The Fraud Enforcement and Recovery Act of 2009: Legislative changes and new challenges

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On May 20, 2009, President Obama signed into law the Fraud Enforcement and Recovery Act of 2009 (FERA). Despite the new political structure on Capitol Hill, FERA crossed party lines and was generously supported by both divisions of the legislative branch, with a Senate affirmative vote of 92-4 at the end of April and a House approval vote of 338-52 one week later. The Senate sponsored the bill in order to strengthen the federal government's capacity to investigate and prosecute various types of fraud related to federal assistance and relief programs, including mortgage fraud, securities and commodities fraud, and financial institution fraud. FERA's enactment has substantially increased the government's power to regulate fraudulent activity by expanding the scope of liability under various criminal statutes and by enacting new amendments to the federal False Claims Act (FCA).[1]

Overview of FERA

At its essence, FERA is intended to combat various forms of financial fraud. One of the most significant changes FERA creates is the authorization of increased funding for federal financial fraud enforcement. As part of a larger mortgage fraud legislation that expands the reach of the criminal mortgage fraud and money-laundering statutes, FERA appropriates and allocates new funding in excess of $500 million over the next two years to aid federal law enforcement, the US Securities and Exchange Commission, and the US Department of Justice in investigating and prosecuting fraud cases.[2] President Obama supported FERA and signed the bill into law two weeks after it passed in Congress, and less than four months after the bill was first introduced. The President justified this budget increase, claiming that the additional funding will help governmental programs identify fraudulent activity and protect the innocent Americans who could be affected.

FERA also amends sections of the United States Criminal Code related to fraud against the government by amplifying the number of individuals and companies who can be held accountable for fraudulent activity. For example, Section 2 of FERA alters the term "financial institution" in the Criminal Code (18 U.S.C. § 20) to now include a mortgage lending business of any person or entity that makes, in whole or in part, a federally-related mortgage loan. FERA also amends the false statements in mortgage applications statute (18 U.S.C. § 1014), the


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major fraud statute (18 U.S.C. § 1031), the federal securities statute (18 U.S.C. § 1348), and the federal money laundering statutes (18 U.S.C. §§ 1956, 1957). The effect of these amendments will most likely be an increase in fraud prosecutions under these laws.

One of the most significant changes imposed by FERA are the amendments to FCA, a civil fraud statute that imposes civil penalties of $5,500 to $11,000 per claim, plus three times the amount of damages inflicted on the government. Among other important changes (discussed in more detail below), the scope of liability under the FCA is extended (1) from persons who make a false statement or claim, to virtually any recipient of federal funds, and (2) to anyone who knowingly and improperly retains a government overpayment, regardless of whether the entity used a false statement or claim to do so.

Specific changes to the FCA

FERA makes a number of significant changes to the FCA. Its FCA amendments are designed to increase the reach of the FCA and to protect the whistleblowers who bring FCA actions against companies, including:

Applicability of FCA to subcontractors

FERA revises former FCA Sections 3729(a)(1) and (a)(2) in order to respond to certain case law and expand the applicability of the FCA. In former Section 3729(a)(1) [now Section 3729(a)(1)(A)], FERA modified the FCA to remove the requirement that a false or fraudulent claim be presented "to an officer or employee of the United States Government or a member of the Armed Forces of the United States." FERA also modifies the definition of "claim" to include a request or demand "for money or property and whether or not the United States has title to the money or property" to either "an officer, employee, or agent of the United States" or "a contractor, grantee, or other recipient, if the money or property is to be spent or used on the Government's behalf or to advance a Government program or interest…." The effect of these changes (and the changes discussed below) is to include within the purview of the FCA those subcontractors that present claims, statements, or records to contractors but do not directly submit such claims, statements or records to the government.

FERA also makes three changes to former Section 3729(a)(2) [now Section 3729(a)(1)(B)]. The first change is the removal of the phrase "to get" from that subsection, which repudiates certain FCA case law that held that the phrase "to get" imposed a supplemental intent requirement. The second change increases the potential for liability by replacing the phrase "paid or approved by the government" with "claim." As discussed above, the revised definition of "claim" reinforces the fact that the fraudulent claim need not be made directly to the government, but can now be made to any recipient of government funding, as long as the money is used on the government's behalf or to advance a government interest. Lastly, FERA adds a materiality requirement (i.e., the false record or statement must be material to a false of fraudulent claim).

In explaining its rationale for amending these provisions, Congress noted that the amendments were in response to "erroneous interpretations of the law"[3] apparent in cases such as *U.S. ex rel Totten v. Bombardier* and *Allison Engine Co. v. U.S. ex rel Sanders*. These cases limited the reach of the FCA and reduced the scope of the government's authority to apply the FCA to subcontractors who did not directly submit claims to the government.

In *Totten*, a former employee of National Railroad Passenger Corporation (Amtrak) filed suit under the FCA against certain Amtrak contractors, alleging that the contractors had supplied parts to Amtrak that did not meet contractual specifications.[4] The Court affirmed the lower court's dismissal of the claim, noting that the "presentment clause" of the FCA was not satisfied because the contractors submitted their invoices to Amtrak (a government grantee) and not directly to "an officer or employee of the United States Government."

Four years later, in *Allison Engine*, the Supreme Court emphasized the intent requirement implied in former Sections 3729(a)(2) and (a)(3) of the FCA.[5] In *Allison Engine*, the US Navy had contracted with two shipbuilders to build destroyers. The shipbuilders in turn contracted with Allison Engine Company, which entered into subcontracts with two companies to assist in the assembly of generators for the destroyers. Former employees of one of the

subcontractors filed suit under the FCA, alleging that Allison Engine Company and the subcontractors had knowingly submitted invoices for work that did not meet the Navy's requirements, and that Allison Engine Company and the subcontractors had issued false certificates of compliance with those specifications. The Supreme Court held that the FCA's phrase "to get" in former Section 3729(a)(2) (i.e., "[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") required an intent to make a false statement that is material to the government's decision to pay a false claim. Therefore, the relators would have to prove that the false claims were made with the intent of encouraging the government to pay or approve payment of a false or fraudulent claim, as opposed to simply defrauding a contractor. The Supreme Court interpreted former Section 3729(a)(3) as having a similar intent requirement.

In the legislative history of FERA, Congress expressed that *Totten* and *Allison Engine* were contrary to the congressional intent of the FCA, because the holdings exempted subcontractors who knowingly

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submitted false claims to general contractors who were then paid with government funds. Noting the need for change, Congress drafted the FCA amendments; thus significantly narrowing, if not overruling, the related case law and increasing the scope of federal power. As a result of these changes, subcontractors and other entities who do business with recipients of federal funds now have increased exposure under the FCA.

"Reverse" False Claims

The FCA amendments clarify that entities that improperly retain overpayments from the government (referred to as "reverse" false claims) are liable under the FCA as well. Former Section 3729(a)(7) required that a false record or statement be used to "conceal, avoid, or decrease an obligation to pay or transmit money or property to the Government" for FCA liability to attach. Section 3729(a)(7) has been replaced by Section 3729(a)(1)(G), which imposes liability if a false record or statement is "material to an obligation to pay or transmit money or property to the Government" or if a person "knowingly conceals or knowingly and improperly avoids or decreases an obligation to pay or transmit money or property to the Government." Although "improperly" is not defined, the FCA amendments add the following definition of "obligation" in Section 3729(b)(3): "an established duty, whether or not fixed, arising from an express or implied contractual, grantor-grantee, or licensor-licensee relationship, from a fee-based or similar relationship, from statute or regulation, or from the retention of any overpayment...."

Under the revised Section 3729(a)(1)(G), FCA liability can exist even when there is no false claim, record, or statement submitted to the government (or a government contractor or grantee). As Congress discussed in its Senate Report, "the violation of the FCA for receiving an overpayment may occur once an overpayment is knowingly and improperly retained, without notice to the Government about the overpayment."[6]

Revised Section 3729(a)(1)(G) should be of particular interest to health care providers, because the retention of Medicare overpayments by providers could, depending on the facts, be viewed as actionable under the FCA, if done knowingly and otherwise in violation of the FCA. However, the Senate Report issued in connection with FERA clarifies that retentions of overpayments that are permitted by regulatory or statutory processes for reconciliation do not violate the FCA, provided that any such retention is not based on any willful act of the recipient to increase its payments from the government when the recipient is not entitled to such increase.[7]

Materiality standards

The FCA amendments attempt to resolve a split in case law by inserting a materiality requirement into two provisions of the FCA [Section 3729(a)(1)(B) and Section 3729(a)(1)(G)]. In each of those sections, a person must submit a false record or statement that is material to the claim or obligation. However, the FCA amendments broadly define "material" as "having a natural tendency to influence, or be capable or influencing, the payment or receipt of money or property." Thus, this materiality requirement may not offer defendants as much protection as they would have expected under certain customary materiality standards.

Expansion of Retaliation Protection

FERA amended the FCA to protect agents and contractors, in addition to employees, from retaliatory actions in the event they bring an action to stop FCA violations. As a result, contractors and agents now are entitled to reinstatement with the same seniority status as they would have had, but for any discrimination due to their FCA action, two times the amount of back pay, interest on the back pay, and compensation for any special damages sustained as a result of the discrimination, including litigation costs and reasonable attorneys' fees.

Relation-back for government complaints

FERA added Section 3731(c) to the FCA, which provides that if the government intervenes in an FCA lawsuit and files its own complaint or amends the complaint of a whistleblower, the government's pleading will "relate back" for statute of limitations purposes to the original filing date of the complaint of the person who originally filed the action. However, the government's complaint must arise out of the conduct or transactions that were set forth in the original complaint. Section 3731(c) may eliminate certain statute-of-limitation arguments that existed under prior law.

Conclusion

Given the amount of federal funds being infused into the United States' economy, it is not surprising that the government is focused on combating various forms of financial fraud. FERA represents a targeted effort on the part of the government to deter fraud and to hold liable those individuals who are responsible for committing fraud. As discussed above, FERA's amendments to the FCA significantly expand the types of individuals and entities who may be subject to the FCA. In particular, subcontractors and grantees in industries that receive federal funds (e.g., transportation, energy, defense, healthcare, and environmental industries) will certainly want to be mindful of the FCA's changes and the legislative intent to overturn relevant case law.

Because the FCA amendments may lead to an increase in FCA enforcement activity, compliance officers and compliance committees should take several proactive steps to avoid unnecessary liability, including:

1. Communicating the changes and the relevant impact to the organization's board and management and ensuring that the organization has the appropriate staffing and structure to respond to these new risks;
2. Examining policies and procedures relevant to the changes (e.g., reporting policies, billing policies, HR policies);
3. Providing training to relevant employees, which would include how to respond to allegations of misconduct;
4. Investigating all allegations of misconduct and establishing a process of triaging the allegations in order to conduct the appropriate level of investigation;
5. Evaluating the effectiveness of the hotline system;
6. Monitoring financial relationships with government payments, contractors and subcontractors; and
7. Monitoring the overall effectiveness of the organization's compliance program on a bi-annual basis. ■

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1 31 U.S.C. §§ 3729-3733
2 Foley & Lardner LLP Legal News Alert, May 20, 2009.
3 Fraud Enforcement and Recovery Act, Senate Report 111-10, Section 4, 111th Congress, 1st Sess., at 10. March 23, 2009.
4 U.S. ex rel Totten v. Bombardier, 380 F.3d 488 (2004).
5 Allison Engine Co. v. U.S. ex rel Sanders, 128 S. Ct. 2123 (2008).
6 See fn. 4, at 15.
7 Id.