Dusting Off FIRREA: Old Statute Poses Challenges for Financial Institutions

Skadden

January 2015

This article is from Skadden's *2015 Insights* and is available at skadden.com/insights.

Contributing Partners

Boris Bershteyn
New York

John K. Carroll
New York

A long-dormant law can become an unexpectedly potent weapon in the hands of an assertive prosecutor. And in recent years, few statutes have undergone a rebirth more dramatic — and for some, more troubling — than the civil penalties provision of the Financial Institutions Reform of 1989, Recovery, and Enforcement Act (FIRREA). 12 U.S.C. § 1833a. Enacted in response to the savings and loan crisis but scarcely used over the following two decades, FIRREA has become a favored tool for prosecutors in the aftermath of the recent financial crisis. FIRREA offers prosecutors unusual and powerful advantages, which have only been amplified by the Department of Justice's aggressive interpretations of the statute — interpretations that have, so far, enjoyed a friendly reception from the courts.

In a nutshell, FIRREA authorizes the DOJ to impose civil financial penalties for violations of 14 enumerated criminal statutes. Some of these predicate statutes specifically penalize conduct injuring financial institutions; others sweep more broadly, but only become FIRREA predicates when the defendant's conduct "affect[s] a federally insured financial institution."

FIRREA's hybrid civil-criminal structure gives the DOJ important advantages in developing and litigating FIRREA cases — advantages that are not available under other federal statutes. For example, the DOJ can recover penalties for violations of predicate criminal statutes that it proves by a preponderance of the evidence — not necessarily beyond a reasonable doubt. FIRREA also provides a 10-year statute of limitations — twice the time generally available for federal criminal statutes. And the DOJ can compel production of documents and testimony using administrative subpoenas.

For defendants in FIRREA actions, the potential exposure can be significant. As a general matter, the statute imposes penalties up to $1.1 million (or, for a continuing violation, the lesser of $1.1 million per day or $5.5 million). But — of critical importance in financial crisis cases involving large financial institutions — penalties also can reach the amount of "gain" or "loss" if "any person derives pecuniary gain from the violation, or if the violation results in pecuniary loss to a person other than the violator." Thus, in a case that awaits appeal, *United States ex rel. O'Donnell v. Countrywide Home Loans Inc.*, 12-cv-1422 (JSR) (S.D.N.Y. July 30, 2014), ECF 343, Judge Jed S. Rakoff imposed a $1.3 billion penalty against Bank of America and Countrywide Financial Corporation after a jury verdict of liability. Meanwhile, in the span of less than a year, the DOJ announced a string of massive FIRREA settlements, including a $13 billion settlement with JPMorgan Chase, a $7 billion settlement with Citibank and an over $16 billion settlement with Bank of America.

In pursuing FIRREA cases, the government has advocated — often with success — expansive interpretations of the statute. Among other things, it has urged that a violation of a predicate criminal statute can "affect[] a federally insured financial institution" even when the alleged wrongdoing of the defendant (which is a financial institution) did not appear to target any other financial institution, but imposed litigation costs and reputational harms on the defendant itself. Three district judges in the Southern District of New York have endorsed this self-affecting reading of FIRREA. *See United States v. Bank of N.Y. Mellon*, 941 F. Supp. 2d 438, 451 (S.D.N.Y. 2013); *United States v. Wells Fargo*, 972 F. Supp. 2d 593, 629-30 (S.D.N.Y. 2013); *United States v. Countrywide Fin. Corp. et al.*, 961 F. Supp. 2d 598, 604-05 (S.D.N.Y. 2013).

Four Times Square
New York, NY 10036
212.735.3000

skadden.com

The government also has pushed the boundaries of FIRREA's predicate criminal statutes. For example, in a FIRREA case brought in the Western District of North Carolina, the DOJ alleged that a prospectus supplement for a securities offering by Bank of America contained material misstatements. Complaint, *United States v. Bank of Am. Corp.*, 13-cv-446 (W.D.N.C. Aug 6, 2013), ECF No. 1. But violations of securities laws are not a FIRREA predicate, so the DOJ alleged instead violations of the federal false statements statute, and a statute prohibiting fraud in loan and credit applications. 18 U.S.C. §§ 1001, 1014. The strategy raised significant questions about the incursion on the securities laws by the (FIRREA-enhanced) application of general false-statement statutes — questions only exacerbated by the fact that the Securities and Exchange Commission brought its own action against Bank of America based on the same conduct. Complaint, *S.E.C. v. Bank of Am., N.A.*, 13-cv-447 (W.D.N.C. Aug. 6, 2013), ECF No. 1.

No less important than the scope of FIRREA offenses is the extent of the penalty the DOJ may seek. In that regard, Judge Rakoff's decision in *United States ex rel. O'Donnell* offers little comfort to FIRREA defendants. In calculating the pecuniary "gain" or "loss" from a purported misrepresentation of the underwriting process for mortgages purchased by Fannie Mae and Freddie Mac, Judge Rakoff calculated the maximum FIRREA penalty based on the full sales price of the mortgages — not on a share of that price directly attributable to the misrepresentation. This makes revenue, rather than purportedly unlawful profit, the measure of "gain." Similarly, Judge Rakoff declined to consider whether purchasers' "loss" resulted from the supposed misrepresentation or from exogenous declines in home values.

None of this is good news for prospective FIRREA defendants. The procedural advantages the statute affords the DOJ are formidable. And the DOJ's expansive interpretations of the statute will be hard for defendants to test in appellate courts — not least because the threat of astronomic penalties encourages early settlements of FIRREA cases. So, while the statute's precise scope remains uncertain, the DOJ has undoubtedly dusted off a powerful not-so-new enforcement tool against financial institutions.