Expert Analysis

Inside A Closely Watched FCA and FIRREA Decision

Law360

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Last week, the United States District Court for the Northern District of Illinois issued its opinion and order[1] in *United States v. Luce*, after the case had been remanded by the United States Court of Appeals for the Seventh Circuit.[2] The decision touches on two important issues relevant to civil enforcement actions by the Department of Justice: (1) the standard of causation, and the application of that standard, under the False Claims Act ("FCA"); and (2) penalties under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA").

In April 2005, Robert Luce, the president of a mortgage company who worked previously as an attorney in the enforcement division of the Securities and Exchange Commission, was indicted on numerous charges. Notwithstanding his indictment, in 2006, 2007, and 2008, he certified to the Federal Housing Administration ("FHA") that he was not involved in a criminal proceeding that could result in a criminal conviction. Those certifications, which the court determined were false, allowed Luce's mortgage company to continue doing business with the FHA and the FHA ultimately suffered losses of $3,452,499 related to loans originated by Luce's company.

In 2011, the United States brought a civil complaint against Luce alleging violations of the FCA and FIRREA related to Luce's allegedly false statements to the FHA. In 2016, the United States District Court for the Northern District of Illinois granted summary judgment to the United States and awarded $10,357,497 in damages under the FCA.[3] Because the FCA damages were far more than Luce's ability to pay, the United States did not request additional penalties under FIRREA.[4]

In finding that Luce's conduct caused damage to the United States, the court applied a "but-for" standard of causation, pursuant to the United States Court of Appeals for the Seventh

Circuit's decision in *United States v. First National Bank of Cicero*.[5] As the court reasoned, but-for Luce's false statements, his company would not have been eligible to do business with the FHA and the loans leading to the FHA's loss would not have been originated by Luce's company. The Seventh Circuit's "but-for" causation standard for damages under the FCA contrasted with four other circuits to consider the issue and determine that a "proximate causation" standard was appropriate.[6]

On the heels of the Supreme Court's decision in *Escobar*[7], the United States Court of Appeals for the Seventh Circuit heard Luce's appeal. While *Escobar* did not address the appropriate causation standard under the FCA, the United States Court of Appeals for the Seventh Circuit reevaluated its decision in *Cicero* because of the Supreme Court's reliance on the common law in *Escobar*, and due to the conflicting decisions from other circuits. It reversed course finding that the more stringent standard of "proximate causation," used in common law fraud cases, rather than "but-for" causation, should apply to FCA cases, and remanded to the district court.[8]

On remand, the government argued that Luce's false statements were the proximate cause of its losses. The issue, wrote the government, "is not whether any specific loan default can be tied directly to the language of the [certification]," but rather "whether the loan defaults were a foreseeable result of Luce's fraudulent conduct, which they were, since the very purpose of the [certification] was to protect HUD from the risks of unscrupulous gatekeepers like Luce."[9] Luce, on the other hand, argued that his certifications did not relate to any specific loan that defaulted, and that there was no evidence or allegations that he had submitted false information about loan applicants, their qualifications, or their creditworthiness.[10] The court agreed with Luce, writing that "the essence of the proximate cause requirement is that there must be some nexus between the type or nature of the action and the type or nature of the loss," and that "there is simply no nexus between false statements about the existence of a federal investigation (particularly one unrelated to the operation of Luce's mortgage business) and loan defaults."[11] As a result, the court granted summary judgment in favor of Luce, finding no damages under the FCA.[12]

The court next turned to the issue of penalties under FIRREA. While defendants have paid tens of billions of dollars in FIRREA settlements over the past decade, the volume of court decisions on FIRREA penalties still can be counted on one hand.[13] The statute provides for

three ways to calculate penalties: (1) $1,000,000[14] per violation; (2) $1,000,000 to $5,000,000[15] for continuing violations; or (3) an amount up to the pecuniary gain from the violation or the pecuniary loss to a person other than the violator.[16] Debates abound, however, regarding how these penalties should be applied. For example, in predicate offenses requiring an "affect" on federally insured financial institutions ("FIFIs"), such as mail fraud (18 U.S.C. § 1341) and wire fraud (18 U.S.C. § 1343), should a pecuniary loss to a person other than the violator include only the affected FIFIs or should it include all losses to investors? In cases without losses, or without significant losses, would the imposition of the maximum per penalty violation of $1,000,000 (now $1,963,870) offend the Eight Amendment's prohibition against "excessive fines"? And should the calculation of pecuniary gain from the violation be gross gain or net gain by the perpetrator? These, and other questions, remain largely untested. Because of the dearth of case law interpreting FIRREA's penalty provisions, significant litigation risk exists for both the DOJ and defendants, which often leads to settlement for risk-adverse organizations. Thus, any opinion that touches on FIRREA penalties is closely watched by practitioners and potential defendants.

The three decisions prior to *Luce* to address FIRREA penalties provide some guidance. In the first decision, *United States v. Menendez*[17], the court outlined a number of a factors it considered when determining the FIRREA penalty: (1) the good or bad faith of the defendant and the degree of his or her scienter; (2) the injury to the public, and whether the defendant's conduct created substantial loss or the risk of substantial loss to other persons; (3) the egregiousness of the violation; (4) the isolated or repeated nature of the violation; (5) the defendant's financial condition and ability to pay; (6) the criminal fine that could be levied for the conduct; (7) the amount defendant sought to profit through his or her fraud; and (8) the penalty range available under FIRREA.[18] In *Menendez*, after considering these factors, the court awarded a penalty of $40,000, far below the maximum fine in that case of $1 million.[19]

In *United States ex rel. O'Donnell v. Countrywide Home Loans, Inc.*[20], the court applied the same factors as in *Menendez*, yet reached the conclusion that an appropriate penalty was $1,267,491,770 against Countrywide Home Loans and $1 million against the individual defendant in the case.[21] Finally, in *United States v. Americus Mortg. Corp.*[22], the court awarded $2.2 million per defendant in FIRREA penalties on top of several hundred million awarded under the FCA.[23]

Turning to the *Luce* opinion issued last week, the court first noted that "proximate cause is not required for liability under FIRREA," as the statute contemplates penalties without an accompanying gain or loss.[24] The government had requested a FIRREA penalty of $3.3 million, $1.1 million for each of the three false certifications by Luce. The court analyzed the factors outlined in *Menendez*, finding that certain factors cut in favor of the imposition of a substantial penalty, whereas others did not. Ultimately, the court concluded that there was "no good-faith explanation for [Luce's] actions," and that his conduct was serious, however it "does not put him within the worst class of FIRREA violators," as he "did not defraud any borrowers, nor did he make any false statements dealing with the soundness of any loans or the creditworthiness of borrowers."[25] As a result, the court awarded a penalty of $500,000, which it described as a "substantial sum of money," but "well short of the maximum penalty of the $3.3 million that could have been imposed under FIRREA for his three violations."[26]

The court also preemptively addressed an argument that could be made on appeal by Luce that $500,000 violates the Eighth Amendment's Excessive Fines Clause. The court wrote that its penalty did not offend the Eighth Amendment because Luce's conduct represented serious wrongdoing, his conduct was that which FIRREA was intended to reach, the award was far less than the statutory maximum, and even though Luce did not proximately cause the government's loss, his actions were a but-for cause of the government's $3,452,499 loss.[27]

While the decision in *Luce* does not significantly alter the limited jurisprudence in FIRREA cases, it is the first decision to find FIRREA penalties without any accompanying proximate loss and could be used as a guide for future decisions that impose FIRREA penalties for conduct without an accompanying loss. The court's award of $500,000 for three FIRREA violations equals approximately $166,666 per violation or 15% of the maximum available penalty. The decision also highlights the power that judges wield when issuing penalties under a statute that provides a per-violation penalty range of $0 to more than $1 million.

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[1] *United States v. Luce*, 2019 WL 3003300 (N.D. Ill. July 10, 2019).
[2] *United States v. Luce*, 873 F.3d 999 (7th Cir. 2017).
[3] *United States v. Luce*, 2016 WL 6892857 (N.D. Ill. Nov. 23, 2016).
[4] *Id*.
[5] 957 F.2d 1362 (7th Cir. 1992).
[6] *See United States v. Hibbs*, 568 F.2d 347, 351 (3d. Cir. 1977); *United States v. Miller*, 645 F.2d 473, 475-476 (5th Cir. 1981); *United States ex rel. Schwedt v. Planning Research Corp.*, 59 F.3d 196, 200, 313 U.S. App. D.C. 200 (D.C. Cir. 1995); *United States ex rel. Sikkenga v. Regence Bluecross Blueshield of Utah*, 472 F.3d 702, 714 (10th Cir. 2006).
[7] *Universal Health Servs. Inc. v. United States, ex rel. Escobar*, 136 S. Ct. 1989, 195 L.Ed.2d 348 (2016).
[8] *United States v. Luce*, 873 F.3d 999, 1010-11 (7th Cir. 2017).
[9] United States' Reply in Support of its Supplemental Brief on its Motion for Summary Judgment on Damages and Penalties and Response to Defendant's Motion for Summary Judgment, filed June 12, 2018, at 8.
[10] Defendant's Combined Memorandum in Response to the Government's Supplemental Summary Judgment Brief and in Support of Defendant's Cross-Motion for Summary Judgment, filed May 9, 2018 at 7-8.
[11] *United States v. Luce*, 2019 WL 3003300, at *11 (N.D. Ill. July 10, 2019).
[12] *Id*. at *12.
[13] *See United States v. Menendez*, 2013 WL 828926 (C.D. Cal. Mar. 6, 2013); *United States ex rel. O'Donnell v. Countrywide Home Loans, Inc.*, 33 F. Supp. 3d 494 (S.D.N.Y. 2014); *United States v. Americus Mortg. Corp.*, 2017 WL 4117347 (S.D. Tex. Sept. 14, 2017).
[14] This amount has been increased by the Federal Civil Penalties Inflation Adjustment Act Improvements Act of 2015, and is currently $1,963,870. *See* 28 C.F.R. § 85.5.
[15] Currently $1,963,870 to $9,819,351.
[16] 12 U.S.C. § 1833a(b).
[17] 2013 WL 828926 (C.D. Cal. Mar. 6, 2013).
[18] *United States v. Menendez*, 2013 WL 828926, at *9-10 (C.D. Cal. Mar. 6, 2013).
[19] *Id*. at *11.
[20] 33 F. Supp. 3d 494 (S.D.N.Y. 2014).
[21] *United States ex rel. O'Donnell v. Countrywide Home Loans, Inc.*, 33 F. Supp. 3d 494, 504 (S.D.N.Y. 2014), overturned on other grounds at 822 F.3d 650 (2d Cir. 2016).
[22] 2017 WL 4117347 (S.D. Tex. Sept. 14, 2017).
[23] *Id*. at *9.
[24] *Id*. at *7; 12 U.S.C. § 1833a(b).
[25] *Id*. at *14-15.
[26] *Id*. at *15.
[27] *Id*.