UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

UNITED STATES OF AMERICA *ex rel.* PETER BELLI, Plaintiff, v. AMERICUS MORTGAGE CORPORATION, *et al.*, Defendants.	)	Case No. 11-CV-5443-VM
UNITED STATES OF AMERICA, Plaintiff-Intervenor, v. AMERICUS MORTGAGE CORPORATION, *et al*,. Defendants.	)	

DEFENDANT AMERICUS MORTGAGE CORPORATION'S
MEMORANDUM IN SUPPORT OF ITS MOTION TO DISMISS

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INTRODUCTION

Americus Mortgage Corporation, formerly known as Allied Home Mortgage Capital Corporation (hereinafter "Allied Capital" to facilitate comparison with the Amended Complaint), respectfully submits this Memorandum in Support of its Motion to Dismiss the government's Amended Complaint (the "Complaint"). While the Complaint nominally purports to allege violations of the False Claims Act, 31 U.S.C. § 3729 *et seq.* (the "FCA") and the Financial Institutions Reform, Recovery and Enforcement Act, 12 U.S.C. § 1833a ("FIRREA"), it fails to state a viable claim under either statute.

The Complaint asserts that Americus was at the heart of a long-standing fraudulent scheme, but there is not one false statement identified or described that concerns a claim for payment from the government. The Complaint also concedes that the government knew about every alleged violation upon which it now relies in an effort to impose unwarranted liability on Allied Capital. Despite this knowledge, the government allowed Allied Capital to continue originating loans as an approved residential mortgage loan broker or "correspondent lender."

Even more fundamentally, the government's theory of liability under the False Claims Act has been thoroughly rejected by the Second Circuit. The only events described in the Complaint concern the participation of Allied Capital as correspondent lender in government insured loan programs. The Second Circuit, and other circuits as well, require a ***false*** claim to involve a request for payment, and not merely a submission to the government as a condition of participation in a government program.

As for FIRREA, no viable claim is stated, because Allied Capital is not an employee, officer, or person connected with and applicable institution under the statute. Moreover, the Complaint fails to allege any false or fraudulent conduct with the specificity required by Rule 9(b), Fed. R. Civ. P.

Despite having many weeks to construct an amended Complaint, the government has failed to establish that jurisdiction or venue is appropriate in this District under Fed. R. Civ. P. 12(b)(2) or (3),[1] and has failed to state a viable claim against Allied Capital, under Fed. R. Civ. P. 12(b)(6). Consequently, the Complaint should be dismissed with prejudice.

BACKGROUND

For the purposes of this motion only, Allied Capital accepts the allegations in the Complaint as true. *Ashcroft v. Iqbal*, 556 U.S. 662, 129 S. Ct. 1937, 1950 (2009). Allied Capital is a corporation organized under the laws of the state of Texas, with its principal place of business in Houston, Texas. Compl. ¶ 17. Allied Capital at all relevant times was a mortgage broker approved by HUD as an FHA-correspondent, with the authority to originate HUD-insured mortgages for sale to other qualified entities. Compl. ¶ 17.

I. FHA-Insurance Generally

Congress created the Federal Housing Administration ("FHA") through the National Housing Act of 1934. 48 Stat. 1246 (1934). FHA became a part of HUD in 1965 and is still a component of HUD to this day. 42 U.S.C. § 3534(a). The FHA was established primarily for the purpose of insuring mortgage lenders against default by borrowers. 48 Stat. 1246 (1934). To accomplish this end, both HUD and FHA depend on the Mutual Mortgage Insurance Fund ("Insurance Fund"). *See* 12 U.S.C. § 1708(a). The Insurance Fund is a revolving fund that uses proceeds from insurance premiums, investment income, and foreclosure sales to provide funds for future mortgage insurance. *Id.* FHA is the largest mortgage insurer in the world. Compl. ¶ 2. Through this program, loans are given to "millions of Americans who could not otherwise qualify for a mortgage." Compl. ¶ 3.

[1] Allied Capital requested permission to file a motion to transfer pursuant to 28 U.S.C. § 1404 on December 31, 2011.

II. HUD's Regulations Regarding Lender Participation in the FHA-Insurance Program

The Complaint makes no allegations regarding any statutes or regulations that govern the approval process for correspondent lenders such as Allied Capital, nor does it describe any statutes or regulations that Allied Capital has violated. Instead, the Complaint sparsely and vaguely alleges violations of the HUD Handbook. *See* Compl. ¶¶ 36, 60, 97, 98. However, the HUD regulations regarding approval of lending institutions are found at 24 C.F.R. § 202.1 through § 202.12. These regulations "establish[] minimum standards and requirements for approval by the Secretary of lenders and mortgagees to participate" in the FHA-insurance program. 24 C.F.R. § 202.1. The regulations specifically allow HUD the discretion to impose various administrative penalties while maintaining a lender's approved status. *See, generally*, 24 C.F.R. § 202.3. HUD has created an extensive administrative scheme through which it enforces compliance with these regulations. *See, e.g.*, 12 U.S.C. § 1708; 24 C.F.R. § 25.6.

The only reference to any regulation in the Complaint is to 24 C.F.R. § 202.5. Compl. ¶ 97. Section 202.5 sets forth specific requirements which must be met in order to participate in the FHA insurance program: "To be approved for ***participation*** in [FHA] programs, and to maintain approval, a lender or mortgagee shall meet and continue to meet the general requirements of paragraphs (a) through (n) of this section . . . ." 24 C.F.R. § 202.5 (emphasis added). Among these continuing participatory requirements are:

- Any lender or mortgagee that accepts a loan application from a non-FHA-approved entity must ensure that the loan is underwritten by the FHA-approved lender or mortgagee (24 C.F.R. § 202.5(a)(3));
- The lender or mortgagee must "implement a written quality control plan . . . that assures compliance with the regulations and other issuances of the Secretary regarding loan or

mortgage origination . . . ." (24 C.F.R. §202.5(h));

- The lender must not employ as an officer, partner, director, principal, manager, supervisor, loan processor, loan underwriter, or loan originator, any person who has been suspended or debarred by a federal agency, indicted or convicted of an offense that reflects poorly upon the program, or convicted of a felony related to the real estate industry (24 C.F.R. § 202.5(j));
- Registering all branch offices with HUD (24 C.F.R. § 202.5(k)).

III. HUD Extensively Audited Allied Capital's Lending Activities

HUD conducted multiple audits into Allied Capital's business activities, including the allegations regarding "shadow branches," and the allegations regarding Allied Capital's quality control provisions. In fact, HUD conducted audits of Allied Capital's operations every year from 2001 through 2010. However, HUD never used its authority to suspend Allied Capital, or terminate Allied Capital's approval as a correspondent lender, despite these reviews. Instead, HUD did not deem any of the findings of its audits to require a termination or suspension proceeding against Allied Capital, allowing Allied Capital to remain a participant in the correspondent lender program until the correspondent lender program was discontinued at the end of 2010. Compl. ¶ 17.

More specifically, in 2000, HUD found that two branches in Arizona operated "thirteen unapproved 'satellite' offices." Compl. ¶¶ 39-40. In 2001, HUD conducted an audit that found Allied Capital's employment agreement was not compliant. Compl. ¶ 57. In 2002, HUD revisited the two Arizona offices and demanded indemnification for certain loans. Compl. ¶ 41. In 2003, Allied Capital entered into an agreement with HUD regarding the payment of branch operating costs. Compl. ¶ 61. In 2004, HUD audited Allied Capital's quality control

department, but did not suspend or terminate Allied Capital as a result of this action. Compl. ¶ 88. In 2005, a HUD audit of a branch in Fresno, California, found it was not properly approved. Compl. ¶ 42. In 2006, HUD issued a Credit Watch termination for a branch in Greensboro, North Carolina. Compl. ¶ 45.[2] In 2007, HUD conducted another audit of Allied Capital's quality control plan. Compl. ¶ 91. In 2008, HUD conducted a follow-up audit of Allied Capital's quality control plan. Compl. ¶ 92. HUD additionally audited Allied Capital's branch operations in 2008, and issued its report from that audit in 2009. Compl. ¶ 72.

As conceded by the government, HUD was aware of the behavior alleged by the government in the Complaint throughout the relevant time period, yet used its discretion to allow Allied Capital to continue originating FHA-insured loans. Compl. ¶ 17.

IV. The Complaint Fails to Allege Any Loan-Level Certifications as the Basis for FCA and FIRREA Allegations

The government alleges that Allied Capital "originated loans out of hundreds of 'shadow' branches that were not approved by HUD, then submitted those loans to HUD using one of the unique branch identification numbers [] assigned to a HUD-approved branch." Compl. ¶ 6. The government also alleges that Allied Capital "falsely certified that the branch office met all HUD/FHA requirements and, specifically, that Allied Capital would pay all operating costs of the branch office," (Compl. ¶ 7), and that Allied Capital "failed to implement an internal quality control plan . . . ." Compl. ¶ 8. Because of these allegedly "false" statements, the government seeks treble damages under the FCA "for each of Allied's defaulted loans," and seeks damages under FIRREA "for each of the hundreds of false certifications and other false

[2] A Credit Watch termination occurs where a mortgagee has a rate of defaults and claims on insured mortgages that exceeds 200% of the normal rate. 24 C.F.R. § 202.3(c)(2)(iii)(A). This determination can be made on a branch-level basis, as was allegedly done here. *Id*. at § 202.3(c)(2)(i) ("The Secretary may also review the insured mortgage performance of a mortgagee's branch offices individually and may terminate the authority of the branch or the authority of the mortgagee's overall operation."). The government never alleges that HUD terminated Allied Capital's overall approval to originate loans.

statements submitted to HUD." Compl. ¶ 12. The government does not however, identify even one loan that has defaulted, nor does it contain a single allegation about a supposedly false statement that was made in connection with a claim for FHA-insurance funds.

LEGAL STANDARD

Fed. R. Civ. P. 12(b)(2) allows a party to move to dismiss based on a lack of personal jurisdiction. The plaintiff bears the burden of establishing that the court has personal jurisdiction over a defendant. To determine whether the plaintiff has made this showing, the court is not obligated to draw "argumentative inferences" in the plaintiff's favor. *Robinson v. Overseas Military Sales Corp.*, 21 F.3d 502, 507 (2d Cir. 1994). The court applies the same standards to a motion to dismiss for improper venue under Fed. R. Civ. P. 12(b)(3) as it does to a motion to dismiss for lack of personal jurisdiction. *Gulf Ins. Co. v. Glassbrenner*, 417 F.3d 353, 355 (2d Cir. 2005).

A motion to dismiss pursuant to Fed. R. Civ. P. 12(b)(6) should be granted if the complaint does not allege "enough facts to state a claim to relief that is plausible on its face." *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007). While courts must accept the plaintiffs' well-pleaded allegations as true and draw all reasonable inferences in their favor, the court need not accept unsupported legal conclusions as true. *Iqbal*, 129 S. Ct. at 1950. Conclusory allegations or legal conclusions masquerading as factual assertions are not sufficient to maintain a cause of action. *Id.*

Thus, a plaintiff needs "more than labels and conclusions, and a formulaic recitation of the elements of a cause of action will not do." *Twombly*, 550 U.S. at 555 (citation omitted). A complaint fails "if it tenders 'naked assertion[s]' devoid of 'further factual enhancement.'" *Iqbal*, 129 S. Ct. at 1949 (quoting *Twombly*, 550 U.S. at 557). "Threadbare recitals" of nothing

more than the elements of a claim, "supported by mere conclusory statements," are not enough to state a claim under Rule 12. *Id.* Moreover, Fed. R. Civ. P. 9(b) requires that allegations of fraud state with particularity the circumstances constituting the alleged fraud, including: 1) the allegedly false or fraudulent statement; 2) the speaker; 3) where and when the statement was made; and 4) the reason it was fraudulent. *Rombach v. Chang*, 355 F.3d 164, 170 (2d Cir. 2004).

ARGUMENT

I. The Government Has Failed to Establish Personal Jurisdiction or Venue

The government alleges that personal jurisdiction and venue are proper in the Southern District of New York "because at least one of the defendants transacts business in this judicial district, including by transferring loans and selling loans to other mortgagees and purchasers in this district, including J.P. Morgan Chase and/or an act proscribed by 31 U.S.C. § 3729 occurred in this judicial district." Compl. ¶ 14. The government states no facts in support of this allegation however, and the only specific connection to New York ever mentioned in the Complaint is that Allied Capital formerly held a New York mortgage license. Compl. ¶¶ 17, 62-63.[3] The Complaint specifically avers that all four named defendants are residents of Texas. Compl. ¶¶ 17-21. Finally, the government does not identify a single claim for payment or report that was submitted in New York. Such bare and conclusory allegations do not begin to establish that jurisdiction or venue in this district court is proper. *See Maranga v. Taj Maran Int'l Corp.*, 386 F. Supp. 2d 299, 308 (S.D.N.Y. 2005) (dismissing claim pursuant to Fed. R. Civ. P. 12(b)(2)); *Mortg. Funding Corp. v. Boyer Lake Pointe, LC*, 379 F. Supp. 2d 282, 287 (E.D.N.Y. 2005) (same).

The government alleges that venue is appropriate based on 28 U.S.C. § 1391(b)(1). 28

[3] The government's allegations regarding submissions to the New York State Banking Department (Compl. ¶¶ 62-63), while inflammatory and conclusory, are irrelevant to FCA and FIRREA claims based on alleged submissions to the federal government.

U.S.C. § 1391(b)(1) states: "A civil action wherein jurisdiction is not founded solely on diversity of citizenship may, except as otherwise provided by law, be brought only in (1) a judicial district where any defendant resides, if all defendants reside in the same State . . . ." This section of the venue statute would only authorize venue in Texas, however, as the government concedes in the Complaint that all four defendants are residents of Texas. Compl. ¶¶ 17-21. *See Daniel v. Am. Bd. Of Emergency Med.*, 428 F.3d 408, 431 (2d Cir. 2005) ("Plaintiffs' reliance on § 1391(b)(1) merits little discussion because all defendants do not reside in New York state.").

The government also alleges that venue is proper in this district pursuant to 31 U.S.C. § 3732(a). Compl. ¶ 14. Section 3732(a) is the venue provision of the FCA, and allows that "[a]ny action under section 3730 [of the FCA] may be brought in any judicial district in which the defendant or, in the case of multiple defendants, any one defendant can be found, resides, transacts business, or in which any act proscribed by section 3729 occurred." The government fails to allege any operative action that occurred in New York, and states that Allied Capital is a resident of Texas. Thus, the Complaint has failed to establish venue is proper in this district.

II. The Government Has Failed to State a Claim Under the False Claims Act

The government fails to meet any of the required elements for a false claim under 31 U.S.C. § 3729(a)(1)(B). The government alleges in conclusory terms that Allied Capital submitted false loan-level certifications, but never identifies a single certification that was false, let alone why the certification was false, who made the false statement, or whether the certification was made to receive government payment. Instead, the government's theory is that violations of regulatory participation requirements create liability for all actions taken after any such violation. The Second Circuit, and virtually every other Circuit Court of Appeals to address this argument, however, has rejected this bootstrapped theory of FCA liability. Further, the

government notably fails to allege scienter or materiality, but actually alleges facts that destroy these crucial elements of an FCA claim under § 3729(a)(1)(B). The government's lengthy exposition is nothing more than a statement that Allied Capital unlawfully harmed the government — this is the exact type of pleading that the Supreme Court rejected in its recent decisions in *Twombly* and *Iqbal*. *See Iqbal*, 129 S. Ct. at 1949 (ruling that a complaint "demands more than an unadorned, the-defendant-unlawfully-harmed-me accusation.").[4]

a. The Government's All-Inclusive Annual Certification Theory Fails Because it is Based on A Theory Rejected by the Second Circuit

To state a claim under 31 U.S.C. § 3739(a)(1)(B), the government must allege that: (1) the defendant made, or caused to be made, a false or fraudulent record or statement; (2) the defendant knew it to be false or fraudulent; (3) the false or fraudulent record was material to a claim made to the government; and (4) it did so to seek payment from the federal treasury. *United States ex rel. Pervez v. Beth Israel Med. Ctr.*, 736 F. Supp. 2d 804, 811 (S.D.N.Y. 2010); *United States ex rel. Blundell v. Dialysis Clinic, Inc.*, No. 5:09-CV-710, 2011 U.S. Dist. LEXIS 4862, at *38 (N.D.N.Y. Jan. 19, 2011); *United States ex rel. Feldman v. City of New York*, No. 09-CV-8381, 2011 U.S. Dist. LEXIS 98251, at *36 (S.D.N.Y. Sept. 1, 2011) ("[§3729(a)(1)(B)] establishes a 'double falsity' requirement: the Government must allege both (i) a false record or statement, and (ii) a false claim."). The Second Circuit has recognized three separate types of actionable theories for false or fraudulent claims: 1) the factually false claim; 2) the express legally false claim; and 3) the implied legally false claim. *United States ex rel. Colucci v. Beth Israel Medical Center*, 785 F. Supp. 2d 303, 311 (S.D.N.Y. 2011) (citing *United States ex rel. Kirk v. Schindler Elevator Corp.*, 601 F.3d 94, 113-14 (2d Cir. 2010)).

[4] All claims the government attempts to allege prior to November 1, 2005, are barred by the FCA's statute of limitations, which precludes any claim brought "more than 6 years after ***the date on which the violation of [the FCA] is committed***." 31 U.S.C. § 3731(b)(1) (emphasis added).

A factually false claim occurs "where the claimant supplies [1] an incorrect description of goods or services or [2] a request for reimbursement for goods or services never provided." *Colucci*, 785 F. Supp. 2d at 311 (citations omitted). An express legally false certification is "a claim that falsely certifies compliance with a particular statute, regulation or contractual term, where compliance is a prerequisite to payment." *Id*. (citations omitted). An implied legally false certification occurs where there is no express certification in the submitted claim for payment, but the claim itself implies compliance. *Id*.

Implied legally false certifications are available only where the underlying statute or regulation "expressly states the provider must comply in order to be paid. . . ." *Id*. This is done in order to "prevent[] the FCA from being used as a 'blunt instrument' to enforce compliance with all manner of regulations, even if such regulations are unrelated to the government's payment decisions." *Id*. (citing *United States ex rel. Mikes v. Strauss*, 274 F.3d 687, 699 (2d Cir. 2001)).

The government's allegations here can only fit into the second category of false claims liability, express legally false certifications. The government alleges no factually false claims, and alleges no violations of statutes or regulations that expressly state the provider must comply with in order to be paid. *See, e.g.*, Compl. ¶¶ 7, 110-11, 125-126.

i. The False Statement Must be Made as A Condition of Payment, Not a Condition of Participation

In order to state a claim for FCA violations, the claim for reimbursement must certify compliance with a statute or regulation as a condition of payment by the government. *Mikes*, 274 F.3d at 697. "While the [FCA] is 'intended to reach all types of fraud, without qualification, that might result in financial loss to the government,' it does not encompass those instances of regulatory noncompliance that are irrelevant to the government's disbursement decision." *Id*.

(internal citations omitted). "[N]ot all instances of regulatory noncompliance will cause a claim to become false." *Id*. *See also United States ex rel. Willard v. Humana Health Plan of Texas, Inc.*, 336 F.3d 375, 381 (5th Cir. 2003) ("This court has recognized that 'services rendered in violation of a statute do not necessarily constitute false or fraudulent claims under the FCA."); *Harrison v. Westinghouse Savannah River Co.*, 176 F.3d 776, 786-87 (4th Cir. 1999) ("The courts in these cases will not find liability merely for non-compliance with a statute or regulation."); *Colucci*, 785 F. Supp. 2d at 315 ("[N]ot every instance in which a false representation of compliance with a regulatory regime is made will lead to liability.") (citations omitted); *United States ex rel. Wall v. Vista Hospice Care, Inc.*, 778 F. Supp. 2d 709, 718 (N.D. Tex. 2011) ("A claim is not necessarily 'legally false' simply because it involves a violation of a statute or regulation . . . ."); *Sweeney v. Manorcare Health Servs., Inc.*, No. 03-CV-5320, 2005 U.S. Dist. LEXIS 45216, at *12 (W.D. Wash. Mar. 4, 2005) ("[M]ere regulatory violations do not give rise to a viable FCA action.") (citing *United States ex rel. Hopper v. Anton*, 91 F.3d 1261, 1266 (9th Cir. 1996)).

Instead, the statute or regulation allegedly violated must be one which is required to be complied with in order to receive payment. *Mikes*, 274 F.3d at 697. Since the FCA attaches liability "not to the underlying fraudulent activity or to the government's wrongful payment, but to the 'claim for payment,'" the central question in FCA cases is whether the defendant ever presented a false or fraudulent claim. *Harrison*, 176 F.3d at 785 (citing *United States v. Rivera*, 55 F.3d 703, 709 (1st Cir. 1995)). General certifications of compliance with the law are insufficient to state a presentment of a false or fraudulent claim. *Colucci*, 785 F. Supp. 2d at 315 (citing *United States ex rel. Conner v. Salina Reg. Health Ctr., Inc.*, 543 F. 3d 1211, 1218-19 (10th Cir. 2008)).

Moreover, where there is an administrative regime setting forth separate repercussions for violations of a statutory or regulatory regime, compliance with such statutes or regulations is not a condition of payment. *Mikes*, 275 F.3d at 701-702; *United States ex rel. Vigil v. Nelnet, Inc.*, 639 F.3d 791, 799 (8th Cir. 2011) (ruling that the relator "must plead and prove that Nelnet's allegedly false Certifications were conditions of payment . . . . By contrast, if the regulatory violations were only conditions of [] participation, they 'are enforced through administrative mechanisms, and the ultimate sanction for violation of such conditions is removal from the government program.'") (citation omitted); *Willard*, 336 F.3d at 382 ("It is clear that compliance with the regulations . . . was not a condition of payment under the contract. If Humana engaged in any practice that 'would reasonably be expected to have the effect of denying or discouraging enrollment' based on health status, the Government is merely authorized to suspend future enrollment, suspend *future* payments, or impose monetary penalties . . . .").

Courts must determine whether the "[c]onditions of participation, as well as a provider's certification that it has complied with those conditions, are enforced through administrative mechanisms, and the ultimate sanction for violation of such conditions is removal from the government program." *Conner*, 543 F.3d at 1220; *Mikes*, 274 F.3d at 701-02. Conditions of payment, however, "are those which, if the government knew they were not being followed, might cause it to actually refuse payment." *Conner*, 543 F.3d at 1220. Where compliance with such statutes and regulations is a condition of participation, no FCA liability lies. *Mikes*, 274 F.3d at 697.

ii. The Branch-Level Certifications Are Conditions of Participation

The government alleges that Allied Capital violated HUD regulations by: failing to register originating branches with HUD (Compl. ¶¶ 38-54); hiring ineligible employees,

including employees with felony convictions (Compl. ¶¶ 68, 104); failing to implement an appropriate quality control plan (Compl. ¶¶ 86-94); failing to disclose administrative actions taken by other state regulatory bodies (Compl. ¶¶ 95-113); and submitting annual certifications stating that Allied Capital was in compliance with HUD regulations, despite the alleged violations. Compl. ¶¶ 33, 110. The only documents specifically alleged to have been submitted to HUD over the entire period covered in the Complaint are two annual certifications in the years 2006 and 2007. Compl. ¶ 110.

These annual certifications, however, are explicitly conditions of participation in HUD's FHA-insurance program for correspondent lenders, and thus cannot state the basis of an FCA claim. 24 C.F.R. § 202.5(m) ("***To be approved for participation in the Title I or Title II programs*** . . . [e]ach lender or mortgagee must submit an annual certification on the form prescribed by the Secretary.") (emphasis added); *Mikes*, 274 F.3d at 697. *See also Conner*, 543 F.3d at 1218 ("[When the] express certification does not state that compliance is a prerequisite to payment, we must look to the underlying statutes to surmise if they make the certification a condition of payment."). Indeed, every alleged violation the government states as to why Allied Capital's certifications were false or fraudulent are conditions of participation in the program. 24 C.F.R. § 202.5(h) (quality control plans); *Id*. at 202.5(j) (eligibility of employees); *id*. at 202.5(k) (registration of branch offices); 202.5(m) (annual certification and disclosure of state actions). Tellingly, the government cites no regulatory or statutory provisions that Allied Capital has allegedly violated, let alone one that would be a condition of payment.[5] HUD's regulations regarding approval of lending institutions and mortgagees, located at 24 C.F.R. § 202.1 through § 202.12, vitiate the government's position: "This part establishes minimum

[5] The only reference in the Complaint to a specific regulation is to 24 C.F.R. § 202.5. Compl. ¶ 97. Section 202.5 expressly states that its requirements are a condition of ***participation*** in the program. 24 C.F.R. § 202.5.

standards and requirements for approval by the Secretary of lenders and mortgagees ***to participate in*** the Title I and Title II programs." 24 C.F.R. § 202.1 (emphasis added). Non-compliance with these regulations merely subjects the approved lender to administrative actions within the agency's discretion. *See, e.g.*, 12 U.S.C. § 1708; 24 C.F.R. § 25.6.

Instead of citing any regulations or statutes Allied Capital allegedly violated to establish the purported false claims, the government relies on citations to HUD Handbook 4060.1, Rev. 2.[6] However, just as with the regulations setting forth the conditions of participation in the FHA program, compliance with the HUD Handbook is a condition of participation, and not a condition of payment. HUD Handbook 4060.1, Rev. 2, § 1-13 authorizes HUD and the Mortgagee Review Board to take administrative actions against non-compliant lenders. Chapter 8 of HUD Handbook 4060.1, titled "Mortgagee Monitoring, Administrative Sanctions and MRB Actions, Credit Watch and Neighborhood Watch," is devoted to the various actions that may be taken by HUD or the Mortgagee Review Board. The purpose of these administrative actions is to "ensure that mortgage practices are in compliance with statutory, regulatory and administrative loan origination and servicing requirements." HUD Handbook 4060.1, Rev. 2, § 8-1(A). These actions may be taken "against individuals, companies and lenders for actions or omissions in connection with FHA mortgage insurance programs." HUD Handbook 4060.1, Rev. 2, § 8-4. The actions available to HUD and the Mortgagee Review Board include:

- Limited Denial of Participation — "Serious, isolated, violations of FHA requirements may lead to an LDP of an individual or company . . . . The LDP precludes the party from participating in the HUD programs specified, within the jurisdiction of the HUD official taking the action, for up to one year." HUD Handbook 4060.1, Rev. 2, § 8-4(A);

[6] *Available at* http://portal.hud.gov/hudportal/HUD?src=/program_offices/administration/hudclips/handbooks/hsgh/4060.1 (last visited March 22, 2012).

- Debarment or Suspension — "Violations of statutes or serious or repeated violations of FHA requirement may lead to a debarment or suspension of an individual, a company, or with approval of the [Mortgagee Review Board], a lender . . . ." HUD Handbook 4060.1, Rev. 2, § 8-4(B);
- Mortgagee Review Board — The Mortgagee Review Board is authorized to impose civil monetary penalties and take administrative actions against violators of HUD's requirements. HUD Handbook 4060.1, Rev. 2, § 8-4(C).

The government fails to allege what regulations or statutes Allied Capital purportedly violated, instead relying on a few provisions from the HUD Handbook, which is neither statute nor regulation. *United States ex rel. Wilkins v. United Health Grp., Inc.*, 659 F.3d 295, 309-10 (3d Cir. 2011) ("the fundamental flaw in appellants' allegations is that the amended complaint does not cite to any regulations demonstrating that a participant's compliance with [these] regulations is a condition for its receipt of payment."). In fact, the Handbook is designed to be "a compilation of procedural information and policy guidelines for mortgagees." *Roberts v. Cameron-Brown Co.*, 556 F.2d 356, 361 (5th Cir. 1977). "Absent an allegation that [the Defendant] was stripped of its status as an eligible lender . . . [its] certification that it was an eligible lender was not false or fraudulent." *Vigil*, 639 F.3d at 796. *See also United States ex rel. Gross v. AIDS Research Alliance-Chicago*, 415 F.3d 601, 604 (7th Cir. 2005) ("As the statute itself puts it, liability only attaches when a false statement is used 'to get a false or fraudulent claim paid or approved by the Government.'") (citing 31 U.S.C. § 3729(a)(2)(2006)).

"Reading the FCA otherwise would undermine the government's own administrative scheme for ensuring that [lenders] remain in compliance and for bringing them back into compliance when they fall short of what [the FHA] regulations and statutes require." *Conner*,

543 F.3d at 1220. "It would be [] curious to read the FCA, a statute intended to protect the government's fiscal interests, to undermine the government's own regulatory procedures." *Id.* at 1222. Because the regulations clearly establish compliance as a condition of participation, and not a condition of payment, there is "no reason to deviate from Second Circuit precedent and the holding in *Mikes*." *Blundell*, 2011 U.S. Dist. LEXIS 4862, at *55. *See also United Health Grp.*, 659 F.3d at 310-11 ("[W]e question the wisdom of regarding every violation of a . . . regulation as a basis for a qui tam suit. Federal agencies are unquestionably better suited than federal courts to ensure compliance with [their] regulations . . . . [W]e believe that by permitting qui tam plaintiffs to file suit based on the violation of regulations which may be corrected through an administrative process and which are not related directly to the government's payment of a claim, courts unwisely would shift the burden of enforcing [such] regulations to themselves . . . ."); *United States ex rel. Cooper v. Gentiva Health Servs., Inc.*, No. 01-508, 2003 U.S. Dist. LEXIS 20690, at *8 (W.D. Pa. Nov. 4, 2003) (ruling that regulations that "permit the sanction of terminating supplier eligibility make it evident that [such a violation] is directed at the provider's continued eligibility in the Medicare program . . . .").

b. The Government Fails to Allege Any Loan-Level Certifications

The government purports to base its FCA claims on allegedly false loan-level certifications by Allied Capital. Compl. ¶¶ 114-118. However, despite drafting a 40 page Amended Complaint with 149 separately numbered paragraphs, the government does not describe a single loan-level certification it alleges to be false.[7] Moreover, the government fails to identify any "shadow" branch office, or any claims made for payment, other than conclusory statements that the "Government paid insurance claims, and incurred losses . . . ." Compl. ¶¶

[7] For this same reason, as well s the speculative nature of the damages pled and failure to allege causation, the government's second cause of action for indemnification (Compl. ¶¶ 119-123) must fail.

116-117. Such bare-bones allegations cannot state the basis of a claim, and fail to put Allied Capital on notice of the government's claims and the grounds upon which it rests. *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 319 (2007); Fed. R. Civ. P. 8(a). Because the government has failed to allege the essential element of an FCA violation, their claim must fail.

c. Government Fails to Demonstrate Materiality

The government has failed to plead facts that would plausibly support materiality, because HUD was on notice of, and conducting an investigation into, the very conduct alleged by the government here to violate the FCA. *See* Background § III, *supra*. Nonetheless, HUD allowed Allied Capital to continue participating in the FHA-insurance program. Compl. ¶ 5 (noting that Allied Capital originated FHA loans through the end of 2010). The government must plausibly allege materiality to sustain an FCA claim. 31 U.S.C. § 3729(a)(1)(b); *United States ex rel. Loughren v. Unum Grp.*, 613 F.3d 300, 307 (1st Cir. 2010) (citing *Allison Engine Co., Inc. v. United States*, 553 U.S. 662 (2008)). The statute defines material as "having a natural tendency to influence, or be capable of influencing, the payment or receipt of property." 31 U.S.C. § 3729(b)(4). HUD's knowledge of, and investigation into, such allegations over a nine-year period, and its acquiescence in allowing Allied Capital to remain in the program, despite administrative mechanisms it could have used to prevent Allied Capital's continued participation, destroys any inference of materiality. *United States ex rel. Lamers v. City of Green Bay*, 168 F.3d 1013, 1019-20 (7th Cir. 1999) ("the FTA approved the City's annual grant application in June of 1995 even when it knew from Carter's direct inspection that GBT's program was not entirely up to snuff. The notion that the FTA was somehow being duped by the City at this point in the process is absurd.").

Moreover, nowhere in the Complaint does the government allege it relied on any

allegedly false statement that was made as a condition of payment. As stated more fully in § I(a)(i), *supra*, the alleged violations were conditions of participation, and thus do not give rise to FCA liability. *Mikes*, 274 F.3d at 697. *See also Kirk*, 601 F.3d at 114 ("Because the language of [the FCA] plainly links the wrongful activity to the government's decision to pay, the statute does not encompass those instances of regulatory noncompliance that are irrelevant to the government's disbursement decisions.") (citations and quotations omitted). The government does not allege it relied on any such statement by Allied Capital, and this alone stands as an independent reason to dismiss the claims: "Although the record indicates that the defendants' performance under the contract was not perfect, the extent of the government's knowledge through its on-site personnel and other sources shows that . . . the 'government knew what it wanted, and got what it paid for.'" *United States ex rel. Costner v. United States*, 317 F.3d 883, 888 (8th Cir. 2003) (citations omitted); *United States ex rel. J. Cooper & Assocs., Inc. v. Bernard Hodes Grp., Inc.*, 422 F. Supp. 2d 225, 239 (D.D.C. 2006) ("The government's decision to award contracts to the defendants, despite its knowledge that the defendants [were not in compliance with the regulations], negates any claim of fraud against the defendants.").

d. Government Fails to Demonstrate Scienter

The government concedes that HUD knew of potential violations by Allied Capital as early as 2000. Compl. ¶ 39. Indeed, the government alleges that HUD conducted an active investigation into Allied Capital every single year during the period from 2000 through 2009. *See* Background § C, *supra*. "[T]he government's knowledge of the facts underlying an allegedly false record or statement can negate the scienter required for an FCA violation." *United States ex rel. Becker v. Westinghouse Savannah River Co.*, 305 F.3d 284, 289 (4th Cir. 2002).

See also United States ex rel. Kreindler v. United Techs. Corp., 985 F.2d 1148, 1157 (2d Cir. 1993) (ruling that "government knowledge may be relevant to a defendant's liability. . . .").

The government does not, and cannot, allege that HUD ever terminated Allied Capital's approval as a result of the investigations. HUD audited Allied Capital multiple times, and each time used its discretion to allow Allied Capital to remain a participant in the FHA-insurance program. "In such a case, the government's knowledge effectively negates the fraud or falsity required by the FCA." *United States ex rel. Durcholz v. FKW, Inc.*, 189 F.3d 542, 545 (7th Cir. 1999).

e. All FCA Claims Prior to June 7, 2008 Must Be Dismissed

Because the only submissions alleged by the government in the entirety of the Complaint were in 2006 and 2007 (Compl. ¶ 110), all of the government's FCA claims pursuant to the revised § 3729(a)(1)(B), must be dismissed. The government brings FCA claims under 31 U.S.C. § 3729(a)(1)(B), as well as its predecessor statute, 31 U.S.C. § 3729(a)(2)(2006). Compl. ¶¶ 114-118. Section 3729(a)(1)(B) did not exist, however, until Congress passed the Fraud Enforcement and Recovery Act of 2009 ("FERA"). 111 Pub. L. 21, 123 Stat. 1621 (2009). *See also Pervez*, 736 F. Supp. 2d at 811 n.38. The effective date for § 3729(a)(1)(B) is June 7, 2008. 123 Stat. 1625. *See also United States ex rel. Sanders v. Allison Engine Co., Inc.*, 667 F. Supp. 2d 747 (S.D. Ohio 2009); *United States v. Sci. Applications Int'l Corp.*, 653 F. Supp. 2d 87, 107 (D.D.C. 2009) *vac'd on other grounds by* 626 F.3d 1257 (D.C. Cir. 2010). Thus, even if the annual certifications in 2006 and 2007 were construed to adequately allege a false claim, they would not be subject to § 3729(a)(1)(B). [8]

[8] The retroactivity clause also implicates potential *ex post facto* issues. *See Sanders*, 667 F. Supp. 2d at 752-58. "Where a statute may be construed to have either retrospective or prospective effect, a court will choose to apply the statute prospectively if constitutional problems can thereby be avoided." *Louis Vuitton S.A. v. Spencer Handbags Corp.*, 765 F.2d 966, 971 (2d Cir. 1985). Because the application of a

To the extent the government alleges a cause of action under former § 3729(a)(2), the government's claims fail for the further reason that they do not plead an intent to defraud the government. Former § 3729(a)(2) imposed liability on any person who "knowingly makes, uses, or causes to be made or used, a false record or statement to get a false or fraudulent claim paid or approved by the government." 31 U.S.C. § 3729(a)(2)(2006); *see also Kirk*, 601 F.3d at 113 n.14. Former § 3729(a)(2) demands proof "that the defendant made a false record or statement for the purpose of getting 'a false or fraudulent claim paid or approved by the government.'" *Allison Engine Co., Inc. v. United States*, 553 U.S. 662, 671 (2008). Such a statement must be made to the government with the intent of the government "rely[ing] on that false statement ***as a condition of payment*** . . . ." *Id*. at 672 (emphasis added). Without such intent, "a false claim is too attenuated to establish liability." *Id*. The government has failed to allege such an intent, stating only conditions of participation. Thus, to the extent that the government's claim may be read to allege violations of former § 3729(a)(2), these claims must be dismissed.

III. The Government Has Failed to Plead FIRREA Allegations[9]

The government has failed to plead any claim under 18 U.S.C. §§ 1006 or 1014, pursuant to the civil provisions of 12 U.S.C. § 1833a. Initially, 18 U.S.C. § 1006 only applies to individuals in their capacity as officers of an applicable institution, and thus cannot apply to Allied Capital as an institution. 18 U.S.C. § 1006 (2011) ("Whoever, ***being an officer, agent or***

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treble damages clause, such as is available to the government under the FCA, could raise constitutional questions under the *ex post facto* clause, U.S. Const. Art. I, § 9, Cl. 3, the FERA amendments should be applied prospectively, thereby vitiating any claim for the 2006 and 2007 certifications. *Id*. (applying amendments to the trademark counterfeiting statute prospectively due to constitutional concerns regarding the *ex post facto* clause and the due process clause).

[9] The government's fifth and sixth claims are identical, both pleading violations of FIRREA based on the same conduct. *See* Compl. ¶¶ 134-144.

employee of . . . .") (emphasis added).[10] The government has also failed to identify any action covered by 18 U.S.C. § 1014.

To state a claim under 18 U.S.C. § 1006, the government must allege:

> (1) that the defendant is an officer or employee of a lending institution organized under the laws of the United States; (2) that the defendant participated, shared in or received, either directly or indirectly, money, profit or benefit by and through any transaction of such institution; (3) that the defendant did such act or acts with intent to defraud the association; and (4) that such act or acts were done knowingly and willfully.

United States v. Griffin, 579 F.2d 1104, 1108 (8th Cir. 1978); *see also United States v. Hykel*, 461 F.2d 721, 723 (3d Cir. 1972). Allied Capital is the lending organization, not an officer or employee of one. Compl. ¶ 17. Thus, Allied Capital cannot be liable for any violation of § 1006 under its own terms.

Similarly, 18 U.S.C. § 1014 requires a knowing submission by anyone of a false statement or report to a laundry list of organizations, including the Federal Housing Administration. For the same reasons that the government's FCA claims failed to allege scienter and false statements, the government has failed to plead plausibly that Allied Capital knowingly submitted any false statement or report in violation of § 1014. *See* § I(d), *supra*.

Finally, the government's alleged violations of 18 U.S.C. § 1014 cannot be sustained for any alleged action prior to July 30, 2008, because § 1014 did not prohibit false or fraudulent statements made to the Federal Housing Administration prior to that date. *See* FHA Modernization Act of 2008, 110 Pub. L. 289 § 2129(1), 122 Stat. 2842 (July 30, 2008) ("Section 1014 of title 18, United States Code, is amended in the first sentence by (1) inserting "the Federal Housing Administration," before "the Farm Credit Administration"; and (2) by striking "commitment, or loan" and inserting "commitment, loan, or insurance agreement or application

[10] The statute also creates liability for employees of certain, enumerated federal agencies. The government makes no allegation that any of the defendants are an employee of such agencies.

for insurance or a guarantee."). *See United States v. Vanoosterhout*, 898 F. Supp. 25, 30 (D.D.C. 1995) ("The predicate act charged in the proposed new Count Six is a violation of 18 U.S.C. § 1014 . . . . This very specific statute makes it a crime knowingly to make any false statement or report or willfully to overvalue any land, property or security for the purpose of influencing in any way the action of any of a list of enumerated agencies or persons. SBA is not mentioned by name and is not among the listed generic types of agencies, and it follows that the proposed Count Six could not stand even if leave were granted to file it.") (footnote omitted). Here, the government's only alleged submissions were in 2006 and 2007 (Compl. ¶ 110), and thus § 1014 does not apply to these submissions.

IV. The Government Has Failed to Plead Any of Its Claims With Particularity

Because the False Claims Act "is an anti-fraud statute . . . claims brought under the [False Claims Act] fall within the express scope of Rule 9(b)." *Pervez.*, 736 F. Supp. 2d at 810. *See also United States ex rel. Atkins v. McInteer*, 470 F.3d 1350, 1357 (11th Cir. 2006) ("[False Claims Act] claims must also be stated with particularity pursuant to Rule 9(b)."). Not only are the False Claims Act allegations subject to Rule 9(b), but the government's allegations under FIRREA are also subject to Rule 9(b). 18 U.S.C. § 1006 and § 1014 both fall into Chapter 47 of Title 18, which is titled "Fraud and False Statements." § 1006 requires the "intent to defraud," and § 1014 requires the actor to "knowingly make [a] false statement or report. . . ."

Any action that sounds in fraud, such as the claims alleged by the government in the Complaint, is subject to the heightened pleading requirements of Rule 9(b): "By its terms, Rule 9(b) applies to 'all averments of fraud.' This wording is cast in terms of the conduct alleged, and is not limited to allegations styled or denominated as fraud or expressed in terms of the constituent elements of a fraud cause of action." *Rombach*, 355 F.3d at 171. Rule 9(b) requires

the plaintiff to: "(1) specify the statements that the plaintiff contends were fraudulent, (2) identify the speaker, (3) state where and when the statements were made, and (4) explain why the statements were fraudulent." *Rombach*, 355 F.3d at 170 (citation omitted). This heightened pleading standard is to ensure that fraud claims are "responsible and supported, rather than defamatory and extortionate." *Borsellino v. Goldman Sachs Grp., Inc.*, 477 F.3d 502, 507 (7th Cir. 2007) (citations omitted); *see also Rombach*, 355 F.3d at 171 ("Rule 9(b) serves to . . . prohibit plaintiffs from unilaterally imposing upon the court, the parties and society enormous social and economic costs absent some factual basis.") (*quoting In re Stac Elecs. Sec. Litig.*, 89 F.3d 1399, 1405 (9th Cir. 1996)); *United States ex rel. Marlar v. BWXT Y-12, LLC*, 525 F.3d 439, 445 (6th Cir. 2008) ("Rule 9(b) is also meant to protect defendants from 'spurious charges of immoral and fraudulent behavior.'"). "When a plaintiff does not specifically plead the minimum elements of [his] allegation, it enables [him] to learn the complaint's bare essentials through discovery and may needlessly harm a defendant's goodwill and reputation by bringing a suit that is, at best, missing some of its core underpinnings, and at worst, . . . baseless allegations used to extract settlements." *Atkins*, 470 F.3d at 1359 (citations omitted).

The government has failed to allege any claim for payment, let alone who made such claims and what made them false. Moreover, the government lumps all defendants together without properly attributing any of its unspecified fraudulent actions to any specific defendants. *See, e.g.*, Compl. ¶¶ 115, 118, 120, 123, 125-126, 128, 130, 135, 141. Such vague allegations fail Rule 9(b)'s standard. *See Apex Maritime Co. v. OHM Enterprises, Inc.*, No. 10-CV-8119, 2011 WL 1226377, at *2 (S.D.N.Y. Mar. 31, 2011) (stating that a fraud claim must "inform each defendant of the nature of his alleged participation in the fraud."); *In re Crude Oil Commodity Litig.*, No. 06-CV-6677, 2007 U.S. Dist. LEXIS 47902, at *19 (S.D.N.Y. June 28, 2007) ("where

multiple defendants are alleged to have committed fraud, the complaint must specifically allege the fraud perpetrated by each defendant, and 'lumping' all defendants together fails to satisfy the particularity requirement.").

Instead of specific allegations, the government engages in conclusory invective. Fatally, there are no details about any claim for payment made by anyone, nor does the Complaint identify a single FHA-related statute or regulation Allied Capital allegedly violated, let alone a regulation that is a condition of payment. *See United States ex rel. Willoughby v. Collegiate Funding Servs., Inc.*, No. 11-1103, 2012 U.S. App. LEXIS 5574, at *43 (4th Cir. March 14, 2012) ("Here, the relators allege only the broad inferential claim that but-for the certifications, the loans would not have been disbursed. They have made no allegations as to any particular transactions between [Defendant] and the government in which the certifications were material . . . . In light of the complete absence of any particularity as to their allegations, we agree with the district court that the relators fail to meet the requirements of Rule 9(b) and their claims were properly dismissed.").

The Complaint contains nothing more than the exact type of defamatory and extortionate allegations Rule 9(b) was designed to prevent. "Mere allegations of 'fraud by hindsight' will not satisfy the requirements of Rule 9(b)." *Harrison*, 176 F.3d at 784. The government has utterly failed to allege any specific facts about Allied Capital regarding any of its claims, and all claims should accordingly be dismissed as against Allied Capital. *Hopper v. Solvay Pharm., Inc.*, 588 F.3d 1318, 1326 (11th Cir. 2009) ("But, the Complaint does not allege the existence of a single actual false claim. In fact, we are unable to discern from the complaint a specific person or entity that is alleged to have presented a claim of any kind, let alone a false or fraudulent claim."); *United States ex rel. Vallejo v. Investronica, Inc.*, 2 F. Supp. 2d, 330, 336 (W.D.N.Y.

1998) ("I find these allegations to be completely inadequate under Rule 9(b). Plaintiff has not alleged the date or dates on which these purportedly false statements were made, but, instead, simply indicates that they were made during a period of at least ten years. Further, plaintiff does not aver where the alleged statements were made or who made them.").

CONCLUSION

The government's attempt to bootstrap every defaulted loan Allied Capital brokered to another FHA-sponsored lender since 2000 into an FCA violation is a travesty. The government has failed to establish that jurisdiction or venue are proper in this District. Moreover, the government's reliance on certifications of compliance with HUD regulations fails as a matter of law because it is in direct conflict with the Second Circuit's ruling in *Mikes*. HUD lender-approval regulations make it clear that compliance is a condition of participation, and not a condition of payment. AS such, there is no liability under the FCA for violating such regulations.

The government's allegations regarding FIRREA fail to even establish that Allied Capital is an institution to which the law is applicable. The FIRREA claims are further defeated by the government's own concession of its knowledge of and acquiescence to the purported actions.

Finally, the government has failed to allege any of its claims with the specificity required by Rule 9(b). Because the government has failed to plead any plausible claim, Allied Capital respectfully requests that this Court dismiss the Amended Complaint in its entirety, with prejudice.

DATE: March 23, 2012

Respectfully Submitted,

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CERTIFICATE OF SERVICE

I hereby certify that, on this 23rd day of March, 2012, a copy of the foregoing Memorandum in Support of Motion to Dismiss was served upon all parties and counsel of record via the Court's CM/ECF system.

/s/ Bruce E. Alexander
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