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COMMITTEE ON THE JUDICIARY

HEARING ENTITLED

"HONEST SERVICES FRAUD"

PRESENTED

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Mr. Chairman, Senator Sessions, and distinguished Members of the Committee – thank you for your invitation to address the Committee and for giving me the opportunity to discuss the Department of Justice's views on the important topic of honest services fraud.

Introduction

I am privileged to represent the Department of Justice at this hearing and to lead the Criminal Division's many exceptional lawyers, including those involved in the investigation and prosecution of fraud and public corruption. Protecting the integrity of our government institutions and our market place is among the highest priorities for the Department of Justice. Our citizens are entitled to know that their public servants are making decisions based upon the best interests of the citizens who elect them rather than for personal gain. Likewise, investors and shareholders are entitled to know that corporate officers and fiduciaries are acting in the investors' and shareholders' best interests and not attempting to secretly benefit themselves.

The Department of Justice is committed to using all available tools in our effort to combat fraud and corruption in the public and private sectors. Our enforcement efforts, which employ a number of different federal statutes, remain active and successful. However, one of the tools that we have relied upon for more than two decades was significantly eroded as a result of the Supreme Court's recent decision in *Skilling v. United States.* In *Skilling*, the Supreme Court held that the honest services fraud statute, 18 U.S.C. § 1346, applies only to bribery and kickback schemes, and not in situations involving undisclosed self-dealing by a public official or private employee. In short, the *Skilling* decision removed a category of deceptive, fraudulent, and corrupt conduct from the scope of the honest services fraud statute and placed that conduct beyond the reach of federal criminal law. The Department believes that the Court's decision has

created a gap in our ability to address the full range of fraudulent and corrupt conduct by public officials and corporate executives, and we urge Congress to pass legislation to fill the void.

In my testimony today, I would like to describe for the Committee the importance of honest services fraud prosecutions, the impact of the *Skilling* decision on our ability to combat fraud and corruption, and the need for legislation to fill the gap created by the Supreme Court's decision.

BACKGROUND

For decades, federal prosecutors used the mail fraud and wire fraud statutes – 18 U.S.C. §§ 1341 and 1343 – to reach not only crimes aimed at depriving victims of money or property, but also schemes designed to deprive citizens of the honest services of public and private officials who owe them a fiduciary duty of loyalty. The two core examples of honest services fraud had always been public officials and corporate officers (1) accepting bribes or kickbacks, or (2) engaging in undisclosed self-dealing. Such schemes did not always cause a tangible loss of money or property to the victims. Instead, the harm was to the integrity of the decision-making process itself.

While other criminal statutes, such as those prohibiting bribery and extortion, have long been the primary tools used by federal prosecutors to attack corruption by public and corporate officials, the honest services theory of mail and wire fraud was used widely because corrupt individuals could be very creative, and the schemes that they devised included a wide range of dishonest conduct that was not always susceptible to definition as a bribe or extortion. For example, if a local health official were to refer citizens with disabilities to a housing facility owned by a third party in exchange for payments from that third party, the corrupt conduct is easily characterized as bribery. But imagine instead a situation where the local health official

profits by referring disabled citizens to a housing facility in which the official himself has a concealed ownership interest. This undisclosed self-dealing or concealed conflict of interest is not bribery, but is just as violative of the public trust. The honest services fraud offense provided prosecutors with a tool that could be used to attack corrupt conduct in all its diverse and creative forms.

In 1987, however, in *McNally v. United States*, the Supreme Court held that the mail and wire fraud statutes did not cover honest services fraud schemes and instead applied only to schemes to deprive victims of money or property. Congress immediately recognized that the *McNally* decision created a gap in the Department's ability to address serious fraud and corruption, and acted quickly to bring honest services fraud within the scope of the mail and wire fraud statutes. In 1988, Congress enacted Section 1346, expressly providing that the mail and wire fraud statutes cover schemes "to deprive another of the intangible right to honest services."

In the twenty-two years since the enactment of Section 1346, the Department of Justice has used the statute extensively to prosecute fraud and corruption in the public and private sectors. Hundreds of prominent defendants and public officials have been convicted using this statute, under both core theories of honest services fraud. To name just a few from recent years:

- Former Congressman William Jefferson was convicted in 2009 of honest services fraud for accepting bribes related to his efforts to influence foreign officials in obtaining contracts for a technology company.
- Former Congressman Robert Ney pleaded guilty in 2006 to honest services fraud conspiracy for taking official action on behalf of clients of Jack Abramoff in exchange for bribes, as well as for taking official action on behalf of a foreign businessman in exchange for over $50,000 in gambling trips.

- Former Lobbyist Jack Abramoff also pleaded guilty in 2006 to honest services fraud conspiracy for his role in orchestrating the bribery of Members of Congress, Congressional staffers, and Executive Branch officials.
- And former Illinois Governor George Ryan was convicted of honest services fraud for his actions while Secretary of State and Governor, when he steered contracts and leases to entities controlled or represented by his co-defendant and others in exchange for thousands of dollars in personal benefits to him and his family.

THE *SKILLING* DECISION

For many decades, both before the *McNally* decision and under Section 1346, the two core forms of honest services fraud recognized by the courts remained the same: first, schemes involving bribery and kickbacks, and, second, schemes involving undisclosed self-dealing. In *Skilling*, the Supreme Court eliminated this entire second category of schemes from the reach of Section 1346, holding that the statute covers only bribery and kickback schemes, and not schemes involving undisclosed self-dealing.

The impact of *Skilling* on pending investigations and our ability to bring criminal charges for certain types of corrupt conduct is significant. The Department's efforts in this area are robust. But by eliminating undisclosed self-dealing from the scope of the honest services fraud statute, the *Skilling* decision takes away one of the tools that the Department has heavily relied on to address corruption. Again, while I cannot comment on any investigations that have not led to criminal charges, I can assure you that the impact of *Skilling* is real, and that there is conduct that would have been prosecuted under the honest services fraud statute before *Skilling* that can no longer be prosecuted under the federal criminal law.

As any prosecutor can attest, corrupt officials and those who corrupt them can be very ingenious, and, as we all know, not all corruption takes the form of bribery. For example, if a mayor were to solicit tens of thousands of dollars in bribes in return for giving out city contracts to unqualified bidders, that mayor could be charged with bribery. But if the same Mayor decides that he wants to make even more money through the abuse of his official position, he might secretly create his own company, and use the authority and power of his office to funnel City contracts to that company. Although this second kind of scheme is corrupt, and undermines public confidence in the integrity of their government, it is not bribery. Accordingly, after *Skilling*, it is no longer covered by the honest services fraud statute or any other federal statute.

NEED FOR LEGISLATION

A public official who conceals his financial interests and then takes official action to advance those interests engages in behavior every bit as corrupt as if he accepts a clear bribe from a third party. The Department urges Congress to act quickly to restore our ability to prosecute individuals for this kind of undisclosed self-dealing. We recognize that Congress cannot remedy the problems caused by *Skilling* in regard to past conduct because of the *Ex Post Facto* Clause of the Constitution, but it can act to provide our prosecutors with an additional important tool to fight fraud and corruption in the future. We look forward to working with the Committee to insure that any legislative solution to fill the gap created by *Skilling* will not only cover the necessary ground, but also stand the test of time.

The need for a statute focusing on the public sector is urgent because undisclosed self-dealing by public officials is the type of corrupt conduct that is most likely to fall outside the reach of any other statute. The Department therefore supports legislation that would restore our ability to use the mail and wire fraud statutes to prosecute state, local, and federal officials who

engage in schemes that involve undisclosed self-dealing. Let me provide a few suggestions regarding such legislation:

First, in order to follow the Supreme Court's direction in *Skilling* that any legislation in this area provide notice to citizens as to what conduct is prohibited, the statute should be clear and specific.

Second, like Section 1346, the new statute should rely upon the mail and wire fraud statutes, which provide a reliable and well-established jurisdictional basis for prosecution, and would enable prosecutors to capture the full scope of an expansive criminal scheme in an appropriate criminal charge.

Third, in order to define the scope of the financial interests that underlie improper self-dealing, the statute should draw content from the well-established federal conflict of interest statute, 18 U.S.C. § 208, which currently applies to the federal Executive Branch.

Finally, the statute should provide that no public official can be prosecuted unless he or she knowingly conceals, covers up, or fails to disclose material information that he or she is already required by law or regulation to disclose. By requiring the government to prove both knowing concealment and a specific intent to defraud, there is no risk that a person could be convicted for a mistake or unwitting conflict of interest.

We believe that legislation along these lines would restore our ability to address the full range of criminal conduct by state, local, and federal public officials, whether the corrupting influence comes from an outside third-party, or from the public official's concealment of his financial interests.

The Department is also interested in working with the Committee on legislation to address corrupt private sector actors as well. For a number of reasons, crafting appropriate

language concerning undisclosed self-dealing in the private sector is more difficult than with respect to the public sector. In addition, because undisclosed self-dealing in the private sector usually involves a loss of money or property, the existing mail and wire fraud statutes can often be used effectively to reach the improper conduct. That said, there are certain types of self-dealing by corporate officers that existing statutes do not allow us to reach and where a new prosecutorial tool would be welcomed. The Department is happy to work with the Committee in crafting an appropriate solution.

CONCLUSION

Corrupt individuals can be very creative in their efforts to benefit themselves at the expense of those to whom they owe a duty of loyalty. While the Department of Justice's work in this area remains active and successful, the Department needs a full range of tools to address fraud and corruption in all forms. the Supreme Court's decision in *Skilling* removed undisclosed self-dealing from the scope of the federal criminal law, and we urge Congress to act quickly to restore our ability to address this significant category of fraudulent and corrupt conduct.