

# When Does the Government Have a Claim to Forfeit Untainted Assets?

By Evan T. Barr

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It's a question that almost every veteran white-collar defense lawyer has been asked at some point by the spouse of a client facing conviction: "When this is over, if the government wins and he/she goes off to prison, what if anything will be left for me and our children?"

Most clients and their loved ones intuitively grasp that the government is likely to take away any ill-gotten gains resulting from the crime. But few appreciate that even indisputably legitimate assets are at risk.

When the government seeks to forfeit the proceeds of illegal activity, under the relation back doctrine, its claim to the tainted property arises from the moment at which the alleged offense giving rise to forfeiture began. The doctrine posits, in effect, that a defendant cannot legally possess that which he was never entitled to have in the first place.

In many cases, by the time an indictment is filed, the criminal proceeds have long since been dissipated. Under those circumstances, the government may seize and forfeit so-called substitute assets. These are otherwise clean properties belonging to the defendant that may well have been acquired long before any criminal scheme. Not surprisingly, there are often other individuals, such as spouses or children, who have a valid and pre-existing ownership interest in such properties.

The circuits are split on the issue of whether the government also may invoke the relation back doctrine regarding substitute assets, or whether a claim to that kind of property only vests later, such as upon the filing of criminal charges. The resolution of that issue, which varies depending on the jurisdiction involved, dramatically impacts the rights of innocent third parties.

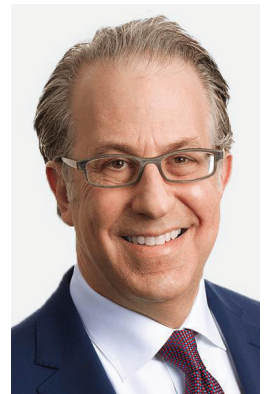
## The Nature of Substitute Assets

Federal law requires forfeiture of "any property constituting, or derived from, any proceeds obtained directly or indirectly, as the result of [a] violation" of certain predicate criminal statutes. See Title 21, United States Code, Section 853(a).

In most white-collar cases, where the amount of fraud or theft dictates the corresponding forfeiture, prosecutors initially will seek to identify and forfeit accounts containing tainted assets, and high-value items purchased with dirty dollars. They will also typically seek at sentencing to have the court impose an open-ended money judgment against the defendant in the amount obtained by the scheme.

If any directly forfeitable asset, as defined under section 853(a), as a result of an act or omission by the defendant has been (1) transferred to a third party; (2) placed beyond the court's jurisdiction; (3) substantially diminished in value; (4) commingled with other property or (5) can no longer be readily located, the court is required to forfeit "*any other property of the defendant*" up to the value of the directly forfeitable assets. See Title 21, United States Code, Section 853(p) (1), (2) (emphasis added). These are substitute assets.

In practice, the government, having failed to locate all crime proceeds, seeks an order establishing that the elements of subsection (p) have been met, and identifying certain specific substitute assets belonging to the defendant to be added to the final order of forfeiture. Typically,



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the government will focus on high-value assets such as a residence, retirement account or ongoing business. Many of these significant substitute assets, not surprisingly, have more than one legal owner of record.

### The Rights of Third Parties in Ancillary Proceedings

Because criminal forfeiture impacts third parties with a potential ownership interest in the forfeitable property, the law provides a system for adjudicating such claims known as ancillary proceedings.

Specifically, following a conviction, and upon entry of a preliminary order which divests the defendant of any rights to the assets, the government must provide direct written notice to any person known to have asserted an interest in any of the property identified in the order. A third-party then has 30 days within which to file a claim challenging the forfeiture.

A third-party petitioner first must establish a legal interest in the property. Then, to obtain relief from forfeiture, it must establish that (A) the petitioner has a legal, right, title or interest in the property which renders the forfeiture invalid in whole or part because that right was vested in the petitioner rather than the defendant *or was superior to any right, title and interest of the defendant at the time of the commission of the acts giving rise to the forfeiture*; or (B) that the petitioner is a bona fide purchaser for value of a right, title, or interest in the property and was without cause to believe the property was subject to forfeiture. See Title 21, United States Code, Section 853(n)(6) (emphasis added).

The statute codifies the relation back doctrine by asserting that title to subsection (a) property (namely, crime proceeds) vests in the United States upon the commission of the crimes leading to forfeiture. As for such directly forfeitable property, the relation back doctrine thus necessarily blocks a third party from ever successfully asserting a claim based on superior title to proceeds.

Since the government will always be first in line to claim illicit funds, the only option left to an aggrieved third party under those circumstances is to show it was a bona fide purchaser for value without reason to believe the asset could be forfeited—a difficult legal and factual standard to satisfy for most petitioners.

### The Circuit Split on Substitute Assets

The circuits are split, however, on the issue of whether the relation back doctrine applies with equal force to *substitute assets* which, by definition, are *not* the proceeds of criminal activity. This division of authority becomes important when a third party in an ancillary proceeding with a valid legal

interest in a substitute asset is seeking to assert a claim based on superior title.

In *United States v. McHan*, 345 F.3d 262 (4th Cir. 2003), Charles McHan was convicted on drug trafficking charges and order to forfeit \$1.5 million in proceeds



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obtained as a result of his activity between 1984 and 1986. When McHan could not account for the whereabouts of these proceeds, the court entered an order forfeiting substitute property in the form of real estate and other items.

McHan's wife and sons filed third-party petitions asserting that the substitute property belonged to them pursuant to a transfer agreement executed in 1988 (well before the charges). The district court rejected the claims, based on the relation back doctrine, and ordered forfeiture in favor of the government.

On appeal, the U.S. Court of Appeals for the Fourth Circuit affirmed. The court held that nothing in that part of the law incorporating the relation back doctrine precluded its application to both tainted property and substitute assets. Indeed, the court pointed to the fact that substitute assets would be credited equally with tainted assets towards satisfying the total obligation as further proof that the two were viewed as interchangeable.

The court also held that the need to interpret the law as broadly as possible to effectuate its “remedial purpose” overrode any doubts as to the construction of the statute.

Finally, the Fourth Circuit noted that innocent transferees could still seek relief as bona fide purchasers for value under subsection 853(n)(2).

A number of district courts within and outside of the Fourth Circuit have followed *McHan's* reasoning. See, e.g., *United States v. Derochemont*, 2011 WL 6319293 (M.D. Fla. Dec. 15, 2011); *United States v. Wittig*, 525 F. Supp. 2d 1281 (D. Kan. 2007).

In *United States v. Erpenbeck*, 682 F.3d 472 (6th Cir. 2012), the defendant, a Cincinnati real estate developer, bilked nearly \$34 million from home buyers and banks between 1999 and 2002. His creditors filed an involuntary bankruptcy petition against him in July 2002. Erpenbeck subsequently pled guilty to fraud charges in April 2003. He was sentenced to 300 months' incarceration and ordered to forfeit the entire amount of the fraud.

Six years later, the FBI learned that, before reporting to prison, Erpenbeck gave a friend \$250,000 in cash and asked him to hide it. The friend buried the money on a golf course in Kentucky. On Oct. 1, 2009, FBI agents unearthed the money, and the government sought to forfeit it as a substitute asset. The bankruptcy trustee asserted a claim to the newly discovered funds, saying the cash belonged to the estate and should be distributed to creditors; the district court rejected the trustee's claim as untimely.

On appeal, the government argued the trustee lacked a valid interest because under the relation back doctrine, title to the cash had retroactively vested in the government as of the time of Erpenbeck's fraud.

The U.S. Court of Appeals for the Sixth Circuit rejected that argument, holding that the relation back clause in section 853 by its terms only extended to those assets described in subsection (a) as criminal proceeds. It expressly disagreed with the Fourth Circuit, finding no ambiguity that would justify a more expansive reading of the law's remedial provisions.

The court further held that as substitute property, the cash did not become subject to forfeiture until such time as the government had failed to find and collect all tainted assets. That could not have happened, the court reasoned, until at least after Erpenbeck's conviction in April 2003, which was already several months after the bankruptcy petition had been lodged. Accordingly, the trustee, having established a legal interest in the funds as of July 2022, was entitled to both notice and an opportunity to assert its title claim to the money in the ancillary proceeding.

The U.S. Court of Appeals for the Second Circuit has held that the relation back doctrine does not apply to substitute assets. See *United States v. Daguerdas*, 892 F.3d 545 (2d Cir. 2018).

District courts within the circuit have come to varying conclusions on when, in the absence of the relation back doctrine, the government's interest in substitute property vests. Compare *United States v. Peterson*, 820 F.Supp. 2d 576 (S.D.N.Y. 2011) (vests upon return of indictment), with *United States v. Kramer*, 2006 WL 3545026 (E.D.N.Y. 2006) (vests at earliest when defendant is convicted), and *United States v. Jennings*, 2007 WL 1834651 (N.D.N.Y. June 25, 2007) (vests upon entry of order granting motion to forfeit substitute assets). See also *United States v. Hallinan*, 2023

U.S. App. LEXIS 18289 (3d Cir. July 19, 2023) (recognizing but without taking position on circuit split, court accepts parties' agreement that government interest in substitute property relates back to time of indictment, not the crime); *United States v. Jarvis*, 499 F.3d 1196 (10<sup>th</sup> Cir. 2007) (removing *lis pendens* lodged against real properties since section 853 is silent as to whether relation back doctrine applies to substitute assets).

### Conclusion and Practice Pointers

Who has the better of the argument? On one hand, the theory behind the relation back doctrine is premised on the notion that a wrongdoer can never get good title to assets that he obtained illegally. But this concept seems irrelevant when it comes to substitute properties which are, by definition, untainted.

On the other hand, as Justice Anthony Kennedy observed in *Luis v. United States*, 136 S.Ct. 1083 (2016), "[m]oney ... is fungible. There is no difference between a defendant who has preserved his or her own assets by spending stolen money and a defendant who has spent his or her own assets and preserved stolen cash instead." Absent the relation back principle, a defendant might be incentivized, perversely, to dissipate illicit funds as rapidly and completely as possible.

Unless and until the U.S. Supreme Court takes up this issue, the answer will be unresolved.

Meanwhile, given the uncertainties, defense counsel in the Second Circuit and elsewhere should proceed with caution when attempting to advise clients (and inevitably their family members) as to whether they can realistically expect even clean assets of any kind to remain available in the aftermath of a conviction.

The best strategy is to forensically account for those assets that are not alleged to be connected to the charged activity and keep them segregated from those which are likely to be linked to the offense conduct. That way, when the time comes, at least in some jurisdictions, third parties may be better positioned to seek a carve-out from the otherwise harsh impact of a sweeping final order of forfeiture imposed against the defendant.

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