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FIRREA Remains Potent Civil Fraud Enforcement Tool

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Despite a proven ability to generate massive recoveries for the federal government and inflict severe financial pain on companies and individuals accused of violating it, the Financial Institutions Reform, Recovery and Enforcement Act continues to operate largely out of the limelight, often overshadowed by the False Claims Act.

But FIRREA enforcement and litigation — and the civil monetary penalties provision — deserve attention as the U.S. Department of Justice continues to use these tools strategically to great effect, as seen in several recent cases.

When courts do speak on FIRREA liability and damages theories, the decisions often are noteworthy because the litigation risk that companies face from FIRREA forces early settlements in most cases, before the courts have an opportunity to rule on substantive legal challenges. In 2019, three court decisions addressing FIRREA's civil monetary penalties provision — two at the final judgment stage and one at the pleadings stage — expand on FIRREA jurisprudence and serve as a reminder of why this statute cannot be ignored.

FIRREA's Civil Monetary Penalties Provision

Congress enacted FIRREA in 1989 in response to the savings and loan crisis. The legislation was intended to strengthen and protect financial institutions and thereby help restore confidence in the financial system. FIRREA is broad in scope, and implemented an extensive regulatory overhaul. This article, however, focuses on one piece of the legislation, 12 U.S.C. Section 1833a, known as the civil penalties provision.

During the first 20 years following its passage, Section 1833a barely caused a ripple in terms of civil fraud enforcement. But, since then, it has emerged as one of the government's most potent tools, resulting in waves of investigations and litigation that have generated tens of billions of dollars in penalty assessments against companies and individuals, including against some of the very financial institutions that FIRREA was intended to protect.

FIRREA's enforcement impact is derived from its unique mechanism for imposing liability. Under Section

1833a, civil monetary penalties can be imposed for violations of certain criminal statutes, including bank fraud and mail/wire fraud affecting a federally insured financial institution.[1] Unlike in criminal prosecutions, however, civil liability under this section merely requires proof on a preponderance of the evidence standard.

The statute authorizes the Department of Justice to issue subpoenas for documents and witness testimony in the investigation phase. And Congress specified a particularly government-friendly 10-year limitations period for FIRREA violations.

Section 1833(a) specifies that the maximum penalty for violations is up to $1 million per violation or up to $5 million for a continuing violation (these ranges are higher now due to subsequent legislation providing for inflation adjustments). However, the provision provides an alternative penalty methodology as well:

> If any person derives pecuniary gain from the violation, or if the violation results in pecuniary loss to a person other than the violator, the amount of the civil penalty may exceed [the standard penalty amounts specified] but may not exceed the amount of such gain or loss.[2]

The contours of this alternative penalty provision have not been extensively litigated, including the question of whether the pecuniary gain or loss is gross or net, but this penalty alternative has led to several multibillion-dollar FIRREA recoveries in recent years.

Congress also provides incentives for whistleblowers to bring potential FIRREA violations to the government's attention.[3] FIRREA whistleblowers who submit declarations of alleged violations to the Department of Justice (and otherwise qualify) are eligible for a substantial award based on the ultimate recovery (e.g., up to $1.6 million of the first $10 million).

Congress does not afford FIRREA whistleblowers the full panoply of rights and responsibilities that it provides to qui tam relators under the FCA, but FIRREA whistleblowers, in certain limited circumstances, may be authorized to prosecute FIRREA actions.[4]

FIRREA Recoveries

FIRREA enforcement has generated massive settlements. In 2018, FIRREA recoveries exceeded $8 billion, mostly from residential mortgage–backed securities, or RMBS, investigations against financial institutions. Recoveries on this scale continued into 2019, with additional individual settlements in excess of $1.5 billion.

By way of comparison, the Department of Justice reported total FCA recoveries of $3 billion in 2019. And the high-water mark for annual FCA recoveries never has come close to $8 billion. This disparity is all the more remarkable given the FCA's treble damages provision (plus penalties).

While the RMBS cases that led to many of these FIRREA recoveries still are wrapping up, the potential for new enforcement initiatives and comparable recoveries remains. FIRREA enforcement activity has extended to the vehicle emissions probe, subprime auto loan industry, and student loan industry, among other targets.

Moreover, from the Department of Justice's perspective, FIRREA enforcement and FCA enforcement are not mutually exclusive. In many cases, including two discussed below, the government has pursued

liability theories under both statutes in the same investigation and litigation, and has taken the position that FIRREA penalties can be awarded based on the same conduct for which FCA damages are collected.

This dual recovery strategy, which raises a host of due process, constitutional and Department of Justice policy concerns, remains largely untested in the courts. The recovery of damages and penalties under both statutes also would appear to run afoul of the Department of Justice's so-called no piling-on policy.[5]

Significant FIRREA Court Decisions in 2019

Because most FIRREA investigations are resolved before they can be litigated on the merits, any occasion for federal courts to weigh in on FIRREA can be noteworthy. We identified three court decisions of interest in 2019, each summarized below.

Hodge

United States v. Hodge is unusual in the affirmative civil fraud enforcement world for the fact that the case — which raised both FIRREA and FCA claims — went through trial and a jury verdict. Putting aside the unique confluence of events that led to a trial, the resulting $300 million judgment against the defendants serves as a powerful reminder of the financial stakes in many of these cases.

The underlying claims in Hodge arose from the conduct of the defendants, formerly known as Allied Home Mortgage Capital Corp. and Allied Home Mortgage Corp., and its CEO, Jim C. Hodge, as loan originators and lenders for federally insured Federal Housing Administration home mortgages.

The FCA allegations, reaching back 10 years and first raised by a qui tam relator in 2011, before the government intervened and filed its complaint, were based on the defendants' use of unregistered branches to originate FHA loans and their so-called reckless underwriting, resulting in losses to the FHA fund when those mortgages later defaulted.

The FIRREA claims, based on the same underlying loan originations, alleged violations of FIRREA predicate offenses for false statements to the U.S. Department of Housing and Urban Development and FHA under 18 U.S.C. Sections 1006 and 1014.

In total, following the jury verdict, the U.S. District Court for the Southern District of Texas imposed FCA damages and penalties of more than $290 million (approximately $279 million in treble damages and $12.95 million in per-claim penalties), and imposed separate FIRREA penalties of $2.2 million against each defendant.

On appeal, the U.S. Court of Appeals for the Fifth Circuit affirmed in all respects. The appeals court essentially determined that there was sufficient evidence to sustain the jury verdict and rejected various challenges to the government's experts. The court did not address legal challenges to the use of FIRREA under these circumstances, and the only FIRREA-related issue decided on appeal was the Fifth Circuit's assessment that an individual could be liable for causing false statements to be made and not just for personally making the false statements.

The Fifth Circuit did not comment on the fact that the government had pursued and obtained damages and penalties awards under both FIRREA and the FCA for the same underlying loan originations. The district court already had rejected the defendants' argument that awarding both FCA and FIRREA civil

penalties would violate the excessive fines clause of the U.S. Constitution by constituting multiple punishments for the same conduct, reasoning that the FCA damages related to the submission of individual FHA insurance claims for defaulted loans while the FIRREA violations related to the submission of annual compliance certifications and other false statements.[7]

By characterizing the underlying conduct as different, the district court sidestepped the question, and the defendants did not raise the issue on appeal. However, this double-recovery question likely will arise again in cases with both FCA and FIRREA allegations.

Luce

Initially filed in 2011, United States v. Luce[8] is a long-running litigation against the individual president of an FHA mortgage originator. The government alleged violations of both FIRREA and the FCA arising out of false statements made by Luce during a three-year period dating back to 2006 regarding his company's eligibility to participate in the FHA mortgage program as a loan correspondent.

According to the government, Luce's prior indictment for various crimes rendered his company ineligible to originate federally insured loans. The U.S. District Court for the Northern District of Illinois initially had entered summary judgment for the government and imposed more than $10.3 million in FCA treble damages and penalties. Although the government had requested an additional $3.4 million in FIRREA penalties, the court assessed no FIRREA penalty based on the government's analysis that Luce lacked the ability to pay that penalty.

Luce then appealed to the U.S. Court of Appeals for the Seventh Circuit, which remanded the case with instructions that the district court assess FCA damages based on a proximate causation standard, rather than a but-for causation standard.[9] On remand, the district court had to determine the proper amount of FCA damages and decide what, if any, FIRREA penalty to impose.[10]

Applying the proximate causation standard to the FCA claims, the district court's new assessment was that no FCA damages were proven. The district court determined that, notwithstanding the false certifications about Luce's past criminal charges, the damages claimed by the government — namely, the losses sustained from mortgages originated by Luce's company that later defaulted — were not proximately caused by Luce's false statements.

In other words, while satisfying a but-for causation standard (that the losses would not have been sustained but for Luce's false certification of eligibility to participate in the program), the government could not show that the mortgage defaults were proximately caused by that certification. The district court therefore reduced the FCA damages to $0 (the government waived FCA penalties on remand).

Turning to FIRREA, and finding changed circumstances, the district court allowed the government to claim FIRREA penalties. The predicate offenses for FIRREA liability purposes were violations of 18 U.S.C. Section 1006 for false statements to HUD, based on the three false certifications of eligibility to participate in the FHA program.

Relying on the standard FIRREA penalty provision, 12 U.S.C. Section 1833a(b)(1), the government asked for the maximum $1.1 million (adjusted for inflation) penalty for each proven false certification, for a total of $3.3 million. The government did not seek a penalty based on FIRREA's alternative pecuniary gain/loss provision.

Unlike the FCA damages causation standard, the district court concluded that FIRREA does not require the government to prove losses under a proximate causation standard. In fact, the government merely had to prove liability for the underlying predicate offense because imposition of a penalty under the statutory language of Section 1833a(b)(1) was not contingent on proof of any losses.

Thus, having decided already that Luce was liable under FIRREA, the court on remand only had to determine the amount of the FIRREA penalty, i.e., whether to impose the maximum $1.1 million amount per offense or some lesser amount.

In evaluating this issue, the district court noted the lack of guidance under FIRREA on this question as well as the lack of prior case law on this topic. In the absence of controlling authority on the question, the court decided that it would make the determination based on the following factors:

> (1) the good or bad faith of the defendant and the degree of his scienter; (2) the injury to the public, and whether the defendant's conduct created substantial loss or the risk of substantial loss to other persons; (3)the egregiousness of the violation; (4) the isolated or repeated nature of the violation; and (5) the defendant's financial condition and ability to pay.[11]

These same factors were applied by the district court in Hodge.[12]

Applying these factors in Luce, the district court assessed a total FIRREA penalty of $500,000. In reaching this decision, the court reasoned:

> Half a million dollars is a substantial sum of money, and it reflects the seriousness of Luce's wrongdoing over a series of years, as well as the fact that there is no good faith explanation for his actions. At the same time, it also reflects that Luce's conduct, while serious, does not put him within the worst class of FIRREA violators.[13]

The district court also addressed Luce's argument that a $3.3 million penalty would violate the excessive fines clause. While this argument should have had resonance given that the government had failed to prove any losses were proximately caused by Luce's conduct, the district court dispensed with it on the grounds that it had imposed the lesser penalty of $500,000 and that it had nonetheless found that some losses had resulted from Luce's conduct, even if not on a proximate cause basis.[14]

USB Securities

In United States v. UBS Securities LLC,[15] the government alleged FIRREA violations arising out of false and misleading statements to RMBS buyers about the characteristics of the underlying loans. The FIRREA claims cover two years of conduct and are based on five separate predicate offenses, including mail/wire fraud and bank fraud.

In contrast to both Hodge and Luce, the claims in this case were brought against only corporate defendants, not any individuals.

The defendants moved to dismiss the complaint for lack of personal jurisdiction under Federal Rule of Civil Procedure 12(b)(1), failure to state a claim under Rule 12(b)(6), and failure to plead fraud with particularity under Rule 9(b).

Specifically, the defendants asserted that the complaint failed to allege that they acted with the

requisite intent and failed to adequately plead the FIRREA predicate offenses. Assuming the truth of the allegations at the motion to dismiss stage, the U.S. District Court for the Eastern District of New York denied the defendants' motion.

Of particular note, in response to the Rule 9(b) challenge, the court held that FIRREA allegations, even those involving securitizations, do not need to meet Private Securities Litigation Reform Act pleading requirements, and such allegations could simply describe the conduct as attributable to the corporate defendants without identifying individual employees.[16]

The court also held that because the defendants allegedly knew that financial institutions were among the RMBS investors, even if the goal was not to harm them, the complaint adequately alleged the elements of bank fraud under 18 U.S.C. Section 1344.[17]

The court further held that violations of the fraudulent bank transactions provision of 18 U.S.C. Section 1005 are not limited to bank insider defendants.[18]

The court, of course, did not make any assessment regarding the merits of the underlying claims, all of which remain allegations only. Even so, the preliminary ruling allows this FIRREA case to proceed, for now.

Takeaways

The civil monetary penalties provision of FIRREA continues to prove itself as perhaps the most potent affirmative civil fraud enforcement tool available to the government. Its 10-year statute of limitations and presuit investigative powers give the government an enormous advantage in these cases, and the risk of loss — as evidenced by the tens of billions of dollars in FIRREA recoveries in relatively few cases over the years — provides the government with tremendous leverage to extract substantial settlements. In the meantime, because so few FIRREA cases are fully litigated, many key legal questions regarding FIRREA's reach and the methodology to be used in the assessment of the alternative penalty provisions remain untested.

As we enter 2020, companies and individuals whose businesses fall within the ambit of FIRREA enforcement should continue to take notice of enforcement efforts and court decisions in this space.

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[1] 12 U.S.C. § 1833a(c)(1) (listing FIRREA predicate offenses as 18 U.S.C. §§ 215, 656, 657, 1005, 1006, 1007, 1014, 1344; 18 U.S.C. §§ 287, 1001, 1032, 1341, 1343 (affecting a federally insured financial institution); and 15 U.S.C. § 645(a)).

[2] 12 U.S.C. § 1833a(b)(3).

[3] See 12 U.S.C. §§4201 et seq.

[4] 12 U.S.C. § 4205(b). See Agarwal v. United States, No. 18-cv-03125 (DLF), 2019 WL 2476613, at *3 (D.D.C. June 13, 2019) ("[S]uits under FIRREA must be brought by the government rather than by a private party."); United States ex rel. Houpt v. Wells Fargo Bank N.A., No. 4:17-cv-00377-CWD, 2019 WL 591441, at *15-16 (D. Idaho Feb. 13, 2019) (granting summary judgment to defendant on individual's FIRREA claims on the grounds that Section 1833a does not authorize an individual to pursue FIRREA penalties on behalf of the government absent express contractual authorization from the US attorney general to do so in a given case).

[5] See, e.g., U.S. Dep't of Justice, Justice Manual, 1-12.100: Coordination of Corporate Resolution Penalties in Parallel and/or Joint Investigations and Proceedings Arising from the Same Misconduct ("[I]n resolving a case with a company that multiple Department components are investigating for the same misconduct, Department attorneys should coordinate with one another to avoid the unnecessary imposition of duplicative fines, penalties, and/or forfeiture against the company.").

[6] United States v. Hodge, 933 F.3d 468 (5th Cir. 2019).

[7] See United States v. Americus Mortg. Corp., No. 4:12-CV-2676, 2017 WL 4117347, at *6 (S.D. Tex. Sept. 14, 2017).

[8] U.S. v. Luce, No. 11 CV 5158, 2019 WL 3003300 (N.D. Ill. July 10, 2019).

[9] United States v. Luce, 873 F.3d 999, 1012-14 (7th Cir. 2017).

[10] Id. at 1014.

[11] United States v. Luce, 2019 WL 3003300, at *10 (quoting United States v. Menendez, No. CV 11-06313, 2013 WL 828926, at *5 (C.D. Cal. Mar. 6, 2013) (internal quotation marks omitted)).

[12] See Americus Mortg. Corp., 2017 WL 4117347, at *7.

[13] 2019 WL 3003300, at *11.

[14] Id. at *12.

[15] United States v. UBS Securities LLC, No. 18-CV-6369 (MKB), 2019 WL 6721718 (E.D.N.Y. Dec. 10, 2019).

[16] Id. at *13.

[17] Id. at *14-15.

[18] Id. at *17.