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### LENDER LIABILITY

## Government Loan Programs Spawn New Liability: False Claims Act Prosecutions



By D. JEAN VETA AND JENNIFER XI

**T**he Justice Department recently sent a strong signal to financial institutions when it secured a \$200 million settlement from Deutsche Bank AG and a \$1 billion settlement from Bank of America based on allegations under the False Claims Act (FCA). While the

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Justice Department has been using the FCA to recover tens of billions of taxpayer dollars from the health care and pharmaceutical industries over the past two decades, it only recently started using this tool against financial institutions. Because the monetary penalties and damages under the FCA can be staggering, federal and state agencies are working together "aggressively" to recover funds, especially in this period of budget shortfalls for agency programs.<sup>1</sup>

Historically, issues involving loans with government backing—whether it be through government guarantees or loans sold to the government—have been resolved relatively amicably between banks and the government, typically through the government's repurchase demands for non-complying loans. That sort of resolution, which was generally regarded by banks as a routine risk when participating in these government programs, is now giving way to an entirely new paradigm for dealing with non-complying loans. Today, the Justice Department is targeting those loans under the FCA, claiming that lenders made "false certifications" when submitting these loans to the particular government program. As a result of this new tactic, the Justice Department is recovering hundreds of millions of dollars per year from financial institutions for alleged violations of the FCA.

This trend has significant implications for banks and other financial institutions that participate in government-backed programs, whether it be for home mortgages, small business loans, or student loans. Alleged FCA violations require intensive investigations and may result in huge monetary settlements and judgments—penalties of up to \$11,000 per claim and treble damages—against such institutions. In 2010 alone, the Justice Department recovered \$3 billion in

<sup>1</sup> See Press Release, U.S. Dep't of Justice, Department of Justice Recovers \$3 Billion in False Claims Cases in Fiscal Year 2010 (Nov. 22, 2010), available at <http://www.justice.gov/opa/pr/2010/November/10-civ-1335.html>.

FCA civil judgments and settlements.<sup>2</sup> Violations also may result in criminal proceedings and actions against the officers and directors of such institutions.

This article provides a brief background on the FCA and examines recent cases against financial institutions. The article also looks at how Justice Department investigations and litigation against health care providers and pharmaceutical companies may prove instructive in this regard because, to a large extent, the Department's efforts against financial fraud parallel its efforts against health care fraud. We offer five lessons from FCA prosecutions in the health care and pharmaceutical industries that may be applied to the financial sector.

## I. The False Claims Act

### A. Liability to the Government under the FCA

In general terms, the FCA provides that any person who (A) "knowingly presents, or causes to be presented" a false claim to the government, or (B) "knowingly makes, uses, or causes to be made or used, a false record or statement material to a false or fraudulent claim," is liable to the government for a civil penalty of \$5,500 to \$11,000 per claim as well as treble damages.<sup>3</sup> A court may reduce damages if a person who violates the FCA provides the government with information about the violation and cooperates in the investigation.<sup>4</sup> The Attorney General "diligently shall investigate" a violation and has authority to bring a civil action to recover penalties and damages.<sup>5</sup>

### B. Qui Tam Actions

The FCA also allows private persons (called "relators") to file FCA suits on behalf of the government in a "qui tam" action.<sup>6</sup> The government must investigate the allegations in a qui tam complaint, and the complaint must be filed with the court under seal. This investigation usually involves another law enforcement agency, such as the Office of the Inspector General of the allegedly defrauded agency, and lasts for approximately two years.<sup>7</sup>

The final decision to intervene in a qui tam action usually requires approval by the Justice Department in Washington, D.C.<sup>8</sup> Intervention does not necessarily mean that the government endorses the relator's complaint; in fact, the Justice Department usually files its own complaint approximately 60 days after the intervention that sets forth its own statement of the facts and the specific relief that it seeks.<sup>9</sup> The Justice Department also often will assert claims under other statutes or common law.<sup>10</sup>

<sup>2</sup> *Id.*

<sup>3</sup> 31 U.S.C. § 3729(a)(1)(A), (B).

<sup>4</sup> *See id.* § 3729(a)(2).

<sup>5</sup> *Id.* § 3730(a).

<sup>6</sup> *See id.* § 3730(b).

<sup>7</sup> *See* Dep't of Justice, False Claims Act Cases: Government Intervention in Qui Tam (Whistleblower) Suits (Dec. 28, 2011), available at [http://www.justice.gov/usao/pae/Civil\\_Division/InternetWhistleblower%20update.pdf](http://www.justice.gov/usao/pae/Civil_Division/InternetWhistleblower%20update.pdf).

<sup>8</sup> *Id.*

<sup>9</sup> *Id.*

<sup>10</sup> *Id.*; U.S. DEP'T OF JUSTICE, UNITED STATES ATTORNEY'S MANUAL, 4-4.110 (Mar. 2003), available at [http://www.justice.gov/usao/eousa/foia\\_reading\\_room/usam/title4/4mciv.htm#4-4.110](http://www.justice.gov/usao/eousa/foia_reading_room/usam/title4/4mciv.htm#4-4.110).

If the government intervenes in the action, then the government has primary responsibility for prosecuting the action, and the defending financial institution is up against the seemingly unlimited resources of the federal government.<sup>11</sup> The relator is entitled to receive 15 to 25 percent of the amount recovered by the government in the action, depending on the extent to which the person "substantially contributed to the prosecution of the action."<sup>12</sup> If the government decides not to intervene, then the relator may conduct the action on behalf of the government and receive 25 to 30 percent of the amount recovered.<sup>13</sup> Even if the government initially elects not to intervene, it may intervene at a later date upon a showing of good cause.<sup>14</sup> This is not uncommon when cases are nearing settlement, as the threat of intervention may place additional pressure on the defendant. A court may reduce the relator's award to less than 10 percent of the proceeds in certain circumstances, and it may reduce the award without limitation if the relator planned and initiated the fraud on which the action was based.<sup>15</sup>

Given the significant monetary incentives for private parties, it is not surprising that most successful recoveries begin as qui tam actions. The Justice Department has called FCA whistleblowers "the federal government's primary weapon in the battle against fraud."<sup>16</sup> Typically, these whistleblowers are disgruntled current or former employees or other individuals with knowledge about the internal processes of the financial institutions at issue. Using the pharmaceutical industry FCA cases as an example, a whistleblower who initiated a qui tam action against Elan Pharmaceuticals received \$10 million out of a \$102 million settlement to resolve allegations that the company illegally promoted a drug for off-label uses in violation of the FCA.<sup>17</sup> One Florida pharmacy has won settlements in at least 18 qui tam suits since 2000 for Medicare and Medicaid fraud, resulting in a total recovery of \$380 million for the pharmacy and \$2.2 billion for federal and state governments.<sup>18</sup>

### C. FCA As a General Antifraud Statute

The Supreme Court has warned against broadening the scope of the FCA and transforming it "into an all-purpose antifraud statute."<sup>19</sup> Similarly, the Eighth Circuit recently affirmed dismissal of a complaint alleging that a student loan lender falsely certified compliance with Department of Education regulations in connection with government-backed student loans.<sup>20</sup> In particular, the court noted that "the FCA is not concerned

<sup>11</sup> *See id.* § 3730(c).

<sup>12</sup> *Id.* § 3730(d)(1).

<sup>13</sup> *Id.* § 3730(c)(3), (d)(2).

<sup>14</sup> *Id.* § 3730(c)(3).

<sup>15</sup> *Id.* § 3730(d)(1), (3).

<sup>16</sup> Press Release, U.S. Dep't of Justice, Department of Justice Recovers \$3 Billion in False Claims Cases in Fiscal Year 2010 (Nov. 22, 2010), available at <http://www.justice.gov/opa/pr/2010/November/10-civ-1335.html>.

<sup>17</sup> Press Release, Fed. Bureau of Investigation, Elan Pharmaceuticals Pleads Guilty, Sentenced for Off-Label Marketing of Zonegran (Feb. 28, 2011), available at <http://www.fbi.gov/boston/press-releases/2011/bs022811a.htm>.

<sup>18</sup> Andrew Zajac, *Blowing the Whistle on Drug Firms*, L.A. TIMES, Jan. 24, 2011, available at <http://articles.latimes.com/2011/jan/24/nation/la-na-whistle-blower-20110124>.

<sup>19</sup> *Allison Engine Co., Inc. v. U.S. ex rel. Sanders*, 553 U.S. 662, 672 (2008).

<sup>20</sup> *United States v. Nelnet, Inc.*, 639 F.3d 791 (8th Cir. 2011).

with regulatory noncompliance” and “consider[ed] it significant” that statutes and regulations already provided detailed remedies for noncompliant student loan lenders and servicers.<sup>21</sup>

Despite this precedent and with encouragement from the Congress,<sup>22</sup> the Justice Department is using the FCA more aggressively and broadly in recent years to combat alleged “fraud” in the financial services sector. Indeed, in 2010 alone, the Justice Department recovered \$327.2 million in settlements and judgments related to financial fraud.<sup>23</sup> This trend is likely to continue given the establishment of the Financial Fraud Enforcement Task Force in 2009<sup>24</sup> and the mortgage fraud task force in 2012,<sup>25</sup> as well as proposed legislation to increase the funds available to the Justice Department to investigate and prosecute fraud.<sup>26</sup>

## II. Recent False Claims Act Litigation Against Financial Institutions

As noted above, in recent years, the government has relied increasingly on the FCA as a tool to recover substantial sums from financial institutions. The recent \$200 million settlement with Deutsche Bank is instructive on this point. In that case, the government alleged that the bank’s wholly-owned subsidiary, MortgageIT, falsely certified certain mortgage loans as qualifying for Department of Housing and Urban Development’s (HUD) Federal Housing Administration (FHA) insurance.<sup>27</sup> MortgageIT participated in the FHA insurance program from 1999 to 2009, although Deutsche Bank AG did not acquire MortgageIT until 2007.<sup>28</sup> The government alleged that FHA paid over \$368 million on insurance claims for more than 3,200 mortgages en-

dorsed by MortgageIT.<sup>29</sup> Deutsche Bank and MortgageIT admitted, acknowledged, and accepted responsibility that MortgageIT did not conform to all applicable HUD and FHA regulations; that it submitted certifications to HUD stating that certain loans were eligible for FHA mortgage insurance when they were not; that FHA insured loans endorsed by MortgageIT that were not, in fact, eligible for FHA mortgage insurance; and that HUD consequently incurred losses when some of the MortgageIT loans defaulted.<sup>30</sup>

The government similarly alleged that Bank of America, through Countrywide, falsely certified mortgage loans for FHA insurance and originated the loans based upon inflated appraisals.<sup>31</sup> The FHA allegedly incurred hundreds of millions of dollars in damages as a result of Countrywide’s conduct. The \$1 billion global settlement required Bank of America to pay \$500 million immediately to provide recovery to FHA, and pay another \$500 million to a loan modification fund for borrowers with underwater mortgages.<sup>32</sup>

In addition, the Justice Department has prosecuted and secured settlements in other false certification claims against mortgage lenders:

- Citigroup agreed to pay \$158.3 million to settle claims that CitiMortgage falsely certified 30,000 mortgages for FHA insurance. The FHA claimed that more than 30 percent of these mortgages defaulted at a cost of nearly \$200 million to the agency. These FCA claims arose from a lawsuit brought by a CitiMortgage employee in Missouri.<sup>33</sup>

- The government intervened in a *qui tam* action against Allied Home Mortgage, as well as its president and vice president, for penalties and treble damages under the FCA on behalf of the United States. The complaint alleged that Allied falsely certified that it originated mortgage loans in compliance with HUD and FHA requirements, and that new Allied branch offices complied with all HUD and FHA requirements. The government estimated that the FHA paid over \$834 million in insurance claims for mortgages originated and fraudulently certified by Allied and could pay \$363 million more in insurance claims.<sup>34</sup>

- The national home builder and mortgage lender, Beazer Homes USA, agreed to pay the government \$5 million, with additional contingent payments of up to

<sup>21</sup> *Id.* at 798.

<sup>22</sup> The Fraud Enforcement and Recovery Act of 2009, Pub. L. 111-21 § 4(a), 123 Stat. 1617, 1621 (2009) (amending 31 U.S.C. § 3729), intended to “clarify and correct” the Supreme Court’s holding in *Allison Engine* that the FCA requires the government to prove that “a defendant must intend that the Government itself pay the claim.” *See, e.g.*, S. Rep. 111-10, at 10 (Mar. 23, 2009).

<sup>23</sup> Statement of Assistant Att’y Gen. for the Civil Div. Tony West Before the Senate Committee on the Judiciary (Jan. 26, 2011), available at <http://www.justice.gov/civil/opa/pr/testimony/2011/civ-testimony-110126.html>.

<sup>24</sup> Press Release, Dep’t of Justice, President Obama Establishes Interagency Financial Fraud Enforcement Task Force (Nov. 17, 2009), available at <http://www.justice.gov/opa/pr/2009/November/09-opa-1243.html>.

<sup>25</sup> *See* Brady Dennis, *Obama Proposes Task Force to Probe Mortgage Misdeeds*, WASH. POST, Jan. 24, 2012, available at [http://www.washingtonpost.com/business/economy/obama-proposes-new-task-force-to-probe-mortgage-misdeeds/2012/01/24/gIQA19I2OQ\\_story.html](http://www.washingtonpost.com/business/economy/obama-proposes-new-task-force-to-probe-mortgage-misdeeds/2012/01/24/gIQA19I2OQ_story.html).

<sup>26</sup> *See* S. 890, Fighting Fraud to Protect Taxpayers Act of 2011, 112th Cong. (2011); CONG. BUDGET OFFICE, COST ESTIMATE, S. 890 FIGHTING FRAUD TO PROTECT TAXPAYERS ACT OF 2011 (June 15, 2011), available at <http://www.cbo.gov/ftpdocs/122xx/doc12244/s890.pdf>.

<sup>27</sup> Press Release, U.S. Att’y Office Southern District of New York, Manhattan U.S. Attorney Recovers \$202.3 Million from Deutsche Bank and MortgageIT in Civil Fraud Case Alleging Reckless Mortgage Lending Practices and False Certifications to HUD (May 10, 2012), available at <http://www.justice.gov/usao/nys/pressreleases/may12/deutschebankmortgageitsettlement.html>.

<sup>28</sup> *Id.*

<sup>29</sup> *Id.*

<sup>30</sup> *Id.*

<sup>31</sup> Press Release, U.S. Att’y Office Eastern District of New York, \$1 Billion to be Paid by the Bank of America to the United States; Largest False Claims Act Settlement Relating to Mortgage Fraud (Feb. 9, 2012), available at <http://www.justice.gov/usao/nye/pr/2012/2012feb09.html>.

<sup>32</sup> *Id.*

<sup>33</sup> *See, e.g.*, Press Release, U.S. Att’y Office Southern District of New York, Manhattan U.S. Attorney Files and Simultaneously Settles Fraud Lawsuit Against CitiMortgage, Inc. for Reckless Mortgage Lending Practices (Feb. 15, 2012), available at <http://www.justice.gov/usao/nys/pressreleases/February12/citimortgageincsettlementpr.pdf>; Jonathan Stempel, *Citigroup Pays \$158 Million in Mortgage Fraud Pact*, REUTERS, Feb. 17, 2012, available at <http://www.reuters.com/article/2012/02/17/us-citigroup-settlement-idUSTRE81E1UW20120217> (98 BBR 352, 2/21/12).

<sup>34</sup> Complaint, *United States v. Allied Home Mortgage Capital Corp.*, No. 11-cv-05443-VM (S.D.N.Y. Nov. 1, 2011) (97 BBR 805, 11/8/11).

\$48 million to be shared with victimized homeowners, to settle allegations that it engaged in fraudulent mortgage origination activities in connection with FHA insured mortgages in violation of the FCA.<sup>35</sup>

- RBC Mortgage Company, a subsidiary of the Royal Bank of Canada, agreed to pay nearly \$11 million to resolve alleged FCA violations concerning 219 federally insured loans.<sup>36</sup>

- ABN AMRO Mortgage Group paid more than \$41 million to settle allegations that it falsely certified federally insured mortgages that did not meet underwriting requirements. ABN cooperated in the government investigation and conducted its own internal investigation into the alleged violations.<sup>37</sup>

The Justice Department also has reached settlements with lenders and servicers of small business loans and student loans:

- Garsh Lending agreed to pay \$300,000 to resolve allegations that it failed to provide the required notice of default on loans guaranteed by the Small Business Administration (SBA) in violation of the FCA.<sup>38</sup>

- Ciena Capital, a private, non-depository lender, and its small business lending subsidiary agreed to pay \$26.3 million to settle allegations that they falsely certified compliance with SBA regulations when they submitted claims for payment on loans guaranteed by the SBA.<sup>39</sup>

- The government and Saehan Bank reached a \$2.2 million agreement to settle allegations that the bank falsely certified that borrowers were current on their loan and that they did not experience adverse change in their financial circumstances in order to secure SBA loans.<sup>40</sup>

- A private individual filed a *qui tam* action alleging that several student loan lenders received improperly inflated interest rate subsidies from the Department of Education in violation of the FCA. Although the government did not intervene, it participated in many stages of

the case and obtained a total of \$57.75 million from the lenders to resolve the allegations.<sup>41</sup>

These actions indicate that any financial institution that makes certifications for loans or makes claims to the federal government with respect to loans involved in government programs faces serious risks of liability—and large monetary penalties—under the FCA. Because many FCA cases remain under seal, it remains unclear how the Justice Department conducts these investigations and which institutions it chooses to target.

### III. Lessons from the Health Care and Pharmaceutical Industries

Based on our extensive representation of major pharmaceutical companies in the leading FCA cases, as well as our experience in representing financial institutions, including in FCA cases, banks and other financial institutions should bear in mind the following five points as they adjust to this new enforcement environment.

**First**, as evidenced by the complaints and settlements described above, the Justice Department targets fraud by banks and other institutions of all sizes as well as officers and directors of such institutions. Thus, increased FCA enforcement is an issue that broadly sweeps across the financial sector and is not just limited to the largest players.

**Second**, institutions should establish effective FCA compliance programs, including policies and procedures for audits, reporting up the chain, and periodic reviews. Notably, most whistleblowers are insiders who first attempted to address the problems internally.<sup>42</sup> Executives and other managers therefore should monitor, elevate and address potential FCA violations internally to reduce the risk of external allegations and investigations.

**Third**, institutions must carefully assess the risk of FCA litigation as well as the risk posed by particular cases if and when they are unsealed. Some cases can be disposed of summarily, while others raise serious issues that warrant a sophisticated and careful analysis. Because *qui tam* actions are filed under seal, companies may be unaware of pending suits for years before the government decides whether to intervene and the company is served with the complaint. This delay also makes effective compliance programs all the more important, as additional violations may occur while a case is pending under seal.

**Fourth**, companies may face civil as well as criminal penalties for FCA violations. In fact, the Justice Department has a policy in favor of parallel civil and criminal proceedings.<sup>43</sup> For instance, the United States recov-

<sup>35</sup> Press Release, Dep't of Justice, United States Settles False Claims Act Allegations Against National Home Builder and Mortgage Lender (July 1, 2009), available at <http://www.justice.gov/opa/pr/2009/July/09-civ-654.html>.

<sup>36</sup> Press Release, Dep't of Justice, RBC Mortgage Company Pays More than \$10.71 Million to Settle Allegations Involving Federally Insured Mortgages (Nov. 25, 2008), available at <http://www.justice.gov/opa/pr/2008/November/08-civ-1051.html>.

<sup>37</sup> Press Release, Dep't of Housing & Urban Dev., HUD Announces Landmark \$41 Million Settlement Against ABN AMRO (Jan. 4, 2006), available at <http://archives.hud.gov/news/2006/pr06-002.cfm> (86 BBR 61, 1/9/06).

<sup>38</sup> Press Release, United States Attorney's Office Southern District of Florida, Lender to Pay \$300,000 to Settle Allegations Involving Small Business Administration Loan (May 23, 2011), available at <http://www.justice.gov/usao/fls/PressReleases/110523-01.html>.

<sup>39</sup> Press Release, Dep't of Justice, New York Small Business Lender to Pay U.S. \$26.3 Million to Resolve False Claims Act Allegations (May 6, 2010), available at <http://www.justice.gov/opa/pr/2010/May/10-civ-532.html>.

<sup>40</sup> Press Release, Dep't of Justice, Bank to Pay \$2.2 Million to Settle Allegations of False Claims to Small Business Administration (Oct. 4, 2010), available at <http://www.justice.gov/opa/pr/2010/October/10-civ-1116.html>.

<sup>41</sup> Press Release, U.S. Dep't of Justice, Four Student Aid Lenders Settle False Claims Act Suit for Total of \$57.75 Million (Nov. 17, 2010), available at <http://www.justice.gov/opa/pr/2010/November/10-civ-1307.html>.

<sup>42</sup> Aaron S. Kesselheim et al., *Whistle-Blowers' Experiences in Fraud Litigation Against Pharmaceutical Companies*, NEW ENG. J. MED. 1832, 1834 (May 13, 2010), available at <http://www.nejm.org/doi/full/10.1056/NEJMSr0912039#t=article>.

<sup>43</sup> U.S. DEP'T OF JUSTICE, UNITED STATES ATTORNEY'S MANUAL, 4-4.110 (Mar. 2003) ("Criminal and civil fraud investigations by the FBI and other investigative agencies should be carried out concurrently, including investigations as to the extent of the government's damage."), available at [http://www.justice.gov/usao/eousa/foia\\_reading\\_room/usam/](http://www.justice.gov/usao/eousa/foia_reading_room/usam/).

ered more than \$3 billion in criminal fines and forfeitures, and more than \$5 billion in civil settlements and judgments, for FCA violations related to pharmaceuticals and medical devices from January 2009 to January 2011.<sup>44</sup> Therefore, it is important to craft any defense strategy with these various risks in mind.

**Fifth**, in developing a defense strategy, banks and other financial institutions should consider whether to make a voluntary disclosure or otherwise cooperate with agency investigations. Self-disclosing institutions may receive credit and reduced damages for cooperation, and settlement agreements often require cooperation with the government. Moreover, federal prosecu-

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<sup>44</sup> Letter from Jim Esquea, Asst. Sec. U.S. Dep't of Health & Human Serv., and Ronald Weich, Asst. Att'y Gen., to Senator Charles E. Grassley, 13 (Jan. 24, 2011), available at <http://www.taf.org/DOJ-HHS-joint-letter-to-Grassley.pdf>.

tors consider an institution's timely and voluntary disclosure of wrongdoing and cooperation with the government in determining whether to charge the institution with criminal wrongdoing.<sup>45</sup> On the other hand, self-disclosure may not be appropriate in all cases, and self-disclosure is not a bar to a *qui tam* suit.

Preparing for and defending against FCA cases is a "bet the company" proposition. Financial institutions should work with experienced counsel to develop effective FCA compliance programs to prevent this significant exposure from occurring and, if such a case is filed, to develop an integrated defense that considers all options and enables the institution effectively to respond against multiple risks.

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<sup>45</sup> U.S. DEP'T OF JUSTICE, UNITED STATES ATTORNEY'S MANUAL, 9-28.700, 9-28.720 (Aug. 2008), available at [http://www.justice.gov/usao/eousa/foia\\_reading\\_room/usam/](http://www.justice.gov/usao/eousa/foia_reading_room/usam/).