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More Corporate Crime Victims Recovering Investigation Fees

Law360, New York (April 08, 2013, 11:42 AM ET) -- On Feb. 25, 2013, former Goldman Sachs Group Inc. director Rajat K. Gupta was ordered to reimburse Goldman Sachs $6.2 million for legal fees Goldman Sachs incurred in its internal investigation into Gupta's illegal insider trading activities.[1] Gupta had already been sentenced by the same court to two years in prison for those same activities. Goldman's fee recovery adds to a growing line of cases allowing corporate crime victims to recover legal fees spent on internal investigations launched to uncover criminal activity.

For corporate crime victims deciding how to recover losses associated with a perpetrator's wrongdoing, the fact the legal fees incurred during the investigation and prosecution may be recoverable as part of the perpetrator's criminal sentencing is a concept worthy of note: While a corporate victim suing a perpetrator in civil court can recover the losses directly attributable to the crime, such as embezzled proceeds, it is unlikely the corporate victim could recover the attorneys' fees spent investigating and suing the perpetrator. Therefore, as white collar criminal defense lawyers evaluate whether to plead out their solvent white collar clients or roll the dice at trial, they need to be aware that their clients could be on the hook for the attorneys' fees their former employers incurred investigating their client's wrongdoing.

Background

Gupta's restitution order requires him to pay the legal fees Goldman Sachs incurred conducting an internal investigation, responding to grand jury subpoenas and document requests from the U.S. Attorney's Office, the U.S. Securities and Exchange Commission, and from Gupta himself, collecting and reviewing millions of documents leading to document productions of over 400,000 pages, and providing counsel to represent various of its officers and employees in depositions and at trial.

The restitution order also covered fees Goldman Sachs incurred relating to the criminal investigation of Raj Rajaratnam, who was unaffiliated with Goldman Sachs, but was convicted for his role in the same insider trading scheme. Finally, Gupta was ordered to pay Goldman Sachs' fees associated with preparing the request for restitution. Goldman Sachs sought its fees under the Mandatory Victim Restitution Act ("MVRA"), which allows some crime victims to recover expenses they incur as a result of a criminal defendant's wrongful conduct.[2] Unlike the Victim and Witness Protection Act of 1982 ("VWPA") which gives federal courts discretionary authority to order restitution for victims, the MVRA's provisions are mandatory.

The MVRA applies in a broad array of crimes, including all property offenses under Title 18. It makes restitution mandatory when the offense of conviction was "committed by fraud or deceit," or was one "in which an identifiable victim or victims has suffered a physical injury or pecuniary loss." Because of the breadth of these categories, the MVRA can provide restitution to many victims of financial crime.

In ordering restitution under the MVRA, the Gupta court made the required findings that the requested attorneys' fees were "necessary," were "incurred during participation in the investigation or prosecution of the offense or attendance at proceedings related to the offense," and were incurred by a "victim." While one may not have thought of Goldman Sachs — the entity from whom Gupta, the tipper, acquired the inside information — as a traditional victim of insider trading, the MVRA defines "victim" as anyone who was "directly and proximately harmed" by the offense of conviction. Reasoning that Goldman Sachs' legal fees were a "necessary, direct and foreseeable result" of Gupta's criminal conduct, the court had no difficulty in finding that Goldman was a victim, and thus awarding it its attorneys' fees.

In contrast to the VWPA, the MVRA requires the court to order restitution in the full amount of each victim's losses, and is not allowed to consider the defendant's economic circumstances.[3] However, recovery under the MVRA is limited to those losses that are (1) directly caused by the offense of conviction, (2) caused by all of the acts included within the scope of the scheme or conspiracy, if a "scheme, conspiracy or pattern of criminal activity" is an element of the offense or (3) amounts otherwise expressly agreed to in a plea agreement.

Goldman Sachs' fee award comes on the heels of a fee award to another investment bank. Last year, Morgan Stanley was able to recover the legal fees it incurred conducting an internal investigation and cooperating with the SEC's investigation of Joseph Skowron III, a Morgan Stanley managing director convicted of securities fraud and obstruction of justice.[4] Like Goldman Sachs, Morgan Stanley filed a motion for restitution as part of Skowron's criminal sentencing, rather than file a civil lawsuit against its former employee.

Implications of the Gupta Ruling

Two separate constituencies should take note of the Gupta ruling: corporate crime victims and white collar criminal defense practitioners. Corporate crime victims such as Goldman Sachs and Morgan Stanley should be aware of the growing line of cases requiring criminal defendants to repay corporate legal fees incurred investigating and uncovering crimes, even if those investigations preceded a later government investigation or arose out of a related criminal case.

Recovering legal fees spent on a voluntary internal investigation is not a settled issue, as some courts have denied recovery of attorneys' fees spent on internal investigations. Those courts have strictly interpreted the MVRA's language finding that it only requires restitution of "expenses incurred during participation in the investigation or prosecution of the offense." They have declined to apply that language to a voluntary internal investigation undertaken well before any criminal prosecution has commenced.

Courts refusing to award restitution in these circumstances typically note that the internal investigation was neither required nor requested by government investigators or prosecutors. Conversely, judges deciding that the MVRA covers internal investigation costs do so on the ground that the insider's criminal acts forced the corporation to launch an internal investigation and/or cooperate with a government investigation, making the costs a direct and foreseeable result of the criminal offense.

Indeed, Skowron has appealed the court's restitution order in his case, arguing that Morgan Stanley incurred its attorneys' fees after learning from the SEC that it was investigating some of Morgan Stanley's trading activities, at a time prior to the U.S. Department of Justice's involvement. Skowron's appeal is currently pending before the U.S. Court of Appeals for the Second Circuit.[5]

Although the uncertainty about the breadth of expenses recoverable under the MVRA has been reduced by the Gupta decision, the pendency of the Skowron appeal means it is too soon to declare with certainty that attorneys' fees can be recovered under the MVRA. Nevertheless, the potential for recovery under the MVRA is significant when compared to the traditional mechanism for recovery of a victim's losses — civil litigation. Typically, in civil litigation, a victim suing for tort losses cannot recover either the attorneys' fees spent investigating the nature and extent of loss or those fees incurred in prosecuting the litigation. As such, where financial crimes are involved, pursuing attorneys' fees as criminal restitution may offer a greater likelihood of recovery than when proceeding civilly.

A second constituency — white collar criminal defense practitioners — should similarly be aware of this line of cases because once a client has admitted being or been found guilty, that person may, in addition to the myriad criminal sanctions, also be ordered to pay his former employer's attorneys' fees spent investigating his conduct. Being aware that a trial loss could include multimillion-dollar financial responsibility, a risk-averse solvent perpetrator may want to plead guilty to a crime that does not carry the same restitution obligations. For example, agreeing to plead to a misdemeanor offense that by definition includes a monetary cap on losses — such as 18 U.S.C. Section 641, theft of government property not exceeding $1,000 — will also cap the defendant's restitution exposure under the MVRA.[6] Victims cannot be compensated for more harm than the offense of conviction necessarily implies was incurred.[7]

Similarly, because defendants under the MVRA only owe restitution to those who suffered injury directly caused by the offense of conviction (or caused by all of the acts included within the scope of the scheme or conspiracy, if a "scheme, conspiracy or pattern of criminal activity" is an element of the offense), the wise practitioner may seek to charge bargain to an offense of conviction that limits the scope of potential restitution obligations.

Of course, federal prosecutors are constrained in their ability to acquiesce to such charge bargaining. The U.S. Attorney Manual provides that "[i]n determining whether it would be appropriate to enter into a plea agreement, the attorney for the government should weigh all relevant considerations, including ... [t]he effect upon the victim's right to restitution."[8] It further provides that "when negotiating plea agreements, prosecutors must give consideration to 'requesting that the defendant provide full restitution to all victims of all charges contained in the indictment or information, without regard to the count to which the defendant actually plead[s].'"[9]

No doubt all eyes will be on the Second Circuit as it addresses these issues in the Skowron appeal. At stake may be the ability of corporate crime victims to recover millions in internal investigation fees incurred as a result of financial crime.

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[1] See United States v. Gupta, Case No. 11 CR 907 (S.D.N.Y. Feb. 25, 2013).

[2] See 18 U.S.C. §3663A.

[3]18 U.S.C. §3664(f)(1)(A).

[4] See United States v. Skowron, Case No. 11 CR 699 (S.D.N.Y. Mar. 20, 2012).

[5] See United States v. Skowron, Case No. 12 CR 1284 (2d Cir.)

[6] U.S. v. Payne, 2009 WL 5062099 (S.D. Ohio 2009).

[7] U.S. v. Radi, 340 Fed. Appx. 401 (9th Cir. 2009).

[8] USAM 9-27.420.

[9] USAM 9-16.320.