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UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

UNITED STATES OF AMERICA, Plaintiff, vs. REUNION MORTGAGE, INC., DAVID THAYER and KENT HARVEY, Defendants. _____/	Case No.: CV 13 02340 SBA DEFENDANTS' REPLY BRIEF IN SUPPORT OF FRCP 12(b)(6) MOTION TO DISMISS Date: October 29, 2013 Time: 1:00 p.m. Dept: Courtroom 1, 4th Floor, 1301 Clay Street, Oakland, CA 94612 Judge: Saundra Brown Armstrong File date: May 22, 2013 Trial date: None Set

I. Introduction

Plaintiff's opposition addresses three arguments made in the moving papers. First, plaintiff asserts that defendant Thayer should remain in the action based solely on his signature as a representative of Reunion on an annual certification required for participation in the HUD-FHA program. As will be demonstrated, that is not sufficient to allege a false claim or tort against an individual because the certification for participation is not a requirement of payment for the claim.

Second, defendant Thayer should not be in any of the tort causes of action because there are no allegations that he had any individual involvement in the 12 transactions at issue. His designation as a broker of record for Reunion does not subject him to liability in a civil lawsuit.

Finally, the tort causes of action are time barred as plaintiff has not made sufficient allegations to justify tolling. Thus, defendant Thayer and Reunion respectfully request that this

motion to dismiss be granted.

II. The US Has Not Alleged An Actionable False Certification Cause of Action Against Thayer.

The government is making an argument that an individual that signs a certification on behalf of a corporation, which receives money (not from the government) for submitting a loan, becomes liable for submitting false claims as a result of the acts of other employees of the corporation. That is very different than holding the corporation responsible for submitting false claims or holding the corporation responsible for making a false certification.

The Court established a four part test for determining whether a false certification is actionable. First, the Court emphasized the necessity of a false claim, rather than a mere unintentional violation. U.S. ex rel. Hendow v. Univ. of Phoenix, 461 F.3d 1166, 1173 (9th Cir. 2006). Second, the Court emphasized the central importance of the scienter element to liability under the False Claims Act, holding that false claims must in fact be "false when made." Id. (citing United States v. Shah, 44 F.3d 285, 290 (5th Cir.1995)). The Court held, "[f]or a certified statement to be 'false' under the Act, it must be an intentional, palpable lie." Id.

Third, the Court held that the false statement or course of conduct must be material to the government's decision to pay out moneys to the claimant. This is evident from the Court's focus on "(1) whether the false statement is the cause of the Government's providing the benefit; and (2) whether any relation exists between the subject matter of the false statement and the event triggering Government's [sic] loss." Univ. of Phoenix, 461 F.3d at 1173.

Fourth, for a false statement or course of action to be actionable under the false certification theory of false claims liability, it is necessary that it involve an actual claim. Id.

Thus, for purposes of this motion the plaintiff has to establish that the false statement was the cause of the event triggering the government's loss. In this case, the plaintiff cannot establish liability by defendant Thayer based on an annual certification.

The annual certification that the plaintiff uses to establish defendant Thayer's liability is based on 24 C.F.R. § 202.5, which states "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 ...." The subsection include requirements

like not being in violations of requirements established by the Secretary, not being engaged involved in imprudent business practices and not being subject to unresolved funding as a result of a HUD investigation. Id., see also 24 C.F.R. § 202.3.

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. United States ex rel. Mikes v. Strauss, 274 F.3d 687, 697 (2d Cir. 2001) . "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."); U.S. ex rel. Colucci v. Beth Israel Med. Ctr., 785 F. Supp. 2d 303, 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 701-702. 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.

The annual certifications are explicitly conditions of participation in HUD's FHA insurance program for correspondent lenders, and thus cannot state the basis of an FCA claim against the individual who signed the certification. "[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." Conner, 543 F.3d at 1218. HUD's regulations

regarding approval of lending institutions and mortgagees, located at 24 C.F.R. § 202.1 through § 202.12, demonstrate such: "This part establishes minimum 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. Noncompliance 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.

To further illustrate the point - no claims were paid on the basis of the annual certification signed by defendant Thayer. The annual certification was to allow Reunion to participate in the program. If the individual loan level certifications weren't signed, then the mortgage insurance would not have been issued by HUD-FHA and no claim would have been paid upon default of each of the 12 loans at issue. Thus, the plaintiff cannot establish that the certification was a requirement of payment on the claim (the pay out on the insurance). The loan level certification was the requirement for payment.

To further the above point, HUD-FHA will continue to pay insurance claims after a lender is no longer certified. Thus, the annual certification cannot be a requirement of payment of the claim. The Eighth Circuit and Tenth Circuit have found that the statute governing the student loans at issue in Vigil and Conner "expressly provides that termination of a lender's authority to make such loans does not affect the insurance of prior loans." Vigil, 639 F.3d at 800 n.7. Similarly, HUD regulations state that termination of a lender's participation in the FHA insurance program shall not affect previously insured mortgages. See 24 C.F.R. § 202.3(c)(2)(vii). Therefore, the annual certification in order to participate in the program is not the certification that is directly responsible for payment of the claim.

In fact, there are certifications submitted with each loan submission. The FAC states that, "The DEL's [Direct Endorsement Lender] underwriter makes the underwriting decision as to whether the mortgage may be approved for HUD-FHA insurance or not, according to HUD-FHA rules... If it has decided that the mortgage may be approved for HUD-FHA insurance in accordance with HUD-FHA rules, the DEL funds the loan. Thereafter, the DEL certifies that the mortgage qualifies for HUD-FHA insurance. FHA endorses the loan on the basis of the DEL's certification and provides the DEL with a mortgage insurance certificate." FAC, para. 30.

The plaintiff alleges that it paid insurance claims on 12 specific loans that it insured. As to each, a Reunion employee (not stated as Defendant Thayer) certified as to the integrity of the data supplied in order to qualify for insurance. FAC, paras. 53-55. Thus, the general annual certification of past and future compliance that defendant Thayer signed is not the reason that the individual loans were made, and thus the individual insurance claims were paid out. The reason was because of the individual certifications that were signed by other employees of Reunion. If the reason that HUD-FHA agreed to insure loans made by Reunion was solely due to the general certification signed by defendant Thayer, there would be no need for individual certifications signed by a person who individually underwrote each loan.

III. Plaintiff Has Not Alleged That Defendant Thayer Has Engaged In Tortious Conduct

Plaintiff's own case authority proves Defendant Thayer's argument that he is not responsible for the torts alleged in the complaint. As stated by plaintiff in their opposition, "[a] corporate officer, for example, "is, in general, personally liable for all torts which he authorizes or directs, or in which he participates..." Opposition, page 5, lines 12-13. Plaintiff has made no allegation that defendant Thayer had any participation in the origination of the 12 loans at issue in this lawsuit. Plaintiff has not alleged that he had involvement in the underwriting, verification of borrower information or submission of the loans. In fact, plaintiff alleged that it was individual underwriter employees of Reunion who certified the loans - not Defendant Thayer and not based on any specific direction by Defendant Thayer. Plaintiff is alleging vicarious liability authority that ties employers for the acts of its employees. However, plaintiff has made no allegation to tie one employee (Defendant Thayer) to the acts of the corporation or its other employees.

The plaintiff also misinterprets Holley v. Crank, 400 F.3d 66 (9th Cir. 2004). The case does not state that Business & Professions Code section 10159.2(a) makes the designated officer of a corporation liable, in a civil lawsuit, for the acts of the corporation's sales persons. That would be a direct contradiction of the Supreme Court's ruling in Meyer v Holley, (2003) 537 U.S. 280, 291.

> Respondents, conceding that traditional vicarious liability rules apply, see supra, at 830-831, argue that those principles themselves warrant liability here. For one thing, they say, California law itself creates what amounts, under ordinary common-law principles, to an employer/employee or principal/agent relationship between (a) a corporate officer designated as the broker under a real estate license

> issued to the corporation, and (b) a corporate employee/salesperson. Brief for Respondents 6-8, 13-36. Insofar as this argument rests solely upon the corporate broker/officer's right to control the employee/salesperson, the Ninth Circuit considered and accepted it. 258 F.3d, at 1134-1135. But we must reject it given our determination in Part II that the "right to control" is insufficient by itself, under traditional agency principles, to establish a principal/agent or employer/employee relationship.

The Supreme Court held and the 9th Circuit followed in Holley v. Crank, 400 F.3d 667, 670, that there needs to be traditional vicarious liability established in order to bind a corporate officer to the acts of other employees of the company. California law is also clear on the issue - Section 10159.2(a) is a part of a licensing scheme. It binds designated officers to the acts of employees of the corporation for purposes of license discipline. Sandler v Sanchez (2012) 206 Cal. App. 4th 1431, 1440-1441.

The only authority plaintiff cites in support of its claim for vicarious liability of Thayer as corporate office is F.D.I.C. v. Cashman, WL 6002611 1 (N.D. Cal. 2011). However, that holding deals with a claim of negligent hiring and supervision against a broker. Id., at p. 4. Plaintiff sought to hold the broker responsible for the tort of negligently supervising another employee - not the actual tort of negligence and negligent misrepresentation the employee allegedly committed. The corporation was being sued for that. The facts aren't specified, but if the Court thought there were sufficient facts to demonstrate that the individual broker had a duty to supervise and hire and failed to satisfy that duty, then it allowed the claim to go forward. However, holding an individual broker liable under the tort of negligent supervision is different than holding the individual broker liable for the actual tort that underlies the claim for damages.

The plaintiff has not established law or facts alleged that could bind defendant Thayer for the actions of Reunion employees. No annual certification of the past and future compliance of Reunion will bind a corporate officer to the alleged torts of the corporations employees without allegations that the corporate officer had some direct involvement in the transaction. Basic principals of vicarious liability prohibit such. The plaintiff has had an opportunity in the original complaint, the first amended complaint and this opposition to make a vicarious liability allegation that defendant Thayer had direct involvement in the 12 transactions at issue and it has not. Thus, it is safe to

assume that plaintiff cannot make that allegation. Thus, there is no amendment that can cure this defect.

IV. The Common Law Claims Are Time Barred.

Plaintiff claims that the unjust enrichment, payment by mistake and breach of fiduciary duty claims are governed by a six year limitations period, not a three year one. The only authority provided by plaintiff is 28 U.S.C. § 2415(a) and (b) and U.S. v. McLeod 721 F.2d 282 (9th Cir. 1983). Sections 2415(a) and (b) only distinguish between the limitations periods for torts versus actions based on contract. As stated in the moving papers, these causes of action for relief are based on claims of tort. U.S. v. McLeod sheds no light on this issue either. That case addresses a claim by the U.S. for conversion of U.S. property. There is no such allegation here. In McLeod, the U.S. paid money to the defendant by mistake and was trying to recover it. However, in this case, the plaintiff paid claims on insurance to third parties when loans defaulted. The government states that it paid money to defendants Reunion and Thayer, but that contradicts statements elsewhere in the lawsuit that HUD-FHA paid insurance claims to unnamed "mortgage holders." FAC, para. 2, 4 and 59, for example. That is because Reunion sold all of the loans at issue soon after making them. Thus, the insurance claims were paid to another entity. HUD-FHA never paid any money to any of the defendants. At the very least, this is not a conversion claim and any amendment of the complaint should address who the plaintiff claims was unjustly paid money to.

Even if this Court finds that the limitations period for the unjust enrichment and the payment by mistake causes of action are six years and the pleading is not ambiguous as to the fact that HUD-FHA never paid any money to defendants, the authority cited in the opposition does not address the fact that the breach of fiduciary duty cause of action is governed by a three year limitations period. Courts have held that the nature of the underlying breach is what governs the limitations period for this cause of action. Fed. Deposit Ins. Corp. v. Former Officers & Directors of Metro. Bank, 884 F.2d 1304, 1306 (9th Cir. 1989). As alleged, this is a breach based on alleged tortious conduct and governed by a three year limitation period.

Plaintiff claims that the limitations period on the tort causes of action only begin to run when HUD-FHA sends the claims the U.S. Attorney. However, 28 U.S.C. § 2416(c) does not state that

the limitations period is tolled until it is referred to officials who can file a civil lawsuit. That would mean that an agency could sit on a potential claim forever without worrying about the limitations running, so long as it sends the information to the U.S. Attorney and the U.S. Attorney files an action within three years. 28 U.S.C. § 2416(c) is a delayed discovery provision. It tolls the limitations period until the facts are known or reasonably could be known by an official of the United States charged with the responsibility to act in the circumstances. HUD-FHA certainly has the responsibility to act if it discovers potential claims. If that means submitting the matter to the US Attorney or cancelling the approval, that is when the notice runs. 12 U.S.C. § 1708. Plaintiff has provided no authority for the position that the statute starts to run from the time the agency sends the potential claims to the US Attorney.

The Court held in U.S. v. Boeing Company, Inc. 845 F.2d 476, 481-482 (4th Cir. 1988) rev'd on other grounds in Crandon v. United States, 494 U.S. 152,(1990)82 (4th Cir. 1988), that the limitation period began to run, per 28 U.S.C. § 2416(c), when officials in the government agency charged with auditing discovered the relevant facts. In that case, the statute of limitations was not tolled. Additionally, the matter was referred to the Justice Department. Id., at 479. However, the Court did not consider that the time the officials of the US charged with responsibility to act in the circumstances ran from the refer to the Justice Department.

In U.S., ex rel. Kreindler & Kreindler v. United Technologies Corp., 777 F. Supp. 195, 205 (N.D.N.Y. 1991) aff'd, 985 F.2d 1148 (2d Cir. 1993), the Court held that once officials who could take action recognize the essential elements of the cause of action, the statute is not tolled. In that case, the Court was dealing with the Army being aware of a problem with a helicopter and that fact was demonstrated by the Army fixing the problem itself. Id., at 204. That example demonstrates the meaning of the term "officials of the US charged with responsibility to act in the circumstances." It doesn't mean sending it to a government lawyer who can file a lawsuit.

In order to overcome the statute of limitations on the face of the pleading, the plaintiff will have to demonstrate more than just HUD-FHA handing the matter off to the U.S. Attorney's office. The plaintiff has to demonstrate why it did not have sufficient information about the facts at the time it received the loan file, conducted audits of the file and paid the insurance claims. As stated in the

moving papers, it makes most, if not all, of the individual loan claims for common law torts time barred under 28 U.S.C. § 2415(a). Plaintiff has not refuted this defense.

V. CONCLUSION

For the above stated reasons, this motion to dismiss should be granted. Defendant Thayer is only part of this lawsuit due to his signature on an annual certification of compliance that allows participation in the HUD-FHA program at issue. Thus, it is not a requirement for payment of any of the 12 claims at issue in this lawsuit. Defendant Thayer is also not vicariously liable for any of the acts of Reunion or its employees based on his designation as Reunion's broker in California. Plaintiff has made no other allegation in support of traditional vicarious liability. Finally, plaintiff has not adequately alleged tolling of the limitations periods for the tort causes of action. Thus, moving defendants respectfully request that this motion to dismiss be granted.

Date: September 13, 2013

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