IN THE COURT OF APPEALS OF THE STATE OF NEW MEXICO

STATE OF NEW MEXICO, Plaintiff,
ex rel. FRANK C. FOY and SUZANNE B. FOY, *qui tam* Plaintiffs

Appellants,

v. Ct. App. No. 31421

AUSTIN CAPITAL MANAGEMENT, LTD; *et al.*

Defendants/Appellees.

REPLY BRIEF BY PLAINTIFFS TO DEFENDANTS' CONTENTION THAT THE COURTS LACK JURISDICTION OVER THEM BECAUSE THE AGENCIES AND THE AG KNEW ABOUT THE FRAUDS

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Oral Argument Is Requested

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This brief, according to the word count provided by WordPerfect Version X5, the body of the foregoing brief contains 2874 words, exclusive of those parts excepted by Rule 12-213(F)(1). The text of the brief is composed in 14 point proportionally-spaced typeface (Calisto MT).

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INTRODUCTION

The defendant Bruce Malott was the Chairman of the Educational Retirement Board until September 2010, when he was forced to resign after it was revealed that he had received a secret $350,000 loan from the defendant Anthony Correra. *See* Information Concerning Bruce Malott's Secret $350,000 Loan from Anthony Correra, attached as Exhibit 2 to Plaintiffs' Supplement to the Record on Appeal: Aldus Transcripts and Malott Resignation. Mr. Malott's secret loan from Anthony Correra came to light more than a year after Mr. Foy had filed the initial and amended complaints in this case, in 2009, and more than two years after Frank Foy had filed his initial qui tam complaint in *Vanderbilt*, in 2008. This evidence about Malott's secret loan from Correra provides more proof to support the amended complaint in this case, which alleges that Bruce Malott conspired with Anthony Correra and Gary Bland (State Investment Officer) and others, to steer state investments to Wall Street defendants who were willing to pay kickbacks to Anthony Correra's son, Marc Correra, another defendant in this case.

However, Bruce Malott argues that "no court" has subject matter jurisdiction over the qui tam claims against him, because, he asserts, all the relevant information was known to the ERB or the SIC or the Attorney

General when Foy's qui tam lawsuits were filed. That assertion is quite untrue. For example, Malott's secret loan was not uncovered until September 2010, more than a year later. Furthermore, Frank Foy supplied information which was not previously known to the agencies or the AG. Mr. Malott has his facts and his chronology wrong, and the law as well. Section 44-9-9(B) simply does not apply to the facts in this case.

Nevertheless, the Wall Street defendants eagerly try to jump on Mr. Malott's bandwagon. Even though § 44-9-9(B) only relates to state officials, these private sector defendants claim that, somehow, they vicariously escape the court's jurisdiction along with Mr. Malott.

I. BOTH DISTRICT JUDGES HAVE ALREADY REJECTED THE CONTENTION THAT THE COURTS LACK JURISDICTION BECAUSE FOY'S INFORMATION WAS ALREADY KNOWN TO THE ATTORNEY GENERAL.

Judge Pope's order of July 8, 2011. Judge Pope entered an order tentatively denying all the defendants' motions to dismiss based on an alleged lack of subject matter jurisdiction. Judge Pope found, "based solely on the papers filed and the existing record at this time, that Mr. Foy has demonstrated the existence of subject matter jurisdiction." Order, Ex.1 to Plaintiffs' Application.

Judge Pfeffer's order on January 27, 2012. Judge Pfeffer entered an order in the *Vanderbilt* case denying the defendants' motions to dismiss on "jurisdictional" grounds. See Notice of Supplemental Authority, filed herewith. Judge Pfeffer rejected the very same arguments which the defendants are trying to make during this interlocutory appeal.

Section 44-9-9(B) – actions against state officials. Judge Pfeffer denied defendants' motion to dismiss based upon an alleged lack of subject matter jurisdiction under § 44-9-9(B). That subsection restricts actions against state officials if the action is based on evidence which was already known to the agency or the attorney general when the action was filed.

A. The court ruled that § 44-9-9(B) does not preclude an action against a co-defendant who is not a state official [such as the Wall Street defendants], "even in those instances where an action would be precluded against another co-defendant based upon the applicability of this sub-section."

B. The court additionally ruled that "an action against a government official in this matter is not properly subject to dismissal under § 44-9-9(B)."

II. FATA DOES NOT DEPRIVE THE JUDICIARY OF SUBJECT MATTER JURISDICTION, BECAUSE THAT JURISDICTION IS CONFERRED BY THE NEW MEXICO CONSTITUTION.

For an analysis of these issues, see Points III and IV, Reply Brief by Plaintiffs About Psilos Defendants' Assertion That the Legislature Has Deprived the Judiciary of Subject Matter Jurisdiction Over This Case. That constitutional analysis also applies to Bruce Malott's contention that no court has subject matter jurisdiction over him.

III. SECTION 44-9-9(B) DOES NOT IMMUNIZE THE WALL STREET DEFENDANTS OR BRUCE MALOTT.

A. Section 44-9-9(B) Only Relates to State Officials, not Private Sector Defendants.

On pages 12-13 of the Topiary/Deutsche Bank Answer Brief, all of the Wall Street defendants argue that § 44-9-9(B) immunizes all of them from suit because the amended complaint also names two state officials (Bruce Malott and Gary Bland) as defendants. Coming from the Wall Street defendants, this argument is simply incomprehensible. By its terms, § 44-9-9(B) only deals with suits against state officials. Simply by reading the statute, one can see that the argument makes no sense.

Furthermore, the argument by the Wall Street defendants would lead to the absurd result that private sector fraudfeasors could defraud the State with

impunity, simply by corrupting public officials, as they did in this instance. This would give private sector fraudfeasors an extra incentive to bribe a public official, so that they could then argue that they enjoy vicarious immunity.

In this present case, all of the Wall Street defendants made false representations about the investments which they sold or recommended to the SIC or the ERB, and these misrepresentations are actionable under the Fraud Against Taxpayers Act. These misrepresentations are not excused by the fact that some of the defendants also bribed public officials.

B. Section 44-9-9(B) does not immunize Bruce Malott, because most of the crucial information was not known until Frank Foy filed his qui tam cases, or afterwards.

1. As Bruce Malott must concede, FATA expressly authorizes qui tam lawsuits against government officials like him.

Section 44-9-9(B) expressly allows qui tam lawsuits against public officials. FATA itself recognizes that frauds against the government are often perpetrated with the participation of corrupt government officials. This is one reason why FATA incorporates the common law tort of conspiracy in § 44-9-3(A)(4). If private sector fraudsters can form a conspiracy with faithless public servants inside the government, then their chances of defrauding the government are greatly increased. *United States v. Rippetoe*, 178 F.2d 735, 737 (4th Cir. 1949): "Some

of the worst frauds upon the government have been those in which officials have participated; and it is hardly reasonable to suppose that Congress intended to forbid suits by informers based on such frauds . . . ."

This is what actually occurred in this case. Some of the fraudsters (like Anthony Correra) conspired with insiders within state government, like Bruce Malott (Chairman of the ERB) and Gary Bland (State Investment Officer). Their conspiracy was extraordinarily successful: Marc Correra received or shared in approximately $22,000,000 (twenty two million dollars) in kickbacks paid by the Wall Street defendants, which they disguised as "third party marketing fees." As a result of this conspiracy, the State of New Mexico lost several hundred million dollars. The amounts of the kickbacks and the investment losses are not yet fully known, because discovery is currently barred by the automatic stay entered by this Court.

2. Section 44-9-9(B) does not apply to the facts of this case.

That subsection bars qui tam suits against public officials if it is based on information known to the agency or the AG at the time the suit was filed. It does not bar suits based on (a) information provided by the qui tam plaintiff himself, or (b) information which comes to light after the qui tam suit is filed.

Bruce Malott concedes the first point: FATA allows qui tam lawsuits against public officials if the lawsuits are based on information gathered by the qui tam plaintiff. *See* Malott Answer Brief at 11: FATA permits a qui tam plaintiff to proceed with a lawsuit that is based on information disclosed to the AG when the lawsuit is filed.

And Malott also concedes that Frank Foy's first suit – *Vanderbilt* – is not affected at all by his argument. Frank Foy filed his original *Vanderbilt* lawsuit under seal on July 14, 2008, almost 4 years ago. He also provided a substantial amount of information to the Attorney General, concerning the subject matter of that lawsuit: the $90,000,000 investment in the Vanderbilt financial trust. The *Vanderbilt* lawsuit alludes to other instances of suspected pay-to-play, but in July 2008 Mr. Foy and his counsel judged that they did not have sufficient information to sue all of the persons they suspected. So Mr. Foy and his attorneys conducted further investigations, gathered more information, and filed the complaint in this case in the spring of 2009, once they had enough information to support a lawsuit. Shortly afterwards, the third-party fees were uncovered and Foy amended his complaint accordingly.

In both *Vanderbilt* and *Austin*, Frank Foy provided substantial amounts of information which was previously not known to the Attorney General. Mr.

Malott falsely claims that the Attorney General knew all of this information all along, but that is simply untrue. The Attorney General is not claiming that he knew all of this information prior to Mr. Foy's lawsuits.

3. Malott's argument is legally defective. Mr. Malott makes the contorted argument that the *Austin* lawsuit is barred because it is based on the same information that Mr. Foy had already provided in the first lawsuit. There are several defects in this argument.

First, the argument is factually wrong. The *Austin* lawsuit contains lots of information which Mr. Foy did not have in July 2008.

Second, the *Austin* lawsuit involves different investments than in the *Vanderbilt* lawsuit.

Third, the *Austin* lawsuit names several dozen defendants who were not named in the *Vanderbilt* case.

Fourth, Mr. Malott's argument is absurd, because it would bar a qui tam plaintiff from filing another lawsuit based in part on information which he had already developed and supplied to the Attorney General. In other words, supplying information to the Attorney General would defeat the qui tam's lawsuit, even though FATA requires the qui tam to provide such information.

Fifth, Mr. Malott's argument does not allow for the fact that a great deal of information will come to light after a qui tam lawsuit is filed – through discovery or press investigations or other sources – and that information needs to be used in the lawsuit.

Sixth, Mr. Malott is playing a grammatical word game. He claims that the *Austin* lawsuit is barred because some of the information was already disclosed – by Foy – in the earlier *Vanderbilt* case. Therefore the case is barred because the information was known "when the lawsuit is filed." Mr. Malott seizes on the use of the statute's use of the singular – "the lawsuit" – to construct his argument that the first lawsuit bars the second. This is contrary to the rules of statutory construction enacted by the Legislature itself. In NMSA 1978, § 12-2A-5(A), the Legislature provided that "Use of the singular number includes the plural, and use of the plural number includes the singular." So the statute must be read as allowing for multiple lawsuits, in which the qui tam plaintiffs supply unknown information in the first lawsuit, and then file additional cases as they develop more information.

Seventh, Mr. Malott's argument would require the qui tam plaintiff to know everything before he files his first lawsuit. This is impossible, because fraudfeasors like Mr. Malott are very careful to conceal their wrongdoing – as

demonstrated by Mr. Malott's concealment of his $350,000 loan from Anthony Correra.

Eighth, Mr. Malott is claiming that another lawsuit is barred if there is any factual overlap, no matter how small, between the first and second lawsuits. Such a rule would be unworkable, and no court has adopted such a strict rule.

Ninth, Malott concedes that the original *Vanderbilt* lawsuit is not barred, so Mr. Foy could amend the *Vanderbilt* lawsuit to add all of the new defendants and all of the new claims against Malott. However, that could prove unwieldy and unnecessary. The Vanderbilt lawsuit focuses on CDO investments, while the Austin case focuses on hedge funds and private equity, so there is somewhat of a natural division between them.

C. The culpable knowledge of a faithless public servant is not attributed to the government.

Malott and the Wall Street defendants argue that the courts lack jurisdiction over them because Gary Bland (and Bruce Malott, according to the Wall Street defendants) knew about the frauds perpetrated on the State. Malott Answer Brief at 7-11; Topiary Answer Brief at 16. This argument fails because the guilty knowledge of a faithless public servant is not attributed to

the agency for which he works. *United States v. Rippetoe*, 178 F.2d 735 (4th Cir. 1949).

In *Rippetoe*, the qui tam plaintiff alleged that corrupt public officials were involved in the fraud upon government. When faced with the very same argument made in this case, the court dealt quite sensibly with it:

> In the first place, we do not think it incumbent upon plaintiff to negative knowledge on the part of government officials of the evidence upon which his action is based.
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> * * *
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> In the second place, we do not think that knowledge on the part of a government official who is implicated in the fraud precludes suit by the informer. The whole history of the provision shows that its purpose was, not to bar bona fide suits by informers merely because corrupt officials of the government might have participated in the fraud or refused to prosecute it, but to prevent the bringing of parasitical actions by those who sought to profit from governmental investigations or prosecutions by using the evidence which these had developed, as occurred in *United States ex rel. Marcus v. Hess*, 317 U.S. 537, 63 S.Ct. 379, 87 L.Ed. 443, the decision in which led directly to the legislation of which the provision here is a part.
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> * * *
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> It is a well settled principle of law that knowledge of an agent who is engaged in an attempt to defraud his principal will not be imputed to the principal. . . . Some of the worst frauds upon the government have

> been those in which officials have participated; and it is hardly reasonable to suppose that Congress intended to forbid suits by informers based on such frauds, merely because of the knowledge of a false agent who participated in the fraud and whose interest would be to conceal it. There is reason in saying that an informer may not sue on a claim of which those who may be expected to protect the interests of the government have knowledge; and this is clearly what the act means. This reasoning does not apply, however, where the knowledge is in possession of one who has participated in a fraud on the government and is interested in concealing it. To so hold would in large measure emasculate the statute and deprive the public of its benefit in cases where it is most needed.
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> It is said that, by the express wording of the statute, knowledge on the part of any officer or employee of the government is sufficient to bar suit by an informer; but the rule is well settled that all laws are to be given a sensible construction and that a literal application of language which leads to absurd consequences should be avoided whenever a reasonable application can be given consistent with the legislative purpose.

178 F.2d at 736-38 (citations omitted).

As *Rippetoe* explains, this rule of law is grounded in basic common sense. Faithless public servants like Malott and Bland cannot claim immunity by attributing their own guilty knowledge to the government. Likewise, the private sector fraudsters cannot claim immunity because they managed to bribe public officials like Bland and Malott.

CONCLUSION

The "jurisdiction" arguments raised by Bruce Malott and all the other defendants are entirely with merit, legally or factual. Those arguments are not jurisdictional at all, in the strictest sense of the term - subject matter jurisdiction. FATA was not intended to, and does not, destroy the subject matter jurisdiction of the courts. As the cases have recognized, the term "jurisdiction" is often used in a looser sense, to refer to issues which might be a bar to a decision on the underlying merits of the case, such as statutes of limitation, exhaustion of administrative remedies. Such issues might be an affirmative defense in a particular case, but such issues do not deprive the judiciary of subject matter jurisdiction under the New Mexico Constitution.

Defendants' arguments about jurisdiction are not within the scope of the interlocutory appeal, which is the retroactivity of FATA. The defendants have injected these pseudo-jurisdictional arguments to distract the Court's focus from the weakness of their arguments on the retroactivity issue. In the meantime, both district judges have correctly rejected defendants' arguments.

However, these "jurisdictional" arguments have the potential to cause delay and confusion, as they already have done in the Foy cases, and as they

threaten to do in many other FATA cases in the future. Therefore it might be useful for the Court to clarify the "jurisdiction" issue during the course of this appeal.

The "jurisdiction" argument can be decided on the briefs. However, if the court wishes to hear oral argument on the "jurisdictional" question, the Plaintiffs respectfully suggest that the Court allow an extra 10 minutes per side, so that this distraction does not cut into the time devoted to the sole question on which the appeal was granted: the express retroactivity of FATA.

Respectfully submitted,

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I hereby certify that a true and correct copy of the foregoing was emailed to all counsel of record and the Honorable John Pope this 13th day of February, 2012.

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