Criminal Law Practitioner

Volume 1 | Issue 1 Article 7

2013

Indemnification Agreements & Right to Counsel for Individuals and Corporations: Implications and Pitfalls for Prosecutors and Defense Counsel in Complex White-Collar Enforcement and Asset Forfeiture Actions

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INDEMNIFICATION AGREEMENTS & RIGHT TO COUNSEL FOR INDIVIDUALS AND CORPORATIONS:

Implications and Pitfalls for Prosecutors and Defense Counsel in Complex White-Collar Enforcement and Asset Forfeiture Actions

by Joseph Hernandez

Forfeiture laws have enormous implications for small and medium sized corporations accused of criminal activity. For instance, a white-collar money laundering or fraud enforcement action may be very broad due to the interconnections between criminal activity and financial transactions. Defendants often use financial institutions and other property to facilitate their activities. In these cases, it is normal to include a criminal and/or civil forfeiture count against property representing the proceeds or means that advanced the fraudulent conduct. Those assets that are "involved in" or "facilitate" the fraudulent conduct are forfeitable[1] and may be seized in an *ex parte* hearing pending the outcome of a criminal or civil enforcement action. Consequently, bank accounts, cars, planes, real property, among other things, may be subject to forfeiture that assists with developing, advancing, concealing, or otherwise enabling criminal activity.

Assume the following set of facts. A medium-sized corporation (twenty to fifty employees) operates a business that generates several million dollars of revenue each year. For several years, though, a few executives and employees allegedly conducted criminal activity that benefitted the corporation and individuals. Both are indicted with a criminal forfeiture count against the individuals, plus a parallel civil forfeiture complaint is filed against the corporation. The government has seized nearly all of the corporation's assets and the corporation is barely able to continue operating. Similarly, the individuals have had nearly all their personal assets seized pending the outcome of their prosecutions. It is the corporation's policy to indemnify its executives and employees pursuant to state corporate law; however, the corporation is unable to indemnify because the underlying asset seizure prevents it.

Is a pretrial hearing available regarding the seized corporate assets? What are the standards to securing the release of corporate assets? Who has standing to pursue that claim? What occurs when both parties claim they need those assets, which have been subject to an *ex parte* seizure to secure defense counsel? These are the challenges white-collar criminal practitioners must be prepared to manage when the ocurrence of a corporate asset seizure affects an indemnification agreement.

I. Forfeiture and *Kaley v. United States*

A. Civil and Criminal Forfeiture

The United States federal government and most states have adopted broad civil and criminal forfeiture statutes.[2] These laws subject all forms of property that either facilitate

1 18 U.S.C. §§ 981(a)(1)(A)-(B) (2006); *see also* 18 U.S.C. § 982(a)(1) (2006).

2 This article will not provide an in-depth analysis and review of forfeiture. It will be limited to analyzing the general procedural and substantive issues that prosecutors and defense counsel will likely confront when managing a complex white-collar action involving the pretrial seizure of assets that are claimed to be necessary to pay for corporate and individual legal defense costs.

or are the proceeds of criminal activity to forfeiture. Forfeiture is designed, *inter alia*, to deter criminal activity by serving as a form of punishment[3] and to combat the incentives that may make criminal activity valuable by disgorging illicit gains.[4]

Civil forfeiture is an *in rem* action against property used to facilitate or represent the proceeds of criminal activity.[5] There are several federal civil forfeiture laws; however, two commonly used statutes include 18 U.S.C. § 981 (financial crimes) and 21 U.S.C. § 881 (narcotics). For purposes of white-collar crime, 18 U.S.C. § 981(a)(1)(A) renders forfeitable all real and personal property relating to money laundering, currency transaction reporting crimes, financial transaction crimes, or fraud against the United States. These statutes provide that the government may, in certain circumstances, seize and take control of property prior to securing forfeiture upon the demonstration of probable cause.[6] Pursuant to the Relation Back Doctrine, the government is vested with title to the property upon the commission of the act giving rise to forfeiture.[7] The government's burden to secure forfeiture is by a preponderance of the evidence.[8]

Criminal forfeiture, on the other hand, is an *in personam* proceeding designed to serve as a form of punishment in the penalty phase.[9] Typically, it is attached to an indictment as a separate count. There are a range of statutes that involve criminal forfeiture but three prevalent statutes are: 18 U.S.C. § 982 (money laundering and financial crimes); 18 U.S.C. § 1963 (RICO); and 21 U.S.C. § 853 (narcotics). Additionally, each statute permits "substitute assets" to be used in the event the assets subject to forfeiture are not located or available.[10]

The structure of both civil and criminal forfeiture permits the government to pursue parallel enforcement actions. Under 28 U.S.C. § 2461(c), when a civil forfeiture action is authorized, a successful criminal conviction can serve as the predicate for action on the civil forfeiture if no specific statutory provision is available for criminal forfeiture. This enables the government to combine a criminal conviction and civil forfeiture in a consolidated proceeding.[11] Additionally, the government may stay a civil forfeiture proceeding pending the outcome of the criminal case.[12]

To assure assets are not used, concealed, lost, or destroyed prior to the completion of a civil or criminal action, the government seizes the property. Typically, this is achieved through an *ex parte* proceeding via a grand jury indictment in the case of a criminal forfeiture or a warrant based on probable cause in the context of a civil forfeiture.[13]

3 *See* 18 U.S.C. § 982(a)(1) (mandating that a person convicted of certain offenses be ordered to forfeit property involved in the offense).

4 S. Rep. No. 98-225, at 84 (1984), *reprinted in* 1984 U.S.C.C.A.N. 3182, 3267.

5 *See, e.g.*, United States v. One 1998 Tractor, 288 F. Supp. 2d 710 (W.D. Va. 2003).

6 18 U.S.C. § 981(b)(1)-(4) (2006); 21 U.S.C. § 881(b) (2006).

7 18 U.S.C. § 981(f) (2006).

8 18 U.S.C. § 983(c)(1) (2006).

9 United States v. Voigt, 89 F.3d 1050, 1082 (3d Cir. 1996).

10 18 U.S.C. § 1963(m) (2006); 21 U.S.C. §§ 853(p)(1)-(2) (2006).

11 *See, e.g.*, United States v. Ali, 619 F.3d 713, 720 (7th Cir. 2010) (asserting that criminal forfeiture is available for convictions of mail and wire fraud, not just circumstances affecting financial institutions); United States v. Schlesinger, 514 F.3d 277, 277-78 (2d Cir. 2008);

12 18 U.S.C. § 981(g)(1) (2006).

13 Under the Civil Asset Forfeiture Reform Act (CAFRA), the government must show a "substantial connection" between the assets and criminal activity. *See* Pub. L. No. 106-185 (2000) *codified as* 18 U.S.C. § 983(c)(3) (2006). Previously, courts had applied two general approaches in assessing probable cause: "substantial connection" and "facilitation." Under the "substantial connection" standard the government must show that that the property was actively involved in perpetuating criminal activity. *See* United States v. $252,000 U.S. Currency, 484 F.3d 1271, 1274-75 (10th Cir. 2007) (affirming that in a civil forfeiture action the government demonstrated probable cause that currency was "substantially connected" to illegal drug trafficking when it was lawfully discovered in a box and briefcase, bundled in stacks and wrapped in cellophane smelling of marijuana, and the driver initially denied knowledge and then later claimed it was for a business venture). *Contra* United States v. One 1989 Jaguar XJ6, No. 92 C 1491,WL 157630 (N.D. Ill. May 13, 1993), at *2-3 (holding that a "substantial connection" was *not*

B. Constitutional Implications

The seizure of property implicates the Fifth and Sixth Amendment rights of individuals and corporations.[14] When a defendant claims he or she needs those assets to secure counsel of choice, courts have recognized that individuals have an opportunity to a post-indictment hearing.[15] However, the scope of that hearing has led to a split across the federal circuits. On October 16, 2013, the United States. Supreme Court heard arguments in *Kaley v. United States*.[16] The question presented was whether the Fifth and Sixth Amendments require that a defendant have the opportunity to challenge the underlying charges of an indictment or merely the traceability of assets to criminal activity. The majority view, colloquially known as a *Jones-Farmer* hearing, provides a defendant who has been indicted with a pretrial hearing to demonstrate that property is not traceable to criminal activity.[17] The minority view holds that the due process issues implicated require a more comprehensive hearing that permits a defendant to present evidence attacking the basis for the underlying criminal indictment.[18]

In *Kaley*, the facts involve a white-collar enforcement action where *personal* assets have been subject to pretrial seizure. The alleged facts, highly summarized, are that Kerri and Brian Kaley were involved in a scheme stealing and reselling medical devices.[19] A criminal forfeiture count led to the seizure of property that a grand jury determined was the proceeds of criminal activity. The Kaleys claimed they needed those assets to retain their defense counsel.[20] At the *Jones-Farmer* hearing, the trial court limited the scope of review to traceability without permitting inquiries into the review of the grand jury's indictment. When the Kaleys failed to present evidence and requested an opportunity to challenge the basis for the indictment, the district court affirmed its protective order to seized assets.[21]

Based on questioning at the Supreme Court, the Justices appeared flummoxed as how to resolve the due process and Fifth and Sixth Amendment issues presented.[22] While

shown when a vehicle that provided transportation between the locations where alleged fraudulent transactions occurred to sustain a seizure of the vehicle). Alternatively, if the statutory language includes the language "to facilitate," it grants a more permissive degree of forfeiture to forfeit legitimate funds or property that have been commingled with illicit funds or property. *See* U.S. v. Coffman, 859 F.Supp.2d 871, 875-76 (E.D. Ky. 2012) (holding that under 18 U.S.C. § 982 "clean" funds commingled with tainted funds are forfeitable because the commingling enables and disguises money laundering). *Contra* United States v. $448,342.85 U.S. Currency, 969 F.2d 474, 476-77 (7th Cir. 1992) (holding that pooling tainted funds with legitimate funds was not sufficient to forfeit property).

14 *See* Caplin & Drysdale v. United States, 491 U.S. 617, 624-27 (1989) (holding that a defendant does not have a Sixth Amendment right to use assets subject to a pretrial restraining order to retain counsel of choice); *see also* Mathews v. Eldridge, 424 U.S. 319, 334-35 (1976) (holding that in weighing due process considerations a court should assess three factors: one, the private interest that will be affected; two, the risk of erroneous deprivation of such interest through the procedures used and value represented by additional or substitute procedural safeguards; and three, the government's interest at stake, including the burdens of additional or substitute procedures).

15 United States v. Jones, 160 F.3d 641, 645-49 (10th Cir.1998); United States v. Monsanto, 924 F.2d 1186, 1191-94 (2d Cir.1991); United States v. Long, 654 F.2d 911, 915 (3d Cir.1981); United States v. Lewis, 759 F.2d 1316, 1324-25 (8th Cir.1985); United States v. Moya-Gomez, 860 F.2d 706, 724-26 (7th Cir. 1988).

16 Kaley v. United States, Docket No. 12-464 (U.S. Oct 16, 2013).

17 United States v. Jones, 160 F.3d 641, 646-47 (10th Cir. 1998) (holding that a proper balance of private and government interests requires a post-restraint, pre-trial hearing only upon defendant's motion); United States v. Farmer, 274 F.3d 800, 805 (4th Cir. 2001) (holding that due process requires a hearing to challenge probable cause on the limited grounds of traceability).

18 *See* United States v. Monsanto, 924 F.2d 1186, 1195, 1197 (2d Cir. 1991) (holding that additional safeguards are necessary to protect a defendant's due process rights); United States v. E-Gold, Ltd., 521 F.3d 411 (D.C. Cir. 2008) (holding that pre-deprivation hearings are required unless there are extraordinary circumstances).

19 United States v. Kaley, 79 F.3d 1246, 1249 (11th Cir. 2009).

20 *Id.* at 1250-51.

21 United States v. Kaley, 677 F.3d 1316, 1326 (11th Cir. 2012) *cert. granted*, 133 S. Ct. 1580 (2013).

22 *See generally* Transcript of Oral Argument, Kaley v. United States (2013) (No. 12-464), *available at* http://www.supremecourt.gov/oral_arguments/argument_transcripts/12-464_j3ko.pdf [hereinafter Kaley Oral Argument].

the Justices seemed to agree that a defendant has a right to be heard in a meaningful manner at an appropriate time, the extent of that opportunity to be heard was largely unclear from the dialogue at oral arguments.[23]

The longstanding tradition and constitutional mandate is that a grand jury's determination is presumptively valid for a criminal indictment.[24] To this issue, Justice Alito expressed concern that a pretrial hearing could aggravate the government's case by requiring the revelation of sensitive information and witness identification.[25] This was a key point emphasized in the government's petition for certiorari and brief.[26] Justice Ginsburg similarly expressed reservation as to whether a judge could preside over a case when a judge determines probable cause does not exist.[27] Alternatively, Justices Roberts and Scalia seemed skeptical of the government's position, with Justice Scalia asking whether courts should demand more than probable cause when seized assets are necessary for securing counsel of choice.[28] Justice Breyer seemed to present a possible compromise between the positions when he suggested that defendants could have greater opportunities to explore the nexus between assets and an indictment subject to greater control by the judge.[29] With such control, the judge can impose restriction that avoids a "mini-trial" that the federal government argued would arise.

C. *Jones-Farmer* Hearing Requirements

The law currently requires a defendant show three factors to succeed in a *Jones-Farmer* hearing.[30] First, the defendant must demonstrate he has standing to challenge the seizure.[31] Second, he must allege and then show he has *no* other assets available to pay for his criminal defense.[32] Any valuable property that a defendant owns must be expensed or committed towards legal defense fees. An exception may be available upon a showing that procedural due process rights are at stake,[33] or evidence that seized property is owned by a third-party.[34] Third, the defendant bears the burden of showing by a preponderance of the evidence that the underlying property did not facilitate or is not the proceeds of criminal activity.[35]

II. Indemnification Agreements: Implications for the Seizure of Corporate Assets

A question implicated, but not specifically addressed by *Kaley*, is the impact asset seizure may have on the ability to honor an indemnification agreement when both corporate and individual asset seizures disable securing counsel of choice. An indemnification agreement is provided pursuant to state corporation law by protecting corporate agents executives, officers, and employees from liability associated with decisions committed within the scope of their employment.[36] The limitation on these agreements is that an agent must act in "good faith" and not be convicted of a criminal violation.[37]

23 *See generally id.*

24 Costello v. United States, 350 U.S. 359, 363 (1956) (stating "[a]n indictment returned by a legally constituted and unbiased grand jury, like an information drawn by the prosecutor, if valid on its face, is enough to call for a trial of the charge on the merits").

25 Kaley Oral Argument at 12-13, 46-47.

26 Brief for the United States at 11, Kaley v. United States, 677 F.3d 1316 (2013) (No. 12-464).

27 Kaley Oral Argument at 9-10.

28 *See id.* at 30-32

29 *See id.* at 32-34, 48-49.

30 *Jones*, 160 F.3d at 647-68 (10th Cir.); *Farmer*, 274 F.3d at 803-04; *Monsanto*, 924 F.2d at 1195-96 (2d Cir. 1991).

31 *Id.*

32 *Jones*, 160 F.3d 641, 647-68 (10th Cir.); *Farmer*, 274 F.3d at 803-04; *Monsanto*, 924 F.2d 1195-96 (2d Cir. 1991).

33 *See, e.g.*, United States v. James Daniel Good Real Prop., 510 U.S. 43, 52-53 (1993) (holding that government violated procedural due process rights by seizing real property *ex parte* without notice or hearing for the owner, reasoning that property cannot be moved or hidden, thus concerns about defendant moving, losing, or hiding property are not present); *see also* 18 U.S.C. § 985 (codifying the position articulated in *James Daniel Good Real Prop*).

34 18 U.S.C. § 983(d)(1) (innocent-owner defense); 18 U.S.C. § 983(d)(3)(A)(i) (bona-fide purchaser for value).

35 18 U.S.C. § 983(d)(3)(B)(iii).

36 *See generally* Mass. Gen. Laws Ann. ch. 156D, § 8.51 (West); Del. Code Ann. tit. 8, § 145 (West); N.Y. Bus. Corp. Law § 725 (McKinney).

37 *See* Waltuch v. Conticommodity Servs., Inc., 88 F.3d 87, 92-93 (2d Cir. 1996) (denying indemnification to a

Criminal or civil forfeiture action represents a threat to the ability of a corporation to uphold an indemnification agreement. A seizure of nearly all of a corporation's assets raises the question of whether a corporation could make a claim to assets on behalf of itself *and* an individual claiming indemnification; or whether a corporation may only assert a claim for itself. Unique risks are presented that prosecutors and defense counsel will likely need to consider when an individual claims that a corporation owes them a duty to indemnify but is denied indemnification because of the seizure of corporate assets. Depending upon the extent of the government's pretrial seizure, the cooperation of the individual defendant and corporation, and the complexity of a given case, strategic decisions made by defense counsel and prosecutors must weigh a range of potential factors.

The standards for a *Jones-Farmer* hearing would apply to a corporation asserting a claim to seized corporate assets: standing, no other available assets, and preponderance of the evidence that assets are not traceable to criminal activity. With respect to standing, the operative question is, "to whom are corporate assets vested?" This is almost always the corporation itself, which means only the corporation has standing to challenge the seizure of corporate assets and not the individual defendants or shareholders.[38] Thus, the question becomes what additional recourse an individual may have to secure the release of assets pursuant to an indemnification agreement.

A. Defense Counsel: Strategy and Considerations

When the interests of the individual and corporation align, the optimal strategy for defense counsel and the corporation is cooperation. The individual wants to avoid being convicted of the underlying crime; similarly, the corporation does not want to be liable under *respondeat superior*. The corporation could assert a *Jones-Farmer* claim for itself and the defendant by claiming the government seizure of corporate assets causes a breach of contract. Because the corporation is the party in breach in this instance, it could attach as part of a *Jones-Farmer* motion, an invoice detailing what is necessary to pay the legal fees of both parties. This enables the individual defendant to avoid being subject to a *Jones-Farmer* hearing and the concomitant requirement that he have no personal assets available to pay legal defense fees.[39]

On the contrary, when the interests of the individual and corporation diverge, the corporation may assert that the individual defendant has failed to uphold his duty of "good faith" and will only pursue a *Jones-Farmer* motion to advance the interest of the corporation. The corporation is asserting as an affirmative defense that public policy permits it to deny indemnification. This claim would raise contract and corporate law disputes that could involve complex statutory and legal questions regarding the terms of the agreement. The individual defendant's recourse in this situation is likely twofold: one, sue for enforcement of the indemnification agreement, or two, move for a *Jones-Farmer* hearing releasing personal assets that have been seized and then seek indemnification in the event of success on the merits.[40] Clearly, the best strategy in this situation de-

vice-president for failure to demonstrate "good faith" under Delaware corporate law).

38 *See, e.g.*, United States v. Wyly, 193 F.3d 289, 304 (5th Cir. 1999) (denying standing to shareholders who challenged seizure of corporate assets because under Louisiana law shareholder's interest is in stock issued and not corporate assets); United States v. $20,193.39 U.S. Currency, 16 F.3d 344, 346 (10th Cir. 1994) (holding that unsecured creditors, unlike secured creditors, lacked standing to challenge civil forfeiture of property seized from businesses, even when all assets were seized); United States v. New Silver Palace Rest., 810 F.Supp. 440, 442 (E.D.N.Y. 1992) (holding shareholders of restaurant used to facilitate drug transactions did not have standing, since shareholders were not owners or lienholders with respect to corporate assets).

39 To the author's knowledge, there has been no case where this has occurred in the context of a *Jones-Farmer* forfeiture proceeding.

40 Delaware law provides that when an agent has been "successful" on the merits, that person shall be indemnified for expenses including attorneys' fees. DEL. CODE ANN. tit. 8, § 145(c); *see also* MASS. GEN. LAWS ANN. ch. 156D, § 8.52 (mandating indemnification when a defendant is "[w]holly successful, on the merits or otherwise").

pends upon individual circumstances.

B. Prosecution: Strategy and Considerations

The prosecutor's goal is to assure that forfeitable assets are maintained pending the outcome of a criminal prosecution or civil action. While needing to be mindful of their actions on interfering with a defendant's access to counsel, a prosecutor could argue that an indemnification agreement is itself forfeitable. A prosecutor could reasonably argue that an indemnification agreement represents a means to facilitate criminal activity. In a sophisticated corporate fraud scheme, the individuals involved may consider the legal risks of their actions and be prepared for the possibility of subsequent liability. Thus, indemnification is not available but instead should be considered, along with other means that facilitate criminal activity, to be forfeitable.

For instance, in *United States v. Wittig*, the prosecution brought a forty count indictment with a forfeiture count for numerous pieces of property, including the right to advanced payment of legal fees, as mandated in the company's Articles of Incorporation.[41] The prosecution claimed that Wittig and a co-conspirator joined the company, Westar Energy, with the intent to defraud the company of millions of dollars.[42] Prior to trial, the government argued that the right to advancement was only available if the defendant "came on board with the proper intent," but they failed to present extrinsic evidence, relying only on argument at a *Jones-Farmer* hearing.[43] The court denied the motion, ruling argument alone was insufficient to support a probable cause determination that the indemnification agreement was connected to the alleged criminal activity.[44] Following a mistrial and the full presentation of the government's case-in-chief, the prosecution moved again to restrain the advancement of legal fees.[45] At this time, the court granted the government's motion, reasoning the evidence presented at trial supported this argument.[46] Thus, an indemnification agreement can be subject to pretrial seizure when the right facts present themselves. As demonstrated by *Wittig*, a prosecutor has to calculate the risks of exposing information relating to his case-in-chief, a point emphasized during oral arguments in *Kaley*.

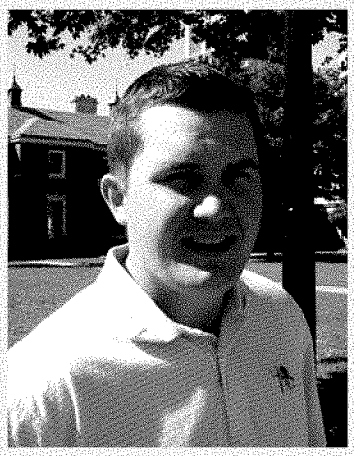
A prosecutor should also be cautious when seeking to block advancement of legal fees. There is a fine line between an argument that indemnification is forfeitable and interference with a defendant's Sixth Amendment right to counsel. Specifically, a prosecutor should limit his arguments to those subjects relating to the enforcement of forfeiture laws in a specific case rather than advancing other policy or legal goals. For instance, in *United States v. Stein*,[47] the U.S. Department of Justice adopted a policy that an employer's payment of an employee's attorney fees would count as a lack of cooperation. The government's policy, and statements to the company during litigation, led the corporation to cease paying legal fees. The court dismissed the case citing violations of the employees' due process rights.

III. Conclusion

The decision in *Kaley* will help resolve the procedural parameters that a criminal defendant has in seeking to unfreeze assets subject to a pretrial seizure order to pay for legal defense costs. It is inevitable that there will be unanswered questions regarding issues of indemnification rights when a corporation *and* individual defendant argue they need corporate assets to secure defense counsel pursuant to an indemnification agreement. However, it is not unreasonable to foresee such a case given the sweeping nature of forfeiture statutes.

41 *See* United States v. Wittig, 333 F.Supp.2d 1048, 1053-54 (D. Kan. 2004).
42 *See id.* at 1051-52.
43 *Id.* at 1052.
44 *Id.*
45 *See* United States v. Wittig, No. 03-40142JAR, 2005 WL 1227914, at *1 (D. Kan. May 23, 2005).
46 *Id.* at *4.
47 435 F. Supp. 2d 330 (S.D.N.Y. 2006), *aff'd* 541 F.3d 130 (2d Cir. 2008).

About the AUTHOR



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