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**IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ALABAMA
SOUTHERN DIVISION**

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UNITED STATES OF AMERICA,

v.

Case No. CR-03-BE-0530-S

RICHARD M. SCRUSHY,

Defendant.

**DEFENDANT'S REPLY BRIEF IN FURTHER SUPPORT
OF MOTION TO MODIFY THE COURT'S
RESTRAINING ORDER DATED NOVEMBER 3, 2003**

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**DEFENDANT'S REPLY BRIEF IN FURTHER SUPPORT
OF MOTION TO MODIFY THE COURT'S
RESTRAINING ORDER DATED NOVEMBER 3, 2003**

Defendant Richard M. Scrushy respectfully submits this reply brief in response to the Government's Opposition Brief (the "Gov. Br.") and in further support of his motion to modify the restraining order dated November 3, 2003 (the "Restraining Order") so as to release those assets not properly restrained.¹

PRELIMINARY STATEMENT

Twice now -- in its original application for a Restraining Order and in its opposition to Mr. Scrushy's first opportunity to be heard -- the Government has asked

¹ This motion could also be construed as seeking the return of unlawfully seized property pursuant to Fed. R. Crim. P. 41(e). See, e.g., In re Protective Order On Intergroup Investment Corporation's Account, 790 F. Supp. 1140 (S.D. Fla. 1992). This provision requires the Court to "receive evidence on any factual issue necessary to decide the motion."

this Court to exercise its formidable power to seize Mr. Scrusby's assets without having the legal authority to do so. The Government's fundamental error (and its obvious ploy) is to ask this Court to disregard a basic tenet of forfeiture law -- that the Government may seek to restrain only those assets which meet a specific statutory definition of "tainted" property. Thus, whether the Government proceeds by indictment, IRS agent affidavit or any other procedure, it cannot ask this Court to freeze that which the law does not give the Government any right to forfeit. By ignoring the difference between "tainted" and "untainted" assets, and by asking the Court to disregard the different procedures and presumptions the forfeiture statute provides, the Government has obtained a Restraining Order far broader than allowed.

While accusing Mr. Scrusby of creating a "straw man" of a "substitute assets" argument, it is the Government advocating a legal fiction by stating that: (1) it has the same power to freeze assets by use of an IRS agent's affidavit as it does through a grand jury indictment, (2) defendant has no access to a hearing before this Court to review the government's actions until his criminal trial begins, and (3) this Court's review, if it should occur, is no more than a rubber stamp to the grand jury's findings. This Court should not accede to the Government's fiction.

ARGUMENT

I. The Government Has Restrained Assets In Excess Of Its Statutory Authority By Improperly Merging Two Distinct Statutory Provisions

The Government does not appear to contest that it must utilize some statutory basis in order to achieve a pre-verdict freeze of Mr. Scrusby's assets. There also appears to be no disagreement that the Government has chosen 21 U.S.C. § 853 ("Section 853")

as its basis. The disagreement arises from the Government's improper efforts to conflate two discrete subsections of that statute. But as the Eleventh Circuit stated just last month in United States v. \$242,484, 2003 WL 22723431, at *10 (11th Cir. Nov. 20, 2003), "[i]n this country, forfeitures are not favored. They 'should be enforced only when within both the letter and spirit of the law.'" Id. (quoting United States v. One Model Ford V-8 Deluxe Coach, 307 U.S. 219 (1939)). See also, United States v. \$38,000, 816 F.2d 1538, 1547 (11th Cir. 1987) (holding that "[f]orfeitures are not favored in the law; strict compliance with the letter of the law by those seeking forfeiture must be required.").

On its face, Section 853 provides two distinct mechanisms for obtaining a pretrial restraint of a defendant's assets. The statute provides that the Government may seek a restraining order either:

(A) upon the filing of the indictment or information charging a violation of this subchapter or subchapter II of this chapter for which criminal forfeiture may be ordered under this section and alleging that the property with respect to which the order is sought would, in the event of conviction be subject to forfeiture under this section; *or*

(B) prior to the filing of such an indictment or information, if, after notice to persons appearing to have an interest in the property and opportunity for a hearing, the court determines that --

(i) there is substantial probability that the United States will prevail on the issue of forfeiture and that failure to enter the order will result in the property being destroyed, removed from the jurisdiction of the court, or otherwise made unavailable for forfeiture; and

(ii) the need to preserve the availability of the property through the entry of the requested order outweighs the hardship on any party against whom the order is to be entered:

Provided, however, That an order entered pursuant to subparagraph (B) shall be effective for not more ninety days, unless extended by the court for good cause shown or unless an indictment or information described in subparagraph (A) has been filed.

Section 853(e)(1) (emphasis added). By its terms, the statute envisions that the Government will seek a restraint *before indictment* by making an independent showing, after notice and a hearing, of the basis for its restraint *or* by relying on the grand jury's probable cause findings *contained in an indictment*. The statute does not include a provision which allows the Government to fold its attempt to seek to restrain assets through the shortcut of Section 853(e)(1)(A) by relying on an IRS agent's affidavit, which may form the basis for a pre-indictment restraining order under Section 853(e)(1)(B).² What the Government seeks to do in this case is to apply two disjunctive statutory provisions interchangeably; to mix and match the procedural benefits it enjoys under (A) with the convenience afforded by (B). It seeks to avoid a mandatory hearing within 10 days of the grant of the *ex parte* restraining order but also seeks to avoid the inconvenience of having to prove to a grand jury probable cause that each asset it seeks to restrain pre-trial is derived from criminal conduct (and the related requirement that those grand jury findings be specifically enumerated in the Indictment). Surely, the Government can do either. But hollow claims of "administrative burden"

² To the extent the Restraining Order is deemed to have been issued pursuant to Section 853(1)(A) or (B), the basis for a post-restraint hearing is set forth in Point II, *infra*. To the extent it is deemed to have been issued as a temporary restraining order, the right to a hearing is set forth in Section 853(e)(2) itself.

(Gov. Br. at 12) do not give it license to do both. The reason is simple. As the Senate

Report on Section 853 notes:

“the probable cause determination established in the indictment or information is, in itself, [deemed] to be a sufficient basis for issuance of a restraining order Since a warrant for the arrest of the defendant may issue upon the filing of an indictment or information, and so the indictment or information is sufficient to support a restraint on the defendant’s liberty, it is clear that the same basis is sufficient to support a restraint on the defendant’s ability to transfer or remove property alleged to be subject to criminal forfeiture in the indictment.”

S. Rep. No. 225, 98th Cong., 2d Sess. 191, reprinted in 1984 U.S. Code Cong. Admin. News 3182, 3385-3386. However, the same indicia of reliability do not accompany probable cause findings made by an IRS agent. As a result, the Government cannot, as it has done here, use an Indictment to bootstrap into Section 853(e)(1)(A) a probable cause determination that could only have been made under Section 853(e)(1)(B).

Cleverly, the Government takes issue with Mr. Scrushy’s “fail[ure] to cite any caselaw or statutory language in support of this proposition.” Gov. Br. at 10. However, when a statute is as clear and plain as the disjunctive provisions of two separate procedures, it would be odd for courts to have to opine that the word “or” means what it says.³ See Barnhart v. Sigmon Cole Co., 534 U.S. 438,450 (2002) (“The first step [in statutory construction cases] is to determine whether the language at issue has a plain and

³ In other criminal law contexts, courts have routinely rejected the Government’s efforts to conflate disjunctive statutory provisions. See, e.g., United States ex rel. Barajas v. United States, 258 F.3d 1004, 1010 (9th Cir. 2001) (requiring Government to choose between disjunctive provisions in the False Claims Act).

unambiguous meaning with regard to the particular dispute in the case. The inquiry ceases if the statutory language is unambiguous and the statutory scheme is coherent and consistent.”) (quotations and citations omitted); Shotz v. City of Plantation, Florida, 344 F.3d 1161, 1167 (11th Cir. 2003) (“The first rule in statutory construction is to determine whether the language at issue has a plain and unambiguous meaning . . . we must presume that Congress said what it meant and meant what it said.”) (quotations and citations omitted); Liteky v. United States, 510 U.S. 540, 552-53 (1994) (“it is unreasonable to interpret one provision of a statute as eliminating another”).

As the United States Court of Appeals for the Seventh Circuit held in United States v. Moya-Gomez, 860 F.2d 706, 722 (7th Cir. 1988), the language of Section 853 is “unambiguous.” It is therefore the Government that must point to caselaw indicating that Section 853(e)(1) can be interpreted to mean that its assets may be restrained based on assertions contained in an IRS agent’s affidavit (as set forth in Section 853(e)(1)(B)) even though an indictment has already been issued (as contemplated by Section 853(e)(1)(A)) and that the Government may do so without regard for the procedural protections that must be adhered to when a restraining order is based on anything other than a grand jury’s finding of probable cause (as set forth in Section 853(e)(1)(B)). The cases relied on by the Government (Gov. Br. at 11) fall far short of satisfying this burden. Rather, those cases stand for the unremarkable (and wholly inapposite) proposition that assets not specifically enumerated in the Indictment may be subject to *post-conviction* forfeiture as long as the defendant is otherwise given notice that those unenumerated assets might be forfeitable. See United States v. Diaz, 190 F.3d 1247 (11th Cir. 1999); United States v. DeFries, 129 F.3d 1293 (D.C. Cir. 1997); United States v. Iacaboni, 221 F. Supp. 2d 104

(D. Mass. 2002). These cases do not apply to a *pretrial setting* and the Government does not (and cannot) point to a single case supporting the interpretation of Section 853 that it advocates here.

This Court should not permit the Government to disregard the literal language of Section 853 and to conflate its discrete subsections so as to restrain assets in a manner not authorized by the statute.

II. The Government's Argument That There Need Not Be A Post-Seizure, Pre-Trial Hearing Results From Its Misapplication Of Two Different Sections Of The Forfeiture Statute And An Erroneous Reading Of The Seizure-Through-Indictment Cases

As explained in Point I, *infra*, there are two separate provisions of Section 853 that address pre-trial asset restraints. The Government has improperly merged the two in order to impose a freeze of virtually all of Mr. Scrusby's assets. Having gotten away with this fusion of discrete procedures until now, the Government asks this Court to allow the transgression to continue without any judicial review. Gov. Br. at 13-19. Neither the rules nor the applicable caselaw afford it this impunity.

A. A Post-Seizure Hearing Is Required By The Express Terms Of Section 853(e)(1)(B)

While the Government resists admitting that it has utilized Section 853(e)(1)(B) to secure the Restraining Order, there is no other possibility. Currently, 248 of Mr. Scrusby's assets have been frozen. Only 42 of these assets are enumerated in the Indictment. Indictment, Counts 71 to 85, pp. 33-38. The remainder, 206 in total, are listed in a separate affidavit of Agent Charles A. Traywick (the "Traywick Affidavit" or "Traywick Aff.") which, of course, does not contain a grand jury's findings of probable cause. Agent affidavits are precisely what the Government relies on when it seeks a restraining order prior to the issuance of an indictment, under Section 853(e)(1)(B). See,

e.g., In re Certain Assets of Allen Petty, Jr., 2002 WL 1377707 (E.D. Tex. April 17, 2002).

Although the use of an agent's affidavit to obtain a post-indictment restraint of assets is unauthorized (see Point I, *infra*), the Government has already done so here. Therefore, at this juncture, the Government has a choice: it can attempt to hold that which is enumerated in the Indictment (under Section 853(e)(1)(A)), with the judicial review that applies to such a procedure and immediately release that which it heretofore has held on the basis of the Traywick Affidavit *or*, as to the assets described in that affidavit, submit to the fuller review required under a non-indictment based asset freeze as set forth in Section 853(e)(1)(B).

The plain language of Sections 853(e)(1)(B) and (e)(2) make clear that after an *ex parte* order is obtained, the person whose assets are restrained is entitled to a hearing before that restraint can continue. Every case has so held or assumed, including those cited by the Government in its opposition brief. See United States v. Kirschenbaum, 156 F.3d 784, 791 (7th Cir. 1998) (defendant given a hearing when government utilized Section 853(e)(1)(B) and thereafter sought additional restraints through an indictment under Section 853(e)(1)(A); In re Certain Assets of Allen Petty, 2002 WL 1377707, at *1 (converting a TRO under Section 853(e)(2) into a preliminary injunction under Section 853(e)(1)(B)); United States v. Jamieson, 189 F. Supp. 2d. 754, 756 (N.D. Ohio 2002); In re Protective Order on Intergroup Investment Corporation's Account, 790 F. Supp. at 1144. Even the Government's brief refers to the law requiring a Section 853(e)(1)(B) hearing (Gov. Br. at 21), while continuing to try to convince the Court that it has utilized something else for part of its application for a freeze.

So, as 206 assets have been restrained without being enumerated in the Indictment,⁴ and therefore must have been restrained under Section 853(e)(1)(B) or (e)(2) (or else there was no basis at all), Mr. Scrushy is entitled to a hearing on the continued restraint of those assets now.

B. A Post Seizure Hearing Is Required Even When The Government Utilizes Section 853(e)(1)(A) As The Basis For An Asset Freeze

The Government takes the position that neither Mr. Scrushy nor any person whose assets have been restrained pursuant to Section 853(e)(1)(A) is entitled to seek judicial review of the Restraining Order prior to fighting the charges at trial. See Gov. Br. at 13-19. It is simply wrong. Even those cases which the Government cites in support of this argument hold only that the Constitution does not require a hearing. Gov. Br. at 13-16. Those cases do not reach the conclusion as to whether such a hearing should (or could) occur, especially under the circumstances (i.e., where the Government is seeking to restrain demonstrably “untainted” assets) of this case.

The Government places most of its weight on the Eleventh Circuit’s decision in United States v. Bissell, 866 F.2d 1343 (11th Cir. 1989). As a threshold matter, the Government concedes that Bissell may not have continuing vitality in light of holdings

⁴ The Government argues it would be an “administrative burden” to have to proceed in a grand jury for all the assets it seeks. Gov. Br. at 12. This is not a valid excuse in the caselaw. Moreover, the length of its investigation and the number of people involved (dozens just for Mr. Scrushy’s arrest and asset seizure) belie this argument. The real reason is that the Government knows it cannot properly prove to a grand jury that the assets are forfeitable, unless it is willing to mislead that panel and hope this Court would not review its action.

by other circuits that a post-seizure hearing is required by the Due Process Clause. See Gov. Br. at 13.⁵ Even if Bissell continues to be viable, it does not govern the circumstances of this case.

Although the 11th Circuit in Bissell held that a post-seizure hearing was not constitutionally required, the Court noted that the legislative history of Section 853(e) reveals Congress' intent that such a hearing could occur after a restraint was imposed. Bissell, 866 F.2d at 1349 (“the district court does retain authority to hold a post-restraint hearing”). Furthermore, the Government's reliance on Bissell to undercut the necessity of such a hearing is misplaced, as that case was decided in a procedural posture wholly distinct from what this Court faces today. In Bissell, the question of whether a *pre*-trial hearing was required arose as an appellate issue only *after* all of the defendants were convicted. None of the defendants sought such a hearing pre-trial. Moreover, the defendant in Bissell did not assert that “untainted” assets had been erroneously seized. He sought only a ruling that he could use “tainted” assets to pay for his legal counsel. Id. at 1350-51 (“[Defendants] do not contend that the government wrongfully restrained assets having no connection with criminal activity. That is, they do not claim that the government restrained non-forfeitable assets”). But Mr. Scrusby is claiming precisely that -- the Government has wrongfully restrained assets having no connection with

⁵ The Government is so bold in its power play to hold on to all of Mr. Scrusby's untainted assets that it even asserts that, in this circuit, a defendant has “no right to a pre-trial hearing . . . even if the Sixth Amendment right to counsel is clearly implicated.” Gov. Br. at 14, n. 3. It makes this assertion even though every other circuit has ruled to the contrary and the Government would not dare assert this position in cases pending in those other circuits. See Gov. Br. at 13.

criminal activity. If anything, it would appear that Bissell actually supports Mr. Scruschy's request in this situation. When the Bissell court referred to the legislative history of Section 853, it specifically set out that which Mr. Scruschy is seeking to do here. Id. at 1349 ("At a hearing, the defendant may undertake to prove that *the government wrongfully restrained specific assets which are outside the scope of the indictment, not derived from, or used in, criminal activity . . .*") (emphasis added).

Some variation of the requirement for or availability of such a hearing has been affirmed by numerous courts, again even those cited by the Government. See United States v. Jones, 160 F.3d 641 (10th Cir. 1998); United States v. Monsanto, 924 F.2d 1186 (2nd Cir. 1991); United States v. Farmer, 274 F.3d 800 (4th Cir. 2001); Kirschenbaum, 156 F.3d 784; United States v. St. George, 241 F. Supp. 2d 875 (E.D. Tenn. 2003); United States v. Ziadeh, 230 F. Supp. 2d 702 (E.D. Va. 2002); Jamieson, 189 F. Supp. 2d 754. Indeed, several courts have noted that the Eleventh Circuit's Bissell decision is the *only* one in which such a hearing is not actually required by the Constitution. See Farmer, 274 F.3d at 802 (4th Cir. 2001); Monsanto, 924 F.2d at 1191.

When it grudgingly acknowledges the cases which have required or provided for Section 853(e) hearings, the Government then seeks to create a hard and fast rule that before a defendant can get such a hearing, he or she must indicate that all of his or her assets are frozen and that he needs assets released to pay attorney's fees. Gov. Br. at 14-16. There is no such rule.

In every case relied on by the Government, there was an indictment which set out the specific property that it sought to restrain under the provisions of Section 853(e)(1)(A). Gov. Br. at 15-16. Here, the Government has sought restraints by

conflating the procedures under both prongs of Section 853(e) -- (1)(A) and (1)(B). Regardless of whether or not such a pre-condition always exists when the only assets sought are enumerated in the indictment, no case has created such a requirement when the assets are listed outside an indictment, as in the Traywick Affidavit in this case. In addition, the cases cited by the Government are those in which the indictment set out the “tainted” assets and stated that it would seek to forfeit only those “tainted” assets at the conclusion of trial. Here, the Indictment makes a broad and general assertion that the defendant obtained \$278 million improperly (Indictment, Count 71, p.34), and then makes no attempt to match that figure with the specific assets it seeks to restrain. This is a critical difference because it is in this way that the Government, despite its protestations to the contrary, is trying to bootstrap a theory of pre-trial restraint of “substitute” assets into this case. See Point III, D, *infra*.

Interestingly, Bissell, which the Government relies on for one purpose -- to avoid judicial review of its actions, authorized a hearing in which the defendant was entitled to challenge the Government’s asset restraint, but makes no mention of any threshold requirement that a defendant demonstrate that assets need to be released to pay attorney’s fees. The Government fails to mention this aspect of Bissell.

For its proposition that such a pre-condition exists, the Government relies most heavily on United States v. Farmer. However, in Farmer, the Government proceeded before indictment by way of a civil proceeding during which the defendant never had a hearing. The basis for the proceeding was the seizure of the same assets that ultimately appeared in the indictment. There was no attempt by the Government to seize all assets to hold them for an eventual judgment. It was only after this civil proceeding and

seizure, two years later, that the Government indicted the defendant, and sought to forfeit only the specific items that had been seized before. It was the proceedings post-indictment that the court reviewed. Farmer, 274 F.3d at 803.

Here, the Government seeks its restraint, both inside and outside of the Indictment, with a generalized statement of an overall forfeiture amount and none of the specific tracing that occurred in Farmer. In other words, the defendant in Farmer sought to show that the specific assets the Government alleged to be forfeitable were not “tainted.” Unlike in Farmer, the Government here has quite openly and purposefully seized assets which it even concedes include “untainted” assets. See, e.g., Traywick Aff. ¶¶ 7, 21, 23, 25, 27, 31, 35. In fact, the Farmer opinion is instructive when a defendant makes a claim, as Mr. Scrushy can here, that the Government *knows* it has restrained “untainted” assets. In providing for a hearing, the Fourth Circuit noted that a Government agent in that case conceded that some of the merchandise seized was related to a legitimate business. Id. at 805. That prompted the court’s inquiry into an erroneous basis for the seizure. The Government here has conceded the same. See Traywick Aff. at ¶¶ 7, 21, 23, 25, 27, 31, 35; see also, St. George, 241 F. Supp. 2d at 880 (noting the court’s role when the government admits it is holding on to more assets than it can properly forfeit).

As to the other cases the Government cites, many require or speak to a defendant having to make a threshold showing of need (all assets have been frozen) to use frozen assets for attorneys fees, but do so when the Government begins by seeking only that which is ultimately forfeitable as “tainted” assets and only when the Government has properly enumerated those “tainted” assets in a properly drawn indictment. See St.

George, 241 F. Supp. 2d at 878; Jamieson, 189 F. Supp. 2d at 756-57; Kirschenbaum, 156 F.3d at 788-89; Jones, 160 F.3d at 646-47; United States v. Michelle's Lounge, 39 F.3d 684, 694 (7th Cir. 1994). The reach of the Government's request here is much broader -- it seeks to restrain assets that include proceeds of perfectly proper and legal activity.⁶

C. At The Post-Seizure Hearing, This Court Is Not Required Blindly To Accept Erroneous Conclusions Made By The Government

After arguing that this Court may not review its actions to seize all of Mr. Scrusy's assets -- "tainted" and "untainted" -- prior to trial, the Government then suggests to the Court that it cannot conduct much of a review because it is bound by the "probable cause" findings of the grand jury and Agent Traywick. Gov. Br. at 19-22. Again, the government states more than the law holds.

There is no presumption of dispositive effect given to an IRS agent's government-serving, one-sided affidavit used to restrain assets. That is precisely why a restraint utilizing the Section 853(e)(1)(B) procedure requires a post-seizure hearing. See

⁶ The Government points to a new Agent Traywick affidavit indicating sums Mr. Scrusy transferred to various counsel, presumably to show that Mr. Scrusy could not make the showing of need in the cases on which it relies. Putting aside the difference in the cases, this Court can take judicial notice that a Delaware court recently ordered Mr. Scrusy to pay \$25 million, more than what has been transferred to counsel in the past, and that the rest of Mr. Scrusy's assets remain frozen. Even if a precondition of demonstrating need existed in the context of what the Government has done in this case, it puts form over substance to conclude Mr. Scrusy has not met it. Indeed, the fact that the Government concedes that it has agreed to release funds so that Mr. Scrusy could pay bills and operate his business indicates that it recognizes that Mr. Scrusy has such a need.

Kirschenbaum, 156 F.3d 784; In re Certain Assets of Allen Petty, 2002 WL 1377707, at *1. At the hearing held to explore the basis for the Government's restraint of assets not contained in the Indictment, the Government will have the burden of showing its probable cause to find an act allowing forfeiture, and that the assets it seeks to freeze are subject to that forfeiture. See Section 853(e)(1)(B); In re Certain Assets of Allen Petty, 2002 WL 1377707, at *1-2; Jamieson, 189 F. Supp. 2d at 758. In addition, as with any application for a preliminary injunction, the Government will have to offer proof that it should be granted the relief sought. See Jamieson, 189 F. Supp. 2d at 756 (Fed. R. Civ. P. 65's burdens for injunctive relief apply in a Section 853(e)(1)(B) setting); In re Certain Assets of Allen Petty, 2002 WL 1377707, at *1 (citing United States v. Thier, 801 F.2d 1463 (5th Cir. 1986) where court applied requirements of Fed. R. Civ. P 65 in a forfeiture setting).⁷

With respect to a hearing looking at assets enumerated in an indictment under Section 853(e)(1)(A), the court continues to play its role of safeguarding against injustice and constitutional infirmity. See Monsanto, 924 F.2d at 1200. In this asset-enumerated-in-indictment setting, Mr. Scrushy agrees that he may not attack the grand jury's findings that there was probable cause that he committed certain offenses, but he certainly may

⁷ Again, it seems the government recognizes it has this burden in Section 853(e)(1)(B), Gov. Br. at 20, which is why it strains so mightily to argue that its agent's affidavit is based on some other (unknown and uncited to) procedure.

question the Government's having caused the grand jury to find that various assets can be traced to that impropriety. This is precisely what the cases hold.⁸

To begin with, the legislative history confirms the court's role in making this inquiry. See e.g., Jones, 160 F.3d at 644; Moya-Gomez, 860 F.2d 706, 727-28 (“This provision [853(e)(1)(A)] does not exclude, however, the authority to hold a hearing subsequent to entry of the order and the court may at that time modify the order or vacate an order that was clearly improper (e.g., where the information presented at the hearing shows that the property restrained was not among the property named in the indictment”). And these decisions have confirmed that a trial court should ensure that the Government is not doing exactly what the Government is attempting here – the pre-verdict restraint of “untainted” assets. Jones, 160 F.3d at 647-48 (once a defendant shows he meets his requirements to have a hearing, “due process requires a district court to conduct an

⁸ In Mr. Scruschy's opening brief, he referred to United States v. Thier, 801 F.2d 1462 (5th Cir. 1986) as precedent for the court's inquiry of a government request for a pre-trial freeze of assets even in a Section 853(e)(1)(A) indictment setting, as was the case in Thier itself. Opening Br at 10-11. The Government makes the completely unsupported argument that Thier has been “overruled” by the Supreme Court's decision in United States v. Monsanto, 491 U.S. 600 (1989). Gov. Br. at 20-21. No more has to be said about this misstatement by the Government to the Court other than that Thier continues to be cited with approval by cases after Monsanto, including the Monsanto case *itself* after it was remanded for proceedings consistent with the Supreme Court's decision. See United States v. Monsanto, 924 F.2d at 119. See also In re Certain Assets of Allen Petty, 2002 WL 1377707, at *1 (a 2003 opinion) but see, Jamieson, 189 F. Supp. 2d at 756 (court in the Sixth Circuit states *not* that Thier was overruled but only that §853(e)(1)(A) “overrides” Rule 65). The Government similarly seeks to bury its head in the sand when it asserts that Grupo Mexicano de Desarrollo, S.A. v. Alliance Bond Fund, Inc., 527 U.S. 308 (1999) is a “civil case [which] has absolutely no application to the present matter.” Gov. Br. at 21. To the contrary, GMD, by its own terms, governs the application of Fed. R. Civ. P. 65 regardless of the nature of the case in which it is utilized.

adversarial hearing at which the Government must establish probable cause to believe that the restrained assets are traceable to the underlying offense”); St. George, 241 F. Supp. 2d at 879 (same).

Courts have recognized that grand juries normally do as they are asked by Government prosecutors and this can be especially problematic in a pre-trial forfeiture setting where there has been no test of the Government’s claims. See Jones, 160 F.3d at 646 (“[T]he nature of grand jury proceedings makes that finding [that assets were subject to forfeiture] susceptible to error. A grand jury investigation is not an adversarial process. For all practical purposes the prosecution directs the proceedings . . . and indictees have no ability to correct inadvertent or deliberate distortions during the grand jury’s fact-finding process.”).

This circumstance -- a grand jury being inadvertently or deliberately misled about freezing “untainted” assets -- is exactly what Mr. Scrushy is alleging and what should be explored at the hearing. See Monsanto, 924 F.2d at 1200 (“grand jury determinations of probable cause may be reconsidered by district courts in ruling upon the continuation of post-indictment restraining orders”).

III The Government Cannot Meet Its Burden Of Demonstrating That All of Mr. Scrushy’s Assets Have Been Properly Restrained

A. The Government Is Collaterally Estopped From Restraining \$49 Million Of Mr. Scrushy’s Assets

The Government denies that it is collaterally estopped from restraining at least \$49 million of Mr. Scrushy assets because “the SEC and the United States (who is

represented in this criminal action by the U.S. Attorney's Office for the Northern District of Alabama and the U.S. DOJ, Criminal Division, Fraud Section) were clearly not in privity with one another in the SEC's asset freeze action before Judge Johnson."⁹ Gov. Br. at 4. While it is certainly true that "United States entities are not in privity under all circumstances, and that one United States entity or officer can sue another under the proper circumstances and legal provisions" (Gov. Br. at 5), separate government entities are routinely treated as one for *res judicata* and collateral estoppel purposes. See Opening Br. at 16. And if ever there were a case where one Government entity should be precluded from resurrecting an issue previously litigated to its conclusion by a different Government entity, this is it.

As a threshold matter, the SEC's objective in the hearing before Judge Johnson is identical to the Government's goal here -- to restrain all of Mr. Scrusby's assets and to keep them restrained until the conclusion of the criminal trial against him. Counsel for the SEC admitted that he was seeking an asset freeze "until the criminal proceedings are over with." SEC v. HealthSouth Corp., 261 F. Supp. 2d 1298, 1303 n.4 (N.D. Ala. 2003). United States Attorney Alice Martin recently echoed that goal in comments made to the Birmingham News and Wall Street Journal on November 27 and 28: "we are trying to position it so that in the event of a guilty verdict, these assets are in place. "

⁹ Despite the Government's effort to suggest something to the contrary, the party in both the SEC action and this case is the United States. The Court made this point clear during the asset freeze hearing. Tr. at 473:19-474:1.

The Government cannot now credibly deny that it was wholly supportive of the SEC's strategy in the asset freeze hearing (and very likely its architect) and that it rendered material assistance to its execution.¹⁰ The manifestations of the assistance rendered by the Department Of Justice (the "DOJ") and the U.S. Attorney's Office (the "USA") to the SEC are multifold.

The very foundation of the SEC's Complaint and the evidence it presented during the Asset Freeze Hearing were based upon DOJ plea agreements and colloquies, Rule 11(f) statements and criminal informations of a handful of DOJ witnesses. Id. at 1305 ("[t]he court notes that the majority of the evidence presented by the SEC, for the purpose of this court maintaining the asset freeze, results from criminal investigations."). See also id. at 1307. In fact, the SEC admitted that its complaint was copied, typos and all, from the Weston Smith guilty plea agreement. Id. at 1303. Other witnesses who testified at the Asset Freeze Hearing were also interviewed by the DOJ and the USA about their testimony. Id. at 1314. The SEC's use of the fruits of the criminal investigation was so endemic that it led Judge Johnson to "question[] the SEC, a civil investigatory body, for its use of the FBI to undertake discovery for this civil action, when the consequence of such methods is that the product of the FBI's labor is non-discoverable to the defendant

¹⁰ Infighting arising from the inefficacy of the SEC's case does not "underscore the fact that the SEC and the United States did not act as a single entity in that proceeding," as the Government suggests. Gov Br. at 5. The Court need only look to the initiation and conduct of the SEC case, which was based solely on evidence and plea agreements developed by the DOJ and the FBI, rather than their acrimonious behavior which accompanied the SEC's unsuccessful efforts.

in this civil proceeding.” Id. at 1305. The same fruits of the criminal investigation form the basis for the Indictment here.

A specific piece of evidence that played a significant role in the SEC’s (ultimately unsuccessful) case (and assumedly will play a significant role in the Government’s case here) is a surreptitious recording of Mr. Scrusby taken by Bill Owens, at the request of the FBI and the USA. Id. at 1306. The CD Rom containing the conversation was offered into evidence by the SEC through FBI Agent Greg Gauger.¹¹ Id. at 1305. Incredibly, counsel for the SEC claimed that he had not even heard the conversation until it was played in open court by Agent Gauger. Id. In fact, the SEC claimed that it needed permission from the FBI to provide a copy of the CD Rom to Mr. Scrusby’s counsel because it was, at all times, in the custody of the FBI. Id. at 1306, 1312.

FBI agents also assisted with other aspects of the SEC’s case, even contacting witnesses immediately prior to their testimony during the Asset Freeze Hearing. Judge Johnson concluded that “[i]t is obvious from the timing of the FBI’s contact with [a witnesses’ daughter] that the FBI was using this civil proceeding to glean evidence it might use in its criminal investigation of defendant Scrusby.” Id. at 1311. Judge Johnson viewed the FBI’s contact with witnesses, and subsequent interactions with the SEC about those witnesses, as so troubling that she felt obliged to remind “the SEC that witness tampering, by the SEC or the FBI, was illegal under 18 U.S.C. § 1512(b). Id. at 1312.

¹¹ Two FBI administrators, Taura Cobb and Oralyn Green, also testified about the chain of custody of the CD ROM. Tr. at 258:13-305:7.

The SEC's collaboration with the DOJ and the USA's office was so endemic that, after several days, it led Judge Johnson to order that the two branches should have no further contact during the proceeding. Gov. Br. at 6, n.3.¹² But even Judge Johnson's order could not quell the DOJ's and the USA's involvement in the Asset Freeze Hearing. Richard Smith (a signatory of the Indictment and the Government's opposition brief here) from the DOJ was a fixture at the hearing, attending virtually every day of the proceeding, filing motions to intervene, along with USA Alice Martin, on five separate occasions (id. at 1308 n.14), and objecting to the defendant's questioning of no fewer than 5 witnesses on the grounds that they "pled guilty as part of the ongoing investigation." Id. at 1313-14. Pat Meadows from the USA asserted similar objections. Id. at 1311. The Court also noted that "Mr. Hood and Ms. Simmons from the United States Attorney's Office had been present for the entire proceeding." Id. at 1309, n.16.

It should be apparent that the SEC and the DOJ/USA worked hand in hand during the Asset Freeze Proceeding and that the factual allegations and legal theories that formed the basis for the SEC Complaint and asset freeze are identical to those that form the basis for the Indictment and the Restraining Order.

The only material differences between the SEC's case and the criminal case commenced by the Government here are the applicable burden of proof and the statute of

¹² In an admirable but puzzling attempt to turn lemons into lemonade, the Government now claims that Judge Johnson's decision "supports their argument that the SEC and those entities were not closely aligned." Gov. Br. at 6 n. 3. To the contrary, Judge Johnson issued her ruling precisely because the two Government agencies were so closely aligned that their continued interaction infringed upon Mr. Scrusby's due process rights.

limitations. At the asset freeze hearing, the SEC was only required to prove a likelihood of success on the merits (a burden which it woefully failed to meet) and, because the court was acting as a court of equity, the SEC was not bound by any statute of limitations. See SEC v. McCaskey, 56 F. Supp. 2d 323, 326 (S.D.N.Y. 1999) (“No statute of limitations applies to the SEC’s claims for equitable remedies”) (citations omitted). Here, by contrast, the Government is required to prove guilt beyond a reasonable doubt and is limited to the period of wrongful conduct alleged in the Indictment. As a consequence, this “difference” pointed out by the Government works against it -- it could not make its showing with a lower burden of proof and no restrictions on the applicable time period. Nor does the fact that Judge Johnson gave the SEC leave to replead the Court for an asset freeze “should it adduce evidence to justify such a freeze in the future” help the Government’s cause here. Gov. Br. at 9 (citing HealthSouth Corp., 201 F. Supp. 2d at 1330). Rather, Judge Johnson stayed the SEC’s case in its entirety “pending the resolution of any criminal charges against Scrushy.” HealthSouth Corp., 281, F. Supp. 2d at 1330. As such, Judge Johnson’s finding that “defendant Scrushy proved that at least 49 million dollars of his assets since 1993 are not derived from HealthSouth income, bonus or stock” bind the Government here as it would not be more successful under a higher burden now. HealthSouth Corp., 261 F. Supp. 2d at 1315.

In short, the Government chose a strategy, took its best shot, eyes wide open, relying on a lower burden of proof and lost. But regretting its strategy decisions made last April does not entitle the Government to a second bite of the apple. Fully cognizant of Judge Johnson’s opinion, the Government went to the grand jury (and to this Court) and asked for probable cause findings inconsistent with what a federal judge had already

decided. The Government should be directed to account for and release \$49 million in assets previously determined by Judge Johnson to be untainted.

B. The Government Has Improperly Restrained Untainted Assets Based On The Legally Flawed Theory That They Have Been “Improved” By Tainted Assets

The Government plainly acknowledges that it has restrained assets that were acquired by Mr. Scrushy “prior to the time period of the conspiracy alleged in the Indictment” and were therefore, at the time of their acquisition, “untainted.” Gov. Br. at 27. However, without citation to any authority whatsoever, the Government claims that, “if the proceeds of illegal activity are subsequently used to improve that property, for example, that property then becomes ‘tainted’ and may be restrained as being subject to forfeiture.” Gov. Br. at 27 (emphasis omitted). When extended to its logical (or illogical) conclusion, the Government’s interpretation would result in it having the right to restrain, pre-trial, the entirety of a \$10 million house purchased with untainted assets on the grounds that it was subsequently “improved” by the addition of a \$100 door knob purchased with tainted money. Or, that the Government could restrain a \$10 million bank account funded with untainted money because \$1 in tainted money was added to it. The Eleventh Circuit, and other courts, have held to the contrary.

In United States v. Puche, 2003 WL 22663310, at *13 (11th Cir. Nov. 12, 2003), the Court, relying on the Tenth Circuit’s decision in United States v. Bornfeld, 145 F.3d 1123, 1135 (10th Cir. 1998), held that “[t]he mere pooling or commingling of tainted and untainted funds in an account does not, without more, render the entire contents of the account subject to forfeiture.” In another case, the Seventh Circuit described the Government’s efforts to restrain a defendants’ untainted assets on the grounds that they became tainted through the commingling with tainted assets as follows:

This approach treats the accounts as criminals, taking the concept of deodands one step further (an account is not even a tangible object). Bank accounts do not commit crimes; people do. It makes no sense to confiscate whatever balance happens to be in an account bearing a particular number, just because the proceeds of crime once passed through the account . . . An ‘account’ is a name, a routing device like the address of a building; the “money” is the property. Once we distinguish money from its container, it follows that the presence of one illegal dollar in an account does not taint the rest – as if the dollar obtained from fraud were like a drop of ink falling into a glass of water.

United States v. \$448,342.25, 969 F.2d 474 (7th Cir. 1992). See also United States v. Account No. 50-2830-2, 857 F. Supp. 1534, 1540 (M.D. Ala. 1994) (holding that “the illegal deposit of \$316,911 in cash did not ‘like a drop of ink falling into a glass of water’ contaminate the entire defendant account.”). The restraint or forfeiture of commingled funds is only proper when the government “demonstrates that the defendant pooled the funds to facilitate or disguise his illegal scheme.” Puche, 2003 WL 22663310, at *13. See also Bornfeld, 145 F.3d at 1135; United States v. Tencer, 107 F.3d 1120, 1135 (5th Cir. 1997).

But the Government in this case cannot, either as a legal or a factual matter, restrain untainted assets on the grounds that they have been pooled with tainted assets to disguise an illegal scheme. Significantly, the “facilitation” theory can only be utilized by the Government in connection with money laundering charges brought pursuant to 18 U.S.C. § 1956. See, e.g., Bornfeld, 145 F.3d at 1135. This is because the transaction charged under 18 U.S.C. § 1956(a)(1)(B)(i) is undertaken with “the intent to conceal or disguise the nature, the location, the source, the ownership, or the control of the proceeds of specified unlawful activity.” Id. Under such circumstances, it is easy to see why, when a transaction is executed with this alleged intent, there is a likelihood that there will be “facilitating” property involved. Contents of Account Numbers 208-06070 and 208-

06068-1-2, 847 F. Supp. 329, 334-35 (S.D.N.Y. 1994) (quoting United States v. Certain Funds on Deposit in Account No. 01-0-71417, 769 F. Supp. 80, 84-85 (E.D.N.Y. 1991)) (holding that forfeiture of legitimate and illegitimate funds commingled in accounts was proper as long as the Government demonstrated that the defendant had pooled the funds to disguise the nature and source of his scheme).

In this case, the Indictment alleges a money laundering violation under 18 U.S.C. § 1957 which has no such intent provision. Accordingly, the Government has not alleged an intent to conceal or disguise, as would be necessary in order to avail itself of the facilitation theory. Nor as a factual matter could the Government in good faith make such an allegation, considering that Mr. Scrusby has owned and maintained many of the commingled assets for decades, has done nothing to transfer them offshore or to transfer them to different ownership, and has used his normal accounts for all of these transactions.

The Government's efforts to support their house of cards with dubious accounting theories amount to a legal fiction in the face of hard facts. Those facts are that only certain amounts of what the Government contends are "proceeds" went into the accounts which have been restrained in their entirety. The Government provided the Court with no information regarding the amounts that went into these accounts, what the balances have been over time or how much untainted money was in the accounts when the alleged tainted money was added. There is no explanation of which accounting theory they utilized or what evidence they have to support the selected accounting theory on the 206 un-indicted assets delineated in Attachment 1. See Marine Midland Bank v. United States, 1993 WL 158542, at * 7-8 (S.D.N.Y. May 11, 1993) (refusing to apply facilitation

theory where legitimate funds in account had merely an “incidental or fortuitous” connection to illegal activity), aff’d in part, remanded in part, 11 F.3d 1119 (2d Cir. 1993).

Forfeiture of innocent funds in accounts along with tainted funds has been referred to as “the nearly limitless contagion the Government seeks to release into the banking system.” United States v. Contents in Account No. 059-644190-69, 253 F. Supp. 2d 789, 799 (D. Vt. 2003). Tainted funds may be traced *either* to the account into which they are first deposited *or* through subsequent transfers to additional accounts or assets. Under the apparent Government theory here, when allegedly tainted funds are commingled with innocent funds, those innocent funds become similarly contagious and forfeitable. This is not the status of the law. Since there is no statutory allegation charging that the accounts “facilitated” the alleged money laundering (no could there be), any additional funds or assets must be released.

The Government claims that it is able to freeze certain assets in their entirety because it has traced those assets by maintaining separate “running balances” of clean assets and criminal proceeds. Gov. Br. at 25. In seeking to freeze untainted assets that have been commingled with allegedly tainted assets, however, the Government must make elections as to their accounting options. See United States v. Banco Cafetero Panama, 797 F.2d 1154, 1159 (2d Cir. 1986). One approach is the “lowest intermediate balance” approach, under which if a certain amount of tainted money is deposited into an active bank account, that account is considered “traceable proceeds” to the extent of that amount, as long as the account balance never falls below that sum. Id. Under the second approach allowed by the Banco Cafetero court, the Government may consider “traceable

proceeds” to be any one withdrawal that equals or exceeds the amount of tainted money deposited or any asset purchased with such withdrawal. Id. However, the Government has done nothing to meet its burden under either standard. Rather, the Traywick Affidavit does not reveal anything regarding the tracing of the proceeds of alleged illegal activities but instead contains only conclusory allegations that the agent possesses sufficient unspecified information about the asset or account in question which permit restraint based upon accounting principles that are not explained.

The Government’s improper restraint of untainted assets on the grounds they have been commingled with tainted assets is of monumental consequence in this case. A review of only five of the 247 assets restrained reveals that the Government has improperly restrained significant assets -- at least \$22.6 million in these five assets alone -- on the grounds that they have been tainted as a result of being “improved” by tainted funds. Supplemental Affidavit of Byron Luke dated December 9, 2003 at ¶¶ 5-10. Because the Government has relied on a flawed legal theory to restrain assets that are indisputably untainted, those assets must be released from the purview of the Restraining Order.

C. The Government Has Conceded That It Has Restrained Substitute Assets, Something The Law Does Not Allow Before Verdict And Judgment

Despite its current protests to the contrary, (Gov. Br. at 26-27), the Government has, in effect, done exactly what it states it was not doing -- keeping “substitute” assets in a pre-trial setting. Once it is clear that it can trace only some parts of the assets it has seized and once it gets the benefits of holding onto what it can in each asset listed -- either by the “first in, last out” theory or any other, (see Banco Cafetero), the rest of what it is holding amounts to “substitute assets.” What else can they be? No authority gives

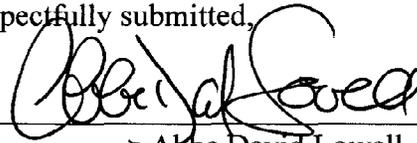
the Government the right to attach assets it cannot trace, yet it has frozen all of Mr. Scrushy's assets. The difference between what it holds and what it can trace, is a Government attempt to hold property now that is not traceable to illegal proceeds or conduct in order to satisfy a forfeiture judgment it hopes to obtain at verdict. That is the definition of "substitute" assets, and it is something that the courts of appeals have rejected. See Opening Br. at 20-22.

CONCLUSION

By sleight of statutory hand, the Government asks this Court to condone its pre-trial, pre-verdict freeze of all of Mr. Scrushy's assets, whether "tainted" or not, without judicial review. For the reasons above, the Government does not have that power, and the relief requested herein should be granted.

Respectfully submitted,

By



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**IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ALABAMA
SOUTHERN DIVISION**

UNITED STATES OF AMERICA,

v.

Case No. CR-03-BE-0530-S

RICHARD M. SCRUSHY,

Defendant.

SUPPLEMENTAL DECLARATION OF BYRON B. LUKE

Alabama, Jefferson County

1. My name is Byron B. Luke. I am of legal age, laboring under no disabilities and otherwise competent to testify to all the matters set forth herein, all of which are within my personal knowledge.
2. I am a Managing Associate of FCL Advisors, Int'l, LLC, a Virginia Corporation engaged in the business of providing forensic accounting services. I am a licensed Certified Public Accountant in the State of Texas. I have more than twenty years experience in public industry accounting, including tax accounting and investigative auditing.
3. FCL Advisors, Int'l, LLC, has been retained by Mr. Scrushy through his legal counsel to gather and review financial records relating to the charges lodged by the Department of Justice (hereafter the Government) against Mr. Scrushy including the forfeiture allegations contained in the Indictment.

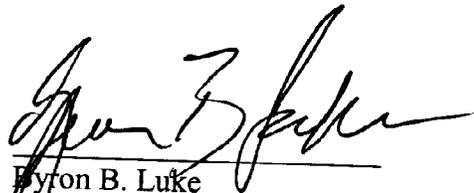
4. I am submitting this affidavit in support of the Defendant's Reply Brief for the Defendant's Motion to Modify the Court's Restraining Order Dated November 3, 2003.
5. The property referred to by the government as the "residence and compound located at 2406 Longleaf Street, Birmingham" is in fact two distinct tracks of land. (Indictment Count 71(a) and Attachment 1 pp. 12-14). The first is the Scrushy residence which is made up of five and a half separate parcels. The home and the parcel it sits on were purchased in 1989. In 1991 Scrushy bought four and a half surrounding parcels as a subdivision, divided the tracts and made them available. The purchase price for all of these properties was approximately 1.5 million dollars. The present market value is approximately 5 million dollars. No more than \$100,000 in improvements have been made to this property since 1996.
6. The second parcel in the land immediately to the south of the residence is a tract of land deeded in 1994 to Scrushy as part of a bonus from HealthSouth. This tract of land is commercial in nature with structures that operate as office and warehouse for Marin Incorporated. It is this commercial parcel, if any, to which the government could try to make claim.
7. With regard to the Ono Island property which is described on page 26 of Attachment 1 as "residence and real property located at Lot 101, unit one, Ono Island," this property was purchased in September of 1991. It is worth approximately 1.5 million dollars at present. I have no information nor seen any indicating that any funds to improve this property were spent after January 1996.
8. Mr. Scrushy's Palm Beach home, listed in Count 71(d) of the indictment, was purchased on March 19, 2001. The home was purchased with 5 million dollars of funds which are directly

traceable to the sale of Caremark stock. This stock was acquired prior to January 1996 and has no relationship to the charges in this case. This constitutes 46% of the total purchase price of the property. Forty six percent of the current value of this property would be 6.4 million dollars.

9. Mr. Scrushy's Orange Beach property listed on page 14 of Attachment 1 was purchased for 2.8 million dollars in October of 2002. This amount resulted from the proceeds of the sale of the "Tangier" property in Palm Beach in August 2002. The Tangier property, in turn, was acquired through the sale of an additional amount of Caremark stock. The Caremark stock, in turn, was acquired prior to January 1996. Its current fair market value remains approximately 2.8 million dollars.
10. With regard to SouthTrust Securities account referenced on page 5 and 32 of Attachment 1, Agent Traywick states that 3.8 million in tainted funds went into the account. I have traced 4 million dollars in Capstone stock which was sold into that account along with 5 million dollars from Morgan Stanley Left Associates which was deposited into the Soloman Smith Barney account in New York. Seven million dollars of these funds were transferred to the SouthTrust Securities account. The government has claimed 3.8 million dollars of an account that has a balance of 13 million. Of the balance remaining which is 9.2 million dollars, I can account for at least 7 million dollars of these funds from transactions described above which would not include any of the funds the government alleges to have been derived from Mr. Scrushy's improper conduct.

Pursuant to Title 28, United States Code, Section 1746, I certify under the penalties of perjury that the contents of the foregoing are true to the best of my knowledge, information and belief.

This 9th day of December, 2003.


Byron B. Luke

**IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ALABAMA
SOUTHERN DIVISION**

UNITED STATES OF AMERICA,

v.

Case No. CR-03-BE-0530-S

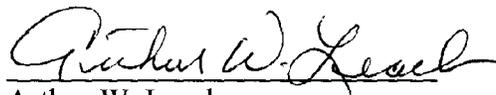
RICHARD M. SCRUSHY,

Defendant.

CERTIFICATE OF SERVICE

I certify that I have this day, December 9, 2003, served a true and correct copy of the foregoing Motion to Modify the Court's Restraining Order Dated November 3, 2003, upon the United States Government and their counsel by hand delivery to the office of the United States Attorney in Birmingham, Alabama to the attention of the following government lawyers:

Alice Martin, United States Attorney
Richard C. Smith, Deputy Chief, Fraud Division
Michael Rasmussen, Assistant United States Attorney
James Ingram, Assistant United States Attorney



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