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TOP STORIES INSIDE

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False Claims Act: Wave of the Future

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For every entity and attorney dealing with recession/recovery issues – from subprime mortgages and mortgage-backed securities to TARP funds and other stimulus programs – there is a new force to be reckoned with. The filing of the Capmark Finance case in June 2009,[1] and the Longhi decision[2] in July, signals the beginning of what is likely to be a tidal wave of creative cases in these emerging areas under the federal False Claims Act (FCA), relating to both the subprime mess and the resulting recovery efforts.

The FCA provides for treble damages and civil monetary penalties of $5,500 or $11,000 per claim against anyone who fraudulently claims money from the federal government. It also allows whistleblowers, known as *qui tam* relators, to file suit on behalf of the federal government and to receive a substantial percentage of any recovery. The results have been extraordinary: total FCA recoveries now totaling over $22 billion since the last major amendments in 1986.

However, liability under the FCA has been largely limited to classic fraud directly against the government. Interpreting the law, courts have found that it requires proof that the defendant intended that the government itself pay the false claim, and that the claim was presented directly to an officer or employee of the US government, not just a government contractor or guarantee. As a result, most FCA cases have focused on the two largest traditional areas of government payments: defense contracting and healthcare.

A combination of dramatic new government expenditures for recovery and the recent amendments to the FCA will change all that.

On the expenditure side, a recent report by the Special Inspector General for the Troubled Asset Relief Program (SIGTARP) estimates that total government funding for the various recovery programs will be close to three trillion dollars. Moreover, it is going to institutions and sectors (particularly, the financial sector) that had little prior experience with government payments, or false claims, or the resulting investigations. In the words of SIGTARP Special Inspector General Neil M. Barofsky:

> We stand on the precipice of the largest infusion of Government funds over the shortest period of time in our Nation's history. History teaches us that an outlay of so much money in such a short period of time will inevitably attract those seeking to profit criminally.

Even before the recent amendments, Senator Grassley (R-Iowa) and others had urged the government to use the FCA against recovery program abuses. The Fraud Enforcement and Recovery Act of 2009 (FERA) greatly expanded its powers to do so.

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The amendments contained in FERA extend the FCA's coverage to any false or fraudulent claim for government money or property, regardless of whether the claim was presented to a government official, whether the government holds title or has physical custody of the money, or whether the defendant specifically intended to defraud the government. The amendments also broaden the FCA's definition of materiality.

The Capmark case is the government's first use of the newly-amended FCA on mortgage issues. Capmark Finance, formerly GMAC Commercial Mortgage, had become one of the largest originators of Housing and Urban Development (HUD)-insured loans in the country. However, like so many others caught up in the mortgage bubble, the government alleges that it made false or fraudulent statements in its documents to close two commercial loans – and to get HUD insurance for them. The loans defaulted, and HUD paid a total of over $25 million on the insurance.

Under the old law, defendants would have argued that there was no

intent to defraud the government: They were just trying to close the deals, not get government money. In the wild-and-crazy California boom days, no one contemplated that such real estate deals would go bad. Not under the new law: the government claims that Capmark knew the claims were false, and could result in government payments. The Department of Justice (DOJ) is seeking treble damages, plus interest, fees, and costs.

There is one important thing missing in Capmark: whistleblowers. Whistleblower cases can take a little longer to develop, so it's not surprising that this early case was brought directly by DOJ. It is a shot across the bow. But, everyone who counsels financial institutions or others who benefit from recovery funds needs to understand that the real danger, the real flood of cases, will come from within. To all the other acronyms, add one more for the law's whistleblower provision: DERA, the "Disgruntled Employee's Retirement Act."

The second case, Longhi, comes on the government's grant side. The case involved research grants so, like the recovery programs, the government was not buying a specific product or service. The Fifth Circuit's July 9, 2009 opinion upholds a 2007 District Court FCA decision, so the FERA amendments were not in effect. But, the court references those amendments, and gives a glimpse of their likely use in three key respects. First, as to false documents, the work was actually done, and there were no real false invoices, but the court held that there were false statements in the original application, therefore the entire contract amount was fraudulently induced.

Second, as to materiality, the court held that the government need not show that the false statements actually caused the government to act, only that they, "have the potential to influence the government's decisions." Finally, since the defendant did the work required under the contract, they argued that any damages should be reduced by the value of that work. However, in a holding we are likely to see repeatedly in recovery funds cases (where unlike traditional cases, the government did not end up with a specific product or service), the Court disagreed. Without the fraudulent inducement, the funds might have gone to another more worthy recipient. Thus, the Court upheld damages of triple the entire original contract amounts.

Compliance officers and counsel for entities in traditional FCA sectors (i.e., health care or defense) are generally aware of the law and its dangers. But, the recovery programs and FERA amendments will bring FCA into new and unfamiliar sectors. They also give the government powerful new tools and arguments. All compliance personnel, and the people they advise, need to stand up and take notice. ✦

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Notes

1 See *United States v. Capmark Financial, Inc.*, No. 09-04104 (CD Cal. filed June 9, 2009) Available at http://www.usdoj.gov/opa/pr/2009/june/09-civ-570.html

2 See *United States ex rel. Longhi v. Lithium Power Tech., Inc.*, Nos. 08-20194, 08-20306, 2009 WL 1959259 (5th Cir. July 9, 2009)