The Hon. John C. Coughenour

UNITED STATES DISTRICT COURT FOR THE
WESTERN DISTRICT OF WASHINGTON
AT SEATTLE

UNITED STATES OF AMERICA, Plaintiff, v. ERIC SHIBLEY, Defendant.	CASE NO. CR20-174-JCC **UNITED STATES' REPLY IN SUPPORT OF MOTION FOR ENTRY OF A COMBINED PRELIMINARY ORDER OF FORFEITURE AND ORDER OF FORFEITURE** NOTED ON MOTION CALENDAR: December 31, 2021

The Court should deny ES1 LLC's attempts to intervene in the criminal case and to transfer the $100,000 seized from ESI LLC's account (the "seized funds") to the ES1 LLC bankruptcy estate (Dkt. No. 142, "Response") and should enter the proposed combined orders of forfeiture. Defendant Eric Shibley ("Shibley") is the sole owner of ES1 LLC. ES1 LLC was one of the entities Shibley used to submit false and fraudulent PPP and EIDL applications as part of his scheme to defraud COVID-19 relief programs. Shibley and ES1 LLC received this money after Shibley fraudulently applied for a PPP loan totaling $100,000 in the name of ES1 LLC from TCF National Bank. On or about May 29, 2020, the United States seized the $100,000 in fraudulently obtained PPP funds pursuant to a judicial forfeiture seizure warrant.

As addressed below, ES1 LLC cannot intervene as a third party claimant in the criminal case against Shibley and the seized funds should remain under this Court's

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jurisdiction until the completion of the criminal case. Criminal proceedings are exempt from the automatic bankruptcy stay. These funds were seized pursuant to a judicial forfeiture seizure warrant, so did not become part of the bankruptcy estate. Further, title to forfeitable property vests in the United States at the time of the underlying offense – which occurred in April 2020 – so even if the funds had not been seized, they would no longer be property of the bankruptcy estate after entry of the order of forfeiture.

ARGUMENT

A. ES1 LLC Cannot Intervene in the Criminal Case Against Shibley.

Third party claims to potentially forfeitable property in a criminal case are deferred until the ancillary proceeding under Rule 32.2, which is triggered by the entry of a preliminary order of forfeiture. While Defendant Shibley is the sole member and owner of ES1 LLC (*see* 21-BK-12109, Dkt. No. 13, pp. 1, 19-21), ES1 LLC must assert any claim in the ancillary proceeding. *See* 21 U.S.C. § 853(k) (no party claiming interest in property subject to criminal forfeiture may intervene in trial or appeal of criminal case or commence an action at law or equity concerning the validity of that interest except as provided in section 853(n)); *see also Libretti v. United States*, 516 U.S. 29, 44 (1995).

There are only two ways that a third party may show a valid interest in property subject to criminal forfeiture under Section 853(n)(6). The petitioner must either: (A) have an interest in the property that is superior to the criminal defendant's interest and arose before the commencement of the crime; or (B) qualify as a "bona fide purchaser for value" of the property who was "reasonable without cause to believe that the property was subject to forfeiture" at the time of purchase. *See* 21 USC § 853(n)(6).

B. The Seized Funds Should Remain in the Court's Control and Jurisdiction.

Federal district courts have exclusive jurisdiction of federal forfeiture cases, 28 U.S.C. § 1355(a), and of federal criminal cases, including criminal forfeitures, 18 U.S.C. § 3231. Once a federal district court takes control of property for forfeiture, it has the authority to prevent other courts from interfering with its jurisdiction. *See Penn General Casualty Co. v. Pennsylvania*, 294 U.S. 189, 195 (1935) (court first taking *in rem*

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jurisdiction over property may maintain and exercise that jurisdiction to the exclusion of other courts); *see also* 18 U.S.C. § 981(c) (property taken or detained for civil forfeiture deemed to be in the custody of Attorney General of Secretary of Treasury; such property is subject only to the orders and decrees of the official or court having jurisdiction); *see also* 21 U.S.C. § 853(k)).

This court has possession of and exclusive jurisdiction over the seized funds. The Indictment was filed on October 15, 2020. *See* Dkt. No. 31. The funds were seized on May 29, 2020 pursuant to a judicial forfeiture seizure warrant finding probable cause to believe they are subject to forfeiture. *See* Dkt. No. 41. They were identified in a bill of particulars and are subject to a protective order restraining them until the conclusion of the criminal case. Dkt. Nos. 39, 60. Federal law prohibits a criminal defendant from filing a bankruptcy that affects criminally forfeitable property after the filing of an indictment or information alleging the property is forfeitable. *See* 21 U.S.C. § 853(k).

Even were the seized funds property of the bankruptcy estate, they would still remain subject to the court's protective order. ES1 LLC may not use turnover provisions to capture assets that are subject to criminal forfeiture. "[I]t is settled law that the debtor cannot use the turnover provisions to . . . demand assets whose title is in dispute." *See United States v. Inslaw, Inc.*, 932 F.2d 1467, 1472 (D.C Cir. 1991) (citing *In re Charter Co.*, 913 F.2d 1575, 1579 (11th Cir. 1990)), *cert. denied*, 502 U.S. 1048 (1992).

C. Forfeiture Proceedings are Exempt from the Automatic Bankruptcy Stay.

Forfeiture proceedings are exempted from the stay by 11 U.S.C. §§ 362(b)(1) and (b)(4). Shibley filed a bankruptcy petition on behalf of ES1 LLC on November 19, 2021, *see* 21-BK-12109, Dkt. No. 1, well after the commencement of the criminal case and the identification and seizure of these funds for forfeiture. While the bankruptcy petition triggers an automatic stay of most civil litigation against the debtor, it does not prevent the government from commencing, or continuing with, a criminal case. *See* 11 U.S.C. §§ 362(b)(1), (b)(4); *see also In re Chapman*, 264 B.R. 565 (B.A.P. 9th Cir. 2001); *also In re Rodriguez*, No. 07-276, 2008 WL 8448043, at *4 (9th Cir BAP Jul. 10, 2008).

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This exemption also protects the victims of fraud offenses. A key difference between bankruptcy and forfeiture is that forfeiture provides recovery for victims who may not qualify as creditors in a bankruptcy setting. Returning forfeited assets to victims through the remission and restoration processes is one of the primary goals of the Department of Justice's ("Department") Asset Forfeiture Program. *See* Asset Forfeiture Policy Manual (2021), Chap. 14, Sec. I (citing The Attorney General's Guidelines on the Asset Forfeiture Program (July 2018), Sec. II). Where, as here, there are identifiable victims of the defendant's crimes, the government seeks to return the proceeds generated from forfeiture to those victims. Remission and restoration authority exists for virtually all offenses for which the government obtains a forfeiture order. Department policy is that victims have priority to forfeited funds after the resolution of any claims of innocent owners, lienholders, and the payment of eligible government expenses. *See* Asset Forfeiture Policy Manual (2021), Chap. 14, Sec. II.A.3 ("Priority in the distribution of forfeited assets is given to valid owners, lienholders, federal financial regulatory agencies, and victims (in that order), who in turn have priority over official use requests and equitable sharing requests.") In bankruptcy, the proceeds would, in all likelihood, be paid pursuant to the statutory priority scheme. Thus, payment for things such as administrative expenses of the estate (including attorney's fees), wages of employees, secured creditors, and taxes would be made before the unsecured victims of the crime that produced the funds in question received any reimbursement. *See* 11 U.S.C. § 507.

D. The Seized Funds Are Not Property of the Bankruptcy Estate.

Section 541(a) provides that all legal or equitable interests of the debtor become property of a bankruptcy estate upon the filing of a petition. 11 U.S.C. § 541(a)(4). Neither Defendant Shibley nor ES1 LLC can hold a legal or equitable interest in the forfeitable proceeds of fraud, which vests in the United States at the time of the offense and is transferred upon entry of the order of forfeiture. ES1 LLC appears to recognize this fact, as it does not identify the seized funds among the assets of the bankruptcy estate. *See* Dkt. No. 13, pp. 2-7 (Asset and Liability Schedules).

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Under the relation back doctrine, the government's interest in forfeitable property vests at the time of the offense giving rise to forfeiture. 21 U.S.C. § 853(c) ("All right, title, and interest in [forfeitable] property . . . vests in the United States upon the commission of the at giving rise to forfeiture under this section"); 18 U.S.C. § 981(f) (same); 21 U.S.C. § 881(h) (same). This means that forfeitable property will not be property of the bankruptcy estate upon entry of the order of forfeiture. Where property is seized pursuant to a forfeiture seizure order issued prior to a bankruptcy petition, courts have held that the seized property never becomes property of the bankruptcy estate.

The relation back doctrine and its impact were clearly articulated by the U.S. Supreme Court in *United States v. Stowell*:

> By the settled doctrine of this court, whenever a statute enacts that upon the commission of a certain act specific property used or connected with that act shall be forfeited, the forfeiture takes effect immediately upon the commission of the act; the right to the property then vests in the United States, although [its] title is not perfected until judicial condemnation; the forfeiture constitutes a statutory transfer of the right to the United States at the time the offense is committed; and the condemnation, when obtained, relates back to that time, and avoids all intermediate sales and alienations, even to purchasers in good faith.

133 U.S. 1, 16-17 (1890); *see also United States v. 92 Buena Vista Avenue*, 507 U.S. 111, 125-126 (1993) (when forfeiture order is entered, the government obtains title back to time of criminal act, absent any applicable innocent owner defenses).

The seized funds are proceeds of Shibley's wire and bank fraud schemes and are forfeitable on that basis. The government's interest in the seized funds vested in April 2020, when Shibley digitally signed applications containing material false representations in support of a $100,000 PPP loan for ES1 LC and submitted them to TCF National Bank; thus, the government's interest vested long before the creation of the bankruptcy estate on November 19, 2021. The PPP loan was approved on or about May 11, 2020 and the funds were deposited to an ES1 LLC account on or about May 15, 2020. On or about May 21, 2020, Shibley transferred the full $100,000 to a Wells Fargo account

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ending 2378, from which they were seized pursuant to the judicial forfeiture seizure warrant. *See* Dkt. No. 140; *see also* Dkt. No. 41, pp. 10-12 (articulating underlying facts in support of the government's motion for protective order). Upon entry of the order of forfeiture, title will pass to the United States, effective April 2020.

Courts have addressed the interaction between bankruptcy and forfeiture proceedings and the application of the relation back doctrine. *See e.g. In re Chapman*, 264 B.R. 565. The *Chapman* court held that title to forfeitable property vests in the United States at the time of the offense, even though title does not pass until entry of an order of forfeiture, and that the bankruptcy filing does not prevent the government from proceeding with judicial forfeiture. *Id.* at 568-573. Thus, where a bankruptcy petition is filed prior to the entry of an order of forfeiture, the forfeitable property may be property of the bankruptcy estate, but only until the order of forfeiture is entered, after which the relation back doctrine removes it from the bankruptcy estate. *Id.* As the court noted, "if that happens, it is because that is the appropriate result under the law." *Id.* at 572.

In *In re Thena, Inc.*, an Oregon district court engaged in a similar analysis, reached a consistent conclusion, and determined that property seized pursuant to a forfeiture seizure warrant did not become part of the bankruptcy estate. *In re Thena, Inc.*, 190 B.R. 407, 95-6226-HO (D. Ore. Oct. 6, 1995). In that case, the United States seized funds pursuant to a criminal forfeiture seizure warrant. Debtors, who filed a bankruptcy petition after seizure but before criminal charges were filed, sought turnover of the seized funds to the bankruptcy estate. *Id.*, 190 B.R. 409-410. The court held the property was not part of the bankruptcy estate and rejected the turnover request. Other district courts have also concluded that seized property is not part of a bankruptcy estate. *See e.g., In re VPH Pharmacy, Inc.*, 65 B.R. 259, 18-11280, 2018 WL 3574721 (E.D. Mich. Jul. 25, 2018) (collecting cases). As one court observed, "[I]f the Court were to hold otherwise, entities subject to forfeiture proceedings could undo any prepetition seizures by filing bankruptcy and seeking turnover." *Id.* at *2, quoting *In re Timiryan*, 2007 Bankr. LEXIS 1627, *11 (Bkrtcy C.D. Cal. Mar. 26, 2007).

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CONCLUSION

For the reasons set forth above, the United States requests the Court deny ES1 LLC's attempts to intervene in the criminal case and to obtain transfer of the seized funds to the ES1 LLC bankruptcy estate. The United States further requests the Court enter the proposed combined forfeiture order.

DATED this 31st day of December, 2021.

Respectfully submitted,
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CERTIFICATE OF SERVICE

I hereby certify that on December 31, 2021, I electronically filed the foregoing with the Clerk of the Court using the CM/ECF system, which will send notification of such filing to the parties of record.

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