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Recovering Assets in Investment Fraud Cases

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The financial crisis has exposed a number of large investment fraud schemes, including the one for which Bernard Madoff has now been convicted and sentenced. The uncovering of these schemes has focused public attention on how the government recovers assets for investment fraud victims. Given how commonplace large fraud schemes have become (one only has to remember Enron and other corporate accounting scandals of a few years ago), you might think the government has perfected a finely tuned plan for marshalling and distributing assets. It has not.

Indeed, those of us who follow the Bernard L. Madoff, Stanford Investments and Marc Dreier cases have observed that government prosecutors and court-appointed receivers and trustees seem to find themselves at cross purposes. The receiver appointed by the court in the Madoff case has had a very public disagreement with the prosecutors about the scope of the receiver's powers.[1] Madoff's victims, perhaps unsure that the government's efforts to recover assets will be adequate, have initiated an involuntary bankruptcy proceeding; a move the government has thus far resisted.[2] The Dreier case has also pitted forfeiture procedures against those available in bankruptcy, but with the added twist that the government and unsecured creditors of Dreier's former law firm, Dreier LLP, have quarreled over what it means to be a victim.[3]

As important as the topic of victim restitution in investment fraud cases has become, there is surprisingly little information available about what options the government and court-appointed receivers and trustees may use when seeking to recover assets for victims and how the different options interact.[4] Part I of this Article summarizes those options, weighing the main benefits and burdens of each. Part II then suggests alternative asset recovery strategies that have either yet to gain the sanction of Congress or to be tested in significant cases. Finally, Part III confronts some of the hard questions that arise in investment fraud cases — questions about who is a victim, who makes that decision, and what efforts, if any, the government should undertake to claw back assets from investors in, and sub-promoters of, fraud schemes.

I. The Problem

The problem is easy to define. On average, the government collects about four to seven cents of early dollar of criminal debt. Of the total criminal debt owed, two-thirds of it consists of restitution debt owed in fraud cases.[5] The Government Accounting Office (GAO) — a government watchdog agency — has repeatedly issued reports faulting the Department of Justice for its less than fulsome efforts to collect criminal debt, particularly in cases involving crime victims.[6]

The problem has several causes. Chief among them is the problem of delay. According to a GAO report dated January 2005, a major problem hindering the government's ability to collect restitution debt in a sampling of cases was the long time interval between the criminal offense and the judgment.[7] This delay allows the defendant time to dissipate the fraud proceeds, transfer them to family members, or place them in bank accounts maintained in foreign jurisdictions.[8] The otherwise powerful federal restitution statutes do not provide for the pretrial restraint of assets.[9] Though Congress long ago mandated restitution in fraud cases, and more recently in the 2004 Crime Victims Rights

Act required prosecutors to exert their best efforts to collect restitution, the hard work of determining restitution comes late in the life cycle of a criminal case.[10] It is not until the defendant is convicted of an offense giving rise to restitution that a court usually sets out to identify the victims and their losses.[11] By that time the defendant may have dissipated the assets on a lavish lifestyle, leaving the victims with a restitution judgment against the defendant but no assets from which to collect on that judgment. Apart from a provision authorizing the court to assist it in computing victim losses there is no provision in the restitution statutes authorizing the appointment of a receiver to marshal and liquidate a defendant's assets.[12]

In the absence of pretrial restraint authority in the restitution law or restitution provisions authorizing the appointment of a receiver, the Justice Department and regulatory agencies such as the Securities and Exchange Commission (SEC) have resorted to using a patchwork of different laws, some better suited to the task of corralling assets prior to conviction than others. Each law has different strengths and weaknesses. With each large fraud case the government struggles anew (and sometimes very publicly) to weigh the advantages of one approach over another. It returns again and again to a threshold question: Who should take the lead in recovering assets — the Department of Justice, a regulatory agency such as the Securities and Exchange Commission, or a bankruptcy trustee?

The Dreier case provides a perfect illustration of the confusion that arises when the government resorts to such a patchwork scheme. There, a court-appointed receiver initially sought a restraining order for assets in a proceeding initiated by the SEC.[13] No sooner had the SEC receiver been appointed than he began to weigh the option of dealing with Dreier's assets and those of his law firm through an involuntary bankruptcy proceeding. Later, a bankruptcy action was filed.[14] For its part, the Justice Department had its own ideas about how best to recover the assets. In the midst of SEC and bankruptcy proceeding, the Justice Department restrained some of Dreier's assets for forfeiture.[15] All three proceedings — the SEC proceeding, the bankruptcy proceeding and the forfeiture proceeding — putatively seek the same outcome: to maximize the recovery of assets for fraud victims. All three make claim to having some unique overarching power to accomplish this objective: Bankruptcy has the automatic stay and orderly rules; the receiver appointed in a civil proceeding brought by a regulatory agency has broad court-authorized powers to claw back assets; and the forfeiture case provides the government with powerful investigatory and asset seizure authority. It remains to be seen which proceeding will take precedence.

II. The Options

A. *Asset Forfeiture and Remission/Restoration*

In the public's mind asset forfeiture is most closely linked with narcotics trafficking. Narcotics traffickers own or possess fruits and instrumentalities of their illegal activity, and the government forfeits those assets. The proceeds of successful drug forfeiture fund various law enforcement initiatives.[16] Forfeiture may also be used in other cases, for example, those involving money laundering and organized crime.[17] In these and other cases the perception exists in the minds of the public (and the judiciary) that the fruits of a successful forfeiture action redound to the benefit of the government and that the government thus has a financial incentive to use the asset forfeiture tool for self-serving reasons.[18]

Dating back approximately twenty years, the government has made increasing use of forfeiture as a means of wresting crime proceeds away from those engaged in fraud. In these cases, forfeiture provides a means not for funding law enforcement initiatives but rather for securing assets for eventual remission or restoration to crime victims.[19] Though a recent editorial in the *New York Times* suggests that it is the exceptional case where the government uses forfeiture to seize assets for crime victims, at the federal level the opposite is probably true.[20] In fiscal year 2006, the Department of Justice returned over $400 million in forfeited assets to 14,000 victims.[21] In several high profile prosecutions involving those responsible for massive corporate frauds the federal government has primarily used asset forfeiture to achieve victim restitution.[22] Forfeiture allows the government to seize or restrain the property acquired with fraud proceeds before trial, dispose of any third party claims, reduce real and personal property to a liquid form, and then remit or restore the forfeited proceeds to the victims of the underlying fraud offense.[23] The argument can and has been made that but for the federal government's use of asset forfeiture as a means of recovering assets for fraud victims, its record in the area of recovering assets for fraud victims would be very poor indeed.[24]

The strength of federal asset forfeiture lies in its pretrial seizure and restraint provisions. In few other contexts has Congress sanctioned the ex parte seizure or restraint of assets — in other words seizure or restraint without a pre-deprivation hearing or even an immediate post-deprivation hearing.[25] Because asset forfeiture is often closely tied to a broader criminal investigation and prosecution, Congress permits the sharing of information between criminal and civil forfeiture prosecutors to a degree unknown in other contexts.[26] Moreover, when the Justice Department pursues a forfeiture matter, it brings with it an array of law enforcement agents and property-management specialists whose labors on behalf of fraud victims are largely funded with forfeiture funds.[27] A successful forfeiture action vests title to the forfeited assets in the government and the government can then undertake the work of marketing and selling such things as houses and vehicles before passing title to the proceeds to the victims at very little cost to the victims.

Once the government has successfully forfeited the assets of a fraudster, and reduced those assets to a liquid form, it has two avenues for returning the assets to the fraud victims. In most cases, the Justice Department returns the forfeited assets to the underlying victim of the offense through the Attorney General's equitable remission authority.[28] In other cases, it turns the forfeited assets over to the district court handling the underlying criminal matter for distribution through the restitution process. In October 2002, the Attorney General issued a policy directive on restoration, which delegated to the Chief of Asset Forfeiture and Money Laundering Section (AFMLS) authority to restore property to victims.[29] Under the new procedures, the government may forfeit a defendant's property and apply the forfeited property directly to an order of restitution.

The weaknesses of using forfeiture as a means of making restitution to crime victims are three-fold. First, except in one circuit, the government cannot restrain before trial so called “substitute” assets, *i.e.*, assets not linked to the crime.[30] Legislative proposals have been put forward that would grant the government that authority, but none have been enacted. In recent years, the issue has grown increasingly complicated. While the Supreme Court has said that defendants have no right to spend crime proceeds on counsel of choice, it is unclear how that principle plays out in the case of so called “substitute” or “equivalent value” assets.[31] If the government reaches too far in restraining “substitute” assets before trial, it risks a subsequent claim that the defendant was denied access to funds necessary to retain his counsel of choice in violation of the Sixth Amendment.[32]

Second, in a forfeiture case, victims have no active role to play in the claims process unless and until the government succeeds in forfeiting property.[33] Even then, the decision about who is a victim and how much the victim should receive from the forfeited assets are typically made by an Executive Branch official in Washington, D.C. who is often far removed from the events giving rise to the forfeiture. In the remission process, neither the Court, nor the prosecutor handling the case, decides whether forfeited assets will be returned to a crime victim or in what amount.[34] The government centralizes these decisions. This practice makes sense from a forfeiture perspective; the government's first objective is to deprive the defendant of the fruits of crime; decisions about who should share in the fruits come later. But the practice runs counter to the spirit of modern victim restitution laws, which favor greater victim involvement in the criminal case itself and the hand-on involvement of prosecutors and the court in decisions about restitution.[35] Perhaps in reaction to forfeiture's treatment of victim remission or restoration issues as a matter to be dealt with in a “back office” process at the end of a successful forfeiture case, some courts have insisted that victims be given a larger role sooner in the forfeiture proceedings — perhaps even standing to appear in the forfeiture case itself.[36] These cases, if taken to their logical extreme, would have the unintended effect of discouraging the government from using its forfeiture authority to benefit fraud victims.[37]

Finally, asset forfeiture, as its name suggests, provides an asset-specific solution to the problem of collecting the defendant's assets. Unlike bankruptcy law, or even federal and state laws defining the powers of a receiver, forfeiture law does not approach the defendant as a debtor whose assets must be brought within an all-encompassing estate. Generally speaking, asset forfeiture targets specific assets, placing emphasis on those that derive from criminal activity.[38] As such, it does not in all cases provide a comprehensive solution to the problem of asset recovery for fraud victims.

B. *Injunctive Actions Brought By Regulatory Agencies*

Over time, we have witnessed an increasing degree of coordination between the functions of regulatory agencies such as the Securities and Exchange Commission and the Federal Trade Commission (FTC) on the one hand and the Justice Department on the other. This trend has been encouraged by recent judicial decisions condoning a relatively high degree of coordination between regulators and law enforcement handling so called "parallel proceedings."[39] In these cases, we often see the SEC or the Federal Trade Commission (FTC) taking the lead in restraining assets for eventual restitution to fraud victims.[40] The SEC or FTC is often in a position to go into court first (ahead of any criminal charges or even asset forfeiture proceedings).

One chief advantage of the SEC/FTC receiver approach is that unlike the asset forfeiture approach it is not "asset-centric." A receiver has broad powers to wrest assets away from the fraudster but also from those to whom assets may have been fraudulently transferred.[41] Receivers and trustees are also adept at perfecting inchoate interests, e.g., option contracts or legitimate business opportunities, and may even stand in the shoes of the fraudster and seek recovery on contracts or other debts. Thus, for example, in the Stanford matter the order appointing the receiver authorized him to take control and possession of and operate the receivership estate and to take all actions with respect to the estate's assets.[42] Similarly in the Madoff case, the receiver is pursuing not simply assets that are in the hands of the defendant, but also assets in the hands of investors or third parties who received money back in the course of the scheme.[43] The receiver in Madoff has begun exercising his broad authority to claw assets back within the receiver estate.[44]

The principal disadvantage of the receivership route is the expense. The efforts that the government undertakes to recover assets through asset forfeiture are largely borne by the taxpaying public, who pay the salaries and expenses of investigating agencies and prosecutors. The expenses of a receiver are paid out of the assets of the estate, and thus directly impact the total pool of money available to distribute to victims. In the Dreier case, for example, the receiver has sought fees and expenses for a three-month period that exceed $1.5 million.[45] These fees do not include the separate fees that the bankruptcy trustee may yet seek.

C. *The Fraud Injunction Statute*

One of the most powerful asset recovery statutes in the government's arsenal is the Fraud Injunction Act (18 U.S.C.A. § 1345). As its name suggests, the Fraud Injunction Act permits the Attorney General to enjoin violations of federal anti-fraud laws. If that was all it did the statute would be of marginal utility — nothing enjoins a fraud more effectively than the execution of a search warrant or the issuance of a grand jury subpoena. However, the statute goes further. Section 1345(a)(2) permits the Attorney General to seek a court order to restrain the proceeds of certain crimes where he can show a risk that those proceeds will be dissipated.

This provision is sneaky in its breadth. Section 1345(a)(2) applies if a person is alienating property obtained as the result of a Federal health care or property obtained as a result of a banking law violation. The term "banking law" violation includes certain financial frauds and money laundering offenses.[46] The statute would thus have broad potential application in cases such as Madoff, where the defendant was engaged in numerous money laundering violations, any one of which could have supported the restraint of so called "equivalent value" assets had the government elected to pursue a Section 1345(a)(2) remedy.[47]

The government seldom uses Section 1345(a)(2). Unlike in state practice, federal criminal prosecutions almost always proceed by indictment, a process that avoids the kinds of preliminary hearings common to state criminal practice.[48] Federal prosecutors have very little experience with preliminary hearings at which they must subject their case to adversarial testing before the matter can be bound over for trial. Thus, federal prosecutors (unlike many of their state counterparts) are unaccustomed to early adversarial testing of their case. To use the property restraint provisions of the Fraud Injunction Act, the government has to proceed, as any civil litigant would, by way of injunction that would subject their investigation or prosecution to just such scrutiny.[49] Obtaining a preliminary or permanent injunction often entails an evidentiary hearing, with the specter that case agents, victims and others may be asked to testify at an early or sensitive stage of the investigation.[50] In long running investigations, the government may also have to submit to civil discovery, and the various disclosure provisions that come with it.[51] Civil discovery rules fit nicely for civil cases, but fit uneasily alongside a federal criminal investigation.

D. *The Federal Receiver Provision*

Notwithstanding recent set backs, the federal money laundering statutes remain a powerful tool in cases in which the fraudster engages in financial transactions with the fraud proceeds. For example, Madoff pleaded guilty not just to fraud and securities law violations but also to money laundering violations.

A seldom used provision — 18 U.S.C.A. § 1956(b) — authorizes a court to impose a civil penalty equal to the value of the funds involved in a money laundering offense.[52] The statute further provides that the court may appoint a "Federal Receiver" to collect and marshal assets of the defendant, wherever located, to satisfy the penalty.[53] What is unique about the statute is that it confers prosecutor-like standing on the receiver for certain information gathering purposes. The Federal Receiver "shall have standing equivalent to that of a Federal prosecutor for purpose of submitting requests to obtain information regarding the assets of the defendant" from certain law enforcement only databases and for purposes of making treaty requests of foreign jurisdictions.

If the statute's strength is that it out-sources certain governmental functions to a receiver, it is also its weakness. When appointed at an early stage of the proceedings a receiver with such broad investigative powers can get in the way of the underlying criminal investigation. The receiver may undertake to interview witnesses and subjects in an effort to trace assets or investigate fraudulent transfers. The Federal receiver statute even allows a receiver to snoop through government databases and even pose as the government itself in terms of sending foreign assistance requests (an activity that the government can perform without expense). These kinds of aggressive receiver actions can drive up the expense of the asset recovery and present a problem for the prosecutor trying to manage a criminal investigation, including the prosecutor's discovery obligations. An aggressive federal receiver could in the course of his or her investigation create Brady,[54]Giglio [55] and even Jencks Act[56] materials without the prosecutor even knowing it. Absent close coordination, the early appointment of a receiver may invite more problems than he or she solves.

III. The Alternatives

A. *Legislative Amendment to the Restitution Statute*

In recent years, Congress has entertained the idea of amending the restitution statutes to provide for the pretrial restraint of assets in cases where the government shows the probable commission of an offense that gives rise to mandatory restitution.[57] In October 2007, the Senate approved a "midnight amendment" to the fiscal 2008 Commerce-Justice-Science (C-J-S) appropriations measure under a unanimous consent request by Senator Brian Dorgan (D-ND). The amendment emerged out of legislation introduced in March 2007 by Senator Dorgan in the Senate as S. 973, the Restitution for Victims of Crime Act of 2007. There was no comparable House provision or any provision related to federal restitution law in the 2008 House C-J-S appropriation bill, HR. 3093, approved by the full House of Representatives on July 26, 2007.

The legislative proposal died in the House after Senator Dorgan agreed to remove it to allow the House the opportunity to hold hearings on the Senate-passed provision. The House Judiciary Subcommittee on Crime, Terrorism and Homeland Security held a hearing on April 3, 2008.[58] No further action has occurred. The Dorgan amendment would have permitted the pretrial restraint of all of a defendant's assets, without regard to tracing, upon a showing that the defendant, if convicted, would be ordered to satisfy a restitution order in an amount no greater than the value of the assets sought to be restrained. The American Bar Association and others expressed concerns that allowing the government to restrain a defendant's assets to pay restitution may in most economic crime cases mean that defendants will be rendered indigent upon indictment and be unable to retain private counsel.[59]

B. *Involuntary Bankruptcy*

By design, victims and other creditors of the fraudster are generally excluded from the forfeiture case. Forfeiture proceedings are not liquidation proceedings and thus do not contain the sort of comprehensive liquidation procedures that exist in bankruptcy law.[60]

Recognizing these limitations, courts and victims have begun to encourage the government to think "outside the box" and explore bankruptcy as an alternative tool for accomplishing restitution objectives in large fraud cases.[61] In a handful of cases the government has begun to do just that.[62] However, in other cases, most notably the Madoff case, the government has resisted the use of involuntary bankruptcy. It continues to prefer the forfeiture remedy if for

no other reason than it tends to be more cost effective. Where the government resists the bankruptcy alternative, then complications ensue. The automatic stay does not affect "the commencement or continuation of a criminal action or proceeding."[63] Unless, the government cooperates it may therefore pursue its own asset recovery efforts through the criminal case in direct competition with those being undertaken by a bankruptcy trustee.[64]

One advantage (or disadvantage depending on your point of view) of bankruptcy is that it has a priority system and a system for avoiding preferential transfers. Bankruptcy trustees attempt to maximize the assets of the estate for all creditors, not just victims, according to the Bankruptcy Code's priority rules. Distributions under federal forfeiture statutes and civil penalty statutes tend to favor victims over other creditors.[65] In contrast, in a bankruptcy proceeding, victims may have to elbow for scarce assets alongside other creditors of the defendant. Some of those creditors may have a preferred status; they may be secured creditors or creditors who have a preference because under bankruptcy and commercial law they perfected their claim against the debtor-defendant before the victims perfected their claims. Bankruptcy proceedings may also tend to favor those victims who have the wit, vigor and financial resources to retain counsel and press their claims vigorously at the expenses of victims who do not.

IV. Hard Issues

A. *Who Should Benefit from Asset Recovery?*

If the government restrains assets by way of injunction — either an injunction obtained by a regulatory agency or by the Attorney General — then in most cases the district court ultimately will determine the disposition of the enjoined assets. Often that disposition will be made pursuant to a restitution order entered in a parallel criminal case. The problem with this approach is that it favors victims. There is no provision in federal restitution law for compensating unsecured creditors of a convicted defendant.[66]

In contrast, if the assets proceed by way of bankruptcy, then a bankruptcy court acting under bankruptcy rules will make that determination. This process tends to favor creditors, or at least gives them the advantage of settled rules establishing the priority of competing creditor claims. In bankruptcy proceedings victims often lose out even to unsecured creditors because their claim has yet to be perfected or reduced to judgment. In contrast, if the assets go by way of forfeiture, then the process favors victims and secured creditors. The interests of secured creditors will typically be addressed in the third party claims process within the forfeiture case and, if not there, then in the remission process. The interests of victims will be addressed by Attorney General's designee (the Chief of AFMLS) in the remission or restoration process. Unsecured creditors have no standing to enter the forfeiture case itself and have no standing to seek even equitable relief from the Attorney General. They lose out in a forfeiture case.

In 2009, the prosecution against Marc Dreier for investment fraud[67] has exposed the strong bias in forfeiture law that favors victims and secured creditors over unsecured creditors. Unsecured creditors of the now-defunct Dreier LLP law firm, including former employees, have argued that they should be treated as "victims" of the underlying fraud scheme.[68] The government has resisted this characterization. In the government's view, some creditors, who were "unintended beneficiaries" of Dreier's fraud, were not similarly situated to buyers of bogus notes, the government has argued. The government instead takes the position that the sole victims of Marc Dreier's criminal activities are those whose funds were directly stolen by Dreier in the course of his alleged scheme.

B. *Who Is A Victim of Ponzi Scheme?*

Any good ponzi scheme (which is to say, any ponzi scheme successful enough to work) requires two things. First, it requires an early wave of investors who receive fabulous returns on their investment — at least on paper that is. Second, it requires promoters (often drawn from the ranks of early investors) to promote the scheme to subsequent investors. In many instances, the early investors know or have reason to believe the investment is a fraud; they play the ponzi in the hope that they will get in and out before the scheme unravels. Similarly, promoters of the ponzi scheme receive fees and other payments for referring later investors to the scheme. Even those who invest late in the scheme and are truly fleeced sometimes act for less than pure motives because schemes such as these have a way of attracting anti-government types, including those who wish to conceal their expected profits from taxing authorities. Indeed, when the government first takes down an investment fraud scheme an often common reaction from the investors is one of accusation: The government's intervention caused the collapse of the investment company and thus the investor's loss.

The more aggressive the nature of the fraudulent scheme the more difficult it is for the government to differentiate between those individual investors who "played the ponzi" and those who were truly victims of it. The investigations can be time consuming. They also run the risk of collateral litigation in which different classes of victims and creditors litigant against one another over their comparative standing as victims or the legitimacy of their respective losses.

C. *What Should Be the Government's Role in the Asset Recovery?*

When Ken Lay died while awaiting sentencing in 2006,[69] the effect of his death was to abate his conviction — it was as if his conviction never happened. A few weeks after his death, the government sent to Congress legislation that would have allowed his conviction to stand at least for the purposes of entering a restitution order — the legislation was never enacted. If it had been enacted, the court could have proceeded to have entered a restitution order based on Lay's conviction. That restitution order would have provided investors in the Enron debacle a judicial determination of their losses and a means of trying to recover assets from Lay's estate. As it is, each investor will now have to litigate his or her claim directly against Lay's estate without the benefit of a prior adjudication of fraud.

The Houston Chronicle published an article strongly critical of the government's legislative proposal.[70] In the words of the columnist: "The money is a moot point. Lay's estate will be drained, if not by the government, then by civil litigation brought by former investors and employees."[71] Though its criticisms of the government's motives for seeking a legislative fix were unfair, the article raises an interesting issue: What should the government's role be in pursuing assets for fraud victims? Should it matter whether the victim is wealthy and sophisticated enough to pursue its own asset recovery against the defendant? Should scarce prosecutorial and investigative resources be used to benefit investors who, in manner cases, acted greedily in investing in a scheme that was too good to be true? Or should we leave the business of asset recovery to civil litigation brought directly by the investors and creditors of the fraudster?

V. Conclusion

The time is right for the government to take a comprehensive look at how it goes about recovering assets for crime victims in large investment fraud cases. The options are numerous: bankruptcy, receivership, and asset forfeiture. And, there are other options yet to be explored, including the option of providing a restitution statute that directly provides for the pretrial restraint of assets and provides for the use of a receiver to marshal and liquidate assets.

One thing that the recent spate of investment fraud cases has exposed is that the government seems to be working through the issues on a case-by-case basis. Different agencies of the government have different ideas about how to recover assets. These agencies sometimes pursue these strategies simultaneously without a coordinated strategy. There may be something to say for this approach, at least for now. In other words, the government has to test the benefits and burdens of the different options before it can devise a plan of action going forward. But once it has done so, Congress, the Judiciary and the Justice Department need to take a strategic approach to problem of recovering assets for victims.

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[FN1] Lisa Epstein, Authorities In Race to Seize Madoff Assets, Daily Finance, Mar. 24, 2009, *available at* www.dailyfinance.com/2009/03/24 (reporting that Madoff receiver and prosecutors have "locked horns in court" over who should have control over Madoff's London operation).

[FN2] Group Seeks Bankruptcy For Madoff, N.Y. Times, Apr. 13, 2009, *available at* http://www.nytimes.com/2009/04/14/business/14madoff.html?partner=rss&emc=rss.

[FN3] *See* Government's Memorandum In Advance of Joint Hearing Scheduled for Wednesday, Apr. 22, 2009, at 4:00 p.m., United States v. Marc Dreier, 1:09-CR-00085 — JSR (S.D.N.Y. Apr. 20, 2009).

[FN4] A main scholarly article on the topic appeared in a United Kingdom journal in 2007 and has not been widely distributed in the United States. *See* Courtney J. **Linn**, *What Asset Forfeiture Teaches Us About Providing Restitution in Fraud Cases*, 10 J. MONEY LAUNDERING CONTROL 215 (2007).

[FN5] *See* U.S. Gov't Accountability Office, Criminal Debt: Oversight and Actions Needed to Address Deficiencies in Collection Processes, GAO-01-664, at 11 (July 2001) (hereinafter *Criminal Debt: Oversight*).

[FN6] *See Criminal Debt: Oversight*, *supra* note 5, at 11; U.S. Gov't Accountability Office, Debt-Actions Still Needed to Address Deficiencies in Justice Collection Processes, GAO Report, 04-338 (Mar. 2004); U.S. Gov't Accountability Office, Criminal Debt: Court-Ordered Restitution Amounts Far Exceed Likely Collections for Crime Victims in Selected Financial Fraud Cases, GAO-05-80 (Jan. 2005) (hereinafter *Criminal Debt: Court-Ordered Restitution*.

[FN7] *Criminal Debt: Court-Ordered Restitution*, *supra* note 6, at 4 ("A major problem hindering the [government's] ability to collect restitution debt in the selected cases was the long time intervals between the criminal offense and the judgment.").

[FN8] *Criminal Debt: Court-Ordered Restitution*, *supra* note 6, at 4.

[FN9] *See* 18 U.S.C.A. §§ 3663–3664(d).

[FN10] *See* Scott Campbell et al., Crime Victims' Rights Act, Pub. L. No. 108-405, §§ 101 to 104, 118 Stat. 2260, 2261 to 65 (2004) (codified at 18 U.S.C.A. § 3771) (conferring upon victims the right to full and timely restitution and requiring prosecutors to exert best efforts to recover restitution).

[FN11] *See* 18 U.S.C.A. § 3664.

[FN12] *See* 18 U.S.C.A. § 3664(d)(6) ("The court may refer any issue arising in connection with a proposed order of restitution to a magistrate judge or special master for proposed findings of fact and recommendations as to disposition, subject to a de novo determination of the issue by the court").

[FN13] *See* United States v. Marc Dreier, S1 09 Cr. 85 (JSR) (S.D.N.Y.) (Government's Letter of Re: Joint Hearing, Apr. 20, 2009, at 2) (setting forth the background of the SEC enforcement action).

[FN14] Marc Dreier, S1 09 Cr. 85 (JSR), at 3.

[FN15] Marc Dreier, S1 09 Cr. 85 (JSR), at 4.

[FN16] *See generally* 21 U.S.C.A. § 853 (authorizing criminal forfeiture); 21 U.S.C.A. § 881 (authorizing civil forfeiture); *see also* 28 U.S.C.A. § 524(c) (establishing an asset forfeiture fund and specifying the uses to which the government may put forfeited assets).

[FN17] *See generally* 18 U.S.C.A. §§ 981(a)(1)(A), 982 & 1963(b).

[FN18] U.S. v. James Daniel Good Real Property, 510 U.S. 43, 114 S. Ct. 492, 126 L. Ed. 2d 490 (1993) (noting that the government has a financial stake in drug forfeitures).

[FN19] By statute, the Attorney General is authorized to restore forfeited assets to victims of the underlying offense giving rise to the forfeiture. *See* 18 U.S.C.A. § 981(e); 21 U.S.C.A. § 853(e). The decision-making authority to restore forfeited assets has been delegated to the Chief of the Asset Forfeiture and Money Laundering Section under standards defined by regulation. *See* 28 C.F.R. § 9.1(b)(2).

[FN20] *See* Charles A. Intriago & Robert A. Butterworth, Fund Government With Dirty Money, N.Y. Times, Apr. 27, 2009, *available at* www.nytimes.com/2009/04/28/opinion.

[FN21] *See* Nancy Rider, Returning Forfeited Assets to Victims, USA Bull., at 30, Nov. 2007.

[FN22] For example, in 2006 in the Southern District of New York, three securities fraud prosecutions led to the forfeiture of over $1.2 billion, which will be used to compensate the defrauded investors: 1) *U.S. v. Rigas (Adelphia)*, 1:02-CR-01236 (Apr. 25, 2005)—forfeiture of $715 million; 2) *U.S. v. Approximately $337.5 Million in United States Currency including Additional Contingent Funds (Bawag Bank)*, 1:06-CV-04222 (May 31, 2006)—forfeiture of $437.5 million; and 3) *U.S. v. Samuel Israel, III*, 7:2005CR01039 (Sept. 29, 2007), *U.S. v. Daniel E. Marino*, 7:2005CR01036 (Sept. 29, 2007), and U.S. v. All Assets of Bayou Accredited Fund, LLC (Sept. 29, 2006)—forfeiture of $100 million.

[FN23] *See generally* U.S. v. Real Property Located at 730 Glen-Mady Way, Folsom, Sacramento County, CA, 590 F. Supp. 2d 1295 (E.D. Cal. 2008) (summarizing forfeiture and remission procedures).

[FN24] *See Criminal Debt: Court-Ordered Restitution*, *supra* note 6, at 3 (noting that most collections in selected fraud cases came about primarily from asset forfeiture actions or from payments made prior to the offenders' sentencing).

[FN25] *See* 18 U.S.C.A. § 981(b) (authorizing seizures for civil forfeiture in the same manner as the government seizes property pursuant to a search warrant); 21 U.S.C.A. § 853(f) (authorizing ex parte seizure of certain assets for criminal forfeiture in cases where a restraining order would not be sufficient).

[FN26] 18 U.S.C.A. § 3322(a).

[FN27] 28 U.S.C.A. § 524(c) (authorizing forfeited funds to be used to pay for forfeiture-related expenses).

[FN28] *See* 21 U.S.C.A. § 853(i)(1); 18 U.S.C.A. § 981(e); 28 C.F.R. § 9.8.

[FN29] *See* Rider, *supra* note 21, at 30.

[FN30] *See* U.S. v. Wingerter, 369 F. Supp. 2d 799, 806–07 (E.D. Va. 2005) (summarizing law and explaining that only in Fourth Circuit is the pretrial restraint of substitute assets permissible).

[FN31] U.S. v. Monsanto, 491 U.S. 600, 612–13, 109 S. Ct. 2657, 105 L. Ed. 2d 512 (1989).

[FN32] *See* U.S. v. Gonzalez-Lopez, 548 U.S. 140, 126 S. Ct. 2557, 165 L. Ed. 2d 409, 33 A.L.R. Fed. 2d 661 (2006) (violation of defendant's right to counsel of choice is structural error requiring reversal); *see also* U.S. v. Stein, 435 F. Supp. 2d 330, 97 A.F.T.R.2d 2006-3138 (S.D. N.Y. 2006), aff'd, 541 F.3d 130, 2008-2 U.S. Tax Cas. (CCH) P 50518, 102 A.F.T.R.2d 2008-6023 (2d Cir. 2008) (government pressure to employer to cut off payment of attorneys fees to employees facing criminal charges violated Sixth Amendment).

[FN33] U.S. v. One-Sixth Share Of James J. Bulger In All Present And Future Proceeds Of Mass Millions Lottery Ticket No. M246233, 326 F.3d 36, 45 (1st Cir. 2003) (family of murder victim has no standing to contest forfeiture of defendant's property: "Congress has provided for justice a different way; it has provided that the Government, which stands for all citizen, may take the criminal's property by forfeiture, and it has limited those who may assert competing claims").

[FN34] U.S. v. Bright, 353 F.3d 1114, 1123–25 (9th Cir. 2004).

[FN35] 18 U.S.C.A. § 3771; *see also* In re Kenna, 453 F.3d 1136 (9th Cir. 2006) (The U.S. inherited a criminal justice system from England that "long functioned on the assumption that crime victims should behave like good Victorian children — seen but heard.").

[FN36] United States v. $4,224,958.57 (Boylan), 392 F.3d 1146 (9th Cir. 2004); U.S. v. Shefton, 548 F.3d 1360, 1365 (11th Cir. 2008).

[FN37] *See* U.S. Department of Justice, Asset Forfeiture Policy Manual, ch.4, at 90–101 (May 2007) (in circuits where courts grant victims standing to maintain a claim in the forfeiture case itself prosecutors should consider other options other than forfeiture for securing assets for crime victims).

[FN38] The one exception has been the development of the concept of a forfeiture money judgment. *See, e.g.*, U.S. v. Vampire Nation, 451 F.3d 189, 202 (3d Cir. 2006) (explaining that a forfeiture judgment may take the form of a sum of money equal to the value of the proceeds the defendant realized from the offense conduct). The entry of a forfeiture money judgment, however, comes at the conclusion of the criminal case and thus does not necessarily solve the problem that the defendant's assets may by that juncture have already been dissipated.

[FN39] *See, e.g.*, U.S. v. Stringer, 521 F.3d 1189, Fed. Sec. L. Rep. (CCH) P 94630 (9th Cir. 2008), opinion amended and superseded, 535 F.3d 929 (9th Cir. 2008), cert. denied, 129 S. Ct. 658, 172 L. Ed. 2d 616 (2008) and cert. denied, 129 S. Ct. 662, 172 L. Ed. 2d 616 (2008) and cert. denied, 129 S. Ct. 663, 172 L. Ed. 2d 616 (2008).

[FN40] *See* F.T.C. v. Assail, Inc., 410 F.3d 256, 2005-1 Trade Cas. (CCH) ¶ 74798 (5th Cir. 2005).

[FN41] *See, e.g.*, Donell v. Kowell, 533 F.3d 762, 770–72 (9th Cir. 2008), cert. denied, 129 S. Ct. 640, 172 L. Ed. 2d 612 (2008) (explaining rules under which a Receiver may claw back money from winning investors in a ponzi scheme); *see also* In re Slatkin, 525 F.3d 805, 814–15, 49 Bankr. Ct. Dec. (CRR) 267, 76 Fed. R. Evid. Serv. 495 (9th Cir. 2008) (once the existence of a Ponzi scheme is established, payments received by investors as purported profits are deemed to be fraudulent transfers as a matter of law).

[FN42] *See Securities and Exchange Commission v. Stanford International Bank, Ltd., et al.*, Case No.:3-09CV0298-N (N.D. Tex.) (Amended Order Appointing Receiver, Mar. 12, 2009).

[FN43] Kevin McCoy, Madoff Clients Told to Return Money They'd Withdrawn, USA Today (Apr. 22, 2009), *available at* http://www.usatoday.com/money/markets/2009-04-22-madoff-clients-money_N.htm.

[FN44] A criminal defendant may only be made to forfeit his own interest in property. Pacheco v. Serendensky, 393 F.3d 348, 355 (2d Cir. 2004); U.S. v. Nava, 404 F.3d 1119, 1124 (9th Cir. 2005). Criminal forfeiture is broader, but even so it protects the interests of so-called "innocent owners." 18 U.S.C.A. § 981(d).

[FN45] *See United States v. Marc Dreier*, S1 09 Cr. 85 (JSR), at n.7 (S.D.N.Y., Government's Letter of Re: Joint Hearing, Apr. 20, 2009) (noting that the SEC Receiver is seeking fees and expenses, for the period Dec. 8, 2008 through Mar. 4, 2009 of $1,518,042.64).

[FN46] *See* U.S. v. Legro, 284 Fed. Appx. 143, 102 A.F.T.R.2d 2008-5069 (5th Cir. 2008).

[FN47] *United States v. Bernard L. Madoff*, 1:09-CR-00213 (S.D.N.Y. Mar. 10, 2009) (information filed, charging Madoff with, inter alia, laundering approximately $54 million in a single transaction).

[FN48] Fed. R. Crim. P. 5.1(a)(2) (granting the federal defendant a right to a preliminary hearing unless indicted).

[FN49] *See* 18 U.S.C.A. § 1345; *see also* Fed. R. Civ. P. 65.

[FN50] *See* Fed. R. Civ. P. 65.

[FN51] *See* 18 U.S.C.A. § 1345(b) ("A proceeding under this section is governed by the Federal Rules of Civil Procedure, except that, if an indictment is returned against the respondent, discovery is governed by the Federal Rules of Criminal Procedure.").

[FN52] *See United States v. v. Lloyds TSB Bank*, Case 1:07-CV-09235 CSH (S.D.N.Y. Mar. 31, 2009) (memorandum opinion and order discussing § 1956(b)).

[FN53] 18 U.S.C.A. § 1956(b).

[FN54] *See* Brady v. Maryland, 373 U.S. 83, 83 S. Ct. 1194, 10 L. Ed. 2d 215 (1963) (defining the prosecutor's duty to produce exculpatory information).

[FN55] *See* Giglio v. U.S., 405 U.S. 150, 92 S. Ct. 763, 31 L. Ed. 2d 104 (1972) (defining the government's obligation to produce impeachment evidence).

[FN56] *See* 18 U.S.C.A. § 3500 (mandating that, upon request, the disclosure of a witnesses' prior statements).

[FN57] *See* S.351, 110th Congress; *see also* Statement of Senator Dorgan Upon Introduction of 3561 (June 23, 2006), *available at* http://Thomas.loc.gov ("This legislation will also address a major problem identified by the GAO for officials in charge of criminal debt collection; that is, many years can pass between the date a crime occurs and the date a court orders restitution. This gives criminal defendants ample opportunity to spend or hide their ill-gotten gains. Our bill sets up pre-conviction procedures for preserving assets for victims' restitution.").

[FN58] *See* http://judiciary.house.gov/hearings/hear_040308.html on the Dorgan bill and another restitution bill, H.R. 845, the Criminal Restitution Improvement Act of 2007, introduced by Representative Steve Chabot (R-OH) on Feb. 6, 2007.

[FN59] *See* http://judiciary.house.gov/hearings/hear_040308.html on the Dorgan bill and another restitution bill, H.R. 845, the Criminal Restitution Improvement Act of 2007, introduced by Representative Steve Chabot (R-OH) on Feb. 6, 2007.

[FN60] *See, e.g.*, U.S. v. $20,193.39 U.S. Currency, 16 F.3d 344, 346 (9th Cir. 1994) ("Unlike secured creditors, general creditors cannot claim an interest in any particular asset that makes up the debtor's estate. For this reason, the federal courts have consistently held that unsecured creditors do not have standing to challenge the civil forfeiture of the debtor's property.").

[FN61] U.S. v. Frykholm, 362 F.3d 413, 417 (7th Cir. 2004) ("Neither side paid much attention to the effect of the fraudulent conveyance, likely because both sides are represented by forfeiture specialists and have focused on the language of § 853 and opinions interpreting the statute. Everything would have been clearer had the United States initiated an involuntary bankruptcy proceeding against Frykholm.").

[FN62] In re Tri-Continental Exchange Ltd., 349 B.R. 627, 47 Bankr. Ct. Dec. (CRR) 31 (Bankr. E.D. Cal. 2006) (reciting how the government agreed to turn over assets subject to civil forfeiture to a liquidator in a Chapter 15 proceeding brought against an insurance company that sold approximately 5,800 fraudulent insurance policies).

[FN63] *See* 11 U.S.C.A. § 362(b)(4).

[FN64] *See* Petition of Smouha, 136 B.R. 921, 928, R.I.C.O. Bus. Disp. Guide (CCH) P 7929 (S.D. N.Y. 1992), dismissed, 979 F.2d 845 (2d Cir. 1992) (criminal forfeiture proceedings not subject to automatic stay).

[FN65] Official Committee of Unsecured Creditors of WorldCom, Inc. v. S.E.C., 467 F.3d 73, 47 Bankr. Ct. Dec. (CRR) 46, Fed. Sec. L. Rep. (CCH) P 93968 (2d Cir. 2006); *see also* 28 C.F.R. § 9.2(v) (defining the term "victim").

[FN66] It is axiomatic that unsecured creditors lack standing to contest forfeitures because they have no preexisting interest in any specific asset of the defendant. *See, e.g.*, U.S. v. $20,193.39 U.S. Currency, 16 F.3d 344, 346 (9th Cir. 1994) ("Unlike secured creditors, general creditors cannot claim an interest in any particular asset that makes up the debtor's estate. For this reason, the federal courts have consistently held that unsecured creditors do not have standing to challenge the civil forfeiture of their debtors' property.").

[FN67] *See* Marc Dreier, Lawyer, Pleads Guilty To Defrauding Hedge Funds Of More Than $400 Million, Huffington Post, May 11, 2009, *available at* http://www.huffingtonpost.com/2009/05/11/marc-dreier-lawyer-pleads_n_201917.html. ("A prominent Manhattan lawyer pleaded guilty Monday to using impersonations and fake documents to defraud hedge funds out of more than $400 million… .").

[FN68] Mark Hamblett & Noeleen G. Walder, *New Charges In Dreier Case As Hearing Airs Forfeiture Issues*, N.Y.L.J., Apr. 23, 2009.

[FN69] *See* Shahleen Pasha Enron Founder Ken Lay Dies, CNN Money.com, July 5, 2006, *available at* http://money.cnn.com/2006/07/05/news/newsmakers/lay_death/ ("Kenneth Lay, who rose from a poor preacher's son to become a millionaire before being convicted of corporate fraud, died early Wednesday in Aspen, Colo., a family spokeswoman said. Lay, 64, was awaiting sentencing after being found guilty of conspiracy and fraud in the Enron trial in May.").

[FN70] Loren Steffy, Even though Lay Is Dead Prosecutor's Can't Let Go, Houston Chron., Sept. 23, 2006), *available at* www.chron.com/disp/story.mpl/business/steffy/4171624.html.

[FN71] Steffy, *supra* note 70.

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