

The False Claims Act
and the Financial Sector:
New Risks, New Compliance
Strategies

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Introduction

The False Claims Act Now Matters More than Ever to Financial Institutions

- New Legislation
 - FERA enacted May 20th
 - False Claims Act Corrections Act advances in both houses
- Influx of Federal Money
- Commitment of New Administration to Combat Fraud



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False Claims Act Basics

- Government's most widely used tool for punishing and remedying every kind of fraud in Government contracting
- Provides for both criminal and civil liability
- Qui tam provision allows whistleblowers—called “relators” —to sue on behalf of the Government
- Government may sue on its own and may also intervene in qui tam cases.



False Claims Act Basics

Litigation Volume

- In FY2008:
 - 542 new civil matters filed
 - Settlements and judgments totaling \$1.04 billion
- Expected to Increase:
 - Both the new Congress and the new Administration have signaled their interest in increasing FCA enforcement.



False Claims Act Basics

Civil Liability Provisions: Most Frequently Used

- False Claim, 31 U.S.C. § 3729(a)(1) / 3729(a)(1)(A)
 - Can apply to claims submitted directly or indirectly (e.g. subcontractor or applicant for government-insured mortgage).
- False Record or Statement, 31 U.S.C. § 3729(a)(2) / 3729(a)(1)(B)
- Conspiracy, 31 U.S.C. § 3729(a)(3) / 3729(a)(1)(C)
- “Reverse” False Claim, 31 U.S.C. § 3729(a)(7) / 3729(a)(1)(G)



False Claims Act Basics

Civil Liability Provisions: Less Commonly Used

- Delivery of Less Property, 31 U.S.C. § 3729(a)(4) / (a)(1)(D)
- False Receipt, 31 U.S.C. § 3729(a)(5) / 3729 (a)(1)(E)
- False Purchase, 31 U.S.C. § 3729(a)(6) / 3729 (a)(1)(F)

Criminal Liability Provisions

- 18 U.S.C. § § 286–287: Conspiracy & Making False Claims
- Subject to up to 10 years imprisonment and a fine.



False Claims Act Basics

False Certifications

Courts have imposed liability for false certifications of statutory, regulatory, and contractual compliance based on § 3729(a)(1) and/or § 3729(a)(2).

- Express Certifications
- Implied Certifications



False Claims Act Basics

FCA Civil Damages

Treble Damages available

Civil Penalties: Ranging from \$5,500 to \$11,000 per violation, in addition to damages.

Qui Tam Relator's Awards: 31 U.S.C. § 3730(d)

- Government Intervention: 15-25% of award, plus attorneys fees, depending on relator's involvement and facts of case.
- No Intervention: 25-30% of award, attorneys fees possible.



False Claims Act Basics

FCA Civil Damages & Voluntary Disclosure

Reduced Multiplier: Voluntary disclosure and cooperation with investigation can reduce damages multiplier from trebling to doubling.

Time Limit: Disclosure must be made within 30 days of when the claimant obtains the information.

Risks of Disclosure: Myriad, including:

- That a court may find that the disclosing party may not meet all of the requirements to obtain volunteer status; and
- That disclosure may waive privilege in subsequent litigation over disclosed communications and/or work product.



False Claims Act Basics

Government Intervention

Standard for Intervention in Qui Tam actions:

- No published guidance regarding intervention decisions
- DOJ intervenes in approximately 25% of qui tam cases
- WH has extensive experience working with DOJ to avoid intervention

Timing:

- Government must move to intervene within 60 days after qui tam complaint filed, but courts routinely extend the investigation period.

Effect of Intervention:

- Government controls the case
- Relator's share of award is limited.



Financial Industry Exposure to FCA

Special Inspector General for TARP (SIGTARP)

TARP Certifications: (may create false certification liability)

- The SIGTARP requested that all recipient institutions provide:
 - 1) an accounting for the institution's use of TARP funds;
 - 2) a description of its plan to comply with the executive compensation requirements; and
 - 3) a certification by an authorized senior executive of the accuracy of information provided.

TALF Task Force:

- SIGTARP has set up a multi-agency task force to deter, detect and investigate instances of fraud in the TALF program



Financial Industry Exposure to FCA

Active WH Investigations/Litigations:

- We represent a major financial institution in a False Claims Act investigation. The government contends that the financial institution did not follow agency underwriting procedures and submitted claims where the insured did not qualify for insurance or only qualified for a lower level of insurance.

SBA Loan Certifications:

- *Brickman et al v. Business Loan Express*, 2009 WL 275186 (11th Cir. 2009) – WH obtained complete dismissal of qui tam action alleging that defendant submitted false certifications in originating SBA guaranteed shrimp boat loans

Other WH Representations:

- WH has also represented numerous non-financial clients in litigating and resolving FCA claims and investigations, including in defense, pharmaceutical, construction, and other industries.



Financial Industry Exposure to FCA

Certifications in Federally Insured Mortgages

- ABN Amro Mortgage Group - \$41 million settlement Jan 2006
 - ABN allegedly improperly certified that it properly underwrote more than 28,000 HUD-insured mortgage loans when underwriting process had not in fact been completed.
- National City Mortgage - \$4.6 million settlement May 2008
 - Allegedly improperly certified that approximately 58 loans were not in default at the time that they were submitted for “late endorsement” HUD insurance coverage (i.e. loans submitted for endorsement more than 60 days after closing).



Financial Industry Exposure to FCA

False Claims Related to HUD/VA Loans

Market Street Mortgage Corp. - \$700,000 cash settlement and indemnification on further losses up to \$5 million – Aug. 2004

- Allegedly submitted false documentation in connection with loan applications, including employment records, “gift” letters, and credit references to qualify borrowers for loans.
- Qui tam action.



Financial Industry Exposure to FCA

False Claims in Administering Flood Insurance Claims

- Travelers Casualty & Surety Co. and EDS - \$2.85 million settlement Jan. 2007
 - Allegedly paid for flood insurance losses under policies not allowable by the National Flood Insurance Program at the time of processing, thus knowingly paying losses on behalf of the government that were not covered by the program
 - Qui tam action.



Financial Industry Exposure to FCA

Municipal Bond Yield Burning

Global settlement with 17 brokerage firms - \$138 million, April 2000.

- Firms allegedly sold U.S. Treasury bonds for temporary escrow accounts at artificially inflated prices to municipalities refinancing bonds without rebating arbitrage profits to Treasury

Other Possible Targets of Investigation:

- Federally insured student loans
- Crop insurance
- Terrorism risk insurance



Legislative Developments

Fraud Enforcement and Recovery Act (FERA)

- Signed into law May 20th
- Authorizes significant additional funds for investigating and prosecuting fraud, particularly mortgage fraud
- Extends criminal fraud prohibitions to mortgage lenders broadly defined.
- Includes pro-plaintiff alterations to the FCA, including:
 - Removes the requirement of presentment to a government official for 3729(a)(1)/(a)(1)(A) claims;
 - Removes reference to intent to defraud from 3729(a)(4)/(a)(1)(D)
 - Defines “material” for purposes of false records provisions as “having a natural tendency to influence, or be capable of influencing” payment
 - Expands the definition of a “claim” to include claims made to government grantees and by subcontractors to contractors
 - Makes statute-of-limitations defense based on government delay much more difficult to sustain



Legislative Developments

False Claims Act Correction/Clarification Act

- Bill introduced in 2007 and 2008, but not passed.
- 2009 version (H.R. 1788) reported out by House Judiciary Committee on May 5; Senate version (S. 458) still in committee; unclear whether they will move forward
- Some of significant proposed changes in H.R. 1788:
 - Expand causes of action to more clearly reach TARP funds
 - Severely restrict public disclosure bar;
 - Eliminate any “presentment” requirement;
 - Extend statute of limitations to 8 years



Important Defenses

Statute of Limitations

Original Source (“Public Disclosure”) Bar

Issues of Proof:

- Knowledge and Intent
- Causation/Materiality
- Presentment



Important Defenses

Statute of Limitations

FCA provides a limit from 6-10 years:

- Bars cases more than six (6) years after submission of claim; or
- If older than 6 years, more three (3) years from date that “the facts material to the right of action are known or reasonably should have been known by the official of the United States charged with responsibility to act in the circumstances”
- But never more than ten (10) years from submission of claim

SOL generally runs from date claim presented

- E.g. when claim made upon FHA or SBA mortgage guarantee, not from date of loan origination.



Important Defenses

Original Source or “Public Disclosure” Bar

FCA prohibits qui tam suits based on publicly disclosed information, unless the relator is an “original source” of the information.

- Designed to deny recovery to parasitic relators who bring claims based upon public information rather than true whistleblowers.
- “Public disclosure” includes: 1) court proceedings; 2) Congressional or agency hearings and reports; and 3) news media.
- WH has successfully defended FCA claims on this ground by identifying allegations in far flung public documents. *Brickman et al. v. Business Loan Express*, 2009 WL 275186 (11th Cir. 2009).



Important Defenses

Knowledge and Intent

Financial Institutions operate in complex regulatory environments, which provide an opportunity to defend FCA claims on the basis of the scienter requirement

- Even under the FCA's relaxed intent requirement, ambiguous regulations or contract provisions cannot be the basis of a false claim if the claimant makes a reasonable interpretation.
- Further, a false statement or conspiracy to defraud must be made for the purpose of getting the government to pay a claim to be actionable

FCA intent element otherwise requires only that claimant knew or should have known of the falsity

- Acts in “deliberate ignorance” or “reckless disregard” for truth or falsity of the claim are actionable.



Important Defenses

Materiality/Causation

- FCA case law includes closely interrelated standards for materiality and causation.
- Standards for materiality and causation are analytically difficult to distinguish, but courts have made distinct rulings on these standards.
- The important issue is that materiality/causation adds a significant issue of proof to the Government's / Relator's claim



Important Defenses

Materiality/Causation

Authority split on whether false statement must be a direct cause of the government's loss

- Some courts apply a “but for” standard – i.e. would the government have made the financial commitment absent the false statement.
- Other courts apply a “benefit of the bargain” rule, adding an additional element of proof to the “but for” rule for plaintiffs: that the statement be the source of the government's loss.
- Significant difference for insurance and loan cases: e.g., a false certification to a particular form of underwriting – but where the underwriting did not cause the loss – would produce different results.



Materiality

Materiality/Causation

Not all false statements create FCA liability

- False certifications and conspiratorial conduct must be material (“a condition of payment”) to obtaining payment to be actionable. *Allison Engines Co. v. U.S. ex rel Sanders*, 128 S.Ct. 2123, 2130.
- Materiality limit applies to other sections of civil FCA depending on jurisdiction, but Supreme Court ruling only explicitly applies to 3729(a)(2) & (3). *Allison Engines Co.*, 128 S.Ct. 2123.



Materiality

Materiality/Causation

Materiality Standards Vary:

- “Natural Tendency to Influence Government Action” test. Many courts state materiality in terms of this lax, pro-plaintiff standard.
 - *Fraud Enforcement Recovery Act just passed by Senate would create statutory definition of materiality using this standard*
- “Prerequisite to Payment” standard: False statement or certification must be to a specific prerequisite to payment, not merely to a condition of participation in a federal program.
- “Heightened Materiality”: Many courts actually apply materiality standard to require that the false statement, claim, or certification directly caused the government’s loss.



Important Defenses

“Cause to be presented” liability varies

- Depends on individual circumstances of the fraud and submission process, but many courts apply traditional tort principles
 - Often decided under common law tort principles (e.g. U.S. ex rel Sikkenga v. Regence Blue Cross Blue Shield of Utah, 472 F.3d 702 (10th Cir. 2006)).
- Other courts apply varying standards, but principles remain largely undeveloped for “causes to be” liability, but all require an affirmative act by claimant.



Important Defenses

Presentment

FCA includes a “presentment requirement”

- Applicable only to § 3729(a)(1) claims
- Means those claims must be submitted or “caused to be” submitted – to the government, not to a third party
- Thus, a defense to liability may exist if false claims on, for example, a loan guarantee are submitted through an intermediary
- While “presentment” does not apply to false statement (a)(2) and conspiracy (a)(3) cases, the false claim must be made to get the Government to make a payment in those cases.
- *The recently passed FERA will eliminate this defense for future claims, but does not apply retroactively*



Liability Prevention Strategies

Why You Should Care: Corporate vicarious liability under the FCA is remarkably broad.

- Corporations can be liable for treble damages for employee acts *despite senior management having no knowledge.*
- Government has used employee guilty pleas as proof of corporate liability in some instances.
- In a recent decision, 10th Circuit upheld a complete dismissal where company vigorously audited internal whistleblower complaint, self-disclosed certain issues, and obtained a release of claim from employee.



Liability Prevention Strategies

Regular and Companywide Fraud Prevention Training

- Sales and administrative personnel such as loan officers, underwriters, loan processors, and billing representatives are key
- Management must participate to create a “culture of compliance”
 - Companies will be held responsible for employees’ fraudulent acts

Establish & Maintain Robust Internal Audit Department

- Empower department to investigate thoroughly its own concerns
- Engage competent counsel to investigate significant concerns
 - Not taking findings seriously may create well informed relators
- Pay particular attention to government overpayments



Liability Prevention Strategies

Maintain Internal Whistleblower Hotline

- Audit department should investigate issues raised seriously and engage competent counsel where appropriate
- Protect whistleblowers from internal retaliation

Act Deliberately When Dealing with Ambiguous Laws, Regulations, and Government Contracts

- Obtain expert opinions to determine reasonable interpretations
- Stay within reasonable interpretations
- Maintain meticulous records of company decision process and any advice obtained



Liability Prevention Strategies

Consider Voluntary Disclosure of Any Fraud Identified

- Reduces the multiplier and can improve negotiating posture
- However, involves significant risk

Maintain Positive Employee Relations

- Good morale and company loyalty may be the best means to preventing frivolous but expensive litigation
- Employee benefits such as employee assistance programs to provide aid for dealing with personal issues may mitigate incentives to bring frivolous suits



Liability Prevention Strategies

Employee Separations

- Detailed Exit Interviews
 - Require disclosure of any allegations of fraud and certification to lack of knowledge of fraud by employees making no disclosure
- Carefully Craft Severance Packages, including considering:
 - Requirement to report fraud allegations to company in first instance
 - Indemnification for high risk employees such as government guaranteed loan officers and loan processors
 - Consider provisions requiring employees to dismiss any qui tam suit not disclosed at exit
 - Require return of company documents and property such as laptops