

## Finally, 8 Factors Governing FIRREA Civil Penalty Awards

*Law360, New York (March 12, 2013, 9:46 PM ET)* -- In recent years, the U.S. Department of Justice has made increasingly aggressive use of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) to target allegations of financial fraud, most notably in its recent, multibillion dollar civil fraud case against Standard & Poor's (S&P). But while the Justice Department files more and more civil fraud suits under FIRREA, there are few court rulings applying that statute. Many of these cases settle without litigation, and the courts in pending cases have not yet issued any significant rulings.

The resulting dearth of FIRREA case law creates a high degree of uncertainty for both the government and financial institutions facing FIRREA investigations, making informed settlement conversations extraordinarily difficult for both sides. Indeed, if published reports are accurate, settlement negotiations between Justice and S&P broke down in part because the government sought more than a billion dollars in civil penalties under FIRREA.

A decision announced recently by a federal court in Los Angeles — where the S&P case happens to be pending — may finally give the government and FIRREA defendants a framework for their discussions. The ruling, in a small civil bank fraud case brought against an individual, Mario Menendez, appears to be the first judicial decision setting forth the factors that a court should consider when imposing civil penalties under FIRREA. *United States v. Menendez*, No. CV 11-06313 (C.D. Cal. Mar. 6, 2013).

### **FIRREA**

FIRREA authorizes the United States to bring a civil lawsuit for violations of any of 14 criminal laws relating to financial fraud. The law authorizes the court to award civil penalties of up to \$1.1 million per violation, or up to \$5.5 million for a continuing violation. The penalty can be higher if the defendant derives a pecuniary gain from the violation or the violation results in a pecuniary loss to any person, in which case the court may award a penalty equal to the gain or loss. In a number of recent cases, including its case against S&P, the Justice Department has sought civil penalties for billions of dollars based on the amount of the gain or loss from the alleged fraud.

In short, FIRREA has no minimum penalty and an indeterminate maximum penalty. Despite that boundless range, the statute provides no guidance on how a court should decide where within that range any given penalty should fall. Prior to the Menendez decision, no reported case had offered any guidance, leaving the government and defendants in the dark.

### **The Case of Mario Menendez**

The Menendez case finally sheds some necessary light. In that case, the Justice Department brought a FIRREA civil suit against Menendez, a real estate broker, alleging that he committed bank fraud when he submitted a false certification on behalf of a homeowner to the United States Department of Housing and Urban Development (HUD) in connection with the homeowner's short sale of his property.

The certification, which also was submitted to the mortgagee, was false because it represented that there were no hidden terms or special understandings with the buyer of the property, when in fact Menendez himself, through a company he controlled, also was the buyer of the property and intended to immediately resell the property for a profit of nearly \$40,000. Menendez did not contest the government's version of the facts, and the only issue before the court was the amount of the civil penalty that it should impose.

### **Factors Considered in Awarding FIRREA Penalties**

Drawing upon principles applied by courts in other civil penalty contexts, the court considered a total of eight factors to assess a civil penalty under FIRREA:

- the good or bad faith of the defendant and the degree of scienter;
- the injury to the public and loss to other persons;
- the egregiousness of the violation;
- the isolated or repeated nature of the violation;
- the defendant's financial condition and ability to pay;
- the criminal fine that could be levied for the conduct;
- the amount of the defendant's profit from the fraud; and
- the penalty range available under FIRREA.

Applying these factors, the court found that the first three weighed in favor of a substantial civil penalty: (1) Menendez acted with intent to defraud; (2) HUD suffered a loss; and (3) Menendez's bank fraud was egregious.

The court found that the next two factors favored Menendez: (4) the admissible evidence reflected only a single instance of bank fraud, and (5) Menendez recently received a discharge from bankruptcy court and had limited ability to pay.

Finally, the court found that the civil penalty requested by the government — nearly \$1.1 million — was excessive, considering that (6) the amount of the criminal penalty for bank fraud was capped at \$1

million, and the likely fine under the sentencing guidelines would have been “in the \$20-30,000 range;” (7) Menendez’s profit was only approximately \$40,000; and (8) FIRREA precluded a penalty in excess of \$1 million when the gain or loss was less than \$1 million, as it was in this case.

Considering these eight factors, the court awarded a civil penalty of \$40,000, an amount proportionate to Menendez’s profit.

### **The Significance of the Menendez Case**

The Menendez case is significant for a few reasons. Most notably, it represents the first decision that provides guidance on the factors a court may consider when imposing a civil penalty under FIRREA. While other courts may or may not choose to follow the Menendez court’s approach, the case provides prosecutors and defense lawyers engaged in FIRREA cases a workable framework to at least help guide their negotiations.

The case also is noteworthy because it cannot be characterized as anything other than a significant loss for the government. Although a portion of that loss can be attributed to evidentiary failings, the fact remains that the \$40,000 civil penalty awarded was less than 5 percent of the amount originally sought by the Justice Department.

At the same time, the case may not be good news for financial institutions facing FIRREA cases either. While the award against Menendez was small, Menendez was a bankrupt individual who had profited by only \$40,000 from his one-time act of bank fraud. And, relevant here, the government was awarded the full value of his profit, notwithstanding its application of the above eight factors.

Applying that logic to recent FIRREA cases against large financial institutions, it is possible that the amount of the profit at issue could be quite substantial (in fact, the government has alleged as much in several matters). The government also has alleged in these recent cases that the institutional defendants engaged in a pattern of misconduct resulting in not only sizeable profits, but also significant losses to those affected by the alleged fraud.

These considerations aside, both prosecutors and defense lawyers will find something they like in the analysis applied in the Menendez case. At the very least, both sides should be happy that they now have something to talk about.

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