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## Friction in Reconciling Criminal Forfeiture and Bankruptcy: The Criminal Forfeiture Part

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## ARTICLE

# FRICITION IN RECONCILING CRIMINAL FORFEITURE AND BANKRUPTCY: THE CRIMINAL FORFEITURE PART\*

SARAH N. WELLING\*\* & JANE LYLE HORD\*\*\*

### INTRODUCTION

The federal government uses two general types of asset forfeiture, criminal and civil. This Article addresses criminal forfeiture, which allows the government to take property from defendants when they are convicted of crimes. It is “an aspect of punishment imposed following conviction of a substantive criminal offense.”<sup>1</sup>

Criminal forfeiture is a sanction that can be imposed on defendants only after they are convicted of an authorizing substantive crime. Thus, criminal forfeiture is basically another part of the sentence rather than a separate charge in itself.<sup>2</sup> And forfeiture is a jury decision: if the defendant is convicted on the underlying crime or crimes, the forfeiture count is then submitted to the jury.<sup>3</sup> The jury must make predicate factual findings in order to impose forfeiture. If the jury decides to impose forfeiture, the judge has no discretion to overrule the jury.

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<sup>1</sup> *Libretti v. United States*, 116 S. Ct. 356, 363 (1995).

<sup>2</sup> *See id.* at 364.

<sup>3</sup> *See* FED. R. CRIM. P. 32.2(b)(5)(B).

Criminal forfeiture has a short history. Between 1790 and 1970 it was authorized by Congress only once.<sup>4</sup> In 1970, Congress revived criminal forfeiture for convictions of the most serious drug crime, the Continuing Criminal Enterprise (CCE), and under the Racketeering Influenced and Corrupt Organizations Act (RICO).<sup>5</sup> In 1984, forfeiture was expanded to apply to all drug felonies,<sup>6</sup> and in 1986, Congress enacted a third criminal forfeiture statute that applied to money laundering crimes.<sup>7</sup> Over the years, Congress has amended the money laundering forfeiture statute to include so many other crimes that it is now more accurately characterized as a general criminal forfeiture statute.

Thus, the law of criminal forfeiture is established by three main statutes:<sup>8</sup> the drug forfeiture statute,<sup>9</sup> the RICO forfeiture statute,<sup>10</sup> and the general criminal forfeiture statute.<sup>11</sup> These three forfeiture statutes are very similar. The drug forfeiture statute and the RICO forfeiture statute were adopted together in 1970 and are identical in many ways. Accordingly, courts often find authority under one persuasive for the other.<sup>12</sup> The general criminal forfeiture statute, enacted later, adopts by

<sup>4</sup> *United States v. Nichols*, 841 F.2d 1485, 1487 (10th Cir. 1988) (between 1790 and 1970, criminal forfeiture was authorized only once to recover life estates of Confederate soldiers).

<sup>5</sup> See 21 U.S.C.A. § 848 (Westlaw 2012); see also 18 U.S.C.A. §§ 1961-64 (Westlaw 2012).

<sup>6</sup> See 21 U.S.C.A. § 853(a) (Westlaw 2012).

<sup>7</sup> 18 U.S.C.A. § 982 (Westlaw 2012).

<sup>8</sup> Other criminal forfeiture statutes exist, see 18 U.S.C.A. § 2253 (Westlaw 2012) (criminal forfeiture authorized for crimes of sexual exploitation and other abuse of children involving visual depictions under 18 U.S.C.A. §§ 2251-2252A, 2260 (Westlaw 2012)) and 18 U.S.C.A. § 1467 (Westlaw 2012) (criminal forfeiture authorized for violations of 18 U.S.C.A. §§ 1460 *et seq.* (Westlaw 2012) (involving obscene materials)).

<sup>9</sup> 21 U.S.C.A. § 853 (Westlaw 2012); see also 21 U.S.C.A. § 970 (Westlaw 2012).

<sup>10</sup> 18 U.S.C.A. § 1963 (Westlaw 2012). RICO does not authorize civil forfeiture, so any RICO forfeiture is necessarily criminal.

<sup>11</sup> 18 U.S.C.A. § 982 (Westlaw 2012).

<sup>12</sup> See, e.g., *United States v. White*, 116 F.3d 948, 950 (1st Cir. 1997) (noting that drug and RICO forfeiture statutes should be interpreted “*in pari passu*”); *United States v. McHan*, 101 F.3d 1027, 1042 (4th Cir. 1996), *cert. denied*, 117 S. Ct. 2468 (1997) (showing by way of legislative history that Congress intended the statutory definitions of proceeds to be interpreted the same under the money laundering and drug and RICO forfeiture statutes); *United States v. Shifflett*, Nos. 93-5693, 93-5721, 93-5742, 93-5787, 94-1417, 94-5069, 94-5287, 1995 WL 125506, at \*3 (4th Cir. Mar. 23, 1995) (stating that legislative history shows Congress intended RICO and drug forfeiture statutes to be relevant to each other); *United States v. Ripinsky*, 20 F.3d 359, 362 n.3 (9th Cir. 1994) (referring to cases and legislative history discussing RICO and drug forfeiture statutes interchangeably); *United States v. Libretti*, 38 F.3d 523, 528 n.6 (10th Cir. 1994), *aff’d sub nom. Libretti v. United States*, 516 U.S. 29 (1995) (noting that cases construing the RICO forfeiture statute may be used in applying the drug forfeiture statute due to the similarity of the statutory language); *United States v. Bissell*, 866 F.2d 1343, 1349 n.3 (11th Cir. 1989) (same).

reference most of the drug forfeiture statute.<sup>13</sup> These three statutes are discussed together below.

Up until the year 2000 or so, the government used criminal forfeiture less frequently than civil forfeiture because civil forfeiture was easier for the government. In civil forfeiture actions, among other advantages, the government's burden of proof was lower, the burden shifted off the government to claimants, and claimants had no privilege against self-incrimination or right to counsel. As discussed further below, in 2000, and again in 2006, criminal forfeiture was expanded dramatically, such that the government now uses criminal forfeiture more frequently.

For the government to take property by criminal forfeiture, the defendant must be convicted of an authorizing substantive crime, and the property the government is seeking must fall within the definition of property subject to forfeiture. These two requirements are discussed in Parts I and II below. Section III then discusses how third-party claimants are treated in criminal forfeiture.

The recent prevalence of large scale white collar crime has created tension between forfeiture and bankruptcy law. Multi-million or sometimes billion dollar Ponzi schemes have made names such as Madoff and Dreier infamous for the sheer number of victims they deceived and the amount of money stolen. Judge Jed Rakoff best described the issue this way:

An under-appreciated evil of substantial frauds like those of Marc Dreier is how they pit their victims against one another. Where, as here, the funds remaining after the fraud is uncovered are insufficient to make whole Dreier's numerous victims and creditors, these unfortunates are left to squabble over who should get what. In this case, moreover, resolution of these competing claims involves consideration of three bodies of law—criminal law, securities law, and bankruptcy law—that cannot always be reconciled without some friction.<sup>14</sup>

Cases such as Dreier cause a collision between the government's right to forfeitable property with the claims of innocent victims and creditors

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<sup>13</sup> 18 U.S.C.A. § 982(b)(1) (Westlaw 2012) provides:

The forfeiture of property under this section, including any seizure and disposition of the property and any related judicial or administrative proceeding, shall be governed by the provisions of section 413 (other than subsection (d) of that section) of the Comprehensive Drug Abuse Prevention and Control Act of 1970 (21 U.S.C. 853).

<sup>14</sup> *United States v. Dreier*, 682 F. Supp. 2d 417, 418 (S.D.N.Y. 2010).

when a defendant, and in some cases his or her business, files for bankruptcy. Without some agreement and compromise with the government,<sup>15</sup> all the forfeitable property of the defendant may be removed from the bankruptcy estate.<sup>16</sup> This property is only available to creditors and victims through asserting a defense available to third parties in contesting criminal forfeiture.<sup>17</sup> Any attempt by the court to intervene in the basic forfeiture process in favor of victims beyond what is either provided by the statute or agreed to by the government would be considered an abuse of discretion.<sup>18</sup> Accordingly, if a third party does not have a viable defense to forfeiture, the victim is left at the mercy of the Department of Justice with a petition for remission or mitigation, for which the Attorney General has sole and unreviewable discretion to grant or deny a request.<sup>19</sup> The goal of this Article is to give an overview of the forfeiture process, specifically in relation to claims victims and creditors might assert as third-party claimants.

#### I. DEFENDANT IS CONVICTED OF A CRIME AUTHORIZING THE FORFEITURE SANCTION

The substantive crimes that authorize criminal forfeiture are set out in the three main forfeiture statutes<sup>20</sup> and numerous specific provisions.<sup>21</sup> In addition, in year 2000, Congress adopted a provision that drastically increased the number of crimes that authorized criminal forfeiture.<sup>22</sup> As part of the second major revision of the forfeiture laws in 2006, the

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<sup>15</sup> See, e.g., *id.* at 418 (describing the “Coordination Agreement” between the government and the chapter 11 bankruptcy trustee for Dreier LLP).

<sup>16</sup> *Gowan v. The Patriot Grp. (In re Dreier LLP)*, 452 B.R. 391, 411-12 (Bankr. S.D.N.Y. 2011).

<sup>17</sup> See *United States v. Frykholm*, 362 F.3d 413, 415 (7th Cir. 2004).

<sup>18</sup> Compare *United States v. Bradley*, 644 F.3d 1213, 1305-11 (11th Cir. 2011) (district court appointed receiver to marshal defendants’ assets for fines, forfeiture and restitution; court of appeals holds this is abuse of discretion because appointment of receiver is extraordinary equitable remedy, and federal and state law provide federal government with adequate remedies based on FDCA, 28 U.S.C. §§ 3001 *et seq.*, and Federal Rules of Civil Procedure 66 and 69, which are far more efficient), with *United States v. King*, No. 3:06-cr-212-J-33MCR, 2009 WL 4628224, at \*1-2 (M.D. Fla. Dec. 2, 2009) (recognizing that the government may agree to forgo forfeiture for legitimate reasons, such as allowing victims to collect restitution, and approving of such an agreement).

<sup>19</sup> Regulations Governing the Remission or Mitigation of Civil and Criminal Forfeitures, 28 C.F.R. § 9.1 (Westlaw 2012).

<sup>20</sup> The statutes cover all drug felonies, 21 U.S.C.A. § 853 (Westlaw 2012); RICO interests, 18 U.S.C.A. § 1963 (Westlaw 2012); and general crimes, 18 U.S.C.A. § 982 (Westlaw 2012).

<sup>21</sup> See, e.g., 18 U.S.C.A. § 1955 (Westlaw 2012) (gambling business); 18 U.S.C.A. § 2252 (Westlaw 2012) (child pornography and exploitation).

<sup>22</sup> NORMAN ABRAMS ET AL., FEDERAL CRIMINAL LAW AND ITS ENFORCEMENT 1047-48 (West Publ’g, 5th ed. 2010); see 28 U.S.C.A. § 2461 (Westlaw 2012).

statute was amended to include a provision that the courts have interpreted to expand the crimes authorizing criminal forfeiture to include all the crimes that authorize civil forfeiture.<sup>23</sup> It now appears that the challenge is to identify a crime that does *not* authorize the sanction of criminal forfeiture.<sup>24</sup> Following that revision, and its attendant increase in forfeiture filings, criminal forfeiture actions outnumbered civil actions for the first time.<sup>25</sup>

## II. DEFINE PROPERTY SUBJECT TO FORFEITURE

After the defendant is convicted of an authorizing crime, the next step is to identify the property subject to forfeiture.

### A. TWO BASIC CATEGORIES OF FORFEITABLE PROPERTY

The property subject to forfeiture can be put into two general categories. The first is proceeds of the crime. The concept of proceeds is relatively new to criminal law. It first appeared in criminal forfeiture statutes only in 1970, so it has no common law history. The statutory language defining proceeds varies among the statutes.<sup>26</sup> In general,

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<sup>23</sup> See generally *United States v. Vampire Nation*, 451 F.3d 189,199-201 (3d Cir. 2006). The statute adopted in 2000 is 28 U.S.C. § 2461. Civil Asset Forfeiture Reform Act of 2000, Pub. L. No. 106-185, 114 Stat. 202. It was amended in 2006. USA Patriot Improvement and Reauthorization Act of 2005, Pub. L. No. 109-177, 120 Stat. 192 (2006). The result is that every crime that authorizes civil forfeiture also authorizes criminal forfeiture, and the crimes that authorize civil forfeiture are many. See 18 U.S.C.A. § 981 (Westlaw 2012), which adopts the list of crimes in 18 U.S.C.A. § 1956(c)(7) (Westlaw 2012), which in turn adopts the list of crimes in 18 U.S.C.A. § 1961(1) (Westlaw 2012).

<sup>24</sup> One crime that does not authorize forfeiture is 18 U.S.C.A. § 1001 (Westlaw 2012) (false statements), which is included under 18 U.S.C.A. § 982 (Westlaw 2012) only for statements “involving the sale of assets acquired or held by the Federal Deposit Insurance Corporation” or “any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent statements, pretenses, representations, or promises.” 18 U.S.C.A. § 982(a)(3)-(4) (Westlaw 2012).

<sup>25</sup> ABRAMS, *FEDERAL CRIMINAL LAW AND ITS ENFORCEMENT* at 1048 n.21. Nevertheless, civil forfeiture is still used by the government in many situations because the government must only prove the defendant’s guilt of a predicate crime by a preponderance of the evidence. See *United States v. Liquidators of Eur. Fed. Credit Bank*, 630 F.3d 1139, 1150 (9th Cir. 2011). Therefore, if the government does not have enough evidence to hold the defendant criminally liable for the crime, it can still seek civil forfeiture and secure a judgment against any forfeitable property. *Id.*

<sup>26</sup> See 21 U.S.C.A. § 853(a)(1) (Westlaw 2012) (“... any property constituting, or derived from, any proceeds the person obtained, directly or indirectly, as a result of such violation”); 18 U.S.C.A. § 982(a)(2) (Westlaw 2012) (“any property constituting, or derived from, proceeds the person obtained directly or indirectly, as a result of such violation”); 18 U.S.C.A. § 982 (a)(3)(F), (a)(5)(E) (Westlaw 2012) (“... any property, real or personal, which represents or is traceable to the gross receipts obtained, directly or indirectly, as a result of such violation”); 18 U.S.C.A. § 982(a)(6)(A)(ii) (Westlaw 2012) (“any property real or personal... that constitutes, or is derived from or is traceable to the proceeds obtained directly or indirectly from the commission of the

however, courts have concluded that proceeds include the gross receipts rather than net profits,<sup>27</sup> and in 2009, Congress adopted this definition in the context of the money laundering crime.<sup>28</sup> Additionally, if there are multiple defendants, they are held jointly and severally liable for all foreseeable proceeds that result from their crime(s).<sup>29</sup>

The second general category of property that the government may forfeit is property used or involved in the crime. Again, the statutory language varies.<sup>30</sup> Based on the historical development of criminal forfeiture, in the context of drug crimes, this property is sometimes referred to as “facilitating property.”<sup>31</sup> Facilitating property has a legitimate genesis unconnected to the underlying criminal activity, i.e., it was not generated by crime and is not the proceeds of the crime. But when defendants use their clean/untainted property in committing a crime, it becomes forfeitable under this second category. So, for example, a defendant who legitimately owns an office building and runs an investment company from the building but turns the company into a Ponzi scheme may forfeit the building as property that facilitated the crime.

## B. MONEY JUDGMENTS

In addition to forfeiting property that is proceeds of the crime and property that facilitated the crime, the government has recently had success in the courts when seeking monetary forfeiture judgments in lieu of particular pieces of property.<sup>32</sup> These money judgments are not mentioned in the forfeiture statutes explicitly but are authorized

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offense of which the person is convicted”); 18 U.S.C.A. § 982(a)(8)(B) (Westlaw 2012) (“constituting, derived from, or traceable to the gross proceeds that the defendant obtained directly or indirectly as a result of the offense”).

<sup>27</sup> See *United States v. McHan*, 101 F.3d 1027, 1042 (4th Cir. 1996), *cert. denied sub nom. McHan v. United States*, 520 U.S. 1281 (1997).

<sup>28</sup> See 18 U.S.C.A. § 1956(c)(9) (Westlaw 2012).

<sup>29</sup> See, e.g., *United States v. Van Nguyen*, 602 F.3d 886, 904 (8th Cir. 2010).

<sup>30</sup> See 21 U.S.C.A. § 853(a)(2) (Westlaw 2012) (“any of the [defendant’s] property used, or intended to be used, in any manner or part, to commit, or to facilitate the commission of, such violation”); 18 U.S.C.A. § 982(a)(1) (Westlaw 2012) (“... any property, real or personal, involved in such offense”); 18 U.S.C.A. § 982(a)(6)(A)(ii)(II) (Westlaw 2012) (“any property real or personal . . . that is used to facilitate, or is intended to be used to facilitate, the commission of the offense”); 18 U.S.C.A. § 982(a)(8)(A) (Westlaw 2012) (“used or intended to be used to commit, to facilitate, or to promote the commission of such offense”).

<sup>31</sup> See 21 U.S.C.A. § 853(a)(2) (Westlaw 2012) (“[A]ny of the [defendant’s] property used, or intended to be used, in any manner or part, to commit, or to *facilitate* the commission of, such violation”) (emphasis added).

<sup>32</sup> See *United States v. Olguin*, 643 F.3d 384, 395-98 (5th Cir. 2011).



implicitly by the government's power to seize substitute property. This power is described in more detail below. The theory is that the government may seek money judgments because the government has the power to seize substitute property when the specific forfeitable property is unavailable for one reason or another, and money is just another form of property.

### C. DEFENDANT HAS AN INTEREST IN THE PROPERTY

In order to forfeit any property, the government must prove that the defendant had an interest in that property. The reason is that criminal forfeiture is considered an *in personam* action against the defendant, over whom the government has jurisdiction because it has seized him.<sup>33</sup> The government therefore has power over all the property the defendant has an interest in. If the defendant has no interest in the property, the government has no jurisdiction over the property.

This theoretical foundation of criminal forfeiture can be contrasted with civil forfeiture actions. Civil forfeiture actions are *in rem* actions against the property itself.<sup>34</sup> These cases have names like *United States v. \$6,976,934.65, Plus Interest Deposited into Royal Bank of Scotland International, Account No. 2029-56141070, Held in the Name of Soulbury Ltd., and Property Traceable Thereto*.<sup>35</sup> In these actions, the government is bringing a civil action against the property directly, seeking to adjudicate all persons' rights in the property, and the government's jurisdiction is based on its seizure of the property. In criminal forfeiture, in contrast, the extent of the defendant's interest in the property, if contested, is adjudicated at the stage called an ancillary

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<sup>33</sup> See *United States v. Liquidators of Eur. Fed. Credit Bank*, 630 F.3d 1139, 1149 (9th Cir. 2011).

<sup>34</sup> *Id.*

<sup>35</sup> *United States v. Soulberry Limited*, 554 F.3d 123 (D.C. Cir. 2009); see also *United States v. Approximately \$1.67 Million (US) in Cash, Stock, and Other Valuable Assets Held by or at: 1) Total Aviation Ltd., Account No. 7092686, Located at Barclays Bank PLC, Grand Cayman, Cayman Islands, British West Indies; 2) Deacon Barclays De Zoete Wedd Limited, Account No. 13603A-2 aka Barclays Private Bank & Trust CM1633, Located at Barclays Private Bank & Trust (Cayman) Limited, Grand Cayman, Cayman Islands, British West Indies; 3) Total Financial Consultants Ltd., Account Reference 310205-633500, Located at the Barclays Private Bank & Trust (Cayman) Limited, Grand Cayman, Cayman Islands, British West Indies; 4) Cashiers Check 11405244-152 in the Amount of \$85,000 (US), Drawn at the Royal Bank of Canada, Georgetown, Grand Cayman, Cayman Islands, British West Indies, on or about March 20, 1995; and 5) Cashiers Check 11405244-141 in the Amount of \$21,250 (US) Drawn at the Royal Bank of Canada, Georgetown, Grand Cayman, Cayman Islands, British West Indies, on or about March 17, 1995*, 513 F.3d 991 (9th Cir. 2008).

proceeding,<sup>36</sup> which is held after the defendant is convicted and sentenced.

#### D. A “NEXUS” EXISTS BETWEEN THE CRIME AND THE PROPERTY

In order for property to be deemed subject to forfeiture, there must be what the courts call a “nexus” between the property and the crime.<sup>37</sup> This nexus requirement was developed by the courts based on the conclusion that it is implicit in the statutory language. Generally, this requirement is only significant when property is forfeited under the theory that it facilitated the crime. In contrast, if the property is forfeited under the theory that it is proceeds, inevitably a nexus exists: the property was by definition generated by the crime. Furthermore, if the government is seeking a money judgment, the theory is that this is substitute property, and no nexus between substitute property and the crime need be established. So, if the government is seeking forfeiture on the basis that property facilitated a crime, the courts require that a nexus, or substantial connection, exist between the crime and the property.<sup>38</sup>

#### E. TITLE TO THE PROPERTY AND THE “RELATION BACK” DOCTRINE

The forfeiture statutes all provide that “[a]ll right, title, and interest in [forfeitable] property . . . vests in the United States upon the commission of the act giving rise to forfeiture . . . .”<sup>39</sup> This legal fiction, called the “relation back” doctrine, means that the title to forfeitable property vests in the federal government at the time the crime is committed or at the time the property is used to facilitate the crime. Because title vests in the government at the time of the crime, anything that is done to the property after that by the defendant or a third party does not change its character—it is still the government’s property.

The effect of the relation back provision varies depending on which theory of forfeiture the government uses. For proceeds, the relation back doctrine means that proceeds were never the property of the criminal defendant, because at their creation, i.e., when the defendant generated them through the crime, title vested in the government. The defendant

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<sup>36</sup> See FED. R. CRIM. P. 32.2(c); see also WRIGHT & WELLING, 3 FED. PRACTICE & PROCEDURE § 573 (4th ed.).

<sup>37</sup> See, e.g., *United States v. Hull*, 606 F.3d 524, 527-29 (8th Cir. 2010); *United States v. Van Nguyen*, 602 F.3d 886, 903 (8th Cir. 2010) (holding that the defendant’s home had a sufficient nexus to support forfeiture but his BMW did not).

<sup>38</sup> *United States v. Hull*, 606 F.3d 524, 527-29 (8th Cir. 2010).

<sup>39</sup> 21 U.S.C.A. § 853(c) (Westlaw 2012).

never has any claim of title. For property that facilitated the crime, on the other hand, relation back means that title shifts from the defendant to the government. Facilitating property legitimately belonged to the defendant up until the time of the crime, and the relation back doctrine legally shifts the title from the defendant to the government when the property is used in the crime.

#### F. GOVERNMENT POWER TO SEIZE SUBSTITUTE PROPERTY

The government is authorized to seize substitute property if the exact property subject to forfeiture is unavailable due to actions by the defendant. The statutes provide:

(1) [I]f any [forfeitable] property . . . as a result of any act or omission of the defendant—

- (A) cannot be located upon the exercise of due diligence;
- (B) has been transferred or sold to, or deposited with, a third party;
- (C) has been placed beyond the jurisdiction of the court;
- (D) has been substantially diminished in value; or
- (E) has been commingled with other property which cannot be divided without difficulty

. . . .

the court shall order the forfeiture of any other property of the defendant . . . .<sup>40</sup>

Congress's rationale for giving the government this power to seize substitute property is to ensure that defendants cannot evade the forfeiture. Seizure of substitute assets is meant to deprive the defendant of *all* forfeitable assets or the value thereof.

The substitute property power is the justification for the allowance of monetary judgments.<sup>41</sup> By allowing monetary judgments, the courts intend to effectuate the broad remedial purpose of the forfeiture acts<sup>42</sup> and “ensur[e] that all eligible criminal defendants receive the mandatory forfeiture sanction Congress intended and disgorge their ill-gotten gains,

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<sup>40</sup> 21 U.S.C.A. § 853(p) (Westlaw 2012).

<sup>41</sup> See *United States v. Olguin*, 643 F.3d 384, 395-98 (5th Cir. 2011) (including a list of other cases approving of monetary judgments).

<sup>42</sup> *Id.* at 397.

even those already spent.”<sup>43</sup> With this purpose in mind, all circuits to which the issue of monetary judgments has been presented have approved of their imposition.<sup>44</sup>

The government’s power to seize substitute property is only relevant to conflicts between the government and defendant, because the doctrine does not authorize the government to forfeit substitute property held by third parties. The provision allowing seizure of substitute property applies only to the defendant’s property.<sup>45</sup> The government can take specific transferred assets out of the hands of a third party, but if that party has since, for example, sold the asset and it is untraceable, the government cannot seize substitute property under the forfeiture laws. Rather, it must resort to state common law actions of conversion and detinue to recover the money.<sup>46</sup>

Unless the third party can establish either of the two statutory defenses available to third parties (noted below),<sup>47</sup> because substitute property cannot be seized from third parties,<sup>48</sup> the court must determine exactly how much of the truly forfeitable property is left in the third parties’ hands. If the forfeitable property is money that has been commingled with other funds, and there has been an outflow of funds from the commingled account, the court must determine if the outflow came from the clean funds or the forfeitable money.<sup>49</sup> Even if there is not enough truly forfeitable money left to satisfy the forfeiture judgment, the government cannot seize substitute assets from third parties under the forfeiture laws to satisfy the judgment.<sup>50</sup>

### III. FOLD IN THIRD-PARTY CLAIMANTS

The legal fiction created by the relation back doctrine, i.e., that title to forfeitable property vests in the government at the moment it becomes forfeitable, creates real problems for third parties. As the defendant no

<sup>43</sup> *United States v. Casey*, 444 F.3d 1071, 1074 (9th Cir. 2006).

<sup>44</sup> *See Olguin*, 643 F.3d at 397.

<sup>45</sup> *United States v. Moffitt, Zwerling & Kemler, P.C.*, 83 F.3d 660, 668 (4th Cir. 1996), *cert. denied*, 117 S. Ct. 788 (1997).

<sup>46</sup> *See id.* (describing how attorneys for a large scale drug dealer took drug proceeds as fees and the government pursued the law firm when it was unable to obtain a sufficient return from the convicted defendants; by the time the government tried to obtain a forfeiture order against the firm, it had allegedly already spent the money out of its general fund, and the government could only pursue the firm through state common law tort actions).

<sup>47</sup> *See infra* Part III, which details third-party claims.

<sup>48</sup> *Moffitt, Zwerling & Kemler, P.C.*, 83 F.3d at 668.

<sup>49</sup> *United States v. Saccoccia*, 354 F.3d 9, 13-14 n.49 (1st Cir. 2003).

<sup>50</sup> *See, e.g., id.; Moffitt, Zwerling & Kemler, P.C.*, 83 F.3d at 668.

longer has good title to any forfeitable property, subsequent transfers to third parties do not change its character from that of the government's property.

The forfeiture statutes specify the interaction between the relation back doctrine and the rights of third parties. Specifically, the statute provides:

**Third party transfers.** All right, title, and interest in [forfeitable] property . . . vests in the United States upon the commission of the [crime]. Any such property that is subsequently transferred to a person other than the defendant . . . shall be . . . forfeited to the United States, unless the transferee establishes [one of the two defenses discussed below.]<sup>51</sup>

Thus, the government can take forfeitable property out of the hands of third parties.<sup>52</sup> Combined with the relation back doctrine, this means that the defendant cannot hide property from the government by giving it or selling it to others. The statute grants third parties two defenses.<sup>53</sup>

At this point, the issue can be articulated in terms familiar to both criminal law and bankruptcy as follows: If title to forfeitable property is vested in the government such that the defendant does not have good title to the property, can the defendant transfer good title to third parties, or are the defendant's transfers to third parties void or voidable by the government?<sup>54</sup>

#### A. TWO STATUTORY "DEFENSES" FOR THIRD-PARTY CLAIMANTS

Section 853(n) provides third-party claimants with two possible defenses.<sup>55</sup> The first, the "superior interest defense," provides that a third-party claimant may defeat the government's effort to forfeit the property if the third party

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<sup>51</sup> 21 U.S.C.A. § 853(c) (Westlaw 2012).

<sup>52</sup> *Id.* ("Any such property that is subsequently transferred to a person other than the defendant may be the subject of a special verdict of forfeiture and thereafter shall be ordered forfeited to the United States . . .").

<sup>53</sup> 21 U.S.C.A. § 853(n) (Westlaw 2012).

<sup>54</sup> An analogy familiar to commercial transaction attorneys lies under section 2-403 of the Uniform Commercial Code, which permits certain good faith purchasers to obtain good title from a transferor who held voidable title, but not from a transferor who held no title (e.g., a thief). U.C.C. § 2-403 (Westlaw 2012).

<sup>55</sup> See *United States v. Huntington Nat'l Bank*, 574 F.3d 329, 330 (6th Cir. 2009) (noting that although there is an "innocent owner" defense to civil forfeiture, this defense is not allowed when criminal forfeiture is sought); *United States v. Sorcide*, 461 F.3d 1351, 1354 (11th Cir. 2006).

has a legal right, title, or interest in the property, and such right, title, or interest renders the order of forfeiture invalid in whole or in part because the right, title, or interest was vested in the [third party] rather than the defendant or was superior to any right, title, or interest of the defendant at the time of the [crime] . . . .<sup>56</sup>

This defense is actually a question of timing: the third-party claimant has a legal interest in the property, and that interest renders the forfeiture invalid because the interest was either (1) vested in the third-party claimant rather than the defendant at the time of the crime, or (2) superior to the defendant's interest at the time of the crime. In plainer English, this means that, at the time of the crime, when defendant's interest shifted to the government, the third party also had an interest in the property, and the third party's interest did not shift to the government as the defendant's interest did.

The second defense for third parties is called the "bona fide purchaser defense." Here, the statute provides that a third-party claimant can protect his or her property from forfeiture by the government if he or she is "a bona fide purchaser for value of the right, title, or interest in the property and was at the time of purchase reasonabl[y] without cause to believe that the property was subject to forfeiture . . . ."<sup>57</sup> This defense has two elements. First, for a conduct element, the third party must be a purchaser for value. Second, for a mens rea element, the third-party claimant must be, at time of purchase, "reasonabl[y] without cause to believe that the property was subject to forfeiture."<sup>58</sup>

#### B. TWO DEFENSES APPLIED TO THE TWO CATEGORIES OF FORFEITABLE PROPERTY

The two third-party defenses work differently when applied to the two general categories of forfeitable property. For the superior interest defense, if the government is forfeiting the property based on the theory that it was clean property but was used to facilitate the crime, the third party will be claiming that, at the time defendant used the property in committing a crime, the third party had an interest in it that was vested or superior to the defendant's interest. This comes up frequently in the cases. An example is where a defendant husband is convicted of a drug

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<sup>56</sup> 21 U.S.C.A. § 853(n)(6)(A) (Westlaw 2012).

<sup>57</sup> 21 U.S.C.A. § 853(n)(6)(B) (Westlaw 2012).

<sup>58</sup> *Id.*

crime involving his jointly owned house. In such a circumstance, the co-tenant / wife's half interest is not forfeited.

On the other hand, when the superior interest defense is applied to property being forfeited on the theory that it is proceeds of the crime, there is some confusion. By definition, proceeds do not exist until they are generated by the defendant committing a crime. Under the relation back doctrine, title to the proceeds vests in the government at the time of the crime. In theory then, the defendant never has any title to the proceeds; title is in the government from birth of the proceeds. Thus, the answer to whether the third-party claimant's title is superior to the defendant's at the time of the crime would seem to be yes, since the defendant has no interest in the proceeds, but whether the third party's interest is superior to that of the government is a question not clearly addressed by most courts. The courts that have addressed the issue have held either that a third party cannot acquire a superior interest, or that any interest acquired is not superior to that of the government.<sup>59</sup> This treatment by the courts logically follows from the nature of the superior interest defense as a question of timing. Nevertheless, the confusion in this area is merited because rare situations where this logic does not work may arise.<sup>60</sup>

Now consider the second third-party defense, the bona fide purchaser defense, when applied to the different types of forfeitable property. The elements of the defense (purchase for value and mens rea) are the same for both proceeds and facilitating property. Nevertheless, because proceeds are normally in the form of currency, whereas facilitating property is usually some form of personal property,<sup>61</sup> the structure of the transactions will be different. As a result, the nature of the elements a third-party claimant must establish will take on a different

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<sup>59</sup> *United States v. Martinez*, 228 F.3d 587, 590 (5th Cir. 2000); *United States v. Hooper*, 229 F.3d 818, 821-22 (9th Cir. 2000); *United States v. Kennedy*, 201 F.3d 1324, 1331 (11th Cir. 2000).

<sup>60</sup> For example, if a husband and wife own a house as co-tenants and a third party has a lien on the house, if the husband sells the lien-holder drugs in exchange for a reduction of the principal of the value of the lien, the equity in the house gained by the couple from this transaction would be proceeds. In this situation, the equity created by the crime would be subject to forfeiture at the time it was generated, but the wife would still have a superior interest in the house itself that would not be subject to forfeiture. The question would then be what relation the wife's title in the house would have to the government's title in the forfeitable portion of the couple's equity in the house.

<sup>61</sup> While this is not always the case, because the property is used to commit the crime or involved in some way, most of the time it is some form of non-monetary real or personal property, such as a car used to traffic drugs, a computer used to download child pornography, etc. Proceeds, on the other hand, are the gross receipts of the crime, which is most likely in monetary form, not real or personal property.

tone depending on whether the forfeitable property is proceeds or used or involved property.

Facilitating property can, by its very nature, lead to a reasonable suspicion that it is subject to forfeiture. While this may not be true of a house or computer, some property by its mere possession or condition should raise some apprehension on the part of a third-party buyer. For example, a car that has hidden compartments would lead a reasonable person to believe that it was used to hide and transport something illegal. Additionally, the defendant is likely to be the seller in the transaction. Unless the third-party claimant is an institution with a lien against the property or a pawn shop, the defendant will usually be engaging in a transaction with an individual in a non-traditional commercial context. Therefore, the third-party claimant will likely have more personal interaction with the defendant than in other arm's length commercial transactions and can analyze the circumstances of the one-on-one transaction more carefully. This allows a court to more easily infer that the claimant had reasonable cause to believe that the property involved was forfeitable. Also, as the defendant will tend to be the seller, the substance of the transaction may be questionable. A defendant looking to get rid of the property linked to the crime may sell the property for a price well under its obvious value. This would call into question the value given by the third party and, if clearly inadequate consideration, the transaction may not be considered a bona fide purchase by the court.<sup>62</sup>

With regard to proceeds, the defendant is more likely to be a buyer in a traditional commercial setting. The structure of the transaction and position of the parties makes it less likely that a third party will be imputed with reasonable cause to believe that the money involved in the transaction would be subject to forfeiture. Unless the third-party claimant has some personal relationship with the defendant that would give the claimant reason to believe that the defendant was involved in some illegal activity, it is more likely that the claimant can establish the requisite mens rea. Nevertheless, it is possible that a court would consider some red-flag events in a transaction enough to impute reasonable cause to believe to a third-party claimant in an arm's length transaction. For example, a large purchase, such as an expensive car or

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<sup>62</sup> Again, Uniform Commercial Code section 2-403(2) provides an analogy, under which greater protections are accorded to buyers who purchase from merchants in the business of selling goods of the kind, provided that the sale was "in the ordinary course of business." U.C.C. § 2-403(2) (Westlaw 2012).



house, fully paid for in cash could raise a red flag.<sup>63</sup> Additionally, because the defendant is more prone to be the buyer in the transaction, the issue of adequate consideration is not likely to be an issue, meaning that the court will tend not to question the transaction's substance.

#### CONCLUSION: WHO GETS WHAT IN CRIMINAL FORFEITURE, AND THE CONFLICT WITH BANKRUPTCY LAW

The law regarding forfeiture in relation to third-party claimants varies depending on the type of property the government is seeking. When the government forfeits proceeds, third-party claimants have good title against the government if they establish the two elements of the bona fide purchaser defense: they gave value and reasonably lacked cause to believe the property was subject to forfeiture. When the government forfeits property based on a theory that it facilitated the crime, third-party claimants have good title against the government if (1) they establish the two elements of the bona fide purchaser defense, or (2) they can show that their interest in the property was superior to the defendant's interest at the time the property was used in committing a crime.

Unlike bankruptcy law, with extensive procedures and statutes covering how much and in what order claimants collect,<sup>64</sup> the criminal law on sorting out the property interests among third-party claimants has received little attention. Although it is clear that the government's claim of forfeiture takes priority over those of victims and creditors when no defense to forfeiture is available,<sup>65</sup> the extent to which the government can compromise claims and the courts' ability to pressure the government to come to an agreement with the other claiming parties has not been addressed. There is also a lack of guidance when there are multiple third-party claimants with interests in the same property. Most forfeiture cases focus on the government's interest in relation to the defendant in the guilt and forfeiture phases of the proceedings. Although there has been an increase in court opinions deriving from ancillary proceedings between the government and third parties, the interaction between the multiple bodies of law that can be at play has caused

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<sup>63</sup> *Cf.* *United States v. Corchado-Peralta*, 318 F.3d 255, 258-60 (1st Cir. 2003) (discussing, in the context of money laundering, circumstances that could raise suspicion that the transaction was designed to conceal the proceeds of criminal activity).

<sup>64</sup> *See* 11 U.S.C.A. §§ 501-11 (Westlaw 2012) (statutes governing the relationship of claims and creditors with the bankruptcy estate); 11 U.S.C.A. §§ 726, 943, 1129, 1225, 1325 (Westlaw 2012) (establishing basic distribution schemes for the various types of domestic bankruptcy cases).

<sup>65</sup> *United States v. Frykholm*, 362 F.3d 413, 415 (7th Cir. 2004).

confusion for the courts and third-party claimants trying to recover stolen or owed funds.<sup>66</sup> The forfeiture process does allow recourse for victims in limited situations, as discussed above. Nevertheless, in cases with dozens of victims and creditors, especially when there is an accompanying bankruptcy action, the only way to ensure that these parties receive some restitution rather than see funds forfeited to the government is by agreement between the third parties and the government.

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<sup>66</sup> See, for example, *United States v. Frykholm*, where the court opines that the government could have filed an involuntary bankruptcy action against the defendant to solve the problems created by the competing claims. *Id.* at 417. In a Ponzi scheme such as *Frykholm*, however, there are likely to be dozens of creditors. No single creditor, including the government, can initiate an involuntary bankruptcy where there are more than twelve creditors. See 11 U.S.C.A. § 303(b)(2) (Westlaw 2012). Nevertheless, the government may have the ability to appoint a receiver, who has the power to initiate a bankruptcy case on the defendant debtor's behalf.