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US V. Heinz May Bolster Expansive FIRREA Interpretation

Law360, New York (June 11, 2015, 9:43 AM ET) --

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The U.S. Department of Justice's aggressive use of the Financial Institutions Reform, Recovery, and Enforcement Act to sue banks for fraud just received an unexpected boost, and from an unlikely source: In a criminal case decided last week,[1] the Second Circuit endorsed an expansive approach to the application of FIRREA to frauds that "affect" a financial institution, including frauds in which the bank is not the target of the fraud.

While the case arose in the criminal context, its impact on civil FIRREA enforcement could be significant, as courts grapple with the government's "reflective" theory of FIRREA. That theory posits that a financial institution can violate FIRREA by engaging in a fraud that "affects" itself. This controversial theory has been upheld in three district court cases in the Southern District of New York,[2] one of which is currently on appeal to the Second Circuit.[3]

"Affecting" a Financial Institution: The Criminal Case Law

It is a common misperception that, because the government rarely used FIRREA prior to 2010, there is hardly any case law on the issue of when a fraud "affects" a financial institution. Not so. While it is true that the government rarely brought affirmative civil fraud cases under Section 951 of FIRREA prior to 2010, several criminal statutes use essentially the same phrase (without the requirement that the institution be "federally insured") in the context of financial fraud.

Most notably, the penalties for mail and wire fraud are enhanced, and the statute of limitations extended from five or six years to 10, when the offense "affects a financial institution."[4] Additionally, the definition of "continuing financial crimes enterprise" in the criminal code include predicate offenses that "affect a financial institution."[5] Also, certain crimes that "affect a financial institution" received harsher sentences under a past version of the Sentencing Guidelines.[6]

Courts in these criminal cases have explained that interpretations of the phrase under one statute are instructive when applying that same phrase to other statutes.[7] Thus, while there are only a handful of district court decisions interpreting the phrase "affecting a federally insured financial institution" as used in Section 951 of FIRREA,[8] the courts in criminal cases have had numerous occasions to address the extent to which a fraud can be said to "affect" a financial institution. These decisions have and will

continue to be cited as precedent by both sides in the ongoing debate about the reach of Section 951.

United States v. Heinz and Its Impact

Last week, the Second Circuit decided a case under one of these criminal statutes. In United States v. Heinz,[9] defendants were individuals who had been convicted of wire fraud and conspiracy to commit wire fraud in connection with an alleged scheme to defraud municipalities by manipulating the bidding process for municipal bonds reinvestment agreements and other contracts. The transactions had occurred more than six years prior to the indictment, so they would have been time-barred unless FIRREA extended the statute of limitations to 10 years because the conduct "affect[ed] a financial institution."

Although the financial institutions were not the object of the alleged fraud but alleged co-conspirators, the court held that the government had established the requisite effect on a financial institution, citing evidence that the banks had incurred significant payments and fees as a result of having entered into nonprosecution agreements with the government that related to these same transactions. The court reasoned that "[t]he verb 'to affect' expresses a broad and open-ended range of influences."

The court also explained that Congress intended to extend the statute of limitations to 10 years even when a financial institution is not the object of the fraud. Although the court recognized that the effect upon a financial institution must be "sufficiently direct,"[10] it found that the payments and fees incurred by the banks sufficed under that standard.[11] Accordingly, the court held that FIRREA's 10-year statute of limitations applied and affirmed the convictions.[12]

Conclusion

In one sense, Heinz broke no new ground, as the Second Circuit had previously held in the criminal context that FIRREA's 10-year statute of limitations applies even when the bank is not the object of the fraud.[13] Moreover, Heinz does not speak directly to the issues presented in the challenges to the government's use of the "self-affecting" theory in civil fraud cases under Section 951 of FIRREA. In those cases, the issue is not whether an individual's conduct affected a financial institution, but whether a financial institution's own could affect only itself. Nor do these criminal cases address the question of whether Congress, in creating a civil penalty cause of action in Section 951, intended to allow the Justice Department to pursue such actions, and impose potentially significant civil penalties, against financial institutions that engage in alleged conduct that affect only themselves.

But Heinz serves as an important reminder that FIRREA is a "hybrid statute,"[14] with both criminal and civil elements and implications. The government surely will be emboldened by cases decided favorably in the criminal context, under different statutes, while civil defendants can be expected to continue to argue that these criminal cases and statutes are distinguishable, and do not shed light on what Congress intended in the civil context. Counsel defending FIRREA cases in the civil context would be well-advised not to overlook these criminal cases, and to be ready to show why their logic does not apply equally in civil cases.

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[1] United States v. Heinz, No. 13-3119 (2d Cir. June 4, 2015) (per curiam).

[2] United States v. Countrywide Financial Corp. (Countrywide II), 996 F. Supp. 2d 247 (S.D.N.Y. 2014); United States v. Wells Fargo Bank NA, 972 F. Supp. 2d 593 (S.D.N.Y. 2013); United States v. Countrywide Financial Corp. (Countrywide I), 961 F. Supp. 2d 598 (S.D.N.Y. 2013); United States v. Bank of N.Y. Mellon, 941 F. Supp. 2d 438 (S.D.N.Y. 2013).

[3] United States v. Countrywide Financial Corp., No. 12 Civ. 1422, 2015 WL 424428 (S.D.N.Y. Feb. 3, 2015), appeal docketed, Nos. 15-496, 15-499, (2d Cir. Feb. 20, 2015).

[4] 18 U.S.C. § 3293.

[5] 18 U.S.C. § 225.

[6] U.S. Sentencing Guidelines Manual § 2F1.1(b)(7)(B) (1998).

[7] See United States v. Grass, 274 F. Supp. 2d 648, 654 n.5 (M.D. Pa. 2003) (quoting United States v. Esterman, 135 F. Supp. 2d 917, 919 (N.D. Ill. 2001)) ("In Esterman, the court pointed out that the term "affecting a financial institution" appears in various other provisions of the United States Criminal Code and Sentencing Guidelines. Therefore, cases interpreting that phrase in these other contexts are equally applicable in interpreting that phrase as it appears in § 982(a)(2)(A).").

[8] Financial Institutions Reform, Recovery, and Enforcement Act of 1989, § 951(c)(2), 12 U.S.C. § 1833a(c)(2).

[9] No. 13-3119 (2d Cir. June 4, 2015) (per curiam).

[10] Id. at 5 (citations and quotation marks omitted).

[11] Id. at 6.

[12] Id.

[13] United States v. Bouyea, 152 F.3d 192, 195 (2d Cir. 1998).

[14] United States v. Countrywide Fin. Corp., 33 F. Supp. 3d 494, 498 (S.D.N.Y. 2014).

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