

The Special Inspector General for TARP: The New Enforcer and the Next Wave of Investigations

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Federal investigators are on the alert for possible illegal schemes, including the use of false pretenses to obtain TARP money and the improper use of TARP funds.

The first criminal charges alleging fraud associated with the Troubled Asset Relief Program (“TARP”) were filed on April 22, 2009 in the United States District Court for the Middle District of Tennessee. Federal authorities are currently conducting at least 20 additional criminal investigations into potential wrongdoing relating to TARP.¹ This marks the beginning of a new wave of investigations and enforcement proceedings that will impact recipients of TARP funds and those that do business with TARP recipients.

Those entities need to educate themselves about the broad scope of enforcement powers that the Office of the Special Inspector General for TARP (“SIG-TARP”) has over the approximately \$3 trillion that may ultimately be provided through TARP. Based upon the actions of SIGTARP to date, there will be further investigations and civil and criminal charges relating to TARP money.

THE CREATION AND POWERS OF SIGTARP

The Emergency Economic Stabilization Act of 2008 (“EESA”), which established TARP, created a new regulator — the Office of the Special Inspector General for TARP. According to SIGTARP, its mission is “to advance the goal of economic stability through transparency, coordinated oversight, and robust enforcement, thereby being a voice for, and protecting the interests of, those who fund the TARP programs — i.e., the American taxpayers.” SIGTARP is an independent agency, and its head is appointed by the President of the United States. SIGTARP has a budget of \$50 million and has a goal of increasing its staff to 150 full-time employees.

SIGTARP’s duties include conducting, supervising, and coordinating audits and investigations of the purchase, management, and sale of assets under

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Published in the September 2009 issue of *Financial Fraud Law Report*.
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TARP. SIGTARP has broad investigative authority and subpoena power. A recent amendment to EESA confirms that SIGTARP can undertake certain law enforcement functions without first obtaining approval from the U.S. Attorney General. SIGTARP does not have the power to commence civil or criminal proceedings on its own; rather, it must rely on partnerships with other enforcement agencies to do so.

On December 15, 2008, Neil M. Barofsky, a former federal prosecutor in the Southern District of New York, was sworn in as Special Inspector General for TARP. Since taking office, Mr. Barofsky has made several public statements concerning the scope of potential fraud relating to the receipt and use of TARP funds and his mission to detect, investigate, and punish those who engage in misconduct relating to TARP money. In a recent statement, Mr. Barofsky explained that the complex nature of the government bailout program makes it “inherently vulnerable to fraud, waste and abuse, including significant issues relating to conflicts of interest facing fund managers, collusion between participants, and vulnerabilities to money laundering.” Mr. Barofsky also has proclaimed that “the United States Government stands ready to detect, investigate and punish any and all who use the TARP program to commit fraud.”

SIGTARP’S ACTIVITIES TO DATE

Mr. Barofsky has been quite busy since his appointment. He has hired a chief of staff, chief counsel, chief of audit, chief of investigations, chief investigative counsel, and many others. To enhance SIGTARP’s enforcement capabilities, Mr. Barofsky has entered into partnerships with various criminal and civil law enforcement agencies, including the Federal Bureau of Investigation, the Securities and Exchange Commission, and the New York State Attorney General’s Office. SIGTARP also has set up a website (www.SIGTARP.gov) and a hotline for whistleblowers to report suspected fraud with respect to TARP funds.

As required by EESA, SIGTARP has issued two public reports to Congress describing SIGTARP’s work, and it will continue to issue reports on a quarterly basis. The first report, dated February 6, 2009, provides an overview of SIGTARP’s plans and its initial steps to implement those plans. The second

report, dated April 21, 2009, provides greater detail about SIGTARP’s activities and outlines SIGTARP’s priorities in the weeks and months to come. These include addressing:

- (1) the use of TARP funds,
- (2) executive compensation compliance by TARP recipients,
- (3) the approval processes associated with TARP assistance to Bank of America,
- (4) external influences potentially impacting decisions on applications for TARP funding,
- (5) AIG bonuses, and
- (6) AIG counterparty payments.

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SIGTARP has made a number of recommendations to the U.S. Treasury Department concerning the distribution of TARP funds. These recommendations include that all TARP agreements contain language that (1) acknowledges the jurisdiction and authority of SIGTARP to oversee compliance with the conditions contained in those agreements, (2) requires recipients to establish internal controls with respect to such conditions, and (3) requires recipients to use best efforts to account for the use of TARP funds. Treasury has indicated that it will include some of the recommended oversight language in future TARP-related agreements but that it will not adopt the recommendations that TARP recipients be required to establish internal controls and account for the use of TARP funds. Treasury is considering other SIGTARP recommendations.

Mr. Barofsky has also begun to exercise SIGTARP’s enforcement powers. In February, SIGTARP sent requests to each of the approximately 360 TARP recipients asking them to:

- (1) describe their use or expected use of TARP funds,
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- (2) describe their plans for complying with executive compensation restrictions,
- (3) provide documentation to support their response, and
- (4) provide a certification attesting to the accuracy of their response. SIGTARP had a 100 percent response rate to its requests.

SIGTARP will now review those responses to determine what additional steps are necessary to determine their accuracy. These additional steps will, no doubt, include additional investigation and referral for civil or criminal charges in the event that SIGTARP finds that TARP funds are not being used for a proper purpose.

THE FIRST TARP-RELATED CRIMINAL FRAUD CASE – UNITED STATES v. GRIGG

SIGTARP's aggressive approach in pursuing wrongdoing associated with TARP funds is already evident. On April 22, Mr. Barofsky, the U.S. Attorney's Office for the Middle District of Tennessee, the Regional Director of the SEC's Atlanta Regional Office, and other regulators jointly announced the filing of the first TARP-related criminal fraud case against Gordon B. Grigg, a financial advisor and owner of ProTrust Management, Inc.

The information filed against Grigg alleges that he operated a Ponzi scheme to defraud ProTrust investors. Grigg represented that client funds would be invested in certificates of deposit, private placements, and corporate notes and debentures. Instead, Grigg allegedly used client money for his personal benefit and expenses, to operate ProTrust, and to disburse supposed earnings to clients that closed out their ProTrust investment accounts. Grigg also allegedly fabricated documents, including correspondence, invoices, and account statements, with the intent of deceiving investors into believing that he was actively managing their accounts and falsely assuring investors of the safety of their investments. Grigg allegedly solicited nearly \$11 million in investments, approximately \$6.6 million of which was returned to investors that cashed out or closed their accounts.

Only one allegation links this scheme to TARP. As part of the scheme, Grigg allegedly represented to investors that he had committed more than \$5 million

in client funds to the purchase of TARP-guaranteed debt. Grigg, however, never committed, or intended, to make such an investment. Focusing on this connection, Mr. Barofsky, in a press release announcing the charges, stated:

The filing of charges today against Gordon Grigg, the first criminal charges brought in connection with a SIGTARP investigation, marks a significant milestone in the evolution of SIGTARP and of TARP oversight generally.... Today, SIGTARP, the U.S. Attorney's Office for the Middle District of Tennessee, the SEC, and the FBI, along with our state and local partners, serve notice on all who might try to profit criminally from the current national crisis that the United States Government stands ready to detect, investigate and punish any and all who use the TARP program to commit fraud.

Grigg agreed to plead guilty to four counts of mail fraud and four counts of wire fraud and faces approximately eight years in prison.

WHAT DOES THE FUTURE HOLD?

In its April report to Congress, SIGTARP noted that there are approximately 20 criminal probes of possible securities fraud, tax violations, insider trading, public corruption, and other crimes relating to the receipt and use of TARP funds. This likely is only the tip of the iceberg, as SIGTARP investigators are on the alert for possible illegal schemes, including the use of false pretenses to obtain TARP money and the improper use of TARP funds.

Mr. Barofsky also will continue to explore the responses to SIGTARP's initial inquiries regarding the use of TARP funds, and SIGTARP likely will make

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additional requests for information. Incomplete or incorrect responses to those inquiries could lead to further investigation. Moreover, false statements in responses to SIGTARP's inquiries could result in criminal charges because communications with SIGTARP are subject to 18 U.S.C. § 1001, which criminalizes false statements made to federal officials in connection with federal matters. The responses to SIGTARP's inquiries, and the investigations that arise from those responses, also could result in liability under other civil and criminal statutes.

Mr. Barofsky has set a broad agenda for SIGTARP. His early actions show that he will be aggressive in ferreting out and pursuing wrongdoing in

connection with TARP funds. Recipients of TARP funds and those that do business with TARP recipients therefore need to be vigilant in their dealings with SIGTARP if they wish to protect themselves from the possibility of civil or criminal liability. As Mr. Barofsky has warned, "We're going to try to push these investigations, be as aggressive as we can and move as quickly as we can."

NOTE

¹ This article was accepted for publication prior to the release of the Special Inspector General for TARP's issuance of a July 20, 2009 report on the use of TARP funds and a July 21, 2009 quarterly report to Congress.