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Supreme Court Forecloses Reimbursement for Certain Internal Investigations Under Mandatory Victims Restitution Act

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On May 29, 2018, the U.S. Supreme Court ruled in *Lagos v. United States,* 584 U.S. ___ (2018), that corporate victims of criminal offenses cannot recover expenses incurred from internal investigations that the federal government has neither requested nor required under the Mandatory Victims Restitution Act of 1996, 18 U.S.C. §3663A (MVRA). In its decision, the Court declined to address whether, going forward, such victims can recover costs from internal investigations initiated at the government's behest under the statute. Prior to this holding, a number of federal courts held that corporate victims were eligible for restitution for the costs incurred from their internal investigations and referrals to law enforcement — regardless of whether the government requested or required such investigations. These courts ordered restitution to reflect these costs on grounds that internal investigations: 1) are a foreseeable result of the crimes enumerated in the MVRA; and 2) provide invaluable assistance to government investigations and proceedings.

However, the Court's unanimous decision in *Lagos* effectively overruled these decisions and poses a setback for companies victimized by criminal conduct in determining what steps to take in reaction to the disclosure of the conduct. The companies likely have no choice but to conduct exhaustive internal investigations to identify the scope of the crime and to receive cooperation credit pursuant to the recently-updated Department of Justice Manual. *See,* U.S. Dep't of Justice, Justice Manual §9-28.000, Principles of Federal Prosecution of Business Organizations. In doing so, they should be aware of the real possibility that they cannot recover the costs incurred from these investigations through restitution and may have to pursue the funds solely through civil litigation. Should companies elect to minimize costs by declining to investigate internally — or by conducting a small-scale investigation — they risk the full extent of the crime remaining undetected and forego the ability to earn cooperation credit with the government. Moreover, public companies face the added dilemma of having to explain to their shareholders what steps they took to investigate the conduct and prevent future incidents, while also being mindful of the fiscal consequences of full-scale investigative work that might not be reimbursed.

THE EMERGENCE OF FEDERAL RESTITUTION

Restitution is intended to restore a victim, to the extent possible, to "the position he occupied before sustaining injury." *United States v. Boccagna*, 450 F.3d 107, 115 (2d Cir. 2006). When a restitution statute applies, the government bears the

burden of proving by a preponderance of the evidence the amount of loss that a victim sustained. However, a restitution award "need only to be a reasonable estimate of the victim's actual losses" and courts must resolve uncertainties in favor of the victim. *See*, *United States. v. Donaghy*, 570 F. Supp. 2d 411, 423 (E.D.N.Y. 2008).

Notably, federal courts have no inherent power to impose restitution and may only order it when authorized by statute. Before 1982, federal law permitted restitution only as part of a defendant's probation. Congress' enactment of the Victim and Witness Protection Act of 1982 authorized federal courts to impose restitution for victims of most federal crimes. *See,* 18 U.S.C. §3663(a). Fourteen years later, Congress significantly expanded federal courts' restitution authority in 1996 by *requiring*courts to impose restitution for certain enumerated crimes under the MVRA, including bank fraud, wire fraud, and most other white-collar crimes.

Specifically, the MVRA obligates district courts to order restitution where an identifiable victim has suffered a pecuniary loss as a result of, among other enumerated crimes: 1) "crime[s] of violence"; and 2) "offense[s] against property …, including any offense committed by fraud or deceit." 18 U.S.C. §3663A(c)(1)(A). The statute defines "victim" broadly to include a person or company "directly and proximately harmed as a result of the commission of [the] offense" and measures "loss" as the value of the property wrongfully taken. *Id*. at §3663A(a)(2). And, where the offense relates to property, the defendant must reimburse the victim for the return of the property taken or its value. *Id*. at §3663A(b)(1). In addition, subsection (b)(4) of the MVRA requires defendants to "reimburse the victim for lost income and necessary child care, transportation, and other expenses *incurred during participation in the investigation or prosecution of the offense or attendance at proceedings related to the offense*." *Id*. at §3663A(b)(4) (emphasis added).

Of the eight federal appellate courts that analyzed the scope of subsection (b)(4) — concerning costs incurred by participating in an investigation or prosecution of the offense — all but the U.S. Court of Appeals for the District of Columbia Circuit interpreted it broadly to include reimbursement for a corporate victim's expenses incurred in an internal investigation or in civil and bankruptcy proceedings. *Compare, United States v. Papagno*, 639 F.3d 1093, 1095 (D.C. Cir. 2011); *with United States v. Lagos*, 864 F.3d 320 (5th Cir. 2017); *United States v. Nosal*, 844 F.3d 1024 (9th Cir. 2016); *United States v. Janosko*, 642 F.3d 40 (1st Cir. 2011); *United States v. Elson*, 577 F.3d 713 (6th Cir. 2009); *United States v. Hosking*, 567 F.3d 329 (7th Cir. 2009); *United States v. Stennis-Williams*, 557 F.3d 927 (8th Cir. 2009); *United States v. Amato*, 540 F. 3d 153 (2d Cir. 2008); *United States v. Coriaty*, 300 F.3d 244, 253 (2d Cir. 2002).

This broad interpretation — which recognized the importance of and encouraged internal investigations — aligned with the federal government's policy of awarding cooperation credit to corporations facing federal charges and penalties that conduct full internal investigations. *See,* Justice Manual §9-28.300. In many cases, the criminal penalties facing these corporations stem from an employee's criminal conduct. By investigating this conduct, the company can earn a cooperation credit that results in reduced charges and penalties — or the avoidance of charges altogether. *Id*. at §9-28.700. The Justice Manual explains that "[t]he extent of the cooperation credit earned will depend on," among other factors, "the timeliness of the cooperation, the diligence, thoroughness and speed of the internal investigation, and the proactive nature of the cooperation." *Id*.

CIRCUIT COURT SPLIT ON THE SCOPE OF THE MVRA

In *United States v. Amato*, 540 F.3d 153, 159-62 (2d Cir. 2008), the U.S. Court of Appeals for the Second Circuit upheld the district court's $3 million restitution award after determining that the corporate victim properly documented the costs it incurred in its internal investigation into the crime, including fees for outside counsel and "forensic accounting firms hired to carry out various audits involved in [the corporation's] resulting investigation." The Second Circuit acknowledged

that accounting and legal fees were not analogous to the recoverable costs expressly mentioned in the MVRA, such as child care and transportation expenses. However, it speculated that the drafters of the MVRA "may have feared that courts would overlook [these enumerated] expenses unless these items were specifically named" and that "[s]uch fears would not likely have extended to attorney fees and accounting costs because these expenses are so obviously associated with investigation and prosecution, particularly in the case of fraud offenses." *Id*. at 161. The Second Circuit concluded that restitution under the MVRA may include attorneys' fees and accounting costs when such costs are a "direct and foreseeable result of the defendant's offense." *Id*. at 162.

In contrast to *Amato* and other federal appellate courts, however, the D.C. Circuit in *United States v. Papagno,* 639 F.3d 1093, 1095 (D.C. Cir. 2011), held that the MVRA does *not* authorize restitution for the costs of a corporate victim's internal investigation when such an investigation "is neither required nor requested by criminal investigators or prosecutors." The D.C. Circuit explained that while such internal investigations may assist the government's investigation or prosecution of an offense, they "do[] not entail the organization's *participation* …." *Id*. (quoting 18 U.S.C. §3663A(b)(4)) (emphasis added by the court). Moreover, the court reasoned, expenses incurred from an internal investigation "neither required nor requested by criminal investigators" are not "necessary." *Papagno*, 639 F. 3d. at 1100. It explained that necessary expenses include, for example: 1) the cost of "a victim's wearing a wire, at the FBI's request, to a meeting with a witness"; or 2) "producing documents in response to a subpoena or document request." *Id*.

THE *LAGOS* DECISION

Acknowledging the emerging circuit split concerning the scope of the MVRA, the Supreme Court granted a petition for *certiorari* arising from an opinion by the U.S. Court of Appeals for the Fifth Circuit affirming a broad interpretation of the MVRA. *Lagos v. United States*, 584 U.S. __ (2018). In the underlying case, Sergio Fernando Lagos used a company he owned and controlled to defraud its lender of tens of millions of dollars. Specifically, Lagos' company generated false invoices for services that it had not rendered and borrowed money from the lender using false invoices as collateral. After Lagos' fraud was revealed and his company went bankrupt, the defrauded lender spent approximately $5 million conducting an internal investigation and participating in the bankruptcy proceedings for Lagos' company. The lender's expenses consisted primarily of fees for attorneys, accountants and consultants.

After the lender referred its findings to the government and Lagos pleaded guilty to wire fraud, the district court ordered Lagos to pay approximately $5 million in restitution to the defrauded lender because the lender's expenses were "necessary … other expenses incurred during participation in the investigation … of the offense …." 18 U.S.C. §3663A(b)(4). The court imposed this restitution to, among other things, reimburse the lender for forensic expert fees, legal fees, and consulting fees that the victim incurred both in its internal investigation and in its bankruptcy claims against the defendant's company. Affirming, the Fifth Circuit explained that such restitution is required by the MVRA.

Reversing, the Supreme Court determined that the plain language of the MVRA, coupled with Congress' intent and practical implications, does not permit the $5 million restitution order. Turning first to the plain meaning of the MVRA, the Court concluded that, as used in subsection (b)(4), "investigation" and "proceeding" are limited to "government investigations and criminal proceedings." The Court also distinguished the plain language of the MVRA from other restitution statutes that expressly include broad language clearly encompassing the value of the victim's time spent remediating the harm.

Next, the Court addressed the practical impact of a broad interpretation, concluding that reading "necessary … other expenses" to include costs of an internal investigation would lead to costly and time-consuming disputes as to whether

specific expenses "incurred during" participation in a private investigation were truly necessary. For example, the Court explained, a district court might need to analyze whether each witness interview was truly "necessary" to the internal investigation. The Court also determined that its narrow interpretation would not foreclose victims from recovering additional losses not covered by the MVRA through civil lawsuits. It emphasized, for example, that the lender defrauded by Lagos secured a $30 million judgment against him in a civil lawsuit.

Finally, the Supreme Court rejected the government's argument that the defrauded lender's private investigation expenses should be reimbursed because the lender shared its investigation findings with the government. The Court emphasized the fact that the government sought reimbursement for expenses incurred by the lender *prior to* participating in the government's investigation and proceeding, rather than for "necessary child care, transportation, and other expenses incurred *during* participation in the investigation or prosecution of the offense."

TAKEAWAY

The Supreme Court's decision in *Lagos* creates a challenge for corporate victims deciding how to respond to an employee's criminal conduct. The Court foreclosed their ability under the MVRA to recover expenses incurred by internal investigations that the government has neither requested nor required. Notably, the Court declined to address whether the MVRA would apply where the federal government has requested or required an internal investigation. Despite this holding, and remaining uncertainty, these victims cannot limit the scope of their internal investigations without creating the risk that they: 1) fail to identify the full scope of the crime and, as a result, adequately address it; 2) forego the opportunity to receive cooperation credit in a federal investigation arising from the employee's crime; and 3) undermine their shareholders' interests. Absent Congress creating a legislative fix, companies will likely have to incur these costs knowing that obtaining an order directing the defendant to reimburse them has been severely curtailed.

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