15-2449-cv

IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

PAUL BISHOP, ROBERT KRAUS, UNITED STATES OF AMERICA EX REL. PAUL BISHOP, EX REL. ROBERT KRAUS,

Plaintiffs-Appellants,

STATE OF NEW YORK, EX REL. PAUL BISHOP, ET AL.,

Plaintiffs,

v.

WELLS FARGO & COMPANY, WELLS FARGO BANK, N.A.,

Defendants-Appellees.

On Appeal from the United States District Court
for the Eastern District of New York

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING NEITHER PARTY

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INTEREST OF THE UNITED STATES

The False Claims Act (FCA), 31 U.S.C. § 3729 *et seq.*, is the federal government's primary tool to combat fraud and recover losses due to fraud in federal programs. Some FCA cases are brought and litigated by the United States itself. Others (like this case) are litigated by private relators who litigate on behalf of the government where the government has declined to participate in the case. Even in cases where the United States has declined to participate, and even in cases that have little likelihood of success, the United States has a significant interest in ensuring that courts properly construe the FCA. Many important legal principles apply equally to actions brought by relators and actions brought by the government, including in future actions where the government takes over the case from a relator.

As explained below, the Supreme Court's decision in *Universal Health Services, Inc. v. United States ex rel. Escobar*, 136 S. Ct. 1989 (2016), requires reconsideration of two aspects of this Court's prior opinion explaining when a claim is "false" under the FCA. First, in addressing relators' implied certification theory, this Court relied on *Mikes v. Straus*, 274 F.3d 687 (2d Cir. 2001), to conclude that an implied certification is not "false" unless the defendant violates a requirement that is expressly designated a condition of payment. But *Escobar* eliminated that rule. And *Escobar* recognized that when a defendant makes "specific representations"—as defendants plainly did every time they applied for Federal Reserve loans—a request for payment is "false" and potentially actionable if it fails to disclose the violation of material requirements.

Second, this Court relied on *Mikes* to hold, under an express certification theory, that it is sometimes not "false" for a defendant to make a literally false statement that it is in compliance with a whole class of regulations—so long as that class is sufficiently broad. As explained below, however, the Supreme Court's decision in *Escobar* undermines that view.

As previously indicated, the United States did not intervene in this case. Nonetheless, while the United States takes no position on the ultimate merits of the relators' claims—including the scienter and materiality prongs—we submit this brief to urge this Court to amend its prior analysis on the falsity prong for both implied and express certification claims in light of *Escobar's* recent guidance.

BACKGROUND

This FCA suit was originally brought by relators as a *qui tam* action, in the name of the United States, against the defendant banks (collectively "Wells Fargo"). In July 2014, the United States declined to intervene, though in doing so the government informed the district court and the parties that it was exercising its statutory right to require the parties to serve it with copies of all filings. *See* Dkt. No. 22; 31 U.S.C. § 3730(c)(3). Relators later filed their Third Amended Complaint. JA13.[1]

Relevant here, that complaint alleged that Wells Fargo took out various loans from the Federal Reserve. JA27-37. Before doing so, the relators alleged, Wells

[1] Citations to the joint appendix are abbreviated "JA[page]."

Fargo had to (and did) enter into a lending agreement containing a series of terms from the then-in-effect version of the Federal Reserve's Operating Circular No. 10 ("the Circular"). JA28, JA35. As set out by Section 9.1 of the Circular, this meant that (among other things) Wells Fargo made certain representations and warranties, including the one in Section 9.1(b) that the bank

> is duly organized, validly existing and in good standing under the laws of the jurisdiction of its organization and is not in violation of any laws or regulations in any respect which could have any adverse effect whatsoever upon the validity, performance or enforceability of any of the terms of the Lending Agreement.

JA150. The Circular also stated (in Section 9.2) that "[e]ach time" Wells Fargo sought a Federal Reserve loan, Wells Fargo was "deemed to make all of the [Section 9.1] representations and warranties on and as of the date" it requested the loan. JA151.

Relators allege that Wells Fargo requested Federal Reserve loans at various times when it was in violation of certain banking regulations. JA18-19. They accordingly allege, JA127-29, that the bank violated FCA provisions that prohibit entities from presenting false claims for payment, *see* 31 U.S.C. § 3729(a)(1)(A), and making or using false records or statements material to false claims, *see id.* § 3729(a)(1)(B).[2] The district court dismissed the case after concluding (among other

[2] Although our citations are to the most current version of the FCA, some of the alleged conduct predates a 2009 statutory amendment. But as this Court recognized in its earlier opinion, those changes do not affect the analysis here. *See Bishop v. Wells Fargo & Co.*, 823 F.3d 35, 43 n.1 (2d Cir. 2016).

things) that relators' allegations did not sufficiently show that any of defendants' certifications to the Federal Reserve were actually "false." JA740-50.

A panel of this Court agreed on appeal, and in doing so the Court offered two conclusions of particular significance to the government. First, the Court dismissed relators' express certification claim based on Section 9.1(b) because it thought Section 9.1(b) was "overbroad." *Bishop v. Wells Fargo & Co.*, 823 F.3d 35, 45 (2d Cir. 2016). The Court read *Mikes v. Straus*, 274 F.3d 687 (2d Cir. 2001), to hold that a claim is not expressly false unless it falsely certifies compliance with a "particular" statute, regulation, or contractual term. *Bishop*, 823 F.3d at 44. And since this Court treated Section 9.1(b) as broadly referring to a very large number of banking regulations, the Court found that a literally untrue certification of compliance with all those regulations was nonetheless not "false" for purposes of the FCA. *Id.* at 45.

Additionally, the Court rejected relators' implied certification claims. Here, the Court applied the rule from *Mikes* that implied certifications are only "false" if the defendant misrepresents its compliance with something the government *expressly* made a condition of payment. *Bishop*, 823 F.3d at 48. The Court found nothing in relators' allegations to show that Wells Fargo violated such an express condition. *Id.* at 48-49.

A little over a month after this Court issued its opinion, the Supreme Court decided *Universal Health Services, Inc. v. United States ex rel. Escobar*, 136 S. Ct. 1989 (2016). Relators petitioned for certiorari, and the Supreme Court granted the petition, vacated this Court's opinion, and remanded for further proceedings in light of *Escobar*.

ARGUMENT

IN LIGHT OF *ESCOBAR*, THIS COURT SHOULD REVISE ITS PRIOR ANALYSIS OF "FALSITY" FOR BOTH IMPLIED AND EXPRESS CERTIFICATION CLAIMS

The False Claims Act imposes liability on any person who "knowingly presents, or causes to be presented, a false or fraudulent claim for payment or approval." 31 U.S.C. § 3729(a)(1)(A). The statute also imposes liability on a person who "knowingly makes, uses, or causes to be made or used, a false record or statement material to a false or fraudulent claim." *Id.* § 3729(a)(1)(B). The "claims" at issue in this appeal are Wells Fargo's requests for various loan disbursements from the Federal Reserve. *See id.* § 3729(b)(2) (defining the term "claim"). A key question in this case is thus whether any of those claims were "false or fraudulent."

Here, relators have principally relied on two different theories to demonstrate falsity: an "implied certification" theory and an "express certification" theory.[3] *Escobar* requires this Court to revise its analysis with regard to both theories.

A. After *Escobar*, A Plaintiff May Maintain An Implied Certification Claim Even If A Defendant Has Not Violated An Express Condition Of Payment

As the Supreme Court explained in *Escobar*, liability can attach under the "implied certification" theory when a defendant makes a request for payment, and, in

[3] Both theories are somewhat inartfully named, and really just represent a judicial shorthand, as no actual "certification" is required under the FCA. *See United States ex rel. Hutcheson v. Blackstone Med., Inc.*, 647 F.3d 377, 385 (1st Cir. 2011).

connection with that request, "makes specific representations about the goods or services provided, but knowingly fails to disclose the defendant's noncompliance with a statutory, regulatory, or contractual requirement." 136 S. Ct. at 1995. If that nondisclosure renders the defendant's representations "misleading with respect to the goods or services provided," the result is that the defendant's representations are (impliedly) "false." *Id.* at 1999. That is an application of the common-law principle that a statement is fraudulent when it states "the truth so far as it goes" but misleadingly omits important qualifying information. *Id.* at 1999-2000.[4]

There is no requirement that the defendant violate something that "expressly states" it is a condition of payment. Indeed, the Supreme Court squarely held in *Escobar* that the FCA "does not impose this limit on liability," 136 S. Ct. at 2001, and the Court specifically cited *Mikes* as an exemplar of the standard it was rejecting, *id.* at 1999. The Court further explained that an express-condition requirement had no support in the FCA's text, *id.* at 2001, and was inconsistent with common-law

[4] In describing the implied certification theory in *Escobar*, the Supreme Court declined to address all aspects of that theory. For example, the Court did not decide whether the submission of a claim for payment, without any further representations about the goods or services provided, could be sufficient to find a false claim under the implied false certification theory. 136 S. Ct. at 2000 ("We need not resolve whether all claims for payment implicitly represent that the billing party is legally entitled to payment."). The United States's view is that in an appropriate case where a request for payment is understood as impliedly making a false statement, a plaintiff can make an implied certification claim even in the absence of a specific representation.

understandings of fraud, *id.* Moreover, while the *Escobar* defendants had argued for an "express" designation limitation "to provide defendants with fair notice and to cabin liability," the Supreme Court made clear that "policy arguments cannot supersede the [statute's] clear statutory text," *id.* at 2002, and further recognized that the defendants' policy arguments could "be effectively addressed through strict enforcement of the Act's materiality and scienter requirements." *Id.*

In its prior opinion, this Court followed *Mikes* and imposed the very requirement that *Escobar* rejected. *Bishop*, 823 F.3d at 48-49. After *Escobar*, this Court cannot continue to reject relators' implied certification claim on the ground that the requirement that Wells Fargo allegedly violated was not expressly designated as a condition of payment.

Rather, the question is whether Wells Fargo has made "specific representations about the goods or services provided" within *Escobar*'s meaning. And assuming the truth of relators' allegations, which concern transactions in which a borrower is taking out a secured loan from a lender, it is clear from the Circular that Wells Fargo made numerous such "specific representations" each time it applied for a loan. For example, the bank unambiguously represented that it had "rights in Collateral sufficient to grant an enforceable security interest" to the Federal Reserve; that these rights were "free of any assertion of a property right that would adversely affect a Reserve Bank's right to Collateral;" and that the lending agreement was "effective to create [for the Federal Reserve] a legal, valid, and enforceable security interest in the

Collateral." JA150-51 (Sections 9.1(d) and 9.1(f)(i)). The bank also specifically represented that it had "the power and authority, and the legal right, to . . . perform the Lending Agreement and to . . . incur indebtedness." JA150 (Section 9.1(a)). And it further represented that the Lending Agreement was "a legal, valid and binding obligation of the Borrower, enforceable against the Borrower in accordance with its terms." JA150 (Section 9.1(c)). There were other specific representations as well. *See* JA150-51.

It does not matter that these statements were not repeated in writing each time a bank applied for a loan, and were instead (pursuant to the agreed-upon Circular) "deemed" to be made at the time of each loan application. *See* JA151. *Escobar* rests on the straightforward, common-law principle that a statement—even one that may otherwise be truthful—can be misleading and fraudulent in context. And, if a direct *statement* can be misleading and fraudulent in context, the same is true when an individual takes an action he knows will be *construed* as that same misleading statement. Indeed, this principle equating actions and words is well established under the common law. *See* Restatement (Second) of Torts § 525 cmt. b (Am. Law Inst. 1977) (explaining that fraudulent misrepresentations include "not only words spoken or written but also any other conduct that amounts to an assertion not in accordance with the truth"). *Accord United States ex rel. Kirk v. Schindler Elevator Corp.*, 601 F.3d 94, 114-15 (2d Cir. 2010) (finding that where a governing regulation deemed an offer's submission to be a representation of compliance with a particular statute, a defendant

who submitted such an offer had *expressly* represented its compliance), *rev'd on other grounds*, 563 U.S. 401 (2011), *reaffirmed in relevant part*, 437 F. App'x 13, 18 (2d Cir. 2011).

Since the allegations show that Wells Fargo made "specific representations," its claims can be "false" under *Escobar* if a "failure to disclose noncompliance with material statutory, regulatory, or contractual requirements" made those representations misleading. 136 S. Ct. at 2001. A court will still need to evaluate, however, whether relators have adequately pleaded such material noncompliance. And to make that assessment, the court will need to conduct a context-specific inquiry to determine whether, in light of the various representations made and the complaint's allegations, any material omissions by Wells Fargo were misleading. (For example, a bank might accurately represent that it has sufficient rights in the collateral, but that representation might still be misleading if the bank omits other information that would show the collateral is not worth what it appears to be).

Our brief does not take a position on whether any of Wells Fargo's specific representations were misleading if the facts are as relators allege. We do note, however, that resolving that question will entail a context-specific inquiry, and that inquiry will be distinct from the analysis a reviewing court will perform when evaluating whether Wells Fargo made false express statements as set out in relators' express certification theory—a theory that (as articulated by relators) covers a different set of representations.

B. After *Escobar*, The "Falsity" Of An Express Certification Does Not Turn On The Breadth Of The Defendant's Certification

Escobar also requires this Court to revisit its analysis of express certification claims. In a typical express certification case, the plaintiff's falsity argument is straightforward: if a defendant expressly makes a representation, and that representation is untrue, the defendant's representation is "false." Consistent with the statutory text, a defendant who tells a lie in connection with asking the government for money has presented "a false or fraudulent claim for payment or approval," 31 U.S.C. § 3729(a)(1)(A), and has "ma[de], use[d], or cause[d] to be made or used, a false record or statement material to a false or fraudulent claim." *Id.* § 3729(a)(1)(B). This Court, in light of *Escobar*, should reaffirm that principle and recognize that the breadth of a certification is irrelevant in determining falsity.

1. Nothing in the Act's text or structure suggests that an otherwise false statement is somehow rendered true simply because the statement happens to be broad. Nor does such a conclusion find support in the common-law understanding of fraud. If a speaker claims that a box has "no red balls in it" even though it actually contains some red balls, the statement is false whether the box holds ten balls or ten thousand balls. *See also* Restatement (Second) of Torts § 525 cmt. b (recognizing that fraudulent misrepresentations include any representation that is "an assertion not in accordance with the truth," and so "words or conduct asserting the existence of a fact constitute a misrepresentation if the fact does not exist"). There is no reason to think

this basic principle of falsity operates any differently when a defendant's statement concerns its own regulatory compliance. A statement that one is in compliance with "all" regulations of a certain type is a false statement if the person is not in compliance with one or more of those regulations; the statement's falsity has nothing to do with the number of regulations that happen to be of the specified type. Otherwise, a defendant who knowingly violated a large number of material regulations could escape liability simply because it broadly certified compliance with a large set of requirements.

Before *Escobar*, this Court in *Mikes* stated that an express certification is only "false" if it "falsely certifies compliance with a *particular* statute, regulation or contractual term." *Mikes*, 274 F.3d at 698 (emphasis added). In its prior opinion in this case, this Court relied on *Mikes* to reject relators' express certification claims based on Section 9.1(b), finding that the provision's reference to a wide variety of banking regulations was too broad to permit any false certification. *Bishop*, 823 F.3d at 44-46.[5] Both *Mikes*, and this Court's prior opinion in this case following it, tied their understanding of "falsity" to policy-based concerns about imposing liability in situations where the violation was unimportant to the government, *see Mikes*, 274 F.3d

[5] In their original appellate brief, defendants argued that Section 9.1(b) is not actually the broad certification relators make it out to be. *See* Wells Fargo Br. 34-37. And the district court expressed skepticism about relators' interpretation. *See* JA741 n.4. We express no opinion in this brief as to the proper interpretation of Section 9.1(b).

at 697, or where fear of *qui tam* suits might discourage entities from pursuing socially desirable behavior (like borrowing from the Federal Reserve), *see Bishop*, 823 F.3d at 46.

This atextual, policy-driven understanding of falsity does not survive *Escobar*. Even assuming that *Mikes*'s "particularity" requirement was binding precedent at the time of the panel's original decision in this case, a panel of this Court can revisit an earlier panel's conclusion when (among other situations) "an intervening Supreme Court decision casts doubt on the prior ruling." *Doscher v. Sea Port Grp. Sec., LLC*, 832 F.3d 372, 378 (2d Cir. 2016). That rule does not require that the Supreme Court have actually addressed the "precise issue" decided by the prior panel. *Id.* Instead, it is enough that the Supreme Court has undermined part of the logic on which the prior decision rested. *Id.*

That standard is met here: *Escobar* has undermined *Mikes*'s policy-based understanding of falsity. Indeed, in rejecting an express designation requirement (which had been adopted in *Mikes*, as noted above), the Supreme Court refused to conclude that an otherwise misleading claim was not "false or fraudulent" in light of policy concerns about expanded liability; the only relevant concern was whether there had been a misrepresentation. *Escobar*, 136 S. Ct. at 2001-02. Moreover, the Court emphasized in *Escobar* that courts should not adopt "a circumscribed view of" falsity based on concerns of fair notice and open-ended liability; such concerns should instead "be effectively addressed through strict enforcement of the [False Claims

Act's] materiality and scienter requirements." *Id.* at 2002. Yet *Mikes* did precisely what *Escobar* forbids: it allowed considerations that we now know relate to the separate requirement of *materiality* to lead the Court to impose a particularity requirement in evaluating *falsity*. *Compare Mikes*, 274 F.3d at 697 (deriving its understanding of falsity in part from the notion that "it would be anomalous to find liability when the alleged noncompliance would not have influenced the government's decision to pay"), *with Escobar*, 136 S. Ct. at 2002-03 (explaining that the False Claims Act has a materiality requirement, and this requirement looks to the effect of a misrepresentation on the likely or actual behavior of the misrepresentation's recipient). Indeed, *Mikes*'s understanding of falsity was likely influenced by that panel's uncertainty as to whether the False Claims Act even had a materiality requirement, *see Mikes*, 274 F.3d at 697 (declining to address "whether the Act contains a separate materiality requirement"), a question that *Escobar* has now answered affirmatively.

The *Mikes* panel also did not have the benefit of *Escobar*'s statements noting that the creation of an express-condition-of-payment requirement might cause the government to "respond by designating every legal requirement an express condition of payment." *Escobar*, 136 S. Ct. at 2002. The same concerns apply equally to a particularity requirement: if the government could not rely on a single statement broadly certifying compliance with all laws and regulations of a certain type, it might

instead avoid this requirement by specifically listing each of those laws and regulations individually on the certification form.

Finally, it accords with common sense to think that *Escobar* has undermined *Mikes*'s policy-based approach to falsity for express certification claims. Those same materiality concerns informed the *Mikes* panel's creation of an express-condition-of-payment requirement for implied certification claims. *See Mikes*, 274 F.3d at 696-700. The Supreme Court's rejection of the latter also casts doubt on the former.

2. Although this Court should hold that the falsity of an express certification does not depend on the breadth of that certification, that does not mean that breadth is completely irrelevant to liability. In *Escobar*, the Court explained that the materiality inquiry under the FCA should be holistic, considering a number of indicia, including whether compliance with a requirement is expressly identified as a condition of payment. *See Escobar*, 136 S. Ct. at 2002-04. Thus, in some cases, the breadth of a certification might bear on whether or not the violation was material to the government's decision to pay. It could also potentially be relevant to a determination of whether the defendant knew that its certification was false. Again, we take no position here on the ultimate merits of relators' claims, nor do we even take a position on whether the district court's judgment on falsity should be affirmed.

Moreover, the United States understands and appreciates this Court's concern about the implications of this case for the broader Federal Reserve system, and the possibility of future lawsuits by *qui tam* relators. The FCA has built-in safeguards to

ensure that the United States can step in to dismiss a case if it concludes that further pursuit of the litigation is not in the public interest. Indeed, the government retains the statutory right to "dismiss the action notwithstanding the objections of the [relator] if the [relator] has been notified by the Government of the filing of the motion and the court has provided the [relator] with an opportunity for a hearing on the motion." 31 U.S.C. § 3730(c)(2)(A).

This case, in particular, is still in its early stages. The claims may fail on issues other than falsity. And the claims may yet evolve further (among other things, relators are arguing that they should be given leave to amend their complaint). The United States takes seriously its monitoring role in declined *qui tam* cases. If this case is remanded to the district court, the government will continue to review the parties' filings and carefully assess the merits of the claims, and will have the option of moving for dismissal under Section 3730(c)(2)(A) if it concludes that doing so would be in the interest of the United States.

CONCLUSION

For the foregoing reasons, this Court should revisit and modify its falsity analysis in light of *Escobar*, as set out above.

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JUNE 2017

CERTIFICATE OF COMPLIANCE

I hereby certify this brief complies with the requirements of Fed. R. App. P. 32(a)(5) and (6) because it has been prepared in 14-point Garamond, a proportionally spaced font. According to the word count of Microsoft Word, the brief contains **3883** words, and is 15 pages, excluding the parts of the brief exempted under Rule 32(f).

/s/ Benjamin M. Shultz
Benjamin M. Shultz

CERTIFICATE OF SERVICE

I hereby certify that on June 6, 2017, I electronically filed the foregoing brief with the Clerk of this Court by using the appellate CM/ECF system. The participants in the case are registered CM/ECF users, and service will be accomplished by the appellate CM/ECF system.

/s/ Benjamin M. Shultz
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