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CORPORATE CRIME

Limiting Options for Corporate Crime Victims Under Federal Restitution Law

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Corporations have long sought to recoup costs incurred in responding to white-collar criminal conduct from individuals, such as former employees, who are subsequently convicted of federal crimes and subject to restitution at sentencing. But courts have been steadily narrowing the extent of such recovery, to the chagrin of cost-conscious in-house counsel and their insurance carriers, and to the relief of defendants already facing jail and other financial penalties.

A recent decision by the U.S. Court of Appeals for the Second Circuit, *United States v. Afriyie*, 27 F.4th 161 (2d Cir. 2022) continues that trend, holding that corporate victims may no longer seek restitution for costs associated with responding to SEC investigations, even though they frequently run closely parallel to many white-collar criminal matters.

The Supreme Court's Decision in 'Lagos'

The Mandatory Victims Restitution Act (MVRA) requires that defendants who are convicted of certain federal crimes must reimburse their victims for property losses including, among other things, "lost income and necessary child care, transportation, and other expenses incurred during participation in the investigation or prosecution of the offense or attendance at proceedings related to the offense." 18 U.S.C. §3663A(b)(4). The court may decline to impose restitution for certain offenses, including fraud, if the number of identifiable victims is so large as to make it impracticable or if the process of determining complex issues of fact related to the cause or amount of the victim's losses would unduly complicate or prolong sentencing.

In the context of corporate crime victims, litigation surrounding the issue of whether the often enormous costs of a private internal investigation qualified for recovery under the MVRA made its way to the U.S. Supreme Court in *Lagos v. United States*, 138 S. Ct. 1684 (2018). The court granted certiorari to resolve a lopsided circuit split on the issue.

A majority of appellate courts (including the Second Circuit) having addressed the issue had previously taken a broad view of "investigation" as used in the MVRA that allowed for recovery of funds expended by companies in hiring outside counsel to conduct internal investigations in matters which ultimately resulted in criminal charges. By contrast, the D.C. Circuit alone had held that the MVRA did not

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authorize restitution for the costs of an internal probe, unless the investigation was required or requested by criminal investigators.

In *Lagos*, the defendant defrauded a lender (GE Capital) out of tens of millions of dollars. The fraud involved generating false invoices for services that the defendant's company had not performed and then borrowing money from GE Capital using the false invoices as collateral. The scheme came to light, GE Capital investigated, and the government indicted Lagos, who pleaded guilty to wire fraud. The district court at sentencing ordered him to reimburse GE Capital for about $5 million in legal fees and expenses incurred during its own investigation, a ruling which was upheld by the Fifth Circuit.

The Supreme Court, in rejecting the restitution award, held that the words "investigation" and "proceedings" as used in the statute were solely limited to *governmental* investigations and *criminal* proceedings. As a threshold matter, the court noted that the term "investigation" was closely paired with the word "prosecution" in the text suggesting it referred to a criminal investigation conducted by the government. The court also noted that a victim was more aptly described as "conducting" rather than "participating" in a private investigation. Third, the court noted that the MVRA also provided for reimbursement of "lost income and necessary child care, transportation, and other expenses," all of which were more likely to be incurred in connection with a governmental criminal investigation than in a private investigation or civil proceeding.

From a policy standpoint, the court emphasized that a broader reading of the statute would create "significant administrative burdens." It might lead to disputes about whether a specific expense was "necessary" for an investigation. Parsing through the record of a multimillion dollar investigation to determine, for example, whether a particular witness interview or set of documents reviewed was "necessary" to an investigation would "invite controversy on those and other matters" that the Supreme Court's narrower interpretation of the MVRA would avoid. Such disputes would be especially pointless, the court noted given that 90% of criminal restitution judgments are never collected in full.

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As defense practitioners know, many white-collar corporate fraud cases also involve an SEC investigation which may or may not be accompanied with a parallel DOJ inquiry. Could a company avoid the impact of *Lagos* and recover fees and expenses associated with responding to a parallel civil or administrative governmental investigation? *Lagos* left that question unanswered but it was the subject of the recent *Afriyie* decision in the Second Circuit.

Recent Second Circuit Decision

John Afriyie was an investment analyst at MSD Capital. A private equity firm retained MSD to explore an acquisition. Afriyie accessed deal documents (although he was not part of the deal team), bought call options for shares of the target company, and netted around $1.5 million in trading profits when the acquisition was announced. Afriyie was subsequently indicted and convicted after trial on securities and wire fraud charges. A parallel SEC enforcement action ended with summary judgment in favor of the Commission, resulting in a multi-million dollar award against Afriyie.

In the criminal case, Judge Engelmayer sentenced Afriyie to 45 months in prison and ordered him to pay $663,028 in restitution to MSD Capital, a sum which was later reduced, in light of the intervening ruling in *Lagos*, to $511,368. The restitution award was intended to compensate the company for the costs of legal fees incurred by MSD's outside counsel, Sullivan & Cromwell, in connection with three categories of legal work that the firm had performed: (1) responding to subpoenas and requests from the U.S. Attorney (USAO) and the SEC; (2) preparing MSD witnesses to testify at trial; and (3) representing MSD in post-verdict restitution proceedings. The district court ordered the defendant to reimburse his former employer for all three categories, including the

SEC-related tasks, because it found that the "USAO and SEC investigations were parallel, coextensive, and symbiotic."

On appeal, the Second Circuit reversed, holding that the statute did not allow a victim to recover at a criminal restitution hearing expenses incurred while the victim had participated in an SEC civil enforcement investigation. The court noted at the outset that *Lagos* alone did not mandate that conclusion, since it only dealt with the question of whether the costs of private investigations could be recoverable. Nevertheless, according to the panel, *Lagos* instructed lower courts to read the term "investigation" narrowly. Given that restitution was a part of the criminal process, and the MVRA was housed in the federal criminal code, the court declined to read the operative language more broadly to encompass non-criminal proceedings.

While acknowledging that a victim could "participate" in an SEC investigation (as opposed to an internal probe), the court stated that it nevertheless did not think an SEC investigation could logically be considered an "investigation … of the *offense*" which the court viewed to mean a crime. The court further noted that it was unpersuaded that mere coordination between the USAO and the SEC somehow rendered otherwise ineligible SEC expenses recoverable. Although the government had pointed out in its restitution request that Sullivan & Cromwell generally made simultaneous productions to the USAO and SEC responding to nearly identical document requests, the court found that the government was conflating two distinct inquiries. "Before determining whether an expense was necessary, we must determine whether it was incurred pursuant to an investigation covered by the statute." Based on its statutory analysis as set forth above, an SEC investigation did not qualify.

The Second Circuit noted that its ruling would require the district court to review Sullivan & Cromwell's timesheets. While some of the time entries would reflect work on both the civil and criminal investigations, there were also numerous others, the court noted, reflecting work done solely in connection with the SEC or USAO investigations, in which case only the latter would be eligible for reimbursement. The court asked the district court "to devise a reasonable solution" relating to the commingled billing entries when recalculating MSD's recovery, but without giving any further guidance on how to do so.

Conclusion

Afriyie has created a bright line rule that may ultimately protect some defendants from having to pay certain exorbitant sums as restitution. While companies justifiably argue that the fees and costs expended in responding to a crime would never have been incurred but for the actions of a rogue bad apple, these kinds of costs, which can run into tens of millions of dollars depending on the length and scope of the investigations, may be grossly disproportionate to the magnitude of the underlying crime. To the extent white-collar defendants, already likely to face crippling criminal forfeitures, fines, legal fees, and a loss of future earnings are not also saddled with costs related to counsel dealing with civil and administrative proceedings, *Afriyie* seems like a reasonable decision.

On the other hand, the decision also creates a maddening and impractical situation for corporate counsel. The SEC and DOJ routinely coordinate document requests and interviews in conducting parallel investigations. They are encouraged to share information when permitted by the rules. Sophisticated outside counsel retained in such matters are likewise expected, as a matter of efficiency and good lawyering, to take both the criminal and civil aspects of a matter into consideration without compartmentalizing tasks. To complicate matters further, the vast bulk of lawyer hours in these types of cases are billed by associates in reviewing millions of documents, to be produced simultaneously to both the SEC and DOJ. It will therefore be interesting to see how the district court on remand figures out how to untie the Gordian knot of commingled time entries.