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Steven L. Schwarcz

Alan E. Rothman

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Cover Page Footnote

 Mr. Schwarcz is a partner and practice group chairman in the law firm of Kaye, Scholer, Fierman, Hays & Handler and also teaches courses in commercial and bankruptcy law at Yale, Columbia, and Cardozo (Yeshiva University) law schools. Mr. Rothman is a 1993 graduate of Columbia Law School and presently is studying advanced Talmudic law at Yeshiva University before joining Mr. Schwarcz's law firm. The authors gratefully acknowledge the research assistance of Paul S. Feira, Robert Grass, Stephan W. Milo, and Eric M. O'Meara in the preparation of this Article, and also express appreciation to Paul J. Curran, Herbert S. Edelman, Egon Guttman, and Martin S. Saiman for their helpful comments on drafts of this Article. The authors particularly wish to thank David Gray Carlson, Gerard E. Lynch, and Paul M. Shupack for their extremely helpful comments and suggestions.

ARTICLES

CIVIL FORFEITURE: A HIGHER FORM OF COMMERCIAL LAW?

*STEVEN L. SCHWARCZ AND ALAN E. ROTHMAN**

In this Article, Messrs. Schwarcz and Rothman analyze the disquieting impact of civil forfeiture law on creditors' rights. The Article begins by describing the historical origins of civil forfeiture and its development into current day law. The Article then explores the tension between forfeiture law and commercial and bankruptcy law by examining the effect of a forfeiture action on unsecured and undersecured creditors. The Article evaluates a recent model for balancing governmental and commercial law interests, and concludes by suggesting reforms to the present civil forfeiture scheme.

INTRODUCTION

> We continue to be enormously troubled by the government's increasing and virtually unchecked use of the civil forfeiture statutes and the disregard for due process that is buried in those statutes.[1]

IN May 1992, the federal government commenced the third largest federal civil forfeiture[2] action in United States history[3] against more than $400 million of the assets of John McNamara, a powerful New York real estate holder, car dealer, philanthropist, and leading Republican Party

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1. United States v. All Assets of Statewide Auto Parts, Inc., 971 F.2d 896, 905 (2d Cir. 1992).

2. The term "forfeiture" has been defined in the legal context as "[l]oss of some right or property as a penalty for some illegal act." Black's Law Dictionary 650 (6th ed. 1990). Under the existing federal statutory scheme, forfeitures may arise as a criminal action, such as under the Racketeer Influenced and Corrupt Organizations Act ("RICO"), *see* 18 U.S.C. § 1963 (1988 & Supp. IV 1992), or as a civil action, *see* 18 U.S.C. § 981 (1988 & Supp. IV 1992); 21 U.S.C. § 881 (1988 & Supp. IV 1992). Criminal forfeitures are *in personam* actions (actions against a named criminal defendant), where the forfeiture is an automatic consequence of the defendant's conviction. *See* United States v. Angiulo, 897 F.2d 1169, 1210 (1st Cir.), *cert. denied*, 498 U.S. 845 (1990). Civil forfeitures, by contrast under the federal statutes, are *in rem* actions (actions against the property to be forfeited).

contributor. This forfeiture proceeding,[4] initiated pursuant to the civil forfeiture provisions of the Anti-Drug Abuse Act of 1986,[5] has had an enormous impact not only on McNamara but also on innocent unsecured and undersecured[6] creditors, including major financial and banking institutions. The *McNamara* case is but one example in an alarming trend in which the federal government's application of civil forfeiture laws, although serving some beneficial purposes,[7] is creating a regime of commercial uncertainty and confusion.

With forfeitures of this scale, the broad reach of the civil forfeiture statutes comes into direct conflict with the rights of innocent third parties who engage in legitimate commercial dealings with the alleged wrongdoer, or with companies or assets traceable to the wrongdoer. Ironically, forfeiture of commercial assets is an inadvertent attack on private property rights perpetrated by the very governmental officials who are sworn to protect and defend those rights. The underlying issue is how to balance the commercially reasonable expectations of third parties with the legitimate forfeiture interests of the government.

The dollar value of assets subject to federal forfeiture actions has risen

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See James R. Maxeiner, *Bane of American Forfeiture Law—Banished at Last?*, 62 Cornell L. Rev. 768, 768 (1977).

Civil forfeiture will be the primary focus of this Article, not only because of its increasingly frequent use by the government, but also because it targets the "guilty property" without regard to the culpability of the property's owners. This does not mean that criminal forfeiture actions do not share potential for some of the criticisms of civil forfeiture raised in this Article, but the fact that property is forfeited only as a consequence of a criminal conviction provides for certain meaningful checks on abuse of due process and general lack of formal procedures.

3. *See* Thomas J. Lueck, *Port Jefferson Auto Dealer Forfeits Most of His Assets*, N.Y. Times, May 20, 1992, at B1, B5. The only larger civil forfeiture actions were Michael Milken's forfeiture of $900 million to the SEC and BCCI's forfeiture of $500 million to U.S. depositors and investors. *See id.*

4. *See* United States v. McNamara Buick-Pontiac, No. CV-92-2070 (E.D.N.Y. July 16, 1992). The authors represent a major creditor in the *McNamara* proceeding, although the views expressed in this Article are solely those of the authors.

5. Pub. L. No. 99-570, 100 Stat. 3207-35 (codified as amended at 18 U.S.C. § 981).

6. *See infra* note 193. References in this Article to unsecured claims will include the unsecured portions of undersecured claims.

7. Civil forfeiture, if narrowly targeted at a wrongdoer, can serve many salutary purposes. For example, the United States Attorney's Office for the Southern District of New York, under the guidance of the United States Attorney Rudolph Giuliani, aggressively utilized civil forfeiture to seize public housing dwellings of narcotic dealers, thus creating a safer living environment for low-income housing dwellers. *See* Harry Berkowitz & May Voboril, *Campaign Trailers: Giuliani Ad Watch*, Newsday, Aug. 15, 1993, at 41.

As this Article will show, some government prosecutors are abusing civil forfeiture by applying civil forfeiture statutes to certain classes of non-culpable third parties. The present forfeiture system's gravest flaw is the seizure of property now in the hands of innocent third parties coupled with the lack of an effective process where these individuals' claims can be meaningfully heard and adjudicated. Because the application of civil forfeiture statutes is supplanting traditional methods of claim resolution in broad sweeping forfeiture actions, prosecutors should pause to reflect upon the impact this application has on commercial law and activity.

dramatically in recent years. As of September 30, 1990, the Department of Justice ("DOJ"), the agency responsible for executing civil forfeiture actions, had a $478 million balance in its Assets Forfeiture Fund.[8] By 1993, the value of forfeited assets in the DOJ inventory had grown to $1.8 billion, including 31,698 pieces of property, real and personal.[9] This increased use of forfeiture by the DOJ has led some observers to question whether "we are seeing fair and effective law enforcement or an insatiable appetite for a source for increased agency revenue."[10]

As the assets confiscated in forfeiture actions continue to grow, so too grow the concerns of the financial community as to the impact these drastic measures have on innocent third party creditors. This Article examines the expansion of forfeiture law into areas previously governed by traditional forms of commercial and bankruptcy law and the conflicts created thereby. The Article also examines two important policy questions[11] raised by these conflicts. First, should forfeiture law permit the government to ignore commercial and bankruptcy laws that have developed over centuries? Second, if forfeiture law is to be applied in a commercial context, how should the rights of innocent third parties be protected? In order properly to address these questions, however, it is first necessary to understand the origins and traditional uses of forfeiture law.

I. ORIGINS AND USES OF FORFEITURE LAW

This Part describes the historical origins of civil forfeiture, its statutory and case law development, and the fundamental elements of current day forfeiture law.

A. *Historical Origins*

Perhaps the most oft-cited source of forfeiture is the Biblical passage: "if an ox gore a man or a woman, that they die, the ox shall be surely

8. *See* U.S. Dep't of Just., 1990 Ann. Rep. of the Dep't of Just. Asset Forfeiture Program, App. A at 39.

9. *See* Steven L. Kessler, *Tide is Turning in Federal Forfeiture Rulings*, N.Y.L.J., Mar. 5, 1993, at 1, 8 n.1.

10. United States v. $12,390.00, 956 F.2d 801, 807 n.6 (8th Cir. 1992) (Beam, J., dissenting).

11. When forfeiture laws were applied in the past—to seizures of specific assets used in crimes—the limited scope of these seizures was unlikely to raise significant policy issues in the commercial arena. The seizure of an asset directly used in criminal activity, such as an automobile used by a drug dealer, probably will not affect an innocent commercial party unless that party has a security interest in the automobile. And, as will be shown, forfeiture law generally respects the rights of secured parties.

As the *McNamara* case illustrates, however, when the government uses forfeiture law to seize not only property used in criminal activity, but all of the assets of a company or affiliated group of companies owned or controlled by a wrongdoer, the government's claims can come into direct conflict with the rights of innocent parties who have commercial dealings with these companies.

stoned, and its flesh shall not be eaten."[12] According to the Talmud's interpretation of this passage, the use of the phrase "and its flesh shall not be eaten" is intended as a prohibition against receiving benefit from the animal. This prohibition becomes effective from the moment the offending animal is convicted, even prior to its stoning.[13] Thus, the Biblical source for the notion of forfeiture does not contemplate a scheme under which a governing body or agency benefits from the use of guilty property.

Civil forfeiture also traces its roots to the historical notion of "deodand."[14] "Deodand" is derived from the Latin phrase "Deo Dandum," meaning "to be given to God."[15] More precisely, deodand itself originated in pre-Judeo Christian practices.[16] These practices, similar to the Talmud's understanding of the "goring ox" passage, reflect the view that the instrument of death is accused and that religious atonement is required. A more expansive view, prevalent in medieval England, perceived the deodand in the "double perspective of a 'religious expiation' and as a forfeiture or amercement similar in function to exactions by the Crown in various contexts and activities with the aim of increasing its revenues."[17] Although deodand was initially confined to "guilty property," the English kings later expanded deodand to include all property and chattels belonging to criminals, serving, in principle, as a type of "fine."[18]

Thus, as the English concept of "deodand" developed, it strayed from Biblical "forfeiture" in two important respects. First, English deodand theory contemplated that some benefit was to be derived from the guilty property rather than prohibiting "its flesh [from] be[ing] eaten."[19] For example, under English common law, persons convicted of treason forfeited all their property to the Crown, while convicted felons forfeited chattels to the Crown and escheated their real property to the lord.[20] Second, unlike its Biblical counterpart, the property subject to forfeiture

12. *Exodus* 21:28. This passage is cited by virtually all sources on forfeiture. *See, e.g.*, George C. Pratt & William B. Petersen, *Civil Forfeiture in the Second Circuit*, 65 St. John's L. Rev. 653, 654 (1991) (tracing the origins of forfeiture and analyzing its continued vitality); Jacob J. Finkelstein, *The Goring Ox: Some Historical Perspectives on Deodands, Forfeitures, Wrongful Death and the Western Notion of Sovereignty*, 46 Temp. L.Q. 169 (1973) (analyzing the history of sovereignty and forfeiture).

13. *See* Talmud, Tractate Baba Kamma 41a.

14. *See* Finkelstein, *supra* note 12, at 169.

15. *See* Calero-Toledo v. Pearson Yacht Leasing Co., 416 U.S. 663, 681 n.16 (1974).

16. *See* Oliver Wendell Holmes, Jr., The Common Law 1-38 (1881).

17. Finkelstein, *supra* note 12, at 183.

18. *See Calero-Toledo*, 416 U.S. at 680-81.

19. *Exodus* 21:28.

20. *See Calero-Toledo*, 416 U.S. at 682. The forfeiture was enforced by the Court of the Exchequer in an *in rem* proceeding. This forfeiture to the Crown was premised upon the notion that a breach of the criminal law was an offense to the King's peace. *See id.* (citing 1 W. Blackstone, Commentaries *299). This aspect of forfeiture, more correctly known as attainder, also represented a British expansion of the forfeiture contemplated by the Bible. Under Biblical law, only those guilty of offenses against the King were

under English law was not limited to the felonious "instrument," but could include nearly all of the criminal's assets.[21]

In America, civil forfeiture was until recently infrequently used. Forfeitures were largely disfavored, primarily because the government's seizure of private property was a leading source of tension between the former colonists and the British Crown.[22] In fact, the United States Constitution protects property not only through the Due Process Clause,[23] but also through a specific limitation on the scope of forfeiture in the treason context.[24]

Forfeiture, however, did find limited use in early America, particularly in admiralty law.[25] The First Congress, for example, adopted several pieces of maritime forfeiture legislation,[26] which generally provided for the forfeiture of ships and cargo for evasion of customs duties and illegal slave trade.[27] The Supreme Court repeatedly upheld the use of forfeiture in this context.[28]

During the Civil War, forfeiture saw extensive use, initially in the confiscation of rebels' property, and later in the confiscation of property of Southern sympathizers.[29] The Supreme Court subsequently upheld forfeiture under a broad construction of the government's military power.[30]

Thus, American law's expansion of forfeiture beyond the concept of "guilty property" ironically parallels the English law expansion of forfeiture that was disdained by the American colonists. American courts, therefore, did not rely on deodand as a premise for using forfeiture, but

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subject to a forfeiture to the Crown. The property of other convicted or condemned felons reverted to their heirs. *See* Talmud, Tractate Sanhedrin 48b.

21. *See Calero-Toledo*, 416 U.S. at 680. In fact, it has been noted that deodand is probably a "misplaced" general principle of English forfeiture law, and in fact such an analogy was rejected by English courts. *See* Maxeiner, *supra* note 2, at 771-72.

22. *See* Maxeiner, *supra* note 2, at 776-81. Moreover, both the English practice of "official seizure and forfeiture" and the British "general warrant," also known as "a writ of assistance," which was used by the British to search ships and allow for their ultimate seizure and forfeiture for violations of customs and revenue laws, have been cited as two of the most significant factors leading to the American Revolution. *See* United States v. 92 Buena Vista Ave., 113 S. Ct. 1126, 1131-32 (1993) [hereinafter *92 Buena Vista Ave. II*], *aff'g*, 937 F.2d 98 (3d Cir. 1991) [hereinafter *92 Buena Vista Ave. I*].

23. *See* U.S. Const. amend. V.

24. *See* U.S. Const. art. III, § 3, cl. 2 (prohibiting "[f]orfeiture except during the life of the person attainted").

25. This historical development may explain why modern forfeiture statutes still call for the application of admiralty law procedures to forfeiture actions. *See* 18 U.S.C. § 981(b) (1988 & Supp. IV 1992); *infra* note 112.

26. *See* Calero-Toledo v. Pearson Yacht Leasing Co., 416 U.S. 663, 683 & nn.21-23 (1974).

27. *See id.* at 683.

28. *See* The Palmyra, 25 U.S. (12 Wheat.) 1, 13 (1827).

29. *See* Pratt & Petersen, *supra* note 12, at 658.

30. *See id.* at 659. ("[T]he power to declare war involves the power to prosecute it by all means and in any manner in which war may be legitimately prosecuted. It therefore includes the right to seize and confiscate all property of an enemy and to dispose of it at the will of the captor.") (quoting Miller v. United States, 78 U.S. (11 Wall.) 268, 305 (1871)).

rather created their own forfeiture regime.[31]

B. *Modern Civil Forfeiture Statutes*

Although less prominent in the century following the Civil War, forfeiture subsequently gained renewed acceptance as a powerful weapon in the modern war on drugs.[32] The civil forfeiture provisions of the Comprehensive Drug Abuse Prevention and Control Act of 1970[33] (the "1970 Drug Control Act") empowered the federal government to seize property used in connection with illegal substances. Although initially confining the statute to the narcotics context, Congress has expanded the 1970 Drug Control Act during the last two decades. In 1978, Congress amended the 1970 Drug Control Act to allow the seizure of proceeds from illegal drug activity.[34] In 1984, Congress further amended the statute to allow for the forfeiture of all property, including real property traceable to the illegal activity.[35]

The enactment of the Anti-Drug Abuse Act of 1986 further expanded the scope of civil forfeiture to include the proceeds of money laundering activity.[36] The 1990 amendments to that Act increased civil forfeiture's scope to include proceeds traceable to counterfeiting and other offenses affecting financial institutions.[37] In 1992, Congress supplemented these categories of offenses,[38] and further amended the statute to include property traceable to motor vehicle theft.[39]

Perhaps the most significant recent development in this area is Congress' enactment of 18 U.S.C. section 984,[40] a statute that applies "[i]n any forfeiture action *in rem* in which the subject property is cash, monetary instruments in bearer form, funds deposited in an account in a financial institution . . . or other fungible property."[41] Under section 984, the

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31. *See* Maxeiner, *supra* note 2, at 771 & n.25.

32. *See* Pratt & Petersen, *supra* note 12, at 664.

33. *See* Pub. L. No. 91-513, § 511, 84 Stat. 1236, 1276-78 (codified as amended at 21 U.S.C. § 881).

34. *See* Pub. L. No. 95-633, § 301(a), 92 Stat. 3777 (codified as amended at 21 U.S.C. § 881(a)(6) (1988 & Supp. IV 1992)).

35. *See* Pub. L. No. 98-473, § 306(a), 98 Stat. 1837, 2050 (codified as amended at 21 U.S.C. § 881(a)(7) (1988 & Supp. IV 1992)).

36. *See* Pub. L. No. 99-570, § 1366(a), 100 Stat. 3207, 3207-35 (codified as amended at 18 U.S.C. § 981(a)(1)(A) (1988 & Supp. IV 1992)).

37. *See* Pub. L. No. 101-647, § 2525(a), 104 Stat. 4789, 4874 (codified as amended at 18 U.S.C. § 981(a)(1)(C) (1988 & Supp. IV 1992)).

38. *See* Pub. L. No. 102-393, § 638(d), 106 Stat. 1729, 1788 (codified as amended at 18 U.S.C. § 981(a)(1)(C)).

39. *See* Pub. L. No. 102-519, § 104(a), 106 Stat. 3385 (codified as amended at 18 U.S.C. § 981(a)(1)(F) (1988 & Supp. IV 1992)).

40. Pub. L. No. 102-550, § 1522(a), 106 Stat. 3672, 4063 (codified at 18 U.S.C. § 984 (Supp. IV 1992)).

41. 18 U.S.C. § 984(b)(1) (Supp. IV. 1992); *see also* United States v. All Funds Presently On Deposit Or Attempted To Be Deposited In Any Accounts Maintained At American Express Bank, No. CV-92-5310, 1993 WL 352099, at *11 (E.D.N.Y. Aug. 31, 1993) (discussing the enactment and effect of § 984).

government need *not* "identify the specific property involved in the offense that is the basis for the forfeiture,"[42] and may seize "any identical property found in the same place or account as the property involved in the offense"[43] which would be subject to forfeiture had it remained in such place or account. Thus, Congress has not only dramatically increased the number of crimes that support a forfeiture action, but also has required an ever lessening relationship between the "culpable act" and the forfeitable property.

As a result of the expansion of civil forfeiture, property subject to seizure in forfeiture actions is increasingly part of the mainstream economy rather than contraband. However, no countervailing measures are being taken to mitigate the harsh effect this can have on innocent third parties such as creditors. To appreciate this impact, it is necessary to understand the mechanisms of civil forfeiture. The following sections discuss five fundamental elements of modern civil forfeiture: (1) the property subject to forfeiture and the doctrine of "traceable proceeds;" (2) the "relation back" doctrine; (3) the "innocent owner" defense; (4) the constitutional limitations on civil forfeiture; and (5) the post-forfeiture claims process and the petition for remission.

1. Property Subject to Forfeiture and the Doctrine of "Traceable Proceeds"

The American statutory forfeiture scheme is broader than the narrow Biblical "guilty property" doctrine. Both the 1970 Drug Control Act and the Anti-Drug Abuse Act of 1986 contain provisions extending the notion of "guilty property" to include any property or chattel "traceable" to the crime.[44] Courts have construed these provisions liberally to include property or funds that have "facilitated" illegal activity.[45] Civil forfeiture law, therefore, has evolved from an approach of punishing "guilty property" to one of punishing those with a business association with a guilty individual.[46]

In order to effectuate a forfeiture against particular assets, the govern-

42. 18 U.S.C. § 984(b)(1)(A) (Supp. IV 1992).

43. 18 U.S.C. § 984(b)(2) (Supp. IV 1992).

44. *See* 18 U.S.C. § 981(a)(1) (1988 & Supp. IV 1992); 21 U.S.C. § 881(a)(6). It should be noted that the original 1970 Drug Control Act only allowed for the forfeiture of either the drugs themselves or the means of their production and distribution. It was not until the 1978 amendments to the Act that "traceable proceeds" were also included. *See 92 Buena Vista Ave. II*, 113 S. Ct. 1126, 1133 n.16 (1993); *see also* 18 U.S.C. § 984 (applying forfeiture to money laundering and fungible property).

45. *See, e.g.*, United States v. Certain Funds on Deposit in Account No. 01-0-71417, 769 F. Supp. 80, 84 (E.D.N.Y. 1991) (stating that "[e]ven if a portion of the property sought to be forfeited is used to 'facilitate' the alleged offense, then all of the property is forfeitable") (citations omitted); *see also* United States v. Daccarett, Nos. 1264, 1265, 92-6229, 92-6259, 1993 WL 347041, at *17 (2d Cir. Sept. 10, 1993) (holding that property need only have "nexus" not "substantial connection" to illegal activity to be subject to forfeiture).

46. *See* Pratt & Petersen, *supra* note 12, at 670.

ment need not present direct evidence supporting its position that the forfeited property is traceable to the illegal activity.[47] It only need demonstrate probable cause that such is the case.[48] For example, in *United States v. Parcels of Land*,[49] the government asserted that certain properties had been purchased with the proceeds of illegal drug activities. The court allowed the forfeiture of the properties based upon evidence that the value of the properties greatly exceeded the purchasers' reported annual income, and that the properties were purchased with large sums of cash.[50]

Furthermore, the Second Circuit's decision in *United States v. Banco Cafetero Panama*[51] illustrates the government's attempt to forfeit property beyond the direct proceeds of an illegal transaction. In *Banco Cafetero*, the government attempted to seize $3 million in five separate accounts belonging to a depositor, although these funds were not directly linked to a particular drug transaction.[52] The court permitted forfeiture not only against the depositor's accounts, but also against the depositee bank's own account at a second bank, into which the depositee bank transferred the depositor's forfeitable funds.[53] The court concluded that uncertainties as to the source of the particular funds are to be resolved in favor of the government.[54] Similarly, in *United States v. Certain Funds on Deposit in Account No. 01-0-71417*,[55] a forfeiture of funds in a money laundering scheme was upheld where legitimate and illegal funds were commingled in the bank accounts of various corporations.[56]

Adding to the uncertainty and instability caused by the breadth of civil

47. *See, e.g., Daccarett*, 1993 WL 347041, at *17 ("A finding of probable cause may be based on hearsay, even hearsay from confidential informants, or circumstantial evidence . . . .") (citations omitted); United States v. One 1987 Mercedes 560 SEL, 919 F.2d 327, 331 (5th Cir. 1990) ("Probable cause can be established by circumstantial or hearsay evidence.").

48. *See Daccarett*, 1993 WL 347041, at *15-17.

49. 903 F.2d 36, 39-40 (1st Cir.), *cert. denied*, 498 U.S. 916 (1990).

50. *See id.* at 42.

51. 797 F.2d 1154 (2d Cir. 1986).

52. *See id.* at 1156, 1158.

53. *See id.* at 1161.

54. *See id.* The Second Circuit in *Banco Cafetero* held that in tracing the proceeds of illicit activity that are commingled in an account with legitimate funds, the government can use either of two methods at its option. First, the government can assume that the account contains the traceable proceeds as long as the account balance remains greater than the amount of the tainted deposit. Alternatively, the government can assume that any withdrawal greater than the amount of the tainted deposit contains the traceable proceeds. *See id.* at 1159-60. This holding left a loophole because the first method could be foreclosed by placing the funds into an account in which the balance would fall below the amount of the tainted deposit. Congress subsequently enacted 18 U.S.C. § 984, which closed that loophole with respect to money laundering activities covered by the Anti-Drug Abuse Act of 1986. *See* United States v. All Funds Presently On Deposit Or Attempted To Be Deposited In Any Accounts Maintained At American Express Bank, No. CV-92-5310, 1993 WL 352099, at *14-16 (E.D.N.Y. Aug. 31, 1993).

55. 769 F. Supp. 80 (E.D.N.Y. 1991).

56. *See id.* at 84-85. Although this case did not specifically adopt the analysis used in *Banco Cafetero*, 797 F.2d 1154, it nevertheless upheld a forfeiture on the grounds that the

forfeiture laws is the government's stated position that it has absolute discretion to determine which assets should be subject to forfeiture. For example, in the recent Supreme Court decision *92 Buena Vista Ave. II*,[57] the government asserted that the "traceable proceeds" provision of the 1970 Drug Control Act left to the government the determination as to which "proceeds" it could seize.[58] Under the government's view, if a house is purchased with drug money and that house is sold to buy another house, the government is allowed to seize both houses or, in order to mitigate the harshness of a forfeiture in certain circumstances, only one house at its discretion.[59] The Court declined to rule on the merits of that issue because it was beyond the subject of the grant of certiorari.[60] Nonetheless, such unbridled discretion must be addressed in order to prevent the increasing use of civil forfeiture statutes from undermining the legitimate expectations of the financial community.

2. "Relation Back" Doctrine

Perhaps the most far-reaching aspect of both the 1970 Drug Control Act[61] and the Anti-Drug Abuse Act of 1986[62] is the so-called "relation back" doctrine. Both statutes provide that "[a]ll right, title, and interest in property . . . shall vest in the United States *upon commission of the act giving rise to forfeiture* . . . ."[63] However, the relation back doctrine has been applied even in the absence of statutory provisions.

For example, in *Western Pacific Fisheries, Inc. v. SS President Grant*,[64] the court, in considering a damage claim arising from a collision at sea, considered the defendant's argument that evidence should have been admitted to show that the plaintiffs' ship was carrying illegal drugs at the time of the collision.[65] Basing its argument upon the relation back doctrine, the defendant maintained that if the drug claim were substantiated, title to the plaintiffs' ship should have retroactively reverted to the government and, therefore, plaintiffs would not have standing to bring the present suit.[66] The court, although rejecting defendant's argument because the government had not yet "consummated" its forfeiture, recognized that had a forfeiture with formal proceedings occurred, "[t]here is clear authority that . . . the forfeiture relates back to the time of the

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funds "facilitated" the illegal activity. *See Certain Funds On Deposit*, 769 F. Supp. at 84-85.

57. 113 S. Ct. 1126 (1993).

58. *See id.* at 1138.

59. *See id.*

60. *See id.*

61. 21 U.S.C. § 881.

62. 18 U.S.C. § 981.

63. 18 U.S.C. § 981(f) (1988) (emphasis added); 21 U.S.C. § 881(h) (1988) (emphasis added).

64. 730 F.2d 1280 (9th Cir. 1984).

65. *See id.* at 1286.

66. *See id.*

violation."[67] Therefore, the broad reach of the relation back doctrine provides another potential for conflict between the government's ability to seize a criminal's property and the rights of non-culpable third parties.

3. "Innocent Owner" Defense

Although seemingly at odds with the relation back doctrine, Congress has statutorily protected certain non-culpable third parties by incorporating "innocent owner" provisions into the federal forfeiture statutes. For example, the 1970 Drug Control Act provides that "no property shall be forfeited . . . to the extent of an interest of an owner, by reason of any act or omission established by that owner to have been committed or omitted without the knowledge or consent of that owner."[68]

Numerous courts have examined who is an "owner" for purposes of the "innocent owner" defense.[69] For example, courts have held that unsecured creditors are not "owners" in this context.[70] Secured creditors, on the other hand, are deemed by statute to be owners.[71]

The Supreme Court, in *92 Buena Vista Ave. II*,[72] held that the innocent owner provision in the 1970 Drug Control Act is not limited to bona fide purchasers and may include donees.[73] This holding is premised upon the unqualified use in the statute of the word "owner" which "foreclose[s] any contention that it applies only to bona fide purchasers."[74] Thus, the respondent who purchased the forfeited property with illegal proceeds received as a gift had standing to challenge the forfeiture.[75]

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67. *Id.* at 1287.

68. 21 U.S.C. § 881(a)(7). The Anti-Drug Abuse Act of 1986 also provides for the protection of nonculpable third parties, but adds "lienholder" to those protected. *See* 18 U.S.C. § 981(a)(2) (1988 & Supp. IV 1992). Note that neither statute, however, protects innocent unsecured creditors.

69. *See* United States v. One 1987 Volkswagen Jetta, 760 F. Supp. 772, 775 (W.D. Mo. 1991) ("Broadly speaking, ownership may be defined as having a possessory interest in the res, with its attendant characteristics of dominion and control.") (quoting United States v. One 1945 Douglas C-54 (DC-4) Aircraft, Serial Number 22186, 604 F.2d 27, 28 (8th Cir. 1979) (citing United States v. Fifteen Thousand Five Hundred Dollars ($15,500.00), 558 F.2d 1359 (9th Cir. 1977))); *see also* United States v. 6109 Grubb Rd., 886 F.2d 618, 625 n.4 (3d Cir. 1989) ("The term 'owner' should be broadly interpreted to include any person with a recognizable legal or equitable interest in the property seized.") (quoting 1978 U.S.C.C.A.N. 9518, 9522-23). *But see* United States v. Contents of Accounts Nos. 3034504504 and 144-07143 at Merrill, Lynch, Pierce, Fenner and Smith, Inc., 971 F.2d 974, 986-87 (3d Cir. 1992) (adopting "dominion and control" test, but declining to apply it to a straw owner), *cert. denied*, 113 S. Ct. 1580 (1993).

70. *See* United States v. One 1987 Cadillac Deville, 774 F. Supp. 221, 224 (D. Del. 1991). It is interesting to note that the court in United States v. Mageean, 649 F. Supp. 820 (D. Nev. 1986), *aff'd*, 822 F.2d 62 (9th Cir. 1987), in the context of a criminal RICO statute, held that unsecured trade creditors were considered "bona fide purchasers" for purposes of an innocent owner defense. *See id.* at 829.

71. *See* 18 U.S.C. § 981(a)(2).

72. 113 S. Ct. 1126 (1993).

73. *See id.* at 1134-36.

74. *Id.* at 1134.

75. *See id.*

The dissent in *92 Buena Vista Ave. II* asserted that a donee who receives property in a transfer without value has no greater rights in a forfeiture action than the donor.[76] This conclusion is necessary, the dissent argued, to prevent the cleansing of tainted proceeds by transferring the proceeds to relatives or other third parties.[77] The dissent concluded that to hold otherwise "rips out the most effective enforcement provisions in all of the drug forfeiture laws."[78]

The level of "innocence" required for an owner to invoke the "innocent owner" defense also is somewhat unclear. The 1970 Drug Control Act speaks of an owner "without the knowledge or consent"[79] while the Anti-Drug Abuse Act of 1986 omits the words "or consent" and simply states "without the knowledge."[80] The Second Circuit, in *United States v. One Tintoretto Painting*,[81] recognized two innocent owner defenses to a civil forfeiture action that the Supreme Court previously addressed in dictum in *Calero-Toledo v. Pearson Yacht Leasing Co.*[82] These two defenses are: (1) the object was stolen or taken without the innocent owner's consent, and (2) the innocent owner did all that could reasonably be expected to prevent the proscribed use of the property.[83] A district court recently held that the innocent owner defenses under the Anti-Drug Abuse Act of 1986 lessened the burden imposed by *Calero-Toledo* and "requires only a showing of ignorance of the illegal transactions."[84]

One issue that the Supreme Court appears to have resolved is whether the relation back doctrine "trumps" the innocent owner provisions included in the federal civil forfeiture statutes. In *92 Buena Vista Ave. I*,[85] the Third Circuit had held that the "relation back" doctrine did not trump the "innocent owner" defense.[86] In *Eggleston v. Colorado*,[87] the Tenth Circuit had reached a contrary result, holding that the innocent

76. *See id.* at 1143-46 (Kennedy, J., dissenting).
77. *See id.* at 1145.
78. *Id.* at 1146.
79. *See* 21 U.S.C. § 881(a)(7).
80. *See* 18 U.S.C. § 981(a)(2).
81. 691 F.2d 603 (2d Cir. 1982).
82. 416 U.S. 663, 689 (1974).
83. *See One Tintoretto Painting*, 691 F.2d at 607 (citing *Calero-Toledo*, 416 U.S. at 689).
84. United States v. 316 Units of Mun. Secs., 725 F. Supp. 172, 180 (S.D.N.Y. 1989). However, an owner that remains "wilfully blind" cannot claim the benefits of the innocent owner defense. *See* United States v. 1977 Porsche Carrera, 748 F. Supp. 1180, 1185 (W.D. Tex. 1990), *aff'd*, 946 F.2d 30 (5th Cir. 1991).
85. 937 F.2d 98 (3d Cir. 1991), *aff'd*, 113 S. Ct. 1126 (1993).
86. *See id.* at 102 ("[T]he relation back doctrine would only be relevant in this case if a determination were made that [the innocent owner] did not take out a valid innocent owner defense."). The Third Circuit relied, in part, on Judge Murnaghan's concurrence in *In re* One 1985 Nissan 300ZX, 889 F.2d 1317, 1322 (4th Cir. 1989). *See 92 Buena Vista Ave. I*, 937 F.2d at 102-03. *One 1985 Nissan* questioned that if the innocent owner defense were applicable only if the property was obtained prior to the illegal act, then "[h]ow can one obtain drug deal proceeds before the transaction even takes place?" *One 1985 Nissan*, 889 F.2d at 1322.
87. 873 F.2d 242 (10th Cir. 1989), *cert. denied*, 490 U.S. 1070 (1990).

owner defense is only applicable if the "owner" acquired the property prior to the commission of the illegal act.[88] Therefore, the government's seizure of property purchased by an innocent buyer after the occurrence of illicit activity would have been upheld in the Tenth Circuit, but not in the Third Circuit.

The Supreme Court's decision in *92 Buena Vista Ave. II*[89] addressed this conflict by holding that for the innocent owner provisions to have meaning they must trump the relation back doctrine.[90] The plurality asserted that the innocent owner defense would be meaningless if it only applied to cases where the ownership arose before the illegal activity.[91] The concurring opinions reasoned on semantic grounds that the government could not forfeit property that it now owned retroactively because it could not forfeit its own property.[92]

4. Constitutional Limitations

Several recent Supreme Court cases have placed constitutional limitations on the government's use of forfeiture. In *United States v. Halper*,[93] the Supreme Court held that civil penalty and forfeiture actions, following a criminal conviction, may be severe enough to constitute a second criminal punishment.[94] In *Halper*, the government instituted a civil action against the respondent following his federal conviction for submitting sixty-five false Medicare claims.[95] The government sought more than $130,000 in "remedial penalties" under the False Claims Act,[96] even though the respondent defrauded the government of only $585.[97] The Supreme Court stated that while most civil penalty suits were remedial, these penalties could rise to the level of punishments if the sanctions were severe enough.[98] The Court held that these civil sanctions constituted punishments when "the civil penalt[ies] . . . b[ore] no rational relation to the goal of compensating the Government for its loss . . . ."[99] Consequently, the Court held that the government's second action was barred under the Double Jeopardy Clause[100] because "under the Double Jeopardy Clause a defendant who already has been punished in a criminal prosecution may not be subjected to an additional civil sanction to

88. *See id.* at 248.
89. 113 S. Ct. 1126 (1993).
90. *See id.* at 1137.
91. *See id.*
92. *See id.* at 1139-41.
93. 490 U.S. 435 (1989).
94. *See id.* at 446-49.
95. *See id.* at 437. Halper had previously been found guilty of overbilling the government for $585. Following his conviction, Halper was sentenced to two years of imprisonment and fined $5,000. *See id.*
96. 31 U.S.C. §§ 3729-3731 (1988 & Supp. IV 1992).
97. *See Halper*, 490 U.S. at 438-39.
98. *See id.* at 448-49.
99. *Id.* at 449.
100. *See id.* at 452.

the extent that the second sanction may not fairly be characterized as remedial, but only as [punitive]."[101]

In *Austin v. United States*,[102] the Supreme Court held that civil forfeiture actions also implicate the Eighth Amendment's prohibition against excessive fines.[103] In *Austin*, the federal government instituted an *in rem* civil forfeiture action, pursuant to the 1970 Drug Control Act,[104] against the respondent's property following his guilty plea to a state drug possession charge.[105] The federal government sought the forfeiture of both the respondent's auto body shop, where the drug sale took place, and the respondent's home, where the cocaine was stored prior to sale.[106] Austin argued that this forfeiture violated the Eighth Amendment's prohibition against excessive fines.[107] Stating that the Eighth Amendment was intended "to limit the government's power to punish,"[108] the Court held that this protection extended to both civil and criminal actions.[109] Relying on *Halper*, the Court held that when a civil forfeiture ceases to be remedial and serves punitive goals, at least in part, then the forfeiture "is subject to the limitations of the [Eighth Amendment's] Excessive Fines Clause."[110] The Court remanded the case to the Eighth Circuit to develop factors to consider when determining whether a forfeiture is "excessive."[111]

5. Post-Forfeiture Claims Process and the Petition for Remission

Current civil forfeiture law presents a two-tiered approach to resolving the claims of third parties affected by the forfeiture. First, parties who are "innocent owners" of seized property may file a proof of claim with

101. *Id.* at 448-49. The Court remanded the case to the district court to determine what portion of the civil suit was remedial—and allowable—and what portion was punitive and barred under the Double Jeopardy Clause. *See id.* at 452.

102. 113 S. Ct. 2801 (1993).

103. *See id.* at 2812.

104. 21 U.S.C. § 881.

105. *See Austin*, 113 S. Ct. at 2803. Austin had previously pled "guilty to one count of possessing cocaine with intent to distribute and was sentenced . . . to seven years' imprisonment." *Id.*

106. *See id.*

107. *See id.*

108. *Id.* at 2805.

109. *See id.* at 2806.

110. *Id.*

111. *See id.* at 2812. Justice Scalia, in a concurring opinion, advocated a different Eighth Amendment analysis for *in rem* forfeitures than for *in personam* fines. In his view, the "excessiveness" of an *in personam* penalty is determined by weighing the "value of the fine in relation to the offense." *Id.* at 2815 (Scalia, J., concurring). However, for *in rem* forfeitures, "[t]he relevant inquiry . . . is the relationship of the property to the offense." *Id.* In short, Justice Scalia's test for determining whether an *in rem* forfeiture is excessive under the Eighth Amendment is whether the property is an "instrumentality of the offense" or whether it is merely tangentially related to the crime. *See id.* As an example, Justice Scalia noted that scales used in unlawful drug sales are forfeitable "whether made of the purest gold or the basest metal." *Id.*

the district court.[112] In determining the validity of such a claim, the district court, usually through appointment of a Special Trustee, considers the proof of claim in light of common law and statutory provisions of forfeiture.

Second, to the extent the parties seeking redress are *not* innocent owners of seized property, there is no cognizable legal claim against the seized assets. Instead, the parties only may seek an equitable remedy from the DOJ in the form of a petition for remission or mitigation over which the government has complete discretion.[113] Therefore, third parties who are not innocent owners are left without recourse if they are dissatisfied with the DOJ's determination on the petition. While a court may compel the Attorney General to consider the merits of a petition if it determines that the Attorney General has ignored the request,[114] judicial review may not be had on the merits.[115] This, however, places almost unchecked authority in the hands of the DOJ, the same government agency that stands to benefit monetarily if the petition is denied. These provisions have generated both controversy and uncertainty.

An example of the difficulty a party faces in contesting the denial of its petition for remission or mitigation is illustrated by *LaChance v. Drug Enforcement Administration*.[116] The Drug Enforcement Administration ("the DEA") had seized $49,000 in cash belonging to LaChance, a professional harness racer.[117] LaChance had attempted to carry the funds on a plane from New York's LaGuardia Airport to Montreal, but was forced to leave the funds in New York after being informed at a routine metal detector search of his luggage that such funds could not be taken abroad. After leaving the funds in the trunk of a borrowed car, LaChance was approached by DEA agents who wanted to know where he had left the money. LaChance took the agents to the car, and the agents gave LaChance a receipt for the funds, now in a brown bag.[118] DEA drug-sniffing dogs detected the presence of narcotics either on the bag or the money. LaChance insisted that the funds were the proceeds from a horse sale and legal gambling activities and chose to challenge the forfeiture by a petition for remission rather than in court.[119] The DEA

112. *See, e.g.*, 18 U.S.C. § 981(b)(2) (1988 & Supp. IV 1992) (providing that the Supplemental Rules for Certain Admiralty and Maritime Claims shall govern the seizure of assets for forfeiture).

113. *See, e.g.*, 18 U.S.C. § 981(d) (1988 & Supp. IV 1992) (adopting procedures provided in customs laws (19 U.S.C. § 1618 (1988))); 21 U.S.C. § 881(d) (1988) (same). The procedures for filing a petition for remission are set forth in 28 C.F.R. §§ 9.1-.7 (1992).

114. *See, e.g., In re* Sixty Seven Thousand Four Hundred Seventy Dollars, 901 F.2d 1540, 1544 (11th Cir. 1990) (holding that a district court may have jurisdiction "when the agency does not even consider a request that it exercise its discretion").

115. *See* United States v. A Parcel of Land in the City of Lucedale, 791 F. Supp. 1144, 1149 (S.D. Miss. 1991).

116. 672 F. Supp. 76 (E.D.N.Y. 1987).

117. *See id.* at 77.

118. *See id.*

119. *See id.* at 78.

denied his petition on the grounds that there was conflicting evidence concerning his claim that the funds stemmed solely from legal activity.[120] The court declined to review the denial of the petition, holding that a petition for remission is purely administrative.[121] The court also held that an agency's refusal to grant the petition may only be reversed where the agency refuses to consider the petition or maintains a "formalized invariable policy of denying petitions and, in fact, fails to give any reason for denial of the petition in question."[122]

II. THE *MCNAMARA* CASE—AN EXAMPLE OF CIVIL FORFEITURE GONE AWRY

This Part explores the tension between forfeiture law and commercial and bankruptcy law by examining the effect of the John McNamara forfeiture[123] action on creditors. In 1992, the federal government accused John McNamara of defrauding General Motors Acceptance Corporation ("GMAC") of more than $400 million.[124] The ensuing civil forfeiture[125] included a Cessna jet, a car dealership, shopping centers, real estate holdings, a gold mine, and other properties owned by McNamara or arguably traceable to his allegedly illegal activities.[126] Excluded from the forfeiture were a $500,000 private trust and a $350,000 house owned by McNamara's estranged wife.[127]

In the years prior to the forfeiture, a significant number of financial institutions had extended loans to McNamara and his various corporate entities without any knowledge of or reason to suspect McNamara's illegal activities. Today, following the forfeiture of McNamara's assets, these financial institutions are confronted with unpaid loans and a debtor whose assets have been seized by the government.

120. Although the DOJ generally reviews petitions for remission, under certain limited instances of administrative forfeiture, as in *LaChance*, the authority is granted to the DEA. *See* 21 C.F.R. §§ 1316.77-.81 (1993).

121. *See LaChance*, 672 F. Supp. at 79.

122. *Id.* at 80 (citing United States v. One 1970 Buick Riviera, 463 F.2d 1168 (5th Cir.), *cert. denied*, 490 U.S. 980 (1972)).

123. United States v. McNamara Buick-Pontiac, No. CV-92-2070 (E.D.N.Y. July 16, 1992).

124. *See* Jane Fritsch, *Prosecutors Depict Vast Fraud Scheme By L.I. Car Dealer*, N.Y. Times, Apr. 16, 1992, at A1.

It should be noted that various estimates of the fraud were reported. Some news reports placed the fraud at $436 million. *See id.* at B4. Other reports placed the fraud at $422 million. *See* John T. McQuiston, *Assets of Auto Dealer in Fraud Case to Be Sold*, N.Y. Times, Aug. 31, 1992, at B2. GMAC itself, in its claim filed against McNamara, estimated the amount at $444 million. *See* Jeanne Dugan Cooper, *Lawsuit Links GMAC to McNamara Fraud*, Newsday, Oct. 27, 1992, at 22.

125. *See McNamara*, No. CV-92-2070 (E.D.N.Y. July 16, 1992).

126. *See* Fritsch, *supra* note 124, at A1.

127. *See* Lueck, *supra* note 3, at B1.

A. *United States v. McNamara Buick-Pontiac*[128]

Described by Andrew Maloney, United States Attorney for the Eastern District of New York, as "the mother of all kiting schemes,"[129] McNamara's fraud lasted for over seven years. From January 1985 until December 1991, McNamara borrowed more than $6 billion from GMAC allegedly to finance car purchases for his Long Island car dealership, McNamara Buick-Pontiac. Under the scheme, McNamara informed GMAC that the borrowed funds would be used to purchase refurbished cars and vans from an Indiana corporation, Kay Industries. These cars and vans, in turn, would be shipped to Cydonia Trading Ltd. in Cyprus. In reality, both entities were "shell companies" linked to McNamara. The loans were used to finance McNamara's personal holdings including real estate, a gold mine, and other personal assets. McNamara never missed a loan payment, and would simply borrow from GMAC to pay off existing loans. It was not until 1991 that GMAC's auditors became suspicious of McNamara's claim that he needed $2.1 billion to purchase 70,000 vehicles. Further inquiry revealed that the vehicle identification numbers did not appear in automotive trade journals. Subsequent investigation confirmed the GMAC auditors' suspicions that the vehicles were indeed shams, created on paper to perpetuate the McNamara loan-kiting scheme.[130]

In addition to the forfeiture action, McNamara was indicted on one RICO count and six federal wire fraud counts.[131] In the aggregate, these charges carried a maximum sentence of 20 years and more than $800 million in fines.[132] McNamara, who originally pleaded not guilty, was released on a bond of $300 million, most of which was forfeited property.[133] He eventually pleaded guilty to the racketeering charge in a plea bargain agreement with the government.[134]

The government maintained that the civil forfeiture action would enable McNamara to devote his remaining resources to defending the criminal charges,[135] by freezing the claims of GMAC and nearly 6,000 other creditors,[136] including the numerous financial institutions that had secured and/or unsecured claims against the McNamara entities.[137] The

128. No. CV-92-2070 (E.D.N.Y. July 16, 1992).

129. Fritsch, *supra* note 124, at B4. "Kiting" is a slang term that refers to a debtor's continuing practice of borrowing money from one source to repay another source of debt. *See id.*

130. For an overview of the fraud, see *id.*

131. *See* Jacques Steinberg, *Auto Dealer is Indicted for Fraud*, N.Y. Times, May 27, 1992, at B4.

132. *See id.*

133. *See* Steven Lee Myers, *L.I. Dealer Pleads Not Guilty to G.M. Loan Fraud Charges*, N.Y. Times, June 3, 1992, at B5.

134. *See* Fredrick M. Winship, UPI, Sept. 9, 1992, *available in* LEXIS, Nexis Library, UPI File.

135. *See* Lueck, *supra* note 3, at B1.

136. *See* McQuiston, *supra* note 124.

137. One of the major problems for McNamara's creditors is that the forfeiture order

government contended that "[i]t is not the policy of the Government to take over properties from innocent parties."[138] The government's intention was to use civil forfeiture in "a novel, imaginative and just way to insure that the public is protected."[139] In actuality, however, the government has used forfeiture law to supplant bankruptcy law by liquidating the McNamara estate and resolving claims of creditors. As this Article shows, forfeiture law never was intended for that broad purpose.

B. *Civil Forfeiture's Usurpation of Commercial and Bankruptcy Law Principles*

In order to understand how civil forfeiture actions affect creditors, it is first necessary to understand the process by which creditors, such as financial institutions, extend credit. In making lending decisions and in determining interest rates and other lending terms, financial institutions consider factors such as the borrower's financial condition, management, and the likelihood of both default and potential recovery of principal and interest on defaulted loans. In assessing the default risk, financial institutions also consider their rights and remedies under the Uniform Commercial Code and the Bankruptcy Code and the likelihood of recoveries.

Notably absent from this "checklist" is the risk of civil forfeiture of the borrower's assets. It is, of course, impossible at the time of the credit decision to estimate the likelihood of civil forfeiture because the underlying illicit action that may give rise to the forfeiture is as yet undiscovered, and also because the bringing of such an action is politically determined. Furthermore, even if the financial institution were to assume the worst—that each borrower's assets would be subject to civil forfeiture—it is impossible to estimate how claims will be paid, if at all.

Note that even small scale forfeitures can affect creditors. For example, a local grocer may extend credit to a neighborhood resident who turns out to be a drug dealer. If the government seizes not only the contraband, but all of the resident's assets, the grocer is left unpaid. One may question whether there is a difference, other than of scale, between forfeiture in this situation and forfeiture in the *McNamara* case. Nonetheless, the government's interest in seizing the assets of the drug dealer, whose victim is really society at large, perhaps may be said to outweigh the occasional and incidental injustice.[140] On the other hand, when the

imposes a stay on all pending actions (including foreclosure proceedings) and requires that state court-appointed receivers turn over all proceeds from the forfeited assets to the Special Trustee appointed in the federal forfeiture action. *See* United States v. McNamara Buick Pontiac, No. CV-92-2070 ¶¶ 4-5 (E.D.N.Y. July 16, 1992). See *infra* note 204 for further discussion of the implications of federal stay of state court proceedings.

138. Jane Fritsch, *U.S. to Seek Forfeiture*, N.Y. Times, Apr. 24, 1992, at B4.

139. Martin Fox, *$400 Million Civil Forfeiture Ordered in Long Island Auto Loan Prosecution*, N.Y.L.J., May 20, 1992, at 1, 5.

140. The government would also argue that the grocer could file a petition for remission. *See supra* note 113 and accompanying text. Nonetheless, the grocer is an innocent trade creditor of the drug dealer, and therefore would have been entitled, under non-

assets seized are a significant part of the mainstream economy, and particularly when the illicit activity is fraud directed toward private parties, the balance more obviously shifts so that the interests of creditors outweigh the government's incidental interest in seizing the assets.

The concerns in either case at least could be mitigated if the seizure were only of those assets directly used in the illicit activity. The conflict with innocent third parties therefore results, to some extent, from the zealousness of prosecutors in seizing traceable proceeds[141] in addition to assets used in the illicit activity.

This conflict is exemplified by six problems that are raised by the application of civil forfeiture in the commercial context: (1) the lack of a well-defined statutory procedure; (2) the failure to recognize unsecured claims; (3) the failure to respect separate corporate entities; (4) the undermining of the Bankruptcy Code policy of discouraging setoffs; (5) the obstruction of state law remedies; and (6) the problems caused by the preemption of bankruptcy avoiding powers.

1. Forfeiture Lacks a Well-Defined Statutory Procedure

In a civil forfeiture action, an unsecured creditor has virtually no procedural mechanisms through which to become informed and contest matters affecting its interests. Because civil forfeiture is a remedy that derives from antiquated admiralty seizures,[142] the creditor lacks the well-established procedures necessary for application in a complex and modern commercial world. In addition, current civil forfeiture law does not present a forum where creditors or their representatives are encouraged to participate or be heard.[143]

In comparison, under federal bankruptcy law, all creditors are notified and invited to attend an initial meeting of creditors and, in the case of reorganization proceedings, to participate in subsequent periodic hearings.[144] Committees of creditors, and where appropriate committees of holders of equity securities, are required or permitted by law to be appointed to represent the parties in interest generally and to participate in the case.[145] Debtor company actions that are outside the ordinary course

forfeiture law, to assert a claim as of right against the drug dealer's assets. The forfeiture takes away this right.

141. *See supra* part I.B.1.

142. *See supra* note 25.

143. Although the Supplemental Rules for Certain Admiralty and Maritime Claims provide for limited notice and hearing requirements, both the procedural and substantive provisions regulating bankruptcy court proceedings appear to be lacking in forfeiture law. *See* 18 U.S.C. § 981 (1988); 28 U.S.C.A. Supp. Rules for Certain Admiralty and Maritime Claims, B(2), C(4).

144. *See* 11 U.S.C. §§ 341, 342, 1109(b) (1988).

145. *See* 11 U.S.C. §§ 705, 1102 (1988). Committees of creditors are required under federal bankruptcy law in chapter 11 reorganizations and permitted at the request of creditors in chapter 7 liquidations. *See* 11 U.S.C. § 1102(a)(1) (1988); 11 U.S.C. § 705(a) (1988). Although a forfeiture action could be in the nature of either a reorganization or a liquidation, the McNamara forfeiture is in the nature of a liquidation. In a chapter 7

of business require court authorization after notice is given to creditors and other interested parties, and after a hearing is held at which a bankruptcy judge can consider all parties' views.[146] Furthermore, in the reorganization of a debtor company, the final resolution of claims and interests normally is negotiated as part of a consensual plan, and is approved through a voting procedure that is carefully balanced to protect the rights of all parties.[147] In short, the Bankruptcy Code is designed to allow a debtor either to reorganize its affairs or to liquidate, while simultaneously allowing creditors to participate in events that could materially affect the debtor or the debtor's obligations.

In a civil forfeiture, on the other hand, there is no meaningful procedure for creditors. Creditors are notified, at best, intermittently.[148] In addition, individual creditors rarely have an economic stake large enough to actively participate in the forfeiture proceeding. Therefore, they are effectively disenfranchised and are unable to formally participate in the proceeding or to be represented by a committee of representative creditors.[149] Indeed, even for creditors having a large stake, there is no forum in which issues and concerns are discussed on a current basis.

2. Forfeiture Fails to Give Formal Recognition to Unsecured Claims

Civil forfeiture does not recognize unsecured creditors as having claims as of right.[150] Except to the extent that a creditor may have a

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liquidation, a trustee is appointed to "collect and reduce to money the property of the estate . . . as expeditiously as is compatible with the best interests of parties in interest." 11 U.S.C. § 704(1) (1988). The committee of creditors is authorized to consult with the trustee or court appointed administrative officers in connection with the administration of the estate, make recommendations respecting performance of the trustee's duties, and submit to the court or its administrative officers questions affecting the administration of the estate. *See* 11 U.S.C. § 705.

146. *See* 11 U.S.C. § 363(b)(1) (1988). Certain administrative and procedural issues are heard before a trustee who is part of the court system, as opposed to a judge. *See* 11 U.S.C. Part X-1001 to X-1010 (1988).

147. *See* 11 U.S.C. §§ 1123-1129 (1988). For an introduction to bankruptcy, see Steven L. Schwarcz, *Basics of Business Reorganization in Bankruptcy*, 68 J. Com. Bank Lending 36 (1985), *revised and updated in* A Special Collection From the J. Com. Bank Lending: Bankruptcy 79 (1988).

148. Title 18 of the United States Code, section 981, has no ongoing notice requirements.

149. It is conceivable that creditors in a forfeiture action could join forces, but no provision for such committees exists in law or in practice. In fact, the discretionary nature of forfeitures may discourage the formation of such committees, as parties may wish to gain favor with the government on an individual basis. Furthermore, such committees would have no legal foundation or norms upon which to premise any plan for distribution, and individual creditors would be unsure of whether the plan would give them better status than a court.

150. The failure of civil forfeiture law to recognize unsecured claims as of right may well result from the fact that, until recently, only specific assets were seized by the government. Where, on the other hand, the government seizes all of a company's assets, all parties with "interests" in the company are affected—whether those interests stem from ownership, collateral, or merely an unsecured claim. Unsecured claims can arise, for

security interest in collateral,[151] the creditor does not have a legally recognized claim. Creditors, to the extent of their unsecured claims, therefore are unable to avail themselves of the "innocent owner" defense,[152] and are limited to filing petitions for remission, subject to the DOJ's whim.[153]

The Attorney General's discretion and a line of forfeiture cases holding that the government's decision as to how to allocate forfeited assets to creditors, if at all, is *not* subject to judicial review on the merits,[154] create a "chilling effect" on creditors. Why, for example, should a creditor attempt to challenge a government action in a forfeiture case if the creditor has no leverage over the government and the possible result of the challenge is to antagonize the same government officials who will have absolute discretion in deciding how or whether to reimburse the creditor's claim?

Furthermore, because there is no requirement that creditors who are similarly situated be equally reimbursed from the forfeited assets, the possibility exists that these creditors will be treated inconsistently. This is contrary to bankruptcy law, which generally requires parity of treatment for creditors having similar claims.[155]

Similarly, in bankruptcy, the claims of unsecured creditors are superior to any governmental claims for "forfeiture . . . or punitive damages . . . to the extent that such [a] . . . forfeiture [is] not compensation for [an] actual pecuniary loss . . . ."[156] While civil forfeitures are usually remedial in nature,[157] the Supreme Court has held that where a "civil penalty . . . bears no rational relation to the goal of compensating the Government for its loss" it is punitive.[158]

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example, from loans made to the company or for payment of the purchase price of goods or services rendered to the company.

151. Title 18, section 981(a)(2), of the United States Code by its own terms recognizes a "lien" on collateral of an innocent creditor. Even that may be subject to negotiation. A valuation of collateral is subjective, and a low valuation can result in the creditor being unsecured to the extent the amount of the claim exceeds the collateral valuation. Furthermore, secured creditors, even though the Supreme Court in *92 Buena Vista Ave. II* explicitly rejected the government's relation back argument, must still establish the "innocent owner" defense prior to being granted their legal claim. *See 92 Buena Vista Ave. II*, 113 S. Ct. 1126, 1134 (1993).

152. *See* 18 U.S.C. § 981(a)(2); United States v. One 1987 Cadillac Deville, 774 F. Supp. 221, 224 (D. Del. 1991).

153. *See* 18 U.S.C. § 981(b)-(e) (1988 & Supp. IV 1992). Compare § 726 of the Bankruptcy Code which creates an unambiguous ordering of priorities of claims and §§ 501 and 502 of the Bankruptcy Code which give legal recognition to unsecured claims. *See* 11 U.S.C. §§ 501, 502, 726 (1988 & Supp. IV 1992).

154. *See supra* note 115 and accompanying text.

155. *See* 11 U.S.C. § 1122(a) (1988).

156. 11 U.S.C. § 726(a)(4) (1988).

157. *See, e.g.*, United States v. 40 Moon Hill Rd., 884 F.2d 41, 43-44 (1st Cir. 1989) (holding that the government's seizure of appellant's seventeen acre marijuana farm was remedial); United States v. 30 Ironwood Ct., 776 F. Supp. 1242, 1245 (N.D. Ill. 1991) (holding that forfeiture of plaintiff's property for a drug offense was remedial).

158. United States v. Halper, 490 U.S. 435, 449 (1989); *see supra* part I.B.4.

In *McNamara*, the government sought the forfeiture of over $400 million of property. McNamara's kiting scheme—although injuring private third party creditors—was not a theft of government money. Consequently, the government's "losses," at most, consisted of its "costs" of investigating and legally pursuing McNamara.[159] Coincidentally, the salaries of *all* the United States Attorneys and their Assistants in 1989 totalled only $434 million.[160] Unless the federal government's entire legal staff surrendered all their other responsibilities in order to pursue McNamara, the $400 million forfeiture appears to go well beyond remediation and bears "no rational relation"[161] to the government's loss. Consequently, under the Bankruptcy Code, the government's forfeiture claims against McNamara—as punitive claims— would be subordinate to the claims of unsecured creditors.[162]

It also should be noted that courts' construction of the forfeiture laws as not recognizing unsecured claims as of right makes for poor public policy in the commercial context. For example, in *United States v. One 1987 Cadillac DeVille*,[163] the government and an innocent third party claimant disputed the priority of their respective interests in an automobile, the purchase of which constituted "money laundering" of illegal drug profits.[164] The claimant asserted that he had loaned his cousin the money to buy the vehicle, and that the car was collateral for the loan. The claimant, however, failed to perfect his security interest in the automobile under state law.[165] Accordingly, the court ruled that "[a]gainst the Government, the claimant stands in the position of an unsecured

159. *See Halper*, 490 U.S. at 445. The injury to the government also "include[s] . . . [the] ancillary costs, such as the costs of detection and investigation, that routinely attend the government's efforts . . . ." *Id.*; *see also* United States v. 38 Whalers Cove, 954 F.2d 29, 37 (2d Cir.) (holding that compensation includes not only remedying the government's direct pecuniary loss but also its investigatory, overhead, and other costs attributable to the matter), *cert. denied*, 115 S. Ct. 55 (1992).

160. *See* Office of Management and Budget, *Budget of the United States Government: Fiscal Year 1991*, at A-224 (1990).

161. *See Halper*, 490 U.S. at 449.

162. *See* 11 U.S.C. § 726 (1988). These facts also raise an issue of whether forfeitures such as the *McNamara* forfeiture constitute "excessive" fines under the Eighth Amendment. In Austin v. United States, 113 S. Ct. 2801 (1993), the majority emphasized that while the Court has used the "guilty property" fiction to justify forfeiture actions in the past, there was always an element of "culpability" present in these actions. *See id.* at 2809. The Court interpreted Calero-Toledo v. Pearson Yacht Leasing Co., 416 U.S. 663 (1974) as holding "that forfeiture of a truly innocent owner's property [which arguably should include a claim of an innocent unsecured creditor] would raise 'serious constitutional questions.'" *Austin*, 113 S. Ct. at 2809 (quoting *Calero-Toledo*, 416 U.S. at 689-90).

In addition, by focusing solely on the acts of the culpable debtor, Justice Scalia's approach in *Austin* of limiting forfeiture to the "instrumentality of the offense" would limit application of the traceable proceeds doctrine and preserve more assets for the benefit of unsecured creditors. *See id.* at 2815 (Scalia, J., concurring).

163. 774 F. Supp. 221 (D. Del. 1991).

164. *See id.* at 222.

165. *See id.* at 223.

creditor."[166]

In addition to noting that an unsecured creditor lacks standing to challenge a federal forfeiture action,[167] the court stated that the government, in a federal forfeiture action, effectively has the status of a lien creditor under Uniform Commercial Code ("U.C.C.") section 9-301(3).[168] Consequently, under U.C.C. section 9-301(1)(b), the claimant's unperfected security interest was subordinate to the government's "lien creditor" interest.[169]

Although *1987 Cadillac DeVille* pertained to an informal family lending arrangement, the court's rationale as to why an unsecured creditor's claim should be subordinate to the government's interest in seized property is revealing. The court concluded that "[i]f the claimant does indeed have a valid agreement with his cousin, the owner of the car, for repayment of a loan, he may seek redress from her."[170] This logic presupposes, however, that the cousin had assets remaining against which the claimant could attempt to recover.

Where, however, the government by using the relation back and traceable proceeds doctrines is able to seize all assets of a corporate borrower, there may be *no* assets remaining from which creditors can be repaid. The logical flaw in the *1987 Cadillac DeVille* court's analysis is that it assumes there are assets—other than those seized by the government—against which an innocent unsecured creditor can seek to be repaid.[171]

Forfeiture law also creates an anomaly in that a donee who does not give value may be protected under the innocent owner provisions. In contrast, the only recourse of an unsecured creditor who does give value is to file a discretionary petition for remission.[172] In *92 Buena Vista Ave. II*,[173] the Supreme Court held that bona fide purchasers who acquire property after the "culpable act" of the prior owner are permitted to retain the property free of any governmental forfeiture claims relating back to the culpable act.[174] Similar results are reached under commercial law, which allows bona fide purchasers who give value to acquire

166. *See id.* at 224.

167. *See id.* (citing United States v. One 1965 Cessna 320C Twin Engine Airplane, 715 F. Supp. 808 (E.D. Ky. 1989)).

168. *See id.*

169. *See id.*

170. *Id.*

171. See *supra* notes 72-78 and accompanying text for a discussion of the right of a bona fide purchaser to defeat the government's claim to a seized asset. If the bona fide purchaser were subordinate to the government's claim, the purchaser would have innocently paid value and, in effect, received nothing in return. But this is the same situation as that of an innocent creditor who, after advancing money or goods to a company, ceases to have a debtor responsible for repayment because the government seized all of the debtor's assets.

172. *See supra* note 113.

173. 113 S. Ct. 1126 (1993).

174. *See id.* at 1134-37.

goods free of pre-existing security interests.[175]

92 Buena Vista Ave. II went further, however, by extending the innocent owner defense to the recipients of gifts even though existing case law fails to extend the defense to unsecured creditors.[176] This creates the inequity that donees who have not given value are protected, while unsecured creditors who have given value are not. This is particularly troublesome because commercial law traditionally disfavors not-for-value exchanges but protects for-value exchanges.[177] The solution would be to extend the innocent owner defense to unsecured creditors who give value.

3. Forfeiture Does Not Respect Separate Corporate Identities

"[T]he real purpose [behind] much [of] commercial law"[178] is the business world's reliance on reasonable contractual expectations. Preserving reasonable expectations also has been recognized as essential in both bankruptcy cases and cases involving interpretation of contracts. For example, in *In re Augie/Restivo Baking Co.*,[179] the Second Circuit refused to substantively consolidate[180] two separate but related bankruptcy debt-

175. *See* U.C.C. § 9-307. For example, U.C.C. § 9-307(1) provides that a "buyer in ordinary course of business" (a person who buys out of the seller's "inventory") takes free of pre-existing perfected security interests in those goods. Section 1-201(9) of the U.C.C. defines a "buyer in ordinary course of business" as one who "buys" by giving cash, property, or other forms of new value. Similarly, § 9-307(2) protects casual buyers of consumer goods (the "garage sale" purchaser) from pre-existing security interests. Most casual purchasers take free of pre-existing perfected security interests in these goods if, *inter alia*, the casual bona fide purchasers gives new value. Moreover, § 2-403(1) of the U.C.C. also protects bona fide purchasers of goods from a seller with voidable title. This section allows, in certain circumstances, the seller to convey better title than he actually owns to a buyer who gives value. For example, if *A* entrusts his watch to jeweler *B* for repairs, and *B* sells *A*'s watch in the ordinary course of business to *C* for value, then *C* acquires title to *A*'s watch. *See* James J. White & Robert S. Summers, Uniform Commercial Code, § 3-11 (3d ed. 1988).

176. *See 92 Buena Vista Ave. II*, 113 S. Ct. at 1134.

177. The U.C.C. generally allows bona fide purchasers who "give value" to acquire goods free of a third party's perfected security interest, or even a third party's bona fide claim to title in the goods. *See supra* note 175. Similarly, the Bankruptcy Code also favors "for value" transactions over gift conveyances or "unequal exchanges." *See* 11 U.S.C. § 548(a)(2)(A) (1988) (allowing the trustee in certain circumstances to set aside conveyances if the debtor's estate did not receive "reasonably equivalent value" in return).

178. G. Richard Shell, *Substituting Ethical Standards for Common Law Rules in Commercial Cases: An Emerging Statutory Trend*, 82 Nw. U. L. Rev. 1198, 1203 (1988); *see also* U.C.C. § 1-205 (emphasizing the importance of course of dealing and the usage of trade); U.C.C. § 2-609 (discussing the right to adequate assurance of performance in commercial transactions).

179. 860 F.2d 515 (2d Cir. 1988).

180. In certain instances, a bankruptcy court may use its equitable powers under § 105 of the Bankruptcy Code to substantively consolidate two or more affiliated corporations. *See* 11 U.S.C. § 105 (1988). This means that the court will order that the assets and liabilities of separate corporations be treated as if such corporations were merged. In determining whether to substantively consolidate the estates of multiple debtors, bankruptcy courts look to a number of factors, including:

ors' estates, a process which would have combined the debtors' assets to form a single pool from which all creditors would share ratably. Had the court allowed substantive consolidation in *Augie/Restivo*, the lender to the more solvent of the two debtors would have received less of a recovery from the pooled assets than it would have obtained by looking exclusively to the assets of its more solvent debtor. The court held that allowing substantive consolidation would run counter to the lenders' expectations that "are central to the calculation of interest rates and other types of loans, and fulfilling those expectations is therefore important to the efficiency of credit markets."[181]

Civil forfeiture law, as presently codified, can wreak havoc upon the reasonable expectations of creditors.[182] This premise is best understood within the context of the *McNamara Buick-Pontiac* forfeiture by considering a fictitious but representative creditor, "Island Bank." Assume that some years before the McNamara fraud became public knowledge, Island Bank, without knowledge of the fraud, loaned $5 million to McNamara Realty Corp. ("Realty"),[183] a corporation whose shares are owned entirely by John McNamara. Island Bank's loan is secured by a mortgage on property of Realty that was worth $6 million at the time of the loan but, because of a declining real estate market, is presently worth only $3 million. In addition, Realty currently has $4 million of unencumbered real estate and $500,000 on deposit in an account at Island

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> [W]hether creditors knowingly deal with corporations as [a] unit . . . whether one debtor was independent of other debtor when certain securities issued; whether creditor dealt only with one debtor and lacked knowledge of its relationships with others; whether interrelationships of group were closely entangled . . . whether entanglement of business affairs of related corporations was so extensive that the cost of untangling would outweigh any benefit to creditors . . . presence or absence of consolidated financial statements; difficulty in segregating individual debtors' assets and liabilities; existence of parent and inter-corporate guarantees on loans; unity of interest and ownership; existence of transfers of assets without observance of corporate formalities; profitability of consolidation at single physical location . . . .

Augie/Restivo, 860 F.2d at 518 (citations omitted).

Furthermore, because substantive consolidation is an equitable remedy, a court is unlikely to order it if the result would injure a class of innocent creditors. *See id.* at 518-19. For a general discussion of substantive consolidation, see Steven L. Schwarcz, Structured Finance: A Guide To The Principles Of Asset Securitization (2d ed. 1993).

181. *Augie/Restivo*, 860 F.2d at 519. Similarly, in Metropolitan Life Insurance Co. v. RJR Nabisco, Inc., 716 F. Supp. 1504 (S.D.N.Y. 1989), the court emphasized the need for predictability by refusing to read into an indenture an implied covenant to prevent a leveraged buyout. *See id.* at 1508.

182. There is also the view that creditors' expectations will change to take forfeiture law into account. The fallacy of that view, however, is that the use of civil forfeiture, being both infrequent and random, can never reasonably be anticipated by an innocent creditor. This should be distinguished from the situation where a new law, or a change in the law, itself reshapes the expectations of parties who may be affected by the law.

183. Although McNamara Realty Corp. is not a real company, the factual scenario described above is both typical and representative of the *McNamara* case and of large civil business frauds generally.

Bank. Realty therefore is a solvent company, in that its assets exceed its liabilities.

Assume further that a fictitious company, XYZ Credit Corp. ("XYZ"), is a primary victim of the fraud. XYZ loaned $100 million to automobile dealerships owned by John McNamara, but did not lend any money to Realty. The automobile dealerships are now insolvent.

The rights and remedies of Island Bank may be significantly different if civil forfeiture law is applied instead of commercial and bankruptcy law.[184] The policy question raised, again, is whether in a commercial context conflicting bodies of law should be allowed to govern the same subject matter, especially when, from the standpoint of innocent third parties, the determination of which body of law applies to a given situation is random.

In a bankruptcy case involving multiple corporations,[185] the separate corporate structure of each company is generally respected. Creditors of a given corporation are reasonably assured that their right to be repaid from that corporation's assets will have priority over the rights, if any, of creditors of another, affiliated corporation. Although a bankruptcy court may pool the assets and liabilities of separate corporations under the equitable doctrine of substantive consolidation, decisions such as *Augie/Restivo*[186] indicate that such power is judiciously invoked.[187] Typically such consolidations occur only after a finding that normal corporate formalities were not respected and, only then, where innocent creditors would not be significantly impaired by that result.[188]

In a civil forfeiture, by contrast, there is no assurance that separate corporate identities will be respected. For example, John McNamara ran his business through multiple corporations, the stock of which he owned

184. Whether, in a particular instance, the civil forfeiture law rights and remedies will require a different result than under commercial/bankruptcy law is immaterial. The salient point for purposes of this Article is that it *may* be different, thus creating uncertain expectations between the parties, and removing the measure of certainty required for the meaningful transaction of business (*e.g.*, loan agreements). Furthermore, a creditor whose claim is secured by collateral valued in excess of the amount of the claim may be better off in a forfeiture than in a bankruptcy case, because forfeiture law specifically recognizes secured claims of innocent creditors. *See* 18 U.S.C. § 981(a)(2). In addition, the creditor would not be subject to the automatic stay in bankruptcy, or to the risk of replacement of the collateral for adequate protection. *See* 11 U.S.C. §§ 361, 362(a), 363, 364 (1988). Nonetheless, forfeiture law may give sufficiently broad power to the government to impose restrictions if it wishes to do so. *See* 18 U.S.C. § 981(a) (1988 & Supp. IV 1992).

185. Modern business often is conducted through affiliated corporations, sometimes under common control of one person or corporation. In the case against John McNamara, United States v. McNamara Buick-Pontiac, Inc., No. CV-92-2070 (E.D.N.Y. July 16, 1992), McNamara owned stock of dozens of separate corporations through which he ran his business empire.

186. 860 F.2d 515 (2d Cir. 1988).

187. *See id.* at 519-20.

188. *See id.* at 518; *supra* note 180.

directly or indirectly through subsidiaries.[189] The government asserted that all of the unencumbered assets of these corporations were derived from traceable proceeds of the fraud,[190] and therefore belong to the government. In effect, through the application of federal forfeiture law, the government, like a bankruptcy court, substantively consolidated the McNamara empire. The government entertains the unsecured creditors' petitions for relief from this large asset pool. To the extent that the government, through these petitions, allocates assets to the unsecured creditors, some creditors will benefit while others suffer. Unfortunately, none of the criteria used to guide bankruptcy courts are considered in forfeiture actions. The traceability of proceeds, not the separate corporate identities or the rights of innocent creditors,[191] is the only touchstone of analysis.

As an example, consider Island Bank's $5 million loan to Realty, a solvent corporation. In a bankruptcy of Realty, Island Bank would expect to recover the entire amount of its loan.[192] XYZ, on the other hand, will not recover its full loan because its borrowers' (the automobile dealerships) liabilities exceed their assets. But in a civil forfeiture, if the government pooled the unencumbered assets of Realty and affiliated corporations for the benefit of all the unsecured creditors, both Island Bank, based on the $2 million unsecured portion of its loan,[193] and XYZ, based on its $100 million loan, would have a remission claim against the combined assets of Realty and the automobile dealerships. If the value of the resultant combined unsecured asset pool is less than the amount of the combined unsecured claims of creditors of Realty and the automobile dealerships, then each creditor holding an unsecured claim would (assuming that the creditor's petition for remission was granted) receive less than the full amount of its remission claim. In effect, XYZ would benefit unfairly from the pooling of Realty's assets, while Island Bank would suffer unjustly from XYZ's claim.

It is ironic that the creditors hurt the most by a consolidation are those who made loans to the most financially sound of the corporate entities and unexpectedly find themselves sharing their borrowers' assets with creditors of riskier enterprises. The least conservative lenders, on the

189. *See* United States v. McNamara Buick-Pontiac, Inc., No. CV-92-2070 (E.D.N.Y. July 16, 1992).

190. The Second Circuit in United States v. Banco Cafetero Panama, 797 F.2d 1154 (2d Cir. 1986), liberally construed forfeiture's "traceable proceeds" provision to allow forfeiture of five separate bank accounts where uncertainty as to the legality of the source of the funds existed. *See id.* at 1159-60; *supra* note 54. Under recently enacted 18 U.S.C. § 984, Congress has even further expanded forfeiture's reach in cases involving money laundering.

191. *See supra* part I.B.1.

192. However, Island Bank will likely suffer a delay in collection because of the automatic stay in bankruptcy. *See* 11 U.S.C. § 362 (1988 & Supp. IV 1992).

193. Recall that Island Bank's $5 million loan is secured by collateral presently worth only $3 million, leaving a $2 million unsecured deficiency. Its loan therefore is undersecured by $2 million.

other hand, who were able to charge higher interest rates on their loans to the less credit-worthy borrowers benefit from the consolidation by sharing in the combined asset pool. It is questionable, at best, whether forfeiture law should impose this fundamental unfairness.

4. Forfeiture Undermines Bankruptcy Code Policy Discouraging Setoffs

The Bankruptcy Code by its terms gives creditors a secured claim with respect to certain deposit accounts in order to discourage creditors from setting off funds in those accounts, and thereby prematurely forcing a company into liquidation.[194] To the extent a bank has a borrower's funds on deposit in an account, such funds in the event of a bankruptcy would become cash collateral for pre-bankruptcy loans made by the bank to the borrower to the extent the bank could have set off such funds prior to bankruptcy.[195] In this way, the Bankruptcy Code harmonizes the interests of the debtor and its estate while protecting the rights of creditors. Therefore, in the case of Island Bank, the $500,000 in Realty's deposit account with Island Bank would become cash collateral for Island Bank's loan to Realty in the event Realty files for bankruptcy. In planning its workout strategy, Island Bank would be encouraged by the policies underlying the Bankruptcy Code not to set off the account, and might be penalized if it did set off the account.[196]

Unlike the Bankruptcy Code, civil forfeiture provides no apparent protection for a party having the right to set off funds in the wrongdoer's deposit account. Furthermore, under the common law, only mutually owing debts can be set off. Therefore, prior to a forfeiture, Island Bank would be entitled to offset (*i.e.*, retain) the $500,000 deposit balance it "owes" to Realty against the outstanding loan Realty owes to Island Bank. However, a forfeiture could prevent the setoff because the relation back provisions[197] provide that all of Realty's assets, including the $500,000 deposit account funds, vest retroactively in the United States to the time of the criminal act.[198] Because Island Bank would then "owe" the $500,000 to the United States and not to Realty, the mutuality of indebtedness may be destroyed and Island Bank's common law setoff rights may be lost.

194. *See* 11 U.S.C. § 506 (1988). Indeed, 11 U.S.C. § 553 (1988 & Supp. IV 1992), further discourages premature setoffs by providing that all or a portion of amounts set off may have to be returned under certain circumstances specified therein.

195. *See* 11 U.S.C. § 506(a) (1988).

196. *See* 11 U.S.C. § 553(b)(1) (1988 & Supp. IV 1992).

197. Under the Supreme Court's decision in *92 Buena Vista Ave. II*, 113 S. Ct. 1126 (1993), Island Bank could still try to assert an "innocent owner" defense and a court would have to rule on the merits of the claim prior to the application of the "relation back" doctrine. *See id.* at 1134-37. Although the court held that donees would qualify as "innocent owners," it did not address the issue (because it was not presented) of whether a bank holding an account subject to set off would possess the requisite "ownership" under the "innocent owner" defense. *See id.* at 1134-35.

198. *See* 18 U.S.C. § 981(f); 21 U.S.C. § 881(h).

Under this scenario, Island Bank reasonably would want to exercise its setoff rights at the earliest possible moment for fear that a civil forfeiture action might be commenced. Once Island Bank sets off, it becomes the owner of the funds in the deposit account, and therefore trumps the government's interest in the funds.[199] Realty, for its part, would suffer the loss of the forbearance Island Bank might otherwise extend if its rights were not impaired by a forfeiture. The result would be to precipitate Realty's slide into bankruptcy at a time when Realty might have been able to avoid a bankruptcy.

5. Forfeiture May Thwart State Law Remedies

Assume that prior to forfeiture Realty defaulted on its loan obligations and Island Bank moved for and obtained the appointment of a receiver for the properties mortgaged to Island Bank. A state court receiver's duties typically include the collection of rents, payment of the properties' operating expenses, and escrow or payment to the mortgagee of any surplus funds to be applied against the mortgage debt.[200] The appointment of a receiver protects Island Bank's interest in Realty's rents as well as the interests of other creditors by preventing Realty's principals from using the company's assets for improper purposes or personal benefit.

If Realty subsequently files for bankruptcy, the receiver may, at the discretion of the court, continue to perform its duties or be ordered to turn over the property to the bankruptcy trustee who would operate Realty's estate for the benefit of all creditors.[201] In either event, Realty's rents would likely become Island Bank's cash collateral.[202]

In a civil forfeiture, the forfeiture order may call for the removal of a state court-appointed receiver for the mortgaged properties.[203] The federal court-appointed Special Trustee, responsible for controlling and overseeing all of the forfeited property, would replace the state court receiver.[204] While contracts or existing statutes define the duties and obligations of a state court receiver, statutes do not prescribe the role that a

199. *See supra* part I.B.3. This assumes that Island Bank is an innocent owner of the funds set off.

200. *See, e.g.*, N.Y. Civ. Prac. L. & R. 6401(b) (McKinney 1980) (setting forth powers of temporary receiver).

201. *See* 11 U.S.C. § 543 (1988).

202. *See In re* Financial Ctr. Assocs., 140 B.R. 829, 834-35 (Bankr. E.D.N.Y. 1992). Island Bank's use of the cash collateral would be limited by § 363 of the Bankruptcy Code. *See* 11 U.S.C. § 363.

203. *See, e.g.*, United States v. McNamara Pontiac-Buick, Inc., No. CV-92-2070 (E.D.N.Y. July 16, 1992) (ordering a decree of forfeiture and appointing a special trustee).

204. Such an order may raise a question under the Anti-Injunction Act, 28 U.S.C. § 2283 (1988), which prohibits federal courts from interfering with certain orders issued by a state court. In National Cancer Hospital of America v. Webster, 251 F.2d 466 (2d Cir. 1958), *cert. denied*, 361 U.S. 824 (1959), the Court held that a federal court could not enjoin a state court receiver who had been directed by a state court to distribute seized monies to certain cancer institutions. *See id.* at 467-68.

Special Trustee will serve in a forfeiture action. Lenders and other creditors have no means to predict how, when, or if a borrower's assets might be seized and, once seized, how the Special Trustee will distribute those assets to creditors.

6. Forfeiture May Prevent Creditor Recovery of Preferences and Fraudulent Conveyances by Preempting a Bankruptcy Filing

Under section 547 of the Bankruptcy Code,[205] transfers of cash or other property made by a company to creditors within 90 days[206] of the company's bankruptcy may, under certain circumstances, have to be returned as preferential. Furthermore, under section 548 of the Bankruptcy Code,[207] transfers made (or obligations incurred) within one year of the company's bankruptcy may have to be returned as fraudulent conveyances if the company did not receive "reasonably equivalent value" in return.[208] The congressional intent behind sections 547 and 548 was to ensure an equal and fair distribution of a debtor's estate.[209]

A civil forfeiture, however, may preempt these important Bankruptcy Code provisions. The government asserts that forfeiture gives it title to and control of all the assets of a wrongdoer. Therefore, because after forfeiture wrongdoers no longer own the stock of corporations previously controlled by them, they may not be able to cause bankruptcy petitions to be filed for those corporations.[210] Involuntary bankruptcy petitions also would be stayed by the forfeiture.

The 90-day period for federal preference actions and the one-year period for federal fraudulent conveyance actions[211] are therefore likely to pass without creditors being able to challenge the transfer as preferential or fraudulent. Furthermore, forfeiture law, being federal law, would appear to preempt any applicable state fraudulent conveyance law.[212]

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205. 11 U.S.C. § 547 (1988).

206. If the creditor is an "insider," the 90-day period becomes one year. *See* 11 U.S.C. § 547(b)(4)(B) (1988).

207. 11 U.S.C. § 548 (1988 & Supp. IV 1992).

208. *See* 11 U.S.C. § 548(a)(2)(A). For a discussion of fraudulent conveyance law and its application, see Steven L. Schwarcz, *The Impact of Fraudulent Conveyance Law on Future Advances Supported by Upstream Guaranties and Security Interests*, 9 Cardozo L. Rev. 729 (1987); Steven L. Schwarcz & Gabe Shawn Varges, Guaranties and Other Third-Party Credit Supports, Commercial Loan Documentation Guide 16-1 (1989).

209. *See, e.g.*, *In re* Antweil, 931 F.2d 689, 692 (10th Cir. 1991) ("The most important purpose of section 547(b) [of the Bankruptcy Code] is to facilitate equal distribution of the debtor's assets among the creditors.") (citing H.R. Rep. No. 595, 95th Cong., 1st Sess., 177-78, *reprinted in* 1978 U.S.C.C.A.N. 5963, 6138), *aff'd*, 112 S. Ct. 1385 (1992); *In re* Weisman, 112 B.R. 138, 140 (Bankr. W.D. Pa. 1990) ("The fundamental purpose of the § 548 fraudulent conveyance statute was to protect creditors from transfers of assets of the debtor.").

210. The issue of whether forfeiture preempts bankruptcy nonetheless appears to be without legal precedent.

211. *See* 11 U.S.C. §§ 547(b)(4), 548(a) (1988 & Supp. IV 1992).

212. *See* United States v. One 1973 Rolls Royce, 817 F. Supp. 571, 577 n.15 (E.D. Pa. 1993).

Consider, for example, that in the final days of the McNamara empire, prior to the revelation of the fraud, McNamara decided to transfer property and/or funds to a large creditor, family, or friends in an attempt to place such assets beyond the reach of forfeiture. Existing civil forfeiture law provides no procedure for creditors to challenge such transfers, placing creditors at the mercy of the government's decision whether or not to institute such a challenge.[213] More importantly, to the extent the transferees are unaware of the fraud, the innocent owner provisions of forfeiture law[214] would protect the transfers, including those made to donees, even if the result of the transfers was to deplete significantly the assets left for repayment of innocent creditors. This is in direct contrast to the bankruptcy preference and fraudulent conveyance laws.[215] These laws operate to bring assets transferred in advance of bankruptcy back to the debtor's estate to the extent the debtor was insolvent and did not receive the requisite measure of value in return for the transfer.

III. A Recent Model For Balancing Governmental And Commercial Law Interests

In reevaluating civil forfeiture law, Congress should compare the present situation with the perceived conflict of interest previously faced by another arm of government, the Securities and Exchange Commission ("SEC"), in the context of a bankruptcy proceeding under the Bankruptcy Act of 1898,[216] the predecessor statute to the Bankruptcy Code. The Bankruptcy Act of 1898, as amended, included a broad role for the SEC in bankruptcy proceedings.[217] The SEC had the right to be "deemed a party in interest" and to be heard on all matters arising in a bankruptcy proceeding. The SEC served as an advisor and final expert for the court, weighing protection of the "public interest" against the commercial interests of the parties in the particular bankruptcy case.[218] This is analogous to the DOJ's role in forfeiture actions—weighing the "public interest" in combating illegal activity against the claims of innocent creditors and other parties to commercial transactions.

Equally striking in the analogy between the SEC's role in bankruptcy and the DOJ's role in forfeiture is the government's conflicting roles in each. *In re Yuba Consolidated Industries*[219] illustrates this conflict. The

213. It is a curious phenomenon that the government, at times, will at its *discretion* exempt certain property from forfeiture. For example in United States v. McNamara Buick-Pontiac, Inc., No. CV-92-2070 (E.D.N.Y. July 16, 1992), the government excluded a private trust and McNamara's estranged wife's house from the Forfeiture Order.

214. *See supra* part I.B.3.

215. *See* 11 U.S.C. § 547; 11 U.S.C. § 548.

216. 30 Stat. 544 (1898). The Bankruptcy Act of 1898 is the predecessor statute to the Bankruptcy Code.

217. Bankruptcy Act of 1898 § 208 (codified as amended at 11 U.S.C. § 1109(a) (1988)).

218. *See* William Miller Collier, Collier on Bankruptcy ¶ 1109.01 (15th ed. 1993).

219. 260 F. Supp. 930 (N.D. Cal. 1966).

court strongly admonished the SEC for its opposition to a fee application by an attorney for a creditor in a bankruptcy proceeding.[220] In harsh language, the court reprimanded the SEC for its "attitude calculated to discourage and stifle individual creditors from actively participating in chapter X proceedings—particularly where a creditor aggressively opposes the views of the SEC."[221]

In the 1978 revision of the bankruptcy laws, Congress re-evaluated the SEC's dual role as both advocate and advisor in bankruptcy proceedings.

Section 1109 of the Bankruptcy Code significantly alters the role of the SEC in a chapter 11 bankruptcy proceeding by providing that, although it may be heard on any issue, it may not appeal from any order entered in the bankruptcy case.[222] Legislative history explicitly reveals congressional intent that the SEC "not [be] a party in interest."[223] The SEC therefore no longer has a statutory right to file a plan of reorganization for the debtor's business; that right is reserved for a "party in interest."[224] The SEC apparently has accepted this more restricted role, and has suggested that it will limit its participation in bankruptcy cases to ensuring that disclosure requirements are met. In addition, the SEC will intervene if a court so requests or if a particular case will set legal precedent.[225] The bankruptcy context thus provides a recent historical precedent where a conflict between protecting the "public interest" and the commercial interests of third parties led to restrictions on governmental power in order to achieve a more reasonable balance.

IV. SUGGESTIONS FOR REFORM

Civil forfeiture law likewise should be reformed to arrive at a more reasonable balance between ensuring that wrongdoers do not retain the profits of their illicit activity and preserving the legitimate expectations of parties to commercial transactions. Although this balance can be achieved in various ways, there is one approach to reform that is both simple and effective. Forfeiture laws should be amended so that when applied to assets not directly used in the illicit activity, only the wrongdoer's *equity* in those assets is seized. In other words, the government's interest should be limited to the residual portion, if any, that remains after innocent creditors have exhausted their rights, remedies, claims, and interests under applicable commercial and bankruptcy laws. The government would have, in effect, only a contingent springing interest in

220. *See id.* at 960-63.

221. *Id.* at 962.

222. *See* 11 U.S.C. § 1109(a).

223. *See* 124 Cong. Rec. S17,419 (daily ed. Oct. 6, 1978) (remarks by Sen. Dennis DeConcini) *cited in* Collier, *supra* note 218, at 1109-17.

224. 11 U.S.C. § 1121 (1988).

225. *See* Collier, *supra* note 218, at 1109-14 n.32a (quoting Daniel L. Goelzer, General Counsel of the SEC).

the wrongdoer's assets that are traceable to, but not used directly in, the wrongdoer's illicit activities.

This approach allows the government to uphold legitimate commercial expectations while preventing the wrongdoer from retaining profits from illicit activity. It also addresses the concerns previously raised by this Article. Because the government does not preempt the claims-paying process, the procedural protections of commercial and bankruptcy law will be applicable. Unsecured claims will be recognized and paid as of right. Separate corporate identities will be respected. In addition, creditors will have exhausted their non-forfeiture rights and remedies before the government's forfeiture rights mature.[226]

Until the forfeiture laws are changed to implement this reform, government forfeiture actions intended to protect the "public interest" inadvertently could deny property rights to innocent creditors. The government therefore should consider adopting interim reforms of its own. First, the government should adopt the claims-paying priorities from bankruptcy law to prevent unfairness to creditors. Furthermore, unsecured claims of innocent creditors should be paid as of right from seized assets. In addition, forfeiture law should respect separate corporate identities unless there is a reason to "pierce the corporate veil."[227] As the law currently exists, the government can gather together property seized from affiliated corporate entities whose only connection with the wrongful conduct is that the property consists of traceable proceeds. Although the natural inclination of prosecutors may be to distribute the seized property to victims of wrongful conduct, the present law simply creates more innocent victims by depriving creditors of their bargained for recovery.

Finally, when innocent parties may be affected, the government should use its discretion to seize, at least at the outset, only property directly used in the wrongdoing. This not only would bring civil forfeiture closer to its historical roots but also would mitigate the disruption of commercial transactions by restricting the property subject to forfeiture.

Creditors also should be given procedural rights under forfeiture law. Creditors are presently confronted by an ad hoc system, devoid of any meaningful process, in which the government retains virtually complete discretion as to the distribution of seized assets. If the government gave creditors the right to be heard after notice, and appointed a representa-

226. Alternatively, the same result could be achieved by amending forfeiture law to allow the government to seize the wrongdoer's traceable assets at the outset, but subordinating the government's interest in the seized assets not directly used in the illicit activity to the rights, remedies, claims and interests of innocent third parties. Such a provision would be enforceable in a bankruptcy proceeding. *See* 11 U.S.C. § 510 (1988). The government therefore could not take any action against the "seized" assets until innocent creditors exhausted their rights and remedies under non-forfeiture law.

227. *See, e.g., In re* Sims, 994 F.2d 210, 217-20 (5th Cir. 1993) (discussing when to treat three corporate entities as one for purposes of filing an involuntary bankruptcy petition).

tive group of creditors to advise the government in administering and distributing seized property, it would go far to alleviate the frustration now felt by unsecured and undersecured creditors.

This Article suggests that unsecured claims of innocent creditors should be paid as of right. Under existing forfeiture law, the mechanism for payment is the petition for remission. The petition for remission is in need of reform, however, not only because it gives the government discretion whether to pay a claim but also because the government's determination is not subject to judicial review on the merits.[228] Under the Administrative Procedure Act ("APA"), by way of contrast, agency action is generally subject to judicial review.[229] Normally, the standard of review applied to agency determinations permits the reviewing court to overrule the agency determination when it is "arbitrary, capricious [or] an abuse of discretion."[230]

Moreover, the failure to provide judicial review of DOJ determinations is exacerbated by the conflict of interest under which the DOJ operates. The DOJ, which is the agency that entertains petitions for relief, may stand to benefit directly if such petitions are denied.

Therefore, the petition for remission should be replaced by a proof of claim procedure, perhaps similar to that provided under sections 501 through 502 of the Bankruptcy Code and the related bankruptcy rules.[231] To the extent that the petition for remission has any ongoing viability, its function should be limited primarily to the determination of the innocence of creditors who file a claim. In making that determination, the government should be subject to the normal standard of judicial review of agency action, as described above.

CONCLUSION

The state of modern civil forfeiture law reveals a statutory and legal web of doctrine that has removed forfeiture not only from its historical origins but also from the realities of modern commercial dealings. By denying fair treatment of creditors, the application of civil forfeiture statutes threatens to undermine the principles of commercial reasonableness and predictability that underlie commercial transactions. Financial insti-

228. At one time, district courts were empowered to remit or mitigate forfeitures. *See, e.g.*, Liquor Law Repeal and Enforcement Act, 27 U.S.C. § 40a (repealed 1948), *cited in* United States v. One 1936 Model Ford, 307 U.S. 219, 220-21 (1939).

229. *See* 5 U.S.C. § 701-706 (1988).

230. 5 U.S.C. § 706(2)(A) (1988). Although the APA does have a "carve out" for instances of "agency action . . . committed to agency discretion by law," 5 U.S.C. § 701(a)(2), courts have established a three-part test for determining whether an agency action fits within this exception. Factors to be evaluated include appropriateness of the issues raised for judicial supervision to safeguard the interests of plaintiffs and the impact of review on the effectiveness of the agency carrying out its responsibilities. *See* Hahn v. Gottlieb, 430 F.2d 1243, 1249 (1st Cir. 1970).

231. *See* 11 U.S.C. §§ 501-502 (1988); 11 U.S.C. Rul. 3001-3022 (1988 & Supp. IV 1992).

tutions and other creditors are subject to forfeiture laws that were never intended to apply to them, and that lead to results substantively different than would be reached under bankruptcy and commercial law. Civil forfeiture historically has served, and still retains, a legitimate role in society's efforts to ensure that crime does not pay. That goal, however, should not be achieved—and indeed need not be achieved—at the expense of innocent third parties.