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New FCA Rules Put Lenders and Brokers Directly in Their Gun Sights

I. INTRODUCTION

Without a doubt, the False Claims Act ("FCA") has been dramatically changed in the last few months. As will be discussed in more detail herein, it certainly appears that the FCA has been retooled so that the playing field is now stacked in favor of the government and *qui tam* plaintiffs. There is also every indication that lenders who have federally insured mortgages, redevelopment funding, or other financial support from the government, are at risk of being sued for false claims unless they take certain precautions to educate and protect themselves.

In fact, it is a good idea for all companies who receive government funding (*e.g.,* defense contractors, health care providers, academic institutions) to look closely at their internal compliance programs, and modify them to reflect the recent changes in the FCA. This article is intended to offer some specific suggestions, and also encourage companies to have their programs amended, and implemented by legal counsel who are receptive to flexible billing arrangements including flat fee schedules.

II. MANY OF THE HURDLES TO LITIGATING FALSE CLAIMS ACTIONS HAVE BEEN REMOVED

The following are some of the more significant changes to the FCA:

(1) There is essentially no time bar for the government to intervene in the private party ("relator") action – the government can easily have its complaint relate back to the timely filing of the relator action.

(2) The government can now essentially "deputize" private parties and local governments to aid in the pursuit of these actions, by sharing documents and testimony that the government has obtained through Civil Investigative Demands ("CIDs"). The FCA now expressly authorizes the sharing of information obtained under a CID with "any *qui tam* relator," with federal, state or local government agencies, and with other interested persons (*i.e.*, courts, consultants, auditors, experts, arbitrators) if it is done in connection with an investigation, case or proceeding. Thus, it is even more important now to involve legal counsel early on in negotiating the parameters of the CID, and coordinating the company's

response.

(3) The universe of potential relators has been expanded dramatically, and can include contractors and agents, all of whom appreciate the considerable financial windfall that relators recover in *qui tam* actions with treble damage awards. Since the 1986 amendments, *qui tam* plaintiffs have accounted for more than half of the over $21.5 billion recovered under the FCA, with the plaintiffs recovering anywhere from 15-30% of the government's recovery. Thus, companies need to worry not only about disgruntled and terminated employees who may recast themselves as possible "whistleblowers," but also contractors with whom relations have become strained for any reason. The FCA anti-retaliation provision now applies to contractors and agents in addition to employees.

(4) Subcontractors or others who submit a bill for payment to a recipient of government funds can now be held liable under the FCA, even if their bill is not submitted to the government directly. The definition of "claim" in the FCA has been expanded to include these indirect claims, so long as the funds involved are used on behalf of the government or in furtherance of a government program or interest. For example, in the context of federally insured mortgages, the government support is provided based on a private entity certifying that the borrower has complied with a variety of criteria underlying the loan agreements, any of which could form the basis of a false claims action, even if the certifying entity is not submitting a claim to the government.

(5) In amending the FCA, Congress specifically rejected several court decisions that made it more difficult for plaintiffs to establish liability. For example, the *Allison Engine* requirement that a claim or statement must be designed "to get" false claims paid or approved has been relaxed considerably, with the FCA amendments:

> These amendments to Section 3729 clarify that the False Claims Act was intended to extend to any false or fraudulent claim for government money or property, whether or not the claim is presented to a government official or employee, whether or not the U.S. Government has physical custody of the money, and whether or not the defendant specifically intended to defraud the U.S. government. With this change, the additional elements read into the statute by the Supreme Court and the D.C. Circuit decisions are vitiated, and *Allison Engine* and *Totten* would be overturned by this legislative action.

February 5, 2009, Statement of Sen. Patrick Leahy, Chairman, Senate Judiciary Committee, Introduction of Fraud Enforcement and Recovery Act of 2009. Thus, the specific intent element that the United States Supreme Court imposed in *Allison Engine*, to keep FCA enforcement from becoming effectively "boundless," has been removed. To establish FCA liability now, the plaintiff only needs to prove that the false statement was "material" to the government's decision to pay a false claim. "Material" is defined loosely as "having a natural tendency to influence, or be capable of influencing, the payment or receipt of money or property."

In addition, there are further amendments moving through Congress that would also increase the number of FCA plaintiffs. Most significantly, the "public disclosure" defense to *qui tam* suits would be greatly weakened by eliminating the FCA defendant's right to move to dismiss a relator complaint based on the public disclosure bar. Further, the bills would redefine what constitutes "public disclosure" to make it more narrow, and also allow a court to dismiss a *qui tam* action only if the "allegations relating to all essential elements of liability of the action or claim are based exclusively on the public disclosure of allegations or transactions…." When viewed in the context of the vast amount of public information that is available through the Internet, the elimination of this defense for defendants could exponentially increase the number of private plaintiff suits. Given the speed with which the recent amendments were approved by Congress and signed by the President, there should be little doubt that further amendments in favor of *qui tam* plaintiffs are just a matter of time.

III. THE GOVERNMENT IS TARGETING THE MORTGAGE LENDING BUSINESS, AND USING THE FCA TO DO IT

These changes also come with considerable bite behind them with the government approving substantial spending budgets for enforcement purposes. The bill authorized $155 million a year for hiring fraud prosecutors and investigators at the Justice Department for fiscal years 2010 and 2011, with the expectation that the FBI can double the number of its mortgage fraud task forces nationwide – from 26 to more than 50.

Finally, if there is any remaining doubt that the FCA is a powerful tool that the government is using to prosecute mortgage fraud, then the following remarks are worth considering, in addition to the cases that the government has been litigating in the last year. In introducing the Anti-Fraud Legislation that included the amendments to the FCA, Senator Patrick Leahy said, "The federal government has spent hundreds of billions of dollars to stabilize our banking system, and Congress will soon spend even more to restart our economic recovery. But to date, we have paid far too little attention to investigating and prosecuting the mortgage and corporate frauds that has so dramatically contributed to this economic collapse." Similarly, President Barack H. Obama in signing the bill stated: "This bill nearly doubles the FBI's mortgage and financial fraud program, allowing it to better target fraud in hard-hit areas. That's why it provides the resources necessary for other law enforcement and federal agencies, from the Department of Justice to the SEC to the Secret Service, to pursue these criminals, bring them to justice, and protect hardworking Americans affected most by these crimes."

Recent cases are a good indication of the mortgage industry practices that are coming under scrutiny. In June 2009, Beazer Homes USA Inc. agreed to pay $5 million to the United States, plus contingent payments of up to $48 million dollars to be shared with victimized private homeowners, to resolve allegations that Beazer Mortgage Company was involved in fraudulent mortgage origination activities with federally insured mortgages. Beazer allegedly induced unqualified home buyers to enter into Federal Housing Administration ("FHA") insured mortgages, and, then, when the buyers defaulted, the FHA was wrongfully required to pay on the mortgage insurance claims.

Similarly, mortgage lenders who offer HUD-insured mortgages are becoming the subject of false

claims actions. In this scenario, the HUD approved lender can "directly endorse" a mortgage for low and middle-income buyers under certain conditions, but can be held liable if the lender submitted unqualified loans to the HUD for insurance endorsement, without disclosing that the loans did not satisfy FHA guidelines. (Nat'l City Mortgage, June 2, 2008, $4.6 million settlement; and RBC Mortgage, November 25, 2008, $10.71 million settlement).

Presently pending in the United States District Court in Los Angeles, California is an action against mortgage lender Capmark Finance, Case No. CV 09-04104 RSWL (JCx), in which, the government is seeking to recover damages and penalties under the FCA arising from Capmark's submission of allegedly false documents and claims to HUD's multifamily mortgage insurance program. Specifically, the complaint alleges that Capmark engaged in fraudulent conduct to obtain HUD mortgage insurance in connection with two loans made by Capmark that financed the borrowers' acquisition of two existing residential nursing home facilities. When the loans defaulted, HUD sustained losses by having to pay $25.9 million dollars in mortgage insurance claims. In the Department of Justice press release for the Capmark case, the Department of Justice representative stated, "Mortgage fraud is a top priority for this Administration, especially when public dollars are at stake. We will aggressively pursue fraud claims against federal mortgage insurance programs, which are so vitally important to this economy." Thus, all loans at risk of default that are covered by government mortgage insurance are ripe for possible false claims actions.

IV. IT IS A PRUDENT BUSINESS PRACTICE FOR COMPANIES, INCLUDING THE MORTGAGE LENDING SECTOR, TO PROTECT THEMSELVES THROUGH EFFECTIVE COMPLIANCE PROGRAMS AND REGULAR INTERNAL AUDITS

There are a number of reasons why it is in a company's best interest to have a current and effective compliance program in place. Early discovery of possible FCA violations can create opportunities for voluntary disclosure, provide a basis for resolving the problems through a negotiated settlement, and shorten the damages time period by identifying problems early on. In light of the recent amendments to the FCA, compliance programs should be updated along the following lines, with additional modifications tailored to the particular needs of the company:

(1) Schedule internal audits of all agreements that involve federal funds that may be at risk, including, without limitation, federally insured loans to at risk borrowers.

(2) Establish an alert system for identifying agreements where the payments are overdue, and there is a risk that the contract will be breached, or the property foreclosed in the case of a mortgage loan.

(3) Establish an audit system of agreements involving subcontractors with whom the company has either terminated the relationship, or the relationship has become strained, in order to ensure that the underlying agreements were handled properly and, therefore, there is no basis for a *qui tam* complaint by a subcontractor or, alternatively, any problems can be identified and addressed.

(4) Evaluate the advantages and disadvantages of having a hotline system for contractors and agents to report FCA concerns, now that they are included in the class of possible *qui tam* plaintiffs.

(5) Remind all company departments that prompt notice to management upon receipt of any subpoena or government inquiry is essential. Now that the documents and testimony produced in response to a CID can be shared more broadly, it is even more critical that companies work with legal counsel in complying with these requests.

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