

**TARP Oversight Agency Promises Vigorous Civil and Criminal Enforcement,
Raising Risk of False Claims Act Liability for Claimants of Federal “Bailout” Funds**

February 10, 2009

On December 22, 2008, Morgan Lewis released a Litigation LawFlash discussing the risk of False Claims Act (FCA) liability for claimants of federal “bailout” funds under the recently enacted Emergency Economic Stabilization Act of 2008 (EESA). That LawFlash discussed the recent congressional efforts spearheaded by Senator Chuck Grassley (R-Iowa), ranking member of the Senate Committee on Finance, urging the U.S. Department of Justice (DOJ) to use the FCA to prosecute entities who use false or fraudulent submissions to obtain federal “bailout” funds through the Troubled Assets Relief Program (TARP) or the Capital Purchase Program (CPP), and strongly encouraging whistleblowers to report any fraud with respect to such funds.

Although Senator Grassley had suggested several potential situations that may be actionable under the FCA, it was unclear how the FCA would apply to recipients of “bailout” funds because there were no explicit rules, conditions, or restrictions on a recipient’s use of TARP funds at that time. However, in its February 6, 2009 Initial Report to the U.S. Congress, the Office of the Special Inspector General for the Troubled Assets Relief Program (SIGTARP) stated its intention not only to impose conditions on future recipients of TARP funds, but also to seek information and require certifications concerning the use of TARP funds by prior recipients. The U.S. Department of the Treasury also recently issued an Interim Rule requiring recipients of TARP funds to disclose and mitigate any organizational and personal conflicts of interest that may impair the proper administration and execution of TARP. Both of these developments may increase the risk of FCA liability and the propensity of qui tam actions for recipients of TARP funds.

I. SIGTARP’s Audit and Enforcement of Recipients’ Use of TARP Funds

Responding to the acknowledged shortcomings in SIGTARP’s oversight of recipients’ use of TARP funds, noted in Special Inspector General Neil M. Barofsky’s January 22, 2009 letter to Sen. Grassley, SIGTARP rededicated itself in its February 6, 2009 Initial Report to increasing the transparency of its operations and assuring the American taxpayer that TARP dollars are being spent wisely. In order to secure greater oversight and transparency, SIGTARP has undertaken two courses of action.

First, SIGTARP has initiated a “Use of Funds Project” geared at collecting information from previous recipients of TARP funds regarding their use of such funds. SIGTARP is preparing requests to each

such entity, asking them to provide, within 30 days of the request:

- A narrative response outlining their use or expected use of TARP funds
- Copies of pertinent supporting documentation (financial or otherwise) to support such response
- A description of their plans for complying with applicable executive compensation restrictions
- A certification by a duly authorized senior executive officer of each company as to the accuracy of all statements, representations, and supporting information provided.

As of the date of its Initial Report, SIGTARP was still in the process of seeking approval from the Office of Management and Budget for these requests and anticipates sending requests to TARP recipients soon.

Second, SIGTARP intends to implement the following changes in the way it drafts agreements in future transactions:

- The program participant should acknowledge explicitly the jurisdiction and authority of SIGTARP and other oversight bodies, as relevant, to oversee compliance with the conditions contained in the agreement in question.
- For each condition imposed, the participant should be required to (1) establish internal controls with respect to that condition, (2) report periodically to the Office of Financial Stability-Compliance (OFS-Compliance) regarding the implementation of those controls and its compliance with the condition, and (3) provide a signed certification from an appropriate senior official to OFS-Compliance that such report is accurate.
- In addition, the participant should be required to use best efforts to account for the use of TARP funds, to set up internal controls to comply with such accounting, and to report periodically to OFS-Compliance on the results, with appropriate certification, in the manner discussed above.

SIGTARP also committed itself “to robust criminal and civil enforcement against those . . . who waste, steal, or abuse TARP funds.” SIGTARP promised to use its own audit and investigative resources and to partner with other relevant law enforcement agencies, including the DOJ, to prevent, detect, and investigate cases of fraud, waste, and abuse of TARP funds and programs. “Those who make intentional misrepresentations in the TARP application process or in their financial reporting to the U.S. Department of the Treasury may violate several criminal statutes, including securities fraud, wire fraud, mail fraud, and false statements.” SIGTARP’s scrutiny of potential recipients’ representations in the application process and compliance with financial reporting and certification requirements may create potential FCA issues for recipients of TARP funds.

II. TARP Conflicts of Interest and Mandatory Disclosure Requirements

The Treasury Department issued an Interim Rule on January 21, 2009 with respect to organizational and personal conflicts of interest, which also raises the specter of FCA liability for entities receiving or seeking bailout funds under TARP, so-called “retained entities.” Treasury and SIGTARP clearly recognized that actual or potential conflicts of interest may exist at an organizational level or pertain to individual employees that may negatively impact the procurement and administration of TARP

funds. While the comment period for the Interim Rule extends through March 23, 2009, the Interim Rule took effect immediately.

Under the Interim Rule, a retained entity is precluded from permitting an organizational conflict of interest unless it discloses and mitigates the conflict under a plan approved by Treasury or Treasury waives the conflict. Retained entities are thus required to “maintain a compliance program designed to detect and prevent violations of federal securities laws and organizational conflicts of interest” regarding “arrangements for the acquisition, valuation, management, or disposition of troubled assets.”

In this regard, retained entities are required to “provide Treasury with sufficient information to evaluate any organizational conflicts of interest,” including (1) the retained entity’s relationship to any related entities; (2) the categories of troubled assets owned or controlled by the retained entity and its related entities; (3) other business or financial interests of the retained entity, its proposed subcontractors, or its related entities, which could conflict with the retained entity’s obligations; and (4) a description of all existing and potential organizational conflicts of interest. Retained entities similarly must ensure that all management officials and key individuals “performing work under the arrangement” do not have non-mitigated or non-waived personal conflicts of interest, and must submit similar detailed information regarding “their personal, business, and financial relationships.”

Both organizational and personal conflict of interest obligations require initial and periodic certification by the retained entity that this information is complete and accurate in all material respects, and require subsequent notification of any potential conflicts of interest that may arise. The Interim Rule further requires a retained entity to disclose any credible evidence that it or one of its management officials, employees, or contractors “has committed a violation of federal criminal law involving fraud, conflict of interest, bribery, or gratuity violations,” including violations of the FCA. The Interim Rule allows for joint enforcement of these conflict-of-interest disclosures with the DOJ.

These disclosures and their associated compliance programs may increase the possibility of FCA prosecution and qui tam actions. The close congressional and public scrutiny of the financial bailout coupled with increased emphasis on FCA enforcement against financial institutions highlights the need for TARP participants to be aware of the scope of the FCA.

Senator Grassley’s November 17, 2008 letter can be read in full at http://www.grassley.senate.gov/news/Article.cfm?customel_dataPageID_1502=18128

Special Inspector General Barofsky’s January 22, 2009 letter can be read in full at <http://grassley.senate.gov/private/upload/Letter-from-Special-IG-Neil-M-Barofsky-to-Senator-Chuck-Grassley.pdf>

The Office of the Special Inspector General for the Troubled Assets Relief Program’s February 6, 2009 Initial Report to the United States Congress can be read in full at http://www.sig tarp.gov/reports/congress/2009/SIGTARP_Initial_Report_to_the_Congress.pdf

The TARP Conflicts of Interest Interim Rule (Jan. 21, 2009), 74 Fed. Reg. 3431, 31 C.F.R. pt. 31 can be read in full at <http://edocket.access.gpo.gov/2009/pdf/E9-1179.pdf>

