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The 'Honest Services' Doctrine

Ethics reform by federal prosecution

Federal prosecutors in New Jersey and elsewhere have been using the “honest services” theory of mail and wire fraud to prosecute state and local public officials with increasing frequency. At its most basic level, the honest services theory posits that such public officials owe a fiduciary duty to the public, which they can breach in one of two ways: either by engaging in classic, quid pro quo bribery or by taking official action that benefits a concealed financial interest. Using the mail or interstate wire transmissions in the latter situation can transform an ethical lapse into federal felonies. Because the honest services statute is so vague and because any federal prosecution of state or local officials raises federalism concerns, federal appellate courts — including the Third Circuit — have attempted to limit the scope of honest services fraud. New Jersey state legislators have, thus far, managed to steer clear of the honest services maelstrom.

In *United States v. Panarella*, 277 F.3d 678 (3d Cir. 2002), a Pennsylvania

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State Senator, F. Joseph Loeper Jr., filed financial disclosure statements omitting \$300,000 he had received as payment for consulting services provided to a tax collection business operated by Nicholas Panarella Jr. While receiving such payments from Panarella, Loeper voted against proposed legislation that would have restricted enforcement of a business privilege tax that was the Panarella firm’s bread and butter. On appeal from his guilty plea, Panarella claimed that the information charging him as an accessory to Loeper’s honest services fraud was defective because it failed to allege that his payments to Loeper were bribes or affected Loeper’s official decision-making.

In affirming the conviction, the *Panarella* court reviewed honest services prosecutions of local officials and identified “two scenarios: (1) bribery, where a legislator was paid for a particular decision or action; or (2) failure to disclose a conflict of interest resulting in personal gain.” The court focused exclusively on the latter, concealed conflict theory, finding the former bribery theory inapplicable to the alleged conduct. It held that the concealed conflict theory applied only to “discretionary action that the official knows will directly benefit a financial interest that the official has concealed in violation of a state criminal law.” Because Loeper’s false disclosure forms violated Pennsylvania criminal statutes (and because his votes against the proposed legislation had directly furthered the

financial interest he omitted from those forms), the court affirmed Panarella’s conviction as an accessory to Loeper’s honest services fraud.

In holding that a public official must not only conceal a financial interest directly benefited by his discretionary legislative action but also must violate state criminal law in doing so, the *Panarella* court imposed a more stringent limitation on the concealed conflict theory than other circuits, which had required only “misuse of office for personal gain.” The court explained that this limitation ameliorated both the vagueness of the honest services statute (18 U.S.C. § 1346) and federalism concerns resulting from federal prosecutions of state and local public officials:

The clarity of Pennsylvania’s disclosure statute criminalizing a public official’s nondisclosure of his sources of income addresses rule of lenity concerns ... more effectively than does ‘misuse of office for personal gain.’ Moreover, the existence of a violation of state law in this case mitigates the federalism concerns that arise from federal prosecutions of local public officials ... in a way that ‘misuse of office for personal gain’ does not.

Notwithstanding its limitation of the concealed conflict theory, *Panarella* promotes the political theory underlying the honest services doctrine. As the court noted, “[c]ritical to the health of the electoral process is the voters’ abili-

ty to judge whether their representatives are acting to further their own financial self-interest instead of the public interest." For that reason, "knowledge of Loeper's income from Panarella would have been relevant both to Loeper's colleagues in assessing Loeper's comments when deciding how to vote on the bill, and to the electorate[.]" Because Loeper concealed a financial interest that was directly benefited by his discretionary legislative action, his conduct breached the fiduciary duty of honest services he owed to the public. At the same time, because that concealment also violated Pennsylvania criminal statutes, federal prosecution of Loeper's (and Panarella's) conduct did not implicate the vagueness or federalism concerns inherent in honest services cases.

Panarella limits the concealed conflict theory of honest services fraud to: (1) discretionary legislative action which (2) directly benefits (3) a financial interest (4) concealed (5) in violation of state criminal law. As a result, changing one or two variables can produce dramatically different legal outcomes. The Third Circuit confirmed that reality in *United States v. Murphy*, 323 F.3d 102 (3d Cir. 2003), when it vacated an honest services conviction by rejecting the prosecution's theory that a local political party chairman, who owed no fiduciary duty to the public as a matter of New Jersey law, nevertheless assumed such a duty by virtue of his dominance and control over local governmental affairs.

Given the different outcomes in *Murphy* and *Panarella*, public officials who serve in New Jersey (and defense attorneys who represent them) should consider how the concealed conflict theory applies to different factual scenarios. For example, suppose Loeper had been a New Jersey legislator who, instead of voting on matters directly benefiting a concealed financial interest, had lobbied local officials on local projects for Panarella without disclosing such lobbying activities on his legislative disclosure forms. As it turns out, both *Panarella* and New Jersey law address this hypothetical situation and establish that it would not implicate the concealed conflict theory, for several independent reasons.

First, and significantly, the charging document in *Panarella* alleged that Loeper had "supported Panarella's business development efforts by appearing with him before local governments in Pennsylvania[.]" Those appearances, however, played no role in the court's ultimate holding that affirmed the honest services conviction. Instead, the court relied exclusively on Loeper's speaking about and voting on legislation — i.e., his discretionary legislative action — directly benefiting his concealed financial interest. Indeed, the *Panarella* court reiterated its holding to make clear that the requisite "discretionary action" was "discretionary action in [the public official's] official capacity." That is why Loeper's voting and speaking against legislation that would have harmed his concealed financial interest — and not his appearances before municipal officials — violated his duty of honest services.

Second, although New Jersey statutory law prohibits a state legislator from representing any party with business pending before any "State agency," N.J.S.A. 52:13D-16b, it clearly permits state legislators to lobby local officials by limiting the definition of "State agency" to agencies and persons above the county government level. N.J.S.A. 52:13D-13a. New Jersey law, therefore, expressly and specifically authorizes legislators to lobby local officials for private gain.

Finally, New Jersey, unlike Pennsylvania, lacks any specific statute criminalizing a legislator's submission of false financial disclosure forms. Thus, any failure to disclose income from lobbying municipal officials would not constitute a financial interest that the official has concealed in violation of a state criminal law," as *Panarella's* holding requires.

The foregoing hypothetical exemplifies the vagueness, lenity and federalism concerns identified by the Third Circuit — and numerous other courts and commentators — in limiting the breadth of federal honest services prosecutions of state and local officials. For instance, almost 20 years ago, Judge Ralph Winter, in urging the reversal of

an honest services conviction against a local political party chairman, said that "what profoundly troubles me is the potential for abuse through selective prosecution and the degree of raw political power the freewheeling club of mail fraud affords federal prosecutors." *United States v. Margiotta*, 688 F.2d 108, 143 (2d Cir. 1982) (Winter, J., dissenting)). In adopting that dissent in *Murphy* only three years ago, the Third Circuit stated that "such a loose interpretation of the mail fraud statute creates a catch-all political crime which has no use but misuse." Professor Sara Sun Beale summed up those concerns as follows:

[t]he amorphous content of the phrase "honest services" gives prosecutors enormous leeway in selecting targets, and this unguided discretion raises many additional concerns. Prosecutors may succumb to the desire to chalk up a victory over prominent political figures, even when the evidence shows only relatively unimportant misconduct. There is also a potential for politically motivated prosecutions, and a threat to First Amendment values. Sara Sun Beale, "Comparing the Scope of the Federal Government's Authority to Prosecute Federal Corruption and State and Local Corruption: Some Surprising Conclusions and a Proposal," 51 *Hastings L.J.* 699, 719 (2000).

Panarella addressed those grave concerns by limiting the concealed conflict theory of "honest services" fraud to: (1) discretionary legislative action which (2) directly benefits (3) a financial interest (4) concealed (5) in violation of state criminal law. Any honest services prosecution attempting to criminalize conduct that state law expressly and specifically permitted, and which involved no discretionary legislative action, would run afoul of those limitations and breathe new life into those concerns of vagueness, lenity and federalism. ■