No. 19-1008

In the
Supreme Court of the United States

JIM C. HODGE, ET AL.,
Petitioners,
v.

UNITED STATES OF AMERICA,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

REPLY BRIEF FOR PETITIONERS

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This petition requests certiorari so that this Court may settle a question that has divided several circuits: whether the causation standard under the False Claims Act (FCA) is proximate cause, requiring both that the harm was foreseeable and that the false statement or fraudulent conduct was a substantial factor in causing the harm, or "but for" causation based solely on the foreseeability of the harm.

The government argues that proximate cause is such a flexible standard that it is based solely on the foreseeability of the harm. As such, the government argues that the decision below is not in conflict with the other circuits even though those other circuits have clearly adopted a more stringent proximate cause standard that required a causal connection between he conduct at issue and the harm in addition to just foreseeability. The government further argues that the proof at trial that a percentage of the loans at issue were "ineligible" for FHA insurance for whatever reason, without more, was sufficient to meet this flexible standard. This is so even though the government did not even attempt to connect an alleged underwriting deficiency or false statement to the default of a single loan. The government finally argues that the Petitioners are seeking to re-litigate the facts—which is not so.

The government is wrong on the required elements of proximate cause. The Fifth Circuit's decision warrants review to resolve this new split between it and the Third, Seventh, Tenth, and District of Columbia Circuits.

I. The FCA requires proof of proximate cause which requires proof that the harm was both foreseeable and that the false statement or fraudulent conduct was a substantial factor in causing the harm.

To hold a person liable under the FCA requires proof, *inter alia*, that the government suffered harm in the form of payment of a claim for money, "because of the actions of that person." § 3729(a)(1). As the government correctly notes, the "phrase 'because of' requires the government to prove some form of causation." Br. in Opp. 8 (citing *Gross v. FBL Financial Servs., Inc.*, 557 U.S. 167, 176-177 (2009)). As explained in the Petition, the Third, Seventh, Tenth, and District of Columbia Circuits have all adopted a proximate cause standard that requires proof that the harm was foreseeable and that the false statement or fraudulent conduct was a substantial factor in causing the harm. Pet. 14-19. In those circuits, the alleged underwriting deficiency or false statement must be a substantial factor in a loan's default.

As the Petition noted, the Fifth Circuit's decision below was based on a causation standard that required only that the harm be foreseeable because, according to the Fifth Circuit, it was not feasible to connect false statements and defaults with specific loans "in a case that relies on sampling and extrapolation, as does this one." Pet. Ap. 9-10. Not only is that reasoning faulty, the resulting foreseeability alone standard places the Fifth Circuit in conflict with four other circuits. Pet. 14-22. Furthermore, the government's position renders the FCA's requirement that the harm result "because

of the actions of that person" superfluous. 31 U.S.C. § 3729(a)(1).

In its response, the government concedes that there was no evidence of any connection between any allegedly false statement or fraudulent conduct by the Petitioners and any loan default. Br. in Opp. 7. According to the government, that was because, according to the Fifth Circuit, it was impossible to connect any loan default to a particular false statement or fraudulent conduct because this case involved sampling and extrapolation. Br. in Opp. 7. The government argues that such a connection was unnecessary because proximate cause is such a flexible concept that in a quasi-criminal case the government can rely on the simple fact that if a loan was ineligible for FHA insurance, then Petitioners are liable under the FCA for any subsequent default, regardless of the reason for the default. Br. in Opp. 10-11. In other words, if a loan was ineligible for FHA insurance because the loan was originated from an unregistered branch, or recklessly underwritten, and the homeowner died causing the loan to default, the Petitioners were liable under the FCA. This *post hoc ergo propter hoc* (after the thing because of the thing) logic is faulty and inconsistent with any recognized concept of proximate cause.

II. Four other circuits have adopted a proximate cause standard that has two elements—proof that (1) the harm was foreseeable and (2) the false statement or fraudulent conduct was a substantial factor in causing the harm.

The government misunderstands the concept of proximate cause. As explained in the Petition, proximate cause requires both that the harm was foreseeable and that the false statement or fraudulent conduct was a substantial factor in causing the harm. Pet. 18-20. Following the Third Circuit's application of the proximate cause standard to claims made under the FCA in its decision in *United States v. Hibbs*, 568 F.2d 347 (3d Cir. 1977), the Seventh, Tenth, and District of Columbia circuits have settled on a proximate cause standard requiring both foreseeability and causality.[1] *Id.*

As well explained by the Seventh Circuit, "[p]roximate cause encompasses both cause-in-fact and legal cause." *United States v. Luce*, 873 F.3d 999, 1013 (7th Cir. 2017). Legal cause focuses on the foreseeability of the harm. *Id.* Cause-in-fact, by contrast, requires proof that the alleged misconduct was a "material and substantial factor in bringing about the injury." *Id.* (citations omitted). Both *Hibbs*

[1] The Ninth Circuit discussed both standards in *United States v. Eghbal*, 548 F.3d 1281, 1284-1285 (2008), but because it found that the conduct at issue in that case satisfied both "but for" and the more stringent proximate cause standard it did not adopt either as a clear causation standard.

and *Luce* involved FCA claims related to the FHA mortgage insurance program just as do the claims in this case. And each of the cases required proof of (1) legal cause and (2) cause-in-fact to satisfy the FCA's causation standard.

The facts in *Hibbs* are analogous to the facts of this case. There, the government sued a real estate broker who furnished false information regarding the condition of homes that received FHA insured mortgages. Like here, when those mortgages defaulted, the government sough liability under the FCA. According to the government, Hibbs was liable simply because he made false statements regarding the homes' condition: "had Hibbs not furnished the false certifications, [FHA] would not have insured the mortgages and therefore would not have been called upon to make any payment" when those mortgages later defaulted. *Hibbs*, 568 F.2d at 351.

In its opposition, the government argued that the Fifth Circuit's decision below was correct, because it was foreseeable that loans that were originated from unregistered branches or recklessly underwritten would default at higher rates and the actual cause of the default did not matter because proximate cause is such a flexible concept that liability could be sustained on foreseeability alone. Br. in Opp. 9. That is wrong. Even the leading case cited by the government, *Paroline v. United States*, 572 U.S. 434, 444-445 (2014), is at odds with that proposition.

According to the government, "[p]roximate cause is a flexible concept that does not lend itself to a black-letter rule that will dictate the result in every case."

Br. in Opp. 9 (quoting *Bridge v. Phoenix Bond & Indemnity Co.*, 553 U.S. 639, 654 (2008)). But that flexibility does not obviate the need to prove both legal cause and cause-in-fact. As explained in *Paroline*: While "[e]very event has many causes…only some of them are proximate, as the law uses that term." 572 U.S. at 444.

While proximate cause might be a "flexible concept," it is not a Gumby doll. There must still be some direct relation between the injurious conduct and the resulting harm. *Id.* Neither *Paroline* nor *Bridge* remove the required nexus between the conduct and harm. This is the cause-in-fact requirement described in *Luce* and, as noted by this Court in *Paroline*, prevents "liability in situations where the causal link between the conduct and result is so attenuated that the consequence is more aptly described as a mere fortuity." *Id.* at 445. Absent this causal link, liability under the FCA is untethered to the actual "because of" statutory language of § 3729(a)(1).

The government incorrectly reads the statement in *Paroline* that proximate cause is "often explicated…in terms of foreseeability or the scope of the risk created by the predicate conduct." Br. in Opp. 9. The fact that proximate cause is often explicated, which simply means to be analyzed, in terms of foreseeability does not mean that foreseeability alone can satisfy the proximate cause standard. To explicate proximate cause does not mean one can discard its constituent parts, i.e. the elements of foreseeability and cause-in-fact.

The government argues that proximate cause is such a flexible concept that it can satisfy the FCA's causation requirement solely based on evidence that certain loans were falsely certified as eligible for FHA insurance. Br. in Opp. 9. The error in the government's argument is well explained by the Third Circuit in *Hibbs*:

> We are unable to accept this argument because it ignores the statute's [FCA] restrictive language "by reason of." The damages were sustained by the United States because of defaults of the mortgagors and to some extent were increased by the unexpected diminution of property value caused by the lead paint injunction. Neither of those events was caused by or related to the false certifications. Indeed, precisely the same loss would have been suffered by the government had the certifications been accurate and truthful.
>
> To further illustrate the extreme to which the government's argument would lead if the mortgagors had defaulted because their houses had been destroyed by a flood or some other uninsured catastrophe, the government's theory would nevertheless hold Hibbs liable because he failed to call attention to defects in the plumbing.

Hibbs, 568 F.2d at 351.

Thus,

> even if the originating branch had been properly registered and/or if the loan file been perfectly

> underwritten, if the borrower died and the loan went into default, the government would have suffered the same loss. The false branch identification numbers and the underwriting flaws the government complained of in this case therefore could not be the proximate cause of the government's losses in those instances.

Pet. 21.

III. The Fifth Circuit's new FCA causation standard is so flexible that it is no standard at all.

The decision below crafted a new FCA causation standard to fit the facts of the case, rather than apply the actual facts of the case to its own settled precedent. As noted in the Petition, nearly forty years ago the Fifth Circuit expressly adopted the Third Circuit's holding and reasoning from *Hibbs*. Pet. 16. In *United States v. Miller,* the Fifth Circuit held that the government must prove "causation between the false statements and the loss" and that "**[i]n 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.**" 645 F.2d 473, 475-476 (5th Cir. 1981) (emphasis added). The Fifth Circuit has now repudiated that holding.

The government argues that the United States does not have to show that causal connection between a false statement in the loan application and the subsequent default. It is sufficient to show only that the loan was ineligible for FHA insurance, the actual cause of the default does not matter. Br. in Opp. 10

("the government was not required to 'connect[] specific false statements to individual defaults'"). In fact, according to decision below, it could not make those connections because the government had "relie[d] on sampling and extrapolation." Pet. App. 9. In other words, the government was relieved of its burden to prove an essential element of its claim because it chose to rely on sampling and extrapolation.

Until its decision below, the Fifth Circuit was in harmony with the other circuits. Pet. 20-22. Now, to sustain FCA liability in the Fifth Circuit, one need only prove that the harm was foreseeable—there is no requirement to link the false statement or fraudulent conduct with the harm.

Under this new causation standard, mislabeled as proximate cause, any company or person that does business with the United States should beware because any loss suffered by the government, regardless of whether that company's or person's actions were a cause-in-fact of that loss, they are now on the hook for those losses. Sell the government a car, if a driver then drives it off a cliff, seller beware, the United States Attorney and Department of Justice are looking for you.

IV. The government's claim that the Petitioner is seeking to re-litigate the facts of the case is false—there is no need to re-litigate the facts as the government has conceded that there was no evidence linking any false statement or fraudulent conduct to a loan default.

In its opposition, the government also attempts to mischaracterize the Petitioner's argument as seeking to re-litigate the evidence from trial. Br. in Opp. 8, 11. This is a red herring. There is nothing to re-litigate.

There is no dispute, as the government conceded at oral argument below that there was no evidence at trial linking any false statement with a particular loan default.[2] The government concedes the same in its opposition. Br. in Opp. 7. Indeed, the government's expert conceded that he was not even asked to analyze causation and did not do so. Pet. App. 71-72. He only retrospectively determined whether a loan was eligible for FHA mortgage insurance. Pet. App. 17-19. The government took its expert's eligibility analysis and used it as its sole evidence for causation. According to the government that was enough.

The government failed to identify a single false statement regarding a borrower's ability to repay a loan such as falsely stating a borrower's income. The government did not even look for false statements regarding the borrower's ability to pay in its

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[2] Available at: http://www.ca5.uscourts.gov/OralArgRecordings/17/17-20720_3-11-2019.mp3 minute 38:04-39:10 (last accessed 6/7/2020).

unregistered branch case. Rather, the expert stated that his "goal was to identify the number of loans on which HUD paid claims where loans originated from these unregistered branches." C.A. ROA 17072. When asked if he had "any reason to believe that an insured loan defaulted because of the [false] branch number that Allied put in Box 13 of a Form 92900-A." C.A. ROA.17770. He admitted that "I've not analyzed that." C.A. ROA.17770. Nor did any of the other government's experts. *See* C.A. ROA 15227; 15240; 15255-56. False branch identification numbers have nothing to do with a borrower's ability to repay.

Furthermore, there was no identified false statement regarding a borrower's ability to repay the loan identified in the reckless underwriting part of the government's case which focused on technical quibbles with HUD underwriting guidelines and missing documents in loan files—the expert just re-underwrote the loans according to his understanding of HUD guidelines. Pet. App. 17-18. He did not look at falsity of any statement within the loan file, he merely performed an analysis of whether the loan was eligible for FHA insurance.

As noted in the Petition, the only evidence regarding the cause-in-fact of any loan default is found in the Early Payment Default Audits that listed causes for default such as death of borrower and loss of job or income. *See e.g.* Pet. App. G. Furthermore, the government never put on any evidence that any deficiency in a loan file led to a loan default.

Thus, there is no need to re-litigate any of the facts as it is conceded that the government's sole evidence at

trial for causation was that there were loans originated from some of the Petitioners' branch offices that were unregistered with HUD and loans that were recklessly underwritten and that those loans were therefore ineligible for FHA insurance. The decision below ratified the government's view of the law that held that when those loans later defaulted, regardless of the reason for the default, the defendants were liable for treble damages under the FCA. This was error.

Absent a causal connection between the Petitioners' false statement or fraudulent conduct, the Fifth Circuit's decision is inconsistent with the requirement that the harm arise "because of the actions of that person" (§ 3729(a)(1)) to sustain liability under the FCA. There is a split among the circuits and the Fifth Circuit created it with its decision below.

CONCLUSION

The Petition asks the Court to resolve an exceedingly important question: what is the proper standard of causation under the False Claims Act? The government argues that the "Petitioner has not identified any court of appeals decision finding evidence similar to that presented here insufficient to support a damages award under the FCA" and that absent such a case, review is not warranted. The government is wrong, the Third Circuit's decision in *Hibbs* is squarely on point factually with the government's evidence here. Pet. 15-16. Review is warranted to prevent different results based on the same conduct in different circuits because of different causation standards. Review is warranted and particularly important to those individuals and

corporations that are subject to the sledgehammer of the FCA's treble damages.

Respectfully submitted,

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