UNITED STATES OF AMERICA
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
OFFICE OF HEARINGS AND APPEALS

UNITED STATES DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, Petitioner, v. TXL MORTGAGE CORPORATION, Respondent.	15-JM-0030-PF-003 May 13, 2015

ORDER GRANTING IN PART AND DENYING IN PART RESPONDENT'S MOTION TO DISMISS

On January 16, 2015, the U.S. Department of Housing and Urban Development ("HUD" or "the Government") filed a *Complaint* seeking $1,820,019.94 in penalties and assessments against TXL Mortgage Corporation ("Respondent") for a dozen alleged violations of the Program Fraud and Civil Remedies Act ("PFCRA"). On February 13, 2015, Respondent filed an *Answer* and a *Motion to Dismiss PFCRA Claims* ("Motion to Dismiss"). On February 19, 2015, upon receipt of the *Answer,* this Court commenced the hearing in this matter by issuing a *Notice of Hearing and Order*.

Legal Standard

When reviewing a motion to dismiss, the Court "must accept all factual allegations in the complaint and draw all reasonable inferences in the plaintiff's favor." ATSI Commc'ns, Inc. v. Shaar Fund, Ltd., 493 F.3d 87, 98 (2d Cir. 2007). A Motion to Dismiss will be granted only if HUD has failed to plead sufficient facts to state a claim to relief that is facially plausible. See, Bell Atl. Corp. v. Twombly, 550 U.S. 544, 570, (2007). A facially plausible claim is one that contains "factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." Ashcroft v. Iqbal, 556 U.S. 662 (2009). More specifically, a plaintiff must allege facts showing "more than a sheer possibility that a defendant has acted unlawfully." Id. A complaint that offers only "labels and conclusions" or "a formulaic recitation of the elements of a cause of action will not do." Twombly, 550 U.S. at 555. Additionally, if a plaintiff has not "nudged [its] claims across the line from conceivable to plausible, [those claims] must be dismissed." Id. at 570.

Discussion

Respondent bases its *Motion to Dismiss* on four grounds: (1) several of the claims exceed the PFCRA's $150,000 jurisdictional cap; (2) two Counts are barred by the six-year statute of limitations; (3) the *Complaint* employs the wrong causation standard; and (4) the *Complaint* does not state a claim. Each argument is addressed in turn.

I. The $150,000 Jurisdictional Cap

Respondent contends that liability under the PFCRA only exists if the amount of the allegedly false claim was under $150,000. The argument is derived from 31 U.S.C. § 3803(c)(1)(a), which states that:

> No allegations of liability under Section 3802 … shall be referred to a presiding officer … if the reviewing official determines that an amount of money in excess of $150,000 is requested or demanded in violation of Section 3802 of this title in such claim or in a group of related claims which are submitted at the time such claim is submitted.

Respondent interprets the term "claim" in the statute as referring to the insurance claim sent from the mortgagee to HUD. Eight of the twelve Counts[1] allegedly featured insurance claims of more than $150,000, ranging from $167,710.85 to $283,619.09.[2] Respondent therefore claims "HUD does not have jurisdiction or authority to bring claims under PFCRA for those loans."

HUD, however, maintains that the "claim" in question is not the insurance claim to HUD, but rather HUD's recovery claim against the respondent. According to HUD's theory, even if a reviewing official is presented with a mortgage insurance claim of more than $150,000, the official may reduce the claim to $150,000 in order to utilize the PFCRA as a remedial mechanism. As support for this position, HUD looks to the language of the statute, case precedent, and the legislative history behind the PFCRA.

The plain language of the PFCRA itself cuts against the Government's theory. The term "claim" is defined at 31 U.S.C. § 3801(a)(3) as "any request, demand, or submission … made to an authority for property, services, or money" or made to an authority that "has the effect of decreasing an obligation to pay or account for property, services, or money." 31 U.S.C. § 3801(a)(3)(A), (C). A claim may also be made from an authority to "a recipient of property, services, or money" under specific circumstances described in 31 U.S.C. § 3801(a)(3)(B). See

[1] The *Complaint* contains twelve counts, representing the twelve mortgages underwritten by Respondent. However, there were fourteen total mortgage insurance claims made to HUD. The mortgages associated with Counts 1 and 2 each contain two separate claims, known as the "A Claim" and the "B Claim." Respondent's jurisdictional cap argument would apply to Count 1's A Claim, which was for $207,033.52. It would not apply to the B Claim, which was for only $10,089.19. HUD is not seeking recovery or penalties for the A Claim in either Count, presumptively because of expiration of the statute of limitations.

[2] The claims that exceed $150,000 are the A Claim in Count 1, and each claim in Counts 4, 6, 7, 8, 9, 10, and 11.

also 24 C.F.R. § 28.5. An "authority" is defined, in part, as "an executive department." 31 U.S.C. § 3801(a)(1)(A).

As a federal agency, HUD is clearly an "authority" for purposes of the PFCRA. It therefore cannot make a claim under 31 U.S.C. §§ 3801(a)(3)(A) or (C), because under both definitions the authority is the recipient of the claim. Section 3801(a)(3)(B) is equally unhelpful. Although HUD may be a claimant under this definition, the Respondent in this case was never a recipient who received property, services, or money from HUD. The insurance payments were received by their respective mortgagees.

HUD also suggests that the reviewing official has discretion to pursue less than the full amount of the original claim, thereby making HUD's claim simply a modified version of the claim presented by the mortgagee to the agency.[3] As such, the claim would be one made "to an authority." Unfortunately, this argument is not supported even by HUD's own implementing regulation.[4]

The statute instructs the reviewing official to determine how much money or property "is requested or demanded in violation of Section 3802 of this title." This can only be understood to refer to the amount demanded *by the claimant*, i.e., the amount of the mortgage insurance payment. HUD did not—and could not—limit the mortgage insurance payments to $150,000.[5] It was obligated to pay the full amount of those claims, and it did so in all twelve of the cases at issue here. Even assuming, *arguendo*, that HUD could cap the mortgage insurance payments, the capped amount would not be the amount the claimant "requested or demanded," It would be the amount that HUD actually paid. Accordingly, the recovery amount sought by HUD against Respondent does not meet the statute's definition of a "claim," and so cannot be used to avoid the PFCRA's jurisdictional ceiling.

HUD presents two relatively recent HUD cases to support its assertion that it can adjust the claim amount to secure PFCRA jurisdiction. See, Salvador Alvarez, HUDALJ No. 04-025-PF (June 23, 2005); Delia Cervantes, HUDALJ No. 08-039-PF (July 15, 2008). Respondent points out, however, that neither case actually contains any discussion of HUD's right to reduce the claim in this way. The court in Alvarez noted that HUD paid a claim of $325,149.49, but reduced the claim to $150,000 for purposes of the PFCRA prosecution. The respondent did not challenge HUD's action, and the court mentioned it only to say that "the amount that HUD can seek in assessment and penalties is dwarfed by the amount lost to the Government." Alvarez, p. 8. The court thus presumed the validity of the claim adjustment rather than analyzing it. Cervantes gives the issue even less attention.

[3] It should be noted that this Court has not been presented with the reviewing official's determination of the amount claimed. Indeed, the Court is unaware of the identity of the reviewing official. It is only by inference from the *Complaint* that this Court, as "presiding official," is aware of the amounts determined to have been claimed by the reviewing official. The Office of Hearings and Appeal's first filing and notice in a PFCRA case is the *Complaint*.

[4] 24 C.F.R. 28.10 (a) (5) states: "Liability under this part shall not lie if the amount of money or value of property or services claimed exceeds $150,000 as to each claim that a person submits. ..."

[5] Generally, a mortgage insurance payment is paid long before any PFCRA investigation is initiated. For HUD's theory to be accurate, the reviewing official, being part of the PFCRA process and not the insurance payment process, would have to be able to retroactively alter the amount of the insurance payment. HUD does not assert or even imply that the reviewing official has such power.

By comparison, the case relied upon by Respondent, Roberts v. Shinseki, 647 F.3d 1334 (Fed. Cir. 2011), directly addressed the effect of the $150,000 PFCRA cap and found that a claim in excess of the cap rendered the PFCRA inapplicable. Shinseki, 647 F.3d at 1341. Although HUD attempts to distinguish Shinseki from the instant case, the Court finds that the differences are immaterial. Shinseki provides an analysis of the PFCRA's scope, language, and intent. Those are the same issues the Court must resolve here, and they are issues that were not discussed in Alvarez or Cervantes. The caselaw therefore falls squarely in Respondent's favor.

HUD next argues that denying the reviewing official discretion to change the claim amount would frustrate the statute's intent because the PFCRA was designed to "expand the remedies available to the Government for fraud."

The Court agrees with HUD's assessment of Congress' intent when implementing the PFCRA. The legislative history confirms that the PFCRA was created to provide federal agencies with the means to pursue "small dollar" fraud cases. See H.R. Rep. 99-1012. Prior to enacting the PFCRA, Congress recognized that "[W]hile judicial remedies are available to penalize and deter fraud against the government, the cost of litigation often exceeds the amount recovered, thus making it economically impractical for the Justice Department to go to court. The government is frequently left without an adequate remedy for the small-dollar cases." Id. at 258; see also Kenneth and Karen Turner, HUDALJ No. 92-1832-PF (September 30, 1992); Michael Davidson, COMBATING SMALL-DOLLAR FRAUD THROUGH A REINVIGORATED PROGRAM FRAUD CIVIL REMEDIES ACT, 37 Pub.Cont. L.J. 213, (2008). As a result, even cases of blatant fraud would often not be prosecuted because they simply were not "worth the trouble." By the mid-1980s, small-scale fraud by government contractors and others had reached epidemic levels, costing the federal government millions of dollars and eroding public faith in government programs. See H.R. Rep. No. 99-1012; S. Rep. No. 99-212. To remedy the situation, Congress enacted the PFCRA as an administrative mechanism to capture those fraud cases that would otherwise slip beneath the U.S. Department of Justice's ("DOJ") radar.

HUD is therefore correct that Congress wanted to arm the government with a new weapon to combat fraud. However, that weapon was specifically aimed at small-dollar targets, which Congress determined to be anything under $150,000.[6] Congress therefore never intended for cases above that figure to be brought pursuant to the PFCRA because those higher-dollar cases were expected to be brought in federal court by DOJ.

The DOJ's jurisdictional supremacy is in fact baked directly into the statute itself. Prior to initiating a PFCRA case, the agency's reviewing official must assess the merits of the case and seek authorization from DOJ. 31 U.S.C. § 3803(a).[7] The DOJ must approve or deny the authorization request, in writing. 31 U.S.C. § 3803(b). In essence, a PFCRA case requires an affirmative statement by the DOJ that it is uninterested in undertaking the prosecution itself. If,

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[6] As originally proposed, the PFCRA would have featured a $100,000 cap. S. Rep. No. 99-212. However, the limit was raised to $150,000 by the U.S. House of Representatives. H.R. Rep. No. 99-1012.

[7] The *Complaint* states that DOJ granted authority to HUD to issue a complaint under the PFCRA against Respondents. However, the Court has not been provided a copy of HUD's request, nor DOJ's written response.

however, DOJ *is* interested in pursuing the case (or related cases) either criminally or via an FCA action, it may commandeer it simply by refusing the agency's authorization request.

HUD also insists that if the reviewing official is denied discretion, "a remedial gap would accrue for claims above $150,000 that would go unaddressed either civilly or administratively." This may be true. However, if such a remedial gap exists, it is only because Congress misidentified the point at which DOJ would be roused into action. A $150,000 fraud claim may have been scandalous in 1986, even if it perhaps appears somewhat paltry in 2015. The Court notes that the PFCRA's jurisdictional cap does not automatically adjust to correct for changing economic realities.[8] It is for Congress, not the courts, to correct that possible oversight. Indeed, if Congress truly intended the PFCRA to reach fraud regardless of the dollar amount involved, it could eliminate the jurisdictional cap entirely.

After due consideration, the Court finds that the only relevant "claim" is the mortgage insurance claim made to HUD. For PFCRA jurisdiction to attach to any claim, it must be for no more than $150,000. Accordingly, Counts 4, 6, 7, 8, 9, 10, and 11 must be **DISMISSED** because each is based on a claim in excess of $150,000. Counts 1 and 2 each have an "A Claim" and a ""B claim." The penalties and recoveries sought by HUD in both Counts 1 and 2 are limited to the B Claims, each of which was under the jurisdictional cap.[9] The *Motion to Dismiss* Counts 1 and 2 must therefore be **DENIED**.

II. Statute of Limitations

The *Motion to Dismiss* next asserts that Counts 1 and 2 are barred by the PFCRA's six-year statute of limitations. It states that the claim upon which Count 1 is based was filed on December 5, 2008, but the *Complaint* was not filed until January 16, 2015. The claim upon which Count 2 is based was filed on December 19, 2008.

The Government counters that Respondent has misidentified the relevant loans, and so starts the limitations clock on the wrong dates. The B Claims for each count were February 21, 2009; and February 26, 2010, respectively. Respondent has now conceded that the B Claims for Counts 1 and 2 are within the statute of limitations because the *Notice of Hearing and Order* was issued on February 19, 2015. The hearing was therefore commenced within six years of the date the claims accrued. Accordingly, the portion of the *Motion to Dismiss* based upon expiration of the statute of limitations must be **DENIED**.

III. Allegations of But-For Causation

Third, Respondent contends that HUD has failed to state a claim as to any Count because the *Complaint* does not allege that Respondent caused any false claims to be filed. At best,

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[8] Another example is the Alternative Minimum Tax (AMT) enacted in 1982, which, as the years rolled by, came to ensnare much of the middle class in addition to the originally targeted small number of billionaires. The problem was addressed by passage of the American Taxpayer Relief Act of 2012, which indexed its impact for inflation. Congress may also fix the jurisdictional void under PFCRA as it previously fixed the erosion of penalties under PFCRA and other statutes by passage of The Federal Civil Penalties Inflation Adjustment Act of 1990 (28 U.S.C. 2461) as amended by the Debt Collection Improvement Act of 1996 (31 U.S.C. 3701).

[9] See note 1, supra.

Respondent argues, HUD alleges only that Respondent's actions were a "but-for" cause of the statements. As such, they are insufficient to state an actionable claim.[10]

In response, HUD notes that the question of causation in false claims cases is not well-settled at the federal level. Regardless, HUD asserts that the false statements alleged here are actionable either under a "but-for" or "proximate cause" theory. The Court agrees.

There is ample precedential support for the proposition that a false statement is actionable under the False Claims Act ("FCA") or the PFCRA when the statement is intended to or is reasonably likely to cause the Government to pay a claim that is supported by the false statement. The U.S. Supreme Court stated that a plaintiff asserting an FCA claim "must prove that the defendant intended that the false record or statement be material to the Government's decision to pay or approve the false claim." Allison Engine Co., Inc. v. U.S. ex rel. Sanders, 553 U.S. 662 (2008). As an example, the Court noted that "a subcontractor violates [the FCA] if the subcontractor submits a false statement to the prime contractor intending for the statement to be used by the prime contractor to get the Government to pay its claim." Id. at 671.

This Court addressed the question in 1993, finding that "[I]n order to recover, the Government must show that Defendants made false written statements that they had reason to know could cause claims against the Government, and that the Government paid claims supported by the false written statements. Leon M. Holman and Lorraine E. Holman, HUDALJ No. 931978-PF (June 10, 1993).

The question of causation was discussed in more detail by this Court in a 2008 decision.[11] Olivia M. Martinez, HUDALJ No. 08-072-PF (December 22, 2008). There, after examining the federal circuit split on the issue, the Court concluded that "where a defendant's false statements concern the buyer's financial qualifications for a HUD-insured home loan, the false statements are 'more than a but-for cause' of any damages that the government sustains as a result of the borrower's default." Id. at 13. Indeed, "[t]o the extent that the false documentation certified by the Respondent understated the likelihood of default and understated the likelihood of a claim for FHA insurance, the Respondent's misconduct was a cause of making such a claim." Id. at 14.

The Fifth Circuit took substantially the same view in 1981 while considering a factual situation not unlike the one presented here. Despite rejecting the "but-for" standard, the court in U.S. v. Miller held that "false statements regarding the ability of purchasers to afford housing could very well be the major factor for subsequent defaults.[12] U.S. v. Miller, 645 F.2d 473, 476

[10] Respondent bases this argument on caselaw analyzing the False Claims Act, 31 U.S.C. § 3729-3733. Both parties agree that the FCA and the PFCRA are "sister schemes," making their analyses generally interchangeable. See, Vermont Agency of Natural Resources v. U.S. ex rel. Stevens, 529 U.S. 765 (2000).

[11] The respondent in Martinez never responded to the *Complaint*, leading to a default judgment for the Government. However, the presiding judge—coincidentally, the undersigned—nonetheless considered the causation question before imposing a penalty against the respondent.

[12] The Fifth Circuit agreed in Miller that the Government "must demonstrate the element of causation between the false statements and the loss. In the context of a federal housing case, the United States must show that the false statements in the application were the cause of subsequent defaults." Miller, 645 F.2d 473, 76. It then immediately concluded that the false claims in question met the causation standard.

(5th Cir. 1981). The District of Columbia Circuit reached the same conclusion in 1995, in U.S. v. Spicer, 57 F.3d 1152 (D.C. Cir. 1995).

Here, HUD alleges that Respondent made material false statements for the purpose of securing FHA insurance on its loans. It also alleges that HUD would not have been induced to approve the loans—or ultimately make the claimed insurance payments—if Respondent had provided accurate information. These allegations are sufficient to state a claim under either a "but-for" or a "proximate cause" standard. Accordingly, Respondent's *Motion to Dismiss* on this ground will be **DENIED**.

IV. Condition of Payment

Finally, Respondent asserts that all of the Counts in the *Complaint* must be dismissed because HUD has not alleged the violation of any regulation upon which payment is conditioned. Instead, Respondent contends that it has merely failed to fully comply with HUD regulations. Under this theory, "a claim under [the PFCRA] is legally false only where a party certifies compliance with a statute or regulation as a condition of governmental payment."[13] U.S. ex rel. Mikes v. Strauss, 274 F.3d 687, 697 (2d Cir. 2001). However, mortgage insurance payments are not predicated on perfect compliance with HUD regulations, they are predicated on the making of a claim by a mortgagee after default. Respondent thus argues that its false certification of compliance is therefore an essential precursor to the issuance of the insurance that permits payment of the claim.

The Government attempts to distinguish the holding in Mikes by noting that it was a Medicare case, and so should be limited to the health care arena. It is true that the Second Circuit was uniquely concerned about the health care context in Mikes, but it is also true that the case's rationale has broken free of its Medicare confines in the 15 years since it was decided. The "condition of payment" theory appears to be an all-but established aspect of FCA and PFCRA analysis in most federal jurisdictions.

That said, the mere fact that the precedent is gaining popularity nationwide does not make it controlling law here. The PFCRA does not contain any language stating that it is only applicable when a payment condition has been violated. The Court must determine if that standard applies. Accordingly, a complaint may allege facially plausible facts without expressly addressing the condition of payment theory. This *Complaint* must therefore survive the *Motion to Dismiss*.

Additionally, HUD contends that even if the condition of payment standard applies, Respondent's certifications of loan eligibility are express conditions that would meet the standard. This theory relies largely on U.S. v. Wells Fargo Bank, N.A., 972 F.Supp.2d 593 (S.D.N.Y. 2013). There, Wells Fargo Bank underwrote mortgage loans but failed to conduct much of the due diligence required to ensure that the loans met FHA requirements. HUD alleged

[13] "Legally false" is a term of art in this context. Mikes popularized the concept that a false certification under the FCA may be either factually false or legally false. A factually false certification "involves an incorrect description of goods or services provided or a request for reimbursement for goods or services never provided." Mikes, 274 F.3d at 697. A legally false certification is "a false representation of compliance with a federal statute." Id. at 696. In most jurisdictions today, a legally false certification may be either express or implied. Id.

that Wells Fargo "fraudulently induced HUD to insure loans that were ineligible for such insurance … by certifying that the mortgages met certain requirements … that they did not, in fact, meet." Wells Fargo, 972 F.Supp. 2d at 622. The court agreed that, if true, the allegations constituted false claims under the FCA. Id. It also agreed that the certifications of loan eligibility were express conditions of payment, making the bank's certifications legally false. Id. at 625.

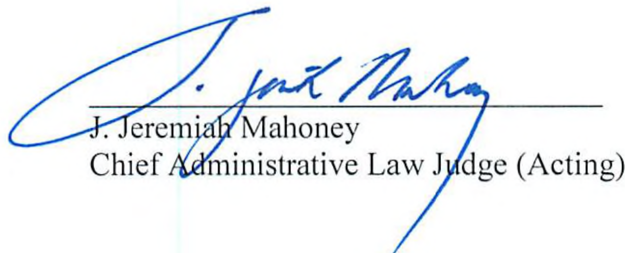
In a 2014 case also involving HUD and a Direct Endorsement loan underwriter, the same court reiterated its position that certifications for FHA loans "are explicit conditions for ongoing payments and therefore proper bases for False Claims Act claims." U.S. v. Movtady, 13 F.Supp.3d 325, 331 (S.D.N.Y. 2014).

HUD has alleged sufficient facts asserting PFCRA claims based on fraudulent inducement or false certification. The *Motion to Dismiss* on this ground will therefore be **DENIED**.

CONCLUSION

For the reasons discussed above, the Court finds that those Counts based solely on mortgage insurance claims in excess of $150,000 are not properly before this Court. Respondent's *Motion to Dismiss* is therefore **GRANTED** as to Counts 4, 6, 7, 8, 9, 10, and 11. The *Motion to Dismiss* the B Claims properly before the Court and timely alleged in Counts 1 and 2 based on the six-year statute of limitation found at 31 U.S.C. § 3803 is **DENIED**. The *Motion to Dismiss* based upon causation and condition of payment grounds is also **DENIED**. Accordingly, Counts 1, 2, 3, 5, and 12 remain pending before this Court for decision.

So **ORDERED**,



J. Jeremiah Mahoney
Chief Administrative Law Judge (Acting)