Portfolio Media. Inc. | 860 Broadway, 6th Floor | New York, NY 10003 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Case Study: US V. Milovanovic

Law360, New York (June 13, 2012, 12:54 PM ET) -- Government contractors know to train their employees, agents and subcontractors to comply with the myriad laws and regulations governing their business relationships with the public sector. Although contractors are often most closely attuned to the requirements of the Federal Acquisition Regulation and analogous state and local procurement rules, they should not neglect the criminal laws when training employees.

A recent Ninth Circuit decision underscored the serious criminal consequences that can result from bribery or kickback activity undertaken by individual independent contractors. Notably, the court held that liability under the “honest services” statute can extend even to contractors who have no formal fiduciary relationship with the government. When devising and improving their training and compliance programs, government contractors should be aware of the scope of the honest services fraud statute and the consequences, up to and including suspension or debarment from government contracting, that can result from an indictment or conviction under the statute.

Government contractors at all levels — federal, state and local — need to be aware of potential criminal liability for so-called “honest services” mail and wire fraud under 18 U.S.C. § 1346. In 2010, the U.S. Supreme Court narrowed the scope of the honest services fraud statute, holding in Skilling v. United States that the statute criminalizes only bribe-and-kickback schemes committed in violation of a fiduciary duty. 130 S.Ct. 2896, 2930–31 (2010). However, the Supreme Court did not clarify who may owe such a “fiduciary duty.”

The Ninth Circuit’s recent en banc opinion in United States v. Milovanovic directly addressed this important issue but unfortunately did little to add certainty to the landscape of potential liability. --- F.3d --- (9th Cir. May 22, 2012). (The U.S. Court of Appeals for the Ninth Circuit has federal jurisdiction over Alaska, Arizona, California, Hawaii, Idaho, Montana, Oregon, Washington, Guam and the Northern Mariana Islands.)

What Milovanovic did clearly hold was that independent government contractors do not fall outside the scope of the honest services statute simply by virtue of their independent contractor status. Following Milovanovic, a government contractor who engages in bribery or kickback activity may be exposed to honest services criminal liability — and up to 20 years in prison per violation — even though the contractor is not an employee or formal fiduciary of the government.

Over the course of the 20th century, federal courts around the country gradually came to recognize, in varying forms, an intangible right of honest services, the deprivation of which could form the basis of a mail or wire fraud conviction even if the victim of the fraud suffered no loss of money or property. Most of these cases involved the bribery of public officials, with the public being the victim deprived of the official’s “honest services,” but over time courts also came to recognize that an employee could violate his or her employer’s right to the employee’s honest services.

However, in 1987, the Supreme Court abruptly repudiated the honest-services theory, holding in McNally v. United States that the mail and wire fraud statutes were limited in scope to the protection of property rights. 483 U.S. 350, 360 (1987). Congress enacted § 1346 in swift response to McNally. Section 1346 simply provides that a “scheme or artifice to deprive another of the intangible right of honest services” may violate the mail and wire fraud statutes.

After several lower courts considered challenges that § 1346 was unconstitutionally vague, the Supreme Court finally spoke to the statute’s constitutionality in Skilling. In that case, involving the former CEO of Enron, the court held that only the “core” of the pre-McNally honest-services doctrine had been resurrected by Congress’ enactment of § 1346: those “honest-services cases involv[ing] offenders who, in violation of a fiduciary duty, participated in bribery or kickback schemes.” Skilling, 130 S.Ct. at 2930.

Justice Antonin Scalia concurred in the judgment overturning Skilling’s honest services conspiracy conviction, but would have gone further and held the statute unconstitutional for vagueness rather than applying a limiting construction as the majority did. Id. at 2940 (Scalia, J., dissenting). Justice Scalia honed in on the failure of the pre-McNally case law to offer a clear test or definition for what constitutes a fiduciary relationship. The majority’s construction limiting § 1346 to bribe-and-kickback cases, he pointed out, does “not solve the most fundamental indeterminacy: the character of the ‘fiduciary capacity’ to which the bribery and kickback restriction applies.” Id. at 2938 (Scalia, J., dissenting).

In Milovanovic, the Ninth Circuit, sitting en banc, had the opportunity to address this very indeterminacy. Milovanovic was an independent contractor for a translation services company that itself contracted with the Washington State Department of Licensing (“DOL”) in Spokane, Wash. Milovanovic would contact Bosnian speakers who lived outside of Washington state and offer to provide them a Washington commercial driver’s license (“CDL”) in return for $2,500. In order to obtain a CDL, a person must be a resident of Washington, have a Washington personal driver’s license, and pass both a written and driving test. A non-English speaker is entitled to have an interpreter translate the written test questions.

In return for the money, Milovanovic would provide local addresses so that the out-of-state Bosnian speakers could satisfy the residency requirement. He also acted as their “translator” for the written test, but rather than simply translating he helped them to cheat by giving them the correct answers. Milovanovic would then pay his co-defendant Lamb $200 to $500 in exchange for falsifying the results of the Bosnian speakers’ driving tests. Lamb was an independent contractor for the DOL who administered CDL driving tests. Milovanovic at *2.

Milovanovic and Lamb argued that the indictment against them was due to be dismissed because, as independent contractors, they had neither an agency nor an employment relationship with the DOL and therefore could not have committed honest services mail fraud. Interpreting Skilling, the Ninth Circuit held that the breach of a fiduciary duty is a required element of honest services fraud, but that such fiduciary duty “is not limited to a formal ‘fiduciary’ relationship well-known in the law, but also extends to a trusting relationship in which one party acts for the benefit of another and induces the trusting party to relax the care and vigilance which it would ordinarily exercise.” Id. at *6–7.

Because Milovanovic and Lamb, despite their independent contractor status, “well knew that the State relied on their fidelity in administering and translating the tests in order to grant CDLs to applicants,” the indictment against them alleged “a breach of a position of trust” sufficient to permit the prosecution to go forward. Id.

Although the Ninth Circuit's decision in Milovanovic clarifies that independent contractor status does not, on its own, preclude the existence of a fiduciary duty, the court nevertheless failed to provide the precise definition of fiduciary duty that Justice Scalia believed to be essential to a clear understanding of the conduct proscribed by § 1346. Instead, the Ninth Circuit largely punted that inquiry to the jury with little guidance apart from its vague "trusting relationship" formulation. A jury, therefore, now must decide whether Milovanovic and Lamb "acted for the benefit" of the DOL and induced the DOL to "relax the care and vigilance which it would ordinarily exercise." Id.

In short, Milovanovic failed to provide much clarity in the honest-services realm. However, it has signaled that contractors of all stripes, and particularly government contractors, must be wary of the possibility that engaging in bribery or kickback activity may result in a charge of federal honest services fraud under § 1346. Moreover, it has also made clear that contractors may not rely on status as an "independent contractor" or arms-length dealing to avoid liability under the honest-services statute.

--By Stephen R. Spivack, Gregory G.Marshall and Erin K. Sullivan, Bradley Arant Boult Cummings LLP

Steve Spivack and Greg Marshall are partners in Bradley Arant Boult Cummings' Washington, D.C., office. Erin Sullivan is an associate in the firm's Birmingham, Ala., office.