

Client Advisory | May 2009

## Fraud Enforcement and Recovery Act of 2009 Expands False Claims Act and Money Laundering Liability

### Failure to Realize Profits from Criminal Activities and Absence of Direct Payment from the Government No Longer Avoid Liability



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Earlier this week Congress passed the Fraud Enforcement Act of 2009 (FERA), which President Obama is expected to sign shortly. FERA accomplishes much, including appropriating more money to fund financial fraud investigations by federal agencies, authorizing a Financial Markets Commission (and a Senate Select Committee on Investigation of the Economic Crisis) to investigate the current financial crisis, subjecting private mortgage lenders to the same oversight and enforcement as other financial institutions, and making clear that whistleblower protections cover government employees and individual third-party contractors who report an corporate wrongdoing. In addition, and the focus of this client advisory, Congress has amended the False Claims Act and the Federal money laundering statutes to make inapplicable court decisions that had limited the reach of these statutes. While the stated justification for these statutory changes is to better equip law enforcement to prevent and prosecute financial frauds, Congress' amendments to the False Claims Act and money laundering statutes are far-reaching, affecting an array of white collar criminal investigations and prosecutions far beyond the arena of mortgage and corporate financial frauds.

#### Money Laundering No Longer Limited to Criminal "Profits"

The Federal money laundering statutes (18 U.S.C. §§1956, 1957) are amended to correct what Congress deems to be an erroneous decision by the U.S. Supreme Court. Since the enactment of the money laundering statutes, courts have construed

"proceeds" to mean "gross receipts." However, in 2008, the Supreme Court, in the case of *United States v. Santos*, 128 S. Ct. 2020 (2008), limited the scope of the money laundering statutes to only the "profits" of crimes, rather than the "gross receipts" of the offense. Under this interpretation, a defendant could escape liability simply by showing that no profits were earned from the charged criminal activity, notwithstanding the amount of proceeds generated. FERA closes this escape hatch by defining proceeds to include gross receipts. (Further, to assist the Internal Revenue Service and the Department of Justice in its ongoing off-shore fund transfer investigations, FERA also amends the international money laundering provision in a Federal money laundering statute (18 U.S.C. §1956(a)(2)) to criminalize the transport or transfer of money to and from the United States to evade taxes.)

#### False Claims Act Now Extends to Non-Government Paid Subcontractors

FERA also expands one of the Government's most powerful tools for combating waste and fraud, the False Claims Act (18 U.S.C. §3729 *et seq.*), which provides for steep criminal and civil penalties, including liability for up to three times the amount of damages which the government suffered. FERA "corrects" court decisions which had limited the scope of the False Claims Act, permitting subcontractors paid with Government money to escape liability under the False Claims Act for proven frauds.

For example, in *Allison Engine Co. v. U.S. ex rel. Sanders*, 128 S. Ct. 2123 (2008), the

Supreme Court held that the False Claims Act required proof that “a defendant must intend that the Government itself pay the claim.” There, a shipyard subcontractor manufactured components for a contractor that was building ships for the Navy. The subcontractor submitted false invoices to the contractor who in turn paid those invoices with government funds. The subcontractor was able to escape liability, as the Court required proof of the subcontractor’s intent to defraud the Government, and not just the general contractor.

Other court decisions had also weakened the False Claims Act. For example, in *Totten v. Bombardier Corp.*, 380 F.3d 488 (D.C. Cir. 2004), the court held that False Claims Act liability could only attach if the claim was “presented to an officer or employee of the Government.” Following this decision, a number of courts have held that the False Claims Act does not reach false claims that are (1) presented to Government grantees and contractors, and (2) paid with Government grants or contract funds. In *Atkins v. McInteer*, 470 F.3d 1350 (11th Cir. 2006), the court affirmed the dismissal of a complaint against a group of psychiatrists that allegedly billed Medicare and Medicaid for services purportedly rendered to residents of a skilled nursing facility, when it was discovered that some of the residents had passed away yet continued to “receive treatment.”

FERA expands liability under the False Claims Act by encompassing any person who knowingly makes a false claim to obtain money or property, any part of which is provided by the Government, whether or not the wrongdoer deals directly with the Government, with an agent acting on the Government’s behalf, or with a third-party contractor, grantee, or other recipient of money or property from the Government. At the same time, FERA limits its changes to a commercial context by explicitly excluding from liability compensation for federal employment and income subsidies, such as Social Security benefits.

FERA eliminates the “presentment clause,” thus clarifying that the claim can be presented to any party, as long as the source of the funds is the Government. Additionally, the bill removes the language “to get,” that was used by the Supreme

Court in *Allison Engine* to establish an intent requirement. FERA substitutes the language “material to,” which FERA defines as “having a natural tendency to influence, or being capable of influencing, the payment or receipt of money or property.” The amendment also extends False Claims Act liability to those who conspire to commit a violation of any section of the statute.

FERA redefines the term “claim” to impose False Claims Act liability for knowingly submitting false requests or demands for money and property from the U.S. Government, without regard to whether the United States holds title to the funds. This was done to address the decision of *United States ex rel. DRC, Inc. v. Custer Battles, LLC*, 376 F.Supp.2d 617 (E.D. Va. 2006) in which the court denied liability for a fraud committed against an Iraqi fund administered by the U.S. Government.

FERA also closes a loophole for “reverse” claims (Government money or property that is knowingly retained by someone who has no right to it), by including actions to conceal, avoid, or decrease the obligation. Furthermore, FERA defines “obligation” as “a fixed duty, or a contingent duty arising from an express or implied contractual, quasi-contractual, grantor-grantee, licensor-licensee, statutory, fee-based, or similar relationship, and the retention of overpayment,” thus removing ambiguities found by some courts. For example, in *Am. Textile Mfrs. Inst. v. The Limited*, 190 F.3d 729 (6th Cir. 1999), the court affirmed the dismissal of a claim against The Limited, finding that it had no obligation to the government when it mislabeled garments made in China in order to avoid paying higher customs duties and being subject to import quotas.

Interestingly, the new definition of “obligation” penalizes the retention of an overpayment from the Government. However, this provision retains the original intent requirement; thus, the violation of the False Claims Act for receiving an overpayment may occur once an overpayment is knowingly and improperly retained, without notice to the Government. On the other hand, the bill expressly states that it is not intended to create liability for a simple retention of an overpayment that is permitted by a statutory or regulatory process for

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reconciliation, provided the receipt of the overpayment is not based upon any willful act by the recipient, when the recipient is not entitled to such money or property.

FERA's changes to the False Claims Act add new weapons to the arsenal of options available to the government when investigating and prosecuting fraud in

any industry where the funds received, whether by a doctor, contractor, or vendor, come from the federal government. This increased exposure to significant financial penalties and possible imprisonment makes corporate internal monitoring and good compliance practices even more critical.

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