15-496-cv(L)

15-499-cv(CON)

IN THE

United States Court of Appeals

FOR THE SECOND CIRCUIT

UNITED STATES OF AMERICA; EDWARD O'DONNELL,

Plaintiffs-Appellees,

—against—

REBECCA MAIRONE; COUNTRYWIDE BANK, FSB; COUNTRYWIDE HOME LOANS, INC.; BANK OF AMERICA, N.A.,

Defendants-Appellants,

—and—

BANK OF AMERICA CORPORATION, successor to COUNTRYWIDE FINANCIAL CORPORATION and FULL SPECTRUM LENDING; COUNTRYWIDE FINANCIAL CORPORATION,

Defendants.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

REPLY BRIEF FOR DEFENDANT-APPELLANT REBECCA MAIRONE

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INTRODUCTION[1]

Through multiple rounds of pretrial briefing, a four-week trial, and a 20,896-word appellate brief, the Government has yet to explain why it singled out Ms. Mairone as the sole individual defendant in this case. The Government has never suggested that Ms. Mairone was a rogue employee who set out to enrich herself at the expense of her employer—or even that she benefited personally from her involvement in the HSSL process. Nor does it point to any evidence that Ms. Mairone exercised unique decision-making authority that would warrant imposing mail and wire fraud liability against her in particular for Countrywide's sale of mortgages to the GSEs. The Government does not dispute that its case rested entirely on collaborative decisions agreed upon by many FSL employees: the institution of the HSSL process, the QOG suspension, the interpretation of the QA and QC numbers, the November 29 email, the decision to broaden the scope of the HSSL program, and Central Fulfillment.

[1] The abbreviations and conventions used in our Opening Brief will apply here as well. The Banks' Opening Brief is cited as "Banks' Br.," the Government's Brief is cited as "U.S. Br.," the Banks' Reply Brief is cited as "Banks' Reply," and our Opening Brief is cited as "Opening Br."

This background informs both of the legal reasons why the Government's case should never have made it to trial. First, the Government concedes that there can be no FIRREA liability unless the effect is "sufficiently direct." U.S. Br. 28. But the Government does not explain how it can satisfy that standard simply by pointing to its own decision to file a lawsuit against the Banks. Nor can the Government avoid reversal with the alternative argument that other evidence would have established the requisite effect had the district court not adopted the erroneous "automatic self-affecting" theory. None of that evidence proves that any federally insured bank actually suffered or could have suffered a penny's loss as a result of the HSSL program, let alone justifies the district court's decision to take the "affecting" requirement away from the jury and declare it satisfied as a matter of law.

The Government also has not refuted the argument that the evidence demonstrates nothing more than a breach of contract. The Government agrees that it had to present evidence of fraudulent behavior separate and apart from the breach of contract. U.S. Br. 44. But the Government points to nothing but the contracts themselves—specifically provisions in the original contracts stating that

representations and warranties reverberate with each sale of a loan to the GSEs. But that is still a breach of the same representation in the same contract—not a later, separate one. In any event, it cannot be a basis for sustaining the verdict against Ms. Mairone. The Government has never suggested—much less proven—that she was aware of this provision. So she cannot be held liable for the purportedly echoing representation.

Finally, the Government does not and cannot plausibly defend the district court's highly prejudicial change of course halfway through trial—*after* the Government rested its case—when it decided that it would no longer allow testimony regarding witnesses' contemporaneous views of the HSSL process. The notion that the district court was simply distinguishing between witnesses who communicated their views to Ms. Mairone, Mr. Lumsden, and Mr. Kitashima, and those who did not, is flatly contradicted by the trial record. The Government's last-ditch effort to characterize the ruling as harmless is belied by the Government's own reliance—both at trial and now on appeal—on *exactly the type of evidence* that the district court refused to let

Defendants elicit. This ruling improperly undercut Ms. Mairone's defense on the issue of intent, and requires a new trial.

ARGUMENT

We join the Banks' Reply, and write separately here to address the portions of the Government's brief directed to our Opening Brief specifically.

I. The Government Did Not Establish That Ms. Mairone's Actions "Affected" A Federally Insured Financial Institution As Required By FIRREA.

The Government acknowledges that FIRREA's "affecting" prong requires proof of a "realistic prospect of loss." U.S. Br. 39 n.5. It also acknowledges that the relationship between the loss and the violation must be "sufficiently direct." *Id.* at 28. But the Government fails to identify evidence that Ms. Mairone's conduct satisfies those requirements, let alone evidence that would justify the district court's refusal to allow the jury to decide the issue.

A. The district court had no basis for holding as a matter of law that Ms. Mairone's conduct exposed a federally insured financial institution to a "sufficiently direct" "realistic prospect of loss."

1. The district court's "automatic self-affecting" holding is at odds with the law of this Circuit.

Everyone agrees that the centerpiece of the district court's holding was that "[a]ny federally insured entity that commits these offenses *automatically* exposes itself to potential civil and criminal liabilities as a matter of law," and "[s]uch potential liability is enough to satisfy FIRREA…." SA84 (emphasis added); *see* Opening Br. 40-46. Far from trying to limit this holding, the Government extends it, asserting that it can satisfy FIRREA simply by positing that "the Bank presumably has been exposed to litigation costs in connection with the instant action, including attorneys' fees, and has incurred civil-penalty liability for the fraud." U.S. Br. 40.

The reach of this reading is breathtaking. It means that the Government can establish that a bank is "affected" for the purposes of FIRREA simply by suing the bank. And, in fact, the Government does not dispute that this means that whenever *anyone* sues a bank alleging any kind of fraud—thereby triggering the need to hire a lawyer—the

Government can bring its own FIRREA suit seeking penalties. This is a real problem, for even the Government concedes that "[t]he readily apparent purpose of [the 'affecting'] limitation in paragraph (c)(2) is to prevent § 1833a liability from being applied to any false statement made within federal jurisdiction, even those having nothing to do with the financial industry." U.S. Br. 31 (internal quotation marks and alteration omitted). Yet, on the Government's reading, so long as a statement was made by a bank—even to its gardener or pencil supplier—the Government can pursue FIRREA penalties.

Even while conceding our point that the relationship between the loss and the violation must be "sufficiently direct," U.S. Br. 28, the Government offers no meaningful analysis of how it satisfies that standard when the only harm is the financial burden caused by the lawsuit the Government itself decided to bring (and could easily have opted not to bring).

The Government's only response is that "[t]his Court recently foreclosed that argument" in *United States v. Heinz*, 790 F.3d 365 (2d Cir. 2015). U.S. Br. 40. But *Heinz* says nothing of the sort. First, the defendants in *Heinz* were accused of affecting not only the bank that

employed them, UBS, but also two other banks. So the Court was not presented with the question whether UBS could affect itself (or whether an employee's conduct as a UBS agent could affect UBS) for the purposes of the statute. *Id.* at 367. The only question was whether the role of the other two banks as "co-conspirators … br[oke] the necessary link between the underlying fraud and the financial loss suffered." *Id.* We are faced with an entirely different scenario here.

Second, even in the face of evidence that the other two banks had already agreed to pay more than $500 million in fines and restitution for the fraudulent transactions, the district court in *Heinz* held only that such evidence was "enough to permit *a jury* to find that the Defendants' conduct 'affect[ed] a financial institution.'" *Id.* (emphasis added). Far from supporting the district court's "automatic self-affecting" theory, then, *Heinz* suggests that, at the very least, the district court here erred in rejecting Defendants' application to send the "affecting" issue to the jury.

2. The repurchase evidence on which the Government alternatively relies does not prove a sufficiently direct effect, was contradicted by the indemnification agreements, and at least should have gone to the jury.

As an alternative to the district court's "automatic self-affecting" theory, the Government attempts to identify other evidence that might have supported a jury's finding of a "sufficiently direct" effect. U.S. Br. 39-40. The Government cites testimony discussing the repurchase remedy generally, JA2668-69, 2761-62, 2994, 3121-23, 3146, testimony about two specific repurchase demands that were sent to BANA, JA3185-90, testimony and exhibits regarding individual loan files, JA3417-19, 3423-28, 7307, and Bank of America Corporation's settlement with Fannie Mae that allegedly involved some HSSL loans, U.S. Br. 40 & n.6.

None of this evidence is sufficient to establish the requisite "effect" here, let alone as a matter of law. As an initial matter, the Government does not and cannot contest that courts have uniformly treated the "affecting" element of FIRREA as a *jury* question. *See, e.g.*, *United States v. Gardley*, No. 10-236, 2013 WL 4786208, at *7 (D. Nev. Sept. 5, 2013); *United States v. Whaley*, No. 10-169, 2012 WL 1193352, at *6

(E.D. Tenn. Mar. 5, 2012);*United States v. Vallem*, No. 02-1204, 2003 WL 1989619, at *2 (N.D. Ill. Apr. 28, 2003) ("Whether the wire fraud actually did affect a financial institution is a jury question."); *United States v. Ruedlinger*, Nos. 97-40012-01, 97-40012-02, 1997 WL 807917, at *2 (D. Kan. Dec. 9, 1997). The Government has not identified a single case supporting the district court's decision to take the "affecting" issue away from the jury. To the contrary, the Government itself stated in opposition to Defendants' summary judgment motions that "There Is a *Genuine Dispute of Fact* as to Whether the Fraud Affected a Federally Insured Financial Institution." Mem. of Law of the United States of America in Opp'n to Defs.' Mot. for Summ. J., Dkt. No. 136, at 47 (emphasis added).

The Government's argument on appeal seems to be—indeed, has to be—that the evidence it cites is enough to satisfy the "affecting" requirement as a matter of law, thus justifying in hindsight the district court's refusal to let the jury decide the issue. A review of the evidence, however, forecloses this possibility—both legally and factually.

First, the only evidence of an "effect" stemming from the potential repurchase claims cited by the Government involved repurchase claims

directed at BANA, not Countrywide Bank (those two banks being the only federally insured financial institutions at issue in this case). *E.g.*, JA3185, 6595-6664, 6665-6715. In other words, the Government's proffered "effect" arose only by way of Countrywide's merger with BANA, which had no connection to the alleged fraud. But the effect in question must be not only "sufficiently direct," *United States v. Bouyea*, 152 F.3d 192, 195 (2d Cir. 1998), but also "foreseeable" to the defendant, *Heinz*, 790 F.3d at 367. So the Government's theory is that when Ms. Mairone, on Countrywide's behalf, was adjusting the loan processes, she was expected to foresee not only that the Government would conclude that the new process generated poor quality loans, but also that BANA would acquire Countrywide, and BANA would then be subjected to possible financial risk. The Government has not explained how a causal chain that attenuated, which has nothing to do with the alleged fraud, could be either "sufficiently direct" or sufficiently "foreseeable" to support FIRREA liability.

In any event, the merger itself was specifically conditioned on indemnification agreements[2] ensuring that BANA—which, again, is the only federally insured bank potentially impacted by the repurchase claims cited by the Government—would *not* be exposed to any such losses as a result of the merger. *See United States v. Agne*, 214 F.3d 47, 52 (1st Cir. 2000) (noting that the bank was "*protected* by R.G.'s promise to compensate it for funds issued to Pump Sales" (emphasis added)). Thus, there could be no effect here as a matter of law because BANA was "protected."

The Government has no real answer to the indemnification agreements. It first argues that the agreements "only cover actual losses rather than risk of loss," and therefore "do not negate the effect on Bank of America." U.S. Br. 41. That is a non sequitur: If a bank cannot suffer an "actual loss" because it is indemnified for it, then there *is* no risk of loss. And even if there were some question as to whether the indemnification agreements did in fact cover all possible losses in this case, that would be an issue for the *jury* to resolve.

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[2] As explained in our Opening Brief (at 39-40), the district court improperly excluded evidence of the indemnification agreements. S*ee* JA1695.

Indeed, the only way this Court can affirm on the basis of the repurchase claims is by categorically holding that an indemnification agreement cannot, as a matter of law, preclude FIRREA liability. *See* U.S. Br. 41. But courts have always looked to the specific facts of the case to determine whether there was an "effect." In *Agne*, for instance, the First Circuit held that the Government failed to prove an "actual financial loss" or a "realistic prospect of loss" because the bank was "protected" from any loss based on the particulars of the financial arrangement between the parties. 214 F.3d at 52-53. In *Heinz*, the court laid out evidence that would have gone to the jury to prove that the bank suffered an actual financial loss. 790 F.3d at 367. And in *Bouyea*, where the defendant committed fraud against the *subsidiary* of a financial institution, this Court cited testimony that the defrauded subsidiary "borrowed the money for its transaction with Bouyea from its parent." 152 F.3d at 195.

The Government relies on two cases to try to defend the district court's exclusion of the indemnification agreements: *United States v. Johnson*, 130 F.3d 1352 (9th Cir. 1997), and *United States v. Millar*, 79 F.3d 338 (2d Cir. 1996). These cases are inapposite for at least two

reasons. First, the indemnification agreements in this case are much more narrowly tailored to the same purpose FIRREA serves than were the sources of recovery in *Johnson* and *Millar*. The indemnification agreements here were mandated by the Office of the Comptroller of the Currency ("OCC") as a condition of its approval of the merger between Bank of America and Countrywide. *See* Rule 56.1 Statement of Undisputed Facts in Supp. of the Entity Defs.' Mot. for Summ. J., Dkt. 129, ¶¶188-95. The OCC required these indemnifications specifically to prevent any federally insured bank from suffering any loss whatsoever from the merger, thereby protecting the FDIC's insurance fund. The point of § 1833a's requirement that the violation affect a *federally insured* bank is similar—to punish conduct that threatens the FDIC's insurance fund. The indemnification agreements therefore did not represent BANA's "great fortune to be fully insured for such losses," SA83, as the district court held. Instead, they were a mechanism designed to prevent *precisely* the same kind of harm that § 1833a(c)(2) was designed to protect—and they were imposed by the same Government that now urges this Court to ignore them.

By contrast, in *Johnson*, the defendant alleged that the bank had recovered through restitution, which as the facts of that case demonstrate,[3] rarely makes the victim whole. 130 F.3d at 1352. And in *Millar*, the bank allegedly recovered via an insurance policy. 79 F.3d at 346. Even if that insurance had covered the loss, the bank presumably would have been affected with higher premiums and/or other mechanisms designed to decrease moral hazard (such as deductibles). The indemnification agreements here, though, were designed to make sure that BANA never suffered a single penny's loss relating to Countrywide's sale of mortgages, including through the HSSL.

Second, in both *Johnson* and *Millar*, the banks were the victims of the fraud or crime, and the bank's coffers were drained as a direct result of the crimes in those cases. The effect was therefore "sufficiently direct" under *Bouyea*. 152 F.3d at 195. Here, in contrast, the purported effect turns on an unrelated corporate merger *and* the decisions of third parties to bring either repurchase claims or claims for criminal or civil penalties. And, again, the indemnification agreements by their own

[3] In *Johnson*, the Ninth Circuit found that the bank actually suffered "an unreimbursed financial loss totalling approximately $500,000." 130 F.3d at 1355. Thus, the *Johnson* court's discussion of the significance of the bank's restitution and insurance recovery is at most dicta.

terms prevented BANA from suffering even the slightest loss relating to the HSSL. Under these circumstances, any risk of loss (if indeed there was such a risk) is simply too remote to trigger FIRREA. *See Agne*, 214 F.3d at 53 (requiring proof of a "realistic prospect of loss").

Moreover, even without the indemnification agreements, whether the repurchase demands satisfy the "affecting" prong is a jury question. The Government concedes that at least 4% of all loans sold to the GSEs were defective.[4] U.S. Br. 18. Even if the Government could point to a specific HSSL loan that was the subject of a repurchase request, it would have to prove that it was the HSSL process that caused that loan to be defective. In other words, the Government would have to prove that HSSL loans were the subject of repurchase demands more often than other loans.[5] If HSSL loans were the subject of repurchase

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[4] As numerous GSE witnesses testified, the actual number was closer to 18-25%. JA3004, 3268; *see also* Opening Br. 22, 26; Banks' Reply 31-32.

[5] For this reason, Defendants sought to introduce the evidence comparing the quality of HSSL loans to non-HSSL loans in part to prove that "HSSL loans have no greater incidence of delinquencies than non-HSSL loans," and therefore that "selling HSSL loans as opposed to non-HSSL loans did not increase the risk that Fannie or Freddie would request a repurchase." Bank Defs.' Mem. of Law in Opp'n to Government's Omnibus Mot. *in Limine* to Exclude Certain Evid., Dkt. No. 222, at 10. The district court excluded that evidence. SA31-32.

demands at the same rate as other loans, the "violation"—here, the HSSL process—would have had no effect on the federally insured financial institutions. 12 U.S.C. § 1833a(c)(2); *see also United States v. Stargell*, 738 F.3d 1018, 1022-23 (9th Cir. 2013) (requiring a "new or increased risk of loss" to meet the "affecting" prong in a similarly worded FIRREA provision).

B. Just as a bank cannot "affect" itself, a bank employee acting within the scope of his or her employment cannot affect the bank.

Our Opening Brief explains (at 47-48) why reversal of the verdict against the Banks necessarily requires reversal for Ms. Mairone. Because a bank acts only through the conduct of its employees, *see Braswell v. United States*, 487 U.S. 99, 110 (1988); *Suez Equity Investors, L.P. v. Toronto-Dominion Bank*, 250 F.3d 87, 101 (2d Cir. 2001), it would be incongruous to hold that a bank cannot "affect" itself, but its employees acting within the scope of their employment can. Opening Br. 47-48.

The Government does not explicitly argue otherwise. Nor does it dispute that it would be incongruous to let the Banks off the FIRREA hook, but nevertheless to impose FIRREA liability on an employee

operating at all times on behalf of the Banks. But at one point (at 41) the Government seems to suggest exactly that result. The Government relies on one sentence in *Heinz* in arguing that a bank employee could "affect[]" his or her bank for FIRREA purposes, even when acting within the scope of his or her employment. U.S. Br. 28 (citing *Heinz*, 790 F.3d at 367). But the *Heinz* court never analyzed whether the employee defendants were acting within the scope of their employment or instead had gone rogue. That was because, as noted earlier, *supra* at 6-7, the effect in *Heinz* was not limited to the defendants' employer, but included two other banks as well. *Heinz*, 790 F.3d at 367. The defendants therefore "affected" the other co-conspirator banks and FIRREA was satisfied regardless of the viability of the "self-affecting" theory. In this case, the only banks that were "affected" under the Government's theory were Ms. Mairone's employer and its successor in interest. Ms. Mairone was acting with the full participation, knowledge, and approval of her superiors at Countrywide in connection with the rollout and implementation of the HSSL. In short, she *was* Countrywide in all relevant respects.

The Government does not really argue otherwise, nor could it. The evidence demonstrated Ms. Mairone acted at all times with the consensus of FSL and her colleagues and superiors. Everyone at FSL, including Mr. O'Donnell, supported the creation of the HSSL program. *See, e.g.*, JA5727-28, 5493. The HSSL program was designed by a nine-member Steering Committee, of which Ms. Mairone was just one member. JA2208. The Central Fulfillment model was also designed collaboratively, and no one disagreed with the move to Central Fulfillment.[6] JA4056. The same goes for the decision to suspend Quality of Grade, which as explained in our Opening Brief, was also a collaborative decision, JA2407-08, 4207; *accord* Opening Br. 21. The November 29, 2007, email was also the product of a collaborative approach at FSL. Opening Br. 20. As was the decision to expand HSSL. JA5413-15, 5601-03.

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[6] The Government's contention that Ms. Mairone was the "head" of Central Fulfillment, U.S. Br. 14, ignores undisputed evidence that Ms. Mairone was never in charge of credit risk and compliance for Central Fulfillment—that was Mr. Kitashima's responsibility. JA5623-24; *see also* JA4239-40. Moreover, the evidence established that the long-term plan was to remove Ms. Mairone from any oversight of Central Fulfillment. JA5624 ("After approximately one year, this group will report to Scott."); *see also* JA4238-39.

An employee carrying out her employer's instructions and working together with other employees and executives to move to a new business model—no matter how flawed—was simply not the type of conduct Congress meant to punish in § 1833a. *Prosecuting Fraud in the Thrift Industry: Hearings Before the H. Subcomm. on Criminal Justice of the Comm. on the Judiciary*, 101st Cong. (1989), 1989 WL 1178203, at *2 (statement of Sen. Schumer) ("What's particularly disturbing is that many of those individuals who ran their institutions into the ground *for their own personal gain* remain unpunished, living off the wealth that they heisted." (emphasis added)); *id.* at *10 (prepared statement of Frederick D. Wolf, Assistant Comptroller General Accounting and Financial Mgmt.) ("[I]ndividuals in a position of trust in the institution or closely affiliated with it have, in general terms, *breached their fiduciary duties; traded on inside information; usurped opportunities or profits; engaged in self-dealing; or otherwise used the institution for personal advantage*." (emphasis added)).

II. The Judgment Against Ms. Mairone Must Be Reversed Because The Government Demonstrated Nothing More Than A Breach Of Preexisting Contracts—And Has No Theory As To How Ms. Mairone Was Responsible For Any Other Statements.

The Government does not contest that a breach of a pre-existing contract, without more, is not mail fraud. *Infra* § II.A. It instead refutes only a straw-man argument that no one here has made: that "the existence of a contract negate[s] the existence of fraudulent intent." U.S. Br. 44. We all agree that the Government cannot prevail unless it points to fraudulent statements beyond the contract itself. *Infra* § II.B. The Government points to no such statement—only to a contractual provision stating that the claimed representation is made every time the Banks sell a loan. But that is not a separate misrepresentation. And even if it were, the Government's theory fails as to Ms. Mairone, because there is no evidence that she even knew about the contractual provision that purportedly creates a new representation every time a loan is sold—and therefore no evidence that she was aware of (much less responsible for) any ongoing representations. *Infra* § II.C.

A. The Government does not contest that a breach of contract, ***without more***, cannot be the basis of a fraud claim.

The Government asserts that "defendants have not established that the federal mail and wire fraud statutes are governed by the New York law described in *Bridgestone*." U.S. Br. 47. We are not arguing that New York law governs, but rather that under a more universal rule, the Government cannot prevail simply by showing a breach of a contractual warranty. U.S. Br. 44. The Government concedes this principle, as it must, given the abundance of *federal* precedent establishing this rule. The Supreme Court first applied the rule in the mail fraud context in *Durland v. United States*, 161 U.S. 306 (1896), and it has been reaffirmed in recent decisions such as *Corley v. Rosewood Care Ctr., Inc. of Peoria*, 388 F.3d 990, 1007 (7th Cir. 2004), *United States v. D'Amato*, 39 F.3d 1249, 1261 n.8 (2d Cir. 1994), and *Mills v. Polar Molecular Corp.*, 12 F.3d 1170, 1176 (2d Cir. 1993). *See* Opening Br. 49-50; Banks' Br. 41-46. Nor does the Government contest the corollary principle, which this Court reaffirmed in *D'Amato*, that "[f]ailure to comply with a contractual obligation is only fraudulent

when the promisor never intended to honor the contract." 39 F.3d at 1261 n.8.

Not one of the many cases cited by the Government casts any doubt on either of these principles—certainly not the cases under New York law, on which the Government inexplicably lavishes attention without focusing on the broader body of federal precedent. As the Banks discuss in their Reply, those New York cases are "inapplicable to situations where, as here, the fraud claim is premised *entirely* upon the same warranty that also underlies the contract claim." *Kriegel v. Donelli*, No. 11-9160, 2014 WL 2936000, at *14 n.15 (S.D.N.Y. June 30, 2014) (collecting cases and reasoning that "*First Bank*[*of Americas v. Motor Car Funding, Inc.*, 257 A.D.2d 287 (N.Y. App. Div. 1999)] should be limited to its facts: situations where the alleged fraudulent misrepresentations pertain to matters addressed by the warranty *as well as* matters that the warranty does not cover"); Banks' Reply 12-13. One example is *In re Refco Inc. Securities Litigation*, where the misrepresentations had nothing to do with contractual promises; they were made in offering memoranda and marketing materials, audited

financial statements, and weekly risk management summaries. 826 F. Supp. 2d 478, 524 (S.D.N.Y. 2011).

The same is true of the federal cases the Government invokes. Banks' Reply 12 (discussing *United States v. Frank*, 156 F.3d 332 (2d Cir. 1998),[7] and *United States v. Naiman*, 211 F.3d 40 (2d Cir. 2000)).

Because "a warranty is a contract," *Chappell v. Boram*, 141 S.W. 19, 20 (Mo. 1911); *accord, e.g.*, *Hoover v. Utah Nursery Co.*, 7 P.2d 270, 274 (Utah 1932), it logically follows that a mere breach of a promise

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[7] The defendants in *Frank* never argued that the fraud was solely a breach of contract. *See generally* Brief on Appeal of Defendant-Appellant Jane Frank Kresch, *Frank*, 156 F.3d 332, 1997 WL 34650974 (May 22, 1997); Brief for Defendant-Appellant Susan Frank, *Frank*, 156 F.3d 332, 1997 WL 34650973 (May 30, 1997); Reply Brief on Appeal of Defendant-Appellant Jane Frank Kresch, *Frank*, 156 F.3d 332, 1997 WL 34650957 (Aug. 22, 1997); Reply Brief for Defendant-Appellant Susan Frank, *Frank*, 156 F.3d 332, 1997 WL 34650956 (Aug. 22, 1997). In fact, it seems evident that the defendants entered into the contract while never intending to honor it. The defendants contracted with municipalities to dispose of raw sewage in the ocean. 156 F.3d at 334-35. The parties later amended their contracts to require that the defendants comply with a law requiring disposal to take place at least 106 miles from shore, in return for more money. *Id.* at 335. The defendants, however, immediately began dumping the waste well short of the 106-mile site and then falsifying their billing-related records to conceal the breach from the municipalities. *Id.* at 335. Thus, although the court had no occasion to consider the issue, the facts plainly satisfied the standard for fraud in *Durland* (and *D'Amato*, and *Corley*, etc.): The defendants promised to dump all sewage 106 miles from shore, but never did, and in fact never intended to do so.

regarding the quality of goods to be sold and delivered in the future is not fraud. *See Suzy Phillips Originals, Inc. v. Coville, Inc.*, 939 F. Supp. 1012, 1016-17 (E.D.N.Y. 1996), *aff'd*, 125 F.3d 845 (2d Cir. 1997); *Dantzler Lumber & Exp. Co. v. Bullington Lumber Co.*, 968 F. Supp. 1543, 1547 (M.D. Fla. 1997). An oft-cited Florida case provides an apt analogy, presenting two scenarios. The first scenario is one the Government concedes is inapplicable here:

> Suppose someone offers to sell you a particular emerald for $5,000 and, in order to induce you to buy it, represents to you that it is "top quality" and that it has not been filled. You buy it based on the factual representation that the stone is unfilled but later you learn that it, in fact, had been filled. If the seller knew the emerald had been filled but lied in order to trick you into agreeing to buy it, you have a cause of action for fraud with all its attendant remedies....

La Pesca Grande Charters, Inc. v. Moran, 704 So. 2d 710, 713 (Fla. Dist. Ct. App. 1998). The second scenario is this case:

> Suppose, on the other hand, on December 1, 1997, the same person enters into a contract with you pursuant to which, in exchange for your payment of $5,000, he will deliver to you on January 1, 1998 a "top quality," unfilled emerald. If, on January 1, 1998, he instead delivers an emerald that has been filled, he has only breached the contract. It is immaterial whether, when he delivered the emerald on January 1, 1998, he knew the emerald was filled. This is breach of contract pure and simple *and cannot be converted into a fraud*....

Id. (emphasis added); *see also DynCorp v. GTE Corp.*, 215 F. Supp. 2d 308, 325 (S.D.N.Y. 2002) (refusing to consider allegations of "breaches of promises concerning future events" in contractual representations and warranties as sufficient to plead fraud). This principle applies, as explained in our Opening Brief (and the Government does not dispute), even if the defendant does not alert the buyer to the breach: "[C]oncealment of a breach is insufficient to transform what would normally be a breach of contract action into one for fraud." *Reuben H. Donnelly Corp. v. Mark I Mktg. Corp.*, 893 F. Supp. 285, 290 (S.D.N.Y. 1995); *accord* Opening Br. 54-55.

B. The Government fails to point to a fraudulent statement beyond the contract itself.

Instead of contesting the central principles that control here, the Government trains its attention largely on the straw-man argument that "existence of a contract negate[s] the existence of fraudulent intent." U.S. Br. 44; *see also id.* at 4-5 (asking in Question 2 whether fraud can exist when "defendant's misrepresentations also breach a contract between the defendant and the victim"). No one here has ever argued that the mere existence of a contract precludes all fraud claims. Rather, the well-established rule is that mail fraud cannot arise from

solely a breach of contract (unless the defendant never intended to honor the contract). As the Government seems to concede, it must point to a separate statement, "*[a]fter*," and apart from, the contract—and demonstrate "[t]hat those false statements" justify "liability for fraud." U.S. Br. 43.

As the Banks explain in detail, the Government's older common-law cases supply examples of misrepresentations that are separate from, and after, the contract. Banks' Reply 14-15. That is why the Government concedes that it had to prove that "*[a]fter* entering into contracts in which Countrywide warranted that loans sold to the GSEs in the future would be investment quality, defendants repeatedly misrepresented the quality of the loans they were delivering to fraudulently induce the GSEs to purchase loans known to be defective." U.S. Br. 43 (emphasis added); *see id.* 22 ("[D]efendants repeatedly misrepresented the quality of the loans they were delivering to fraudulently induce the GSEs to purchase loans known to be defective.").

Each time the Government asserts that it proved that factual proposition, it fails to cite to the record. The reason is clear: *The*

Government never alleged any misrepresentation in this case other than the breach of the contractual representation and warranty that the loans were "investment quality." There was no evidence of any separate statements to the GSEs about the quality of the loans or the HSSL process. This is particularly true for Ms. Mairone; uncontested evidence established that she had *no* interactions with anyone from the GSEs during her time at FSL. JA3041, 3145, 4304-05, 4797. Rather, the allegations of fraud in this case involved nothing more than a breach of contract: Defendants sold loans to the GSEs; the governing contracts said those loans had to be investment quality; and they were not.[8] End of story.

[8] In the fact section of its brief, the Government alludes to testimony by the GSE witnesses that they were never told about the HSSL, and that only six defective HSSL loans were self-reported to the GSEs. U.S. Br. 19. These facts do not make their way into the argument section of the Government's Brief because they are irrelevant to its theory of fraud. The district court rightfully refused to charge the jury on a theory that FSL employees failed to disclose to the GSEs the facts of the HSSL process, because FSL was under no duty to do so. JA4915-16. And it also rightfully refused to let the jury consider any failure to self-report defective loans, since there was no evidence that Ms. Mairone, Mr. Lumsden, or Mr. Kitashima knew anything about that contractual requirement. JA4984-87. In any event, the jury heard evidence that the GSEs *did* know about the HSSL process at the time. JA3031-33, 3256.

Remarkably, when the Government finally does cite the record in support of its assertion that "[t]he trial evidence showed that representations and warrantees were made with each loan sale," it concedes that the "post-contract fraudulent misrepresentations" that purportedly provided the basis for its claims were *not* in fact separate statements to the GSEs. U.S. Br. 46. Instead, the Government cites language in the original GSE contracts stating that the representations and warranties "are made as of the date transfer is made to [Fannie]." JA5905, 5935; *see* JA6366 (similar language in Freddie Mac contract). Thus, the Government contends, those pre-existing contractual clauses are somehow transformed into separate fraudulent misrepresentations to the GSEs every time they purchased a loan.

Unsurprisingly, the Government found no authority supporting this strained notion of "fraud." Like an installment contract, *see, e.g.*, *Dell's Maraschino Cherries Co. v. Shoreline Fruit Growers, Inc.*, 887 F. Supp. 2d 459, 472 (E.D.N.Y. 2012), or a requirements contract, *see, e.g.*, *In re Delphi Corp.*, 394 B.R. 342, 344-45 (S.D.N.Y. 2008), Countrywide's relationship with each GSE was governed by a forward-looking agreement, and there was no evidence that Countrywide intended to

breach either agreement at the time it entered into it. That is all that matters under this Court's precedent. *See D'Amato*, 39 F.3d at 1261 n.8.

The Government never disputes our hypothetical under which Ms. Mairone could have been prosecuted for mail fraud (and sent to federal prison for up to 20 years) simply by continuing to mail her rent payment after losing her job, thus breaching a lease agreement that contained a similar reverberating representation that she was employed "as of the date" of each rent payment. Opening Br. 55. Using contractual language like that to turn what would otherwise be a simple breach of a contractual representation and warranty into mail or wire fraud would give the Government (and private civil RICO plaintiffs) a terrifying power. Thankfully, it has been the law for well over a hundred years that mail and wire fraud based on nothing other than a breach of contract requires proof that the defendant intended to breach the contract from the outset. Because the Government all but concedes that it has no such proof, this Court should reverse the judgment against Ms. Mairone.

C. The Government's sole theory of separate and subsequent misrepresentations does not apply to Ms. Mairone.

Even if the Government's theory of liability were valid as to the Banks, it requires reversal with respect to Ms. Mairone. The Government (at 19) points only to evidence that Ms. Mairone was vaguely aware of the original warranty that the loans would be "investment quality." The Government does not and cannot point to *any* evidence that Ms. Mairone was aware of the provision that purportedly repeats the representation with each sale. That omission is fatal, since the Government had the burden of proving each element of the offense as to Ms. Mairone. She cannot be held responsible for a repeated representation when she was unaware that the representation was repeatedly being made.

III. The Government Cannot Defend The District Court's Decision To Allow Government Witnesses To Testify About Their Contemporaneous Views Of The HSSL Process While Denying Defendants That Same Opportunity.

Our Opening Brief explains how the district court's evidentiary rulings created an unfair double standard under which the Government was permitted to introduce witnesses who described their contemporaneous concerns about the HSSL process, but Defendants

were prohibited from eliciting testimony from witnesses who took the opposite view. Opening Br. 58-59. The prejudice to Defendants, and Ms. Mairone in particular, is obvious: The jury was left with the impression that no one at FSL shared Ms. Mairone, Mr. Lumsden, and Mr. Kitashima's view that the HSSL process did not undermine loan quality, when in fact Defendants had plenty of evidence to the contrary that they were not allowed to admit.

The Government repeats the district court's claim that it permitted witnesses to testify about their personal views of the HSSL process only if they communicated those views to the three FSL employees alleged to have the requisite fraudulent intent—Ms. Mairone, Mr. Lumsden, and Mr. Kitashima. U.S. Br. 71. As we explained in our Opening Brief, however, that post-hoc justification for the rulings makes no sense: It would have been *impossible* for the district court to enforce such a rule prior to the close of the Government's case, as the Government did not identify those three individuals as the relevant actors until halfway through trial. Opening Br. 59; *accord* JA3516. The Government's appellate brief does not even attempt to address this fatal problem with the district court's

explanation. And in any event, as the Banks demonstrate, the district court's rationale was also flatly wrong as a factual matter. Banks' Reply 27-28.

The Government's contention that Defendants failed to preserve this argument proves our point. U.S. Br. 71. At the time the Government's witnesses testified, there was nothing to preserve, because the district court's only ruling had been that witnesses would not be able to testify as to whether they thought the HSSL was fraudulent or as to any particular person's "character for truthfulness or honesty." Opening Br. 57. It was not until the district court abruptly switched course in the middle of Mr. Barnett's testimony, JA4014, that Defendants had any reason to believe that they would not be able to present their own witness testimony addressing the same issues as the Government's witnesses.

Moreover, even if the district court had consistently applied its post-hoc rule and prohibited both Defendants' witnesses *and* the Government's witnesses from testifying about their contemporaneous opinions of the HSSL process unless they directly communicated those opinions to Ms. Mairone, Mr. Lumsden, or Mr. Kitashima, the rule

would have been unfairly prejudicial to Defendants, and especially Ms. Mairone. As a practical matter, an employee has far less reason to speak up when he agrees with a supervisor's direction than when he disagrees; it would be strange for an employee to tell his boss every time he approves of her decision-making. The only way for Ms. Mairone to demonstrate to the jury that her optimistic views of the HSSL process were consistent with those of other FSL employees was to offer testimony to that effect from those employees. In a case that turned on the legitimacy of a business decision, the district court's decision to exclude any evidence tending to show that decision in a positive light while admitting evidence to the contrary was an abuse of discretion.

The Government's assertion that the district court's ruling was harmless is belied by the Government's own prosecution strategy. During summation, the Government repeatedly made the precise point that Defendants are making now: that employees' opinions as to the propriety of the key decisions at issue in this trial were central to the question whether this was an intentionally fraudulent scheme or a valid business disagreement. JA5011 ("And you heard from Mr. Thomas that he was immediately concerned about the Hustle model and he said so.");

JA5012 ("[Y]ou heard from Mr. Price and you heard from John Boland about their concerns with loan specialists."); JA5034 ("Michael Thomas and Ed O'Donnell, among others, knew the reason that quality was bad during this time, and we know the reason, too. The reason was the Hustle."). Even in its brief on appeal, the Government emphasizes the importance of this opinion testimony. U.S. Br. 66 ("Witnesses, such as O'Donnell and Thomas, testified that the defects found in the pre-funding QA stage bore on loan quality and were a preview of post-funding ratings if the defects were not corrected."). The reasonableness of Ms. Mairone's interpretation of the QOG suspension and QA numbers was absolutely critical to Ms. Mairone's defense, but the district court allowed the jury to hear only the Government's side of that issue. A new trial is necessary to correct that highly prejudicial error.

CONCLUSION

For the foregoing reasons, and for the reasons explained in the Banks' Briefs, this Court should either reverse the judgment of the district court because the Government's case failed as a matter of law,

or vacate the judgment and remand for a new trial in light of the district court's erroneous evidentiary rulings.

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Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

I hereby certify that this brief complies with the type-volume limitation of Federal Rules of Appellate Procedure Rule 32(a)(7)(B) because it contains 6,999 words, based on the "Word Count" feature of Microsoft Word 2010, excluding those parts of the brief exempted by Federal Rule of Appellate Procedure 32(a)(7)(B)(iii). I certify that this brief complies with the typeface requirements of Federal Rule of Appellate Procedure 32(a)(5) and the type style requirements of Federal Rule of Appellate Procedure 32(a)(6) because it has been prepared in proportionally spaced typeface using 14-point Century Schoolbook font.

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