21st Century Money, Banking & Commerce Alert®

Please click here to view our archives

CIVIL FALSE CLAIMS ACT: Recent Developments Increase Possibility of FCA Claims Against Recipients of TARP Funds and Contractors Retained by Treasury for TARP Services

A recent 21st Century Money, Banking & Commerce Alert discussed congressional efforts to compel application of the civil False Claims Act ("FCA"), 31 U.S.C. § 3729, *et seq*., to recipients of funds under the Troubled Asset Relief Program ("TARP") and Capital Purchase Program ("CPP") as authorized by the Emergency Economic Stabilization Act of 2008. *See* *21st Century Money, Banking & Commerce Alert No. 08-11-19*. The Alert focused on a letter from Sen. Grassley to then-Treasury Secretary Paulson and then-Attorney General Mukasey — and, quite pointedly, to *qui tam* lawyers as well — urging use of the FCA against recipients of TARP and CPP funds. At that time, it was difficult to see how the FCA would apply to those funds because, other than restrictions on executive compensation, there were no explicit rules, conditions, or certifications as to the use of the funds, or other actions by recipients. The FCA, which allows recovery of three times any "loss" to the government arising from false claims, plus civil penalties, is the federal government's primary civil tool for enforcement against those who receive money from, or pay money to, the federal government. The law is enforced both by the Department of Justice and by private whistleblowers (known as "*qui tam* relators") who receive up to 30% of any recovery. If applied to TARP and CPP recipients, the FCA has the potential for devastating civil judgments.

Special Inspector General's Proposal for Oversight of TARP Fund Recipients

A new potential basis for FCA suits was recently raised in a letter from the Special Inspector General for TARP ("SIGTARP") to Sen. Grassley, stating the intention to require all TARP fund recipients to provide the following within 30 days of the request: (1) an account of their use or expected use of TARP funds, with supporting documentation, (2) a description of plans for complying with executive compensation restrictions, and most importantly, (3) certifications by senior executives of each company as to the accuracy of the responses and information provided. *See* Letter from Neil Barofsky, SIGTARP, to Sen. Grassley (Jan. 22, 2009). False certifications have been the basis for FCA suits where they were material to the government's decision to release funds, or not to seek return of funds. *See, e.g., United States Ex rel, Mikes v. Straus,* 274 F.3d 687 (2d Cir. 2001); *United States ex rel. Laird v. Lockheed Martin Eng'g & Science Servs. Co*., 491 F.3d 254 (5th Cir. 2007).

With regard to TARP funds already paid, it may be argued that false certifications in response to the SIGTARP's questionnaire should not be considered "claims" under sections 3729(a)(1) or (a)(2) because the

TARP funds that are the subject of the certifications were distributed before requirements as to their use were imposed. With regard to new TARP distributions, however, recipients should expect that DOJ and/or *qui tam* relators' counsel will argue that any false certification before funds are paid out are "material" to the payment decision, subjecting the entire amount to trebling on the basis that it reflects the government's "loss."

With regard to TARP funds already received, DOJ and/or the *qui tam* relators' bar may file FCA cases based on 31 U.S.C. § 3729(a)(7), the so-called "reverse false claim" provision, which extends liability to a person who:

> knowingly makes, uses, or causes to be made or used, a false record or statement to conceal, avoid, or decrease an obligation to pay or transmit money or property to the Government.

Liability in such cases is not at all certain because, as the SIGTARP recognized, the question of what recipients of TARP funds have done with the money is "almost entirely opaque." Moreover, the plaintiff (DOJ or *qui tam* relator) would have to prove an existing "obligation" to repay. *See American Textile Mfrs. Inst. v. The Limited, Inc.,* 190 F.3d 729 (6th Cir. 1999). With the exception of the transactions with Citigroup and Bank of America, TARP agreements do not require recipients to "report or even to track internally" the use of those funds. Thus, potential FCA liability under TARP is far from clear, but a claim under subsection (a)(7) is not impossible.

New Conflict of Interest and Mandatory Disclosure Requirements for "Retained Entities"

A recent interim rule issued by the Treasury Department on conflicts of interest also increases the possibility of FCA actions against private sector contractors and financial agents, known as "retained entities," that enter into contracts or financial agency agreements with the Treasury to provide services related to the acquisition, valuation, management, and disposition of troubled assets under TARP. *See* Dept. of the Treasury, TARP Conflicts of Interest Interim Rule, 74 Fed. Reg. 3431 (Jan. 21, 2009) (to be codified 31 C.F.R. pt. 31). Although it invited public comment and stated that a final rule would be issued, the interim rule took effect immediately. Under the interim rule, a retained entity

> shall not permit an organizational conflict of interest unless the conflict has been disclosed to Treasury . . . and mitigated under a plan approved by Treasury, or Treasury has waived the conflict. With respect to arrangements for the acquisition, valuation, management, or disposition of troubled assets, the retained entity shall maintain a compliance program designed to detect and prevent violations of federal securities law and organizational conflicts of interest.

74 Fed. Reg. 3434. In addition to this responsibility to prevent, disclose, and mitigate organizational conflicts, retained entities must also ensure that management officials and key individuals performing work under the arrangement have no personal conflicts unless mitigated or waived. Both types of conflicts require detailed information to be submitted to Treasury, and raise compliance issues that could invite FCA suits against "retained entities."

Failure to comply with organizational conflicts of interest has already been the basis for FCA liability under construction contracts and technical assistance contracts. *See, e.g., United States ex rel. Harrison v. Westinghouse Savannah River Co.,* 352 F.3d 908 (4th Cir. 2003). Personal conflicts of interest by employees have also been alleged as a basis for FCA claims against their employers. *See, e.g., United States v. President & Fellows of Harvard Coll*., 323 F. Supp. 2d 151, 193-94 (D. Mass. 2004) (holding that Harvard was not vicariously liable for the acts of employees who did not hold themselves out as agents of

Harvard when engaged in personal investment activity, but employees who had undisclosed conflicts were liable under the FCA).

In addition, the interim rule requires that retained entities must disclose to the TARP Office of Inspector General when there is any credible evidence of FCA violations. *See* § 31.213(d), 74 Fed. Reg. 3435. This disclosure requirement is quite similar to one recently imposed on all federal contractors. *See* *FraudMail Alert No. 08-12-11* ("FAR Amendment Requires Federal Contractors to Make Mandatory Disclosure if "Credible Evidence" of False Claims Act Violations Exists, But Lacks Clear Standards for Action"). These disclosures, as well as the internal investigations preceding them, raise the possibility of increased enforcement and *qui tam* suits. *See* John T. Boese, Civil False Claims and *Qui Tam* Actions, at § 4.03[D] (3d ed. & Supp. 2009-1) (discussing *qui tam* issues in the voluntary disclosure setting).

Authors and Contributors

For more information, please contact your usual Fried Frank attorney or the attorneys listed below:

Washington, DC

Thomas P. Vartanian
+1.202.639.7200

John T. Boese
+1.202.639.7220

James J. McCullough
+1.202.639.7130

David L. Ansell
+1.202.639.7011

Robert H. Ledig
+1.202.639.7016

Gordon L. Miller
+1.202.639.7173

Fried, Frank, Harris, Shriver & Jacobson LLP

New York
One New York Plaza
New York, NY 10004-1980
Tel: +1.212.859.8000
Fax: +1.212.859.4000

Washington, DC
1001 Pennsylvania Avenue, NW
Washington, DC 20004-2505
Tel: +1.202.639.7000
Fax: +1.202.639.7003

Frankfurt
Taunusanlage 18
60325 Frankfurt am Main
Tel: +49.69.870.030.00
Fax: +49.69.870.030.555

Hong Kong
in association with
Huen Wong & Co.
9th Floor, Gloucester Tower
The Landmark
15 Queen's Road Central
Hong Kong
Tel: +852.3760.3600
Fax: +852.3760.3611

Shanghai
40th Floor, Park Place
1601 Nanjing Road West
Shanghai 200040
Tel: +86.21.6122.5500
Fax: +86.21.6122.5588

Fried, Frank, Harris, Shriver & Jacobson (London) LLP

London
99 City Road
London EC1Y 1AX
Tel: +44.20.7972.9600
Fax: +44.20.7972.9602

Fried, Frank, Harris, Shriver & Jacobson (Europe)

Paris
65-67, avenue des Champs Elysées
75008 Paris
Tel: +33.140.62.22.00
Fax: +33.140.62.22.29

A Delaware Limited Liability Partnership