Volume 60, Issue 5 Page 1371

Stanford Law Review

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INTRODUCTION

This Article is about how federal white collar crime law is put to the test of defining corruption. We focus on the concept of "corruption" while acknowledging that it is hopelessly vague and that the legal system, so long as it identifies more specific goals for criminal or civil legislation, bears no intellectual responsibility to define "corruption" or to resolve larger philosophical debates about its meaning. Nevertheless, the effort at definition

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The authors thank Perry Grossman, Stanford J.D. 2008, and Mark Noferi, Stanford J.D. 2005, for extraordinary research assistance.

finds motivation in several sources, such as deference to the normative concerns of juries or the public generally, sincere respect for the normative standards imputed to legislatures, and concern for coherence in or restraint on prosecutorial and jury discretion in the absence of clear legislative criteria. Whatever the key motivation, white collar crime prosecutions frequently turn on difficult value-laden judgments about types and effects of conduct for which the term "corruption" is, in the spheres of laws and morals, our dominant name.

Although some version of the word "corrupt" appears as an actual statutory term in some laws,[1] we examine broader social and economic concerns about how a polity or an economy gets "corrupted" by crime, and how those concerns animate our legal definitions of the nature and effects of criminal misconduct.[2] Our thesis is that federal white collar criminal law has exhibited a remarkable trend toward the principle that the victim protected by our white collar laws is an abstraction: the theoretical equilibrium (or, in more ethical terms, the "integrity") of a fair commercial market. This trend has been far from linear—it has been anxious and fitful and has produced considerable inconsistency among the federal courts. Moreover, its manifestations may be very hard to capture through empirical crunching of case filings. Rather, the manifestations lie in the conceptual expressions of the courts, abetted of course by prosecutorial arguments and framing of indictments.

The notion of the market as a victim is remarkable because it creates in federal white collar law a new concept of an inchoate crime, no longer focused on the causation of, or even the attempt to cause, the kinds of demonstrable material harm that most criminal law, even traditional white collar law, aims to prevent. To capture this trend, we focus on two key statutory crimes—so-called "honest services" fraud under mail and wire fraud laws[3] and securities fraud.[4]

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1. In the case of two statutory crimes, bribery of federal officials under 18 U.S.C. § 201 (2000), and obstruction of justice, e.g. 18 U.S.C. § 1503 (2000), Congress has expressly made "corruptly" the mental state requirement—with vexingly uncertain results. The former is discussed at *infra* notes 43-44. 49-50, 62 and accompanying text. On the latter, see generally Eric Tamashasky, *The Lewis Carroll Offense: The Ever-Changing Meaning of "Corruptly" Within the Federal Criminal Law*, 31 J. LEGIS. 129 (2004).

2. Since our focus is on how the law understands the corrupting effects of white collar misconduct, our approach complements the very different focus of a major new book on white collar crime by Professor Stuart Green. STUART P. GREEN, LYING, CHEATING, AND STEALING: A MORAL THEORY OF WHITE-COLLAR CRIME (2006). Although our interests, of course, overlap with his, Green is much more concerned with the ethical criteria by which we judge deceptive motives and, specifically, culpable mental states that define criminal behavior under the varieties of fraud and other white collar laws.

3. Mail fraud is proscribed in 18 U.S.C. § 1341 (2000) and wire fraud in 18 U.S.C. § 1343 (2000). Both were augmented by the 1988 addition of 18 U.S.C. § 1346 (2000), which says that the term "scheme or artifice to defraud" under those original sections now includes a "scheme or artifice to deprive another of the intangible right of honest services."

4. 15 U.S.C. § 77x (2000); 17 C.F.R. § 240.10b-5 (2000). Somewhat arbitrarily, we exclude from our discussion the related law of extortion, especially in its federal form under 18 U.S.C. § 1951 (2000), where the difficulty of defining the actus reus or mens rea of corruption produces parallel problems of white collar jurisprudence. However, we briefly

But as a prelude to our detailed examination of mail/wire fraud and securities fraud, we first review the state of the law in the more straightforward area of the federal statutory scheme proscribing the bribery of federal government officials. Our legal system necessarily accepts the absence—or infeasibility—of any requirement of a demonstrable material economic loss in the public bribery arena. So this public bribery scheme is a useful predicate for our main statutory subjects, where absence of such a harm requirement is very much a political and philosophical choice.

In the mail/wire and securities fraud areas, we associate the new notion of inchoate harm with a general concern that the contemporary breed of white collar criminals has breached vital fiduciary duties. The implicit (sometimes explicit) incorporation of notions of fiduciary duty into anti-corruption laws points to parallel areas of recent scholarship that have directly addressed the meaning of "fiduciary" in American law and culture. Scholars have been examining these questions from a number of disciplinary angles. Indeed, recent years have seen a flourishing of this writing, underscoring how fiduciary duty is both a compelling and highly contested phenomenon in American law—though few connections to criminal corruption law have been made in the academic writing.[5] Whereas traditional fiduciary duties are usually associated

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allude to some features of extortion below where they are relevant to refining our definitions of bribery. *See infra* note 59.

5. Some of the scholars working in the area of definitions of public corruption have tried to translate general norms of fidelity to governmental or public interest into an affirmative taxonomy of fiduciary duties. Most notable is Kathleen Clark**,** *Do We Have Enough Ethics in Government Yet?: An Answer from Fiduciary Theory*, 1996 U. ILL. L. REV. 57. Clark hopes to give us an alternative to the twin choices of, on the one hand, vague normative criteria of fidelity, and, on the other, the maze of ethical conflict-of-interest rules facing all public institutional actors. Seeking an internal definition of fiduciary duty, Clark, relying on the work of Robert Flannigan, *The Fiduciary Obligation*, 9 OXFORD J. LEGAL STUD. 285 (1989), suggests breaking down the duty into component elements:

> [T]he *conflict* component of fiduciary obligation prohibits a fiduciary from placing herself in a position where her own interest conflicts with her duty toward the beneficiary. The *influence* component subjects transactions between certain fiduciaries and their beneficiaries to heightened scrutiny to ensure that the fiduciary has not unduly influenced the beneficiary's decision to enter the transaction. The *partiality* component requires fiduciaries who have responsibility for allocating benefits among beneficiaries to treat beneficiaries of the same class equally and beneficiaries of different classes fairly. Finally, the *avoidance* component prohibits certain fiduciaries from delegating their duties to others or putting themselves in a position where, because of conflict or other concerns, they could not act on behalf of the beneficiary.

Clark, *supra* at 71.

Another approach comes from the economic perspective, mostly by law and economics scholars interested in corporate law. The theme of this writing is that there is grave danger of economic inefficiency if we accord independent or mystical status to fiduciary duties by suggesting that such a duty is anything more than a contract. Thus, Larry Ribstein, in *The Structure of the Fiduciary Relationship* (Ill. Law and Economics Working Paper Series No. LEO-003, 2003), and Frank H. Easterbook and Daniel R. Fischel, in *Contract and Fiduciary Duty*, 36 J.L. & ECON. 425 (1993), argue that a fiduciary duty is no more than a kind of delegation where the principal needs to give considerable authority to an agent who he cannot monitor, and must bind the agent to act wholly in the principal's interest (but of

with contractual duties to specific individuals or some formal legal responsibilities required by virtue of a special relationship to a set of corporate beneficiaries, federal fraud crime has implicitly redefined fiduciary duty. Our legal and political systems assume a general principle that when public officials take bribes, they violate a fiduciary duty to the body politic, even if the terms and boundaries of that fiduciary duty are rarely examined. Moreover, recent developments in the law governing federal white collar crime treat private corruption as mimicking *public* corruption—in that the duty allegedly breached is to the market, conceived as broadly and amorphously as the body politic. In this Article we demonstrate the tropism of both mail wire/fraud and securities law doctrines toward this new inchoate harm, and we note how components of

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course paying the agent enough to make it worth his while). In an elaboration of this theme, Robert Cooter and Bradley J. Freeman describe a fiduciary duty as no more than a kind of duty of care with a reverse burden of proof. *The Fiduciary Duty: Its Economic Character and Legal Consequences*, 66 N.Y.U. L. REV. 1045 (1991). That is, if the fiduciary does anything that seems to harm the beneficiary, he bears the burden of showing it was not lack of care, whereas in duty of care cases the reverse is true. And for a similar and passionate argument that courts have dangerously intervened in the corporate world of explicit private contracts by creating fiduciary duties to non-shareholder claimants such as creditors, see Frederick Tung, *The New Death of Contract: Creeping Corporate Fiduciary Duties for Creditors*, 57 EMORY L.J. (forthcoming 2007).

This theoretical commentary suggests that reliance on a benchmark of fiduciary duty can pose quite a challenge to courts or legislators trying to establish clear definitions of fraud. That is, honest services and related fraud concepts may create the kind of inefficient standards of loyalty that the economists fear; or, if limited to the narrower definition, fraud law may come perilously close to making it a crime to intentionally breach a contract.

Even in an area as supposedly technical and rule-like as the federal sentencing guidelines, we have seen troubled efforts to define standards of fiduciary duty. U.S. SENTENCING GUIDELINES MANUAL § 3B1.3 (2008) provides for a two-level enhancement if the defendant "abused a position of public or private trust . . . in a manner that significantly facilitated the commission or concealment of the offense." As interpreted by the courts, a violation of a duty to be truthful is not sufficient for imposing this sentencing upgrade. *See, e.g.*, United States v. Hirsch, 239 F.3d 221, 227 (2d Cir. 2001). Rather, the defendant has to abuse an independently defined relationship of trust "in a manner that significantly facilitated the commission or concealment of the offense." United States v. Jolly, 102 F.3d 46, 47 (2d Cir. 1996). The key is that he possessed "'substantial discretionary judgment that is ordinarily given considerable deference,'" United States v. Laljie, 184 F.3d 180, 194 (2d Cir. 1999) (quoting U.S. SENTENCING GUIDELINES MANUAL § 3B1.3 Application Note 1 (2008)), and hence "'the freedom to commit a difficult-to-detect wrong,'" *id.* (quoting United States v. Viola, 35 F.3d 37, 45 (2d Cir. 1994)). In *United States v. Santoro*, 302 F.3d 76 (2d Cir. 2002), an agent for investors gave favored brokers extraordinary commissions to recommend the stock to their clients, and himself received inflated commissions never disclosed to his investor-clients. The court held that a trust can be established by virtue of a specific transaction with one who is expecting honest dealing, even without any more formal, general structural relationship that would be necessary to meet the legal criteria of a fiduciary. Indeed, even where, as here, the "trusting party" may not have even relied in any important way on the trusted party's advice, the sentencing upgrade can apply so long as the defendant acted in such a way as to risk the fully trusting acceptance. In short, there is a kind of federal crime of "attempted reckless trust-inducement."

the new Sarbanes-Oxley Act[6] have the potential to augment this tropism.

As a matter of historical context, the new trend in white collar law could be explained by what might be called a new cultural criminology of financial corruption, and a populist perception that the United States has been suffering a "crime wave" of white collar offenses. Even in a more familiar crime wave, for example a rise in the rate of violent crime, segments of the populace who are not really threatened with victimization often adopt—or have ascribed to them—the social role of the fed-up, vulnerable citizen.[7] In the imagery of most modern American crime waves, the perpetrator is a malevolent, sociopathic street criminal, alas, all too well exemplified by the 1988 figure of Willie Horton. For the crime wave to have any political purchase, of course, the victim needs to be a figure of populist sympathy, and for conventional crime waves, the victim is the frightened, law-abiding, fed-up, resentful good citizen.[8]

But white collar crime complicates the role of the prototypical victim of endemic crime.[9] In white collar crime waves, the perpetrator is the powerful politician or wealthy businessperson who is both corrupt and corrupting. Self-described ordinary citizens, the iconic victims of street crime waves, are especially implausible claimants of direct vulnerability to white collar crime. Rather, to achieve a sense of victimization, they must feel, or profess, outrage at some greater, diffuse social harm. They must believe—or plausibly profess to believe—that the crime wave is concretely linked to their own economic frustration; they must alter the imagined target of their moral outrage from the sociopathic street predator to the calculating, moral choice-maker.[10]

Complicating things further—and this is especially true of the Enron crime wave—the notion of measuring a crime wave is especially challenging when the most salient consideration justifying the use of prosecutorial resources is not the number of crimes, but the total economic loss and the number of people

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6. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745.

7. On how the war on crime of the late twentieth century helped create iconic images of victimhood, see, for example, MARKUS DIRK DUBBER, VICTIMS IN THE WAR ON CRIME 3-4, 7-8, 177 (2002).

8. In terms of the politics of modern crime waves, this victim is the lower-middle class white voter, best represented as a Southerner, but also morphed into a blue-collar Northern Reagan Democrat, living in a border-suburban world. *See* Robert Weisberg, *The New York Statute as Cultural Document: Seeking the Morally Optimal Death Penalty*, 44 BUFF. L. REV. 283, 284-85 (1996).

9. Another somewhat anomalous kind of "crime wave" is exemplified by cybercrime, where we are told that there is a specific and theoretically measurable increase in conduct that might not quite be covered by conventional crime (theft/vandalism law). Rather, the novelty lies in the awkwardness and uncertainty of comprehending new technology under old legal categories. *See* Orin S. Kerr, *Cybercrime's Scope: Interpreting "Access" and "Authorization" in Computer Misuse Statutes*, 78 N.Y.U. L. REV. 1596, 1599 (2003).

10. On how populist anger at white collar criminals creates a convenient, if erroneous, image of its target villain, see DUBBER, *supra* note 7, at 218-19.

potentially affected, however indirectly.[11] That loss is difficult to calculate, perhaps conceptually unknowable, and, ironically, often made harder to know by the highly conflicted self-interest of the businesses and shareholders who are arguably victims. Similar to perceived street crime waves, perceived white collar crime waves hardly require any actual increase in crime to develop political salience. But, of course, for white collar crime, measurement is in any event quite elusive, because the definitions of bad action and mental state are always more amorphous and contested than anything that could be captured in a Uniform Crime Index.[12]

In the case of the Sarbanes-Oxley legislation—the dramatic legal response to the Enron crime wave—public sentiment and political rhetoric addressed these complications by redefining the iconic crime victim as the populist shareholder for whom the loss in portfolio value seems to be a legitimate, personal harm. Millions of Americans can now (somewhat) plausibly claim to have experienced measurable losses, even though there is often little clear correlation between those losses and the crime itself. This new victim is a participant in capitalism, often a profit-seeking participant in her employer's wealth, who feels as much betrayed as victimized. Put differently, the victim of an Enron-crime perpetrator is a kind of co-dependent capitalist decrying a relationship gone bad.

It might seem that the criminal laws condemning mail/wire fraud and securities fraud, or white collar crime law more broadly, have no special role to play here, since civil and regulatory constraints on corruption raise and address the same questions. But white collar crime prosecutions are cultural events that test our notions of combating corruption far more dramatically than civil suits and regulations. More importantly, we have to remember what is special about these being *criminal* laws. An act becomes a crime because it is an act against the public order, even if it is also an act that victimizes a private individual in some material way. The very decision to make an act criminal is a way of impressing the targets of the criminal law's coverage into a public role.

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11. Probably far more than with violent or street crime, the rate of prosecutorial filings may be a very bad measure of actual incidence of crime. *See* Daphne Eviatar, *What's Behind the Drop in Corporate Fraud Indictments?*, AM. LAW., Nov. 1, 2007, *available at* http://www.law.com/jsp/ihc/PubArticleIHC.jsp?id=1193821429242.

12. One approach to measuring the rate of white collar crime is to track filings of class action shareholder lawsuits—a possible proxy for or indicator of criminal fraud. By that measure, the crackdown on Enron and the advent of Sarbanes-Oxley and other measures are at least associated with a reduction in perceived corporate malfeasance. Of course, in so complex a legal and economic area, the variables and controls are elusive. Theories vary between attributing the decline in civil litigation to an actual reduction in fraud and a strong stock market that has decreased the incentive to litigate and may, depending on how one measures these things, have decreased the harm, if not the incidence, of fraud. *See* CORNERSTONE RESEARCH, SECURITIES CLASS ACTIONS CASE FILINGS: 2007: A YEAR IN REVIEW 3 (2008), *available at* http://securities.cornerstone.com/pdfs/YIR2007.pdf.

I. DEFINING CORRUPTION IN THE PUBLIC SPHERE

Our first premise, however, is that a study of the legal regulation of fraud and corruption requires some grasp of the intellectual history of the notion of corruption, to help appreciate the complexities and contingencies of the subject. We thus start with a brief survey of the scholarly landscape of efforts to define, evaluate, and explain "corruption"—a necessary background to examining the difficulties of translating concepts and definitions of corruption into legal rules. We begin that survey with a focus on "public" corruption, or corruption of government officials, because public corruption, less tethered to common law theft as a deprivation of material harm, serves as a predicate for our thesis about the redefinition of harm in the private sector—the subject we turn to thereafter.

The point of this preliminary inquiry is that even where white collar law has no intellectual obligation to define punishable harm in the theft-based sense, huge implicit questions lurk about how to conceive the social or economic harm that should motivate public corruption laws, and those questions get masked as, or transformed into, debates over more technical-looking components of crime definition.

Even in the field of government malfeasance, it is a risky enterprise to attempt to define "corruption" broadly. The one undeniable form of corruption would be outright theft or embezzlement by a public official from the public treasury.[13] But once we set aside such taking of definable property, any definition will partake of uncertain notions about how we identify when an "outside" influence so distorts the governmental structures, processes, or economic systems as to merit the term "corrupt." Such a definitional effort often invokes some concern about deception as the core of the wrong, although there is arguably something unrealistic, if not disingenuous, about the consequent suggestion that the harm of fraud is simply the failure to disclose what would otherwise be corrupt conduct.[14]

As one more initial matter, we note that in any discussion of fraud, the common legal scholar's trope of the "public/private distinction" seems inevitable. It descriptively distinguishes cases where the bribed or fraudster is a government official from those where no government official is involved—what we sometimes refer to in this Article as "private bribery" or "private fraud." While we acknowledge that this distinction has historical significance and that the courts and academia still believe that this distinction has great legal significance, our main thesis is that there is a trend towards the blurring of the

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13. In her two books, CORRUPTION: A STUDY IN POLITICAL ECONOMY (1978), and CORRUPTION AND GOVERNMENT: CAUSES, CONSEQUENCES, AND REFORM (1999), Susan Rose-Ackerman demonstrates that this outright theft is the dominant form of corruption in developing countries.

14. For a discussion of this odd "disclosure" solution, see Daylian M. Cain, George Loewenstein & Don A. Moore, *The Dirt on Coming Clean: Perverse Effects of Disclosing Conflicts of Interest*, 34 J. LEGAL STUD. 1 (2005).

public/private distinction.[15] That is, the notions applicable to explain the prosecution of public corruption have bled over to support the prosecution of purely private acts.[16]

A. *A Brief Intellectual History of "Corruption"*

In history and the social sciences, there is a vast academic literature on the subject of describing and defining corruption—a body of work so vast that we can only briefly allude to it here. But any review of this scholarship must acknowledge that it is very difficult to derive any consensus definition of corruption or to measure the alleged *harm* of what positive law calls corruption, and that any effort at a positive or even normative definition of corruption is heavily contingent on independent economic, political, and social factors.

More specifically, a glance back at the evolving definitions of corruption in European history reveals two useful admonitions. First, the contemporary notion that corruption is something that the profane private realm *does* to the sacred public realm is hardly essential or universal. And, second, denunciations

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15. The distinction has two other possible meanings that may help to illuminate why this morphing has taken place. Within the category of fraud involving officials, the trope often refers to the effort to distinguish legitimate (public-interested) motivations for action from illegitimate (self-interested) motivations. But still more subtly, within government official fraud or bribery, and depending on one's preferred theory of the fiduciary duty of officials, the "public" side may refer to those things an official (most obviously executive or judicial) must or, in some strong normative sense, *should* do under some legislative or constitutional mandate, as opposed to those areas (especially for legislator, sometimes for an executive branch official) where the official is allowed to exercise pure policy preference. Thus, officials may do perfectly legal things that can be "private" in that they are motivated by the desire to please the material interests of some constituents, or perhaps an idiosyncratic philosophical goal of the official, and they need not be justified by any objective standard, so long as they do not violate any express legal boundary—or, in the terms of this paper, any definable fiduciary duty.

16. One of the most interesting recent treatments of the elusive public/private distinction comes from Roderick Hills. He observes that we tolerate—and suggests that we should tolerate—a much softer line between public and private interests in state and local government, as opposed to the federal system. Hills argues that the federal government follows a fairly bureaucratized model, with full-time professional officials obligated—at least formally—to keep very alert to the consequences of dealing with private actors. By contrast, state and local officials are often part-timers who work through flexible local structures whereby private interests blend in with governmental authority fairly loosely. As Hills insists, neither type of system is more inherently democratic than the other. The federal system reduces direct citizen access, but is more efficient in concentrating citizen attention on the most dramatic and salient public issues. The typical local system, on the other hand, provides far more citizen access, though it usually diffuses citizen interest by virtue of the parochialism or relative triviality of many of the issues. In any event, Hills argues for much greater tolerance for the incursion of arguably conflicting private interests in the actions of local officials in order to encourage lay and populist participation. Roderick M. Hills, Jr., *Corruption and Federalism: (When) Do Federal Criminal Prosecutions Improve Non-Federal Democracy?*, 6 THEORETICAL INQUIRIES L. 113 (2005).

of political corruption have always been matched by agnosticism about the provable harm of corruption or even guarded praise for its potential benefits. In modern comparative political science, the different mixes and stages of development of public and private spheres lead to different forms of corruption. For example, a glance not so far back to studies of corruption in communist systems reveals that the kind of corruption we associate with capitalism simply exists in a variant form in communist countries and is often a contributor to stable social and economic equilibriums. Under the so-called "covert participant" model, a dominant private ethos can be harmonious with the government, as individual self-interest can lead an official to disdain official rules, but at the same time, to aim for higher system outputs.[17]

If we link the perspective of law-and-economics to studies of corruption in Third World countries, we see further uncertainty about how to define harmful corruption. Once we get past the uncontroversial case of outright theft from the public fisc and look at subtler breaches of public duty, a key theme of this work is that efforts at general definitions of corruption founder on at least two issues: (a) economics is a neutral tool for defining corruption, and many official actions taken at least partially in response to private benefits conferred on officials are sound policy for reasons sometimes relevant and sometimes irrelevant to the inducement; and (b) by some definitions of corruption, the major cause of corruption is government itself—i.e., the greater the government power, the greater the amount of corruption.[18] To the legal economist, in a second-best world with preexisting policy-induced distortions, graft may sometimes encourage productive economic transactions and prod the government to help entrepreneurs at critical times in economic development by reducing the uncertainties of investment. Corruption can be a force for democracy, or at least egalitarian distribution, and it is an open question whether a fair and honest public administration can accomplish these things better than petty bribery can.[19]

Corruption in that sense is a "normal" and functional substitute for

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17. Wayne DiFranceisco & Zvi Gitelman, *Soviet Political Culture and Modes of Covert Influence*, *in* POLITICAL CORRUPTION: A HANDBOOK 467, 484 (Arnold J. Heidenheimer, Michael Johnston & Victor T. LeVine eds., 1989).

18. Fred S. McChesney, *Ever the Twain Shall Meet*, 99 MICH. L. REV. 1348 (2001).

19. Koenraad W. Swart, *The Sale of Public Offices*, *in* POLITICAL CORRUPTION: A HANDBOOK, *supra* note 17, at 87, 92-98. In fact, bribery is sometimes a form of "speed money" that merely hastens otherwise legitimate outcomes, a kind of price discrimination among bribers with different time preferences. Pranab Bardhan, *Corruption and Development: A Review of Issues*, 35 J. ECON. LITERATURE 1320, 1323 (1997). Bardhan notes Francis Lui's model, whereby the key factor is the briber's opportunity cost of time. *Id.* If kickbacks come from funds designed for projects contributing little to the sum of capital investment, the diversion of those funds through bribery may be toward more productive uses, as, for example, where funds are diverted from famine relief or inefficient cottage industries into the hands of civil servants backing firms that manufacture tires or machine tools. Francis T. Lui, *An Equilibrium Queuing Model of Bribery*, 93 J. POL. ECON. 760 (1985).

conventional access to power.[20] In this regard, some have suggested that corruption can well serve minority groups who can afford, in the financial sense, to buy government services that they cannot afford socially or politically—that is, they cannot openly campaign for such services.[21] More optimistically, corruption, while it could be a sign of hyper-individualistic social anomie or moral anarchy, may actually have the usefully constraining effect of enmeshing people into investments in inclusive networks.[22] Graft can also serve as a mediator to help a society avoid contentious and morally fraught legal disputes;[23] it can serve as a kind of organized political hypocrisy to modify or render unenforceable rigid or inefficient laws and regulations that cannot readily be attacked head on in public debate.[24] Corruption thus enables participants in a functioning market to purchase the regulation they need, rather than invite public politicking that may simply lead to newer bad laws. As for more technical or abstract economics, some work has taken the wizened view that corruption is simply a specific subset of agency cost problems in the public sphere and that it is unavoidable.[25]

Parallel insights have come from sociologists who have concluded that there is an independent valence to certain social structures and types of relations that either explains corruption or the particularly persistent forms it can take. For example, Mark Granovetter has shown that the relative social status of parties to social exchange matters a great deal in understanding corruption.[26] In some societies, he notes, a bribe is a condescending gift, so to accept a bribe is to acknowledge that one is socially inferior to the briber. Thus, one factor affecting the extent of corruption is the pattern of status differentials

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20. Jeanne Becquart-Leclercq, *Paradoxes of Political Corruption: A French View*, *in* POLITICAL CORRUPTION: A HANDBOOK, *supra* note 17, at 191.

21. James C. Scott, *Handling Historical Comparisons Cross-Nationally*, *in* POLITICAL CORRUPTION: A HANDBOOK, *supra* note 17, at 129.

22. *See* Linda Levy Peck, *Corruption and Political Development in Early Modern England*, *in* POLITICAL CORRUPTION: A HANDBOOK, supra note 17, at 219, 221-22.

23. *See* James C. Scott, *Corruption, Machine Politics and Political Change*, *in* POLITICAL CORRUPTION: A HANDBOOK, *supra* note 17, at 275, 276-77. On the socially integrative effects of corruption, see Michael Johnston, *The Political Consequences of Corruption: A Reassessment*, *in* POLITICAL CORRUPTION: A HANDBOOK, *supra* note 17, at 985.

24. V.O. Key, Jr., *Techniques of Political Graft*, *in* POLITICAL CORRUPTION: A HANDBOOK, *supra* note 17, at 39, 47.

25. Edward C. Banfield, *Corruption as a Feature of Governmental Organization*, 18 J.L. & ECON. 587 (1975).

26. Mark Granovetter, *The Social Construction of Corruption*, *in* ON CAPITALISM 152, 152 (Victor Nee & Richard Swedberg eds., 2007). In many societies, to accept a bribe is to acknowledge social inferiority, like accepting a tip or gratuity, and the offering of excessive overtly material consideration can be a status insult. If a favor is done in the hope of supporting some claim of status similarity, then the preferred reciprocation is gratitude, social approval, gifts and/or the promise of future assistance in return. Recharacterizing an exchange as a gift implies the likelihood of a social relationship in which gifts and favors will continue to be exchanged. *Id.* at 154-55.

between groups whose exchanges are typically implicated in corruption, e.g., government officials and private economic actors.[27] This sociological perspective also helps us address extortion, a form of corruption which American law has great difficulty distinguishing from bribery.[28] Sociology suggests that the often elusive difference between coerced extortion and consensual bribery is itself a matter of social interpretation to the extent that it rests at least partly on the question of which party initiates the exchange.[29] Whereas a lower status businessman may find his bribe refused by a higher status civil servant, the latter has no problem taking the payment if he extorted it—after all, it cannot be an insult if he is the one who solicited it to begin with, because extortion by the socially superior of the socially inferior would be quite normal. The proper characterization of an exchange as between bribery and extortion thus may require exquisite social subtlety.

From yet another disciplinary perspective, political theorists have decried the lack, or inadequacy, of systematic scholarship addressing the difficulty of drawing meaningful boundaries around condemnable corruption,[30] and Daniel Lowenstein, the major legal scholar to tackle these issues has also lamented the failure of non-legal scholarship to provide their law colleagues much help.[31]

The failure of non-legal scholarship to produce a meaningful definition and political theory to distinguish "acceptable" forms of corruption from non-acceptable forms has only confounded efforts to resolve confusion within legal doctrine itself—as we will demonstrate in the next section. Lowenstein has made noble efforts to derive a political theory to evaluate corruption laws. But he himself admits to having to rely on vague criteria such as consensus notions of the public interest or culture-specific norms, and he laments that many theorists from whom he seeks guidance end up conceding that the only possible definitions are purely positive.[32] Lowenstein recognizes that political

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27. As Granovetter explains, this general pattern of money going downward socially does not preclude bribes flowing between equals or from those socially inferior to those socially superior. But such a flow goes "against the grain of normal social interaction and is more complicated, requiring extensive management and buffering at much higher cost and complexity, and requiring far more skill, [at manipulating social symbolism] than simple monetary payments." *Id.* at 158.

28. Extortion is best divided into two component forms, though at the federal level both are punished through the Hobbs Act, 18 U.S.C § 1951 (2000).

29. This social interpretation is often a self-rationalizing act of status reinforcement, where it would insult a person's sense of hierarchical status to pay a bribe, but where it is no insult to have been extorted. Granovetter, *supra* note 26, at 159-60.

30. *Terms, Concepts, and Definitions: An Introduction*, POLITICAL CORRUPTION: A HANDBOOK, *supra* note 17, at 3.

31. Daniel H. Lowenstein, *Legal Efforts to Define Political Bribery*, *in* POLITICAL CORRUPTION: A HANDBOOK, *supra* note 17, at 29.

32. Daniel H. Lowenstein, *Political Bribery and the Intermediate Theory of Politics*, 32 UCLA L. REV. 784 (1985). Lowenstein worries, for example, about such situations as the legitimacy of candidate A agreeing to back B in election race 1 if B agrees not to oppose A in election race 2, and tries (to his own explicit dissatisfaction) to resolve the question through a subtle analysis of the relative social values of party unity and candidate

philosophy offers the temptations of various traditional guideposts for defining corruption. There is Burkean trusteeship theory, whereby officials must only look to an objective public interest and never respond to public opinion or political influence, much less private interest.[33] There is its complement, mandate theory, which accommodates public opinion, and whereby organized political pressure may be a legitimate expression of public opinion, but officials must never yield to private benefit.[34] But Lowenstein concludes that these guideposts are ultimately too abstract to answer questions about how politicians should make disinterested decisions about the public interest,[35] and he has relentlessly attacked as wishful thinkers various scholars who claim to have found normatively uncontroversial alternatives.[36]

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competition. He also worries over such questions as how to sort out public from private in humanly typical mixtures of motivation, and whether secrecy is itself a badge of corruption. Lowenstein also insists that the ambiguous position of party loyalty, lying somewhere between private and public interest, challenges us to develop nuanced distinctions between corrupt/legitimate and public/private interests. *Id.*

33. *See* Edmund Burke, Speech to the Electors of Bristol, *in* 1 BURKE'S WORKS 442-49 (London 1854) (discussed in Lowenstein, *supra* note 32, at 831-34).

34. Lowenstein, *supra* note 32 at 834-35.

35. *Id.* at 836; Daniel H. Lowenstein, When is a Campaign Contribution a Bribe?, (Mar. 1996) (unpublished paper presented at the annual meeting of the Midwest Political Science Association, on file with author). A notable pattern in Lowenstein's work is his resort to sliding scale hypotheticals of the following sort:

> (1) An issue-oriented group contributes money to a challenger more sympathetic to the group's ideological interest than the incumbent, but has no other contact with the challenger.
>
> (2) A corporation gives campaign money to a safe-seat incumbent, hoping that the official will vote in a way favorable to the donor's interests on as-yet unknown issues, and the official accepts the money with the expectation that when it is costless for him to do so he will indeed vote in that way.
>
> (3) The same corporation gives money to a safe-seat incumbent, hoping that this will influence the official to support a project crucial to the corporation's business, but the candidate remains undecided on the issue, though she now considers shifting her position towards favoring the project.
>
> (4) The corporation gives money to the safe-seat incumbent just as in #2 above, except a corporate official directly converses with the official to elicit the favorable action.
>
> (5) Same as #3, above, except that official says he has previously disfavored the project but now promises to change his mind if he receives the money.

Lowenstein somewhat distinguishes the first from the other four on the categorical ground that it is part of an "electoral strategy," while the others are part of "legislative strategy." He concedes, however, that the real distinctions are along a continuum of specificity and distortion from some presumed baseline position of neutrality. And so he laments that we cannot escape reliance on the official's motive, again in relation to some unspecified assumptions about the official's actual subjective position before the deal, or some objective norm of a publicly interested position he should have had before the deal. Lowenstein, *supra*.

A useful parallel taxonomy of hypotheticals is provided by John G. Peters and Susan Welch, in *Gradients of Corruption in Perceptions of Academic Public Life*, *in* POLITICAL CORRUPTION: A HANDBOOK, *supra* note 17, at 723, 728-35. Peters and Welch use their hypotheticals in a questionnaire survey of public officials to gauge their attitudes about the "gradients" of corruption, and their results resonate fairly closely with Lowenstein's normative analysis.

36. Two scholars with whom Lowenstein has conducted a spirited debate are David

Lowenstein worries that the best political or legal theory can do is to lay out a continuum of actions that contains gradually differing mixes of public and private motivations for action, augmented by situation-specific aggravating and mitigating criteria. He thus ends up somewhat dissatisfied with the best he can produce—a set of rough balancing tests: for example, a presumption that bargains for personal financial benefit are corrupt because they are unrelated to voting; but another presumption that bargained-for endorsement is not corrupt because it only works if it is harmonious with voting sentiment; and a final concession that campaign contributions are ambiguous cases because they can work independently of voter support and because electoral politics and money interact in very varied and unpredictable ways.[37]

Strauss and Bruce Cain. Strauss has argued that we can eschew any concern with normative political baselines of individual officials or with moral motive once we recognize that the only justifiable purpose of any regulation of campaign finance is ensuring equality of influence. David A. Strauss, *What Is the Goal of Campaign Finance Reform?*, 1995 U. CHI. LEGAL F. 141. Strauss adds that regulation must also address collective action problems. In short, we have no need to define corruption—we need only equalize. (This is may be too severe a reduction of Strauss's position, but for now I simply want to set up his contrast with Loewenstein). For Bruce Cain, the key distinction is between "moral/idealist" views of political responsibility and "proceduralism." Bruce E. Cain, *Moralism and Realism in Campaign Finance Reform*, 1995 U. CHI. LEGAL F. 111. Thus, in partial parallel to Strauss, Cain believes that legal engineering of campaign finance and other structural regulation can ensure that the maximum or optimal airing of political positions occurs, in turn ensuring that the maximum or optimal reflection of divergent and minority political positions by our officials. Moreover, Cain argues that any motive-based restriction on an official's behavior is incoherent, because it must allow for the legitimate self-interest of the official in reelection and any incidents thereof, and the impossibility of coherently distinguishing that kind of self-interest from others (e.g., those which are strictly financial) renders pointless any effort to distinguish proper, public-minded from improper, private-minded motivation. Daniel Hays Lowenstein, *Campaign Contributions and Corruption: Comments on Strauss and Cain*, 1995 U. CHI. LEGAL F. 163. Unsurprisingly, Lowenstein thinks that Cain's distinction is hopeless, because "proceduralism" contains inherent "moral/idealist" assumptions. *Id.* at 175.

37. Lowenstein does respectfully acknowledge one of the more ambitious, if ultimately very hedged, efforts to develop a normative theory of corruption, which appears in DENNIS F. THOMPSON, ETHICS IN CONGRESS: FROM INDIVIDUAL TO INSTITUTIONAL CORRUPTION (1995). For Thompson, the distinction in his title is crucial: institutional corruption involves use of public office for private purposes, but it encompasses conduct that under certain circumstances is a necessary or desirable part of the job—such as pushing a bill or constituent service. Corruption is institutional, as opposed to individual, when it meets these criteria: the gain the official receives is political; the service she delivers is procedurally improper; and the connection between the gain and service damages the legislative or democratic process. Thompson argues that institutional corruption is more pervasive and corrupting to government than individual corruption. He therefore laments that both the media and the ethics officials who purport to police their colleagues for reducing institutional corruption tend to limit their focus to highly individual cases of corruption involving individual and purely private gain. Thompson eschews any claim of usefully defining corrupt motive, because motive, he argues, is too troublesome factually, subjectively, and definitionally. Especially in mixed cases, he argues, any distinct mens rea is a phantom. Indeed, Thompson appropriately worries about cases that may meet the clear criteria of corruption, but that exhibit private self-interest only in the sense that satisfaction

B. *The Federal Law of Public Corruption*

As we turn to specific legal definitions of corruption and focus on public bribery, we first note that campaign finance law is itself a large category of regulation of potentially corrupt relations and transactions. Even though legal structures specifically aimed at campaign financing often have criminal prohibitions within them, they tend to pose much smaller sanctions than general bribery laws, and we set them outside the category of white collar laws that concern us.[38] Nevertheless, a brief look at the views of Justice Scalia on campaign finance cases helps to underscore our overall theme. In *Austin v. Michigan State Chamber of Commerce*,[39] one of the cases elaborating the implications of *Buckley v. Valeo*'s[40] tortured effort to reconcile campaign finance regulation and the First Amendment, the Court upheld, against a First Amendment challenge, a local rule restricting the power of corporations to fund independent expenditures in relation to state candidates. In a sharp dissent, Justice Scalia sounded a great note of skepticism about normative definitions of corruption.[41]

In Justice Scalia's view:

> The Court does not try to defend the proposition that independent advocacy poses a substantial risk of political "corruption," as English speakers understand that term. Rather, it asserts that that concept (which it defines as "'financial *quid pro quo*' corruption,") is really just a narrow subspecies of a hitherto unrecognized genus of political corruption. "Michigan's regulation," we are told, "aims at a different type of corruption in the political arena: the corrosive and distorting effects of immense aggregations of wealth that are accumulated with the help of the corporate form and that have little or no correlation to the public's support for the corporation's political ideas." Under this mode of analysis, virtually anything the Court deems politically undesirable can be turned into political corruption—by simply describing its effects as politically "corrosive," which is close enough to "corruptive" to qualify. It is sad to think that the *First Amendment* will ultimately be brought down not by brute force but by poetic metaphor.[42]

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of any preference can be deemed self-interested—even if the preference is deeply charitable.

38. See 26 U.S.C. § 9012 (2000) (maximum sentence for such federal election law violations as excess expenses or unauthorized contributions set at one year, but maximum for unlawful use of payments or false statements can be five years). In any event, these campaign-specific laws do not express any legislative intent to preempt general bribery or extortion laws. *Cf.* McCormick v. United States, 500 U.S. 257, 272 (1991) (mandating cautious application of federal extortion law to state campaign contributions.

39. 494 U.S. 652 (1990).

40. 424 U.S. 1 (1984) (upholding federal limits on campaign contributions against First Amendment attack but holding that the First Amendment entitles candidates to give unlimited money to their own campaigns).

41. 494 U.S. at 684 (Scalia, J., dissenting).

42. *Id.* (citations omitted). In the most important sequel to *Buckley*, the recent case of *McConnell v. FEC*, 540 U.S. 93 (2003), Justice Scalia again expressed doubt that a legislature could define corruption in any meaningful sense and added that the one arguably

But our first detailed focus on public bribery law focuses on 18 U.S.C. § 201, the law that prohibits *federal* officials from taking, and private parties from giving, bribes and "gratuities." As we will discuss below, federal mail and wire fraud statutes enable federal prosecutors to punish local and state corruption, but the federalism concerns underlying such prosecutions greatly complicate the doctrinal mechanisms prosecutors must deploy. By contrast, § 201, raising no federalism problems, can be used to attack bribery head on.

Section 201 defines two crimes. The harshly punished felony of official bribery (with a maximum theoretical sentence of fifteen years) occurs if something of value is "corruptly give[n], offer[ed] or promise[d] . . . to . . . a public official" or "corruptly demand[ed], [sought], receive[d], accept[ed], or agree[d] to [be] receive[d] or accept[ed]" by a public official with "intent to influence any official act" or in return for "being influenced in . . . the performance of any official act."[43] Whether the colorful term "corruptly" is a redundant moral gesture, rhetorical flourish, or a separate element is a tempting question—one that has proved quite an obstacle to rational doctrine-making in its other key manifestation, the law of obstruction of justice.[44] The lesser but hardly trivial crime under § 201 is that of illegal gratuities (with a maximum theoretical sentence of two years), defined as the giving of "anything of value" to any past, present, or future official "for or because of any official act performed or to be performed" by the official.[45]

A major doctrinal puzzle § 201 presents is how to distinguish bribes from gratuities (and both from innocent transactions). And one of the key elements of the puzzle is the requirement that a bribe be given or taken "corruptly," whereas an illegal gratuity occurs without proof that it be "corruptly" given or

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clear crime of quid pro quo exchange agreement between candidate and supporter could be regulated by 18 U.S.C. § 201. For Justice Scalia, writing in partial concurrence, all of the other versions of exchange the statute might condemn could be imputed to the "nature of politics—if not indeed human nature." *Id.* at 259 (Scalia, J., concurring). A more extended essay in skepticism is in Justice Kennedy's *McConnell* dissent, where he argues that the only form of corruption that the Court has recognized in the campaign finance context is quid pro quo, and he heavily criticizes the majority for trying to read their precedents to encompass a richer notion of corruption that concerns not only "actual or apparent *quid pro quo* arrangements," but also "any conduct that wins goodwill from or influences a Member of Congress." *Id.* at 294 (Kennedy, J., dissenting). Finally, Chief Justice Rehnquist, in his dissent, notes that "[b]y untethering its inquiry from corruption or the appearance of corruption, the Court has removed the touchstone of our campaign finance precedent and has failed to replace it with any logical limiting principle." *Id.* at 356 (Rehnquist, C.J., dissenting). Any broad legislative incursion into election financing, he notes, could in theory be justified as somewhat reducing the appearance of corruption. *Id.* But Justice Kennedy views such legislation as falsely grounded in the notion that the "private" side of politics is a *corruption* of politics; whereas, he sees it as an inherent *part* of politics. *Id.* at 297 (Kennedy, J., dissenting). And that, he believes, means quid pro quos, which is to say "actual corrupt, vote-buying exchanges, as opposed to interactions that possessed *quid pro quo* potential even if innocently undertaken." *Id.* at 293.

43. 18 U.S.C. § 201(b) (2000)

44. Tamashasky, *supra* note 1, at 141-45.

45. 18 U.S.C. § 201(c)(1).

accepted. Obviously, both the bribe and gratuity provisions assume some public consensus on the harm which arises when a public official allows a material conflict of interest to influence her work. Since harm is assumed rather than defined, these laws concentrate wholly on defining the overt elements of the crime. Yet these laws have also thereby largely dodged defining the term "corruptly" in any explicit and substantive sense, declining to identify differential actor's mens rea elements in these laws that could serve as indirect instruments of capturing supposed degrees of corruption.

Section 201 has been the subject of a modest amount of judicial interpretation in recent years, but, as exemplified by the only major recent Supreme Court case, *United States v. Sun-Diamond Growers of California*,[46] the scope of interpretation has been limited to very narrow matters of legislative language and history, as if the statute neither requires nor encourages, whether or not it permits, more purposive judicial interpretation addressing the philosophical or political bases of these laws. Sun-Diamond, a trade association, allegedly gave illegal consideration (sports tickets, meals, and small gift items) to Secretary of Agriculture Michael Espy. The alleged official acts involved Espy deeming the association's members qualified for subsidies for foreign marketing and trying to persuade the EPA not to ban certain pesticides favored by the member growers.

The debate in *Sun-Diamond* was about the nature, degree, and specificity of the quasi-contractual consideration between a public official and an alleged gratuity-giver. The case turns on a fairly crabbed effort of construction to draw the elusive distinction between bribery, requiring something like a commensurate quid pro quo between a fairly specific beneficial governmental act in exchange for value given to the official, and a gratuity, which can at best be described as some sort of value given to the official as a general expression of gratitude or support for the official's actions. The trial court had said that under the gratuity statute it was not necessary for the government to allege "a direct nexus between the value conferred . . . and an official act performed or to be performed . . . ." Rather, it was sufficient to allege that the item was given "because of" the donee's position or "because he held public office."[47] Thus, as described in the Supreme Court,, "the indictment did not . . . allege a specific connection between either of those matters (or any other Espy action) and the gratuities conferred." But, says the Supreme Court, the indictment was therefore deficient, because "[t]he [statute's] insistence upon an 'official act,' carefully defined [in 201(a)(3)], seems pregnant with the requirement that some particular official act be identified and proved."[48]

The key question left open by the Supreme Court's *Sun-Diamond* decision is whether in its effort to distinguish a bribe from a gratuity, the Court has left

46. United States v. Sun-Diamond Growers of Cal., 526 U.S. 398 (1999).

47. *Id.* at 402-03, 413.

48. *Id.* at 406.

any conceptual room for immunizing a legal campaign contribution or a minor, legal gift by distinguishing it from a gratuity. In condemning the trial instruction, Justice Scalia, unsurprisingly, proffers some sharp arguments to support his reading of the statute.[49] But an undertone in the opinion suggests that Justice Scalia is aware that Congress has posed for him a problem he cannot solve. For one thing, lurking in the background is the bribery section of the statute and the issue of whether the term "corruptly" supplies any independent element of the crime. Justice Scalia's *Sun-Diamond* opinion is clear—or purports to be clear—that it is the quid pro quo requirement that distinguishes bribery from gratuities. The question whether the quid pro quo is merely necessary or is also sufficient for bribery is technically not before the court. But when Justice Scalia does refer to the quid pro quo he describes it as distinguishing the *intent* requirement of the greater crime—i.e., the gravamen of bribery seems to be the *intent* to exchange a gift for an official act in some directly causal way.[50] If the quid pro quo is not some special actus reus or a proxy for some especially severe harm to the public weal, but is instead the evidence of a required aggravating intent, then the term "corruptly" may be left unmoored in the statute.

As for gratuities, Justice Scalia says that the trial court's bad instruction would permit prosecution where the gift was given merely "to build a reservoir of goodwill that might ultimately affect one or more of a multitude of unspecified acts, now and in the future."[51] But Justice Scalia does not thereby help us very much in distinguishing the bad instruction from the statutory language, since this "specified act" could still be one that occurs well down the road and is performed by an official not yet in office.[52] The distinctions become exquisitely subtle, and, given that the prosecution in *Sun-Diamond* certainly gave the jury evidence of specific acts to be done, the requirement of a specified act begins to look like a sort of technical pleading requirement imposed on the judge at the instruction stage.[53]

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49. As Justice Scalia says, the language of the gratuities subsection suggests that in giving the consideration the donor must have some specified governmental act in mind. Moreover, the trial court's reliance on the term "because of his position" invites such absurdities as punishing harmless ceremonial gifts given, for example, on the occasion of an official's appearance or speech or the giver's visit to an official's office, though Justice Scalia acknowledges that his reading would not entirely avoid all potential absurdities. *Id.* at 406-07.

50. *Id.* at 404.

51. *Id.* at 405.

52. Alternatively, Justice Scalia complains that the Government treated the statute as if it said "for or because of such official's ability to favor the donor in executing the functions of his office." *Id.* at 406-07. Indeed, to complicate things further, the court of appeals in *Sun-Diamond*, in language cited by Justice Scalia, said that in a gratuities case the government must at least show "'the requisite intent to reward past favorable acts or to make future ones more likely.'" *Id.* at 403-04 (quoting United States v. Sun-Diamond Growers, 138 F.3d 961, 969 (D.C. Cir. 1998)).

53. Still more hyper-subtly and in a seemingly contradictory statement, the court of

Thus, Congress, having sought at least to partly calibrate and parse the gradations of public corruption, may not have overcome the inherent vagueness and subtlety of the continuum of public/private relations of which the sociologists and political scientists have warned. And the Court has therefore avoided more speculative consideration of the nature of the fiduciary duty owed by officials to their constituents or to the government. Presumably, the logical basis for this kind of corruption law is some barely-stated notion of a baseline of political fidelity—fidelity to what at best can be described as the processes of democracy. Voting for legislators or executives is a matter of pure preference, so there can be little substantive content to that duty in any positive sense. After all, the very nature of a political office is the official's oath to serve the public or the electorate. Or, to put it differently, the bribery and gratuity laws, along with other conflict of interest laws, constitute in a sense the official's employment contract. And if contract law is the model, then we feel less need to prove the harm of wrongful conduct. Thus, in terms of the laws explicitly designed to prohibit corruption by government officials, we do not—perhaps because we cannot—lay out very interesting normative criteria to distinguish legitimate from illegitimate official conduct or to give content to *some* notion of an official's fiduciary duty.

To put the argument in terms of criminal law components, we might ask whether § 201 might be seen as one of the following: (a) Section 201 is a mens rea based crime, in which the subtle language differences between bribery and gratuity reflect a difference in actus reus necessary to prove the mental state, but where the focus is on the malevolent or corrupt attitude toward the public weal. (b) Section 201 is an inchoate crime focused on risk of harm to the body politic, but in a context in which no actual harm could ever be proved. Bribery is then a kind of specific-intent, high-risk-creating crime; a gratuity is a crime in which there is conceivable but less probable risk of actual harm or the appearance of harm to the body politic. (c) Section 201 is a harm-based crime in which the difference between a quid pro quo and the elusively lesser transaction in a gratuity case has to do with the question of actual causation of harm, where the harm at issue is the actual distortion of the official's judgment to produce a result or undertake an act she otherwise would not have done.[54] Thus, in a quid pro quo bribe, there is at least a strong presumption that the official act would not have happened without the bribe; the gratuity then becomes a somewhat inchoate crime in which the causation of harm is still

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appeals added that the absence of a quid pro quo requirement in the gratuities section does not read the official act requirement out of the statute: "It is only to say that, in contrast to bribery, the gratuity and the official act need not each motivate the other. But the gratuity statute by its terms does still require at least a unidirectional relationship—the gift must be 'for or because of' the act." 138 F.3d at 966.

54. An interesting formulation from the court of appeals in *Sun-Diamond*, never mentioned by the Supreme Court, is that in a gratuity we know that the fact or prospect of a specified official act motivated the donor to give, but we do know whether it motivated the official act, whereas causation is bi-directional in a bribe. *Id.*

possible, or one in which there is indeed a presumption of harm, but it is the harm of the appearance of corruption. Finally one can imagine (d), whereby § 201 would ideally be a unitary crime but Congress put it in two parts because it foresaw that in various cases the prosecution would face greater or lesser evidentiary difficulties in proving the existence of the influence of the payment, and it wanted to offer juries a milder alternative to increase the probability that some conviction could be salvaged where the facts were shaky.

An intriguing recent case under § 201 helps to elaborate these different jurisprudential paths. In *United States v. Alfisi*,[55] Alfisi was a wholesaler who made secret payments to a federal official who inspected produce at a major New York market. The case illustrates one of the grayer areas of law and commercial fact about the world of public bribery. On one set of facts in the very ambiguous trial record, Alfisi was expressly paying the inspector, Cashin, for erroneous inspections, as a way of cheating Alfisi's customers. By another set, Alfisi was simply frustrated that Cashin was not performing the inspections per se, regardless of the outcome, and the payment was solely to nudge Cashin to perform the function he was supposed to perform anyway.[56] The real question in the case is whether that difference in facts should decide the question of whether Alfisi had acted "corruptly." On the first set of facts, we have either bribery or gratuities under § 201, depending on the somewhat unsettled distinction between the but-for-cause/quid-pro-quo requirement of bribery and the on-account-of component of gratuities. On that set of facts, the official was obviously violating his duty in some objective sense by lying about the quality of the produce.

On the latter set of facts, the issue is more complicated (and there was sufficient evidence of the latter that the court had to address the issue). For one thing, the latter facts suggest that Alfisi, rather than being a briber, might rather be seen as a *victim*--of extortion. If Cashin had simply said he would not do the inspection without a fee, the question would arise whether this was force under color of official office that would establish extortion.[57] Assuming a jury would find a bribery conviction unfair on those facts, was there some gray area whereby a jury might consider the lesser crime on the theory that Alfisi could manage to survive financially even if he lost one particular transaction, and hence that he was not truly coerced into making the payment? Since the trial judge gave an instruction on an affirmative defense of "economic coercion"[58]—a kind of partial proxy for an extortion charge against the official—the judge must have recognized the existence of this gray area.

This otherwise garden-variety case raises important and unexplored issues about public corruption: How do we assess the relative guilt of the briber and the bribed? If these two levels of guilt are different, what do we then learn

55. United States v. Alfisi, 308 F.3d 144 (2d Cir. 2002).
56. *Id.* at 148.
57. *See infra* note 59.
58. 308 F.3d at 150.

about the nature of the harm that the bribery laws aim to punish or prevent? Where the bribe is given to cause the official to do something she should not do (i.e., grant a license to an unqualified applicant), then it is not too difficult to imagine ways of describing the harm, nor is it difficult to roughly equate the guilt of briber and bribed. But *Alfisi* challenges us to ask whether the harm is different in cases where the official accepts the payment as a condition of doing something that is clearly his duty. In this latter case, do we blame the briber less? Perhaps yes, if the core of the official's guilt is the unfair pressure he places on the briber. On the other hand, perhaps the harm is the general risk that government process will be undermined if official actions are conditioned upon improper payments. If so, then the person who does pay the bribe, though somewhat sympathetic, is abetting this form of harm and should be punished for failing to resist the demand for payment.

In theory, courts like the one in *Alfisi* have some tools external to § 201 to help resolve these questions. One such tool is the law of extortion, whereby we can recharacterize the transaction as one in which the bribed party is the villain and the briber the victim. But it turns out that the standard law of extortion is only ambiguously helpful on this score.[59] Or the court could appeal to some

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59. Extortion is best divided into two component forms, though at the federal level both are punished through the Hobbs Act. 18 U.S.C § 1951 (2000). *See generally*, James Lindgren, *The Elusive Distinction Between Bribery and Extortion: From the Common Law to the Hobbs Act*, 35 UCLA L. REV. 815 (1988). Extortion falling under the common law name of "under color of official right" is really a form of public bribery, but where the crime is conceived asymmetrically. That is, the official is thought of as coercing the payment from the private person, most obviously as a condition of granting the extorted party some government benefit to which he is legally entitled.

The other form, solely between private parties, is extortion through "force, violence, or fear," as exemplified by the colorful image of the labor racketeer offering protection money to the employer. *E.g.*, People v. Dioguardi, 8 N.Y.2d 260, 203 N.Y.S.2d 870 (1960) (applying New York extortion law on which Hobbs Act was originally based).

Obviously, extortion under color of official right can overlap with public bribery, the difference being that the very term "extortion" naturally suggests not only that the transfer is being proposed by the "bribe,", but also that the "briber" as helplessly coerced. But Lindgren suggests that under a historically accurate reading of extortion law, this color of official right extortion is dissociated from 'force or fear" extortion. If so, the legal outcome is less intuitively satisfying if the private party is not really helpless. Unlike public bribery under 18 U.S.C. § 201, where the crime is only committed by the official, not the party seeking the benefit, § 1951 may seem consistent with the idea that the extorted party is a victim. But the case law does not require specific proof of coercion, instead implicitly finding the coercion in the very official power of the extorter. Thus, under the doctrine of *McCormick v. United States*, 500 U.S. 257 (1991), it is sufficient for a government extortion charge that an official demand payment as a quid pro quo for the benefit.

The Court complicated things further in *Evans v. United States*, 504 U.S. 255 (1992), where it held that the official could be guilty of extortion even if he was the "victim" who initiated the idea of the payment. Thus, where the official works for the federal government, the prosecutor may have substantial discretion to assess what she thinks is the relative culpability of the "victim" and can then choose whether to prosecute both parties or only the official under § 201, or (necessarily) only the official under § 1951. Moreover, since the Hobbs Act, which was based on the interstate commerce clause, can apply to state and local

general doctrines of the substantive criminal law, doctrines involving accomplice liability that might allow for differential guilty of the two parties,[60] or, more strongly, the affirmative defense of duress for the coerced briber. But general accomplice doctrines never seem to get mentioned in these corruption cases, and the duress defense may prove fruitless because it sets such a high bar for the defendant claiming it[61]—especially in the case of the potential briber who could, after all, walk away from the demand.

In any event, Alfisi was left to frame his arguments on other legal grounds. He argued that the quid pro quo versus "on account of" distinction that has become the convention was not sufficient for these facts because it elided the meaning of the term "corruptly." In short, Alfisi argued that unless "corruptly" were surplusage, the quid pro quo was a necessary but insufficient component of bribery. And to lend some meaning to the term "corruptly," he argued that the government had to prove that the act sought was an actual affirmative violation of duty—i.e., that Cashin was not so much being paid to avoid doing what he was supposed to do, but rather to *affirmatively* do what he was not legally allowed to do.[62]

In upholding the conviction, the Second Circuit effectively held that the quid pro quo requirement was the same as the corruption requirement, or at most that the term "corruptly" supplied the requirement of the briber's intent that the quid be for the quo. Alfisi insisted on an instruction that required proof of his intent "to procure a violation of the public official's duty."[63] The court thought that what it and the trial court called the "economic coercion" defense was sufficient to solve any problem of overinclusion—even though there is no clear legal basis for this defense, nor does it map on to conventional duress doctrine.[64] It also worried about underinclusion, i.e., for those cases where the official must exercise some judgment or discretion rather than carry out an

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officials now that *McNally* has been overruled by § 1346, in such cases the federal prosecutors also have the challenge and opportunity of choosing between the Hobbs Act and the mail and wire fraud statutes. *See infra* notes 79-82 and accompanying text.

60. *E.g.*, MODEL PENAL CODE § 2.06 (1985) (allowing for the possibility of exonerating a person who aids a purposive criminal where the former knows her action will help cause the crime but lacks the purpose that it do so).

61. *E.g.*, MODEL PENAL CODE § 2.09(1) (1985) (requiring coercion "by the use of, or a threat to use, unlawful force against his person or the person of another, that a person of reasonable firmness in his situation would have been unable to resist").

62. The difference between the two sets of facts may be still grayer than *Alfisi* portrayed it. Cashin's insistence on a payment as a condition of granting an entitled inspection is obviously illegal and, therefore, if we must use this language, a breach of his fiduciary duty to government and public (although this first set of facts at least reduces by one the number of victims—in this case, the broker). The moral and economic distinctions are probably subtler than the ones the defendant and the dissent portrayed. But surely they had a good argument that to take the word "corruptly" seriously might mean an obligation to tackle those subtleties or to permit or encourage the jury to draw some finer-grained moral distinctions than the approved instruction allowed for.

63. 308 F.3d at 150.

64. *See supra* note 60.

automatic or objectively determined duty, the court did not want to immunize bribes where it could not be established that the outcome was objectively wrong.[65] Thus, it feared that the instruction Alfisi sought would immunize the judge who takes a bribe from a party and yet nevertheless delivers what can later be viewed as the "correct" judgment on the merits.

The analogy to judicial bribery was perhaps the best reflection of the argument between majority and dissent. The court is right that where a judge takes a bribe that increases the chance that she will side with the briber, the fact that the judge ultimately makes the "correct" decision on the merits may not matter. But in such a case, we would want to know why the bribe was paid in the first place. In some cases, where the briber wins anyway, he has rationally paid up front for insurance in the face of uncertainty. In cases where the briber loses, the briber presumably has been cheated. Indeed, the relationship of bribe to outcome in the case of lawsuits is much more complicated still, since, as Ian Ayres has shown, a repeat player bribe-taking judge may distort the outcomes in a lot of cases, and in a lot of ways, to mask the effect of any one clear case where he is selling a favorably erroneous outcome to the briber.[66]

But the analogy has its flaws. Most obviously, if we accept Alfisi's second set of facts, it is hard to imagine a party bribing a judge to decide a case where the judge was threatening never to decide it at all. For another, the question of "correctness" of any kind or ruling or verdict in a lawsuit is obviously much more complicated than the question of measuring the quality of vegetables.

The *Alfisi* dissent sought to put some normative content into the notion of "corruption."[67] Judge Sack confronted the question whether it is an abuse or dereliction of duty to refuse to do a ministerial act, where the outcome is predetermined and where the briber is not seeking to influence the choice of outcome. If the private party pays under those circumstances, says the Sack dissent, it is hard to argue that the payment has "corrupted" the official.[68] Where the majority wanted to compartmentalize this as the "complete defense" of duress, Judge Sack thought the statutory language tried to capture a concern for a certain kind of goal that should be viewed as an affirmative element of corrupt intent.[69] The dissent was at least trying to distinguish bribery from

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65. 308 F.3d at 151.

66. Ian Ayres, *The Twin Faces of Judicial Corruption: Extortion and Bribery*, 74 DENV. U. L. REV. 1231 (1997).

67. 308 F.3d at 154 (Sack, J., dissenting).

68. *Id.* at 155-56 (Sack, J., dissenting).

69. *Id*. at 154 (Sack, J., dissenting). A recent commentary on *Alfisi* criticizes the decision for paying no heed to the word "corruptly," and for therefore condemning an action that does not exhibit the requisite culpability. Jeremy N. Gayed, *"Corruptly": Why Corrupt State of Mind Is an Essential Element for Hobbs Act Extortion Under Color of Official Right*, 78 NOTRE DAME L. REV. 1731, 1761-65 (2003). Indeed, Gayed blames the Second Circuit for adopting the proposed Model Penal Code redefinition of bribery (which eliminates the alleged surplusage of "corruptly"), complaining that the Model Penal Code deprives bribery of the moral valence it has carried since the common law and also,

extortion and a bribe from a gratuity, and, more meaningfully, trying to insist on some requirement that the term and concept of "corruptly" play its necessary role in the prosecution.

This brief excursus into the substantive criminal law of federal-official bribery can hardly produce any precise definitions of corruption, and the alternative definitions generated or implied in the case law are in any event far from mutually discrete. Instead, this inquiry helps underscore the problem that judges face in triangulating among the language of legislation, the implicit ruling norms of corruption, and the pragmatic legalistic machinery needed to make the law coherent and enforceable. Section 201 has posed quite a doctrinal challenge to courts trying to distinguish among "bribes," mere "gratuities," and legal campaign donations. The statute also offers a more basic philosophical challenge: courts and prosecutors must define corruption in consensual arrangements where, regardless of what things of material value might get exchanged, the most significant "thing taken" by the malefactors is the public's entitlement to uncorrupted loyalty of service by government officials, something impossible to measure.

What we have attempted to demonstrate by this foray into the definition-of-corruption cases is that bright line tests are created that criminalize certain specified behavior while apparently allowing other behavior which seems quite similar (at least in effect to the criminalized behavior) to remain unpunished. The reasons for these distinctions are often couched in terms of the presumed intent of the legislature, but these reasons seem very unsatisfying. It seems that the best we can do is say that society has made the understandable, if philosophically shaky, decision to criminalize certain behavior that appears to distort what we assume to be the otherwise undistorted processes of

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ironically, that the adoption has exacerbated rather than solved the confusion in typical statutory language. *Id.* at 1762; *see* MODEL PENAL CODE § 240.1 (1985). A reading of the issue contrary to *Alfisi* can be found in *Roma Construction Co. v. Arusso*, 96 F.3d 566 (1st Cir. 1996) (raising the definition of bribery in a civil RICO context), where new partners in a real estate venture were surprised to discover that the original partners had made a deal with the "de facto government of the Town" to ensure permission for their project and ultimately chose to make the payoff. *Id.* at 568. The district court explicitly relied on the Model Penal Code, but the court of appeals reversed, emphasizing that bribery should still require the mens rea it described as "the intention to obtain ill-gotten gain," whereas "the Model Penal Code converts the lack of willpower to stand up to abusive authority into a degree of culpability," thereby "ignoring the settled law of centuries and current notions of right and wrong." *Id.* at 574 (citations omitted). Somewhat melodramatically, Gayed says of the Second Circuit that "its phobia of making culpability an element of the crime rather than an issue of judicial discretion has no place in a free society operating on a presumption of innocence." Gayed, *supra* at 1765. For Gayed, the "corrupt" mental state is what can distinguish licit from seriously illicit behavior, notwithstanding a safety valve like the Second Circuit's remand in *Alfisi* to allow an "economic coercion" defense. But can we say that the private party is not corrupt in any sense of the term, or that Alfisi and Roma faced some responsibility to resist the bribe-demand, on the theory that they should not be "enablers" of illegal activity? Do they expose themselves to the charge of some kind of reckless complicity in corruption?

government, while we leave as unpunished other behavior that arguably has quite similar effects.

Although we find some of the distinctions morally dubious at best, we have no real quarrel with the results. The protection of the political system may well require the somewhat arbitrary application of the criminal law. But, as we argue below, similar reasoning has now morphed into protecting private arrangements as well by criminalizing violations of only vaguely defined fiduciary relationships. There is no federal law expressly criminalizing violations of fiduciary duties, but the broad mail fraud statute has been enlisted to accomplish this goal.

II. MAIL/WIRE FRAUD

The colorful first 100-plus years of the federal mail fraud statute (enacted in 1872), with its wonderful gallery of hucksters and Ponzi-designers, cannot be rehearsed here.[70] As it celebrated its 100th birthday, the law of mail fraud continued to apply to old-fashioned swindles in new contexts, while undergoing modest refinements. Thus, modern case law confirmed that "mere puffery" in a commercial solicitation was not fraudulent,[71] and that consumer advertising could be fraudulent if, despite the literal truth of its statements, it was highly misleading.[72] By the late 1980s, it was clear that so long as a sufficient mail[73] or wire[74] linkage established federal jurisdiction, 18 U.S.C. §§ 1341 and 1343 could, at least theoretically be used to punish at least any kind of conduct that would meet the common law components of fraud, as those notions were derived in the traditional history of theft law, and even a wider array of conduct if it suggested intent to take property by deception.[75] With its origins in theft law, traditional fraud law required that the deceived party suffer a material economic loss, and the phrasing of the original mail fraud statute suggests that most prosecutions should involve actual loss. But the express emphasis on a "scheme to defraud" clearly contemplates punishing inchoate fraud, i.e., fraud that does not succeed in its goal.[76] Thus, the civil lawsuit notions of justifiable reliance and damages are not requirements of a

70. An excellent overview article is Jed S. Rakoff, *The Federal Mail Fraud Statute (Part I)*, 18 DUQ. L. REV. 771 (1980).

71. United States v. Regent Office Supply, 421 F.2d 1174 (2d Cir. 1970).

72. Lustiger v. United States, 386 F.2d 132 (9th Cir. 1967).

73. *E.g.*, Schmuck v. United States, 489 U.S. 705 (1989) (mailing must be foreseeable as act in furtherance of scheme).

74. *E.g.*, United States v. Bryant, 766 F.2d 370 (8th Cir. 1985) (fact of use of interstate wires sufficient for federal jurisdiction, even if defendant lacked mens rea with respect to this fact).

75. The foundational case is Durland v. United States, 161 U.S. 306 (1896), which held that unlike common law of false pretenses, mail fraud law applies to lies about future promises, not just past facts.

76. *See* United States v. Serrano, 870 F.2d 1, 6 (1st Cir. 1989).

mail fraud prosecution.[77]

That kind of "inchoate" fraud, however, is no more unconventional than what traditional criminal law views as common law attempt. The fraud law thus becomes a per se attempt statute, a verbal variant on what might have been "attempted theft by deception," where conventional requirements of attempt law—i.e., the culpable mens rea and some substantial step to execute the fraud—are established.

Translated into mail fraud doctrine, this means that even though the ultimate economic gain to defraud and cause a loss to a victim need not have occurred, the deceptive representations must be *material* to the contemplated transaction.[78] Some of the original mail fraud prosecutions for advertisements of Ponzi-type schemes might have been protecting a large and unnamed set of potential victims, i.e., anyone who responded to the deceptive advertisement. But this breadth of attempted fraud law is still utterly conventional, i.e., if the bad actor intends to deceive real people of real money, it is no defense that he does not know which particular persons will be the victims or even how far he has succeeded. However, as we now try to demonstrate, fraud law has become inchoate in a far stronger sense.

A. *The Road to § 1346*

The "honest services" law, 18 U.S.C. § 1346 is one of the most remarkable and underappreciated statutes in the federal criminal code. Section 1346 amends the mail and wire fraud statutes, §§ 1341 and 1343, by making one alternative basis for the crime the fact that the defendant deprived the victim of her entitlement to the defendant's "honest services." We begin with a somewhat extended introductory section on the legal background of § 1346 before we explore the implications of these developments in considerable thematic detail.

Section 1346 was passed in 1988 to reverse the Supreme Court's decision in *McNally v. United States*, a case that kept the mail/wire fraud laws tethered to their origins in theft law.[79] *McNally*, in rejecting a prosecution of a local bribe-taking official for depriving his constituents of the "intangible property" of his honest services, held that the statutes only covered things that could by some legal definition be called property. That same year, *Carpenter v. United States*[80] held that prosecutors could be quite expansive in defining "property" to include the abstract and even ephemeral notions of property we associate with intellectual property law.[81] In that famous case, a reporter passing on an

77. United Sates v. Rowe, 56 F.2d 747, 749 (2d Cir. 1932) (Hand, J.)
78. Neder v. United States, 527 U.S. 1 (1999).
79. McNally v. United States, 483 U.S. 350 (1987).
80. Carpenter v. United States, 484 U.S. 19 (1987).
81. *Id.* at 25.

inside stock tip was held to have deprived the *Wall Street Journal* of the "property" inherent in its right to control the timing of publication of his column.[82] Even if no precise financial value could be placed on this rather slender stick-in-the-bundle, the Court was making clear that loss of something of s*ome* conceivable economic nature had to be proved as the result or object of any fraud.

Yet *McNally* made it impossible for federal prosecutors to extend to state and local officials the expansive (or vexing) consideration of notions of public fiduciary duty that inhere in defining public bribery. Federal prosecutors and federal courts were deprived of—or relieved of—the challenges inherent in distinguishing the legitimate from the illegitimate relationships with interested parties that might influence their exercise of their governmental functions.

McNally also left in place a restriction on the scope of mail fraud law as applied to *private* defendants, though it was a restriction few may have noticed. However expansive the potential scope of mail/wire fraud law in punishing private or commercial fraud, the general assumption confirmed in *McNally*—that fraud involved a deprivation of *property*—meant that actual monetary loss, or at least intended or highly likely monetary loss of a measurable kind, was an element of these crimes. Mail/wire fraud law probably did not apply to private malfeasance that harmed other private parties by merely breaching private fiduciary duties where that breach did not involve the fact or likelihood of proximate measurable economic harm. Thus, in the area of mail/wire fraud applied to securities and insider trading, the *Carpenter* case became the exception that proved the rule, because it involved the taking of what could just barely be called a kind of intellectual property.

A good example of how pre-§ 1346 law stubbornly hewed to the requirement of material property deprivation is Judge Easterbrook's overturning of the mail fraud conviction of the colorful Norby Walters.[83] Walters was a sports agent who paid off college student-athletes. Although the athletes were barred by NCAA rules from accepting compensation while in college, Walters gave them cars and money in exchange for their signing contracts which guaranteed that he would be their exclusive agent when they turned pro years later. The prosecution initially won conviction succeeded even though it could not easily establish that either the colleges or the NCAA suffered any measurable economic harm of the direct kind that we normally associate with fraud. The government, of course, argued that the universities suffered the harm of "lost" scholarship money that it paid to the faithless athletes. Judge Easterbrook rebuffed this argument by noting that the scholarship money did not go to Walters, nor was any loss of scholarship money the motivating purpose of his scheme. But this rebuff seems peculiar, since the ultimate destination of the scholarship money—money that obviously

82. *See* R. Foster Winans, Op-Ed, *Notes from a Little Fish*, N.Y. TIMES, May 3, 2003, at A19 (a post-Enron, op-ed lament).

83. United States v. Walters, 997 F.2d 1219 (7th Cir. 1993).

was not used the way the university intended—hardly seems dispositive.[84] Judge Easterbrook's decision was motivated in part by his understandable antipathy towards the NCAA as a cartel whose private rules deserved little respect. But his more significant reason was his determination that the defendant must intentionally cause a definable material loss to the victim of his scheme,[85] as opposed to a situation where the harm to the alleged victim is a secondary consequence of the scheme. This may seem an odd basis for denying a fraud charge in a case where it was perfectly harmonious with the success of the nefarious scheme that a university *not* suffer any material harm.

Easterbrook acknowledged that traditional mail fraud law allows for punishment of an inchoate scheme to defraud; nevertheless, in effect, he ruled that to be punishable an inchoate scheme must have as its goal, or extremely likely effect, the infliction of material harm on a party who is also the one directly deceived. In *Walters*, the scheme to defraud was in a sense not inchoate at all—it succeeded in that the deal was closed, the players got the money, and Walters got at least an executory promise of later profitable employment. The *Walters* holding represents an awkward but forceful judicial insistence that fraud cases be premised on the likely or intended material harm suffered by an identifiable victim of the deception. We will see that Judge Easterbrook's concern about the reach of inchoate fraud law became more significant once the § 1346 honest services doctrine became available to prosecutors.

Nevertheless, in the years before § 1346, fraud law was fitfully and ambiguously expanding in ways that Judge Easterbrook would disdain. Many courts had come to accept and embrace the inchoateness of mail fraud law where the loss or the intended loss was difficult to discern, often relying on a notion of "intangible rights" even in the purely private sector.[86] The cases moved in the direction of holding that so long as a private economic actor engaged in that practice called scheme to defraud—which meant either some inarguably immoral business practices, some violation of a private fiduciary duty, or some violation of a state business statute or private association rule—mail fraud might be established even if the defendant had neither intended nor actually caused economic harm to a discernable victim.

In any event, Congress abruptly put § 1346 into the mail fraud law and

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84. The only one who did suffer such measurable loss was Walters himself, who was ultimately betrayed by his ungrateful clients.

85. *Walters*, 997 F.2d at 1225-27.

86. *E.g.*, United States v. Silvano, 812 F.2d 754 (1st Cir. 1987) (referring to a company's right to honest services of employees); United States v. Bronston, 658 F.2d 920 (2d Cir. 1981) (lawyer convicted of mail fraud for knowingly taking on conflict of interest, even though he did not appropriate confidential information from first client, nor did prosecutor allege that lawyer intended or caused actual economic harm to first client); *see also* John E. Gagliardi, *Back to the Future: Federal Mail and Wire Fraud Under 18 U.S.C. § 1346*, 68 WASH. L. REV. 901, 907 (1993) (pre-§ 1346 intangible rights doctrine extended to right to "'time, effort . . . and expectations'" (citations omitted)).

thereby made the "deprivation" (read "theft") of honest services one of the official components of federal liability. For reasons not elaborated in any legislative history, Congress did not limit the invented concept of "honest services" fraud to public officials in enacting § 1346. Several consequences thereby followed. First, Congress ensured that fraud law would continue what had already begun before 1987 before abruptly being halted by *McNally*: a recycling of the history of (ancient) theft law itself, whereby the core category of a definable kind of taking of tangible property slowly morphed into deprivations of property that turned more on acts of disloyalty than on flagrant lies in bargains (the fraud version of the taking in theft law).[87] Section 1346's "honest services" fraud thereby complicated the question of what harm had to be proved as the result of object of criminally fraudulent conduct. Congress, through § 1346, enhanced the notion that disloyalty or breach of fiduciary duty was itself the harm that fraud law punished, because such bad conduct corrupts the marketplace generally by generating distrust, fear, and suspicion into commercial relations. Second, by applying 1346 to actors operating solely in the private sector, Congress appears to have moved federal law towards "impressing" private business into a form of public service—a public service owed to the market.

B. *Fits and Starts in the Redefinition of Harm Under § 1346*

A fair summary of the various readings of § 1346 in its first two decades might be as follows:[88] some courts simply require proof (1) that the defendant engaged in a scheme to defraud; (2) with the intent to deprive another of the intangible right of honest services; and (3) that it was reasonably foreseeable to the defendant that the scheme could result in some economic or pecuniary harm to the victim that is more than *de minimis*.[89] In short, some courts hold that to prove "a scheme or artifice to deprive another of the intangible right of honest services" as the object of mail or wire fraud, the government need not prove either that the defendant intended to cause the victim economic or pecuniary harm or that such harm actually resulted from the scheme to defraud. As verbal variants, some courts require that the misrepresentation or omission at issue be "material," such that an employee has reason to believe the information would lead a reasonable employer to change its business conduct.[90] Others require that the deprivation of "honest services" must either result in some articulable harm to the victim or be intended for some gainful, though not necessarily

87. *See* Carrie A. Tendler, Note, *An Indictment of Bright Line Tests for Honest Services Mail Fraud*, 72 FORDHAM L. REV. 2729 (2004).

88. A good review of key cases is Tendler, *supra* note 87, at 2742-44.

89. The fourth element is, of course, "that the mails or wires were used in furtherance of the scheme." United States v. Rybicki, 287 F.3d 257, 259-60 (2d Cir. 2002).

90. United States v. Cochran, 109 F.3d 660, 667 (10th Cir. 1997) (requiring a showing of materiality); United States v. Jain, 93 F.3d at 436, 441-42 (8th Cir. 1996) (same).

economic, use to the defendant.[91] Still others hold that it must have been reasonably foreseeable to the alleged defrauder that the scheme at issue could result in some economic or pecuniary harm to the victim.[92]

Thus, § 1346 has left courts and prosecutors to face the vagueness of the boundaries of and criteria for applying it in its myriad possible contexts. Seeking to take stock of this confusion and put some sense into modern federal fraud law, Professor John Coffee, in an important article[93] with which we respectfully take some issue, offers some guidance in applying § 1346. Coffee's main conceptual device for doing so is a fairly sharp distinction between public and private targets for federal corruption laws—a distinction that he simultaneously offers as "positive, normative, and predictive . . . ."[94] Responding to the first few years of cases under § 1346, Coffee argues that prosecutors have tended to invoke a fairly broad federal common law crimes in cases of state and local public officials prosecuted for mail and wire fraud, but that they have been much more restrained in prosecuting private commercial actors. In particular, with respect to private actors, Coffee sees prosecutors tending to limit cases to those where a private fiduciary breach violates an explicit state law—sometimes even with the requirement that the state law be a criminal law.[95]

Coffee views this distinction as logical, given various aspects of mail and wire fraud. First, most of the legislative history of § 1346 involved overturning *McNally* and thereby restoring mail fraud charges against *politicians*.[96] Second, politicians cannot complain about the potential vagueness of common law doctrine because, far more clearly than private commercial parties, public offcials have inherently fair notice of the reach of criminal anti-corruption laws law because of their public fiduciary undertakings—indeed, their very oaths of office.[97] Third, the mail fraud statute imposes less marginal liability on public officials because they are already regulated by so many other state and federal laws.[98] Finally, and most interestingly, the very fact that it is easier to prove empirically financial harm in private cases makes more concrete rules feasible. By contrast, a broad prohibition of certain actus reus elements, independent of

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91. *See* United States v. Jordan, 112 F.3d 14, 18 (1st Cir. 1997); United States v. Czubinski, 106 F.3d 1069, 1074-77 (1st Cir. 1997) (reversing conviction based on defendant's unauthorized accessing of confidential tax records where there was no showing that defendant intended to disclose or otherwise use the confidential information for personal gain).

92. *See* United States v. Vinyard, 266 F.3d 320, 327-29 (4th Cir. 2001).

93. John C. Coffee, Jr., *Modern Mail Fraud: The Restoration of the Public/Private Distinction*, 35 AM. CRIM L. REV. 427 (1998).

94. *Id.* at 430.

95. *Id.* at 430-31.

96. *Id.* at 431.

97. *Id.* at 460.

98. *Id.* at 460-61.

proven harm, is necessary for public cases.[99]

Coffee also observes that many so-called private frauds actually enhance the principal's value, while, by contrast, politicians have greater power over us and leave us little choice of exit from our relationship to them, so that more stringent regulation in the public sphere is necessary.[100] He therefore recommends that private defendant cases be reined in by the requirement of a violation of either state law or an independent federal statute identifying a particular actor's duty to a particular beneficiary, as well as a requirement that the fraud cause material, actual harm.[101]

We suggest that a fuller and updated look at the evolution of § 1346 doctrine does not bear out Coffee's description and prediction, and that the approach of many courts has cast some doubt on the normative plausibility of Coffee's reading of the private/public distinction. Instead, § 1346 has invited a creative—if inconsistent—broadening of the reach of fraud law into the area of honest services by both private and public actors.

In the following sections, we describe three major ways in which, in our view, Professor Coffee's effort to sustain a sharp public/private distinction in § 1346 law falters. First, even at the initial level of descriptive classification, § 1346 has made it difficult to tell when we are dealing with public bribery as opposed to private bribery. Second, the public/private distinction fails to account for the phenomenon of the commercial kickback, an ostensibly private transaction which, given the emerging redefinitions of harm under § 1346, has far more "public" implications than traditional law might conceive. Finally, in the crucial venue of the Second Circuit, the recent history of fraud law—especially the law governing kickbacks—depicts the world of white collar crime as far too fluid and complex to be captured by a simple public/private distinction.

C. *The Public/Private Blur*

Coffee is right that when public actors are involved, some courts have been willing to require that the service violation have been a violation of state or local law as was required in *United States v. Brumley*.[102] But the coherence that this doctrine of incorporating state law seems to offer, though tempting in a number of ways, may prove illusory. It obviously offers a short-cut way of solving the federalism concerns over mail fraud by invoking the old idea that by "assisting" state governments in enforcing state law where state enforcement structures are not operating well—i.e., where state officials must prosecute state officials—the United States is carrying out its constitutional

99. *Id.* at 450.

100. *Id.* at 462-63.

101. *Id.* at 460.

102. United States v. Brumley, 116 F.3d 728, 734 (5th Cir. 1997).

duty to guarantee Republican government to the states.[103] That constitutional rationalization for the mail and wire may be more rhetorical than substantive. State or local law can also serve as that sought-after independent benchmark for determining whether the bad actor had a definable fiduciary duty to the defrauded party. But if so, is state statutory law any more than one alternative to a private contract establishing the fiduciary relation? To the extent one is relying on state law to find a federal crime, perhaps one can somewhat narrow, and thereby strengthen, Coffee's approach by proposing that the strongest case for federal intervention into private corruption is where the relevant state law has a strong criminal prohibition on the fraudulent conduct. But that too seems like a rhetorical rationalization: even if it is legitimate for federal criminal law to borrow from state-created expectations or norms created by contract or other legal means, there is no general constitutional principle whereby federal criminal law gains legitimacy from the existence of a parallel state criminal law.

In any event, as an actual holding, not even the modest requirement of *Brumley* is good law across the circuits; for example—as Coffee acknowledges with some exasperation[104]—in *United States v. Sawyer*, the First Circuit found an honest services deprivation in a case of a lobbyist wining and dining a local official where the consideration exchanged might not have even risen to the level of a gratuity under the state equivalent of 18 U.S.C § 201.[105] In the Eleventh Circuit, in *United States v. Lopez-Lukis*,[106] an elected member of a county board took a bribe from a private contractor in exchange for a vote favorable to a contract for the briber. But also, as part of the deal, Lopez-Lukis successfully exerted her political power to help one Manning—a board member who favored the contract—to retain his seat in a close election against an insurgent who opposed it. The court upheld a mail fraud indictment here and suggested that the latter action itself could be illegal. Key to the holding was that even though political advocacy for another candidate had nothing to do with Lopez-Lukis's official duties, nor was it barred by her elected office, the advocacy could form a part of mail fraud so long as it was tied in with, and animated by, a goal otherwise manifested in a clearly illegal bribe. The court concedes that if we focus on the defendant official's efforts to favor one candidate over another, that candidacy may not have been necessary or sufficient to achieve the briber's goal. Moreover, the basis for criminal fraud is

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103. *See* U.S. CONST. art. IV, § 4 ("The United States shall guarantee to every state in this Union a Republican Form of Government . . . ."). Coffee proffers this argument, Coffee, *supra* note 93, at 432, but he acknowledges some ambivalence in deploying it, *id.* at 456-57 (noting that clause "has been more regarded . . . as a shield for the states than as a sword for Congress").

104. Coffee, *supra* note 93, at 444-45.

105. Sawyer v. United States, 85 F.3d 713 (1st Cir. 1996). Roderick Hills views this case as the prime example of a federal court misapplying to local government the rigid public/private line more relevant to the federal government. Hills, *supra* note 16, at 147-54.

106. 102 F.3d 1164 (11th Cir. 1997).

even more fragile here because the court concedes that Manning could not be charged with fraud as a result of this action, since it is possible that he voted as he did for legitimate reasons.[107] Rather, the defendant's efforts to derail another candidate, even though it was something a nonofficial could have done, was part of a larger scheme to sell her governmental services. Thus, even on the supposedly neat public side of the Coffee equation, the honest services doctrine cannot be easily limited to clear violations of official duties.

Further complicating any neat public/private divide—as well as challenging the notion that there need be a violation of local law—are the cases dealing with "quasi-public officials." These are generally political party leaders who by themselves do not exert any state action, but whose influence over the actions of true officials is undeniable. The Second Circuit had treated these ambiguous figures as the equivalent of true official bribe takers,[108] thereby provoking a furious and important accusation of Judge Winter that the court had exploded the meaning of mail fraud into a vague infinity.[109] After § 1346 was passed, some courts found ways to dodge the issue of "quasi-public status" by finding in state fiduciary law some duty on the part of the party official that did not depend on resolving the formal distinction between public and private. But the Third Circuit has been so suspicious of the illusory attractions of the *Brumley* doctrine that in one of the "party boss" cases, it held that even where the state criminal bribery laws explicitly applied to "private" party officials, mail fraud could not apply unless a separate state regulatory law laid out through express conflict-of-interest rules a separate, non-criminal set of essentially fiduciary duties for these figures.[110]

Even after the enactment of § 1346, some courts have read "honest services" especially narrowly where corruption of government is at issue. In a case pre-§ 1346 involving old-fashioned Chicago corruption,[111] a public tax-licensing agency took a bribe from a seeker of a license, but the court (through Judge Easterbrook), held that the malefactors had not deprived the city of any property.[112] The Supreme Court itself held in the case involving state video

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107. *Id.* at 1169-70.

108. United States v. Margiotta, 688 F.2d 108 (2d Cir. 1982).

109. *Id.* at 139, 142-43 (Winter, J., concurring in part and dissenting in part) ("The limitless expansion of the mail fraud statute subjects virtually every active participant in the political process to potential criminal investigation and prosecution.").

110. United States v. Murphy, 323 F.3d 102 (3d Cir. 2003).

111. Toulabi v. United States, 875 F.2d 122 (7th Cir. 1989).

112. The agency official enabled the license-seeker to cheat on the qualifying exam. The court conceded that the city had been deprived of a kind of intangible property that, in this pre-*McNally* case, might arguably still be covered by the mail fraud law, and that the city may have materially *invested* in preparing the exam, and even that what the applicant ultimately obtained might be "new property" in his hands. But the court concluded that what the city was tricked into giving up was just regulatory permission. Indeed, the judge noted wryly that the city did not have a fixed cap on licenses, so the alleged fraud actually increased the city's coffers by one license fee. *Id.*

poker licenses[113] that a city's regulatory interest in the integrity of the application process for gambling licenses does not constitute "property."[114] This case came after the passage of § 1346, and it is telling that the Court never even contemplated the possibility that the good citizens of Louisiana owed any honest services obligation to the state. Rather, in the Court's view, unless the program meets certain material indicia of economic value in the hands of the government, what is left is simply the state's interest in enforcing its own regulations.[115]

These cases show the irony that even though the bribery in the public sector would seem to be the core of corruption law, our legal system has been ambivalent and erratic in devising means of capturing the corruption under a coherent statutory scheme.

And even when a court is untethered to the property requirement and can deploy the honest services theory, and where the malefactor is actually a government official flagrantly breaking the law, some courts have demanded some especially convincing proof of material deprivation. A telling case is *United States v. Czubinski*, where the defendant was employed as a contact representative for the Internal Revenue Service.[116] To perform his official duties, which mainly involved answering questions from taxpayers regarding their returns, Czubinski routinely accessed information from an IRS computer system known as the Integrated Data Retrieval System (IDRS). Czubinski was able to retrieve income tax return information regarding virtually any taxpayer, even though IRS rules plainly stated that employees with passwords and access codes were not permitted to access files on IDRS outside of the course of their official duties. Czubinski carried out numerous unauthorized searches of IDRS files. Despite the apparently political nature of some of his searches, he seemed to act solely out of curiosity, never disclosing the information to third parties or using it for any political ends.

The government charged that Czubinski had defrauded the IRS of confidential property and defrauded the IRS and the public of his honest services by using his valid password to acquire confidential taxpayer information as part of a scheme to (1) build "dossiers" on his associates in the KKK, (2) seek information regarding an assistant district attorney who was then prosecuting Czubinski's father on an unrelated criminal charge, and (3)

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113. Cleveland v. United States, 531 U.S. 12 (2000).

114. The Court noted:

> Licenses pre-issuance do not generate an ongoing stream of revenue. At most, they entitle the State to collect a processing fee from applicants for new licenses. Were an entitlement of this order sufficient to establish a state property right, one could scarcely avoid the conclusion that States have property rights in any license or permit requiring an upfront fee, including drivers' licenses, medical licenses, and fishing and hunting licenses. Such licenses, as the Government itself concedes, are "purely regulatory."

Id. at 22.

115. *Id.* at 21.

116. 106 F.3d 1069 (1st Cir. 1997).

perform opposition research by inspecting the records of a political opponent in the race for a Boston City Council seat.[117] The government noted that confidential information may constitute intangible "property" and that its unauthorized dissemination or other use may deprive the owner of its property rights. Nevertheless, the court held that merely accessing confidential information, even with intent to deceive about one's doing so, is not tantamount to a deprivation of IRS property under the wire fraud statute, at least without intent to do more.

The court made much of the fact that Czubinski had never received a bribe. That is understandable, given that bribery was the animating focus of the enactment of § 1346 in reversing *McNally*, but the framing of § 1346 obviously cuts more widely. The court also tried, unconvincingly, to rest reversal on such facts as that Czubinski, though he had accepted a covenant in his employment contract forbidding exactly what he did, had not been put on notice that a violation could be criminal. Moreover, somewhat illogically, the court partly rested its finding of no property deprivation on the absence of proof that Czubinski intended either to create dossiers for the sake of advancing personal causes or to disseminate confidential information to third parties. It is not even clear that such proof was absent, but in any event, the court's feint in this direction shows that had it held differently on these hypothetical facts, it would have been confusing Czubinski's privately motivated use of the information with the entirely separate question whether such use would have taken "property" from the government.

Czubinski committed his actions well after § 1346 was enacted, so the case necessarily has implications for honest services fraud as well; the government alleged that, in addition to defrauding the public of his honest services, Czubinski had also defrauded the IRS of the honest services he owed the agency. But the court rejected this argument as well by finding that Czubinski breached no fiduciary duty owed to his employer:

> Even if the IRS were a private employer, however, the pre-*McNally* honest services convictions involving private fraud victims indicate that there must be a breach of a fiduciary duty to an employer that involves self-dealing of an order significantly more serious than the misconduct at issue here.[118]

The court's meaning here is obscure. A super-narrow reading of § 1346 would say that so long as Czubinski performed his required job duties adequately, he was not breaching his duty if, even though he performed his unauthorized actions at his work site or with his work resources, he did so after hours. But one would expect to find courts loath to accept such a narrow reading, regardless of whether the employer had taken pains to write into the employment contract or work rules a specific provision forbidding such unauthorized use of employer resources. So to conclude that Czubinski did not

117. *Id.* at 1072.

118. *Id.* at 1077.

in fact commit honest services fraud, we perhaps should look farther down the chain of conduct to see why not. If he had succeeded in his goal—such as amassing political information which he could in some concrete way use against his enemies—it would be a very narrow view of materiality to say that he had not accomplished the goal of fraud. True, we might have to focus on his *gain*, as opposed to a victim's loss, since even identifying an individual victim, much less monetizing the loss, would have been difficult. Surely modern honest services law could find that had Czubinski achieved some of the political goals, the fraud would have "materialized" enough to make him punishable.

Perhaps then we can read the case as requiring—but just barely—some kind of "materialized harm" or "materialized gain" and managing, perhaps anxiously and only implicitly, to stop just short of acknowledging how broad the reach of honest services fraud could be. If so, *Czubinski* becomes especially interesting proof of the blurring of the public and private in fraud. Had the defendant actually compiled those dossiers or managed to attack his enemies in some concrete way, he would have corrupted public resources to engage in a private, unauthorized effort, and the harm might then have been to the body politic as well as to private individuals. If what he communicated to the world about his enemies was not so false as to be defamatory, his doing so would have been illegal only because he had gained the information for those truthful denunciations by breach of a fiduciary duty to his employer.[119] The disconnect between the fiduciary breach that is the heart of the crime, and the target and nature of the victimization that occurred, is a perfectly ironic precursor to what we will see under securities fraud law.

Czubinski is one of the more revealing fits and starts of current fraud law. As we will see below, later developments under § 1346 suggest that courts will be far more open to arguably creative fraud constructions made by the government. At the same time, *Czubinski* does not present a clear old benchmark from which the new direction is linear. Rather, it is a useful reminder of the judicial anxiety that underlies the generally strong tropism that follows it. The great irony is that in parallel to the resistance of the courts to applying fraud law to *government* corruption in such cases as *Toulabi*, *Cleveland*, and *Czubinski*, the most remarkable recent expansion of fraud doctrine has come within the *private* sector.

119. Of course, if the IRS rules created a privacy right in taxpayers, then perhaps the victims would have had some special statutory standing to sue for violation of that protection.

D. *The Curious History—and Economics—of the Kickback*

1. *What is wrong with a kickback?*

As we will show, the courts have been remarkably willing to find honest services fraud where they see breach of a common law fiduciary duty in purely private transactions, without requiring demonstrable economic harm. Perhaps the most important development has been in a fascinatingly under-explored area—commercial bribery.[120] The commercial bribe, a.k.a. the "kickback," turns out to be something of an economic mystery. Although many jurisdictions have statutes and doctrines supposedly targeted toward such questionable exchanges,[121] the federal courts have increasingly turned to honest services fraud to capture their alleged harms. In so doing, having supposedly escaped the requirement of material deprivation we associate with *Carpenter*-type fraud, the courts have nevertheless found that commercial kickbacks pose a special challenge in an area of law already troubled over whether, and how, to require demonstrable harm as predicate to a white collar crime.

A good example of such a law comes from New York. Under New York law, a person is guilty of commercial bribery in the second degree if he or she "confers, or offers or agrees to confer, any benefit upon any employee, agent or fiduciary without the consent of the latter's employer or principal, with intent to influence his conduct in relation to his employer's or principal's affairs."[122] New York law prohibits the receipt of commercial bribes as follows:

> An employee, agent or fiduciary is guilty of commercial bribe receiving in the second degree when, without the consent of his employer or principal, he solicits, accepts or agrees to accept any benefit from another person upon an arrangement or understanding that such benefit will influence his conduct in relation to his employer's or principal's affairs.[123]

Any fresh look at commercial bribery raises the question of just why it should be a crime. If a buying agent demands a premium from a potential vendor, the vendor could (probably futilely) claim *extortion*, or, more mundanely, breach of a preexisting sales contract if it is specific enough. Or perhaps the harmed party is the kickback-demander's principal, whom the vendor presumably has the option of alerting—i.e., the principal is a mail fraud victim of the theft of honest services, or has actually been the victim of theft for some portion of the

120. Ironically, the courts have been able to do so because if we search for some contractual or common law grounding of fiduciary duty as a basis for defining an honest services obligation, private arrangements often provide these. The briber of a private party is more susceptible to a § 1346 prosecution than the briber of a government official like Cleveland or Toulabi.

121. *See supra* note 22 and accompanying text.

122. N.Y. PENAL LAW § 180.00 (1999).

123. N.Y. PENAL LAW § 180.05 (1999).

premium the vendor was willing to pay. If the vendor has the option of alerting the principal or walking away, might he be seen as an accomplice to the fraud of the principal if he pays the kickback? These are difficult and rarely examined questions in commercial and criminal law. Where does the fiduciary duty lie, and more importantly, who is getting hurt?

Early in the history of § 1346, one court imposed a requirement of demonstrable and intentional harm for what was, in effect, a commercial kickback. In *United States v. Jain*,[124] a psychologist was convicted of both mail fraud and Medicare kickback crimes for receiving payments from a psychiatric hospital for referring patients to that hospital. He argued that the government had failed to prove mail fraud to prove its theory that he had deprived his patients of their intangible right to his "honest services," because no witness claimed that any patient received unnecessary care or excessive hospitalization, and thus, under the local health care scheme, there was no proof that any government insurance program suffered a financial loss. The court conceded that, given the inchoate nature of a "scheme to defraud," the scheme need not have been successful or complete to be punished. It held that in a private fraud cases the government must show that some actual harm or injury was at least contemplated by the schemer. As the Court noted:

> When there is no tangible harm to the victim of a private scheme, it is hard to discern what intangible "rights" have been violated. For example, what "honest services" do we expect from a used car salesman, beyond a truthful description of the car being sold?[125]

The court concluded that when there has been no demonstrable actual economic harm to the particular victim, "the government must produce evidence independent of the alleged scheme to show the defendant's fraudulent intent."[126] Note that although the court's position seems consistent with Coffee's concerns—that is, it imposes a heavy burden on the federal government to justify applying § 1346 to a private transaction—this is not the burden Coffee recommended: the court finesses the issue of a state law violation by resting liability on the very different requirement of demonstrably caused, or clearly intended, financial harm.

Another very colorful example of courts' skepticism about the punishable

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124. 93 F.3d 436 (8th Cir. 1996).

125. *Id.* at 442. As the court noted in *Jain*, earlier intangible rights convictions involving private sector relationships usually included proof of tangible harm. *Id.* at 441. In *United States v. Garfinkel*, 29 F.3d 1253, 1258 (8th Cir. 1994), for example, the defendant was a University of Minnesota psychiatrist whose fraud deprived a financial sponsor of the benefits of legitimate pharmaceutical research.

126. 93 F.3d at 442 (quoting United States v. D'Amato, 39 F.3d 1249, 1257 (1st Cir. 1996)). A parallel case is *United States v. Medina*, 485 F.3d 1291 (11th Cir. 2007), where "patient recruiters" were charged with defrauding Medicare by arranging kickbacks for clinics and pharmacies. The convictions were overturned because the court found no evidence that a patient ever received anything different than the legitimately prescribed medicine or care or that Medicare was given false information about the medical basis for the care.

harm of a kickback involves a different legal regime—the rarely examined federal Travel Act.[127] This statute provides that anyone who travels in interstate commerce with the intent to commit and who commits "any unlawful activity" is guilty of a federal crime, and "unlawful activity" is defined as including "bribery. . . in violation of the laws of the State in which committed or of the United States."[128] At the time the Travel Act was passed in 1961, in forty-two states[129] and in the federal system,[130] "bribery" included the bribery of individuals acting in a private capacity. The Travel Act was aimed at corruption of activities impressed with a social interest in their integrity—such as game shows and athletics.[131] One of the early intriguing issues raised by the Travel Act was whether *commercial* bribery prohibited by a *state* criminal law was now a federal crime as well. In *Perrin v. United States*[132] the Court did recognize that the obvious motivating purpose for this odd-looking statute was to use the unique strength of the federal government to combat Mafia activity, but it found the legislative purpose broad enough to cover very garden-variety commercial bribery as well. The somewhat shaky rationale for exploiting the interstate commerce pretext was that states might need some assistance in enforcing their own antibribery laws.[133]

A remarkable example of the kind of commercial bribery that might arise

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127. 18 U.S.C. § 1952 (2000).

128. *Id.* The Travel Act was one of several bills enacted into law by the 87th Congress as part of the Attorney General's 1961 legislative program directed against "organized crime." Then-Attorney General Robert Kennedy testified at Senate and House hearings that federal legislation was needed to aid state and local governments which were no longer able to cope with the increasingly complex and interstate nature of large-scale, multiparty crime. The stated intent was to "dry up" traditional sources of funds for such illegal activities. *Legislation Relating to Organized Crime: Hearings on H.R. 468, H.R. 1246, etc., Before Subcomm. No. 5 of the H. Comm. on the Judiciary*, 87th Cong. (1961) [hereinafter *Organized Crime Legislation Hearings*].

129. A similar enlargement of the term beyond its common-law definition manifested itself in the states prior to 1961. Fourteen states had statutes outlawing commercial bribery generally. An additional twenty-eight had adopted more narrow statutes outlawing corrupt payments to influence private duties in particular fields, including bribery of agents, common carrier and telegraph company employees, labor officials, bank employees, and participants in sporting events. Since 1961, of the eight States which had not adopted nonpublic official bribery statutes, Georgia, Kansas, New Hampshire, New Mexico, North Dakota, and Wyoming now have such statutes. Moreover, a number of the states that did not have a commercial bribery statute in 1961 do so today.

130. Federal statutes specifically using "bribery" in the sense of payments to private persons to influence their actions are the Transportation Act of 1940, 54 Stat. 898 (prohibiting the "bribery" of agents or employees of common carriers), and the 1960 Amendments to the Communications Act, 47 U.S.C. § 509 (2000) (prohibiting the "bribery" of television game show contestants).

131. *See* Perrin v. United States, 444 U.S. 37, 46 (1979) ("Attorney General Kennedy in his opening statement in both the Senate and House hearings in 1961 expressed his concern that 'gamblers have bribed college basketball players to shave points on games.'").

132. *Id.*

133. *Id.*

under the Travel Act, and one which illustrates how mysterious an economic and legal phenomenon the kickback can be, involved the 2002 Winter Olympic scandal in Salt Lake City. Two local promoters of the event arranged large payoffs to International Olympic Committee (IOC) officials to win the Games for Salt Lake City. No doubt Salt Lake City benefited from the promoters' efforts, and the local prosecutors found no basis, or motivation, to indict. Yet a federal indictment ensued solely on the basis that some form of bribe was paid to the IOC officials and that payment somehow violated Utah bribery law. And the Tenth Circuit found it a sufficient basis for indictment that the Travel Act charge rested on the defendants' alleged violation of a Utah commercial bribery statute.[134]

And a subtle kickback it was. Thomas K. Welch and David R. Johnson were the President and Senior Vice President, respectively, of the Salt Lake City Bid Committee. Organized as a nonprofit corporation, the Committee had as its mission to secure the 2002 Winter Games by being the winning suitor before the various country members of the IOC. The indictment alleged that Welch and Johnson made direct and indirect payments of money and other things of substantial value to IOC members[135] and that they managed to conceal these arrangements well. Neither the SLBC, its board of trustees, nor its contributors were aware of defendants' scheme, nor were any local, state, or federal officials.[136]

The state law made it a misdemeanor for a person

> without the consent of the . . . principal, contrary to the interests of the . . . principal [if that person] confers, offers, or agrees to confer upon the . . . agent, or fiduciary of [the] principal any benefit with the purpose of influencing the conduct of the . . . agent, or fiduciary in relating to his . . . principal's affairs.[137]

Although the Travel Act appears to incorporate state bribery law, the Tenth Circuit conceded that no Utah prosecutor was likely to ever consider actually charging Welch and Johnson under the state bribery statute. But the court was

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134. United States v. Welch, 327 F.3d 1081 (10th Cir. 2003).

135. These cash payments, totaling about one million dollars, included medical expenses and personal and vacation travel expenses for IOC members and their relatives and even college tuition for their children. In addition, the defendants allegedly obtained permanent resident alien status for an IOC member's son through submission of false and misleading documents to immigration authorities. *Id.* at 1085.

136. The *Welch* court recounted the allegations:

> To further conceal their illicit activities, Defendants allegedly (1) made payments to IOC members in cash; (2) created and funded a sham program known as the National Olympic Committee Program ostensibly to provide athletes in underprivileged countries with training and equipment; (3) entered into sham contracts and consulting agreements on behalf of the SLBC; (4) recorded payments and benefits which the SLBC provided to IOC members inaccurately in corporate books and records; (5) placed false, fraudulent, and misleading information in SLBC financial records and statements, and (6) failed to disclose material information in public documents.

Id. at 1086.

137. UTAH CODE ANN. § 76-6-508(1)(a) (2007).

able to sustain the indictment because it found a sufficient basis for breach of fiduciary not in the statute per se but by a rather selective reading of general Utah state law on fiduciary duty,[138] a conflict-of-laws excursus on Swiss fiduciary law (both the Swiss doctrine on its own and as incorporated into Utah law) abetted by a legal expert witness,[139] and a general evocation of the national, indeed patriotic, interest that Americans had in the integrity of the Olympic Games.[140]

Thus, the court felt no need to establish any concrete harm to the principal—only that the defendant agents acted in some way in relation to the principal's affairs that could be construed as morally disloyal. For the court, the issue came down to compromising the duty of loyalty in the face of general declarations of fairness and loyalty in the IOC charter. In the court's view, the IOC's interest lay not just in the desirability of the chosen city but also in the fairness of the bidding process, a principle reflected in, among other things, the Olympic Charter. "Fairness in the site selection process depends on the undivided loyalty of IOC members to the IOC—a loyalty critical to the IOC's mission."[141]

Perhaps then it is no surprise that on remand the trial judge, having been told to reinstate the indictment, and probably anticipating the views of a local jury delighted to have the Olympic Games, took the opportunity the remand afforded to grant the defendants victory by acquittal instead of dismissal. At the close of the government's case, the trial judge declared there was insufficient evidence of a commercial bribe under the Utah statute. The judge also apologized to the defendants for the case having been brought. Jeopardy had attached and the decision was nonreviewable, and indeed, the jurors

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138. The federal court noted: "The Utah Supreme Court, in a civil law context, defines 'agent' as a person authorized by another to 'act on his behalf and subject to his control.'" *Welch*, 327 F.3d at 1102 (quoting Gildea v. Guardian Title Co., 970 P.2d 1265, 1269 (Utah 1998)). A fiduciary is a person in whom another places particular confidence. A fiduciary has a duty to act primarily for the benefit of the other and thus also may be an agent. *See* RESTATEMENT (SECOND) OF AGENCY § 13 (1958) ("An agent is a fiduciary with respect to matters within the scope of his agency."). "Generally, in a fiduciary relationship, the property, interest, or authority of the other is placed in the charge of the fiduciary." *Welch*, 327 F.3d at 1103 (quoting First Sec. Bank v. Banberry Dev. Corp., 786 P.2d 1326, 1333 (Utah 1990)).

139. *Welch*, 327 F.3d at 1101-02.

140. *Id.* at 1093.

141. *Id.* at 1099. As the court put things rather haughtily:

> The IOC entrusts its members with the power and responsibility to select on behalf of the IOC the host city for the Olympic Games. To ensure fairness in the site-selection process, IOC members must make their selection with undivided loyalty to the IOC free from commercial influence. IOC members appear subject to the control of the IOC at least to the extent they operate under certain express standards of conduct designed to promote fairness, and may be expelled from the "organization" for failure to adhere to these standards . . . . [W]e view the question of a principal-agent/fiduciary relationship between the IOC and its members as one of fact which the Government must establish and against which Defendants may defend.

Id. at 1103.

interviewed following the dismissal indicated that they would have voted to acquit.[142]

The Salt Lake City case wonderfully illustrates the problem of kickbacks, where the difficulty of identifying harm to any victim is tied to the difficulty of finding a fiduciary duty breached. It resembles the *Walters* case in its strange disconnection between gain and loss, between an immoral wrong and the elusiveness of any identifiable victim, and it becomes especially amusing because though it has the civic flavor of government bribery—indeed almost the dignity of international relations—it is embedded in the kind of local political culture that Roderick Hills has described as usefully blurring the public/private line.[143] The case thus helps set the stage for the commercial bribery cases prosecuted not under the Travel Act, but under the honest services provision of § 1346.[144]

2. *The mysterious economics (and occasional law) of commercial kickbacks*

If harm is indeed required for private § 1346 violations, then what is the harm of a kickback? To pursue that inquiry, we must invoke an area of federal law—and occasionally white collar crime—rarely brought into dialogue with fraud law—the world of antitrust. Commercial bribery has been something of a mystery to courts and legal economists, who most recently have spent much time trying to understand if and how the practice should fit into the scheme of antitrust laws. Largely at issue is whether § 2(c) of the Robinson-Patman Act condemns the standard private kickback[145] where the agent has not disclosed

142. *Id.* at 1099.

143. *See* Hills, *supra* note 16.

144. A parallel example is *United States v. Szur*, 289 F.3d 200 (2nd Cir. 2002), where the Second Circuit considered the conviction of a defendant charged with both a § 1346 violation as well as a Travel Act violation. The defendants were involved in a scheme to sell securities to customers and receive a commission of 50% of the sales proceeds without disclosing to the customers the excessive commissions. The theory of the prosecution was that the defendants owed a fiduciary duty to disclose the commissions to their customers and, therefore, deprived the customers of their honest services. The defendants argued that they were not under an obligation to disclose the commissions, but the Court rejected the claim and found that they were under a fiduciary obligation to disclose the commissions. The Travel Act claim was that under the New York commercial bribery statute, it is a violation of fiduciary duty to accept a bribe:

> An employee, agent or fiduciary is guilty of commercial bribe receiving in the second degree when, without the consent of his employer or principal, he solicits, accepts or agrees to accept any benefit from another person upon an agreement or understanding that such benefit will influence his conduct in relation to his employer's or principal's affairs.

N.Y. PENAL LAW § 180.05 (1999).

Since the violation of the Travel Act, just as the mail fraud violation, required a fiduciary duty violation, the Court found that the defendants were appropriately convicted of the Travel Act violation as well. Notably, the court reasoned backwards to the presence of a fiduciary duty, but inferred that duty simply from the size of the commission. *Szur*, 289 F.3d 200.

145. Or "classic commercial bribery" as one major commentator refers to it. Franklin

to her principal or the public her receipt and where she has not offered the paying party any clear useful services to justify the kickback.[146] The Supreme Court has suggested that the act does so, but on vague grounds and without much follow-through from lower courts. Nor have litigants succeeded in winning condemnations of commercial bribery under §§ 1 or 2 of the Sherman Act.[147]

Franklin Gevurtz has proposed that "classic commercial bribery" should be per so illegal under Robinson-Patman[148] because of the practice's design to allow its perpetrators to "avoid competition, thereby maintain[ing] higher prices (or poorer quality)."[149] One of the chief assumptions supporting Gervurtz's thesis is that commercial bribery is devoid of "any redeeming pro-competitive attributes."[150] However, recent work in law and economics[151] suggests that practices similar in nature to Gevurtz's "classic commercial bribery" may actually possess some redeeming pro-competitive aspects.

The law of commercial bribery has proved far more uncertain about cognizable harm than Gevurtz's analysis suggests.[152] In apparent recognition

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A. Gevurtz, *Commercial Bribery and the Sherman Act: The Case for Per Se Illegality*, 42 U. MIAMI L. REV. 365, 391 (1987).

146. 15 U.S.C. § 13(c) (2000).

147. *See* Gervurtz, *supra* note 145, at 376-78; *id.* at 368 n.21 ("While the Supreme Court twice provided dicta favorable to the interpretation that section 2(c) proscribes bribery, it never ruled on the question." (citations omitted)).

148. Unlike §§ 2(a) and 2(b) of the Clayton Act, as amended by Robinson-Patman in 1936, which require a showing of actual or threatened harm, § 2(c) makes certain behavior "per se" illegal, meaning that no harm need be demonstrated. Gevurtz and others argue that "commercial bribery" should fall within the ambit of 2(c) because it is *ipso facto* harmful since it is merely a substitute for a lower price that would otherwise be available. Gevurtz, *supra* note 145, at 393.

149. *Id.* at 391.

150. *Id.* at 393.

151. *See, e.g.*, Stephen Horan & D. Bruce Johnsen, *Does Soft Dollar Brokerage Benefit Portfolio Investors: Agency Problem or Solution?* (Law and Econ. Working Paper Series, Paper No. 04-50, 2004), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=615281; Jonathan Klick, Performance of Bond Pooling: An Efficiency Argument for Insurance Steering (Sept. 15, 2004) (unpublished manuscript), *available at* http://www.isnie.org/ISNIE04/Papers/Klick%20Paper.pdf.

152. A series of lower court opinions, although rejecting defendant liability under § 2(c), have raised questions about when courts may be tempted to find criminal liability for commercial bribery. In a pair of cases with similar facts, *Bridges v. MacLean-Stevens Studios*, 201 F.3d 6 (1st Cir. 2000), and *Stephen Jay Photography v. Olan*, 903 F.2d 988 (4th Cir. 1990), school photographers offered a commission to the school district in exchange for the right to become the exclusive provider of on-site school portraits. When districts accepted the commission, the cost of the commission was passed on to the parents. When districts refused the commission, the cost of the photographs would remain at their original prices. In *MacLean-Stevens*, the parents sued the photographer under § 2(c) on grounds that the photographer had offered a bribe to the district, the parents' agent, and as a result of that agreement, the parents had been forced to pay above market prices for the photographs. In *Stephen Jay*, a competing photographer brought suit against the two photographers who had each received exclusive contracts to a certain percentage of schools in the district. Although

that commercial bribery may not directly cause material harm the principals, the courts have looked to fiduciary duty law to find harm.[153] But such a limitation raises only more questions about the efficacy and clarity of § 2(c) in preventing any competitive injuries resulting from commercial bribery.[154] This result would again lead to the per se illegality of commercial bribery called for by Gevurtz. Any payment from one party to the opposing party's agent, regardless of whether the agent does render any valuable service, would trigger liability.[155] As some researchers are now arguing, commercial bribery may not be a sufficiently evil practice to warrant per se illegality under § 2(c). They argue that some commercial bribes or kickbacks should be thought of as somewhat akin to "performance bonds" in the sense that they operate to ensure the continuing quality of the work being performed.[156]

Jonathan Klick demonstrates that the "performance bond" could theoretically be created in an arrangement whereby an insurance company recommends particular auto repair shops to its policyholders seeking to have insured work done. If the insurance company receives either an upfront payment or a discount, but pays above-market prices as the repair shops prove the high quality of their work, the performance bond is created. If the shops fail to provide high quality service, then the insurance company can steer its policyholders elsewhere and the repair shop will lose its bond. The performance bond, although fostering above- and below-market pricing, does

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the court in *MacLean-Stevens* "assume[d] without deciding that commercial bribery is actionable under section 2(c)," the decision did note that "five circuits have concluded that commercial bribery is within the ambit of section 2(c)." 201 F.3d at 11 (citing cases). A central issue in the cases is whether the school districts had acted as intermediaries or representatives on the parents' (buyers') behalf and, therefore, whether the payments from the photographers (sellers) to the school districts had crossed the "seller-buyer" line. The First and Fourth Circuits each concluded that there was no violation of § 2(c) in these instances because the seller-buyer line had not been crossed—the district in each case, by indicating to the parents that the decision to buy portraits from the school's provider, or to buy portraits at all, was optional, "did not assume a position resembling that of a . . . purchasing agent." *MacLean-Stevens*, 201 F.3d at 12 (citing *Stephen Jay*, 903 F.2d at 993).

153. *See also* S. REP. NO. 1502, at 7 (1936) ("The relation of the broker to his client is a fiduciary one. To collect from a client for services rendered in the interest of a party adverse to him, is a violation of that relationship; and to protect those who deal in the streams of commerce against breaches of faith in its relations of trust, is to foster confidence in its processes and promote its wholesomeness and volume.").

154. Restricting liability to fiduciary relationships may have the effect of mooting the "services rendered" language in § 2(c) because an agent in a fiduciary relationship may not receive any benefits without reporting and/or delivering those benefits to the buyer. Tarnowski v. Resop, 51 N.W.2d 801 (Minn. 1952).

155. Moreover, the broad application of § 2(c) to commercial bribery has the effect of adding to the expansion of federal criminal law into areas traditionally in the purview of state criminal law or non-criminal financial regulation. Bruce H. Kobayashi & Larry E. Ribstein, *The Hypocrisy of the Milberg Indictment: The Need for a Coherent Framework on Paying for Cooperation in Litigation*, 2 J. BUS. & TECH. L. 369, 371 (2007), *available at* http://ssrn.com/abstract=955952.

156. *See* Klick, *supra* note 151, at 5 ("[S]ellers have the incentive to provide low quality goods and services because there is no expectation of future business dealings . . . .").

create competition among repair shops to provide the best service so that they may receive the long-term added value of the performance bond pricing.[157] As Klick notes, the performance bond system that steering arrangements create may provide better protection from low-quality auto repair than the prohibition on steering.[158]

A similar argument is made by Stephen Horan and D. Bruce Johnsen in connection with "soft dollar" arrangements in the institutional financial services industry. Horan and Johnsen identify the three categories of inputs in portfolio management: research, manager labor, and brokerage execution.[159] Portfolio managers are usually paid a small percentage (one half of one percent) of the portfolio's net assets and the cost of brokerage commissions is charged directly to the fund as a whole. Research costs can either be paid for directly by portfolio managers, or can be bundled with brokerage costs in the form of soft dollars.[160] If managers have to pay for research directly, they may spend too little money on research because they only receive a tiny fraction of the benefit from that research. Because it can be costly to monitor the quality of brokerage execution, portfolio managers may not invest sufficient effort into determining the best quality broker and may engage in trades that do not add value to the portfolio "to create the appearance of having performed diligently."[161]

"Soft dollars" are, in essence, a kickback from the broker to the manager that is directly charged to the portfolio investors, and can serve as a kind of performance bond that ensures the quality of brokerage service and greater consumption of research by managers. The broker first provides the performance bond in the form of soft dollar research credits to managers. The manager then pays above-market commissions to the broker to cover the cost of the research-performance bond and to ensure that the broker continues to provide execution of high quality. If the quality of execution falls, the manager may cease to do business with the broker and the broker will lose whatever

157. Although the government has sometimes declined to enforce prohibitions on steering arrangements prescribed in consent decrees, states have picked up the anti-steering slack in an attempt to protect consumers. *Id.* at 2.

158. *Id.* at 3.

159. Horan & Johnsen, *supra* note 151, at 4.

160. In the typical "soft dollar" arrangement, a manager will commit to providing a broker with a certain threshold amount of his portfolio's business. In exchange, the broker offers the manager an upfront payment of sorts in the form of research—such as Bloomberg screens, stock diagnostic software, or access to proprietary research—that the manager would normally have to buy from a third party. The costs of brokerage execution—commissions on the total value of the quantity bought or sold (not on the buyer's or seller's net gain)—are generally charged directly to the portfolio. Although investors hope that brokers will execute trades as expediently as possible, capitalizing on their short-lived information advantage, "[b]ecause brokers have no immediate stake in the diligence with which they search, they may shirk in performing portfolio executions." *Id.* at 5 (citation omitted).

161. *Id.*

amount of the performance bond has not been covered by paid commissions.[162]

Although couched in the language of performance bonds, the examples provided by Klick, Horan, and Johnsen present the kind of payments from seller's to buyer's agent that Gevurtz describes as "classic commercial bribery."[163] Klick, Horan, and Johnsen have undermined a central assumption of Gevurtz, Bloch, and others who would support the *per se* illegality of commercial bribery by demonstrating the pro-competitive value of the practice. These economists thereby further challenge the notion that actual economic harm to a party exists whenever a commercial bribe takes place.

E. *Kickbacks and the Adventures of the Second Circuit*

The legal and economic questions raised by the convergence of the kickback phenomenon and § 1346 find their best illustration in an important legal episode in the nation's most important business crimes court. To begin this story of the Second Circuit's vexation with these issues, it is useful first to refer to an important pre-§ 1346 case. *United States v. Wallach*[164] may now be technically moot, but it is intellectually telling for its awkward prescience. Robert Wallach is a fine figure to illustrate the blurry nature of the public/private distinction in fraud cases, because his very career straddled the line.

Wallach extracted large sums from the owners of the infamous Wedtech company, which became a poster child of sorts of the Nixon approach to providing benefits to impoverished communities. Deeply connected to federal officials and always on the verge of winning an administration position himself, Wallach was paid well by Wedtech's owners for securing federal contracts, but the bills to Wedtech mischaracterized his services as providing legal services.[165] One can readily imagine the prosecutors having gone after Wallach on a § 201 charge—if one could only establish that he caused the granting officials to somehow distort their public duty. That was not, however, where the prosecutors located the corruption. Rather, the supposed victims of his violation—that his, the intended beneficiaries of the fiduciary duty he owed—were not members of the public but the Wedtech shareholders in that he

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162. Horan and Johnsen also provide empirical evidence to show that a soft dollar system has generated efficient outcomes for the market by improving the performance (quality) of portfolios: "[The study's] results are consistent with the [incentive alignment hypothesis] . . . . The incentive alignment hypothesis holds that soft dollars discourage shirking and provide a mechanism by which managers can better capture the returns to identifying mispriced securities by assuring execution quality."). *Id.* at 20. Gevurtz would probably endorse what Horan and Johnsen refer to as the "unjust enrichment hypothesis," which posits that "soft dollars allow managers to misappropriate investors' wealth," or that the practice is basically a way in which a buyer's agent can steal from the buyer. *Id.*

163. Gevurtz, *supra* note 145, at 375.

164. 935 F.2d 445 (2d Cir. 1991).

165. *Id.* at 451-53.

failed to disclose on his legal bills to Wedtech that his services were for his lobbying efforts, as opposed to legal services. The problem, however, was the difficulty of establishing the material harm the shareholders suffered—if anything, they *benefited* from Wallach's sleazy actions. Then was his crime against *them* that he somehow implicated them in his possibly illegal communications with the government? Was it the harm of insinuating moral taint into the business?

The court seemed breezily confident in solving this problem, even under the old pre-§ 1346 requirement that deprivation of property be proved. In what is probably the most bizarre extension of the *Carpenter* property criterion, the court held that the shareholders had the right to be properly informed of the actions of management and to thereby influence those actions—and that this right of control was an incident of, and fully inherent in, the undeniable "property' right of shareholders in the ownership for the corporation.[166] This was true even if the actions did not deprive the supposed victims—the shareholders—of any property, because the actions caused the shareholders no demonstrable financial loss. The defendants in *Wallach* argued that the shareholders had no corporate right to control managerial decisions, and hence that no intangible control right was violated. But the court adopted a *Carpenter*-based notion of property that would easily fit into post-§ 1346 decisions providing definitions of deprivation of right of honest services. Shareholders, the court insisted, had a right to at least full disclosure of the managerial decisions of the corporation, and hence at least the right to object to those decisions. In effect, the shareholders are the body politic of the corporation.

To anticipate the end of the story, note the interesting ambiguity of *Wallach*. Let us assume we cannot view *Wallach* as a kind of § 201 case, because we have no idea whether any money ended up in the personal hands of the government officials. Wallach was wielding *some* sort of power over the government, and, viewed as a contractor for, not an employee of Wedtech, he was extorting from Wedtech an underhanded fee to arrange for Wedtech to participate in the government's contract. If we remove the public part of the case, it becomes a kind of a kickback case, the very kind that years later, as we note below, can precipitate the most important new extensions of the mail/wire fraud law under 1346. Thus, as we will see in private kickback cases to follow, the courts encounter an economic mystery: despite zero-sum assumptions about the transactions, the gain to the kickback receiver causes no demonstrable or provable loss to anyone else.

So under *Wallach*, what harm, if any, is necessary for conviction? Just as with a kickback, the core of the harm is a transaction hidden from the shareholders and thereby upsetting the assumed transparency of corporate transactions. Under this approach, shareholders may have no right to tell

166. *Id.* at 462.

managers what deals to make, but they have a right to know what those transactions are and to thereby ensure that managers feel pressure to act in the shareholders' interest. If this way of viewing the harm of a private kickback sounds suspiciously like the matter of a political official's generalized fiduciary duty to her constituents, then § 1346's announcement of an honest services basis for both public and private corruption is an obviously fitting doctrinal vehicle to do what the *Wallach* court had to do with considerably more judicial creativity.

To bring the story up to the § 1346 era, we must note the remarkable case of *United States v. Handakas*.[167] The potential breadth of modern fraud law recently led a panel of the Second Circuit to denounce § 1346 as unconstitutional under the void for vagueness doctrine. In *Handakas*, a construction company owner under state contract falsely certified that he was paying the prevailing wage rate and submitted false lists of employees, all in violation of a New York statute. The court treated this as a species of contract law and noted cautiously that it did not constitute a "tort" under New York law. The theory of "honest services" argued to the jury by the government was that a state agency had a right to determine how its contracts would be fulfilled, and that Handakas "took away that right."[168] The court held:

> If we were to affirm Handakas's mail fraud conviction on the grounds that he violated a state-mandated undertaking to pay "prevailing rate of wages," or to furnish accurate reports of work performed, we would effect a breathtaking expansion of mail fraud. Every breach of a contract or state law (committed in the vicinity of a telephone) and every false state tax return (sent by mail) would become punishable as a felony in federal court.[169]

The panel was appalled that the prosecutor had argued to the jury that an intentional breach of contract could constitute a federal felony as a "concept without boundary or standard."[170]

While this was happening, a separate panel of the Second Circuit was directly addressing the matter of private kickbacks. In *United States v. Rybicki*,[171] two Staten Island personal injury attorneys offered kickbacks through adjusters to insurance companies to ensure favorable settlements. It was understood by all concerned that the payments made to the middlemen, generally a percentage of the total settlement amount, would be shared equally between the middlemen and the adjusters. Although each of the insurance companies that employed the adjusters had written policies that prohibited the

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167. 286 F.3d 92 (2d Cir. 2002).

168. *Id.* at 100.

169. *Id.* at 107 (emphasis omitted). "[I]t could make a criminal out of anyone who breaches any contractual representation: that tuna was netted dolphin-free; that stationery is made of recycled paper; that sneakers or T-shirts are not made by child workers; that grapes are picked by union labor—in sum so called consumer protection law and far more." *Id.* at 108.

170. *Id.* at 109.

171. 287 F.3d 257 (2d Cir. 2002).

adjusters from accepting any gifts or fees and required them to report the offer of any gifts or fees, the payments offered to the adjusters were accepted but were not reported to their employers. The participants in the conspiracy took considerable steps to disguise and conceal the payments made to the middlemen and the adjusters. Although the kickbacks added up to $3,000,000 in twenty cases over a 3-year period, the government acknowledged that it would not seek to prove that the amount of any of the settlements had been inflated above what would have been a reasonable range for that settlement. But it maintained that the settlements were necessarily inflated above the amount that the appellants' clients (the personal injury victims) would have been willing to accept by at least the amount paid to the middlemen and adjusters, since these amounts did not go to these victims. Conversely, the defendants argued that even for honest services fraud under § 1346, the government had to prove actual or intended pecuniary harm.

The panel court rejected "this effort to impose the rule enunciated in *McNally* on a conviction for honest services fraud."[172] It implicitly held that the only real intent requirement in the statute is the intent to deprive the victim of honest services; thus, in effect, the mens rea with respect to economic harm becomes a kind of reckless or negligent endangerment.

Shortly thereafter, *Rybicki* was reconsidered by the whole Second Circuit en banc in light of the other panel's void for vagueness ruling in *Handakas*.[173] Rejecting—or finessing—the constitutional argument that succeed in *Handakas*, the *Rybicki* en banc decision found § 1346 just barely un-vague enough to avoid due process danger, but only by tweaking the earlier *Rybicki* ruling on materiality:

> With respect to the intent necessary to make out a violation, we agree with the *Rybicki* panel's observation that, in accordance with our post-1988 case law, actual or intended economic or pecuniary harm to the victim need not be established. *Rybicki*, 287 F.3d at 261."[T]he only intent that need be proven in an honest services fraud is the intent to deprive another of the intangible right of honest services." *Id.* at 262 (citing [*United States v.Sancho*, 157 F.3d 918, 921 (1998)]).
>
> . . .
>
> [T]he misrepresentation or omission at issue for an "honest services" fraud conviction must be "material," such that the misinformation or omission would naturally tend to lead or is capable of leading a reasonable employer to change its conduct.
>
> . . .
>
> In the case of private actors, at least, the "materiality" test captures those cases covered by the *Rybicki* panel opinion's version of the "reasonably foreseeable harm" test. Where it is "reasonably foreseeable that the scheme could cause some [non-*deminimis*] economic or pecuniary harm to the

172. *Id.* at 261.

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

> victim," *Rybicki*, 287 F.3d at 266, the misrepresentation is material because, in such cases, the victim's knowledge of the scheme would tend to cause the victim to change his or her behavior.[174]

The court therefore held that the "materiality" test may capture some cases of non-economic, yet serious, harm in the private sphere. The kickbackers could, within shakily safe constitutional boundaries, be punished:

> The phrase "scheme or artifice [to defraud] by depriv[ing] another of the intangible right of honest services," in the private sector context, means a scheme or artifice to use the mails or wires to enable an officer or employee of a private entity (or a person in a relationship that gives rise to a duty of loyalty comparable to that owed by employees to employers) purporting to act for and in the interests of his or her employer (or of the other person to whom the duty of loyalty is owed) secretly to act in his or her or the defendant's own interests instead, accompanied by a material misrepresentation made or omission of information disclosed to the employer or other person. The defendants in this case, using the mails and the wires with specific intent to defraud, caused the insurance-adjuster employees of the insurance companies to be bribed so that the insurance companies would pay claims in a manner that was not in the interests of the insurance companies but was, instead, secretly in the interests of the defendants. There were material omissions in the employees' communications with their employers that were necessary to the success of the scheme. The defendants' behavior therefore fell within the statutes' clear proscription.[175]

The en banc opinion, while requiring that honest services deprivation must result or be intended to result in some pecuniary harm, dramatically limits the burden on the government of proving the harm. Moreover, by defining harm as resulting when any faithless employee or contractor acts in a manner which might have led to a change in the victim's behavior, the court has come perilously close to criminalizing all forms of contractual violations.

The decision of the en banc Second Circuit in *Rybicki* attempts to delineate the precise elements of § 1346 when applied to the private sector: First, the defendant must be an employee of, or other person who has a similar fiduciary duty to, the victim. Second, the defendant must have been dishonest in the sense of either taking a bribe or acting in her own self-interest, and must have failed to disclose or have misrepresented either the bribe or conflict. Third, with regard to conflict cases, the defendant must have risked imposing some loss on the victim. Fourth, the court requires that the misrepresentation or nondisclosure have been "material" in the sense that it likely would have caused the victim to change her behavior (probably, but not certainly in some economic manner), as opposed to merely requiring, as the initial *Rybicki* panel held, some foreseeable loss to the victim. The materiality test seems somehow to put some teeth in the notion that there be a real economic loss, but it is difficult to see it as requiring anything more than at most a *de minimis* loss for

174. *Id.* at 145-46.

175. *Id.* at 146-47.

a fraud conviction.

In other circuits, the courts have gone even further in eliminating the need for actual losses. For example, in *United States v. Hausmann*,[176] Hausmann, a Milwaukee personal injury lawyer, referred clients to Rise, a chiropractor, who paid Hausmann twenty percent of the fees he collected for these services, while the retainer agreement with the client authorized Hausmann to pay third-party bills. Hausmann was indicted for, and, after denial of his motion to dismiss, pled guilty to, a charge of conspiracy to violate § 1346. Hausmann argued that the indictment should have been quashed at the start, because there was no actual or foreseeable harm to his clients and that, in any event, under his retainer agreement he was entitled to these payments. The appellate court rejected his claims because:

> under the intangible-rights theory of federal mail or wire fraud liability, a valid indictment need only allege, and a finder of fact need only believe, that a defendant used the interstate mails or wire communications system in furtherance of a scheme to misuse his fiduciary relationship for gain at the expense of the party to whom the fiduciary duty was owed.[177]

The court went on to cite the Wisconsin Supreme Court Rules of Professional Conduct barring lawyers from allowing "related business interests" to affect representation of their clients, and rejected Hausmann's argument that there was no demonstrable financial harm to the client:

> In this sense, reason Appellants, no harm resulted to Hausmann's clients, who were deprived of nothing to which they were entitled. This reasoning ignores the reality that Hausmann deprived his clients of their right to know the truth about his compensation: In addition to one third of any settlement proceeds he negotiated on their behalf, every dollar of [the chiropractor's] effective twenty percent fee discount went to Hausmann's benefit. Insofar as Hausmann misrepresented this compensation, that discount should have inured to the benefit of his clients. It is of no consequence, . . . that . . . [the] fees (absent his discount) were competitive, or that clients received the same net benefit as they would have absent the kickback scheme. The scheme itself converted Hausmann's representation to his clients into misrepresentations, and Hausmann illegally profited at the expense of his clients, who were entitled to his honest services as well as their contractually bargained-for portion of [the] discount.[178]

To the extent the court believed that Hausmann's agreements with his clients required him to pay them any discount for medical services he received, obviously the clients were directly injured by his actions. But the court seemed to go well beyond this notion and apparently concluded that the clients were injured by the failure of the disclosure alone. The jury instruction required a finding of a breach of fiduciary duty but offered no definition of it, and the court simply concluded that the lawyer owed the client full disclosure of his

176. 345 F.3d 952 (7th Cir. 2003).

177. *Id.* at 956.

178. *Id.* at 957.

true "fee arrangement." Haussmann also argued that his allegedly ill-gotten gains should be netted out against the overall consideration his client gained from his representation, and that his kickback was harmless, for the undisputed reason that his contingent fee arrangement with his clients was "competitive." The court nevertheless concluded that the loss of faithful service was all that the government need prove.

Although the Second Circuit might have viewed the *Hausmann* case differently, depending on its view of whether the clients would have changed their behavior if they knew of Hausmann's "deal," it is far from certain. Other Circuits have adopted notably different tests from the one adopted by the *Hausmann* and *Rybicki* courts,[179] as the dissent in the en banc decision in *Rybicki* spells out in detail.[180] In *United States v. Brown* the Fifth Circuit confronted the *Rybicki* harm issue and produced a somewhat surprising result.[181]

In *Brown*, a number of very senior executives at Merrill Lynch and Enron were indicted for wire fraud in connection with an attempt to artificially increase Enron's earnings. Enron gave Merrill legal title to barges in a putative "sale" arrangement with a secret understanding that it would repurchase the barges for the original purchase price plus an interest factor. The Merrill executives were convicted of wire fraud and received lengthy prison sentences. They appealed their wire fraud convictions on the ground that Enron was not harmed by the scheme. Moreover, they noted that the established incentive structure at Enron correlated executive pay to the company's earnings. The court agreed with the defendants and reversed their convictions for wire fraud, expressing great reluctance about endorsing the idea that a fiduciary breach, by itself, can constitute mail fraud. The court pointed out:

> In order that not every breach of fiduciary duty owed by an employee to an employer constitute an illegal fraud, we have required some detriment to the employer. *United States v. Ballard*, 663 F.2d 534, 540 (5th Cir. 1981). *Ballard*, however, implies that breach of the duty to disclose material information is a sufficient detriment to the employer because the materiality requirement, added to the false disclosure or nondisclosure of information, contemplates that the undisclosed information would have led a reasonable employer to change its business conduct. *Id.* at 541 . . . .
>
> . . . [Here], the Government presents a very plausible, even strong, case for a criminal deprivation of honest services, alleging a fiduciary breach—the failure to disclose the full truth about the barge transaction—that resulted in

179. *See* United States v. Vinyard, 266 F.3d 320, 327-29 (4th Cir. 2001) (reasonably foreseeable harm); United States v. Cochran, 109 F.3d 660, 667 (10th Cir. 1997) (requiring materiality); United States v. Jordan, 112 F.3d 14, 19 (1st Cir. 1997) (requiring "articulable harm" or clear intended gain).

180. United States v. Rybicki, 354 F.3d 124, 155, 162-63 (2d Cir. 2003) (en banc) (Jacobs, J., dissenting).

181. 459 F.3d 509 (5th Cir. 2006).

> both a personal benefit (increased bonus) to the duty-breaching Enron employees and detriments (but also benefits) to the corporation itself.[182]

The court was troubled by the suggestion that Enron actually suffered harm in this case beyond the mere breach of fiduciary duty.[183] The majority purported to act consistently with *Rybicki*, while still finding a subtle way of rejecting the government's case. It agreed with the suggestion by the defense that "between the core of cases affirming honest-services fraud convictions and the shell of cases reversing them, there is a gap, a lacuna, a vacuum, a no-man's land, a demilitarized zone, in which this case awkwardly sits alone."[184]

This mysterious "lacuna" is a case in which the alleged fiduciary breach was not motivated by an economic interest diverging from that of the party to whom the duty is owed:

> While it may be argued that the Defendants here were conscious of the fact that their actions were "something less than in the best interests of the employer," at least long term, that argument relies on the presumption, inherent in the Government's insistent argument, that a fiduciary breach is itself a sufficient reflection of interest divergence. But that view encompasses every knowing fiduciary breach, and we meet again our oft-mentioned chariness of making every knowing fiduciary breach a federal crime. What makes this case exceptional is that, in typical bribery and self-dealing cases, there is usually no question that the defendant understood the benefit to him resulting from his misconduct to be at odds with the employer's expectations. This case, in which Enron employees breached a fiduciary duty in pursuit of what they understood to be a corporate goal, presents a situation in which the dishonest conduct is disassociated from bribery or self-dealing and indeed associated with and concomitant to the employer's own immediate interest.
>
> Here [the court finds no such harmful divergence] . . . . [T]he only personal benefit or incentive originated with Enron itself—not from a third party as in the case of bribery or kickbacks, nor from one's own business affairs outside the fiduciary relationship as in the case of self-dealing—Enron's legitimate interests were not so clearly distinguishable from the corporate goals communicated to the Defendants (via their compensation incentives) that the Defendants should have recognized, based on the nature of our past case law, that the "employee services" taken to achieve those corporate goals constituted a criminal breach of duty to Enron.
>
> We do not presume that it is in a corporation's legitimate interests ever to misstate earnings—it is not. However, 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

182. *Id.* at 519-20 (citation omitted).

183. The court hypothesized that the breach in question actually increased Enron's stock price, exactly as Enron had hoped. On the other hand, it noted the Government's argument that the detriment lay in Enron's spending money (in the form of fees paid to Merrill and bonuses paid to employees) "for the 'sole purpose of misleading shareholders and the investing public.'" *Id.* at 520 n.8. The court found this less than fully convincing because it implied something that could not be proved—that the deal actually caused Enron's downfall. *Id.*

184. *Id.* at 520.

> employer, and where the employee's conduct is consistent with that perception of the mutual interest, such conduct is beyond the reach of the honest-services theory of fraud as it has hitherto been applied.[185]

There is something subtly remarkable about the *Brown* opinion. It purportedly rejects any notion that mere fiduciary breaches are a sufficient basis for a wire or mail fraud conviction, but the additional harm to the victim it requires seems difficult to discern. The majority seems to rely on the inference that whatever harm Enron suffered, it brought it upon itself by its incentive structure relying on increasing earnings at any price. But the incentive structure and the participation by Enron's executives were really part of the fraud itself. The executives were the Merrill co-conspirators. So the "lacuna case" is one in which the fiduciaries and the corporation are so perfectly aligned in their fraudulent intent and interest that the *Rybicki* standard of distortion of the principal's decision-making cannot be satisfied. If that is logical limit of *Rybicki*, the case where even the Rybicki's minimalist requirement of materiality and harm is not met, then materiality and harm do not carry much valence under § 1346.

Perhaps anxiously recognizing what *Rybicki* has wrought, Judge DeMoss, concurring in part in *Brown*,[186] found another way to help out the defendants. Although he thought the defendants had a good constitutional challenge to an indictment under § 1346, he also worried about the question of harm:

> I also believe that a serious problem arises with respect to the Government's theory of harm in this case. It is absolutely undisputed that Merrill paid $ 7 million to Enron as a result of the closing of the transaction contemplated by the Engagement Letter of December 29, 1999 that was the final written agreement of the two parties ("the Engagement Letter"). Even granting the Government that Enron paid back $ 250,000 as the advisory fee to Merrill, Enron still had $ 6,750,000 more in its bank account as a result of the Engagement Letter than it had before. The Government's theory of harm would have us ignore the initial gains to Enron and focus solely upon some later loss only tangentially connected to the particular investment transaction

185. *Id.* at 521-22 (emphasis omitted). The court cites but distinguishes the intriguing case of *United States v. Gray*, 96 F.3d 769 (5th Cir. 1996), where "university basketball coaches were convicted of mail and wire fraud for fraudulently establishing the academic eligibility of transfer students recruited to play on the basketball team." 459 F.3d at 522 n.13. There the court "rejected the defendants' argument that their actions furthered the fortunes of the basketball team and of the university and were therefore not within the purview of fraud statutes." *Id.* In the *Brown* court's view, *Gray* is dissimilar because it "presents only the coaches' own belief that their scheme benefited the university; no one or any authority outside the cadre of coaches encouraged, approved, or even knew of the wrongdoing." *Id.* But the court conceded its real fear: "The Government, in fact, would go even further; it plainly stated at oral argument its position, explicitly based on *Gray*, that the honest-services charge would reach the Defendants' conduct *even absent an oral buyback agreement*. The Government's desire to *build* on *Gray* crystalizes [*sic*] the danger we face of defining an ever-expanding and ever-evolving federal common-law crime." *Id.*

186. *Brown*, 459 F.3d at 534 (DeMoss, J., concurring and dissenting).

that forms the basis of the Indictment.[187]

This concern about whether financial harm even occurred here leads Judge DeMoss to a broader and more anxious admonition:

> The cumulative effect of a vague criminal statute, a broad conception of conspiracy, and an unprincipled theory of harm that connects the ultimate demise of Enron to a single transaction is a very real threat, of potentially dramatic proportion, to legitimate and lawful business relationships and the negotiations necessary to the creation of such relationships.[188]

Judge DeMoss thus seems concerned that this case would allow nearly every action which is determined ex-post to not be in the best interests of the company will create a potential mail fraud prosecution. It may well be that Judge DeMoss is rightly portending where federal fraud law is heading.

By significantly reducing the harm requirement in § 1346 *Rybicki*, *Hausmann*, and even *Brown*, along with *Wallach*'s interpretation of § 1341 as not requiring demonstrable harm, all seem to have an unstated premise: the harm wrought by fraud is to the market or society at large, not any individual victim suffering the fiduciary breach. Underpinning these decisions, and the very congressional action in adopting § 1346 with the broadest possible language, is an apparent assumption that honesty in the private sector is as important as honesty in the public sector. Put differently, the punishable harm in criminal fraud cases is to the "system," and those who undermine the integrity of the system will be prosecuted with the potential for very severe penal sanction.

Notably, the defendants in *Brown* were not charged with securities fraud. An alternative charge under the securities statutes and SEC rules would have been that the defendants had effectively made misrepresentations to the investing public about the value of the stock of Enron by inflating the company's earning figures through the barge transaction. Perhaps the prosecutors thought the securities charge would have set the punishment too low, or that the version of "materiality" required under the securities provision would have demanded a stronger nexus between the defendants' deceptive actions and harm to the investors or to the stock price. It is securities law to which we now turn.

III. INSIDER TRADING AND FAITHLESS FIDUCIARIES

The new prosecutorial freedom from having to prove measurable harm in honest services cases has begun to spread into that great area of federal regulation of private markets that has never been viewed as raising the same degree of federalism concern as mail/wire fraud, but where some requirement of actual harm to actual victims had traditionally been assumed—securities law. Typically criminal securities violations are punished through the specific

187. *Id.* at 535.

188. *Id.*

federal securities fraud statutes and their key regulatory component, Rule 10b-5. Mail and wire fraud have, episodically, been available alternatives for prosecutors of securities cases, and the relationship between these sets of laws has been intriguingly, if ambiguously, enhanced by the enactment of § 1348 of the new Sarbanes-Oxley Law.[189] That new section makes it a very severely punished felony "to defraud any person in connection with any security"—using language significantly broader than the traditional "in connection with the purchase or sale" thereof.

Where a charge under the securities laws goes to explicit material misrepresentations, the linkage of wrongful action to harmed victim is relatively straightforward—the party receiving the misinformation is the victim,[190] and, as noted below, the court, through non-criminal case law over measures of damages, has addressed the question of measuring harm.[191] But in the other major area of securities law violations, insider trading and "misappropriation," we again, as under § 1346, encounter struggles to define fiduciary duty and to find identifiable victims of obviously bad actors. Put simply, securities fraud, as embodied by § 10b of the Securities Exchange Act of 1934 and by Rule 10b-5, requires a "fraud," and the question to explore then is whether securities fraud has come to conceive victim-hood as broadly and amorphously as mail fraud.

In the classical case of insider trading, an insider with material, nonpublic, information trades without disclosing the information to shareholders to whom the insider owes a fiduciary duty. One party to the trade has been defrauded by the other party to the trade. The fact that the broader market is, in a sense, implicated in any trade as a set of potential transactors in the trade is only a matter of description and context, and is irrelevant to the underlying fraud; thus general notions about "commercial fairness" or "level playing fields" in the market do not serve as independent normative factors. If a trader discovers material, nonpublic information from a source outside of the company, and if the trader has no fiduciary duty to not trade on that information, the trader may trade. Hence, in the classic insider case, all of the traditional hallmarks of fraud are preserved, and characterizing the crime as the distinct species called securities fraud is almost a formality.

A. *The New "Victimology" of Insider Trading*

Some decades ago, as the government started taking aggressive action against a wider variety of dishonest characters in the institutional dramas of the financial markets, the boundaries of the classic insider category were pushed

189. For a discussion of Sarbanes–Oxley, *see infra* Part III.C.

190. *See e.g.*, TSC Industries v. Northway, Inc., 426 U.S. 438 (1976) (false or misleading proxy statements to shareholders).

191. *See infra* notes 239-46 and accompanying text.

very hard. The early cases of *Chiarella v. United States*[192] and *SEC v. Dirks*[193] were the Supreme Court's initial attempts to retain the notion of an identifiable victim of an illegal trade as predicate to an insider trading crime. In *Chiarella*, the defendant worked for a financial printer and thereby learned of an imminent takeover bid. He immediately purchased stock in the target companies before the takeover became publicly known, and he was charged with a criminal violation of Rule 10b-5. The Supreme Court reversed the conviction because Chiarella, an outsider to the company, had no duty rooted in a relationship of trust and confidence to any party to the transaction. Justice Powell specifically found it erroneous to instruct the jury that Chiarella owed a duty to the market as a whole. In *Dirks*, a civil case, a securities analyst received inside information from employees of a company and advised his clients of the information so that they could then trade on the information. The Court rejected the notion that the market itself is a protected party, or that market participants as a general class have an independent right in to "parity of information." Rather the Court concluded that even though Dirks received the information from insiders, he did not receive it subject to any fiduciary obligation and hence was free to trade.[194]

Thus both Chiarella and Dirks may have opportunistically breached various rules of contract or ethics and thereby taken advantage of unwitting transactors in the stock market, but they had not breached any legally cognizable duty owed to those transactors or to the companies about which they had nonpublic information. For a while the Court resisted a broad reading of insider trading laws that would have imposed on all traders a fiduciary duty to the general market. To quote Justice Powell's opinion in *Chiarella* as he resisted this trend:

> We cannot affirm petitioner's conviction without recognizing a general duty between all participants in market transactions to forgo actions based on material, nonpublic information. Formulation of such a broad duty, which departs radically from the established doctrine that duty arises from a specific relationship between two parties, should not be undertaken absent some explicit evidence of congressional intent.[195]

Return for a moment to Messrs. Chiarella and Dirks, and note that although they escaped liability, Chiarella and (perhaps) Dirks can be seen as unethical opportunists who violated the explicit or implicit expectations of the occupational roles in which they were given confidential information. Imagine that we developed some categorical definitions of trust into which their roles could be fitted, because we had recognized that the corporate insider role need

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192. Chiarella v. United States, 445 U.S. 222 (1980) (rejecting insider trading liability for document printer who had no fiduciary duty to corporation).

193. SEC v. Dirks, 463 U.S. 646 (1983) (limiting "tippee" liability where "tipper" did not seek illicit gain).

194. In *Dirks*, the insiders were attempting to publicly disclose an ongoing fraud at the company. *Id.* at 649-50.

195. *Chiarella*, 445 U.S. at 233 (citation omitted).

not be the only such category. From this perspective, even if they were not insiders by original role or "inheritance," they were faithless fiduciaries who exploited their malfeasance in such a way as to take unfair advantage of unwitting traders in the stock market. That imaginative step is what emerged in the misappropriation doctrine. In the key misappropriation case, *United States v. O'Hagan*,[196] the Court softened the boundaries around the category of fiduciary breaches that could lead to criminal charges, and also softened the link between the identity of the betrayed party and the securities transaction. The result is that the Court has come close to implicitly defining securities law, along with mail fraud, as a kind of reckless endangerment of capitalism.

O'Hagan chiefly asked whether a person who trades in securities for personal profit, using confidential information misappropriated in breach of a fiduciary duty to the source of the information, is guilty of violating § 10(b) and Rule l0b-5.[197] The Court affirmed the government's "misappropriation theory," under which a fiduciary's undisclosed, self-serving use of a principal's information to purchase or sell securities, in breach of a duty of loyalty and confidentiality, defrauds the principal of the exclusive use of that information. As the Court pointed out:

> In lieu of premising liability on a fiduciary relationship between company insider and purchaser or seller of the company's stock, the misappropriation theory premises liability on a fiduciary-turned-trader's deception of those who entrusted him with access to confidential information. . . . [It] is thus designed to "protect[] the integrity of the securities markets against abuses by 'outsiders' to a corporation who have access to confidential information that will affect th[e] corporation's security price when revealed, but who owe no fiduciary or other duty to that corporation's shareholders."[198]

As for the requirement that the misappropriator deceptively use the information "in connection with the purchase or sale of [a] security," a requirement presumably added to moor the fraud to a potential injured party, the Court held that this element was established because "the fiduciary's fraud is consummated, not when the fiduciary gains the confidential information, but when, without disclosure to his principal, he uses the information to purchase or sell securities."[199] This is so even though the person or entity defrauded is not the other party to the trade, but is, instead, simply the *source* of the nonpublic information.[200]

The Court offered the ostensible reassurance that the theory does not apply

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196. United States v. O'Hagan, 521 U.S. 642 (1997).

197. O'Hagan was a lawyer in a firm retained to assist a company about a potential tender offer, though he did no work on the matter. Both while and after his firm advised the company, he used confidential information about the tender offer plan to buy both call options for the target's stock and stock itself, and turned a huge profit after the tender offer announced boosted the price. *Id.* at 647-48.

198. *Id.* at 652-53.

199. *Id.* at 656.

200. *Id.* at 653.

to all forms of fraud involving securities transactions: "The misappropriation theory would not . . . apply to a case in which a person defrauded a bank into giving him a loan or embezzled cash from another, and then used the proceeds of the misdeed to purchase securities."[201] It also noted "two sturdy safeguards Congress has provided regarding scienter."[202] To establish a criminal violation of Rule l0b-5, the Government has to prove that a person "willfully" violated the provision. Furthermore, a defendant may not be imprisoned for violating Rule l0b-5 if he proves that he had no knowledge of the rule.[203]

Despite the attempts to pay lip service to a required relationship between fraud and harm, in the *O'Hagan* Court seemed to come close to adopting the notion that there need not be an identifiable victim for securities fraud:

> The misappropriation theory comports with § 10(b)'s language, which requires deception "in connection with the purchase or sale of any security," not deception of an identifiable purchaser or seller. The theory is also well-tuned to an animating purpose of the Exchange Act: to insure honest securities markets and thereby promote investor confidence. See 45 Fed. Reg. 60412 (1980) (trading on misappropriated information "undermines the integrity of, and investor confidence in, the securities markets"). Although informational disparity is inevitable in the securities markets, investors likely would hesitate to venture their capital in a market where trading based on misappropriated nonpublic information is unchecked by law.[204]

This argument rests on the fiction that every shareholder "is" the corporation. If we reject that fiction, then the SEC's and Court's use of the misappropriation theory exposes a serious problem even in certain "classic" insider case. What of a "classic" insider case where the insider gets bad news about the corporation's prospects and is motivated to sell his stock? The unwitting buyer of stock was not a corporate shareholder (until the purchase) and hence was not the party defrauded. Thus, even "classic insider trading" cases must, in effect, rest on the principle that the conversion of the confidential information can be separate from the transaction that causes financial loss to the other party in the market. By itself, that disentanglement has broad consequences beyond what the Court and the SEC have acnowledged.

The Thomas dissent in *O'Hagan* notes the very slippery use the majority makes of the analogy between misappropriation of information and theft of money when used to purchase securities:

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201. *Id.* at 656. As the Court said:

> In such a case, the Government states, "the proceeds would have value to the malefactor apart from their use in a securities transaction, and the fraud would be complete as soon as the money was obtained." In other words, money can buy, if not anything, then at least many things; its misappropriation may thus be viewed as sufficiently detached from a subsequent securities transaction that § 10(b)'s "in connection with" requirement would not be met.

Id. at 656-57 (citation omitted).

202. *Id.* at 665.

203. *See* 15 U.S.C. § 78ff(a) (Supp. V 2006).

204. *O'Hagan*, 521 U.S. at 658.

> The majority correctly notes that confidential information "qualifies as property to which the company has a right of exclusive use." It then observes that the "undisclosed misappropriation of such information, in violation of a fiduciary duty, . . . constitutes fraud akin to embezzlement—-the fraudulent appropriation to one's own use of the money or goods entrusted to one's care by another." So far the majority's analogy to embezzlement is well taken, and adequately demonstrates that undisclosed misappropriation can be a fraud on the source of the information.
>
> What the embezzlement analogy does not do, however, is explain how the relevant fraud is "use[d] or employ[ed], in connection with" a securities transaction. And when the majority seeks to distinguish the embezzlement of funds from the embezzlement of information, it becomes clear that neither the Commission nor the majority has a coherent theory regarding § 10(b)'s "in connection with" requirement.[205]

In effect, Justice Thomas argues that through the vehicle of respecting the overall purpose of the statute, the Court has made harm to such abstractions as maintaining fair and honest markets, promoting investor confidence, and protecting the integrity of the securities markets, sufficient to prove a crime.

As the majority concedes, because "the deception essential to the misappropriation theory involves feigning fidelity to the source of information, if the fiduciary discloses *to the source* that he plans to trade on the nonpublic information, there is no 'deceptive device' and thus no § 10(b) violation.'"[206] Were the source to expressly authorize its agents to trade on the confidential information—as a perk or bonus, perhaps—there would likewise be no § 10(b) violation. Yet in either case—disclosed misuse or authorized use—the majority's hypothesized notion of an "inhibiting impact on market participation" would be identical to that from behavior violating the misappropriation theory: "outsiders" would still be trading based on nonpublic information that the average investor has no hope of obtaining through his own diligence.[207]

Stressing the contrived connection here, the dissent notes that trading on nonpublic information may hurt the markets regardless of whether there is any

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205. *Id.* at 680, 681-82 (Thomas, J., concurring and dissenting) (citations omitted).

206. *Id.* at 689 (citation omitted).

207. *See* Transcript of Oral Argument at 7, *O'Hagan*, 521 U.S. 642 (No. 96-842) ("[J]ust as in [*Carpenter v. United States*], if [the defendant] had gone to the Wall Street Journal and said, look, you know, you're not paying me very much. I'd like to make a little bit more money by buying stock, the stocks that are going to appear in my Heard on the Street column, and the Wall Street Journal said, that's fine, there would have been no deception of the Wall Street Journal."). The Government's concession and the dissent's interpretation resonate with a recent insight by Joseph Bankman and Ian Ayres. *Substitutes for Insider Trading*, 54 STAN. L. REV. 235 (2001). Ayres and Bankman argue that even vigorous enforcement of insider trading law might leave insiders free to use the information to trade instead on the stock of that firm's rivals, suppliers, customers, or the manufacturers of complementary products. They note that such substitute trading can be quite profitable and, they argue, is even less desirable than banned insider trading.

deception of the source of the information.[208] Where the relevant element of fraud has no effect on the integrity of the subsequent transactions, as distinct from the non-fraudulent element of using nonpublic information, one can reasonably question whether the fraud was perpetrated *in connection* with a securities transaction. One can likewise question whether removing that element of fraud, though perhaps laudable, has anything to do with the confidence or integrity of the market. As Justice Thomas admonished:

> The dishonesty in misappropriation is in the relationship between the fiduciary and the principal, not in any relationship between the misappropriator and the market. No market transaction is made more or less honest by disclosure to a third-party principal, rather than to the market as a whole.[209]

In any event, since Justice Ginsburg prevailed, it is now clear that the fraud does not need to be perpetrated against a person who participated in the trade. The Court has thereby come dangerously close to concluding that the justification for this result is the risk to the market itself and not the harm done to any party who traditionally can be thought to have been injured by the fraudulent act. By virtue of detaching the fraud from the fraudulent act, the Court seems to have reached that result while denying it was doing so.[210]

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208. Thus, the dissent criticizes the Court for conflating causation and correlation:

> That the misappropriator may both deceive the source and "simultaneously" hurt the public no more shows a causal "connection" between the two than the fact that the sun both gives some people a tan and "simultaneously" nourishes plants demonstrates that melanin production in humans causes plants to grow. In this case, the only element common to the deception and the harm is that both are the result of the same antecedent cause—namely, using non-public information. But such use, even for securities trading, is not illegal, and the consequential deception of the source follows an entirely divergent branch of causation than does the harm to the public.

521 U.S. at 691.

209. *Id.* at 690 n.6.

210. In fact, Justice Thomas's concern about the slippery slide towards the embezzlement case came perilously close to truth in a later opinion by the Court itself. In *O'Hagan* he questioned the Court's attempt to distinguish the embezzlement case.

> Accepting the Government's description of the scope of its own theory, it becomes plain that the majority's explanation of how the misappropriation theory supposedly satisfies the "in connection with" requirement is incomplete. The touchstone required for an embezzlement to be "used or employed, in connection with" a securities transaction is not merely that it "coincide" with, or be consummated by, the transaction, but that it is *necessarily* and *only* consummated by the transaction. Where the property being embezzled has value "apart from [its] use in a securities transaction"—-even though it is in fact being used in a securities transaction—the Government contends that there is no violation under the misappropriation theory.

139 F.3d at 683.

In that light, consider *SEC v. Zandford*, 535 U.S. 813 (2002),where a securities broker persuaded William Wood, an elderly man in poor health, to open a joint investment account for himself and his mentally retarded daughter. According to the SEC's complaint, the "stated investment objectives for the account were 'safety of principal and income.'" *Id.* at 815 (quoting Petition for Writ of Certiorari at 27a, *Zandford*, 535 U.S. 813 (No. 01-147)). The Woods granted Zanford discretion to manage their account and a general power of attorney to engage in securities transactions for their benefit without prior approval. Relying on Zandford's promise to "conservatively invest" their money, the Woods entrusted him with $419,255. Before William Wood's death in 1991, all of that money was gone—drawn

Lower courts were then left to figure out just what kind of fraudulent acts—what violations of fiduciary duties—will give rise to securities fraud. Since fraud still requires some breach of a fiduciary duty, the courts are left in the odd situation of having to identify the relevant categories of criminally culpable breaches involving sources of information, without any definitional guide or anchor to a victimized party to the trade.

B. *The New World of Fiduciary Relations*

Even before *O'Hagan*, when the connection to the trading party was still a predicate for insider crimes, the courts had been forced to canvass the whole range of human relationships to identify those that are sufficiently fiduciary in nature to allow the securities laws to be engaged. Indeed, the *Carpenter* case, noted earlier for its important holding under mail and wire fraud,[211] itself involved the breach of an employer-employee relationship, and was also litigated on a securities fraud count. On that count, the Second Circuit held that to be a sufficiently fiduciary-like relationship to support a securities fraud charge. The court reached that conclusion because an employee owes an implicit oath of fealty not to engage in "foul play," this duty actually imposes a higher obligation on the employee that the employer itself would be legally free to ignore, because the employer's reputational self-interest is a sufficient constraint on such foul play in the market.[212] In *United States v. Chestman*,[213]

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and spent by Zandford for his personal use. The SEC brought a civil case under 10b-5, claiming that the Woods had been defrauded by Zandford. That civil case was dismissed by the lower courts because of a failure to show any connection between the theft and the securities transactions other than that the transactions allowed for the embezzled case proceeds. The Supreme Court reinstated the civil case brought by the SEC:

> Taking the allegations in the complaint as true, each sale was made to further respondent's fraudulent scheme; each was deceptive because it was neither authorized by, nor disclosed to, the Woods. With regard to the sales of shares in the Woods' mutual fund, respondent initiated these transactions by writing a check to himself from that account, knowing that redeeming the check would require the sale of securities. Indeed, each time respondent "exercised his power of disposition for his own benefit," that conduct, "without more," was a fraud. In the aggregate, the sales are properly viewed as a "course of business" that operated as a fraud or deceit on a stockbroker's customer.

535 U.S. at 820-21 (citation omitted).

211. See notes 80-82 *supra* and accompanying text.

212. United States v. Carpenter, 791 F.2d 1024 (2d Cir. 1986), *aff'd*, 484 U.S. 19 (1987). The Second Circuit noted, "a reputable newspaper, even if it could lawfully do so, would be unlikely to undermine its own valued asset, its reputation, which it surely would do by trading on the basis of its knowledge of forthcoming publications." *Id.* at 1033; *see* Jonathan R. Macey, *From Fairness to Contract: The New Direction of the Rules Against Insider Trading*, 13 HOFSTRA L. REV. 9, 43 (1984). "Although the employer may perhaps lawfully destroy its own reputation, its employees should be and are barred from destroying their employer's reputation by misappropriating their employer's informational property. Appellants' argument that this distinction would be unfair to employees illogically casts the thief and the victim in the same shoes." *Carpenter*, 791 F.2d at 1033.

213. 947 F.2d 551 (2d Cir. 1991).

where a businessman disclosed insider information at a dinner party among extended family, the question went straight to the heart of the fiduciary definition. The court ruled that marriage itself is not sufficient to serve as the fiduciary predicate of the securities doctrine, even though it does give rise to two evidentiary privileges.[214] Rather, degree of consanguinity becomes just one factor in determining fiduciary duty, along with more relationship-specific matters of relational intimacy and personal trust.[215] It is hard to tell whether the court is drawing on family norms to illuminate legal doctrine or vice versa.[216]

O'Hagan has vastly expanded the realm in which such breaches can be found, as well as the consequences of such breaches. The result in both the courts and the SEC has been a strangely ragged intellectual effort to describe the categories of trusting relationships in the financial market, the unethical breach of which causes sufficient harm to merit felony liability. We now see a broad and vague mix of rules-and-standards doctrine-making by which the judicial and executive branches have tried to develop a moral jurisprudence of fiduciary breach, at the very time that, as noted below in connection with Sarbanes Oxley, Congress may be broadening things further.

For example, in *SEC v. Falbo*,[217] giving a key to a company's building janitor created a fiduciary duty in the janitor, such that his use of inside information led at least to civil liability under § 10b-5. In *United States v. Willis*,[218] the wife of famed financier Sanford Weill disclosed to her psychiatrist that her husband was planning a major bank acquisition, and the doctor then purchased stock in the bank. The court held that the independently confidential and intimate nature of the psychotherapist-patient privilege made it a fiduciary relationship under the securities law so as to prohibit trading, even

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214. *Id.* at 569-70.

215. "[M]arriage does not, without more, create a fiduciary relationship. 'Mere kinship does not of itself establish a confidential relation.' . . . Rather, the existence of a confidential relationship must be determined independently of a preexisting family relationship." *Id.* (citations omitted). The court added that "more than the gratuitous reposal of a secret to another who happens to be a family member is required to establish a fiduciary or similar relationship of trust and confidence." *Id.*

216. The court held that the recipient of the inside information fell outside the fiduciary circle. First, "Keith was an extended member of the Waldbaum family, specifically the family patriarch's (Ira Waldbaum's) 'nephew-in-law.'" *Id.* at 570. Second was the matter of Ira's discussions of the business with family members. "'My children,' Ira Waldbaum testified, 'have always been involved with me and my family and they know we never speak about business outside of the family.' His earlier testimony indicates that the 'family' to which he referred were his 'three children who were involved in the business.'" *Id.* The court concluded, "In sum, because Keith owed neither Susan nor the Waldbaum family a fiduciary duty or its functional equivalent, he did not defraud them by disclosing news of the pending tender offer to Chestman. Absent a predicate act of fraud by Keith Loeb, the alleged misappropriator, Chestman could not be derivatively liable as Loeb's tippee or as an aider and abettor." *Id.* at 571.

217. 14 F. Supp. 2d 508 (S.D.N.Y. 1998).

218. United States v. Willis, 737 F. Supp. 269 (S.D.N.Y. 1990).

though it was far from apparent how the breach of the patient relationship arose in connection with the purchase and sale of a security.[219] In the *Willis* case, the court faced the comic challenge of defining the securities-relevant fraud in terms of breach of the Hippocratic Oath,[220] but then disingenuously redefined the patient's right in economic terms by saying that the doctor had defrauded the patient in part because his use of the secret information threatened Mr. Weill's economic interest in pulling off the acquisition.[221]

If in *Willis* the relationship of doctor-patient was a sufficient form of fiduciary relationship to prohibit trading despite the apparent lack of direct harm to the relationship caused by the violation, a contrast is offered by *United States v. Kim*,[222] where an associational bond of confidentiality on a social club fell short of a cognizable fiduciary duty prohibiting trading. In *Kim*, a club member, who was CEO of a company called Meridian, informed other members of the club that he could not attend a meeting because of merger activity he was involved in, and one of the members acted on this information.[223] In the court's view, "fiduciary-like dominance generally arises out of some combination of (1) disparate knowledge and expertise, (2) a persuasive need to share confidential information, and (3) a legal duty to render competent aid."[224] In *Kim*, an explicit agreement in the club charter not to divulge confidences was proved insufficient to establish a fiduciary duty, because it did not meet what the court inferred to be the normative criteria—especially the criterion of dominance and control that the court associated with the very concept of the fiduciary.

The SEC added more confusion to this area with a change to Rule 10b5-2 in the 2000 Selective Disclosure and Insider Trading Rulemaking.[225] In doing

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219. *Id.* at 274-75.

220. The Hippocratic Oath provides:

> Whatsoever things I see or hear concerning the life of men, in my attendance on the sick or even apart therefrom, which ought not be noised abroad, I will keep silence thereon, counting such things to be as sacred secrets.

Id. at 272. The court abruptly jumped to the following question-begging conclusion:

> [B]y practicing psychiatry, Dr. Willis held himself out as a physician with recognized obligations of confidentiality for his patient's secrets. By not advising his patient of his intention to disclose her confidential information and to profit personally from it, Dr. Willis fraudulently induced his patient to confide in him in connection with his purchase and sale of securities.

Id. at 274.

221. "Courts recognize that a patient has a cause of action against a psychiatrist who discloses confidential information learned in the course of treatment. Furthermore, Mrs. Weill had an economic interest in preserving the confidentiality of the information disclosed because Willis' release of the information might have jeopardized her husband's advancement to CEO of BankAmerica in which she had a financial interest." *Id.* (citations omitted).

222. 184 F. Supp. 2d 1006 (N.D. Cal. 2002).

223. *Id.*

224. *Id.* at 1011.

225. The SEC stated in its Executive Summary:

> Rule l0b5-1 addresses an important unsettled issue in insider trading law: whether the

so, the SEC launched another comic legal venture in a new version of the rules-standards dilemma. The rule sets forth a three-criteria solution to the definition of misappropriation/fiduciary duty:

> The Rule would set forth three non-exclusive bases for determining that a duty of trust or confidence was owed by a person receiving information: (1) when the person agreed to keep information confidential; (2) when the persons involved in the communication had a history, pattern, or practice of sharing confidences that resulted in a reasonable expectation of confidentiality; and (3) when the person who provided the information was a spouse, parent, child, or sibling of the person who received the information, unless it were shown affirmatively, based on the facts and circumstances of that family relationship, that there was no reasonable expectation of confidentiality.[226]

The SEC criticized *Chestman* and other cases for undervaluing "the degree to which parties to close family and personal relationships have reasonable and legitimate expectations of confidentiality in their communications."[227] The Commission especially criticized the court's insistence on either an express agreement of confidentiality or some clearly pre-established "fiduciary-like relationship." The SEC rightly noted that there are many cases in which insiders unlawfully intend to give a friend or family member information to allow them to trade, and that these are classic tipper-tippee cases, regardless of the family context. The new rules are aimed, in effect, at something quite different: innocent, or at worst negligent, disclosure by the insider who has confided the material, nonpublic information to the friend or relation with the reasonable expectation that the recipient of the information will maintain the confidence. In these situations, as the SEC reads *Chestman* and other cases as holding that it is not sufficient for a § 10b-5 charge that the disclosing insider had a situation-specific reasonable expectation of confidentiality based on her

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> Commission must show in its insider trading cases that the defendant "used" the inside information in trading, or merely that the defendant traded while in "knowing possession" of the information. The Rule would state the general principle that insider trading liability arises when a person trades while "aware" of material nonpublic information, but also provides four exceptions to liability. In these four situations, where a trade resulted from a pre-existing plan, contract, or instruction that was made in good faith, it will be clear that the trader did not use the information he or she was aware of.

Selective Disclosure and Insider Trading, Exchange Act Release Nos. 33-7787, 34-42259 (Dec. 20, 1999); *see also* 17 C.F.R. § 240.10b5-2 (2008).

226. Selective Disclosure and Insider Trading. As the SEC noted:

> Two courts have considered this issue in criminal cases: *United States v. Chestman*, [947 F.2d 551 (2d Cir. 1991)], and *United States v. Reed*, [601 F. Supp. 685 (S.D.N.Y 1985)]. Although *Chestman* and *Reed* took into account common law notions of fiduciary and confidential relationships, they both took a relatively narrow view of when a duty of confidence exists in the context of criminal liability for insider trading. In *Reed*, the court did not find a father-son relationship sufficient in itself to provide the required duty of confidence. But it stated that if family members have a prior history of sharing confidences, such that one family member has a reasonable expectation that the other will keep those confidences, there may be a sufficient relationship of trust and confidence. The final determination is left to the fact finder.

Selective Disclosure and Insider Trading, Exchange Act Release Nos. 33-7787, 34-42259 (Dec. 20, 1999) (citations omitted).

227. *Id.*

prior relationship with the trader. In the SEC's view, such a holding is perverse.

> We think that this anomalous result harms investor confidence in the integrity and fairness of the nation's securities markets. The family member's trading has the same impact on the market and investor confidence in the third example as it does in the first two examples. In all three examples, the trader's informational advantage "stems from contrivance, not luck," and the informational disadvantage to other investors "cannot be overcome with research or skill." We believe that permitting the trader in the third example to trade legally is inconsistent with investors' expectations about what types of informational advantages can be properly exploited. Moreover, this result provides all trading family members—including those in the classical tipper-tippee example—with a roadmap for concooting [sic] a story that could provide a lawful explanation for the trading. Finally, the need to distinguish between the three types of cases may require an unduly intrusive examination of the details of particular family relationships.[228]

These words describe an extension of fiduciary duty to cases in which there is no real fiduciary duty, in the sense that that term has been used over the years, related to the need to maintain the integrity of the markets. The result sought dictates the fiduciary obligation rather than the fiduciary obligation creating the result. And the analysis used by the SEC is the natural outgrowth of the analysis used by the majority in *O'Hagan.*

C. *Sarbanes-Oxley, § 1348, and the Future of Fraud Law*

In Sarbanes-Oxley, Congress responded to the Enron disaster with some of the most aggressive and comprehensive legislative regulation of business since the original securities laws sixty-five years ago. For our purpose the most relevant part of the law is a little noticed one—18 U.S.C. § 1348. As its very code placement shows, § 1348 is technically part of mail and wire fraud, not securities fraud, but that placement only underscores the way in which this "sleeper" provision draws the two main strands of this Article together.

The new provision proscribes schemes or artifices to defraud in "connection with a security." Does this provision, in conjunction with *O'Hagan*'s disentanglement of the fraud from the fraudulent transaction, now effectively allow prosecutions based on the notion that the defendant simply had an unfair informational advantage? In other words, is it now simply enough to find that the information was improperly obtained and used, even if not in violation of some fiduciary duty? The rationale for such a rule appears to be that integrity of the markets is such a crucial value that any attack on that integrity,, or any threat to the public's confidence in it, is a sufficient ground for a criminal charge.

Support for a very broad reading of § 1348 comes from no less a figure than Senate Judiciary Committee Chair Patrick Leahy, a principal draftsman of

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228. *Id.*

the statute. Following adoption of § 1348, the Department of Justice released a commentary on the new statute: "This provision complements existing securities law. The statute requires a nexus to certain types of securities, no proof of the use of the mails or wires is required."[229] Senator Leahy wrote a letter to Attorney General John Ashcroft objecting to some of the DOJ's interpretations, especially the "complements" language.[230] "'You do not point out the many advantages of the new criminal provision,'" Senator Leahy noted, mentioning increased flexibility and freedom from the "'often problematic intent requirements'" associated with prosecuting "'willful' violations of the securities laws and regulations."[231]

The hint that new § 1348 augments the trend toward redefining victimhood in the market finds support in the Senate Report on Sarbanes-Oxley:

> This bill, then, would create a new 25 year felony for securities fraud—a more general and less technical provision comparable to the bank fraud and health care fraud statutes in Title 18. It adds a provision to Chapter 63 of Title 18 at section 1348 which would criminalize the execution or attempted execution of any scheme or artifice to defraud persons in connection with securities of publicly traded companies or obtain their money or property. The provisions should not be read to require proof of technical elements from the securities laws, and is intended to provide needed enforcement flexibility in the context of publicly traded companies to protect shareholders and prospective shareholders against all the types of schemes and fraud which inventive criminals may devise in the future. The intent requirements are to be applied consistently with those found in 18 U.S.C. 1341, 1343, 1344, 1347.[232]

One of the first cases to consider the new § 1348 was *United States v. Mahaffy*,[233] in which seven defendants were charged with a "front running" securities operation involving the sharing with day traders of allegedly confidential information derived from their relationship with their institutional clients. The defendants argued that the indictment was insufficient for failing to allege that they intended any economic loss to any real or putative holder of the security. But the court invoked Senator Leahy's comment for a broad reading of the provision:

> The statute, however, defines no such narrow range of prospective victims . . . . It does not restrict, or even contemplate, the status of the victim; rather, it simply requires that the government prove that the scheme to defraud was designed "in connection" with a security. Stated another way, though not with the intention of identifying the outer boundary of the statute's

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229. ATT'Y GEN., FIELD GUIDANCE ON NEW CRIMINAL AUTHORITIES ENACTED IN THE SARBANES-OXLEY ACT OF 2002 (H.R. 3763) CONCERNING CORPORATE FRAUD AND ACCOUNTABILITY § 807 (2002).

230. *See* White Collar Crime: Leahy Faults Ashcroft Guidance on Implementation of Sarbanes-Oxley Act, 71 Crim. L. Rep. (BNA) 583 (Aug. 14, 2002).

231. *Id.*

232. 148 CONG. REC. S7421 (daily ed. July 26, 2002).

233. No. 05-CR-613, 2006 U.S. Dist. LEXIS 53577 (E.D.N.Y. Aug. 2, 2006), *reh'g granted* 499 F. Supp. 2d 291 (E.D.N.Y. 2007).

> application, the requirement that the scheme be "in connection" with a security is satisfied where as a result of the scheme, the defendants either benefited, or attempted to benefit, from trading in securities. This broad construction is consistent with the report of Senator Leahy . . . . [T]he broad language of § 1348 shows that the intent of Congress was not only to protect the holders of securities, but to prohibit all forms of fraudulent conduct associated with securities, regardless of who the conduct affects.[234]

The court did find implicit in the statute a requirement that the government prove a fraudulent intent; nevertheless, relying on *O'Hagan*, the court found that intended harm could simply be defined as the benefit to the defendant,[235] and it drew expansively on *Rybicki*'s broad notion of materiality.[236]

As a general matter, this language suggests impatience with "technical" regulatory rules created by agencies to constrain corporate behavior. It also thereby implies that the doctrinal nuances and arguably arbitrary limitations on securities fraud under Rule 10b-5 will no longer matter in criminal cases, but are being legislated into irrelevance. The mail and wire fraud prosecutions of securities trades may have already accomplished what Sarbanes-Oxley seems to aim for here. If so, this change is simply cosmetic—or perhaps can be viewed as a clear Congressional validation of the mail/wire-fraud cases and hence a motivator toward more federal prosecutions under those laws. This changer may be broader still, since *Carpenter* and other mail fraud/securities cases rely on the theft of property of some kind, and to the extent that that fictive concept supplied any constraint at all on fraud prosecutions, it is no longer present. A scheme to defraud in connection with a security may turn out to involve property only in the ultimately meaningless or tautological sense that someone might lose money as a result of the action.

Once we wholly unmoor the fraudulent action from a particular victim or the loss of money from a person actually transacting with and thereby directly hurt by the defrauder, the property concept means very little. Where a stock manipulator or earnings-inflator so influences the stock price that somebody in the market loses money, that "money" was that latter person's property only in the sense that she had a legal entitlement to the likely fair returns of, say, minimally competent trading in the market. If the market flunks that test of fairness where it has been "defrauded" (a term definable only via the common law of § 1341), we get perilously close to a "fraud on the market" theory, a concept we discuss below.

One subsidiary effect of the expansion of mail fraud law has been to reconfirm that it can do the work of securities fraud law by treating insider

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234. *Id.* at *35 (citations omitted).

235. *Id.*

236. *Id.* at *39-40. The *Mahaffy* defendants were all acquitted of the 1348 charges, but the jury hung on the conspiracy count alone. In a recent decision, the court allowed a retrial on the conspiracy count despite the double jeopardy concerns. United States v. Mahaffy, 499 F. Supp. 2d 291 (E.D.N.Y. 2007).

trading cases as instances of theft. Under mail and wire fraud law, we have a progressively vaguer standard and a greater reach of inchoate crime doctrine. On the securities side, we have, by regulation and common law development, something closer to categories and rules. These sets of doctrine converge, however, towards a general standard-like norm of fiduciary responsibility or bad-faith fiduciary breach as the gravamen of the crime, so long as that breach is somehow in connection with a security. Section 1348, with all its tools of inchoateness, might suggest a way for prosecutors to use mail and wire fraud even more expansively as a substitute for SEC laws, with the only necessary linkage being the arguably minimal connection with a security. The new law might, in effect, moot the need for the government to use the insider trading or misappropriation doctrines, but it is also another manifestation of the confluence of these doctrines into a principle that people who run public companies in the United States are a strange mixture of heroes and villains. They have become our Burkean, republican fiduciaries, but they are always suspected of high crimes and misdemeanors against capitalism; they bear a fiduciary responsibility to the whole market, one enforceable by criminal laws, the actus reus of which is far vaguer and more inchoate than Congress has imposed on, say, members of Congress who take bribes.

IV. THE POSITIVE LEGAL MEANINGS OF "FRAUD ON THE MARKET"

We have attempted to show that American white collar crime law has been broadening the boundaries of criminal fraud even to encompass cases lacking an identifiable individual victim or injured party. The public law doctrines punishing supposed injuries to honest government have begun to blend with, or morph into, doctrines punishing actions alleged to cause diffuse harms to the honesty of the capital markets. Throughout this Article we have deliberately invoked "the market" as a victim in a very abstract of an undefined economic and social phenomenon that the courts (and/or implicitly, the legislature and the SEC) invoke when they find it too constraining on fraud and securities law to identify any material harm to any individual. We therefore close by assessing two contexts in which federal law has made some effort to give positive meaning to the notion that harming markets as a cognizable legal injury must result in harm to an identifiable victim as well.

A. *Fraud on the Market in Private Securities Law*

In *O'Hagan* the Supreme Court may have moved away from traditional fraud notions in the context of the securities laws, but in theory the Court still requires as components of securities fraud that an actual fraud (in the traditional sense) have been committed and have been directly related to a purchase or sale of a security. Sarbanes-Oxley, in some sense, may be seen as doing away with traditional fraud notions entirely, but the Court itself has not

explicitly embraced the notion that conduct undermining the integrity of or faith in securities markets in and of itself constitutes securities fraud. Nevertheless, by unhinging the fraud from the securities transaction, the Court has opened the gate to an argument that any fraudulent behavior that has the effect of influencing market prices could indeed be deemed securities fraud, and we can readily imagine a creative prosecutor making an argument that a securities transaction by a party who undertakes a wrongful act is no longer necessary for a Rule 10b-5 violation. The name Martha Stewart comes to mind.

The question whether the market itself can be the "defrauded victim," as opposed to an actually defrauded individual, arises in the *private* enforcement side of Rule 10b-5 as well. In *Basic Inc. v. Levinson*,[237] the Court faced the issue of whether a private securities fraud action brought under § 10b-5 requires the plaintiff to demonstrate harm caused by the defendant. The defendant in *Basic* apparently violated the provision of § 10b-5 that proscribes any "untrue statement of a material fact" and requires that all statements made not "omit to state a material fact."[238] Specifically, the defendant company falsely denied that merger discussions were occurring. The plaintiffs, who owned stock in Basic, could not prove actual reliance on the misleading statements, yet they wished to proceed with their claim on the theory that they relied on the honesty and integrity of the market generally, and these crucial qualities of the market had been undermined by the false denial.

Although the Court seems to have accepted this theory, in reality it continued to require that a direct nexus between the fraud and the loss incurred by the individual market participant. In *Basic*, Justice Blackmun's plurality opinion allows for a claim based on a fraud that has affected the market, but, under the *Basic* holding, if the defendant can truly demonstrate that the fraud did not affect the market, the fraud does not give rise to a cause of action. In other words, *Basic* did nothing more than use fraud to shift the burden from the plaintiff to the defendant. In a recent essay on *Basic*,[239] Donald Langevoort somewhat challenges the notion that the plaintiffs will not have to demonstrate actual fraud and reliance:

> [T]he Court's opinion makes sense if we see it as creating an entitlement to rely on market price integrity even though there is no good reason for any investor simply to assume the absence of fraud. That, as said earlier, is an act of juristic grace rather than recognition of any pre-existing right. *Basic* thus allows recovery without a showing of actual reliance on the fraud that is justifiable so long as the market is sufficiently well-organized that we have reason to believe that fraud is likely to distort the price. . . . Eventually, whether on the merits or as a matter of class certification, plaintiffs will have

237. 485 U.S. 224 (1988).

238. 17 C.F.R. § 240.10b-5 (2008).

239. Donald C. Langevoort, *Basic at Twenty: Rethinking Fraud-on-the-Market* (Georgetown Law & Econ. Research Paper No. 1026316, 2007), *available at* http://ssrn.com/abstract=1026316.

to show that the fraud did in fact distort the market price.[240]

Indeed, Langevoort's article could be thought to support Justice White's dissenting opinion in *Basic*, where he did not even agree with the shifting of the burden, because the notion of the market being harmed seemed too far-fetched to him:

> To define the term "integrity of the market price," the majority quotes approvingly from cases which suggest that investors are entitled to "rely on the price of a stock as a reflection of its value." But the meaning of this phrase eludes me, for it implicitly suggests that stocks have some "true value" that is measurable by a standard other than their market price. While the Scholastics of Medieval times professed a means to make such a valuation of a commodity's "worth," I doubt that the federal courts of our day are similarly equipped.[241]

Recently, in *Dura Pharmaceuticals, Inc. v. Broudo*,[242] the Court unanimously reaffirmed the requirement that there be a direct nexus between the alleged fraud and the loss incurred by the market participant and that misrepresentations that affect the market do not necessarily give rise to a cause of action. In that case, the plaintiff alleged that the company misrepresented the status of approval of a medical device, thereby inflating the price of the stock. The Ninth Circuit had held that an inflated price at time of purchase was sufficient to allow for a cause of action, but the Supreme Court reversed, concluding that the subsequent loss incurred by the purchaser of the stock was not necessarily caused by the misrepresentation. The Court held that at the time of the purchase of the stock, the purchaser was not harmed since he received the share at the market price, even if that market price was an inflated price; and if this purchaser then sells before the truth comes out, the purchaser is unharmed.[243] Moreover, even if the purchaser sells after the truth comes out and the price declines, the lower price may be caused by factors other than the misrepresentation. Summing up its reasoning, the Court stated:

> The securities statutes seek to maintain public confidence in the marketplace. See *United States v. O'Hagan*. . . . They do so by deterring fraud, in part, through the availability of private securities fraud actions. . . . But the statutes make these latter actions available, not to provide investors with broad insurance against market losses, but to protect them against those economic losses that misrepresentations actually cause. Cf. *Basic*, 485 U.S., at 252 . . . (White, J., joined by O'Connor, J., concurring in part and dissenting in part) ("[A]llowing recovery in the face of affirmative evidence of nonreliance—would effectively convert Rule 10b-5 into a scheme of investor's insurance. There is no support in the Securities Exchange Act, the Rule, or our cases for such a result.")[244]

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240. *Id.* at 27.

241. 485 U.S. at 255 (White, J., dissenting) (citation omitted).

242. 544 U.S. 336 (2005).

243. *Id.*

244. *Id.* at 345 (citations omitted).

Although the Court finds further support for its view from sections of the Private Securities Litigation Reform Act of 1995, the Court is clearly hostile to civil causes of action based on frauds affecting the market in general. Little wonder, then, that the Court initially approached this possibility in criminal cases with considerable hesitancy. Yet as we have shown throughout this Article, the courts seem to be moving in this direction in criminal cases.

This disjuncture between civil and criminal law is both logical and illogical. It is logical because it is in the very nature of a private lawsuit that we require proof of damages as a predicate for the common legal remedy. By contrast, most criminal statutes describe types of conduct and culpable mental states, and, although they often make specific harms elements of the statute or punishment enhancement, they are under no constitutional obligation to do so.[245] But it is illogical because the state necessarily has a greater moral in justifying criminal liability than civil liability; at least in a broad social sense, condemning people to prison for a category of harm that could never give rise to civil liability is very troublesome—especially in the business arena, where the notion of "crimes against morality" per se seems inapposite. Even if legislatures are under no constitutional requirement to do so, we normally expect the legislature to express some sense of the harm it is criminalizing.

We wonder why this ironic disjuncture between the civil and the criminal has happened, and we can imagine two related reasons. One is a matter of cultural symbolism: notably, in the last decade the key symbol public concern about the apparent egregious rapacity and deceitfulness of such modern iconic defendants as the Enron and WorldCom fraudsters. The irony here is that the high burden of proof that the government carries in proving the moral culpability of these mega-criminals ends up relieving the government of its burden of proving the material resulting harm of many white collar crimes more broadly. The second reason, as noted earlier, is the increasing ownership of stock by the middle-class and even working class constituencies. Ironically, more American individuals may indeed be harmed fairly materially by stock fraud because of the greater breadth of stock ownership, and yet the result has been to come close to nullifying the need for any proof of that materiality.

There is one context, however, in which American government has tried to define a set of formulaic parameters for the proof of harm in commercial fraud cases, and we offer it here, not so much as an exception to our thesis, but as a cautionary way to underscore our thesis. The context is the United States Sentencing Guidelines.

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245. Of course, inchoate criminal laws—in the old-fashioned sense of the term—can punish *potentially* harmful acts done with highly culpable mental states, but normally we can identify the specific harms sought to be prevented.

B. *Loss and Punishment in Federal Sentencing*

Perhaps the most riveting consequence of allowing detachment of the fraud from the securities transactions is the effect that expanding notions of fraud have on sentencing. In charging the United States Sentencing Commission with writing the federal sentencing guidelines, Congress sought to curb the discretion of judges in the sentencing process and to end the perceived disparity in sentencing between similarly situated defendants.[246] The Commission recognized that economic crimes in particular had been treated with much leniency in the past in comparison to other theft crimes, even those that caused similar pecuniary harm.[247] Accordingly, the Commission increased sentences for those crimes above their historical levels and made the amount of "loss" caused by the crime the key amplifying factor in sentencing.[248] If one assumes that criminal liability for fraud can be based on general market harms, the loss (one of the most critical elements for determining sentences) can be almost without limit.

Among scholars, there has been some ambivalence and agnosticism about the escalating sentences for perpetrators of economic crimes; among politicians, however, there has been no such cautions. Since the 2001 collapse of Enron and WorldCom and the subsequent series of high-profile accounting scandals resulting from the increased scrutiny on financial crimes, Congress has taken a particularly "tough" stance towards economic crimes. The 2002 Sarbanes-Oxley Act is the centerpiece of a movement to increase the accountability of corporate executives and auditors to shareholders, the market, and the public. What Sarbanes-Oxley's proponents have lauded as the law's "teeth" and what its detractors have called "draconian" and "tragic" is the dramatic increase in criminal penalties, both fines and prison sentences, for malefactors. The central issue in this debate is whether these penalties are out of proportion with the extent of the harm that results from these crimes and

246. Frank O. Bowman, III, *Pour Encourager Les Autres? The Curious History and Distressing Implications of the Criminal Provisions of the Sarbanes-Oxley Act and the Sentencing Guidelines Amendments That Followed*, 1 OHIO ST. J. CRIM. L. 373, 379 (2004).

247. U.S. SENTENCING COMM'N, FIFTEEN YEARS OF GUIDELINES SENTENCING: AN ASSESSMENT OF HOW WELL THE FEDERAL CRIMINAL JUSTICE SYSTEM IS ACHIEVING THE GOALS OF SENTENCING REFORM vii (2004) ("The Commission's study of past sentencing practices revealed that in the pre-guidelines era, sentences for fraud, embezzlement, and tax evasion generally received less severe sentences than did crimes such as larceny or theft, even when the crimes involved similar monetary loss. A large proportion of fraud, embezzlement, and tax evasion offenders received simple probation.").

248. Frank O. Bowman, III, *The 2001 Federal Economic Crime Sentencing Reforms: An Analysis and Legislative History*, 35 IND. L. REV. 5, 25 (2001) ("[W]hen the original Sentencing Commission wrote guidelines for economic crimes, it made the idea of 'loss' the linchpin of the enterprise. In both the former theft and fraud guidelines the base offense level resulting from conviction alone was very low (4 in theft cases, and 6 in fraud cases), while the offense level could increase by up to eighteen levels in fraud cases and twenty levels in theft cases, depending on the amount of 'loss' found by the court.").

whether courts are even capable of accurately measuring that harm.

The focus that the guidelines placed on loss as the chief determinant of the offense level of economic crimes was controversial at the time, but has become far more so as sentencing enhancements corresponding to loss have increased and methods of calculating loss have come into question.[249]

Of course the status of the federal guidelines in general has changed dramatically since the Supreme Court, in the *Booker* case, held that applying the guidelines as binding rules violated the Sixth Amendment.[250] But the guidelines continue to operate legitimately as "advisory" factors, and, especially in light of post-*Booker* fine-tunings of this advisory status,[251] the role of the guidelines relevant to economic crimes is likely to change little in practice in the wake of *Booker*.

Under the pre-2001 system, "loss" was defined by a patchwork of rules that spoke only indirectly to the issue.[252] Under the 2001 reforms, "loss" has been defined as "the greater of actual or intended loss," where "actual loss" refers to "the reasonably foreseeable pecuniary harm that resulted from the offense," and "intended loss" includes even "pecuniary harm that would have been impossible or unlikely to occur."[253] This new definition more or less codifies something resembling the standard of causation in negligence cases, where the amount of damage resulting from an actor's cause-in-fact is limited by the reasonable forseeability of that damage. And of course, forseeability is not much of a limitation.

What did not change at all, however, was the role of "loss" as the overwhelming factor in determining the severity of sentencing.[254] In his 2001 article, Bowman produces several reasons why quantity of loss is an appropriately weighted consideration in sentencing:

> First, although actual loss . . . plainly measures harm, it also serves as a gauge of the defendant's guilty mind. . . . [F]rom the point of view of statutory law, all convicted thieves, embezzlers, and con artists are formally indistinguishable as regards *mens rea*. Even so, stealing more is worse than stealing less and merits greater punishment, not only because a larger loss

249. Bowman, *supra* note 246, at 386.

250. United States v. Booker, 543 U.S. 220 (2005) (applying Blakely v. Washington, 542 U.S. 296 (2004), to the federal sentencing guidelines).

251. *E.g.*, Rita v. United States, 127 S. Ct. 2456 (2007) (holding that courts of appeals should treat sentences by trial courts that are within the guidelines as presumptively reasonable).

252. *See* Bowman, *supra* note 248, at 41 ("[T]he 'definition' of actual loss scattered in bits and pieces through the commentary on the former theft and fraud guidelines was a hodgepodge—a core definition ('the value of the property taken, damaged, or destroyed') drawn from the common law of larceny combined with an apparent rule of causation derived by negative inference from the exclusion of a classification of harms ('consequential damages') drawn from civil contract law, plus a gaggle of special rules. Virtually no one defended the old definition.").

253. 18 U.S.C.A. app. § 2B1.1 (West 2008).

254. Bowman, *supra* note 248, at 38.

> inflicts a greater harm, but also because one who *desires* to inflict a large harm is customarily thought to have a more reprehensible condition of mind than one who desires to inflict a small one. . . .
>
> Second, careful study of the pre-reform economic crime guidelines . . . confirmed the original Sentencing Commission's finding that . . . a defendant who plots, plans, and schemes to achieve an evil end is thought more culpable than one who causes the same harm on impulse. . . .
>
> The third and final consideration that may have cemented the Sentencing Commission's continued reliance on the loss measurement was that by redefining actual loss in terms of causation, the Commission was able to make loss a better proxy measurement of the defendant's guilty mind than it had been under the former definition.[255]

In spite of Bowman's faith in the value of loss in the sentencing process, he still expresses reservations about the actual timing and mechanics of quantifying loss, a calculation that he leaves up to the courts to promulgate as common law.[256] Even so, the 2001 Economic Crimes Package made dramatic increases in offense levels based on loss, leaving trial courts to develop methods for calculating loss on an ad hoc basis. Within just over a month after the Economic Crimes Package took effect, however, almost daily, front-page revelations of fraud and mismanagement in some of the most prominent and widely held public corporations made economic crime a hot political issue, resulting in Sarbanes-Oxley.

Given that the method to measure loss has been left undefined, the loss is supposed to based on some objective notion of forseeability, and the underlying fraud may now consist of a potential threat to abstract market integrity, the potential loss that can serve as the basis for sentencing is nearly limitless. Indeed, that has become virtually true, as near-life sentences have become the norm for middle-aged executives convicted of securities fraud. The case of James Olis, an energy company executive convicted of several of white collar crime's most vague offenses, including mail, wire, and bank fraud in connection with an accounting scandal, provides context for this discussion.

In 2004, Olis, senior director of tax planning at Dynegy, Inc., was sentenced to twenty-four years and four months in prison for his role in "Project Alpha," a scheme intended to disguise a $300 million loan as revenue from business operations.[257] The plan funneled money through a "special purpose entity" to make a series of purchases and sales of natural gas at above- and below-market prices to deceive the company's auditors, shareholders, and the market about the corporation's financial health. After an SEC investigation revealed the fraudulent accounting to the market and ordered the company to restate earnings in April 2002, Dynegy's stock price began to slide. Shortly thereafter, Olis, along with Gene Foster and Helen Sharkey, who had also participated in Project Alpha, were each indicted on one count of conspiracy to

255. *Id.* at 38-39, 41.

256. *Id.* at 68-70.

257. United States v. Olis, 429 F.3d 540, 541-42 (5th Cir. 2005).

commit mail fraud, wire fraud, and securities fraud; one count of securities fraud; one count of mail fraud; and three counts of wire fraud.[258] Sharkey and Foster each pled guilty to one count each of wire fraud, mail fraud, securities fraud, and conspiracy to commit all of the above in exchange for a maximum sentence of five years.[259] Olis, however, refused to agree to a plea bargain and was convicted at trial on all counts.[260]

At sentencing, Judge Simeon Lake relied on the guidelines, as they stood after the changes from the 2001 Economic Crimes Package, to sentence Olis to almost twenty-five years in prison. The issue that has made Jamie Olis's case famous is how the district court's calculation of loss caused it to add a 26-level sentencing enhancement.[261]

To determine the amount of loss caused by Olis's criminal actions, the prosecution offered a study from Clifton Gunderson, which concluded that the defendant, Mr. Olis, was responsible for total shareholder losses in the amount of $589,285,000.[262] Judge Lake, however, did not rely on the Gunderson study, but rather on Jeff Heil, an investment manager for University of California Retirement System (UCRS), who testified that the pension fund, one of Dynegy's largest shareholders, lost approximately $105 million from the value of its holdings in Dynegy between 2001 and 2002.[263] Of course, under *Dura Pharmaceuticals* this loss would not be recoverable civilly without a much greater showing than simply that the value of the stock declined. Both the Heil testimony and the Gunderson report relied on a form of the calculation that "[bases] loss on a gross correlation between stock price decline and the revelation of a fraudulent transaction."[264] Heil did not claim that the whole of UCRS' loss on its Dynegy stock was due to the Project Alpha, nor did he limit the calculation to losses sustained during the period where the fraud was uncovered and publicized.[265]

The only possible justification for this loss calculation is that the fraud somehow harmed the general market climate for this stock and hence was indirectly responsible for the price decline, even if there was no evidence that the actual fraud had anywhere near this magnitude of effect. The district court's inability to precisely confine the amount of loss triggered an enhancement that increased Olis's sentence nearly five-fold. On appeal, the Fifth Circuit found Olis's sentence invalid for applying the guidelines in a mandatory manner

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258. *Id.* at 542.

259. *Id.*

260. *Id.*

261. *Id.* at 545.

262. United States v. Olis, No. H-03-217-01, 2004 WL 3756361, at *1 (S.D. Tex. Mar. 30, 2004).

263. *Id.*

264. *Olis*, 429 F.3d at 546-47.

265. *Id.* at 548.

declared unconstitutional under *Booker*;[266] it then set out somewhat more precise parameters for sentencing based on calculation of loss in civil securities fraud cases.[267] As a result, the Fifth Circuit decided to vacate the sentence and remand the case to consider "the impact of extrinsic factors on Dynegy's stock price decline."[268] On remand, and following submission of solicited and unsolicited affidavits contesting the calculation of the loss, the District Court sentenced Olin to six years in prison, down from nearly twenty-five years.

CONCLUSION

We have tried to show that mail and wire fraud law has revolved around several closely related themes or axes: (1) the difference between property and more ethereal or deontological interests; (2) the notion of fiduciary duty, a breach of which might be the gravamen of fraud, especially in terms of defining criteria not captured by specific statute or contract; (3) the difference between public and private corruption; and (4) the difference between measurable harm to identifiable victims and more diffuse harm to a social interest. All of these themes or axes were dramatically realigned by § 1346. The new statute obviated the need to stretch the concept of "property" to capture the obligation of public officials to be non-corrupt. Thus, at the very least, it insinuated federal law into state and local government as a means of identifying public corruption, with all those philosophical challenges that attend 18 U.S.C. § 201.

Our argument, then, is that American white collar crime law has loosened any requirement of an identifiable harm other than a mistrust-inducing breach of fiduciary loyalty, or any requirement of an identifiable victim other than an abstraction parallel to the public, such as the market itself. Federal criminal law has therefore become complicated by broad notions of fiduciary duty, loose causal links between fiduciary duty and financial harm, and general principles of contractual fairness (i.e., a duty to bargain in good faith). Moreover, all this is happening at the same time as, and to some extent has been caused by, the popular American perception that we are facing a horrendous "crime wave" of fiduciary breach and confidence-destroying tainting of financial markets. The average American who is often the "constructed subject" of populist crime fear has now become the victim of white collar crime, not just out of resentment, but out of capitalist self-interest in stock value. That means that two massive and abstract entities, the body politic and the securities market, have increasingly merged.

266. *See supra* text accompanying note 255.
267. *Id.* at 544-49.
268. *Id.* at 548-49.