Andrews Publications VOLUME 6, NUMBER 8 SEPTEMBER 1992

WHITE-COLLAR CRIME REPORTER

THE INNOCENT OWNER DEFENSE TO CIVIL FORFEITURE UNDER FEDERAL NARCOTICS LAW

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I. INTRODUCTION

Asset forfeiture is a powerful weapon in the government's war on crime. Any financial institution or other secured creditor should take notice of the increasingly aggresive use by United States Attorneys offices around the country of the civil forfeiture provisions under federal narcotics laws. Under these statutes, a financial institution or other secured creditor may lose its interest in real property if the property was purchased with narcotics proceeds or was used for narcotics activity by the borrower. This article provides an overview of the substance and procedure of the "innocent owner" defense under the federal narcotics forfeiture laws, with a particular focus on the issues that a commercial lender faces when a borrower is under investigation or under indictment for suspected violations of the narcotics law.

A. GOVERNING LAW

Traditionally, civil forfeiture applies only to contraband or property used during the commission of a crime. In 1978, Congress amended the Comprehensive Drug Abuse Prevention and Control Act of 1970 to provide for forfeiture of "all proceeds traceable to [a narcotics] exchange, and all moneys, negotiable instruments, and securities used or intended to be used to facilitate any violation of this title." 21 U.S.C. § 881(a)(6) (1988). In 1984, Congress further amended the Act to include

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subsection 881(a)(7), which specifically provides for forfeiture of "[all real property, including any right, title, and interest...which is used or intended to be used, in any manner or part to commit, or to facilitate the commission of, [a narcotics felony]." 1/ Id. at § 881(a)(7).

Both of these provisions set forth an identical "innocent owner" defense, which provides that "no property shall be forfeited..., to the extent of an interest of the owner, by reason of any act or commission established by that owner to have been committed or omitted without the knowledge or consent of that owner." Id. at §§ 881(a)(6), (7)2/

B. PRELIMINARY ISSUES

1. Burden of Proof

A forfeiture under either subsection (a)(6) or (a)(7) is an in rem action brought against the seized property. 3/ The procedures to challenge a forfeiture action are the same under either provision. First, a claimant must establish that he has standing to challenge the forfeiture by demonstrating an interest in the property. Once the claimant has established the requisite standing, the government bears the initial burden of showing only "probable cause" to believe that the property was purchased with drug proceeds or used in a drug transaction. Probable cause in this context is defined as "reasonable grounds for belief of guilt, supported by less than prima facie proof, but more than reasonable suspicion." U.S. v. Certain Real Property, 724 F. Supp. 908, 913 (S.D. Fla. 1989) (citations omitted). The government can usually meet this burden simply by filing its verified complaint. Once the government establishes probable cause, the burden of proof shifts to the claimant to prove the "innocent owner" defense by a preponderance of the evidence.

2. Proof of Ownership Interest

In order to assert this affirmative defense, the claimant must first establish an ownership interest in the property. Courts have broadly construed the term "owner" to include any person with a recognizable legal or equitable interest in the property seized. Thus, although not literally an "owner," a bank as a mortgage or lien holder may invoke the "innocent owner" provisions to recover the value of its interest in the forfeited property. See, e.g., U.S. Fed. Nat'l Mortgage Ass'n, 946 F2d 264 (4th Cir. 1991); U.S. v. $41,305 in Currency and Traveler's Checks, 802 F.2d 1339, 1346 (11th Cir. 1986) (valid security interest perfected before illegal act occurred is sufficient).

One issue which has arisen in this context is whether the "relation back" doctrine, which provides that the government's interest in the forfeited property relates back to the time of the offense, cuts off the interest of a claimant whose interest in the property did not arise until after that property was used in or derived from an illegal transaction. This doctrine was codified by a 1984 amendment to Section 881, which provides that the government's interest in the property vests "upon commission of the act giving rise to forfeiture." 21 U.S.C. § 881(h) (1988). Relying on legislative history, several courts have concluded that a bona fide purchaser is entitled to the protection of the innocent owner defense notwithstanding the relation back doctrine. See, e.g., Eggleston v. State of Colorado, 873 F.2d 242 (10th Cir. 1989), cert. den'd, Colorado Dept. of Revenue v. U.S., 493 U.S. 1070 (1990); U.S. V. 6960 Miraflores Ave., 731 F. Supp. 1563 (S.D. Fla. 1990).

C. EXPEDITED PROCEDURES FOR BANKS

Recognizing that forfeitures involving financial institutions pose special problems, the United States Department of Justice has established expedited procedures governing the settlement and payment of perfected liens held by a financial institution. 4/ Settlement with the Justice Department under these procedures enables a financial institution to receive payment of its unpaid principle and accrued interest upon entry of the final forfeiture order, regardless of when the government ultimately sells or disposes of the property.

The procedures are fairly simple. First, when the government commences a forfeiture action, it is required to notify any financial institution that has a perfected lien on the property of its right to request expedited settlement of its claim. To invoke the expedited settlement process, the bank must then submit a request to the U.S. Attorney who initiated the action. This request must be in the form of an affidavit setting forth: 1) a complete description of the real property; 2) documentation regarding the perfected interest in the property; and 3) satisfactory proof of facts and circumstances that justify payment of the lien or mortgage. The bank has the burden of proving under this expedited settlement process that it is an "innocent owner" as defined by the applicable forfeiture statute and case law. After receiving all requested documents, the U.S. Attorney has 60 days to notify the bank of its acceptance or rejection of the the settlement request. The U.S. Attorney's decisions appears to be final since the policy manual does not provide for any mechanism of appeal.

The settlement is in lieu of 1) litigation of the financial institution's civil forfeiture claim; 2) criminal petition for ancillary hearing; and 3) a petition for remission or mitigation of the forfeiture. However, a lienholder is not precluded from pursuing its interest in the judicial forfeiture action if settlement is not reached.

II. INTERPRETATION OF THE "INNOCENT OWNER" DEFENSE

The "innocent owner" defense requires the claimant to show that the narcotics offenses occurred "without the knowledge or consent of the [claimant]." Id. at 21 U.S.C. 881(a)(6) and (7). In interpreting this provision, federal courts have struggled with four related issues: 1) whether the constitutional standard of innocent ownership should be imported into the statutory defense under subsections (a)(6) and (7); 2) whether a claimant can prevail by proving either lack of knowledge or lack of consent, or whether it must prove both elements; 3) whether the "knowledge" element imposes a subjective or an objective standard; and 4) whether lack of consent requires some affirmative steps by the claimant. Finally, another issue of concern to lienholder claimants is whether they are entitled to foreclose the property, or to post-seizure interest and other fees and costs, if they prevail as innocent owners. The courts' struggle with these issues can be best understood in light of the constitutional standard of innocent ownership set forth by the Supreme Court in 1974. 5/

A. THE CALERO-TOLEDO CONSTITUTIONAL STANDARD

In Calero-Toledo v. Pearson Yacht Leasing Co., 416 U.S. 663 (1974), the Supreme Court established the constitutional test for protecting the interests of innocent third parties in civil forfeiture cases. In upholding a Puerto Rico civil forfeiture statute which was used to justify the seizure of a yacht leased to a drug trafficker, the Court noted in dictum that it might be "difficult to reject the constitutional claim" of an owner who "proved not only that he was uninvolved in and unaware of the wrongful activity, but also that he had done all that reasonably could be expected to prevent the proscribed use of his property." Id. at 689 (emphasis added). It is this last part of the test which has divided lower federal courts. The courts have struggled over whether an "innocent owner" claimant under subsections 881(a)(6) and (7) should also be required to establish the "reasonableness" prong of the Calero-Toledo test.

B. "KNOWLEDGE OR CONSENT"

A preliminary issue in interpreting the innocent owner defense is to determine whether Congress intended that knowledge alone would deprive a claimant of the "innocent owner" defense, or whether a claimant who had knowledge of the illegal use of the property may still assert lack of consent as a defense. 6/ Under the first interpretation, a lender would not be able to use the innocent owner defense whenever it had actual knowledge of the mortgaged property being purchased with the proceeds of a narcotics transaction or of narcotics felonies occurring on the mortgaged property, regardless of whether it had "consented" to such activity. Two Circuits

have reached opposing conclusions as to whether the phrase "without knowledge or consent" constitutes one or two separate defenses.

1. Second Circuit's interpretation of the Phrase "Without Knowledge or Consent" as Allowing Two Separate Defenses

The leading decision for the view that the claimant may show either lack of knowledge or lack of consent but not both is U.S. v. 141st Street Corp., 911 F.2d 870 (2d Cir. 1990), cert. den'd., 111 S. Ct. 1017 (1991). See also U.S. v. 418 57th St., 922 F.2d 129 (2d Cir. 1990) (reaffirming 141st Street and rejecting the government's characterization as dictum its conclusion in 141st Street that a defense to forfeiture may depend alternatively upon lack of consent or lack of knowledge); U.S. v. Grubb Road, 886 F.2d 618 (3d Cir. 1989), reh'g den'd, 890 F.2d 659 (3d Cir. 1989) (spouse could prove innocent ownership if she established that the illegal use of the property occurred either without her knowledge or without her consent); U.S. v. Lots 12, 13, 14, and 15, 869 F.2d 942, 946 (6th Cir. 1989) (there is "no reason to suppose that when Congress said 'or' [when referring to 'without knowledge or consent'] it meant 'and'").

141st Street involved government seizure of an apartment building pursuant to subsection 881(a)(7) because of extensive drug trafficking on the property. The court found that the claimant corporation which owned the building had knowledge that the building was a "veritable anthill of drug activity" because its principal stockholder had visited the property on approximately 100 occasions and had spoken weekly to its superintendent. Alternatively, the court found that even if the claimant had no knowledge, it still failed to establish lack of consent. Nevertheless, the court also noted that while knowledge of the illegal use of the property will not defeat a defense based on lack of consent, consent "must be something more than a state of mind." Id. at 879. In that context, the court defined consent as "the failure to take all reasonable steps to prevent illicit use of premises once one acquires knowledge of that use." Id. Because the claimant did not take steps to stop the narcotics activity, the court precluded him from asserting the innocent owner defense.

2. Ninth Circuit's Interpretation of the Phrase "Without Knowledge or Consent" as "Without Knowledge and Consent"

In contrast to the Second Circuit, the Ninth Circuit requires the claimant to show both lack of knowledge and lack of consent. In a terse, thinly reasoned per curiam opinion, the court simply noted that "if the claimant either knew or consented to the illegal activities, the 'innocent owner' defense is unavailable." U.S. v. Lot 111-B, 902 F.2d 1443 (9th Cir. 1990) (emphasis in original). 7/ However, the vitality of Lot 111-B is unclear in light of later decisions by two district courts within the Ninth Circuit. These courts characterized the Ninth Circuit's conclusion that the defense requires proof of both lack of knowledge and consent as dictum because the Ninth Circuit ruled that the claimant lacked standing to contest forfeiture. See U.S. v. Property Titled in the Names of Ponce, 751 F. Supp. 1436 (D. Hawaii), and U.S. v. 5,935 Acres of Land, 752 F. Supp. 359 (D. Hawaii 1990). In 5,935 Acres of Land, the court expressly rejected the Ninth Circuit's interpretation of the innocent owner defense in favor of the Second Circuit's ruling in 141st Street, which permitted a claimant to assert two defenses, one based on lack of knowledge and the other based on lack of consent. Id. at 363.

Similarly, while the court in Ponce purportedly agreed with the Ninth Circuit's statutory interpretation in Lot 111-B, it also noted that the Ninth Circuit "was not confronted with the situation of a claimant who was only briefly aware of the illicit activity." Ponce, 751 F. Supp. at 1439-40. The court held that the "broad dicta in Lot 111-B implying that a claimant must show lack of knowledge and lack of consent must be qualified" because it did not involve a "situation where an allleged innocent owner makes reasonable efforts to terminate the illegal activity on the property as soon as possible." Id. at 1441. In

distinguishing Lot 111-B from the facts in its own case, the court in Ponce effectively rejected Lot 111-B in favor of the contrary holding in 141st Street.

While the Circuits are not in agreement in their interpretation of the "without knowledge or consent" element of the innocent owner defense, case law shows that the courts are moving toward the position adopted by the Second Circuit in 141st Street. Nevertheless, this issue is far from settled. The Fifth Circuit, for example, noted a split in authority and declined to take a position "without a complete record and thorough briefing of [the] issue." U.S. v Lot 9, Block 2 of Donnybrook Place, 919 F.2d 994 (5th Cir. 1990). Similarly, a district court noted that the Seventh Circuit had not taken a position on whether the innocent owner defense requires the claimant to show the lack of both knowledge and consent, or the lack of one or the other. U.S. v. 8848 South Commercial Street, 757 F. Supp. 871 (N.D. Ill. 1990).

C. THE KNOWLEDGE REQUIREMENT: ACTUAL VS. OBJECTIVE KNOWLEDGE

The question presented here is whether a claimant must show lack of subjective or objective knowledge of the illegality in order to raise the innocent owner defense. This issue is especially important in the context of commercial lenders since their knowledge of the illegal source of the money or of drug activities on the property usually comes from second-hand sources. One issue which has arisen is whether a lender can rely on the fact that it did not know about the source of the money or the illegal use of the property, although it could have known had it made inquiries.

The government has occasionally argued that the innocent owner defense should be denied to claimants who "should have known" that their property was put to illegal use. This argument is derived from the Supreme Court's dictum in Calero-Toledo. Under the actual knowledge standard, a lender who was negligent in extending the loan may still be entitled to the innocent owner defense. On the other hand, application of the Calero-Toledo standard would impose a greater burden on the lender to investigate a borrower under certain circumstances. Although a number of courts continue to read subsections 881(a)(6) and (7) as requiring only actual knowledge, a majority of the courts have imported the "reasonableness" requirement of Calero-Toledo into the statutory scheme. While these courts state that only actual, subjective knowledge is required to raise the innocent owner defense, they often include objective requirements in determining what constitutes actual knowledge. Likewise, the cases which have dealt specifically with a lender's knowledge under subsection 881(a)(6) also seem to follow this trend.

1. Incorporation of the Calero-Toledo "reasonableness" test into the statutory scheme

One court effectively incorporated the Calero-Toledo standard by adopting a "reasonable inference" approach to determine actual knowledge. U.S. v. 8848 South Commercial Street, 757 F. Supp. 871 (N.D. Ill. 1990). Commercial Street involved forfeiture of property under 881(a)(7). The court noted that although the innocent owner defense turns on a claimant's actual, not constructive knowledge, "if the evidence supports a 'reasonable inference' of actual knowledge and the claimant fails to come forward within [sic] anything more than a naked protestation" of lack of knowledge, the defense of innocent ownership fails. Id. at 884. Nevertheless, the court concluded that the claimants' affidavits were sufficient to preclude summary judgment in favor of the government.

In U.S. v. 15603 85th Ave., 933 F.2d 976, 982 (11th Cir. 1991), the 11th Circuit held that "the 'reasonably possible' language of Calero-Toledo applies to section 881(a)(6) proceedings." 85th Ave. involved a claimant who contributed legitimate funds to the purchase of real estate, but who knew of the co-owner's use of drug proceeds to purchase the property. The court held that the claimant did not meet the "reasonableness" standard under Calero-Toledo because he could not prove that "everything reasonably possible was done to withdraw the commingled