

Ex-Duane Reade CEO Case A Model For VWPA Restitution

Law360, New York (October 08, 2014, 11:05 AM ET) --

Few crises are worse for a public corporation than to lose one of its top officers to a federal criminal investigation, particularly one resulting in a conviction. Yet, the loss of such an officer to an investigation is not unheard of, particularly in a change-of-control transaction.

In past decisions, the Second Circuit has provided a silver lining. At least, the corporate employer can recover as restitution the costs of an internal investigation that assisted in an employee's subsequent conviction.[1] In *United States v. Cuti*, [2] the Second Circuit recently established and reiterated guidelines for such restitution. The decision is a reminder for corporations (which can see their costs of investigation covered by their culpable employees) as well as for putative defendants (who will face the risk not only of conviction but of funding the investigation that leads to it). It also sets forth rules that will be important for corporations seeking restitution, or contemplating the pursuit of restitution, to follow.



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The facts of *Cuti* are easily stated and fall within a recognizable pattern. Anthony Cuti was the chief executive officer and board chairman of Duane Reade. In 2005, a private equity firm, Oak Hill, acquired Duane Reade. Cuti's employment was terminated thereafter and he sued.

Duane Reade hired outside counsel to defend against Cuti's employment lawsuit. In the course of defending against that employment-related claim brought by Cuti, outside counsel uncovered what it asserted was evidence that Cuti had perpetrated numerous acts of fraud during his time at Duane Reade. Duane Reade then retained separate counsel and a forensic accounting firm to conduct an internal investigation.

The costs of the investigation were shared by Oak Hill and Duane Reade under a cost-sharing agreement. Eventually, outside investigation counsel presented its findings to the United States Attorneys' Office and a prosecution soon followed. Ultimately, Cuti was convicted of conspiracy, securities fraud and making false statements in U.S. Securities and Exchange Commission filings.

At sentencing, Duane Reade sought to recover from Cuti both the costs of counsel who handled the employment-related claim and outside investigation counsel under the Victim and Witness Protection

Act of 1982 (VWPA), claiming that both investigations were necessary expenses, since the misconduct was initially identified in the course of defending the employment claim.

After initially denying the restitution request, the district court ultimately agreed with Duane Reade and held that restitution was available under the VWPA for the fees paid to both sets of lawyers. It awarded over \$7 million in restitution to Oak Hill and Duane Reade for expenses incurred in connection with the investigation of Cuti's fraudulent conduct. The restitution included expenses related to the internal investigation, the employment dispute, as well as the payment of legal fees to retain counsel for current and former employees who were interviewed by the USAO.[3]

Cuti appealed, arguing that Oak Hill was not a victim of the offense and that costs incurred in connection with the reimbursement of legal fees for employee-witnesses were not recoverable, and that the costs expended on counsel who handled the employment-related claim did not qualify as "necessary ... expenses related to participation in the investigation or prosecution ... related to the offense" and therefore, were improperly included in the restitution award by the district court.

On appeal, the Second Circuit affirmed the restitution award in part and vacated and remanded the restitution award in part. The court held that because Oak Hill paid expenses on Duane Reade's behalf, it was entitled to restitution as a nonvictim and that the legal fees for Duane Reade's employees were properly included in the restitution order. Those rulings appear to be unexceptional.

The Second Circuit, however, vacated the award of restitution for the fees of the counsel who handled the employment-related litigation. Previously, in *United States v. Maynard*, the court held that under the Mandatory Victims Restitution Act, "necessary ... expenses related to participation in [an] investigation" include "expenses the victim was required to incur to advance the investigation or prosecution of the offense." [4] In that case, the Second Circuit vacated the award of restitution for investigative expenses that were not necessary.

Recognizing that the statutory language regarding the scope of restitution is "nearly identical" in the MVRA and VWPA, the Cuti court held that the definition of "necessary ... expenses" under the MVRA also applied to cases under the VWPA. Using the language of discretion, the VWPA provides with respect to restitution that the court may order the defendant to "reimburse the victim for ... necessary ... expenses related to participation in the investigation or prosecution of the offense." [5]

The court thus held that the government had not established that the costs of counsel who handled the employment-related claim were subject to restitution because it had not established that the purpose of their internal investigation was to "uncover or investigate fraud 'when faced with evidence, indicia, or a grounded suspicion of internal misconduct.'" The court ruled that if the investigation was commenced, and its corresponding expenses were incurred, for another reason than to aid in a government's investigation, the victim is not entitled to restitution, because "that particular investigation cannot be 'a means calculated to achieve the protection' of a corporation's 'ongoing operations and reputation'" as required in *Maynard*.

The court additionally found that because two sets of law firms both conducted parallel and independent investigations into Cuti's misconduct, it could not find that the costs incurred by Duane Reade for legal services from counsel who handled the employment-related claim were "necessary" to advance the government's claims under the VWPA. The court concluded that "to be 'necessary' for restitution, it is not enough that the expenses incurred 'helped the investigation.'"

The decision has several important implications:

- In order to collect restitution for costs incurred in connection with an internal investigation, a corporation must show that the purpose of the investigation was to aid the government in its investigation of the matter.
- Corporations will likely not receive restitution for costs incurred in connection with a civil litigation or arbitration proceeding if the investigation conducted in these proceedings is redundant or duplicative of a similar investigation that is being conducted in conjunction with a government agency.
- If the above requirements are met, the Second Circuit takes a liberal view regarding the scope of what expenses are “necessary” to the advancement of the government’s investigation. Thus, in addition to facing criminal and civil liability, white collar defendants may also be liable for paying millions of dollars in restitution damages to corporations that conducted internal investigations into their wrongdoing.

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[1] See *United States v. Amato*, 540 F.3d 153 (2d Cir. 2008) (holding victim’s costs of an investigation are recoverable as restitution under the Mandatory Victims Restitution Act of 1996 (MVRA)); *United States v. Battista*, 575 F.3d 226 (2d Cir. 2009) (holding victim’s costs of an investigation are likewise recoverable under the Victim and Witness Protection Act of 1982 (VWPA)).

[2] See *United States v. Cuti*, No. 13-2042-cr, 2014 WL 4452976 (2d Cir. Sept. 11, 2014).

[3] See *United States v. Cuti*, No. 08-CR-972 (DAB), 2013 WL 1953741 (S.D.N.Y. May 13, 2013).

[4] *United States v. Maynard*, 743 F.3d 374, 381 (2d Cir. 2014). The MVRA requires restitution when a defendant is convicted of specified offenses, including crimes of violence, offenses against property (including any offense committed by fraud or deceit) and offenses related to theft of medical products, “in which an identifiable victim or victims has suffered a physical injury or pecuniary loss.” See Mandatory Victims Restitution Act, 18 U.S.C. § 3663A (2012). It does not apply to all federal offenses. The Victim and Witness Protection Act of 1982, by contrast, applies to any offense listed under Title 18 or 49 of the U.S. Code, as well as certain offenses under the Controlled Substances Act. See Victim and Witness Protection Act of 1982, Pub. L. No. 97 – 291, 96 Stat. 1248 (1982) (codified as amended in scattered sections of 18 U.S.C., with the restitution provision at 18 U.S.C. § 3663 (2012)).

[5] See 18 U.S.C. § 3663.