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A Bad Fit—Criminal Forfeiture of Substitute Assets, the Lis Pendens

Criminal asset forfeiture continues to be a darling of federal prosecutors. Often combined with another favored prosecutorial tool, the ever-flexible money laundering statutes, the criminal forfeiture laws provide prosecutors with an array of powerful weapons to raise the stakes of contesting even relatively modest criminal charges to a level that many white-collar defendants cannot bear.

At least in New York, however, one such means that the government recently seems to have made a practice of utilizing—tying up a defendant's concededly untainted property prior to trial by filing a notice of pendency—appears ripe to be struck down by the courts.

Restraining Assets

When federal prosecutors claim that specific assets owned by a criminal defendant are “dirty,” that is, the fruits or instrumentalities of criminal activity, the forfeiture laws expressly provide that the government can move the court to restrain such assets prior to trial. See 21 USC §853(e). The government's aggressive use of this power, particularly in cases where the government effectively impedes the defendant's ability to hire counsel to defend himself from the very charges at issue, has been the subject of much discussion and litigation. With some exceptions with respect to procedural rights, the litigated cases generally have not gone well for defendants; courts have found that the right to counsel does not include the right to pay for counsel using money that there

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is probable cause to believe was obtained through criminal activity.¹

But the forfeiture laws also provide federal prosecutors with rights against assets that they do not even claim to be tainted—that is, “substitute assets.” Codified in 21 USC §853(p), the substitute asset provisions permit the government to forfeit upon conviction “any other property of the defendant,” up to the value of the tainted assets, when, as a result of the defendant's actions, the tainted assets cannot readily be located, have been transferred to a third party, have been placed beyond the court's jurisdiction, have been substantially reduced in value or have been commingled with other property which cannot easily be divided.

For example, take the case of a securities lawyer who prepares a prospectus which his clients, investment promoters, use to raise \$1.5 million from investors in 2004. Assume that the lawyer also allows his attorney trust account to be used to receive the funds and that he then transfers the funds to entities controlled by his clients. The government, claiming that the lawyer knew that the prospectus contained material omissions and misstatements, brings money-laundering charges, and a count seeking criminal forfeiture of \$1.5 million, based on the lawyer's transfers of funds he knew were obtained by securities fraud. Assume that most of the lawyer's own assets are represented by his home, worth \$2.0 million, which he purchased in 1995 with funds he earned through years of honest toil well before he ever met the clients alleged to have conducted the 2004 fraud.

Nevertheless, because the lawyer transferred the \$1.5 million in alleged tainted money to third parties—his clients' entities—the government can list the lawyer's home in the indictment as a “substitute asset” subject to forfeiture up to \$1.5 million and can, in the event of the lawyer's conviction, seek the forfeiture of that home if the tainted \$1.5 million is unavailable.

'United States v. Gotti'

The forfeiture law draws a substantial distinction between the government's powers with respect to substitute assets, as opposed to alleged tainted assets, prior to trial. In *United States v. Gotti*, 155 F3d 144, 149-50 (2d Cir. 1998), the U.S. Court of Appeals for the Second Circuit, joining several other Courts of Appeal,² held that the forfeiture laws do not permit the pretrial restraint of substitute assets, recognizing that the language of the relevant section of the statute, 21 USC §853(e), grants such power only with respect to instrumentalities or proceeds of crime. In addition, unlike their treatment of criminal proceeds or instrumentalities (see 21 USC §853(c)), with respect to substitute assets, the forfeiture statutes do not include a “relation-back” provision, providing that all interest in such assets vests in the government at the time of the underlying acts. The statutes thus do not presumptively void third-party transfers of substitute assets.³

Notwithstanding the rule stated in *Gotti*, in cases where the defendant's substitute assets consist of real property, the government appears to have adopted the practice of filing a notice of pendency or lis pendens on such property, effectively achieving the same result while avoiding any prior review by a judicial officer. The pertinent cases hold that a lis pendens is not technically a “pretrial restraint,” reasoning that because a lis pendens is appropriately filed only in lawsuits that directly affect real property, the restraint is created not by the filing of the lis pendens, but by “the suit itself,” which puts the title of the real property at issue. *Chrysler Corp. v.*

Fedders Corp., 670 F2d 1316, 1334 (3d Cir. 1982) (concurring opinion). A lis pendens is not viewed as constituting a seizure, because the owner maintains use and enjoyment of the property, and, theoretically, is even permitted to transfer it. This deft bit of legal fiction is of little solace to the real-world defendant who needs to dispose of his concededly untainted real property to support himself and his criminal defense. As the cases recognize, as a practical matter the lis pendens, by clouding title, prevents any sale of real property. See, eg., *United States v. Monsanto*, 924 F2d 1186, 1193 (2d Cir. 1991) (the "filing of a lis pendens ... would effectively avert ... a transfer.")

Filing a Lis Pendens

The question remains, however, whether naming a property as a substitute asset in a criminal forfeiture count can support the filing of a lis pendens. There does not appear to be any published decision actually ruling upon the propriety of this practice, although, without analysis, it has been presumed valid in dicta in two reported district court opinions. See *United States v. Miller*, 26 FSupp2d 415, 432 fn. 15 (NDNY 1998); *United States v. Field*, 867 FSupp 869, 873 fn. 4 (D. Minn. 1994). An examination of the law of substitute assets and the law regarding notices of pendency, however, demonstrates that the two doctrines do not fit together at all and that filing of a notice of pendency under such circumstances is inappropriate.

At common law, a lis pendens was a notice that any purchaser of real property fundamentally affected by a lawsuit took the property subject to the interests of the parties to the lawsuit. In New York, the common-law rule has been codified in Civil Practice Law and Rules (CPLR) §6501, which provides that "a notice of pendency may be filed in any action in a court of the state or of the United States in which the judgment demanded would affect the title to, or the possession, use or enjoyment of, real property...." The notice, identifying the property, the parties, and the nature of the action, is filed directly with the clerk of the county where the property is located, effectively clouding its title. See CPLR §6511.

New York law narrowly construes the right to file a notice of pendency. The New York Court of Appeals has referred to the lis pendens as an "extraordinary privilege," reasoning that "the powerful impact that [the lis pendens] has on the alienability of property, when conjoined with the facility with which it may be obtained, calls for its narrow application to only those lawsuits directly affecting title to, or the possession, use

or enjoyment of, real property." 5303 *Realty Corp. v. O&Y Equity Corp.*, 64 NY2d 313, 315-16, 476 NE2d 276, 278 (N.Y. 1984).

Thus, it has long been well-settled that where the party filing the notice of pendency seeks only a sum of money or even the proceeds of a sale of real property, the direct relationship to the title to or possession of real property is lacking, and a lis pendens is not proper. 5303 *Realty Corp.*, 64 NY2d at 321 (tracing history of doctrine and collecting cases); see, eg., *Hailey v. Ano*, 136 NY 569, 575 (1893) (trespass action seeking money damages only would not support notice of pendency); *Lunney & Crocco v. Wolfe*, 579 NYS2d 388 (1st Dept. 1992) (lis pendens cancelled where filed in connection with law firm's special proceeding to obtain portion of proceeds of sale of husband's residence).

In short, a notice of pendency is not permitted when the object is to "tie up [the defendants'] real estate so as to obtain security for the payment of a judgment for damages if [plaintiffs] succeed in obtaining it." *Braunston v. Anchorage Woods, Inc.*, 10 NY2d 302, 305, 178 NE2d 717 (1961).

N.Y.'s Strict Requirements

The government's listing a parcel of real property as a substitute asset in an indictment does not appear to meet New York law's strict requirements for a claim "directly affecting title to, or the possession, use or enjoyment of" such property. The Supreme Court has held that forfeiture in general is "an element of the sentence imposed following conviction" as part of the punishment, and is not a substantive charge. *Libretti v. United States*, 516 US 29, 38-39, 116 SCt 356 (1995) (holding that forfeiture not subject to requirement that court determine factual basis for guilty plea). Indeed, the reason that criminal forfeiture claims are typically set forth in the indictment is found in Rules 7(c)(2) and 32.2(a) of the Federal Rules of Criminal Procedure, which provide that a court may not enter a judgment of forfeiture unless the indictment provides notice to the defendant that it will seek forfeiture as part of the sentence. Forfeiture is included in the indictment not as a substantive claim, but to provide notice of a potential sentence.

Further, it has been held that listing a specific asset in the indictment as a substitute asset is actually superfluous. As the U.S. Court of Appeals for the Eighth Circuit held in upholding a judgment of forfeiture of substitute assets when no such assets were specified in the indictment, "their specific identity does not matter for forfeiture purposes." *United States v. Hatcher*, 323

F3d 666, 673 (8th Cir. 2003). Listing a specific asset in the indictment as a substitute asset thus provides the government with no greater right to obtain it than not listing it. In *United States v. Voigt*, 89 F3d 1050 (3d Cir. 1996), in holding that a district court could amend a judgment to provide that assets previously erroneously designated as criminal proceeds were in fact substitute assets, the U.S. Court of Appeals for the Third Circuit characterized the substitute asset provisions as a mere procedural mechanism for collecting a forfeiture judgment.

Conclusion

Indeed, by definition, in listing real property as a substitute asset, the government is stating that it does not claim the property to be the fruit or instrumentality of any crime; rather, it is stating that if, after the hoped-for conviction, it cannot recover tainted assets without too much trouble, it will pursue the real property to satisfy the debt. The substitute asset provisions are at best a slightly more streamlined version of the right of any judgment debtor to look to the judgment creditor's assets for satisfaction of the judgment, which the courts have expressly held is insufficient to support a notice of pendency.

In short, at least with respect to property located in New York, federal prosecutors' practice of filing notices of pendency in criminal forfeiture cases with respect to property listed as substitute assets appears highly vulnerable to challenge.



1. See *Caplin & Drysdale, Chartered v. United States*, 491 U.S. 617 (1989); *United States v. Monsanto*, 491 U.S. 600 (1989).

2. See also *In re Assets of Martin*, 1 F3d 1351, 1359 (3rd Cir. 1993); *United States v. Floyd*, 992 F2d 498, 502 (5th Cir. 1993); *United States v. Field*, 62 F3d 246 (8th Cir. 1994); *United States v. Ripinsky*, 20 F3d 359, 363 (9th Cir. 1994).

3. Notwithstanding the language of the statute, the U.S. Court of Appeals for the Fourth Circuit has found to the contrary, holding that the statute's "relation-back" provision does apply to substitute assets, and ruling that the government may seek forfeiture of substitute assets transferred to third parties. See *United States v. McHan*, 345 F3d 262, 270-272 (4th Cir. 2003). The Fourth Circuit's position, premised almost entirely upon the statute's general instruction that it "be construed liberally" to "effectuate its remedial purposes," 21 USC §853(o), is contrary to the approach of the Second Circuit in *Gotti* and the other circuits that have ruled on the issue addressed in *Gotti*. See *United States v. Saccoccia*, 165 F. Supp.2d 103, 113 (D.R.I. 2001) (holding contrary to the rule stated in *McHan* based on the express language of the relevant section of the statute), vacated on other grounds, 354 F3d 9 (1st Cir. 2003).