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2nd Circ. Lays Out New Rules For Restitution

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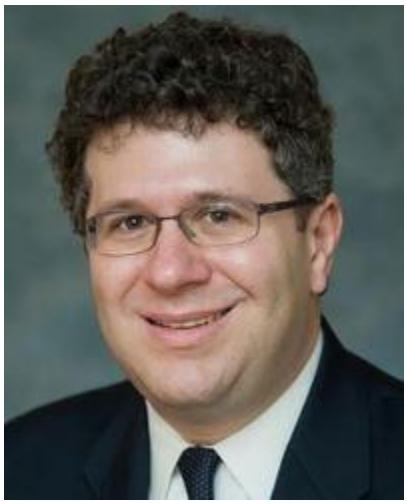

Harry Sandick

On Feb. 6, 2015, the United States Court of Appeals for the Second Circuit amended an earlier opinion in an appeal, United States v. Cuti, interpreting the restitution provisions of the Victims and Witnesses Protection Act.[1] The decision is significant because it seems to place a notable limitation on the ability of a victim of white collar crime to recover expenses incurred in the course of investigating and reporting the defendant's criminal activity. Namely, the court suggests that fees incurred by the company's counsel and by counsel for a board audit or special committee cannot, in some cases, both be fully recovered. This ruling does not take into account how internal investigations are typically conducted when the allegations concern wrongdoing by senior management.

Anthony Cuti was the former chairman and CEO of Duane Reade Inc., the well-known New York City drugstore chain founded in 1960.[2] Oak Hill, a private equity firm, acquired Duane Reade in 2004 and the following year it terminated Cuti's employment without cause.[3] The dispute over Cuti's termination led to an arbitration initiated by Cuti. Oak Hill retained its longtime counsel, Paul Weiss Rifkind Wharton & Garrison LLP, to represent Duane Reade in the arbitration.[4] In the course of defending Duane Reade, Paul Weiss learned about certain potentially improper transactions in which Cuti was involved. These allegations led the audit committee of Duane Reade to retain Cooley LLP as independent counsel to conduct an internal investigation.[5]

At various points over the successive months, Paul Weiss provided to Cooley evidence of other potentially improper transactions involving Cuti.[6] Paul Weiss did so as counsel to Duane Reade, and then Cooley incorporated and investigated these facts as part of its investigation. Ultimately, it appears from the court's decision that both firms provided information to the U.S. attorney's office and the U.S. Securities and Exchange Commission.[7]

After Cuti's conviction at trial, there were extensive post-trial proceedings relating to restitution. The district court ultimately determined that payments for legal fees made by Oak Hill, not only Duane Reade, were compensable under the VWPA.[8] The district court also held that a host of different types of legal fees were "necessary and related to Duane Reade's participation in the investigation or prosecution" of Cuti.[9] These included certain legal fees paid both to Paul Weiss and Cooley, as well as the expenses of forensic accountants and the cost of counsel for current and former Duane Reade

employees. In all, restitution for these matters exceeded $7.6 million.[10]

On appeal, the court of appeals affirmed certain aspects of the reasoning employed by the district court. First, the court agreed that Oak Hill was entitled to restitution even though it was not a direct victim of the offense because Oak Hill paid for certain expenses on Duane Reade's behalf.[11] However, the court remanded the case in order to make sure that the expenses to be paid by Cuti only related to work for Duane Reade, and not work for Oak Hill.[12]

Second, the court agreed that Cuti should pay restitution to Duane Reade for legal fees paid for Duane Reade employees who needed separate representation in connection with the investigation.[13] Duane Reade was obligated to indemnify its employees and the district court was careful only to include fees relating to the government's investigation. This is a sensible ruling, as retaining counsel for employees is a necessary step in most investigations and quite often a productive one.

Third, the court agreed that prior holdings in the context of the Mandatory Victims Rights Act, such as Maynard, Battista and Amato, should be applied in the context of the VWPA, which has almost identical statutory language.[14] Under these decisions, necessary expenses in connection with internal investigations conducted by outside counsel that "unmasked fraud" and led to investigations by the authorities are subject to restitution under the MVRA.[15]

The court departed from the analysis of the district court, however, with respect to what was "necessary" in the particular factual context presented here. The court of appeals was troubled that Paul Weiss (counsel to the company in the employee arbitration) and Cooley (counsel to the audit committee conducting an internal investigation) did work that may have been overlapping or redundant.[16] In particular, the court held that "the entirety of the expenses incurred by Duane Reade for both the Cooley and the Paul Weiss internal investigations, premised on the same underlying findings and conduct, cannot both have been 'necessary' to advance the government's investigation under the VWPA."[17] The court of appeals remanded the case to determine whether the government has proved by a preponderance of the evidence that "some, or any, of Paul, Weiss's and Cooley's expenses were 'necessary to the investigation or prosecution' of Cuti's criminal case."[18]

The district court, on remand, must "consider at least whether the claimed expenditures by Paul, Weiss were redundant or duplicative of the expenses incurred for Cooley's investigatory work — including whether one firm's work served merely as a second opinion or to corroborate the other's findings — as well as whether the fact that two independent firms were at times working in tandem created additional, needless administrative costs."[19]

At first glance, the court's decision raises thoughtful questions about what fees are in fact "necessary to the investigation or prosecution" of a white collar defendant. The court made it clear that to constitute a "necessary" expense under the VWPA, it is not sufficient for the expenses incurred to have merely "helped the investigation."[20] On remand, the defendant may be able to demonstrate that certain costs were not "necessary," and the award will be reduced.

But separate representation for the company and for an audit or special committee of the board is far from novel. Indeed, it is standard practice when the accusations of wrongdoing reach high up into the boardroom, as was the case here. The court of appeals refers to the investigations as "redundant" or "serv[ing] merely as a second opinion," and seems not to appreciate fully the important interests served by an independent investigation conducted by an audit or special committee.[21] Such an investigation has value in the special case when a former chairman or CEO is the subject of a serious accusation of

wrongdoing because the investigation is more easily distanced from the wishes of management. One hopes that the value and necessity of audit committee or special committee investigations is given due consideration on remand and in any subsequent appeal.

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[1] 18 U.S.C. § 3663.

[2] United States v. Cuti, No. 13-2042-cr, slip op. at 4 (2d Cir. Feb. 6, 2015).

[3] Id. at 5.

[4] Id. at 5.

[5] Id. at 6.

[6] Id. at 6–7.

[7] Id. at 7.

[8] United States v. Cuti, No. 08 Cr. 972 (DAB), (S.D.N.Y. May 13, 2013).

[9] Id.

[10] Id.

[11] Cuti, slip. op. at 18–19.

[12] Id. at 19–20.

[13] Id. at 20–21.

[14] Id. at 22–24 (discussing United States v. Maynard, 743 F.3d 374 (2d Cir. 2014); United States v. Battista, 575 F.3d 226 (2d Cir. 2009); United States v. Amato, 540 F.3d 153 (2d Cir. 2008)).

[15] Maynard, 743 F.3d at 381.

[16] Cuti, slip op. at 25–29.

[17] Id. at 27.

[18] Id. at 28 (quoting Maynard, 743 F.3d at 382; Amato, 540 F.3d at 161).

[19] Id. at 28.

[20] Id. at 28.

[21] Id. at 28.
