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SECOND CIRCUIT REVIEW

Expert Analysis

Defense Attorneys May Bring Third-Party Claim to Forfeited Property

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This month, we discuss *United States v. Watts*,[1] in which the U.S. Court of Appeals for the Second Circuit, in an opinion by Judge Gerard Lynch, joined by Judge Amalya Kearse and Judge Guido Calabresi, reversed the district court's dismissal of a petition by the lawyers for a criminal defendant who asserted a third-party interest in forfeited property, based on a pre-trial assignment of the property in exchange for legal services.

This opinion resurrects the possibility that criminal defense lawyers can recover fees from property forfeited as proceeds of crime as bona fide purchasers for value. Prior to this decision, there was precedent suggesting that defense lawyers could not meet the statutory requirement that bona fide purchasers be "reasonably without cause to believe"[2] that the property was subject to forfeiture at the time of purchase. As long as the indictment contained a forfeiture allegation, the only way a defense lawyer could escape notice that the funds were subject to forfeiture, would be to "fail to read the indictment of his client."[3]

In this opinion, the Second Circuit held that defense lawyers could reasonably believe, post-indictment, that their client's property is not subject to forfeiture if, among other things, the government failed to show probable cause at a pre-trial hearing that the property was traceable to the proceeds of the charged offenses.

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Background

In August 2010, a grand jury indicted three senior executives of GDC Acquisitions based on allegations that they participated in a scheme to defraud a bank by obtaining loans based on false information. The month before, the government had seized several bank accounts held by one of GDC's wholly-owned subsidiaries, UWS, as forfeitable property. The indictment, as well as a Bill of Particulars filed thereafter, gave notice that the government intended to seek forfeiture.

One of the indicted executives, GDC's Chief Financial Officer Rodney Watts, moved for the release of the seized funds to pay his defense costs. A Monsanto hearing, named after the Second Circuit decision in *United States v. Monsanto*,[4] was held to determine whether the government had probable cause to restrain the accounts as traceable to the proceeds of the charged offenses. No probable cause was found in relation to a subset of the funds, and the district court ordered their release. The order was stayed for 30 days.

On Aug. 11, 2011, during the stay period, two key events took place. First, GDC's subsidiary UWS, in partial satisfaction of the obligation to pay for Watts' defense, assigned Watts' lawyers DePetris & Bachrach (D&B) the funds the district court had ordered released. Second, the government opposed the release of the funds to Watts by moving for a reconsideration of the probable cause determination and clarification as to whether the funds should instead be released to the victim bank, given its pre-existing lien over all of GDC's accounts.

The district court declined to revisit its probable cause determination, but ordered the funds deposited in the court's registry rather than released to Watts for his defense. Watts appealed that decision to the Second Circuit.

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While the appeal was pending, GDC's Chief Executive Officer Courtney Dupree was convicted. The jury at his trial found that all the funds in the seized bank accounts were derived from proceeds traceable to his offenses, resulting in their forfeiture. In a summary order, the Second Circuit held that Watts' appeal was moot given that verdict, but that Watts could pursue his claim to the funds under 21 U.S.C. §853(n), which sets out the procedure for adjudicating third-party claims to forfeited property.[5]

Pursuant to that statute, Watts and D&B filed a petition[6] claiming an interest in the funds on the basis of the Aug. 11, 2011, assignment under each of the two grounds in §853(n)(6) that authorize a court to amend a forfeiture order in light of a valid third-party interest in the forfeited property. Under the first ground, §853(n)(6)(A), a petitioner must demonstrate that he had a legal interest in the property superior to that of the defendant at the time the underlying offense was committed. Under the second ground, §853(n)(6)(B), a petitioner must demonstrate that he is a bona fide purchaser for value reasonably without cause to believe the property was subject to forfeiture at the time of the purchase.

The government moved to dismiss the petition. First, it argued that D&B lacked standing to bring the petition because the assignment was a fraudulent conveyance. On the merits, it argued that D&B could not state a plausible claim under either ground in §853(n)(6): The assignment to D&B occurred after the commission of Dupree's offense, and D&B had notice that the government sought forfeiture of the funds. In turn, D&B argued that the government lacked standing to challenge the assignment as fraudulent because it was not a "creditor" under New York law.

The district court rejected both parties' standing arguments, but dismissed the petition for the reasons advanced by the government. Watts and D&B appealed.

Second Circuit Decision

The Second Circuit reviewed de novo the district court's dismissal of Watts' and D&B's petition. The question before the panel was whether the facts alleged, if assumed true, were sufficient to state a claim to relief that was plausible on its face.

At the outset, the court de-scribed the scheme of the criminal forfeiture regime. In order to successfully assert an interest in the forfeited property under the procedures provided in 21 U.S.C. §853(n), a third party must first establish standing by showing a legal interest in the forfeited property. On the merits, he must establish a superior claim to the property based on one of the grounds in §853(n)(6).

> Prior to 'Watts,' there was precedent suggesting that defense lawyers could not meet the statutory requirement that bona fide purchasers be "reasonably without cause to believe" that the property was subject to forfeiture at the time of purchase.

Fraudulent Conveyances Under New York Law. The Second Circuit noted that since D&B's claim to the funds rested on the validity of the assignment from UWS, it did not have standing if, as the government alleged, the assignment was void as a fraudulent conveyance. The court analyzed the assignment under §273 of the New York Debtor and Creditor Law, which provides that transactions without fair consideration made by an insolvent transferor, or that would render the transferor insolvent, are voidable by creditors of the transferor.

The court rejected Watts' and D&B's argument that the government was not a creditor at the time the offenses were committed. It drew an analogy between the government's forfeiture claim and a plaintiff's claim in a tort action, noting that in both cases, the relationship of debtor and creditor arises the moment the cause of action accrues. This timing is consistent with §853(c), which provides that property subject to criminal forfeiture vests in the United States at the time the act giving rise to forfeiture is committed.

The court did not address whether the assignment was a fraudulent conveyance based on the other criteria in §273—insolvency of the transferor or lack of fair consideration. Assuming the facts stated in the petition were true, the court found that it could not be certain that UWS was insolvent at the time of the conveyance and thus petitioners had standing to challenge the forfeiture order.

The Relation-Back Doctrine. Section 853(n)(6)(A) authorizes a court to amend a forfeiture order if a third party demonstrates a legal interest in the forfeited property superior to that of the criminal defendant at the time he committed the act giving rise to the forfeiture.[7] The Second Circuit explained that this temporal reference point worked "hand in hand" with the relation-back doctrine embodied in §853(c), which holds that all property subject to forfeiture under §853(a) vests in the United States upon commission of the act giving rise to forfeiture. Since the funds were deposited in UWS's accounts only after Dupree's crimes had already begun in 2007, they were vested in the United States by that time, and the relation-back doctrine barred D&B from asserting a superior claim to the funds under §853(n)(6)(A).

However, Watts and D&B argued that the case warranted an exception to the relation-back doctrine as was granted by the Second Circuit in *Willis Management (Vermont) v. United States*.[8] In that case, the court held that an employer had a legal claim under §853(n)(6)(A) to prop-

erty purchased by an employee with funds embezzled from the employer, on a theory of constructive trust. Without arguing that they or UWS were entitled to a constructive trust, Watts and D&B invited the Second Circuit to apply the Willis exception to the relation-back doctrine. The court declined, holding that *Willis* recognized a constructive trust to benefit the victim of the crime, whereas Watts and D&B were asserting priority over the funds on behalf of the beneficiary of Dupree's crimes, UWS.

Reasonable Cause to Believe That Property is Subject to Forfeiture. D&B's final option for asserting a legal interest in the funds based on the Aug. 11, 2011, assignment lay in §853(n)(6)(B), a codified exception to the relation-back doctrine which recognizes a third-party interest in forfeited property for bona fide purchasers for value "reasonably without cause to believe" that the property was subject to forfeiture at the time of purchase. The panel acknowledged the Supreme Court's express doubts in *Caplin & Drysdale*[9] and *Monsanto*[10] that a defense lawyer could ever prove that he was without cause to believe that his client's property was subject to forfeiture when the indictment contained a forfeiture allegation. However, the panel pointed out that on remand from the Supreme Court in *Monsanto*, the Second Circuit had ruled that a criminal defendant was entitled to a pre-trial adversarial hearing at which the government had to show probable cause to continue restraining his assets.[11]

Given that this hearing was intended to check the government's ability to limit a defendant's choice of counsel merely by obtaining a forfeiture charge in the indictment,[12] the Second Circuit decision in *Monsanto* "presumed, in essence, that a defense attorney could—and would—rely on the outcome of a Monsanto hearing to appraise whether his client's contested funds would ultimately be ordered forfeited or would remain available to pay his fees."[13] This compelled the conclusion that the government's failure to establish probable cause at a Monsanto hearing could leave a defense attorney "reasonably without cause to believe" his client's property was subject to forfeiture for the purpose of accepting that property in consideration for legal services. The reasonableness of that belief would depend on other facts as well, in D&B's case, what it believed about how the funds were derived; how they came into UWS's possession; who it received that information from; and what it could infer from the government's discovery materials.

Accordingly, the panel held that the record did not preclude a fact-finder from ultimately finding in D&B's favor. It found that the petitioners had pleaded facts sufficient to survive a motion to dismiss on their claim that D&B was a bona fide purchaser entitled to relief under §853(n)(6)(B).

Rejecting the In Personam Theory of Criminal Forfeiture. Watts and D&B argued as well that the funds were not subject to criminal forfeiture under 18 U.S.C. §982(a)(2) because UWS, and not Dupree personally, held title to them, and they never passed through Dupree's hands. This argument relies on the theory that criminal forfeiture is an in personam proceeding that implicates only the property owned by the criminal defendant.

First, the court held that this could not support a reasonable belief that the funds were not subject to forfeiture because the precedent in *De Almeida v. United States*[14] interpreted similar statutory language as authorizing forfeiture of any property derived from proceeds obtained through a defendant's offense, regardless of whether the property was ever owned by the defendant. Next, the court held that this argument was not available to third parties because §853(k) makes clear that §853(n)(6)(A) and (B) are the only grounds that support a third-party interest in forfeited property.

Conclusion

This ruling demonstrates that the Second Circuit remains concerned with the government's power to restrain a criminal defendant's property pending trial. In *Monsanto*, before it was reversed by the Supreme Court on appeal, the Second Circuit held that orders restraining a defendant's property had to be modified to permit the defendant to use the restrained assets to pay his attorney fees.[15] On remand, it instituted the requirement of a pre-trial probable cause hearing as a check on the government's ability to limit a defendant's choice of counsel.[16]

In this case, the Second Circuit held that a successful outcome on that hearing could reasonably be relied on by defense lawyers as an indication that the property was not subject to forfeiture, removing a barrier to using that property toward defense costs. Since the decision only reverses the denial of a motion to dismiss, however, it leaves open whether a defense lawyer could in fact actually succeed in claiming a third-party interest in forfeited property.

1. No. 13-911-cr (2d Cir. May 4, 2015).
2. 21 U.S.C. §853(n)(6)(B).
3. *Caplin & Drysdale, Chartered v. United States*, 491 U.S. 617, 632 n.10 (1989).
4. 924 F.2d 1186 (2d Cir. 1991).
5. See *United States v. Watts*, 477 F. App'x 816, 817 (2d Cir. 2012).
6. Watts joined the petition as a third-party beneficiary of the assignment to D&B.
7. 21 U.S.C. §853(n)(6)(A).
8. 652 F.3d 236 (2d Cir. 2011).
9. *Caplin & Drysdale*, 491 U.S.at 632, n.10.
10. *United States v. Monsanto*, 491 U.S. 600, 604 n.3 (1989).
11. See *Monsanto*, 924 F.2d at 1203.
12. See *United States v. Monsanto*, 836 F.2d 74, 84 (2d Cir. 1987), on reh'g, 852 F.2d 1400 (2d Cir.. 1988), rev'd, 491 U.S. 600 (1989), vacated, 924 F.2d 1186 (2d Cir. 1991).
13. *Watts*, No. 13-911-cr, at 46.
14. 459 F.3d 377, 381 (2d Cir. 2006).
15. *Monsanto*, 852 F.2d at 1402, rev'd, 491 U.S. 600 (1989).
16. *Monsanto*, 924 F.2d at 1203.