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Aggressive federal fraud prosecutions based on broad intangible rights theories reined in by the Supreme Court

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Last month, the U.S. Supreme Court once again reined in federal prosecutors' ability to prosecute public corruption cases involving expansive intangible rights theories under the federal fraud statutes. In the two cases, decided on May 11, the Court unanimously overturned federal fraud convictions involving alleged corruption in New York state government.

In *Ciminelli v. United States*, the Court rejected the Second Circuit's "right to control" theory, pursuant to which a defendant could be found guilty of wire fraud if he schemed to deprive the victim of "potentially valuable information that was "necessary to make discretionary economic decisions." Ciminelli reaffirmed that the mail and wire fraud statutes only criminalize "schemes to deprive people of traditional property interests."

Then, in *Percoco v. United States*, the Court addressed under what circumstances a private individual can be convicted of depriving the public of its right to honest services. The Court rejected the argument that a private citizen could never be convicted of honest services fraud, but held that the Second Circuit's domination and control standard was unconstitutionally vague and violated due process. In a passionate concurrence, Justice Gorsuch suggested that the honest services statute itself was unconstitutionally vague.

Ciminelli and Percoco are the latest chapter in a long running tug of war between the Court and prosecutors to determine the reach of the federal fraud statutes. The mail and wire fraud statutes criminalize "any scheme or artifice to defraud, or … obtain[] money or property by means of false or fraudulent pretenses, representations, or promises." For decades, prosecutors and lower courts believed that these statutes protected intangible interests unconnected to traditional property rights, including the right to receive honest services, the right to an honest election, and even the right to privacy. This allowed prosecutors to charge public officials with fraud if they accepted bribes or kickbacks, even without financial harm to the government, because the officials had deprived the government of their honest services.

In 1987, the Supreme Court reversed this trend in *McNally v. United States*, holding that the mail and wire fraud statutes did not cover intangible rights, and applied only to "money or property." In response, Congress amended the fraud statutes by adding 18 U.S.C. § 1346, which specified that a "scheme or artifice to defraud" included depriving others of "the intangible right of honest services." Prosecutors subsequently attempted to expand the scope of this right in two key ways. First, the government tried to redefine "property" to include intangible interests related to property, like the "right to control" the use of one's assets, a theory adopted by the Second Circuit in *United States v. Wallach* in 1991. Second, prosecutors began broadening the reach of "honest services fraud" in numerous ways.

In *Skilling v. United States* (2010), for instance, the Supreme Court reversed the conviction of Jeffrey Skilling, the former Enron CEO, on honest services fraud charges. The Court rejected Skilling's argument that Section 1346 was impermissibly vague, but held that to preserve the statute from due process concerns, it should be construed to criminalize only cases involving bribes or kickbacks, the core of the pre-*McNally* honest services fraud case law. More recently, in *Kelly v. United States* (2020), the Supreme Court once again held that the fraud statutes only applied to schemes to deprive the victim of money or property. Kelly involved the 2013 "Bridgegate" scandal in which Port Authority employees in New Jersey created severe traffic jams by unnecessarily closing key traffic lanes to punish a mayor for not supporting Governor Christie's re-election. The Court held that closing lanes was a regulatory decision that did not concern government property as the object of the fraud, which was required for a conviction under the wire and federal program fraud statutes. This distinction narrowed the application of federal fraud statutes even further.

Ciminelli and Percoco continue this pattern, reversing convictions that broadened the scope of the federal fraud statutes.

Ciminelli rejects the Second Circuit's "right to control" theory

In *Ciminelli*, federal prosecutors alleged that the defendant, a real-estate developer, engaged in a scheme to improperly influence individuals in charge of awarding contracts under then-New York Governor Andrew Cuomo's "Buffalo Billions" urban renewal initiative. The government alleged that Ciminelli manipulated the bidding process to ensure that he obtained a marquee project by paying a lobbyist to design the selection process criteria to unfairly favor his firm. Prosecutors charged Ciminelli with wire fraud, arguing that the alleged manipulation deprived the nonprofit in charge of awarding the contracts of information "that it would consider valuable in deciding how to use its assets," including the information that Ciminelli was conspiring to rig the bidding process. Under the Second Circuit's long-established "right to control" theory, a defendant could be found guilty of wire or mail fraud for depriving one of the right to control their assets by depriving them of "valuable economic information" which was "necessary to make discretionary economic decisions."

The Supreme Court, in a unanimous opinion by Justice Thomas, reversed Ciminelli's conviction and articulated three reasons why the Second Circuit's "right to control theory" could not stand. First, the theory "cannot be squared with the text of the federal fraud statutes, which are 'limited in scope to the protection of property rights.'" The Court explained that "[t]he so-called right to control is not an interest that had 'long been recognized as property' when the wire fraud statute was enacted." Second, the right to control theory is inconsistent with the structure and history of federal statutes, including *McNally*, which put a halt to the "wide array of intangible rights" theories that prosecutors previously developed. The Court noted that Congress's response to *McNally* was to revive only "the intangible right of honest services" through Section 1346, and that Congress remained silent on other intangible rights like the Second Circuit's "right to control" theory. Third, the right to control theory vastly "expands federal jurisdiction without statutory authority" by treating information as property, which essentially criminalizes "almost any deceptive act." Remarkably, despite indicting and obtaining convictions under the "right to control" theory, even the government conceded in the Supreme Court that depriving a victim of economically valuable information without more was not sufficient to sustain a fraud conviction. The government asked the Court to affirm on alternate grounds (arguing that the evidence was sufficient to establish wire fraud under a traditional property fraud theory), but the Court declined, noting that it should not serve as the jury in addition to the reviewing court.

Percoco and Private Citizens

In *Percoco*, the Court focused on "whether a private citizen with influence over government decision-making can be convicted for wire fraud on the theory that the public was deprived of its 'intangible right of honest services,'" pursuant to Section 1346. Percoco was a longtime aide to Governor Cuomo, but resigned from his position in April 2014 to help run the governor's re-election campaign. On Dec. 3, 2014, a few days before he was set to return to the administration, Percoco accepted payments from a real estate developer. In exchange, Percoco allegedly convinced a state agency to drop a requirement necessary for the developer to secure a lucrative state contract. Prosecutors charged Percoco with, among other things, conspiracy to commit honest services wire fraud by depriving the state agency of his honest services despite being a private citizen at the time.

Over defense counsel's objections, the jury was instructed that Percoco could be found guilty of honest services fraud as a private citizen if (1) he "dominated and controlled any government business" and (2) "people working in the government actually relied on him because of a special relationship he had with the government." Percoco was convicted, and the Second Circuit affirmed.

The Supreme Court, in a unanimous decision by Justice Alito, reversed. At the outset, the Court rejected the argument that a private citizen could never be held criminally responsible for committing honest services fraud against the government. Justice Alito noted, for instance, that there might be instances in which a non-government employee becomes an agent of the government by virtue of a formal agreement or delegation of authority; there, the private citizen could have a fiduciary duty to provide honest services to the government. The Court held, however, that the Second Circuit's "domination and control" standard was impermissibly vague. Justice Alito observed that the standard for when a private party exercised sufficient "domination and control" was so "ill-defined" that it could easily sweep in lobbyists and political party officials who have no clear-cut fiduciary duties to the government. The Court noted, for instance, that this could criminalize "an elected official [who] always heeds the advice of a long-time political adviser," or "leans very heavily on recommendations provided by a highly respected predecessor, family member, or old friend." The Court reasoned that this would sweep far too broadly, and might "encourage arbitrary and discriminatory enforcement" instead.

As in *Ciminelli*, the Government once again abandoned the Second Circuit's expansive standard before the Supreme Court, but argued that the error was harmless and asked the Court to affirm on different grounds. In particular, the Government argued that private individuals like Percoco were covered by the statute if they were (1) selected to work for the government in the future and (2) exercise the functions of a government position. Noting that these standards were substantially different than the jury instructions, the Court declined the government's request and reversed Percoco's conviction.

In his separate concurrence, Justice Gorsuch, joined by Justice Thomas, went even further. He suggested that Section 1346's "intangible rights" theory was unconstitutionally vague and urged Congress to refine it. He noted that "even 80 years after the lower courts began experimenting with the honest services fraud theory, no one can say what sort of fiduciary relationship is enough to sustain a federal felony conviction and decades in federal prison." Justice Gorsuch stated that to pass muster under the Constitution, Congress must "identify the conduct it wishes to prohibit," in advance so as to give "ordinary people fair notice of the conduct it punishes."

Implications looking forward

The unanimous decisions in Ciminelli and Percoco send a clear signal that the Supreme Court will continue to reign in aggressive federal fraud prosecutions based on broad intangible rights theories. Pursuant to Ciminelli, prosecutors will be forced to show that the government was deprived of a "traditional property interest" for mail and wire fraud prosecutions. Merely corrupting a public process, even for personal financial gain, may no longer be sufficient. Percoco will substantially narrow the ability of prosecutors to move against lobbyists, party officials and other private actors accused of public corruption unless they have a clear agency relationship or fiduciary duty to the government. Justice Gorsuch's concurrence in Percoco suggests, moreover, that barring Congressional action clarifying the scope of Section 1346, the Government will act at its peril if it tries to use the honest services statute to prosecute corruption cases that do not involve bribes or kickbacks.

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