THIRD-PARTY INTERESTS IN CRIMINAL AND CIVIL FORFEITURES

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When the government has seized the assets of a fraudster in a civil or criminal forfeiture proceeding, defrauded victims turn to the government for compensation from those assets, while third parties, including secured creditors, may assert interests in those same assets. The matter of third party claims to forfeited assets has become an issue of great significance in the administration of assets in a fraudulent scheme, particularly where a parallel bankruptcy or receivership action is pending regarding the same fraud and the same assets. Conflicts arise when the government enforces the criminal and drug control laws containing provisions for asset forfeiture, while bankruptcy trustees and regulatory receivers seek to fulfill their mandate by marshalling and liquidating assets for the benefit of the creditors of the estate. When you add to that the individual defrauded investors who want to pursue direct claims to the assets, along with other unrelated third parties and secured parties who claim an ownership interest in an asset that they believe to be superior to everyone else’s interests, a complicated mess of litigation ensues. These materials address a third party’s rights to assert an interest in property subject to criminal forfeiture. In summary, a third party cannot contest a criminal forfeiture allegation in the forfeiture proceeding itself and may not commence an ancillary proceeding to assert an interest until entry of a preliminary order of forfeiture is entered in the proceeding as between the criminal defendant and the government. Such a preliminary order will become final if there is not a successful ancillary challenge.

**Civil Forfeiture**

Civil forfeiture is an in rem action against the property sought to be forfeited. The effect of a civil forfeiture is that the government takes the “guilty property” because the property was used in the crime. If the government bears the initial burden of showing probable cause that the property sought to be forfeited is “involved in” or “traceable to” certain fraudulent activity. If a party asserts ownership of the property, the burden then shifts to that party to prove that the property is not subject to forfeiture.

**Interests of Third Party Claimants in Forfeited Property**

Once the government has commenced a civil or criminal forfeiture proceeding, a trustee, receiver, secured creditor, or an individual victim of the fraudulent scheme may seek to assert an interest in the forfeited property. Generally, there are two ways in which a claimant can assert an interest in property that is subject to forfeiture. The first way is that the claimant can assert a legal interest in the property. The second is to
assert a constructive trust in the property. There are no provisions for a third party to challenge the criminal allegations in the first instance or to challenge whether the property was used in connection with the criminal activity, so a third party’s rights are limited to proving an interest in the property itself.

**ASSERTING A LEGAL INTEREST IN PROPERTY SUBJECT TO CRIMINAL FORFEITURE**

**The Process**

The process by which a claimant can assert a legal interest in forfeited property stems from a provision in the drug control laws. The forfeiture statute states, “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).”

A claimant asserts a legal interest in forfeited property pursuant to a specific statutory procedure. Under this procedure, the first step is for the government to publish and serve notice of the forfeiture order and of the proposed disposition of the forfeited property. The claimant asserting a legal interest then has 30 days to petition the court for a hearing to adjudicate the validity of the alleged interest. A petition in an ancillary proceeding is the exclusive means by which a third party may assert a claim to forfeited assets. A third party is barred from intervening in a criminal case to challenge forfeiture of property.

It must be noted that claimants are explicitly barred from intervening in a criminal forfeiture action in an attempt to establish that the property is not subject to forfeiture. The statute mandates: “[N]o party claiming an interest in property subject to forfeiture under this section may (1) intervene in a trial or appeal of a criminal case involving the forfeiture of such property under this section . . . .” The ancillary proceedings established in § 853(n) are the only means for a claimant to assert an interest in property subject to criminal forfeiture.

**Vested Legal Title or Bona Fide Purchaser for Value**

The petitioner then must establish by a preponderance of the evidence that either the title was vested in the petitioner rather than the defendant, or that “the petitioner is a bona fide purchaser for value of the right, title, or interest in the property and was at the time of purchase reasonably without cause to believe that the property was subject to forfeiture under this section . . . .”

[T]he statute provides that if a petitioner can prove by a preponderance of the evidence that (1) the petitioner has some interest in forfeited property and (2) that the defendant had an inferior interest (e.g., no interest) in forfeited property at the time of the commission of the acts which gave rise to the forfeiture of the property, then the petition has effectively challenged the forfeiture.

So a secured creditor must establish as a petition that it has an interest in the property that arose prior to the time of commission of the acts which provide the basis for the forfeiture. Alternatively, the petitioner must be a “bona fide purchaser for value” who was “reasonably without cause to believe that the property was subject to forfeiture.”

In United States v. Egan, several claimants asserted superior legal interests in cash seized from the defendant’s vaults. The court denied the government’s motion to dismiss, concluding that the claimants’ petitions adequately stated claims that the defendant’s possession of the cash was merely a bailment for them and that the funds subject to the bailment had not been misappropriated or commingled, and were therefore not the proceeds of the defendant’s fraud. The court also rejected the government’s argument that returning the claimants’ funds to them would be inequitable to the defendant’s victims. The court stated:

The Government’s argument in favor of the “equitable” distribution of the property fails because it is without support in the criminal forfeiture statute, which gives third-parties the right to recover property in which they have a legal interest. The statute contains no distinction between those who are victims of fraud and those who are not victims of fraud; under the plain language of the statute, any third party with a legal interest in property superior to the defendant’s may recover that property.
Standing to Assert a Claim in a Criminal Forfeiture Proceeding

“Under § 853(n), only a person asserting a ‘legal interest in property which has been ordered forfeited’ may petition the Court for redress. This ‘legal-interest’ requirement ‘impose[s] a statutory-standing requirement on claimants.’”\(^{21}\)

A legal interest may be established as set forth herein. Unsecured general creditors “lack standing as claimants of forfeited assets,” because they “cannot claim an interest in any particular asset.”\(^{22}\)

Asserting Legal Interest in Property Subject to Civil Forfeiture

The Process

A somewhat similar procedure is established for a claimant to assert a legal interest in property subject to civil forfeiture. Within 30 days after service of the government’s civil forfeiture complaint, “any person claiming an interest in the seized property may file a claim asserting such person’s interest in the property in the manner set forth in the Supplemental Rules for Certain Admiralty and Maritime Claims . . . .”\(^{23}\) The contents of this claim are set forth in Rule G(5)(A) of Supplemental Rules for Certain Admiralty and Maritime Claims. The claimant then has 20 days to file an answer to the government’s forfeiture complaint.\(^{24}\)

Innocent Owner Defense

A third party may seek to assert superior interests in the forfeited property under the “innocent owner” defense.\(^{25}\) The statutory basis for the “innocent owner” defense is:

An innocent owner’s interest in property shall not be forfeited under any civil forfeiture statute. The claimant shall have the burden of proving that the claimant is an innocent owner by a preponderance of the evidence.\(^{26}\)

For a property interest in existence at the time the illegal conduct giving rise to forfeiture took place, an “innocent owner” is an owner who “(i) did not know of the conduct giving rise to forfeiture; or (ii) upon learning of the conduct giving rise to the forfeiture, did all that reasonably could be expected under the circumstances to terminate such use of the property.”\(^{27}\)

For a property interest acquired after the conduct giving rise to the forfeiture has taken place, an “innocent owner” is an owner who “(i) was a bona fide purchaser or seller for value (including a purchaser or seller of goods or services for value); and (ii) did not know and was reasonably without cause to believe that the property was subject to forfeiture.”\(^{28}\) The statute does not contain a requirement that the “innocent owner” establish that it acquired the property for value, which is in contrast to an assertion of rights in a criminal forfeiture proceeding.

“Owner” is defined to mean a leasehold, lien, mortgage, recorded security interest or a valid assignment of an ownership interest.\(^{29}\)

To successfully assert the innocent owner defense, however, the owner must demonstrate a lack of any knowledge of the illegal activity; turning a blind eye or willful blindness is equated with knowledge of the illegal activity.\(^{30}\)

Standing to Assert a Claim in a Civil Forfeiture Proceeding

As in every matter in federal court, a claimant to property in a civil forfeiture action must establish its standing to assert its claim.\(^{31}\) Generally, however, this should not be an onerous burden, because it only requires the claimant to follow the applicable procedures for asserting its claim and to allege an interest in the subject property, such as an ownership, possessory or security interest.\(^{32}\) However, unsecured creditors are specifically excluded from the definition of owner.\(^{33}\) “Unlike secured creditors, general creditors cannot claim an interest in any particular asset that makes up the debtors’ estate.”\(^{34}\)

The standing of a claimant to assert a legal interest in property subject to civil forfeiture was discussed in depth in the Ponzi case of United States v. Assets Described in “Attachment A” to the Verified Complaint Forfeiture in Rem.\(^{35}\) In that case, Kinetic filed a claim asserting that its judgment against the Ponzi perpetrators gave it an interest in the assets at issue. The government moved to dismiss Kinetic’s claim. It asserted that Kinetic lacked standing to assert a claim against the property that was not titled to the Ponzi perpetrators, and that as to the property that was titled to them, Kinetic could not show that it was an “innocent owner” under § 983(d).\(^{36}\)