

Second Circuit Holds that the FCA Applies to Regional Federal Banks

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by Nathan J. Ebnet

On November 21, 2019, the Second Circuit held that allegedly fraudulent loan requests presented to one or more of the Federal Reserve System's twelve Federal Reserve Banks are "claims" within the meaning of the FCA. The court clarified that while personnel of those Federal Reserve Banks are not officers or employees of the United States, the Federal Reserve Banks themselves are agents of the United States and fraudulent requests to them are subject to the FCA. In so holding, the court revived a long-running whistleblower case and rejected the arguments of the lower court, the U.S. Government, and the Federal Reserve Board of Governors.

The lawsuit was first filed by plaintiffs in 2012. According to the complaint, two banks engaged in a massive fraud in the early to mid-2000s against the U.S. Department of the Treasury by representing to regional Federal Reserve Banks that they were in sound financial condition and thus eligible for desirable credit programs.

The regional Federal Reserve Banks are subject to a Board of Governors, but their stock is held by private commercial banks. According to the federal government, the regional banks administer their money-lending activities for themselves. The regional banks' loans are delivered in the form of credit to the borrowing bank, not lent out of federal money.

The lower court—U.S. District Judge Brian M. Cogan for the Eastern District of New York—dismissed the fourth amended complaint in May of 2018. The lower court concluded that under the Federal Reserve Act, the 12 Federal Reserve Banks (one for each of the Federal Reserve's 12 districts) are private corporations separate from the actual Federal Reserve System. Moreover, because the Federal Reserve Banks do not receive government money, the lower court concluded that defendants could not be properly accused of submitting false claims to the government by requesting loans from the regional banks.

On appeal, the Second Circuit requested that the government weigh in on whether

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regional Federal Reserve Banks should be considered part of the government for FCA purposes. In August of 2019, the Federal Reserve Banks' Board of Governors responded unequivocally that the regional banks should not be treated as part of the government due to their relative autonomy and lack of government appropriations. The Board of Governors likened the regional banks to other "federally chartered corporations" such as Amtrak, Fannie Mae, and Freddie Mac, entities that courts have treated as separate from the government for FCA claims.

The Second Circuit disagreed. According to the appellate panel, the federal government created the regional banks to extend emergency credit to banks on the federal government's behalf. Those regional banks must extend emergency credit in compliance with regulations from the Board of Governors—an independent agency within the executive branch. The appellate panel stated that the FCA does not require "agents" for purposes of the Act to be actual government agencies, but instead merely requires that those agents are empowered to act on behalf of the government.

The Second Circuit's opinion is a major win for *qui tam* relators. The Second Circuit affirmed that in enacting the FCA, "the objective of Congress was broadly to protect the funds and property of the Government from fraudulent claims, *regardless of the particular form, or function*, of the government instrumentality upon which such claims were made."

The case is *U.S. ex rel. Kraus et al. v. Wells Fargo & Co. et al.*, Case Number 18-1746, in the U.S. Court of Appeals for the Second Circuit.