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Expert Analysis

New Law Targets Banks For Whistle-Blower Actions

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Two completely unrelated events in 2008 created the perfect storm for drastic amendments to the federal False Claims Act that promise to expose unsuspecting banks, investment companies and other financial institutions to devastating damages and penalties for years to come.

First, the U.S. Supreme Court announced a unanimous decision setting logical limitations on potential liability under the FCA, a statute originally aimed at Civil War profiteers that increasingly threatened health care providers, educational institutions and other entities involved in government contracts or grants. Then, only months later, many of the nation's preeminent financial institutions collapsed.

Together, these events provided all the ammunition needed for proponents of expansive FCA liability to attack the Supreme Court's decision and transform the statute into an even deadlier weapon against any entity receiving federal funding of any kind. In amending the FCA in the wake of the Troubled Asset Recovery Program, Capital Purchase Program and stimulus funding, Congress has now made it clear that financial institutions are in the cross hairs of this potent and punitive statute.

The FCA Through the Years

The FCA was enacted in 1863 in response to pervasive fraud by corrupt Union defense contractors who reportedly provided soldiers with cardboard boots instead of the promised leather ones, sawdust in place of gunpowder, defective muskets, rancid food, and lame mules and horses. To account for the federal government's scarce resources in pursuing these fraud claims, the FCA included a "*qui tam*" provision that allowed private citizens, called "relators," to bring allegations of fraud on the government's behalf. The law rewarded these private whistle-blowers with a healthy portion of any recovery.

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The statute was amended in 1943 to give the government the right to take over relators' cases and to discourage opportunistic relators who did not bring new information to the government's attention from filing suit. These amendments all but killed the FCA as a fraud-fighting tool for the government; for the next 40 years, the statute generated very few cases and minimal recovery.

But the 1980s brought renewed public attention to alleged price-gouging by defense contractors. Reports that the Department of Defense had purchased $600 hammers and $1,000 toilet seats made their way to the media.

Where others saw abuse, relators' lawyers and their allies in Congress saw opportunity. In 1986 Congress again amended the FCA, this time with an eye toward creating more *qui tam* lawsuits and greater recoveries for the government.

Among other measures, the 1986 amendments lowered the bar for liability, raised the available damages and penalties, provided successful relators with reimbursement of their attorney fees, and sought to punish entities that retaliated against employees for blowing the whistle on government fraud. Any entity that allegedly submitted false claims to the government for payment, made false records or statements to get a false claim paid by the government, or conspired to defraud the government by getting a false claim paid became fair game under the FCA.

Unlike most civil statutes, the FCA gives both the government and private citizens (often disgruntled company employees or former employees) standing to assert claims of fraud against the United States. If a relator files suit, the government has an opportunity to investigate the claims and determine if it will intervene in the action. Given the almost limitless resources of the federal government, a decision by the Justice Department to take over a relator's case increases the odds of the plaintiff's success dramatically. Even if the United States intervenes, the relator can still recover a bounty of up to 25 percent of the government's total recovery. And whether or not the government takes over the case, a defendant faces the prospect of treble damages plus a maximum penalty of $11,000 per violation of the FCA.

New Targets, New Limits

While the 1986 amendments were slow to take hold, the number of *qui tam* actions grew steadily throughout the 1990s. By the last third of the decade about 500 new *qui tam* matters were filed annually. No longer a problem for defense contractors alone, the FCA quickly cast a wide net over alleged fraudulent conduct involving all recipients of federal funding, from hospitals to universities to disaster relief organizations. Since 1986 more than 10,000 cases have been filed, and judgments and settlements under the FCA have exceeded $21.5 billion, more than $19 billion of which has been returned to the U.S. Treasury.

Then, in June 2008, the Supreme Court drew the line. Consistent with Justice Stephen Breyer's observation during oral argument that "government money today is in everything," the court, in *Allison Engine Co. v. United States ex rel. Sanders*, 128 S. Ct. 2123, overturned a sweeping appellate court decision that would have made any invoice submitted by one private entity to another in the context of a government-funded program subject to the FCA.

After years of steady expansion of the scope of the statute, the Supreme Court insisted that plaintiffs prove a "direct link" between a defendant's fraud and payment of a false claim by the United States in order to create liability under the FCA. By establishing this requirement, the *Allison Engine* decision finally stood guard against the possibility of FCA liability for simple contract and common-law fraud claims between private companies.

Arming for Battle

The reaction to *Allison Engine* from the relators' bar and their old friends in Congress was immediate. Sen. Charles Grassley, R-Iowa, the sponsor of the 1986 FCA amendments, lamented that the Supreme Court had created a "free fraud zone for subcontractors" and vowed to "fix this problem" through legislation.

As proposed FCA amendments aimed at undermining *Allison Engine* slowly wound their way through Congress, the world's financial markets collapsed in September 2008. Congress' response to the economic crisis, through TARP, the Capital Purchase Program and stimulus funding, suddenly rendered Justice Breyer's observation that government money was "in everything" more literal than ever. With hundreds of billions of dollars flowing from the federal government into every nook and cranny of the economy, the FCA was primed to be applied to more industries and with more frequency than ever before. And that was without changes to the statute to encourage more

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lawsuits, remove potential defenses and clear the path for liability.

Again sensing an opportunity, proponents of expansive FCA liability seized upon the massive new government funding programs to push through radical changes to the statute. Even though the FCA, as written, clearly would have captured false claims involving TARP or stimulus funding, Congress cited the need to reach fraud by financial institutions as the principal purpose for passing the Fraud Enforcement and Recovery Act of 2009. President Obama signed FERA into law May 20.

Staggering Scope

The amendments to the FCA contained within FERA now threaten to open the floodgates of liability for any entity that receives federal funding through any mechanism and in any amount. The new statute centers on overturning the Supreme Court's *Allison Engine* decision and thus eliminating the long-standing rule that the FCA is meant to redress fraud against the government.

Under FERA the United States does not need to have any title to the money or property being sought by the defendant, and the defendant does not need to have any intent to induce an improper payment by the government. Instead, FERA covers any request for money or property to any entity as long as the money or property will be used "on the government's behalf or to advance a government program or interest."

The potential scope of this provision is staggering; as one example, any invoice to or by a TARP, CPP or stimulus funding recipient could be construed as a claim related to a "government program or interest" and thus subject to treble damages and penalties under the FCA.

Boundless Risks

There can be little doubt that, with or without amendments, enterprising relators' lawyers and the Justice Department would have used the FCA as an instrument to attack financial institutions in the wake of the economic crisis and corresponding explosion in federal funding. With FERA and the elimination of the logical limits on liability established by *Allison Engine*, however, financial institutions receiving federal funding of any kind — along with every other government contractor, health care provider, grantee or recipient of federal dollars — now face punitive liability never before contemplated by the FCA.

The boundless scope of FCA liability provided by FERA was surely designed to increase the volume of cases while decreasing the average length of each individual case. The watered-down standard for liability announced by FERA promises to coerce more early settlements by defendants unable to assume the incredible risks posed by an FCA lawsuit.

At the same time, the broad and ambiguous terms of the new statute invite any number of novel, tenuous and potentially frivolous theories of FCA liability. Because FERA removes many of the pretrial defenses to liability articulated by Supreme Court in *Allison Engine*, institutions that are ready and willing to fight these novel allegations of fraud will need to defend themselves at trial — where the stakes have never been higher.

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