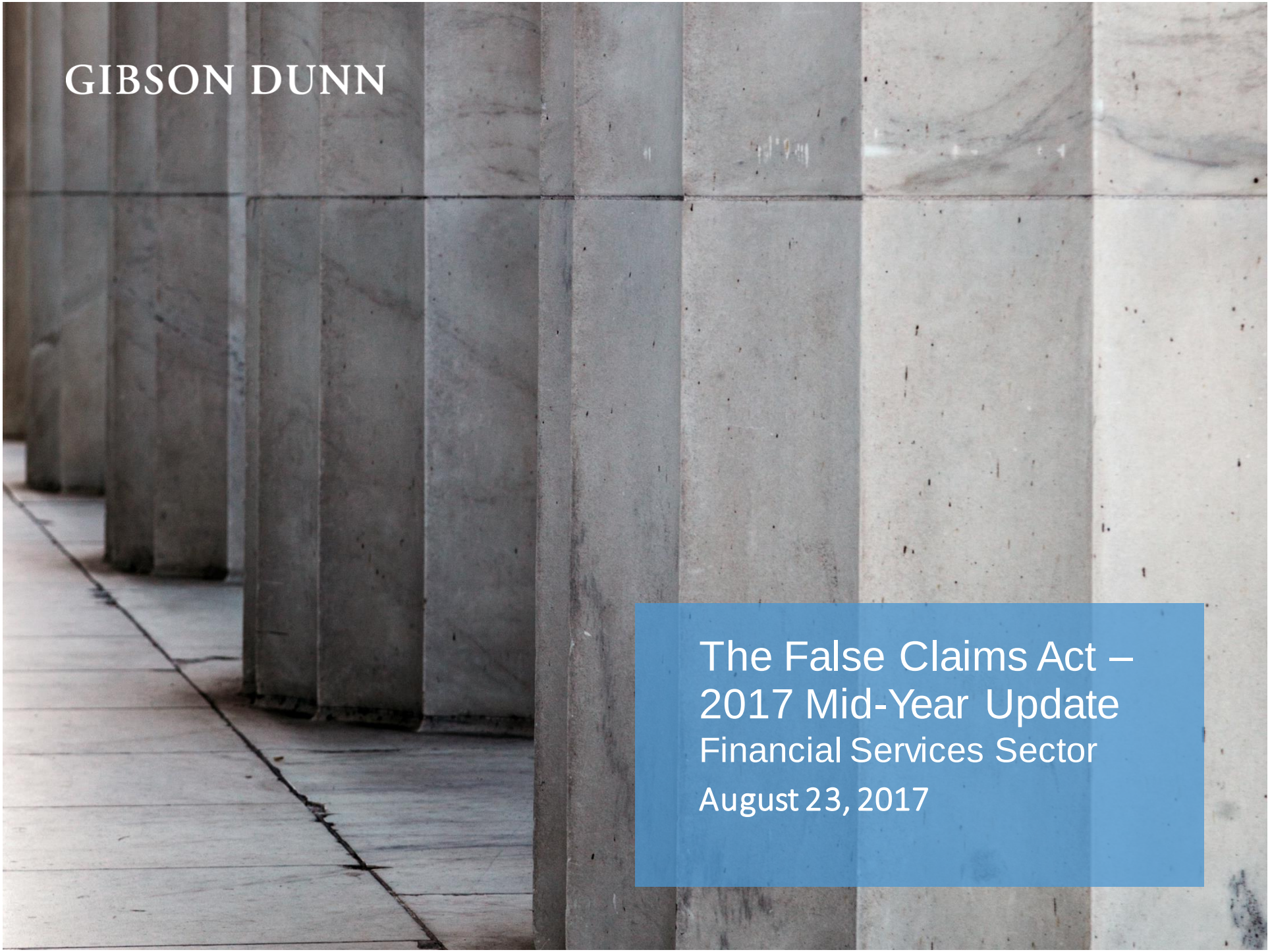


The False Claims Act – 2017 Mid-Year Update

Financial Services Sector

August 23, 2017

Today's Panelists

F. Joseph Warin is a partner in the Washington, D.C. office, Chair of the office's Litigation Department, and Co-Chair of the firm's White Collar Defense and Investigations practice group. His practice focuses on complex civil litigation, white collar crime, and regulatory and securities enforcement – including FCA cases, FCPA investigations, special committee representations, compliance counseling and class action civil litigation.

Stuart Delery is a partner in the Washington, D.C. office. He represents corporations and individuals in high-stakes litigation and investigations that involve the federal government across the spectrum of regulatory litigation and enforcement. Previously, as the Acting Associate Attorney General of the United States (the third-ranking position at the Department of Justice) and as Assistant Attorney General for the Civil Division, he supervised the DOJ's enforcement efforts under the FCA and FIRREA.

Mylan Denerstein is a partner in the New York office. She is Co-Chair of the firm's Public Policy practice group, and a member of the White Collar Defense and Investigations, Securities Litigation, Appellate, and Crisis Management practice groups. She handles a broad range of complex litigation, as well as white collar, legislative and investigation matters. She is former Counsel to New York State Governor Andrew Cuomo, and previously served as Deputy Chief of the Criminal Division of the U.S. Attorney's Office in the Southern District of New York.

James Zelenay is a partner in the Los Angeles office and a member of the firm's Litigation Department. He is experienced in federal and state FCA matters and whistleblower litigation, in which he has represented a breadth of industries and clients.

Agenda

- FCA Overview
- FCA Enforcement Overview
- Recent Developments: (Implied) False Certifications
- Recent Developments: FCA Financial Sector Decisions
- Recent Developments: FCA Financial Sector Settlements
- FCA Compliance Best Practices

- **We encourage your questions throughout this presentation**

FCA Overview

The False Claims Act (FCA)

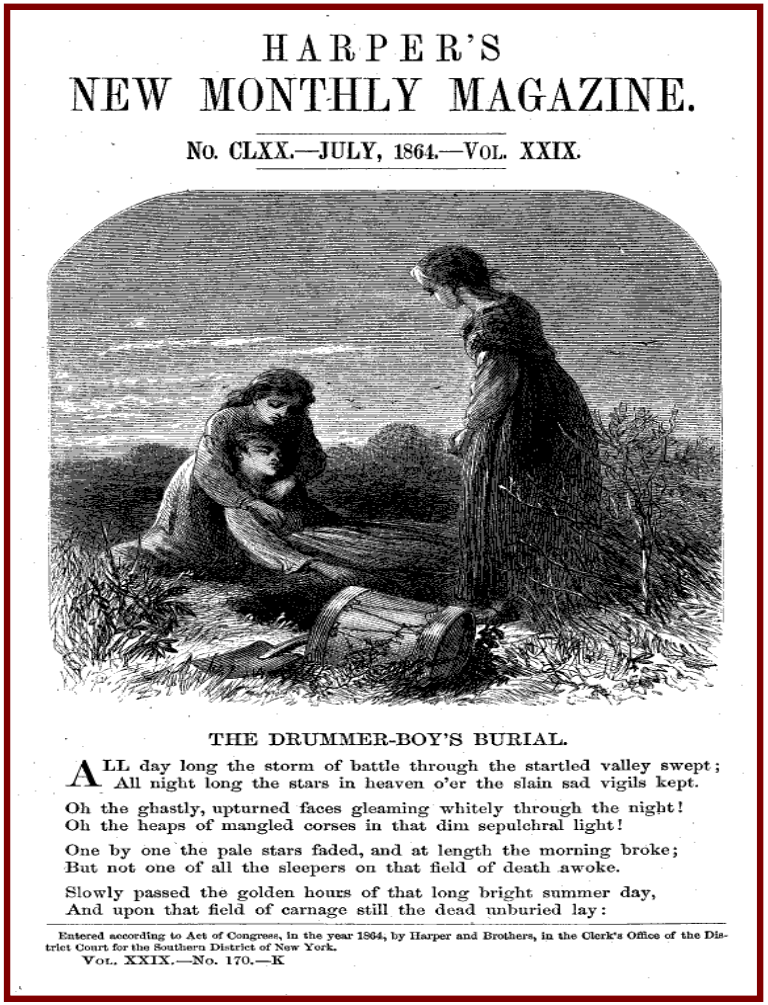
- The FCA, 31 U.S.C. §§ 3729-3733, is the federal government's **primary weapon to redress fraud** against government agencies and programs
- The FCA provides for recovery of **treble damages** and **civil penalties** from any "person" (natural or corporate entity) who knowingly submits or causes the submission of a false or fraudulent claim to the United States for money or property
- DOJ attorneys (Civil Division, as well as U.S. Attorneys' Offices) investigate and pursue FCA cases
- DOJ is devoting more and more resources to pursuing FCA cases—and increasingly considering whether *qui tam* cases merit parallel criminal investigations

"It seems quite clear that the objective of Congress was broadly ***to protect the funds and property of the Government from fraudulent claims*** …."
Rainwater v. United States, 356 U.S. 590 (1958)

FCA – History

- Civil War profiteering prompted enactment of the "Lincoln Law" in 1863

> For sugar [the government] often got sand; for coffee, rye; for leather, something no better than brown paper; for sound horses and mules, spavined beasts and dying donkeys; and for serviceable muskets and pistols the experimental failures of sanguine inventors, or the refuse of shops and foreign armories.



HARPER'S
NEW MONTHLY MAGAZINE.

No. CLXX.—JULY, 1864.—Vol. XXIX.

THE DRUMMER-BOY'S BURIAL.

ALL day long the storm of battle through the startled valley swept;
All night long the stars in heaven o'er the slain sad vigils kept.

Oh the ghastly, upturned faces gleaming whitely through the night!
Oh the heaps of mangled corses in that dim sepulchral light!

One by one the pale stars faded, and at length the morning broke;
But not one of all the sleepers on that field of death awoke.

Slowly passed the golden hours of that long bright summer day,
And upon that field of carnage still the dead unburied lay:

Entered according to Act of Congress, in the year 1864, by Harper and Brothers, in the Clerk's Office of the District Court for the Southern District of New York.

Vol. XXIX.—No. 170.—K

R. Tomes, *The Fortunes of War*, Harper's New Monthly Magazine 228 (July 1864).

FCA – Key Provisions

31 U.S.C. § 3729(a)(1)	Statutory Prohibition	Summary
(A)	Knowingly presents, or causes to be presented, a false or fraudulent claim for payment or approval	False/Fraudulent Claim
(B)	Knowingly makes, uses or causes to be made or used, a false record or statement material to a false or fraudulent claim	False Record/Statement
(G)	Knowingly conceals or knowingly and improperly avoids or decreases an obligation to pay or transmit money or property to the government	"Reverse" False Claim
(C)	Conspires to violate a liability provision of the FCA	Conspiracy

FCA – Scienter

- "Knowingly" requires scienter and is defined as:
  - Actual knowledge;
  - Deliberate ignorance; or
  - Reckless disregard
- Negligence is not actionable
- Specific intent to defraud is not required

FCA – Overview of Key FCA Theories

Factual Falsity

- False billing (e.g., services not provided)
- Overbilling

Legal Falsity / False Certification

- Express certification of compliance with legal requirements
- Submission of claim with representations rendered misleading as to goods/services provided

Promissory Fraud / Fraud in the Inducement

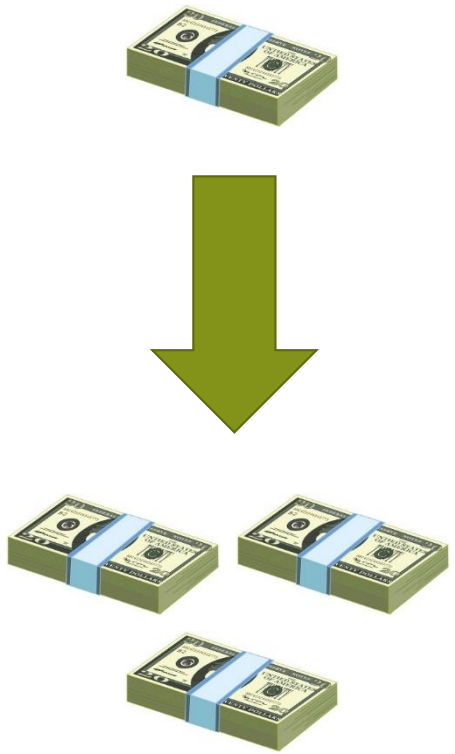
- Obtaining a contract through false statements or fraudulent conduct
- *U.S. ex rel. Marcus v. Hess*, 317 U.S. 537 (1943) (claims by contractors who colluded on bids)

Reverse False Claims

- Improper avoidance of obligation to pay money to the government
- Retention of government overpayment

FCA – Damages and Penalties

- **Simple Damages Calculation**
  - Treble damages are traditionally calculated by multiplying the government's loss by three (*e.g.*, if defendant charged government $100 for goods not received, damages would be $300)
- **Complex, Contested Damages Calculation**
  - Calculations are more complicated (and less certain) when the government receives goods or services it considers deficient or when there is a "false certification" or "promissory fraud"
- **Civil Penalty Per Claim**
  - Previously $5,500 to $11,000
  - Nearly doubled effective August 1, 2016
  - 2017 inflation adjustment increased to range of $10,957 to $21,563 per violation
  - Penalties are **in addition to** treble damages



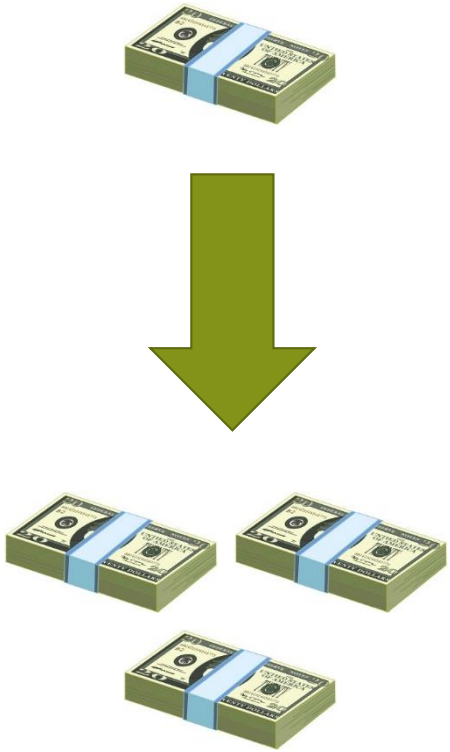
FCA – Damages and Penalties

- **DOJ's View**
  - Damages include the **full amount obtained under the contract/program**, regardless of the value of goods or services received in exchange, **trebled**.

- **Huge Potential Damages**
  - *U.S. v. Anchor Mortg. Corp*., 711 F.3d 745 (7th Cir. 2013) - "Net trebling" v. "gross trebling"
  - $100MM contract minus benefit to the government (e.g., $75MM), ***then*** trebled

    or

  - $100MM **trebled** then minus benefit to the government



FCA – Statute of Limitations

- The statute of limitations is:
  - 6 years from the date of violation *or*
  - 3 years from when facts material to the violation are known or reasonably should have been known to the government
- ***But*** not more than 10 years from the violation

FCA – Public Disclosure and First-to-File Bars

- The **public disclosure bar** provides that relator's *qui tam* complaint cannot be "substantially the same" as allegations publicly disclosed in certain enumerated sources such as public hearings, government audits or reports, or the news media
    - *"Original source" exception*: A relator may proceed on publicly disclosed allegations if he is an "original source" of the allegations, meaning he ***voluntarily disclosed*** them before filing and has knowledge that is "***independent of and materially adds to***" the public disclosures
    - *2010 Amendments*: The public disclosure provisions were amended to the current language in 2010; previously, the bar contained slight differences in the public disclosure and original source provisions
- The **first-to-file bar** provides that, when a *qui tam* action is "***pending***," "***no person*** other than the Government ***may intervene or bring a related action based on the [same] facts***"

Recent Legal Development: Public Disclosure Bar

Amphastar Pharmaceuticals Inc. v. Aventis Pharma SA,
856 F.3d 696 (9th Cir. 2017)

- Affirmed district court dismissal of generic pharmaceutical company's FCA allegations that defendant overcharged the government after fraudulently obtaining a patent on one of its drugs
- Court found that the allegations were publicly disclosed during discovery in its own earlier patent litigation with defendant
  - Although government reimbursement of the drug was not publicly disclosed in that suit, that reimbursement was "***an obvious inference based on the publicly disclosed allegations***"
- Relator also was not an "original source" under the pre-amendment version of the bar because it developed the allegations through the discovery process
  - Relator admitted this fact in its required disclosures to DOJ

Recent Legal Developments: First-to-File Bar

***U.S. ex rel. Shea v. Cellco Partnership, Inc.*, No. 15-7135 (D.C. Cir. July 25, 2017)**

***U.S. ex rel. Carter v. Halliburton Co.*, No. 16-1262 (4th Cir. July 31, 2017)**

- Both courts addressed the question of whether a violation of the FCA's first-to-file provision requires dismissal of the action or, rather, can be cured by an amendment to the complaint
- Both held that the first-to-file provision ***requires dismissal of the second-filed action***, rejecting the argument that amending the second-filed complaint cures the violation of the first-to-file provision

***But see U.S. ex rel. Gadbois v. Pharmerica Corp.*, 809 F.3d 1 (1st Cir. 2015)**

FCA – *Qui Tam* Provisions

- ***Qui Tam* Provisions**
  - Enable so-called "relators" to bring cases in the government's name and recover **as much as 30%** of favorable judgment or recovery
  - Allow government to intervene
    - An increasing number of whistleblower cases are pursued **without government intervention** (but often with government statement of interest)
  - DOJ argues that it has unlimited authority to dismiss FCA cases, but seldom exercises it
- **Whistleblower Protections (31 U.S.C. § 3730(h))**
  - Protect employees and others (e.g., contract workers)
  - Relief may include double back pay and interest on back pay; reinstatement (at seniority level); and/or costs and attorneys' fees

"In short, sir, I have based the [*qui tam* provision] upon the old-fashioned idea of holding out a temptation and '**setting a rogue to catch a rogue**,' which is the safest and most expeditious way I have ever discovered of bringing rogues to justice."

Statement of Senator Howard, Cong. Globe, 37th Cong. 955-56 (1863)

**qui tam pro domino rege quam pro se ipso in hac parte sequitur* ("who sues on behalf of the King as well as for himself")

Government Players

DOJ

DOJ is devoting more and more resources to pursuing FCA cases—and considering whether *qui tam* cases merit criminal investigation

Support Agencies

Parent agencies (e.g., HUD, SBA) participate in financial sector FCA investigations

Cooperation

Inspectors General

DOJ's Absolute Right of Veto Over Voluntary Settlements

U.S. ex rel. Michaels v. Agape Senior Community, Inc.
848 F.3d 330 (4th Cir. 2017)

- Relators and defendant sought to settle a non-intervened FCA case alleging defendant fraudulently billed Medicare for services to patients that were not provided
- DOJ objected on the grounds the settlement was insufficient and it disputed the district court's refusal to permit statistical sampling as a basis for higher damages
- Relators sought to enforce the settlement over DOJ's objection
- District court rejected the settlement, holding that DOJ had absolute veto power over settlements
- Fourth Circuit affirmed, holding that "the Attorney General possesses an absolute veto power over voluntary settlements in FCA *qui tam* actions"
    - The statute "is not temporally qualified or explicitly limited in any other manner" and "does not overtly require the Government to satisfy any standard or make any showing reviewable by the court"
- Decision is in line with views of Fifth and Sixth Circuits, but contrary to ruling of Ninth Circuit

FCA – The "Yates Memo"

September 9, 2015 memorandum by then-Deputy Attorney General, "Individual Accountability for Corporate Wrongdoing," sets forth six priorities for DOJ civil and criminal investigations, including those of suspected FCA violations:

1. Corporations must provide all relevant facts relating to the individuals responsible for the misconduct in order to qualify for cooperation credit;
2. Prosecutors to focus on individuals from inception of corporate investigation;
3. Close coordination between DOJ criminal and civil attorneys;
4. DOJ will not release culpable individuals from civil or criminal liability when resolving a matter (absent extraordinary circumstances or DOJ policy);
5. DOJ resolution with corporation should not occur without clear plan to resolve related individual cases; and
6. DOJ civil attorneys should focus on individuals and evaluate whether to bring suit against them based on considerations beyond ability to pay

FCA Enforcement Overview

FCA Enforcement by the Numbers: FY 2016

$4.7 billion

Civil Settlements and Judgments Under the FCA

800

New FCA Cases Filed

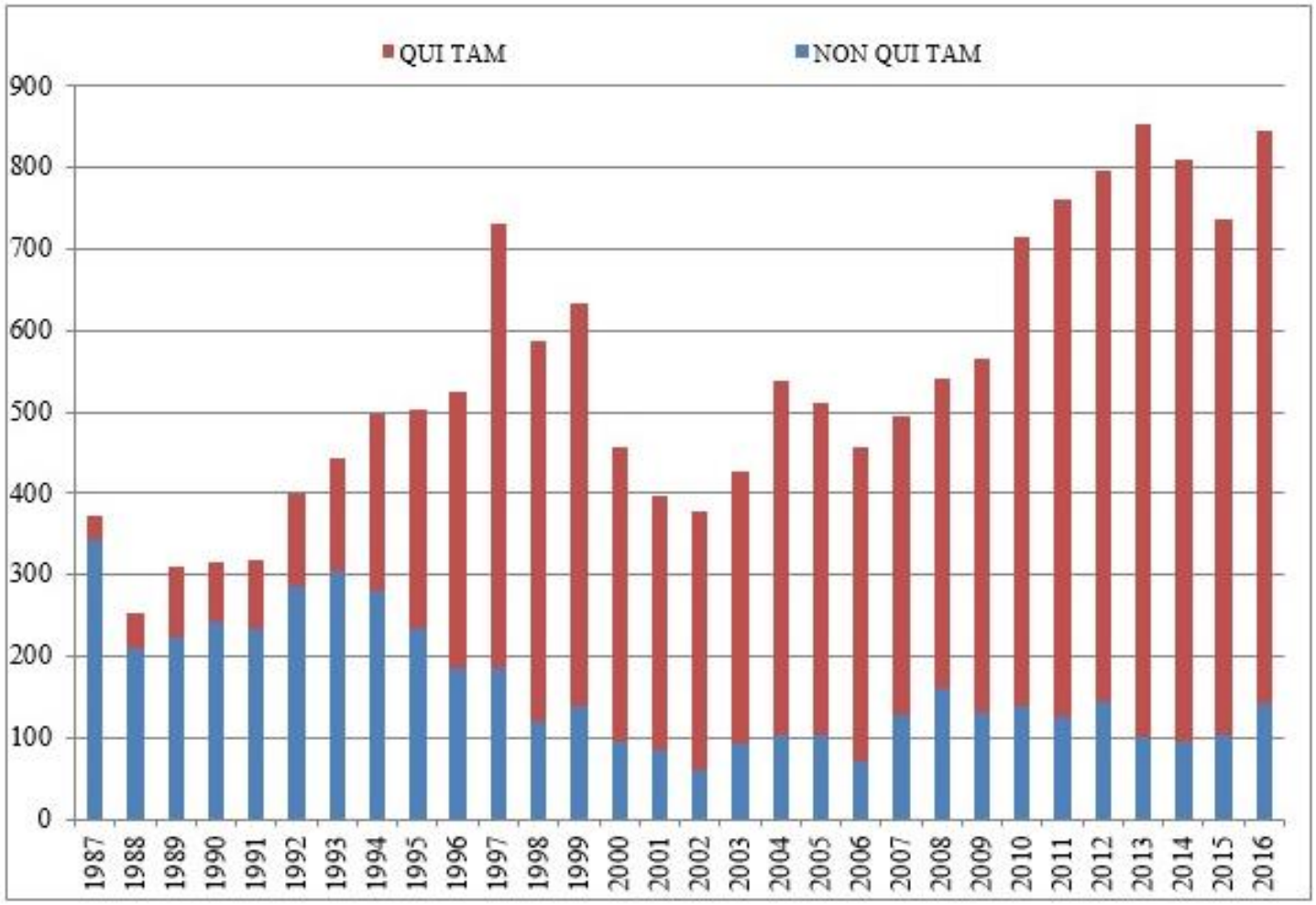
83 percent

Percentage of New FCA Cases Initiated by a Whistleblower

98 percent

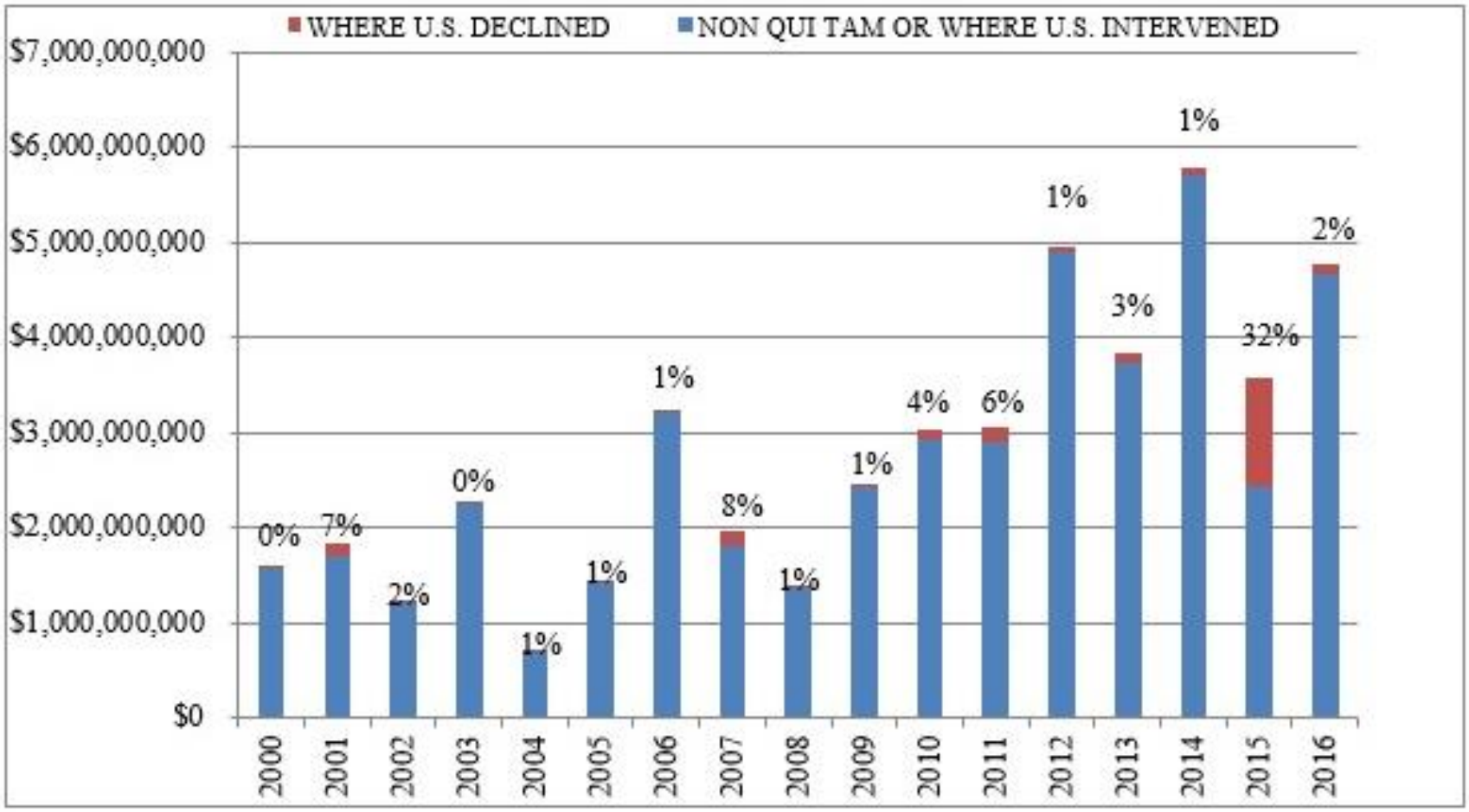
Percentage of Overall Federal Recovery from Cases in Which the Government Intervened

Number of New FCA Suits (FY 1987 – 2016)



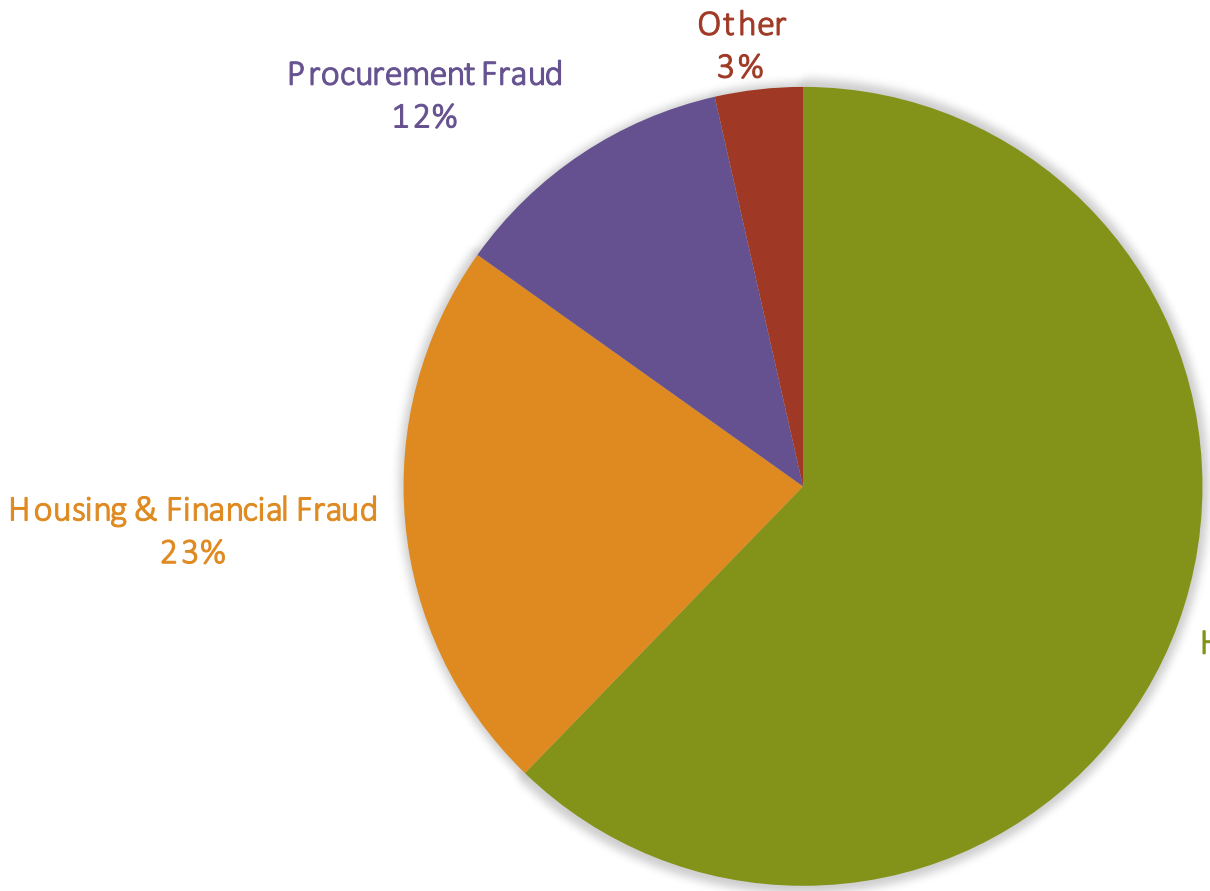
Source: DOJ "Fraud Statistics – Overview" (Dec. 13, 2016)

Declined Cases in FCA Actions (FY 2000 – 2016)



Source: DOJ "Fraud Statistics – Overview" (Dec. 13, 2016)

FCA Recovery by Industry (FY 2009 – 2016)



"The Department recovered more than $7 billion for the federal government in [FCA] settlements and judgments relating to housing and financial fraud in fiscal years 2009 to 2016, and billions more during the same period in penalties under [FIRREA] and for consumer relief."

Source: Department of Justice, "2009-2016 Fact Sheet on Civil Recoveries"

Recent Statements from the New Administration

"We cannot afford to lose a single dollar to corruption, and you can be sure that if I am confirmed, I will make it a high priority of the department to root out and prosecute fraud in federal programs and to recover monies lost due to fraud or ***false claims***"

- Attorney General Jeff Sessions III

(Senate Judiciary Committee Hearing on Nomination of Sen. Jeff Sessions to be Attorney General (Jan. 10, 2017))

"We certainly will continue to enforce [the FCA]" and the DOJ will ensure that "whistleblowers receive any protection they are entitled to by law or regulation"

– Deputy Attorney General Rod Rosenstein

(Senate Judiciary Committee Hearing on Nomination of Rod Rosenstein (Mar. 7, 2017))

Recent Statements from the New Administration

"The second message I want to make clear today is that under my leadership, the Department of Justice remains committed to enforcing all the laws. That includes laws regarding corporate misconduct, fraud, foreign corruption and other types of white-collar crime. . . .

The Department of Justice will continue to emphasize the importance of holding individuals accountable for corporate misconduct. It is not merely companies, but specific individuals, who break the law."

- Attorney General Jeff Sessions III

Source: Office of Pub. Affairs, U.S. Dep't of Justice, Attorney General Jeff Sessions Delivers Remarks at Ethics and Compliance Initiative Annual Conference, (April 24, 2017)

Recent Statements from the New Administration

"Government mortgage programs designed to assist homeowners — including programs offered by the FHA, VA, Fannie Mae and Freddie Mac — depend on lenders to approve only eligible loans . . . . The Department has and will continue to hold accountable lenders that knowingly cause the government to guarantee, insure, or purchase loans that are materially deficient and put both the homeowner and the taxpayers at risk."

- Acting Assistant Attorney General Chad A. Readler

(Press Release, Office of Pub. Affairs, U.S. Dep't of Justice, PHH Agrees to Pay Over $74 Million to Resolve Alleged False Claims Act Liability Arising from Mortgage Lending, (Aug. 8, 2017))

DEPARTMENT of JUSTICE
CIVIL DIVISION

2017 Mid-Year Check-In on FCA Enforcement

$1.3 billion

FCA recoveries from settlements in the first half of 2017

$370 million

Judgments from FCA cases in the first half of 2017

8th

DOJ remains on pace for 8th consecutive year exceeding $3 billion in total FCA recoveries

Recent Developments: (Implied) False Certifications

Escobar and Implied Certification: *Universal Health Srvs., Inc. v. U.S. ex rel. Escobar*

- 136 S. Ct. 1989 (2016)

- Relator brought FCA suit against nationwide provider of mental health services, alleging that hospital submitted payment claims to Medicaid for services rendered by personnel who did not meet state-regulated staffing qualifications
- Implied certification theory advanced was that when defendant submitted the claims, it impliedly certified compliance with all applicable regulations
- The Court endorsed the implied certification theory of FCA liability, "at least where two conditions are satisfied":
    1. "the claim does not merely request payment, but also makes ***specific representations about the goods or services provided***"; and
    2. "the defendant's ***failure to disclose noncompliance with material statutory, regulatory, or contractual requirements*** makes those representations misleading half-truths"
- The Court declined to decide "whether ***all*** claims for payment ***implicitly*** represent that the billing party is legally entitled to payment"

Escobar Materiality

- Implied certification liability and fair notice can be policed through "rigorous" enforcement of FCA's "materiality" and "scienter" requirements
  - Materiality "look[s] to the effect on the likely or actual behavior of the recipient of the alleged misrepresentation"
  - Violation is "material" if:
    - "A reasonable man would attach importance to [the misrepresented information] in determining his choice of action in the transaction"; or
    - "the defendant knew or had reason to know that the recipient of the representation attaches importance to the specific matter 'in determining his choice of action,' even though a reasonable person would not"

Escobar Materiality

- Materiality does not "rest on a single fact or occurrence as always determinative," but must be weighed in the context of each case:
  - Government's right to refuse payment based on noncompliance is insufficient, by itself, to demonstrate materiality
  - Rejected argument that government may require "contractors to aver their compliance with the entire U.S. Code and [CFR]," then deem all violations material; noncompliance cannot be minor or insubstantial
  - Proof can include, but is not limited to, "evidence that the defendant knows that the Government consistently refuses to pay claims in the mine run of cases based on noncompliance with the particular statutory, regulatory or contractual requirement"
  - Government's payment of "particular claim," or practice of paying "particular type of claim," with "actual knowledge" of violation of certain requirements, is "strong evidence" that those requirements are not material

Post-*Escobar*: Necessity of "Specific Representations"

- At least two circuits have required *both Escobar* conditions, dismissing cases that do not plead "specific representations"
  - *U.S. ex rel. Kelly v. Serco*, 846 F.3d 325 (9th Cir. 2017)
  - *U.S. v. Sanford-Brown*, 840 F.3d 445 (7th Cir. 2016)

- At least two other courts have refused to require both conditions, holding specific representations not required for actionable "half-truths":
  - *U.S. ex rel. Badr v. Triple Canopy, Inc.*, 857 F.3d 174 (4th Cir. 2017)
  - *U.S. ex rel. Landis v. Tailwind Sports Corp., et al.*, 2017 WL 573470 (D.D.C. Feb. 13, 2017)

Post-*Escobar*: Materiality of Government Intervention

- Two courts have examined the impact of the government's intervention decision as a factor in the materiality analysis
  - *U.S. ex rel. Badr v. Triple Canopy, Inc.*, 857 F.3d 174 (4th Cir. 2017)
    - Evidence that upon discovering the alleged misrepresentation the "Government did not renew its contract for base security . . . and immediately intervened in the litigation" tends to demonstrate that the misrepresentation was material
  - *U.S. ex rel. Petratos v. Genentech Inc.*, 855 F.3d 481 (3d Cir. 2017)
    - Government's failure to take any action against pharmaceutical company after relator disclosed the alleged misrepresentations, including by deciding not to intervene, tended to demonstrate that the misrepresentation was not material

Post-*Escobar*: Government Acquiescence

Since *Escobar*, a number of courts have cited "government knowledge" of alleged misrepresentations, and failure to take action in response thereto, as demonstrating immateriality:

- *U.S. ex rel. Kelly v. Serco*, 846 F.3d 325 (9th Cir. 2017) (no materiality where government accepted and paid defendant's reports that on their face did not comply with time-charging guidelines)
- *U.S. ex rel. McBride v. Halliburton Co.*, 848 F.3d 1027 (D.C. Cir. 2017) (affirming summary judgment where DCAA investigation of alleged inflated headcounts did not result in any disallowance and company continued to receive award fees for exceptional performance)
- *Abbott v. BP Exploration & Prod., Inc.*, 851 F.3d 384 (5th Cir. 2017) (affirming summary judgment of alleged false certification of "compliance with various regulatory requirements" where Congress and the Department of Interior had both investigated allegations and taken no action)

The FCA and the Financial Sector

The FCA Implicates a Wide Range of Financial Services

- **False Certification Regarding Servicing & Origination of FHA-Insured Loans**
- **False Statements Regarding Servicing of "Reverse" Mortgage Loans**
- **False Statements to Obtain Ex-Im Bank Loan Guarantees**
- **False Representations Regarding Financial Health to Borrow Money**
- **False Certification to Obtain Reimbursement**
- **False Promises to Obtain Federal Grant Dollars**
- **Any other interactions with federal or state government**

Government's Additional Enforcement Tool – FIRREA (Financial Institutions Reform, Recovery & Enforcement Act of 1989, 12 U.S.C. § 1833a)

FIRREA Often Used with FCA

- Most FIRREA claims against financial institutions involve structuring, underwriting, and issuance of defective residential mortgage-backed securities to federally insured financial institutions.
- FIRREA is broader in scope than FCA. Government loss or injury is not required. It allows the government to pursue civil money penalties for any fraud involving or affecting federally insured financial institutions, not just those relating to a false claim for payment.
- FIRREA provides the AG with broad investigative authority, including the power to subpoena documents and testimony, and authorizes disclosure of grand jury material for use in a civil case.
- FIRREA authorizes civil enforcement of certain predicate offenses that affect financial institutions (e.g., General false claims provision, 18 U.S.C. § 287, False Statements, § 1001). For most of the predicate offenses, the government does not have to provide any additional element beyond violation of the predicate offense itself.

FIRREA Nexus Requirement for False Claims

FIRREA Does Not Define "Affecting"

- Courts in the Southern District of New York have held that FIRREA may be used to bring fraud charges against a federally insured bank for misconduct "affecting" only the bank itself (the "self-affecting" theory).
- Notably, on May 23, 2016, the Second Circuit expressly declined to weigh in on the efficacy of the self-affecting theory in its decision to reverse a jury's $1.27 billion civil penalty on Countrywide under FIRREA for mail and wire fraud "affecting" a federally insured financial institution. *U.S. ex rel. O'Donnell v. Countrywide Home Loans, Inc.*, 822 F.3d 650, 661 (2d Cir. 2016).
- The Second Circuit did admonish the government's attempt to improperly expand FIRREA's reach and in essence to "convert every intentional or willful breach of contract in which the mails or wires were used into criminal fraud, notwithstanding the lack of proof that the promisor intended to deceive the promisee into entering the contractual relationship." *Id.* at 822.

FIRREA Penalties

Penalties Available

- The amount of a civil penalty is capped at $1,000,000, while for continuing violations, the penalty may not exceed $5,000,000. 12 U.S.C. § 1833a(b)(1), (2).

- To adjust for inflation, civil penalties assessed after February 3, 2017 for violations that occurred after November 2, 2015 are capped at $1,924,589. For continuing violations the amount of the penalty could be as much as $9,622,947 for penalties assessed after February 3, 2017. 28 C.F.R. § 85.5.

- Where any person derives pecuniary gain from a violation, or the victim suffers pecuniary loss from the violation, the penalty assessed is the actual amount of the gain or loss. 12 U.S.C. § 1833a(b)(3).

- Whistleblowers entitled up to 20-30% of any recovery up to the first $1,000,000; 10-20% of the next $4,000,000 recovered; and 5-10% of the next $5,000,000.

Traditional Financial Sector FIRREA and FCA Cases

***U.S. ex rel. Sherry A. Hunt v. Citibank*, 11-cv-5473 (Aug. 05, 2011 S.D.N.Y.)**

- The government intervened in this *qui tam* action, alleging FCA and FIRREA violations. Defendant faced alleged potential liability under FCA of $600 million. Government alleged that: defendant failed to conduct proper underwriting/due diligence for loans submitted to HUD for FHA insurance; its quality control program was insufficient; it failed to investigate early payment defaults, as required by program guidelines; and it "politicized" its quality control reports, and actively prevented its quality control programs from reporting loans identified as fraudulent to HUD. The government alleged up to $200 million in losses for wrongly paid insurance claims. Defendant settled for $158.3 million.

***U.S. v. Wells Fargo Bank, N.A.*, 12-cv-7527 (Oct. 9, 2012 S.D.N.Y.)**

- Government alleged that defendant was liable under FCA, FIRREA, and the common law for making false certifications when submitting loans for FHA mortgage insurance. Government claimed defendant: had systematic origination and quality control problems; wrongly used temporary underwriters in violation of guidelines; incentivized staff to value quantity of loans over quality of the loans; and failed to self-report loans with findings of fraud or suspected fraud as required by program guidelines. On April 8, 2016, defendant agreed to pay the government $1.2 billion pursuant to a settlement.

Financial Sector FIRREA and FCA Jury Trial

Allied Home Mortgage Capital Corp. & Allied Home Mortgage Corp. (Nov. 20, 2016)

- On November 30, 2016, after a five-week trial in the Southern District of Texas, a jury found two related mortgage originators liable for violations of the FCA and FIRREA, and awarded single damages of more than $92 million. The mortgage companies allegedly originated mortgages at a network of "shadow" branches that were not approved by HUD, and therefore not subject to HUD oversight, resulting in unapproved FHA loans. The single-damages award could grow larger after statutory trebling and imposition of per-claim civil penalties.

Recent Developments: Financial Sector FCA Decisions

U.S. Supreme Court Vacates and Remands Second Circuit Decision Dismissing FCA Claims Against Financial Institution

***Bishop v. Wells Fargo & Co.*, 823 F.3d 35 (2d Cir. 2016), *vacated*, *Bishop v. Wells Fargo & Co.*, 137 S. Ct. 1067 (2017)**

- On May 5, 2016, the Second Circuit issued a decision in FCA case brought by former employees alleging bank falsely certified compliance with banking laws and regulations to borrow money at favorable rates from the Federal Reserve.
  - Institution allegedly certified that it "is not in violation of any laws or regulations in any respect which could have any adverse effect whatsoever upon the validity, performance or enforceability of any of the terms of the Lending Agreement."
- Second Circuit held that the general certification of compliance with "any laws or regulations" is "too broad to give rise to a claim under the FCA."
- On February 21, 2017, SCOTUS vacated and remanded the Second Circuit's decision "in light of" *Escobar*.
- On remand, DOJ filed an amicus brief contending that an express condition of payment is not required under the FCA. Rather, under *Escobar* "the FCA 'does not impose this limit on liability.'"

Post-*Escobar* – Materiality Cannot Be Found Where Noncompliance is Minor or Insubstantial

Grabcheski v. Am. Intl. Group, Inc.
No. 16-1516, 2017 WL 1381264 (2d Cir. 2017)

- Second Circuit affirmed dismissal of relator's FCA suit against a parent company that allegedly misrepresented its subsidiaries were duly licensed to conduct domestic insurance business in debt-reduction agreements with the Federal Reserve Bank of New York ("FRBNY")
- Relator alleged the subsidiaries were worth "at least $100 million less" than they appeared given their domestic insurance business and that FRBNY entered the agreements "to avoid a total financial panic and collapse."
- Second Circuit found relator failed to allege materiality (a material misrepresentation) with required particularity.
- Citing *Escobar,* court held that "even assuming arguendo that Grabcheski has sufficiently alleged knowing false . . . statement[s] . . . he has not plausibly pled that they were material." Specifically, "even assuming that Grabcheski's $100 million figure is backed by sufficient allegations, he has failed to allege with particularity facts that demonstrate how that difference in value—only 0.4%—was likely to have had any effect on the Agreements."
- Court noted *Escobar's* holding that "Materiality . . . cannot be found where noncompliance is minor or insubstantial."

Materiality Absent at Pleading Stage Where Government Knew of Alleged Fraud But Paid Anyway

U.S. ex rel. Kolchinsky v. Moody's Corp.
2017 WL 825478 (S.D.N.Y. Mar. 2, 2017)

- Judge Pauley of SDNY dismissed relator's FCA claims against Moody's alleging that the credit reporting agency engaged in manipulation of credit ratings.
- Court held relator failed to plead facts that give rise to inference that government was not aware of the agency's alleged fraud and failed to plead specific and materially false claims with the requisite particularity.

- Relator had alleged that the reporting agency provided ratings directly to subscribers (including government entities) in return for payments that were improperly deflated or inflated.

- In reaching its decision, court characterized relator's claims as being premised on implied legal falsity – that the reporting agency "promised . . . that the credit ratings it issues were accurate representations of the risk of the financial products they rated."
- Relying on *Escobar* the court held that "materiality is absent at the pleading stage" where, as here, "the relator's chronology suggests that the Government knew of the alleged fraud, yet paid the contractor anyway."

Relators Must Identify Specific False Claims or a Scheme that "Necessarily" Resulted in Submission of False Claims

U.S. ex rel. Szymoniak v. Am. Home Mortg. Servicing, Inc.
679 Fed. App'x 299, 301 (4th Cir. 2017)

- Fourth Circuit affirmed dismissal of claims against banks, mortgage-backed securities trustees and servicers for failure to sufficiently allege defendants engaged in an "elaborate scheme" to submit false claims.

- Relator alleged defendants violated the FCA by: "1) charging the government, as an investor in mortgage-backed-securities trusts containing fraudulent assignments, for trustee and custodial services; 2) selling to the government securities in mortgage-backed-securities trusts whose values were impaired due to missing or forged assignments; 3) using false assignments to apply for payments from [HUD] . . . ; and 4) charging the government for the filing of falsified documents when foreclosing on federally insured mortgages."

- The Fourth Circuit held that "the district court's thorough order properly applied *Nathan*'s rule requiring an FCA relator to identify specific false claims *or* allege a scheme that *necessarily* resulted in the submission of false claims."

Relators Must Have Direct Knowledge of Fraudulent Claims and Provide Government with Information That Materially Adds Value to Be "Original Source"

U.S. Hastings v. Wells Fargo Bank, NA, Inc.
656 Fed. App'x 328 (9th Cir. 2016)

- Court affirmed dismissal of relator's claims alleging lenders made false claims to the government about federal mortgage insurance because relator was not an "original source."
- 1986 Definition – someone who has "direct and independent knowledge of the information on which the allegations are based."
- 2010 Definition – someone who (1) "prior to a public disclosure … has voluntarily disclosed to the Government the information on which allegations or transactions in a claim are based," or (2) "has knowledge that is independent of and materially adds to the publicly disclosed allegations or transactions."
- 1986 Analysis – Relator's 1997 letters to HUD consisted of speculation rather than knowledge because these letters lacked any factual allegations of fraudulent claims. Relator's 2012 letter to HUD fails because relator's knowledge of the alleged fraud was not "direct" because relator "did not see the fraud with" his "own eyes"; rather he assembled a collection of internal lending guidelines, real estate postings by brokers and a list of allegedly fraudulent insurance claims.
- 2010 Analysis – The 1997 letters did not provide the government with "information" because they did not state that HUD's requirements would continue to be violated or whether banks would certify that loans complied with HUD requirements. Relator's 2012 letter did not materially add to what HUD already knew because it contained only background information and details but did not add value.

Prior Consent Order and Foreclosure Practices Review About Alleged Misconduct Triggered Public Disclosure Bar

U.S. ex rel. Advocates for Basic Legal Equal., Inc. v. U.S. Bank, N.A.
816 F.3d 428 (6th Cir. March 14, 2016)

- Sixth Circuit affirmed the dismissal of ABLE's FCA suit because the alleged fraudulent conduct had been previously publicly disclosed in both a consent order between U.S. Bank and the federal government and in a foreclosure practices review by three federal agencies.
- Additionally, court held ABLE is not an original source because ABLE did not provide "information that materially adds to the prior publically disclosed information."

- SCOTUS denied ABLE's petition for writ of certiorari on May 22, 2017.

Settlement Coverage Not Triggered Where Sufficient Notice to Insurers of Government FCA Settlement Offer Lacking

First Horizon Nat'l Corp. et al. v. Houston Casualty Co.
15-CV-2235-SHL-DKV, 2017 WL 2954716 (W.D. Tenn. June 23, 2017)

- Tennessee federal judge held that insurance carriers of First Tennessee bank do not have to cover part of the bank's $212.5 million 2015 FCA settlement because First Tennessee did not provide sufficient notice to insurers concerning the circumstances that led to the settlement.

- The 2015 settlement concerned claims that First Tennessee originated FHA-backed loans in violation of the FCA. In April 2014, the DOJ made an offer to settle the claims for $610 million. In May 2014, the bank sent a notice of circumstances ("NOC") to insurers stating it was cooperating with the DOJ investigation but did not mention the $610 million settlement offer.
- In June 2015, First Tennessee agreed to settle for $212.5 million. Prior to this settlement, the bank sued the insurers to provide insurance coverage for the deal.
- Insurers argued they did not have to cover the settlement because they received inadequate or untimely notice.

- Judge Lipman held that the bank's NOC did not provide sufficient notice: "To permit plaintiffs to rely on the NOC submitted in May 2014 as notice of the April 2014 claim defeats the policy behind a claims-made policy, wherein the purpose of the notice requirement is to inform the insurer of its exposure to coverage."
- Appeal to 6th Circuit filed by First Horizon on July 26, 2017.

Recent Developments: FCA Financial Sector Settlements

FHA Mortgage Insurance Program Settlements

- **PHH Corp. (August 8, 2017) - $75 Million**
- **Financial Freedom (May 16, 2017) - $89 Million**
- **United Shore Financial Services LLC (Dec. 28, 2016) - $48 Million**
- **Branch Banking & Trust Company (Sept. 29, 2016) - $83 Million**
- **Regions Bank (Sept. 13, 2016) - $52.4 Million**
- **Primary Residential Mortgage Inc. (Oct. 3, 2016) - $4.25 Million**
- **M&T Bank Corp. (May 13, 2016) - $64 Million**

Small Business Administration Loan Program Settlement

HSBC Bank PLC (April 13, 2017)

- An HSBC Bank PLC unit settled a FCA suit in the Southern District of New York for $2.1 million that alleged it knowingly sought reimbursement for loans made through the U.S. Small Business Administration ("SBA") loan program based on false information. Here, prosecutors alleged that an internal review demonstrated that HSBC discovered dozens of loans that were fraudulent because they were based on false information from borrowers but that HSBC nevertheless sought reimbursement from SBA after the loans defaulted without disclosing that the debt was based on false information.

Financial Institution Settlements

Estate and Trusts of Layton P. Stuart and One Bank & Trust N.A. (Oct. 16, 2016) - $4 Million

- The estate and trust of the former owner of One Financial Corporation and its subsidiary One Bank Trust N.A. agreed to pay $4 million to settle FCA allegations that the late owner knowingly made false statements about the financial condition of One Financial and its subsidiary to induce the Department of the Treasury to invest Troubled Asset Relief Program (TARP) funds into One Financial. It was further alleged that the company president made false statements about the intended use of the TARP funds.

Global Settlement (February 2, 2012) - $25 Million

- Bank of America, JPMorgan Chase, Wells Fargo, Citigroup and Ally Financial – the nation's five largest mortgage servicers – agreed to a $25 billion settlement with the government and attorneys general of 49 states plus the District of Columbia to settle claims regarding mortgage servicing and foreclosure abuses. The settlement included new homeowner protections.

FCA Compliance Best Practices

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Minimizing Exposure

- Set a compliance-focused "tone from the top"
- Adopt and implement reasonable compliance policies and controls
  - Standards and procedures, internal audits, external audits, compliance hotline
  - A strong internal compliance program may not prevent a rogue employee from committing fraud, but it may help to defeat scienter
- Train employees on compliance policies and reporting options
- Monitor and audit
- Investigate and remediate
  - Develop standards and procedures to prevent, detect, and respond to improper conduct

Risk Assessment

- Monitor government interactions
- Understand compliance requirements
- Account for internal quality control measures
- Evaluate business partners
- Have strong HR system in place – most whistleblowers are aggrieved/disgruntled former employees
- Document the government's knowledge, awareness, and ratification of contractual and programmatic deviations
- Take care in responding to billing inquiries as incorrect explanations may be used as evidence of fraud
- Documentation and transparency are key

Investigation Responsiveness

- Critical to know of FCA complaints as soon as possible
- Foster an environment in which employees and other interested parties report concerns internally
- Separate the message from the messenger, take allegations seriously and follow up
- *Qui tam* warning signs
  - HR issues;
  - Exit interview statements;
  - Unexpected audits;
  - Requests for billing explanations;
  - Increased web activity; and
  - Former employees contacted

- Proactively engage with and present your case to DOJ and USAO
- The most critical juncture is the government's intervention decision

Gibson Dunn FCA Summer Webcast Series

- This has been one in a series of webcasts on the FCA and various industry sectors in which our clients and friends have an interest.
  - FCA and Education Sector (July 26)
  - FCA and Drug & Device Industry (August 2)
  - FCA and Government Contracting (August 9)
  - **FCA and Financial Services Sector (August 23)**
  - FCA and Health Care Providers (August 30)
- The series is available at http://www.gibsondunn.com/publications/pages/webcasts.aspx
- If you have any unanswered questions, please feel free to contact any one of us at:
  - Joseph Warin (202.887.3609, fwarin@gibsondunn.com)
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