

12-2383-cr
United States v. Walsh

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

August Term, 2012

(Argued: March 18, 2013 Decided: April 2, 2013)

Docket No. 12-2383-cr

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UNITED STATES OF AMERICA,

Appellee,

- v. -

STEPHEN WALSH,

Defendant-Appellant.

- - - - -x

Before: JACOBS, Chief Judge, CABRANES and WESLEY,
 Circuit Judges.

In this criminal case, Defendant Stephen Walsh appeals from an order of the United States District Court for the Southern District of New York (Cedarbaum, J.) denying his motion to release assets frozen in a parallel civil enforcement action. Walsh, charged with fraud, seeks release of the proceeds from the sale of his house. Walsh obtained the house from his wife in a divorce settlement in which his wife received (inter alia) a \$12.5 million

1 distributive award, \$6 million of which was paid using funds
2 traceable to Walsh's fraud. The district court properly
3 applied the tracing analysis from United States v. Banco
4 Cafetero Panama, 797 F.2d 1154 (2d Cir. 1986). We affirm.

5
6 MARK A. FLESSNER, Holland &
7 Knight LLP, Chicago, Illinois,
8 for Defendant-Appellant.

9
10 JOHN J. O'DONNELL, (Iris Lan, on
11 the brief), for Preet Bharara,
12 United States Attorney for the
13 Southern District of New York,
14 for Appellee.

15
16 DENNIS JACOBS, Chief Judge:

17 Stephen Walsh, defendant in this criminal fraud case,
18 appeals from an order of the United States District Court
19 for the Southern District of New York (Cedarbaum, J.)
20 denying his motion to release \$3.7 million in assets that
21 were frozen in a parallel civil enforcement action. Walsh
22 seeks to use those funds for his defense. Walsh and his
23 wife had purchased a house in her name using funds unrelated
24 to the alleged fraud. Pursuant to a divorce settlement,
25 Walsh received title to the house and gave his wife (inter
26 alia) a \$12.5 million distributive award, at least \$6
27 million of which was directly traceable to Walsh's alleged
28 fraud.

1 After a hearing conducted pursuant to United States v.
2 Monsanto, 924 F.2d 1186 (2d Cir. 1991) (in banc), the
3 district court concluded that the \$3.7 million at issue was
4 "traceable" to the fraud. Walsh does not contest the
5 underlying finding that there was probable cause to believe
6 that Walsh committed the fraud. But he does challenge the
7 finding that there was probable cause to believe that, after
8 the divorce settlement, the house became traceable to the
9 proceeds from the fraud.

10 He argues that the "tracing fiction" used by the
11 district court is inapplicable to his situation. He also
12 argues that the district court erred at the Monsanto hearing
13 by admitting hearsay testimony from the FBI agent who
14 investigated the fraud and by quashing Walsh's subpoenas.

15 For the following reasons, we affirm.
16

17 **I**

18 In 1983, the Walshes bought a house on Arden Lane in
19 Sands Point for \$900,000 and renovated it over the next
20 several years at a cost of more than \$2 million. In 1999,
21 they sold the property in parcels for a total of \$4.135
22 million. That same day, they applied most of the proceeds

1 to the \$3.15 million purchase of another Sands Point house,
2 on Half Moon Lane (the "Half Moon House" or the "House").
3 The title of the House remained in Walsh's wife's name alone
4 until the divorce in 2006.

5 In November 2006, the Walshes entered into a
6 Stipulation and Settlement and Agreement ("Divorce
7 Agreement") that divided their assets and resolved all
8 future claims for maintenance and/or an equitable
9 distribution award. Walsh received title to the Half Moon
10 House, as well as cars, certain bank accounts, and the
11 business interests that were involved in the alleged fraud.
12 His wife got condominiums in Florida and New York, cars,
13 bank and securities accounts and life insurance policies,
14 and a distributive award¹ of \$12.5 million. At the time of
15 Walsh's indictment, the only asset of substantial value he
16 owned was the Half Moon House.

¹ Under New York law, a "distributive award" is a "payment[] provided for in a valid agreement between the parties . . . in lieu of or to supplement, facilitate or effectuate the division or distribution of property where authorized in a matrimonial action, and payable either in a lump sum or over a period of time in fixed amounts." N.Y. Dom. Rel. Law § 236(B)(1)(b).

1 Walsh made payments to his wife pursuant to the Divorce
2 Agreement using the proceeds of the fraudulent scheme.² The
3 district court found that, all told, Walsh transferred at
4 least \$6 million of proceeds of the scheme to his wife,
5 including the \$3 million New York condominium acquired in
6 her name prior to the divorce.

7 Walsh does not contest these findings on appeal.

8
9 **II**

10 On February 24, 2009, the government filed a criminal
11 complaint against Walsh and codefendant Paul Greenwood
12 alleging an investment fraud that began around 1996. The
13 next day, the CFTC and SEC filed civil actions alleging the
14 same conduct against Walsh, Greenwood, and their various
15 entities. That same day, Judge Daniels, who was presiding

² In a related case, the New York Court of Appeals answered a certified question from this Court and determined that "where the innocent spouse and matrimonial court are unaware of the tainted nature of particular assets, distribution of marital assets under Domestic Relations Law § 236 . . . would become unworkable, particularly where the illegal activity of one spouse is not revealed for a number of years subsequent to the divorce, as occurred in this particular case." Comodity Futures Trading Comm'n v. Walsh, 927 N.Y.3d 162, 173-74 (2011). Thus, although the proceeds of the fraud are clearly reachable as to Walsh's property, they are not as to that of his ex-wife.

1 over the civil case, granted the government's motion for a
2 preliminary injunction seizing Walsh's assets.

3 Walsh and Greenwood were indicted on July 24, 2009, and
4 Walsh pled not guilty a week later.

5 In December 2009, Walsh moved to unfreeze the Half Moon
6 House to finance his defense in the criminal case. Judges
7 Daniels and Cedarbaum jointly heard oral argument on the
8 motion and ruled in February 2010 that Walsh was entitled to
9 \$900,000--the purchase price of the house on Arden Lane.
10 The decision was without prejudice to Walsh's ability to
11 seek additional funding.

12 In March 2011, the receiver sold the Half Moon House
13 for approximately \$3.7 million. Walsh thereafter moved to
14 have the remaining portion of the sale price released to pay
15 for his criminal defense. The parties agreed to hold a
16 Monsanto hearing. The government advised the court that its
17 only witness would be FBI Agent Barnacle, who had
18 investigated the fraud.

19 Walsh subpoenaed two fact witnesses: his codefendant
20 Greenwood, and Deborah Duffy, a partner at one of the
21 entities involved in the fraud. Walsh also subpoenaed Brick
22 Kane, the Chief Operating Officer of the court-appointed

1 receiver in charge of selling the Half Moon House. The
2 court granted the government's motion to quash all three
3 subpoenas, on the ground "that the defendants seek . . . to
4 hold a wholesale dress rehearsal of the trial by subpoenaing
5 the principal cooperating witnesses of the government."
6 Telephone Conference Tr. 2, Apr. 15, 2011.

7 At the Monsanto hearing, held over three days in May
8 and June 2011. Agent Barnacle recounted what Greenberg and
9 Duffy told him about the fraudulent scheme and set out the
10 transactional history of the Half Moon House. The
11 government introduced documents relating to the fraud and to
12 the source of the assets.

13 Judge Cedarbaum denied the motion to unfreeze the
14 remaining proceeds from the sale of the Half Moon House in
15 May 2012, finding probable cause to believe (1) that Walsh
16 perpetrated the scheme, and (2) that the proceeds from the
17 sale of the Half Moon House were traceable to the profits
18 from the scheme.

19
20 **III**

21 "In order to seize property . . . , the government must
22 demonstrate that there was probable cause to believe that

1 the property is subject to forfeiture." In re Seizure of
2 All Funds in Accounts in Names Registry Pub. Inc., 68 F.3d
3 577, 580 (2d Cir. 1995). "The findings supporting a
4 district court's determination as to probable cause are
5 reviewed for clear error, but the determination itself is a
6 conclusion of law reviewed de novo." Id.; accord United
7 States v. Holder, 990 F.2d 1327, 1328 (D.C. Cir. 1993).
8 Since Walsh does not contest any factual findings, but
9 instead argues that the district court made an error of law
10 in applying the tracing fictions from United States v. Banco
11 Cafetero Panama, 797 F.2d 1154 (2d Cir. 1986), to this case,
12 we review the district court's decision de novo.

13 Part of the Sixth Amendment's guarantee of the right to
14 counsel is "the right of a defendant who does not require
15 appointed counsel to choose who will represent him." United
16 States v. Gonzalez-Lopez, 548 U.S. 140, 144 (2006).

17 Nevertheless, a defendant may not use the proceeds of a
18 fraud to fund his criminal defense: "A defendant has no
19 Sixth Amendment right to spend another person's money for
20 services rendered by an attorney, even if those funds are
21 the only way that that defendant will be able to retain the

1 attorney of his choice." Caplin & Drysdale, Chartered v.
2 United States, 491 U.S. 617, 626 (1989).

3 "[T]he [F]ifth and [S]ixth [A]mendments, considered in
4 combination, require an adversary, post-restraint, pretrial
5 hearing as to probable cause that (a) the defendant
6 committed crimes that provide a basis for forfeiture, and
7 (b) the properties specified as forfeitable in the
8 indictment are properly forfeitable." United States v.
9 Monsanto, 924 F.2d 1186, 1203 (2d Cir. 1991) (in banc). The
10 issue in this appeal is whether there was probable cause to
11 believe that the proceeds from the sale of the Half Moon
12 House were traceable to the proceeds of the fraud--i.e.,
13 that they were "another person's money."³ Caplin, 491 U.S.
14 at 626.

15 The Walshes purchased the Half Moon House with funds
16 that were not traceable to the fraud, and the title was put
17 in then-Mrs. Walsh's name alone. But Walsh ultimately
18 acquired the house pursuant to the Divorce Agreement in
19 exchange for, inter alia, a \$12.5 million distributive

³ We need not decide whether a Monsanto hearing is necessary in a case such as this where the government seized the assets in a parallel civil case, since we affirm the district court's decision within the Monsanto framework.

1 award, of which at least \$6 million consisted of funds
2 directly traceable to the fraud.

3 When some funds in a seized bank account are traceable
4 to criminal activity and some are not, we consult Banco
5 Cafetero, 797 F.2d 1154. We have three "accounting choices"
6 at our disposal to determine what amount of commingled funds
7 are traceable to criminal activity. Of relevance here is
8 the "drugs-in, first-out" approach, which "consider[s]
9 'traceable proceeds' to be any one withdrawal, or any asset
10 purchased with such withdrawal, to the extent of" the amount
11 of the deposited tainted funds. Id. at 1159. Applying that
12 approach, the district court analogized the sale proceeds of
13 the Half Moon House "to a withdrawal from a commingled
14 account, i.e., the marital estate." United States v.
15 Greenwood, 865 F. Supp. 2d 444, 450 (S.D.N.Y. 2012).

16 We conclude that the district court's application of
17 Banco Cafetero was proper. Walsh negotiated to get the Half
18 Moon House and to keep his (now worthless) business
19 interests in exchange for the \$12.5 million distributive
20 award. Although the House itself is not a fungible asset,
21 it was "an asset purchased with" the tainted funds from the
22 marital estate, by operation of the Divorce Agreement. See

1 Banco Cafetero, 797 F.2d at 1159. Since Walsh's total
2 assets did not exceed \$6 million at the time of his arrest,
3 under Banco Cafetero's "drugs-in, first-out" approach, all
4 of his assets are traceable to the fraud.

5 Walsh argues that he had a preexisting right to the
6 Half Moon House under New York's 1980 Equitable Distribution
7 Law and that he therefore did not "purchase" the House in
8 the Divorce Agreement. This argument ignores New York
9 Domestic Relations Law section 236(B)(3), which allows
10 parties to opt out of equitable distribution in favor of a
11 negotiated settlement, which is what the Walshes did. The
12 analysis might differ if the marital estate had been
13 distributed according to a court order under New York
14 Domestic Relations Law section 236(B)(5). We need not
15 address that hypothetical, however, because Walsh freely
16 negotiated title to the House in exchange for at least \$6
17 million in funds traceable to the fraud. Accordingly, the
18 district court properly applied Banco Cafetero.

19
20 **IV**

21 Walsh argues that the district court made two related
22 erroneous evidentiary rulings at the Monsanto hearing: (1)

1 admitting Agent Barnacle's hearsay testimony; and (2)
2 quashing Walsh's subpoenas. For the reasons that follow, we
3 reject both arguments.

4
5 **A**

6 The admissibility of hearsay at a Monsanto hearing is a
7 question of law that we review de novo. See generally
8 United States v. Ferguson, 676 F.3d 260, 285-86 (2d Cir.
9 2011) (reviewing hearsay decision de novo).

10 In order to "preclud[e] unwarranted exposure of
11 government witnesses," Monsanto permits a "court [to]
12 receive and consider at such a hearing evidence and
13 information that would be inadmissible under the Federal
14 Rules of Evidence." 924 F.2d at 1198, 1203. Although Walsh
15 argues that Monsanto's evidentiary rule should be limited to
16 cases where witnesses may be in physical danger--such as
17 those involving drugs⁴--we are persuaded by district court
18 opinions in this Circuit applying Monsanto's evidentiary

⁴ Monsanto involved a seizure pursuant to 21 U.S.C. § 853(e)(3), a drug statute. There is no analogous statute in this case; the government froze Walsh's assets in the related civil case under the court's equity powers granted to it by Section 22(a) of the 1933 Securities Act, 15 U.S.C. § 77v(a), and Section 27 of the 1934 Securities Exchange Act, 15 U.S.C. § 78aa. See SEC v. Manor Nursing Ctrs., Inc., 458 F.2d 1082, 1103 (2d Cir. 1972).

1 rule to non-drug cases. E.g., United States v. All Funds on
2 Deposit in any Account at Certain Fin. Insts. Held in the
3 Names of Certain Individuals, 767 F. Supp. 36, 42 (E.D.N.Y.
4 1991) (Spatt, J.); see also United States v. Clarkson Auto
5 Elec., Inc., No. 10-CR-6111CJS, 2012 WL 345911, at *1 n.4
6 (W.D.N.Y. Feb. 1, 2012) (Payson, M.J.). The unwarranted
7 exposure of government witnesses was a valid consideration
8 in this case, to avoid what the district court called a
9 “dress rehearsal” of the trial. In any event, the Monsanto
10 hearing involved only a finding of probable cause, and “[a]
11 finding of probable cause may be based on hearsay.” United
12 States v. Daccarett, 6 F.3d 37, 56 (2d Cir. 1993).

13
14 **B**

15 We review the quashing of a subpoena for abuse of
16 discretion. See Arista Records, LLC v. Doe 3, 604 F.3d 110,
17 117 (2d Cir. 2010). The same consideration that justifies
18 receipt of hearsay evidence in a Monsanto hearing
19 (unwarranted exposure of witnesses) supports the district
20 court’s exercise of discretion to quash the subpoenas of two
21 fact witnesses: Greenwood and Duffy. Walsh argues that his
22 right to an “adversary proceeding” should be weighed against

1 the government's interest in protecting its witnesses, and
2 argues that his is the greater interest. But Monsanto has
3 already decided, when the government has an interest in
4 preventing the "unwarranted exposure" of its witnesses, that
5 interest tends to outweigh a defendant's right to cross-
6 examine those witnesses before the trial. See 924 F.2d at
7 1195-98.

8 The subpoena served on the receiver raises no risk of
9 "unwarranted exposure of government witnesses," but in any
10 event, the district court did not consider any hearsay
11 evidence that was based on the receiver's analysis or
12 conclusions. Rather, the district court based its decision
13 entirely on the documentary evidence in the case--the same
14 documents that were available to the receiver.⁵ Walsh fails
15 to show what he would have gained by calling the receiver.

⁵ Walsh argues that the court *did* consider the receiver's conclusions by admitting Government Exhibit 603, which was a chart prepared by the receiver detailing payments Walsh made to his wife. As is clear from the hearing transcript, the government introduced this chart only "[f]or convenience and ease." Hr'g Tr. 134:13, May 24, 2011. The underlying records--upon which the receiver based the figures in the chart--were also admitted into evidence, and Agent Barnacle testified that he had reviewed those records and the chart and that the chart accurately reflected them. That the receiver created the chart is irrelevant because the chart did not reflect any independent analysis or computation on the receiver's part.

1 Accordingly, the district court did not abuse its discretion
2 in quashing Walsh's subpoenas.

3 For the foregoing reasons, we affirm the order of the
4 district court.