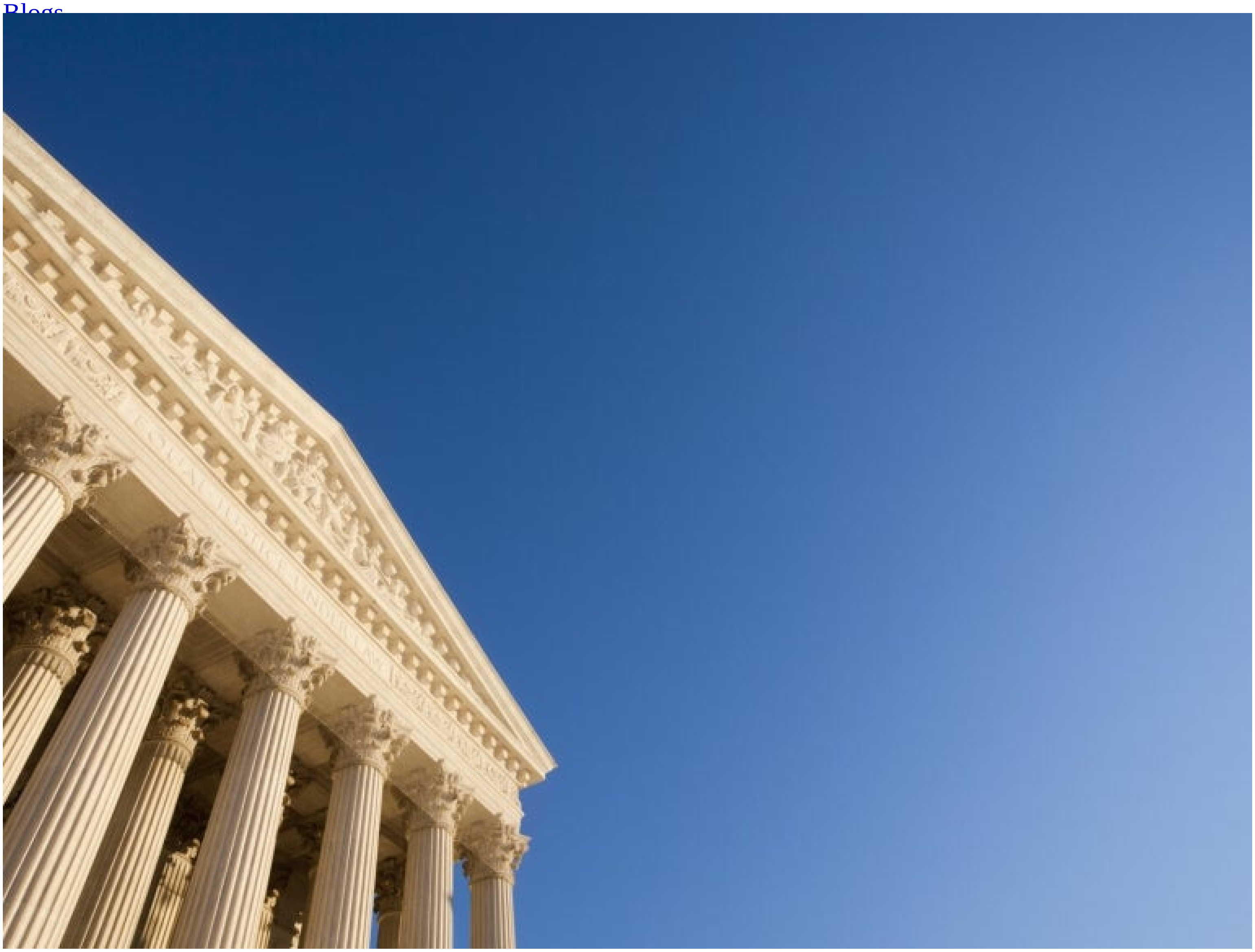
Blogs



On May 23, 2016, the Second Circuit presented a significant setback to the Department of Justice (DOJ) by reversing a $1.27 billion penalty against Bank of America and Countrywide Loans.

As we've posted before, in October 2012, DOJ filed a civil suit against Bank of America and Countrywide based on mortgages sold to Fannie Mae and Freddie Mac. The Government alleged that Countrywide had a program named "the Hustle" or "High-Speed Swim Lane," which rewarded the speed of processing residential mortgage loans regardless of their quality. This, according to the Government, resulted in thousands of fraudulent or defective loans that were subsequently sold to Government Sponsored Entities (GSEs) such as Fannie Mae and Freddie Mac. Although Countrywide started the program in August 2007, the program continued after Bank of America purchased Countrywide in 2008. In the aftermath of the 2008 financial crisis, the Government began invoking a statute called the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), which was enacted in response to the Savings & Loan crisis of the 1980s. FIRREA imposes monetary penalties for fraud that "affects a federally insured financial institution." In the wake of the financial crisis, FIRREA was viewed by federal prosecutors as a promising alternative to a criminal action given (1) its 10-year statute of limitations; (2) preponderance of the evidence standard; (3) the ability to issue broad administrative subpoenas while conducting a civil investigation; and (4) civil penalties authorized up to the lesser of $1.1 million per day or $5.5 million per violation, which can be increased by the amount of pecuniary loss caused. While the trial court in the *Countrywide* case focused on what it means to "affect a federally insured financial institution," the Second Circuit questioned whether the breach of a contractual promise, ***without proof of fraudulent intent at the time of contracting***, could sustain a claim for fraud under FIRREA. The Circuit held that "the proper time for identifying fraudulent intent is contemporaneous with the making of the promise, not when a victim relies on the promise or is injured by it. Only if a contractual promise is made with no intent ever to perform it can the promise itself constitute a fraudulent misrepresentation." In other words, even if a breach of contract is willful and intentional, that breach is not fraudulent unless it can be proven that there was never an intent to perform the promise at the time the contract was executed. Accordingly, the Circuit found that the "Government did not prove – in fact, did not attempt to prove – that at the time the contracts were executed Countrywide never intended to perform its promise of investment quality." Rather, the conduct alleged and proven by the Government is, at most, a series of intentional breaches of conduct. Proving that Countrywide never intended to sell sufficient residential loans, particularly when the Government acknowledged that the contracts' execution pre-dated the alleged scheme to defraud, presents a more challenging burden than the Government likely had hoped.

Explore more in

White Collar & Investigations
Blog series

White Collar Briefly

Drawing from breaking news, ever changing government priorities, and significant judicial decisions, this blog from Perkins Coie's White Collar and Investigations group highlights key considerations and offers practical insights aimed to guide corporate stakeholders and counselors through an evolving regulatory environment.
Subscribe ?

View the blog