15-496-cv(L)

15-499-cv (CON)

UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

UNITED STATES OF AMERICA, EX REL. EDWARD O'DONNELL,
UNITED STATES OF AMERICA,
Plaintiffs-Appellees,

v.

COUNTRYWIDE BANK, FSB, COUNTRYWIDE HOME LOANS, INC.,
BANK OF AMERICA, N.A., AND REBECCA MAIRONE,
Defendants-Appellants.

On Appeal from the United States District Court
for the Southern District of New York, No.12-cv-1422
Before the Honorable Jed S. Rakoff

BRIEF FOR AMICI CURIAE THE CLEARING HOUSE ASSOCIATION, L.L.C., AMERICAN BANKERS ASSOCIATION, FINANCIAL SERVICES ROUNDTABLE, AND CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA IN SUPPORT OF DEFENDANTS-APPELLANTS

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CORPORATE DISCLOSURE STATEMENT

Pursuant to Federal Rule of Appellate Procedure 26.1, the undersigned counsel for amici curiae The Clearing House Association, L.L.C. ("The Clearing House"), the American Bankers Association ("ABA"), the Financial Services Roundtable ("FSR"), and the Chamber of Commerce of the United States of America (the "Chamber") hereby certifies that amici are not a subsidiary of any other corporation. The Clearing House is a limited liability company and as such has no shareholders. Rather, each member holds a limited liability company interest in The Clearing House that is equal to each other member's interest, none of which is more than a 10% interest in The Clearing House. The ABA, FSR, and Chamber are non-profit trade groups and have no shares or securities that are publicly traded.

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STATEMENT OF INTEREST OF AMICI CURIAE[1]

Amici and their members have an abiding interest in enforcing the Nation's banking laws consistent with Congress's intent and in furtherance of the regulatory and enforcement scheme Congress envisioned. Established in 1853, The Clearing House is owned by the world's largest commercial banks. The Clearing House is a nonpartisan advocacy organization representing the interests of its member banks on a variety of systemically important banking issues. Its affiliate, The Clearing House Payments Company L.L.C., provides payment, clearing, and settlement services to its member banks and other financial institutions, clearing almost $2 trillion daily.

The ABA is the principal national trade association of the financial services industry in the United States. Founded in 1875, the ABA is the voice for the nation's $13 trillion banking industry. The ABA, whose members hold a substantial majority of domestic assets of the banking industry of the United States and are leaders in all forms of consumer financial services, often appears as amicus curiae in litigation that affects the banking industry. Accordingly, the ABA has a strong interest in the Court's interpretation of banking laws.

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[1] All parties consent to the filing of this brief. Amici state that no party or party's counsel authored this brief in whole or in part. Defendant-appellant Bank of America, N.A. is a member of or otherwise affiliated with amici. No party, party's counsel, or any person other than amici, their members, or their counsel contributed money intended to fund preparing or submitting this brief.

The FSR represents 100 of the largest integrated financial service companies that provide banking, insurance, and investment products and services to American consumers. The Roundtable has a significant interest in promoting policies that ensure the stable regulation of financial institutions.

The Chamber is the world's largest business federation. It represents 300,000 direct members and indirectly represents the interests of more than three million companies and professional organizations of every size, in every industry sector, from every region of the country. An important function of the Chamber is to represent the interests of its members in matters before Congress, the Executive Branch, and the courts. To that end, the Chamber regularly files amicus curiae briefs in cases raising issues of concern to the Nation's business community.

INTRODUCTION

The district court's novel interpretation of 12 U.S.C. § 1833a is not only wrong but also potentially dangerous to the national banking system. Since its enactment a quarter of a century ago as part of the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA), § 1833a has been consistently understood to protect the safety and soundness of the banking system by subjecting parties to civil liability when they engaged in fraud that "affect[ed] a federally insured financial institution." Before 2012, no court had interpreted § 1833a to sanction a bank's own self-affecting conduct. That only changed when the

government pursued an aggressive reading of the statute that ignored its language, structure, history, purpose, and effects on public policy.

FIRREA already contains other, effective deterrents to bank misconduct—imposing substantial civil penalties for violations of any law or regulation, subject to the ordinary five-year statute of limitations for federal enforcement actions—and properly delegates that power to banking regulators who are best positioned to balance punishment with other important regulatory goals. *See* 12 U.S.C. § 1818(i). Regulators make their enforcement decisions under § 1818(i) within the broader regulatory architecture, which places paramount importance on bank safety and soundness—concern for which animated FIRREA's enactment in the first place. DOJ, which enforces § 1833a, is not so constrained. The government's use of § 1833a to expand liability and bring actions up to ten years after the fact—after the same conduct may have already been the basis for enforcement or global settlement with other regulators—should be rejected.

The Court should also reverse the district court's imposition of a $1.3 billion penalty, which is unsupported by the statute and grossly disproportionate to any gains or losses proximately caused by defendants. This Court should clarify that any penalties available against financial institutions under § 1833a must comport with the traditional understanding that (1) gains and losses mean *net* or *actual* gains and losses, and (2) any such gains and losses must have been proximately

caused by the defendant's actions in order to form the basis of a coercive monetary penalty.

ARGUMENT

I. FIRREA DOES NOT EMBRACE THE GOVERNMENT'S SELF-AFFECTING THEORY

Congress enacted FIRREA to respond to the savings and loan crisis of the mid-1980s and related scandals in which insiders abused their positions and mismanaged financial institutions to benefit themselves. *See* GAO, *Thrift Failures: Costly Failures Resulted From Regulatory Violations and Unsafe Practices* 17-23 (1989) (detailing such concerns, including "fraud and insider abuse"). The statute vests DOJ with authority to seek deterrent and punitive civil penalties from parties whose criminal conduct "affect[s]" federally insured financial institutions. 12 U.S.C. § 1833a. The statute also "greatly expanded" federal bank regulators' "power to impose civil monetary penalties but incorporated safeguards to ensure that excessive penalties are not assessed." *Oberstar v. FDIC*, 987 F.2d 494, 504-505 (8th Cir. 1993) (discussing penalties under 12 U.S.C. § 1818(i)).

This case presents the question whether § 1833a can lawfully be applied to a federally insured financial institution for affecting itself (*i.e.*, where the conduct at issue does not victimize a different institution). The language, structure, purpose,

and legislative history of FIRREA all confirm that § 1833a cannot be used in this manner.

A. FIRREA Separated Its Agency-Enforcement Mechanisms Against Unsound Bank Practices From Its Civil-Enforcement Provisions Against Bank Fraudsters

FIRREA established an intricate regime for ensuring that federally insured financial institutions are subject to an appropriate civil penalty if they "violate[] any law or regulation," 12 U.S.C. § 1818(i)(2)(A)(i), or "recklessly engage[] in any unsafe or unsound practice in conducting the affairs of such depository institution," *id.* § 1818(i)(2)(B)(i)(II). If a covered financial institution commits any violation of federal law or regulations, or recklessly mismanages its affairs in an unsafe or unsound manner, then the "appropriate Federal banking agency" is authorized to institute enforcement proceedings and seek civil penalties under § 1818(i)(2). *See id.* § 1818(i)(2)(E)(i). Actions brought under this section are subject to "the general statute of limitations for collection of civil penalties, 28 U.S.C. § 2462." *United States v. Godbout-Bandal*, 232 F.3d 637, 639 (8th Cir. 2000).

Congress deliberately protected this regime from unwarranted overlap or intrusion. The courts of appeals have consistently recognized that "by devising a comprehensive scheme governing the oversight of financial institutions, from administrative control through judicial review of the administrative agency's actions, and by explicitly making the scheme exclusive, Congress intended to

exclude other methods of interfering with the regulatory action." *Carlton v. Firstcorp, Inc.*, 967 F.2d 942, 946 (4th Cir. 1992); *Ridder v. Office of Thrift Supervision*, 146 F.3d 1035, 1039 (D.C. Cir. 1998) (collecting cases); *see also* 12 U.S.C. § 1818(i)(1) (stripping federal courts of jurisdiction "to affect by injunction or otherwise the issuance or enforcement of any notice or order" under § 1818(i)).

Congress also carefully crafted the penalties available in these administrative enforcement proceedings, enacting a multi-tiered regime that calibrates penalties based on the gravity of an institution's wrongful conduct. *See* 12 U.S.C. § 1818(i)(2)(A) ($7,500 per day for violations without ill intent); *id.* § 1818(i)(2)(B) ($37,500 per-day penalty for certain offenses, including patterns of misconduct); *id.* § 1818(i)(2)(C), (D) (lesser of $1.425 million or 1 percent of total assets for knowingly breaking the law to cause a substantial gain or loss); *see also* 12 C.F.R. § 263.65(b)(2). The contemporaneous legislative record suggests that regulators were to make civil-penalty determinations based on pre-existing Federal Financial Institutions Examination Council guidelines. H.R. Rep. No. 101-54, pt. 1, at 469 (1989). Those guidelines directed the regulators to consider, among other things, safety and soundness concerns and whether other agreements or orders (*e.g.*, with other regulators or government agencies) were effective prophylactics against future violations. *Civil Money Penalties*, 1981 WL 388431, at *4-5 (O.T.S. Dec. 17, 1981) (attaching FFIEC's guidelines). The guidelines also

instructed regulators to inform each other of assessed civil penalties; as they explained: "[I]nteragency notification is desirable in view of the size of the penalties that may be assessed[.]" *Id.* at *4; *see also* FFIEC Revised Policy Statement on Interagency Coordination of Formal Corrective Action by the Federal Bank Regulatory Agencies, 62 Fed. Reg. 7782, 7783 (Feb. 20, 1997).

Therefore, until the string of three district court opinions in this Circuit, the "comprehensive scheme" embodied in § 1818(i)(2) provided the sole basis under FIRREA for administering civil penalties imposed on financial institutions for self-affecting conduct—that is, for conduct by the institution that potentially threatened the institution's own safety and soundness. *See, e.g.*, *In re Citigroup Inc., New York, New York*, 2012 WL 529568, at *3 (F.R.B. Feb. 13, 2012) (ordering $22 million civil penalty as part of a consent order against Citigroup under § 1818(i)(2)).

Congress also enacted—in a separate section of FIRREA—a provision allowing the Attorney General to seek civil penalties against "[w]hoever violates" any of three categories of criminal laws. 12 U.S.C. §1833a(a). Two of these categories (subsections (c)(1) and (c)(3)) specifically relate to criminal offenses in which the underlying conduct inherently affects financial institutions—*e.g.*, bank fraud, bribery of a bank officer or employee, and fraud against the Small Business Administration. *See id.* § 1833a(c)(1), (3). The third category incorporates

generally applicable criminal laws, like wire and mail fraud when such fraud "affect[s] a federally insured financial institution." *Id.* § 1833a(c)(2).[2] Section 1833a gives the Attorney General the exclusive authority to bring proceedings thereunder, and includes a set of particularly permissive procedural requirements, including a ten-year statute of limitations and a lightened "preponderance of the evidence" burden of proof. *Id.* §§ 1833a(f)-(h). The defendant will generally face

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[2] The district court in *United States v. Bank of New York Mellon*, 941 F. Supp. 2d 438, 453 (S.D.N.Y. 2013), accepted the government's "self-affecting" theory, in part because it concluded that some offenses contained within subsections (c)(1) and (c)(3) "do not require that any financial institution be victimized." That, however, misses the point. Those subsections cover species of fraud that by their very nature will ordinarily harm financial institutions. The government can point to nothing in subsection (c)(2) to indicate that Congress intended to depart from this theme.

The court in *Bank of New York Mellon* further erred by concluding that subsection (c)(2) is not intended to protect financial institutions because it includes a reference to the False Claims Act, 18 U.S.C. § 287, which prohibits crimes against the United States, not banks. *See* 941 F. Supp. 2d at 453-454. Congress amended subsection (c)(2) to include references to the False Claims Act, the False Statement Act, and 18 U.S.C. § 1032, which Congress simultaneously enacted with the amendment to criminalize the concealment of bank assets from the FDIC acting as a conservator or receiver. Crime Control Act of 1990, Pub. L. No. 101-647, §§ 2501, 2596, 104 Stat. 4789, 4859, 4882. Read together, those amendments make clear that Congress expanded the scope of subsection (c)(2) to penalize individuals who attempted to steal money from institutions under government control. *See* 136 Cong. Rec. H13,271, H13,290 (daily ed. Oct. 27, 1990) (Rep. Brooks: the savings and loan amendments "tighten[] criminal penalties to be levied against individuals who defraud financial institutions"); *id.* at H13,296 (Rep. Schumer: "You do not want the savings and loan crooks to abscond and escape with their money. This bill will stop it.").

a maximum fine of $1.1 million, but can alternatively face a greater penalty based on the pecuniary gain or loss caused by the violation. *Id.* § 1833a(b).

In the decades following FIRREA's enactment, § 1833a was used to bring civil-penalty actions against individuals whose conduct defrauded or otherwise injured a covered financial institution. There was no indication of any understanding at the time of the statute's enactment—including in prosecutions or in academic commentary—that § 1833a penalties could be applied against financial institutions for conduct affecting *themselves*. *See* Malloy, *Nothing to Fear But FIRREA Itself*, 50 Ohio St. L.J. 1117, 1122-1123, 1151-1152 (1989) (discussing expanded civil penalty provision against banks without mentioning § 1833a); Providenti, *Playing With FIRREA, Not Getting Burned*, 59 Fordham L. Rev. S323, S335 (1991) (discussing penalties for institutions under § 1818(i)(2)). Indeed, there was no such understanding even decades later. *See* Nuccio et al., *Special Liability Risks for Director Appointees to Banking Organizations*, 127 Banking L.J. 120, 131-132 (2010) (discussing enforcement of § 1833a against individuals for, among other things, making false statements to the FDIC and misapplication of bank funds). Not until the government introduced its self-affecting theory in this and other recent cases did anyone even contemplate that FIRREA could be used in this manner.

B. Section 1833a(c)(2) Does Not Penalize A Bank's Self-Affecting Conduct

The language, structure, purpose, and history of FIRREA all demonstrate that § 1833a has no application here. The government's argument otherwise, which the district court adopted, rests on an impermissibly broad and awkward reading of the word "affecting."

1. Section 1833a must be read in context

Statutes must be construed sensibly and in accordance with their purpose. Even if the term "affecting" could, standing alone, be read in the manner the government proposes—and, for the reasons discussed below, it cannot—that reading would "strangle [the term's] meaning." *Utah Junk Co. v. Porter*, 328 U.S. 39, 44 (1946); *cf. Diskin v. Lomasney & Co.*, 452 F.2d 871, 874 (2d Cir. 1971) (Friendly, J.) ("Even if a completely literal reading would lead to [a particular] conclusion … '[t]here is no surer way to misread any document than to read it literally.'" (quoting *Guiseppi v. Walling*, 144 F.2d 608, 624 (2d Cir. 1944) (L. Hand, J., concurring))); Scalia & Garner, *Reading Law: The Interpretation of Legal Texts* 357 (2012) ("To read the phrase hyperliterally is to destroy its sense.").

In the few cases construing the "affecting" language of §1833a (before the three Southern District opinions addressing the question presented in this appeal), courts have declined to read the term expansively to reach conduct outside the scope of its common usage. *See United States v. Vanoosterhout*, 898 F. Supp. 25,

30 (D.D.C. 1995) ("Punitive statutes, such as FIRREA, are to be narrowly construed."). For instance, the Fourth Circuit has held that merely using a financial institution "in the transfer of funds" as part of a wire-fraud scheme does not "affect" the financial institution. *United States v. Ubakanma*, 215 F.3d 421, 426 (4th Cir. 2000). Rather, to be liable under § 1833a, the financial institution must be "victimized by the fraud." *Id.*

By contrast, the district court reasoned that "affecting" means "to have an effect on," and concluded that defendants' conduct necessarily had an effect on themselves. *See United States v. Countrywide Fin. Corp.*, 961 F. Supp. 2d 598, 605 (S.D.N.Y. 2013). No English speaker would use the word "affect" in this manner. Section 1833a(c)(2) provides for liability when there is a specified "violation … affecting a federally insured financial institution." Because the financial institution is the direct object of this sentence—the entity *being* affected—it is natural to understand that the relevant violation is committed by another party, namely a criminal who is defrauding the institution. It would be unnatural to use the word "affecting" to refer back, reflexively, to the party who committed the violation in § 1833a. The government's reading, while conceivable, is not the way a person normally refers to the perpetrator of the described conduct. *See Watson v. United States*, 552 U.S. 74, 79 (2007) ("The Government may say

that a person 'uses' a firearm simply by receiving it in a barter transaction, but no one else would.").

The Supreme Court rejected a similarly implausible reading in *Abuelhawa v. United States*, 556 U.S. 816 (2009). There, the statute made it a felony "to use any communication facility in committing or in causing or facilitating" certain felonies prohibited by the statute. 21 U.S.C. § 843(b). The government argued that using a cellphone to buy illegal drugs counted as using a communication facility to "facilitate" the felony of drug distribution. The Court acknowledged that "the phone calls *could* be described as 'facilitating' drug distribution," but declined to adopt such a reading, explaining that "[w]here a transaction like a sale necessarily presupposes two parties with specific roles, it would be odd to speak of one party as facilitating the conduct of the other." 556 U.S. at 819-820 (emphasis added). Likewise, in *Gebardi v. United States*, 287 U.S. 112 (1932), the Court held that a woman who voluntarily crossed a state line with a man to engage in "illicit sexual relations" could not be held to account for "aid[ing] or assist[ing] in ... transporting, in interstate or foreign commerce ... any woman or girl for the purpose of prostitution or of debauchery, or for any other immoral purpose" in violation of the Mann Act. *Id.* at 118. The Court thus rejected a "self-affecting" theory similarly implausible to the one the government has proffered here. *See id.* at 118-119 ("The Act does not punish the woman for transporting herself; it

contemplates two persons—one to transport and the woman or girl to be transported."). These cases honor the ordinary operation of English grammar and forbid the result the government proposes here.

Most recently, in *Yates v. United States*, 135 S. Ct. 1074 (2015), the Court held that the term "tangible object" in 18 U.S.C. § 1519 (an anti-shredding law passed in the wake of the Enron scandal) did not encompass a fish. Although the Court recognized that the dictionary definition of a "tangible object" certainly encompasses "fish from the sea," that straightforward application of the plain words could not alone sanction the government's prosecution. 135 S. Ct. at 1081-1082 (plurality opinion); *contra Countrywide*, 961 F. Supp. 2d at 605 (decision "requires nothing more than straightforward application of the plain words of the statute").

As in those cases, the statutory text here does not support the government's reading given "the specific context in which that language is used, and the broader context of the statute as a whole." *Yates*, 135 S. Ct. at 1082 (plurality opinion) (quoting *Robinson v. Shell Oil Co.*, 519 U.S. 337, 341 (1997)). For instance, § 1833a was originally enacted as § 951 of FIRREA, and it was immediately followed by dozens of amendments to other criminal statutes, increasing the criminal liability for individuals who committed fraud *against* financial institutions. Pub. L. No. 101-73, §§ 951, 961, 103 Stat. at 498, 499. By contrast,

§ 1818(i)(2)—which authorizes a bank regulator to enforce a different, tiered penalty scheme against the banks themselves (and their employees)—was included in FIRREA's sections expanding regulatory authority over banks and increasing the penalties for wayward banks. *Id.*, 103 Stat. at 446-478, §§ 901-910. There is no reason to presume, as the government does, that Congress intended § 1818(i)(2), designed explicitly to regulate the assessment of civil penalties against banks, to overlap with § 1833a, which focuses on parties who defraud banks. *See, e.g.*, H.R. Rep. No. 101-54, pt. 1, at 466 (§ 1833a was designed principally to "punish culpable individuals [and] to turn this situation around").

2. FIRREA's legislative history demonstrates that Congress did not intend for § 1833a to subject financial institutions to liability for self-affecting conduct

The legislative history of § 1833a further demonstrates that the statute was designed to punish individuals who harm banks—"crooks, wearing tailor-made suits and wily smiles" who had "pilfered the industry"—not the financial institutions themselves. 101 Cong. Rec. H2,725 (daily ed. June 15, 1989) (Rep. Annunzio). In signing the bill, President Bush remarked that it would subject "officers and directors of insured institutions" to § 1833a(b)'s penalty; he made no mention that banks would be subject to that same provision. *Remarks on Signing the Financial Institutions Reform, Recovery, and Enforcement Act of 1989*, 25 Weekly Comp. Pres. Doc. 1226, 1227 (Aug. 9, 1989).

The legislative history also clarifies that § 1833a(c)(2) was not intended to greatly expand the breadth of § 1833a. Rather, subsection (c)(2) was included to penalize those individuals who committed bank fraud—the references to wire fraud and mail fraud were added once Congress realized that, in its "rush[,]" it had omitted these "types of white-collar crime." *Prosecuting Fraud in the Thrift Industry: Hearing Before the Subcomm. on Criminal Justice of the H. Comm. on the Judiciary*, 101st Cong., 118, 121 (1989), *at* 1989 WL 1178203.

The government has previously argued that the legislative history demonstrates that Congress intended for § 1833a to be cumulative with administrative and criminal penalties imposed against financial institutions for their own misconduct. U.S. Opp. to Mot. to Dismiss 35, No. 12-cv-1422 (S.D.N.Y Apr. 1, 2013) (Dkt. No. 59). That argument does not help the government here.

First, § 1818(i)(2) expressly applies to individuals who are an "institution-affiliated party," a term understood to cover bank officers and directors. *See Office of Thrift Supervision v. Paul*, 985 F. Supp. 1465 (S.D. Fla. 1997); *United States v. Leuthe*, 2002 WL 442840 (E.D. Pa. Mar. 20, 2002); *In re Robards, Jr.*, 1992 WL 545096 (O.C.C. June 8, 1992). To the extent § 1833a's penalties may be cumulative with other penalties, this is true only with respect to those institution-affiliated parties who commit offenses against financial institutions. It is unsurprising that Congress, focused on curbing individual fraud, would recognize

that culpable individuals working for the regulated financial institutions may be subject to cumulative penalties. It seems far less likely that Congress would establish an intricate regulatory regime for financial institutions—one outfitted with tailored remedies—while also authorizing DOJ to bring substantial civil-penalty actions (without regard to safety-and-soundness concerns) against financial institutions for the very same conduct. *Cf. Carlton*, 967 F.2d at 946 ("Congress intended to exclude other methods of interfering with the regulatory action.").

Second, the very committee report cited by the government clarifies that, as to § 1833a, Congress understood the provision to apply to individuals who defraud banks, not institutions. H.R. Rep. No. 101-54, pt. 5, at 7 ("If the *individual in question* caused losses in excess of $1 million, it would be inappropriate to cap his penalty at this amount" under § 1833a (emphasis added)).

C. Reading § 1833a(c)(2) To Subject Banks To Liability For Self-Affecting Conduct Would Be Contrary To FIRREA's Goals And Public Policy

Congress calibrated an appropriate level of deterrence in § 1818 and similar provisions by providing for a measured, tiered system of penalties that the banking regulators could impose to punish institutions, taking into account not only the degree of culpability and the severity of the violation, but also safety and soundness considerations. *See supra* pp. 5-7. Congress was unsparing in the offenses for which financial institutions could be held to account, prescribing

substantial civil penalties when financial institutions or institution-affiliated parties "violate[] *any* law or regulation." 12 U.S.C. § 1818(i)(2)(A)(i) (emphasis added). FIRREA thus "expanded the ability of the agencies" to "respond forcefully to abusive conduct" while still fulfilling their charge of protecting "the safe and sound operation of insured depository institutions." Weinstein, *Moral Hazard Deposit Insurance and Banking Regulation*, 77 Cornell L. Rev. 1099, 1103 (1992).

This expanded enforcement power, however, is not the only tool available to regulators. Bank regulators continue to "implement prudential laws through a supervisory system that relies on both onsite and offsite periodic examination" in order to continuously ensure "the safety and soundness of [any] bank." Schooner, *Consuming Debt: Structuring the Federal Response to Abuses in Consumer Credit*, 18 Loy. Consumer L. Rev. 43, 56-57 (2005). By primarily supervising, rather than enforcing, regulators are able to "determine compliance of consumer protection laws ex ante, *i.e.*, possibly before harm has accrued, rather than ex post and through investigations and administrative enforcement proceedings." *Id.* at 57. That is a critical difference and a prominent feature of successful regulation: working cooperatively with the regulated industry to anticipate and correct problems as they develop. By declining to place enforcement as the default state of affairs, regulators can focus on ensuring the safety and soundness of bank operations, liquidity, and capital strength on a real-time basis.

It made sense for Congress to entrust bank regulators, which have a more thorough and nuanced understanding of financial institutions than DOJ, to seek an appropriate penalty under §1818 that will balance the needs for deterrence and punishment against the needs of stability and predictability in the financial system. Section 1833a, by contrast, is a blunt prosecutorial instrument intended only to impose "hefty fines" to punish and deter. It provides none of the calibrated tools and meaningful checks designed to promote institutional compliance while still preserving a financial institution's overall financial health.

Moreover, where some systemic problem has beset a financial institution, it often attempts to address it directly and globally with any relevant regulatory authorities. In many cases, this might involve discussions with multiple federal regulators—the SEC, the CFTC, the OCC, etc.—to determine whether the financial institution can achieve a resolution that satisfies all parties. Those discussions are often had in the shadow of—and encouraged by—the running of a general five-year statute of limitations for civil penalties actions. *See* 28 U.S.C. § 2462. If, however, DOJ can still seek civil penalties under § 1833a for ten years after the underlying conduct subject to its lightened burden of proof, then DOJ may lack the incentives needed to explore settlement alongside all other interested agencies. Instead, DOJ can continue to build a case and either file suit or seek its own individual resolution much later. If DOJ can use these § 1833a powers

against banks—who were supposed to be protected by § 1833a—then it might make less sense for a bank to reach a comprehensive resolution with the other overlapping regulators, or at least those negotiations will now become more complicated.[3]

Such roadblocks to resolution are undesirable. They tax government resources and subject defendants to oversized threats of liability. *See SEC v. Citigroup Global Mkts., Inc.*, 752 F.3d 285, 295 (2d Cir. 2014) (explaining incentives for regulators and financial institutions to seek resolution, and that such settlements "are primarily about pragmatism"). Under the government's reading, a bank could be liable *both* for 1% of its net worth, § 1818(i)(2)(D)(ii)(II), and significant civil penalties, § 1833a(b)(3), for the same underlying conduct without a guarantee of coordination by DOJ and the regulators or even a consideration of the dual penalties. That duplicative liability destabilizes FIRREA's enforcement scheme and hinders the prospects for reaching a worthwhile, comprehensive settlement because the potential scope for liability remains unclear and contingent on DOJ's choices for the duration of the 10-year statute of limitations. By

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[3] There are obvious and inherent problems when multiple agencies have overlapping regulatory and enforcement authority over a single bank for the same or substantially similar conduct. Ceding further civil authority over these issues to DOJ—transforming it into a *de facto* regulator by virtue of § 1833a—is even more problematic. *See* Vartanian, *How Many Bank Supervisors Do We Need?*, Am. Banker (Mar. 17, 2014), *at* http://www.americanbanker.com/bankthink/ how-many-bank-supervisors-do-we-need-1066286-1.html.

undermining finality and a prospect of repose, such duplicative liability contravenes "the strong public interest in encouraging settlement." *Bank of Am. Nat'l Trust & Sav. Ass'n v. Hotel Rittenhouse Assocs.*, 800 F.2d 339, 344 (3d Cir. 1986); *McDermott, Inc. v. AmClyde*, 511 U.S. 202, 215 (1994) ("[P]ublic policy wisely encourages settlements[.]"). Rather, it foments uncertainty and deprives banks of a "means to manage risk" to better serve their shareholders and the public at large. *Citigroup Global Mkts.*, 752 F.3d at 295.

II. THE DISTRICT COURT ERRED IN FIXING A $1.3 BILLION CIVIL PENALTY

Even in a world where FIRREA's civil-penalties provision were to apply to financial institutions for affecting themselves, the $1.3 billion penalty imposed here was improper.

A. The District Court Improperly Fixed The Penalty Based On Gross Gain/Loss

The district court determined that FIRREA's ordinary penalty cap (of $1.1 million) did not apply in this case because defendants "derive[d] pecuniary gain from the violation," or, in the alternative, Freddie and Fannie suffered "pecuniary loss." *See* 12 U.S.C. § 1833a(b)(3)(A). In that event, "the amount of the civil penalty" could "not exceed the amount of such gain or loss." *Id.* The district court found that defendants misrepresented the quality of some, but not all, of the HSSL mortgages. In calculating the "pecuniary loss" to Freddie and Fannie, and the "pecuniary gain" derived by defendants, the district court simply determined what

Freddie and Fannie paid Countrywide for the mortgages. It did not account for the value of the mortgages—value that Countrywide gave up and value that Freddie and Fannie received.

Section 1833a does not support that reading. As this Court has explained, in the absence of applicable statutory definitions, courts should look to "the ordinary, common-sense meaning of the words." *United States v. Dauray*, 215 F.3d 257, 260 (2d Cir. 2000). Here, the ordinary, common-sense meaning of the words "gain" and "loss" refers to *actual* gain and *actual* loss. *See* Appellants Br. 81-87. If someone pays $250,000 for a house that turns out to be worth $200,000, their loss is ordinarily understood as being $50,000, not $250,000. Likewise, someone who sells a $200,000 property for $250,000 has gained $50,000, not $250,000. The case law overwhelmingly confirms—indeed, takes as obvious—this understanding. *See, e.g.*, *United States v. Anchor Mortgage Corp.*, 711 F.3d 745, 749 (7th Cir. 2013) ("Basing damages on net loss is the norm in civil litigation.").

This definition is cemented in the civil law of damages.[4] As the Supreme Court has recognized, "pecuniary harm" is a species of "actual damages," and

[4] The civil law of damages necessarily informs this Court's interpretation and application of the penalties provision of a quasi-criminal statute like FIRREA. *See United States v. Olis*, 429 F.3d 540, 546 (5th Cir. 2005) ("the civil damage measure should be the backdrop for criminal responsibility"); *cf. United States v. Rutkoske*, 506 F.3d 170, 179 (2d Cir. 2007) (finding "no reason why considerations relevant to loss causation in a civil fraud case should not apply, at least as strongly, to" loss calculations for sentencing purposes); *United States v. Nacchio*, 573 F.3d

"actual damages" constitute "compensation for … actual and real loss or injury, as opposed … to 'exemplary' or 'punitive' damages." *FAA v. Cooper*, 132 S. Ct. 1441, 1449 (2012). Congress's reference in FIRREA to "pecuniary gain" and "pecuniary loss" thus clearly evinces its intent to limit civil penalties to *actual* damages. And, as the Supreme Court has explained, "actual damages are equal to the difference between the market value of the [product received] and retained and the market value that the [product] would have had if they had been of the specified quality." *United States v. Bornstein*, 423 U.S. 303, 316 n.13 (1976); *see also Randall v. Loftsgaarden*, 478 U.S. 647, 662-633 (1986) (interpreting "actual damages" to mean the plaintiff's "actual loss" or "the amount of the defendant's profit" (internal quotation marks omitted)).

Moreover, Congress legislates against a common-law backdrop and chooses its words purposefully. *See, e.g.*, *Astoria Fed. Sav. & Loan Ass'n v. Solimino*, 501 U.S. 104, 108 (1991). The words "loss" and "gain," even unmodified by the word "pecuniary," evoke common-law theories of damages—specifically compensatory damages, which aim to compensate for loss, and unjust enrichment, which serves to make defendants disgorge gains earned from wrongdoing. *See, e.g.*, Dobbs, *Law of Remedies* § 3.1, at 279 (2d ed. 1993) ("Damages differs from restitution in

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1062, 1072 (10th Cir. 2009) (courts "look to civil jurisprudence for guidance concerning the appropriate criminal sentencing approach").

that damages is measured by the plaintiff's *loss*; restitution is measured by the defendant's unjust *gain*" (emphases added)); *State Farm Mut. Auto Ins. Co. v. Campbell*, 538 U.S. 408, 416 (2003) ("Compensatory damages are intended to redress the concrete *loss* that the plaintiff has suffered by reason of the defendant's wrongful conduct." (internal quotation marks omitted) (emphasis added)).

This long-established legal background undermines the district court's approach. It is thus unsurprising that the district court could not cite any dictionary definitions or case law to support its deviation from this norm. Unadjusted determinations of so-called "gross gain" and "gross loss" are scarcely found in the federal reporters, because they are so rarely prescribed. In the few instances where those measures are used, they are expressly called for by statute or regulation. *See, e.g.*, 18 U.S.C. § 3571(d) (specifying the use of "gross gain" and "gross loss"); *United States v. Milstein*, 401 F.3d 53, 74 (2d Cir. 2005) (the Sentencing Guidelines' calculation of loss provides "no credit … for the value of … items and services" in enumerated circumstances).

The district court turned this experience on its head, arguing that if Congress meant to provide for net gain and net loss—which, as noted, is the common understanding of the terms "gain" and "loss"—then it could have said so, as it did with the civil forfeiture law. *United States ex rel. O'Donnell v. Countrywide Home Loans*, 33 F. Supp. 3d 494, 500 (S.D.N.Y. 2014). That law requires consideration

of "net gain or profit" when dealing with "lawful goods or lawful services," but clarifies that proceeds in cases involving unlawful goods or services "is not limited to the net gain or profit realized from the offense." 18 U.S.C. § 981(a)(2)(A)-(B). The example cited by the district court only demonstrates the commonsense notion that when Congress wants to provide something different from the *typical* measure of gain and loss, it is more specific about its intent. Such precision was unnecessary in § 1833a.

The district court also supported its broad reading by pointing to the "punitive and deterrent purposes" of FIRREA. 33 F. Supp. 3d at 501. But those purposes are accomplished by penalties equivalent to pecuniary loss and pecuniary gain, ordinarily understood. *See, e.g.*, *Pasquantino v. United States*, 544 U.S. 349, 365 (2005) ("The purpose of awarding restitution … is … to mete out appropriate criminal punishment."). The district court's reasoning thus starts from the premise that punitive provisions should be interpreted as broadly as possible. But of course, the principle established in the law is just the opposite. *See* 1 Blackstone, *Commentaries on the Laws of England* 88 (Tucker ed. 1803) ("Penal statutes must be construed strictly."); *United States v. Thompson/Ctr. Arms Co.*, 504 U.S. 505, 518 n.10 (1992) (plurality opinion) (explaining that this canon of statutory interpretation applies in the criminal *and* civil context); *see also United States v. One 1973 Rolls Royce*, 43 F.3d 794, 819 (3d Cir. 1994) (because civil forfeiture

statute "is punitive and quasi-criminal in nature … we must apply the rule of lenity").

The district court's reasoning is also difficult to reconcile with this Court's understanding of losses and damages in the context of fraud more generally. For example, when interpreting the False Claims Act, a statute that also involves punitive and deterrent purposes, this Court has explained that damages are generally measured by "the difference between the value that the government received and the amount that it paid." *United States ex rel. Feldman v. van Gorp*, 697 F.3d 78, 87 (2d Cir. 2012).[5] Likewise, in other contexts involving fraud, courts generally recognize that loss should be measured by what was *actually* lost. *See, e.g.*, *FindWhat Investor Group v. FindWhat.com*, 658 F.3d 1282, 1315-1316 (11th Cir. 2011) ("Investors who quickly resell their stock during the inflationary period generally will not suffer any economic loss from the fraud, because, although they overpaid for their stock, they can recoup the amount they overpaid by selling at the same inflated price."); *Rolf v. Blyth, Eastman Dillon & Co.*, 637

[5] The district court inexplicably distinguished the False Claims Act as being in a "civil context[]" in which the aim is to "restore a victim," rather than to "deter and punish." *Countrywide*, 33 F. Supp. 3d at 500 n.6. It cited nothing for this proposition. In fact, the Supreme Court has recognized that "the FCA … has compensatory traits along with the punitive." *Cook County v. United States ex rel. Chandler*, 538 U.S. 119, 130 (2003). To that end, the FCA is in some ways even more punitive than § 1833a, as it provides for treble damages. *Id.*

F.2d 77, 84 (2d Cir. 1980) (adjusting "gross economic loss" by "subtract[ing] the value of the portfolio at the end of the period" in fraud case).

Even on its own terms, the district court should have at least considered actual goods provided and services rendered when conducting its multi-factor analysis. As this Court has explained, "[a] district court may properly consider 'a number of factors' in determining the size of a civil penalty" including "(1) the level of defendant's culpability, (2) the public harm caused by the violations, (3) defendant's profits from the violations, and (4) defendant's ability to pay a penalty." *Advance Pharm., Inc. v. United States*, 391 F.3d 377, 399 (2d Cir. 2004). Neither the second nor third factor in such an analysis would be complete without looking at what Freddie and Fannie actually gained from the transactions at issue here. The public harm, for example, would be virtually nonexistent if the loans transferred ended up being worth more than what Freddie and Fannie paid for. Indeed, the only case cited by the district court supports a more holistic view. *See United States v. Menendez*, 2013 WL 828926, at *8-9 (C.D. Cal. Mar. 6, 2013) (examining defendant's *net* profit). Under the district court's contrary approach, a financial institution is punished based on the size of the transaction, rather than the size of the fraud—a result that is both perverse and unfair.

B. The District Court Erred In Dispensing With The Requirement That The Underlying Fraudulent Conduct Must Have Proximately Caused Any Loss

The district court also failed to limit the civil penalty to gains or losses that were proximately caused by defendants' misrepresentation. This means it put defendants on the hook for all losses that followed the sale of the HSSL mortgages to Freddie and Fannie, even if those losses had nothing to do with the alleged misrepresentations in this case. This analysis exposes financial institutions to boundless civil penalties for any loss following an arguable fraud, no matter how unrelated the loss and the wrongdoing.

That cannot be right. It is a bedrock rule of both tort and criminal law that a defendant is only liable for harms he proximately caused. *See, e.g.*, 6 Keeton et al., *Prosser and Keeton on the Law of Torts* § 41, at 263 (5th ed. 1984); Lafave, *Substantive Criminal Law* § 6.4, at 464 (2d ed. 2003); *see also id.* § 6.4(c), at 471 ("The problems of [proximate] causation arise in both tort and criminal settings, and the one situation is closely analogous to the other.").

Proximate causation serves "to preclude liability in situations where the causal link between conduct and result is so attenuated that the consequence is more aptly described as mere fortuity." *Paroline v. United States*, 134 S. Ct. 1710, 1719 (2014). It is, as the Supreme Court put it, a "very effective way, and perhaps the most obvious way … of excluding costs" that are insufficiently connected to

wrongful conduct. *Id.* at 1722; *see also Exxon Co., U.S.A. v. Sofec, Inc.*, 517 U.S. 830, 839 (1996) (asking whether the "blameworthy act was sufficiently related to the resulting harm to warrant imposing liability for that harm on the defendant"). As a result, courts have long applied a proximate-cause requirement, even when the "statute … did not expressly impose one." *Paroline*, 134 S. Ct. at 1720; *but see* 12 U.S.C. § 1833a(b)(3) (FIRREA's "special rule for violations *creating* gain or loss" applies where "the violation *results in* pecuniary loss" (capitalization altered; emphasis added)).

The same is true in the context of fraud. *See Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 346 (2005) (in a fraud-on-the-market case, plaintiffs must "*prove* proximate causation and economic loss"). The federal securities laws, for example, require a showing of "loss causation": "a plaintiff must show[] that the economic harm that it suffered *occurred as a result of* the alleged misrepresentations" and that "the damage suffered was a foreseeable consequence of the misrepresentation." *Citibank, N.A. v. K-H Corp.*, 968 F.2d 1489, 1495 (2d Cir. 1992); *see also Dura*, 544 U.S. at 343-344 ("[T]he common law has long insisted that a plaintiff in such a case show … that he suffered actual economic loss."). That requirement is not unique to federal securities law; it derives from general principles of causation. *See Moore v. PaineWebber, Inc.*, 189 F.3d 165, 174 (2d Cir. 1999) (quoting *Bastian v. Petren Resources Corp.*, 892 F.2d 680, 683-

684 (7th Cir. 1990) (Posner, J.) ("Indeed what securities lawyers call 'loss causation' *is* the standard common law fraud rule … , merely borrowed for use in federal securities fraud cases. It is more fundamental still; it is an instance of the common law's universal requirement that the tort plaintiff prove causation.")).

Nothing in FIRREA rebuts this well-established presumption. Yet the district court disregarded it, declining even to inquire into whether any loss Freddie or Fannie allegedly suffered was proximately caused by any misconduct by defendants. This sets a dangerous precedent. Defendants provided thousands of loans to Freddie and Fannie, many of them concededly legitimate. Those loans—even those the government concedes were legitimate—depreciated in value following the financial crisis. The district court simply put defendants on the hook for *all* of this loss, without any regard for whether the alleged fraud caused the loss at issue. In doing so, it ignored this Court's observation that "[s]omewhere a point will be reached when courts will agree that the link has become too tenuous—that what is claimed to be consequence is only fortuity." *Petition of Kinsman Transit Co.*, 338 F.2d 708, 725 (2d Cir. 1964).

The district court's approach is inconsistent with the strong presumption that a defendant is only liable for harms he proximately caused. It should be rejected.

CONCLUSION

The judgment of the district court should be reversed.

Respectfully submitted.

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CERTIFICATE OF COMPLIANCE

Pursuant to Fed. R. App. P. 32(a)(7)(C), the undersigned hereby certifies that this brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B).

1. Exclusive of the exempted portions of the brief, as provided in Fed. R. App. P. 32(a)(7)(B), the brief contains 6,997 words.

2. The brief has been prepared in proportionally spaced typeface using Microsoft Word 2010 in 14 point Times New Roman font. As permitted by Fed. R. App. P. 32(a)(7)(C), the undersigned has relied upon the word count feature of this word processing system in preparing this certificate.

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SETH P. WAXMAN

April 29, 2015

CERTIFICATE OF SERVICE

I hereby certify that on this 29th day of April, 2015, I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Second Circuit using the appellate CM/ECF system. Counsel for all parties to the case are registered CM/ECF users and will be served by the appellate CM/ECF system.

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