GOVERNMENT ACCOUTABILITY PROJECT

Banking Sector Accountability: Understanding and Handling the Complex "SOX Plus One" Whistleblower Claim

September 18, 2013

Washington, DC

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I. INTRODUCTION: CONTEMPORARY BANKING/MORTGAGE WHISTLEBLOWER ALLEGATIONS

The 2008 Wall Street meltdown may be over, but new cases are still being presented by whistleblowers to the Government Accountability Project (GAP) and regulators not only about 2008 era misconduct, but about current fraud and misrepresentation by banks as to the reliability and effectiveness of their remedial efforts and regulatory compliance since 2008. Below are several examples of the misleading statements made by the banks engaged in the mortgage business that been made by whistleblowers to GAP in recent months.

- Banks are issuing misleading statements regarding their progress in complying with regulatory consent orders: These banks have submitted comprehensive action plans to regulators, which set forth the steps necessary to ensure the bank's residential mortgage servicing, forcelosure and loss-mitigation activities are conducted in accordance with the requirements of consent and regulatory orders. The plans were approved by the government, and the bank has claimed to have implemented a number of corrective actions and made significant progress with remediation. This remediation may include claims that the bank has (1) enhanced its approach to oversight over third-party contractors for foreclosure or other related functions; (b) strengthened its compliance program so as to ensure mortgage-servicing and foreclosure operations, including loss-mitigation and loan modification, comply with all applicable legal requirements; (c) developed a comprehensive assessment of risks in servicing operations including, but not limited to, operational, transaction, legal and reputational risks; and (d) deployed an internal validation process to monitor progress under the comprehensive action plans. In sum, banks are claiming compliance with regulatory directives to r to enhance oversight of its mortgage servicing activities, including oversight by compliance, management and audit personnel and changes in its organization structure, control oversight and customer service practices.

- Banks have issued misleading statements to the regulators and in their SEC filings regarding their intentions and efforts to comply with the National Mortgage Settlement. For example, these banks will have reported that they settled with the U.S. government and state attorneys general and implemented strong new policies - for the good of all.

- Some banks have made statements in their 2011 and 2012 "Resolution Plans" regarding their supposed ability to undergo a speedy and orderly resolution. In statements to shareholders, these banks will have reiterated these assurances that they are complying with the Dodd-Frank Act's "Living Will" requirements to build and sustain a strong and safe financial system, with a common interest with shareholders and taxpayers in eliminating "too big to fail", and adopting plans for orderly liquidation if need be in the future to eliminate too big to fail.

- In many cases, bank executives have also issued public and media statements indicating that remediation efforts are complete and that there banks can now divert their resources from regulation to new investment.

As demonstrated by the excerpts above, many banks in 2012-2013 have been making statements referring to their compliance with regulatory requirements in general, rather than specifically listing its direct and third party oversight remediation efforts. Yet, a bank's failure to properly remediate paints a troubling picture, a picture that may extend far beyond the bank's third party oversight issues. Whistleblowers involved with or even supervising remediation efforts are reporting that some banks have failed to put forth a good faith effort to properly remediate, particularly as to its use of third party contractors. Whistleblower lawyers must be prepared to view these whistleblower allegations not just under Dodd Frank, but under several federal statutes that can provide bounties and rewards.

II. "SOX PLUS ONE" BANKING SECTOR CASES

GAP has reviewed banking sector allegations by employees and former employees of both banks and contractors providing services to banks regarding past and present mortgage practices. Some cases deal exclusively with 2008 era mortgage practices. Others involve contemporary responses by banks to regulators that require the banks to undertake assessment and remediation of past practices. If the whistleblower is no longer employed by the bank or contractor, or is making his or her disclosures completely anonymously without the bank's knowledge, an employment retaliation scenario is not presented, and GAP categorizes that as a "disclosure only" or "bounty only" case. However, when the whistleblower is facing employer retaliation, then he or she may chose to invoke the protections of the Sarbanes Oxley Act (SOX), 18 U.S.C. 1514A by filing a claim with the U.S. Department of Labor (DOL) under 29 CFR Part 1980. After 180 days, the SOX whistleblower may file the claim in a federal district court if the DOL has not issued a final ruling.[1]

A "SOX Plus One" claim refers to a whistleblower who is seeking not just a remedy under SOX for employment retaliation, but also any bounty or reward that may be available under one or more of the statutes discussed below. These can present

[1] Additionally, a whistleblower who has faced retaliation because of his or her disclosures to the SEC has additional protections from retaliation under the Dodd Frank Act of 2010. 5 U.S.C.S. § 78u-6(h), titled "Protection of whistleblowers," provides whistleblowers a private right of action against employers who take retaliatory actions against the whistleblower for taking certain protected actions. § 78u-6(h). The courts are in disagreement as to the scope of this Dodd Frank protection, with some judges granting the protection broadly to cover almost any SOX violation, including those only internally disclosed to the employer but not yet to the SEC. See, e.g., *Kramer v. Trans-Lux Corp*., No. 3:11CV1424 (SRU), 2012 U.S. Dist. LEXIS 136939, 2012 WL 4444820, at 4 (D. Conn. Sept. 25, 2012); *Nollner v. S. Baptist Convention, Inc*., 852 F. Supp. 2d 986, 994 n.9 (M.D. Tenn. 2012); *Egan v. TradingScreen, Inc*., No. 10 Civ. 8202 (LBS), 2011 U.S. Dist. LEXIS 47713, 2011 WL 1672066, at 4-5 (S.D.N.Y. May 4, 2011). For instance, in *Egan*, the court explained that "a literal reading of the definition of the term 'whistleblower' in 15 U.S.C. § 78u-6(a)(6), requiring reporting to the SEC, would effectively invalidate § 78u-6(h)(1)(A)(iii)'s protection of whistleblower disclosures that do not require reporting to the SEC." Egan, 2011 U.S. Dist. LEXIS 47713, 2011 WL 1672066, at 4; see also *Nollner*, 852 F. Supp. 2d at 994 n.9 (approvingly citing Egan and explaining that "the plain terms of anti-retaliation category (iii), which do not require reporting to the SEC, appear to conflict with the [Dodd-Frank Act's] definition of 'whistleblower' at § 78u-6(h)(1)(A)(iii), which defines a whistleblower as anyone who reports securities violations 'to the Commission'" (emphasis in original)). In *Kramer*, the district court focused on the same interplay between § 78u-6(a)(6) and § 78u-6(h)(1)(A)(iii) and concluded that it was not "unambiguously clear that the Dodd-Frank Act's retaliation provision only applies to those individuals who have provided information relating to a securities violation to the Commission." *Kramer*, 2012 U.S. Dist. LEXIS 136939, 2012 WL 4444820, at 4. However, other judges have ruled that the Dodd Frank protections do not broadly cover all SOX violations, and do not cover internal whistleblowing prior to the filing a claim with the SEC. See, *Asadi v. G.E. Energy United States, L.L.C*., 720 F.3d 620, 625 (5th Cir. Tex. 2013) and *Wagner v. Bank of Am. Corp*., 2013 U.S. Dist. LEXIS 101297 (D. Colo. July 19, 2013).

lawyers with very complex claims requiring sophisticated strategies and difficult decisions as to the timing of bringing multiple claims. The attached Powerpoint presentation offers suggestions for how whistleblower lawyers should approach these complex and "SOX Plus One" claims.

III. SEC BOUNTY CLAIM

A. Description of the Law

Pursuant to Section 21F of the Securities Exchange Act of 1934, the SEC is required to pay awards to certain whistleblowers who provide information regarding securities laws violations.[2] For the purposes of an SEC bounty claim, an individual may be considered a whistleblower if, "alone or jointly with others, [the individual] provide[s] the Commission with information pursuant to the procedures set forth [below], and the information relates to a possible violation of the Federal securities laws (including any rules or regulations thereunder) that has occurred, is ongoing, or is about to occur."[3]

The SEC does not appear to limit the types of securities law violations it will consider as part of its whistleblower program. In fact, when submitting a complaint via the SEC's online questionnaire, the first question on the form asks for an individual to select the best option to describe his or her complaint.[4] One of the options provided is: a "[m]aterial misstatement or omission in a company's public filings or financial

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[2] 17 C.F.R. § 240.21F-1.
[3] 17 C.F.R. § 240.21F-2(a)(1).
[4] *Tips, Complaints and Referrals Portal*, U.S. SECURITIES AND EXCHANGE COMMISSION, https://denebleo.sec.gov/TCRExternal/questionaire.xhtml.

statements, or a failure to file."[5] A complainant is also given an opportunity to describe a complaint that does not fit any of the options provided.[6]

Two of the federal securities laws listed on the SEC website that appear particularly relevant for a banking/mortgage whistleblower claim are Rule 10b-5 of the Securities Exchange Act of 1934 and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.[7]

B. Potential Application of Rule 10b-5 to Banking/Mortgage Cases

The SEC website states that due to investors' reliance on the markets to secure their futures, the Commission's "investor protection mission is more compelling than ever."[8] The SEC notes the importance of requiring public companies to share financial and other information with the public, stating: "This provides a common pool of knowledge for all investors to use to judge for themselves whether to buy, sell, or hold a particular security. Only through the steady flow of timely, comprehensive, and accurate information can people make sound investment decisions."[9] In an effort to achieve this mission, one of the SEC's key responsibilities is to enforce Rule 10b-5 of the Securities Exchange Act of 1934, which provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any

[5] *Tips, Complaints and Referrals Portal*, U.S. SECURITIES AND EXCHANGE COMMISSION, https://denebleo.sec.gov/TCRExternal/questionaire.xhtml.
[6] *Tips, Complaints and Referrals Portal*, U.S. SECURITIES AND EXCHANGE COMMISSION, https://denebleo.sec.gov/TCRExternal/questionaire.xhtml.
[7] *See Researching the Federal Securities Laws Through the SEC Website*, U.S. SECURITIES AND EXCHANGE COMMISSION, http://www.sec.gov/investor/pubs/securitieslaws.htm.
[8] *The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, U.S. SECURITIES AND EXCHANGE COMMISSION, http://www.sec.gov/about/whatwedo.shtml.
[9] *The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, U.S. SECURITIES AND EXCHANGE COMMISSION, http://www.sec.gov/about/whatwedo.shtml.

> facility of any national securities exchange, (a) To employ any device, scheme, or artifice to defraud, (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.[10]

In order to show a material misrepresentation or the omission of a material fact, the following elements are required: "(1) a material misrepresentation or omission by the defendant; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation."[11]

A bank's SEC filings, as well as its reports to its shareholders, may form the basis for a violation of Rule 10b-5. While this is not a private action for damages and the whistleblowers would only need to demonstrate a potential violation, it is useful to examine a few of the elements of a Rule 10b-5 offense.

The first element is satisfied if a bank's statements are fraudulent and misleading.[12] Specifically, a Dodd Frank claim may be based on a bank's statements that lead the SEC, shareholders, and regulators to believe that a bank intends, and is making wholehearted efforts, to comply with its regulatory requirements, including the OCC Consent Order, the National Mortgage Settlement, and the Dodd-Frank Act.

A bank's misrepresentations must also be material. A fact is considered "material" for the purpose of Rule 10b-5 "'if there is a substantial likelihood that a

[10] 17 CFR § 240.10b-5.
[11] *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 157 (2008).
[12] *But see Janus Capital Group Inc. v. First Derivative Traders*, 131 S. Ct. 2296, 2303–05 (2011), for more information on who may be held liable for "making" a statement.

reasonable shareholder would consider it important in deciding how to vote.'"[13] More specifically, "'there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available.'"[14]

Moreover, a bank's consistent misrepresentations may lead investors to believe the bank is complying with its regulatory requirements, including by remediating deficiencies in its third party contract and enhancing its third party oversight policies. Were such a "too big to fail" bank to face future financial difficulty, it would be virtually impossible for regulators to take over and unwind the bank's contractual obligations or liabilities in any reasonable timeframe. Thus, potential investors would likely consider it important to know that a bank has failed to establish a sufficient third party oversight framework and failed to ensure that its contracts with key third party providers are enforceable.

With regard to the remaining elements of a Rule 10-b5 violation, it is plausible that executives at a bank knew the company was issuing misleading statements or failing to disclose material information. Additionally, it is plausible that shareholders relied on these statements in deciding whether to invest in the company. And if a bank is subject to lawsuits, increased liabilities or additional regulatory action as a result of its noncompliance, shareholders will ultimately bear the loss.

C. <u>Potential Application of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 to Banking/Mortgage Whistleblower Cases:</u>

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[13] *Basic Inc. v. Levinson*, 485 U.S. 224, 231 (1988) (quoting *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976)).
[14] *Basic Inc. v. Levinson*, 485 U.S. 224, 231–32 (1988) (quoting *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976)).

Section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") provides that the Board of Governors shall establish enhanced supervision and prudential standards for certain bank holding companies with total consolidated assets equal to or greater than $50 billion.[15] One of the prudential standards required of these bank holding companies is a resolution plan.[16] With regard to the required resolution plan, the Dodd-Frank Act states in particular that the bank holding companies must:

> [R]eport periodically to the Board of Governors, the Council, and the Corporation the plan of such company for rapid and orderly resolution in the event of material financial distress or failure, which shall include – (A) information regarding the manner and extent to which any insured depository institution affiliated with the company is adequately protected from risks arising from the activities of any nonbank subsidiaries of the company; (B) full descriptions of the ownership structure, assets, liabilities, and contractual obligations of the company; (C) identification of the cross-guarantees tied to different securities, identification of major counterparties, and a process for determining to whom the collateral of the company is pledged; and (D) any other information that the Board of Governors and the Corporation jointly require by rule or order.[17]

Thus, while the Act does not directly reference the need for enforceable and detailed contracts with third party remediation service suppliers, it does state that the banks' reports must include full descriptions of the companies' contractual obligations.[18] Additionally, in order to remain true to the intended purposes of the living will – namely, to ensure that a bank may be unwound and key operations will continue largely undisrupted – it is only logical that a bank with a large number of third parties performing key services should detail those relationships as part of its annual resolution plan.

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[15] Dodd-Frank Wall Street Reform and Consumer Protection Act § 165(a)(1), 12 U.S.C. § 5365(a)(1).
[16] Dodd-Frank Wall Street Reform and Consumer Protection Act § 165(b)(1)(A)(iv), 12 U.S.C. § 5365(b)(1)(A)(iv).
[17] Dodd-Frank Wall Street Reform and Consumer Protection Act § 165(d)(1), 12 U.S.C. § 5365(d)(1).
[18] *See* Dodd-Frank Wall Street Reform and Consumer Protection Act § 165(d)(1)(B), 12 U.S.C. § 5365(d)(1)(B).

Following the first submissions of banking resolution plans, the Federal Reserve and the FDIC issued additional guidance for the banks to follow in submitting their 2013 resolution plans.[19] Included in this report were details regarding the initial set of obstacles the agencies identified as hindering the banks' abilities to ensure rapid and orderly resolutions.[20] As a result, the agencies are now requiring the banks to provide a separate section in their 2013 resolution plans to address each obstacle.[21] The banks must also provide details regarding the steps it has taken or plans to take to remediate or mitigate each obstacle.[22]

One such obstacle cited by the agencies involves concerns that third party services could be disrupted or that a third party might fail to comply with its service level agreements.[23] As a result, the agencies are requiring banks to describe in their 2013 plans the actions they will take to ensure that third party services continue and to establish processes that address the potential disruption of service level agreements.[24] In regard to material service level agreements, the agencies are also requiring banks to submit the following information:

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[19] *See* Federal Deposit Insurance Corporation and Board of Governors of the Federal Reserve System, *Guidance for 2013 165(d) Annual Resolution Plan Submissions by Domestic Covered Companies that Submitted Initial Resolution Plans in 2012*.
[20] *See* Federal Deposit Insurance Corporation and Board of Governors of the Federal Reserve System, *Guidance for 2013 165(d) Annual Resolution Plan Submissions by Domestic Covered Companies that Submitted Initial Resolution Plans in 2012*, pg. 5.
[21] *See* Federal Deposit Insurance Corporation and Board of Governors of the Federal Reserve System, *Guidance for 2013 165(d) Annual Resolution Plan Submissions by Domestic Covered Companies that Submitted Initial Resolution Plans in 2012*, pg. 5.
[22] *See* Federal Deposit Insurance Corporation and Board of Governors of the Federal Reserve System, *Guidance for 2013 165(d) Annual Resolution Plan Submissions by Domestic Covered Companies that Submitted Initial Resolution Plans in 2012*, pg. 5.
[23] *See* Federal Deposit Insurance Corporation and Board of Governors of the Federal Reserve System, *Guidance for 2013 165(d) Annual Resolution Plan Submissions by Domestic Covered Companies that Submitted Initial Resolution Plans in 2012*, pg. 5.
[24] *See* Federal Deposit Insurance Corporation and Board of Governors of the Federal Reserve System, *Guidance for 2013 165(d) Annual Resolution Plan Submissions by Domestic Covered Companies that Submitted Initial Resolution Plans in 2012*, pg. 12.

> i. Describe the process of how the Covered Company initiates, manages and tracks its SLAs. Describe any operating procedures and controls for negotiating, documenting and terminating SLAs. ii. Provide a summary of services rendered by and received from each Material Entity, including the cost and transfer pricing of each service. iii. Identify any services for which the Covered Company does not have formal written SLAs with inter-affiliate service providers in support of Material Entities.[25]

D. <u>Processes and Procedures for Bringing an SEC Bounty Claim</u>

The SEC may provide eligible whistleblowers with a monetary award, provided they meet four requirements:[26] (1) The whistleblower must voluntarily provide information to the SEC.[27] The submission of information is deemed voluntary if the whistleblower provides the information without first receiving a request, demand, or inquiry relating to the information.[28] (2) The whistleblower must provide the SEC with original information.[29] Information is deemed original if (a) it is derived from the whistleblower's independent knowledge or analysis, (b) it is not already known to the SEC, (c) it is not exclusively derived from some other source, such as a hearing, report, or news account, and (d) it is submitted to the SEC for the first time after July 21, 2010.[30] (3) The information provided must lead to a successful enforcement action by the SEC.[31] (4) As a result of the enforcement action, the SEC must obtain more than $1 million in sanctions.[32]

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[25] *See* Federal Deposit Insurance Corporation and Board of Governors of the Federal Reserve System, *Guidance for 2013 165(d) Annual Resolution Plan Submissions by Domestic Covered Companies that Submitted Initial Resolution Plans in 2012*, pg. 13.
[26] 17 C.F.R. § 240.21F-3(a).
[27] 17 C.F.R. § 240.21F-3(a)(1).
[28] 17 C.F.R. § 240.21F-4(a).
[29] 17 C.F.R. § 240.21F-3(a)(2).
[30] 17 C.F.R. § 240.21F-4(b)(1). For additional details regarding these requirements, see 17 C.F.R. § 240.21F-4(b).
[31] 17 C.F.R. § 240.21F-3(a)(3). For additional details regarding these requirements, see 17 C.F.R. § 240.21F-4(c).
[32] 17 C.F.R. § 240.21F-3(a)(4).

The whistleblower may also receive a portion of an award collected in related actions brought by the U.S. Attorney General, a regulatory authority, a self-regulatory organization, or a state attorney general in a criminal case.[33] The same evaluation as to whether a whistleblower is entitled to an SEC award applies in determining whether the whistleblower is entitled to a reward in a related action.[34] However, a whistleblower will not be eligible for an award in a related action if the CFTC has already granted or denied the whistleblower an award for the same action.[35]

Eligible whistleblowers are entitled to 10-30% of the money collected, with the SEC given the discretion to determine the exact amount awarded.[36] If more than one eligible whistleblower is involved, the total amount awarded still may not be less than 10% or greater than 30% of the amount collected.[37] In determining the amount of an award, the SEC may consider the significance of the information, the amount of assistance provided by the whistleblower, the SEC's interest in the matter, and whether the whistleblower internally reported the possible violations before submitting a complaint to the SEC.[38] Similarly, the SEC may choose to decrease a whistleblower's award based on the whistleblower's culpability in the possible violation, whether the whistleblower unreasonably delayed reporting the conduct, and whether the whistleblower interfered with any internal compliance and reporting systems.[39]

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[33] 17 C.F.R. § 240.21F-3(b)(1).
[34] 17 C.F.R. § 240.21F-3(b)(2). For additional details regarding procedures for determining awards based on a related action, see 17 C.F.R. § 240.21F-11.
[35] 17 C.F.R. § 240.21F-3(b)(3).
[36] 17 C.F.R. § 240.21F-5(a),(b). For additional details regarding making a claim for a whistleblower award, see 17 C.F.R. § 240.21F-10.
[37] 17 C.F.R. § 240.21F-5(c).
[38] 17 C.F.R. § 240.21F-6(a).
[39] 17 C.F.R. § 240.21F-6(b).

In order to qualify for an award, a whistleblower must submit either online or via mail the relevant SEC form, which allows the complainant to detail the alleged violation.[40] Aside from a few exceptions (for example, when it is necessary to provide the information to the DOJ or a state attorney general in order to protect investors), submissions are kept confidential and the SEC will not disclose a whistleblower's identity.[41] Additionally, whistleblowers may submit a complaint anonymously, provided an attorney represents them.[42] But in order to receive a bounty, the whistleblower must disclose his or her identity to the SEC.[43]

IV. THE FALSE CLAIMS ACT

A. Description of the Law

The False Claims Act ("FCA") imposes liability on any individual who "knowingly presents, or causes to be presented, a false or fraudulent claim for payment or approval."[44] It also imposes liability on any individual who "knowingly makes, uses, or causes to be made or used a false record or statement material to a false or fraudulent claim."[45] Furthermore, another FCA provision imposes liability on any individual who "knowingly makes, uses, or causes to be made or used, a false record or statement material to an obligation to pay or transmit money or property to the Government, or knowingly conceals or knowingly and improperly avoids or decreases an obligation to pay or transmit money or property to the Government."[46] This last provision defines

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[40] 17 C.F.R. § 240.21F-9(a); *see Submit a Tip*, U.S. SECURITIES AND EXCHANGE COMMISSION, http://www.sec.gov/about/offices/owb/owb-tips.shtml. The required form can be found here: http://www.sec.gov/about/forms/formtcr.pdf.
[41] 17 C.F.R. § 240.21F-7(a).
[42] 17 C.F.R. § 240.21F-7(b)(1).
[43] 17 C.F.R. § 240.21F-7(b)(3).
[44] 31 U.S.C. § 3729(a)(1)(A).
[45] 31 U.S.C. § 3729(a)(1)(B).
[46] 31 U.S.C. § 3729(a)(1)(G).

what is commonly referred to as a reverse false claim because instead of involving an improper request by the individual to the government, it involves the individual's failure to pay the government.

All elements of an FCA violation must be proven by a preponderance of the evidence.[47] For the purposes of the FCA, "knowingly" means the person "(i) has actual knowledge of the information; (ii) acts in deliberate ignorance of the truth or falsity of the information; or (iii) acts in reckless disregard of the truth or falsity of the information."[48] The government is not required to prove that the individual had the specific intent to defraud.[49]

A "claim" under the FCA is defined as "any request or demand, whether under a contract or otherwise, for money or property" that is either made to an employee or agent of the U.S., or to a contractor or recipient if the money is to be used to advance a government interest and the U.S. has provided some portion of the money or will reimburse the contractor or recipient.[50]

On May 20, 2009, the Obama Administration enacted the Fraud Enforcement and Recovery Act ("FERA"), which both amended the FCA and ultimately expanded its scope.[51] One of the most significant changes resulting from FERA is that the reverse false claims provision now has a broader definition of "obligation."[52] As a result, "obligation" under the FCA is now defined as "an established duty, whether or not fixed, arising from an express or implied contractual, grantor-grantee, or licensor-licensee

[47] 31 U.S.C. § 3731(d).
[48] 31 U.S.C. § 3729(b)(1)(A).
[49] 31 U.S.C. § 3729(b)(1)(B).
[50] 31 U.S.C. § 3731(b)(2).
[51] Pub. L. No. 111-21, 123 Stat. 1617 (May 20, 2009).
[52] Pub. L. No. 111-21, 123 Stat. 1617, § 4(a) (May 20, 2009).

relationship, from a fee-based or similar relationship, from statute or regulation, or from the retention of any overpayment."[53] The "whether or not fixed" language was intended to overturn the Sixth Circuit's decision in *United States ex rel. American Textile Manufacturers Institute, Inc. v. The Limited, Inc.*, which held that an obligation meant an amount of money that was fixed and due immediately.[54]

B. <u>Potential Application of the FCA to Wall Street Mortgage Cases</u>

Since an FCA action can often be brought in any district in which the defendant transacts business,[55] and because Banks often conduct business in many states, the research below cites legal precedent from jurisdictions that might be most amenable to a potential FCA claim.

A most significant hurdle to an FCA action in a banking/mortgage case is the FCA element stating that there must be a claim, which is defined as a request or demand for money or property.[56] As noted by the plain text of the statute, the FCA requires a fraudulent claim or obligation to pay; it does not serve as a general anti-fraud statute aimed at combating noncompliance with federal or state regulations. Unfortunately, many banking/mortgage cases are not tied to any demand or request for money or property.[57] This may be true even where regulatory consent orders may mention certain

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[53] 31 U.S.C. § 3729(b)(3).
[54] *See* 190 F.3d 729, 734–35 (6th Cir. 1999); Letter from M. Faith Burton, Acting Assistant Attorney Gen., U.S. Dep't of Justice, to Patrick J. Leahy, Chairman, Comm. on the Judiciary, U.S. Senate (Apr. 1, 2009), *available at* http://www.justice.gov/ola/views-letters/111-1/040109-s386-fraud-enforcement-recovery-act.pdf.
[55] *See* 31 U.S.C. § 3732(a).
[56] *See* 31 U.S.C. § 3731(b)(2).
[57] Distinguish the FCA qui tam and the FIRREA claims in *United States v. Countrywide* where there was an apparent claim and the government alleged "the Bank Defendants made knowing or reckless representations as to each of the HSSL loans that were sold to the GSEs after May 20, 2009." Memorandum of Law of the United States in Opposition to Defendants' Motion to Dismiss, *United States ex rel. O'Donnell v. Countrywide Fin. Corp.*, 12 Civ. 1422, 45 (S.D.N.Y. Apr. 1, 2013). Regardless, the

federally funded programs and the bank has received incentive payments via its participation in the Home Affordable Modification Program ("HAMP"). As a result, some banking whistleblowers will not be able to provide any information that leads one to believe that the bank's loan modifications or practices under HAMP were in any way false or fraudulent.

It may be that the best opportunity for bringing a successful FCA action in some banking/mortgage cases is under the reverse false claims provision. It might be plausible to argue that the bank, by inaccurately representing that it is complying with its regulatory requirements, is knowingly and improperly avoiding its obligation to pay the government penalties that might normally result from such violations.[58] Obviously any requirement by the bank to pay a penalty for its noncompliance would not be immediately apparent and the exact penalty that the government would impose is unknown. However, such uncertainties do not appear problematic under the revised definition of "obligation," which includes a duty, "whether or not fixed."[59] The revised language is intended to expand the definition of a duty to that which is neither fixed nor immediately due. If the duty is not fixed, it seems as though it would then be contingent upon a certain event occurring, for example, upon noncompliance with a consent order or judgment.

Unfortunately, the majority of the case law and analyses since the expansion of the term "obligation" has centered on the health care industry and the need to carefully track government overpayments. And while the plain text of the statute appears to

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judge in that case dismissed the FCA claims, announcing that a detailed explanation is forthcoming. Order, *United States v. Countrywide Fin. Corp.*, 12 Civ. 1422 (S.D.N.Y. May 8, 2013).

[58] *See* 31 U.S.C. § 3729(a)(1)(G).

[59] 31 U.S.C. § 3729(b)(3).

potentially apply to many banking/mortgage cases, much of the commentary seems to indicate otherwise. The government has apparently noted that it does not intend to apply the FCA to the payment of penalties or fines.[60] Additionally, FERA's legislative history apparently demonstrates that Congress did not intend for the term "established duty" to include contingent duties such as potential penalties or fines.[61] Given this information, the government might not be interested in pursuing a reverse false claims action in most cases.

C. Processes and Procedures for Bringing an FCA Claim

If the banking/mortgage whistleblower were to provide information regarding fraudulent loan modification practices or if a reverse false claims action is deemed plausible, the following processes and procedures would be used to pursue an FCA claim.

An action under the FCA "may be brought in any judicial district in which the defendant…can be found, resides, transacts business, or in which any act proscribed by [the False Claims Act] occurred."[62] The Attorney General is tasked with investigating and bringing civil actions for violations of the FCA.[63]

The FCA also provides a qui tam provision that allows a private individual to sue on behalf of the government.[64] If utilizing the qui tam provision, the individual is required to file in camera a complaint, which must also be served on the government and

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[60] John T. Boese, *Civil False Claims Act: The False Claims Act is Amended for the First Time in More Than Twenty Years as the President Signs the Fraud Enforcement and Recovery Act of 2009*, FRIED FRANK (May 21, 2009), http://friedfrank.com/siteFiles/Publications/96C624E1C1C818605ABF4C050E2677B9.pdf.
[61] *See 2009 Amendments to False Claims Act Pose New Challenges for Health Care Industry*, AKIN GUMP (June 2, 2009), http://www.akingump.com/en/news-publications/2009-amendments-to-false-claims-act-pose-new-challenges-for-health-care-industry.html.
[62] 31 U.S.C. § 3732(a).
[63] 31 U.S.C. § 3730(a).
[64] 31 U.S.C. § 3730(b)(1).

must remain under seal for sixty days.[65] Within those sixty days – unless the government moves for an extension of the time during which the complaint must remain under seal[66] – the government must either choose to conduct the case itself, or decline to proceed, thereby allowing the individual to proceed with the action.[67] Before commencing an action or deciding whether to proceed with an action commenced by a private individual, the Attorney General may issue a civil investigative demand requiring individuals to hand over documents, respond to written interrogatories, or give oral testimony.[68]

If the government opts to conduct the case itself, the individual who originally brought the action may remain as a party to the action.[69] However, the government is entitled to dismiss or settle the action and may impose certain limitations on the individual's ability to participate in the litigation.[70]

Violation of the FCA renders the offender liable to the government for a penalty of \$5,500-\$11,000, plus three times the amount of damage sustained by the government.[71] If the government decides to proceed with an action originally brought by a private individual, that individual is entitled to 15-25% of the settlement or claim obtained, dependant upon the degree to which the individual's information contributed to the action.[72] However, if the action is based primarily on disclosures unrelated to information provided by the individual, the individual is entitled to a maximum of 10% of the settlement or claim.[73] The individual is also entitled to reimbursement for

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[65] 31 U.S.C. § 3730(b)(2).
[66] 31 U.S.C. § 3730(b)(3).
[67] 31 U.S.C. § 3730(b)(4).
[68] 31 U.S.C. § 3733(a)(1).
[69] 31 U.S.C. § 3730(c)(1).
[70] 31 U.S.C. § 3730(c)(2).
[71] 31 U.S.C. § 3729(a)(1); 28 CFR 85.3(a)(9).
[72] 31 U.S.C. § 3730(d)(1).
[73] 31 U.S.C. § 3730(d)(1).

expenses incurred plus attorneys' fees.[74] The government may also choose to pursue the case in some other type of proceeding, though the private individual would still be entitled to the same rights he or she would have pursuant to an FCA proceeding.[75]

If the government opts not to proceed with the action, the individual is entitled to 25-30% of all proceeds, plus expenses and attorneys' fees.[76]

The statute of limitation for FCA cases is measured by whichever date occurs last: either (1) six years after the date of the violation, or (2) three years after material facts become known or reasonably should have been known by the government.[77] If the second date is used, the action still must be brought within ten years of the violation.[78]

V. THE FINANCIAL INSTITUTIONS REFORM, RECOVERY AND ENFORCEMENT ACT OF 1989

A. Description of the Law

The Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA") is generally broader than the FCA and reaches a greater number of offenses, though the government often raises both the FCA and FIRREA simultaneously.[79] Section 951 of the Act authorizes the Attorney General to bring a civil action[80] against anyone who violates or conspires to violate any one of fourteen enumerated criminal statutes.[81]

[74] 31 U.S.C. § 3730(d)(1).
[75] 31 U.S.C. § 3730(c)(5).
[76] 31 U.S.C. § 3730(d)(2).
[77] 31 U.S.C. §3731(b).
[78] 31 U.S.C. § 3731(b).
[79] *See* Jay Williams et al., *FIRREA: An Old Acronym is Turning into the Government's New Hammer on Banks and Other Financial Institutions*, 129 BANKING L. J. 579, 582 (2012).
[80] *See* 12 U.S.C. § 1833a(e).
[81] 12 U.S.C. § 1833a(c).

Amongst the fourteen criminal statutes listed in Section 951, nine deal specifically with financial institutions.[82] As a result, in order to successfully prove a FIRREA violation under one of these statutes, the government need only establish the elements of the offense.[83] The nine criminal statutes are provided below, with those that are most relevant to potential banking/mortgages cases marked in bold and discussed further below:

- 18 U.S.C. 215, regarding the receipt of commissions or gifts for procuring loans, does not appear relevant to most cases we have seen.
- 18 U.S.C. 656, regarding the theft, embezzlement, or misapplication of funds by a bank officer or employee, does not appear to present the strongest arguments for FIRREA claims GAP has reviewed. While a bank may have potentially misapplied some of its funds, this misapplication must be willful,[84] and many courts have held that there must also be an intent to injure the bank.[85]
- 18 U.S.C. 657 is similar to 18 U.S.C. 656, but does not apply to FDIC-insured banks.
- **18 U.S.C. 1005** (discussed in more detail below) criminalizes the making of false entries in a bank's books, reports, or statements.
- 18 U.S.C. 1006 is similar to 18 U.S.C. 1005, but does not apply to FDIC-insured banks.
- **18 U.S.C 1007** (discussed in more detail below) criminalizes the improper influence of an action by the FDIC.

[82] 12 U.S.C. § 1833a(c)(1), (3).
[83] *See* 12 U.S.C. § 1833a(c)(1), (3).
[84] 18 U.S.C. § 656.
[85] *See, e.g., United States v. Clark*, 765 F.2d 297, 302 (2d Cir. 1985); *United States v. Castro*, 887 F.2d 988, 994 (1989).

- 18 U.S.C. 1014, regarding the use of false statements or records with regard to loan and credit applications, renewals and discounts, or crop insurance, appears highly relevant to several cases GAP has reviewed.
- 18 U.S.C. 1344 on bank fraud criminalizes efforts to defraud financial institutions or fraudulently obtain the moneys or assets of a financial institution.
- 15 U.S.C. 645(a), regarding false statements and the willful overvaluation of securities, is relevant to some of the cases GAP has reviewed.

The five other criminal statutes listed in Section 951 require the government to not only prove the underlying offense, but also demonstrate that it is an offense "affecting a federally insured financial institution."[86] The five criminal statutes are provided below, with those that are most relevant to expected banking/mortgage cases marked in bold and discussed further below:

- 18 U.S.C. 287 is the criminal counterpart to the False Claims Act, providing:

> Whoever makes or presents to any person or officer in the civil, military, or naval service of the United States, or to any department or agency thereof, any claim upon or against the United States, or any department or agency thereof, knowing such claim to be false, fictitious, or fraudulent, shall be imprisoned not more than five years and shall be subject to a fine in the amount provided in this title.

With regard to the "claim" requirement, the Supreme Court has noted:

> While the word 'claim' may sometimes be used in a broad juridical sense of 'a demand of some matter as of right made by one person upon another, to do or to forbear to do some act or thing as a matter of duty,' it is clear, in the light of the entire context, that in the present statute, the provision relating to the payment or approval of a 'claim upon or against' the Government relates solely to the payment or approval of a claim for money or property to which a right is asserted against the Government, based upon the Government's own liability to the claimant.[87]

[86] 12 U.S.C. § 1833a(c)(2).
[87] *United States v. Cohn*, 270 U.S. 339, 345–46 (1926) (internal citations omitted).

Thus, for the same reason that a claim might likely fail under the FCA – in that there is no "claim" – the action would presumably also not succeed under 18 U.S.C. 287.

- **18 U.S.C. 1001** (discussed in more detail below) provides the general law criminalizing the making of false statements or entries.
- 18 U.S.C. 1032 involves the concealment of assets from a conservator, receiver, or liquidating agent, and thus does not appear relevant to the current case.
- **18 U.S.C. 1341** (discussed in more detail below) details the crime of mail fraud.
- **18 U.S.C. 1343** (discussed in more detail below) details the crime of wire fraud.

B. Potential Application of FIRREA to Banking/Mortgage Whistleblower Cases

(1) Relevant Crimes Under FIRREA that do not Require Proof that the Conduct Affects a Federally Insured Financial Institution:

With regard to 18 U.S.C. 1005, the portion most relevant to the current case states:

> Whoever makes any false entry in any book, report, or statement of such bank, company, branch, agency, or organization with intent to injure or defraud such bank, company, branch, agency, or organization, or any other company, body politic or corporate, or any individual person, or to deceive any officer of such bank, company, branch, agency, or organization, or the Comptroller of the Currency, or the Federal Deposit Insurance Corporation, or any agent or examiner appointed to examine the affairs of such bank, company, branch, agency, or organization, or the Board of Governors of the Federal Reserve System.[88]

A crime involving false entries includes any entry on the books of a bank that is intended to represent a falsehood or something that does not exist.[89] If, according to the evidence provided by the whistleblower, it may be possible to contend that the bank falsified information contained in its reports in an effort to deceive the OCC, the FDIC, the

[88] This crime imposes up to a one million dollar fine and/or up to thirty years in prison.
[89] *See Agnew v. United States*, 165 U.S. 36, 52–53 (1896).

Federal Reserve, the FSOC, the National Mortgage Settlement Monitor, and any other federal or state regulators.

A bank may also have violated 18 U.S.C. 1007, which provides: "Whoever, for the purpose of influencing in any way the action of the Federal Deposit Insurance Corporation, knowingly makes or invites reliance on a false, forged, or counterfeit statement, document, or thing shall be fined not more than $1,000,000 or imprisoned not more than 30 years, or both." Thus, the crime can be broken down into three elements: the "(i) knowing (ii) making of a false statement (iii) for the purpose of affecting an action of the FDIC."[90]

The bank's conduct may have violated 18 U.S.C. 1007 where it appears the bank knowingly made false representations in its resolution plans or other regulatory filings, and/or false statements to regulators and the public regarding its compliance with the Dodd-Frank Act's living will provisions. A bank might have made these misrepresentations as a means of ensuring that the FDIC would not punish the bank for failing to comply with Dodd-Frank. For example, if the FDIC and the Federal Reserve determined that a bank's resolution plan was insufficient and the bank failed to resubmit a credible plan, the Board and FDIC "may jointly impose more stringent capital, leverage, or liquidity requirements, or restrictions on the growth, activities, or operations of the company" until the Bank resubmits a sufficient plan.[91] Dodd-Frank also includes

[90] *United States v. Autorino*, 381 F.3d 48, 51 (2d Cir. 2004).
[91] Dodd-Frank Wall Street Reform and Consumer Protection Act § 165(d)(5)(A), 12 U.S.C. § 5365(d)(5)(A).

provisions detailing the Board and the FDIC's ability to order non-complying banks to divest assets or operations as a means of facilitating an orderly resolution.[92]

(2) Relevant Crimes Under FIRREA that Require Proof that the Conduct Affects a Federally Insured Financial Institution:

All of the crimes listed in 12 U.S.C. 1833a(c)(2) require not only proof of the underlying offense, but also proof that the conduct affected a federally insured financial institution. In April 2013, in the case of *United States v. Bank of New York Mellon*, the U.S. District Court for the Southern District of New York became the first court to consider the following question: "whether a federally insured financial institution may be held civilly liable under Section 1833a for allegedly engaging in fraudulent conduct 'affecting' that same institution."[93] There, the court rejected the idea that a financial institution "cannot be affected by a fraud solely because it participates in it."[94] The court also stated that actual loss is not necessary in showing that fraud has affected a financial institution; rather, the fraud need only expose the bank to liability or present a risk of loss.[95] While until recently the government has rarely used FIRREA, the court's decision in *Bank of New York Mellon* is viewed as a significant victory in terms of the government's ability to impose civil penalties on large financial institutions.[96]

Another case currently before the Southern District of New York presents similar issues regarding the "affecting" requirement. In *United States v. Countrywide*, the

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[92] Dodd-Frank Wall Street Reform and Consumer Protection Act § 165(d)(5)(B), 12 U.S.C. § 5365(d)(5)(B).
[93] *United States v. Bank of N.Y. Mellon*, No. 11 Civ. 6969, 2013 U.S. Dist. LEXIS 58816, at *3 (S.D.N.Y. Apr. 24, 2013).
[94] *United States v. Bank of N.Y. Mellon*, No. 11-C6969, 2013 U.S. Dist. LEXIS 58816, at *44 (S.D.N.Y. Apr. 24, 2013).
[95] *United States v. Bank of N.Y. Mellon*, No. 11-C6969, 2013 U.S. Dist. LEXIS 58816, at *46–47 (S.D.N.Y. Apr. 24, 2013).
[96] *See* Nate Raymond and Jonathan Stempel, *U.S. Can Sue BNY Mellon Over Currency Trades: Judge*, REUTERS, Apr. 24, 2013. http://www.reuters.com/article/2013/04/24/us-bankofnewyorkmellon-lawsuit-idUSBRE93N12820130424.

government contends that the defendants' violations of the mail and wire fraud statutes affect not only other financial institutions, but also expose the defendants themselves to "actual losses and risks of additional losses.[97] After hearing oral arguments on the defendants' motions to dismiss, Judge Rakoff denied the motion to dismiss the FIRREA charges, announcing that a more detailed ruling will follow.[98] Regardless of the outcome of these cases before the Southern District, due to the significance of the court's ruling in *Bank of New York Mellon*, it is expected that the issue will eventually be brought before the Second Circuit.

While the Southern District has recently become the first court to define the "affecting" requirement under 12 U.S.C. 1833a, other courts have considered the term in different contexts. For example, in *United States v. Serpico*, the Seventh Circuit held that the requirement that an offense "affects" a financial institution[99] does not mean that the financial institution suffered actual harm; rather, an increased risk of loss was sufficient to demonstrate an affect on the institution.[100] Additionally, the court rejected the defendant's argument that an institution cannot be "affected" by an offense if the institution was an "active perpetrator" in the crime.[101]

If the emerging trend in the Southern District of New York holds, the "affecting" clause of 12 U.S.C. 1833a(c)(2) will likely present fewer problem in future banking/mortgage whistleblower case. Under the standard adopted by the Southern

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[97] Memorandum of Law of the United States in Opposition to Defendants' Motion to Dismiss, *United States ex rel. O'Donnell v. Countrywide Fin. Corp.*, 12 Civ. 1422, 29 (S.D.N.Y. Apr. 1, 2013).
[98] Order, *United States v. Countrywide Fin. Corp.*, 12 Civ. 1422 (S.D.N.Y. May 8, 2013).
[99] The Seventh Circuit was interpreting the text of 18 U.S.C. § 3293(2), which extends the statute of limitations for mail and wire fraud to ten years, "if the offense affects a financial institution."
[100] *United States v. Serpico*, 320 F.3d 691, 694–95 (7th Cir. 2003). However, the circuit courts are not unanimous in finding a risk of loss sufficient to constitute an offense that affects a financial institution. *See, e.g.*, *United States v. Whaley*, No. 3:10-CR-169, 2013 U.S. Dist. LEXIS 50123, at *72–74 n.10. (E.D. Tenn. Mar. 5, 2012).
[101] *United States v. Serpico*, 320 F.3d 691, 695 (7th Cir. 2003).

District, a bank's fraudulent actions will likely appear to have "affected" the financial institution. For example, banks are increasingly relying upon third party contractors to prove regulatory compliance. A potential claim may be found if failing to remediate unenforceable or insufficient contracts with its third party contractors (for example, contracts containing vague or nonexistent service level agreements, unexecuted contracts, expired contracts, or contracts with missing terms), a bank has increased its risk of loss and exposed itself to increased legal liability. Thus, the "affecting" clause would likely not pose a hindrance to bringing any of the following potential claims in banking/mortgage cases. But, as in the section above, the government will still need to prove the elements of these offenses by a preponderance of the evidence.

The relevant portion of 18 U.S.C. 1001 provides:

> Except as otherwise provided in this section, whoever, in any matter within the jurisdiction of the executive, legislative, or judicial branch of the Government of the United States, knowingly and willfully—(1) falsifies, conceals, or covers up by any trick, scheme, or device a material fact; (2) makes any materially false, fictitious, or fraudulent statement or representation; or (3) makes or uses any false writing or document knowing the same to contain any materially false, fictitious, or fraudulent statement or entry.[102]

18 U.S.C. 1001 is broad and thus appears to present fertile arguments for a FIRREA claim in such cases. With regard to the overarching jurisdictional requirement, the intent of such language is to "identify the factor that makes the false statement an appropriate subject for federal concern."[103] Considering that many banking/mortgage cases will involve allegations that a bank has lied to federal government entities regarding its compliance with federal laws and judgments, such misstatements will likely be subjects for substantial federal concern.

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[102] 18 U.S.C. § 1001(a). This offense provides for imprisonment up to five years.
[103] *United States v. Yermian,* 468 U.S. 63, 68 (1984).

Materiality is also an overarching theme in the statute and applies to all three categories of the offense. Materiality is defined as a statement or presentation that "has a natural tendency to influence, or was capable of influencing, the decision of the decisionmaking body to which it was addressed."[104] It will sometimes be possible to make a strong argument that a bank's fraudulent reports and statements to regulators regarding its compliance with the a regulatory directive or consent order and Dodd-Frank are all material. A bank's failure to remediate its third party contracts and comply with the living will provisions not only subjects the Bank to increased liabilities and risk, but also results in risks to other financial institutions and the economy in general. A bank's representations regarding its compliance are intended to allay the government's concerns and prevent the government from imposing penalties or regulations on banks.

Additionally, a Bank's conduct may constitutes a violation of any of the three clauses provided in the statute. With regard to the first clause, bank officials might knowingly conceal from federal regulators that they did not perform the due diligence required to properly identify relevant third party suppliers, thereby covering up the fact that some of its most important contracts may never even have been reviewed. Instead, ta bank might use its earlier reports and representations to assure regulators that it had identified the scope of all relevant service providers. Bank officials might also have violated the second clause if they knowingly represented to federal regulators that they were complying with regulatory requirements and making progress in regard to third party contract remediation efforts. Thirdly, bank officials might be knowingly submitting fraudulent reports to federal regulators, including potentially the OCC, the Federal Reserve, the FDIC, the FSOC, and the National Mortgage Settlement Monitor.

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[104] *Kungys v. United States*, 485 U.S. 759, 770 (1988) (internal quotations omitted).

The portion of the mail fraud statute under 18 U.S.C. 1341 that will be relevant to banking/mortgage whistleblower cases states:

> Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, or to sell, dispose of, loan, exchange, alter, give away, distribute, supply, or furnish or procure for unlawful use any counterfeit or spurious coin, obligation, security, or other article, or anything represented to be or intimated or held out to be such counterfeit or spurious article, for the purpose of executing such scheme or artifice or attempting so to do, places in any post office or authorized depository for mail matter, any matter or thing whatever to be sent or delivered by the Postal Service, or deposits or causes to be deposited any matter or thing whatever to be sent or delivered by any private or commercial interstate carrier, or takes or receives therefrom, any such matter or thing, or knowingly causes to be delivered by mail or such carrier according to the direction thereon, or at the place at which it is directed to be delivered by the person to whom it is addressed, any such matter or thing, shall be fined under this title or imprisoned not more than 20 years, or both.

Thus, the essential elements of a claim under the mail fraud statute are: "(1) a scheme to defraud, and (2) the mailing of a letter, etc., for the purpose of executing the scheme."[105] However, it is not necessary "that the scheme contemplate the use of the mails as an essential element."[106]

The relevant portion of the wire fraud statute under 18 U.S.C. 1343 is similar to the mail fraud statute and provides:

> Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, transmits or causes to be transmitted by means of wire, radio, or television communication in interstate or foreign commerce, any writings, signs, signals, pictures, or sounds for the purpose of executing such scheme or artifice, shall be fined under this title or imprisoned not more than 20 years, or both.

[105] *Pereira v. United States*, 347 U.S. 1, 8 (1954).
[106] *Pereira v. United States*, 347 U.S. 1, 8 (1954).

The most significant potential hurdle to a successful mail or wire fraud claim in many cases involves the requirement in both laws that there be a scheme to defraud. It has been generally understood that such deprivations include not only money or property, but also intangible rights.[107] 18 U.S.C. 1346 explicitly states that the scheme to defraud includes the scheme to deprive an individual of the right of honest services. However, while the appeals courts have been split on the exact meaning of this provision, the Supreme Court decided in 2010 that the right of honest services includes only bribes and kickbacks.[108]

That being said, a potentially successful case may not involve any allegations involving bribes or kickbacks. But a wire or mail fraud offense remains potentially feasible in the property-mail fraud or property-wire fraud context. Courts have permitted convictions under the mail fraud statute in situations in which the defendant has used fraudulent mailings as a means to convince individuals to invest in a company.[109] Where a bank has engaged in a scheme to defraud, that fraud might include that it has knowingly misrepresented both its regulatory compliance efforts and its general stability in its 10-K filings and annual reports. This in turn may have deprived investors of money in that they were deceived into investing in the bank.

Additionally, some courts have found that "the use of the mails, even after money has been obtained, is within the reach of the [mail fraud] statute if it is for the purpose of executing the scheme, as, for example, the lulling of victims and the continuance of the

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[107] *Skilling v. United States*, 130 S. Ct. 2896, 2904 (2010).
[108] *Skilling v. United States*, 130 S. Ct. 2896, 2905 (2010).
[109] *See, e.g., United States v. Porter*, 441 F.2d 1204, 1211 (8th Cir. 1971).

relationship between the schemer and his victims."[110] Thus, a bank's scheme to defraud may also involve current shareholders because the bank's public statements may have lulled shareholders into feeling confident as to the bank's stability and into remaining invested in the bank. Finally, the bank has likely shared its 10-K filings and annual reports with shareholders and potential investors either by mail or electronic communications, therefore satisfying the additional requirements under these two offenses.

C. Processes and Procedures for Bringing a FIRREA Claim

As noted above, several of the crimes articulated in the FIRREA statute may prove relevant to the current case. The following section details the processes and procedures for bringing a FIRREA claim.

FIRREA provides the Attorney General with broad administrative subpoena powers, including the ability to administer oaths, take evidence, summon witnesses and require the production of any relevant information.[111] The Act also provides for a ten-year statute of limitations,[112] thereby giving the government ample time to investigate and build a strong case against any suspected wrongdoers. And while FIRREA encompasses criminal offenses, it remains a civil statute, meaning the government need only establish a FIRREA claim by a preponderance of the evidence.[113]

While a successful suit under FIRREA may not result in any prison time, the Act does provide for potential civil penalties, including up to $1.1 million dollars for each

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[110] *Bliss v. United States*, 354 F.2d 456, 457 (8th Cir. 1966). *See also United States v. Sampson*, 371 U.S. 75, 80–81 (1962).
[111] *See* 12 U.S.C. § 1833a(g).
[112] *See* 12 U.S.C. § 1833a(h).
[113] 12 U.S.C. § 1833a(f).

violation.[114] However, this limit may be exceeded for continuing violations, for which the penalty may be the lesser of either $1.1 million per day or $5.5 million.[115] Additionally, the civil penalty may exceed these limits in order to equal the pecuniary gain derived from the violation or the pecuniary loss to an individual affected by the violation.[116]

VI. THE FINANCIAL INSTITUTIONS ANTI-FRAUD ENFORCEMENT ACT OF 1990

A. Description of the Law

The Financial Institutions Anti-Fraud Enforcement Act of 1990 ("FIAFEA") provides that any individual may file a declaration detailing a violation "giving rise to an action for civil penalties under [FIRREA] affecting a depository institution insured by the Federal Deposit Insurance Corporation or any other agency or entity of the United States."[117]

B. Potential Application of FIAFEA Banking/Mortgage Whistleblower Cases:

Any individual can submit a declaration detailing a violation of one or more of the fourteen crimes under FIRREA. Thus, provided there is a plausible FIRREA violation in this case, there may also a viable FIAFEA claim.

C. Processes and Procedures for Bringing a FIAFEA Claim

The individual must submit the declaration to the Attorney General or an agent designated by the Attorney General as authorized to receive such declarations.[118] The declaration must meet the following requirements: (1) provide the declarant's name and

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[114] 12 U.S.C. § 1833a(b)(1); 28 CFR 85.3(a)(6).
[115] *See* 12 U.S.C. § 1833a(b)(2); 28 CFR 85.3(a)(7).
[116] 12 U.S.C. § 1833a(b)(3)(A).
[117] 12 U.S.C. § 4201(a).
[118] 12 U.S.C. § 4201(b).

address and the basis for his or her knowledge; (2) under oath and affirmation, state the particular facts that give rise to a violation of one of the criminal statutes under FIRREA; (3) provide at least one fact necessary to demonstrate a prima facie case that was previously unknown to the government; and (4) detail all of the facts giving rise to a violation of one of the laws contained in FIRREA, including the names of any material witnesses and the details and location of any documentary evidence.[119]

Once filed, the declarant may not acknowledge the existence of his or her declaration.[120] The required length of time for this period of confidentiality depends upon the events that occur. The following list identifies possible scenarios and the confidentiality requirements that accompany each course of events:

- If the Attorney General decides not to proceed with either a civil or criminal case, the Attorney General will notify the declarant in writing and provide reasons as to why the Attorney General has decided not to pursue the case.[121] Once this occurs, the declarant may disclose that a declaration was filed.[122]
- If the United States receives a judgment, order or settlement based at least in part on the declaration, the Attorney General will notify the declarant in writing and detail the amount of the award to which the declarant is entitled.[123] Once this occurs, the declarant is entitled to disclose that he or she filed a declaration.[124]

[119] 12 U.S.C. § 4202.
[120] 12 U.S.C. § 4203(a).
[121] 12 U.S.C. § 4206(b).
[122] 12 U.S.C. § 4203(a)(1).
[123] 12 U.S.C. § 4206(c).
[124] 12 U.S.C. § 4203(a)(2).

- If the Attorney General determines that the case should be awarded to private counsel, the declarant is afforded the opportunity to select such counsel.[125] The existence of the declaration is then no longer confidential.[126]
- If the Attorney General notifies[127] the declarant that the Attorney General has not yet addressed the allegations contained in the declaration, the declarant is afforded thirty days to notify the Attorney General to award a contract to pursue the case.[128] In reply to the declarant's notification, the Attorney General may either grant a contract to other counsel or proceed with the case.[129] If the Attorney General grants the contract, declarant may select counsel[130] and can then acknowledge the filing of the declaration.[131]

Regardless of these circumstances, the Attorney General may still notify a declarant that continued confidentiality is required if disclosure of the declaration's contents could in any way compromise either a government investigation or any case that may utilize the information contained in the declaration.[132]

If information contained in the declaration leads, at least in part, to a criminal conviction, the Attorney General may choose to pay the declarant a reward.[133] If the information contained in the declaration leads at least in part to payment received pursuant to a civil action, the declarant may also be entitled to an award.[134] And if the

[125] 12 U.S.C. § 4205(b).
[126] 12 U.S.C. § 4203(a)(3).
[127] The Attorney General must send notification of his or her decision within one year after the declaration is filed. 12 U.S.C. § 4206(e)(2)(A).
[128] 12 U.S.C. § 4207(a).
[129] 12 U.S.C. § 4207(b).
[130] 12 U.S.C. § 4207(c).
[131] 12 U.S.C. § 4207(b).
[132] 12 U.S.C. § 4203(b).
[133] 12 U.S.C. § 4205(c).
[134] 12 U.S.C. § 4210.

declarant's information leads to a judgment, order or settlement in which the United States acquires funds or assets, the declarant is entitled to a portion of the recovery.[135] Specifically, the declarant is entitled to 20-30% of the first $1 million recovered, 10-20% of the next $4 million recovered, and 5-10% of the next $5 million recovered.[136]

VII. CONCLUSION

As detailed above, there may be claims for banking/mortgage whistleblowers under Dodd Frank, FCA, FIRREA, and/or FIAFEA. On first review, it may seem that the case is best suit as a Dodd Frank bounty claims to the SEC. But on further review, the whistleblower lawyer must assess the facts to determine if the case is equally or better suited as a FIRREA or FIAFEA claim, and in particular, a FIRREA claim alleging violations of 18 U.S.C. 1001, and possibly 18 U.S.C. 1005, 18 U.S.C. 1007, 18 U.S.C. 1341, and 18 U.S.C. 1343.

[135] 12 U.S.C. § 4205(d)(1).
[136] 12 U.S.C. § 4205(d)(1)(A)(i).

POWERPOINT SLIDES

UNDERSTANDING AND HANDLING THE COMPLEX "SOX PLUS ONE" WHISTLEBLOWER CASE

UNDERSTANDING AND HANDLING THE COMPLEX WHISTLEBLOWER CASE

A. Complex cases present risk of malpractice for failing to identify and strategize multiple claims.

B. Elements of the complex whistleblower case:

1. Multiple claims requiring different forums (eg. SOX in DOL, Dodd Frank bounty in SEC)
2. Conflicting needs as to knowledge/nexus element
3. Divergent statutes of limitation
4. Need for document appropriation from employer
5. Involvement of corporate compliance program
6. Settlement pressures to not give global release

1. Multiple Claims Requiring Different Forums

1. **Most typical** multiple claims scenario is "**SOX plus One**" or more of these "bounty" claims:

   A. Dodd-Frank bounty claim for the SEC

   B. False Claims Act/Qui Tam claim for the DOJ

   C. FIRREA claim to the OCC

   D. Tax fraud claim to the IRS

2. **Question:** The still employed whistleblower may contact a lawyer to ask this complex and difficult question: "IN VIEW OF ALL THE CLAIM POSSIBILITIES, WHICH CLAIMS SHOULD I FILE?"

2. Conflicting Needs as to Knowledge/Nexus Element

A. Protection for internal disclosures requires employer knowledge– BUT

B. Viable "bounty" claims either

1. Put a premium on non-disclosure to the employer "target"; or
2. Under "seal" (False Claims/Qui Tam), or DOJ/agency firm expectations of non-disclosure.

C. **Rational for Non-Disclosure**: The target employer will spoliate (shred, alter, misplace) documents, and pressure co-employees to perjure or misrepresent themselves.

D. Question: The still employed whistleblower may contact a lawyer to ask this complex and difficult question: "AS TO TIMING, SHOULD I INTERNALLY DISCLOSE NOW MY PROTECTED ACTIVITY AT THE RISK OF MY LIVELIHOOD?"

2A. Protection for Internal Disclosures Requires Employer Knowledge

A. Without employer knowledge of the disclosure, there can be no "nexus" or contributing factor.

B. ***Asadi v. G.E. Energy United States*, L.L.C., 720 F.3d 620 (5th Cir. Tex. July 13, 2013)** held that Dodd Frank does not protect purely internal whistleblowing:

> Under Dodd-Frank, there is only one category of whistleblowers: individuals who provide information to the SEC. Individuals may take protected activity yet still not qualify as a whistleblower under Dodd Frank.

C. The district court in ***Wagner v. Bank of Am. Corp*., 2013 U.S. Dist. LEXIS 101297 (D. Colo. July 19, 2013)** praised *Asadi*:

> "I also note that just this week a panel of the Fifth Circuit issued an opinion with which I agree entirely. See Asadi v. G.E. Energy."

3. Divergent Statutes of Limitation

* The 180 day SOX statute of limitation harshly compresses the time within which a whistleblower must effectively “elect” remedies.

A. The **ideal scenario** is for a whistleblower to continue working while making secret disclosures to the government.

B. But resolution of bounty claims to the SEC or DOJ will likely take **years**.

C. If the whistleblower is discovered, then he or she may be fired on other grounds by an **employer who conceals that it has learned of the protected activity**. A whistleblower who decides not to inform the employer will likely have greatly diminished protection from pretextural retaliation.

4. **Question**: The still employed whistleblower may contact a lawyer to ask this complex and difficult question: “SHOULD I FILE ALL OF MY CLAIMS AT THE SAME TIME?”

4. Need for Document Appropriation from Employer

A. Complex whistleblower cases will always involve **optimal need for appropriation of documents** from the employer.

B. **Question**: The still employed whistleblower typically contacts an attorney asking this paramount question: "TO PROVE BOTH MY SOX AND BOUNTY CLAIMS, SHOULD I START TAKING ALL THE RELEVANT DOCUMENTS NOW".

5. Involvement of Corporate Compliance Programs

A. Whether by internal disclosure, or internal discovery, corporate **compliance programs will likely be involved** in the complex whistleblower case at some point.

B. Under Dodd-Frank, the failure to first internally disclose can result in a **lower SEC bounty**.

C. **Question**: The still employed whistleblower may contact a lawyer and ask this complex and difficult question: "SHOULD I CONTACT AND/OR COOPERATE WITH OUR COMPLIANCE AND ETHICS PROGRAM?"

Case Study: *Vannoy v. Celanese* (*Vannoy 1* in 2011, *Vannoy 2* in 2013)

A. ***VANNOY I*** *:* *Vannoy v. Celanese Corp*., ARB Case No. 09-118, 2011 DOLSOX LEXIS 68, pp. 38-39 (September 28, 2011)::

1. "Thus the crucial question *** is whether the information that Vannoy procured from the company is ***the kind of 'original information' that Congress intended be protected*** under either the IRS or SEC whistleblower programs". AND

2. "whether ***the manner of the transfer of information was protected activity*** within the scope of SOX. These are mixed questions of law and fact***".

Vannoy II (July 2013)

In ***Vannoy II***, The ALJ found for Mr. Vannoy as follows:

"The Board recognized the conflict that exists between a company's legitimate business interest in protecting confidential information, and the potential need for such information [for] *** whistleblower bounty programs created by Congress ***".

***

"I find nothing in the transfer of this information to be reckless or unnecessary so as to remove its protection under the IRS program. The fact that not all such data was turned over to the IRS but retained by Vannoy's counsel does not show either a reckless or unnecessary transmission ***".

Compliance Views Rejected by the SEC Persist that "Legitimate" Whistleblowing Requires Internal Reporting

Comments of the Association of Corporate Counsel ("ACC) on the Proposed Rules for Whistleblower Provisions of Section 21F (December 15, 2011)

A. The sine qua non for compliance programs to work is the expectation that employees will report misconduct internally **so that the company can timely correct problems.**

B. Fraudulent misconduct, the bane of good compliance systems, will become **the gold mine**, rather than an impetus for companies with effective compliance systems to address the underlying issues.

C. Prospective whistleblowers will quickly learn that **waiting to allow the problem to fester and then report** directly to the Commission will yield a better award than immediately reporting to compliance officials

Whistleblowers and Their Lawyers Regard Corporate Compliance Programs as Risky

A. Compliance Programs Are Too Often Used as Tools of Cover-Up and Retaliation:

2009 Complaint**,** ***State of New York v. Intel Corp***: "Intel emails strongly suggest that the actual effect of the program was to school Intel executives in cover-up, rather than compliance."

B. Compliance Programs Are Part of a Burgeoning Corporate Bureaucracy Lacking Meaningful Accountability:

The metrics being used to judge how well compliance money is being spent do not make sense. CFOs should look at metrics that are more firmly grounded in corporate principles, such as ones that measure the ability of employees to "speak up" .

6. Settlement of the Complex Case

A. A **global release** almost every employer demands is not possible after **any bounty claim** is filed.

B. The **law is unclear** as to giving releases that prohibit Dodd Frank claims, or promising to accept no bounty.

C. Early bounty **claim valuation is difficult**.

D. **Question**: The still employed whistleblower may ask the complex question: "IF I GIVE A GLOBAL RELEASE, CAN THAT BE ENFORCED AS TO MY BOUNTY CLAIMS?"

COMPLEX QUESTION 1 RE MULTIPLE CLAIMS

Q. "IN VIEW OF ALL THE CLAIM POSSIBILITIES, WHICH CLAIMS SHOULD I FILE?"

A1. File the SOX claim first to preserve highest settlement possibilities on bounty claims generally.

A2. File the Qui Tam last to avoid "seal" problems.

A3. File the SOX claim first based on short limitations.

COMPLEX QUESTION 2 RE INTERNAL WHISTLEBLOWING

Q. "AS TO TIMING, SHOULD I INTERNALLY DISCLOSE NOW MY PROTECTED ACTIVITY AT THE RISK OF MY LIVELIHOOD?"

A1. Yes, unless there is reasonable belief that employer will likely spoliate evidence.

A2. No, if the whistleblower plans a near term job change.

COMPLEX QUESTION 3 RE MANAGING STATUTES OF LIMITATION

Q. "AS TO THE STATUTES OF LIMITATIONS, SHOULD I FILE ALL OF MY CLAIMS AT THE SAME TIME?"

A1. No, if the timing of filing within the limitations period is a highly strategic issue.

A2. Yes, if serious issues may arise under collateral estoppel or issue preclusion, especially as to SOX, Dodd Frank employment claim, and Qui Tam.

COMPLEX QUESTION 4 RE DOCUMENT APPROPRIATION

Q. "TO PROVE BOTH MY SOX AND BOUNTY CLAIMS, SHOULD I START TAKING ALL THE RELEVANT DOCUMENTS NOW?"

A1. Yes, if *Vannoy* criteria for discrete selection and transmission can be met.

A2. No if it involves unauthorized computer access.

A3. No, if there is reasonable probability of criminal action for theft or trespass under state law

COMPLEX QUESTION 5 RE COMMUNICATION WITH COMPLIANCE PROGRAM

Q. "TO PROTECT MYSELF, SHOULD I CONTACT OR COOPERATE WITH OUR COMPLIANCE AND ETHICS PROGRAM?"

A1. Yes if it is a mandated job duty and will insure chain of command notified for knowledge/nexus.

A2. Yes if in support of a strong Dodd Frank bounty claim.

A3. No if it is an already commenced False Claims Act, Qui Tam or IRS case

COMPLEX QUESTION RE RELEASE OF BOUNTY CLAIMS

Q. "IF I GIVE A GLOBAL RELEASE, CAN THAT BE ENFORCED AS TO NOT FILING OR COLLECTING ON MY BOUNTY CLAIMS?"

A1. No one knows.

A2. But the probable answers are that:

A. other than a qui tam, a bar to filing bounty claims is unenforceable;
B. but a bar to accepting the bounty is enforceable.