U.S. Department of Justice

Office of Legislative Affairs

Office of the Assistant Attorney General

Washington, D.C. 20530

April 1, 2009

The Honorable Patrick J. Leahy
Chairman
Committee on the Judiciary
United States Senate
Washington, DC 20510

Dear Mr. Chairman:

This presents the views of the Department of Justice (the Department) on S. 386, the "Fraud Enforcement and Recovery Act of 2009" (FERA), as recently reported by the Judiciary Committee.

The Department strongly supports enactment of FERA. The provisions of the legislation would provide federal investigators and prosecutors with significant new tools and resources, both civil and criminal, with which to combat mortgage fraud, securities and commodities fraud and related offenses. For example, the legislation would amend the definition of "financial institution" to include "mortgage lending business" in Title 18, United States Code. This new definition would ensure that private mortgage companies are covered under federal financial institution fraud laws.

The legislation would also expand the prohibition regarding false statements to financial institutions under of 18 U.S.C. § 1014 to cover false statements made to mortgage lending businesses. Currently, section 1014 applies only to federal agencies, banks, and credit associations and does not extend to private mortgage lending businesses. This new provision would ensure that private mortgage companies are fully covered under this federal fraud provision by providing prosecutors with an important tool to charge those who make false applications and appraisals.

In addition, section 2(g) of the legislation would add 26 U.S.C. § 7201 and 26 U.S.C. § 7206(1) as specified unlawful activities to 18 U.S.C. § 1956(a)(2)(A) (involving the transporting or transmitting of monetary instruments or funds with intent to promote the carrying on of specified unlawful activity). Such an addition would give the Department a very useful weapon in addressing a number of tax and fraud schemes. Increasingly, individuals who illegally obtain a variety of "proceeds" sequester these funds offshore. More often than not, these funds are not properly reported to the Internal Revenue Service (IRS). This includes individuals who "skim" profits from otherwise legitimate business, which are not reported to the IRS, and are forwarded to known terrorist operations overseas. This provision would greatly assist us in prosecuting these individuals.

Section 4 of S. 386 would amend the False Claims Act (FCA), which is one of the Department's most effective tools for deterring and redressing fraud on the Treasury. The Department supports the Senate's goal of ensuring that the FCA remains a potent weapon against the misuse of taxpayer funds.

In 1986, Congress amended the FCA to strengthen its provisions, and to reinvigorate the public-private partnership envisioned by the Act. Since then, the Department's recoveries have increased exponentially. Working with U.S. Attorneys' Offices, other Government agencies, and private citizens, the Department has recovered more than $1 billion in eight of the last nine years, and more than $22 billion since 1986. The Department's recent recoveries include several settlements and judgments with entities that sought to defraud HUD's housing and mortgage insurance programs.

Despite these successes, the Department's experience demonstrates that attempts to defraud the Government remain manifest, and that no government agency or program is immune from this threat. The passage of the American Recovery and Reinvestment Act of 2009 presents new opportunities for unscrupulous persons to divert funds that Congress has dedicated to help restore our Nation's economy. At the same time, due to several court decisions that have unduly narrowed the FCA's liability provisions, the Department will face additional challenges in safeguarding these and other taxpayer funds from those who would abuse them.

For these reasons, the changes to the FCA proposed in section 4 are both necessary and timely. These changes include language clarifying that neither proof of presentment to a U.S. official nor ownership by the federal government of the relevant funds is required. The legislation would also supersede the United States Supreme Court's recent decision in *Allison Engine Co. v. United States ex rel. Sanders*, ___ U.S. ___, 128 S. Ct. 2123 (2008), and expand the scope of the reverse false claim provision. The Department welcomes these changes, with several refinements.

The Department's more specific comments and recommendations concerning the proposed amendments to the FCA (and an unrelated budget matter) are set forth in the attached Appendix as is a technical amendment related to the authorization language contained in the bill.

If we may be of additional assistance, we trust that you will not hesitate to call upon us. The Office of Management and Budget has advised that there is no objection from the standpoint of the Administration's program to the presentation of this letter.

Sincerely,

M. Faith Burton

M. Faith Burton
Acting Assistant Attorney General

cc: The Honorable Arlen Specter
Ranking Minority Member

APPENDIX

Section 4 of S. 386 seeks to amend section 3729 of the False Claims Act (FCA), which sets forth the FCA's substantive liability provisions. The Department's specific comments on these amendments (and an unrelated budget matter) are set forth below.

False Claims Act Amendments

1. Presentment and Federal Funds

Section 4 proposes changes to supercede the primary holdings in *U.S. ex rel. DRC v. Custer Battles*, 376 F.Supp.2d 617 (E.D. Va. 2005), *appeal filed*, No. 07-1220 (4th Cir.), and *U.S. ex rel. Totten v. Bombardier Corp.*, 380 F.3d 488 (D.C. Cir. 2004). In *Custer Battles*, the United States District Court for the Eastern District of Virginia held that the FCA encompasses only claims for federal funds, and that false claims paid from the Development Fund for Iraq (DFI funds) did not give rise to FCA liability because DFI funds were not federal funds.

In *Totten*, the United States Court of Appeals for the District of Columbia Circuit held that paragraphs 3729(a)(1) and (a)(2) of the FCA require that a false claim be presented to an official of the United States, and not just a recipient of federal funds. The Supreme Court's decision in *Allison Engine Co. v. United States ex rel. Sanders*, ___ U.S. ___, 128 S. Ct. 2123 (2008), subsequently suggested that presentment to a U.S. official is not required under paragraphs 3729(a)(2) and (a)(3), but is required under paragraph 3729(a)(l).

The Department has argued against the interpretations of the FCA adopted by *Totten* and *Custer Battles*. The Department therefore supports the modifications designed to overrule these decisions, which include eliminating the reference to presentment in proposed subparagraph 3729(a)(1)(A), and revising the definition of a "claim." These changes will ensure that the FCA reaches all attempts to defraud the Government, whether the defendants do so directly or indirectly, and whether they seek funds owned or just administered by the Government. At the same time, by limiting a claim to a request for money or property that is either "presented to an officer, employee, or agent of the United States" or that is "to be spent or used on the Government's behalf or to advance a Government program or interest", the bill ensures that the FCA will not reach fraud involving purely private parties. The bill therefore strikes a proper balance, by broadly prohibiting efforts to defraud the public fisc, while simultaneously excluding private transactions that do not impact the Government or taxpayer funds.

2. *Allison Engine*

In addition to correcting the holdings in *Custer Battles* and *Totten*, section 4 redresses the intent requirement imposed by the Supreme Court in *Allison Engine*, 128 S. Ct. 2123. Although the Supreme Court held that paragraph 3729(a)(2) of the FCA does not require presentment, it held that this provision requires proof that the defendant "intended that the false record or statement be material" to the Government's payment decision. 128 S. Ct. at 2128. The Supreme Court read a similar intent requirement into paragraph 3729(a)(3). *Id.* at 2130-31.

In the limited time since *Allison Engine* was decided, defendants have invoked it as a defense to allegations of fraud on the Medicare and Medicaid programs, as well as a wide array of other Government programs that have historically received FCA protection, and a district court has relied on the decision to dismiss a case brought by the government for fraud on the federal crop insurance program. *United States* v. *Russell T. Hawley, et al.*, No. C 06-4087-MWB (N.D. Iowa), appeal filed, No. 08-2992 (8^{th} Cir.). Moreover, defendants have attempted to extend the rationale of *Allison Engine* to other provisions of the FCA that were not even addressed in the decision. The fact that the Supreme Court imposed an intent requirement in a classic case of fraud on the Treasury - a subcontractor alleged to have supplied defective parts for use in naval vessels - demonstrates the problems with this decision, and the appropriateness of a legislative response.

The Department therefore supports the changes proposed by Section 4 to eliminate any intent requirement. These changes include removing the language that the Supreme Court, and defendants, have relied upon to read such a requirement into the act, and revising proposed paragraphs 3729(a)(1)(B) and 3729(a)(1)(G) to require only a "material" connection between the defendant's use of a false statement or record, and the submission of an affirmative or reverse false claim. Section 4 also defines the term "material" to mean "having a natural tendency to influence, or be capable of influencing, the payment or receipt of money or property."

In addition, the Department recommends adding a separate provision at the end of subsection 3729(a) clarifying that liability does not require proof of the defendant's intent or purpose in submitting an affirmative or reverse false claim. In particular, the Department suggests inserting the following as a new paragraph 3729(a)(4):

> (4) PROOF OF INTENT OR PURPOSE NOT REQUIRED. – No proof shall be required that a defendant had (I) the intent or purpose of getting a false or fraudulent claim paid or approved by the Government, or the intent or purpose that a false record or statement be material to the Government's decision to pay or approve a claim, or (ii) the intent or purpose to conceal, or improperly avoid or decrease, an obligation to pay or transmit money or property to the Government, or the intent or purpose that a false statement or record conceal, avoid or decrease an obligation to pay or transmit money or property to the Government.

Along with the changes discussed above, this clarification will restore Congress' original intent that a knowing or reckless attempt to defraud the Government is sufficient to establish liability under the FCA, and that no additional proof of intent or purpose is necessary.

3. <u>Conspiracy</u>

Section 4 modifies the FCA's current conspiracy provision to impose liability on any person who conspires to violate any of the other substantive liability provisions. This change would be a useful correction to the rulings of several courts that the current FCA conspiracy provision does not encompass a conspiracy to submit a reverse false claim.

4. Failing to Deliver Money or Property

Section 4 revises paragraph 3729(a)(4) of the FCA, which imposes liability for failing to deliver money or property to the Government. The proposed legislation eliminates the reference to a "certificate or receipt", which has unduly restricted the application of this provision. Additionally, by removing the reference to intent and requiring a showing only that the defendant acted "knowingly", the bill will make paragraph 3729(a)(4) more consistent with the FCA's other liability provisions.

5. Reverse False Claims

Section 4 amends the FCA's reverse false claim provision to impose liability on one who "knowingly conceals or knowingly and improperly avoids or decreases" an obligation, and adds a definition of the term "obligation". The Department supports these changes with the refinements recommended below.

While the FCA's affirmative false claim provisions currently impose liability even in the absence of any false statement or record, there is no analogue in the reverse false claim context. Section 4 would remedy this asymmetry by imposing reverse false claim liability without any additional requirement of a false statement or record. Additionally, the new definition of obligation seeks to correct those cases that unduly narrowed the reverse false claim provision by holding or suggesting that the term obligation encompasses only a duty to pay that is fixed in all particulars, including the specific amount owed. *See, e.g., American Textile Mfrs. Inst. v. The Limited, Inc.*, 190 F.3d 729 (6th Cir. 1999); *United States v. Q International Courier, Inc.*, 131 F.3d 770 (8th Cir. 1997).

Although the Department supports the Committee's efforts to revise and clarify the scope of reverse false claim liability, the Department recommends a technical change to proposed subparagraph 3729(a)(1)(G). In this provision, commas should be placed around the phrase "or knowingly and improperly avoids or decreases" to clarify that the words "knowingly and improperly" modify both "avoids" and "decreases".

The Department also recommends several refinements to the definition of "obligation" proposed in paragraph 3729(b)(3). First, to ensure that this provision reaches only a party's wrongful attempts to minimize the party's obligations to the Government, the Department recommends replacing the phrase "a fixed duty, or a contingent duty" with the phrase "an established duty, whether or not fixed". Second, because an established duty may be created by regulation as well as statute, the Department suggests inserting the term "regulatory" after the term "statutory". Third, to correct an error in syntax, the Department proposes striking from the end of the definition the phrase "and the retention of any overpayment" and replacing it with the phrase "or arising from the receipt of an overpayment". Thus, incorporating these recommendations, the definition of "obligation" in proposed paragraph 3729(b)(3) would read:

> (3) the term 'obligation' means an established duty, whether or not fixed, arising from an express or implied contractual, quasi-contractual, grantor-grantee,

licensor-licensee, statutory, regulatory, fee-based, or similar relationship, or arising from the receipt of an overpayment;

6. Effective Date

Section 4 provides that "the amendments made by this section shall take effect on the date of enactment of this Act and shall apply to conduct on or after the date of enactment, except that subparagraph (B) of section 3729(a)(1) of title 31, United States Code, as added by subsection (a)(1), shall take effect as if enacted on June 7, 2008, and apply to all claims under the False Claims Act (31 U.S.C. 3729 et seq.) that are pending on or after that date." Since the *Allison Engine* decision was issued on June 9, 2008, the apparent objective of this provision is to make the changes in subparagraph (B) that redress that decision effective prior to that decision. Since some of the changes to subparagraphs (C) and (G) of proposed section 3729(a)(1) are also designed to correct for the *Allison Engine* ruling, the Senate may wish to consider expressly making the effective date of those subparagraphs the same as subparagraph (B).

A change in the law is presumed to be prospective unless there is "clear congressional intent" to the contrary. *Landgraf v. USI Film Products*, 511 U.S. 244, 280 (1994). If Congress expressly provides for a change to be applied prior to the date of the change, Congress' decision is subject to review under the due process clause. *Pension Benefit Guaranty Corporation v. R.A. Gray & Co.*, 467 U.S. 717, 730 (1984). But that burden is met simply by showing that Congress' decision is justified by a "rational legislative purpose." *Id.*

For the reasons previously discussed, the *Allison Engine* ruling has the potential to remove FCA coverage for federal programs and benefits that have traditionally received protection under the Act and, at a minimum, to impose a substantial burden on the Government's fraud related resources. As a result, in the Department's view, the Senate has a rational basis for making all changes redressing that decision – including the changes in subparagraphs (C) and (G) – applicable to cases pending prior to that decision. These subparagraphs also include changes correcting issues other than those presented by the *Allison Engine* decision. However, these other changes also serve the important purpose of protecting the public fisc, and are inextricably intertwined with the bill's *Allison Engine* fixes. Accordingly, the Department does not believe that making June 7, 2008, the effective date of subparagraphs (C) and (G) – in addition to subparagraph (B) – would raise any due process concerns.

Technical Authorization-Related Issue

We note a potential technical problem with section 3(a) of the legislation. In particular, section 3(a) would authorize appropriations to the Attorney General totaling $165 million for each of Fiscal Years (FY) 2010 and 2011. Paragraph (2) of subsection (a) would allocate these funds, as follows: $75 million for the FBI for FY 2010 and $65 million for FY 2011; $50 million for the United States Attorneys Offices; $20 million for the Criminal Division; $15 million for the Civil Division; and $5 million for the Tax Division. If the $10 million reduction in the authorization level for the FBI for FY 2011 is intended, then the overall authorization level for that year would be $155 million, not $165 million, and an appropriate amendment would need to be made. In addition, it would be helpful if the language allocating funds for the other offices and divisions of the Department were amended to make it clear that the specified funding levels are for "each of fiscal years 2010 and 2011." It might also be desirable to include additional authorizing language in section 3 to ensure that this important program extends beyond the expiration of FY 2011.