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HEADLINE: Banks as Innocent Owner In Forfeiture Cases

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THE RECENT Supreme Court decision in *U.S. v. 92 Buena Vista Avenue*[1] provides some comfort to banks and other lenders who have found themselves caught in the crossfire of the war on drugs.

Under federal law, all proceeds traceable to a narcotics deal and all real property used in the commission of a narcotics felony are subject to forfeiture to the United States—even if this property has been properly pledged to a leader as security.

In *92 Buena Vista Avenue*, the Supreme Court confirmed the existence of the "innocent owner" defense that provides the lender's only hope of salvaging its interest in the forfeited property.

Under this defense, the property will not be forfeited to the government if the owner can establish that it did not know about or consent to the commission of the narcotics felony that triggered the seizure. Although not literally an "owner," a bank as mortgage holder may invoke the "innocent owner" provisions to recover the value of its interest in the forfeited property.[2]

The Court emphasized that for purposes of asserting the innocent owner defense, the term "owner" is not limited to one who is a bona fide purchaser for value, but rather includes anyone with a recognizable legal or equitable interest in the property.[3] Since lenders have an obvious legal interest in property pledged to secure a loan, they are now assured that they will continue to be allowed to assert the innocent owner defense in forfeiture actions.

More significant, the Court also held that the relation-back doctrine embodied in 21 USC §881(h), which states that title in the seized property vests in the United States "upon commission of the act giving rise to forfeiture," did not invalidate all interests in the property which were acquired after the commission of the narcotics felony.[4]

This aspect of the decision is particularly beneficial to lenders because, at least for real property purchased with the proceeds of a drug deal, any interest the lender had would necessarily have been acquired after the commission of the felony.

The federal civil (in rem) narcotics forfeiture law provides, in pertinent part, for the forfeiture to the U.S. of "all proceeds traceable to" a narcotics transaction, 21 USC §881(a)(6), and of "[all] real property . . . which is used, or intended to be used . . . to commit, or to facilitate the commission of, [a narcotics felony]. 21 USC §881(a)(7).

Both provisions set forth an "innocent owner" defense: "[No] property shall be forfeited . . . to the extent of an interest of an owner, by reason of any act or omission

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[1] 61 USLW 4189 (U.S. Feb. 24, 1993).
[2] *United States v. Federal National Mortgage Association*, 946 F2d 264 (4th Cir. 1991); *United States v. 6960 Miraflores Avenue*, 731 F. Supp. 1563 (S.D. Fla. 1990).
[3] *92 Buena Vista Avenue*, 61 USLW at 4192.
[4] Id. at 4192-94.

established by that owner to have been committed or omitted without the knowledge or consent of that owner."[5]

In a proceeding under either subsection (a)(6) or (a)(7), the government bears the initial burden of establishing only "probable cause" to believe that the property was purchased with drug proceeds or used in a drug transaction. Once that burden had been met, the burden then shifts to the claimant (here, the bank) to satisfy the provisions of the "innocent owner" defense by a preponderance of the evidence.[6]

Buena Vista

The owner of the seized property in *92 Buena Vista Avenue* had received $240,000 from her boyfriend and used the money to buy a house for herself and her children. Years later, the government asserted that this money was proceeds of the boyfriend's narcotics trafficking and that house was therefore subject to seizure and forfeiture under §881(a)(6).

The owner claimed that she had not known that the money came from drug dealing and that she was protected by the "innocent owner" exception of §881(a)(6) because she could establish lack of "knowledge [of] or consent" to the narcotics felony.[7]

The government had argued to the court below (but did not press on appeal) that the innocent owner defense was not available to her, because she had received the money as a gift and was not a bona fide purchaser for value. The Court quickly dismissed this argument by stating that "[the] term 'owner' is used [in the statute] three times and each time it is unqualified. Such language is sufficiently ambiguous to foreclose any contention that it applies only to bona fide purchasers."[8]

The Court then considered the government's assertion that under the relation-back provision in §881(h), she could not be the "owner" because the U.S. had owned the $240,000 from the moment the drug deal had occurred.[9] The Court rejected the government's interpretation, pointing out that "[because] neither the money nor the house could have constituted forfeitable proceeds until after an illegal transaction occurred, the government's submission would effectively eliminate the innocent owner defense in

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[5] 21 USC §§881(a)(6), (7) (West Supp. 1992).

[6] E.g., *United States v. Real Property Located at §18, Township 23*, 976 F2d 515, 520 (9th Cir. 1992); *United States v. 7326 Highway 45 North*, 965 F2d 311, 314, reh'g denied, 1992 U.S. App. LEXIS 25464 (7th Cir. 1992).

[7] While the court only discussed the innocent owner defense in §881(a)(6), the language in §881(a)(7) is identical and the analysis would be the same.

[8] *92 Buena Vista Avenue*, 61 USLW at 4192. The dissent, however, would limit the innocent owner defense to bona fide purchasers for value by applying general principles or property transfers, trusts and commercial transactions as though the seizure of private property by the government was the equivalent of an ordinary ownership dispute. *92 Buena Vista Avenue*, 61 USLW at 4197-98 (Kennedy, J., dissenting).

[9] Section 881(h) provides that "All right, title, and interest in property described in subsection (a) of this section shall vest in the United States upon commission of the act giving rise to forfeiture under this section."

almost every imaginable case in which proceeds could be forfeited. It seems unlikely that Congress would create a meaningless defense."[10]

Section 881(h) only applies to property described in §881(a), and the last clause in §881(a)(6) specifically exempts property that belongs to an innocent owner from forfeiture, the Court said. Therefore, "[because] the success of any defense available under §881(a) will necessarily determine whether §881(h) applies, §881(a)(6) must allow an assertion of the defense *before* §881(h) applies."[11] Thus, owners are allowed to invoke defenses before the government's title vests, and only if these defenses fail will title, related back to the date of the commission of the crime, vest in the government.[12]

Justice Scalia, in his concurrence, took a different route to the same result. He wrote that the codification of the relation-back doctrine in §881(h) is merely an imprecise way of stating that "title shall vest in the United States upon forfeiture, effective as of commission of the act giving rise to the forfeiture." Under his view, there is no need to refer to §881(a). 61 USLW at 4194-96 (Scalia, J., concurring).

Innocent Owner Defense

Although *92 Buena Vista Avenue* assures secured lenders that they will be able to assert the "innocent owner" defense, it does not alter the owner's burden: lenders must still prove that the narcotics offenses occurred without their "knowledge or consent."

The federal courts, however, are split as to whether owners have to show either lack of knowledge *or* lack of consent but not both, or whether they have to show both lack of knowledge *and* lack of consent. In practical terms, once the owner has knowledge, will proof of lack of consent prevent the forfeiture, or is lack of consent irrelevant?

The leading decision for the view that the claimant need show either lack of knowledge *or* lack of consent but not both is the Second Circuit's holding in *United States v. 141st Street Corporation*.[13] Little more than a month ago, the Second Circuit applied this "either/or" test in *United States v. 755 Forest Road*.[14] The court held that, despite an affidavit to the contrary, a woman clearly had *knowledge* of her husband's narcotics trafficking because drug paraphernalia was in plain sight in their bedroom. The court then separately considered the issue of *consent* and found that she had not proved lack of consent, because "the abundance and visibility of the narcotics evidence contradict that contention that [she] took all reasonable steps to prevent illegal use of the property."[15]

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[10] *92 Buena Vista Avenue*, 61 USLW at 4192.
[11] Id. at 4193.
[12] Id. at 4194.
[13] 911 F2d 870 (2d Cir. 1990), cert. denied, 111 S.Ct. 1017 (1991). This case provides a helpful review of the decisions and issues that have divided the federal courts on this topic. Id. at 877-78.
[14] No. 92-6109, slip op. at 1235 (2d Cir. Feb. 3, 1993).
[15] Id. at 1240.

Other circuit courts and district courts also have adopted the Second Circuit's view that a claimant with actual knowledge may still successfully invoke the "innocent owner" defense by proving lack of consent.[16] However, some courts hold the contrary view that the claimant must show *both* lack of knowledge *and* lack of consent. Under this view, if you *know*, it does not matter whether or not you *consented*; you lose.

The Ninth Circuit adopted this view in a terse, thinly reasoned per curiam opinion, *United States v. One Parcel of Land, Known As Lot 111-B, Etc.*,[17] and applied it without discussion in *United States v. Real Property Located at §18, Township 23, Etc.*[18] Still other courts have refused to decide which of the two views to follow.[19] This issue thus appears ripe for Supreme Court review.

Knowledge

In order to establish lack of knowledge, most courts look to the circumstances and other objective proof to support the other's subjective assertion of lack of "actual" knowledge.[20] The Seventh Circuit, however, stated that "[the] language of §881(a)(7) constrains courts to employ a subjective rather than an objective standards for assessing the claimant's knowledge. . . . Nothing in §881(a)(7) suggests that the court must determine whether the claimant *should* have known of illegal activities taking place on the claimant's property."[21]

This assertion appears to be dictum, because the matter at issue in the case was whether the admitted knowledge of an employee could be inputed to the corporation, not whether the objective facts supported a claim of lack of knowledge. Of more interest to lenders is the court's application of general agency principles to determine that the claimant corporation did not have "actual" knowledge via its employee because the employee was not acting, even in part, for the benefit of the corporation.[22]

Most of the case law on knowledge and consent deals with individuals, not corporations or banks, but the cases that have involved banks indicate that banks will not be accorded any "special insulation from vulnerability to forfeiture of assets traceable to drug proceeds."[23]

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[16] See *United States v. 1012 Germantown Road*, 963 F2d 1496, 1503 (11th Cir. 1992); *United States v. Grubb Road*, 886 F2d 618 (3d Cir. 1989), *reh'g* denied, 890 F2d 659 (3d Dir. 1989); *United States v. Lots 12-15*, 869 F2d 942, 946 (6th Cir. 1989), appeal dismissed, 925 F2d 1466 (1991).

[17] 902 F2d 1443 (9th Cir. 1990) (per curiam).

[18] 976 F2d 515 (9th Cir. 1992). A fuller analysis of this view was presented in *United States v. 890 Noyac Road*, 739 F.Supp. 111 (EDNY, 1990), reversed and remanded, 945 F2d 1252 (2d Cir. 1991), which the district court wrote before the Second Circuit's ruling in *141st Street Corp*.

[19] *United States v. 7326 Highway 45 North*; 965 F2d 311, reh'g denied, 1992 U.S. App. LEXIS 25464 (7th Cir. 1992); *United States v. Lot 9, Block 2 of Donnybrook Place*, 919 F2d 994 (5th Cir. 1990).

[20] See *755 Forest Road*, No. 92-6109, slip op. at 1239-40; *United States v. U.S. Currency*, $ 584,091, 1992 U.S. App. LEXIS 610 at * 8 (9th Cir. 1992); *United States v. 8848 South Commercial Street*, 757 F.Supp. 871 (N.D. III. 1990).

[21] *United States v. 7326 Highway 45 North*, 965 F2d at 315.

[22] Id. at 316.

[23] *United States v. Banco Cafetero Panama*, 797 F2d 1154, 1162 (2d Cir. 1986).

Banks cannot rely on the fact that they are off-site third parties to claim lack of knowledge. Instead, if the objective facts indicate that the circumstances surrounding the loan or mortgage were suspicious, a court is likely to find that the bank has failed to establish lack of knowledge.

In *United States v. 6960 Miraflores Avenue*,[24] court determined that the circumstances surrounding the loan were suspicious where: (1) the borrower was a shell corporation selling off its primary asset—a vacant residence; (2) the borrower was unknown to the lender; (3) the borrower was not doing business and had no source of income; (4) the borrower did not indicate how an $ 800,000 loan was to be repaid; and (5) the lender transferred the loan proceeds to the borrower's Swiss bank account.

Because, among other things, the lender did not ask the purpose of the loan, conduct a title search or set up a payment schedule, the court found that the bank was not an innocent owner.[25] Presumably, most banks asserting an innocent owner defense will be able to present better facts than did the lender in *Miraflores Avenue*.

For example, in *United States v. A Fee Simple Parcel of Real Property Situated in the City of Bal Harbour*,[26] the court found the bank to be an innocent owner where: (1) the borrower had an 18-year relationship with the bank; (2) there were no unusual events during that relationship; (3) the bank conducted a title search; (4) the borrower had deposited large sums or two previous occasions from the sale of stock; and (5) the loan was fully secured by the property.[27] The less of *Miraflores Avenue* and *Bal Harbour* is that a lender should make inquiries whenever the circumstances appear suspicious and not simply turn a blind eye.

Further guidance on how a bank can be deemed to have knowledge of an illegal transaction is found in *United States v. Banco Cafetero Panama*,[28] which addressed whether a bank account was forfeitable as proceeds traceable to a drug transaction.

The court determined that the accounts were forfeitable, but gave banks some solace by holding that "the bank's knowledge, for purposes of the innocent owner defense, is not the cumulative knowledge of all the bank's employees. For a bank to be vulnerable to forfeiture of its cash, the fact that particular funds have been deposited at the bank must be down to the same employee of that bank."[29]

Consent

Even if lack of knowledge cannot be established, in some circuits (including the Second Circuit) the lender may still be able to assert the innocent owner defense by establishing lack of consent. The general rule is that lack of consent is found where the

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[24] 731 F.Supp. 1563, 1573 (S.D. Fla. 1990).
[25] Id. at 1572.
[26] 650 F.Supp. 1534 (E.D. La. 1987).
[27] Id. at 1539.
[28] 797 F2d at 1162.
[29] Id. The court reserved decisions as to "what level of authority the employee with knowledge of both taint and deposit must occupy to render forfeitable cash or accounts of a bank." Id.

owner took all reasonable steps to stop the illegal activity.[30] Although there is no case law giving mortgage holders guidance as to what those steps might be, some affirmative action may well be required of them, just as it has been required of individuals seeking to establish lack of consent.

Procedure for Banks

Although the substantive standards are the same for lenders as they are for individuals, the U.S. Department of Justice has established an "Expedited Forfeiture Settlement Policy for Mortgage Holders" to resolve legal issues where financial institutions hold a perfected lien or mortgage on property subject to forfeiture.

When a financial institution reaches a settlement under this policy, it receives guaranteed satisfaction of unpaid principal and accrued interest upon entry of the final forfeiture order, regardless of when the government ultimately sells or disposes of the property. A DOJ handbook sets forth the purpose of and procedure under the settlement policy and includes model forms.[31]

When the government commences a forfeiture action, it must notify any financial institution that has a perfected lien or mortgage or record against the property to be forfeited. To invoke the expedited settlement process, the bank must then submit to the U.S. Attorney an affidavit that includes a complete description of the property, documentation of the security interest and supporting documentation such as the loan file and loan committee minutes. Under this expedited settlement process, the bank still has the burden, as does any owner, of proving that "it is an 'innocent owner' as defined by the applicable forfeiture statute and case law."[32]

The U.S. Attorney has 60 days after receiving the affidavit to notify the bank of its acceptance or rejection of the settlement request. The expedited procedure does not provide an appeal process, but a lienholder may pursue its interest in the judicial forfeiture action if settlement is not reached through this expedited procedure.

Conclusion

In *92 Buena Vista Avenue*, the Supreme Court confirmed that most lower courts had assumed all along: that the forfeiture law meant what it said when it provided for an "innocent owner" defense. Now the Court may have to resolve the more difficult issue of whether the owner must show *both* lack of knowledge and lack of consent, or if the owner need show *either* lock of knowledge *or* lack of consent.

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[30] *United States v. 1012 Germantown Road*, 963 F2d at 1504; *United States v. 755 Forest Road*, No. 92-6109, slip op. at 1240; *United States v. 141st Street Corp.*, 911 F2d at 879.
[31] U.S. Dep't of Justice, *Expedited Forfeiture Settlement Policy for Mortgage Holders* (July 1991).
[32] Id. at 3, P5.