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From Tort to Crime: Some Reflections on the Criminalization of Fiduciary Breaches and the Problematic Line between Law and Ethics

John C. Coffee Jr.

FROM TORT TO CRIME:

Some Reflections on the Criminalization of Fiduciary Breaches and the Problematic Line Between Law and Ethics†

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Within the context of mail and wire fraud prosecutions, criminal liability for breach of fiduciary duties is being imposed with increasing frequency. Professor Coffee discusses the disturbing failure of the courts to require that the fiduciary's conduct have caused legally cognizable harm to the beneficiary. He concludes that an affirmative defense should be available to fiduciaries to show the lack of proximate cause between a breach and the injury. In addition, federal enforcement should occur only after state and private remedies have proven inadequate.

Something about the topic of fiduciary duty seems to impel courts to indulge in fulsome rhetoric. From Cardozo, the subject evoked his most purple prose:

> Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the marketplace. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior.[1]

Similar statements lacking only the lushness of Cardozo's vocabulary can be found in the major corporate law decisions of recent years,[2] and, at least in California, the fiduciary is subject to "a comprehensive rule of 'inherent fairness from the viewpoint of the corporation and those interested therein'."[3] Few would describe these developments as other than salutory.

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1. Meinhard v. Salmon, 249 N.Y. 458, 464, 164 N.E. 545, 546 (1928).

2. Among the major corporate law decisions of recent years which have placed substantial, and probably decisive, emphasis on the nature of a fiduciary's responsibilities are Rosenfeld v. Black, 445 F.2d 1337, 1342–44 (2d Cir. 1971) (investment adviser to mutual fund may not sell advisory contract at premium as fiduciary held to high standard of conduct which forbids transfer of office for personal gain), *cert. denied,* 409 U.S. 802 (1972); Zahn v. Transamerica Corp., 162 F.2d 36, 45 (3d Cir. 1947) (stockholder voting as director of corporation subject to special fiduciary duty which binds him from using office for personal benefit at expense of other stockholders); Singer v. Magnavox, 380 A.2d 969, 976–78 (Del. 1977) (majority stockholders' attempt to "freeze out" minority stockholders through merger transaction violates majority's fiduciary duty to minority to act under high standards of honesty, good faith, loyalty, and fairness); Donohue v. Rodd Electrotype Co., 367 Mass. 578, 593, 328 N.E.2d 505, 515 (1975) (stockholders of close corporation owe fiduciary duty to other stockholders to act in accordance with strict good faith standard); Diamond v. Oreamuno, 24 N.Y.2d 494, 497–98, 248 N.E.2d 910, 912, 301 N.Y.S.2d 78, 80–81 (1969) (fiduciary duty owed by senior corporate executives to corporation prohibits insider trading for personal gain).

3. Jones v. H.F. Ahmanson & Co., 1 Cal. 3d 93, 110, 460 P.2d 464, 472, 81 Cal. Rptr. 592, 600 (1969). The court also stated:

But, now consider the next quotation, which follows naturally enough from these precedents:

> Such a fiduciary relationship on the part of the defendants... required that they exercise the utmost good faith in their relations with the corporation and the [stockholders], including fully advising the corporation and [stockholders]... of any interest which the defendants had that would in any way affect the corporation.... Such a full disclosure requirement... would obligate them to faithfully make known all facts which might have influenced prospective [stockholders].[4]

Although this apparent statement that a fiduciary duty is owed to prospective stockholders might be overbroad as a statement of civil law,[5] the surprising fact here is that this language comes from the charge to the jury in *Post v. United States*,[6] a criminal case. The *Post* charge seems to say that a knowing breach of a fiduciary duty amounts to a federal criminal offense.[7] Indeed, in upholding the conviction of the promoters in that case, the D.C. Circuit first wrote broadly that "by elementary legal principles, promoters stand in a fiduciary relationship exacting good faith in their intracompany activities and demanding adherence to a high standard of honesty and frankness."[8] Then, it specifically approved the foregoing jury instruction:

> Majority shareholders may not use their power to control corporate activities to benefit themselves alone or in a manner detrimental to the minority. Any use to which they put the corporation or their power to control the corporation must benefit all shareholders proportionately and must not conflict with the proper conduct of the corporation's business.

1 Cal. 3d at 108, 460 P.2d at 471, 81 Cal. Rptr. at 599.

4. Post v. United States, 407 F.2d 319, 328 n.51 (D.C. Cir. 1968), *cert. denied,* 393 U.S. 1092 (1969). Footnote 51 in *Post* reprints the jury instruction in the case which involved the fraud in the promotion of a country club and the sale of membership interests therein by promoters who failed to disclose a secret interest in the club as managers and creditors. The defendants objected to this instruction not because it incorrectly stated the duties of corporate officials, but on grounds that it should not have applied to a nonprofit enterprise such as a country club. *Id.* at 328. Thus, the D.C. Circuit's approval of the jury charge suggests that it applies equally to fiduciaries of nonprofit organizations, such as hospital and college trustees, as well as to corporate directors.

It should be noted, however, that the final sentence of the *Post* jury instruction refers to the promoters' use of "their fiduciary position to obtain secret profits... [as] not only... a breach of that fiduciary duty but [also as] an act of fraud." *Id.* at 328 n.51. In this light, it is arguable that the court was not approving criminal liability based only on non-disclosure of a conflict of interest, but that the receipt of "secret profits" was also a necessary element of its formula for criminal liability. As this article will demonstrate, subsequent decisions, including United States v. Bronston, No. 81-1015 (2d Cir. Aug. 19, 1981) [hereinafter cited as United States v. Bronston] and United States v. Barta, 635 F.2d 999 (2d Cir. 1980), *cert. denied,* 101 S. Ct. 1703 (1981), have placed less emphasis on this point, even though their facts probably involved the receipt of such profits too.

5. *Compare* Old Dominion Copper Mining & Smelting Co. v. Lewisohn, 210 U.S. 206, 211-13 (1908) (promoters' fiduciary obligations do not extend to prospective investors) *with* Old Dominion Copper Mining & Smelting Co. v. Bigelow, 203 Mass. 159, 187-89, 89 N.E. 193, 206 (1909) (promoters owe fiduciary duties to corporation's prospective investors), *aff'd on other grounds,* 225 U.S. 111 (1912). The Massachusetts decision probably represents the modern trend of decisions which hold that a promoter does stand in a fiduciary relationship to a corporation's prospective stockholders.

6. 407 F.2d 319 (D.C. Cir. 1968), *cert. denied,* 393 U.S. 1092 (1969).

7. *See* note 4 *supra* (discussing *Post*'s broad imposition of criminal liability in principal/fiduciary context).

8. 407 F.2d at 328.

> By explicating a knowledgeable or purposeful breach of fiduciary duty as an essential characteristic of the conduct upon which a conviction might be rested, the instruction plainly and correctly defined a major type of dishonesty for the facilitation of which the mail fraud statute penalizes the use of the postal service.[9]

This language, which seems to equate dishonesty with the criminal offense of mail fraud, raises troubling questions, which grow in importance when one learns that, in the wake of *Post*, its jury instruction has been widely adopted and is now regularly requested by the Department of Justice in a wide range of cases involving defendants who conceivably can be characterized as fiduciaries.[10] Nor does *Post* stand alone. In both earlier[11] and subsequent[12] cases, conduct described as a knowing fiduciary breach has been found to violate the mail or wire fraud statutes, assuming the requisite use of the mails or telephone.

Does this mean that to secure a conviction a federal prosecutor has only to convince a jury beyond a reasonable doubt that a fiduciary's behavior fell below the standard of "the punctilio of an honor the most sensitive?" One would think that to ask this question was to answer it, but in an important recent criminal case the court's charge to the jury actually quotes the Cardozo quotation on which this article opened in order to define the standard to which the defendant would be held criminally responsible.[13]

The recent pattern has not, however, simply been one of continuous expansion. Other decisions have questioned the idea that a breach of a fiduciary duty, standing alone, could constitute a criminal offense.[14] Some decisions have found that the

9. *Id.* at 329.

10. My informant as to the frequency of use of the *Post* charge was Mark Richards, Deputy Assistant Attorney General, Criminal Division, United States Department of Justice.

11. *See* notes 65 & 67 *infra* (listing cases).

12. *See* United States v. Bohonus, 628 F.2d 1167, 1172-73 (9th Cir.) (employee's knowing breach of fiduciary duty to provide honest services to employer violates mail fraud statute), *cert. denied*, 447 U.S. 928 (1980); United States v. Reece, 614 F.2d 1259, 1261 (10th Cir. 1980) (employees' knowing breach of fiduciary duty to provide employer with loyal, honest, and disinterested services punishable under mail fraud statute); United States v. Bryza, 522 F.2d 414, 422 (7th Cir. 1975) (deprivation of employee's loyal and honest services can constitute fraud under mail fraud statute), *cert. denied*, 426 U.S. 912 (1976); United States v. George, 477 F.2d 508, 511-15 (7th Cir.) (purchasing agent's knowing breach of fiduciary duty to provide honest and faithful services to employer constituted fraud punishable under mail fraud statute), *cert. denied*, 414 U.S. 827 (1973).

13. *See* note 73 *infra*, and accompanying text.

14. In the following cases there is language to the effect that the mere existence of a breach of a fiduciary duty to provide honest and faithful service is insufficient to violate the mail fraud statute. *See, e.g.*, United States v. Barta, 635 F.2d at 1005 n.14, 1006-07 (mere breach of fiduciary duty to serve loyally and honestly, by itself, does not necessarily constitute criminal mail fraud offense) (citing United States v. Dixon, 536 F.2d 1388, 1399 n.11 (2d Cir. 1976) and United States v. Regent Office Supply Co., 421 F.2d 1174, 1180 (2d Cir. 1970)); United States v. Bush, 522 F.2d at 648 (breach of fiduciary duty alone, depriving city of honest and faithful service, could never violate mail fraud statute but constitutes violation when combined with active concealment of fraud and material misrepresentation); *cf.* United States v. Dixon, 536 F.2d at 1401 (failure to disclose to stockholders information required by SEC, absent some "element of corruption," probably not a violation of mail fraud statute); United States v. Regent Office Supply Co., 421 F.2d at 1180 (misrepresentation must result in actual or contemplated harm to constitute "scheme to defraud" under mail fraud statute); United States v. Courtois, [1981] FED. SEC. L. REP. (CCH) ¶ 98,024 at 91,301 (S.D.N.Y. June 5, 1981) (relying on *Barta*, *Dixon*, and *Regent Office Supply Co.*, court finds breach of fiduciary duty of loyalty and honesty insufficient, by itself, to constitute

acceptance of gratuities by fiduciaries did not alone amount to fraud, absent some proof that the fiduciary had acted in a manner adverse to the interests of those he represented.[15] The tension in the case law is perhaps best shown by several recent cases in the Second Circuit. In June, a Southern District court ruled in *United States v. Courtois*[16] that repeated stock market trading by individuals who had advance knowledge of a series of tender offers would constitute a violation of neither SEC rules and regulations as then in force[17] nor the mail fraud statute. The mail fraud count was essentially predicated on a theory that the defendant, who included officers of highly respected investment banking firms, had wronged both their firms and their clients by trading on inside knowledge of approaching tender offers to be made by those clients.[18] Rejecting the prosecution's theory that such conduct caused real harm both to the investment banking firms' clients, which may have been forced to pay a higher premium in the tender offer as a result, and to their firms' own "business-getting ability," by injuring the firms' reputations as discrete and reliably confidential investment bankers,[19] the court held that "direct, tangible, economic

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violation of mail fraud statute) [hereinafter cited as United States v. Courtois], *rev'd on other grounds sub nom.* United States v. Newman, No. 81-1225 (2d Cir. Oct. 30, 1981) [hereinafter cited as United States v. Newman].

15. *See* United States v. Rabbitt, 583 F.2d 1014, 1024-26 (8th Cir. 1978) (without evidence of tangible loss to state and citizens, Missouri legislator's acceptance of commission on architectural contracts awarded by state does not alone establish crime of mail fraud), *cert. denied,* 439 U.S. 1116 (1979); United States v. McNieve, 536 F.2d 1245, 1249-52 (8th Cir. 1976) (where no tangible injury resulted from St. Louis plumbing inspector's receipt of unsolicited gratuities, acceptance of such gratuities, by itself, does not constitute mail fraud).

16. United States v. Courtois, *supra* note 14.

17. *Courtois* relies heavily on Chiarella v. United States, 445 U.S. 222 (1980), insofar as liability for violation of SEC rules and regulations is an issue in the case, although it technically addresses an issue *Chiarella* left open which is whether by trading on inside information about an impending undisclosed tender offer the individual has breached a duty owed to the bidder, rather than to the market generally. United States v. Courtois, *supra* note 14, at 91,290. This article is concerned only with the *Courtois* decision's analysis of the mail fraud statute and does not consider the *Courtois* treatment of SEC law, which focuses on SEC rule 10b-5, 17 C.F.R. § 240.10b-5 (1981). Nonetheless, *Courtois* notes that the adoption of SEC rule 14e-3, 17 C.F.R. § 240.14e-3 (1981), subsequent to the time of the transaction involved in *Courtois* would make the same activity clearly illegal today. *Id.* at 91,292. Section 32(a) of the Securities and Exchange Act of 1934 provides criminal penalties for persons who willfully violate that Act or the rules adopted thereunder, including rule 14e-3, which proscribes trading on the basis of knowledge of an impending undisclosed tender offer. Securities and Exchange Act of 1934, § 32(a), 15 U.S.C. § 78ff(a) (Supp. III 1979). Both *Chiarella* and *Courtois* are, however, consistent with this article's thesis that fiduciary duties are not owed to the world generally, but to specific persons.

18. United States v. Courtois, *supra* note 14, at 91,290. Courtois was a member of the merger and acquisition department of Morgan Stanley & Co, Inc. ("Morgan Stanley"), a highly respected investment banking firm with a special expertise in tender offers. *Id.* at 91,288. The court accepted the charge that Courtois had "misappropriated" information about approaching tender offers to be made by Morgan Stanley's clients and conveyed this information to outside co-conspirators who secretly purchased shares in the target companies. *Id.* After their indictment, Courtois and a second inside trader fled from the United States. *Id.* at 91,287 n.1. The only defendant remaining before the court was Newman, a co-conspirator of Courtois, but not an employee of either investment banking firm. *Id.* at 91,287-88. Thus the June 5, 1981 decision of the Southern District concerned an outside trader. Neither the district court decision nor the circuit court decision reversing it appear to place much weight on this point.

19. *Id.* at 91,301 n.22. In *Courtois*, the Government's theory appears to have been that such trading defrauded not the selling stockholder but the bidder and the investment bankers. The bidder would be injured because such trading would drive up the price of the stock and possibly cause the bidder to increase

loss to the victim, actually caused or contemplated" by the defendant[20] was necessary to support a mail fraud prosecution. *Courtois* then seemed to stand for a "harm or injury"[21] requirement, which generally would be satisfied only by proof that the defendant contemplated[22] or actually caused economic loss to the victim through a scheme to defraud.

In contrast, less than three months later, the Second Circuit held in *United States v. Bronston*[23] that an attorney who gave legal assistance to a personal client who was competing for an important franchise with another client represented by his own firm not only committed a serious breach of legal ethics, but also the crime of mail fraud. The court reached this finding even though there was no proof that Bronston's conduct had in fact *caused* harm or injury to the supposed victim of the crime or was even likely to have caused such harm. *Bronston* is an important case whose facts will be analyzed in more detail herein, but in overview, it read the harm or injury requirement very differently than did *Courtois*.

This was proven shortly thereafter when the Second Circuit reversed *Courtois* and reinstated the indictment in a decision ironically authored by the very judge who had emphatically dissented in *Bronston*.[24] In the Second Circuit's decision, *United States*

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the price at which it was tendering in order to maintain the same margin between the tender offer price and the market price. *Id.* The investment banker, it was argued, was injured in its "business getting-ability" by the disclosure that its own officers were exploiting confidential inside information acquired from a client. *Id.* The existence of unfair gain was also accepted by the court: "[W]hen the proposed takeovers became known to the public, and the target's stock predictably increased in value, the conspirators sold out and divided the spoils." *Id.* at 91,288.

20. *Id.* at 91,301. The court observed: "[In] the private field, as opposed to the acts of faithless public servants, that theory, if unaccompanied by allegations of proof of direct, tangible, economic loss to the victim, actual or contemplated, is insufficient in law under controlling authority in this circuit." *Id.* The controlling authority is not cited, but would appear, by implication, to be United States v. Barta, 635 F.2d at 1005 n.14.

The court's rejection of the Government's position, as mere theorization about the harm which might arise from the defendant's conduct, seems highly questionable. By comparison, a consensus appears to exist among investment bankers that a successful tender offer requires both secrecy and complete confidence by the parties in the integrity of the investment banker. *See* Greenhill, *Structuring an Offer*, 32 BUS. LAW. 1305, 1309 (1977) (ironically, the author is the Morgan Stanley partner in charge of its mergers and acquisitions departments) [hereinafter cited as Greenhill, *Structuring an Offer*].

21. United States v. Courtois, *supra* note 14, at 91,301 n.22. This reference to an actual or contemplated harm or injury requirement appears to be borrowed from United States v. Regent Office Supply Co., 421 F.2d at 1180 (to prove mail fraud violation prosecution must show schemes contemplated or actually caused harm or injury); *see* United States v. Barta, 635 F.2d at 1004 n.14 (applying *Regent Office Supply*'s standard requiring actual or contemplated harm or injury); United States v. Dixon, 536 F.2d 1388, 1399 n.11 (2d Cir. 1976) (same).

22. The *Courtois* court defines "contemplate" as "to have in view as contingent or probable as an end or intention." United States v. Courtois, *supra* note 14, at 91,301 n.22 (quoting BLACK'S LAW DICTIONARY 389 (4th ed. 1951)).

23. United States v. Bronston, *supra* note 4. The facts of this case are also reported in the district court's decision dismissing pre-trial motions by the defendant. United States v. Bronston, 491 F. Supp. 593, 593 (S.D.N.Y. 1980).

24. United States v. Newman, *supra* note 14, slip op. at 5219 (Van Graafeiland, J.). Judge Van Graafeiland dissented in *Bronston*, but cites it with apparent approval in *Newman*. *Id.* slip op. at 5218. Again one judge dissented; Judge Dumbauld accepted the securities fraud theory of the prosecution but declined to adopt the government's mail fraud theory.

Although there is thus a narrow line between the Van Graafeiland dissent in *Bronston* and his majority opinion in *Newman*, this author would submit that it is the proper line, assuming that the government can *v. Newman*,[25] the only defendant actually before the court did not occupy a fiduciary position with respect to either the investment banking firms or their clients, but rather was basically a conduit for the inside information divulged by the other defendants.[26] Thus, while the court insisted that the mail fraud statute did not cover all fiduciary breaches, it expanded the scope of criminal liability to cover those who aid or abet some fiduciary breaches.

The wellspring of these recent decisions is *United States v. Barta*,[27] under whose test criminal liability becomes possible only when the fiduciary breach involves at least in part a failure to disclose material information by the employee to the employer.[28] This in turn raises the question of whether traditional agency law will determine when an employee must disclose his own misconduct to his employer or whether the employee must adhere to the same high standard of disclosure that rule 10b-5(b) has long mandated for the limited context of securities transactions.[29]

Obviously, different possible dividing lines exist by which to distinguish the "mere breach" of a fiduciary duty from those more serious violations that justify liability. Recent cases appear to be in agreement that such a watershed must be recognized, lest serious overcriminalization result.[30] This article will not pretend to map fully where this difficult watershed should lie, but to even the amateur legal cartographer it is apparent that the present dividing line rambles as aimlessly across the legal landscape as the Continental Divide does through Yellowstone National Park. Others have suggested that a straighter, clearer line would result if the evolving concept of fraud were cut back to its common law core of an attempt to obtain money or

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eventually prove actual injury, tangible or intangible, from the conduct or at least a strong potential for injury which existed on the actual facts of the case and not just as a generic possibility. The potential injury in *Newman* seems much like that in *Barta*; the employee is risking injury to his employer which he hopes will not actually materialize.

25. *Supra* note 14.

26. Paragraph 10(d) of the indictment charges that Newman and others "aided, participated in and facilitated Courtois and Antoniu in violating the fiduciary duties of honesty, loyalty and silence owed directly to Morgan Stanley, Kuhn Loeb, and clients of those investment bankers." United States v. Newman, *supra* note 14, slip op. at 5218 n.5. The implications of the court's acceptance of an "aider and abetter" liability for those not owing a fiduciary duty themselves are broad and reach not only the knowing tippee, but, in a case like *Bronston*, the officers and directors of C & S who know that the defendant is breaching a duty to his own client and induce the defendant to do so. Conspiratorial liability under 18 U.S.C. § 371 (1976) would also seem to follow as well. For a general discussion of § 371, see Conspiracy section of Survey.

27. 635 F.2d 999 (2d Cir. 1980), *cert. denied*, 101 S. Ct. 1703 (1981).

28. *Id.* at 1006–07.

29. SEC rule 10b-5(b) states:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, ...
>
> (b) To make any untrue statement of a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading.

17 C.F.R. § 240.10b-5(b) (1981).

30. The *Barta* court implied that "the breach of an employee's fiduciary duty, without more, does not violate the mail fraud statute." 635 F.2d at 1006. Nonetheless, it upheld the conviction because the fiduciary breach before it also involved an employee's failure "to disclose material information to his employer." *Id.* at 1006–07. Other decisions have drawn a roughly similar line through the universe of

property through false pretenses.[31] However, this prescription seems questionable as a matter of historical interpretation,[32] dubious in its attempt to freeze the evolution of a fundamental legal concept,[33] and undesirable on a policy level in terms of the cases it would exclude.[34] In the modern business world, one can be defrauded of information in a manner that has consequences as grave as any

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fiduciary breaches. *See* United States v. Bush, 522 F.2d at 647-48 (fiduciary breach alone insufficient to violate mail fraud statute but violation exists when material misrepresentations and active concealment of fraud also occurred); United States v. Bryza, 522 F.2d at 421-23 (specific intent to defraud must accompany fiduciary breach to constitute violation of mail fraud statute). Earlier decisions tended to emphasize that the breach must have amounted to an "actual fraud" rather than a constructive fraud. *See* Epstein v. United States, 174 F.2d 754, 766 (6th Cir. 1949) (to prove scheme violative of mail fraud statute must prove "actual fraud," such as intentional deception); Shushan v. United States, 117 F.2d 110, 115 (5th Cir. 1941) (mail fraud statute inapplicable to "constructive frauds" which lack intentional purpose to do wrong), *cert. denied,* 313 U.S. 574 (1941). Still another distinction is the "actual harm or injury" test used by *Regent Office Supply* and other cases discussed in note 21 *supra.*

31. *See* Comment, *The Intangible-Rights Doctrine and Political-Corruption Prosecutions Under the Federal Mail Fraud Statute,* 47 U. CHI. L. REV. 562, 578 (1980) (legislative history of mail fraud statute and 19th century understanding of term suggest fraud occurs only if defendant receives something of value from victim). [hereinafter cited as *Intangible-Rights Doctrine*].

32. Although the author in *Intangible-Rights Doctrine, supra* note 31 argues that the crime of fraud was understood to mean the obtaining of money or property through trickery or deception, *id.* at 573, Congress passed a statute in 1867, well before the passage of the mail fraud statute in 1889, criminalizing any conspiracy to "defraud the United States in any manner whatever." Act of March 2, 1867, ch. 169, § 30, 14 Stat. 484 (current version at 18 U.S.C. § 371 (1976)). *See generally* Goldstein, *Conspiracy to Defraud the United States,* 68 YALE L.J. 405, 417-20 (1959) (legislative history of § 30 broadly construed to permit prosecution for conspiracy to defraud any governmental entity). This statute, which also relies on the critical concept of fraud without defining it, has been understood from its earliest days to cover bribery of governmental officials. This interpretation was accepted by the courts well before the current controversy over the scope of the mail fraud statute arose. *See* United States v. Johnson, 383 U.S. 169, 172 (1966) (statute encompasses any conspiracy to interfere with lawful operation of government); Haas v. Henkel, 216 U.S. 462, 479-80 (1910) (same).

33. In addition to their use as a means of combatting public and private corruption, the mail and wire fraud statutes have recently been used to prohibit some forms of sexual exploitation, see United States v. Condolon, 600 F.2d 7, 9 (4th Cir. 1979) (phony talent agency established by use of telephone for purpose of sexually exploiting clients; defendant convicted for defrauding victims of "time, effort, money, and expectations"), and to protect the individual's privacy. *See* United States v. Louderman, 576 F.2d 1383, 1387 (9th Cir. 1978) (customers deprived of privacy rights when defendants defrauded telephone company of intangible, confidential information). They also have considerable potential utility as a means of prohibiting the sale of products having serious undisclosed safety defects or adverse side effects. For other issues that they might conceivably reach, *see* notes 159 through 163, *infra.*

34. Not only have the mail and wire statutes been used for several decades to combat public and private corruption, *see* notes 60 through 65 *infra*, but Congress appears to have accepted these developments in its recodification efforts with respect to the federal criminal code. The House bill expressly incorporates the "intangible rights" doctrine with respect to public officials by including within the prohibited "schemes to defraud" any conduct "with an intent to... deprive the citizens of a State or locality of the honest and faithful services of a public servant of such State or locality . . . ." H.R. 6915, 96th Cong., 2d Sess. § 2534(a) (1) (C) (1980). This language does, however, give rise to a negative pregnant with respect to the private fiduciary, such as an attorney, like Bronston, or a corporate director. The Senate bill does not explicitly adopt the "intangible rights" doctrine, but it does carefully separate "a scheme or artifice... to defraud" from a "scheme or artifice... to obtain property of another by means of a false or fraudulent pretense, representation, or promise." *See* S. 1722, 96th Cong., 1st Sess. § 1734(a) (1) (A) and (B) (1980). This has the necessary effect of implying that some prohibited schemes to defraud seek something other than tangible property, and must therefore be intended to deprive the victim of an intangible right. In short, the two bills both show some Congressional acceptance of the "intangible rights"

embezzlement of money or tangible property.[35] Still, it must be recognized that not every material non-disclosure amounts to a criminal fraud.[36] Thus, this article will urge not a bright line test but a refocusing on one of the common law's critical and most complex concepts: proximate causation.[37] It does so not for the reasons that underlie the civil law's attachment to this concept, but rather for reasons that closely relate to the criminal law's central concerns with culpability and deterrence.

In the end, the real message of this article may be that the criminal law cannot be safely guided by Cardozo's prose poem to the fiduciary, but rather must undertake the more painstaking analysis suggested by Frankfurter's equally famous, but cold-eyed dictum:

> But to say that a man is a fiduciary only begins analysis; it gives direction to further inquiry. To whom is he a fiduciary? What obligations does he owe as a fiduciary? In what respects has he failed to discharge those obligations? And what are the consequences of his deviation from duty?[38]

Ultimately, the criminal law should similarly ask: (1) Was a fiduciary duty knowingly breached? (2) Did defendant's breach cause specific injury to a beneficiary of the duty, or expose him to a substantial risk thereof, in a manner that was foreseeable to the defendant?[39] and (3) Was the actual or potential injury so caused or risked of sufficient generic gravity as to be legally cognizable?[40]

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doctrine.

35. *See* United States v. Barta, 635 F.2d at 1003 (failure to tell victim employer that client unable to cover losses and undercapitalized resulted in $2 million loss to victim). In essence, the scheme in *Barta* sought to defraud the victim not of money, which the defendant had formally borrowed and presumably intended to repay, but rather of intangible rights: the opportunity to avoid a serious risk and uncreditworthy loans. Alternatively, one can be defrauded of proprietary information which the traditional common law might not regard as a sufficient property right. *Courtois*, seemingly presents such a case, although it was wrongly decided in the view of this author.

36. *See* United States v. Regent Office Supply Co., 421 F.2d at 1179 (sales based upon false representations not schemes to defraud because misrepresentations did not bear on any element of bargain).

37. For an overview of the criminal law's treatment of this issue, see H.L.A. HART & A.M. HONORE, CAUSATION IN THE LAW (1959).

38. SEC v. Chenery Corp., 318 U.S. 80, 85-86 (1943). Justice Frankfurter never completed his own analysis in *Chenery*, but his emphasis on the consequences of a deviation from duty seem important. Despite the emphasis in recent cases on whether a duty to disclose existed, it is easy to imagine disclosure violations which do not of themselves produce actual or contemplated harm or injury. Indeed, it will be suggested that this is the critical shortcoming in the reasoning of the *Bronston* court.

39. This article will advocate an alternative to making causation a substantive element of the crime and argue instead that it should be made an affirmative defense going to the defendant's state of mind and level of culpability. This proposal raises serious and complex constitutional issues about the state's ability to shift the burden of proof to the defendant which are considered in the final section of this article. *See* notes 221 through 225 *infra*, and accompanying text.

40. Not all injuries justify the imposition of a criminal sanction, and the case law on fraud has recognized that "actual harm" must be shown. *See* United States v. Courtois, *supra* note 14, at 91,301 n.22 (S.D.N.Y. June 5, 1981) ("direct, tangible, economic loss to the victim, actual or contemplated" necessary to finding mail fraud violation); United States v. Dixon, 536 F.2d at 1399 n.11 (affirming *Regent Office Supply*'s requirement that actual or contemplated harm be shown under mail fraud statute); United States v. Regent Office Supply, 421 F.2d at 1181 (false statements, even though intended to deceive, not *per se* fraudulent absent actual injury to victims). These cases are discussed *infra*, but in many instances it is impossible to discuss meaningfully the quantum of the harm that is involved without simultaneously

Although the focus of this article will be on the federal anti-fraud statutes, developments in these areas are part of a larger pattern. The Hobbs Act[41] has similarly experienced a period of inflation which has substantively changed it from a relatively simple prohibition of extortion to a far more ambiguous proscription of corruption in a variety of contexts.[42] A related expansion has occurred in the case of the Travel Act[43] and RICO.[44] In common, these developments suggest that an

discussing the proximity of that harm as a result of the defendant's conduct which, in short, is a causation issue. For example, if the defendant in *Bronston* had disclosed to the rival of his law firm's client the unlisted phone number of the client's chief executive officer without permission, it would be possible to say that the attorney defendant had breached a duty not to disclose a confidence and that he had deprived the client of the full and undivided services and loyalty of his law firm by this act of mild disloyalty. But any sensible court would hold that this act did not satisfy the "actual harm" requirement. Why? Unavoidably, the answer the court would have to give, if pressed, was that it was not foreseeably capable of causing any significant injury to the client. Thus, causation and injury are interlinked concepts. In some cases, a distinction between these two concepts is possible to a limited degree. For example, suppose a corporate director decides with specific intent, and using the mails in furtherance thereof, not to attend a series of scheduled board meetings at which important decisions are to be made and instead to take a vacation, although he receives a substantial annual salary for his services as director. Under the intangible rights theory discussed in this article, it could be said that he has deprived the corporation of the full, faithful services that he owes them as a corporate fiduciary. Again, any sensible court would say that the injury here, his nonparticipation at the board meeting, was too speculative to support criminal liability for fraud. But here, the defendant has caused the injury; he is not liable only because the injury is trivial. Still, if his nonparticipation was instead intended to avoid having to protest a self-dealing and unfair transaction that the corporation was about to enter into to its injury with other corporate insiders, it is possible to say that sufficient harm can now be ascribed to his failure to exercise due care so as to satisfy the requirement of actual harm. Still, it can now be legitimately asked whether his nonparticipation was a proximate cause of the ultimate financial harm suffered by the corporation. For example, would his participation have been too marginal and uninfluential to have changed the result at the board meeting? If so, the law would traditionally deny that he was a proximate cause of actions initiated and pursued by others. *See* Barnes v. Andrews, 298 F. 614, 616 (S.D.N.Y. 1924) (Hand, J.) (to prove misprision of office showing must be made that performance by defendant of his duties would have avoided loss). In so saying, however, we are "unpacking" the notion of "actual harm" into its two components: (1) the ultimate deprivation, here, the financial injury, rather than the loss of the director's full and faithful services; and (2) the causal relationship between the defendant's action or inaction and this ultimate injury, whether actual or merely threatened. In the final analysis, the prosecution's success in asserting intangible injuries as sufficient to satisfy the "actual harm" requirement enables it to cloud the issue of whether the defendant has himself done enough to produce the possibility of real harm to some victim to justify the imposition of liability for fraud. The shift from a focus on the ultimate economic or personal injury done to the victim, to a focus on the deprivation of the victim's right to loyal and faithful service from the fiduciary, significantly expands the scope of criminal liability by downgrading the historic role of causation.

41. 18 U.S.C. § 1951 (1976).

42. *See* United States v. Kenny, 462 F.2d 1205, 1211, 1219 (3d Cir.) (conspirators convicted for procurement of kickbacks from contractors and concealing money so obtained), *cert. denied,* 409 U.S. 914 (1972). As discussed below the critical developments here were the assertion of economic duress as a form of extortion and the separation of payments received by political officials "under color of official right," beyond the usual requirement that the victim be coerced or otherwise placed in fear of physical harm or injury to himself or others. In reality, the Hobbs Act has undergone a far more striking, if earlier, metamorphosis than now appears to be occurring in the context of the mail and wire fraud statutes.

43. 18 U.S.C. § 1952 (1976); *see* Perrin v. United States, 444 U.S. 37, 45 (1979) (bribery of private persons covered by Travel Act; not limited to common law meaning under which bribery applied only to government officials). *See generally* Travel Act section of Survey.

44. 18 U.S.C. §§ 1961 – 1968 (1976 & Supp. III 1979); *see* United States v. Huber, 603 F.2d 387, 391, 396 (2d Cir. 1979) (court warned that overcriminalization could occur under RICO, cautioned prosecutors to examine each indictment on case-by-case basis). *See also* Note, Elliott v. United States:

amoeba-like growth of federal criminal jurisdiction is occurring which cannot be rationalized under any single theory or justification. This article has no simple answer to this problem, but it will suggest both some prosecutorial guidelines for self-restraint and a means by which the defendant could place before the factfinder his claim that the conduct in question, even if unethical, was ultimately innocuous.

I. THE GROWTH OF MAIL FRAUD: TODAY, THE POST OFFICE—TOMORROW, THE WORLD

Among prosecutors, a well-known maxim says "when in doubt, charge mail fraud."[45] The reasons for this popularity of the mail and wire fraud statutes are easy to discern as the prosecution need only prove the existence of a "scheme or artifice to defraud" and the use of the mails or wires in furtherance thereof.[46] Although both statutes also require proof of "specific intent," case law has relaxed this requirement by permitting the factfinder to infer intent from the circumstances,[47] and at least one decision has paralleled recent developments in securities fraud by equating a "reckless disregard of the truth" with an intent to deceive.[48] More important, courts have refused to define "scheme to defraud" in terms of any objectively verifiable set of facts or circumstances. Indeed, judicial definition of the term has been almost

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Conspiracy Law and the Judicial Pursuit of Organized Crime Through RICO, 65 VA. L. REV. 109, 120-21 (1978) (federal court interpretations of RICO ignore federalism concerns and separation of powers; result in overly broad constructions). *See generally* RICO section of Survey.

45. The author has heard this line used by more than one Assistant United States Attorney for the Southern District of New York, but will not disclose their indentities (absent sufficient inducement).

46. 18 U.S.C. § 1341 (1976) provides:

> Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, or to sell, dispose of, loan, exchange, alter, give away, distribute, supply, or furnish or procure for unlawful use any counterfeit or spurious coin, obligation, security, or other article, or anything represented to be or intimated or held out to be such counterfeit or spurious article, for the purpose of executing such scheme or artifice or attempting to do so, places in any post office or authorized depository for mail matter, any matter or thing whatever to be sent or delivered by the Postal Service, or takes or receives therefrom, any such matter or thing, or knowingly causes to be delivered by mail according to the direction thereon, or at the place at which it is directed to be delivered by the person to whom it is addressed, any such matter or thing, shall be fined not more than $1,000, or imprisoned not more than five years, or both.

For a comprehensive review of the history and development of the mail fraud statute *see* Rakoff, *The Federal Mail Fraud Statute* (pt. 1), 18 DUQ. L. REV. 771 (1980) [hereinafter cited as Rakoff].

The wire fraud statute, 18 U.S.C. § 1343 (1976), has substantially similar language, except that it requires a transmission of a message "by means of wire, radio or television communication in interstate or foreign commerce."

47. *See* United States v. Alston, 609 F.2d 531, 538 (D.C. Cir. 1979) (requisite intent to defraud need not be proved by direct evidence; where loan applications and credit records falsified to induce extension of credit, jury can reasonably infer intent to defraud), *cert. denied*, 445 U.S. 918 (1980); United States v. Cady, 567 F.2d 771, 774-75 (8th Cir. 1977) (indirect circumstantial evidence sufficient to demonstrate attorney knowingly and intentionally participated in scheme to defraud), *cert. denied*, 435 U.S. 944 (1980).

48. United States v. Marley, 549 F.2d 561, 563-64 (8th Cir. 1977) (evidence that defendant acted with reckless indifference as to truth of representations satisfies intent requirement under wire fraud statute violation).

exclusively negative; a wealth of case law has established that a "scheme to defraud" need not result in actual pecuniary or property loss to any victim[49] nor need the scheme be contrary to state[50] or federal law.[51] Rather, the governing standard seems to be that of fair play, an obviously elusive standard upon which to make the question of criminal liability turn. As several courts have said, apparently without pausing to consider very long the enormous implications of their statement, the "[l]aw puts its imprimatur on . . . accepted moral standards and condemns conduct which fails to match the reflection of moral uprightness, of fundamental honesty, fair play and right dealing in the general and business life of members of society."[52] Under such a definition, cheating at bridge is apparently as much a federal offense as bribing a governor or defrauding investors in a stock swindle, at least if the mails are used to clear the check.[53]

In light of the inherent overbreadth in this prevailing interpretation of the scope of mail and wire fraud statutes, it is hardly surprising that several recent commentators have raised the spectre of overcriminalization.[54] This criticism has had two focal points which involve very different issues and legal terrain and are united principally by their common use of the word "fiduciary." First, several commentators have expressed alarm at the use of the mail fraud statute to reach elected state

49. *See, e.g.,* United States v. Bryza, 522 F.2d at 421-23 (employee's breach of fiduciary duty constitutes scheme to defraud; violates mail fraud statute even though employer may not have suffered harm); United States v. Reicin, 497 F.2d 563, 571 (7th Cir.) (pecuniary loss to victim not prerequisite to finding scheme to defraud), *cert. denied,* 419 U.S. 996 (1974); United States v. George, 477 F.2d at 512 (to prove scheme to defraud, government need not show victim actually defrauded or suffered loss); United Sates v. Fraser, 303 F. Supp. 380, 384 (E.D. La. 1969) (scheme to defraud exists where state agent received bribes for causing state funds to be deposited in particular bank despite lack of actual pecuniary or property loss).

50. *See* United States v. Foshee, 606 F.2d 111, 113 (5th Cir. 1979) (whether Alabama law prohibits check-kiting scheme has no bearing on application of federal mail fraud statute), *cert. denied,* 444 U.S. 1082 (1980); United States v. Mandel, 591 F.2d 1347, 1360-61 (4th Cir.) (that scheme to defraud may not violate Maryland law not determinative of whether federal mail fraud statute prohibits such scheme), *aff'd on rehearing,* 602 F.2d 653 (4th Cir. 1979) (en banc), *cert. denied,* 445 U.S. 961 (1980); United States v. States, 488 F.2d 761, 767 (8th Cir. 1973) (federal prosecution under mail fraud statute not affected by applicability of Missouri law to fraudulent absentee ballot scheme), *cert. denied,* 417 U.S. 909 (1974).

51. United States v. Bush, 522 F.2d at 646 (defendant liable under mail fraud statute despite lack of evidence of any other violation of federal or state law).

52. Blachly v. United States, 380 F.2d 665, 671 (5th Cir. 1967), *quoted in* United States v. Keane, 522 F.2d 534, 545 (7th Cir. 1975), *cert. denied,* 424 U.S. 976 (1976). *See also* United States v. States, 488 F.2d at 764 (quoting *Blachly*); Gregory v. United States, 253 F.2d 104, 109 (5th Cir. 1958) (scheme to defraud measured by standard reflecting societal values of honesty, fair play).

53. At oral argument, in *United States v. Turkette,* Justice Brennan sought to test the limits of the government's theory on the scope of federal criminal jurisdiction by asking the government if the RICO statute, 18 U.S.C. §§ 1961-68 (1976 & Supp. III 1979), "reaches bridge clubs." 29 CRIM. L. REP. 4049, 4050 (Apr. 27, 1981). He received the answer that if the club violated state law RICO could reach it. *Id.* The mail fraud statute could apparently reach the same crooked bridge game if the mails were used in furtherance of the activity even if it did not violate state criminal law.

54. *See* Morano, *The Mail-Fraud Statute: A Procrustean Bed,* 14 J. MAR. L. REV. 45 (1980) (analyzing and proposing limitations to abuse in excessive sweep of mail-fraud statute as now applied); Comment, *Federal Prosecution of Elected State Officials for Mail Fraud: Creative Prosecution or An Affront to Federalism?,* 28 AM. U.L. REV. 63 (1978) (analyzing propriety of increasing federal involvement in state and local political corruption cases) [hereinafter cited as *Federal Prosecution of Elected State Officials*]; *Intangible-Rights Doctrine, supra* note 31 (analyzing mail fraud cases adopting intangible rights theory in expansive definition of fraud).

officials who have engaged in some species of public corruption.[55] The convictions of Governors Kerner of Illinois, Mandel of Maryland and, most recently, Blanton of Tennessee have highlighted this use of the mail fraud statutes.[56] Under the "intangible rights" theory that these decisions have established, the prosecutor may today allege in the case of a public official that a "scheme to defraud" simply consists of any act which deprives, or seeks to deprive, the state or its citizens of the "faithful and loyal services" of the defendant, its employee and servant. A fair reading of these cases probably does support the conclusion that they amount to "a general theory of fraud liability of elected officials who engage in public corruption,"[57] and some have claimed that they imply that "[a]ny breach of such an official's fiduciary duty, accompanied by even incidental use of the mails, constitutes mail fraud and invites federal intervention."[58] Other decisions have, however, taken a more conservative view of an elected official's duty,[59] and thus the overall picture remains uncertain as to whether the breach of duty is alone sufficient to constitute a scheme to defraud.

The second line of cases that has found a breach of fiduciary duty to provide loyal and honest service to amount to a "scheme to defraud" has involved private officials, typically corporate officers and employees.[60] Here, the most common pattern has involved kickbacks. Typically, a buying officer for the corporation receives undisclosed income as the result of favoring one seller over another. Because it might otherwise be open to dispute in such a case whether the corporation suffered or the defendant caused any loss,[61] the fiduciary breach theory simplified the prosecutor's task since under it the prosecutor had only to prove under the fiduciary breach theory that the employee was disloyal and not that the corporation suffered or that the defendant caused an economic loss. One still suspects, however, that the underlying injury here is economic as the seller's offer to give a kickback can be translated into an offer to grant an equivalent price reduction, which the corporation employee has effectively disdained in favor of a personal benefit. Such a case

55. For a list of cases in which the mail fraud statute has been employed to combat political corruption, see *Intangible-Rights Doctrine, supra* note 31, at 563 n.2.

56. *See* United States v. Mandel, 591 F.2d at 1361-64; United States v. Isaacs, 493 F.2d 1124, 1150 (7th Cir.) (conviction of Governor Kerner for mail fraud), *cert. denied*, 417 U.S. 976 (1974). Governor Blanton of Tennessee was convicted of mail fraud, conspiracy, and extortion charges based on the sale of liquor store licenses in June of 1981. N.Y. Times, June 10, 1981, § A, at 19, col. 1. *See also* United States v. Diggs, 613 F.2d 988, 997-99 (D.C. Cir. 1978) (mail fraud conviction of Congressman Diggs for receipt of kickbacks from employees' salaries).

57. *Federal Prosecution of Elected State Officials, supra* note 54, at 66.

58. *Id.*

59. *See* discussion note 14 *supra*, in particular, United States v. Bush, 522 F.2d at 648, and note 15 *supra*.

60. The first of these cases was probably United States v. Procter & Co., 47 F. Supp. 676, 678 (D. Mass. 1942) (mail fraud conviction of defendant company for bribing employees of competitor to obtain and turn over trade secrets). For more recent cases involving the same basic pattern of kickbacks or side payments to corporate employees, see United States v. Bryza, 522 F.2d at 422 (mail fraud conviction based on employee's breach of fiduciary duty, depriving employer of loyal and honest service by failure to disclose receipt of kickbacks); United States v. George, 477 F.2d at 512-14 (mail fraud conviction of purchasing agent for undisclosed receipts of kickbacks for purchases of cabinets for employer).

61. In *Bryza*, for example, the corporate defendant had bribed competitor's employees. 522 F.2d at 415-16. In general, the prosecutor might find it difficult in such a case to prove that the competitor suffered an economic loss, as the facts may not clearly indicate a causal relationship between defendant's

troubles few, but its manner of articulation opens the door to more questionable extensions of the fiduciary duty theory.

Both the public official and corporate officer cases assert a deprivation of "intangible rights" belonging to the citizenry and government in the first case and the stockholders and the corporation in the second. Recent criticism of this theory has described it somewhat breathlessly as a new and ominous trend.[62] Ominous it may be, but its newness is largely illusory.[63] As early as 1940, the Fifth Circuit upheld the mail fraud conviction of a state official,[64] and at least nine[65] successful prosecutions of state officials under the theory can be found before the landmark *Isaacs* decision in 1974.[66] Similarly, in the context of the private fiduciary breach, the Second Circuit upheld in 1941 the mail fraud conviction of one Wallace Groves for seeking "to gain control of and defraud the General Investment Corporation."[67] The case involved insider trading, prior to the adoption of rule 10b-5, and liability under the mail fraud statute was essentially rested on "the use by a fiduciary of inside

payment and the deception. *Intangible-Rights Doctrine, supra* note 31, at 586 n.153.

62. *See id.* at 563 (conviction of officials under federal mail fraud statute for scheming to defraud citizenry of abstract political rights and civil rights perhaps most important development in history of statute).

63. The first clear appearance of the intangible rights doctrine was probably in Shushan v. United States, 117 F.2d at 115 (any scheme to obtain advantage by corrupting public official, who has "sacred duties," constitutes scheme to defraud under federal law). Concededly, however, *Shushan* involved economic loss as well. *Id.* at 114.

64. *See* Hart v. United States, 112 F.2d 128, 129-30 (5th Cir.) (sale of hotel at inflated price by state university president and others defrauded taxpayers), *cert. denied,* 311 U.S. 722 (1940).

65. Of these nine, eight resulted in convictions. *See* Parr v. United States, 363 U.S. 370, 391-93 (1960) (school board officials acquitted of mail fraud charges for scheme to misappropriate taxes because state law required mailings and amount collected not in excess of school district's needs or padded; defendants' behavior, although "bad and brazen," states crimes of misappropriation, conversion, embezzlement and theft not federal mail fraud violation); United States v. States, 488 F.2d 761, 765 (8th Cir. 1973) (mail fraud statute violated where public and election authorities deprived of intangible political and civil rights), *cert. denied,* 417 U.S. 909 (1974); United States v. Edwards, 458 F.2d 875, 880-81 (5th Cir.) (Oklahoma judge convicted of mail fraud for granting divorces of questionable validity, depriving people of fees and right to valid divorces), *cert. denied,* 409 U.S. 891 (1972); Steiner v. United States, 134 F.2d 931, 933 (5th Cir.) (city clerk convicted of mail fraud for scheme to procure fraudulent tax assessment reductions, depriving taxpayers of fee money and city of lawful taxes), *cert. denied,* 319 U.S. 774 (1943); Bradford v. United States, 129 F.2d 274, 276 (5th Cir.) (city finance commissioner convicted of mail fraud for defrauding city and breaching public trust by using office and political influence to sell buses to city at exorbitant prices), *cert. denied,* 314 U.S. 617 (1941); Shushan v. United States, 117 F.2d at 120-21 (president of levee board and chairman of city finance committee, among others, convicted of mail fraud for scheme to defraud board of levee commissioners by means of bond refunding plan notwithstanding fact board made savings by plan); Hart v. United States, 112 F.2d at 129-30, *supra* note 31; United States v. Faser, 303 F. Supp. 380, 384-85 (E.D. La. 1969) (mail fraud conviction of state agent for causing state funds to be deposited by mail in a particular bank, thereby fraudulently depriving state of honest and faithful performance of duties as public official); United States v. Classic, 35 F. Supp. 457, 458 (E.D. La.) (defendants convicted of mail fraud for tampering with ballots, thereby violating duties as election commissioners), *aff'd on other grounds,* 313 U.S. 299 (1941).

66. United States v. Isaacs, 493 F.2d at 1139, 1149 (former governor of Illinois convicted under mail fraud statute; state suffered no monetary loss from governor's arrangement to purchase race track stock at below market prices from owner of Chicago-area racing interests in return for agreeing to promote interests before state racing board and state legislature, but court used intangible rights theory to find Illinois citizens deprived of "honest and faithful services of. . . governor").

67. United States v. Groves, 122 F.2d 87, 89 (2d Cir.), *cert. denied,* 314 U.S. 670 (1941).

information to his own benefit and to the detriment of his *cestui*."[68] In a more recent case, the Second Circuit has taken it as self-evident that a clear case of unfair self-dealing by a corporate fiduciary would come within the ambit of the mail fraud statute.[69]

The absence of any sharp discontinuity in the prior case law, however, is in contrast to the significant break that *Bronston* may represent. Before *Bronston*, it could be said with relative confidence that the fiduciary duty theory of mail fraud was limited by the requirement that the fiduciary breach be the proximate cause of the harm, or at least the potential harm, to the injured class.[70] This limit, however, is called into question by *Bronston*. Equally important, *Bronston* also illustrates the subtleties inherent in another aspect of criminalizing breaches of fiduciary duties in that the scope of the theory expands dramatically depending on who we view as the victim of the breach, and, in the most common cases, it is likely that there will be multiple parties who can reasonably claim that a duty of loyalty owed to them has been breached.

A. THE PRIVATE FIDUCIARY BREACH

Bronston is clearly the most publicized recent case imposing criminal liability for private fiduciary breach; in part, this is because the defendant was a New York state senator and a partner in a respected New York law firm. But its greater siignificance lies in its articulation of a theory that reaches all who are members of the legal

68. *Id.* at 90. *See also* United States v. Buckner, 108 F.2d 921, 926-27 (2d Cir. 1940) (heads of bondholders' committee conviction for mail fraud for intentional conversion of trust funds for personal use and use of fiduciary position to obtain secret profits based on inside information, thereby committing breach of trust and active fraud on shareholders). The author has adopted the term "cestui" to denote, in the context of a violation of intangible rights, those to whom the fiduciary owes a duty of responsibility.

69. *See* United States v. Dixon, 536 F.2d at 1400 (court assumed use of deficient proxy statement violating fiduciary duty could create liability under mail fraud statute, but not on facts of instant case).

70. No decision has used explicit "proximate causation" terminology, and *Bronston* clearly rejects it. Nonetheless, several cases have invoked conceptual distinctions that amount to such a requirement. *Dixon* does so when it says that "a scheme to *use* a private fiduciary position to obtain direct pecuniary gain is within the mail fraud statute." 536 F.2d at 1399 (emphasis added). Moreover, *Dixon*'s real holding is that a willful breach of a duty of disclosure to shareholders does not amount to a scheme to defraud "where the non-disclosure did not cause the asserted harm." *Id.*at 1400. A similar emphasis on the use of the fiduciary position is clear in United States v. Buckner, 108 F.2d at 926, where the court noted that "[u]sing a fiduciary position. . . to obtain secret profits based upon inside information is not only a breach of trust, but an active fraud on the bondholders." *See also* United States v. Mandel, 591 F.2d at 1363 (the "breach of fiduciary duty must be linked with some actionable fraud" for mail fraud statute to apply); United States v. Dorfman, 335 F. Supp. 675, 679 (S.D.N.Y. 1971) (may convict defendant where he "agrees to use that fiduciary position" to profit himself). Finally, in both United States v. Rabbitt, 583 F.2d at 1024-25, and United States v. McNieve, 536 F.2d at 1249-50, convictions were reversed where no use of the fiduciary position was shown.

The second requirement ennunciated by *Dixon* is that in the case of a "private" fiduciary, the scheme to defraud must involve at least "the potential of pecuniary loss to the victims and gain to the perpetrators." 536 F.2d at 1399. *But see* United States v. Bryza. 522 F.2d at 422 (defendant violated mail fraud statute when failed to give loyal, faithful service even though court indicates that defendant secured best possible deal for employer). The *Dixon* requirement, in the opinion of the Second Circuit, has been satisfied in *Bronston. See* United States v. Bronston, *supra* note 4, slip op. at 4597 (defendant's scheme designed to inflict actual economic harm and capable of doing so); *id.* at 4598 (fraud by defendant benefitted him by $12,500). United States v. Newman, *supra* note 14, also calls into serious question whether the Second profession.[71] Bronston's firm undertook to represent the minority investors of Bus Top Shelters, Inc. ("Bus Top"), a firm then holding an interim franchise from the City of New York to build and maintain bus shelters. Knowing of this representation, Bronston sought to have his law firm represent instead a rival contender for that franchise, Convenience and Safety Corp. ("C & S"), with whose officers he had extensive prior dealings. According to the prosecution's theory, Bronston's firm declined to represent C & S because of the conflict, and Bronston then secretly did so on a personal basis, attending meetings, working on strategy and ultimately billing C & S for some $12,500, a fee that apparently reflected what would have been his law firm's normal billing rate for his time. Bronston's legal services for C & S consisted principally of attending "strategy sessions" at which C & S personnel planned their political campaign to obtain the contested franchise. In this capacity, Bronston chiefly commented on draft letters sent by C & S to city officials, but in an act of possibly critical importance, he also sent a letter in his own name as a state senator on his official stationery to a subordinate official in the City Comptroller's office, which declared that "a renewal of [Bus Top's] franchise would not appear to be in the public interest. . . ."[72]

At the conclusion of the trial, Judge Milton Pollack instructed the jury according to the familiar *Post* charge:

> I instruct you that a lawyer, such as the defendant Jack E. Bronston, owes a duty, sometimes referred to as a fiduciary duty, to the clients of his law firm to act with the utmost good faith and loyalty toward the firm's clients and to fully disclose any participation in a conflicting relationship with [*sic*] and the services of the mutually exclusive business interests of a competitor of the firm's clients which would in any way injure, impair, interfere with or frustrate the business interests of the client in order to promote the mutually exclusive interests of the competitor.
>
> If you find beyond a reasonable doubt that Bronston knowingly and with fraudulent intent schemed to work some injury to the client's economic interests in a valuable business opportunity or participated in such a scheme in order to promote the mutually exclusive interest of a competitor in which he allegedly was interested and held a corporate office, that would not only be a breach of fiduciary duty, but an act of fraud.
>
> A lawyer such as the defendant... has a duty not to act in any manner which is inconsistent with a client's interest .... It is immaterial whether or not Bronston, a partner of the law firm, had a direct responsibility for or handled any part or serviced the firm's engagement by the client. He

Circuit still believes that the "potential of pecuniary loss to the victims" is necessary insofar as, in *Newman*, the loss to the investment banking firms was more reputational than financial.

The connotation that arises from the words "loss to the victims" and "gain to the perpetrators" supports the notion that the plaintiff is required to prove the fiduciary breach was the proximate cause of harm to the injured class.

71. The facts of the case are set forth succintly in the district court's decision denying defendant's motion to dismiss the indictment. United States v. Bronston, 491 F. Supp 593, 593 (S.D.N.Y. 1980), *aff'd*, No. 81-1015 (2d Cir. Aug. 19, 1981).

72. United States v. Bronston, *supra* note 4, slip op. at 4591.

> was a partner, and as has been said very succinctly, many forms of conduct permissible in a work a day [*sic*] world for those acting at arm's length are forbidden to those bound by fiduciary ties. A fiduciary is in a position of trust and is held to something stricter than the morals of the marketplace.[73]

Thus, in this last sentence, Cardozo's rhetoric from *Meinhard v. Salmon*[74] apparently evolves from an aspirational standard of common law to the test of criminal liability. Its consequence, however, was harsh. Convicted and sentenced to prison, Bronston told the court at sentencing, "[M]y life [is] in a shambles. My career, my reputation, my practice and my finances have been wrecked."[75] Whether one should sympathize with defendant Bronston is open to debate. Arguably, a civil sanction such as bar association censure or suspension would have been more appropriate. But the concern of this article is less with Mr. Bronston, whose conduct was clearly improper, than with the decision's impact on a wide range of other persons who are neither attorneys nor corporate officials, but who could find themselves equally surprised by the criminal law's adoption of common law standards of fiduciary duty.

Is there any intermediate position before every breach by a fiduciary becomes a potential criminal prosecution at the option of the federal prosecutor? The facts of *Bronston* illustrate one potential compromise which neither denies that a fiduciary breach can amount to a criminal violation nor makes every ethical shortcoming a felony offense. Assume for the moment that Bronston has done nothing more than breach his fiduciary duty for personal pecuniary gain.[76] Classically, this might seem sufficient to support criminal liability since, on these assumed facts, the conduct consisted of more than a naked fiduciary breach standing alone, but had the motive of personal profit. So simplified, the *Bronston* fact pattern as a paradigm has two critical elements: (1) a fiduciary breach, and (2) a self-seeking motive. What more could be required? Scrutinized carefully, previous mail fraud convictions based on a fiduciary breach directly advanced the scheme to defraud.[77] Under such a test, it is insufficient that there be a fiduciary breach and a pecuniary gain to the defendant or loss to the victim; rather, the former must in some manner cause the latter.

To illustrate this proximate causation test, consider the very different case where the lawyer obtains confidential data from his firm's client (BusTop) and passes it on to his personal client (C & S) so that the latter is able to underbid the former and thus win the franchise.[78] Here, as before, there is a breach and a loss, but now, the fiduciary violation (the act of transmitting confidential data from BusTop to C & S)

73. Record, at 1242-43, United States v. Bronston, 491 F. Supp. 593 (S.D.N.Y. 1980), *aff'd*, No. 81-1015 (2d Cir. Aug 19, 1981) (on file at the American Criminal Law Review) [hereinafter cited as *Bronston* Record].

74. 249 N.Y. at 463, 164 N.E. at 546.

75. Lubasch, *Bronston Gets 4 Months in Bus-Stop Fraud Case*, N.Y. Times, Jan. 3, 1981, at 25,col. 5.

76. Bronston's personal pecuniary gain could be, for example, the $12,500 fee received from C & S.

77. *See* note 70 (cases requiring causal relationship between fiduciary breach and harm).

78. For a case successfully prosecuted under the mail fraud statute which involved such a secret revelation of one competitor's bid to another, even without any clear element of fiduciary breach, *see* United States v. Patterson, 644 F.2d 890, 892 (1st Cir. 1981) (performance bond writer leaked bids to postal route bidder). Arguably, in such a case the agent or employee is under an implicit duty not to harm the employer or principal he serves. *Cf.* United States v. Barta, 635 F.2d 1007 (defendant, salesman and trader for small securities firm, occupying position of great trust and responsibility, advised to keep

directly causes the loss to BusTop investors.[79] In contrast, under the facts assumed in *Bronston*, the defendant has not used his fiduciary postion to cause any loss to the BusTop investors. Stripped to the essentials, the facts show only a lawyer having a conflict of interest still doing legal work for a rival of his firm's clients. Under such an expansive theory, the lawyer conceivably might be liable if he only gave tax advice to his secret client, helped it amend its certificate of incorportaion or performed some similarly innocuous service which did not involve use of his position as an adviser to BusTop.[80]

The importance of this third element, that the breach directly further the actual or potential loss to the victim of the scheme to defraud, to the formula for criminal liability, comes into focus when we consider the full range of cases that potentially come within a test that lacks any element of proximate causation. Suppose an attorney is a silent partner in one contender for the franchise and his firm then takes on a rival bidder as a client. Is he criminally liable under the mail fraud statute if he does not promptly reveal his personal interest?[81] To take matters one step further, suppose Bronston does disclose that he is representing a rival bidder on a personal basis and his firm's clients (Bus Top) neither change law firms nor consent to this open conflict of interest. There is an apparent violation of legal ethics and a

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employer informed of adverse market developments and possessing authority to extend employer's credit, under duty to apprise employer of material information concerning trading by undercapitalized firm in which employee had interest; court specifically left open question whether all employees have duty to disclose).

79. In the following colloquy, the defendant's attorney, Mr. Louis Nizer, takes exception to the court's failure to require proof that Bronston used his position to cause loss to the BusTop investors:

> Mr. Nizer: I respectfully except because as we heard [the jury charge], it was clear that the lawyer owes a fiduciary duty and they may consider whether that was breached, but not that there must be also a confidentiality, some use of the fiduciary relationship, an abuse of it, and I respectfully ask in addition to that it be charged directly that there is no evidence of such misuse or breach.
>
> The Court: That's something that you argued to the jury and I will stand on the charge as furnished.

Bronston Record, *supra* note 40, at 1268-69.

80. Under *Barta*, the defense might be available that the fiduciary breach here did not involve any element of disclosure which legal ethics made necessary. This is questionable, however, because legal ethics do not distinguish between major and minor services performed by a law firm or attorney who is subject to a conflict of interest. Once an attorney is subject to a conflict, he may not represent the potential client in any capacity. Nor can the "actual harm" requirement provide a rational distinction for justifying an acquittal in the hypothesized facts but not in *Bronston*. If one were to say that the attorney who gives tax advice to a competitor of his firm's client does not deprive his firm's client of a valuable service, or, alternatively, that the loss of the full and undivided loyalty of the law firm does not of itself constitute "actual harm or loss," a position United States v. Courtois, *supra* note 14, at 91,301, would probably support, this same conclusion seems unavoidable on the facts of *Bronston* as well, where the services provided by Bronston to C & S were of minimal value. The line that could be used to distinguish *Bronston* from the above hypothetical is that of proximate causation; there is far less danger of real injury, such as deprivation of the franchise, when the attorney subject to the conflict gives advice on how to outbid his own firm's client than when he merely gives tax advice or other perfunctory services.

81. According to the ABA CODE OF PROFESSIONAL RESPONSIBILITY, DR 5-101(A), "[e]xcept with the consent of his client after full disclosure, a lawyer shall not accept employment if the exercise of his professional judgment on behalf of his client will be or reasonably may be affected by his own financial, business, property, or personal interests." In principle, the failure to obtain the client's consent to a material conflicting economic interest is as much a breach of legal ethics as an unauthorized revelation of

consequent breach of fiduciary duty, but if the key element in fraud is deception,[82] it defies both language and logic to call such an open and notorious act a "scheme to defraud."

Thus, we have a possible watershed: a mere fiduciary breach is not a "scheme to defraud," but the exploitation of the fiduciary position to injure the *cestui* is. On the simplified facts of the *Bronston* case as discussed here, it is difficult to see any such exploitation. To be sure, Bronston actively promoted the interest of C & S by writing letters and planning strategy, but his position as a partner in the law firm representing BusTop did not enable him, but rather only constrained his ability to do so. In short, the fiduciary breach did not enhance, further or assist the aid he gave to C & S. Thus, it did not "proximately cause" the loss or potential for loss. If, however, Bronston had disclosed secret plans or strategy of BusTop to C & S, criminal liability would be appropriate. The breach then would be related to the loss by an intervening causal link which, under this analysis, becomes critical.

This simple three-element formula of (1) breach of duty, (2) actual or threatened loss and (3) a causal link of requisite proximity between the breach and loss gives a conceptual framework to the criminalization of fiduciary violations that prevents every ethical shortcoming from becoming a felony, but permits the state to prosecute serious deprivations. In principle, it would reach the classic forms of fiduciary abuse by corporate insiders: self-dealing transactions, diversion of corporate opportunities and use of "inside" information, all of which require a use or exploitation of the fiduciary position.[83] Nonetheless, it was exactly such a test that the district court

privileged confidences by the attorney. But this conclusion only raises again the issue of whether all ethical breaches involving a failure to make a required disclosure should be criminal offenses. Here, the range of covered circumstances seems potentially enormous and considerable discretion should be left to the fact-finder. This is exactly what a proximate cause test would do.

82. *See Federal Prosecution of Elected State Officials, supra* note 54, at 573 (historically, "crimes of fraud generally have been regarded as crimes against property involving some form of trickery or deception").

83. Some asserted fiduciary duties would not, however, be reached. For example, neither sale of control at a premium nor sale of a control bloc to a looter typically involves use or exploitation of a fiduciary position. *See* Swinney v. Keebler Co., 480 F.2d 573, 578 (4th Cir. 1973) (although not absolute insurers, if sellers of control are in position to foresee likelihood of fraud on corporation or remaining stockholders by transferee, they have fiduciary duty not to sell if reasonable investigation shows to reasonable person fraud is intended or likely); Insuranshares Corp. v. Northern Fiscal Corp., 35 F. Supp. 22, 25 (E.D. Pa. 1940) (sellers of controlling interest liable to corporation for buyers' looting where circumstances suspicious and should have put them on guard); *But see* Perlman v. Feldmann, 219 F.2d 173, 178 (2d Cir.) (defendant, as both dominant stockholder and principal officer of steel corporation, owed fiduciary duty not to appropriate for himself premium resulting from sacrifice of corporate good will to extent price paid in sale of controlling stock represented payment for right to control distribution), *cert. denied*, 349 U.S. 952 (1955). Although sale to a looter generally is considered actionable today, it is highly dubious that the theory of *Perlman* will be expanded beyond its precise facts. *See* Clagett v. Hutchison, 583 F.2d 1259, 1264 (4th Cir. 1978) (seller of controlling shares of corporation does not owe fiduciary duty to minority shareholders to afford them equal opportunity to sell minority shares); Zetlin v. Hanson Holdings, Inc., 48 N.Y. 684, 685, 397 N.E. 2d 387, 388 (1979) (absent looting, conversion of corporate opportunity, fraud or other acts of bad faith, controlling stockholder is free to sell controlling interest at a premium). Nor does the duty not to compete with the firm for which one is serving as a director or corporate official necessarily involve exploitation of a special position within the corporation. *See* Note, *Fiduciary Duty of Officers and Directors Not to Compete With the Corporation*, 54 HARV. L. REV. 1191, 1197-99 (1941) (corporate directors or officers should be precluded from engaging in directly competitive business, but may undertake merely related collateral enterprise) [hereinafter cited as *Fiduciary Duty of*

rejected in *Bronston*, holding that any precedent for such a test was lacking.[84] On appeal, the Second Circuit emphatically upheld the trial court's refusal to charge the jury that the use of the fiduciary position was a necessary element of a scheme to defraud based upon a breach of a fiduciary duty,[85] writing broadly that "proof that the fiduciary relationship was used or manipulated in some way is not necessary."[86] To support this position, it relied essentially on language in an earlier Second Circuit decision, *United States v. Barta*, that "[t]he additional element which frequently transforms a mere fiduciary breach into a criminal offense is a violation of the employee's duty to disclose material information to his employer."[87] But the degree of support that *Barta* provides for *Bronston*'s result is questionable. In fact, *Barta* involved a paradigm of the manipulative use of a confidential position. The defendant was a margin clerk of an investment banking firm who through deceit and bald misrepresentations lent himself and his co-conspirators several million dollars of his employer's funds in order to speculate on the stock market in violation of the federal margin rules. On his eventual insolvency, the loss fell on his employer, who had repeatedly been assured by the defendant that the loans were to legitimate third parties. In short, *Barta* is basically a sophisticated embezzlement, albeit with an intent to repay, while *Bronston* seems more a simple breach of professional ethics, albeit of a relatively clear and uncomplicated duty.

The dissent in *Bronston* understood this and took the majority to task for failing to recognize that in prior mail fraud convictions "[w]here liability has been found,... it was inevitably because the fiduciary relationship enabled the defendant to commit the wrongful acts for which he was convicted."[88] In an apparent reply, the majority opinion suggests that there may have been a transmission of

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Officers]. *See also* Lincoln Stores, Inc. v. Grant, 309 Mass. 417, 424, 34 N.E.2d 704 (1941) for an example of a case where a special position was exploited. In that case, the corporate directors violated fiduciary duties not by the acquisition of a noncompetitive store, but by the use of information obtained while still in the employ of the corporation to transform the store into active competition. *Id.* at 708. Most of the cases that have imposed liability, however, have involved the transfer of proprietary information from the corporation that the fiduciary served to its rival. *See Fiduciary Duty of Officers*, at 1198 (officer may not use corporation's property interest, such as customer lists, name, or goodwill). Interestingly, even in the context of corporate opportunities, before courts have found civil liablity, evidence that the plaintiff "has been harmed by the [defendants'] ownership and operation of the properties they acquired" must be found. Burg v. Horn, 380 F.2d at 901 (citing *Federal Prosecution of Elected State Officials, supra* note 54 to similar effect and RESTATEMENT (SECOND) OF AGENCY Section 393, Comment (b) (1958)). Thus, even in civil law, evidence that harm was caused and that the fiduciary position was actually used to promote the harm has generally been necessary to show a fiduciary breach in the first instance. The criminal law should be broader than the civil law only in its willingness to penalize the risking of potential harm which never transpires.

84. United States v. Bronston, 491 F. Supp. 593, 593-94 (S.D.N.Y. 1980).

85. United States v. Bronston, *supra* note 4, slip op. at 4601. At the conclusion of the trial, defense counsel requested a charge that: "in order to find a scheme to defraud, the prosecution must establish beyond a reasonable doubt that Mr. Bronston *used* the fiduciary position he held on behalf of the minority investors to further the interests of Convenience and Safety." *Id.* slip op. at 4592 (emphasis in original). The district court declined to give this charge. *Id.* Although it is arguable whether a jury could have so found on the record before it, the more important contention of this article is that the jury should be required to find causation before criminal liability for fraud can be imposed.

86. *Id.* at 4593.

87. 635 F.2d at 1006.

88. United States v. Bronston, *supra* note 4, slip op. at 4603 (Van Graafeiland, J., dissenting).

confidential information by Bronston from BusTop to C & S.[89] However, this argument is not only ineffectively made,[90] but, like the proverbial thirteenth chime of a broken clock, it undercuts the certainty of the court's earlier statements in which it emphatically denied that proof that the fiduciary misused his status was necessary. The majority opinion then adds another curious qualification which makes the scope of its decision even more uncertain. Replying to the defendant's claim that the prosecution's theory "would make every disloyal or ethically questionable act which is accompanied by the mailing of a letter a crime,"[91] the majority opinion attempts a distinction, which ultimately raises more questions than it answers:

> We disagree. Although a hypothetical can be posed in which one could be prosecuted for mail fraud on the basis of a breach of fiduciary duty accompanied by little more than a failure to disclose the breach to the person to whom the duty was owed, without any prospect of substantial economic harm to the victim, this is not such a case.[92]

This language suggests that only undisclosed fiduciary breaches that carry the "prospect of substantial economic harm to the victim" rise to the level of a criminal offense. Such a statement is certainly sound in principle, but in the context in which it is made it is logically circular. As an abstract proposition, the statement is consistent with those decisions that have spoken of an "actual harm" requirement and dismissed injuries as insufficient which consisted only of a non-disclosure of a material fact upon which the victim could not have acted meaningfully.[93] But, it is circular since the real issue in *Bronston* was whether the defendant's relatively minor assistance to C & S was capable of causing "significant economic harm" to BusTop. Thus, we are back to the issue of how a fiduciary breach that is not causally connected to a potential loss can be viewed as capable of causing significant harm.

89. *Id.* at 4598 (immediately following conference with firm partner in charge of BusTop account, defendant discussed conversation with C & S president).

90. The majority decision describes this conference as one that "provided the basis for an inference that such activity [transmission of privileged information] occurred." *Id.* at 4599. But obviously, juries need more than an "inference" to satisfy the "beyond a reasonable doubt" standard. While transmission of such information could provide the necessary causal link in this author's view, the issue still would have to be submitted to the jury. By denying the requested charge, the trial court in *Bronston* refused to present this issue to the jury. *See* note 85 *supra*. *See also* United States v. Bronston, *supra* note 4, slip op. at 4604 (Van Graafeiland, J., dissenting) (suggestion that there was a use of fiduciary status "is completely without support in the record").

91. *Id.* at 4600.

92. *Id.* Particularly ambiguous here is the word "prospect." If it means that the defendant's action must give rise to the possibility of "substantial economic harm," this is a re-introduction *sub silentio* of the concept of causation, under which the act is criminal only if it is capable of causing economic injury. But this is more or less the same standard that the defendant requested in the jury charge and that the court emphatically denied was necessary. If, however, the court does not require that defendant's action gives rise to the "prospect," then it is making him an insurer under threat of criminal liability for actions that do not of themselves seem likely to cause injury.

93. *See* United States v. Dixon, 536 F.2d at 1398–1400 (although corporate president's failure to list personal loans on proxy statements sent to shareholders for purpose of selecting unopposed management slate of directors was securities violation, omission did not affect election nor cause pecuniary loss or gain or potential of loss or gain); United States v. Regent Office Supply Co., 421 F.2d at 180–82 (mail fraud statutes require some actual injury to victim, however slight, that is reasonably probable result of deceitful representations; merely giving false reason for offering a bargain not fraud).

These comments do not deny that a criminal statute could penalize some, most or even all fiduciary breaches on the grounds that they had the potential for harm; clearly, such a law would render irrelevant the issue of causation. Nevertheless, this would be a legislative judgment, not one to be made by a court in the course of deciding whether a "scheme to defraud" actually has been put into effect. Within the four corners of existing law, it would probably have been sufficient if the court had instructed the jury that it could find Bronston guilty if it found that he had attempted to use his fiduciary position to injure his *cestui*, or, alternatively, if it found that, but for the non-disclosure of his conflict of interest, he would have been unable to take the steps he did take to oppose the renewal of BusTop's franchise. For example, the letter to the New York City Controller's Office would have been difficult to send if at the same time Bronston had been required to disclose that he was one of the attorneys for the party whose interest he was opposing.[94] Still, these issues basically were framed by the defendant's requested jury instruction, which the trial court refused to give and the Second Circuit sustained.[95]

In this light, the danger inherent in *Bronston* is that it may be read to give an almost talismanic significance to the non-disclosure itself, while in earlier cases the disclosure violation was critical only as the means by which the fiduciary misused his position. Such a transition overlooks the basic distinction evident to the ordinary citizen between a failure to observe a prophylactic rule designed to prevent fiduciary misconduct and actual predatory conduct. To the less sensitive morality of the man-in-the-street, prophylactic rules, such as the prohibition on accepting clients with conflicting interests, constitute a penumbra around the essential criminal activity they are designed to prevent, such as fraud and deceit, but are not themselves the subject of criminal prohibititons. Intuitively, it may be seen as one thing to help a friend, even though the effect is by definition to injure a client, but quite another to act affirmatively to injure the client. Although it would be difficult to argue that Bronston observed this distinction,[96] the opportunity to make such an evaluation was denied the jury by the court's failure to give the proximate cause instruction.[97]

This conclusion that an important line exists between ethical insensitivity and active fraud does not necessarily mean, however, that a defendant in a *Bronston*-type

94. United States v. Bronston, *supra* note 4, slip op. at 4590-91. The letter sent by Bronston to the Executive Assistant of the New York City Controller included the following statement: "[o]bviously, a renewal of the existing franchise would not appear to be in the public interest since it might be taken for a reward for nonperformance." *Id.* at 4590. This statement alone appears to represent an act designed, unequivocally, to harm a client. Still, the issue remains whether it was a proximate cause of a loss of the franchise or, more precisely, whether it was understood clearly by Bronston to be capable of having such an effect. Absent such a test, the infinite number of derogatory remarks that attorneys make in the wee hours of the morning about their clients, sometimes to opposing attorneys, might also be seen as criminal offenses, despite their inability to cause serious harm. To the extent that *Bronston* remains "good law" and is followed in other circuits, it should probably be read as a case involving acts, chiefly the mailing of the above letter, that were *per se* capable of causing harm and thus did not require a special jury instruction. The Second Circuit's statement that use of the fiduciary position or furtherance of the loss would then be irrelevant and could be distinguished as dictum.

95. *See* note 85 *supra* (instruction would have required jury to find Bronston used his position to further interests of client's competitor).

96. Lest there be any doubt, this article fully agrees that Bronston's conduct in deceiving his fellow partners and his firm's client was egregious and would merit fully disciplinary action by a bar association.

97. *See* note 85 *supra*.

case should escape criminal liability simply because he has not acted to injure the client. Interesting complexities arise if we expand our field of vision to consider who else may have been victimized by the defendant's actions in such a case. Under the theory plead in the indictment, Bronston allegedly breached a fiduciary duty owed to the minority investors in BusTop. The irony is that this may be the fiduciary duty that Bronston breached least. In fact, there are three distinct fiduciary duties that Bronston reasonably can be said to have breached, each running to a different class of beneficiaries. First, there is the fiduciary duty a lawyer owes to his client, the duty the state understandably relied on.[98] Second, under existing case law, Bronston, as an elected state official, owed a fiduciary obligation to his constituents and the state to give loyal, honest and unbiased public service.[99] The admittedly nebulous scope of this class of fiduciary duty will be examined shortly, but it is certainly arguable that his act in mailing a letter on official state senate stationery to other public officials in order to influence the awarding of public contracts in return for undisclosed remuneration was as much an act of mail fraud as were acts that led to the convictions of Governors Mandel and Kerner on similar charges.[100] Indeed, these first two duties merge because special ethical obligations attach to the attorney who holds public office.[101] Finally, a third and classic species of fiduciary duty is that owed by a partner to his fellow partners. Indeed, this is the very principle for which *Meinhard v. Salmon* stands.[102] Assuming that Bronston owed a duty to his fellow

98. The Second Circuit cited Disciplinary Rule 5-105 of the ABA CODE OF PROFESSIONAL RESPONSIBILITY, which requires an attorney to give his undivided loyalty to his client. United States v. Bronston, *supra* note 4, slip op. at 4595. *See also* Cinema 5, Ltd. v. Cinerama, Inc., 528 F.2d 1384, 1386-87 (2d Cir. 1976) (attorney owed duty of undivided loyalty to each client; adverse representation prima facie improper and attorney must show "no actual or *apparent* conflict in loyalty or diminution in vigor" of representation).

99. This duty appears to have received its first complete expression in United States v. States, 488 F.2d 761, 765-66 (8th Cir. 1973) (money or tangible property need not be involved to invoke mail fraud statute; defendants convicted of scheme to defraud public of intangible political and civil rights), *cert. denied*, 417 U.S. 909 (1974). *See Federal Prosecution of Elected State Officials, supra* note 54, at 563 (politicians convicted under mail fraud statute for "defrauding citizens of their rights to honest government").

100. *See* United States v. Mandel, 591 F.2d at 1362-63 (Gov. Mandel, in return for bribes, took certain positions on racetrack legislation, depriving state of his independent judgement); United States v. Isaacs, 493 F.2d at 1132-40, 1150 (Gov. Kerner obtained shares of stock for fraction of actual worth in return for influencing allocation of favorable racing dates).

101. *See* ABA CODE OF PROFESSIONAL RESPONSIBILITY DR 8-101 which states in pertinent part "A lawyer who holds public office shall not: (1) Use his public position to obtain, or attempt to obtain, a special advantage in legislative matters for himself or for a client under circumstances where he knows or it is obvious that such action is not in the public interest." Because the franchise was to be awarded by the New York Board of Estimate, an elected legislative body, this subparagraph would appear to apply to Bronston. Alternatively, if the board were deemed a tribunal, DR 8-101 (A) (2) might apply, which proscribes using a public position to influence, or attempt to influence, a tribunal to favor a client. *Id.* Finally, DR 8-101 (A) (3) covers the acceptance of anything of value, including legal fees, when "the lawyer knows or it is obvious that the offer is for the purpose of influencing his action as a public official." *Id.* Because Bronston wrote his letter to the city controller's office on the official stationery of the New York State Senate, this arguably was "use of a public position" both for value received and to influence a legislative body to favor a client.

102. 249 N.Y. 458, 463-64, 164 N.E. 545, 546 (1926). In *Meinhard*, one partner secretly acquired the future rights to the property at which the partnership's business was conducted without disclosure to the other partner. It frequently has been said by courts that fiduciary duties will be interpreted more strictly in the case of close corporations and partnerships than in that of publicly held corporations. *See* Donahue v. Rodd Electrotype Co., 367 Mass. 578, 593-94, 328 N.E. 505, 515-16 (1975) (contrasting strict good

law partners, he arguably violated this duty both by disobeying express instructions from his partners not to represent C & S and by secretly receiving the $12,500 from C & S, an amount which apparently represents funds diverted from the law partnership.[103] Given the express instruction from the firm's managing partner to Bronston not to represent C & S, the case now fits the pattern of *United States v. Barta*.[104] Under *Barta*, it is irrelevant that Bronston's purpose was not to harm his law firm, so long as he created a serious risk of harm to his employer to profit himself, a risk he affirmatively hid from his employer.[105]

The attraction of this last theory to the prosecutor is that if the defendant, or his partners, seeks to defend on the grounds that there was disclosure to, or acquiescence by, the law firm in the representation of the conflicting interest, the law firm itself, becomes implicated.[106] If the law firm knows of and tolerates a breach by one of its members, it may be liable under either of the following theories: (1) *respondeat superior*, which applies, at least in federal court, if the crime is committed by an agent of the firm within the scope of this duties and in order to benefit the firm,[107] or (2) more simply, the object of the scheme to defraud now could be said to be the obtainment of legal fees from clients with conflicting interests, because disclosure of the conflict would be likely to cause at least one of the clients to seek other legal representation.[108] Under this last theory, the client is once again the victim of the fiduciary breach, but now the object of the scheme to defraud has shifted

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faith standard of stockholders in close corporation with less stringent standard of fiduciary duty of other corporations).

103. Bronston received a personal check for $12,500 from the chairman of C & S, which the court observed could reasonably be interpreted as a payment from C & S even though it was never recorded on C & S's own books, a fact that also suggests stealth and specific intent. United States v. Bronston, *supra* note 4, slip op. at 4591. The figure of $12,500 represented the "precise amount which Bronston had previouly estimated to [his firm] as the retainer that would be forthcoming in 1978" from C & S. *Id.* Thus, it represents a payment for the defendant's time which did not go into the firm coffers even though firm time and resources were utilized.

104. 635 F.2d 999 (2d Cir. 1980), *cert. denied,* 101 S.Ct. 1703 (1981). In *Barta*, the employer specifically told the employee not to extend excessive credit to any customer and repeatedly asked for confirmation that this had not occurred. *Id.* at 1007. In *Bronston*, the parallel lies in the law firm's decision not to permit work to be done by it for C & S without express approval by one of the firm's senior partners. United States v. Bronston, *supra* note 4, slip op. at 4585.

105. Indeed, in *Barta*, the defendant's efforts at first earned substantial commissions for his employer. 635 F.2d at 1003.

106. A partnership can be held criminally liable. *See* United States v. A & P Trucking Co., 358 U.S. 121, 123-24 (1958) (partnership may be proceeded against under statute criminalizing conduct by "any person" or "whoever"); United States v. West Side Bakery, 181 F. Supp. 941, 941 (S.D.N.Y. 1960) (for purposes of prosecution under Federal Food, Drug and Cosmetic Act, "person" included partnership). *See also* MODEL PENAL CODE, § 2.07 (1962) (unincorporated association may be convicted of commission of offense).

107. H. REUSCHLEIN, W. GREGORY, AGENCY AND PARTNERSHIP § 52 (1978); *see Developments in the Law, Corporate Crime: Regulating Corporate Behavior Through Criminal Sanctions,* 92 HARV. L. REV. 1227, 1241-42 (1979) (corporation morally responsible for acts of its agents, imputing employee's mental state to corporation). This theory would not apply if it were the intent of the agent to convert the legal fees to his own use and not surrender them to the firm, *id.*, as appears to have occurred in *Bronston*, *see* note 103 *supra* (Bronston kept personal check for services which otherwise would have gone to firm).

108. Such conduct again would violate ABA CODE OF PROFESSIONAL RESPONSIBILITY DR 5-105, *supra* note 98 (prohibiting acceptance or continuance of employment if interests of another client may impair independent professional judgements of lawyer).

from Bronston's desire to obtain the franchise for C & S to the law firm's desire to maximize its revenues by impermissibly representing clients with conflicting interests without disclosure. For the defendant, such a fact pattern presents a "Catch 22" dilemma: if he concedes he did not disclose to the firm, he has breached his duty to it, but, if he argues that he did disclose, then he is a co-conspirator in the firm's defrauding of these irreconcilable clients, unless the firm itself disclosed the conflict to both sides and received permission from both to continue as their counsel.

The idea that a fiduciary duty, enforceable by criminal penalties, is owed to one's employer, as opposed to clients or shareholders, has now been established as a principle by the Second Circuit's decisions in *Barta* and *Newman*. That the principle's contours remain obscure is illustrated by the *Courtois/Newman* case.[109] The prosecution had argued that investment bankers who traded on non-public information that a tender offer was to be made for a target corporation defrauded both the bidder, because such trading eroded the premium by which the tender offer exceeded the market price,[110] and the investment banking firm which employed the defendant, by stigmatizing its professional reputation.[111] The trial court rejected what it termed the "Government's theorizing as to the economic harm that defendant's conduct might cause bidding companies" and investment bankers on the grounds that it was too speculative an injury to have been within the contemplation of the defendants.[112] One can agree with the Second Circuit's reversal of this proposition, but still question if the mail fraud statute is sufficiently elastic to reach all forms of insider trading. The lower court's insistence that insider trading cannot produce the "actual harm" necessary for fraud may be arbitrary,[113] but so also is any fixed conclusion that insider trading always harms the employer. It must be recognized that harm to the employer is more likely to occur where the defendant has sought to profit from information about *favorable developments* concerning the corporation.[114] Thus, an undifferentiated theory of criminal liability for fiduciary breaches that treats insider trading on the basis of favorable information in the same manner as

109. United States v. Courtois, *supra* note 14.

110. *See* note 19 *supra* (discussing prosecution's theory in *Courtois*). Many bidders in recent tender offers have acted on the belief that unless a given margin (recently anywhere from 40% to 100%) exists between the tender offer and the market price immediately before the tender offer is announced, investor reaction will be sluggish and other bidders may make counter-bids. To preempt such rival bids, the bidder may increase the price at which he tenders. Thus, insider trading which drives up the market price prior to disclosure of the offer also may injure the bidder by forcing him to increase the tender offer price correspondingly to maintain the same margin.

111. The indictment charged that defendants by so trading violated "the fiduciary duties of honesty, loyalty and silence owed directly to Morgan Stanley, Kuhn Loeb, and clients of those investment bankers." United States v. Courtois, *supra* note 14, at 91,301 n.22. Similarly, Bronston could be said to have breached a duty of loyalty to his firm that injured its reputation for integrity and loyalty to its clients. Indeed, it is hard to distinguish the degree of loyalty that a client expects from an investment banker in such delicate negotiations from those he expects from his counsel. This author's experience is that the two roles blend in this area. As a result, *Courtois* is in considerable tension with *Bronston*.

112. *Id.*

113. *See* note 110 *supra* (insider trading may injure bidder); Greenhill, *Structuring an Offer*, *supra* note 20, at 1309 (tender offer requires parties to place special confidence in integrity of investment banker).

114. This point has been well made by Professor Kenneth Scott, who argues that a fundamental theory underlying SEC rule 10b-5 is that the corporation has a right to protect valuable business information from premature disclosure before it can act thereon. Scott, *Insider Trading: Rule 10b-5, Disclosure and Corporate Privacy*, 9 J. OF LEGAL STUD. 801, 817-18 (1980) [hereinafter cited as Scott, *Insider Trading*].

insider trading on adverse information fails to distinguish between those defendants who harmed their employer from those who did not.[115]

Together, *Bronston* and *Newman* underscore two general observations about the equation of fiduciary breach with fraud. First, such a theory invites, and sometimes compels, the court to make its own law. Not only is legislative guidance lacking, but the potential legal issues proliferate at every turn. Second, by whatever name it is called, the issue of causation constantly reappears. In *Newman*, the lower court rebuffed the prosecution by saying that possible injury was too remote and speculative to satisfy what it termed the "actual harm" requirement. Although the court's decision merited reversal, its mode of analysis did not. It focused on the relationship between the foreseeability of the harm and the justifiability of defendant's conduct which is the classic *Palsgraf* issue,[116] in general, denominated in the law as the issue of "proximate causation."

Unconstrained by a causation standard, the fiduciary breach theory is inherently elastic and protean in character. As the corporate lawyer knows, and as the criminal lawyer may soon learn, the term "fiduciary" can become a substitute for close analysis, a rhetorical flourish to be used in place of a logical distinction. Nor is there any clear limit to its possible expansion. Academics have long debated the scope of fiduciary duties; highly regarded commentators have argued that corporate officials owe a fiduciary duty not simply to the stockholders, but to employees, creditors, and society generally.[117] Does this mean that an employer who knowingly fails to

Thus, in a case similar to SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969), where the corporation had made a major ore discovery, premature disclosure through insider trading would be likely to increase the cost to the corporation of acquiring the surrounding land. *Id.* at 804–05. In this sense, the corporation has a clear interest in keeping confidential some information about itself, and, as Scott points out, this theory applies with special force to the context of the tender offer. *Id.* at 817. It does not apply, in his view, to information about adverse corporate developments because the corporation cannot profit permissibly on news about its own misfortune. *Id.* In this light, decisions such as Diamond v Oreamuno, 24 N.Y.2d at 497, 501, 248 N.E.2d at 911, 914, 301 N.Y.S.2d at 80, 84, which found insider trading on news of adverse corporate developments to constitute a breach of fiduciary duty, should not be followed by a criminal court because the corporation is not deprived of any valuable business right by such trading. A criminal court could articulate this result, as *Courtois* did, United States v. Courtois, *supra* note 14, at 91,298, by saying that the "actual harm" precondition to criminal liability for fraud was not met.

115. Professor Scott's statement, that insider trading on adverse news about the corporation rarely deprives it of valuable business property, may be somewhat overbroad since premature disclosure, for example, often may interfere with sensitive negotiations in which the corporation has no obligation to make detailed disclosure regarding its financial condition. *See* Scott, *Insider Trading*, *supra* note 114 at 817. Yet, his basic point seems sound insofar as it suggests that mail fraud should reach only some forms of insider trading that do have the potential for injuring the corporation. Equally, the culpability of the actor seems very different in these two situations: where a favorable development, such as an ore strike or a tender offer is about to be announced, the insider knows he may be costing his corporation an opportunity to exploit this still undislosed information; but in the case of a negative development, the insider sees no clear corporate injury that will result and so this absence of foreseeable harm makes his conduct less blameworthy. This again suggests that it might be desirable to place the burden on the defendant to show a lack of foreseeable harm from his conduct.

116. Palsgraf v. Long Island R.R., 248 N.Y. 339, 162 N.E. 99 (1928).

117. *See* Dodd, *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145, 1160–63 (1932) (corporate fiduciaries must consider interests of employees, consumers, and general public as result of changing public and legal attitudes toward business); Gibbons, *Governance of Industrial Corporations in an Industrial Democracy*, 31 BUS. LAW. 1393, 1398–4000 (1976) (advocating new approaches

disclose an unsafe working condition to an employee or a hidden danger in a product to a consumer commits a knowing fiduciary breach which, if the mails or interstate wires are used, thereby violates federal criminal law, even though neither OSHA nor consumer safety laws are breached?[118] For present purposes, the extension of the fiduciary's obligations to this point seem remote, but the reach of a principle that a knowing fiduciary breach creates criminal liability goes well beyond the classic subject matter of derivative suits and attorneys' professional ethics.[119]

B. THE PUBLIC FIDUCIARY

If the *Bronston* fact pattern is troubling because it ignores the common law's ancient concern with causation, the disturbing implications of recent prosecutions involving public officials center around (1) the expansion of the concept of fiduciary status, (2) the imputation of a "scheme to defraud" to a person who does not individually benefit from the scheme in any tangible sense, and (3) the possible chilling effect that may arise to deter participation in the political process.

Recent history can conveniently begin with the conviction of former Illinois Governor Otto Kerner under the mail fraud statute for defrauding the state and its citizens of "honest and faithful services" as governor.[120] Factually, the prosecution alleged that, in return for helping race track owners to secure racing dates from the state racing commission, Kerner received a bribe in the form of a fictitious loan which enabled him to purchase stock in the track at substantially below market price. The case presented two novel problems for a fraud theory. First, because the parties involved were aware that Kerner did not have the power to actually grant the additional racing dates, as only the state commission could do this, Kerner's corrupt acts consisted not of attempting to defraud the race track owners, but of promoting their interests in return for a bribe.[121] Second, no one was defrauded of money or property; in fact, state revenues were actually increased by the additional horse racing in Illinois that the scheme produced.[122] Since federal bribery statutes did not apply to state officials under the facts of this case, a federal bribery prosecution was inappropriate. The prosecutors were able to successfully plead a case of federal mail

to corporate governance which provide for public participation or consultation in control of capital investments); Kaysen, *The Social Significance of the Modern Corporation*, AM. ECON. REV., May, 1957, 311, 313-14 (management of modern corporation should be responsible to stockholders, employees, customers, general public, and corporate firm as an institution).

118. Historically, the mail fraud statute has been repeatedly used to outflank the limitations of more narrowly drawn criminal prohibitions. *See generally* Trowbridge, *Enforcement of Criminal Sanctions for the Violation of Federal Controls on the Prices of Crude Oil and Petroleum Products*, 17 AMER. CRIM. L. REV. 201, 222-23 (1978) (emerging trend of applying general criminal fraud statutes to acts which willfully violate more specific oil price control statute).

119. *See* notes 159 through 164 *infra* (discussing extension of traditional reach of criminal liability for fiduciary breaches).

120. United States v. Isaacs, 493 F.2d 1124, 1149 (7th Cir.), *cert. denied*, 417 U.S. 976 (1974).

121. *Id.* at 1145-46. Bribery of state officials is not expressly criminalized by federal law; thus, mail fraud was once again the prosecutorial theory of last resort in *Isaacs*. For an example of a prosecution for extortion of an official who exploited the belief that he had power to control granting of state executive agency leases, even though no statutory basis for such belief existed, see United States v. Mazzei, 521 F.2d 639, 643-44 (3d Cir.), *cert. denied*, 423 U.S. 1014 (1975).

122. United States v. Isaacs, 493 F.2d at 1139.

fraud, despite both of the problems noted above, by advancing the theory that Kerner had defrauded the citizens of Illinois of their intangible right to his honest and loyal services.[123]

This intangible rights theory received a further extension in the prosecution of Maryland Governor Marvin Mandel.[124] Again, the basic pattern involved the granting of additional racing dates for a race track, but the distinguishing feature in *Mandel* was the absence of anything resembling a traditional bribe. Indeed, the Court of Appeals found no evidence of Mandel having "a direct interest in the race track business" and that "no direct connection on his part was either alleged or proven."[125] Put simply, Mandel seems to have been guilty of the sin of cronyism, but not the crime of bribery. The application of the mail fraud statute, in effect, made such favoritism a crime because, as the indictment charged, such conduct constituted a scheme "to defraud the citizens of the State of Maryland and her governmental departments, agencies, officials and employees... of the right to conscientious, loyal, faithful, disinterested and honest government through bribery and non-disclosure and concealment of material information."[126]

Thus, the progression from Kerner's conviction to Mandel's is from a case holding it irrelevant that the enrichment did not come at the public's expense to one suggesting that there need not be any enrichment, actual or contemplated, so long as there is "concealment of material information" about favors done for one's friends. In this emphasis on the concealment of information, *Mandel* approaches expanding the mail fraud statute into a "Truth-in-Government" Act.

Finally, the most recent chapter in this evolution of the mail fraud statute into a general anti-corruption statute is United States v. Margiotta.[127] Although the jury was unable to reach a verdict,[128] both the indictment and the court's charge to the jury reveal another quantum leap in the extension of the statute. The position of defendant Margiotta was unlike that of Governors Kerner and Mandel in two critical respects. First, Margiotta did not occupy what would generally be termed an elected public office, but was rather a County Chairman of the Nassau County Republican Party. Second, the alleged scheme to defraud was based less on bribery or cronyism than on the operation of a system of political patronage that, at least until recently, would have been fairly standard in many jurisdictions.[129] These distinctions raise in turn three clusters of significant issues: (1) When, if ever, does a

123. *Id.* at 1149. The use of this intangible rights theory was necessary because the parties paying the bribe were not defrauded. *See* note 121 *supra*, and accompanying text.

124. United States v. Mandel, 591 F.2d 1347 (4th Cir.), *aff'd on rehearing,* 602 F.2d 653 (4th Cir. 1979) (en banc), *cert. denied,* 445 U.S. 961 (1980).

125. *Id.* at 1364.

126. *Id.* at 1359-60. Although the indictment also charged that Mandel had indirectly received money, the court affirmed the prosecution's theory solely on the basis of the intangible rights doctrine. *Id.* at 1359 n.7.

127. Indictment, United States v. Margiotta, No. CR-80-00636(S) (E.D.N.Y., filed Jan. 15, 1981) [hereinafter cited as *Margiotta* Indictment]. The only reported decision in the case to date is United States v. Margiotta, 646 F.2d 729 (2d Cir. 1981) (reinstating portion of indictment).

128. *See U.S. Prosecutors Lose Appeal of Curb on Evidence at Margiotta Trial,* N.Y. Times, Oct. 14, 1981, at B-2, col.1 (new trial date set for Nov. 9, 1981).

129. There are issues of federal-state relationships lurking in *Margiotta* which courts have rarely considered in the context of the criminal law. For an example of a court's treatment of these issues *see* Rewis v. United States, 401 U.S. 808, 812 (1971) (noting issue of "sensitive federal-state relationships" in

private citizen not in the employ of the state owe a fiduciary duty to the public? (2) To what extent can the mail fraud statute be fairly used to enforce standards of public or business morality, where those standards are rapidly evolving and substantial conflict exists as to appropriate behavior? Moreover, is such an expansion desirable in the adversarial setting of politics, where the winners have considerable incentive to indict the losers and to punish insurgents? (3) Finally, are constitutional values implicated by this expansion of the ambiguous term "scheme to defraud" to reach traditional forms of political association?

This last issue may be the most important. Arguably, patronage is an established political institution which strengthens our two party system and supplies incentives that attract a steady stream of active participants into the lower echelons of our political process.[130] To describe political patronage as in conflict with the common morality, and hence a "scheme to defraud" citizens of their intangible right to honest government, seems inconsistent with the undeniable existence of that institution as a recognized and highly visible part of American political life at least since the time of Andrew Jackson.[131] From this starting point, constitutional questions come into view. If the notion of fiduciary is expanded to include all participants in the political process who wield significant influence, and a federal criminal statute then subjects them to an obligation to participate in governmental affairs only "honestly, impartially, free from bribery, corruption, fraud, dishonesty, bias and deceit,"[132] such a vague standard of criminal liability may chill the willingness of individuals to participate in politics. The standard may interfere with the delicate process of coalition formation, a process which often demands reciprocity and the striking of deals. Traditionally, the perceived need for a robust debate in the marketplace of ideas has led the Supreme Court to protect political speech that could hardly be described as honest, impartial, or free from bias or deceit.[133]

Of course, distinctions can be drawn, particularly where personal profit is involved, and for purposes of this article, the constitutional status of such a theory need not be explored in detail. The immediate question is how far the law has truly advanced in this direction. Here, it is difficult to answer, because the *Margiotta* indictment is a curious amalgam of both old and new elements. In part, the indictment alleges kickbacks which were received in some cases by friends, in other cases by an attorney who had represented the defendant, and, in at least one case, by the defendant himself.[134] The reach of the mail fraud statute to such conduct was already

construing scope of the Travel Act).

130. As Justice Powell has observed, "[p]atronage practices [broaden] the base of political participation by providing incentives to take part in the process, thereby increasing the volume of political discourse in society." Elrod v. Burns, 427 U.S. 347, 379 (1976) (Powell, J., dissenting).

131. *See* M. TOLCHIN & S. TOLCHIN, TO THE VICTOR . . . POLITICAL PATRONAGE FROM THE CLUBHOUSE TO THE WHITE HOUSE 323-26 (1971) (tracing history of patronage from Jefferson's first use of it to its popularization by Jackson). *See also* J. JUPP, POLITICAL PARTIES 25-28 (1968) (comparing historical role of patronage in American political party system with its role in British and Soviet systems).

132. *Margiotta* Indictment, *supra* note 127, at 4.

133. *Cf.* Near v. Minnesota, 283 U.S. 697 (1931) (Minnesota law imposing prior restraint on publication of malicious, scandalous, and defamatory matter held void as infringement of freedom of press, irrespective of truth of charges contained in particular periodical). The speech involved in *Near* is set forth in Justice Butler's dissenting opinion. *Id.* at 724 n.1 (Butler, J., dissenting). In sharp contrast, consider the jury charge in the *Margiotta* trial. *See* note 142, *infra*.

134. The *Margiotta* indictment charges that Margiotta directed payments to two disbarred attorneys

established in *Mandel* and presents few additional questions of interest. But, as pleaded, these allegations are only a subsidiary theme in an indictment which places greater emphasis on the use of the kickbacks to help subsidize a political machine. Basically, the indictment alleges that the defendant made it possible for an insurance agency to obtain and retain the position of "Broker of Record" for Nassau County and the Town of Hempstead, thereby enabling the agency to receive commissions totaling in excess of $1,500,000, of which a substantial portion were kicked back to various units of the Nassau County Republican Party at the specific direction of the defendant. This scheme, the indictment alleges, deprived "the citizens... (1) of the right to have the affairs of [the jurisdiction] conducted honestly, impartially, free from bribery, corruption, fraud, dishonesty, bias and deceit, and (2) of the honest and faithful participation of the defendant... in the governmental affairs of the [jurisdiction]."[135] This language seemingly assumes exactly what is to be proved: did the defendant as a private citizen owe a duty to others of "honest and faithful participation... in the governmental affairs" of his jurisdiction? If not, it seems difficult to argue that the public is deprived of some intangible right when the defendant's participation was motivated by a special interest.

The need for such an expanded theory seems suspect on the practical level, given the earlier extension of the Hobbs Act to encompass the obtaining by a public official of property, not lawfully due from another, "under color of official right."[136] Because the Hobbs Act today reaches virtually any attempt by a public official to pressure any individual or entity for a political contribution under the threat of loss of eligibility for public contracts,[137] a policy justification seems lacking for similarly expanding the mail and wire fraud statutes to require those who have the capacity to wield significant influence in governmental decision-making to act only out of selfless and proper motives. Political scientists would likely chuckle at this normative theory if it were offered as an empirical description of the reasons for political participation in a pluralistic society which is heavily dependent on governmental largess. Still, the immediate question is whether such a theory is containable even on the normative level. Initially, some *reductio ad absurdum* results seem possible. For example, what distinguishes a political boss from any well-connected lobbyist who might have a direct financial interest in securing a profitable contract for a client and who may legitimately negotiate an "honest kickback" in the form of a

who had held political office in Nassau County as judge and district attorney, respectively, and to his own attorney who had handled a prior state investigation into the alleged kickback scheme. *Margiotta* Indictment, *supra* note 127, at 8-9. Allegedly, these kickbacks were disguised to appear as payments for services rendered to an insurance agency which had been designated as the Broker of Record for Nassau County. *Id.* The indictment further charges that Margiotta instructed the insurance agency to make a $10,000 payment to an intermediary who then delivered $5,000 to Margiotta. *Id.* at 10. To the extent that separate counts addressing the patronage payments and the kickbacks are pled in the indictment, these issues will be treated distinctly because the jury could disbelieve the evidence on the personal payments and still convict on the political kickbacks to party units.

135. *Id.* at 4.

136. The Hobbs Act, 18 U.S.C. § 1951 (1976), broadly defines extortion to include "the obtaining of property from another, with his consent, induced by wrongful use of actual or threatened force, violence or fear, *or under color of official right*." 18 U.S.C. § 1951(b) (2) (1976) (emphasis added).

137. For an excellent review of the Hobbs Act's recent expansion and of the questions raised thereby see Ruff, *Federal Prosecution of Local Corruption: A Case Study in the Making of Law Enforcement Policy*, 65 GEO. L.J. 1171 (1977) [hereinafter cited as Ruff].

contingent fee? The lobbyist may, of course, be required to register and disclose his associations, but this is hardly the invariable pattern in all American jurisdictions, nor does the absence of disclosure, where not required, seem inherently fraudulent.

A narrower theory by which to sustain the indictment might be that defendant Margiotta was a quasi-public official under the applicable law of the jurisdiction. The indictment, in effect, makes this point, citing a New York criminal statute which forbids a political party official to sell nominations or appointments to public office.[138] But then the indictment retreats from this potential bright-line distinction and offers a far fuzzier line. In its first paragraph, the *Margiotta* indictment charges that "[t]he power and influence which the defendant Joseph M. Margiotta knowingly assumed... enabled him to exert great influence over the public officials of [the jurisdictions]... and, in particular, to influence the appointments made by [specified elected officials]."[139] If the theory here is that a knowing assumption of power creates a fiduciary duty to use that influence in an unbiased fashion, such a duty logically applies as well to large political donors, special interest groups, and other persons or organizations possessing political clout. Put simply, the power held by a Republican Party Chairman to influence appointments in a particular county may be no greater than that held by the head of the AFL–CIO to influence the appointment of the Secretary of Labor or of the Executive Director of the NAACP to veto a proposed Chairman of the EEOC.

Even if we narrowly read the indictment to mean only that certain "quasi-public officials" are obliged to conduct the affairs of government "honestly, impartially, free from bribery, corruption, fraud, dishonesty, bias and deceit,"[140] problems still remain. For example, legislators frequently engage in vote trading, and presidents have been known to bestow judgeships and other federal appointments on individuals with questionable qualifications who just happened to be associates of senators whose votes were undecided on pending legislation. If this is permissible, and surely it is, the question arises as to what distinguishes the efforts of a party official, where he is not personally benefiting and where no express criminal prohibition applies, from promoting an appointment that is in the best interests of his party. It is too facile a response to this question to say that the party official is benefiting only a special constituency and not the public generally or that he is seeking to secure a financial benefit for that constituency. This hardly distinguishes what the legislator frequently does on behalf of his constituents and indeed is expected to do. In short, the *Margiotta* indictment pleads a theory which is still in search of a definition.

In his charge to the jury, Judge Sifton tried a slightly different approach to the problem of defining when a fiduciary duty arises in the case of an individual who is not actually a governmental employee. He instructed the jury that such a duty arose when the individual "participated in the conduct of the governmental affairs,"[141]

138. *Margiotta* Indictment, *supra* note 127, at 3 (citing N.Y. ELEC. LAW § 17-158 (McKinney 1978)). It is, of course, a debatable issue whether the position of "Broker of Record" constitutes a "public office" or "position of public employment" within the meaning of this statute.

139. *Margiotta* Indictment, *supra* note 127, at 1.

140. *Id.* at 4.

141. *See* Record, at 3990, United States v. Margiotta, No. CR-80-00636(S) (E.D.N.Y. 1981) (on file at American Criminal Law Review) [hereinafter cited as *Margiotta* Record].

and he then defined the requisite level of participation that triggered this duty as follows:

> A person participates in the affairs of government if he regularly takes part in the conduct of the business of government with the knowledge that his participation is relied upon by others in government in order to carry forward the business of governing as a whole and with the intention of conducting and carrying forward the affairs of the government he participates in.... In order... to make [such] a determination..., you must find the work done by him was in fact wholly or in substantial part the business of government rather than party business, and that his performance of that work was intended by him and relied on by others in government as part of the business of government in order to carry forward its affairs as a whole.[142]

Implicit in these vague words are two ideas: (1) a reliance test under which, for example, one is a fiduciary when others rely on him because of some special relationship[143] and (2) a *de facto* control test whereby if one in fact makes governmental decisions, one is a governmental fiduciary.[144] This second test parallels the corporate law's treatment of the *de facto* corporate officer or director who, even if not officially appointed to office, may exercise power but who thereby acquires a fiduciary status.[145] More important, this theory of *de facto* control recognizes that there is a distinction between party business and government affairs, and thus the party official is permitted to act as a partisan up to the point where he wholly dominates government. While the problem of determining this point is still substantial, Judge Sifton's test at least creates a safe harbor for the political activist who merely wields a veto power over decisions of interest to his group. Such a test could supplement the other narrow theory noted above that Margiotta violated a New

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142. *Margiotta* Record, *supra* note 141, at 3991-92. In its charge to the jury, the court clearly endorsed the extension of the intangible rights doctrine even to an individual who is not actually a government employee:

> a person who has undertaken to participate in the affairs of Government honestly and free of corruption, of bias, fraud or deceit, makes a fraudulent misrepresentation which deprives the County and the Town and their citizens of what he has undertaken to provide if pursuant to his undertaking he makes recommendations or gives advice which conceals the fact that he's agreed to kickback to another a portion of the income he expects to earn if his advice is acted upon, provided such concealment is in the circumstances materially misleading.

Id. at 3394-95.

143. This idea has some support in the common law. *See* notes 155 through 158 *infra*, and accompanying text (for discussion of when fiduciary relationship arises at common law).

144. This concept seems borrowed from Hobbs Act cases, where courts have said that, although a political official was without legal power to grant or withhold action with respect to which he demanded extortion payments, the law will look to actual power, rather than legal right. *See* United States v. Mazzei, 521 F.2d at 641 (extortion conviction upheld where state legislator, who had no legal power to control granting of state leases, exploited lessor's belief that he had such power).

145. *See* H. HENN, HANDBOOK OF THE LAW OF CORPORATIONS AND OTHER BUSINESS ENTERPRISES § 222 (2d ed. 1970) (acts of person who, although not a *de jure* officer, exercises corporate office under color of title often given legal effect).

York law which forbids a political party official from selling an office.[146]

The ambiguities in the prosecution's theory in *Margiotta* again suggest the desirability of a causation test. Suppose a political party openly requires those of its members who hold a salaried office to pay $1,000 in annual dues. Is this a mandatory kickback requirement? Some recent cases suggest that payments which do not affect the discretion of the political official cannot constitute a scheme to defraud.[147] A clearer way to articulate the idea implicit in these cases would be to return to the concept of causation; in the *Margiotta* case, a causation requirement might be satisfied were the prosecutor to allege that, but for the agreed upon kickbacks, the insurance agency would have sought or secured lower insurance rates for the state.[148] In contrast, although the kickback requirement in the above example may seem morally odious, it is more difficult to find that the defendant's fiduciary breach has caused any "actual harm or injury" to the state or its citizens. Salaried employees are less able than an independent contractor to pass on the cost of their kickbacks to the state or its taxpayers, and thus the real cost seems more likely to fall on the salaried political party members who initially bear it.[149]

In short, although the case law has distinguished the context of the private fiduciary from that of the public one, the same hard issues arise in both contexts: (1) whether improper or unethical conduct alone is sufficient to constitute a "scheme to defraud" or must there be some actual or realistically threatened injury caused by it; and (2) how broad a net is cast by the operative word "fiduciary." Both the *Bronston* decision and the *Margiotta* indictment suggest expansive answers to these questions, and they are perhaps most important as barometers of the highly uncertain and potentially transitional stage of the law in this area. While each is subject to criticism, it is more useful to consider what alternative answers emerge to these same questions from a more traditional common law perspective. The next section will so attempt.

146. *See* note 138 *supra*, and accompanying text (discussing applicable New York statute).

147. *See* United States v. Rabbitt, 583 F.2d at 1024-26 (despite acceptance of kickbacks, no violation of mail fraud statute where defendant did not control awarding of state contracts and did not fail to perform responsibilities of office); United States v. McNieve, 536 F.2d at 1251-52 (same result where plumbing inspector's receipt of unsolicited gratuities from contractors did not injure government or affect official duties).

148. Such an allegation was in fact made in the introductory section of the *Margiotta* Indictment, *supra* note 127, at 3, but it was never alleged to have been the object of the conspiracy between Margiotta and the insurance agency, nor was it referred to in the specific counts of the indictment.

149. While it may be hard to prove mail fraud in the foregoing hypothetical of a mandatory political contribution, a Hobbs Act violation will be simpler to prove. The criteria of the Act that either the employees were exposed to "economic duress" if they fail to contribute, or the payment was made to one claiming it "under the color of official right," have been satisfied. *See* notes 136 and 137 *supra*. Interestingly, this example of a mandatory kickback is not entirely hypothetical. The prosecutor tried to assert that Margiotta had demanded such payments to the Republican Party from Hempstead town employees to the extent of 1% of their salaries, but the court dismissed such evidence as prejudicial. *See* Lubasch, *U.S. Prosecutors Lose Appeal of Curb of Evidence at Margiotta Trial*, N.Y. Times, Oct. 14, 1981, at B-2, col. 1.

II. ON ROUND PEGS AND SQUARE HOLES: THE FRICTION BETWEEN FIDUCIARY DUTY AND CRIMINAL RESPONSIBILITY

"Overcriminalization" is an easily used term which often means little more than that the defense counsel objects to the use of the statute in the case of his client. Generally, the dangers of overcriminalization have been raised as objections to the prosecution of "victimless" crimes or basically regulatory offenses, such as antitrust, price control or disclosure statutes, where the underlying conduct arguably would have been morally neutral in the absence of a criminal prohibition.[150] In contrast, the prospective criminalization of fiduciary misconduct raises different issues, in part because the underlying standards are frequently aspirational in character, but even more so because the penetration of the criminal law into "everyday life" that follows on the heels of such a theory may be deeper and more pervasive. This section will take a closer look at these problems as a prelude to suggesting a reasonable line of demarcation.

A balancing observation is, however, necessary as a strong case exists for prosecution of some fiduciary breaches. In principle, a knowing fiduciary breach may be as egregious, injurious and deliberately fraudulent as the garden variety embezzlement. One suspects that traditional forms of fraud are sometimes chiefly distinguishable from newer, more original varieties by the socio-economic status of the defendant. For example, while clerks and cashiers embezzle, the senior corporate executive may use his control over the corporation to purchase a valuable corporate asset at a substantial discount off market value. Moreover, there are persuasive reasons why a federal criminal prosecution may be a necessary deterrent in cases of unfair self-dealing. Most obviously, the transaction may be beyond the effective reach of any single state jurisdiction, given the multi-jurisdictional character of large corporations. Frequently, the responsible parties and relevant documents will span state and perhaps national boundaries. Even where a legal basis for jurisdiction exists, local law enforcement authorities may feel an understandable parochialism about taking on a costly and time consuming investigation which has had only a minimal impact on their constituents. In addition, the governing state law with respect to the fiduciary duty violated may be that of a jurisdiction which has little contact with the transaction and even less incentive or ability to prosecute. Moreover, the traditional civil remedy for a fiduciary breach, the derivative suit, today seems weaker than in the past because of recent case law upholding the power of the board to dismiss the action.[151] Finally, even if successful, civil litigation will typically result only in compensatory damages. Yet, if disgorgement is the only penalty, the potential offender sees a gamble which is essentially of the "Heads-I-win, tails-we-break-even"

150. *See* Kadish, *Some Observations on the Use of Criminal Sanctions in Enforcing Economic Regulations*, 30 U. CHI. L. REV. 423 (1963) (discussing economic regulations whose enforcement is effected through imposition of criminal sanctions). *See generally* H. PACKER, THE LIMITS OF THE CRIMINAL SANCTION (1968).

151. *See* Coffee & Schwartz, *The Survival of the Derivative Suit: An Evaluation and a Proposal for Legislative Reform*, 81 COLUM. L. REV. 261 (1981) (citing Burks v. Lasker, 441 U.S. 471 (1979); Lewis v. Anderson, 615 F.2d 778 (9th Cir. 1979), *cert. denied*, 101 S. Ct. 206 (1980); Gall v. Exxon, 418 F. Supp. 508 (S.D.N.Y. 1976); Zapata Corp. v. Maldonado, 430 A.2d 779 (Del. 1981); Averbach v. Bennett, 47 N.Y.2d 619, 393 N.E.2d 994, 419 N.Y.S.2d 920 (1979)) [hereinafter cited as Coffee & Schwartz].

sort.[152]

Nothing hereafter said challenges the basic validity of these arguments. Nevertheless, before one accepts the equation that a knowing fiduciary breach equals a "scheme to defraud," some troubling consequences of this proposition need to be considered. Four stand out and will be briefly examined below: (1) the concept of a fiduciary relationship is an inherently vague one, which is far more expansive than it first appears; (2) significant differences exist among state jurisdictions in terms of the duties that fiduciaries owe, thereby possibly creating significant disparities in the coverage of federal criminal law depending on the applicable state civil law; (3) if the result of the criminalization of fiduciary breaches is also their federalization, this conflicts with the principle of deference to state corporate law which recent Supreme Court decisions have established; and (4) perhaps most important, the "internal affairs" rule of corporate law under which the law of the jurisdiction of incorporation controls as to all intra-corporate disputes seems irreconcilable with the policies underlying the traditional criminal law rule that one jurisdiction will not enforce the penal statutes of another.[153] These problems do not by any means require immunity from criminal prosecution for the corporate executive who engages in a fiduciary breach, but they do make desirable a far more focused and less sweeping standard of criminal liability, which will be assessed in the following section of this article.

A. WHO IS THE FIDUCIARY?: THE UNIVERSALIZATION OF FIDUCIARY STATUS

"Fiduciary" is, of course, one of those words with which lawyers mesmerize their clients; its arcane sound suggests precision and certainty. Indeed, even among lawyers, the term connotes several specific subcategories: executors, guardians, trustees, attorneys and, to a marginally more problematic extent, corporate directors[154] and senior executives. Still, this list is far from exhaustive, and the common law has in fact always defined the term with deliberate imprecision and perhaps surprising expansiveness. In its most frequent formulation, the common law has said

152. In short, the civil law seeks compensation, not deterrence, and absent penalties which more than cancel out the gain by a margin that adjusts for the possibility of nonapprehension, the offender is not logically deterred. This point has been elaborately developed by economists, most notably Professor Gary Becker of the University of Chicago. *See generally* ESSAYS IN THE ECONOMICS OF CRIME AND PUNISHMENT (G. Becker & W. Landes eds. 1974). For a review and partial critique of this approach, see Coffee, *Corporate Crime and Punishment: A Non-Chicago View of the Economics of Criminal Sanctions,* 17 AM. CRIM. L. REV. 419 (1980).

153. *See* RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 89 (1971) ("No action will be entertained on a foreign penal cause of action."); *cf.* Doggrell v. Southern Box Co., 208 F.2d 310, 311 (6th Cir. 1953) (vacating judgment in 206 F.2d 671 (6th Cir. 1953) and following, as required by *Erie,* state court decision that found foreign statute penal and hence unenforceable under Tennessee law); Arcouet v. Papp, 21 Misc.2d 294, 295–97, 190 N.Y.S.2d 549, 551–53 (Sup. Ct. 1959) (action held penal and therefore not maintainable in New York); Nesbit v. Clark, 116 A. 404, 497 (Pa. 1922) (action held penal and not maintainable in Pennsylvania). Other decisions have, of course, found foreign statutes not to be penal in intent and hence are enforceable, but this is beside the point because in virtually all cases the statutes were at least denominated as civil in character. Here, we are addressing the question of whether conduct considered a fiduciary breach in one jurisdiction should be considered a criminal offense in another, which may not consider the same conduct to be a fiduciary breach, but does consider a "knowing" fiduciary breach to be a criminal offense. *See* text accompanying note 175, *supra.*

154. For a detailed discussion of the special position of the corporate director, *see* Marsh, *Are Directors Trustees?,* 22 BUS. LAW. 35 (1966) [hereinafter cited as Marsh].

that a fiduciary relation arises "when there is special confidence reposed in one who in equity and good conscience is bound to act in good faith and with due regard to [the] interests of [the] one reposing the confidence."[155] The rule thus stated, that a relationship in which one party reposes "special trust and reliance" in the other gives rise to a fiduciary duty to deal fairly and in good faith,[156] has diverse applications, in part because the case law has also emphasized that "the relation need not be legal, but can be moral, social, domestic or merely personal."[157] Thus, landlord and tenant, employer and employee, principal and agent, client and broker may or may not be fiduciaries for the other, or may be reciprocal fiduciaries, depending on the facts of the case and under criteria that are simply not capable of clear definition.[158]

Accordingly, the following examples present legitimate questions as to whether the behavior in question is subject to a criminal sanction:

> (1) A doctor engaged in medical research wishes to administer an experimental drug, both to further his experiment and also because he believes it offers the best treatment for a patient referred to him. To induce the recalcitrant patient to enter the treatment program, he either fails to disclose or affirmatively deceives the patient as to the drug's possible adverse side effects. Is this a "scheme to defraud" based on the doctor's desire to advance his experimental program?[159]
>
> (2) An attorney representing numerous plaintiffs in a class or derivative action receives a settlement offer from defendants which he

155. *See* BLACK'S LAW DICTIONARY 563-64 (5th ed. 1979).

156. For decisions adopting this formula, see Cheese Shop Int'l, Inc. v. Steele, 303 A.2d 689, 691 (Del. Ch. 1973) (no fiduciary duty absent dependency on or superiority of party alleged to owe duty); *In re* Heilman's Estate, 37 Ill. App. 3d 390, 396, 345 N.E.2d 536, 540 (App. Ct. 1976) (fiduciary relationship exists between 80 year-old woman and neighbor who visited and cared for her daily); *In re* Jennings Estate, 335 Mich. 241, 244, 55 N.W.2d 812, 813 (1952) (no fiduciary relationship absent showing of faith, confidence, trust, and reliance); Mobil Oil Corp. v. Rubenfeld, 72 Misc. 2d 392, 399-400, 339 N.Y.S.2d 623, 632 (Civ. Ct. 1972) (fiduciary relationship exists only when confidence reposed by one person actually accepted by alleged fiduciary); 36A C.J.S. *Fiduciary* 385 (1955) (same).

157. Trustees of Jesse Parker Williams Hospital v. Nisbet, 191 Ga. 821, 841, 14 S.E.2d 64, 76 (1941) (fiduciary relationship found where one party to transaction clearly in dominant position); Higgins v. Chicago Title and Trust Co., 312 Ill. 11, 17, 143 N.E. 482, 484 (1924) (relation of broker and client not of itself a fiduciary relationship); Miranovitz v. Gee, 163 Wis. 246, 249, 157 N.W. 790, 792 (1916) (fiduciary relationship found between land purchasers relying on superior knowledge of fellow countryman in whom they trusted).

158. *See* Robins v. Hope, 57 Cal. 493, 497 (1881) (no fiduciary relationship between principal and agent or between first cousins); Fort Valley Coca Cola v. Lumberman, 69 Ga. App. 120, 125, 24 S.E.2d 846, 850 (Ct. App. 1943) (agent is fiduciary and owes principal duty of good faith and loyalty); Thomas v. Whitney, 186 Ill. 225, 231, 57 N.E. 808, 810 (1900) (fiduciary relationship exists when family takes in old and feeble man). Other cases have held that a given individual on specific facts was not a fiduciary. *See* Lehner v. Crane, 448 F. Supp. 1127, 1131 (E.D. Pa. 1978) (employer-employee relationship does not of itself give rise to fiduciary relationship); Allen v. Borlin, 336 Ill. App. 460, 465, 84 N.E.2d 575, 578 (App. Ct. 1949) (no fiduciary relationship between vendor and vendee); Reily v. Fleece, 259 Ky. 330, 335, 82 S.W.2d 193, 197 (1932) (agent not fiduciary); Rardon v. Davis, 52 S.W.2d 193, 197 (Mo. 1932) (bank cashier and customer not fiduciaries). Note that all of these decisions are fact specific and do not establish safe harbors.

159. One may well answer this question in the negative on the grounds that "specific intent" to defraud is lacking. If so, one can vary the facts slightly and say that the doctor is not sure that the drug will be effective but needs human subjects for experimentation. For a discussion of the medical ethics relating to

recognizes is attractive. However, the defendants have not offered to pay what he considers adequate legal fees to him as well. May he refrain from approving the settlement until agreement is reached as to his fee, or by so holding the settlement hostage to his fee award does he engage in a "scheme to defraud?"[160]

(3) A male graduate school professor has effective veto power over the future employment prospects of a woman Ph.D candidate depending on the character of his letter of recommendation for her. Does he owe this student a fiduciary duty which is breached by seeking to exploit the relationship to secure sexual favors or by denying a recommendation when rebuffed?[161]

(4) A real estate broker fails to disclose to an out-of-state buyer that the neighborhood school near the house he is about to buy will be closed in an economy drive. Had the buyer known this fact, he would not have made the purchase. Does the obvious reliance of an out-of-state buyer

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such experimentation which, like legal ethics, are frequently aspirational in character, see *Symposium-Ethical Aspects of Experimentation with Human Subjects*, DAEDELUS (Spring 1969).

If the prosecution of an individual doctor seems farfetched, prosecution of a drug company is more realistic. In June, 1981 the Food and Drug Administration (FDA) recommended criminal prosecution to the Justice Department of Smith, Kline & French Laboratories for allegedly withholding data concerning liver damage caused by a drug it was marketing. *See* Health Research Group Asks Order Against Drug Concerns, N.Y. Times, Sept. 17, 1981, at A-22, col. 3. In such an instance, it is unlikely that there is a fiduciary relationship, but it is certainly still arguable that either the public or the regulatory agency has been defrauded of an intangible right to disclosure established by statute. As a practical matter, however, other statutes, such as the false statements statute (18 U.S.C. § 1001 (1976)) provide a simpler basis for prosecution. Still, where disclosure to an agency is not required, the wire and mail fraud statutes have an unexplored potential for criminal prosecution of unsafe or hazardous products and might even apply in an extreme case where disclosure is made to the agency but not to the consumer. The implications of such a theory and the issue of the primary jurisdiction of the agency are not explored here.

160. Recently, the Committee on Professional and Judicial Ethics of the Association of the Bar of the City of New York issued a formal opinion in which it said, in dicta, that an attorney violates professional ethics whenever he "holds the settlement of the merits hostage" to the issue of attorneys fees. *See* N.Y. CITY ABA COMM. ON PROFESSIONAL AND JUDICIAL ETHICS, OPINIONS, No. 80-94 (1981), *reprinted in* N.Y. LAW J., September 22, 1981, at 1. Several decisions have also indicated that simultaneous negotiation of the settlement and the awarding of attorneys fees in class and derivative litigation raises an appearance of impropriety. *See* Mendoza v. United States, 623 F.2d 1338, 1352 (9th Cir. 1980) (simultaneous negotiation of attorneys fees and substantive issues in settlement discussions improper); Regaldo v. Johnson, 79 F.R.D. 447, 451 (N.D. Ill. 1978) (improper for lawyer in civil rights suit to inject question of attorneys fees into balance of settlement discussion); Prandini v. National Tea Co., 557 F.2d 1015, 1021 (3rd Cir. 1977) (discussion of appropriate compensation for attorneys should begin only after court approval of damage settlement). Indeed, the potential for "actual harm" here is high, given the ability of such a practice to make possible a collusive settlement. Nevertheless, is there fair enough notice to the actors involved of this new extension of a vague ethical precept? The defense, of course, can deny that there is "specific intent" to defraud, but this argument is actually weaker here than in *Bronston* since the attorney knows frequently that he is trading a higher recovery for the class he represents in return for a higher attorneys fee for himself, whether paid directly by the defendant or out of the settlement. *See* Taylor v. Lindsley, 456 F.2d 896, 899-90 (2d Cir. 1972) (Friendly, J.) (discussing built-in conflict of interest between attorney and class he represents in contingent fee litigation).

161. Although a fiduciary relationship can be postulated here, the implication of United States v. Barta, that only fiduciary breaches involving a failure to disclose can amount to mail fraud cuts against prosecution here. 635 F.2d at 1006.

Presumably, the woman subjected to sexual harassment knows that the superior she rebuffs is on the broker create a fiduciary relationship and an obligation to disclose?[162]

(5) A financial institution is requested by a principal corporate client to provide it with confidential financial and operating data about another customer with respect to whom it wishes to make a hostile tender offer. If it complies, does the institution breach a fiduciary duty owed to the latter client? [163]

(6) Several employees of a broker-dealer or a law firm collectively resign and establish their own competing firm, taking with them numerous clients. Over the last months of their association with their former firm, they have deliberately collected proprietary information—client lists, business practice techniques, research reports—to use in their new firm. Although civil liability seems more likely than not on these facts, it is a considerably different question whether the law should permit employers to threaten criminal liability as well if their employees establish a rival firm.[164]

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retaliating against her on an economic basis and hence it is difficult to find any non-disclosure. Arguably, the sending of a misleading letter could be fraud on the potential employer, but there is no clear fiduciary duty owed to the prospective employer, and it would be questionable whether the deception meets the "actual harm" requirement, to the extent that requirement survives *Newman*. Finally, the victim might be able to claim that she could have responded to and corrected the misimpression made by her graduate adviser's misleading letter had she known of it. Note, however, that the invasion of sexual privacy can amount to an intangible right of which one can be defrauded under the existing law of criminal mail fraud. *See* United States v. Condolon, 600 F.2d 7, 8 (7th Cir. 1979) (scheme to "seduce young women" by false promise of modeling or acting job held violative of wire fraud statute); *cf.* United States v. Louderman, 576 F.2d 1383, 1387-88 (9th Cir. 1978) (scheme to invade privacy, although intangible, within scope of statute).

162. This fact pattern presents a border line issue as to whether a fiduciary relationship exists. If the local real estate board has a code of ethics, and this is frequently the case, the same *Bronston*-type issue of whether a violation of a code of ethics constitutes fraud would re-surface. Note, however, that the existence of a fiduciary relationship is not strictly necessary to the imposition of criminal liability if there were a deliberate and material misrepresentation.

Thus, this case again raises the problem of overcriminalization; is all commercial life to be conducted by the same strict standards as rule 10b-5 prescribes for a special and limited range of conduct? Also, would such an extension of criminal liability produce judicial evasion and nullification and eventual distortion of the substantive law of fraud? Imponderable as these questions may be, they are legitimately raised by the *Bronston* and *Margiotta* prosecutions.

163. Important distinctions can be made here between investment bankers and commercial bankers; the latter is more a creditor than an advisor, and hence not generally a fiduciary. The former is, however, uniquely an advisor and consultant and *may* be a fiduciary in some cases. *Compare* Walton v. Morgan Stanley & Co., 623 F.2d 796, 798 (2d Cir. 1980) (no fiduciary relationship existed on special facts of case between stockholders and financial advisory concern to which corporation disclosed confidential information) *with* Washington Steel Corp. v. TW Corp., 602 F.2d at 594, 603 (3d Cir. 1979) (no fiduciary duty owed by bank to one of its borrowers when using information received from that borrower in deciding whether to make loan to another prospective borrower). *But see* Walton v. Morgan Stanley & Co., 623 F.2d at 800-03 (Oakes, J., dissenting). *See also* Note, *Bank Financing of Involuntary Takeovers of Corporate Customers: A Breach of Fiduciary Duty?*, 53 NOTRE DAME LAW. 827, 833-37 (1978) (financing not per se breach, but misuse of confidential customer information may be fiduciary breach).

164. Civil litigation in this area is recurrent. *See Merrill* [Lynch] *Sues Four Ex-Officials,* N.Y. Times, Sept. 4, 1981 at D-1, col.6., for a recent example. The overlay of criminal liability, however, may have an adverse and anti-competitive effect since employers could vaguely threaten such a prosecution with possibly *in terrorem* effect. In contrast, civil litigation is likely to grant only limited relief to the employer.

In all of these cases, arguments can be made both ways. But this is exactly the point. These examples illustrate not egregious behavior but recurring problematic areas where an unintended penetration of the federal criminal law into "everyday life" could result if the common law's broad definition of fiduciary duties is adopted by the criminal law. Nor is it an answer that prosecutors would rarely employ their ample discretion to reach such marginal cases. Publicity, politics and the desire to secure "cooperation" from material witnesses in more important prosecutions can all influence the decision to prosecute. Moreover, the evil here is not simply the unjust prosecution, but the threat of criminal prosecution overhanging many areas of life where conflicts of interest are as inevitable as death and taxes.

The threat of "overcriminalization" thus posed is new in at least one significant sense. Traditionally, the debate has focused on either allegedly "victimless" crimes, for example prostitution or gambling, or "regulatory" crimes which involved no *mala in se* offense, such as antitrust offenders or violation of price controls. In such instances, it can at least be said that the person so subjected to criminal liability had knowingly entered a sphere of higher risk activity and so assumed the consequences. In contrast, pervasive criminalization of fiduciary breaches would so expand this category of higher risk activity as to approach making it co-extensive with commercial life. The ordinary citizen involved in commercial or professional life may not be able to arrange his affairs so as to escape problematic situations where the breach of a fiduciary duty could mean criminal prosecution. Most importantly, all this would occur without either a clear legislative authorization or any showing that existing civil, administrative or professional penalties were generally inadequate.

B. DISPARITIES IN THE DUTIES OWED

Corporate law is the context where fiduciary duties have been most elaborately developed and analyzed. Symptomatically, the result of this careful attention has not been homogeneity. Significant disparities exist among state jurisdictions. For example, some decisions hold corporate fiduciaries strictly liable for failing to turn over a corporate opportunity, while others permit considerable business judgment by the person or entity subject to the conflict of interest.[165] In New York, insider trading is considered a breach of fiduciary duties, but elsewhere this theory has been rejected.[166] California and Delaware disagree fundamentally as to the meaning of the term "self-dealing," so that both can agree that fiduciaries have the burden of proving the fairness of "self-dealing transactions" but still diverge substantially as to

165. *Compare* Higgins v. Shenango Pottery Co., 279 F.2d 46, 50 (3d Cir. 1960) (directors accountable to shareholders when making personal profits through use of corporation's funds) *and* Irving Trust Co. v. Deutsch, 73 F.2d 121, 123 (directors held liable for profits from sale of shares purchased for selves) *with* Burg v. Horn, 380 F.2d 897, 899 (2d Cir. 1967) (corporate opportunity doctrine should not be used to bar director from purchasing any property which might be useful to corporation) *and* Johnson v. Greene, 35 Del. Ch. 479, 487-88, 121 A.2d 919, 923-24 (1956) (director permitted to individually purchase aircraft materials potentially available to corporation itself).

166. *Compare* Diamond v. Oreamuno, 24 N.Y.2d 494, 497, 248 N.E.2d 910, 912, 301 N.Y.S.2d 78, 80 (1969) (in New York, officer held accountable) *with* Freeman v. Decio, 584 F.2d 186, 196 (7th Cir. 1978) (in Indiana, officer not held accountable) *and* Schein v. Chasen, 313 So. 2d 739, 749 (Fla. 1975) (officer held not liable).

the application of this rule.[167]

Even in the case of the most basic conflict of interest with which corporate law deals, the interested director transaction in which a board member buys property from, or sells it to, his corporation, considerable variation exists in statutory approach. In some jurisdictions, the common law rule that the director must prove the intrinsic fairness of the transaction survives;[168] in others, he must disclose all material information concerning the transaction; [169] in still others, he must disclose only his own interests in the transaction.[170] Assume then that a corporate fiduciary wishes to sell a termite-ridden building which adjoins the corporate headquarters to the corporation at an inflated price. Under the law of the first group of jurisdictions cited above, the transaction is *per se* a fiduciary breach; in the second group, he would be required to disclose the termite problem, but might still negotiate the sale with a controlled board of passive directors, and in the third group, he would be required to disclose no more than the fact of his ownership of an interest in the building.

Compounding these disparities is the effect of subequent board or shareholder ratification once full disclosure is made. In some jurisdictions, it would probably be effective on the theory that the transaction was only voidable and hence might be ratified, while in others it would be considered fraudulent and hence not ratifiable except by unanimous consent, or would require judicial approval of the fairness of the transaction.[171] Additionally, in many jurisdictions, the board or shareholders can make a decision not to sue even if there were a breach, but in some jurisdictions the effect of this decision will depend once again on a reviewing court's decision as to the substantive merits underlying the action and the substantiality of the reasons given.[172] This raises the troubling question of whether the board's power in effect to

167. *Compare* Jones v. H.F. Ahmanson & Co., 1 Cal. 3d 93, 108-12, 460 P.2d 464, 471-74, 81 Cal. Rptr. 592, 599-602 (1969) *with* Sinclair Oil Corp. v. Levien, 280 A.2d 717, 721-22 (Del. 1971). In short, Delaware denies that a transaction which treats all shareholders pro-rata can be considered "self-dealing," while California law would consider most transactions in corporate control, such as liquidation, to be subject to the obligation of the controlling shareholder to prove its "inherent fairness," even though shareholders were treated pro-rata.

168. For an overview, *see* Marsh, *supra* note 154. *See also* H. BALLENTINE, CORPORATIONS 167-84 (rev. ed. 1946). For modern cases that have followed the strict older rule, *see* Cathedral Estates Inc. v. Taft Realty Corp., 228 F.2d 85, 87 (2d Cir. 1955) (alternative holding) (in Conn., director has burden of proving intrinsic fairness); Gillespie v. Branham, 47 Tenn. App. 234, 241, 337 S.W.2d 689, 692 (Tenn. 1959) (in Tenn., president who owned 62% of corporate stock could not act for corporation); Davis v. Heath Dev. Co., 558 P.2d 594, 596 (Utah 1976) (contract between corporate officers and corporation voidable at option of corporation); Stoiber v. Miller Brewing Co., 257 Wis. 13, 19, 42 N.W.2d 144, 147-48 (1950) (same).

169. *See* CAL. CORP. CODE §§ 310(a)-(b) (West Supp. 1976) (requires disclosure of "material facts as to the transaction *and* as to such director's interest are fully disclosed or known") (emphasis added).

170. *See* MODEL BUSINESS CORPORATION ACT § 41; N.Y. BUS. CORP. LAW § 713(a) (McKinney 1976) (both require disclosure only as to director's "interest" in contract or transaction, and not requiring disclosure as to all material facts as to transaction itself). *See generally* Pinto & Bulbulia, *Statutory Responses to Interested Directors' Transactions: A Watering Down of Fiduciary Standards,* 53 NOTRE DAME LAW. 201 (1977).

171. *See generally* W. CARY & M. EISENBERG, CASES AND MATERIALS ON CORPORATIONS 606-13 (5th ed. 1980) [hereinafter cited as W. CARY & M. EISENBERG].

172. *Compare* Auerbach v. Bennett, 47 N.Y.2d 619, 633-34, 393 N.E.2d 994, 1002, 419 N.Y.S.2d 920, 928 (1979) (court may not review substantive decision by special litigation committee not to pursue claims

"forgive" a civil breach should extend as well to a criminal breach of a fiduciary duty. In theory, there are significant differences between civil and criminal offenses, but not if all knowing fiduciary breaches are viewed as criminal offenses.

C. MULTI-JURISDICTIONAL ASPECTS

More troubling than the existence of significant disparities among state jurisdictions in the fiduciary duties owed by corporate officials is the fact that the applicable fiduciary law will frequently lack any relationship to the jurisdiction in which the conduct occured. With only modest exception, the "internal affairs" rule is recognized in all American jurisdictions. This rule specifies that the law of the jurisdiction of incorporation will govern as to all intra-corporate disputes.[173] Thus, whether a corporate president based in Chicago who engages in a self-dealing transaction that allegedly injures shareholders in New York and Illinois breached a fiduciary duty will commonly be determined under the law of Delaware.[174] As a matter of civil law, this rule gives certainty and avoids the possibility of conflicting determinations. But if it becomes the test of whether a criminal "scheme to defraud" has occurred, an incongruity results; the applicable law has no relationship to the community in which the conduct occurred or in which the trial will occur. The basic conflict rule that one jurisdiction will not enforce the penal statute of another is founded on the sound premise that criminal statutes express community morality and are bounded in their application by that morality.[175] Thus, if the Illinois legislature permits a corporate fiduciary to disclose only the fact of his material interest in a transaction, it is arguably unjust to convict him based on the judgment of some other jurisdiction that full disclosure and intrinsic fairness is required, where only the historical accident of incorporation in that other jurisdiction has made its law applicable. In short, the conflict of laws rule applicable to corporate law seems fundamentally inconsistent with that applicable to criminal law; the corporate law rule permits choice of a foreign jurisdiction's law while the criminal law rule rejects this.

The impact of the "internal affairs rule" on the criminalization of fiduciary

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advanced in shareholders' derivative actions) *with* Zapata Corp. v. Maldonado, 430 A.2d 779 (Del. 1980) (court should apply its own independent business judgment to determine whether derivative suit should be permitted). For an overview of these decisions, *see* Coffee & Schwartz, *supra* note 151.

173. Shaffer v. Heitner, 433 U.S. 186, 215 n.44 (1977). *See also* RESTATEMENT (SECOND) OF CONFLICT OF LAWS §§ 296–310 (1971).

174. This does not mean, however, that a Delaware court has jurisdiction. As *Shaffer* made clear, there is a major distinction between choice of law rules and jurisdiction rules, and the former may require the application of Delaware law, although the latter do not give a Delaware court jurisdiction.

Delaware remains the favorite home (albeit seldom visited) of major U.S. corporations. As of 1977, 256 out of the nation's largest 500 industrial corporations were incorporated there. *See* Smith, *Delaware Works Hard to Stay a Corporation Home Sweet Home,* FORTUNE Feb. 13, 1978, at 132.

As a result of these two circumstances, many American courts will regularly be deciding if Delaware law considers some conduct a fiduciary breach even though their own legislatures see the matter differently. In some respects, Delaware is also more stringent in its regulation of corporate fiduciaries. *Compare* Brophy v. Cities Serv. Co., 31 Del. Ch. 241, 245–47, 70 A.2d 5, 8 (Del. Ch. 1949) (insider trading violates fiduciary duty) *with* Freeman v. Decio, 584 F.2d at 197–98 (under Indiana law, insider trading not necessarily violation of fiduciary relationship) *and* Schein v. Chasen, 313 So. 2d at 747 (under Florida law, insider trading not a violation of fiduciary relationship).

175. *See* note 153 *supra* (discussing basic conflict rule).

breaches can also be criticized from a law enforcement perspective as well as from a civil libertarian one. If there is a "race to the bottom" among jurisdictions competing for corporate franchises,[176] the resulting Gresham's Law effect means that weak fiduciary statutes may drive out strong ones, thereby denying a given jurisdiction the ability to use its own corporate law as a trigger for federal criminal liability. In short, the fiduciary law of "tough" jurisdictions will become irrelevant for purposes of criminal liability because corporations will elect to incorporate in other states, even though they principally operate in the first one.

These issues of inter-jurisdictional disparities have rarely been faced by courts in a criminal law context. However, a recent Supreme Court decision dealing with the Travel Act,[177] a statute with considerable similarities to the mail and wire fraud statutes, constitutes an important exception to this generalization. In *Perrin v. United States*,[178] defendants argued that the Travel Act did not criminalize interstate travel to effect commercial bribery, since commercial bribery was not illegal under federal law or the law of numerous state jurisdictions. Thus, they reasoned that when Congress used the term "bribery" in the Travel Act, it must have intended only to reach those forms of bribery illegal under federal law. For the Court, however, the decisive fact was that commercial bribery was illegal in Louisiana where the act occurred, and this outweighed the problem of inter-jurisdictional disparities in the application of federal law. While the decision is largely based on a narrow question of statutory interpretation, one suspects that the Court saw little problem in a statute intended to buttress local community standards and so construed the Travel Act as being intended to aid the enforcement of local law by criminalizing out of state activities which were preparatory to its violation.[179] Although *Perrin* might seem to suggest that disparities among states in the scope of the duties owed by fiduciaries are not relevant, this is too facile an intepretation of its basic policy premise. Instead, its sensible recognition that federal criminal jurisdiction is often "auxiliary"[180] to state criminal jurisdiction cuts in exactly the opposite direction once we return to the context of corporate fiduciary breaches where the governing law need not be that of the local jurisdiction. *Perrin* is distinguishable in two critical respects: (1) although it upholds the use of state criminal statutes in determining the scope of a federal criminal statute, state law does not criminalize fiduciary breaches, but rather only makes them civilly

176. For the development of this thesis, *see* W. Cary, *Federalism and Corporate Law: Reflections Upon Delaware,* 83 YALE L.J. 663 (1974).

177. 18 U.S.C. § 1952 (1976).

178. 444 U.S. 37 (1979).

179. The Court emphasized that Congress intended to add "a second layer of enforcement" to supplement inadequate state authority and enforcement, and in so doing did not alter state/federal relationships. *Id.* at 42. In Rewis v. United States, 401 U.S. 808 (1971), the Court was more emphatic that it would not infer that Congress intended a statute should apply to an activity "solely because the activity is at times patronized by persons from another state." *Id.* at 812. Thus, *Perrin* is in some respects an easier case than that which any thorough-going attempt to criminalize "knowing" fiduciary breaches would present because the Court was able to find that a total of 42 states proscribed at least some forms of commercial bribery, of which 14 made all forms of commercial bribery illegal. United States v. Perrin, 444 U.S. at 44. Hence, the prevalence of this statutory pattern was seen as necessarily within Congress' contemplation when it referred to "in violation of the laws of the state in which committed." 18 U.S.C. § 1952(b)(2) (1976).

180. 444 U.S. at 42, 50.

actionable; and (2) *Perrin*'s rationale is essentially based on the citizen's obligation to conform to the criminal law of the community he inhabits, a duty that has no necessary relationship to the jurisdiction of incorporation of the entity that the corporate fiduciary serves.[181]

D. THE FEDERALISM PROBLEM: SHOULD THERE BE FEDERAL FIDUCIARY STANDARDS?

A logical solution to the dilemma created by disparities in individual state's fiduciary duties would be to abandon the *Perrin* approach, under which federal law is simply ancillary to each state's criminal law, and instead define fiduciary transgressions as uniform federal frauds. Although the *Barta* opinion takes the first step in this direction,[182] there are problems with the path it follows as well. If one message runs through the Supreme Court's recent corporate law decisions, it is that the corporation is a creature of state law.[183] Having established that premise, the Court has concluded that federal duties should not be implied from ambiguous statutes if those newly created duties would preempt or displace a state's own corporate law.[184] Admittedly, this argument has been advanced most often to demonstrate that an implied private right of action is not available under a federal statute. In *Santa Fe Industries, Inc. v. Green*, however, this principle was applied by the plurality not only as a rule of statutory construction but as a doctrine of federalism as well.[185] Although one may question the extent to which the *Santa Fe* opinion is binding on that point,[186] the decision still stands and presents an obstacle

181. Corporate fiduciaries in effect elect the law that is to govern them by choosing the jurisdiction of incorporation. Although this makes a fiduciary breach analogous to a breach of contract, contractual breaches are rarely criminalized. To the extent that the breach is also one recognized by the law of the jurisdiction in which the conduct, or some sufficient element of it occurred, there is no disparity between the principle established in *Perrin* and the rule that the law of the jurisdicition of incorporation will govern. There still is, however, the formalistic problem that it is a foreign and non-penal rule that is the basis for criminal liability. At least where there is a disparity between the two states' law on fiduciary duties, the corporate context more closely resembles the fact pattern in *Rewis v. United States*, where the Court said it would not stretch an ambiguous statute to criminalize activity that was lawful under local law and custom. 401 U.S. at 811-12.

182. *Barta* involved a securities transaction furthered by an employee's fraudulent representation to his employer, and by his illegal extension of that employer's "margin credit." 635 F.2d at 1002-07. Both acts touch on federal interests expressed in the Securities and Exchange Act of 1934, 15 U.S.C. §§ 78a-78kk (1976 & Supp. III 1979), but were prosecuted under the federal mail and wire fraud statutes, 18 U.S.C. § 1341 (1976) (mail fraud) and 18 U.S.C. § 1343 (1976) (wire fraud).

183. *See* Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 479-80 (1977) (rule 10b-5 of Securities and Exchange Act should not be extended if interferes with established state policies of corporate regulation); Cort v. Ash, 422 U.S. 66, 84 (1975) (unless federal law expressly requires certain duties of directors, state law governs such internal corporate affairs).

184. For an overview of the developing law in this area, *see* W. CARY & M. EISENBERG, *supra* note 171, at 13-14, 406-11. Whether a cause of action was "one traditionally relegated to state law" was a major consideration in determining whether a corporate shareholder had an implied private right of action against the board of directors, under a federal statute not expressly requiring specific responsibilities of corporate officers in Cort v. Ash, 422 U.S. at 78, 84-85. The Court in Sante Fe Indus., Inc. v. Green, 430 U.S. at 478-79, conducted that same examination in construing a similarly ambiguous federal securities law before dismissing a shareholder's complaint.

185. *See* note 183 *supra* (citing cases that endorse application of state, rather than federal, law to regulate corporations).

186. In Sante Fe Indus., Inc. v. Green, 430 U.S. at 480-81, Justices Stevens and Blackmun declined to

to advocates of defining fiduciary obligations under federal law. Certainly, if a federal law was interpreted to define the corporate official's fiduciary duty more broadly than did state law, the state law's significance would diminish, contrary to the trend forwarded in the *Santa Fe* case.

State law can be eclipsed in other ways as well. To the extent that we punish fiduciary breaches with more draconian penalties, in the form of federal criminal sanctions, we are likely to alter the underlying character of the substantive law. Remedies do not merely enforce rights, but affect their nature and impact also.[187] In a corporate context, this may be especially true in the case where a board decides against bringing a derivative suit called to its attention by a minority stockholder.[188] The board's authority to so decide can amount to a power of forgiveness, which may make the state's substantive law on fiduciary duty somewhat illusory. If so, to criminalize deviations from this body of unenforced law through the use of a federal fraud statute produces a jarringly inconsistent result.

III. TOWARDS COMPROMISE: THE ROLE OF CAUSATION

In *United States v. Barta*, the Second Circuit recently rejected what it characterized as the "sweeping theory advanced by the Government"[189] that any breach of an employee's duty of loyalty to his employer, motivated by the anticipation of pecuniary gain, constitutes a "scheme or artifice to defraud"[190] under the mail and wire fraud statutes. As noted earlier, the defendant in *Barta* occupied a position of unique responsibility and sensitivity: as a margin clerk for a brokerage firm, he had the ability to commit the firm's entire financial resources. Despite express instructions from his employer to exercise caution in those dealings, the defendant arranged for the extension of substantial credit to an undercapitalized arbitrage firm in which he was a silent partner. When the borrower's investments ultimately soured,

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join in Part IV of the majority opinion, in which the Court advocated reliance on state corporate law in the absence of express Congressional authority to the contrary. Thus, *Santa Fe* was only a plurality opinion on that point. Subsequent, more "liberal" lower court opinions, have distinguished *Sante Fe* on other grounds, and have noted that the *Sante Fe* Court itself qualified its statements on the application of state versus federal law by carefully pointing out that the existence of a state law remedy is not "dispositive" of whether a similar federal remedy also exists. *Id.* at 478. That statement, along with several later decisions which address the same issue, suggest that a federal substantive law of corporations is still alive. *See* Goldberg v. Meridor, 567 F.2d 209, 220-21 (2d Cir. 1977) (court rejected defendant's argument that charges should not be brought under rule 10b-5 of Securities and Exchange Act because offense traditionally was also covered by state law), *cert. denied,* 434 U.S. 1069 (1978).

187. For a brief summation of the problematic relation of rights and remedies, see Schuck, *Suing Our Servants: The Court, Congress, and the Liability of Public Officials for Damages,* 1980 SUP. CT. REV. 281, 368.

188. *See* note 172 *supra*, and accompanying text (discussing possible shareholder ratification of director's breach and role of court in reviewing such vote). Distinctions can be drawn between the Delaware rule as expressed in Zapata Corp. v. Maldonado, 430 A.2d 779, 788-89 (Del. 1981), which essentially makes the board's "power of forgiveness" subject to judicial review and thus not an unqualified right, and the New York rule propounded in Auerbach v. Bennett, 47 N.Y.2d at 629-35, 393 N.E.2d at 1000-03, 419 N.Y.S.2d at 926-29, which leaves the board's decision-making authority in this area virtually unreviewable as a matter of business judgment, suggesting that the decision to sue for an injury should be left to the corporation as the legal victim.

189. 635 F.2d at 1002.

190. *Id.*

the defendant's employer was forced to share a $ 2,000,000 loss. Seeking to draw a line between the employee's "mere fiduciary breach" and the more serious violation that justified the imposition of a criminal sanction, the Second Circuit established a watershed in asserting that "[t]he additional element which frequently transforms a mere fiduciary breach into a criminal offense is a violation of the employee's *duty to disclose material information* to his employer."[191]

At first glance, this formula may give considerable comfort to the corporate executive as *Barta* does appear to excuse the fully disclosed but unfair transaction. Still, upon closer examination, the Second Circuit's decision actually expands the scope of criminal liablity for fiduciary breaches in two important respects. First, it expressly recognizes that the deprivation of an intangible right can constitute a "scheme to defraud" when a fiduciary transgression occurs in a private business setting. In *Barta*, the defendant neither converted money nor assets from his employer, but rather induced him through deception, to take an undesired and extreme business risk. To be sure, that fraud resulted in a tangible loss, but it was the intangible opportunity to avoid that risk that the employer was actually deprived of by the defendant. Presumably, the defendant's conduct would have been just as fraudulent and felonious had the borrower never become insolvent and had the financial loss never been incurred.

Second, the *Barta* court stressed that the finding of a fiduciary breach does not depend on its falling within the narrow categories recognized by state or federal law, but rather rests on the totality of the relationship between the parties involved. That point was particularly noteworthy, because at common law it is far from clear that an employee owes any fiduciary duty to his employer. In summary, the crucial elements in *Barta* appear to be the repeated warnings of the employer to the defendant not to overextend credit, coupled with the defendant's flagrant deception in doing exactly that. This indicates that the duty of disclosure, which the court used to distinguish criminal from non-criminal breaches, is not itself an independent variable but is instead a dependent variable, which arises out of the course of conduct between the parties. Even though the duty of disclosure thus does not exist apart from substantive deception, such deception is common to many, if not most, fiduciary violations. Consequently, though *Barta* still seems to have been correctly decided, its formula for criminal liability is more elusive and open-ended than it at first appears. Indeed, there is an element of bootstrapping here, since the prosecutor may in effect be able to argue that any form of misconduct committed by an employee should have been disclosed and, if not, amounted to the requisite disclosure violation.

If disclosure is to become the critical element in federal criminal liability for fiduciary breaches, *Barta* leaves open a number of important questions including: (1) To whom must disclosure be made — the board of directors, a committee thereof, or the stockholders in general?[192] (2) Must the disclosure cover all material

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191. *Id.* at 1006 (emphasis added).

192. In Goldberg v. Meridor, 567 F.2d at 215-18, the Second Circuit suggested that disclosure must be made to the stockholder when the board is controlled by the defendant. *See* Schoenbaum v. Firstbrook, 405 F.2d 215, 219-20 (2d Cir. 1968) (en banc) (corporation defrauded under securities laws when all directors participated in deception of minority shareholders to whom no disclosure made). *But cf.* Maldonado v. Flynn, 597 F.2d 789, 795 (2d Cir. 1979) (no fraud when four fully informed and

information or only the fact of a conflict of interest?[193] (3) Is disclosure required even when the outcome of a vote is predetermined[194] because the corporate defendant owns a majority of the stock?[195] These questions have been litigated frequently in past years under the securities laws. The expansive definition of the disclosure obligation generally given in those decisions may owe much, however, to the typically prophylactic and painless relief sought by the SEC as plaintiff, and may not carry over to cases brought by private parties.

The *Barta* decision provides clearer guidance in achieving a degree of symmetry between the scope of liability under the securities fraud and mail fraud statutes. Self-dealing transactions that fall outside the scope of securities laws because they involve no offer or sale of a security can be prosecuted more easily now under mail or wire fraud statutes.[196] After *Santa Fe*, it was clear that a fully disclosed but unfair

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disinterested directors, representing majority of board, vote for corporate action challenged by stockholders; knowledge of disinterested directors attributed to corporation).

193. *See* notes 168 through 170 *supra*, and accompanying text (discussing varying degrees of disclosure required of board members in different states).

194. Even when a majority of stock is owned by the defendants, so that a vote is practically assured, some federal decisions have allowed the plaintiff to satisfy the requirement of showing that nondisclosure, which influenced minority stockholder voting, was a "cause" enabling the directors to effectuate a fraud. In such cases, the courts may hypothesize that, had disclosure been made, management might have been either sufficiently embarrassed by the unfairness of the transaction to cancel it, or might have been prevented from acting by a state court injunction issued at the request of an irate minority stockholder. *See* Swanson v. American Consumer Indus., Inc., 415 F.2d 1326, 1332 (7th Cir. 1969) (defendants controlling majority of stock may have altered plans if, upon disclosure to minority stockholders, objections were raised to anticipated corporate action).

195. *Id.* at 1331-32 (court focused on injury to shareholders resulting from rule 10b-5 violation, not on fact that challenged merger would have been effected despite nondisclosure because defendant controlled 87% of corporate stock); Laurenzano v. Einbeinder, 264 F. Supp. 356, 262 (E.D.N.Y. 1966) (board meetings must be held and truthful proxy statements sent even though one shareholder controls enough stock to carry vote).

Such cases illustrate a tendency in federal securities law decisions to relax the requirement that a shareholder demonstrate that his vote, induced by misrepresentation, actually was a cause of the directors' ability to perpetrate a fraud. Similarly, courts have minimized the importance of the shareholder's proving he actually relied on incompletely disclosed information in voting as he did. *See* TSC Indus., Inc., v. Northway, 426 U.S. 438, 449 (1978) (showing of reliance on incomplete information disclosed in proxy statement not necessary as long as "substantial likelihood" exists that reasonable shareholder would have considered omitted facts material in deciding how to vote).

The liberal view in decisions such as *Swanson* and *Laurenzano* of what satisfies the causation requirement in cases of corporate fiduciary breaches possibly support the Second Circuit's refusal to require a showing of causation in a case like *Bronston*, involving a lawyer's nondisclosure of his conflict of interest to his firm and clients. But, while it may be easier, under such relaxed requirements, to show that Bronston's deception was an ultimate "cause" of his being able to carry out his fraudulent scheme, courts traditionally have required a more narrow and certain chain of causation in criminal cases. *See* People v. Warner-Lambert, 51 N.Y.2d 295, 305-06, 44 N.E.2d 660, 665-66, 434 N.Y.S.2d 159, 165 (1980) ("but for" test of causation applied in civil tort case rejected as standard for criminal culpability, court required challenged act be "sufficiently direct" cause of death and stated chain of causation must be closer in criminal case than civil); People v. Kibbe, 35 N.Y.2d 407, 412, 321 N.E.2d 773, 775-76, 362 N.Y.S.2d 848, 851-52 (1974) (same).

196. For example, a usurpation of a corporate opportunity, hidden compensation, or a self-dealing transaction involving property other than securities would be outside the purview of rule 10b-5 of the Securities and Exchange Act, but would fall within the scope of the mail and wire fraud statutes, assuming that jurisdictional requirements were met.

transaction does not offend rule 10b-5,[197] and after *Barta*, it is unlikely that that same transaction can constitute mail fraud. This result may increase the potential for fiduciary abuse, but such a risk is arguably counterbalanced by minimizing the possibility that mere differences of opinion over valuation will result in criminal prosecution. Whether the costs of such a tradeoff outweigh its benefits is debatable, but it is difficult, in any event, to justify the mail and securities fraud statutes reaching different conclusions on this issue and after *Barta* they do not.

On a policy level, the *Barta* opinion also makes considerable sense, considering the availability of civil remedies by which to contest substantively unfair transactions. It is only the undisclosed breach that cannot be remedied by private action. Hence, in those cases of nondisclosure, the special deterrence generated by use of criminal sanctions is more justifiable. *Barta*, therefore, focuses the criminal sanction on those cases where private remedies are least likely to be adequate.

Although the *Barta* line of reasoning seems sensible, it nonetheless requires supplementation. In particular, the precise criteria for determining the existence of a fiduciary relationship remain unclear. In that area, *Barta* only intensifies the existing ambiguity by emphasizing the ability of such a relationship to arise independently of state or federal law. The problem is especially acute for professionals, whether doctors, lawyers, brokers, or accountants, as they are typically subject to codes of ethics of professional responsibility that are phrased in aspirational terms. *Barta*'s emphasis on the specific instructions given by the employer to the employee suggests that, even if these codes do not in themselves require disclosure to a client, some prior course of dealing between the professional and the client or an express request for information by the client may give rise to a similar duty of disclosure. By incorporating in effect the duties that an agent owes to his principal within the scope of fiduciary duties, *Barta* thus lowers the criminal liability threshold which a professional may cross without any clear warning that a degree of disclosure is required of him.

What defenses should a professional have in such circumstances to prevent any slight impropriety on his part from being prosecuted as a crime? Some commentators have suggested that the intangible rights doctrine, should be abandoned on the ground that it is an extension of criminal liability never intended by Congress.[198] Such a result would require overturning not only *Issacs*[199] and *Mandel*,[200] but *Barta* as well, and would be inconsistent with recent developments under related

197. The plurality joining Part IV of the Court's opinion in Sante Fe Indus., Inc. v. Green, asserted that "once full and fair disclosure has occurred, the fairness of the transaction is at most a tangential concern of the statute." 430 U.S. at 478.

198. *See Intangible-Rights Doctrine, supra* note 31, at 566–72 (nothing in legal history of mail fraud statute suggests Congress aimed to provide criminal penalties for political corruption, wherein victim deprived only of intangible right to honest government, and not tangible property). The historical accuracy of the assertion that Congress never intended to prosecute political corruption through the mail fraud statute, and was legislating only against the deceptive procuring of money or property, is questionable. *See* Rakoff, *supra* note 46, at 780-81 n.46 (crime of conspiracy to defraud U.S., legislated against prior to adoption of mail fraud statute, was understood clearly by Congress to encompass bribery and related forms of political corruption). This article will not attempt, however, to work through that historical thicket.

199. 493 F.2d 1124 (7th Cir.), *cert. denied,* 417 U.S. 976 (1974).

200. 591 F.2d 1347, *aff'd on rehearing,* 602 F.2d 653 (4th Cir. 1979) (en banc), *cert. denied,* 445 U.S. 961 (1980).

statutes.[201] Judicial reversal of the intangible rights doctrine thus seems unlikely, therefore, unless the Supreme Court takes a sudden interest in substantive criminal law. Moreover, although the impact of such a retrenchment on the government's attempt to attack political corruption would be devastating, the abolition of the intangible rights doctrine probably would do little to help the defendant in cases of private fiduciary breaches. Because professionals receive fees from their clients, the theory that such tangible fees were obtained under false pretenses when the professional failed to disclose a conflict of interest or other material fact which would have caused the client to go elsewhere would still be available to plaintiffs. The net effect might be a rephrasing of the indictment; it would cease to speak of the deprivation of "honest and loyal services" and would instead emphasize the deceitful procurement of professional fees. Thus, abolition of the intangible rights doctrine might be an overreaction which fails even to curb the primary evil it addresses.

Another possible reform might be to preempt the mail and wire fraud statutes in situations where more detailed criminal statutes apply. Although there is much to recommend this theory of preemption as a viable legislative measure,[202] it faces a stonewall of precedent to the contrary as a judicial doctrine.[203] Nor would such a step assist the professionals who are most likely to be in the path of advancing criminalization in their fields, since more specific statutes do not apply to them. For example, neither Bronston or Margiotta would have been helped by such a preemption doctrine.

What test can help to distinguish impropriety from criminal fraud? This article has already hinted at a partial answer: the use of a proximate causation standard. Under that requirement, the state would have to allege a causal nexus between the fiduciary breach and the actual or threatened loss to the victim. Until *Bronston*, this was, at least implicitly, the law.[204]

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201. For example, interpretation of the Hobbs Act, 18 U.S.C. § 1951 (1976), has expanded within the last decade, and now includes any improper receipt of money or property by a public official "under color of official right." *Id.* at § 1951(b)(2). *See generally* Ruff, *supra* note 137, and accompanying text (discussing the expanded interpretation of the Hobbs Act for use in federal prosecution of political corruption).

Although recodification of the mail and wire fraud statutes would help establish clearer guidelines, it is neither random coincidence nor a matter of judicial oversight that both statutes have been reinterpreted to reach political corruption. Rather, judicial acceptance of that result in all likelihood reflects a broad social and political consensus, which preceded but was later intensified by the Watergate conspiracy, concerning the gravity of offenses involving institutional corruption.

202. Certainly, it is unjustifiable, though apparently not uncommon, that specific defenses established by Congress in enacting one statute can be circumvented by the simple expedient of resorting to prosecution under the broader mail fraud statute, which does not provide the same defenses. *See* Trowbridge, *supra* note 118, at 222-32 (discussing refusal of courts to adopt theory of implied repeal of general criminal statutes by more specific petroleum price control laws which preempt area and are more appropriate to prosecution of oil pricing violations).

203. *See* United States v. Dixon, 536 F.2d at 1399 (asserting that mail fraud statute is still available as basis for prosecution of frauds, even in area where legislation since enacted is more tailored to particular area in which fraud occurred); United States v. Courtois, *supra* note 14, at 91,297 (court rejected argument that existence of a detailed regulatory scheme governing security transactions preempts use of mail fraud statute in prosecuting corporate fraud). *But see* United States v. Henderson, 386 F. Supp. 1048, 1052 (S.D.N.Y. 1974) (mail fraud statute preempted by tax fraud provisions which more specifically address fraud alleged in that case).

204. *See* note 70 *supra*.

Still, demonstrating that a proximate causation requirement has support in the case law is not equivalent to showing that such a requirement is wise or just, or even a coherent standard by which to guide the criminal law. At first glance, causation seems a legal category more related to the concerns of tort laws where the unavoidable problem is always loss allocation between the plaintiff or defendant. In the tort context, the social interest of adequate compensation to victims also looms large. Yet, compensation to victims and loss allocation are at most subordinate concerns of the criminal law, where attempts as well as consummated acts have long been criminalized. Where tort law requires an injury which created a loss,[205] the criminal law is concerned with the creation of risk, and accordingly it penalizes attempts, conspiracies, solicitations, and even misprision. Above all, the criminal law's focus has been on the culpability of the actor, rather than on the consequences of his deed.[206] To the extent that the criminal law does grade its penalties in proportion to the harm achieved, commentators have justly criticized the results that have followed as lacking moral coherence.[207]

Given these not insubstantial objections, why should a requirement of proximate causation between the fiduciary breach and some foreseeable loss or harm still be imposed? Two reasons that stand out, relating to the traditional primary concerns of the criminal law, are blameworthiness and deterrence.

First, from the standpoint of the criminal law's traditional concern with culpability, many fiduciary breaches which a professional may commit involve relatively minor transgressions of aspirational standards. For example, an attorney may reveal a client's confidence that is relatively insignificant or may have a minor conflict of interest that does not impair his effectiveness. Undoubtedly, prophylactic rules which prohibit such transgressions are desirable, but they need not be uniformly enforced by the criminal sanction. Yet other fiduciary violations are capable of causing serious injury or loss and require the threat of criminal enforcement for adequate deterrence. In this light, the significance of a causal linkage requirement is that it serves as an adequate, if imperfect, proxy for culpability, because acts that foreseeably will cause harm tend to be more blameworthy than those that do not. Merely focusing on the intentional character of the fiduciary violation does not pick up this distinction, because the knowing breach may have been a minor one incapable of causing any serious harm, as in *Dixon* or, arguably, in *Bronston*. In

205. RESTATEMENT (SECOND) OF TORTS, §§ 525, 546, 548 (1976).

206. For a recent review of New York case law on causation in the criminal law, *see* People v. Warner-Lambert Co., 51 N.Y.2d 295, 306–07, 414 N.E.2d 660, 665–66, 434 N.Y.S.2d 159, 165 (1980), which emphasizes the importance of culpability to the criminal law. *See also* MODEL PENAL CODE § 2.03 (2)(b)(1980) (requiring that conduct which produced harmful result different from harm intended or contemplated shall result in criminal liability only if connection between harm and conduct "is not too accidental in its occurrence to have a just bearing on the actor's liability or on the gravity of his offense."); H.L.A. HART & A.M. HONORE, CAUSATION IN THE LAW 348–63 (1959) (discussing relation between causation and criminal punishment generally and with specific reference to drafting of Model Penal Code). Similarly, the criminal law has also generally declined to accept the rule of respondeat superior, even though this doctrine is clearly accepted as a matter of tort law.

207. *See* Allen, *Retribution in a Modern Penal Law: The Principle of Aggravated Harm*, 25 BUFFALO L. REV. 1, 32 (1975) ("unadorned theory of retaliation" only justification for aggravated assault theory); Schulhofer, *Harm and Punishment: A Critique of Emphasis on Results of Conduct in the Criminal Law*, 122 U. PA. L. REV. 1497, 1603-07 (1974) (concluding that emphasis on results justifiable in only very limited number of areas).

short, if the criminal law's touchstone is blameworthiness, proximate causation supplies a watershed by which to segregate minor offenses from major ones. To be sure, the legislature could elaborate this classification in more detail and thereby avoid some problems that a causation standard engenders. But little suggests that it is about to do so,[208] and, absent such a dividing line in the formula for criminal liability, venial "sins" can be transformed into crimes, even though the defendant's conduct had only a remote causal relationship to the victim's loss.

A similar point can be made with regard to the criminal law's other polestar, deterrence. Injuries that are not foreseeable are not easily deterred. The actor who does not see the possibility of harm does not feel the need to act carefully. Nor does he stop to realize that he risks liability. Economists have elaborated on this point, emphasizing that the human mind can perceive only a limited range of risk, including legal risks, associated with any activity.[209] Hence, attempts to deter conduct not foreseeably leading to harm to a visible party are likely to be unfruitful. The common sense of this underlies the *Palsgraf*[210] rule and comes into clearer focus when one asks oneself if Bronston or a similar defendant would have necessarily realized that assistance given a long-time client necessarily implied that one was defrauding the current client of his firm, because it was a competitor.[211]

Causation is then an element that permits the court considerable discretion in dealing with violations by fiduciaries. But it is also a complex concept which the civil law of securities fraud has sensibly broken down into two elements, "transaction causation" and "loss causation," both of which need to be present for civil liability to result.[212] If the criminal law were to adopt this result, some important questions would be answered. For example, in the *Bronston* case, it might be argued that but for the nondisclosure of defendant's conflict, the client would have fired the law firm or the law firm would have forced Bronston to desist from assisting a rival of its client. This assertion may suffice to meet the "transaction causation" test, but it does not satisfy the "loss causation" requirement because nothing Bronston actually did appears to have affected the outcome. Alternatively, if one focuses on the legal fees

208. After more than a decade of work, Congress still has been unable to recodify the federal criminal laws, and the progress of these efforts, which virtually all have supported in principle, remains in doubt.

209. Shavell, *Analysis of Causation and the Scope of Liability in the Law of Torts*, 9 J. OF LEGAL STUD. 463 (1980).

210. Palsgraf v. Long Island R.R. Co., 248 N.Y. 339, 344, 162 N.E. 99, 100 (1928). The dissent in *Palsgraf* clearly makes a valid point in its statement that proximate causation is in fact largely a mediating political doctrine. "What we do mean by the word 'proximate' is that because of convenience, of public policy, of a rough sense of justice, the law arbitrarily declines to trace a series of events beyond a certain point. This is not logic. It is practical politics." *Id.* at 352, 162 N.E. at 103 (Andrews, J., dissenting). Even if the dissent is correct, it is exactly this "rough sense of justice" issue that should be placed before the jury under our traditional view of the jury as the arbiter of community moral standards.

211. To be sure, Bronston may well have intended to injure his firm's client by aiding his personal client, but it is easy to imagine another equivalently situated individual in a firm of nearly 200 attorneys continuing to assist a former client despite a present conflict of interest because of a sense of loyalty or out of a belief that the violation was only technical in nature. This statement does not deny the state's power to criminalize "technical" violations, but it does question the wisdom of such a policy absent either evidence of potential harm or the insufficiency of non-criminal sanctions.

212. For a brief discussion on this point *see* W. CARY & M. EISENBERG, *supra* note 171, at 788-89. *See also* Schlick v. Penn-Dixie Cement Corp., 507 F.2d 374, 380 (2d Cir. 1974) (making same point), *cert. denied*, 421 U.S. 976 (1975); 2 A. BROMBERG, SECURITIES LAW: FRAUD—SEC RULE 10b-5, § 8.7(1), at 215-16 (1967) (same).

received by the law firm, it is arguable that they would not have been paid had the disclosure been made to the client. It is much less arguable that a true loss was thereby incurred by the client since the client got basically what it paid for from the firm, which diligently represented its interests.[213] A causation standard might also allow the court to give weight to other relevant factors, such as a subsequent bona fide ratification by disinterested shareholders, on the grounds that the transaction would have been consummated anyway and so was not "caused" by the non-disclosure.[214]

IV. CONCLUSION: THE NEED FOR A LEGISLATIVE RESPONSE

That the law evolves over time is hardly a new or exciting conclusion. But the pace of change in the federal criminal law of fraud has been so rapid over the last decade as to resemble not evolution but mutation. In overview, three distinct developments have significantly expanded the scope of criminal liability for fraud and left it with highly uncertain contours: (1) the intangible rights doctrine has gained widespread acceptance as a theory of liability applicable to the public official;[215] (2) with *Barta, Bronston* and most recently in *Newman*,[216] the Second Circuit has extended this doctrine to the private fiduciary and sufficiently relaxed the "actual harm" requirement so that prosecutors may now believe themselves able to allege simply that a knowing fiduciary breach is criminal because it deprives the victim of the full loyalty of his fiduciary; and (3) the prior implicit requirement of a causal link between the conduct and resulting harm to the victim has been at least formally rejected in *Bronston*.

Closely linked as these developments are, it is still possible to appraise them very differently. First, it is difficult to reject the common sense behind the intangible rights doctrine as an abstract proposition. Some injuries, such as to the victim's privacy or reputation, clearly can be as grievious as any loss of property or money. Operationally, the doctrine fills a void, albeit one that recent expansion of the Hobbs Act has also addressed with stronger statutory support. Indeed, if the crime of defrauding the citizens of their right to an honest government did not exist, it would be necessary to invent it, as Congress has seemingly recognized in the process of recodifying the Federal Criminal Code.[217] Finally, such a theory does not extend

213. In this light, the "loss causation" standard may produce results quite similar to the "actual harm" requirement in mail fraud prosecutions discussed in *Dixon* and *Courtois*. Both require a showing of "loss" or "harm" whereas the "transaction causation" component could be satisfied simply by showing an act that deprived the *cestui* of the full and faithful loyalty of the fiduciary. For a further discussion, see notes 20 & 21 *supra*.

214. A similar issue arises whenever the defendant in a self-dealing transaction has the numerical voting strength to vote through the transaction by voting his own shares for it. Some securities law decisions here, however, still found the causation requirement satisfied on such facts on the theory that disclosure might have prompted an injunctive or similar action by an aggrieved minority stockholder. For a further discussion and list of cases on this point, see notes 192 through 195 *supra*.

215. Cases prior to the last decade can concededly be found in which the mail fraud statute was used to penalize political corruption. *See* notes 63 through 65 *supra*, and accompanying text. But the broad acceptance of the intangible rights doctrine can probably be dated to United States v. States, 488 F.2d 761 (8th Cir. 1973), *cert. denied*, 417 U.S. 909 (1974).

216. *See* note 14 *supra* (discussing Second Circuit's extension of intangible rights doctrine).

217. *See* note 34 *supra* (discussing inclusion of intangible rights doctrine in House and Senate bills to

the limits of criminal responsibility much farther than do older statutes, such as that of conspiracy to defraud the United States which has long been applied to public corruption.[218]

In contrast, the emerging idea that a private fiduciary criminally defrauds a beneficiary of his right to loyalty when the fiduciary acts out of a conflict of interest or violates professional ethics is a proposition of much greater breadth particularly when coupled with the corollary that the crime is complete irrespective of the lack of potential for any economic loss. Such a development may make a misrepresentation alone criminal even where it could have caused no harm. While the *Mandel* decision approached this result with respect to public officials,[219] the significance of such a proposition for the private sector is vastly greater for several reasons. First, the criminal law intrudes upon everyday life to a much greater extent and without the same inherent notice that our culture has long attached to public office. Second, such an expansion disregards the greater availability of non-criminal remedies. Third, because the definition of fiduciary status is perhaps necessarily uncertain, the businessman is exposed to the very conflicting standards of both the "morals of the marketplace" and the "punctilio of an honor the most sensitive." Nor should the morals of the marketplace be invariably rejected; in reality, they express the commercial values of a competitive, acquisitive and self-reliant society and are so understood by the businessmen and professionals who conform to them. Finally, there is another important distinction between the private and public sectors. Unlike the politician, the professional is subject to fairly comprehensive and certainly aspirational ethical standards, whose breach can easily be termed fraudulent, as defendant Bronston found.[220]

The author does not deny that many forms of conduct which constitute private fiduciary breaches can also merit criminal prosecution. Many of the classic fiduciary breaches such as self-dealing transactions, usurpation of corporate opportunities and receipt of kickbacks, are not sharply distinguishable from embezzlement. *Still, a critical difference in these cases is that the fiduciary breach was the means to an ultimate end and not the end itself.* In contrast, if merely depriving the victim of the loyalty and faithful service of his fiduciary constitutes criminal fraud, the ends/means distinction is lost. Once the ends/means distinction is abolished and disloyalty alone becomes the crime, little remains before every civil wrong is potentially indictable.

So what then should be done? This article will make two specific proposals, neither of which is intended as anidea fully ready for legislative adoption nor as a response which should exclude others. First, because one suspects the Second Circuit's refusal in *Bronston* to require proof by the prosecution that the defendant

recodify federal criminal code).

218. *See* note 32 *supra* (discussing use of criminal conspiracy statute to reach bribed government officials).

219. 591 F.2d at 1360–65 (emphasizing concealment of material information by governor); *cf. Margiotta* Record, *supra* note 141, and accompanying text (jury charge in *Margiotta* trial).

220. This problem is intensified for the lawyer by the Kutak Commission's decision to abandon the distinction between "Ethical Considerations" and "Disciplinary Rules" in its model rules of professional conduct. Merging the two will inevitably result in a greater aspirational content to rules which now give rise to both potential criminal and professional sanctions. ABA COMM. ON EVALUATION OF PROFESSIONAL STANDARDS (Final Draft May 30, 1981), *reprinted in* 69 A.B.A. J. 1225 (1981).

actually used his fiduciary position to harm the victim was motivated in part by a judicial sense that such a rule might place an unreasonable burden on the prosecution, some compromise seems necessary. Indeed to require the state to prove beyond a reasonable doubt that given conduct was capable of causing "actual harm" sounds contradictory; certainty and possibility mix here no better than oil and water. Potentially, the soundest accommodation of the two concepts would be to make proximate causation a matter of affirmative defense; if the defendant could show that his specific conduct was not capable of harming the putative victim, or that such harm was not reasonably foreseeable within the range of proximity that the concept of causation has traditionally implied, such a showing would negate criminal liability. Such an allocation of burdens also sensibly reflects the defendant's greater access to the relevant facts. In rebuttal, some will suggest that this allocation of the burden is unconstitutional because it impermissibly shifts to the defendant the burden of disproving a substantive element of the crime.[221] But this assumes what is to be proved, namely, whether causation is a substantive element of the crime. Or, alternatively, whether it is more like those questions of intent or culpability that traditionally and constitutionally have been made matters of affirmative defenses.[222] After *Bronston*, the answer provided by the case law would appear to be that causation is not a substantive element of the crime of mail fraud. This may be a blessing in disguise because it enables us to write upon a clean slate and add the concept as a defense precisely because the case law has held that it is not a necessary element of the state's proof. Other precedent also exists; the Model Penal Code treats causation basically in terms of its foreseeability [223] and this further suggests that the issue can be made an affirmative defense under *Patterson v. New York*.[224] Alternatively,

221. Three important Supreme Court decisions could be cited for the proposition that the burden may not be placed on the defendant: Sandstrom v. Montana, 442 U.S. 510, 521 (1979) (jury instruction that law presumes person intended natural consequences of his voluntary acts improper as places burden on defendant to disprove intent); Mullaney v. Wilbur, 421 U.S. 684, 701-04 (1975) (state may not use rebuttable presumption that defendant acted out of malice because this shifts burden to defendant); *In re* Winship, 397 U.S. 358, 361-64 (1970) (state must prove every element of crime beyond reasonable doubt). The scope of these decisions, however, has been limited by Patterson v. New York, 432 U.S. 197, 207-09 (1977), which permitted the state to shift the burden not by a presumption, but by an affirmative defense. Obviously, the distinction between presumptions and affirmative defenses is formalistic, and much recent commentary has attempted to trace the line which should exist. *See* Allen, *Structuring Jury Decisionmaking in Criminal Cases: A Unified Constitutional Approach to Evidentiary Devices*, 94 HARV. L. REV. 321 (1980); Jefferies & Stephan, *Defenses, in the Criminal Law*, 88 YALE L.J. 1325 (1979); Nessen, *Rationality, Presumptions and Judicial Comment: A Response to Professor Allen*, 94 HARV. L. REV. 1574 (1981). But for the following reasons, this author believes that the assignment of the accusation burden to the defendant in fraud cases would meet any of the tests specified in the foregoing articles.

222. A recent decision by the Supreme Court treats duress and necessity as affirmative defenses on which the defendant must satisfy the burden of production. United States v. Bailey, 444 U.S. 394, 415 (1980). Traditionally, the defense of withdrawal from a conspiracy is one which the defendant must also prove affirmatively. United States v. Dorn, 561 F.2d 1252, 1256 (7th Cir. 1977). Distinctions can be made between the burden of production and the burden of persuasion, and it is possible to advocate sensibly that only the first burden should be shifted to the defendant with respect to the causation issue. This article intends, however, only to raise these issues and not to draft a model statute.

223. A.L.I. MODEL PENAL CODE § 2.03(2) (P.O.D. 1963).

224. *Patterson* emphasized the historical treatment of the burden there at issue, 432 U.S. at 202-05, and determined that the common law had traditionally placed it on the defendant. *Id.* at 202.

fairness to the defendant might be maximized if the burden was made only one of production, with the government still made ultimately to carry the burden of persuasion once the defendant introduced credible evidence showing that harm had not been caused by his conduct.[225]

Concededly, proximate causation is an inexact concept. But it is precisely this characteristic that makes it attractive as a mediating doctrine capable of responding to the inevitably new and novel forms of fraud which will be invented without criminalizing essentially innocuous ethical transgressions.

A second proposal, involving a question which this article has to this point assiduously avoided, is whether there really is a federal interest in disciplining fiduciaries. Clearly, none of the classic bases for federal criminal jurisdiction are present: there is no special federal interest such as there is in matters concerning defense or foreign policy, nor any federal regulatory structure that might be generally imperiled, nor is such an effort at criminal enforcement "auxiliary" to state criminal law enforcement,[226] because state law does not criminalize the same conduct. Professionals, such as attorneys, are also subject to sufficiently severe disciplinary sanctions as to make the need for federal prosecution questionable.

The orthodox answer to any expression of skepticism about the need for expansion of federal criminal jurisdiction into the fields of "white-collar" crime and political corruption has long been that state criminal enforcement is likely to be ineffective in these areas.[227] This is true up to a point. For example, it is doubtful that Governor Mandel could have been effectively prosecuted by law enforcement officials he appointed and controlled. Similarly, corporate internal affairs in the public corporation may be beyond the practical reach of most state jurisdictions, which have historically deferred to the SEC. Nor is the minority stockholder as effective a private attorney general today as he may once have been.[228] Thus a strong case exists for federal prosecution of significant acts of self-dealing by those in control of the corporation, where such acts fall outside the scope of the federal securities laws but still undermine investor confidence and engender public cynicism.

But this argument as to state incapacity has its logical limits. No such state incapacity exists in the most frequently prosecuted corporate case in which a low level corporate employee received kickbacks. Indeed, internal corporate discipline, of

225. For example, in an insider trading case like *Courtois*, the defendant would seek to show that the bidder had not been required to raise his bid because of insider trading, that the sellers had already determined to sell and had, if anything, received an increased price because of the insider trading. The defendant would also wish to demonstrate that the investment banking firms had not suffered a decline in their ability to attract business. The defendant could be required to give notice of an intent to raise such a defense, and the prosecution would then be required to sustain the burden of persuasion in showing some pecuniary harm or severe reputational injury to some victim.

226. For an overview of the "auxiliary enforcement role of the federal government" under current law, see 1 WORKING PAPERS OF THE NATIONAL COMMISSION ON REFORM OF FEDERAL CRIMINAL LAWS 33-39 (1970) and Schwartz, *Federal Jurisdiction and Prosecutor's Discretion*, 13 LAW & CONTEMP. PROB. 64, 73-77 (1948) [hereinafter cited as Schwartz].

227. *See* Ruff, *supra* note 137, at 1209-10; Schwartz, *supra* note 226, at 73-77.

228. Both the recent case law subjecting the derivative action to a power in the corporation's board to terminate it and a series of Supreme Court decisions narrowing the scope of the federal securities laws as a remedy for corporate mismanagement make this reluctant conclusion unavoidable. *See* Coffee & Schwartz, *supra* note 151, for a description of both trends.

which dismissal and refusal to provide an employment reference are two examples, may well be a sufficient sanction for such lower echelon employees.[229] Thus, federal criminal enforcement in such cases may amount to little more than a governmental subsidy to business, which increases the sanctions with which corporations can discipline employee misconduct. Except in the egregious case presented by *Barta's* facts, it is doubtful that such prosecutions merit a high federal priority.

In this light, the primary need in this area may be for clearer federal standards as to the exercise of prosecutorial discretion. This suggestion, however, opens up the much broader topic of centralization and internal control within the Department of Justice. As others have ably analyzed, the Department's efforts to standardize policy through the use of manuals and a requirement of pre-indictment approval by the Criminal Division have had only limited success and have not stopped the expansion of federal criminal jurisdiction into new areas.[230] This is not said to criticize such possible reforms as a detailed Justice Department Manual on White Collar Crime that would place internal limits on the ability of the federal prosecutor to indict fiduciary breaches under novel theories or a requirement of Criminal Division approval prior to indictments brought by local U.S. Attorneys in this area. Such steps would be sound ones, but their impact will predictably be marginal and uneven.

What seems necessary, therefore, is the adoption of a more basic and visible philosophy of federal criminal jurisdiction to which individual U.S. Attorneys can adhere and from which deviations will be more visible. Put most simply, it seems time to abandon the notion of federal "auxiliary" criminal jurisdiction and redefine the federal role in terms of what it has already become: a federal "backstop" jurisdiction, under which the federal prosecutor intervenes once the paralysis or incapacity of state enforcement has been shown. The federal prosecutor then does not simply assist state enforcement as a loyal colleague; rather, he is a virtual trustee or guardian for the state agency where conflict of interest or other incapacity render local enforcement impotent. To be sure, the proponents of "auxiliary" jurisdiction were sophisticated thinkers who wisely wished the federal prosecutor to surrender anachronistic notions that federal crimes were truly justified by the use of some instrumentality of interstate commerce and instead to focus on the need for federal enforcement to aid state authorities.[231] Such a role is certainly more sensible than pretending that mail fraud is truly a "crime against the mails," but it also dilutes and over-extends federal enforcement resources. This is evident today when any local policeman who receives a $5.00 bribe is potentially indictable under the Hobbs Act and any corporate purchasing officer who accepts a gratuity from a salesman is similarly vulnerable under mail and wire fraud charges.[232] Realism and sound policy require that we see federal criminal enforcement for what it is and should be,

229. For this speculation, *see* R. POSNER, ANTITRUST LAW: AN ECONOMIC PERSPECTIVE 225-26 (1976).

230. *See* Ruff, *supra* note 137, at 1201-08 (noting "perpetuation of the uncomfortable relationship between the Department [of Justice] and the United States attorneys").

231. *See* Schwartz, *supra* note 226, for the leading statement on the rationale for an auxiliary federal criminal jurisdiction.

232. Professor Ruff uses the example of a policeman who receives a small gratuity to provide protection to make his point about the seeming overextension of federal criminal jurisdiction into the field of official corruption. Ruff, *supra* note 137, at 1173-74, 1218. *See also* United States v. Crowley, 504 F.2d 992, 997-98 (7th Cir. 1974) (Hobbs Act used to indict policeman for extorting $600). As for commercial bribery of the middle echelon businessman see Perrin v. United States, 444 U.S. 37 (1979).

namely, a reserve force which intervenes only once a local body, political or corporate, shows signs of sufficient internal corruption as to be unable to reform itself. Thus, the decision to prosecute a governor or a corporate president is far more easily justified than a similar decision to indict a traffic cop or purchasing agent. More importantly, communication of such a generalized policy that supports intervention primarily when local enforcement appears inadequate or compromised by political conflicts may have a long-term salutory effect on state and local prosecutors. In time, a federal decision to undertake such a prosecution might come to be understood to imply a lack of confidence in the ability or willingness of the local authorities to undertake successful corrective actions. The implicit criticism in such a federal prosecution would likely give teeth to preliminary federal efforts at making a referral to state or other authorities.

Analogously, much of this same approach could be adopted in the corporate context. While few would urge the federal prosecutor to rely on a board's decision not to sue a corporate fiduciary, board action requiring the dismissal or similar penalization of a corporate official at the prodding of the prosecutor might often be sufficient sanction where the underlying offense was basically that of a fiduciary breach. Moreover, a prosecutorial policy of deferring to internal remedies, where they were more than nominal, might also activate corporate boards to take their disciplinary role more seriously. At present, commentators have generally agreed that the corporate board suffers from a "structural bias" which disables it from taking corrective action at the behest of a private derivative suit plaintiff.[233] But, a request for corrective action from the federal prosecutor might have a very different impact where a decision not to act based on a cosmetic justification might be followed by a federally commenced prosecution that both indicted the corporate executive who was the subject of the referral and implicitly expressed a lack of confidence in the board. This is not to imply that every board decision not to act should be followed by a federal prosecution of the defendant, but the discounted threat of such action seems an appropriate remedy to the basic syndrome of board passivity. Precedent for this recommendation already exists to a degree in the draft Federal Criminal Code, which instructs the U.S. Attorney not to prosecute state public officials for bribery without first providing the state a reasonable opportunity in effect to clean its own house.[234] The approach suggested above would extend this policy, by internal regulation, to the context of private fiduciary breaches. It would require the U.S. Attorney to certify to the Department either that the board, after notification, had

233. Coffee & Schwartz, *supra* note 151, at 283.

234. *See* H.R. 1647, 97th Cong., 1st Sess. § 1751 (1981) ("Bribery"). Subsection (b)(1) of this section provides that no prosecution for bribery shall be undertaken "based on such [defendant's] being a State or local public servant unless" the Attorney General certifies either that (a) local authorities "acquiesced in the Federal prosecution," (b) "at the time of the indictment there was no pending State prosecution... and, in the judgment of the Attorney General or Assistant Attorney General, the State was not about to undertake such a prosecution," or (c) "the Attorney General certifies that the Federal prosecution is required by the interests of justice." *Id.* For an explanation of this provision's intent, see H.R. Rep. No. 1396, 96th Cong., 2d Sess. 192 (1980) (explaining that provision intended "to preserve the balance between State and Federal interests").

Perhaps more importantly, however, such a provision also increases internal control within the Department of Justice and reduces the possibility that a U.S. Attorney can force the Department to accept as a *fait accompli* a sensitive prosecution which was not first authorized by it.

failed to take adequate measures or that the case was too serious for such measures to suffice. Reasons supporting the determination that the board's response was inadequate would be specified, and such a determination would eventually become public either through SEC disclosure or by a FOIA request.[235] For example, the U.S. Attorney could inform the corporation's board that he was considering a criminal prosecution of the chief executive officer, but would as a matter of discretion consider whether internal corrective actions taken by the board were sufficient. To do so both conserves scarce prosecutorial resources, activates internal corporate discipline, forces the corporation's independent directors to appraise the situation and take action, and reduces the problem of class discrimination under which clerks and cashiers are prosecuted, but chief executive officers escape without a sanction.

The federal prosecutor's staff is in the last analysis our society's elite shock troops and its final reserve; it must not be committed to battle prematurely. Thus, the nature of this role necessitates that an attempt be made to give civil remedies and state criminal enforcement a right of first refusal. In addition, the dynamics of public accountability today apply to the corporate boards of publicly held corporations almost as much as to local political bodies. As a result, it is a realistic scenario to believe that such a prosecutorial demand may produce legitimate internal reform. More importantly, because the prosecution of both "white" and "blue" collar fiduciary breaches simply cannot be given the same priority as crimes that threaten life or safety or even crimes that produce public corruption, it is a way of multiplying the impact of potential federal criminal intervention without draining limited federal resources. When to this balance is added the inherent grayness of the fact patterns in this area of private fiduciary misconduct, the spectre of overcriminalization becomes a legitimate, if still distant, consideration. For these reasons, the fiduciary breach is a species of fraud to which the prosecutor's response probably should be to bark more often than to bite.

Contrast the House version with S. 1630, 97th Cong., 1st Sess. § 1351(c) (6) (1981) ("Bribery"). Federal jurisdiction would exist if "the public servant is an agent of a State or local government charged by a federal statute, or by a regulation issued pursuant thereto, with administering monies or property derived from a federal program, and the official action or legal duty is related to the administration of such program."

235. In the case of publicly-held corporations which are subject to the proxy rules of the Securities Exchange Act of 1934, it seems likely that the board's response to such a request would be material information, unless the prospective defendant were a lower echelon official. *See* SEC v. Schlitz Brewing Co., 452 F. Supp. 824, 829-31 (E.D. Wis. 1978) (improprieties of director's acts may be significant; "delicate assessment" of importance of information should not be made on motion to dismiss); SEC v. Kalvex, 425 F. Supp. 310, 315 (S.D.N.Y. 1975) (failure to disclose illicit activity of director violation of rule 14a-3).