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Worried about regulatory strings that come with the billions of dollars the federal government has offered to stabilize the economy, many financial institutions have been reluctant customers. Only a few may have also considered that by accepting this largesse they expose themselves to massive potential liability under the False Claims Act.

Ropes & Gray attorneys Mayer and Wong have seen how easy it is to fall afoul of the FCA, which entails treble damages and large civil fines, and how the law spurs whistleblowers into action with hopes of huge financial rewards.

Institutions that choose to participate in these stabilization programs should carefully survey the FCA risks and structure their compliance programs accordingly.

## Firms Receiving U.S. Stimulus Funds May Also Receive False Claims Scrutiny

BY KIRSTEN V. MAYER, MICHAEL LI-MING WONG

The federal government is injecting trillions of dollars into banking and financial services to stabilize the economy. But this money comes with strings attached. Institutions might not realize that their receipt of government stimulus funds could expose them to the federal False Claims Act, and through it to both civil and criminal liability.

Although a version of the False Claims Act, 31 U.S.C. § 3729 *et seq.* (the ''FCA'') has been a part of U.S. law since 1863, Congress updated and significantly strengthened the FCA's liability and whistleblower provisions in 1986. Since then, the FCA has driven record-setting recoveries in the healthcare and government-contracting fields. Since January 2009, the Department of Justice (''DOJ'') has announced settlements with companies in these industries that total almost $1.5 billion, and the cases that led to these settlements were brought to DOJ's attention by FCA whistleblowers who collectively reaped more than $90 million for their efforts.[1] Yet, inasmuch as the FCA creates liability only in cases involving funds paid by or owed to the government, banks and financial services companies have operated largely outside of its prohibitions—until now.

The major federal economic stabilization programs announced by the Obama administration are rife with FCA risk. These programs include the Capital Assistance Program (''CAP''),[2] Commercial Paper Funding

[1] These settlements include Eli Lilly ($1.4 billion); Southern Care, Inc. ($24.7 million); Leo Burnett Co. ($15.5 million); APL Ltd. ($26.3 million); and AMEC Constr. Management, Inc. ($19 million). *See generally* http://www.usdoj.gov/03press/03_1_1.html.

[2] The CAP, is designed to provide eligible financial institutions with capital to strengthen their balance sheets. In return,

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Facility (''CPFF''),[3] and Consumer Business Lending Initiative's Term Asset-Backed Lending Facility (''CBLI-TALF'').[4]

**The major federal economic stabilization programs announced by the Obama administration are rife with FCA risk.**

Institutions seeking to take advantage of these programs should take a close look now at their internal compliance controls and consider immediate steps to mitigate their FCA exposure. This is especially critical because the power and the reach of the FCA, already very expansive, are likely only to grow. Last year, House and Senate legislation that would significantly strengthen the FCA easily passed through the respective Judiciary Committees. Already this year, Senators Leahy and Grassley have introduced two additional bills, the Fraud Enforcement and Recovery Act of 2009, S.386 (''FERA 2009'') and the False Claims Clarification Act of 2009, S. 458 (''FCCA 2009''), that would amend the FCA to increase its power and broaden its sweep.

## FCA Whistleblowers Cast Wide Net

The strength of the FCA comes from its combination of broad prohibitions and strong whistleblower provisions. Stated generally, the FCA prohibits the knowing use of false statements to obtain or retain government funds. However, the ''knowledge'' element does not require actual knowledge, but includes acting with deliberate ignorance or recklessness with regard to the truth. *See* 31 U.S.C. § 3729(b). What constitutes a ''claim'' is similarly broad. It includes any request for money or property from the federal government—whether or not that request is made directly to the government itself—so long as the government provides at least some of the requested funds. *See* 31 U.S.C. § 3729(c).

Thus, an application for a loan or guarantee from a federal program, or a certification of compliance with laws, regulations, or contract provisions, could provide a basis for FCA liability if the documents include false information.[5] Under the FCA, the government's recovery can also be significant: up to treble damages and civil fines. *See* 31 U.S.C. § 3729(a).

**Strong whistleblower provisions provide a strong financial incentive for insiders to report claims to the government.**

In addition to its liability provisions, the FCA contains strong whistleblower provisions that provide a strong financial incentive for private insiders to report claims to the government. While complex fraud is difficult for the government to discover from the outside, insiders understand potential schemes and can point the government to relevant documents and witnesses. Whistleblowers can include anyone from rank and file employees to upper management, including compliance officers or in-house counsel.[6] Furthermore, under the FCA, whistleblowers not only bring information to the government, they also file a civil complaint under seal in federal court. *See* 31 U.S.C. § 3730(b).

While the government has the first opportunity to investigate the claims and lead the litigation, whistleblowers have the right to pursue their claims on their own if DOJ chooses not to intervene. Importantly, the FCA gives whistleblowers a significant personal financial stake in any government recovery: from 15 to 30 percent. *Id.* at §§ 3730(c)(3); (d).

Moreover, an FCA investigation triggered by a whistleblower could result not only in civil liability, but also criminal exposure.[7] The strong incentives and clear processes that the FCA provides to whistleblowers stand in stark contrast to the burdens faced by potential whistleblowers in other arenas, such as Ponzi schemes involving private investment funds.[8] It is no wonder, then, that the FCA continues to have such a significant impact in sectors of the economy involving significant government disbursements, such as health care and government contracting.

## Stimulus, Stabilization Funds Open Door

Because the new economic stabilization programs involve putting government money into private hands, they expose participants to the FCA. Since the roll-out of these programs has proceeded on an expedited basis, the final rules and regulations that will define partici-

the United States receives preferred securities from the participating institutions.

[3] The CPFF is designed to improve liquidity in the commercial paper market. A special purpose vehicle of the New York Federal Reserve buys commercial paper from U.S. issuers.

[4] The CBLI-TALF is designed to improve credit market conditions for consumers and businesses. The New York Federal Reserve will lend money to eligible borrowers who own eligible asset-backed securities.

[5] *See e.g., United States v. Neifert-White Co.*, 390 U.S. 228 (1968) (loans); *United States v. Eghbal*, 548 F.3d 1281 (9th Cir. 2008) (certifications); *United States v. VanOosterhout*, 96 F.3d 1491 (D.C. Cir. 1996) (guarantees).

[6] *See e.g., U.S. ex rel Repko v. Guthrie Clinic, P.C.*, 557 F. Supp. 2d (M.D. Pa 2008) (relator was defendant's General Counsel); *U.S. ex rel Frazier v. IASIS Healthcare Corp.*, 554 F. Supp. 2d 966 (D. Ariz. 2008) (relator was defendant's Compliance Officer).

[7] For example, in 2008, Cephalon agreed to plead guilty and pay $425 million to resolve criminal and civil claims regarding the marketing of its drugs. Relators shared $46.5 million. http://www.usdoj.gov/opa/pr/2008/September/08-civ-860.html. Also in 2008, National Air Cargo pled guilty and paid $28 million to resolve criminal and civil allegations that it had defrauded the Department of Defense. The relator received $3.3. million. http://www.usdoj.gov/usao/nyw/press/press_releases/NACPlea2.pdf.

[8] For example, a potential whistleblower in the Madoff matter was reported to have spent nine years attempting to persuade regulators to investigate what turned out to constitute a massive Ponzi scheme. *See, e.g.*, ''Madoff Whistleblower Went Unheeded For Years,'' Dec. 19, 2008 at http://www.msnbc.msn.com/id/28310980.

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pants' obligations remain works in progress. However, based on what has been disclosed so far, participants face risk in at least three areas.

**1. Eligibility Requirements**

The financial stabilization programs are not available to just any entity. Each imposes its own eligibility requirements. If an institution applies for funds based on false information regarding its eligibility, this could trigger FCA liability if knowingly done.

The theory that FCA liability may attach as a result of eligibility certifications is not new. In *U.S. ex rel Main v. Oakland City University*, a relator was allowed to proceed under the FCA on the theory that the defendant University's false certification of eligibility for federal subsidies caused later-filed applications for loans and grants to be false. Here, the government funds that were provided in response to the factually correct loan and grant applications were disbursed only because the government believed the University was eligible for the program. Because the University's prior certification of eligibility was false, and the University knew it was false when it executed the certification, the court held that the relator had alleged an FCA claim. *U.S. ex rel Main v. Oakland City University*, 426 F.3d 914 (7th Cir. 2005).

This theory will apply to the economic stabilization programs. Participants in the programs, like the University in *Main*, must satisfy certain requirements in order to be eligible for federal funds. For example, many of the programs require participants to be U.S. based. Thus, issuers seeking to issue commercial paper under CPFF, and banking institutions seeking capital under CAP, must be U.S. companies in order to be eligible to participate in these programs.[9] Additional eligibility requirements may also apply. Under CPFF, issuers that were inactive prior to the creation of the CPFF will not be able to sell asset-backed commercial paper under the program.[10] Eligibility requirements may also apply to other components of the programs. Under CBLI-TALF, only eligible asset-backed securities (ABS) may be used as collateral for TALF loans. To be eligible, the ABS must meet certain credit-rating requirements, satisfy restrictions on the loans that have been securitized, and originators of the credit exposures must have agreed to comply with the executive compensation restrictions set forth in the Emergency Economic Stabilization Act of 2008.[11]

These requirements are also often accompanied by required certifications. Thus, CPFF issuers must certify their eligibility to participate in the program,[12] and under TALF, the issuer and sponsor of the ABS are required to include a certification of TALF-eligibility in the final offering document for any securities issued under the program.[13] If a participant knowingly (or recklessly) certifies that eligibility requirements are met when they are not, the false certification may trigger FCA liability under cases such as *Main*.

**2. Application Materials**

A second area of risk involves the information and other materials that participants are required to submit as a condition of participation in the programs.

Each of the economic stabilization programs requires participants to provide or make available detailed financial information in order to receive funds. If the institution knowingly submits inaccurate information and secures funds as a result, this could trigger FCA liability. For example, in a case involving U.S. Small Business Administration (''SBA'') loan guarantees, the president of an investment company financed by SBA-guaranteed debentures faced FCA claims based on his certification that reports submitted to the SBA with an application for additional financing were true and correct. At issue was an application for additional financing that contained false certifications of the continued correctness of an earlier annual report and the company's full compliance with program requirements. In response to the application, the SBA provided a loan guarantee. The company later defaulted, and the SBA made a guarantee payment to the bank that held legal title to the company's debentures. The defendant had signed the application that contained the statements at issue, thus triggering liability under the FCA.[14] *VanOosterhout*, 96 F.3d at 1493-94.

Participants in the new economic stabilization programs face similar FCA risk. Under CAP, a participating institution must submit documentation with its application that will be used to calculate the government's capital investment. CAP imposes an upper limit on the amount of convertible preferred stock that a participant may issue under the program. This upper limit is based on the institution's total risk-weighted assets. While a participating institution may be allowed to sell convertible preferred stock to Treasury in excess of its upper limit, special permission from Treasury is required, and Treasury may impose additional conditions on the issuer before agreeing to the transaction.

[9] What is U.S. based may differ across programs. Under the CPFF, a U.S. issuer is an entity organized under the laws of the United States, or a political subdivision or territory thereof, or is a U.S. branch of a foreign bank. http://www.newyorkfed.org/markets/cpff_faq.html. Under CAP, a qualifying financial institution includes similar U.S.-based requirements, but explicitly excludes entities controlled by a foreign bank or company. http://www.treas.gov/press/releases/reports/tg40_captermsheet.pdf. A TALF borrower is also required to be a U.S. Company, but this includes a U.S. branch or agency of a foreign bank (other than a foreign central bank) that maintains reserves with a Federal Reserve bank, or a U.S. organized investment fund that is managed by an investment manager with a principal place of business in the U.S., provided it is not controlled by a foreign government or managed by an investment manager controlled by a foreign government. http://www.newyorkfed.org/markets/talf_terms.html.

[10] *Commercial Paper Funding Facility: Frequently Asked Questions*, http://www.newyorkfed.org/markets/cpff_faq.html.

[11] *Term Asset-Backed Securities Loan Facility (TALF) Terms and Conditions* at 1 (available at http://www.newyorkfed.org/markets/talf_terms.html).

[12] *Issuer Registration Form and Qualification Certification in connection with Federal Reserve bank of New York Commercial Paper Funding Facility*, at http://www.newyorkfed.org/markets/cpff.html.

[13] http://www.ny.frb.org/markets/Form_Certification_TALF_Eligibility.pdf.

[14] The Circuit Court did affirm the District Court's dismissal of the claims against VanOosterhout, but this was on statute of limitations grounds. The United States filed its claims after the six year limitations period had expired. *VanOosterhout*, 96 F.3d at 1495.

### Inaccurate information about an institution's total risk-weighted assets could trigger FCA liability.

The measurement of an institution's total risk-weighted assets will be based on information contained in a report that the institution must include with its application to the program.[15] If the information in that report is inaccurate, and the institution knows this, or is reckless with regard to the accuracy of that information, the institution may face FCA liability.

Similarly, issuers under CPFF face FCA exposure based on information that they must provide with their registration. CPFF limits how much of an issuer's commercial paper the Federal Reserve's Special Purpose Vehicle (''SPV'') may own. The limit is calculated based on an issuer's total commercial paper outstanding to all investors (including the SPV). To establish the limit for an issuer and evaluate whether a proposal would reach or exceed that limit, the Federal Reserve relies on information provided in the issuer's registration for the program.[16] Knowingly (or recklessly) providing inaccurate information in this registration could expose the issuer to FCA claims.

Finally, CBLI-TALF requires borrowers to maintain an account relationship with a primary dealer. CBLI-TALF further mandates that borrowers execute an agreement with the primary dealer promising to provide the dealer with all information reasonably requested in connection with the dealer's compliance programs, and authorizing the dealer to share that information with the TALF lender, custodian and administrator upon request.[17] These additional documents and materials that a participant must provide or make available for inspection as a condition of receipt of federal money expose participants to further FCA risk, to the extent that participants knowingly or recklessly provide their primary dealer with false information.

**3. Compliance, Disclosure Obligations**

Finally, a third area of risk involves emerging compliance obligations and disclosure requirements that the government has imposed, or will impose, as a condition of receiving funds under the stabilization programs.

The government has emphasized that accountability is a critical component of all of the economic stabilization programs going forward.[18] Although certain specific compliance and disclosure requirements are already in place, the specific rules that will bind program participants have yet to be promulgated. Placeholder provisions in the CAP term sheet, for example, require participating institutions to agree in advance to be bound by all compliance, monitoring, and other rules that are in place as of the date the investment closes.[19] Nonetheless, the interim rules relating to oversight announced thus far, and other types of FCA-related compliance and disclosure requirements that exist in the health care and contracting industries, provide some insight into what participants' obligations could ultimately be.

### Accountability has been made a critical component of all of the economic stabilization programs.

To date, Treasury has issued interim rules on conflicts of interest for retained entities and compliance measures related to executive compensation that shed light on how the government intends to address compliance in the economic stabilization programs. So far, the government has taken two different approaches: for some participants, mandating certifications of compliance up front, followed by periodic reaffirmations for some issues;[20] for others, exercising more active compliance oversight.[21]

Although the government has not yet imposed broad mandatory disclosure requirements or specific training and internal control obligations on participants in the programs, should Treasury and the Federal Reserve choose to implement such measures, they would not need to look far.

In November 2008, the Federal Acquisition Regulations were amended to require federal contractors to make written disclosure to the government if they find any ''credible evidence'' of certain violations of the law, including violations of the FCA.[22] The revised regulations also impose new standards for contractor compliance training programs and internal controls for certain contracts.[23]

In health care, the Deficit Reduction Act of 2005 imposed FCA-specific compliance requirements as a condition of participation in the Medicaid Program. Program participants are required to train employees on

[15] *Application Guidelines for Capital Assistance Program,* at http://www.ustreas.gov/press/releases/tg40.htm.

[16] *See* http://www.newyorkfed.org/markets/cpff_terms_conditions.html; *Issuer Registration Form and Qualification Certification* at http://www.newyorkfed.org/markets/cpff_issuer_registration_process.html.

[17] *TALF Master Loan and Security Agreement*, App. 2-1, at http://www.newyorkfed.org/markets/talf_docs.html.

[18] *See e.g.*, Remarks by Treasury Secretary Timothy Geithner, February 10, 2009 at http://www.treas.gov/press/releases/tg18.htm.

[19] Express conditions of participation in the CAP include a requirement that the applicant and its covered officers and employees agree to comply with the rules, regulations and guidance of Treasury with respect to executive compensation, transparency, accountability, and monitoring, as published and in effect at the time of the investment closing. *See Capital Assistance Program, Mandatorily Convertible Preferred Stock and Warrants, Summary of Mandatorily Convertible Preferred Stock (''Convertible Preferred'') Terms* at 6 (available at http://www.ustreas.gov/press/releases/tg40.htm).

[20] *See* 31 C.F.R. §§ 30.5; 30.12 (certification and record keeping requirements for participants in Capital Purchase Program); 31 C.F.R. §§ 31.211(d), (f)-(h) (certification and record-keeping requirements for retained entity conflicts of interest).

[21] *See e.g.,* 31 C.F.R. §§ 31.211(a), (b), (e) (describing information that retained entities must provide to Treasury regarding conflicts of interest, retained entities' obligation to propose a mitigation plan, and Treasury's obligation to determine adequacy of that plan).

[22] 48 C.F.R. § 52.203-13(b). In fact, Treasury has imposed mandatory disclosure requirements on retained entities for violations of certain criminal laws related to the conflict of interest rules or the FCA. *See* 31 C.F.R. § 31.213(d).

[23] 48 C.F.R. § 52.203-13(c).

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the FCA and its whistleblower provisions, including its anti-retaliation provision, and to provide written materials explaining liability under the FCA.[24] While such requirements have not yet been imposed on participants in the economic stabilization programs, they are tools that the government frequently uses in other contexts and could well use in this one.

## Moves to Beef Up, Expand False Claims Act

Despite the FCA's evident strength and breadth, many in the current Congress have expressed desires to make the FCA even stronger and broader. The four pending bills that propose to amend the FCA are slightly different, but share the goals of expanding liability and weakening defendants' ability to limit claims and discovery.[25] For example, under the proposed amendments, a claim would stand as long as government funds were paid based on a false record or statement, even if no claim was made on the government itself,[26] and the use of a false record or statement to conceal even a contingent obligation to pay the government would trigger liability.[27] Other proposals in the pending bills would extend the statute of limitations to ten years;[28] allow relators access to documents collected by DOJ;[29] eliminate the applicability of the Rule 9(b) pleading standard;[30] and weaken or eliminate defendant's right to assert a currently applicable jurisdictional bar against certain relators.[31]

If even some of these proposals become law, the impact on FCA enforcement under the new economic stabilization programs would be significant. For example, the three Senate bills propose to amend and expand the FCA's reverse false claim provision, 31 U.S.C. § 3729(a)(7). Currently, that provision allows the government to recover from someone who uses a false record or statement to avoid paying an obligation owed to the government. However, courts have consistently required the ''obligation'' to be definite and to have attached *before* the defendant made or used the false record or statement to avoid payment. *See e.g., Amer. Textile Mfrs. Inst., Inc., v. The Limited, Inc.* 190 F.3d 729, 735-736; 738 (6th Cir. 1999).

**Pending bills all aim to expand liability and weaken defendants' ability to limit claims and discovery.**

Relators have urged courts to adopt a less restrictive interpretation of ''obligation,'' to allow the FCA to reach defendants who use false records or statements to cover up potential government claims and thus prevent the government from turning those potential claims into definite obligations. The FCA should reach this conduct, so the argument goes, because if the false records had not been submitted, the government would have learned of its potential claims, and if the government had successfully prosecuted those violations, the defendant would have been obliged to pay the government fines and forfeitures. *See United States ex rel Sequoia Orange Co. v. Oxnard Lemon Co.*, 1992 WL 795477, *7-9 (E.D.Cal. May 4, 1992).

Although this theory is typically rejected on the grounds that a *contingent* obligation to pay does not give rise to an FCA claim, the three Senate bills would change that by defining ''obligation'' in the FCA specifically to include contingent obligations. In fact, these bills would go one step further and amend the reverse false claim section to create liability whether or not a defendant used a false record or statement to conceal its obligation to the government. Thus, if any of the Senate bills become law, a relator may be able to pursue an FCA claim against a defendant that knowingly (or recklessly) conceals a contingent obligation to the government—including, perhaps, a defendant's violation of another statute or regulation that could trigger criminal or civil fines or penalties.

## How Program Participants Can Reduce Risk Now

The False Claims Act will be used to pursue participants in the new economic stabilization programs. Given the sheer magnitude of a participant's potential exposure, institutions considering participation, or who already have applied for funds, should review their current compliance controls to ensure that they are adequate. While any such review should be tailored to the institution, in general, it should consider at least three things.

**1. Does the institution's current compliance program cover the specific risks associated with participation in the federal program?** An effective compliance program will address an institution's specific risk areas. Participation in the economic stabilization programs may create or enhance risk in new areas.

For example, to the extent that an institution must make certain certifications, has the institution had to report and certify the accuracy of that information before? To the extent an institution must submit financial information as part of an application for participation, what controls does the institution have over whether that information is accurate? Do these controls comply with industry best practices?

**2. Does the institution document its compliance program and ongoing efforts to ensure the accuracy of information that is provided or made available to the government under the program(s)?** An effective compliance program includes written policies and procedures, employee training, auditing and monitoring of compliance, and discipline in the event of noncompliance.[32]

If an institution faces government scrutiny for its participation in the programs, the ability to point to a

[24] Deficit Reduction Act of 2005, Pub. L. No. 109-171, § 6032 (2005).

[25] The four pending bills are the False Claims Act Correction Act of 2007 (H.R. 4854), the False Claims Act Correction Act of 2008 (S. 2041); FERA 2009 (S. 386), and the False Claims Act Clarification Act of 2009 (S. 458).

[26] *See* FCCA 2009 § 2; FERA 2009 § 4; False Claims Act Correction Act of 2008 (''FCCA 2008'') § 2.; False Claims Act Correction Act of 2007 (''FCCA 2007'') § 2.

[27] *See* FERA 2009 § 4; FCCA 2009 § 2; FCCA 2008 § 2.

[28] *See* FCCA 2009 § 6; FCCA 2007 § 4; FCCA 2008 § 6.

[29] *See* FCCA 2009 § 7; FCCA 2007 § 6; FCCA 2008 § 7.

[30] *See* FCCA 2007 § 4.

[31] *See* FCCA 2009 § 4; FCCA 2007 § 3; FCCA 2008 § 4.

[32] United States Sentencing Guidelines, § 8B2.1.

strong and well-documented compliance program can help the institution achieve a favorable resolution.[33]

**3. Does the institution promote and reward open internal communication about compliance? Do employees raise their concerns internally, and is the institution responsive to those concerns?** Employees in FCA-exposed companies have a choice: to report compliance concerns internally, or to file a complaint. If employee concerns are raised first with the company, the company has the opportunity to avoid litigation over unfounded concerns, and to preserve the option of self-reporting if a serious violation has occurred.[34]

## Conclusion

No company can protect itself against all FCA risk. However, an institution that is participating in the new federal programs can take steps now to reduce the risk of litigation down the road and to create the record that it wants to defend should litigation arise.

[33] Principles of Federal Prosecution of Business Organizations, § 9-28.800 at http://www.usdoj.gov/opa/documents/corp-charging-guidelines.pdf.

[34] *Id* at § 9-28.750; *see also* United States Sentencing Guidelines § 8B2.1(a)(2) .

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