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Commentary

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Expanding FIRREA Liability for Financial Institutions: Recent Second Circuit Developments

In a brief — and swiftly decided — *per curiam* decision issued June 4, 2015, the US Court of Appeals for the Second Circuit affirmed the wire fraud and wire fraud conspiracy convictions of three former UBS Financial Services, Inc. (UBS) traders, finding that their wire fraud offenses triggered a lengthy 10-year statute of limitations available to prosecutors under the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA).[1] The decision, issued less than a month after oral argument, marks the first time in more than a decade that the Second Circuit has interpreted FIRREA's controversial requirement that an offense "affect" a financial institution. As importantly, this case might foreshadow how the court may interpret the same language with respect to the application of FIRREA more generally.

FIRREA's Expansive Scope

The traders in *United States v. Heinz* had been convicted under FIRREA's lengthier 10-year statute of limitations for certain offenses found to "affect[] a financial institution."[2] Originally passed in the wake of the savings and loan crisis, the powerful statute made sweeping reforms to the financial institution regulatory and enforcement system, most notably, under Section 1833a of FIRREA, creating harsh new civil penalties for violations of pre-existing criminal laws involving or affecting financial institutions.[3] Specifically, Section 1833a imposes hefty fines — up to US$1 million per violation or US$5 million for a continuing violation.[4] Prosecutors may also seek penalties for *each* discrete violation, enabling the government to seek potentially billion dollar aggregate penalties. Although the underlying offenses are defined in the criminal code, because Section 1833a imposes civil penalties, prosecutors need only prove FIRREA violations by a preponderance of the evidence, instead of the more burdensome "beyond a reasonable doubt" standard that applies in the criminal context.

The bundling of a civil enforcement regime with pre-existing criminal statutes has made FIRREA a go-to mechanism for the Department of Justice (DOJ) when seeking recompense for alleged financial wrongdoing over the past four years. Notably, DOJ has brought FIRREA claims against the very financial institutions the statute was designed to protect, arguing that allegedly fraudulent actions can, in practice, "affect" the banks themselves. The use of the statute against the financial institutions represents a departure from early FIRREA claims, which were typically brought against companies and individuals who allegedly defrauded financial institutions by submitting fraudulent claims to the institutions.[5]

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Section 1833a's "Affecting" a Financial Institution Requirement

In a series of cases brought against defendant banks by the US Attorney's Office for the Southern District of New York, DOJ proposed a novel legal theory, arguing that FIRREA's powerful enforcement regime applied to alleged mail and wire fraud violations because the alleged wrongdoing "affected" the banks by exposing them to legal liability and related expenditures, and by leading to increased risk of loss and actual financial loss.[6] In those actions, each defendant bank filed motions to dismiss, arguing, *inter alia*, that it could not be both the perpetrator of the alleged fraud *and* the affected victim for the purposes of Section 1833a.[7] Those arguments fell on deaf ears. In *United States v. Bank of New York Mellon*, Judge Kaplan became the first to interpret whether Section 1833a's "affecting" requirement allowed claims to be brought against bank itself. Judge Kaplan's opinion offered myriad reasons for supporting the government's interpretation of the statute, looking to dictionary definitions, Congressional intent and statutory structure. The court also cited the Second Circuit's decision in *United States v. Bouyea*, interpreting a different provision of FIRREA — the provision at issue in *Heinz* — for the proposition that an institution could be "affected" even if it were not itself the victim of the defendant's acts.[8]

Two subsequent cases also turned in favor of the government's interpretation of Section 1833a. In *United States v. Countrywide Financial Corporation*, Judge Rakoff noted that "affect" means "to have an effect on," and, as such, found that the government had adequately alleged that the defendant bank had been "affected" by its paying to settle claims stemming from the alleged wrongdoing.[9] In *United States v. Wells Fargo Bank, N.A.*, Judge Furman, building upon both *Bank of New York Mellon* and *Countrywide Financial Corporation*, also held that the government had sufficiently alleged that the defendant bank had "affected" itself through both actual harm and, significantly, an increased risk of loss, including potential damages from the government's suit itself.[10]

United States v. Heinz

Against this backdrop the Second Circuit issued its *per curiam* in *Heinz*, interpreting FIRREA's "affecting" requirement for the first time in more than a decade. In *Heinz,* the three appellant traders had been convicted on substantive and conspiracy wire fraud charges relating to their manipulating the bidding process for municipal bonds and other finance contracts while employed at UBS. Before trial, the district court rejected the traders' argument that the case was time barred because the transactions identified in the indictment occurred more than six years before the indictment was filed — *i.e.*, beyond the five- and six-year statutes of limitations for wire fraud and wire fraud conspiracies, respectively.[11] The district court found that the government's proffered evidence — including the fact that alleged co-conspirator financial institutions entered into non-prosecution agreements (which required certain monetary payments) — was sufficient to permit a jury to find that the traders' conduct had "affected" a financial institution, thereby triggering FIRREA's 10-year statute of limitations.[12] On appeal, the defendants argued that FIRREA's ten-year statute of limitations was incorrectly applied to the case, as the government had not alleged that the traders' actions had either defrauded a financial institution or caused a financial institution to lose money.[13]

Referring to its decision in *Bouyea*, the Second Circuit affirmed that the "affecting" requirement under 18 U.S.C. § 3293(2) — FIRREA's 10-year statute of limitations — "'broadly applies to any act of wire fraud that affects a financial institution,' provided the effect of the fraud is 'sufficiently direct.'"[14] The court noted that the non-prosecution agreement and settlement agreements entered into by the co-conspirator banks had been prompted, in part, by the traders' conduct. Accordingly, the court reasoned that the payments required under the agreements and the related fees "affected" the banks for the purpose of FIRREA. The fact that the banks were co-conspirators in the underlying conduct, and were not victims themselves, did "not break the necessary link between the underlying fraud and the financial loss suffered."[15]

Conclusion: The Second Circuit May Continue to Construe "Affecting" Broadly

Importantly, *Heinz* interprets a different FIRREA section than the one at issue in the Southern District Section 1833a cases discussed above.[16] In *Heinz*, the court interpreted FIRREA's statute of limitations provision, while the Section 1833a cases interpreted the applicability of FIRREA's civil enforcement mechanism more generally. Moreover, *Heinz* can be further distinguished by the fact that it considered the conduct of individuals that affected financial institutions — not the conduct of financial institutions themselves — and therefore is not a true application of the so-called "self-affecting" theory. Whether the Second Circuit considers those to be meaningful distinctions will be revealed when the court decides the *Countrywide* appeal.

If you have questions about this *Client Alert*, please contact one of the authors listed below or the Latham lawyer with whom you normally consult:

Christopher J. Clark
Christopher.clark2@lw.com
+1.212.906.1350
New York

Benjamin A. Naftalis
benjamin.naftalis@lw.com
+1.212.906.1713
New York

Richard D. Owens
richard.owens@lw.com
+1.212.906.1396
New York

William O. Reckler
william.reckler@lw.com
+1.212.906.1803
New York

Brigid T. Morris
brigid.morris@lw.com
+1.202.637.2274
Washington, D.C.

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Endnotes

1 *See United States v. Heinz*, No. 13-3119, 2015 U.S. App. LEXIS 9292 (2d Cir. June 4, 2015); Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA), P.L. 101-73, 103 Stat. 183 (1989).

2 18 U.S.C. § 3293.

3 Codified in 12 U.S.C. § 1833a. Unless specifically noted otherwise, references in the text to Sections refer to sections of the United States Code.

4 *See* 12 U.S.C. § 1833a(b). With the inflation adjustments, the fines may reach US$1.1 million per violation or US$5.5 million for a continuing violation. *See* 28 C.F.R. § 85.3 (inflation adjustments for civil monetary penalties).

5 *See, e.g.*, Amended Complaint, *United States v. Buy-a-Home, LLC et al.*, No. 1:10-cv-09280 (S.D.N.Y. Feb. 15, 2012) (alleging that defendants created false and fraudulent records, appraisals, and certifications and submitted the same to the U.S. Department of Housing and Urban Development (HUD) and the Federal Housing Administration (FHA) in violation of 18 U.S.C.§§ 1006 and 1014, and that defendants sent false, fraudulent, and misleading records, appraisal, and certifications to Countrywide Home Loans, Inc., in violation of 18 U.S.C. §§ 1341 and 1343); *United States v. Luce*, No. 11 C 5158, 2012 U.S. Dist. LEXIS 85095 (N.D. Ill. June 20, 2012) (alleging that defendant made numerous false statements to HUD and FHA in connection with the origination of FHA-insured loans in violation of 18 U.S.C. §§ 1006 and 1014); Second Amended Complaint, *United States v. Allied Home Mortg. Corp.*, No. 12 Civ. 02676 (GCH) (S.D. Tex. Nov. 2, 2012) (alleging that defendants knowingly made false statements to HUD for the purpose of fraudulently obtaining HUD mortgage insurance and obtaining HUD approval of various programs in violation of 18 U.S.C. §§ 1006 and 1014).

6 Amended Complaint, *United States v. Bank of New York Mellon*, 11 Civ. 06969 (LAK) at ¶¶ 124–129 (S.D.N.Y. Feb. 16, 2012), First Amended Complaint of the United States of America at ¶¶ 169, 171–172*, United States v. Wells Fargo Bank*, N.A., No. 12 Civ. 7527 (JMF) (S.D.N.Y. Dec. 14, 2012); Amended Complaint of the United States of America ¶¶ 159, 219, 221, Countrywide Fin. Corp., No. 12 Civ. 1422 (JSR) (S.D.N.Y. Jan. 11, 2013).

7 Motion to Dismiss the Second Amended Complaint at 10–15, Bank of New York Mellon, No. 11 Civ. 6969 (LAK) (S.D.N.Y. Aug. 6, 2012); Defendant Wells Fargo Bank, N.A.'s Memorandum of Law in Support of Its Motion to Dismiss the First Amended Complaint at 39–44, Wells Fargo Bank, N.A., No. 12 Civ. 7527 (JMF) (S.D.N.Y. Jan. 16, 2013); Memorandum in Support of Motion to Dismiss at 7–17, Countrywide Fin. Corp., No. 12 Civ. 1422 (JSR) (S.D.N.Y. Dec. 21, 2012); Supplemental Memorandum in Support of Motion to Dismiss at 6–10, Countrywide Fin. Corp., No. 12 Civ. 1422 (S.D.N.Y. Feb. 28, 2013).

8 *United States v. Bank of New York Mellon*, 941 F. Supp. 2d 438, 451–452 (S.D.N.Y. 2013) (citing *United States v. Bouyea*, 152 F.3d 192 (2d Cir. 1998)).

9 *United States v. Countrywide Fin. Corp.*, 921 F. Supp. 2d 598, 605 (S.D.N.Y. 2013) (citing Webster's New World Collegiate Dictionary 23 (4th ed. 2002).

10 *United States v. Wells Fargo Bank, N.A.*, 972 F. Supp. 2d 593, 629–631(S.D.N.Y. 2013).

11 *See Heinz*, 2015 U.S. App. LEXIS 9292 at *2–3; 18 U.S.C. § 3282(a); 26 U.S.C. § 6531(1).

12 *Heinz*, 2015 U.S. App. LEXIS 9292 at *3.

13 Final Form Superseding Consolidated Brief for Defendant-Appellant Gary Heinz at 32 and Final Form Superseding Consolidated Brief for Defendant-Appellant Peter Ghavami at 24, *United States v. Heinz*, No. 13-3119 (S.D.N.Y Dec. 17, 2014).

14 *Heinz*, 2015 U.S. App. LEXIS 9292 at *5 (citing *Bouyea*, 152 F.3d at 195).

15 *Heinz*, 2015 U.S. App. LEXIS 9292 at *5.

16 The Section 1833a "affected" language has not yet reached the Second Circuit. *Countrywide* went to trial in September 2013; a jury returned a verdict in favor of the government. The execution of the US$1.27 billion judgment entered by the district court has been stayed pending the defendant banks' appeal of the denial of their motion for a new trial. In their appeal, the defendant banks have argued, *inter alia*, that the district court erred by permitting the FIRREA claim against the banks as they could not be liable for "affecting" themselves. In March 2015, Bank of New York Mellon entered a settlement agreement with the United States Attorney's Office for the Southern District; in the agreement, the bank agreed to pay US$167.5 million as a civil penalty pursuant to FIRREA. *Wells Fargo* remains in pre-trial discovery.