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RESTITUTION & FORFEITURE

Two Patterson Belknap Webb & Tyler LLP attorneys examine a Second Circuit decision addressing whether an insurer may step forward as a subrogee to pursue claims for restitution and forfeiture. The authors note that the decision may serve as a road map for how district court judges approach this issue in the future.

Second Circuit Addresses Victims' Rights, Restitution, and Asset Forfeiture in Insurance Context



By HARRY SANDICK AND STEPHANIE TEPLIN

In a case arising out of the CityTime scandal, the Second Circuit issued a thoughtful opinion addressing the operation of restitution and asset forfeiture on victims of white collar crime. The decision, *Federal Insurance Co. v. United States*, Nos. 16-2967-op and 16-3402-cr, emphasizes that though restitution and forfeiture are both means for victims to be made whole, they are not subject to the same analysis. Ultimately, the Court (Parker, Lynch, Carney) affirmed the decision denying restitution, but remanded for additional proceedings on forfeiture. The decision is worth a careful read for those representing victims in white collar criminal matters, and also serves as a road map for how district court judges might approach these issues in the future.

Background

The case arises out of New York City's attempt to implement a time-keeping and management system called CityTime. Beginning in 2000, New York City contracted with Science Applications International Corp.

(SAIC), but the project was plagued with delays and cost overruns—later discovered to be the result of a kickback scheme. From 2003 to 2011, a number of SAIC's employees directed work to subcontractors at inflated rates in exchange for kickbacks and bribes. Starting in 2006, New York City paid SAIC on a "cost plus" basis, meaning that the cost of the kickbacks were ultimately shouldered by New York City. One SAIC employee, Carl Bell, pleaded guilty to five counts related to the scheme in 2011; three other co-conspirators were convicted at trial and sentenced in 2014. SAIC itself entered into a deferred prosecution agreement in 2012 where it accepted responsibility for the illegal conduct of its employees and its own failure to monitor them. Under the DPA, SAIC agreed to pay more than \$370 million to New York City in restitution and \$130 million to the government as a penalty. The \$130 million payment was to be made pursuant to a civil forfeiture action filed by the government, which SAIC agreed not to contest as a condition of the DPA.

From 2011 to 2012, SAIC was insured by Federal Insurance Co. (Federal) under a policy that covered employee theft up to \$15 million. In 2014, Federal paid up to the policy limit for the losses related to SAIC's employees' conduct. In 2016—when only Bell remained to be sentenced—Federal intervened as SAIC's subrogee and sought \$15 million in restitution from Bell. The district court denied Federal's request for restitution. The district court ruled that SAIC's subrogee could not receive restitution because SAIC was a co-conspirator in Bell's criminal conduct. It also ruled that Federal was bound by SAIC's promises in the DPA with respect to financial penalties, and that, on the merits, SAIC had no losses. Federal filed a mandamus petition seeking review of the order denying restitution. Separately, Fed-

eral claimed a superior right to the government in SAIC's forfeited property under 21 U.S.C. § 853(n); this petition was also denied by the district court based on the terms of the DPA, SAIC's unclean hands, and the government's superior interest in the funds. Federal appealed the denial of its forfeiture petition, which was consolidated with the mandamus petition.

The Second Circuit's Decision

The decision, authored by Judge Gerard E. Lynch, begins by describing the unusual features of this case in comparison to run-of-the-mill cases involving recovery by victims of a crime. First, because of the limited pool of recovered funds and the multiple victims of the fraud, Federal's interests were not automatically aligned with the prosecution. As the Court explained, a victim's role is "sometimes at odds with the normal two-sided scheme of criminal proceedings." Second, as an insurer, Federal was not the direct victim of any crime. The relevant statutes do not explain in detail how insurers or other subrogees should be treated—are their rights distinct from the rights of other victims? Third, Federal sought to use the forfeiture laws for reimbursement of its insurance payments, even though those laws are not designed to compensate victims at all but instead to deprive a wrongdoer of profiting from a crime. This is true even if the remission process allows victims to ask the government, in its discretion, to share forfeited proceeds with them. *See* 28 C.F.R. Part 9 (regulations for remission). And fourth, because restitution and forfeiture are governed by different statutory schemes, Federal had two distinct paths to seek recovery, each with its own path to the court of appeals. There will be cases in which one path will lead to recovery and the other does not. In this complicated factual setting, the Court took up each issue in turn.

Restitution Beginning with restitution, the Court offered a history of the Crime Victims' Rights Act (CVRA), a procedural mechanism by which crime victims could seek recovery, and the Mandatory Victims Restitution Act (MVRA), the substantive provision requiring those convicted of certain federal crimes to make payments to victims of their crimes as an element of their sentence.

The CVRA, the Court noted, began as a proposed constitutional amendment, accounting for its "relatively sparse technical detail." The CVRA gives victims many "'voice-based' rights," such as the right to be heard at public proceedings and to be treated with fairness and respect. Consistent with the need for those issues to be decided expeditiously, the CVRA authorizes a victim to challenge a denial of rights by the district court through a mandamus petition heard by the court of appeals, which must be decided by the appeals court within 72 hours of filing. The right to "full and timely restitution" provided by the CVRA is a different type of right, but—as the Court noted with evident frustration—is subject to the same "onerous" appellate deadlines. Here, a 72-hour deadline struck the Court as a particularly awkward fit: the district court took months to decide restitution issues, Federal took an additional three months to file a mandamus petition, and yet the Second Circuit arguably was required to issue a decision in just three days. The Court gratefully noted the unopposed motion for an extension of briefing to justify its failure

to meet the 72-hour deadline. (The mandamus petition was filed on August 26, 2016 and oral argument held on Aug. 29, 2017.)

Before addressing the merits, the Court began by examining its jurisdiction over the mandamus petition, which the government argued was lacking because Federal did not file its petition within the 14-day limit set by the CVRA. *See* 18 U.S.C. § 3771(d)(5). After a lengthy review of arguments on both sides—and observing that "[l]egislation clarifying this point would be welcome"—the Court sidestepped the question of whether the 14-day limit is jurisdictional by holding that it did not apply to the petition Federal filed here. Section 3771(d)(5) refers to "rights to be heard" and, by its express terms, "does not affect the victim's right to restitution as provided in title 18, United States Code." As a policy matter, the Court reasoned it made sense not to impose a 14-day deadline because, unlike the voice-based rights in the CVRA, an error in a restitution award could easily be remedied after the fact, and without forcing either the litigants or the courts to act with unusual speed.

In the absence of a statutory deadline for a victim seeking restitution to petition for mandamus, the Court applied a traditional laches analysis to determine if Federal's 105-day delay was too long. Although it determined that Federal's "uninspired excuses" for the delay were not compelling, in the absence of any prejudice to the government, the Court declined to dismiss the petition on equitable grounds.

The Court then turned to the merits of Federal's restitution claim. Applying an abuse of discretion standard, the Court held that the district court did not err in holding that "SAIC was sufficiently implicated in Bell's overall conduct to render an award of restitution to SAIC (and by extension to Federal, its subrogee) improper." The Court cited SAIC's acceptance of responsibility, in the DPA, for all of Bell's conduct, even that conduct that arguably harmed SAIC and not the city. It also observed that—without delving into the question of intracorporate conspiracy—a corporation is generally responsible for the criminal acts of its employees under principles of *respondeat superior* so long as the employee acted within the scope of his or her employment (unless the conduct furthered the employee's interests at the employer's expense). This was enough to support the district court's decision that restitution to SAIC, and therefore to Federal, was not warranted.

Forfeiture The Court reached a different result in the criminal forfeiture proceeding, vacating the district court's order denying Federal's motion to intervene and remanding for additional proceedings. The district court summarily denied the intervention request, relying on the order denying restitution, but the Circuit held that a different analysis is required. Of the procedural challenges raised by the government, the Court dwelled the longest on the statute of limitations, acknowledging that Federal asserted that a constructive trust was established in SAIC's favor for the first time in its intervention petition, filed long after the limitations period on such a claim had expired. The Court held, however, that criminal law deliberately prevents a third party from intervening while criminal proceedings are ongoing, and it would therefore be inconsistent to allow the government to use statute of limitations arguments to defeat third-party claims to forfeited assets.

On the merits, Federal argued that “SAIC obtained a constructive trust in the [forfeited] property at the moment that Bell acquired it” based on Bell’s wrongful acquisition of funds through kickbacks that rightfully belonged to his employer. A constructive trust is appropriate under state law when there has been a wrongful acquisition of property to which another party is entitled. The theory here was that Bell’s acquisition of the funds to be forfeited was made under such circumstances that the holder of legal title may not in good conscience retain the beneficial interest.

The government disagreed and argued that it had a priority interest because the property was traceable to a criminal offense, and that the government interest “related back” to the moment the crime was committed. The Court held that the government’s argument was “squarely foreclosed” by a 2011 decision in *Willis Management (Vermont) Ltd. v. United States*, 652 F.3d 236 (2d Cir. 2011), which held that a third-party constructive trust in property is superior to the government’s interest based on forfeiture of criminal proceeds. *Willis Management* rejected the relation-back argument made by the government here.

The Court acknowledged that SAIC’s own admission of wrongdoing might support a holding that it came to the court with unclean hands, but saw no automatic bar to the imposition of a constructive trust. It instructed the district court, on remand, to permit the parties to supplement the record on “the equities governing these circumstances.” Further, it instructed the district court to develop the factual record regarding the amount of SAIC’s constructive trust. The Court said that it was not automatic that SAIC would have earned a higher profit by obtaining its subcontractor’s services at a lower rate absent the kickback scheme. In particular, once the city put in place a “cost plus” contract, SAIC’s profit margin was fixed based on what it paid out, whether those amounts were inflated or not, such that its right to forfeited property likely only covered the period before the cost plus contract was put in place. Suggesting that a hearing on these matters would be “highly beneficial,” the Court remanded the case. It also denied Federal’s request for reassignment away from Judge Daniels; there was no actual or appearance of bias, and the error identified by the Circuit was an understandable one given the complicated and overlapping nature of the legal issues involved.

Commentary

This decision concerns an area of the law—financial penalties and victims’ rights—that is ripe for future developments. As the Court makes clear, the enactment of the CVRA was driven by a concern that crime victims were not being treated with sufficient respect and dignity by our criminal law procedure. Judge Lynch explains that in the two-sided nature of criminal prosecution, victims historically have stood somewhat off to the side, without rights of their own. But this is not true any longer; there are procedural and substantive rights that must be accorded to victims by the government and the Court. Judge Lynch wrote that “[b]y vesting a *right* in victims to obtain restitution . . . the CVRA confers standing on victims to seek restitution on their own behalf, rather than relegating them to bystander status while the government decides, for its own reasons and pursuant to its own strategy, whether, for whom, and in

what amount to seek restitution.” Crime victims who believe that they have been harmed by the offense conduct will no doubt take advantage of these provisions.

Given the relative newness of the statutes and the fact that most disputes involving financial penalties are resolved consensually by the government and the defendant, there is not much decisional law. The decision addresses several important questions that courts will have to resolve going forward.

First, how should a court treat an insurer stepping forward as a subrogee? In many cases, a victim will be partly or fully reimbursed by an insurer. Title 18, U.S. Code, § 3664(j)(1) provides that an insurer can receive restitution if the insurer has provided compensation to the victim. However, restitution must be paid to victims before any restitution is paid to the insurer. The instant appeal raises a more complicated question: can an insurer recover restitution when the party to whom the insurer paid compensation is both a victim and a perpetrator of the underlying offense? The person in whose shoes the insurer stands would not be able to claim restitution, as a participant in the offense conduct, but should the insurer be held to this same limitation given that the insurer did not engage in the offense conduct?

Second, how should courts handle the procedural rules laid out in the CVRA when it comes to addressing issues relating to restitution? The Circuit seems right to say that there is a poor fit between the mandamus petition route requiring immediate review and the complicated, fact-specific issues that can be at issue in restitution. No one is served by a 72-hour review period if it does not give enough time for the parties to brief the issue and for the Court to issue a considered decision. Here, the Circuit relied on an unopposed briefing extension request—which Federal acknowledged was inconsistent with the 72-hour rule—to get around these procedural strictures. This seems like the right result for both the parties and the Court, although there is an uncomfortable tension between the Court’s ruling and the literal language of the CVRA.

Third, the Circuit makes a prudent request that Congress amend the CVRA to make clear that a victim does not need to petition for a writ of mandamus within 14 days when the relief sought relates to restitution, as the statute currently provides. See 18 U.S.C. § 3771(d)(5)(B). This short time period makes little sense given that the restitution order is part of a sentence imposed at the end of the proceeding. Allowing a crime victim the traditional 30 days to take an appeal from an adverse decision on this subject is more consistent with the other aspects of the system of appellate review.

Finally, the Court’s use of the “constructive trust” doctrine in this case is potentially significant for corporations who are beset by employee misconduct, and something they should consider invoking when an employee’s assets are the subject of a forfeiture claim. Although the doctrine’s applicability is fact-dependent, the Circuit seems inclined to make sure that these claims receive a full airing in the district court.

Author Information

Harry Sandick is a partner at Patterson Belknap Webb & Tyler LLP in New York and a member of the firm’s White Collar Defense and Investigations team. A former assistant U.S. attorney for the Southern District of New York, he focuses his practice on white collar

criminal defense, securities fraud, internal investigations, complex civil litigation and appellate litigation.

Stephanie Teplin, an associate at Patterson Belknap in New York, served as a law clerk to the Honorable

John M. Walker Jr. of the U.S. Court of Appeals for the Second Circuit.