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Corporate Criminal Liability: Lessons From The *Rothstein* Debacle

Caitlin F. Saladrigas

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Corporate Criminal Liability: Lessons from the *Rothstein* Debacle

CAITLIN F. SALADRIGAS*

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“An under-appreciated evil of substantial frauds . . . is how they pit their victims against one another.”¹

INTRODUCTION

This article proposes the application of an existing solution to a recurring problem concerning bankruptcy and criminal forfeiture. It examines the existing procedures used by bankruptcy trustees and U.S. Attorneys to investigate financial fraud and to compensate the victims of such fraud.² Traditionally, bankruptcy trustees and U.S. Attorneys investigate different areas of the law, which rarely overlap. Bankruptcy trust-

* The author is a 2011 *magna cum laude* graduate of the University of Miami School of Law and is an associate at Lapin & Leichtling, LLP, in Coral Gables, Florida. She wishes to thank her husband for his patience and support in this endeavor. She also wishes to thank Professor Anthony V. Alfieri, Barbara Brandon, Professor Sergio Campos, Professor Patricia Redmond, Robin Schard, Evelyn B. Sheehan, and Francesco Zincone for their creative and meticulous editing and continuous direction and encouragement, as well as the *University of Miami Law Review* for transforming this piece into a publishable article. Lastly, she would like to thank Dr. Martin J. Sweet for always imploring her to chase her dreams.

1. *United States v. Dreier*, 682 F. Supp. 2d 417, 418 (S.D.N.Y. 2010).

2. “The U.S. Attorney’s Offices contributed to the collection of \$1.8 billion in asset forfeiture actions in FY2010. Forfeited assets are deposited into either the Department of Justice Assets Forfeiture Fund or the Department of Treasury Forfeiture Fund and are used to restore funds to crime victims and for a variety of law enforcement purposes.”

Press Release, United States Attorney’s Office Dist. of Conn., U.S. Attorney’s Office Collects More Than \$24 Million in FY2010 (Jan. 13, 2011).

ees focus on legal activities, while the U.S. Attorneys focus on criminal activities, and both are governed by separate statutory frameworks. Recently, however, a number of fraud schemes have involved otherwise legal business entities, thereby entangling the once-isolated worlds of criminal forfeiture and bankruptcy. This article addresses the problems that arise from the resulting collision of bankruptcy and criminal law, and proposes minor legal reforms that satisfy the objectives of both areas of law.

The collision of bankruptcy and criminal law typically arises when the collapse of the fraud scheme throws an organization voluntarily or otherwise into bankruptcy. Once the organization is in bankruptcy, jurisdictional battles can ensue to determine who best can marshal all of the assets belonging to the perpetrator and distribute the proceeds to victims and creditors. As bankruptcy trustees and U.S. Attorneys attempt to solve a legal juggernaut unforeseen by existing law, victims and creditors stand by and watch as their hopes of collecting a fraction of what they lost dwindle as fees rise and values of forfeited property depreciate. Ironically, these battles to determine who is best to collect and distribute the assets of the fraud result in draining the asset pool, making the victims worse off. This article uses the recent litigation in *United States v. Rothstein*³ as a cautionary tale, showing that the jurisdictional tête-à-tête that occurred between the bankruptcy trustee and the U.S. Attorney's Office squandered⁴ assets available to the victims and undermined the bankruptcy and criminal objectives reflected in law,⁵ to compensate the victims.

Instead of dragging financial victims and creditors through such endless battles, this article proposes a simple solution. In essence, the article proposes that, at the time that the government chooses to indict the defendant fraudster, it should consider strongly to indict the corporation subject (or potentially subject) to bankruptcy. Doing so sets clear boundaries between the bankruptcy trustee and the U.S. Attorney's Office, and, as I show below, increases the assets available to the victims and ensures a fair distribution of those assets.

3. *United States v. Rothstein*, No. 09-60331-CR-COHN, 2009 WL 6411668 (S.D. Fla. Dec. 1, 2009).

4. It is important to note here that although the debate between the bankruptcy trustee and the United States Attorney's Office in the *Rothstein* case presented arguments that centered on the protection and proper distribution of assets, in reality, the litigation moved comparatively quickly. Had Rothstein not pled guilty, the distribution of assets would have been delayed by several months due to trial. Further, the eve of Summer 2010 brought a briefing schedule from the district court, which also assisted in bringing about the speediest possible resolution of the case. All in all, given the conflict, this was the best-case scenario for the victims under the circumstances.

5. See 18 U.S.C. § 3771 (2006); see also Mandatory Victims Restitution Act of 1996, 18 U.S.C. § 3663A.

Corporate criminal liability is not a novel solution. Rather, it has been imposed as a method of regulating corporate conduct in ebbs and flows for more than a century.⁶ In the same amount of time, scholars have struggled with corporate criminal liability on an intellectual level.⁷ Attribution of personhood to a corporate entity,⁸ meaningful limitations on vicarious liability,⁹ and the effectiveness of deterrence¹⁰ all prove to be obstacles for scholars in the field.

Suggesting that U.S. Attorney's Offices include consideration of corporate criminal liability whenever they prosecute corporate fraud, requires a different approach to this ongoing debate. The intellectual obstacles present should be properly weighed against the utility corporate criminal liability can provide. Corporate criminal liability should be viewed as an enforcement tool; a means of facilitating coordination between concurrent civil and criminal proceedings and streamlining litigation. As an enforcement tool, corporate criminal liability offers a significant public policy advantage: maximized recovery to claimants in both the bankruptcy and criminal contexts.

This article has three parts. Part I briefly summarizes the corporate criminal liability debate to which this article contributes, but more importantly, this section suggests reframing the debate to focus on the societal benefits of corporate criminal liability. Part II constitutes a primer on both bankruptcy and criminal forfeiture procedure, and uses *United States v. Rothstein* as a case study of the coordination problems that arise when the procedures overlap. Part III proposes a solution to these coordination problems, arguing that U.S. Attorney's Offices handling cases similar to *United States v. Rothstein* ought to proceed by indicting both the individual defendant and the corporation in bankruptcy. It further details how this solution is legally viable, equitable, and practically applicable.

I. A BRIEF HISTORY OF THE NATURE OF THE CORPORATE CRIMINAL LIABILITY DEBATE

The struggle to determine whether criminal liability is an appropriate method of corporate regulation has plagued lawyers, judges, and scholars for more than a hundred years. Debates center on how the lack of natural personhood and concomitant issues of liability construction

6. See generally WILLIAM S. LAUFER, *CORPORATE BODIES AND GUILTY MINDS: THE FAILURE OF CORPORATE CRIMINAL LIABILITY* 1-99 (2006).

7. *Id.*

8. V.S. Khanna, Article, *Corporate Criminal Liability: What Purpose Does it Serve?*, 109 HARV. L. REV. 1477, 1479-1480 (1996).

9. *Id.* at 1484-87.

10. *Id.* at 1495-97.

affect methods and extent of punishment.¹¹ A concurrent theme underlying the debate is the apparent need for effective corporate regulation and enforcement mechanisms.¹² Corporate criminal liability is often imposed because “[i]f it were not so, many offenses might go unpunished and acts be committed in violation of law where . . . the statute requires all persons, corporate or private, to refrain from certain practices, forbidden in the interest of public policy.”¹³

Suggesting the application of corporation¹⁴ criminal liability when doing so would coordinate enforcement efforts and maximize victim recovery, which is exactly what this article purports to assert, lands this article squarely within the corporate criminal liability debate. Although this solution serves a distinct public purpose by creating order and hierarchy between bankruptcy trustees and U.S. Attorneys, it nevertheless raises the same concerns pertaining to personhood, construction of liability, and punishment. Because the proposition offered in this article touches on these debates, the sections that follow are necessary to provide the reader with sufficient background to understand where the *Rothstein* debacle falls within the debate and why applying corporate criminal liability in that case is specifically justified.

A. Personhood

While corporate criminal liability is part of the legal tapestry in this country today, it was not always so. Construction of corporate personhood began with two distinct theories: artificial entity theory and real entity theory.¹⁵ Artificial entity theory proceeds from the notion that a corporation is “nothing more than a creature of law, whose rights consisted only of those conferred by the state.”¹⁶ Real entity theory “posited that the corporation was a naturally occurring being, independent of the law and separate from its individual shareholders.”¹⁷ Over time, courts resorted to the application of real entity theory over artificial, founding

11. See Carol R. Goforth, “A Corporation Has No Soul”—*Modern Corporations, Corporate Governance, and Involvement in the Political Process*, 47 *Hous. L. Rev.* 617, 624 (2010); Khanna, *supra* note 8.

12. See generally Reinier H. Kraakman, *Corporate Liability Strategies and the Costs of Legal Controls*, 93 *YALE L.J.* 857 (1984).

13. *N.Y. Cent. & Hudson River R.R. Co. v. United States*, 212 U.S. 481, 495 (1909).

14. It is important to note that in the context of the piece, each reference to the “corporation” should be read to include all types of corporate entities that can be used to facilitate fraud, including, but not limited to, partnerships, limited liability partnerships, and limited liability corporations.

15. Daniel Lipton, Note, *Corporate Capacity for Crime and Politics: Defining Corporate Personhood at the Turn of the Twentieth Century*, 96 *VA. L. Rev.* 1911, 1915 (2010).

16. *Id.*

17. *Id.*

the analysis on property rights.¹⁸ Though, in actuality, corporations are mere legal fictions born of the filing of state-specific documents of incorporation, they are “persons at the law’s convenience.”¹⁹ This attribution of personhood allows corporations to sue and be sued in civil actions; it ascribes certain rights to the organization; and, most importantly for the purposes of this paper, the construction of personhood with relation to a corporation facilitates criminally charging the organization.²⁰

At common law, corporations were not viewed as capable of possessing the requisite intent to be held criminally liable.²¹ Corporate criminal activity is considered to be *ultra vires*.²² Born of the submission of certain signed documents, corporations act through their agents. These and other qualities of the corporate organization proved intellectually problematic to judges and scholars discussing corporate personhood.²³

However, with the increase in the number of corporations in the United States and the depth of their involvement in the daily lives of Americans during the Industrial Revolution and loose regulation, there was increased opportunity for corporate misconduct.²⁴ In the decades following society’s reliance on corporations coupled with rampant unpunished misconduct in the early 1900s, courts began to construe both personhood and criminal liability upon those corporations.²⁵ As scholars note, at this point in history, courts began to ignore corporate soullessness²⁶ and *ultra vires* constraints²⁷ in favor of imposing liability. At the turn of the twentieth century, “[e]nforcement concerns heightened as the nation witnessed the emergence of interstate commerce without effective legislative restraint.”²⁸ These “early instances of corporate criminal liability resulted from public harms, such as nuisance, for which private

18. *Id.* at 1915–16.

19. LAUFER, *supra* note 6, at 48.

20. *See generally* LAUFER, *supra* note 6; Lipton, *supra* note 15, at 1927.

21. In the historic *Dartmouth College* case, Chief Justice John Marshall wrote that a corporation is but “an artificial being, invisible, intangible, and existing only in contemplation of law. . . [with] only those properties which the charter of its creation confers upon it.” *Trs. of Dartmouth Coll. v. Woodward*, 17 U.S. (4 Wheat.) 518, 636 (1819).

22. Lipton, *supra* note 15, at 1926.

23. *See generally* Goforth, *supra* note 11.

24. LAUFER, *supra* note 6, at 23–45.

25. *Id.* at 20–21.

26. The notion that a corporation has no soul was regarded as an “old maxim of common law.” Mary Kreiner Ramirez, *The Science Fiction of Corporate Criminal Liability: Containing the Machine Through the Corporate Death Penalty*, 47 ARIZ. L. REV. 933, 933 (2005) (quoting LAWRENCE M. FRIEDMAN, *A HISTORY OF AMERICAN LAW* 513 (2d ed. 1985)).

27. Goforth, *supra* note 11, at 630 (citation omitted).

28. LAUFER, *supra* note 6, at 49 (citation omitted).

enforcement was unlikely.”²⁹ Without the intervention of federal legislation to help quell the storm of corporate takeover, attributing personhood to corporate entities arose as the only way to ensure that “corporation[s] and [their] actors properly internalized the cost of their activities to society.”³⁰

Although intent typically serves as the dividing line between civil and criminal liability, over time the line has blurred.³¹ This line of demarcation strikes a disharmonious chord when applied to corporations for the reasons stated above: namely that a corporation can only act through its authorized agents and the scope of its existence is expressly limited by the boundaries of the incorporating documents. Yet, by “the turn of the twentieth century . . . courts employing personhood as a threshold requirement for liability realized the costs of viewing corporations as nothing more than artificial beings, invisible, intangible, and existing only in contemplation of law.”³² Applying the law of agency, intent reflects back from officers, directors, employees, and other agents onto the corporate entity.³³

B. *Liability and Blame*

Accepting that corporations can be construed as persons capable of possessing the requisite intent to commit crimes, we turn to constructing the theory of that liability. Early theorists in the field of corporate criminal liability fought to draw a workable standard out of tort law. The question they endeavored to answer is simple: “In which cases should liability and blame for criminal acts of corporate agents be attributed to corporate entities?”³⁴ Answering this question, however, is incredibly complicated. Unlike human actions, “[c]orporate actions reflect a melding of individual decisions set within an organizational structure and embedded in an organizational culture.”³⁵ This organizational behavior transcends a single individual and concurrently so does liability.³⁶ Finding corporate criminal liability under a respondeat superior-type theory allows one individual’s misconduct to reflect on an entire corporate

29. Khanna, *supra* note 8, at 1485–86 (citation omitted).

30. *Id.* at 1486 (citation omitted).

31. “If the individual omitted the act purposely, we consider it to be a crime, while if the individual committed the act accidentally, we do not.” Pamela H. Bucy, *Corporate Ethos: A Standard for Imposing Corporate Criminal Liability*, 75 MINN. L. REV. 1095, 1099 (1991).

32. LAUFER, *supra* note 6, at 49 (citation omitted).

33. Stacey Neumann Vu, Note, *Corporate Criminal Liability: Patchwork Verdicts and the Problem of Locating a Guilty Agent*, 104 COLUM. L. REV. 459, 475–76 (2004).

34. LAUFER, *supra* note 6, at 70.

35. *Id.* at 59 (citation omitted).

36. Patricia S. Abril & Ann Morales Olazábal, *The Locus of Corporate Scierter*, COLUM. BUS. L. REV. 81, 161–62 (2006).

entity and, due to the nature of said entities, onto all other agents of it.³⁷

Cognizant of these concerns as well as others, a three-part standard emerged over time. To begin, the corporation must have committed an illegal act.³⁸ Further, the act must be committed with intent to commit the illegal act, *mens rea*.³⁹ This can be proven on an individual basis, i.e., that a specific individual had the intent to commit the illegal act or on a collective basis, i.e., where the employees of the corporation on the whole or a sufficient group were sufficiently aware that the illegal act was being committed.⁴⁰

Next, prosecutors must prove that either the individual agent or the group of agents were within the scope of their employment when he or they committed the illegal act. The scope of employment is defined as any “act that ‘occurred while the offending employee was carrying out a job-related activity.’”⁴¹ As in the areas of tort and business association law, there are instances when courts will hold corporations liable for the illegal acts of their employees even if the specific act was forbidden. Within this element of analysis, the breadth of the term “agent” should be noted; an agent need not be a member of the board of directors or a manager.

Finally, it must be shown that the agent intended to benefit the corporation with his illegal actions. This element of the standard is seemingly the easiest to meet. Courts have found that “the employee need not act with the exclusive purpose of benefiting the corporation”⁴² and courts do not always require that the corporation actually receive the intended benefit.⁴³

Understandable resistance has surfaced in scholarly debate with respect to the application of criminal liability in light of various undercutting agency theories. Within a corporate entity, there are multiple layers of actors. To some, “[c]orporate crime generally is not conceived of as a pervasive failure of organizations; it is a function of failed govern-

37. See Miriam H. Baer, *Organizational Liability and the Tension Between Corporate and Criminal Law*, 19 J.L. & POL’Y 1, 3 (2010); see also John C. Coffee, Jr., *Does “Unlawful” Mean “Criminal”?: Reflections on the Disappearing Tort/Crime Distinction in American Law*, 71 B.U. L. REV. 193, 213–15 (1991).

38. See LAUFER, *supra* note 6, at 11, 63–81.

39. See Khanna, *supra* note 8, at 1489 (citation omitted). Note that this current approach to liability assumes a corporation can possess *mens rea*, rejecting the Victorian tradition that a corporation cannot possess such intent. See Henry W. Edgerton, *Corporate Criminal Responsibility*, 36 YALE L.J. 827, 843 (1927).

40. See Khanna, *supra* note 8, at 1494–98.

41. See *id.* at 1489 (quoting *Developments in the Law—Corporate Crime: Regulating Corporate Behavior Through Criminal Sanctions*, 92 HARV. L. REV. 1227, 1250 (1979)).

42. *Id.* at 1490.

43. Khanna, *supra* note 8, at 1490 (citations omitted).

ance or failed leadership by officers and directors in a select few companies.”⁴⁴ Where the reach of criminal law extends only to “those individuals and organizations that demonstrate a certain willfulness, recklessness, intention, purpose, or knowledge in committing a prohibited act,”⁴⁵ it seems officers and directors bear the majority, if not the entirety, of the risk of criminal sanctions “for failures to make reasonable efforts to implement policies and practices that prevent crime.”⁴⁶ In sum, emerging complaints paint this construction of corporate liability as both over and under inclusive; critics find that it fails to optimally deter corporate misconduct.⁴⁷

C. Punishment

It seems self-evident that corporate punishment cannot parallel individual punishment. After all, corporate entities cannot be enclosed behind prison bars. However, punitive sanctions, monetary or equitable, can constitute criminal punishment.⁴⁸ In the same ways that substantive criminal law finds fodder for debating questions of whether a certain punishment meets a crime, the effectiveness of punitive sanctions, recidivism, etc., scholars debate the intersection of these familiar topics in the realm of corporate criminal liability.⁴⁹

44. LAUFER, *supra* note 6, at 74.

45. *Id.* at 59.

46. *Id.* at 57.

47. See Jennifer Arlen & Reinier Kraakman, *Controlling Corporate Misconduct: An Analysis of Corporate Liability Regimes*, 72 N.Y.U. L. REV. 687 (1997); see also Baer, *supra* note 37, at 1 (citation omitted); LAUFER, *supra* note 6, at 70–72 (Laufer suggests a liability theory he refers to as “constructive fault,” which construes “facts, circumstances, conduct, and intentionality of an organization, prompting a fair or reasonable attribution of liability.” *Id.* Further,

Constructive fault assumes that corporations may be distinguished from individual agents or aggregations of agents on the basis of their structure, decision making, size, formality, functionality, and complexity. It also assumes that corporate criminal liability should be reserved for crimes committed by agents whose actions and intentions are related in ways that reflect features and attributes of the organization, and agents whose relationship to the organization is such that their actions are in the name of the firm and thus those of the organization. Evidence of corporate criminal liability under a model of constructive fault may be found in distinct aspects of the organization, such as policies, goals, and practices that reveal more than the individual or collective nature of agents’ intentions and actions.

Id. (citations omitted). Finally, Laufer writes that “[c]ulpable organizational action may be identified through an objective test where it is determined that given the size, complexity, formality, functionality, decision-making process, and structure of the corporate organization, it is reasonable to conclude that the agents’ acts are those of the corporation.” *Id.* at 72.

48. See Khanna, *supra* note 8, at 1487, 1497–1500.

49. See generally Brent Fisse, *Reconstructing Corporate Criminal Law: Deterrence, Retribution, Fault, and Sanctions*, 56 S. CAL. L. REV. 1141, 1189–90 (1982); Regina A. Robson, *Crime and Punishment: Rehabilitating Retribution as a Justification for Organizational Criminal Liability*, 47 AM. BUS. L.J. 109, 111–12 (2010); Steven Walt & William S. Laufer, *Why*

With the growth in the regulatory powers of the federal government and its ordained enforcement agencies, many scholars question whether corporate criminal liability is still “needed” to achieve the task of deterring corporate misconduct.⁵⁰ Enforcement agencies, as sub-agents of the executive branch, operate civilly to enforce specific statutes. Corporations found in violation of a statute are subject to an enforcement proceeding and subsequently the imposition of a fine or some other penalty.⁵¹ Despite these numerous federal agencies, the Department of Justice nonetheless resists relinquishment of its power to hold corporate entities criminally liable.⁵²

Additionally, because of the difficulty and often incongruity in assigning organizational liability, some scholars fear that imposing criminal liability on corporations will appear more as “unpredictable ‘hard shoves’” rather than streamlined regulatory strategy.⁵³ Standards of proof are not reduced simply because the defendant is a corporation and not an individual, which makes attributing intent, given the agency dilemmas at issue, difficult.⁵⁴ To the public, the few criminally prosecuted corporations stand out as instances of the government taking the opportunity to make an example of corporate misconduct.⁵⁵ Further still, some argue that the negative publicity associated with an often public trial results in more than what is necessary to deter corporate misconduct.⁵⁶ In a sense, the negative reception of the company by the public after criminal indictment smacks of excessiveness.⁵⁷ By convicting a corporation, the jury may in fact be destroying the livelihood, if not the lives, of tens, hundreds, sometimes even thousands of people, and “it is not clear that corporate criminal liability is the best way to influence corporate behavior.”⁵⁸

Despite the various arguments raised against corporate criminal liability, significant public policy advantages remain. Especially when viewed through the lens of the current ad hoc methodology of bank-

Personhood Doesn't Matter: Corporate Criminal Liability and Sanctions, 18 AM. J. CRIM. L. 263 (1991).

50. Khanna, *supra* note 8, at 1521.

51. Wilson Meeks, Comment, *Corporate and White-Collar Crime Enforcement: Should Regulation and Rehabilitation Spell an End to Corporate Criminal Liability?*, 40 COLUM. J.L. & SOC. PROBS. 77, 83 (2006).

52. Memorandum from Larry D. Thompson, Deputy Attorney Gen., U.S. Dep't of Justice, to Heads of Dep't Components, U.S. Attorneys, Principles of Fed. Prosecution of Bus. Orgs. (Jan. 20, 2003).

53. LAUFER, *supra* note 6, at 193.

54. Khanna, *supra* note 8, at 1512–17.

55. For an anecdotal example, see LAUFER, *supra* note 6, at 45–47.

56. *Id.*

57. *Id.*

58. Khanna, *supra* note 8, at 1478.

ruptcy trustees and federal prosecutors engaged in corporate fraud litigation, corporate criminal liability makes sense. At a minimum, it saves time and money while maximizing victim recovery. On a broad scale, it provides a cohesive strategy that more effectively deters corporate misconduct in the first place. Either approach surely provides sufficient public policy incentives that warrant the treatment of corporations as individuals in order to subject them to criminal charges and punishment.

As this summary demonstrates, the debate over corporate criminal liability is wrought with intertwined normative concerns and positive realities. This piece endeavors to refocus the debate by casting some normative quandaries aside, so as to focus on a situation that warrants the use of corporate criminal liability. First, this piece recognizes corporate personhood as the critical building block for corporate criminal liability. Further, this piece limits its recommendation of corporate criminal liability only to *Rothstein*-like scenarios (i.e., where a legitimate business entity is utilized as a vehicle for an investment fraud scheme, and thus becomes the criminal enterprise for purposes of prosecuting a principal of the entity). Finally, this article advocates for corporate criminal liability only to the extent that it cleanly coordinates the U.S. Attorney's Office and the bankruptcy trustee in order to maximize the recovery to victims; punishing the business entity is not the purpose, nor, in *Rothstein* scenarios where involuntary bankruptcy is also on the table, is it the outcome. To expand on this stance, the next section articulates the specific statutory framework under criminal forfeiture law and bankruptcy law, and then—using *United States v. Rothstein* as a case study—demonstrates their unanticipated failure when both are applied to the same case.

II. THE *ROTHSTEIN* MELTDOWN

In the past few years, corporate principals have one by one been charged with criminal conduct perpetrated through the use of legitimate businesses. Newspapers have fed details of investment fraud to the news-hungry public, describing unfathomable amounts of money invested and lost at the hands of corporate fraudsters.⁵⁹ Because corporate fraud is often complicated, this section explains Scott Rothstein's Ponzi scheme, its exposure, and the ensuing litigation. The *Rothstein* case exemplifies a clash between bankruptcy and criminal litigation and

59. See Kevin McCoy, *Recession Forces Unraveling Ponzi Schemes into the Open*, USA TODAY, Apr. 17, 2009, http://www.usatoday.com/money/markets/2009-04-17-markets-recession-scheme-ponzi_N.htm; Leslie Wayne, *The Mini-Madoffs*, N.Y. TIMES, Jan. 28, 2009, at B1; Benjamin Weiser, *Lawyer Sentenced to 20 years for \$700 Million Fraud*, N.Y. TIMES, July 14, 2009, at A20.

illustrates the chaos that can result without coordination. In an effort to clarify the complex litigation that erupted in the aftermath of the *Rothstein* scandal, this section also articulates how bankruptcy and criminal forfeiture law function absent an investment fraud scheme perpetrated through a legitimate business that entangles the two. In so doing, this section builds upon the corporate criminal liability debate by detailing a situation that falls at the crossroads of civil and criminal liability.

South Florida arrived on the national investment fraud scene with the collapse of a Ponzi scheme⁶⁰ perpetrated by the CEO and chairman of the region's now-defunct law firm Rothstein, Rosenfeldt & Adler ("RRA").⁶¹ Beginning in 2006, Scott W. Rothstein went the way of Bernard Madoff,⁶² Marc Dreier,⁶³ and other notable investment fraudsters by eliciting investors to buy non-existent, out-of-court structured settlements relating to sexual harassment and whistle-blower cases.⁶⁴ As 2009 marched to an end, Rothstein's fraud crumbled until its ultimate collapse in November of that year. When the dust settled, over \$1.2 billion had churned through the scheme.⁶⁵

From his position within the firm and with the help of his co-conspirators, Rothstein began soliciting clients and friends to invest in confidential settlement agreements.⁶⁶ Specifically, Rothstein represented to potential investors that his firm was negotiating confidential settlement agreements for sexual harassment and whistle-blower causes of action.⁶⁷ In order to secure the credibility of the investment opportunity, Rothstein infused his solicitation with false statements regarding the firm's prestige and extensive client base. The talented lawyers employed created the veneer of prestige with lavish expenditures,⁶⁸ including law firm parties and charity contributions.⁶⁹

Rothstein maintained that RRA's internal controls solidified the

60. "A ponzi scheme is a scheme whereby a corporation operates and continues to operate at a loss. The corporation gives the appearance of being profitable by obtaining new investors and using those investments to pay for the high premiums promised to earlier investors." *McHale v. Huff (In re Huff)*, 109 B.R. 506, 512 (S.D. Fla. 1989).

61. Information at 1, *United States v. Rothstein*, No. 09-60331-CR-COHN (S.D. Fla. Dec. 1, 2009), ECF No. 1.

62. Complaint at 1-2, *United States v. Madoff*, No. 08-MAG-2735 (S.D.N.Y. Dec. 11, 2008).

63. Indictment at 1, *United States v. Dreier*, No. 09-CRIM-085 (S.D.N.Y. Jan. 29, 2009), ECF No. 11.

64. Information at 4, *Rothstein*, No. 09-60331-CR-COHN, ECF No. 1.

65. *Id.* at 2-3.

66. *Id.* at 4.

67. *Id.* at 3-4.

68. *Id.* at 6.

69. Michael Mayo, *A New Big Shot in Town: Lawyer Builds Powerful Firm*, SUN SENTINEL, Nov. 16, 2008, http://articles.sun-sentinel.com/2008-11-16/news/0811150310_1_law-firm-lawyer-friend.

security of the investments. The firm allegedly “rigorously screened” the confidential settlement agreements and “utilized former law enforcement personnel and employed highly sophisticated methods in selecting and pursuing claims against purported defendants”⁷⁰ The firm would consult with the defendant company after the company was made aware of the claim, and negotiate a payout to the claim holder; all negotiation purportedly occurred with “no court or governmental” involvement.⁷¹ The investment opportunities arose when the claimholders turned down periodic payments and instead opted for a smaller lump sum payout.⁷² Investors would supply the money for the lump sum payouts, and then receive the returns from the purported defendant payments.⁷³

To grease the wheels, Rothstein routinely informed investors that RRA maintained trust accounts for each investor, and that the funds were regularly verified by “independent verifiers.”⁷⁴ Further, funds were allegedly kept in trust accounts in a reputable international bank from which regular statements would be issued.⁷⁵ All of these details compose the underpinnings of an investment scheme that promised to double their investment in six months.⁷⁶

In classic Ponzi scheme fashion, RRA’s actual conduct with respect to its investors’ money fell exceedingly short of the promises offered to investors. In fact, RRA began paying out the returns on its earlier investors’ money with subsequent investors’ initial investments.⁷⁷ Pressure mounted, thanks to the economic downturn, and the “house of cards” built by Rothstein came crashing down.⁷⁸ The beginnings of Rothstein’s Ponzi scheme trace back to 2006, but it was not until the recession took hold of the economy that his fraud was discovered.⁷⁹ Following the col-

70. Information at 6–7, *Rothstein*, No. 09-60331-CR-COHN, ECF No. 1.

71. *Id.* at 7.

72. *Id.*

73. *Id.* at 7–8.

74. *Id.* at 8–9.

75. *Id.* In fact, investor funds were deposited into trust funds in the name of the firm; said accounts, however, were a far cry from the individualized, monitored accounts Rothstein described. Instead, the accounts were glorified slush funds containing mixed investor and non-investor funds—a reality that plagued both the bankruptcy trustee and the Assistant U.S. Attorneys attempting to fashion an equitable outcome despite the financial mess. See DE 90 from USA v. Rothstein; see also John Pacenti, *Rothstein Prosecutors Fear Attorney Fees May Bleed Estate Dry*, DAILY BUS. REV., July 2, 2010, at A1.

76. Michael Mayo, *Do Investors in Ponzi Schemes Deserve Money Back?* SUN SENTINEL, Aug. 31, 2010, http://articles.sun-sentinel.com/2010-08-30/news/sfl-mike-mayo-rothstein-link-08302010_1_rothstein-investors-law-firm-trust-accounts-scott-rothstein.

77. Information at 10, *Rothstein*, No. 09-60331-CR-COHN, ECF No. 1.

78. See Joshua Marcus & Jake Greenberg, *Ponzi Schemes: Washed Ashore by Recession’s Low Tide, Reveal Controversial Issues*, AM. BANKR. INST. J., Oct. 2010, at 48.

79. See Tonya Alanez, *Lawyer’s Scandal is a Windfall for Others*, SUN SENTINEL, Dec. 5,

lapse of the investment scheme came two simultaneous litigation efforts: one headed by a federal bankruptcy trustee wading through the mire of the defunct RRA, and the other headed by the Department of Justice prosecuting Rothstein and collecting his assets.

As I will illustrate below, the uniqueness of Rothstein's fraud was not the scheme itself; rather, it was the overlapping of the ensuing litigation in the criminal forfeiture and bankruptcy contexts. The following two subsections look at the *Rothstein* litigation first as it would have played out absent the simultaneous bankruptcy proceeding, and then as it actually happened, to demonstrate how a lack of priority and coordination between the two enforcers nearly railroaded both efforts and ultimately cost victims and creditors. What newspaper reporters in the South Florida community dubbed the "Rothstein fallout" referring to the exposure of the Ponzi scheme and the failure of his Fort Lauderdale law firm, more aptly described the jurisdictional battles, the frustrated attorneys, the empty-handed creditors and victims, and the ever-ticking fee meter that existed due to the lack of coordination.⁸⁰ Much like the preceding case against lawyer Marc Dreier in New York, both proceedings putatively sought the same outcome: to maximize the recovery of assets for fraud victims.⁸¹ Each "ma[d]e claim to having some unique overarching power to accomplish this objective: Bankruptcy has the automatic stay and orderly rules . . . and the forfeiture case provides the government with powerful investigatory and asset seizure authority."⁸²

A. *The Best Laid Plans: Criminal Forfeiture & Rothstein*

A criminal fraud case begins, as Rothstein's did, with the formal charging of the defendant. In the charging document, either an information (typically indicative of some type of plea arrangement or offer to cooperate with the prosecution) or an actual indictment, a forfeiture allegation will be included.⁸³ Criminal forfeiture requires that the defendant

2009, http://articles.sun-sentinel.com/2009-12-05/news/0912040189_1_rothstein-rosenfeldt-adler-criminal-defense-non-equity-partner.

80. Peter Franceschina, Sally Kestin & Brittany Wallman, *Rothstein Fallout Lands Far and Wide*, SUN SENTINEL, Jan. 27, 2010, http://articles.sun-sentinel.com/2010-01-27/news/1001270072_1_rothstein-rosenfeldt-adler-firm-co-owner-stuart-rosenfeldt-scott-rothstein.

81. Chapter 11 Bankruptcy Trustee's Motion to Refer All Third Party Claims to the United States Bankruptcy Court, *United States v. Rothstein*, No. 09-60331-CR-COHN (S.D. Fla. Feb. 19, 2010), ECF No. 88; Government's Response in Opposition to Chapter 11 Bankruptcy Trustee's Motion to Refer All Third Party Claims to the United States Bankruptcy Court at 3, *United States v. Rothstein*, No. 09-60331-CR-COHN (S.D. Fla. Mar. 5, 2010), ECF No. 94.

82. Courtney J. Linn, *Recovering Assets in Investment Fraud Cases*, 45 CRIM. L. BULL. 744, 747 (2009).

83. FED. R. CRIM. P. 32.2(a). This statement raises the question of how the government determines what property should be subject to forfeiture. In reality, the investigative agencies working with the government would have begun their work long before a formal charge was

be convicted of the related criminal offense.⁸⁴ Because forfeiture is part of the sentence, if the prosecution fails to prove the underlying criminal conviction, the forfeiture also fails.⁸⁵ In addition, the Government will typically file a bill of particulars listing specific forfeitable assets found after the filing of the charging document.⁸⁶ The next step would traditionally be conviction by way of trial or the guilty plea of the criminal defendant.⁸⁷ A conviction or a guilty plea is necessary for the forfeiture proceeding, as only the assets related to the convicted crimes are eligible for criminal forfeiture.⁸⁸

With a guilty plea from the defendant to the criminal allegations or a conviction from the jury as to both the criminal and forfeiture allegations, the Government would compose its final list of forfeitable assets and file a preliminary order of forfeiture with the corresponding district court.⁸⁹ The preliminary order would establish, by a preponderance of the evidence, that the assets named were one of three things: (1) proceeds of the charged crimes, (2) sufficiently involved in the commission of those crimes, or (3) used to disguise the commission of those crimes.⁹⁰ The district court will review the forfeiture allegations and determine whether the Government met its burden of providing an essential nexus between the assets and the crime and if the facts are sufficient to show that the forfeited assets were involved in the fraud.⁹¹

If the district court agrees with the U.S. Attorney's Office and issues the preliminary order of forfeiture, ancillary proceedings can then commence.⁹² These ancillary proceedings are much like quiet title

lodged against the defendant. Prior investigation results in the bill of particulars subject to forfeiture used in the charging document.

84. See *United States v. Aramony*, 88 F.3d 1369, 1387 n.11 (4th Cir. 1996) (vacating forfeiture order because the convictions were vacated); see also Craig Peyton Gaumer, *When Two Worlds Collide: The Relationship and Conflicts Between Asset Forfeiture and Bankruptcy Law*, AM. BANKR. INST. J., May 2002, at 10, 37 ("Criminal forfeiture is imposed as part of the sentence on a convicted person." (citation omitted)).

85. See Heather J. Garretson, *Federal Criminal Forfeiture: A Royal Pain in the Assets*, 18 REV. L. & SOC. JUST. 45 (2008).

86. DEE R. EDGEWORTH, *ASSET FORFEITURE: PRACTICE AND PROCEDURE IN STATE AND FEDERAL COURTS* 186 (2d ed. 2008) (citations omitted).

87. Stefan D. Cassella, *Criminal Forfeiture Procedure: 2007*, 43 CRIM. L. BULL. 461, 478-84 (2007).

88. EDGEWORTH, *supra* note 86, at 5, 191.

89. *Id.* at 194. The order is entered irrespective of any third-party claims, as those will be resolved at the ancillary hearing. FED. R. CRIM. P. 32.2(b)(2).

90. See Stefan D. Cassella, *Criminal Forfeiture Procedure: An Analysis of Developments in the Law Regarding the Inclusion of a Forfeiture Judgment in the Sentence Imposed in a Criminal Case*, 32 AM. J. CRIM. L. 55, 70, 74 (2004).

91. See EDGEWORTH, *supra* note 86, at 13 ("The government is required to establish a nexus between the property to be forfeited and the criminal violation.").

92. FED. R. CRIM. P. 32.2(b)(2)(A).

actions to settle ownership of the forfeited assets with respect to third-party claimants.⁹³ During an investigation preceding a criminal charge, the prospective defendant's assets may be seized.⁹⁴ Whether seized prior to or in accordance with an indictment, the true ownership of assets remains a question until the ancillary proceedings.⁹⁵ The ancillary proceedings exist to protect the rights of the true owners of the seized and forfeited property.⁹⁶ Third-parties who claim an interest in the seized property may file claims to that property at the ancillary proceedings.⁹⁷ Once the claim is filed, federal courts will look to the controlling state law to determine the nature of the claimant's interest in the property and then will apply federal forfeiture law.⁹⁸

If the federal court is satisfied that the claimant has an interest in the property, the court will then look to 21 U.S.C. § 853(n)(2) to determine if the individual has standing in federal court,⁹⁹ and subsequently 21 U.S.C. § 853(n)(6) to determine if the claimant prevails on the merits.¹⁰⁰ Under § 853(n)(2), the claimant must assert "a legal interest in the property which has been forfeited to the United States," by a preponderance of the evidence.¹⁰¹ In doing so, all of the usual constitutional principles governing Article III standing apply.¹⁰² Specifically, a third-party claimant in a criminal forfeiture case must show "actual or imminent injury—not a hypothetical, conjectural, or abstract injury"—resulting from the forfeiture of the property.¹⁰³ By successfully establishing an interest in the property, the claimant will be awarded standing in the federal forum.

Having established standing, the third-party claimant would then proceed to the merits within the ancillary proceeding.¹⁰⁴ Section 853(n)(6) allows two distinct categories of claimants to prevail:¹⁰⁵ only "those whose legal interests in the property were superior to the defendant at the time the interest of the United States vested through the com-

93. See Cassella, *supra* note 90, at 93.

94. See EDGEWORTH, *supra* note 86, at 186–90.

95. *Id.* at 196 (footnote omitted).

96. See *United States v. Gilbert*, 244 F.3d 888, 913 (11th Cir. 2001), *superseded on other grounds*, *United States v. Marion*, 562 F.3d 1330 (11th Cir. 2009) ("[T]he statute [18 U.S.C. § 1963(l) (2000)] was designed to protect only the property rights of innocent third-parties, not those of the government.").

97. 21 U.S.C. § 853(n)(2)–(3) (2006).

98. EDGEWORTH, *supra* note 86, at 199 (citations omitted).

99. Cassella, *supra* note 87, at 505 (citing 21 U.S.C. § 853(n)(2)).

100. 21 U.S.C. § 853(n)(2), (n)(6).

101. Cassella, *supra* note 87, at 505.

102. See *United States v. Lazarenko*, 476 F.3d 642, 649 (9th Cir. 2007) (citation omitted).

103. *Id.* (citation omitted).

104. See Cassella, *supra* note 87, at 506.

105. 21 U.S.C. § 853(n)(6)(A)–(B).

mission of an act giving rise to forfeiture and bona fide purchasers for value without knowledge of the forfeitability of the defendant's assets."¹⁰⁶ Pleading a superior right, title, and interest is narrower than it sounds. Under forfeiture law, the government's interest in the forfeitable property vests at the time the offense occurs, not when the offense is discovered or charged or when the property is seized.¹⁰⁷ In order to prevail in an ancillary proceeding, therefore, the claimant must show that he or she had superior title to the defendant at the time of the offense.¹⁰⁸ Bona fide purchasers must simply prove that they purchased the ultimately forfeited property without any knowledge that it was related to criminal offenses and have a legal interest in the property.¹⁰⁹

The claimants, having established one of these two legal bases, would be returned title to the property. In more basic criminal offenses where the forfeited property is personal or real property belonging to a claimant, the title to that property is simply returned to the rightful owner.¹¹⁰ Typically in investment fraud schemes, however, things are more complicated. There are usually fewer assets to hand out than claimants petitioning return of property.¹¹¹ With insufficient assets to fully retribute victims, courts then have to decide the percentage victims are entitled to receive.¹¹² A victim's recovery can be greatly influenced by when the victim invested in the scheme and the extent of his or her respective losses.¹¹³

Ultimately, the U.S. Attorney's Office operates in pursuit of strict goals when handling fraud. Punishment of the fraudster is a top priority, but in more recent years, so is restituting the victims. The job once left to the civil arena now represents an important and successful objective. More importantly, federal prosecutors endeavor to manage this new priority in the most cost-effective manner, utilizing the many agency-related resources available to do so.¹¹⁴

106. See Cassella, *supra* note 87, at 507 (citation omitted).

107. *Id.* at 495 (citation omitted).

108. *United States v. Hooper*, 229 F.3d 818, 821 (9th Cir. 2000) (citation omitted).

109. Cassella, *supra* note 87, at 510–11 (citation omitted).

110. See *Caplin & Drysdale, Chartered v. United States*, 491 U.S. 617, 629 (1989) (“[T]he statute [21 U.S.C. § 853(n)(6)(A)] permits ‘rightful owners’ of forfeited assets to make claims for forfeited assets before they are retained by the Government.”).

111. “On average, the government collects about four to seven cents of [every] dollar of criminal debt. Of the total criminal debt owed, two-thirds of it consists of restitution debt owed in fraud cases.” Linn, *supra* note 82, at 745 (citation omitted).

112. *Id.* at 744–754.

113. See generally Karen E. Nelson, *Turning Winners into Losers: Ponzi Scheme Avoidance Law and the Inequity of Clawbacks*, 95 MINN. L. REV. 1456 (2011).

114. See generally Linn, *supra* note 82.

B. *Enter Bankruptcy*

On the other hand, the Bankruptcy Code provides for a wholly separate framework for effectuating a similar purpose: collecting assets of a defunct business enterprise and redistributing their value to properly claiming creditors. As it currently stands, Title 11 of the United States Code (“Bankruptcy Code”) is fashioned to provide eligible debtors (both individuals and business entities) the opportunity to restart financially through reorganization or liquidation. To commence a case under bankruptcy, a petition, voluntary or involuntary, must be filed.¹¹⁵ As a matter of law, the filing of a bankruptcy petition creates a bankruptcy estate comprised of “all legal or equitable interests of the debtor in property as of the commencement of the case,”¹¹⁶ and the statutory automatic stay becomes effective.¹¹⁷

With the legal creation of the bankruptcy estate, managerial authority of the estate must be established. The bankruptcy court where the petition was initially filed will either appoint a bankruptcy trustee or, in certain circumstances pertaining to reorganization, a debtor-in-possession.¹¹⁸ Throughout the course of the bankruptcy proceedings, whether they be exemption proceedings or the development of a reorganization plan, either the trustee or the debtor-in-possession will represent the debtor.¹¹⁹ Depending on the complexity of the estate, the trustee will be responsible for maintaining all aspects of the estate while proceedings are pending. In the case of the trustee, fees are paid from the pool of assets acquired in either a reorganization or a liquidation proceeding.¹²⁰

During the administration of the estate, the automatic stay serves an invaluable function. Essentially injunctive relief protecting both the debtor and the creditors as a whole, the automatic stay limits individual creditor actions against the estate for the duration of the bankruptcy proceeding.¹²¹ The automatic stay allows the bankruptcy trustee or debtor-in-possession time to develop a way of resolving the financial affairs of the debtor.¹²² In the winding up or reorganization of the debtor’s financial affairs, the automatic stay ensures that creditors are treated equally

115. FED. R. BANKR. P. 1002.

116. 11 U.S.C. § 541(a)(1) (2006).

117. *Id.* § 362(a).

118. *Id.* §§ 701–703.

119. *Id.* § 1107(a).

120. Phillip L. Kunkel, Jeffrey A. Peterson & Jessica A. Mitchell, *Bankruptcy: Chapter 7 Liquidations*, UNIV. MINN. EXTENSION (2009), <http://www.extension.umn.edu/distribution/businessmanagement/df/7295.html>.

121. 11 U.S.C. § 362(a)(2)–(3).

122. DOUGLAS G. BAIRD, *ELEMENTS OF BANKRUPTCY* 14 (4th ed. 2006); Michael L. Cook & Jessica L. Fainman, *The Bankruptcy Code’s Automatic Stay*, in 29TH ANNUAL CURRENT DEVELOPMENTS IN BANKRUPTCY & REORGANIZATION 661 (2007).

rather than permitting a race to file against the debtor, which would benefit the single creditor to the disadvantage of other creditors.¹²³ Despite the breadth of application of the automatic stay, it does not stop collection of alimony, child support payments, or the commencement or continuation of criminal proceedings against the debtor.¹²⁴

To ensure repayment of debts and obligations, creditors must take certain actions. Indeed, timely preparation and filing of a proof of claim establishes the nature of the claim, whether secured or unsecured, and the amount.¹²⁵ A claimant's establishment of secured status is significant because it will greatly affect the extent of repayment. Creditors are prioritized based on the secured or unsecured status of their claims; secured creditors receive repayment before unsecured creditors.¹²⁶ When all assets are accounted for and the time for settling debts arrives, secured creditors will likely receive closer to the total amount of the debt owed in repayment and unsecured creditors will only receive a percentage of the debt repayment.¹²⁷

The bankruptcy estate is actually larger than the statutory language suggests. In addition to all the legal and equitable interests of the debtor at the commencement of the proceeding, the bankruptcy estate can expand to include all assets fraudulently transferred.¹²⁸ Under the Bankruptcy Code, any assets transferred within ninety days of a bankruptcy filing are automatically subject to the trustee's fraudulent transfer powers—denoted in the trade as “clawbacks.”¹²⁹ Further, any preferential transfers made to friends, family members, or business associates prior to the filing of bankruptcy are also subject to the clawback power.¹³⁰ In practice, trustees can significantly expand the size of the asset pool through the use of the clawback power.¹³¹

Trustee fees remain the single most important element within the statutory framework for bankruptcy.¹³² The Bankruptcy Code provides a

123. H.R. REP. NO. 95-595, at 174, 340 (1977).

124. 11 U.S.C. § 362(b)(2)(A)–(C). This paper concerns the exemption to the automatic stay that arises in the context of criminal proceedings. Conceivably, under the Bankruptcy Code, federal prosecutors could choose to indict a corporate entity at almost any stage of the bankruptcy case and effectively halt its continuation. The effect of a given criminal action would depend on the nature of assets involved and the amount subject to criminal forfeiture.

125. *Id.* § 501.

126. *Emp'rs Ins. of Wasau v. Ramette (In re HLM Corp.)*, 183 B.R. 852, 854 (D. Minn. 1994).

127. Miriam A. Cherry & Jarrod Wong, *Clawbacks: Prospective Contract Measures in an Era of Excessive Executive Compensation and Ponzi Schemes*, 94 MINN. L. REV. 368, 397–403 (2009).

128. Nelson, *supra* note 113, at 1459.

129. See Cherry & Wong, *supra* note 127.

130. *Id.*

131. *Id.*

132. See 11 U.S.C. §§ 547–548.

statutory entitlement for fees for the bankruptcy trustee and any attorneys or accountants he or she may hire to assist in the bankruptcy proceeding.¹³³ To ensure payment of fees, priority is given to the trustee to collect his or her fees first. Prior to distributing any assets to deserving creditors, the bankruptcy trustee will be paid, with approval by the bankruptcy court, his or her fees.¹³⁴ Fees include the attorneys and accountant fees all totaled by multiplying the hourly rate by the amount of hours; fees must be approved by the court as reasonable.¹³⁵

Once the entire bankruptcy estate is accumulated and reduced by the fee, the trustee will then distribute assets. As described above, the status of each creditor's claim is of maximum importance. Often, a defunct business has fewer assets on its balance sheet than debts owed to creditors. Secured creditors can worry less because their claims will be paid first with the existing assets.¹³⁶ Meanwhile, unsecured creditors must wait with fingers crossed in hopes that there will be enough left over.¹³⁷ In order to provide some level of protection for their claims, many times creditors develop "committees" which hire lawyers to advocate for their claims.¹³⁸

Although numerous means exist through which a debtor may proceed through the bankruptcy process, these steps are generalized and will pertain to most all debtors and creditors. This short recitation also makes clear that a broad statutory framework exists to handle financial failures of individuals and entities.¹³⁹ When aligned with the criminal forfeiture framework, certain parities arise while at the same time one may note distinctions. Given the incentives and drawbacks, coordination is even more important. Reviewing the *Rothstein* case study further illustrates the need for alignment of both processes.

C. *Two Worlds Colliding: United States v. Rothstein*

In *United States v. Rothstein*, the statutorily proscribed process did not transpire according to plan. Instead, a simultaneous bankruptcy proceeding began involuntarily against Scott Rothstein's firm at functionally the same time that the government began its case against Rothstein. Unlike other fraud cases, Rothstein's Ponzi scheme took the federal prosecutors by surprise; instead of building a strong case through inves-

133. *Id.* §§ 326–328.

134. *Id.* § 507(a)(1)(C).

135. *Id.* §§ 326, 330.

136. *Id.* § 724; Omer Tene, *Revisiting the Creditors' Bargain: The Entitlement to the Going-Concern Surplus in Corporate Bankruptcy*, 19 *BANKR. DEV. J.* 287 (2003).

137. *See generally* 11 U.S.C. § 507.

138. *See, e.g., In re Advisory Comm. of Major Funding Corp.*, 109 F.3d 219 (5th Cir. 1997).

139. *See* 11 U.S.C. § 109.

tigation, the initial steps in the prosecution were purely reactive. In the bankruptcy world, with the filing of the involuntary petition of bankruptcy against Rothstein, Rosenfeldt & Adler, the quickly appointed trustee began to arrange the bankruptcy estate.¹⁴⁰ Much to his chagrin, however, many of the assets that would otherwise be under his control or at least subject to the automatic stay were seized by the Government and inaccessible.¹⁴¹ As will be demonstrated by the forthcoming reconstruction of both the district court and the bankruptcy dockets, the bankruptcy trustee exercised his powers under the Bankruptcy Code and attempted at every possible opportunity to bring the seized assets in the possession of the federal government within the bankruptcy estate of Rothstein, Rosenfeldt & Adler.¹⁴² As the reconstruction of the major points in the litigation should demonstrate, the *Rothstein* meltdown illustrates a stark need for coordination between the federal prosecutor's office and bankruptcy trustees involved in the aftermath of financial frauds. Further, this coordination serves the interest of public policy in and of itself while also protecting both creditors and victims, whose interests seemed a sideshow during the *Rothstein* litigation.

Litigation began on November 10, 2009, prior to Rothstein's apprehension by the Federal Bureau of Investigation, when four creditors filed a Chapter 11 Involuntary Petition for Bankruptcy against alleged debtor Rothstein, Rosenfeldt & Adler.¹⁴³ Ten days later, the United States Bankruptcy Court for the Southern District of Florida appointed Herbert Stettin to serve as trustee.¹⁴⁴

The United States filed formal charges against Rothstein, by way of Information, on December 1, 2009, alleging racketeering, money laundering conspiracy, mail and wire fraud conspiracy, and wire fraud.¹⁴⁵ Count I (Racketeering) of the criminal Information, named RRA the criminal enterprise through which the defendant, Scott Rothstein, conducted his alleged racketeering.¹⁴⁶ Rothstein's means of engaging in criminal racketeering are listed at length, and include distributing "lavish

140. See Paula McMahon, Jon Burstein & Sally Kestin, *Rothstein Gives Up Homes, Businesses to Government*, SUN SENTINEL, Dec. 4, 2009, http://articles.sun-sentinel.com/2009-12-04/news/0912030367_1_scott-rothstein-rothstein-rosenfeldt-adler-ponzi-scheme.

141. Peter Franceschina, *Battle Over Rothstein's Assets Goes to Court Monday*, SUN SENTINEL, Aug. 29, 2010, http://articles.sun-sentinel.com/2010-08-29/news/fl-rothstein-forfeiture-hearing-20100829_1_rothstein-rosenfeldt-adler-law-ponzi-schemer-scott-rothstein-clawback-suits.

142. 11 U.S.C. §§ 323, 361–366.

143. Involuntary Petition, *In re* Rothstein Rosenfeldt Adler, P.A., No. 09-34791-RBR (Bankr. S.D. Fla. Nov. 10, 2009), ECF No. 1.

144. Appointment of Chapter 11 Trustee and Setting of Bond, *In re* Rothstein Rosenfeldt Adler, P.A., No. 09-34791-RBR (Bankr. S.D. Fla. Nov. 20, 2009), ECF No. 35.

145. See *United States v. Various Real Props.*, No. 0:09-cv-61780-WJZ (S.D. Fla. Nov. 9, 2009).

146. *Id.* at 2.

gifts including exotic cars, jewelry, boats, loans, cash and bonuses to individuals and members of RRA in order to engender goodwill and loyalty and to create the appearance of a successful law firm,"¹⁴⁷ and

utiliz[ing] funds obtained through the "Ponzi" scheme to supplement and support the operation and activities of RRA, to expand RRA by the hiring of additional attorneys and support staff, to fund salaries and bonuses, and to acquire larger and more elaborate office space and equipment in order to enrich the personal wealth of persons employed by and associated with the Enterprise.¹⁴⁸

In addition, Count II (Money Laundering Conspiracy) alleged that Rothstein and RRA had thirty-eight accounts at TD Bank, N.A. and at least four other accounts at Gibraltar Private Bank and Trust.¹⁴⁹ The last three counts, one of mail fraud combined with wire fraud and two of wire fraud particularly, involved only the defendant.¹⁵⁰

In addition to the criminal allegations, the Information contained an allegation of criminal forfeiture that attached due to the nature of the criminal charges.¹⁵¹ The federal statutes tied to the five counts within the Information provide for forfeiture of any interest or proceeds gained from the commission of the crimes.¹⁵² In addition to the allegation of forfeiture, the Government provided a bill of particulars detailing the property subject to forfeiture, which included, "a sum of money equal to [\$1.2 billion] in United States currency" as well as a list of real properties, vehicles, vessels, tangibles, bank accounts, and business interests.¹⁵³ The bill of particulars lists all the assets that were allegedly purchased or otherwise acquired through the proceeds of Rothstein's fraud or attempts to hide the fraud as a legitimate business.¹⁵⁴ The trust accounts are of particular importance because traditionally a bankrupt entity's bank accounts are unquestionably part of the bankruptcy estate.¹⁵⁵ In this case, the accounts were used to funnel money for Rothstein's fraud as well as to hide the fact that a fraud was going on at

147. *Id.* at 12.

148. *Id.* at 11.

149. *Id.* at 14.

150. *Id.* at 15–17.

151. *Id.* at 17.

152. Under criminal forfeiture law, the criminal defendant must be convicted of a criminal act in violation of a statute that allows for forfeiture upon conviction. *See* Information at 17–19, *United States v. Rothstein*, No. 09-60331-CR-COHN, ECF No. 1; Stefan D. Cassella, *Criminal Forfeiture Procedure in 2008: An Annual Survey of Developments in the Case Law*, 44 *CRIM. L. BULL.*, Summer 2008.

153. Information at 19–34, *Rothstein*, No. 09-60331-CR-COHN, ECF No. 1.

154. *Id.* at 17–18.

155. 11 U.S.C. § 541.

all.¹⁵⁶ The bank accounts serve as an integral part of the battle between the trustee and the U.S. Attorney's Office since a large number of funds were maintained there.

On December 6, 2009, the U.S. Attorney's Office filed for a protective order requesting that the district court grant the federal government the exclusive role of seizing and maintaining Rothstein's assets involved in the fraud, including the RRA trust accounts through which Rothstein funneled investor funds and extracted funds for his own enjoyment.¹⁵⁷ The court granted the motion on December 7, 2009,¹⁵⁸ causing exasperated cries from attorneys working in the concurrent bankruptcy proceeding.¹⁵⁹

Barely a week later, the bankruptcy trustee filed a Motion to Modify Protective Order and Authorize the United States Marshals Service to Turnover 8 RRA Bank Accounts.¹⁶⁰ Citing requests by previous clients and employees of the firm, the trustee assumed the stance that "[g]iven the complex task involved in dismantling a sophisticated Ponzi scheme involving an operating law firm . . . the bankruptcy system is best equipped to marshal the debtor's assets and to resolve competing claims to the same properties."¹⁶¹ This motion began the battle over control of the assets, particularly RRA trust accounts, and power to distribute those assets to those who claimed entitlement to them.¹⁶² The district court denied the trustee's motion on the grounds that it was premature, suggesting that the latter may yet file a claim under the 21 U.S.C. § 853(k)—which requires ancillary proceedings.¹⁶³

Less than two months following the filing of the Information, Rothstein pled guilty.¹⁶⁴ In paragraph six of his plea agreement, it states:

156. Information at 3, *Rothstein*, No. 09-60331-CR-COHN, ECF No. 1; Plea Agreement at 1, *United States v. Rothstein*, No. 09-60331-CR-COHN (S.D. Fla. Jan. 27, 2010), ECF No. 69.

157. Government's Ex Parte Motion and Memorandum of Law for Post-Information Protective Order at 1, 7–8, *United States v. Rothstein*, No. 09-60331-CR-COHN (S.D. Fla. Dec. 6, 2009), ECF No. 12.

158. Protective Order at 2–3, *United States v. Rothstein*, No. 09-60331-CR-COHN (S.D. Fla. Dec. 7, 2009), ECF No. 13.

159. Jordana Mishory, *Feds Get First Dibs on Lawyer's Seized Property*, *DAILY BUS. REV.*, Dec. 8, 2009, at A3.

160. Process Receipt & Return at 1, *United States v. Rothstein*, No. 09-60331-CR-COHN (S.D. Fla. Apr. 15, 2010), ECF No. 17.

161. Chapter 11 Bankruptcy Trustee's Motion to Refer All Third Party Claims to the United States Bankruptcy Court, *United States v. Rothstein*, No. 09-60331-CR-COHN (S.D. Fla. Feb. 19, 2010), ECF No. 88.

162. See Marcus & Greenberg, *supra* note 78.

163. Order Denying Without Prejudice Chapter 11 Trustee's Motion to Modify Protective Order and to Authorize Turnover of Eight Accounts at 3, *United States v. Rothstein*, No. 09-60331-CR-COHN (S.D. Fla. Jan. 4, 2010), ECF No. 25.

164. Plea Agreement at 1, *United States v. Rothstein*, No. 09-60331-CR-COHN (S.D. Fla. Jan. 27, 2010), ECF No. 69.

The defendant further understands and acknowledges that, in addition to any sentence imposed under paragraphs 3, 4 and 5 of this agreement, forfeiture may be imposed as part of that sentence. The defendant agrees to the forfeiture of all of his right, title and interest to all assets listed in the Information and listed in the Bill of Particulars, and/or their substitutes (hereinafter “the assets”), whether controlled individually or through defendant’s wholly owned or partially owned corporations or third-parties, which are subject to forfeiture pursuant to Title 18, United States Code, Sections 1963, 982(a)(1) and/or 981(a)(1)(C).¹⁶⁵

Since “[c]riminal forfeitures are in *personam* judgments¹⁶⁶ . . . there must be a conviction for a criminal offense before there can be a forfeiture based on that offense.”¹⁶⁷ Rothstein’s guilty plea replaced a conviction and allowed the federal prosecutors to move forward with the forfeiture action.

On February 19, 2010, the Trustee filed a Motion to Refer All Third Party Claims to the Bankruptcy Court.¹⁶⁸ Paying lip service to the shared goals of

(1) maximizing the value of all assets, both those seized by the government and those currently part of the Debtor’s estate; (2) maximizing the distribution to all investor victims of Rothstein’s crimes, which victims are likely to comprise the overwhelming majority of the creditors of the Debtor’s estate; and (3) making such distributions as efficiently and expeditiously as possible¹⁶⁹

the trustee argued that “the Bankruptcy Code offers a principled, efficient and equitable means of preserving the investors’ claims to restitution without ignoring the legitimate rights of other non-investor creditors.”¹⁷⁰ Unwilling to agree, the Government responded by emphasizing that “the District Court is bound by the confines of federal criminal law, specifically the provisions dealing with criminal forfeiture and restitution,”¹⁷¹ and challenged the Bankruptcy Code with its own “clear,

165. *Id.* at 3. By agreeing to the forfeiture allegations, the defendant agrees to the forfeiture of his property as part of his sentence, which renders unnecessary the trial the defendant would have been entitled to under Rule 32.2(b)(1) of the Federal Rules of Criminal Procedure. *See* FED. R. CRIM. P. 32.2(b)(1); Cassella, *supra* note 87, at 478–79.

166. Cassella, *supra* note 77, at 461 (citation omitted).

167. *Id.* at 462 (citing STEFAN D. CASSELLA, ASSET FORFEITURE LAW IN THE UNITED STATES 476 (2007)).

168. Chapter 11 Bankruptcy Trustee’s Motion to Refer All Third Party Claims to the United States Bankruptcy Court at 1, *United States v. Rothstein*, No. 09-60331-CR-COHN (S.D. Fla. Feb. 19, 2010), ECF No. 88.

169. *Id.* at 2.

170. *Id.* at 10.

171. Government’s Response in Opposition to Chapter 11 Bankruptcy Trustee’s Motion to Refer All Third Party Claims to the United States Bankruptcy Court at 3, *United States v. Rothstein*, No. 09-60331-CR-COHN (S.D. Fla. Mar. 5, 2010), ECF No. 94.

streamlined, statutory framework for the issuance and enforcement of a restitution order that affords due process to third party claimants.”¹⁷² Ultimately, the district court sided with the Government.¹⁷³

Simultaneous with the Motion to Refer All Third Party Claims, the trustee proposed a joint status conference in light of the “fundamental conflicts over the best manner to proceed to achieve [the] common goals”¹⁷⁴ he shared with the Government. Relying in part on the actions of the district court in *United States v. Dreier*,¹⁷⁵ a parallel New York case in both fact and law which issued a coordination agreement requiring cooperation between the trustee and the Government, the trustee advanced that a joint status conference would settle that “tension . . . created as a result of the role of the government in seeking to obtain the criminal forfeiture of properties belonging to Scott Rothstein and the efforts of the Trustee to marshal all assets to which RRA may have legal or equitable claims.”¹⁷⁶ Due to the “substantial complex legal and logistical issues” that had yet to be “deliberated and resolved to ensure that the United States” fulfilled “its mandate under The Justice for All Act of 2004,” namely to determine whether forfeiture or restitution would be appropriate for the victims, the Government opposed the trustee’s motion.¹⁷⁷ Despite the trustee raising the point in his Reply that the true cost of the government’s position was the continued depreciation of the seized assets,¹⁷⁸ the court sided with the Government.¹⁷⁹

After the court’s entrance of a Preliminary Order of Forfeiture,¹⁸⁰ the trustee again entered the jurisdictional thicket, this time with a Motion to Amend a Preliminary Order of Forfeiture and Return of RRA Bank Accounts, arguing forfeiture language in the district court and alleging that the Government had not met the essential nexus required

172. *Id.* at 9.

173. Order Denying Motion for Referral of Third Party Claims and Order Denying Motion for Joint Status Conference at 5, *United States v. Rothstein*, No. 09-60331-CR-COHN (S.D. Fla. Mar. 16, 2010), ECF No. 99.

174. Chapter 11 Bankruptcy Trustee’s Motion for Joint Status Conference at 1, *United States v. Rothstein*, No. 09-60331-CR-COHN (S.D. Fla. Feb. 19, 2010), ECF No. 89.

175. No. 09-CRIM-085 (S.D.N.Y. Jan. 29, 2009), ECF 11.

176. Chapter 11 Bankruptcy Trustee’s Motion for Joint Status Conference at 1–2, *Rothstein*, No. 09-60331-CR-COHN, ECF No. 1.

177. Government’s Response in Opposition to Chapter 11 Bankruptcy Trustee’s Motion for Joint Status Conference at 3, *United States v. Rothstein*, No. 09-60331-CR-COHN (S.D. Fla. Mar. 8, 2010), ECF No. 95.

178. Chapter 11 Trustee’s Reply to Government’s Response in Opposition to Trustee’s Motion for Joint Status Conference [D.E.95] at 4, *United States v. Rothstein*, No. 09-60331-CR-COHN (S.D. Fla. Mar. 15, 2010), ECF No. 98.

179. *United States v. Rothstein*, No. 09-60331-CR, 2010 WL 966647, at *2 (S.D. Fla. Mar. 26, 2010).

180. DE 134 on 4/19/2010 of *United States v. Rothstein*.

under 21 U.S.C. § 853(n).¹⁸¹ The court convicted Rothstein on the grounds that the Government could not

distinguish the Ponzi-investor funds from funds deposited into RRA accounts by the law firm's clients, and therefore the government cannot trace all of the funds in the RRA accounts to criminal proceeds; . . . the non-investor funds were not used to conceal or disguise the investor funds; and . . . the funds in the RRA accounts were not used to promote the underlying fraud.¹⁸²

The trustee countered the court's finding of a nexus between the fraud and the monies located in RRA accounts and demanded that those accounts be turned over to the trustee.¹⁸³ From the Government's standpoint, the trustee attempted to "relitigate the forfeitability of property"¹⁸⁴ and lacked the standing as a third party attempting to challenge forfeiture at an improper time, i.e., after a *preliminary* order of forfeiture, rather than doing so during the statutorily proscribed ancillary proceedings.¹⁸⁵ In its Order, the court stated that because "the statutory framework provides for ancillary proceedings, the Court finds that the Trustee has not been deprived of an opportunity to assert its right to forfeited property."¹⁸⁶ The court thereby ruled that the amendment was "outside the statutory mechanism"¹⁸⁷ and further held, with respect to the RRA accounts, that the trustee failed to show "that he lacks an adequate remedy at law" because "[t]he Court, in the ancillary proceeding, will adjudicate the validity of the Trustee's alleged interest in the RRA Accounts."¹⁸⁸

Finally, just prior to Rothstein's sentencing, the trustee filed his Verified Claims and Petition for Adjudication of Interest, pertaining to the majority of forfeited property listed in the Preliminary Order of Forfeiture as a final attempt to corral Rothstein's assets into bankruptcy court.¹⁸⁹ Relying on forfeiture language, the trustee argued that, as

181. Trustee's Response in Opposition to Adlers' Motion to Enforce Protective Order[D.E. 108 & 109] at 2, *United States v. Rothstein*, No. 09-60331-CR-COHN (S.D. Fla. Apr. 20, 2010), ECF No. 135.

182. Chapter 11 Bankruptcy Trustee's Motion to Amend Preliminary Order of Forfeiture & for Return of RRA Bank Accounts at 7, *United States v. Rothstein*, No. 09-60331-CR-COHN (S.D. Fla. May 17, 2010), ECF No. 186.

183. Government's Response in Opposition to Chapter 11 Bankruptcy Trustee's Motion to Amend Preliminary Order of Forfeiture and for Return of RRA Bank Accounts at 2, *United States v. Rothstein*, No. 09-60331-CR-COHN (S.D. Fla. May 27, 2010), ECF No. 218.

184. *Id.* at 4.

185. *Id.* at 1.

186. *United States v. Rothstein*, No. 09-60331-CR-COHN, 2010 WL 2351466, at *1-2 (S.D. Fla. June 11, 2010) (footnote omitted).

187. *Id.* at *2.

188. *Id.*

189. DE 290 on 6/9/10 of *United States v. Rothstein*.

administrator of the bankruptcy estate, he maintained a superior interest in the bank accounts titled to RRA, is a bona fide purchaser for value of the real properties, and had a superior legal interest as a beneficiary of a constructive trust as to all other forfeited assets.¹⁹⁰ Unraveling the assumptions underlying the trustee's argument, the Government contended that the trustee failed to establish a legal interest in the funds within the specific bank accounts and failed to show that the monies were derived from legitimate business operations by a preponderance of the evidence, as required by Eleventh Circuit interpretations of criminal forfeiture law.¹⁹¹ The Government addressed the ever-present threat of a court-imposed constructive trust¹⁹² under Georgia law by attempting to demonstrate how the trustee's failure to trace creditor funds in the bank accounts coupled with the existing remedy in the ancillary proceedings eliminates any applicability of constructive trust law.¹⁹³ The district court agreed that the trustee has a legal interest in the accounts and further identifies that the trustee has a legal interest sufficient to bear imposition of a constructive trust, but since the trustee failed to allege or adequately plead that investors can trace their money, the court did not to impose one.¹⁹⁴ With this final order from the district court, the Government was given permission to reconstitute victims through its own statutory framework and the bankruptcy trustee was left with the assets wholly uninvolved with the fraud along with his clawback powers to pay back remaining creditors.

Ultimately, the court's order meant the Government succeeded in its forfeiture of assets.¹⁹⁵ Following the final order of forfeiture, the Government proceeded to restitution.¹⁹⁶ The court modified the judgment to reflect the restitution to be paid to qualifying victims.¹⁹⁷ The trustee continues and will continue to pursue clawback suits against indi-

190. Chapter 11 Trustee's Verified Claims & Petition for Adjudication of Interests at 3-4, 7-8, *United States v. Rothstein*, No. 09-60331-CR-COHN (S.D. Fla. May 24, 2010), ECF No. 192.

191. *United States' Motion to Dismiss Chapter 11 Trustee's Verified Claims and Petition* at 8, 10, 12, *United States v. Rothstein*, No. 09-60331-CR-COHN (S.D. Fla. June 11, 2010), ECF No. 310. The Government purported that this analysis also disposed of the issue of whether the trustee was a bona fide purchaser for value of the real properties because under forfeiture law, 21 U.S.C. § 853(n)(2), petitioner must first establish a legal interest, which the trustee failed to do. *Id.* at 8.

192. "An equitable remedy that a court imposes against one who has obtained property by wrongdoing. A constructive trust, imposed to prevent unjust enrichment, creates no fiduciary relationship. Despite its name, it is not a trust at all." *BLACK'S LAW DICTIONARY* 1649 (9th ed. 2009). See also *United States v. Ramunno*, 599 F.3d 1269, 1274 (11th Cir. 2010) (citation omitted).

193. *United States v. Rothstein*, No. 09-60331-CR, slip op. at 4, 5 (S.D. Fla. July 26, 2010).

194. *Id.*

195. *Id.* at 6.

196. Government's Final Report as to Restitution at 1, *United States v. Rothstein*, 09-60331-CR-COHN (S.D. Fla. Aug. 30, 2010), ECF No. 589.

197. Amended Order Modifying Preliminary Order of Forfeiture to Describe Funds Once Held

viduals who, under the Bankruptcy Code, improperly received funds from the debtor prior to the initiation of the bankruptcy proceeding.¹⁹⁸ Despite formal resolution of the dispute between the Government and the trustee, no definitive answer as to how to handle this intersection exists.¹⁹⁹ Were a similar case to appear again, the same frustrations would likely arise because, after the plethora of motions were filed, a proper procedure failed to be established. In light of the continuous exposure of fraud schemes and the Department of Justice's commitment to engaging in the marshaling and distribution of assets to victims, a *Rothstein* scenario will likely arise again—in fact, it is only a matter of time. Without a major financial fraud on the horizon, now is the time to develop a protocol and synthesize an approach on how to handle fraud schemes where the perpetrator is also the principal of an operating business entity.

III. STRIVING FOR COORDINATION

What came to pass in the overlapping *Rothstein* litigation serves as an illustration of how two enforcers at cross-purposes can limit, if not extinguish, each other's effectiveness. As the discussion of criminal forfeiture and bankruptcy law each illustrate, sustainable justifications for affirmations of jurisdictional propriety and priority exist for both the federal government and the bankruptcy trustee.²⁰⁰ In light of the provisions in each statutory framework, which allowed for the *Rothstein* litigation's jurisdictional standoff, one must consider other legal alternatives to avoid that same situation from occurring in the future. I propose that federal prosecutors more seriously consider the avenue of corporate indictment. Not disregarding the difficult reality of corporate prosecutions, criminal charges against the entity in complex fraud cases cannot only streamline litigation and avoid the dual-purpose²⁰¹ clash

by Gibraltar Bank, *United States v. Rothstein*, 09-60331-CR-COHN (S.D. Fla. Aug. 31, 2010), ECF No. 593.

198. 11 U.S.C. §§ 547–548 (2006).

199. See Spencer C. Barasch & Sara J. Chesnut, *Controversial Uses of the “Clawback” Remedy in the Current Financial Crisis*, 72 TEX. B.J. 922 (2009); Garretson, *supra* note 85; Gaumer, *supra* note 84, at 10, 36; Linn, *supra* note 82, at 744, 746; Clarence L. Pozza, Jr., Thomas R. Cox, Robert J. Morad, *A Review of Recent Investor Issues in the Madoff, Stanford and Forte Ponzi Scheme Cases*, 10 J. BUS. & SEC. L. 113 (2010).

200. “The scenarios for encountering forfeiture in a bankruptcy case are virtually endless.” Myron M. Sheinfeld, Teresa L. Maines & Mark W. Wege, *Civil Forfeiture and Bankruptcy: The Conflicting Interest of the Debtor, Its Creditors and the Government*, 69 AM. BANKR. L.J. 87, 87 (1995).

201. Chapter 11 Bankruptcy Trustee's Motion for Joint Status Conference at 1, *United States v. Rothstein*, No. 09-60331-CR-COHN (S.D. Fla. Feb. 19, 2010), ECF No. 89. The ultimate cause of the clash between the bankruptcy trustee and the federal prosecutors stems from the fact that RRA operated as both a legitimate business and a guise of the underlying fraud. See Information

evidenced in *Rothstein*, but they can also be a useful tool in maximizing recovery to victims and creditors alike. There are a number of factors established from an evidentiary standpoint in order to pursue corporate prosecution.²⁰² In the repertoire of tools the U.S. Attorney's Offices possess, corporate prosecution is among the most useful, but is of limited use. The threat of corporate prosecution wields significant power;²⁰³ therefore, it should be strongly considered as a means of coordinating and managing the logistical, procedural, and policy challenges concurrent bankruptcy and criminal litigation of corporate fraud schemes.²⁰⁴

Heeding reasoning on either side of the jurisdictional tug-of-war, the extensive motion practice elucidates that both criminal forfeiture law and bankruptcy possess unique attributes within their respective statutory frameworks. Under criminal forfeiture, the federal government maintains authority to marshal assets through various law enforcement-related agencies in a manner that exceeds the powers of the bankruptcy trustee.²⁰⁵ Distribution of forfeited assets can follow any of a variety of prescribed statutory, cost-effective frameworks.²⁰⁶ Further, government-run marshaling, organization, and distribution of assets subtracts nothing from the overall recovery to victims.²⁰⁷ An arguable downfall, raised by the trustee during the *Rothstein* litigation, is the inexperience government attorneys have in maintaining business enterprises and related assets such to limit depreciation of their value to the maximum extent possible.²⁰⁸ Apart from the criminal forfeiture framework, "[i]n order to achieve an equitable distribution to creditors, bankruptcy law gives the

at 1, *United States v. Rothstein*, No. 09-60331-CR-COHN (S.D. Fla. Dec. 1, 2009), ECF No. 1; don't have access to ECF 127.

202. See Thompson, *supra* note 52.

203. See Khanna, *supra* note 8, at 1497-1512.

204. Linn, *supra* note 82.

205. Jason S. Brookner et al., *On a Collision Course: Ponzi Schemes, Bankruptcy, Receiverships and Forfeitures*, AM. BANKR. INST., 357 (2009); Linn, *supra* note 82, at 747-51.

206. Once the government has successfully forfeited the assets of a fraudster, and reduced those assets to a liquid form, it has two avenues for returning the assets to the fraud victims. In most cases, the Justice Department returns the forfeited assets to the underlying victim of the offense through the Attorney General's equitable remission authority. In other cases, it turns the forfeited assets over to the district court handling the underlying criminal matter for distribution through the restitution process. In October 2002, the Attorney General issued a policy directive on restoration, which delegated to the Chief of Asset Forfeiture and Money Laundering Section (AFMLS) authority to restore property to victims. Under the new procedures, the government may forfeit a defendant's property and apply the forfeited property directly to an order of restitution.

Linn, *supra* note 82, at 749 (citations omitted).

207. *Id.*

208. Chapter 11 Bankruptcy Trustee's Motion to Refer All Third Party Claims to the United States Bankruptcy Court at 12, *United States v. Rothstein*, No. 09-60331-CR-COHN (S.D. Fla. Feb. 19, 2010), ECF No. 88.

Trustee the power to recover certain assets transferred prior to the bankruptcy to ensure equality of treatment.”²⁰⁹ These “clawback suits,” where the bankruptcy trustee sues individuals and entities who receive transfers from the debtor prior to the bankruptcy, are a tool unavailable to the federal government in criminal forfeiture and increase overall recovery to victims.²¹⁰ Yet, as emphasized by the Government,²¹¹ any fees²¹² accrued by the bankruptcy trustee and his team of lawyers and accountants will cost the victims (more likely than creditors),²¹³ and in a case of significant legal complexity, it will cost them handsomely.²¹⁴

Indictment of the corporate entity, in cases like that of Rothstein, Rosenfeld & Adler, serves to coordinate the federal prosecutor and the bankruptcy trustee while preserving their respective unique attributes. A federal indictment operates as a stay (regardless of whether a corresponding bankruptcy proceeding has been filed);²¹⁵ it does not divest a bankruptcy court of ultimate authority to administer the estate at the appropriate time. Contrary to that notion, the indictment would permit the federal government to marshal significant assets, relying on law enforcement agencies and the leniency in forfeiture law to do so,²¹⁶ proceed to forfeit those assets, and ultimately distribute them.²¹⁷ However, once the Government has exhausted these remedies—with district court

209. *Id.* at 9.

210. See Nelson, *supra* note 113.

211. Government’s Response in Opposition to Chapter 11 Bankruptcy Trustee’s Motion to Refer All Third Party Claims to the United States Bankruptcy Court at 4–5, United States v. Rothstein, 09-60331-CR-COHN (S.D. Fla. Mar. 5, 2010), ECF No. 94 (footnote omitted).

212. 11 U.S.C. §§ 326, 330.

213. Bankruptcy trustees attempt to maximize the assets of the estate for all creditors, not just victims, according to the Bankruptcy Code’s priority rules. Distributions under federal forfeiture statutes and civil penalty statutes tend to favor victims over other creditors. In contrast, in a bankruptcy proceeding, victims may have to elbow for scarce assets alongside other creditors of the defendant. Some of those creditors may have a preferred status; they may be secured creditors or creditors who have a preference because under bankruptcy and commercial law they perfected their claim against the debtor-defendant before the victims perfected their claims. Bankruptcy proceedings may also tend to favor those victims who have the wit, vigor and financial resources to retain counsel and press their claims vigorously at the expense of victims who do not.

Linn, *supra* note 82, at 757 (citations omitted).

214. *Id.* at 758.

215. “The automatic stay does not affect ‘the commencement or continuation of a criminal action or proceeding.’” *Id.* at 744, 756–57 (quoting 11 U.S.C. § 362(b)(4)).

216. “In a criminal forfeiture case, a court may issue a warrant for the seizure of property pursuant to 21 U.S.C. § 853(f). To obtain such a warrant, the Government must have probable cause to believe that the property is subject to forfeiture” (footnote omitted). Cassella, *supra* note 87, at 465.

217. “Forfeiture allows the government to seize or restrain the property acquired with fraud proceeds before trial, dispose of any third party claims, reduce real and personal property to a liquid form, and then remit or restore the forfeited proceeds to the victims of the underlying fraud

approval—any remaining assets can be transferred to the trustee²¹⁸ to distribute the influx of forfeited assets in combination with assets acquired by the bankruptcy trustee to any remaining creditors.

The uniqueness of this response is its simplicity. As certain Department of Justice statistics tend to indicate,²¹⁹ the federal government is not going to stand for financial fraud. Indeed, with President Obama's reification of what once was the Corporate Fraud Task Force under the Bush administration, now renamed Financial Fraud Enforcement Task Force, the investigation and prosecution of financial and investment fraud is a primary concern.²²⁰ Though the federal government intends to investigate and prosecute financial fraud, its complexity coupled with the intricate legal maze that follows in a prosecution (or as some other scholars have suggested enforcement actions or equity receiverships)²²¹ that ultimately collides with a bankruptcy proceeding, renders the task daunting. In attempting to achieve its continued objective, the federal government through its prosecutorial offices should consider simple and effective ways of streamlining their efforts. Including a meaningful consideration of corporate criminal liability, when concurrent bankruptcy and criminal litigation exists, is an opportunity to facilitate the federal prosecutors' ability to crack down on white-collar crime, like financial or investment fraud. Maximized distribution to victims of the fraud and creditors of the entity is a significant byproduct of streamlining litigation efforts in corporate fraud litigation that enhances the potential utility of corporate criminal liability. The legal viability, equitable outcomes, and practical applicability of this suggested approach are discussed below to further encourage U.S. Attorney's Office to consider corporate criminal liability as a matter of practice.

offense." Linn, *supra* note 82, at 748 (citing *United States v. 730 Glen-Mady Way*, 590 F. Supp. 2d 1295 (E.D. Cal. 2008)).

218. "In cases involving continuing schemes and conspiracies," like the *Rothstein* Ponzi scheme, "the amount involved in the entire scheme is subject to forfeiture." See Cassella, *supra* note 87, at 463.

219. 2009 *Financial Crimes Report*, FED. BUREAU OF INVESTIGATION, <http://www.fbi.gov/stats-services/publications/financial-crimes-report-2009> (last visited Oct. 31, 2011).

220. *About the Task Force*, FIN. FRAUD ENFORCEMENT TASK FORCE, <http://www.stopfraud.gov/about.html> (last visited Oct. 31, 2011).

221. See generally Brookner et al., *supra* note 205; Faith Devine and Jeffery I. Golden, *Civil Forfeiture and Bankruptcy Fraud: An Alternative to Fraudulent Conveyance Litigation*, 25 CAL. BANKR. J. 170 (2000); David A. Gradwohl & Karin Corbett, *Equity Receiverships for Ponzi Schemes*, 34 SETON HALL LEGIS. J. 181 (2010).

A. *Legal Viability*

To begin, prosecuting the corporation is well within the discretion of the federal government.²²² As the literature discussed in Part I reveals, prosecution of corporate entities has been a part of our legal landscape for nearly two centuries. Accepting that prosecuting a corporation criminally is within the discretion of the federal government, it is important to review the reasoning necessary to decide whether to prosecute. These reasons provide a useful roadmap for determining whether to pursue corporate criminal liability when parallel bankruptcy and criminal proceedings are to exist side-by-side, or more aptly put, one-by-one.

When a corporate entity is sufficiently intertwined with the perpetrated fraud to be named as the criminal enterprise, objections for lack of personhood are easily overcome. Indeed, a corporation lacks the capacity for intentional conduct, in the traditional sense.²²³ Courts have been willing, however, to accept imposition of criminal liability even against “soulless entities” when such imposition creates increased social justice. As discussed above, imposition of criminal liability in a *Rothstein*-like scenario maximizes recovery to both victims and creditors. It serves as the most effective coordination of these enforcement efforts possible.

Further, limiting the imposition of criminal liability to instances where the corporate entity is the criminal enterprise, defeats any challenges based on vicarious liability.²²⁴ Criminal liability should not be applied carelessly, and limiting its application to scenarios that simulate the relationship between Scott Rothstein and Rothstein, Rosenfeld & Adler or Marc Dreier and Dreier, LLP ensures maximum fairness to creditors, victims, and defendants alike.

Appropriate punishment reflective of the nature and level of corporate misconduct finds application in the specific criminal charge and the resulting plea agreement. As discussed above, the Department of Justice, when considering whether to seek a specific charge against a business organization, analyzes a litany of factors.²²⁵ The purpose of this thorough analysis is to ensure fairness in the charge as applied to the entity. Further, the Department of Justice negotiates an appropriate plea agreement after the grand jury indictment, where specific penalties are detailed with respect to admitted misconduct.²²⁶ Through these two

222. Elizabeth R. Sheyn, *The Humanization of the Corporate Entity: Changing Views of Corporate Criminal Liability in the Wake of Citizens United*, 65 U. MIAMI L. REV. 1, 7 (2010) (stating that “federal prosecutors make the ultimate decision regarding whether a given company will be indicted and charged for its unlawful activities” (citation omitted)).

223. See generally Khanna, *supra* note 8, at 1479–80.

224. See *id.* at 1484.

225. Thompson, *supra* note 52.

226. *Id.*

methods, the Department of Justice endeavors to match proper punishments in a way that silences arguments pertaining to effectiveness and corporate rights.

B. *Equitable Outcomes*

Moving beyond the theoretical justifications, corporate criminal liability in *Rothstein*-like scenarios is fundamentally more equitable than the current ad hoc administration of concurrent criminal forfeiture and bankruptcy proceedings. Where criminal forfeiture actions tend to favor victims and operate with an increased ability to cost-effectively marshal investment fraud related assets,²²⁷ the federal government is not best situated to maintain the value of all said assets to limit depreciation.²²⁸ Therefore, while the battle wages on with any trustee willing to challenge the Government's forfeiture action, government attorneys must balance the uncommon task of managing depreciating assets while engaging in complex motion practice. On the bankruptcy side, each motion has an expensive price tag. The more motions filed, the more time is required of the bankruptcy trustee's attorneys. And of course, the more time spent by those attorneys, the more the overall fee will be. As the Bankruptcy Code requires, those fees will be paid first, before claims of any creditors.²²⁹ Bankruptcy fees paid to the trustee and all of his staff can dramatically reduce the overall recovery of the victims and creditors alike.

Given the resulting lose-lose scenario of the current approach to concurrent bankruptcy and criminal forfeiture actions, corporate criminal liability increases recoverability and limits the ability to manipulate current indecision over the priority of one system over the other. Allowing the government to proceed first permits the cost-effective marshaling of significantly more assets through the utilization of the Federal Bureau of Investigation, the United States Marshal Service, and the comparatively lenient forfeiture law. Combined, properties can be seized and brought into forfeiture proceedings seamlessly. Those assets, post-conviction, can be distributed with an eye toward preserving the value of the assets because the Government will not charge fees that subtract from the pool of assets. Without the interruption of the bankruptcy trus-

227. "A successful forfeiture action vests title to the forfeited assets in the government and the government can then undertake the work of marketing and selling such things as houses and vehicles before passing title to the proceeds to the victims at very little cost to the victims." Linn, *supra* note 82, at 749.

228. Chapter 11 Bankruptcy Trustee's Motion to Refer All Third Party Claims to the United States Bankruptcy Court at 12, *United States v. Rothstein*, No. 09-60331-CR-COHN (S.D. Fla. Feb. 19, 2010), ECF No. 88.

229. 11 U.S.C. § 326.

tee attempting to intervene in the forfeiture action, depreciation of any assets should be limited as the forfeiture action should proceed as efficiently as possible.

Transferring any remaining assets to the bankruptcy trustee at the conclusion of the forfeiture action will properly situate the bankruptcy trustee to use his or her unique powers under the Bankruptcy Code.²³⁰ Any remaining creditors, not classified as victims and with remaining debts, can proceed under bankruptcy procedures to file proofs of claim if the bankruptcy proceedings have begun or proceed to initiate a bankruptcy action.²³¹ Relying on clawback powers under the Bankruptcy Code, the trustee can negate any pre-bankruptcy transfers that either occur within the prohibited time frame or are in their nature fraudulent, thereby augmenting any remaining assets.²³² Thus, creditors not restituted in the forfeiture action would maintain an outlet for compensation for unpaid debts. As described, corporate criminal liability provides a means to maximize victim and creditor recovery that underscores its equitable function.

C. *Practical Applicability*

Despite the theoretical awkwardness innate to the prosecution of a corporation, its utility in properly situating bankruptcy courts with relation to district courts in concurrent proceedings outweighs the awkwardness. Prosecution of the corporation will situate the criminal proceeding such that the federal government can proceed without tangling with the bankruptcy proceeding. As an Article I tribunal, bankruptcy courts are adjuncts to district courts and by their nature subservient to district court proceedings.²³³ Yet, when the criminal enterprise and the principal defendant together perpetrate a fraud resulting in two concomitant proceedings, this distinction is blurred. A criminal indictment against the criminal enterprise will bring that distinction back into focus by stalling the bankruptcy proceeding for the duration of the criminal action.

Further, the Department of Justice already has protocol to handle the prosecution of a corporate entity.²³⁴ In determining whether to

230. See generally Nelson, *supra* note 113.

231. 11 U.S.C. § 501.

232. See *id.* §§ 547–548; James Butler Cash Jr., Note, *When is an Equity Participant Actually a Creditor? The Effects of the In re AFI Holding on Ponzi Scheme Victims and the Good Faith Defense*, 98 Ky. L. J. 329 (2010).

233. *N. Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 53–54 (1982); Troy A. McKenzie, *Judicial Independence, Autonomy, and the Bankruptcy Courts*, 62 STAN. L. REV. 747, 765 (2010).

234. See Thompson, *supra* note 52.

charge an entity, in addition to factors related to charge individuals, U.S. Attorney's Office should consider the following:

1. the nature and seriousness of the offense, including the risk of harm to the public, and applicable policies and priorities, if any, governing the prosecution of corporations for particular categories of crime . . .
2. the pervasiveness of wrongdoing within the corporation, including the complicity in, or condonation of, the wrongdoing by corporate management . . .
3. the corporation's history of similar conduct, including prior criminal, civil, and regulatory enforcement actions against it . . .
4. the corporation's timely and voluntary disclosure of wrongdoing and its willingness to cooperate in the investigation of its agents, including, if necessary, the waiver of corporate attorney-client and work product protection . . .
5. the existence and adequacy of the corporation's compliance program . . .
6. the corporation's remedial actions, including any efforts to implement an effective corporate compliance program or to improve an existing one, to replace responsible management, to discipline or terminate wrongdoers, to pay restitution, and to cooperate with the relevant government agencies . . .
7. collateral consequences, including disproportionate harm to shareholders, pension holders and employees not proven personally culpable and impact on the public arising from the prosecution . . .
8. the adequacy of the prosecution of individuals responsible for the corporation's malfeasance . . . [and]
9. the adequacy of remedies such as civil or regulatory enforcement actions.²³⁵

The Department of Justice, also aware of the difficulty in pursuing a trial against a corporate entity focuses attention on negotiating effective and complete plea agreements to achieve its objectives of punishment and deterrence.²³⁶ Indicative of contemplation centering on the theoretical underpinnings of corporate criminal liability, these considerations reflect the commitment of the Department of Justice to eradicating corporate misconduct through criminal sanctions appropriately tailored to business entities.

235. *Id.*

236. *Id.* Although prosecuting through the trial phase remains an option.

CONCLUSION

Developing a cohesive protocol for responding to nefarious corporate behavior directed by principals who utilize their respective corporate entities is imperative. The alarming illustrations of how fraudsters can indirectly punish victims and creditors vis-à-vis the current lack of coordination between the federal prosecutors' offices and bankruptcy trustees further emphasizes this need. Protecting those individuals from undue losses can be done with agreement among U.S. Attorney's Offices to strongly consider prosecuting corporations utilized as vehicles for investment fraud purposes. As discussed, doing so would not only be theoretically justified and, practically speaking, implementable, but also would further victim and creditor recovery in such a way that would increase the equitable nature of both criminal forfeiture and bankruptcy proceedings related to corporate fraud.