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A Timely Update On Recovering Legal Fees And Costs Through Criminal Restitution



BY LEWIS J. LIMAN, BREON S. PEACE, AND BENJAMIN J.A. SAUTER

In January 2009, with the deepening financial crisis heralding a new wave of corporate investigations and prosecutions, we wrote an article for the *White Collar Crime Report*[1] discussing the importance of the U.S. Court of Appeals for the Second Circuit's decision in *United States v. Amato*.[2] The Second Circuit held that a corporation was entitled to have a former executive make mandatory restitution of forensic accounting and attorneys' fees the corporation incurred while investigating and assisting in the criminal prosecution of the executive.

Amato was a landmark decision because it established that district courts have no discretion under the Mandatory Victims Restitution Act of 1996 (MVRA)[3] to deny restitution of such fees, thus creating a significant new liability for white collar defendants and opening a new avenue for corporations to recover costs that in some cases may be superior to insurance or civil remedies.

Although *Amato* firmly established a corporation's right to restitution of necessary investigative expenses related to its employee's criminal misconduct, it left open a number of important questions regarding the precise contours of a corporation's right to recover its investigative expenses—questions district courts were sure to encounter in the course of escalating investigations arising out of the financial crisis.

This article provides an update on the current state of the law in the Second Circuit. We also discuss two recent decisions, *United States v. Gupta*[4] and *United States v. Cuti*, which may provide the Second Circuit with another opportunity to clarify the scope and application of the MVRA with respect to corporate victims.

[1] 04 WCR 47 (1/16/09).
[2] 540 F.3d 153 (2d Cir. 2008) (03 WCR 629).

Lewis J. Liman, a former assistant U.S. attorney, is a partner at Cleary Gottlieb Steen & Hamilton LLP in New York whose practice focuses on complex commercial litigation, including securities class action lawsuits and white collar defense matters. Breon S. Peace, a former assistant U.S. attorney, is a partner at Cleary Gottlieb in New York whose practice focuses on white collar defense, regulatory enforcement matters, and complex civil litigation. Benjamin J.A. Sauter is an associate at Cleary Gottlieb in New York whose practice focuses on securities and commercial litigation.

[3] 18 U.S.C. § 3663A.
[4] 08 WCR 160 (3/8/13).

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United States v. Amato

In *Amato*, a defendant was convicted of criminal fraud and conspiracy for participating in a scheme to falsely inflate his group's financial performance to receive higher compensation. The U.S. District Court for the Southern District of New York ordered the executive to pay mandatory restitution to his former employer of nearly $13 million, including $3 million in forensic accounting and attorneys' fees incurred by the corporation during the investigation and prosecution of the case. The issue on appeal was whether the court had authority to order such restitution under the MVRA, which provides that a court ''shall order'' a defendant convicted of a property crime, including any crime committed by fraud or deceit, to pay restitution to any identifiable ''victim'' that has been ''directly and proximately harmed'' and has suffered ''pecuniary loss.''[5] Pecuniary losses are defined to include not only the diminished value of property but also ''lost income and necessary . . . other expenses incurred during participation in the investigation or prosecution of the offense or attendance at proceedings related to the offense.''[6] The Second Circuit held that forensic accounting and attorneys' fees incurred by the corporation while investigating the defendant were ''other expenses'' covered by the plain language of the MVRA.[7]

Defining the Victim—Proving Causation

Under the MVRA, a ''victim'' is any person ''*directly and proximately* harmed as a result of the commission of an offense.''[8] The Second Circuit has recognized that this ''direct and proximate'' causation requirement reflects ''Congress's interest in maintaining efficiency in the sentencing process'' and its understanding that ''the less direct an injury is, the more difficult it becomes to ascertain the amount of a plaintiff's damages attributable to the violation.''[9] Thus, restitution is not required if ''determining complex issues of fact related to the cause or amount of the victim's losses would complicate or prolong the sentencing process to a degree that the need to provide restitution to any victim is outweighed by the burden on the sentencing process.''[10] Several Second Circuit decisions have attempted to define an appropriate causation standard that does not unfairly exclude worthy victims but also does not overly burden the sentencing process.

In *United States v. Marino*, the Second Circuit drew from causation principles applicable to analogous civil law remedies to determine whether investors in a hedge fund were entitled to restitution of an estimated $60 million in losses caused by a defendant convicted of misprision of a fraudulent accounting scheme.[11] The defendant in the case argued that he was not directly engaged in the operational activity of the fraud and, therefore, the investors' losses were not directly and proximately caused by his conduct.

The Second Circuit rejected the argument on the basis of principles of loss causation applicable to private securities actions. The court first held that the victims were not required to prove individual reliance to establish ''but for'' causation; rather, the court ''presume[d] that had appellant disclosed the crime in a timely fashion, no investor would have invested fresh cash in the Ponzi.''[12] Second, the court found that the defendant's concealment of the accounting scheme was ''clearly'' a proximate cause of the investors' losses under the ''zone of risk'' approach to loss causation and in any event was of ''critical'' importance to the overall fraud.[13] Without the fraudulent accounting scheme, the fund would have been unable to attract new investors, ''the *sine qua non* of any successful Ponzi scheme.''[14] Importantly, the court also limited dicta in *United States v. Reifler*, which suggested that even innocent investors might have difficulty satisfying the MVRA's causation requirement.[15] The court clarified that all its dicta meant ''is that where an analogous private right of action exists, case law under it may inform, but perhaps not control, causation determinations in restitution proceedings.''[16]

Marino is significant because it largely did away with complex causation determinations in ordering restitution in financial fraud cases. Under *Marino*, it appears unnecessary to show individual reliance as long as a misstatement or omission would be material to a reasonable investor and as long as the risk that caused the loss is within the ''zone of risk'' concealed by the misrepresentation or omission.

In the context of corporate victims, *Marino* might be read to suggest that a corporation will almost always—perhaps presumptively—be a victim of its employees' fraudulent conduct because the risk of substantial investigative expenses is clearly within the zone of risk of such conduct. Such an interpretation is consistent with *United States v. Skowron*, in which the U.S. District Court for the Southern District of New York rejected a defendant's argument that a corporation must establish that it is a ''victim'' independent of any legal costs it suffers.[17]

Defining the Victim—Shifting Burdens

Under the MVRA, the government has the burden to establish the loss sustained by a victim by a preponderance of the evidence.[18] However, the court has discretion to shift the burden with respect to ''such other matters as the court deems appropriate.''[19] In *United States v. Archer*, the Second Circuit further cut away at the MVRA's causation requirement by shifting the burden of production to the defendant to show that any particu-

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[5] 18 U.S.C. § 3663A(a)(1)-(2), (b)(1), (c)(1)(A)-(B).
[6] 18 U.S.C. § 3663A(b)(4).
[7] *Amato*, 540 F.3d at 159-61.
[8] 18 U.S.C. § 3663A(a)(2) (emphasis added).
[9] *United States v. Reifler*, 446 F.3d 65, 135 (2d Cir. 2006) (internal citation omitted).
[10] Section 3663A(c)(3)(B).
[11] 654 F.3d 310, 321 (2d Cir. 2011) (06 WCR 754).
[12] Id. at 322.
[13] Id. at 323 and n.8 (citing *Lentell v. Merrill Lynch & Co.*, 396 F.3d 161, 173 (2d Cir. 2005) (''A misstatement or omission is the 'proximate cause' of an investment loss if the risk that caused the loss was within the zone of risk *concealed* by the misrepresentations and omissions alleged by a disappointed investor.'')).
[14] Id. at 324.
[15] *Reifler*, 446 F.3d at 137.
[16] *Marino*, 654 F.3d at 321.
[17] *United States v. Skowron*, 839 F. Supp. 2d 740, 745, 748 (S.D.N.Y. 2012) (07 WCR 291).
[18] 18 U.S.C. § 3664(e).
[19] Id.

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lar victim is ineligible for restitution because he or she was complicit in the fraud.[20]

In *Archer*, an attorney was convicted of filing false visa applications, and his clients sought restitution of the fees they had paid. The issue was whether the clients were complicit in the scheme. If the clients thought they were purchasing the attorney's honest services, they might be victims. But if they knew they were purchasing false visa applications, then they would have ''suffered no loss that was proximately caused'' by the lawyer's visa fraud.[21]

As a preliminary matter, the court recognized that in some cases—as in *Marino*—''it will be clear that no reasonable person would have given the defendant her money if she had known of his plans.''[22] In such cases, ''a generalized description of the fraudulent scheme is enough to support restitution.''[23] On the other hand, ''where it is plausible that some individuals would have paid the defendant even if they had been informed of his fraudulent plan, then the government must proffer some individualized evidence to meet its burden of showing that each alleged 'victim' was actually a victim.''[24] In *Archer*, the government met its initial burden simply by showing that the defendant's former clients had paid fees for visa services. The burden of production then shifted to the defendant to raise an issue of fact as to whether a particular client knew of the fraud. Finally, to the extent the defendant is able to carry its burden of production, the burden of persuasion then shifts back to the government to prove that the victim would not have participated in the fraud had he known about it.

Archer thus suggests that even when a corporation is plausibly complicit in a fraudulent scheme, the burden of establishing that complicity rests largely on the defendant, at least as an initial matter. Read together, *Marino* and *Archer* might establish a presumption that a corporation that is required to pay investigative expenses in connection with the criminal prosecution of an employee is a ''victim'' entitled to restitution and that a defendant seeking to avoid such restitution has the initial burden to show that the corporation was complicit.

Defining the Victim—Offense of Conviction

In conspiracy cases, victims include those directly harmed by the defendant's ''conduct'' in the course of the conspiracy.[25] A recurring issue has been whether this provision requires district courts to compare a purported victim's harm with the elements of the offense of conviction or instead to the manner in which the offense was committed. As with the Second Circuit's causation jurisprudence, the law in this area has been evolving in favor of the victim.

In *In re Local #46 Metallic Lathers Union*, the Second Circuit held that restitution could not be ordered for losses caused by conduct that was not an element of the specific offense of conviction.[26] More recent cases, however, have significantly expanded this rule. For example, in *United States v. Paul*, the Second Circuit upheld a restitution order in favor of banks that suffered losses as a result of conduct that was ''a significant part of the greater fraud'' but that was not necessarily an element of the offense of conviction.[27] In *Paul*, the defendant inflated the price of stock he owned by trading between multiple accounts he controlled. In the process, he was able to obtain several margin loans from banks. When the scheme eventually collapsed, the defendant was unable to repay the loans. After being convicted of securities fraud, the defendant argued that he should not be required to pay restitution to the banks because their losses may have been caused by bank fraud but were not caused by the securities fraud of which he was convicted. The court rejected the argument, finding that the banks would not have made the loans had they known that their collateral was falsely inflated stock. In *United States v. Desnoyers*, the Second Circuit confirmed that ''*Paul*'s broad view of restitution controls.''[28]

Archer provides an even clearer example of the Second Circuit's current view that a victim's loss need not be directly tied to the elements of the offense of conviction. In *Archer*, even though the conviction for filing fraudulent visa applications did not necessarily involve any payments by clients (after all, the applications could have been filed for free), the court nonetheless found that restitution was warranted because the clients' payments were the ''mechanism'' through which the lawyer profited and an ''integral part'' of the illegal scheme.[29] Notably, the court reasoned that its decisions in *Archer* and *Paul*, and by implication not its decision in *In re Local #46*, ''echoe[d]'' the language of the MVRA. [30]

The Southern District of New York applied the Second Circuit's ''victim'' cases in *United States v. Skowron*.[31] In *Skowron*, a former managing director of hedge funds owned by Morgan Stanley engaged in insider trading to avert losses and then attempted to cover up the scheme in response to internal and Securities and Exchange Commission investigations. He eventually pleaded guilty to a single count of conspiring to commit securities fraud and obstruct justice. In response to Morgan Stanley's request for restitution, the defendant claimed Morgan Stanley was not a ''victim'' because it suffered harm only through ''intervening events,'' such as the SEC's investigation and investors' loss of faith.

The district court rejected the argument. Citing *Archer*, the court found that Morgan Stanley's harm was sufficiently tied to the offense of conviction because Morgan Stanley was the ''mechanism'' through which the defendant committed his crimes, and deceiving Morgan Stanley was an ''integral'' component of the offense of conviction.[32]

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[20] *United States v. Archer*, 671 F.3d 149, 171-72 (2d Cir. 2011).

[21] Notably, the court in *Archer* stated that the rule prohibiting co-conspirators from receiving restitution ''is not about denying benefits to those with unclean hands'' but rather is a rule of causation. *Archer*, 671 F.3d at 171-72.

[22] Id. at 172.

[23] Id. (citing *Marino*).

[24] Id.

[25] Section 3663A(a)(2).

[26] 568 F.3d 81, 85 (2d Cir. 2009).

[27] 634 F.3d 668, 677 (2d Cir. 2011).

[28] *United States v. Desnoyers*, No. 11-5194-cr, 2013 BL 40014 at *9 (2d Cir. 2013).

[29] *Archer*, 671 F.3d at 172.

[30] Id. at 171.

[31] *Skowron*, 839 F. Supp. 2d at 744.

[32] Id. at 745.

The Effect of Civil Settlements

Another issue left open by *Amato* was whether courts might rely on corporate settlements or deferred prosecution agreements to deny a corporation restitution on the ground that it was a co-conspirator. This theory does not yet appear to have been tested in the Second Circuit, but in *Skowron* the district court addressed a related issue: whether a corporation was entitled to restitution of the amount it paid to settle civil claims brought by the SEC. The court ultimately denied restitution of Morgan Stanley's $30 million SEC settlement—but not because Morgan Stanley was a co-conspirator. Rather, on the facts of the case, the court held that the SEC settlement simply represented the disgorgement of the losses the hedge funds avoided as a result of the defendant's insider trading.[33] *Skowron* thus left open the possibility that a corporation may be entitled to restitution of amounts paid to settle civil lawsuits if it can show that it has a legitimate claim to those funds (for example, when a corporation agrees to pay damages but does not admit wrongdoing).

'Necessary' Expenses Incurred 'During Participation in' Government's Investigation

Questions often arise with respect to when investigative expenses are incurred ''during participation in'' the government's criminal investigation. Some cases are fairly easy. For example, in *United States v. Battista*, the Second Circuit found that attorneys' fees incurred by the National Basketball Association in connection with its public response to a corrupt referee's guilty plea and with rehabilitating the league's damaged reputation were not compensable.[34] Other cases, however, are more difficult. In *Skowron*, the Southern District of New York granted restitution of attorneys' fees incurred by Morgan Stanley in cooperating with an SEC investigation, reasoning that the ''criminal prosecution of [the defendant] for securities fraud rested on essentially the same conduct as the SEC's civil case'' and that ''any other conclusion would create an artificial and unrealistic distinction between SEC civil investigations and criminal prosecutions of securities fraud.''[35] The court in *Skowron* also granted restitution of the legal fees Morgan Stanley advanced to its employees for their participation in the government's investigation.

These issues—and a number of other issues discussed above—are currently being litigated in two important cases pending in the Southern District of New York: *United States v. Gupta* and *United States v. Cuti*.

United States v. Gupta. Rajat Gupta was convicted in June of three counts of securities fraud and one count of conspiracy for his disclosure of inside information concerning Goldman Sachs to billionaire hedge fund manager Raj Rajaratnam.[36] Following Gupta's sentencing, Goldman Sachs sought criminal restitution of more than $6.9 million in fees paid to Sullivan & Cromwell LLP in connection with the criminal case against Gupta, the parallel SEC case against Gupta, and the related criminal prosecution of Rajaratnam. In support of its request, Goldman Sachs submitted 542 pages of billing records from Sullivan & Cromwell for ''legal services and advice relating to Gupta's conduct.''[37]

The court granted substantially all of the restitution Goldman Sachs sought. First, recognizing that *Amato* had adopted a ''broad view'' of what may constitute ''necessary'' expenses incurred ''during participation in'' the government's investigation, the court granted restitution of fees incurred in connection with the SEC proceedings against Gupta as well as the criminal case against Rajaratnam.[38] Citing *Skowron*, the court reasoned that each of these proceedings involved ''overlapping allegations'' and ''essentially the same conduct'' that resulted in Gupta's criminal conviction.[39]

The court next rejected Gupta's argument that his acquittal of certain counts of insider trading should limit his restitution. Citing Second Circuit precedent, though not *Paul* or *Archer*, the court reasoned that restitution is payable by all co-conspirators ''regardless of the facts underlying counts of conviction in individual prosecutions.''[40]

Lastly, the court rejected Gupta's challenge to the sufficiency of the evidence. The court observed that Goldman Sachs had ''provided a voluminous disclosure of its legal fees'' and that its time entries ''specify the work performed with sufficient particularity to assess what was done, how it was done, and why it was done.''[41] Apparently shifting the burden of production to Gupta, the court emphasized that Gupta had not raised a ''colorable challenge to the veracity of the records.''[42]

It is noteworthy that Gupta's objections to the restitution order relied heavily on the D.C. Circuit's decision in *United States v. Papagno*, which expressly rejected the Second Circuit's analysis in *Amato* and held that expenses incurred during an organization's preliminary internal investigation into an employee's theft were incurred for its ''own purposes'' and not ''during participation in'' the government's subsequent criminal investigation and prosecution.[43] The D.C. Circuit reasoned that the term ''during participation in'' necessarily excludes investigative activities that precede a criminal investigation.[44]

In light of this fundamental difference of opinion over the scope of the MVRA, it is possible that the U.S. Supreme Court will be asked to provide guidance in the near future. In any event, *Gupta* and *Papagno* make clear that there is still substantial room for litigation about when expenses are ''necessary'' and incurred ''during participation in'' the government's criminal in-

[33] Id. at 746-47.
[34] 575 F.3d 226, 234 (2d Cir. 2003).
[35] *Skowron*, 839 F. Supp. 2d at 748-49; compare *United States v. Weitzman*, No. 1:09-cr-00989, 2010 WL 3912735, at *1 (S.D.N.Y. Sept. 15, 2010) (denying restitution of fees ''incurred solely in connection with the civil litigation, or after the sentencing hearing in this matter'').
[36] 07 WCR 500 (6/29/12).
[37] *United States v. Gupta*, No. 1:11-cr-00907, 2013 BL 60326, at *1 (S.D.N.Y. Feb. 25, 2013).
[38] Id.
[39] Id. at *4.
[40] Id.
[41] Id. at *4.
[42] Id.
[43] *United States v. Papagno*, 639 F.3d 1093, 1098-99 (D.C. Cir. 2011) (06 WCR 372).
[44] Id. at 1100.

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vestigation. At the very least, *Gupta* should provide the Second Circuit with an opportunity to clarify whether expenses incurred while participating in parallel SEC investigations and separate criminal prosecutions are properly included in restitution orders.[45]

United States v. Cuti. *United States v. Cuti* is another ongoing case exploring some of the same issues raised in *Gupta*.[46] Anthony Cuti, the former chairman and chief executive officer of Duane Reade Inc., was indicted and convicted in 2010 on five counts of conspiracy, securities fraud, and making false statements to the SEC. During his tenure at Duane Reade, Cuti orchestrated a two-part accounting scheme to artificially inflate Duane Reades's income. First, he sold certain Duane Reade real estate interests to third-party buyers for inflated prices, and in exchange he entered into lucrative side agreements with those buyers. Second, Cuti induced Duane Reade's suppliers to issue false credits to Duane Reade, again entering into side agreements with the vendors to compensate them for the false credits. The result of both of these schemes was to enable Duane Reade to report higher income than it earned.

In 2004, Duane Reade was acquired by Oak Hill through two wholly owned intermediary corporations. Cuti was terminated in 2005, and an employment dispute arose. Paul, Weiss, Rifkind, Wharton & Garrison LLP was retained to represent Duane Reade and the intermediary corporations in arbitration. Some of its fees were paid by Duane Reade, while others were paid by Oak Hill. During the course of the arbitration, Cuti's fraudulent schemes came to light, and Duane Reade retained Cooley LLP and a forensic accounting firm to conduct internal investigations. The results of Cooley's investigations were eventually incorporated into Duane Reade's arbitration defenses and counterclaims. Subsequently, Duane Reade informed the SEC and criminal prosecutors of Cuti's conduct and cooperated with those investigations. Duane Reade also retained independent counsel for several of its employees who participated in government interviews and testified at trial.

At sentencing, Duane Reade and Oak Hill sought restitution from Cuti totaling more than $50 million. In a report and recommendation, Magistrate Judge Henry Pitman made several notable findings. First, he found that as long as Duane Reade's investigation costs related to Cuti's conduct and not ''matters relevant only to the arbitration or the SEC civil action,'' they would be compensable.[47] He noted that ''absolute precision'' was not required and that Cuti should ''bear[ ] the burden of that imprecision.''[48]

Second, relying on *Skowron*, the magistrate judge found that Duane Reade was entitled to recover fees associated with providing independent counsel to its current and former employees. He reasoned that it was ''highly probable'' that without independent counsel the employees would have refused to cooperate with the government's investigation.[49]

Third, the magistrate judge found that Oak Hill was not a victim because it had structured its acquisition such that it was not a ''successor'' of Duane Reade and did not assume any of Duane Reade's debts. The magistrate judge reasoned that because Oak Hill never had ''legal responsibility'' for Duane Reade's legal bills, it was not ''directly and proximately harmed'' by Cuti's conduct.[50]

The report and recommendation is currently being opposed by both Cuti and Oak Hill. Regardless of what Judge Deborah Batts decides, the decision is a reminder that although the law in the Second Circuit has become favorable for victims, investigative expenses still must be proximately caused by the defendant's conduct and ''necessary'' to the government's prosecution. When a corporation voluntarily undertakes to pay investigative expenses, it runs the risk that its expenses will not meet this standard.

Maximizing Odds of Recovering Expenses

Restitution under the MVRA remains an important issue for all parties involved in white collar criminal investigations. Astute corporations now have several examples of how to conduct an investigation in a way that maximizes their opportunity to recover restitution of expenses extending well beyond the confines of the government's criminal investigation.

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[45] Gupta March 13 appealed the restitution order (08 WCR 231).

[46] *United States v. Cuti*, No. 08-cr-972, 2012 BL 336223 (S.D.N.Y. Dec. 21, 2012).

[47] Id. at *16.

[48] Id. at *13.

[49] Id. at *11.

[50] Id. at *15.