U.S. using subpoenas under 1989 act as new tool to probe financial firms

Jan 03 2013 Andrew W. Schilling

The U.S. Department of Justice has increased its use of the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) to prosecute wrong-doing by financial firms. Accordingly, more institutions may find themselves having to deal with a subpoena under the act, including those that are directly targeted under the act. In-house counsel would be well advised to familiarize themselves with the statute and to respond to such subpoenas cautiously.

Responding to subpoenas has become routine business for in-house counsel at financial institutions, whose records are often necessary to "follow the money" in fraud prosecutions and civil lawsuits.

When an institution receives a subpoena, it is typically because the institution is merely a witness; i.e. the institution is considered to possess information relevant to an investigation of a third party. Typically, producing the documents obviates the need for any testimony, by a document custodian or otherwise.

But what if a financial institution receives a subpoena from the Justice Department or a U.S. Attorney's Office pursuant to FIRREA? Given that the department has increasingly been using FIRREA to target financial institutions, is it safe to assume that the institution is merely a witness to the investigation, rather than a target? Will the information provided in response to the subpoena be shared with criminal prosecutors, or with state attorneys general? If executives or other company witnesses are subpoenaed to testify, can and should they invoke their Fifth Amendment rights?

While the Justice Department's authority to issue FIRREA subpoenas has been on the books for more than two decades, it has only recently begun using this powerful investigative tool. Accordingly, most in-house counsel (and external counsel, for that matter) are unfamiliar with FIRREA subpoenas and their implications for the financial institutions receiving them. Those implications can be significant, particularly in today's charged enforcement environment.

So what do financial institutions need to know before responding to a FIRREA subpoena?

What is FIRREA?

First, and perhaps most obviously, counsel need to know that FIRREA, enacted in 1989 in response to the savings and loan crisis, is a federal law that authorizes the Justice Department to sue for civil penalties when a person or entity has

violated any one of fourteen enumerated criminal statutes. The predicate offenses for a FIRREA suit include bank fraud, false statements, mail fraud and wire fraud, and other offenses involving or affecting federally insured financial institutions. The statute authorizes civil monetary penalties of up to the amount of the gain or loss resulting from the fraud.

In recent years, the Department of Justice has been bringing more and more civil penalty lawsuits under FIRREA, with United States Attorneys in New York, Chicago, Denver, and Los Angeles leading the charge. In fact, the Department has filed more FIRREA lawsuits in the last three years than it did in the prior two decades combined.

These lawsuits are typically built upon information obtained by the government pursuant to FIRREA subpoenas. And more FIRREA investigations and lawsuits are expected. Notably, the Department (through the website of its Financial Fraud Enforcement Task Force) has indicated that FIRREA may also apply to conduct that is under investigation by the federal-state Residential Mortgage Backed Securities Task Force. That Task Force has recently brought several significant civil fraud suits against financial institutions, and more are sure to follow.

What is a FIRREA subpoena?

FIRREA subpoenas are administrative subpoenas that are issued exclusively by the civil side of the Justice Department. Section 901 of FIRREA, which is codified at 12 U.S.C. § 1833a, authorizes the Attorney General to subpoena witnesses and documents "[f]or the purpose of conducting a civil investigation in contemplation of a civil proceeding."

They are "administrative" rather than "judicial" subpoenas because they are used only during the pre-suit, investigative stage. In other words, they allow the government to take all of the discovery it wants, before it files any lawsuit. Like grand jury subpoenas, they are issued directly by the Justice Department, rather than by the FBI or any other investigative agency.

The Attorney General's authority to issue FIRREA subpoenas has been delegated to subordinate attorneys in the Civil Division of the Department of Justice and to local U.S. Attorneys' Offices. FIRREA subpoenas can seek the production of documents, the testimony of witnesses, or both.

Is the recipient financial institution a witness or the target?

It depends. In the two decades following FIRREA's enactment, the Justice Department brought only a handful of small FIRREA lawsuits – and those cases were typically against individuals accused of defrauding financial institutions. So for twenty years, the department used FIRREA to protect financial institutions from fraud. But in the last two years, it has brought significant FIRREA suits against financial institutions, including several suits seeking hundreds of millions of dollars or more in civil penalties.

Additionally, the complaint filed by the Justice Department and most state attorneys general against the largest five

mortgage servicers earlier this year, which led to an unprecedented $25 billion settlement, included FIRREA claims against the servicers. Moreover, while some predicate offenses under FIRREA require the government to establish that the fraud "affected" a financial institution, the government has recently taken the position that a financial institution can be "affected" by a fraud that it commits. This interpretation underscores the government's intent to use FIRREA against financial institutions, and not just to protect them.

So while the government will continue to need financial institutions to produce records necessary to build a case against someone else, the increasing use of FIRREA subpoenas to target financial institutions means that firms that receive such a subpoena should never assume that they are merely a witness.

Does receipt of a FIRREA subpoena mean that there is no parallel criminal investigation?

No. Although a FIRREA subpoena may be issued only in furtherance of a civil investigation, the receipt of a FIRREA subpoena does not mean that the only pending investigation is civil. To the contrary: since the predicate offenses under FIRREA are all criminal, the issuance of a FIRREA subpoena by definition means that the Department of Justice is investigating whether the facts establish a violation of the federal criminal laws.

While criminal prosecutors generally may not share the fruits of a grand jury subpoena with civil prosecutors without a court order, nothing bars civil prosecutors from sharing the fruits of a FIRREA subpoena with criminal prosecutors. Indeed, Justice Department policy has for years encouraged the coordination of civil and criminal investigations and the sharing of information between criminal and civil prosecutors. Accordingly, if the evidence collected in a civil investigation substantiates a violation of a FIRREA predicate offense, such as mail fraud, nothing would prevent the government from using evidence developed in the civil investigation in a parallel or subsequent criminal prosecution.

In fact, in 2012 a federal grand jury in Manhattan indicted the owner of a real estate brokerage firm who was, at the time, a defendant in a pending civil fraud lawsuit brought by the civil division of that same office pursuant to FIRREA, among other laws.

How can I find out the nature of the matter under investigation?

Because FIRREA does not itself prohibit any conduct, but simply authorizes the Justice Department to sue for violations of fourteen other statutes, the mere receipt of a FIRREA subpoena does not tell the recipient much about what or whom the government is investigating. Under the law, however, a FIRREA subpoena is required to state the nature of the conduct under investigation and the applicable provision of law.

Accordingly, a FIRREA subpoena that fails to describe the nature of the investigation or the applicable provision of law is subject to challenge. The threat of such a challenge may be enough to persuade government counsel to provide more information about the nature and scope of the investigation.

Indeed, while the government's administrative subpoena authority is extremely broad, it is not unbounded. In any court challenge to a subpoena, the government would be forced to disclose the nature of the investigation in order to establish that the information sought is relevant to the investigation. To avoid that fight, government counsel may be persuaded to disclose more about the investigation.

Must the government tell the witness in a FIRREA investigation that he or she is the target of the investigation?

Not necessarily. In criminal cases, Department of Justice policy requires prosecutors to notify a grand jury witness, before testifying, if he or she is the target of the investigation. Such notice allows the target to consider whether to invoke the Fifth Amendment privilege against self-incrimination.

There is, however, no corollary notice requirement in purely civil investigations, even if the underlying predicate offenses for the civil investigation are criminal – as is necessarily the case with FIRREA. Rather, it is up to the government attorneys conducting the civil investigation to decide whether to provide notice and warnings to the target. In practice, when government counsel are aware of a pending criminal investigation into the same conduct, they are likely to notify the witness, if only to avoid any later challenges to the use of the testimony in any criminal prosecution.

Given the serious consequences of providing testimony under oath about conduct that is potentially criminal, counsel representing witnesses in FIRREA investigations should seek to ascertain the witness's status from the government, before that witness is allowed to testify. Counsel should also consider the costs and benefits of invoking the Fifth Amendment privilege in a civil case, because "taking the Fifth" in a civil case can and will be used against you.

How soon must I respond to a FIRREA subpoena?

The recipient of a FIRREA subpoena, properly served, must respond with the information requested or appear to testify by the return date specified in the subpoena, unless that deadline is unreasonable. Failure to comply promptly with a FIRREA subpoena can result in sanctions for contempt against the recipient.

The "reasonableness" requirement is not found in the text of FIRREA, but instead comes from the procedures applicable to civil investigation demands (CIDs) served under the Racketeer Influenced and Corrupt Organizations (RICO) laws. FIRREA adopts those procedures by reference and adds the limitation that a person may not be held in contempt if the return date is fewer than five days after service, assuming that a timely objection is made.

How can I object to a FIRREA subpoena?

As with most subpoenas, a person objecting to the subpoena typically seeks to negotiate the deadlines and scope of the subpoena with the government attorney who issued it. But if the government will not agree to withdraw or limit the subpoena as requested, then FIRREA again adopts the procedures under RICO for objecting to a CID.

Under those procedures, a party objecting to the subpoena must file a petition to modify or set aside the subpoena either within twenty days after service, or before the return date specified in the subpoena, whichever period is shorter.

Today, more and more financial institutions that are targets of a FIRREA investigation are finding themselves on the receiving end of a FIRREA subpoena. Given the implications for parallel criminal proceedings in particular, in-house counsel would be well advised to get to know this newly discovered statute better, and to respond to these new subpoenas cautiously.

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