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By: ROBERT R. CALO

OPERATIONS THE SUBPRIME CRISIS

Will the feds show up at your doorstep?

The subprime mortgage crisis is unique in America's array of economic downturns. There have been banking crises on Wall Street (most recently, the Savings and Loan scandal) and real estate and mortgage crises on Main Street, but this crisis is on both. It spans the entire mortgage industry and reaches across the globe.

On Main Street, the downturn and possible fraud relates primarily to the lender/homeowner or lender/developer relationship. Here, the principal complaints are that lenders misled borrowers on the nature of the mortgages or financing packages, or that the money was loaned to borrowers on terms and in circumstances in which the borrowers were taking on debt far above their financial capacity. There is also concern that there has been collusion between lenders, mortgage brokers and appraisers (and sometimes borrowers) to commit fraud. The classic players for this scheme are: real estate scam artists who take advantage of lax oversights to dole out risky loans; mortgage brokers who select loan products with minimum underwriting standards; corrupt appraisers willing to overstate the value of properties; "straw" loan applicants who are willing to lend their name and credit histories for a fee; and/or closing agents who keep lenders in the dark about obvious fraudulent transactions.

The Wall Street subprime crisis is a bit more sophisticated, but it involves similar core principles of collusion and misrepresentations. Here, lenders package a series of individual loans into investment vehicles to be bought and sold. Unfortunately, as individual mortgages default, the value and creditworthiness of these packages also take a dive. The question is whether the investors on Wall Street were misled or defrauded on the risks of these investment vehicles.

THE RESPONSE: MORE COPS ON THE BEAT

The subprime crisis has engendered numerous lawsuits. The FBI is investigating 14 companies in connection with home loans. Other federal agencies are also gearing up. The SEC has opened scores of investigations. HUD and the FTC have announced increased enforcement efforts. U.S. Attorney's Offices across the country are establishing mortgage fraud task forces. State and local agencies are also jumping into the fray. Attorneys general in New York, California, Ohio and elsewhere have announced investigations related to the mortgage industry. Last month, the Massachusetts Secretary of State accused Merrill Lynch of defrauding the city of Springfield with subprime-linked investments. Moreover, several state attorneys are successfully suing Ameriquest Mortgage and its related companies for predatory lending. Many of these agencies have announced that they will be working with each other in joint or parallel investigations.

HOW THE FEDS COULD COME AT YOU AND WHY

Obviously, those in the construction industry have little exposure to the Wall Street side of the investigation, but there is a very good chance the regulators and prosecutors could show up at your door investigating frauds at the retail level, where the money is initially doled out. Here, the inquiry will be whether the contractor/builder assisted in the fraud (the possible suspect or target of the investigation) or had knowledge of fraud by others (a mere witness). Either way, the government could come at you in three ways.

First, they could request testimony from you. Whether informally (interview) or formally (grand jury subpoena), this is a serious matter. What is said in these interviews could be construed (or misconstrued) by an aggressive prosecutor as perjury or obstruction of justice. For this reason, it is foolhardy to run this gauntlet without the assistance of an attorney who can negotiate your status (immunity or a letter confirming you are just a witness) and the scope of the questions, prepare you for the interview and, if needed, assert your right under the Fifth Amendment not to answer any question that could be used against you.

Second, they could seek information from you informally, by simply requesting the documents, or formally, by subpoena. Again, there are serious ramifications to your response. Government subpoenas are powerful tools, with very few categories of documents that can be withheld from a prosecutor. Also, a notion you or your employees are destroying or withholding documents could focus the investigation on you for obstruction of justice. An attorney here is vital to negotiate the scope and timing of your production of documents, to set up document retention protocols so that all responsive documents are turned over, and/or to review all documents to see that privileged documents (i.e., documents under attorney client privilege or containing proprietary business information) are either not disclosed or disclosed with an aggressive confidentiality agreement.

Finally, a prosecutor can get a search warrant for your jobsite or office. Prior to Enron, search warrants were rarely used in so-called white collar fraud crimes; however, these warrants are increasingly being used to grab documents quickly and to do "on the spot" (and uncounseled) interviews of you and your employees. To mitigate the blunt force of a search warrant, your company and experienced outside counsel should develop a response plan to be executed if/when the agents show up with a search warrant. Also, the attorneys should be on call 24/7 to intervene and ensure: a) Agents do not take documents that are privileged or outside the scope of the warrant b) Employee interviews are shut down or limited, and c) The rights of your employees are safeguarded and the search disruption— and adverse publicity—to your business minimized.

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