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VARIABLE RATE DEMAND OBLIGATIONS - CALIFORNIA

State ex rel. Edelweiss Fund, LLC v. JPMorgan Chase & Company

Court of Appeal, First District, Division 4, California - April 27, 2023 - Cal.Rptr.3d - 2023 WL 3115668

Relator filed seventh amended qui tam complaint under the California False Claims Act (CFCA) against financial institutions and subsidiaries that served as remarketing agents for State that managed variable rate demand obligations (VRDO), alleging that they engaged and conspired to engage in "robo-resetting" scheme, in which they mechanically set interest rates for the VRDO en masse, without consideration of individual characteristics of the bonds, associated market conditions, or investor demand, which resulted in artificially high interest rates, in violation of contractual obligation to reset each VRDO's interest rate at the lowest possible level to enable them to sell the series at face value.

The Superior Court sustained defendants' demurrer without leave to amend. Relator appealed.

The Court of Appeal held that:

- Relator's allegations that comparison of defendants' average interest rates with average commercial paper rate showed artificial inflation were insufficient to support CFCA claim;
- Relator's allegations about forensic analysis and study that it performed to evaluate interest rate resetting by defendants were sufficient to support CFCA claim;
- Relator's allegations that seven former employees of defendants stated and corroborated that defendants engaged in "robo-resetting" scheme were sufficient to support CFCA claim;
- Relator stated claim against defendants for conspiracy to violate CFCA;
- Commercial paper comparison information on websites providing business and market news could not support application of CFCA's public disclosure bar;
- Interest rate reset information on website that published information on all municipal bonds was not a "report" of the state, as required for public disclosure bar to apply; and
- Interest rate reset information on website that published information on all municipal bonds did not constitute a public disclosure in "news media," as required for public disclosure bar to apply.

Relator alleged an implied certification claim under the California False Claims Act (CFCA) against remarketing agents for State that managed variable rate demand obligations (VRDO), but not a "literal false or fraudulent" claim for payment, under the federal False Claims Act (FCA); relator alleged that agents impliedly certified compliance with their contractual obligations reset each VRDO's interest rate at the lowest possible level to enable them to sell the series at face value by submitting claim for payment for remarketing services, and that implied certification was false because agents knew those services had not been performed, but relator did not allege any other express false statements in agents' claims for payment.

Compliance by remarketing agents for State that managed variable rate demand obligations (VRDO), with express contractual obligation to reset each VRDO's interest rate at the lowest possible level to

enable them to sell the series at face value, was material government's payment decision, such that agents' false implied certification of compliance with that contractual term could support qui tam action against agents under California False Claims Act (CFCA); although the remarketing agreements did not mandate a specific process that agents had to use to reset the interest rate levels, it followed from the rate-resetting obligation that agents had to employ some methodology that was capable of allowing them to set the rates at the lowest possible level.

Relator's seventh amended complaint satisfied heightened pleading requirements for maintaining qui tam action under California False Claims Act (CFCA) against remarketing agents that managed variable rate demand obligations (VRDO), by alleging that during specific time frame, agents submitted claims for payment, impliedly certifying that they complied with contractual obligation to reset each VRDO's interest rate at the lowest possible level to enable them to sell the series at face value, and that those claims were false because agents mechanically set interest rates for VRDO en masse, without any consideration of individual characteristics of the bonds, associated market conditions, or investor demand, which resulted in artificially high interest rates.

Qui tam relator's allegations that comparison of State remarketing agents' average interest rates for variable rate demand obligations (VRDO) with average commercial paper rate showed that agents artificially inflated their interest rates for the VRDO by mechanically setting them en masse were insufficient to support claim, under California False Claims Act (CFCA), arising from false implied certification of compliance with express contractual obligation to reset each VRDO's interest rate at the lowest possible level to enable them to sell the series at face value; relator's complaint also contained allegations that agents' mechanical rate setting practices were the same both when the average VRDO rate was lower than the average commercial paper rate and when it was higher.

Qui tam relator's allegations about forensic analysis and study that it performed to evaluate interest rate resetting for variable rate demand obligations (VRDO) by remarketing agents were sufficient to support relator's claims, under California False Claims Act (CFCA), for false implied certification of compliance with contractual obligation to reset each VRDO's interest rate at the lowest possible level; relator alleged that forensic analysis revealed that agents grouped collections of VRDOs into "buckets" and applied to each "bucket" an identical pricing spread which moved the interest rate of each bond in the bucket up or down in lock-step fashion, and that study provided dozens of specific instances in which interest rate of a VRDO was set at a level higher than it should have been.

Qui tam relator's allegations that seven former employees of remarketing agents stated and corroborated that agents shirked their contractual and regulatory obligations to reset interest rates for variable rate demand obligations (VRDO) at the lowest possible level to enable them to sell the series at face value, by engaging in rate-setting misconduct that relator's forensic analyses revealed, were sufficient to support relator's false implied certification claim, under California False Claims Act (CFCA); taken together, employees' statements added support for inference from rate-setting data that agents did not evaluate factors such as credit quality, revenue source, economic sector, and size, for each VRDO, and that their failure to do so resulted in rates that were too high.

Qui tam relator stated a claim against State remarketing agents that managed variable rate demand obligations (VRDO), for conspiracy to violate California False Claims Act (CFCA), arising from collusion to inflate VRDO interest rates; complaint alleged "cross-bank bucketing" of VRDO interest rate resets, that agents agreed to ignore a downgrade to short-term credit rating of one defendant, which would have lowered interest rates on VRDO, and to continue coordinated pricing, that agents used indexing services to exchange information about future VRDO rate-setting, and facts showing agents had the opportunity and incentive to inflate VRDO rates.

Seventh amended qui tam complaint against State remarketing agents that managed variable rate

demand obligations (VRDO), rather than original complaint, was the operative pleading for purposes of determining whether California False Claims Act's (CFCA) public disclosure bar foreclosed CFCA claims based on allegations that agents set artificially high interest rates on VRDO, in violation of contractual obligation to reset each VRDO's interest rate at the lowest possible level to enable them to sell the series at face value.

Commercial paper comparison information available on website providing business and market news and on the Federal Reserve Economic Data (FRED) website were not material to relator's claims against State remarketing agents that managed variable rate demand obligations (VRDO), under California False Claims Act (CFCA), for false implied certification of compliance with express contractual obligation to reset each VRDO's interest rate at the lowest possible level to enable them to sell the series at face value, and thus could not support application of CFCA's public disclosure bar; relator's allegations that comparison of agents' average interest rates for VRDO with commercial paper rates showed that agents' rates were artificially inflated were insufficient to support his CFCA claim.

Interest rate reset information on website that published information on all municipal bonds was not a "report" of the state, as required for California False Claims Act's (CFCA) public disclosure bar to apply, in relator's qui tam action against State remarketing agents that managed variable rate demand obligations (VRDO) for false implied certification of compliance with express contractual obligation to reset each VRDO's interest rate at the lowest possible level to enable them to sell the series at face value; the information on the website was provided by remarketing agents and made available by the Municipal Securities Rulemaking Board (MSRB), a non-governmental self-regulatory organization.

Interest rate reset information on website that published information on all municipal bonds did not constitute a public disclosure in "news media," as required for California False Claims Act's (CFCA) public disclosure bar to apply, in relator's qui tam action against State remarketing agents that managed variable rate demand obligations (VRDO) for false implied certification of compliance with contractual obligation to reset each VRDO's interest rate at the lowest possible level to enable them to sell the series at face value; an online repository containing agents' daily or weekly submission of interest rate reset data was not generally newsworthy, and if interest rate data were considered a disclosure by "news media" simply because it was on a publicly available website, it would effectively swallow fora limitations in CFCA.

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