The Fraud Enforcement and Recovery Act of 2009

On May 20, 2009 President Obama signed into law the Fraud Enforcement and Recovery Act of 2009 ("FERA" or the "Act") (S. 386),[1] which is designed to strengthen the government's ability to investigate and prosecute financial and mortgage fraud. The Act changes several criminal fraud and money laundering statutes, expands the False Claims Act (the "FCA"),[2] increases funding for agencies that investigate and prosecute financial fraud, and establishes a 9/11 style commission to examine the causes of the current financial crisis.

I. Changes to Criminal Fraud and Money Laundering Statutes

The Act revises several criminal fraud and money laundering statutes. It aims to ensure the government can prosecute the types of fraud that contributed to the financial crisis and fraud related to the troubled assets relief program (the "TARP") and the economic stimulus package.[3] Specifically, the Act:

- Amends the definition of "financial institution" in the criminal code (18 U.S.C. § 20) to include mortgage lending businesses that are not directly regulated or insured by the federal government.[4] This change extends the criminal fraud laws to fraud perpetrated on mortgage lenders and brokers. For example, statutes that prohibit defrauding "financial institutions" (18 U.S.C. § 1344) and bribing "financial institution" officers (18 U.S.C. § 215) now also prohibit defrauding mortgage lending businesses and bribing their officers.
- Revises the false statements in mortgage applications statute (18 U.S.C. § 1014) to criminalize knowingly making false statements or willfully overvaluing a property to influence a mortgage lending business. Previously, the section applied to such statements made to influence federal agencies, banks, and credit associations, but did not explicitly extend to mortgage lending businesses.
- Allows the government to prosecute fraud related to the TARP and various economic stimulus packages under the Major Fraud Act, which applies to fraud against the government for contracts exceeding $1 million and carries an elevated maximum penalty (18 U.S.C. § 1031).[5]

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1 Public Law 111-21.

2 31 U.S.C. §§ 3729-3733.

3 *See* Senate Judiciary Committee Report (March 23, 2009), *available at* http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_reports&docid=f:sr010.pdf.

4 The Act defines "mortgage lending business" as "an organization which finances or refinances any debt secured by an interest in real estate, including private mortgage companies and any subsidiaries of such organizations, and whose activities affect interstate or foreign commerce.''

5 The stated purpose of this section was to apply the major fraud statute to funds provided from the TARP and the Economic Stimulus Act. *See e.g.*, Senate Judiciary Committee Report (March 23, 2009), *available at* http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_reports&docid=f:sr010.pdf. But the language in the legislation is broader--the statute applies to "*an* economic stimulus, recovery or rescue plan" (emphasis added), which seemingly encompasses funds provided by any economic stimulus plan.

- Expands the federal securities fraud statute (18 U.S.C. § 1348)--the statute added to the criminal code by the Sarbanes-Oxley Act-- to include fraud involving commodities, options, or futures.
- Broadens the criminal money laundering statutes (18 U.S.C. § 1956-57) by reversing the Supreme Court's recent decision in *United States v. Santos.* [6] The money laundering statutes make it an offense to conduct financial transactions involving the "proceeds" of a crime. The Supreme Court held that "proceeds" referred to the profits of a crime, not its gross receipts; consequently, the decision limited the money laundering statutes' applicability to profitable crimes. The Act reverses this decision by defining the "proceeds" of a crime as the entire gross receipts of the illegal activity.

II. Expansion of the False Claims Act

Prior to FERA, the FCA permitted the government and private whistleblowers suing on the government's behalf to recover money from any person who "knowingly makes, uses, or causes to be made or used, a false record or statement to get a false or fraudulent claim paid or approved by the Government."[7] The amendments to the FCA reverse several recent judicial decisions and expand liability both for those who receive government bailout funds as well as others.

Modification of the intent requirement

FERA modifies the intent requirement, overruling the Supreme Court's decision in *Allison Engine v. United States ex rel. Sanders*.[8] *Allison Engine* held that FCA liability attaches only if a defendant makes a false statement with the intent that the U.S. government relies on that statement. Thus, a subcontractor who intended to defraud the general contractor, but did not intend that the government rely on that false statement, would not be liable. FERA changes the FCA such that a person is liable if the false statement has "a natural tendency to influence" or is "capable of influencing" the government's decision to pay a claim. Now, a subcontractor would be liable if he intended to defraud the contractor and that false statement influenced the government's payment decision. FERA makes this amendment to the FCA retroactive to June 7, 2008, two days before *Allison Engine* was handed down.[9]

Expansion of liability to include claims presented to certain non-governmental officials and certain claims to which the US government lacks title

FERA overrules the D.C. Circuit's decision in *United States ex rel. Totten v. Bombardier Corp.*, [10] which held that FCA liability attaches only if the defendant presents the false claim directly to an officer or employee of the U.S. government, and that a submission to an entity that is federally funded does not trigger liability. Specifically in *Totten,* the court ruled that false claims submitted to Amtrak were not covered by the FCA, even though Amtrak is federally funded, because the claims were not presented directly to an officer or employee of the government. FERA defines a "claim" to include requests or demands presented to contractors, grantees, or other recipients of government funds—*i.e.*, certain non-governmental officials. Under FERA, liability would

6 128 S.Ct. 2020 (2008).

7 31 U.S.C. § 3729(a)(2).

8 128 S. Ct. 2123 (2008).

9 Whether this retroactive provision is constitutional remains to be decided.

10 380 F.3d 488 (D.C. Cir. 2004).

attach if a defendant presented a false claim either to a government official or any one of the categories of non-governmental entities listed.

The Act also expands the definition of "claim" to include certain funds to which the government lacks title, statutorily confirming the 4th Circuit's reversal of a district court decision. In *United States ex rel. DRC, Inc. v. Custer Battles, LLC,*[11] the district court held that there was no FCA liability for presenting a false claim for Iraqi funds administered by the US government because the money was not paid directly from the U.S. Treasury. FERA revises "claim" to clarify that liability attaches in the case of funds administered by the government or provided to further a government interest, regardless of whether or not the government has title to the money or property.

Other pro-prosecutor and pro-plaintiff changes

The other changes to the FCA include:

- creating liability for knowingly concealing the retention of government overpayments;
- effectively extending the statute of limitations for the government to intervene when a private party files a complaint;
- strengthening the Attorney General's ability to investigate FCA claims and share information with private plaintiffs; and
- expanding protection for whistleblowers who bring FCA suits.

III. Increased Funding to Combat Financial and Mortgage Fraud

FERA authorizes the appropriation of $245 million per year for the next two years for the Department of Justice ("DOJ"), the Securities and Exchange Commission ("SEC"), and several other agencies to investigate and prosecute financial fraud. More specifically FERA authorizes:

- $165 million per year for the DOJ, with this money divided among the FBI--which must use it to investigate mortgage fraud--the US Attorneys' Offices, and the criminal, civil and tax divisions of the DOJ;
- $20 million per year for the SEC to use in investigation and enforcement proceedings involving financial institutions; and
- $80 million per year for the Postal Inspection Service, the Department of Housing and Urban Development's Inspector General, and the Secret Service to investigate financial fraud.

11 376 F. Supp. 2d 617 (E.D. Va. 2005), *rev'd*, 562 F.3d 295 (4th Cir. 2009).

IV. Creation of the Financial Crisis Inquiry Commission

The Act establishes the Financial Crisis Inquiry Commission to examine the domestic and global causes of the current financial crisis. The Commission will have 10 members, with six appointed by Democrats and four by Republicans, and must report its findings to Congress by December 15, 2010. To accomplish its goal, the Commission will have the authority to hold hearings and issue subpoenas for testimony and documents.[12]

In investigating the causes of the current financial and economic crisis, the Act instructs the Commission to examine, among other things, the role of:

- fraud and abuse in the financial sector, including fraud and abuse toward consumers in the mortgage sector;
- accounting practices, including mark-to-market and fair value rules, and treatment of off-balance sheet vehicles;
- tax treatment of financial products and investments;
- capital requirements and regulations on leverage and liquidity, including the capital structures of regulated and non-regulated financial entities;
- securitization, including the originate-to-distribute model for extending credit and transferring risk;
- the concept that certain institutions are "too-big-to-fail" and its impact on market expectations;
- credit rating agencies in the financial system, including reliance on credit ratings by financial institutions and federal financial regulators;
- compensation structures, including a comparison between changes in compensation for financial companies' employees and those with similar skill sets; and
- derivatives and unregulated financial products and practices, including credit default swaps, short-selling, and the financial institutions' reliance on numerical models.

The Act also directs the Commission to examine the reasons each "major financial institution" failed, including the institutions acquired by surviving institutions to prevent failure, and those that were "likely to have failed" had they not received government assistance.[13]

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Charles A. Gilman at 212.701.3403 or cgilman@cahill.com; Jon Mark at 212.701.3100 or jmark@cahill.com; or John Schuster at 212.701.3323 or jschuster@cahill.com.

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12 To limit the Democrats' control over the Commission, a majority--including one member appointed by a Republican--must vote to subpoena a witness.

13 The Act does not define "major financial institution," or indicate which institutions were "likely to have failed" without government assistance.