congress declined to reinstate aiding and abetting liability by including an express private right of action in the PSLRA. \footnote{\textit{Stoneridge}, 552 U.S. at 161.} As in \textit{Santa Fe}, consideration of these combined factors compelled the Court to restrict the statute's reach.

The Supreme Court's prior securities law jurisprudence highlights some important normative judgments about the ill-defined border between state and federal regimes governing the liability of corporate executives, perhaps foreshadowing how the Court will analyze the honest services statute. Prosecuting executives under \S\ 1346 federalizes enforcement of corporate executives' fiduciary duties, affecting these same interests, as I explain in Part V. While most appellate courts interpreting \S\ 1346 have ignored the decision model utilized by the Court in \textit{Santa Fe} and \textit{Stoneridge}, competing constructions of \S\ 1346 necessarily implicate federalism, respect for state law, separation of powers, and the enforcement mechanisms available under state corporate law.
D. Empirical Evidence: Directors and Officers Rarely Liable for Breaching Their Fiduciary Duties

Rarely is civil liability imposed on public company executives. Not surprisingly, boards seldom authorize such lawsuits. In the exceptional circumstance that directors approve such litigation, they previously terminated the executive, yet the firm avoided bankruptcy after the executive’s wrongdoing became public. Empirical research also demonstrates that shareholders rarely obtain judgments holding executives liable for fiduciary duty violations. A well-publicized study by Professor Bernard Black and colleagues determined that, from 1980 through 2005, only five derivative suits against outside directors of public companies went to trial, and plaintiffs won just two of them. Professors Robert Thompson and Randall Thomas examined all Delaware derivative suits filed during 1999 and 2000 and found that, out of the fifty lead cases resolved, only six resulted in any monetary recovery for the corporations. This past year, Professor Black and his colleagues published another article, this time comparing shareholder litigation against public company directors in the United States and the United Kingdom. Searching nationwide in the United States for lawsuits filed between 2000 and 2007 alleging a breach of duty, they found that only a small percentage of such cases were sufficiently contentious that the U.S. courts issued written decisions, and a substantial fraction of those cases were dismissed. When the researchers matched their U.S. lawsuit data to the data from Thompson and Thomas' Delaware studies, they determined that only one in seven complaints filed against directors in Delaware produced a written decision. Most written decisions favored the defendants, but, more often than not, judges dismissed the complaints without any written

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183 The shareholders' derivative action filed against former HealthSouth chairman and CEO Richard Scrushy exemplifies such a lawsuit. See, e.g., Valerie Bauerlein & Mike Esterl, Judge Orders Scrushy to Pay $2.88 Billion in Civil Suit, WALL ST. J., June 19, 2009, at B1.


187 Id. (manuscript at 12, 18).

188 See id. (manuscript at 15).
opinion. Indeed, the researchers located just ten written decisions (3% of all written decisions) entering judgments against defendants and awarding damages following trials on the merits. In those cases, D&O insurance likely covered almost all payments owed by the defendants.

Empirical studies also confirm that, applying the PSLRA's heightened pleading standards, courts have dismissed more securities fraud class actions on pre-discovery motions by the defendants, as Congress intended. After enactment of the PSLRA, securities class action dismissals doubled. In the Ninth Circuit, previously a "hotbed" of securities litigation, the dismissal rate nearly tripled. An early study found that courts granted, at least in part, 79% of defendants' motions to dismiss securities fraud class actions. Another more recent study reported that courts had dismissed some 44% of all post-PSLRA securities fraud complaints. Furthermore, there is some evidence that courts are dismissing an even higher fraction of cases since the Court's 2005 Dura decision.

If plaintiffs' complaint survives defendants' motions to dismiss and the trial court certifies the shareholder class, defendants almost always settle rather than proceed to trial. But the defendant corporation and its insurer

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189 See id. (manuscript at 15, 16, tbl.6). The authors found no written decisions in a breach of fiduciary duty suit filed solely against non-director officers. Id. (manuscript at 12 n.55).
190 See Armour et al., supra note 186 (manuscript at 16 tbl.6).
191 Id. (manuscript at 16-17).
192 Compare ELAINE BUCKBERG ET AL., RECENT TRENDS IN SHAREHOLDER CLASS ACTION LITIGATION: ARE WORLDCom AND ENRON THE NEW STANDARD? 3 (2005) (discussing courts' dismissal of some 20.3% of securities class actions from 1991 through 1995), with RONALD I. MILLER, RECENT TRENDS IN SHAREHOLDER CLASS ACTION LITIGATION: BEYOND THE MEGA-SETTLEMENTS, IS STABILIZATION AHEAD? 4 (2006) (explaining that from 1998 through 2003, the dismissal rate in securities class actions was 40.3%).
196 Id. at 2, 30 (inferring that plaintiffs have found it more challenging to meet their burden of proof and show loss causation in their complaints).
197 See Black et al., supra note 184, at 1084.
Individual defendants rarely contribute funds out of their own pockets to settle securities fraud litigation, a fact that has led many academics to question the deterrence value of securities class actions. Plaintiffs seldom name outside directors as defendants in a typical section 10(b)/Rule 10b-5 lawsuit. When plaintiffs have sued outside directors, and those director-defendants actually contributed to the settlements, the amounts paid by the directors were small compared to the individuals' overall net worth, and trivial compared to the massive damages (hundreds of billions of dollars) claimed by the defrauded shareholders. In most cases, plaintiffs do not seek damages directly from culpable corporate executives even if the executives personally profited from the fraud or their conduct was egregious.

* * *

Part III has shown that public company managers are seldom held accountable under civil law for breaching their fiduciary duties. As the Citigroup decision illustrates, Delaware judges still insulate public company directors from civil liability through resolute enforcement of the business judgment rule, exculpatory charter provisions exonerating directors from monetary damages, and generous indemnification rights. Shareholders do not fare much better when they sue executives in federal court. Congress and the United States Supreme Court have restricted shareholders' federal remedies over the past three decades. On the civil side, then, the trend in the law is against enforcement. From both a procedural and substantive perspective, fiduciary breaches by public company executives seem increasingly likely to go unremedied under civil law. Yet, as I show next, corporate fiduciaries face greater potential criminal liability under criminal law for breaching these same state law duties.

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198 See id. at 1080.
199 See id. at 1068, 1084.
201 See Thompson & Sale, supra note 159, at 896-97 (demonstrating that non-officer directors are rarely named as defendants in securities fraud actions).
202 For more information, see supra Part III.B.
IV. PROSECUTING BREACHES OF FIDUCIARY DUTY AS CRIMINAL VIOLATIONS

Because shareholder litigation is an expensive but ineffective disciplinary device, civil enforcement of executives' fiduciary duties is deficient in at least two important respects. First, such lawsuits do not seem to deter opportunistic behavior and dishonesty by public company executives. Second, the actions fail to provide incentives to outside directors to exercise diligent monitoring that might detect, and even prevent, managerial wrongdoing. Without any plausible threat of enforcement, liability rules arguably cannot function, and certainly not optimally, to constrain fiduciary opportunism. Might criminal prosecutions against offending fiduciaries fill this enforcement gap?

A. Prosecuting Corporate Executives for Honest Services Fraud

Federal prosecutors have used § 1346 to criminalize a progressively wider range of conduct since its enactment in 1988. For the first decade, the government employed the statute principally to prosecute public corruption, inditing state legislators, political machine operatives, and, occasionally, state governors. Less common was prosecutors' use of § 1346 to combat corporate fraud, self-dealing, or other unlawful activity arising in the purely private sphere; that is, until just after the turn of this century, when Congress and the executive branch declared "war" on corporate crime. Criminal indictments of public company executives increased at that time, with prosecutors charging, among the myriad of other federal crimes, violations of § 1346.

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1. The Motivation

The catalysts for more aggressive criminal enforcement were, of course, Enron and WorldCom—or, more precisely, revelations of massive financial frauds, shameful management self-dealing, and even outright looting by executives of those corporations and other of the country's largest public companies. Enron collapsed first. Stock prices fell. WorldCom failed six months later, and its bankruptcy, just six months after Enron's failure, caused capital to flee the stock markets. Between the two then-largest corporate bankruptcies in history came weekly, even daily, news that yet another public company had discovered misstatements in its prior financial reports and would have to file restatements. Some of those companies include Adelphia, Xerox, Global Crossing, Lucent, Qwest, and Rite Aid. Meanwhile, as Congress held hearings to dissect Enron's fraudulent financial reporting and off-balance sheet entities, abusive executive loans, and other conflict-of-interest transactions, the media reported on the gross misuse of corporate funds by top officers of other public companies. Otherwise reputable corporate boards, comprised mostly of outside directors, claimed that they, too, were deceived by corrupt CEOs, CFOs, and other senior officers. Stock prices fell further. The public voiced outrage, and commentators urged criminal prosecutions for those responsible. Even Fortune magazine's cover declared: "They lie, they cheat, they steal and they've been getting away with it for too long." In July 2002, with share prices and investors' confidence in a free fall and mid-term elections fast approaching, Democrats and Republicans alike called for the scalps of public company executives. Both the White House and Congress, reacting quickly to WorldCom's devastating announcement, developed and championed policies promoting the aggressive prosecution of corrupt officers. Looking to distance himself from Enron and its former chairman Kenneth Lay, a supporter and family friend, President George W. Bush got out of the gate first. Vowing that his administration would "put the bad guys in prison and take away their money," the president established the Corporate Fraud Task Force (CFTF) by executive order on July 9, 2002. 

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208 Id.
209 Clifton Leaf, Enough Is Enough, FORTUNE, Mar. 18, 2002, cover.
210 See, e.g., The Unlikeliest Scourge, supra note 206, at 26 (referring to creation of DOJ "financial-crimes SWAT team").
out corruption," he said that day. 213 "My administration will do everything in our power to end the days of cooking the books, shading the truth and breaking our laws." 214 Notably, President Bush also called on Congress to "give the Administration new powers to enforce corporate responsibility and to improve oversight of corporate America" including, as its first request, "[t]ough new criminal penalties for mail and wire fraud." 215

Just two weeks after President Bush established the CTF, Congress passed the Sarbanes-Oxley Act of 2002 (SOX). 216 SOX boosted criminal enforcement by creating new crimes punishing securities fraud (without proof of technical elements otherwise required under the securities laws), conspiracy to commit mail, wire, or securities fraud (without proof of an overt act), 217 obstruction of justice, 218 and retaliation against whistleblowers. 219 Following enactment of SOX, criminal penalties also could be imposed on CEOs and CFOs who knowingly or willfully certified false financial statements. 220 Additionally, Congress quadrupled the maximum prison term for mail and wire fraud to twenty years, 221 doubled (from ten to twenty years) the maximum prison term for securities fraud, and directed the U.S. Sentencing Commission to revise the sentencing guidelines to lengthen sentences for public company officers and directors convicted of fraud. 222

Importantly, Sarbanes-Oxley did almost nothing to enhance private enforcement of fiduciaries' obligations. 223 In the wake of Enron, WorldCom, and the rest, Congress created no new civil rules or remedies to discipline

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214 Id.
217 Id. § 902(a) (adding 18 U.S.C. § 1349, conspiracy and attempt).
218 Id. § 805.
219 Id. § 1107.
220 Sarbanes-Oxley Act §§ 302, 906.
221 Id. § 903.
222 Id. § 1104. When Congress enacted Sarbanes-Oxley, the "popular imagination" was that "white-collar criminals spend a couple of years in a country-club jail and emerge, reborn, as earnest philanthropists—like, say, Michael Milken, who was convicted during America's last big corporate crime wave, in the 1980s, and spent just two years in jail." Bosses Behind Bars, ECONOMIST, Sept. 21, 2004, at 1.
223 The only reform directed to improving private enforcement was extending the statute of limitations for securities fraud claims. See Sarbanes-Oxley Act § 804 (lengthening statute of limitations from one to two years and the period of repose from three to five years).
executives who breach their fiduciary duties.\textsuperscript{224} Public company fiduciaries still faced little risk of civil liability, regardless of their culpability or harm to the corporations they managed. Despite the recognized need to punish corrupt acts and hold responsible executives more accountable, shareholder litigation remained politically disfavored as a deterrent.\textsuperscript{225} In contrast, even the head of the U.S. Chamber of Commerce endorsed criminal enforcement.\textsuperscript{226}

2. The Results

Although government lawyers suffered several embarrassing defeats, the Justice Department recorded an unprecedented number of successful prosecutions of corporate executives.\textsuperscript{227} From the CFTF's inception through January 6, 2009, federal prosecutors obtained nearly 1,300 corporate fraud convictions,\textsuperscript{228} most of which (1,236) came in its first five years of operation. Among the convicted felons were more than 200 chief executive officers and presidents, more than 120 corporate vice presidents, and more than 50 chief financial officers. In addition to jail terms, sentencing judges also imposed substantial financial penalties on convicted executives, including criminal fines, restitution, and forfeiture. Indeed, the DOJ obtained more than $1 billion in forfeitures from defendants convicted of financial offenses.\textsuperscript{229}

While federal prosecutors have charged executives with a host of criminal violations,\textsuperscript{230} mail and wire fraud counts appeared in many, if not most, indictments. To be sure, the vast majority of mail and wire counts


\textsuperscript{225}For the same reason, Delaware legislators and judges have taken almost no action to make responsible directors and officers more accountable for breaching their fiduciary duties.

\textsuperscript{226}At a press conference in July 2002, Chamber President Tom Donahue pounded his fist on a table and demanded, "Put 'em in jail!" \textit{The Unlikeliest Scourge, supra} note 206, at 26.

\textsuperscript{227}See William Donaldson, Chairman, SEC & Larry Thompson, Deputy Attorney Gen., Press Briefing (July 22, 2003), available at \url{http://www.justice.gov/dag/cftf/press/072203whitehousecfbriefing.htm} ("Before the task force was created, . . . [the DOJ] didn't keep statistics with respect to corporate fraud in a discreet [sic] manner. They were lumped in with other white collar criminal activity.").

\textsuperscript{228}Press Release, Dept of Justice, President's Corporate Fraud Task Force Adds Six New Member Agencies (Jan. 6, 2009), available at \url{http://www.usdoj.gov/opa/pr/2009/January/09-odag-003.html}.

\textsuperscript{229}Id.

\textsuperscript{230}See id. ("Prosecutors . . . have brought charges for accounting fraud, securities fraud, insider trading, market manipulation, wire fraud, obstruction of justice, false statements, money laundering, Foreign Corrupt Practices Act violations, stock option backdating and conspiracy, among things.").
alleged deprivations of money and property. A number of indictments, however, also included mail and wire fraud counts alleging deprivations of honest services, including, most notably, many of the indictments charging former Enron executives. It seems that government lawyers often allege mail and wire frauds, including honest services fraud, because the statutes are versatile, and the violations serve as predicate offenses for money laundering and/or racketeering under the Racketeer Influenced and Corrupt Organization Act (RICO) charges. By indicting and convicting the corporate executive for money laundering or RICO, prosecutors can seek criminal forfeiture of the ill-gotten gains still in the executive's possession and control.

Unfortunately, we can only estimate the number of corporate executives charged with honest services fraud. The DOJ's Statistics Bureau does not treat honest services fraud as a crime separate from mail fraud and wire fraud.231 Thus, government records do not distinguish indictments alleging honest services deprivations under § 1346 from those relying solely on money or property theories under §§ 1341 and 1343.232 Nonetheless, using online resources,233 I developed a noncomprehensive catalog of the corporate executives charged with honest services fraud after 2000. Available records indicate that federal prosecutors charged at least 113 corporate officers, directors, and other senior corporate officers with violating § 1346. Among the indicted were at least twenty-five chief executive officers, about a third of whom served as chairmen of the board. Also charged were at least six non-chair directors, five presidents, four chief operating officers, fifteen

231 Because § 1346 is a definitional provision that expanded the scope of mail and wire fraud, information on the government's use of § 1346 is not captured systematically. Obtaining data directly from district court dockets proved underinclusive as well; honest services fraud charges often are omitted from docket entries due to inconsistent charging conventions and docketing practices. In the absence of a searchable public data base containing the texts of all federal indictments, any comprehensive analysis of § 1346 usage is subject to error.


233 The listing of corporate executives charged with honest services fraud (and available from the author) was compiled by searching a variety of online databases. Westlaw's docket database was searched for federal dockets mentioning 18 U.S.C. § 1346 or "honest services." Next, the indictments from potentially relevant dockets were cross-checked to identify defendants alleged to be corporate executives. The results were incomplete, however, as many relevant dockets do not explicitly reference § 1346 or honest services. The original listing then was supplemented with additional prosecutions found on the CFTF webpage at the DOJ's website (especially its "Significant Criminal Cases and Charging Documents" heading), the DOJ's media releases, and other major media outlets. These resources also provided names of corporate executives charged with mail and wire fraud and court filing information. Finally, indictments were accessed and reviewed to determine whether the charges included honest services fraud.
chief financial officers, and twenty-six vice-presidents and executive vice-presidents. Many of these defendants were former executives of companies that were the subjects of well-publicized frauds, including Enron, Adelphia, Rite Aid, AOL, and Qwest. In addition to Conrad Black and Jeff Skilling, the defendants included other now well-known executives: Enron's Andrew Fastow and Richard Causey, Adelphia's John Rigas, and HealthSouth's Richard Scrushy, who was acquitted of all charges following a jury trial in 2005. Also convicted of honest services fraud were many professionals who advised top management, such as attorneys and investment bankers. To the extent the charging documents identified a specific duty breached, the indictments alleged breaches of the duty of loyalty.

In 2006, federal prosecutors also began charging honest services fraud in high-profile prosecutions of corporate executives accused of "backdating" stock options. Nonetheless, after President Bush's second term began, the number of corporate executives charged with honest services fraud declined, in parallel with the reported decline in major corporate fraud indictments overall. Since other evidence indicates that use of § 1346 for public corruption remained high, the observed decline likely reflects the overall decline in corporate fraud prosecutions during the same period.

234 The remainder included at least six general counsel, one corporate treasurer, a chief accounting officer, and various managers, owners, controllers, division directors, and other senior personnel.
238 Causey, 2004 WL 2414438.
241 See, e.g., United States v. Nicholas, No. SACR 08-00139, 2008 WL 5233199 (C.D. Cal. Dec. 15, 2008). "Backdating" options refers to the practice of setting the grant date retroactively to a date when the stock traded at a lower price, thereby creating an instant paper gain for the recipient.
242 From 2002 to 2005, the CFTF averaged over 119 indictments annually. From 2006 to 2007, the annual average appears to have dropped to approximately 13. See Daphne Eviatar, Case Closed?, AM. LAW., Fall 2007, at 19, 21.
243 Id. at 30 (reporting 2007 year-to-date number of white-collar filings was 64% lower than the 2006 number and 77% lower than the 2004 number).
244 For example, a Westlaw search for federal dockets referencing honest services fraud or § 1346 returned 107 cases from 2008, up from 86 in 2007, and greater than the previous high of 95 from 2005. This number exceeds the 2002-2004 average of 86.7 cases per year. While the search cannot be viewed as comprehensive, it does indicate that the decline in honest services fraud
B. Procedural Advantages to Criminal Prosecution

For public company executives, the federal government's political commitment to fight corporate fraud through aggressive criminal enforcement is troubling enough. But political will aside, government lawyers have significant procedural advantages in criminal cases that lead to sizeable conviction rates. First, prosecutors have the authority to make charging decisions. They determine not only whom to charge but whether and which crimes to charge in any particular case. Government lawyers generally also have the authority to negotiate plea agreements and accept pleas from defendants. Through their authority over charges and dispositions, the law gives prosecutors power to determine the defendant's likely punishment. As they exercise this substantial discretion, prosecutors have the sprawling federal criminal code at their disposal. Critics have long complained that the federal criminal code arms prosecutors with a quasi-legislative, administrative license to brand as "criminal" a variety of non-violent conduct. This prosecutorial power—and its potential for abuse—persists apart from the lack of congressional specificity in drafting § 1346.

Furthermore, prosecutors receive near-total cooperation from grand juries, which rarely refuse to return requested indictments. Commentators attribute prosecutors' success rate to the grand juries' dependence on government lawyers to provide relevant evidence. Prosecutors, moreover, need not present exculpatory evidence to the grand jury. As a result, "the grand jury, having been conceived as a bulwark between the citizen and the Government, is now a tool of the Executive." More colorfully, Sol Wachtler, former chief judge of the New York Court of Appeals, once

indictments is best explained by an overall decline in corporate fraud prosecutions, rather than a decline in the use of § 1346.

246 An analysis of the 785 federal grand juries impaneled in 1991 revealed that grand jurors refused to return indictments in only 16 of 25,943 cases (less than 0.1%). Roger Roots, If It's Not a Runaway, It's Not a Real Grand Jury, 33 CREIGHTON L. REV. 821, 827-28 (2000). A 1984 study found only 68 rejections out of 17,419 cases (0.4%). Andrew D. Leipold, Why Grand Juries Do Not (and Cannot) Protect the Accused, 80 CORNELL L. REV. 260, 274-75 (1995).


248 Id. at 204.

249 United States v. Mara, 410 U.S. 19, 23 (1973) (Douglas, J., dissenting); see Kevin K. Washburn, Restoring the Grand Jury, 76 FORDHAM L. REV. 2333, 2352 n.99 (2008) (detailing the extent to which grand juries are viewed as "rubber stamps").
suggested that prosecutors could convince a grand jury to indict a ham sandwich.\(^2\)

Motions to dismiss also pose little threat to prosecutors' criminal charges. Unlike shareholder plaintiffs, who must plead fraud with heightened particularity in both state and federal court, prosecutors need only provide a "plain, concise, and definite written statement of the essential facts constituting the offense charged."\(^2\) In contrast to the requirements under Delaware law and the PSLRA, courts do not analyze the sufficiency of any factual allegations, and scienter and causation need not be plead at all, much less with great specificity. The government need not allege its theory of the case or specify its supporting evidence,\(^2\) and no law requires that the government plead or prove harm, loss, or damage to anyone. To survive dismissal, the indictment need only (1) contain the elements of the offense charged, (2) inform the defendant of the nature of the charges against him in order to allow him to prepare an adequate defense, and (3) be specific enough to preclude subsequent prosecutions for the same offense.\(^2\)

Indictments very rarely fail this modest pleading standard. Thus, trial courts routinely deny criminal defendants' motions to dismiss after relatively perfunctory hearings.\(^2\)

Rather than proceeding to trial, however, most criminal cases conclude with the defendant pleading guilty to one or more charges. According to government statistics, federal prosecutors obtained some sort of conviction in 90% of all federal criminal cases closed from 2005 through 2007, and nearly all of those convictions, 96%, were obtained through guilty pleas.\(^2\)

\(^{250}\)See Washburn, supra note 249, at 2352 & n.99.

\(^{251}\)FED. R. CRIM. P. 7(c)(1).

\(^{252}\)See, e.g., United States v. Vegas, 309 F. Supp. 2d 609, 616 (S.D.N.Y. 2004) (holding that the government need not "disclos[e] the manner in which it will attempt to prove the charges, the precise manner in which the defendant committed the crimes charged, or a preview of the Government's evidence or legal theories").

\(^{253}\)See, e.g., Hamling v. United States, 418 U.S. 87, 117 (1974); United States v. Hausmann, 345 F.3d 952, 955 (7th Cir. 2003); see also United States v. deVegter, 198 F.3d 1324, 1330 (11th Cir. 1999) (finding honest services fraud indictment sufficient even when government failed to allege defendant owed any fiduciary duty).


\(^{255}\)See infra note 254.
The numbers are even higher in cases charging mail and wire fraud; prosecutors racked up a 91.4% conviction rate during that time.\textsuperscript{256}

Federal prosecutors' substantial record of success underscores the importance of the Supreme Court's upcoming review of § 1346 for corporate fiduciaries. How might the Court narrow or even eliminate honest services fraud as a substantive criminal offense? The next section addresses these questions.

V. THE EVOLVING CRIME OF HONEST SERVICES FRAUD

Before analyzing the complex interpretive problems facing the Supreme Court—puzzles that have confounded federal appellate courts for two decades—Part V begins by exploring the statute's origins, including the antecedent development of the intangible rights theory that preceded the enactment of § 1346. As the lower federal courts have recognized, the statute cannot be understood without reference to Congress's overall scheme for prohibiting fraud through use of the mails and wires.\textsuperscript{257}

A. A Brief History of Honest Services Fraud\textsuperscript{258}

Although honest services fraud had an inauspicious beginning, the doctrine unexpectedly grew "like a kudzu vine"\textsuperscript{259} in the late 1970s and the 1980s before the Supreme Court took action to prune it back in 1987. The next year, however, Congress responded to the Supreme Court's decision to eliminate honest services fraud by enacting § 1346. Since then, honest services fraud has become increasingly prominent in prosecutions of both public corruption and corporate crime.\textsuperscript{260}

\textsuperscript{256}See infra note 254.

\textsuperscript{257}See United States v. Brown, 459 F.3d 509, 519 (5th Cir. 2006) ("[Section 1346] can be understood only in the light of the long history of the mail- and wire-fraud statutes, which were intentionally written broadly to protect the mail and, later, the wires from being used to initiate fraudulent schemes.").

\textsuperscript{258}See Casey, supra note 23, at 179-206 (describing the judicial and legislative history of honest services fraud, including its mail and wire fraud antecedents, and citing background articles). Class Action Criminality examines the DOJ's prosecution of the Milberg Weiss law firm and its four senior partners for honest services fraud. The government indicted the defendants for sharing court-awarded attorneys' fees with their clients who served as named plaintiffs in securities fraud class actions. Because the indictments centered on alleged breaches of "fiduciary duties" not recognized under state or federal law, the article concluded that government lawyers overreached by grounding their prosecution on honest services fraud. Id. at 225-34.

\textsuperscript{259}John C. Coffee, Jr., Modern Mail Fraud: The Restoration of the Public/Private Distinction, 35 AM. CRIM. L. REV. 427, 427 (1998) (analogizing honest services fraud to the kudzu vine).

\textsuperscript{260}See U.S. DEP'T OF JUSTICE, PUBLIC INTEGRITY SECTION, REPORT TO CONGRESS ON THE
Initially, it is important to identify honest services fraud as a species of mail and wire fraud.\textsuperscript{261} Indeed, some of the interpretive issues associated with honest services fraud follow from the controversial features of the mail and wire fraud statutes.\textsuperscript{262} The federal mail and wire fraud laws have generated disapproval and debate ever since Congress enacted the first such statute in 1872,\textsuperscript{263} criminalizing fraudulent mail schemes apparently perpetrated by urban "flimflam artists"\textsuperscript{264} and "rapscallions" against "the innocent people in the country."\textsuperscript{265} Described as a "first line of defense" to new frauds, the statute's broad language has been rationalized as "a stopgap device to deal on a temporary basis with the new phenomenon, until particularized legislation can be developed and passed to deal directly with the evil."\textsuperscript{266} Nonetheless, the malleability of the mail and wire fraud statutes has engendered significant criticism. Detractors have described the statutes as creating "essentially element-free criminal liability," enabling prosecutors to employ "virtually unbridled discretion" to combat "virtually every type of untoward activity known to man."\textsuperscript{267}

In the post-Watergate 1970s, government lawyers persuaded the federal courts to extend the reach of the mail and wire fraud statutes to prosecute public officials who allegedly had deprived the public, not of money or property, but of the public's "intangible right" to the officials' activities and operations of the public integrity section for 2007, at 18-19 (2007), available at http://www.usdoj.gov/criminal/pin; U.S. SENTENCING COMM'N, SOURCEBOOK OF FEDERAL SENTENCING STATISTICS FOR 1998, at 22-23, 30 (1998), available at http://www.ussc.gov/annrpts.htm (sentences under U.S.S.G. § 2C1.7 (2004)). Both sources separately track only public corruption honest services fraud prosecutions. Nonetheless, the growing body of private honest services fraud case law demonstrates a parallel, if not greater, trend in the private arena.

\textsuperscript{261}See 18 U.S.C. § 1341 (2006) (mail fraud); id. § 1343 (wire fraud). Sections 1341 and 1343 are construed to require (1) a scheme to defraud, (2) intent to deprive another of money or property, and (3) use of the mails (or wires) in furtherance of that scheme. See, e.g., United States v. Turner, 465 F.3d 667, 680 (6th Cir. 2006).

\textsuperscript{262}Section 1346 "can be understood only in the light of the long history of the mail- and wire-fraud statutes, which were intentionally written broadly to protect the mail and, later, the wires from being used to initiate fraudulent schemes." Brown, 459 F.3d at 519.

\textsuperscript{263}See Daniel W. Hurson, Comment, \textit{Mail Fraud, The Intangible Rights Doctrine, and the Infusion of State Law: A Bermuda Triangle of Sorts}, 38 Hous. L. Rev. 297, 302 (2001) (calling "the mail fraud statute one of the most criticized yet utilized of federal criminal statutes").

\textsuperscript{264}United States v. Bronston, 658 F.2d 920, 931 (2d Cir. 1981) (Van Graafeiland, J., dissenting) ("[T]he statute was originally aimed at flimflam artists who use the mails to defraud the gullible."); Geraldine Scott Moohr, \textit{Mail Fraud and the Intangible Rights Doctrine: Someone to Watch Over Us}, 31 Harv. J. On LEGIS. 153, 158 (1994) (discussing original enactment of the mail fraud statute to address sending counterfeit currency through the mail).


"honest services." Judicial opinions sanctioning this new theory often used broad, aspirational language to describe the duties owed by an elected official to her constituents. Courts largely agreed with Justice Department prosecutors that the citizenry had the "right to conscientious, loyal, faithful, disinterested and honest government." A scheme to defraud citizens of those rights that involves "bribery and non-disclosure and concealment of material information . . . [then] may come within the purview of the federal mail fraud statute even though no state or federal statute or common law is transgressed in terms."271

Prosecutors gradually expanded the intangible rights theory of mail fraud to cases beyond the public sphere—that is, to cases involving purely private relationships. Grounding charges on breaches of the duty of loyalty, prosecutors charged employees with honest services fraud, later adapting the theory to other principal-agent relationships.273 Government prosecutors found the statute useful particularly when a putative victim suffered no financial or property loss; indeed, some victims were not even threatened with such losses.274

By the early 1980s, the Justice Department had invoked the honest services theory to charge private fiduciaries for failing to divulge their conflicts of interest. Because fiduciary duty law is especially "soft-edged and aspirational,"275 predicating criminal liability on fiduciary breaches—

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268 See, e.g., United States v. Mandel, 591 F.2d 1347, 1362 (4th Cir. 1979) (litigation against governor of Maryland), vacated, 602 F.2d 653 (4th Cir. 1979) (en banc); United States v. Isaacs, 493 F.2d 1124, 1149-50 (7th Cir. 1974) (litigation against governor of Illinois).

269 See, e.g., Mandel, 591 F.2d at 1361 (explaining that mail fraud statute could be used to prosecute any "scheme involving deception that employs the mails in its execution that is contrary to public policy and conflicts with accepted standards of moral uprightness, fundamental honesty, fair play and right dealing").

270 Id. at 1359.

271 Id. at 1359-60 (emphasis added) (footnote omitted).

272 See, e.g., United States v. Conner, 752 F.2d 566, 569-72 (11th Cir. 1985); United States v. George, 477 F.2d 508 (7th Cir. 1973); cf: United States v. Brown, 459 F.3d 509, 519 (5th Cir. 2006) ("Honest services are services owed to an employer under state law, including fiduciary duties defined by the employer-employee relationship.") (quoting United States v. Caldwell, 302 F.3d 399, 409 (5th Cir. 2002)).


274 See, e.g., United States v. Margiotta, 688 F.2d 108, 121 (2d Cir. 1982) ("In the private sector, it is now a commonplace that a breach of fiduciary duty in violation of the mail fraud statute may be based on artifices which do not deprive any person of money or other forms of tangible property.").

275 John C. Coffee, Jr., Paradigms Lost: The Blurring of the Criminal and Civil Law Models—And What Can Be Done About It, 101 YALE L.J. 1875, 1879 (1992); see also Margiotta, 688 F.2d at 142 (Winter, J., concurring in part and dissenting in part) ("The words fiduciary duty are no more than a legal conclusion and the legal obligations actually imposed under that label vary
and particularly on alleged failures to disclose conflicts of interest—greatly expanded the reach of the mail and wire fraud laws. The honest services theory threatened to morph the mail and wire fraud statutes into mandatory conflict of interest disclosure laws with criminal sanctions for violation.\textsuperscript{276}

The Supreme Court halted the government's expansion of the intangible rights theory in 1987, if only briefly. In \textit{McNally v. United States},\textsuperscript{277} a public corruption case, the Court held that the mail and wire fraud statutes prohibited only deprivations of money or property, not the "intangible right of the citizenry to good government."\textsuperscript{278} There, federal prosecutors indicted two Kentucky officials for directing that the Commonwealth buy insurance through an agent who then shared his commissions with an agency partly owned by one of the officials.\textsuperscript{279} This undisclosed arrangement allowed the owner-defendant to profit from the transactions,\textsuperscript{280} although nothing in the record suggested that Kentucky paid inflated premiums or received substandard insurance.\textsuperscript{281} Without any claim involving the deprivation of property or money, the Court reversed the defendants' convictions.\textsuperscript{282} Despite the statute's historically broad construction, the Court concluded that \textsection{}1341 did not criminalize deprivations of intangible rights to honest services.\textsuperscript{283}

In reaching its conclusion, the Court reasoned:

\begin{quote}
[W]hen 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. As the Court said in a mail fraud case years ago: "There are no constructive offenses; and before one can be punished, it must be shown that his case is plainly within the statute." Rather than construe the statute in a manner that leaves its outer boundaries ambiguous and involves the Federal Government in
\end{quote} 

\textsuperscript{276}See, \textit{e.g.}, Hurson, supra note 267, at 429.

Almost any action undertaken by a fiduciary, agent, or employee which causes detriment to his beneficiary, principal, or employer and which involves some material deception, will likely trigger a responsibility to make disclosure. Failure to disclose will be construed as a breach of fiduciary duty and subject the actor to federal prosecution for mail fraud.

\textsuperscript{277}483 U.S. 350 (1987).
\textsuperscript{278}Id. at 355.
\textsuperscript{279}Id. at 352-53.
\textsuperscript{280}Id. at 360-61.
\textsuperscript{281}McNally, 483 U.S. at 360.
\textsuperscript{282}Id. at 360-61.
\textsuperscript{283}Id. at 356-59.
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. If Congress desires to go further, it must speak more clearly than it has. 284

In this brief paragraph, the McNally Court identified a number of interrelated concerns about honest services fraud, including leniency, the need to clearly define the criminalized conduct, fair notice, separation of powers, and respect for federalism. At the urging of the Justice Department, Congress responded to McNally by enacting § 1346 the next year. 285 The statute reads, in its entirety: "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." 286 There is no reliable legislative history to guide the courts as to the meaning of this language, and Congress has never amended the statute. Thus, Congress left federal courts with numerous interpretive questions. What is the "intangible right of honest services"? Whose right is it? Where does the right come from, and must the right be recognized under state law? Who must do the "depriving"? Must there be some tangible harm to a victim or economic benefit to the defendant?

From its enactment and continuing through today, courts and commentators have complained about the statute repeatedly. According to its critics, § 1346 is too "vague and undefined," 287 "amorphous and open-ended." 288 Because its language "provides no perimeters" 289 for prosecutors, the statute, if read literally, could criminalize any dishonesty by an employee. 290 Defendants, along with some jurists and academics, have argued that these defects render the statute unconstitutional, although no appellate court has struck down the statute. 291 Thus, while passage of § 1346 satisfied

284 Id. at 359-60 (internal citations omitted).
285 For more detail on the statute's limited legislative history, see Casey, supra note 23, at 186-88.
287 United States v. Urciuoli, 513 F.3d 290, 294 (1st Cir. 2008).
288 United States v. Sorich, 523 F.3d 702, 707 (7th Cir. 2008).
289 United States v. Brown, 459 F.3d 509, 519 (5th Cir. 2006).
290 United States v. Frost, 125 F.3d 346, 368 (6th Cir. 1997); see also United States v. Kincaid-Chauncey, 556 F.3d 923, 940 (9th Cir. 2009) ("[R]ead literally, §1346 would make a crime of the nondisclosure of virtually every breach of any public or private employment relationship—turning §1346 into a 'draconian personnel regulation' that transforms private and governmental 'workplace violations into felonies'" (quoting Julie R. O'Sullivan, The Federal Criminal "Code" is a Disgrace: Obstruction Statutes as Case Study, 96 J. CRIM. L. & CRIMINOLOGY 643, 663 (2006))).
291 Although a panel of the Second Circuit determined the law to be unconstitutional, United
Congress's reflexive need to respond to the Court's invitation to "speak more clearly," the statute actually did little to address the concerns that animated *McNally*. Indeed, as I argue next, enactment of § 1346 actually jumbled some pieces of the honest services puzzle.  

**B. Private Honest Services Fraud**

In the two decades since § 1346 became law, courts have grappled with many of the same issues that confounded them before Congress enacted the statute. Courts agree only that Congress intended to overturn the result in *McNally*. They dispute how much pre-*McNally* case law—an incoherent body of decisions—was resurrected. And no courts have concurred as to whether they should construe § 1346 as addressing the policy concerns raised in *McNally*. Consequently, appellate courts have not only failed to agree on the statute's scope, but the promulgation of § 1346 created even more doctrinal disarray.

This part examines key pieces of the honest services fraud puzzle, paying particular attention to how the issues likely will present themselves to the Supreme Court in *Black, Weyhrauch, and Skilling*. Where applicable, I also identify points of friction with Delaware corporate law. Finally, I consider how specific interpretive problems—and their potential resolution by the Court this Term—affect the standards of conduct applicable to public company executives.

1. The Fiduciary Duty Requirement

Defendants who may have breached their fiduciary duties in purely private transactions (and even defendants who transacted business with them) confront acute complexity in ascertaining the breadth of § 1346.

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292 See Kincaid-Chauncey, 556 F.3d at 939-40. “The 'intangible rights' theory [of honest services fraud] has been a subject of controversy in the history of the federal mail and wire fraud statutes,' and, we would add, it continues to cause controversy despite (or perhaps because of) Congress's statutory abrogation of McNally.” *Id.* (quoting United States v. Williams, 441 F.3d 716, 721 (9th Cir. 2006)).

293 *Rybachyki II*, 354 F.3d at 136.

294 See Kincaid-Chauncey, 556 F.3d at 939 (listing the holdings of the different circuits regarding the extent to which enactment of the statute resurrected pre-*McNally* case law).
Courts generally concur that honest services fraud requires more than a simple breach of contract, or even breach of the covenant of good faith inherent in contractual relationships. Although § 1346 does not mention fiduciaries, courts usually restrict honest services fraud to situations where someone (but not always the defendant) owed a fiduciary duty to provide honest services to the victim. Many opinions also emphasize that not every breach of fiduciary duty constitutes an honest services fraud. That said, the courts have failed to reach consensus on the doctrinal boundary between fiduciary breach and federal felony. Part of the difficulty arises from using fiduciary duty as the benchmark for liability. Fiduciary relations, and their attendant duties, are highly fact-sensitive associations. However, courts also have created confusion by applying a variety of approaches to the basic statutory construction problem. Multiple methodologies have led to irregular, and even conflicting, interpretations. This problem, of course, is not unique to § 1346, or even statutory construction generally. In this context, however, with the liberty of fiduciaries at stake, the courts' inconsistent approaches raise acute concerns. A defendant's freedom should not depend on the vagaries of geography or a potentially idiosyncratic application of prosecutorial discretion.

To date, the seminal case construing § 1346 is the Second Circuit's en banc decision in United States v. Rybicki. While widely cited, the court's opinion ultimately leaves a number of the most vexing interpretive issues—issues especially important to corporate fiduciaries—unresolved. In fact, the decision's analysis seems to have added further confusion to an already convoluted jurisprudence.

The defendants in Rybicki, two law firm partners, secretly paid insurance adjusters, encouraging them to process their clients' claims more

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295 See, e.g., Handakas, 286 F.3d at 106-07; United States v. deVetger, 198 F.3d 1324, 1328 (11th Cir. 1999) ("Most private sector interactions do not involve duties of, or right to, the 'honest services' of either party.").

296 See, e.g., United States v. Turner, 465 F.3d 667, 675 (6th Cir. 2006) (noting that pre-McNally case law also required the "finding of a fiduciary duty owed by the defendant to the victim").


299 The case was originally heard by a panel in United States v. Rybicki (Rybicki I), 287 F.3d 257 (2d Cir. 2002), but was later heard en banc in United States v. Rybicki (Rybicki II), 354 F.3d 124 (2d Cir. 2003) (en banc), where Justice Sotomayor, then sitting on the Second Circuit, sided with the majority.
Prosecutors did not allege that the adjusters paid more on the claims submitted by the defendants' clients, nor did they charge that the defendants themselves breached any duties. Nonetheless, the government indicted the two partners for honest services fraud on the theory that the defendants' bribes deprived the insurance companies of the honest services of their employee adjusters. Affirming the defendants' convictions, the court attempted to synthesize the extant (especially pre-McNally) private honest services case law by dividing the earlier opinions into two categories: (1) bribes or kickbacks; and (2) self-dealing.

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

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

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

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300Rybicki II, 354 F.3d at 127.
301Id.
302Id. at 139-41.
303Id. at 139.
304Rybicki II, 354 F.3d at 140.
305Id. at 141-42 (emphasis added) (footnote omitted). With self-dealing, unlike bribery/kickback cases, there was also "a requirement of proof that the conflict caused, or at least was capable of causing, some detriment." Id. at 142.
Although the majority asserted that its interpretation did not leave "too much uncontrolled discretion to police or prosecutors," the dissenters sharply disagreed. They criticized both the statute itself and the majority's construction of § 1346. According to the dissent, § 1346 not only "flunks the test for facial vagueness," but its text provides "insufficient constraint on prosecutors, gives insufficient guidance to judges, and affords insufficient notice to defendants." Specifically, the dissenters refuted the notion that § 1346 "has any settled or ascertainable meaning or that the offense it describes has known contours." As for the majority's now-seminal opinion, the dissenters characterized it "as standardless as the statute itself." Indeed, the dissent argued that the majority's interpretation effectively "criminaliz[ed] all material acts of dishonesty by employees or by persons who owe analogous duties."

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

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

Second, determining whether a person is "in a relationship that gives rise to a duty of loyalty" is inherently fact-sensitive, creating imprecision and serious complications when it is used to support criminal charges. As Judge Winter emphasized before McNally, "The words fiduciary duty are no more than a legal conclusion and the legal obligations actually imposed under that
label vary greatly from relationship to relationship. . . . Partners, employees, trustees and corporate directors are all fiduciaries, yet their legal obligations may be wholly dissimilar." Yet, under current law, government prosecutors can invoke the same statutory language (which, again, makes no mention of fiduciaries or duties) to regulate not only relationships between public officials and their constituents but also the myriad private relationships that may give rise to a duty of loyalty. The text of § 1346 does not differentiate between cases on the basis of their public or private context.

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

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

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312 See Rybicki II, 354 F.3d at 161-62 (Jacobs, J., dissenting).
313 See id.
314 While not unheard of, there is little Delaware case law on this potential cause of action. See Globis Partners, L.P. v. Plumtree Software, Inc., No. 1577-VCP, 2007 WL 4292024, at *15 (Del. Ch. Nov. 30, 2007) (holding that a claim requires proof of: "(1) the existence of a fiduciary relationship; (2) the fiduciary breached its duty; (3) a defendant, who is not a fiduciary, knowingly participated in a breach; and (4) damages to the plaintiff that resulted from the concerted action of the fiduciary and the nonfiduciary").
315 United States v. Sorich, 523 F.3d 702, 708 (7th Cir. 2008); see also United States v. Rybicki (Rybicki I), 287 F.3d 257, 264 (2d Cir. 2002) ("Because the statute does not define honest services, the potential reach of § 1346 is virtually limitless.").
316 See United States v. Kincaid-Chauncey, 556 F.3d 923, 940 (9th Cir. 2009).
317 Id. ("Without some kind of limiting principle, honest services wire fraud could potentially make relatively innocuous conduct subject to criminal sanctions."); Sorich, 523 F.3d at 707-08.
"avoid the constitutional question" engendered by the statute's vagueness.\footnote{See United States v. Brown, 459 F.3d 509, 534 (5th Cir. 2006) (DeMoss, J., concurring in part and dissenting in part) ("Rather than address the larger constitutional problem with this statute, which would provide clarity to Congress, prosecutors, and the lower courts, the circuit courts have instead only clouded the meaning of § 1346 by repeatedly resolving the ambiguities of the statute's text via judicially created definitions and limitations.").} Regardless of the motivation for their creation, all of the limiting principles announced by the lower federal courts over the past two decades have generated considerable criticism, and none have been accepted universally.

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

Rybicki II did not specify the law applicable to its analysis—federal, state, or some combination. Unfortunately, appellate courts have differed widely in framing and answering choice of law questions. Some courts have expressed the question as whether an independent violation of state law is necessary for an honest services fraud conviction. Several circuits have concluded that, at least when dealing with public honest services fraud, a government official must have violated some state law to be convicted for honest services fraud.\footnote{See, e.g., United States v. Brumley, 116 F.3d 728, 734-35 (5th Cir. 1997) (en banc). The Third Circuit's position is unclear. See United States v. Carbo, 527 F.3d 112, 117 n.4 (3d Cir. 2009) (concluding that its prior decisions had only held that an independent violation of state law was sufficient for an honest services fraud violation, but noting it had never expressly held it was necessary).} Most circuits, however, have decided that proving an independent violation of state law is not necessary for an honest services fraud conviction.\footnote{See United States v. Weyhrauch, 548 F.3d 1237, 1245 (9th Cir. 2008), cert. granted, 129 S. Ct. 2863 (June 29, 2009) (No. 08-1196); Sorich, 523 F.3d at 712; United States v. Urciuoli, 513 F.3d 290, 294, 298-99 (1st Cir. 2008) (expressing concern that the statute might "embrace every kind of legal or ethical abuse remotely connected to the holding of a governmental position"); United States v. Walker, 490 F.3d 1282, 1299 (11th Cir. 2007), cert. denied, 128 S. Ct. 1649 (2008); United States v. Bryan, 58 F.3d 933, 942 (4th Cir. 1995), abrogated by United States v. O'Hagan, 521 U.S. 642 (1997).} In fact, in other circumstances, the Supreme Court ruled that, "in the absence of a plain indication to the contrary, . . . Congress when it enacts a statute is not making the application of the federal act dependent on state law."\footnote{Jerome v. United States, 318 U.S. 101, 104 (1943) (construing the federal Bank Robbery Act). According to the Court, this "assumption is based on the fact that the application of federal legislation is nationwide . . . and at times on the fact that the federal program would be impaired if state law were to control." Id. Courts analyzing § 1346 have not applied Jerome, however.}

This raises an antecedent question. Is state law even relevant to finding that the honest services fraud statute has been violated? While some courts have looked to state law to find the fiduciary duty whose breach is the
basis for a violation, others have relied on federal fiduciary doctrine, or some unstated standard, instead. In many honest services fraud cases, the courts cite no state law as support for the defendant's conviction. The Seventh Circuit has justified such omissions, explaining:

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

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

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

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

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

Id.

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


329 Id. at 3-4 (citing R. at 21239, 22848, 22843, 37065).
state corporate law. Indeed, the Delaware Court of Chancery barred strikingly similar civil claims for breach of fiduciary duty from proceeding against Citigroup's executives.

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

3. What Other Evidence Is Necessary for Conviction?

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

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330 United States v. Weyhrauch, 548 F.3d 1237, 1244 (9th Cir. 2008), cert. granted, 129 S. Ct. 2863 (June 29, 2009) (No. 08-1196).
332 See United States v. Vinyard, 266 F.3d 320, 328 (4th Cir. 2001); Sun-Diamond, 138 F.3d at 974; United States v. Frost, 125 F.3d 346, 368 (6th Cir. 1997) (absent reasonably foreseeable economic harm, "[p]roof that the employer simply suffered only the loss of the loyalty and fidelity of the [employee] is insufficient to convict").
these limiting principles have any textual basis. Indeed, none of the restrictive rules appear to limit prosecutors' actual discretion or the scope of conduct that courts may deem criminal.

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

The Seventh Circuit has used the improper gain that flows from the fiduciary breach as the litmus test for honest services fraud. According to that court, "Misuse of office (more broadly, misuse of position) for private gain is the line that separates run of the mill violations of state-law fiduciary duty . . . from federal crime."\(^3\) However, the meaning of this distinction is not clear, and this limiting principle actually has evolved, expanding the scope of "private gain" over time. In earlier cases, the defendant herself had to receive some personal, financial gain because of the misuse of office or position.\(^3\) Later, the Seventh Circuit recognized benefits from deprivations beyond simply the defendant's gain. This doctrinal enlargement occurred incrementally, beginning with the gain going to participants in the fraudulent scheme other than the defendant.\(^3\)

Then, in *United States v. Sorich*,\(^3\) the court broadened its interpretation of "other participants" to mean not simply others complicit in the fraud but third parties who appear to have known nothing about the defendants' activities. *Sorich* began as yet another honest services fraud indictment against a Chicago public official. Defendants included several officials from Mayor Richard Daley's Office of Intergovernmental Affairs who engaged in a "corrupt and far-reaching scheme" that "doled out thousands of city civil service jobs based on political patronage and nepotism."\(^3\) Among other things, the defendants conducted sham interviews of potential job applicants, falsified interview forms to ensure that those with political connections received jobs, and ignored various merit evaluations. To hide the scheme, the defendants purportedly misrepresented to city attorneys that the hires were legitimate, and they attempted to destroy evidence to hide their involvement once a governmental investigation began. Defendants engaged in this behavior despite two federal consent decrees prohibiting the use of

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\(^3\) United States v. Bloom, 149 F.3d 649, 655 (7th Cir. 1998).
\(^3\) See United States v. Hausmann, 345 F.3d 952, 956 (7th Cir. 2003).
\(^3\) See United States v. Spano, 421 F.3d 599, 603 (7th Cir. 2005) ("A participant in a scheme to defraud is guilty even if he is an altruist and all the benefits of the fraud accrue to other participants.").
\(^3\) 523 F.3d 702 (7th Cir. 2008).
\(^3\) Id. at 705.
politics in hiring by the City of Chicago. Following their convictions for honest services fraud (and mail fraud), defendants' principal argument on appeal was that their conduct did not violate § 1346 because they received no gain.

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

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

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

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338 Id. at 706.
339 Id. at 706-08.
340 Sorich, 523 F.3d at 707.
341 Id. (quoting United States v. Bloom, 149 F.3d 649, 655 (7th Cir. 1998)).
342 Id. at 708-11.
343 Id. at 709.
344 Sorich, 523 A.2d at 707-08 (citing Bloom, 149 F.3d at 654-55); see also Bloom, 149 F.3d at 654 (noting that "it is frightening to contemplate the prospect that the federal mail fraud statute makes it a crime punishable by five years' imprisonment to misunderstand how a state court in future years will delineate the extent of impermissible conflicts[,]" in which case "we would have a federal common-law crime, a beastie that many decisions say cannot exist").
he is an altruist and all the benefits of the fraud accrue to other participants.345

According to the court of appeals in Sorich, the "true purpose of the private gain requirement—and one that does not depend on who gets the spoils—is to prevent the conviction of individuals who have breached a fiduciary duty to an employer or the public, but have not done so for illegitimate gain."346 Yet, the boundary created by the private gain requirement is, itself, indistinct; indeed, the demarcation seems visible only with the benefit of hindsight. In the Seventh Circuit, for example, the line apparently falls somewhere between Sorich and United States v. Thompson.347 In Thompson, the Justice Department prosecuted a state employee for circumventing the bidding process to award a government contract to a particular travel agency because she thought the grant would please her boss. In that case, however, the Seventh Circuit concluded that defendant's receipt of a bonus in the ordinary course of her employment, along with the goodwill she achieved with her boss, constituted insufficient personal gain to support her conviction for honest services fraud.348

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

345 Id. at 709 (quoting United States v. Spano, 421 F.3d 599, 603 (7th Cir. 2005)). According to the court, "Robin Hood may be a noble criminal, but he is still a criminal." Id. at 710.
346 Id. at 710.
347 484 F.3d 877 (7th Cir. 2007).
348 Id. at 884.
349 Other circuits have criticized this approach. See, e.g., United States v. Welch, 327 F.3d 1081, 1107 (10th Cir. 2003); United States v. Panarella, 277 F.3d 678, 691-92 (3d Cir. 2002).
breaches become punishable as crimes under § 1346. For all of these reasons, the private gain rule seems ineffective as a limiting principle.

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

Rather than adopting the Seventh Circuit's private gain requirement, other circuits have focused on the potential harms resulting from the fiduciary's breach. Some opinions evaluate the results from the victim's perspective, while others seem to appraise the outcomes objectively. Specifically, several appellate courts have engrafted onto § 1346 the requirement that the government prove that the defendant "foresaw or reasonably should have foreseen that his employer might suffer an economic harm as a result of the breach." As an initial matter, this limiting principle (if taken seriously) would merge § 1346 with §§ 1341 and 1343, provisions which similarly require some deprivation or threatened deprivation of money or property. In practice, however, courts do not require proof of actual economic loss or even proof of defendant's intent to cause economic loss. Instead, many courts simply require evidence that the agent/employee "reasonably foresaw that the breach would create 'an identifiable economic risk' for the employer," which might include the risk of foregone potential future business opportunities. Conduct violative of § 1346 may extend beyond conduct in contravention of §§ 1341 or 1343 insofar as hypothetical economic risk could sustain a conviction for honest services fraud. If the "possibility of a suboptimal outcome was reasonably foreseeable," a conviction could stand under § 1346 regardless of whether the underlying business transactions were "objectively fair."

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

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

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


353 *Id.* at 330.
behavior." Although the inquiries are similar in many respects, most courts maintain that the analyses are distinct. Advocates of the "reasonably foreseeable harm" test assert that their rule is more appropriate because it "keeps the focus of the analysis on employee intent rather than on employer response." The test also purportedly avoids the possibility of criminal liability based on an employer's overreaction to an "insignificant fraud" or an employer's attempt to "avoid the mere appearance of impropriety."

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

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

c. The Fifth Circuit's Contradictory Jurisprudence

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

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355 Vinyard, 266 F.3d at 328.  
356 Id.  
357 Id.  
358 See *Rybicki II*, 354 F.3d at 146.  
359 Id.  
360 Id.  
361 If it was not reasonably foreseeable to the victim that he could suffer harm from the fiduciary breach, presumably he would not change his behavior if he learned of the conduct.  
362 354 F.3d 529 (5th Cir. 2009), cert. granted, 130 S. Ct. 393 (U.S. Oct. 13, 2009) (No. 08-
review most recently. While the Fifth Circuit's honest services fraud jurisprudence seemed to be converging toward reasonable limits before Enron, the court of appeals vacillated about the scope of § 1346 in a series of three decisions arising from the government's indictments of Enron executives and the financial professionals who advised them. The resulting case law evidences both confusion and disagreement about the proper boundaries for prosecuting corporate fiduciaries under § 1346.

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

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

The Fifth Circuit disagreed. Concerned that the government's theory could "mak[e] every knowing fiduciary breach a federal crime," the Brown court opted for a more narrow interpretation of the honest services fraud statute. According to its decision, § 1346 is not violated "where an
employer intentionally aligns the interests of the employee with a specified corporate goal, where the employee perceives his pursuit of that goal as mutually benefiting him and his employer, and where the employee's conduct is consistent with that perception of mutual interest. Based on the evidence presented at trial, the court determined that the Merrill Lynch defendants had not deprived Enron of its executives' honest services because the Enron deal-makers believed they were furthering Enron's corporate interests in addition to their own self-interests. Enron's incentive structure tied employee compensation to corporate earnings targets and rewarded employees for helping to attain those targets. Moreover, Enron's senior management (e.g., then-CFO Andrew Fastow) was aware of, and approved of, the transaction. The court, therefore, concluded that the Enron employees should not have recognized that their failure to disclose (the purported breach) actually constituted a criminal breach of their fiduciary duty to Enron.

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

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

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373 Id.
374 Id. at 522 n.13.
375 Brown, 459 F.3d at 522.
376 Id.
377 Id. at 523. The Fifth Circuit repeated this approach in United States v. Howard, 517 F.3d 731, 732, 735, 737 (5th Cir. 2008) (involving an Enron transaction similar to the Nigerian barge deal).
379 Id. at 545.
prosecutors did not present evidence that Skilling bribed anyone or received any kickbacks. Before the Fifth Circuit's decision, then, some commentators predicted that the Fifth Circuit would follow Brown's logic and, again, construe the honest services fraud statute narrowly.

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

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

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380 See Brown, 459 F.3d at 522 (noting that the Nigerian barges case was "a situation in which the dishonest conduct is disassociated from bribery or self-dealing").
381 See Skilling, 554 F.3d at 545 ("Brown created an exception for honest-services fraud where an employer not only aligns its interests with the interests of its employees but also sanctions the fraudulent conduct, i.e., where the corporate decisionmakers, who supervised the employees being prosecuted, specifically authorized the activity.").
382 Id. at 546.
383 Id. at 546-47.
384 Id. at 546-47.
385 Id. at 547 (footnotes omitted).
had reason to believe would lead a reasonable employer to change its conduct. The "detriment" to the employer, it would seem, is essentially the breach of the duty of honesty itself. A fiduciary's failure to be honest with his employer, then, can be both the material breach of a fiduciary duty under state law and the detriment to the employer. Whether the detriment element is simply a reformulation of the materiality standard, or something different, is unclear. Regardless, the Fifth Circuit's test seems to require little more than proof that the employee breached his duty to disclose material information to his employer. Indeed, it seems that the Fifth Circuit in Skilling has construed § 1346 as a "mandatory disclosure" statute, the pre-McNally outer limits of liability for honest services fraud.

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

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

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

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387 Id.
388 However, the court did not find specifically that Skilling breached his fiduciary duty to Enron under Oregon, Delaware, or any other state's law.
389 As discussed previously, the government argued at closing that Skilling breached his "fiduciary duty" to Enron's employees and breached his duty to Enron and its investors to "do his job and do it appropriately." See supra notes 328-29 and accompanying text, Neither of these purported duties is cognizable under Oregon (or Delaware) law as a basis for a shareholder derivative claim. Indeed, recognition of such duties would expand corporate law dramatically in either jurisdiction.
390 United States v. Rybicki (Rybicki II), 354 F.3d 124, 138 (2d Cir. 2003).
Court, having declined so many previous opportunities to construe § 1346, granted three petitions for writs of certiorari, raising multiple questions about the scope and constitutionality of the statute in the same Term. Justice Scalia's trenchant dissent in Sorich apparently paved the way for the Court's review of Weyhrauch, Black, and Skilling, underscoring many of the most salient criticisms of the statute and its use by the Justice Department to prosecute corporate fraud. Since Justice Scalia's opinion provides a roadmap to the issues before the Court, several points about the Sorich dissent are worth noting.

1. Justice Scalia's Dissent in Sorich

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

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

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392 The dissent from the Seventh Circuit's denial of rehearing en banc flagged several of these issues. See United States v. Sorich, 531 F.3d 501 (7th Cir. 2008) (Kanne, J., dissenting from denial of rehearing en banc). This dissent questioned whether: (1) a federal consent decree, rather than state law, could create a fiduciary duty which, if violated, could give rise to an honest services fraud prosecution, id. at 503-04, and (2) the Seventh Circuit's "private gain" requirement had been diluted out of existence. Id. at 503.
393 See Sorich, 129 S. Ct. at 1310 (Scalia, J., dissenting from denial of certiorari) (remarking that "what principle it is that separates the criminal breaches, conflicts and misstatements from the obnoxious but lawful ones, remains entirely unspecified"). As a jurist who often applies a textualist approach to statutory interpretation, his agreement with those who find little meaning in the text itself should raise concerns for the statute's supporters.
394 Id.
significantly impinged if the Court permitted federal prosecutors and courts to create ethical rules and disclosure obligations regulating state and local governmental officials.\(^{395}\) The second concern was that the law provide constitutionally "fair warning of the conduct that it makes a crime."\(^{396}\) According to Justice Scalia, § 1346, as written, is "nothing more than an invitation for federal courts to develop a common-law crime of unethical conduct."\(^{397}\)

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

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

### 2. *Weyhrauch* and the State Law Limiting Doctrine

The Supreme Court granted certiorari in *Weyhrauch* to address the state law limiting doctrine.\(^{402}\) Weyhrauch served as a state representative in

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\(^{395}\) *Id.*

\(^{396}\) *Id.* (quoting Bouie v. City of Columbia, 378 U.S. 347, 350 (1964)).

\(^{397}\) *Sorich*, 129 S. Ct. at 1310.

\(^{398}\) *Id.* at 1310-11.

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

\(^{400}\) Skilling Petition, *supra* note 328, at i.

\(^{401}\) See Reply Brief of Petitioners at 2, Black v. United States, No. 08-876 (U.S. filed Apr. 27, 2009).

\(^{402}\) The specific question presented in *Weyhrauch* is "whether a federal honest services mail fraud prosecution under 18 U.S.C. §§ 1341 and 1346 requires proof that the conduct at issue also violated an applicable state law." United States v. Weyhrauch, 548 F.3d 1237, 1239 (9th Cir. 2008),
Alaska as lawmakers considered legislation to alter the taxation of oil production. Having decided that he would not run for reelection, but before his term expired, Weyhrauch contacted an oil services company (VECO) to solicit legal work. Weyhrauch had multiple communications with VECO seeking new work while the Alaska legislature continued to draft and consider new statutes affecting VECO. VECO purportedly never compensated Weyhrauch, nor did VECO offer work to Weyhrauch. Nonetheless, federal prosecutors charged Weyhrauch with honest services fraud under the theory that his discussions with VECO constituted a conflict of interest, a conflict that Weyhrauch failed to disclose. Importantly, Alaska law did not require legislators to disclose their employment negotiations, and Alaska's Ethics Code mandated disclosure only if a legislator received more than $1,000 in compensation for personal services. Although the state's law made no mention of potential or future conflicts of interest, prosecutors argued that a state legislator commits honest services fraud by failing to disclose a potential conflict of interest contrary to federal standards of good government. Weyhrauch moved to dismiss the indictment, urging that federal common law cannot provide the requisite duty supporting a conviction for honest services fraud.\(^4\)\(^0\)\(^3\)

The district court excluded evidence of various state ethics publications and ethics training that lacked the force of law which, the government claimed, supported its position that Weyhrauch's conduct was discouraged, if not somehow prohibited. According to prosecutors, the evidence supported the government's argument for a "uniform standard for 'honest services' that governs every public official," regardless of any independent violation of state law.\(^4\)\(^0\)\(^4\)\(^0\)\(^5\) Following this evidentiary ruling, the trial court dismissed the indictment.

The government appealed, and the Ninth Circuit reversed. While acknowledging that states logically should have sole control over the ethical standards of their public officials (or, at a minimum, state law should establish the bounds of acceptable conduct), the appellate court declined to "adopt the state law limiting principle."\(^4\)\(^0\)\(^5\) Part of the court's rationale is fairly weak and could as easily support the opposite conclusion. The court reasoned that its pre-\textit{McNally} decisions did not derive their content solely

\footnotesize{\textit{cert. granted}, 129 S. Ct. 2863, 2863 (U.S. June 29, 2009) (No. 08-1196). The Ninth Circuit distinguished \textit{Weyhrauch}, a public honest services fraud case, and honest services fraud prosecutions in the private context, about which the court offered no opinion. \textit{Id} at 1245 n.5. Nonetheless, the Supreme Court's analysis in \textit{Weyhrauch} likely will impact both public and private honest services fraud cases.\(^4\)\(^0\)\(^3\) \textit{Id} at 1239-40.\(^4\)\(^0\)\(^4\) \textit{Id} at 1248.\(^4\)\(^0\)\(^5\) \textit{Id} at 1245.}
from state law (actually, the prior decisions did not address the issue either way), and that neither the text nor legislative history of § 1346 conditioned the meaning of the statute on state law (again, however, the statute and the legislative history are silent).406

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

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

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

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

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406 Weyhrauch, 548 F.3d at 1244-45.
407 Id. at 1246.
408 Id. (citing U.S. CONST. art. VI, cl. 2).
409 Id. at 1248.
The decision as to whether state law limits the scope of § 1346 will affect both the propriety of, and need for, additional limiting principles.

3. Black and the Economic Harm Doctrine

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

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

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

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411Petition for Writ of Certiorari at 14, Black v. United States, No. 08-876 (U.S. filed Jan. 9, 2009) [hereinafter Black Petition].
412United States v. Black, 530 F.3d 596, 600 (7th Cir. 2008), cert. granted, 129 S. Ct. 2379 (U.S. May 18, 2009) (No. 08-876).
413See Black Petition, supra note 411, at 22.
414Black, 530 F.3d at 599.
but, rather, from Canada, in the form of a tax benefit. On appeal, however, the Seventh Circuit rejected both arguments. Describing the question as whether Black received an improper private gain from Hollinger, not whether Hollinger suffered economic harm, the court analogized Black's receipt of an improper gain to the "straightforward" prosecution of a judge for accepting a bribe. Even if a third party paid the bribe, the judge still breached his fiduciary duty to the public and committed honest services fraud. Indeed, the judge would violate § 1346 even if he claimed not to benefit the third party. Similarly, even if Black received the private gain from a third party (Canada), he nonetheless deprived Hollinger of his honest services as well. The court also held that Black's failure to disclose the Canadian tax benefit to Hollinger's board of directors harmed Hollinger, reasoning that an informed employer could reduce its compensation to Black in order to share in the economic rent created by the Canadian tax benefit.

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

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

416 Black, 530 F.3d at 601.

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

418 Black Petition, supra note 411, at 22. Black's Petition also argued that the case merits Supreme Court review because it highlighted disagreements over "core issues" of federal criminal law, such as (1) "the balance between matters of state and federal concern"; (2) "the rule against a common law of federal crimes"; and (3) "the threat to due process posed by broadly and vaguely worded criminal statutes." Id. at 32.
4. *Skilling* and the Constitutionality of § 1346

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

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

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419 Skilling Petition, *supra* note 328, at i.
420 See *id.* at 20-21. Skilling asserts that the Second Circuit (in *Rybicki II*) and the Sixth Circuit have also adopted a personal gain requirement. *Id.* at 19.
421 *Id.* at 23.
422 *Id.* at 23-24.
423 Skilling Petition, *supra* note 328, at 22-23.
VI. FUTURE ENFORCEMENT OF FIDUCIARY DUTIES THROUGH CRIMINAL PROSECUTION OF HONEST SERVICES FRAUD

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

A. The Federal Interest in Prosecution

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

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426 See Id., supra note 424, at 1.
427 Id.
428 Id.
429 Id.
revealed that financial industry executives received and continued to be awarded oversized performance bonuses and other questionable compensation despite their firms' failures or near failures. Congress intensified its pressure on the DOJ and the SEC to prosecute corporate actors who have broken the law. On several occasions in late 2008 and in 2009, legislators called senior officials from these agencies, along with the FBI, to Capitol Hill to testify about their efforts to hold accountable those persons who, in the minds of many, caused the economic crisis.\textsuperscript{430} For their part, lawmakers expressed bipartisan support for criminal prosecutions, urging that the "full might of federal law enforcement [be brought] against the people who illegally profited or destroyed companies at the expense of our country."\textsuperscript{431}

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

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


\textsuperscript{432}Pub. L. No. 111-21, 123 Stat. 1617.


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

\textsuperscript{435}Id. § 3(a)(1).

\textsuperscript{436}Fraud Enforcement and Recovery Act § 5.
necessary. Modeled (somewhat) after the 9/11 Commission, the FCIC's broad investigatory mandate directs it to consider twenty-two enumerated potential causes of the current financial and economic crisis in the United States, including, first and foremost, "fraud and abuse in the financial sector." Congress specifically instructed FCIC to make referrals to the U.S. attorney general (and any appropriate state attorney general) of any person that it concludes may have violated federal laws in relation to the financial crisis. For these reasons, too, it is reasonable to predict that the DOJ ultimately will institute criminal proceedings against executives of failed, or nearly-failed, financial institutions.

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

B. Civil Law and Criminal Law Trending in Opposite Directions

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

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437 FERA authorizes appropriations of "such sums as are necessary to cover the costs of the Commission." Id. § 5(j).
438 Id. § 5(c)(1)(A).
439 Id. § 5(c)(4).
440 Besides enlarging executives' exposure to criminal liability, FCIC's investigation also could lead the SEC or other regulators to institute enforcement actions against them.
consequences to corporate executives for malfeasance much less mis-
feasance—creates pressure on the federal government to "do something" to
restore investor confidence.

Developments in Delaware corporate law and federal securities law
have created an enforcement gap, a space in which many breaches of
fiduciary duty by corporate executives and their advisors will go unrem-
edied, and a space where executives who engage in significant wrongdo-
ing are fairly insulated from potential liability, at least civilly. Corporate execu-
tives are not likely to pay damages for breaching their fiduciary duties.
Worse yet for investor confidence, executives may leave the employ of failed
companies with substantial assets, even judgment-proof wealth. Professor
Fairfax said it well: "[O]ur [civil] legal system appears to lack the will to
hold corporate executives personally liable for dereliction of their duties."\footnote{Fairfax, supra note 224, at 440.}

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

With liability under civil law and criminal law trending in opposite
directions and the Supreme Court poised to construe § 1346, we have
reached a defining moment in the enforcement of corporate executives' fiduciary duties. The DOJ has prosecuted and convicted corporate executives, as well as financial professionals and lawyers, for failing to disclose
that they breached their fiduciary duties or otherwise had conflicts of interest. Until now, the progression of the law has favored broad application of § 1346, as I demonstrated in Part V. Despite lip service to the contrary, it seems that most breaches of fiduciary duty are—or at least can be—criminalized, and in many jurisdictions, federal prosecutors may indict public company executives for breaching duties not even recognized under state corporate law. Furthermore, it may well be easier for the government to convict miscreant corporate executives for acts that breach their fiduciary duties than it is for shareholders to obtain discovery about those acts, much less hold corporate executives accountable for them in civil litigation alleging the same illegal conduct.

C. Potential Ramifications of Weyhrauch, Black, and Skilling

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

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

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445 See supra Part V.
446 See, e.g., In re Refco, Inc. Sec. Litig., 609 F. Supp. 2d 304, 318 n.15 (S.D.N.Y. 2009). The court stated that [i]t is perhaps dismaying that participants in a fraudulent scheme who may even have committed criminal acts are not answerable in damages to the victims of the fraud. However, as the Court noted in Stoneridge, the fact that the plaintiff-investors have no claim is the result of a policy choice by Congress... This choice may be ripe for legislative reexamination. Id. Section 10(b) claims against attorneys who assisted Refco in perpetrating its fraud were dismissed even though they had been indicted for the same conduct (and subsequently convicted).
447 The Court on occasion has handed down two opinions interpreting the same statute or federal rule on the same day. See, e.g., Johnson v. De Grandy, 512 U.S. 997 (1994) (construing section 2 of the Voting Rights Act of 1965); Holder v. Hall, 512 U.S. 874 (1994) (same); Celotex Corp. v. Catrett, 477 U.S. 317 (1986) (construing FED. R. CIV. P. 56); Anderson v. Liberty Lobby, Inc., 477 U.S. 242 (1986) (same). Research has not, however, located situations in which three decisions construing the same statute were delivered on the same date.
source of the duties whose breach gives rise to criminal liability under § 1346, the question raised by Weyhrauch. Depending on the source or sources of fiduciary duties giving rise to the intangible right of honest services, the Court may or may not identify other elements necessary to sustain a conviction under § 1346. For example, if the Court decides that state fiduciary law exclusively governs the scope of the duties enforceable under the statute, it may not endorse any additional limiting principles. Conversely, if state law provides but one potential source for the duties that, if breached, could give rise to an honest services prosecution, the Court presumably would need to adopt some other limitation(s) on the potential breadth of the statute in order to save the law from constitutional challenge.

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

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

448 If the Supreme Court endorses the state law limiting principle, state fiduciary duty law arguably will continue to develop primarily in the state courts, especially given the federal courts' traditional reluctance to create, as opposed to simply interpret, state law. See Erie R.R. Co. v. Tompkins, 304 U.S. 64, 80 (1938). If, instead, the Court permits federal prosecutors and courts to disregard Delaware's corporate fiduciary doctrine, corporate law could be altered in ways that create tension with Erie.
varying and even conflicting fiduciary duties, including fiduciary duties not recognized under the law of the state of incorporation. Federal fiduciary law could supplement, if not eventually supplant, Delaware and other states' corporate fiduciary doctrine. The Justice Department's more expansive use of § 1346 to prosecute defendants over the past decade suggests even greater confusion and controversy in the future should the Court reject the state law limiting principle.

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

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

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

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

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

451 See Jerome v. United States, 318 U.S. 101, 104 (1943). [W]e must generally assume, in the absence of a plain indication to the contrary, that Congress when it enacts a statute is not making the application of the federal act dependent on state law. That assumption is based on the fact that the application of federal legislation is nationwide...and at times on the fact that the federal program would be impaired if state law were to control.

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

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

1. Doctrinal Support for Construing § 1346 Narrowly

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

452 See Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 479 (1977) (avoiding "federaliz[ing] the substantial portion of the law of corporations that deal with transactions in securities, particularly where established state policies of corporate regulation would be overridden"). In Stoneridge, the Court read section 10(b) narrowly to avoid the risk "that the federal power would be used to invite litigation beyond the immediate sphere of securities litigation and in areas already governed by functioning and effective state-law guarantees." Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc., 552 U.S. 148, 161 (2008).
corporations as "creatures of state law," the Santa Fe decision also presumed that "state law will govern the internal affairs of the corporation" unless federal law "expressly requires" otherwise.\textsuperscript{453}

The Court's opinions interpreting section 10(b) also are grounded in the notion that separation of powers theory constrains the power of the courts to construe federal statutes. Because federal courts, not Congress, created section 10(b)'s private remedy, the Court declined to expand the scope of investors' remedies under the statute without express congressional action.\textsuperscript{454}

In the absence of express language in the statute evidencing congressional purpose, the Court usually has decided against the party proffering the more expansive interpretation of the right of action. This preference is evocative of the Court's admonition in McNally that "[i]f Congress desires to go further, it must speak more clearly than it has."\textsuperscript{455}

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

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

\textsuperscript{453}Santa Fe, 430 U.S. at 479 (quoting Cort v. Ash, 422 U.S. 66, 84 (1975) (emphasis in Santa Fe)).

\textsuperscript{454}See id. at 477; see also Stoneridge, 552 U.S. at 164-65.


\textsuperscript{456}Santa Fe, 430 U.S. at 479.

\textsuperscript{457}Id. at 479 n.16.

\textsuperscript{458}See id. at 477; see also Stoneridge, 552 U.S. at 166 (noting that the SEC's "enforcement power is not toothless").
additional federal regulation but that to hold otherwise would unsettle the existing state law regime.

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

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

Still, the separation of powers constraint provokes concern. Neither a broad nor a narrow interpretation of § 1346 is well-anchored in the statute's opaque language. Other than simply overturning *McNally*, Congress's
statutory purpose is not clear from the almost nonexistent legislative history, much less from the text. Nor has twenty years of post-enactment legislative neglect served to elucidate the statute's meaning. Congress has not spoken clearly about the source of the predicate fiduciary duty (or even said that that is the touchstone), and federal legislators have not considered any limiting principles. Since § 1346 is a criminal statute, this indeterminacy also triggers fair notice problems, potential constitutional infirmities sometimes avoided by invoking lenity principles, as Justice Scalia previously noted.

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

2. The Federal Interest in Enforcing Corporate Fiduciaries' Duties

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

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

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

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

D. The Civil Liability—Criminal Liability Paradigm
   Turned Upside Down

Stepping back for a moment, it also makes sense to consider the impact of the enforcement anomaly that I have identified on our normative expectations about civil and criminal liability. The courts' concern with litigation costs has created a situation where it is easier to indict and convict a defendant of honest services fraud for "breaching" a fiduciary duty than it is
to successfully assert a civil claim for breach of fiduciary duty against that defendant. This development reverses our traditional notions about the relative culpability and blameworthiness of civil violations and criminal violations. Classically, conduct violative of the criminal law is a subset of the conduct that violates civil law. Again, however, as the enforcement anomaly has developed, conduct (breach of fiduciary duties by corporate executives) no longer violative of civil law nonetheless violates criminal law (if prosecuted as honest services fraud). This phenomenon represents a shift in the traditional civil liability–criminal liability paradigm, a change with potentially far-reaching and unanticipated ramifications. Among the consequences are the blurring of the distinction between civil and criminal law and the threat of overcriminalization.

1. Blurring the Civil-Criminal Distinction

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

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465Coffee, supra note 275, at 1878.
466Kenneth Mann, Punitive Civil Sanctions: The Middleground Between Criminal and Civil Law, 101 YALE L.J. 1795, 1863 (1992); see also Coffee, supra note 275, at 1890 ("[T]he criminal law should be confined ‘to areas of clearly egregious behavior in which severely punitive civil monetary sanctions are ineffective.’" (quoting Mann, supra, at 1802)).
467Coffee, supra note 275, at 1876. Traditionally, criminal law is also legislatively created and publicly enforced, whereas civil law is principally judge-made and privately enforced. Id. at 1878.
468See id. at 1875.
Specificity to satisfy due process notice concerns. Second, criminalizing conduct proscribed under civil law can distort civil law. Courts may become increasingly cautious in their explications of fiduciary duties, lest their rhetoric become the basis for later criminal prosecutions. Courts also may hesitate to create new fiduciary duties to avoid subjecting additional conduct to potential criminal sanction. Third, the difficulty in setting clear boundaries for criminal breaches of fiduciary duty creates risk that more citizens will unwittingly cross the line into criminal behavior in their ordinary professional lives.

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

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

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

471 See id. at 1881.
472 Id. at 1879.
473 See id.
474 See id.
475 Id. at 1876-87.
476 See supra Part IV.A.2.
corporate fiduciaries' duty of care (although the government did argue in closing that Skilling took inappropriate risks and failed to perform his job appropriately).

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

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

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

\(^{477}\) See *supra* Part V.B.1.

\(^{478}\) Whether defendant executives plead guilty to honest services fraud and whether juries convict executives for honest services fraud will also impact the development of fiduciary standards under criminal law.
be no conflict between duty and self-interest\textsuperscript{479}—that public company fiduciaries come to know. They believe, too, that if they follow good process, they will not incur personal liability for violating the lofty standards. Potential criminal liability for failing to achieve these aspirational objectives changes that dynamic significantly.

2. The Threat of Overcriminalization

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

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

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


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

\textsuperscript{482}Id. at 60, 62.


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

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

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

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488 See United States v. Thompson, 484 F.3d 877, 884 (7th Cir. 2007) (reversing conviction "of a civil servant for conduct that . . . was designed to pursue the public interest as the employee understood it").
489 See Coffee, supra note 275, at 1879 (characterizing such a view as "simplistic").
490 See Beale, supra note 487, at 766.
criminalizes both loyalty breaches involving significant self-dealing (like *Black*), and less blameworthy breaches, such as failures to disclose a conflict of interest (like *Bronston* or *Rybicki II*), this criticism of § 1346 seems well-taken.

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

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

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

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

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

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

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

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

494Flannigan, supra note 31, at 428.
Such an approach offers several advantages. First, the Court would provide greater certainty for corporate fiduciaries that not every lapse will subject them to criminal prosecution; the relevant duty is a fiduciary duty, and specifically the duty of loyalty, rather than the duty of care. Second, the Justices would avoid (or at least defer) delineating the statute's outer boundaries, preserving the law enforcement advantages of §1346 in fighting novel frauds by corporate executives. That Congress twice amended the mail and wire fraud laws to encourage their use in fighting corporate crime—and never amended them to restrict their application—demonstrates the federal interest in maintaining the laws' adaptability. By sanctioning the use of §1346 to criminalize breaches such as Black's, §1346 still may function as a foundation for a more expansive federal role in regulating corporate governance, as Congress has suggested, in order to instill greater investor confidence.

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

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

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

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

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

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

VII. CONCLUSION

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

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