

## Second Circuit Permits Companies to Recover Costs of Investigation as Restitution under the VWPA

Few crises are worse for a public corporation than to lose its top officers to a federal criminal investigation, especially one resulting in a conviction. Yet, the loss of such officers to an investigation is not unheard-of, particularly in a change-of-control transaction. In *United States v. Anthony Cuti*, the Second Circuit recently 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.<sup>1</sup> The decision is a reminder both for corporations (which can see their costs of investigation covered by their culpable employees) as well as putative defendants (who will face the risk not only of conviction but of funding their persecutor).

The facts of *Cuti* are easily stated and fall within a recognizable pattern. Anthony Cuti was the Chief Executive Officer ("CEO") and board chairman of Duane Reade. In 2005, a private equity firm, Oak Hill, acquired Duane Reade. Cuti's employment was terminated thereafter. In the course of defending against an employment-related claim brought by Cuti, Duane Reade uncovered what it claimed was evidence that Cuti had perpetrated numerous acts of fraud during his time at Duane Reade and retained separate counsel and a forensic accounting firm to conduct an internal investigation. Separate outside counsel represented Duane Reade in the employment-related action. Eventually, outside investigation counsel presented its findings to the United States Attorney's Office ("USAO"). A prosecution soon followed. Cuti was convicted of conspiracy, securities fraud and making false statements in SEC filings.

At sentencing, Duane Reade sought to recover from Cuti 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

---

<sup>1</sup> See *United States v. Cuti*, No. 13-2042-cr. (2d Cir. Sept. 11, 2014).

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. It awarded over \$7 million in restitution to Oak Hill and Duane Reade for expenses incurred in the internal investigation of Cuti's fraudulent conduct. The restitution included expenses related to the internal investigation, the employment dispute, and the payment of legal fees to retain counsel for current and former employees who were interviewed by the USAO.<sup>2</sup>

Cuti appealed, arguing that Oak Hill was not a victim of the offense, that costs incurred in connection with the reimbursement of legal fees for employee-witnesses and for the costs of the investigation were not reimbursable under the VWPA, 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. In perhaps its most important ruling, the Circuit held that the standard for restitution under the Mandatory Victims Restitution Act ("MVRA") also applied to the VWPA. 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."<sup>3</sup> 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.<sup>4</sup> Using the language of discretion, it provides with respect to restitution that the court may order the defendant to "reimburse the victim for . . . necessary . . .

---

<sup>2</sup> See *United States v. Cuti*, No. 08-CR-972 (DAB), 2013 WL 1953741 (S.D.N.Y. May 13, 2013).

<sup>3</sup> See Mandatory Victims Restitution Act, 18 U.S.C. § 3663A (2012).

<sup>4</sup> 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)).

expenses related to participation in the investigation or prosecution of the offense.”<sup>5</sup> In the recently decided *United States v. Maynard*, the Circuit held that under the MVRA, “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.”<sup>6</sup> 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.

The Circuit court thus concluded that Duane Reade was entitled to recover restitution for costs incurred in the course of the internal investigation. It held that because Oak Hill paid expenses on Duane Reade’s behalf, it was entitled to restitution as a non-victim and that the legal fees for Duane Reade’s employees were properly included in the restitution order. Finally, however, the Second Circuit found that the district court erred in including legal expenses from work performed in the course of the employment-related claim in its calculation of the restitution amount. In order to establish that an expense was “required” to advance the investigation of the offense, the victim must establish that the purpose of the internal investigation was to “uncover or investigate fraud ‘when faced with evidence, indicia, or a grounded suspicion of internal misconduct.’” In contrast, 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 Circuit 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 Circuit concluded that “to be ‘necessary’ for restitution, it is not enough that the expenses incurred ‘helped the investigation.’”

---

<sup>5</sup> See 18 U.S.C. § 3663 (2012).

<sup>6</sup> *United States v. Maynard*, 743 F.3d 374, 381 (2d Cir. 2014).

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 scope of what expenses are “necessary” to the advancement of the government’s investigation. 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.

\* \* \*

If you have any questions, feel free to contact any of your regular contacts at the firm. You may also contact our partners and counsel listed under “[White-Collar Defense, Securities and Enforcement and Internal Investigations](#)” located in the “Practices” section of our website at <http://www.clearygottlieb.com>.

## Office Locations

### NEW YORK

One Liberty Plaza  
New York, NY 10006-1470  
T: +1 212 225 2000  
F: +1 212 225 3999

### WASHINGTON

2000 Pennsylvania Avenue, NW  
Washington, DC 20006-1801  
T: +1 202 974 1500  
F: +1 202 974 1999

### PARIS

12, rue de Tilsitt  
75008 Paris, France  
T: +33 1 40 74 68 00  
F: +33 1 40 74 68 88

### BRUSSELS

Rue de la Loi 57  
1040 Brussels, Belgium  
T: +32 2 287 2000  
F: +32 2 231 1661

### LONDON

City Place House  
55 Basinghall Street  
London EC2V 5EH, England  
T: +44 20 7614 2200  
F: +44 20 7600 1698

### MOSCOW

Cleary Gottlieb Steen & Hamilton LLC  
Paveletskaya Square 2/3  
Moscow, Russia 115054  
T: +7 495 660 8500  
F: +7 495 660 8505

### FRANKFURT

Main Tower  
Neue Mainzer Strasse 52  
60311 Frankfurt am Main, Germany  
T: +49 69 97103 0  
F: +49 69 97103 199

### COLOGNE

Theodor-Heuss-Ring 9  
50688 Cologne, Germany  
T: +49 221 80040 0  
F: +49 221 80040 199

### ROME

Piazza di Spagna 15  
00187 Rome, Italy  
T: +39 06 69 52 21  
F: +39 06 69 20 06 65

### MILAN

Via San Paolo 7  
20121 Milan, Italy  
T: +39 02 72 60 81  
F: +39 02 86 98 44 40

### HONG KONG

Cleary Gottlieb Steen & Hamilton (Hong Kong)  
Hysan Place, 37<sup>th</sup> Floor  
500 Hennessy Road  
Causeway Bay  
Hong Kong  
T: +852 2521 4122  
F: +852 2845 9026

### BEIJING

Twin Towers – West (23<sup>rd</sup> Floor)  
12 B Jianguomen Wai Da Jie  
Chaoyang District  
Beijing 100022, China  
T: +86 10 5920 1000  
F: +86 10 5879 3902

### BUENOS AIRES

CGSH International Legal Services, LLP-  
Sucursal Argentina  
Avda. Quintana 529, 4to piso  
1129 Ciudad Autonoma de Buenos Aires  
Argentina  
T: +54 11 5556 8900  
F: +54 11 5556 8999

### SÃO PAULO

Cleary Gottlieb Steen & Hamilton  
Consultores em Direito Estrangeiro  
Rua Funchal, 418, 13 Andar  
São Paulo, SP Brazil 04551-060  
T: +55 11 2196 7200  
F: +55 11 2196 7299

### ABU DHABI

Al Sila Tower, 27<sup>th</sup> Floor  
Sowwah Square, PO Box 29920  
Abu Dhabi, United Arab Emirates  
T: +971 2 412 1700  
F: +971 2 412 1899

### SEOUL

Cleary Gottlieb Steen & Hamilton LLP  
Foreign Legal Consultant Office  
19F, Ferrum Tower  
19, Eulji-ro 5-gil, Jung-gu  
Seoul 100-210, Korea  
T: +82 2 6353 8000  
F: +82 2 6353 8099