

White Collar

E-ALERT

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THE "LINCOLN LAW" MEETS THE BANK BAILOUT The False Claims Act and Financial Recovery Measures

Federal programs designed to stabilize the U.S. banking sector and the economy have resulted in a massive and unprecedented outpouring of public funds to financial institutions. Recipients of funding under the Troubled Asset Relief Program ("TARP"), including through Treasury's "Capital Purchase Program ("CPP") and its recently-announced "Financial Stability Plan," should be aware of potential litigation risk under the civil False Claims Act ("FCA").

The False Claims Act, 31 U.S.C. § 3729 *et seq.*, historically known as the "Lincoln Law," was enacted in 1863 to redress Civil War defense contractor fraud against the government. The Act is a potent weapon against civil fraud because it provides for punitive-like treble damages and statutory penalties of \$5,500 to \$11,000 per false claim. Private whistleblowers, known as *qui tam* relators, are authorized under the False Claims Act to pursue lawsuits on behalf of the United States and earn a "bounty" of up to thirty percent of any monetary award.

In modern times, health care companies and defense contractors have been the most frequent targets of False Claims Act suits brought by the Department of Justice and *qui tam* relators. However, several legislative and executive branch developments may lead whistleblowers and the civil fraud plaintiff's bar, as well as the Department of Justice, also to scrutinize financial institutions' TARP applications and representations in search of potential False Claims Act violations.

Fraud Enforcement and Recovery Act of 2009

Senate Judiciary Committee members Charles Grassley (R-Iowa) and Patrick Leahy (D-Vermont) recently introduced the comprehensive Fraud Enforcement and Recovery Act (FERA) of 2009. The Senate Judiciary Committee held a preliminary hearing on the bill in mid-February and is scheduled to "mark-up" the bill on March 5th. The bill (i) appropriates \$115 million in fiscal years 2010 and 2011 to the Department of Justice and other federal agencies to investigate and prosecute financial fraud, (ii) amends the definition of "financial institution" in the criminal code to extend to mortgage lending businesses not directly regulated or insured by the federal government, and (iii) amends the major fraud statute to include grants, contracts, and other assistance provided through the "Troubled Assets Relief Program, an economic stimulus, recovery or rescue plan provided by the Government, or the Government's purchase of any preferred stock in a company."

The bill also amends key provisions of the civil False Claims Act to broaden its scope. According to Senator Leahy's introductory statement, "the False Claims Act must quickly be corrected and clarified in order to protect from fraud the Federal assistance and relief funds expended in response to our current

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economic crisis.” The amendments chiefly undo the effects of two recent court decisions. In *Allison Engine Co. v. United States ex rel.*, 128 S.Ct. 2123, 2128 (2008), the Supreme Court of the United States held that False Claims Act liability requires proof that “a defendant must intend that the Government itself pay the claim;” proof of intent to cause a claim to be paid by a private entity using public funds is insufficient. And, in *United States ex. rel. Totten v. Bombardier Corp.*, 380 F.3d 488 (D.C. Cir. 2004), the United States Court of Appeals for the D.C. Circuit interpreted the Act’s “presentment clause” (requiring a claim to be “presented to an officer or employee of the United States Government”) to limit recovery where the funds are expended or granted not by a federal agency but by a government grantee. Against the background of these decisions, the bill eliminates the requirement that a false claim be presented to a federal government officer or employee and defines a claim as any request or demand for money or property, irrespective of whether the claim is presented to a federal officer or is made to a contractor, grantee, or other recipient of government funds. The bill does not contain several other provisions included in last year’s proposed False Claims Act Correction Act of 2008, but it may be expanded in scope as it moves through the legislative process.

TARP Special Inspector General Report

The Office of the Special Inspector General for TARP (“SIGTARP”) submitted its initial report to Congress on TARP oversight efforts in early February.¹ SIGTARP’s recommendations to Congress include (i) the addition of oversight-enabling language in all TARP agreements, (ii) the establishment by TARP participants of internal controls relating to each condition imposed by TARP agreements, (iii) periodic reporting regarding implementation of controls and compliance with TARP agreement conditions, and (iv) the provision of signed certificates from senior officials to the government that such reports are accurate.

SIGTARP is in the process of pursuing an effort to determine how recipients have used TARP funds. To further this initiative, the SIGTARP Audit Division is asking every recipient of TARP funds to provide (a) a narrative response outlining the use or expected use of TARP funds, (b) copies of pertinent documentation to support such a response, and (c) a certification by a duly authorized senior executive officer regarding the accuracy of all statements, representations, and supporting documentation provided in the response. The request for a certification may be especially significant to potential False Claims Act liability. A “false certification” that is a prerequisite for the receipt of government money or property can provide a basis for False Claims Act liability. See, e.g., *United States ex rel. Mikes v. Straus*, 274 F.3d 687 (2d Cir. 2001).

Financial Stability Plan

The Obama Administration’s Financial Stability Plan, unveiled on February 10 but still evolving, calls for “greater transparency, accountability and conditionality with tougher standards for firms receiving exceptional assistance.” Several of the Plan’s concepts and conditions may ultimately provide the bases for potential liability under the False Claims Act.

For example, in order to qualify for government funding, financial institutions will be required to (i) submit a plan describing their intended use of the assistance “to preserve and strengthen their lending capacity,” (ii) commit to participate in mortgage foreclosure mitigation programs that are consistent with soon-to-be-announced Treasury guidelines, (iii) comply with senior executive compensation restrictions, and (iv) undergo a financial

¹ SIGTARP was created by Emergency Economic Stabilization Act of 2008 (“EESA”); its mission is to conduct, supervise, and coordinate audits and investigations of the purchase, management, and sale of assets under TARP.

"stress test" to assess whether the institution has the capital necessary to continue lending and to absorb potential losses from a more severe decline in the economy than projected. The specific details of the Financial Stability Plan are currently being developed. To the extent that the final Plan imposes material conditions on the receipt of bailout funds, including certifications of compliance or accuracy, financial institutions that apply for and receive economic recovery funding will need to be cognizant of potential False Claims Act exposure and take appropriate steps to minimize such exposure.

Covington & Burling LLP attorneys have advised and represented a broad range of companies and individuals in False Claims Act matters, including pharmaceutical companies, defense contractors, telecommunications companies, and financial institutions. For further information about recent False Claims Act developments relating to economic recovery programs, please contact one of the attorneys listed below.

Sarah Wilson	202.662.5397	swilson@cov.com
Ethan Posner	202.662.5317	eposner@cov.com
Stuart Stock	202.662.5384	sstock@cov.com
Keith Noreika	202.662.5497	knoreika@cov.com

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