Statement before the House Judiciary Committee
Subcommittee on Regulatory Reform, Commercial and Antitrust Law

Oversight of the Justice Department's Mortgage Lending Settlements

Theodore H. Frank

Center for Class Action Fairness

February 12, 2015

The views expressed in this testimony are those of the author alone and do not necessarily represent those of the Center for Class Action Fairness.

Mr. Theodore H. Frank
Center for Class Action Fairness
1718 M Street NW, No. 236
Washington, DC 20036
e-mail: tfrank@gmail.com

Thank you, Mr. Chairman, and members of this Subcommittee, for your kind invitation to testify today about the Justice Department mortgage lending settlements.

I serve as President for the Center for Class Action Fairness,[1] but I am not testifying here on their behalf and the views that I am sharing today are my own. My perspective comes from my legal practice running a non-profit public-interest law firm focusing on litigation in class actions on behalf of class members in cases where their court-appointed attorneys have failed to fairly represent their clients' interests by structuring settlements to have defendants pay money to third-party organizations rather than to the alleged victims of their conduct—a practice often justified under the misnomer "*cy pres*." I was elected to the American Law Institute in 2008, and have published and spoken across the country on topics related to class action settlements and *cy pres*.[2]

Private class action settlements are problematic because of the inherent conflict of interest between class counsel and their putative clients. Public enforcement would normally avoid these problems, but when public enforcers are permitted to use

---

[1] I founded the Center for Class Action Fairness in 2009. The Center is a 501(c)(3) non-profit public-interest law firm that represents *pro bono* consumers and shareholders objecting to unfair class action settlements that benefit class counsel at the expense of their putative clients. Attorneys with the Center have won several landmark cases expanding the rights of consumers in class action settlements and tens of millions of dollars for consumers and shareholders. *E.g.*, *Oetting v. Green Jacobson, P.C.*, No. 13-2620 (8th Cir. 2015); *Pearson v. NBTY, Inc.*, 772 F.3d 778 (7th Cir. 2014); *In re Baby Products Antitrust Litigation*, 708 F.3d 163 (3d Cir. 2013); *Nachshin v. AOL, LLC*, 663 F.3d 1034 (9th Cir. 2011); *In re Bluetooth Prod. Liab. Lit.*, 654 F.3d 935 (9th Cir. 2011).

[2] Portions of this testimony are drawn from Theodore H. Frank, Statement before the House Judiciary Committee Subcommittee on the Constitution and Civil Justice, *Examination of Litigation Abuse* (Mar. 13, 2013); Ted Frank, *Class Actions, Arbitration, and Consumer Rights*, Legal Policy Report No. 16 (Manhattan Institute 2013); Theodore H. Frank, *Cy Pres Settlements*, Class Action Watch (Mar. 2008).

settlements to structure public policy or divert settlement money to third parties, it reintroduces the conflict-of-interest problem into the mix.

The Justice Department settlement with Bank of America presents a particularly problematic application of *cy pres*. When the Justice Department negotiates settlements that send money to third parties instead of to the United States Treasury or to the primary victims of the challenged conduct without legislative authority, they violate separation of powers by effectively using executive-branch enforcement authority to create legislative spending power. The spending may evade laws and regulations limiting or controlling federal spending, or create or fund programs that Congress never would have agreed to spend. The settlement further meddles in public policy in counterproductive and unfair ways that will ultimately result in making many consumers worse off.

Background: Private Class Action Settlements and the Problem of *Cy Pres* Relief

Class actions were designed to provide injured parties with a more efficient means of accessing justice by aggregating claims for violations of individual rights.[3] Although most successful class action litigation under Rule 23 is resolved in the form of a class settlement, such class settlements frequently provide little or no meaningful compensation to consumers. Indeed, a significant number of consumer class settlements do not provide consumers with any monetary relief whatsoever. This systematic under-compensation is the product of two structural problems in class actions. First, because class attorneys' fees generally come from the same source as the class members' compensation—the defendant—class attorneys settling class claims have a fundamental conflict of interest.[4] Second, to the extent class attorneys exploit that conflict of interest, judges lack the necessary information or incentive to rectify self-dealing in most cases.

The principal reason for the failure of many class settlements to provide meaningful compensation is obvious: class attorneys have incentives to engage in self-dealing during the negotiation of class settlements.[5] Because class members, especially

---

[3] *See* Martin H. Redish, *Class Actions and the Democratic Difficulty: Rethinking the Intersection of Private Litigation and Public Goals*, 2003 U. Chi. Legal F. 71, 77 (2003).

[4] *E.g., Pearson, supra*; *Redman v. RadioShack Corp.*, 768 F.3d 622 (7th Cir. 2014); *Eubank v. Pella Corp.*, 753 F.3d 718 (7th Cir. 2014).

[5] *See, e.g.*, Ted Frank, *Class Actions, Arbitration, and Consumer Rights*, Legal Policy Report No. 16 at 6-11 (Manhattan Institute 2013); Lester Brickman, *Lawyer Barons* 335-72 (Cambridge U. Press 2011); John C. Coffee, Jr., *Class Wars: The Dilemma of the Mass Tort*

those in a small-claims consumer class action, have small stakes in the case and therefore usually do not closely monitor their attorneys' conduct, class attorneys often are able to obtain high fees without obtaining meaningful compensation for class members.[6]

Indeed, all three branches of government have recognized this economic reality. In enacting the Class Action Fairness Act of 2005,[7] Congress found that "[c]lass members often receive little or no benefit from class actions, and are sometimes harmed, such as where . . . counsel are awarded large fees, while leaving class members with coupons or other awards of little or no value."[8]

Similarly the FTC has recognized that "[e]xcessive class action attorney fee awards represent a substantial source of consumer harm."[9]

Class Action, 95 Colum. L. Rev. 1343, 1347-48 (1995); Coffee, 54 U. Chi. L. Rev. at 883-84; Jonathan R. Macey & Geoffrey P. Miller, *The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform*, 58 U. Chi. L. Rev. 1, 7-8 (1991).

[6] In a now-classic study, Andrew Rosenfeld demonstrated that a class attorney that settles a class action enjoys a "settlement premium" above the average attorney's fee awarded in a class action that proceeds to judgment. *See An Empirical Test of Class-Action Settlement*, 5 J. Legal Stud. 113, 115-17 (1976). This premium is consistent with the hypothesis that class attorneys will maximize their fees at the expense of the class members' compensation. *See also, e.g.*, Frank, *Class Actions* 6-11; Coffee, 54 U. Chi. L. Rev. at 883-84.

[7] CAFA, Pub. L. No. 109-2, § 2, 119 Stat. 4.

[8] *See id.* at 4; *see also* S. Rep. No. 109-4, at 33.

[9] R. Ted Cruz, Dir. Office of Policy Planning, FTC, Friend of the Court: The Federal Trade Commission's Amicus Program, Remarks Before the Antitrust Section of the American Bar Association 13 (Dec. 12, 2002) ("Not infrequently, the interests of a private class action attorney may substantially diverge from the interests of the class."), *available at* http://ftc.gov.speeches/other/tcamicus; Deborah Platt Majoras, Chairwoman, FTC, *Comments at the FTC Workshop: Protecting Consumer Interests in Class Actions* (Sept. 13, 2004), *in* 18 Geo. J. Legal Ethics 1161, 1162-63 (2005) (class actions may not "truly serve consumers' interests by providing them appropriate benefits"; encouraging "consumers to carefully scrutinize opt-out notices and class action settlement terms and

Courts also have recognized the harm to consumer welfare caused by the class attorney's conflict of interest: "the negotiator on the plaintiffs' side, that is, the lawyer for the class, is potentially an unreliable agent of his principals" given the possibility that he may trade a small class award for the relatively certainty of a high fee award.[10]

One of the leading ways for self-dealing class counsel to benefit themselves at the expense of the class is through what are called *cy pres* settlements.

The idea of *cy pres* (pronounced "see pray" or "sigh pray," from the French *cy pres comme possible*—"as near as possible") originated in the trust context, where courts would reinterpret the terms of a charitable trust when literal application of those terms resulted in the dissolution of the trust because of impossibility or illegality.[11] In a classic 19th-century example, a court repurposed a trust that had been created to abolish slavery in the United States to instead provide charity to poor African-Americans.[12] The California Supreme Court endorsed the use of *cy pres* or "fluid recovery" mechanism in class action settlements in 1986, to distribute proceeds to a "next best" class of

---

particularly attorney fee awards that may reduce the total compensation available to consumers").

[10] *Mars Steel Corp. v. Continental Ill. Nat'l Bank & Trust Co.*, 834 F.2d 677, 681-82 (7th Cir. 1987).

[11] Susan Beth Farmer, *More Lessons From the Laboratories: Cy Pres Distributions in Parens Patriae Antitrust Actions Brought by State Attorneys General*, 68 FORDHAM L. REV. 361, 391-93 (1999); RICHARD POSNER, ECONOMIC ANALYSIS OF LAW 509-10 (4th ed. 1992); BRYAN A. GARNER, BLACK'S LAW DICTIONARY 392 (7th ed. 1999). "Justification for the use of the doctrine [in the middle ages] was laid on the shoulders of the donor, the idea being since the object of the testator in donating the money to charity was to obtain an advantageous position in the kingdom of heaven, he ought not to be frustrated in this desire because of an unexpected or unforeseen failure." *Id.* (quoting EDITH L. FISCH, THE CY PRES DOCTRINE IN THE UNITED STATES 4 (1950)). For more on *cy pres*, *see* Frank, *Class Actions* 8-9; Martin Redish *et al.*, *Cy Pres Relief and the Pathologies of the Modern Class Action: A Normative and Empirical Analysis*, 62 Fla. L. Rev. 617 (2010); John H. Beisner *et al.*, *Cy Pres: A Not So Charitable Contribution to Class Action Practice* (2010); Theodore H. Frank, *Cy Pres Settlements*, Class Action Watch (Mar. 2008).

[12] *Jackson v. Phillips*, 96 Mass. 539 (1867). *But see* Evans v. Abney, 396 U.S. 435 (1970) (upholding Georgia Supreme Court's dissolution of trust providing for segregated municipal park).

consumers, and many other courts have gradually adopted the procedure.[13] *Cy pres* settlements arise in one of three circumstances:

- There is a fixed settlement fund that exceeds the amount paid out because only a few class members have registered to be claimants;
- The court (often at the parties' behest) decides that administering a settlement by paying class members directly would be too expensive;
- The parties otherwise agree that a case shall be settled by paying a third party.

While original *cy pres* class action settlements provided that left-over money be distributed to a different set of consumers who may or may not coincide with the class, in recent years, left-over, or specifically earmarked, funds are typically given directly to a third-party charity.

The problem with *cy pres* is that it exacerbates existing conflicts of interest in the class action settlement context. When a class attorney settles a class action, he or she is not only negotiating class recovery, but is also negotiating his or her own fee. A defendant may be willing to spend a certain amount of money to settle a class action to avoid the expense and risk of litigation, but that money must be divided between the class and their attorneys. Every dollar going to the attorneys does not go to the class, and vice versa. At the same time, a class action settlement must be approved by the court. Attorneys who do not adhere to their fiduciary responsibility to the class have an incentive to exaggerate class recovery to a court to maximize their fees.

The possibility of *cy pres* awards gives an additional incentive to class action attorneys to breach their fiduciary duties to the class. Every dollar that a class member does not recover can now be spent by the attorney himself to the charity of the attorney's choice. Attorneys essentially get free advertising: witness the existence of websites like "ohiolawyersgiveback.com" where lawyers are using their clients' money to advertise themselves. At best this is unseemly; at worst, it is an unethical breach of the attorneys' fiduciary duty to put the interests of their clients first. If courts permit unfettered *cy pres*, then attorneys have an incentive to make it difficult for their own putative clients to recover, because then they can maximize the amount of money that goes to charity in the attorneys' names. This hurts class members. For example, in a settlement I successfully challenged in the Third Circuit,[14] the parties created substantial burdens, including a five-page claim form with confusing instructions, that successfully

[13] *State v. Levi Strauss & Co.*, 41 Cal. 3d 460, 715 P.2d 564, 224 Cal. Rptr. 605 (1986).

[14] *Baby Products, supra.*

deterred class members from making claims on the settlement fund. If my client had not successfully appealed the settlement approval, class members would have received less than $3 million, while the class counsel would have received about $15 million to distribute to its favorite charity, plus another $14 million for itself.

Judge Richard Posner has argued that *cy pres* is a misnomer in the class action context:

> [*Cy pres*] doctrine is based on the idea that the settlor would have preferred a modest alteration in the terms of the trust to having the corpus revert to his residuary legatees. So there is an indirect benefit to the settlor. In the class action context the reason for appealing to cy pres is to prevent the defendant from walking away from the litigation scot-free because of the infeasibility of distributing the proceeds of the settlement (or the judgment, in the rare case in which a class action goes to judgment) to the class members. There is no indirect benefit to the class from the defendant's giving the money to someone else. In such a case the "cy pres" remedy (badly misnamed, but the alternative term—"fluid recovery"—is no less misleading) is purely punitive.[15]

But sometimes *cy pres* is less a matter of being punitive and more a matter of disguising the true cost of a settlement to the defendant to maximize the share of the actual recovery received by the plaintiffs' attorneys. If the beneficiary is related to the defendant, or the defendant otherwise benefits from the payout, then the contingent attorneys' fee can be exaggerated by claiming that the value to the class is equal to nominal value of the payment to the beneficiary; the defendant is willing to make a larger nominal contribution to settle the case than the actual cost to the defendant. For example, a California state court settlement of a derivative action against Larry Ellison alleging insider trading settled when Ellison agreed to pay $100 million to a charity chosen by Oracle—even though the billionaire has previously stated that his fortune would go to charity.[16] The only real expense to Ellison was the $22 million attorneys'

---

[15] *Mirfahisi v. Fleet Mortgage Corp.*, 356 F.3d 781, 784 (7th Cir. 2004).

[16] Ted Frank, "Final update: Oracle settlement," Point of Law weblog, http://www.pointoflaw.com/archives/001875.php (Nov. 23, 2005) ("That the plaintiffs are settling for pennies on the dollar with no benefit to the corporation on whose behalf they're ostensibly suing, as well as the fact that a Delaware court has already absolved Ellison of the same charges, suggests that even the plaintiffs recognize the suit as meritless."); Michael Paige, "Judge OKs Ellison's $122M settlement," MarketWatch, Nov. 22, 2005; Peter Branton, "Wealth of Experience," IT Weekly (Jul. 9, 2006) ("I think

fee. More recently, Facebook settled a suit by establishing a charity run by a Facebook board member, and funding it with $6.5 million dollars; again, the class did not benefit, and the only expense to Facebook was the $2 million fee paid to the class attorneys.[17] If the charitable contribution is one that the defendant was making anyway, the effect on the defendant is one of a change of accounting entries rather than any cost to the defendant or benefit to the class aside from the attorneys' fees.[18] While federal courts are starting to crack down on such abuses, they are doing so inconsistently, and parties are still trying to get away with such shenanigans.[19]

Further ethical problems arise if the beneficiary is related to the judge. The *New York Times* has documented the problem of charities soliciting judges for leftover settlement money.[20] In one notorious case, a judge directed *cy pres* to an animal-rights group in a class action over a hotel fire.[21] In a mass-tort inventory settlement of fen-phen cases in Kentucky, tens of millions of dollars intended for plaintiffs was diverted to a newly created charity, where the judge who approved the settlement and three of

---

after a certain amount, I'm going to give almost everything I have to charity because what else can you do with it?").

[17] *Marek v. Lane*, -- U.S. --, 134 S.Ct. 8 (2013).

[18] For example, Kellogg agreed to class action settlements that required it to donate a few million dollars of products to food-banks—something it was already doing to the tune of tens of millions of dollars a year. *Dennis v. Kellogg*, 697 F.3d 858 (9th Cir. 2012) (rejecting settlement).

[19] *Compare Dennis v. Kellogg*, 697 F.3d 858 (9th Cir. 2012); *Nachshin v. AOL LLC*, 663 F.3d 1034 (9th Cir. 2011); *and Klier v. Elf Atochem N. Am.*, Inc., 658 F.3d 468 (5th Cir. 2011); *with Lane v. Facebook*, 696 F.3d 811 (9th Cir. 2012), *en banc review denied,* 709 F.3d 791 (9th Cir. 2013), *cert. denied*, *Marek v. Lane*, 134 S.Ct. 8 (2013). In *Lane*, the *cy pres* went to a new charity established by defendant Facebook, who could then direct the money to recipients favorable to Facebook's lobbying interests, a tactic that is being repeated by Facebook in the pending *Fraley v. Facebook* settlement. Adam Liptak, *When Lawyers Cut Their Clients Out of the Deal*, N.Y. TIMES (Aug. 12, 2013); Roger Parloff, *Google and Facebook's new tactic in the tech wars*, CNN MONEY (Jul. 30, 2012), available at http://tech.fortune.cnn.com/2012/07/30/google-and-facebooks-new-tactic-in-the-tech-wars/.

[20] Adam Liptak, *Doling Out Other People's Money*, N.Y. TIMES (Nov. 26, 2007).

[21] *In re San Juan Dupont Plaza Hotel Fire Litigation*, 2010 WL 60955 (D. P.R. Jan. 7, 2010).

the plaintiffs' attorneys sat as board members, each receiving tens of thousands of dollars for their service. The settlement also provided a million dollars to the alma mater of one of the trial lawyers, which then hired the attorney for a $100,000/year no-show job. (Two of the attorneys were eventually convicted, and too few people went to prison over this.)[22]

While this is obviously an extreme case, it does illustrate the ethical problems associated with judges choosing or approving charitable destinations for settlement money. In a settlement I objected to, the parties in a nationwide class action proposed a *cy pres* award to a local charity where the judge's husband served as a board member; the judge rubber-stamped the proposed settlement over an objection regarding the appropriateness of the *cy pres* award.[23] The Ninth Circuit reversed on other grounds, but refused to condemn the conflict of interest.[24] This appearance of impropriety damages public perceptions of the fairness of the justice system, and appellate courts should be doing more to police it.

More frequently, if the beneficiary is related to the plaintiffs' attorneys, or the plaintiffs' attorneys otherwise benefit from the payout, the award rewards trial lawyers twice: first by providing *cy pres* recovery to an organization that supports the agenda or causes of the trial lawyers bringing the case, and then a second time by basing attorneys' fees on the first amount.

In July 2007, a district court judge granted a motion to award $5.1 million of unclaimed antitrust settlement funds to George Washington University to create a "Center for Competition Law" on the grounds that it would "benefit the plaintiff class and similarly situated parties by creating a Center that will help protect them from future antitrust violations and violations of other competition laws."[25] The lead plaintiffs' attorney was a GWU Law alumnus.[26] I represent a client whose class counsel

---

[22] Ted Frank, "Fen-Phen Zen," American.com (Apr. 4, 2007).

[23] Nathan Koppel, *Proposed Facebook Settlement Comes Under Fire*, WALL STREET JOURNAL (Mar. 2, 2010).

[24] *Nachshin v. AOL, LLC*, 663 F.3d 1034 (9th Cir. 2011).

[25] Diamond Chemical Co. v. Akzo Nobel Chemicals B.V., No. 01-2118 (May 14, 2007) ("Diamond I"); Diamond Chemical Co. v. Akzo Nobel Chemicals B.V., No. 01-2118 (Jul. 10, 2007); George Washington University press release, July 11, 2007.

[26] Ashley Roberts, *Law School Gets $5.1 Million to Fund New Center*, GW Hatchet (Dec. 3, 2007).

succeeded in having a district court divert $2.7 million of shareholder's money in a national shareholder class to a local St. Louis charity; the Eighth Circuit reversed the diversion on appeal.[27] In another case, I represent a client appealing an approval of a settlement of a class action with a national class where over $2 million of *cy pres* is going to three San Diego universities (including the *alma mater* of class counsel), class counsel is being paid $8.85 million, but the class will receive only about $225,000 in cash.[28] In another settlement where class counsel was already scheduled to receive $27 million, *cy pres* was designated to a charity run by the ex-wife of class counsel.[29]

In practice, *cy pres* "creates the illusion of class compensation" without actually compensating the class.[30] And as Judge Edith Jones has said, "district courts should avoid the legal complications that assuredly arise when judges award surplus settlement funds to charities and civic organizations."[31]

In recent years appellate courts have started to take a stand against *cy pres* abuses, often at the behest of my non-profit's litigation. In *Oetting v. Green Jacobson*, the Eighth Circuit explicitly adopted Section 3.07 of the American Law Institute's Principles of the Law of Aggregate Litigation:

> A court may approve a settlement that proposes a cy pres remedy . . . . The court must apply the following criteria in determining whether a cy pres award is appropriate:

---

[27] *Oetting, supra*.

[28] *In re EasySaver Rewards Litigation*, No. 13-55373 (9th Cir.). I have also previously successfully blocked a diversion of $2.5 million of a settlement fund to third-party charities (including two schools affiliated with class counsel). Alison Frankel, "Legal Activist Ted Frank Cries Conflict of Interest, Forces O'Melveny and Grant & Eisenhofer to Modify Apple Securities Class Action Deal," *American Lawyer Litigation Daily* (Nov. 30, 2010).

[29] *In re: Chase Bank USA NA "Check Loan" Contract Litigation*, No. 09-md-02032 (N.D. Cal.). The conflict of interest was not disclosed to the district court, which approved the settlement.

[30] Redish, 62 Fla. L. Rev. at 623.

[31] *Klier v. Elf Atochem*, 653 F.3d 468, 481-82 (5th Cir. 2011) (Jones, J., concurring). *Accord Ira Holtzman, C.P.A., & Assocs. v. Turza*, 728 F.3d 682, 689-690 (7th Cir. 2013) (Easterbrook, J.).

> (a) If individual class members can be identified through reasonable effort, and the distributions are sufficiently large to make individual distributions economically viable, settlement proceeds should be distributed directly to individual class members.
>
> (b) If the settlement involves individual distributions to class members and funds remain after distributions (because some class members could not be identified or chose not to participate), the settlement should presumptively provide for further distributions to participating class members unless the amounts involved are too small to make individual distributions economically viable or other specific reasons exist that would make such further distributions impossible or unfair.
>
> (c) If the court finds that individual distributions are not viable based upon the criteria set forth in subsections (a) and (b), the settlement may utilize a cy pres approach. The court, when feasible, should require the parties to identify a recipient whose interests reasonably approximate those being pursued by the class. If, and only if, no recipient whose interest reasonably approximate those being pursued by the class can be identified after thorough investigation and analysis, a court may approve a recipient that does not reasonably approximate the interests being pursued by the class.

Cy Pres and Justice Department Settlements

Normally, one would expect Justice Department settlements and public enforcement to avoid the conflicts of interest presented by private enforcement because of the absence of a profit motive. But when the Justice Department has the unfettered power to structure settlements in ways other than direct compensatory relief to victims or payments to the Treasury, it reintroduces the conflict-of-interest problems inherent in litigation on behalf of absent victims.

Settlement *cy pres* by the Justice Department and by state attorneys general present problems beyond the mere conflicts of interest and breaches of fiduciary duty in the private civil litigation context. *First*, such settlements present separation of powers issues. If the Justice Department cannot take money from the U.S. Treasury to fund new programs and third parties without Congressional approval, it should not be able to ignore those checks on its power by structuring litigation settlements to bypass the

Treasury and have defendants to spend that money on the executive branch's preferred priorities—priorities that might never be authorized by Congress.

Second, the *de facto* slush fund created by such Justice Department settlements evades Congressional oversight; neither courts nor the Justice Department are well situated to ensure that *cy pres* is effectively or efficiently used, and there is no evidence that the Justice Department has ever performed that oversight function itself.

Third, such settlements create a conflict of interest that permits Justice Department officials to reward cronies and political allies at the expense of taxpayers. For example, Professor Richard Epstein criticized a Bush administration settlement with Bristol-Myers Squibb requiring them to endow a chair of ethics at the District of New Jersey U.S. Attorney's *alma mater*, Seton Hall Law School; *Investors Business Daily* criticized the recent Bank of America settlement[32] as a "raft of political payoffs to Obama constituency groups."[33]

Fourth, because of that conflict of interest, if executive-branch officials have unfettered authority to use *cy pres* in settlements, they will prefer to structure settlements in a manner that increases their own spending and political power rather than maximizes recovery to taxpayers.

The August 2014 Bank of America and July 2014 Citigroup settlements are especially abusive in this last regard. Justice Department officials issued press releases on July 14 and August 21, 2014, taking credit for a supposed benefits of "$2.5 billion" and "$7 billion" for consumers. But the fine print of each Annex 2 of the two settlements shows that this number is wholly illusory. For example, under Menu Item 4, if Bank of America funds a "Critical Need Family Housing" development, it is entitled to a $3.75 "credit" against the settlement for every $1 of loss Bank of America incurs on the resulting subordinated loan. Citigroup gets a $2 "credit" for every dollar given to qualified non-profit housing counseling agencies—which, as the Investors Business

[32] http://www.justice.gov/iso/opa/resources/3392014829141150385241.pdf

[33] Richard A. Epstein, *The Deferred Prosecution Racket*, WALL ST. J. (Nov. 28, 2006); Investors Business Daily, *Holder Cut Left-Wing Groups In On $17 Bil BofA Deal* (Aug. 27, 2014). *See also* Bob Goodlatte and Jeb Hensarling, Letter to Eric H. Holder, Jr. (Nov. 25, 2014).

Daily editorial notes, tend to involve friends of the administration.[34] Nothing in the settlement ever requires disclosure to taxpayers who

Bank of America and Citibank also get a $2 credit for every $1 given to IOLTA; many of the resulting legal-aid organization beneficiaries will be able to evade federal-funding restrictions.[35]

It's further questionable whether the settlement should be structuring any consumer relief at all. The settlement is of claims that Bank of America and Citigroup possibly defrauded investors when issuing residential mortgage-backed securities or collateralized debt obligations. If so, billions of dollars for loan modifications to mortgage holders does absolutely nothing to compensate the alleged victims who purchased overpriced RMBS or CDOs and lost money. And it is likely that the consumer relief program will be a fiasco in and of itself. The Home Affordable Modification Program (HAMP) was justly criticized by the Special Inspector General for the Troubled Asset Relief Program because of its 47% re-default rate, which wasted taxpayer money and left many homeowners worse off. The Bank of America settlement credits the defendant for mortgage modifications that are not eligible under HAMP criteria—which will surely result in a higher re-default rate in the long run. And that is before one considers the moral hazard problems and fundamental unfairness of providing benefits to consumers who were financially irresponsible at the expense of consumers who played by the rules and refused to overextend themselves to purchase more housing than they could afford.

If nothing else, it is truly questionable whether the Justice Department can create a more effective consumer relief program than Treasury or Congress or a more effective low-income housing development program than HUD or Congress. The settlement makes public policy decisions that are ultimately counterproductive and certainly not within Justice's expertise. For example, in Menu Item 2.A, Bank of America gets a $10,000 credit in the settlement for every loan made to first-time low-to-moderate-income homebuyers. There are two possibilities: either Bank of America is being incentivized to make loans that would already be financially viable, in which case there is no incremental consumer benefit because the loan would have happened anyway; or Bank of America is being incentivized to make loans that would have an expected value

[34] It is unclear whether such donations to non-profits will also result in tax benefits on top of the settlement's incentives to substitute payments to the non-profits in lieu of direct consumer relief.

[35] *E.g.*, 45 C.F.R. § 1617.

of between zero and negative $10,000—the same sort of distortion of the market that led to expansion of risky mortgages to underqualified buyers that led to the housing crisis in the first place.[36]

The administration of the consumer relief program is a hidden social cost: to ensure compliance, millions of dollars will be spent on lawyers and audits that would have been unnecessary had Bank of America simply written a larger check to the United States Treasury in lieu of spending money on Justice Department public-policy priorities. Why one can understand why Justice Department lawyers might feel that pumping money into the legal economy is a social good, taxpayers would tend to differ.

The Justice Department has traded billions of dollars of leverage in the underlying litigation for an expansion of its own power and an impressive press release, all ultimately at taxpayer expense. And the resulting damage to the future economy from problematic public-policy decisions by Justice Department officials without any regulatory or Congressional oversight may end up costing taxpayers billions of dollars more directly and indirectly.

Section 3.07 of the *ALI Principles* suggests that *cy pres* should never be utilized in Justice Department settlements without express Congressional authorization. If the Justice Department cannot ensure restitution of alleged victims of defendant wrongdoing in settlements, the money is always available for the U.S. Treasury, and Congress can decide whether to create compensation programs, such as HAMP authorized by the Emergency Economic Stabilization Act of 2008; the SEC Fair Funds created by the Sarbanes-Oxley Act of 2002; or the various September 11 Victim Compensation Programs. Such decisions should be made by Congress, and not by a Justice Department operating without oversight.

I welcome your questions.

---

[36] *E.g.*, Lawrence H. White, *Housing Finance and the 2008 Financial Crisis* (2009).