

Nos. 15-55920, 15-56357 and 15-56721

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA, Plaintiff
and
Nassim Bayat, an individual; Poupak Bayat, an individual;
Nacent Trust, by and through its trustee Ziba Sanai; and
Raymond G. Schreiber Trust, by and through its trustee Lynn Schreiber,
Claimants-Appellants

v.

CORNERSTONE EQUITY FUND, LLC,
Claimant-Appellee

On Appeal from the United States District Court
For the Central District of California
No. 14-51-JLS (DFMx)
Hon. Josephine Staton

**PETITION OF THE SCHREIBER CLAIMANT-APPELLANTS FOR
REHEARING OR REHEARING EN BANC**

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INTRODUCTION

Two sets of victims of the same fraud scheme filed competing claims to the fraud proceeds. The first set asked that the property be forfeited to the United States so that it could be distributed to all victims on a *pro rata* basis by the Attorney General. The second set argued that because it could trace its losses to the recovered fraud proceeds, it was entitled to recover all of the money as the beneficiary of a constructive trust.

The district court recognized the constructive trust and awarded all of the money to the second set of victims. A panel of this court affirmed.

The case presents a matter of extraordinary importance. In awarding all of the recovered funds to one set of victims based solely on their ability to trace, the decision violates the equitable principle that similarly-situated victims of fraud should be treated equally. Under the panel decision, a district court need not even consider whether competing claimants were similarly situated but must impose a trust based solely on the ability to trace.

The panel decision is also appropriate for *en banc* review for the following reasons.

First, the unfair result in this case was compelled by the decision in *United States v. \$4,224,958.57 (“Boylan”)*, 392 F.3d 1002 (9th Cir. 2004), which held that a constructive trust arises automatically under California law based solely on the beneficiary’s ability to trace, and without regard to whether imposing the trust would be

fair or equitable. *See United States v. Wilson*, 692 F.3d 947 (9th Cir. 2011) (applying *Boylan*). As the *Wilson* court recognized, if *Boylan* was wrongly decided, only this court sitting *en banc* can correct the error.

Second, *Boylan* and *Wilson* put the Ninth Circuit at odds with the other circuits. In every other circuit, a court must consider whether imposing a constructive trust based solely on the ability to trace would be unfair to similarly-situated parties.

Third, *Boylan* was also inconsistent with prior Ninth Circuit case law on this precise issue. Accordingly, there is an intra-circuit conflict that only this court sitting *en banc* can resolve.

Fourth, as courts in this circuit and elsewhere have recognized, *Boylan* was based on a misreading of California law, which recognizes that a constructive trust is an equitable remedy, and that principles of equity and fairness must be considered *before* the trust is imposed.

Finally, to the extent that *Boylan* and *Wilson* attempted to ensure fairness by providing that a district court, *after* imposing a constructive trust in favor of victims who can trace, nevertheless must *administer the trust* in a way that treats all parties fairly, their instructions were not followed in this case. Moreover, even if that procedure had been followed, it would turn the forfeiture proceeding into a receivership with the court acting as the liquidator of a forfeited estate – a role for which the district court is unsuited -- and which would usurp the function that Congress allocated to the Attorney General,

who has the statutory authority to distribute the proceeds of fraud to all victims on a *pro rata* basis in accordance with published regulations – a procedure that ensures nationwide uniformity in the way victims are compensated.

FACTS

On January 13, 2014, the United States commenced a civil forfeiture action against approximately \$558,000 in assets derived from a fraud scheme perpetrated by Lynn Dale Bogart. The district court found that virtually all the defendant assets were traceable to an investment made by Cornerstone Equity Fund (“the Cornerstone Claimants”) in response to Bogart’s fraudulent misrepresentations. *United States v. \$451,624.51 Seized from FXDD Account*, 2015 WL 12683800, at *2 (C.D. Cal. May 5, 2015).

The Cornerstone Claimants filed a claim in the forfeiture action, asserting that they were entitled to recover all the defendant assets as beneficiaries of a constructive trust. But another set of victims, collectively known as the Schreiber Claimants, filed a competing claim asserting that they were earlier victims of the same fraud scheme and had lost \$2,000,000 to Bogart. The Schreiber Claimants acknowledged that they could not directly trace their losses to the defendant assets, but they opposed the Cornerstone claim because it would result in the unfair allocation of the recovered assets based solely on the ability to trace and would ignore Schreiber’s role in assisting in Bogart’s apprehension.

In cases where the only difference between two sets of victims is that one can trace its losses, the Schreiber Claimants argued, equity requires that the court ignore the tracing rules and to decline to impose the constructive trust.

If the district court had followed that rule, the entire \$578,000 would have been forfeited to the United States and the Attorney General would have been able to distribute the money on a *pro rata* basis to all victims of Bogart's fraud in accordance with the applicable regulations.¹ Instead, basing its decision solely on the Cornerstone Claimants' ability to trace, and thus without considering whether the Schreiber Claimants had been defrauded as part of the same scheme, the court held that the Cornerstone Claimants were entitled to recover all \$578,000 as the beneficiaries of a constructive trust. *Id.* at 7.

The Schreiber Claimants appealed, but the panel affirmed the judgment of the district court. *United States v. Cornerstone Equity Fund, LLC*, ___ Fed. Appx. ___, 2018 WL 1979164 (9th Cir. Apr. 27, 2018). The panel held that the Schreiber Claimants provided "no legal basis" for their claim that the imposition of the constructive trust was inequitable. Under California law, the panel said, a third party is entitled to a constructive trust if it was the victim of "some wrongful act" and can trace its loss to specific property. "California law," the panel said, "does not require more." *Id.* at *1.

¹ The Attorney General's authority to distribute forfeited property to the victims of the underlying crime is set forth in 28 C.F.R. Part 9 and 18 U.S.C. § 981(e)(6). It is the policy of the Department of Justice to distribute forfeited property to identifiable victims as a first priority. *See Asset Forfeiture Policy Manual* (2013), Chap. 12.

As a consequence, all of the money has been awarded to the Cornerstone Claimants and the Schreiber Claimants have been dismissed from the case and no longer have any opportunity to recover even a fraction of their losses from the forfeited funds.

ARGUMENT

A. The Panel Decision is Contrary to the Law in Other Circuits

1. Constructive trust is an exception to the rule that unsecured creditors lack standing to contest the forfeiture of criminal proceeds

It is well-established in the Ninth Circuit and elsewhere that unsecured creditors, including fraud victims, lack standing to contest the forfeiture of criminal proceeds because they lack a legal interest in the specific assets subject to forfeiture. *United States v. \$20,193.39 U.S. Currency*, 16 F.3d 344, 346 (9th Cir. 1994); *United States v. 133 U.S. Postal Service Money Orders*, 496 Fed. Appx. 723, 724 (9th Cir. 2012) (unpublished).

This is true even if the unsecured creditor can trace his formerly-owned property to the property being forfeited. *See United States v. 1976 Sabreliner Business Jet*, 2017 WL 5691009, *6 (E.D. Tenn. Mar. 7, 2017); *United States v. 8 Gilcrease Lane*, 641 F. Supp.2d 1, 5 (D.D.C 2009); *United States v. \$7,599,358.09*, 2011 WL 3611451, *3 (D.N.J. Aug. 15, 2011), citing *Asset Forfeiture Law in the United States* (1st ed. 2007), § 10-3(d), p. 359).

Most courts, including this one, recognize, however, that a constructive trust provides an alternative means of establishing standing to contest the criminal or civil

forfeiture of criminal proceeds. *133 U.S. Postal Service Money Orders*, 496 Fed. Appx. at 725 (“*Boylan* thus recognized an alternate, equitable theory for establishing secured creditor status”). Under this alternate theory, a claimant who can show that the elements of a constructive trust under state law are satisfied, can both establish standing to contest the forfeiture action and, if the court imposes the trust, prevail on the merits.² *See generally* Stefan D. Cassella, *Asset Forfeiture Law in the United States*, (2d ed. 2013), § 23-15(g), pp. 846-55 (collecting civil and criminal forfeiture cases applying a constructive trust to establish standing and recover on the merits).

In general, a claimant is entitled to a constructive trust if he can trace lost property to the *res* of the trust and can prove that the loss was due to fraud or some other unlawful act on the part of a person with whom he was in a confidential or fiduciary relationship. *Id.* at 847-49. In addition, and critical to the issue before the court, because a constructive trust is an equitable remedy, the claimant must show that imposing the trust would be consistent with the principles of equity including the “clean hands” doctrine, the avoidance of unjust enrichment, and the lack of an adequate remedy at law. *Id.* (collecting cases). Most important, as a matter of equity and fairness, courts outside of the Ninth Circuit will not impose a constructive trust on behalf of one victim if doing so would work to the disadvantage of other victims who are similarly situated. *Id.* at 849.

² In a civil forfeiture action, prevailing on the merits means establishing an innocent owner defense in terms of 18 U.S.C. § 983(d)(2). Accordingly, in this case, the issue is whether the Cornerstone Claimants were innocent owners within the meaning of Section 983(d)(2) because they were beneficiaries of a constructive trust.

2. Equal treatment of similarly-situated parties is a requirement.

The leading case on this issue is the Eleventh Circuit's decision in *United States v. Ramunno*, 599 F.3d 1269 (11th Cir. 2010). There, the victim of a fraud scheme who could trace his losses to the forfeited property argued that it was improper for the district court to consider "traditional principles of equity and fairness" in finding that he was not entitled to a constructive trust. To the contrary, he argued, "a constructive trust arises automatically when a fraud occurs." 599 F.3d at 1272, 1274. But the Eleventh Circuit did not agree.

Applying Georgia law, the court held that a constructive trust does *not* arise automatically, and the court's role is *not* limited to recognizing an already existing interest. To the contrary, a court must "consider principles of fairness" in determining whether to impose a trust and must reject the claim of the victim requesting the trust if the only difference between him and the other victims was that "he was defrauded last." 599 F.3d at 1274-75. Imposing a constructive trust in those circumstances, even if the claimant could satisfy the tracing requirement, the court said, would be unfair "because it would elevate his position over that of similarly situated victims." *Id.*

The Tenth Circuit reached the same result in *United States v. Andrews*, 530 F.3d 1232, 1238 (10th Cir. 2008), as have the district courts in other circuits. *See United States v. BCCI Holdings (Luxembourg) S.A. (Petition of Chawla)*, 833 F. Supp. 9, 14 (D.D.C. 1993), *aff'd* on other grounds, 46 F.3d 1185 (D.C. Cir. 1995); *United States v. 1976*

Sabreliner Business Jet, 2017 WL 5691009, *8-10 (E.D. Tenn. Mar. 7, 2017); *United States v. Bailey*, 2013 WL 681826, *4 (W.D.N.C. Feb. 25, 2013).

In contrast, the panel in this case upheld the district court’s imposition of the constructive trust based solely on the Cornerstone Claimants’ ability to trace and without considering the principles of equity. Thus, there is a conflict between the Ninth Circuit and all other courts on this issue.

B. The Panel Decision Conflicts with Other Ninth Circuit Law

1. Pre-Boylan law.

Historically, this court recognized that a court must apply the principles of equity before determining whether to impose a constructive trust.

In *In re North American Coin & Currency, Ltd.*, 767 F.2d 1574 (9th Cir. 1985), the court held that a constructive trust is an equitable remedy, and that a court must “act very cautiously in exercising such a relatively undefined equitable power in favor of one group of potential creditors at the expense of other creditors” 767 F.2d at 1575.

Accordingly, when the court found that the plaintiffs “comprise only one of several comparable groups of creditors who sustained substantial losses,” and were able to trace their losses only because of the timing of when their transactions with the debtor took place, it held that a constructive trust should not be imposed. 767 F.2d at 1577-78.

“We fail to discern the equitable principle that requires us to protect the plaintiffs’ investments fully, at the expense of these other creditors,” the court concluded. “Indeed, the equities . . . point in the other direction.” *Id.*

This court reached the same result in *United States v. Real Property Located at 13328 and 13324 State Highway 75 North*, 89 F.3d 551 (9th Cir. 1996). In that case, the Securities and Exchange Commission brought an enforcement action to recover the proceeds of a fraud scheme, with the intention of distributing the property “to the victims in a pro rata manner.” 89 F.3d at 553. One group of claimants who could trace their losses opposed the distribution plan and asked the district court to impose a constructive trust instead.

The district court refused to do so. “Where, as here, the struggle over the res derived from fraudulent conduct is between innocent parties, tracing should not and will not apply.” 89 F.3d at 553 (emphasis added). To the contrary, the court continued, “Instead of engaging in a tracing fiction, the equities demand that all Wymer’s defrauded customers share equally in the fund of pooled assets in accordance with the SEC plan.” *Id.*

This court fully endorsed the district court’s ruling, holding that “We agree with the district court’s eminently sensible statement of the law on this point.” *Id.* Indeed, the panel held that the suspending the tracing rules and treating all victims equally was consistent with the Supreme Court’s teaching in the original Ponzi case, *Cunningham v. Brown*, 265 U.S. 1, 12-13 (1924), with the law in other circuits, with the leading treatises on trusts, and with California law. 89 F.3d at 554. *See also Federal Trade Commission v. Network Services Depot, Inc.*, 617 F.3d 1127, 1142 (9th Cir. 2010) (holding that a court must “look to common law principles of equity to determine whether the district court’s application of constructive trust constitutes legal error”).

2. *Boylan* was a departure from Ninth Circuit law.

This court departed from this historical view in *Boylan*. There, the Government brought a civil forfeiture action to recover \$4.2 million in fraud proceeds without sending notice of the forfeiture proceeding to any of the victims. When no claims were filed, the Government obtained a default judgment, intending to distribute the forfeited proceeds to the victims in accordance with the remission regulations.

One group of victims, however, protested that they had standing to contest the forfeiture as the beneficiaries of a constructive trust and therefore should have been given notice of the forfeiture action. The district court disagreed and held that “the facts of this case do not warrant imposition of a constructive trust.” 392 F.3d at 1004. The claimants appealed, and a panel of this court reversed.

“It is an elementary mistake to suppose that a court creates the trust,” the court said. “The expression ‘the court creates the trust’ is ‘absurd’.” “The obligation on the fraudster is imposed by law and arises immediately with his acquisition of the proceeds of the fraud.” *Id.* (emphasis added).

The court went on to address the Government’s concern that the imposition of a constructive trust would be unfair to the victims who did not contest the forfeiture. “This apparent concern,” the court said, “is irrelevant to the legal question of Appellants’ standing, and in any event, it can be addressed by the district court in the context of the forfeiture proceedings.” 392 F.3d at 1005 (emphasis added).

Accordingly, the court held that the district court erred in exercising its own judgment that a constructive trust should not be imposed and reversed the district court’s

rejection of the claim for lack of standing. Nevertheless, the panel admonished the district court that, on remand, it was to administer the trust “giving notice to all potential claimants and taking steps to assure that no claimant obtains more than his or her fair share.” *Id.*

C. *Boylan* Mistakenly Applied California Law

The *Boylan* court based its decision on what it understood to be California law. As the district court in *Wilson* pointed out, however, a long line of California cases holds that a “constructive trust is merely a remedy [that] does not exist until a court has decreed it,” and that insofar as it holds that a constructive trust arises automatically without any determination by the court, *Boylan* may be inconsistent with California law. *United States v. Wilson*, 640 F. Supp.2d 1257, 1259-60 (E.D. Cal. 2009). *See also CHoPP Computer Corp. Inc. v. United States*, 5 F.3d 1344, 1349 (9th Cir. 1993) (California law “discourages the use of equitable remedies to ward off competing [claims]”). The district court in *Wilson* concluded, however, that it was “bound by *Boylan* and only the Circuit or the Supreme Court can remedy the apparent error.” 640 F. Supp.2d at 1260.

Similarly, on appeal, the panel noted its own “misgivings” about *Boylan* but held that it was powerless to correct the error. “Critics argue,” the court said, “that *Boylan* runs counter to a number of California appellate cases, which hold that constructive trusts only arise at the time they are put into effect by a court” *Wilson*, 659 F.3d at 954, citing California cases. It held, however, that “a three-judge panel of this Court may not overturn circuit precedent,” and concluded that “even if we agree that *Boylan* should be overturned, we are without power to do so.” 659 F.3d at 955.

Appellate courts in other circuits have also disagreed with *Boylan*'s interpretation of California law. *See Federal Ins. Co. v. United States*, 882 F.3d 349, 371-72 (2nd Cir. 2018) (before imposing a constructive trust under California law, a court must apply equitable principles and deny relief to a party with “unclean hands”). Nevertheless, *Boylan* remains the law of this circuit. Only this court, sitting *en banc*, can correct the error.

D. *Wilson* Compounded the Error in *Boylan* by Applying it to the Merits of the Claim and not Merely to Standing.

It is possible to read *Boylan* as dealing only with the fraud victim's standing to contest the forfeiture of fraud proceeds, and not with the merits of his claim. Indeed, while some courts (like the district court in *Boylan* itself) hold that a court should determine whether a claimant is entitled to a constructive trust *before* determining if he has standing, others hold that the ability to trace is sufficient to establish a “colorable interest” in the property for standing purposes, only to deny the claim on the merits after determining that elevating one set of victims over others based solely on the ability to trace would violate the principles of equity. *See, e.g., 1976 Sabreliner*, 2017 WL 5691009, at *6-10.

In *Wilson*, however, this court expressly declined to limit *Boylan* to standing. “As to the question of whether a court must weigh the equities before establishing a constructive trust,” the court said, “the *Boylan* court noted that it is an elementary mistake to suppose that a court creates a trust.” 659 F.3d at 955 n.2. The trust arises

automatically. Thus, *Boylan* did not merely hold “that the equities warranted a trust for the purposes of a standing analysis.” To the contrary, “[i]t held that a constructive trust was imposed, and it directed the district court to administer ‘that trust’.” *Id.*

The panel recognized that this interpretation of *Boylan* put the Ninth Circuit in conflict with the Eleventh Circuit’s decision in *Ramunno*, but it held that this was the consequence of *Boylan*’s interpretation of California law – the interpretation that the court had suggested earlier was in error. The following quotation sets forth the precise issue that this court should resolve.

“Under *Boylan*, the court said, “this court interprets California law as establishing a constructive trust at the time the fraud is perpetrated, without further court action.” 659 F.3d at 955 (emphasis added). In contrast, in *Ramunno*, the Eleventh Circuit interpreted Georgia law as requiring judicial action to establish a constructive trust, and further requiring that principles of equity and fairness be considered in determining whether to establish a constructive trust.” *Id.* The latter view, the court concluded, is not the law in the Ninth Circuit.

E. The Procedure Envisioned by *Boylan* and *Wilson* Would Turn the Trial Court into a Liquidator.

Boylan and *Wilson* preclude district courts from considering equitable principles when deciding if a constructive trust claim should be granted, but mandate that after the claim has been granted, and the claims of victims who cannot trace have been denied, the

court should assume the guise of a bankruptcy court distributing the available assets on a *pro rata* basis in a liquidation proceeding. *Wilson*, 659 F.3d at 955 n.3 (“courts still consider equity and fairness under *Boylan* – [but] consider them in the administration, and not the creation, of constructive trusts”).

Thus, following *Boylan*, the *Wilson* court instructed the district court on remand to “take steps to assure than no claimant obtains more than his fair share,” and held that “this case arguably presents circumstances where equity would justify suspension of [the] tracing rules” so that one fraud victim does not “recover all of his losses at the expense of other victims.” *Id.*

If the district court had followed that procedure in this case, the Schreiber Claimants would still have an opportunity in the ensuing liquidation proceeding to lay claim to a pro rata share of the recovered funds. The court, however, did not follow that procedure and left the Schreiber Claimants with no opportunity to recover any portion of their losses. That was error as a matter of Ninth Circuit law and is grounds for reconsideration of the decision affirming the district court’s judgment.

But the procedure outlined by *Boylan* and *Wilson* is not appropriate. Requiring a court first to deny the claims of the non-tracing victims and to award all of the assets recovered in a fraud case to those who can trace, only to void both of those rulings and administer the constructive trust as a liquidator, is a waste of judicial resources. Not only does it waste the time of the district court and place the court in a role for which it is

unsuited, but it is costly to the innocent victims who must continue to pay counsel to represent them in the protracted federal court proceeding instead of relying on the Attorney General to distribute the money. *See United States v. Rothstein*, 2010 WL 2943315, *4 (S.D. Fla. Jul. 26, 2010) (following *Ramunno* and declining to impose a constructive trust where it would work to the disadvantage of victims who have chosen to await the fair distribution of the forfeited property through the Attorney General's restitution process by reducing the pool available for distribution).

The other circuits have resisted the urge to usurp the role of the Attorney General in allocating forfeited assets. *See, e.g., United States v. BCCI Holdings (Luxembourg) S.A. (Petition of Chawla)*, 46 F.3d 1185, 1191-92 (D.C. Cir. 1995) (parceling assets to victims as part of the judicial forfeiture proceeding “appears patently at odds with the statutory scheme, which directs parties without an interest in specific property to seek relief from the Attorney General, not the court adjudging the forfeiture”).

Accordingly, in contrast to what *Boylan* and *Wilson* have mandated, and what the district court in this case would have done if it had followed Ninth Circuit law, a far more sensible procedure would be for the district court, in the first instance, to consider whether the Schreiber and Cornerstone Claimants were victims of the same fraud offense, to apply the principles of equity to reject the imposition of a constructive trust on behalf of *any* claimants who were thus similarly situated, and to leave it to the Attorney General to distribute the funds as equity dictates in accordance with the regulations in 28 C.F.R. Part 9.

The courts in this case could not do that, however, because they were constrained by *Boylan* and *Wilson*. This court now has the opportunity to remove that obstacle by abrogating the erroneous ruling in *Boylan* and allowing cases of this nature to be handled as Congress intended.

CONCLUSION

For all of these reasons, the court should grant a rehearing or rehearing *en banc* on the appeal of the Schreiber Claimants from the adverse decision of the district court, abrogate the decisions in *Boylan* and *Wilson* insofar as they are inconsistent with the precedents of this court and with California law regarding constructive trusts, and allow the district court on remand to consider the equity of awarding all the seized funds to the Cornerstone Claimants instead of ordering the forfeiture of those funds and allowing the Attorney General to distribute them to all the victims fairly and equitably in accordance with law.