

February 11, 2009

The Honorable Patrick Leahy
Chairman
Committee on the Judiciary
United States Senate
Washington, DC 20510

The Honorable Arlen Specter
Ranking Member
Committee on the Judiciary
United States Senate
Washington, DC 20510

Re: Fraud Enforcement and Recovery Act of 2009 (S. 386)

Dear Chairman Leahy and Ranking Member Specter:

We are writing to express our concern about Section 2 of S. 386, the Fraud Enforcement and Recovery Act of 2009 (FERA), which was introduced on February 5, 2009, and is the subject of the February 11, 2009, hearing on "The Need for Increased Fraud Enforcement in the Wake of the Economic Downturn." Our two organizations, the National Association of Criminal Defense Lawyers and the Heritage Foundation are on opposite ends of the liberal-to-conservative spectrum. As such, we often disagree on a wide range of legal issues, but we agree on our analysis of Section 2 of FERA. While we recognize that the press and many members of the public are looking to the federal government for action and vindication of any wrongs inflicted by Wall Street on Main Street, Section 2 of S. 386 would be redundant and risks overreaching.

Among the over 4,450 criminal offenses already in federal law, Congress has already enacted all of the tools prosecutors need (and far more) to prosecute any criminal activity associated with the subprime market or the current financial crisis. In fact, analysis of the federal criminal code demonstrates that the federal government is sufficiently armed to prosecute any criminal conduct that has a federal nexus and may be related to the market crisis.

In making a preliminary assessment of the types of wrongdoing coming to the surface as part of the subprime investigations, Benton Campbell, U.S. Attorney for the Eastern District of New York explained that the current "types of criminal activity are fundamentally familiar" to the criminal conduct his office has seen over the years.¹ If criminality is determined to be a pervasive cause or feature of the market crisis, additional resources in the form of money and manpower for federal, state, and local authorities may be warranted. But as U.S. Attorney Campbell said, the game is still the

¹ Noeleen G. Walder, *Criminal Prosecutions Predicted to Surge Over Financial Crisis*, New York Law Journal (Oct. 9, 2008), available at <http://www.law.com/jsp/article.jsp?id=1202425138326> (last visited Feb. 10, 2009).

same and the same tools that have proven reliable and effective in the past, remain in place today.

Prosecutors Have the Tools They Need To Police Financial Markets

General federal fraud statutes, such as the mail and wire fraud statutes, are available to address **any** crimes related to the subprime market and market crisis. The federal courts' expansive reading of the mail fraud statute "has made it possible for the federal government to attack a remarkable range of criminal activity even though some of the underlying wrongdoing does not rest comfortably within traditional notions of fraud."² Leading commentators agree that "scheme to defraud," the key phrase of the mail fraud and wire fraud statutes, "has long served . . . as a charter of authority for courts to decide, retroactively, what forms of unfair or questionable conduct in commercial, public, and even private life, should be deemed criminal. In so doing, this phrase has provided more expansive interpretations from prosecutors and judges than probably any other phrase in the federal criminal law."³

Unlike the federal bank fraud statute, the mail and wire fraud statutes are not limited in their application to frauds "perpetrated against a financial institution." It would in fact be fair to say that virtually all bank frauds are either mail or wire frauds, as well. Regardless of which federal fraud statute a prosecutor uses to charge a defendant, the potential penalty is substantial. Mail and wire fraud violations already carry a maximum penalty of 20 years imprisonment. In addition, any fraud that "affects" a financial institution carries an increased possible penalty of a \$1,000,000 fine, 30 years imprisonment, or both. The maximum federal penalty for attempted murder, by comparison, is 20 years, and the maximum for voluntary manslaughter is 15 years.⁴ Unlike the elements of the bank fraud statute, conduct qualifying for the enhanced penalty must only "affect" a financial institution; it need not be perpetrated *against* a financial institution in order to draw the increased penalties. Thus, even if a fraud perpetrated against a "mortgage lending business" could not be characterized as bank fraud, the fraud inevitably "affects" a financial institution such that the 30-year maximum sentence under the mail and wire fraud statutes would apply.

² Julie O'Sullivan, *FEDERAL WHITE COLLAR CRIME: CASE AND MATERIALS* 483 (2d ed. 2003).

³ John C. Coffee, Jr. & Charles K. Whitehead, *The Federalization of Fraud: Mail and Wire Fraud Statutes*, in 1 Otto G. Obermaier & Robert G. Morvillo, *WHITE COLLAR CRIME, Business and regulatory offense* § 9.01 (2002).

⁴ 18 U.S.C. §§ 1112 (manslaughter), 1113 (attempted murder).

Beyond any potential criminal conduct on Wall Street, federal prosecutors have a multitude of methods for addressing whatever "retail-level" mortgage fraud schemes that have been conducted on Main Street. Overall, the largest area of mortgage fraud activity seems to be on the local level and may be characterized as "white-collar street crime," in that it consists of traditional white collar crime – mail fraud and wire fraud – on an individual and personal level. Thus, prosecutors can use the same tools to prosecute white-collar street crime that they use to prosecute any alleged criminal conduct taking place on Wall Street. The FBI itself recently acknowledged the applicability of the same provisions used for Wall Street – including Chapters 47 (fraud and false statements), 63 (mail fraud), and 73 (obstruction) of Title 18 of the United States Code – to mortgage fraud. The FBI specifically identified nine "applicable Federal criminal statutes which may be charged in connect with mortgage fraud."⁵

According to its own public statements, the FBI is not limited in its means of pursuing allegedly criminal conduct associated with the meltdown of the subprime mortgage market or with the current financial crisis. If, for some reason, certain conduct is beyond the express reach of the bank fraud statute, federal prosecutors have other ways of charging that conduct. Furthermore, conduct that is beyond the jurisdiction of federal prosecutors, as unlikely as that is under current laws, can always be prosecuted on the state and local level. Criminal conduct thus need not go unpunished even if there is no federal statute reaching it – and given the multiple federal statutory authorities currently in place, it would be exceedingly difficult to identify conduct having a constitutional nexus to the federal government that cannot be charged by federal authorities.

Indeed, the case is strong for increased state-level activity, in some instances as an alternative to federal prosecutions. At both the state and local levels, prosecutors have been aggressively battling retail-level fraud perpetrated by individual brokers, real-estate agents, lenders, buyers, and borrowers.⁶ Like the federal government, the states have ample legal authority to prosecute fraud. In addition, states – and **not** the

⁵ Federal Bureau of Investigation, *Press Release: FBI Issues Mortgage Fraud Notice In Conjunction With Mortgage Bankers Association* (Mar. 8, 2007), available at <http://www.fbi.gov/pressrel/pressrel07/mortgagefraud030807.htm> (last viewed Feb. 10, 2009). The list includes the following statutes: (1) 18 U.S.C. § 1001 – Statements or entries generally, (2) 18 U.S.C. § 1010 – HUD and Federal Housing Administration Transactions, (3) 18 U.S.C. § 1014 – Loan and credit applications generally, (4) 18 U.S.C. § 1028 – Fraud and related activity in connection with identification documents, (5) 18 U.S.C. § 1341 – Frauds and swindles by Mail, (6) 18 U.S.C. 1342 – Fictitious name or address, (7) 18 U.S.C. § 1343 – Fraud by wire, (8) 18 U.S.C. § 1344 – Bank Fraud, and (9) 42 U.S.C. § 408(a) – False Social Security Number.

⁶ Coffee and Whitehead, *supra* note 3.

federal government – are the primary regulators of mortgage brokers and the insurance industry. Thus, conduct that takes place entirely on the state or local level and that is within the state's expertise should be investigated and prosecuted by state and local officials. As the U.S. Supreme Court has frequently recognized, the federal government does not have a plenary police power. Nor does this nation have a nationalized police force.

Section 2 Is Unnecessary and Counterproductive

Considering the many charging statutes that are already available to federal prosecutors, analysis of Section 2 of FERA reveals that it is both redundant and an inappropriate expansion of federal authority, at the expense of state and local law-enforcement operations, based on the thinnest of Commerce Clause jurisdictional hooks. While the purpose of FERA is laudable, that purpose is achieved through the substance of existing federal and state statutory authorities, as well as whatever increased funding and related resources is warranted under Section 3 based on the evidence available to date. Section 2 neither serves that purpose nor accomplishes anything that is not already possible under current law.

Addressing each subsection specifically, for the following reasons we believe Section 2 should be struck:

Subsection 2(a) and 2(b) – Definition of Financial Institution Expanded to Include Mortgage Lending Businesses and Mortgage Backers

- The Mail Fraud and Wire Fraud statutes, 18 U.S.C. §§ 1341 and 1343, reach any fraud perpetrated against a "mortgage lending business" because those statutes already are not limited only to crimes involving "financial institutions." Thus, the enhanced penalty under the mail and wire fraud statutes for "affecting a financial institution" would apply in cases involving a mortgage-lending business.
- The increased possible penalty under these statutes – \$1 million fine, 30 years imprisonment, or both – is equal to the penalty for bank fraud.
- Most conduct that would be covered under 18 U.S.C. § 215's expanded definition of financial institution under FERA is already covered under 18 U.S.C. §§ 657 and 666.
- Intrastate conduct that is purely private, without any significant ties to federal money, insurance, assistance, etc., should be left to the jurisdiction of the state and local authorities.

Subsection 2(c) – False Statements and Appraisals by Mortgage Brokers and Agents in Loan Applications

- The expansion of 18 U.S.C. § 1014 to include any action by a mortgage-lending business is unnecessary because mortgage-lending businesses do not operate in a vacuum. Any false statement made in order to influence any action by a mortgage-lending business is also made in order to influence action by those individuals and organizations all along the line of the financial and real estate transaction.
- Under current federal law, false statements made to a mortgage broker, who then seeks any form of action from a financial institution, would trigger criminal liability. The false statement need only “influence” the financial institution; this wrongful conduct need not be directly “perpetrated against” the financial institution in order to support a conviction under existing federal law.
- Intrastate conduct that is purely private, without any significant ties to federal money, insurance, or assistance, or to federally related or connected financial institutions, should be within the jurisdiction of the state and local authorities.

Subsection 2(d) – Major Fraud Against the Government Amended to Include Economic Relief and Troubled Asset Relief Program Funds

- All frauds associated with funds and assistance the federal government dispenses to address the subprime mortgage meltdown and current financial crisis, including under the Troubled Asset Relief Program (TARP) and related economic relief, can be prosecuted under the existing mail fraud and wire fraud statutes, 18 U.S.C. §§ 1341 and 1343.
- In fact, the so-called major fraud statute, 18 U.S.C. § 1031, that subsection 2(d) of FERA seeks to amend only covers frauds where the value of the services exceeds \$1 million. By contrast, the mail and wire fraud statutes are not similarly limited.
- The mail and wire fraud statutes carry substantial maximum penalties that are equal to the major fraud statute’s maximum penalties.

Subsection 2(e) – Amending Securities Fraud Statute to Include Commodities Fraud

- Commodities fraud can be prosecuted under, among others, 7 U.S.C. § 13, which provides criminal penalties for fraud, embezzlement, theft, manipulation, and false statements related to commodities, and for willful violations of parts of the Commodity Exchange Act, 7 U.S.C. § 1 *et seq.*, and rules and regulations issued by the Commodity Futures Trading Commission.
- Commodities fraud may be prosecuted under the federal mail fraud and wire fraud statutes, 18 U.S.C. §§ 1341 and 1343.

- This subsection is therefore redundant.

Subsection 2(f) – Amending the Money Laundering Statute to Include the Proceeds for Specified Unlawful Activity

- Federal money laundering charges require an underlying predicate offense, which can be prosecuted with or without the money laundering charges.
- Section 2(f) would overrule the Supreme Court’s decision in *United States v. Santos*, No. 06-1005 (U.S. 2008), in which Justice Stevens pointed out that the practical effect of allowing the Government to charge money laundering for the gross receipts of conduct that is being charged as a separate offense would be “in practical effect tantamount to double jeopardy.” The Court correctly limited the term “proceeds,” as used in the principal money laundering statute, to the profits of a crime, not its gross receipts.
- Before the *Santos* decision, expansive interpretations of “proceeds” fostered inappropriate and unfair use of the money laundering statute to “tack on” additional charges and significantly enhance penalties based on conduct that is virtually indistinguishable from the underlying offense.
- Outside the context of drug trafficking, money laundering charges generally result in sentences far greater than the sentences imposed for the underlying predicate offense itself. The prospect of much higher sentences for essentially the same conduct allows the government to extract plea bargains and forfeitures that might not otherwise be obtained and are often not in the interests of justice.

In sum, the expansions proposed by Section 2 of FERA do not provide the prosecutors with any methods that are not already in their arsenal.

In the mortgage fraud context, the adequacy and severity of these tools is illustrated by the case of Chalana McFarland.⁷ For the crimes of “money laundering, bank fraud, wire fraud, and conspiracy to commit such acts as well as obstruction of justice and perjury,” McFarland, a first-time offender, is now serving a 360-month sentence (30 years). To the extent that criminal law is capable of deterring financial crimes, such laws are already in place, often resulting in enormous fines and terms of imprisonment that are effectively life sentences.

⁷ *United States v. McFarland*, 255 Fed. Appx. 462, 2007 WL 4142782 (11th Cir. 2007).

Conclusion

Federal investigators and prosecutors alike have publicly stated that they already have the statutory authority they need to pursue whatever criminal activity might be associated with the subprime meltdown and financial crisis. This is not surprising given the vast breadth of conduct that may be prosecuted under the federal mail and wire fraud statutes and many of the other 4,450 criminal offenses in the federal criminal code.

Criminal fraud in all of its forms should be prosecuted and punished. We share your goal of ensuring that conduct that truly is criminal can always be investigated, prosecuted, and punished by the appropriate federal, state, or local authorities. But the fact remains that investigators and prosecutors at all levels of government are sufficiently armed with the tools necessary to accomplish the job.

We commend your Committee for engaging in this hearing and for taking additional steps to debate this proposal and to open it to appropriate amendments. Thorough democratic deliberation is always warranted when Congress is contemplating laws that will deprive Americans of their personal liberty, livelihood, careers, and reputations; and just, well-crafted criminal offenses and penalties cannot be created without such deliberation.

Respectfully,



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