Justices Should Consider Harm To Defendants In FCA Seal Case

Law360, New York (November 3, 2016, 11:39 AM EDT) -- The unresolved question debated at the Nov. 1 U.S. Supreme Court hearing in State Farm Fire & Casualty Co. v. United States ex rel. Rigsby, No. 15-513, involves the standard for dismissing a False Claims Act qui tam suit where the relator (i.e., whistleblower plaintiff), or the relator's attorney, willfully violates the statute's mandatory seal requirement. See 31 U.S.C. § 3730(b)(2). Some of the justices' questions focused on how heavily to weigh the harm, if any, that a particular seal violation actually inflicts on the government, especially in cases where the U.S. Department of Justice's otherwise confidential investigation of a qui tam relator's allegations has not been impaired. Seal violations, however, also can harm a qui tam defendant's reputation, financial position and ability to compete.

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In deciding whether to require automatic dismissal of qui tam suits for willful seal violations, or instead, whether to allow district courts to exercise case-by-case discretion regarding what seal-violation sanction to impose, the Supreme Court should consider not only the government's interests, but also the interests of qui tam defendants — which relators often target speculatively if not unjustifiably.

Qui Tam Background

The False Claims Act's qui tam provisions, 31 U.S.C. § 3730(b), are supposed to serve the laudable purpose of assisting the government rout out fraudulent claims for federal payments or reimbursements, and penalize the businesses or other entities that submit them. Unfortunately, during the past 30 years, a growing number of opportunistic qui tam relators and their contingency-fee counsel have transformed the filing of qui tam suits into a seemingly bottomless pot of gold. Without ever having to prove their allegations of fraud in court, relators and their attorneys have succeeded in exacting substantial settlements from qui tam defendants. Qui tam defendants that enter into such pretrial settlements often are motivated by the need to avoid or mitigate the reputational, financial and competitive harm that can result from even unfounded qui tam allegations. They also want to avoid the risk of incurring treble damages and stiff civil penalties under ever-expanding grounds for False Claims Act liability, such as false "implied certification" of compliance with material statutory, regulatory, or contractual requirements. See, e.g., Universal Health Services, Inc. v. United States ex rel. Escobar, 136 S. Ct. 1989 (2016).

Lured by the prospect of substantial financial bounties, relators file hundreds of qui tam suits every year against government contractors, health care providers, federal grant recipients, and others entities that submit claims for federal payments or reimbursements. By filing a qui tam suit "for" and "in the name of" the United States government, 31 U.S.C. § 3730(b)(1), a relator can recover between 15 and 25 percent of a qui tam judgment or settlement if the Department of Justice, following an investigation, decides to intervene on

behalf of the United States and take over prosecution of the relator's suit. Id. § 3730(d)(1). And if the Justice Department declines to intervene, as is usually the case, a relator can receive an even sweeter reward, between 25 and 30 percent of any judgment or settlement. Id. § 3730(d)(2). Members of the growing "qui tam bar" typically pocket 30 to 50 percent of their relator clients' recoveries. According to Justice Department statistics, between 1987 and 2015, total qui tam settlements and judgments exceeded $33 billion. You do the math.

The qui tam seal provision enables the Department of Justice to carry out an important case-screening function. It states that a relator's complaint "shall be filed in camera, shall remain under seal for at least 60 days, and shall not be served on the defendant until the court so orders." 31 U.S.C. § 3730(b)(2). In addition, "[a] copy of the complaint and written disclosure of all material evidence and information the [relator] possesses shall be served on the Government pursuant to Rule 4(d)(4)." Ibid.

The primary purpose of the seal requirement is to afford the Justice Department an adequate opportunity to investigate a relator's fraud-on-the-government allegations — and decide whether to intervene on behalf of the United States and take over prosecution of the suit — without first "tipping off" the defendant. But the seal requirement also benefits qui tam defendants. For example, by prohibiting the relator from "going public," the seal requirement precludes the relator from pressuring the defendant to settle before the Justice Department decides whether the relator's allegations have enough merit to warrant government intervention. This is important because statistics show that qui tam settlement and judgment amounts are considerably lower in cases where the government decides not to intervene. The seal requirement also benefits qui tam defendants by enabling the government, with the court's approval, to settle directly with a defendant, even over the relator's objections, while the case is still under seal. See 31 U.S.C. § 3730(c)(2)(B).

The Parties' Positions

The State Farm case involves an egregious qui tam seal violation: The relators' former attorney willfully disclosed to national news media their allegations that State Farm knowingly submitted fraudulent claims for Hurricane Katrina-related federal flood insurance reimbursements. Justice Samuel Alito pulled no punches at the Nov. 1 hearing when he described the seal violation in the State Farm case as "the greatest degree of bad faith ... in violating the seal requirement that is really possible to imagine." Tr. 27.

Despite the deliberate seal violation, the district court denied State Farm's motions to dismiss the litigation, and judgment was rendered against State Farm following a bellwether trial. The Fifth Circuit affirmed, and the Supreme Court granted certiorari to resolve a circuit split over what standard should govern dismissal of qui tam suits for seal violations.

At the Supreme Court hearing, State Farm advocated adoption of an automatic-dismissal rule for willful or bad-faith seal violations, except under de minimis circumstances. Alternatively, State Farm argued that if the court decides to adopt a discretionary, balance-of-factors standard for dismissal of seal-violation cases, bad faith should be the primary if not dispositive factor, great weight should be afforded to the severity of the seal violation, and actual harm to the Government should not be a requirement. Tr. at 13. The respondent relators argued that district courts should be allowed to exercise their normal discretion to fashion sanctions, not necessarily dismissal, that are appropriate under the circumstances of a particular case. Tr. at 30. The United States, as amicus curiae supporting the respondents, urged the court to adopt a three-factor standard to guide a trial court's exercise of discretion when fashioning a sanction for a qui tam seal violations: (1) actual harm to the government, (2) severity of the violation, and (3) intent or bad faith. Tr. at 46.

Reputation Matters

False Claims Act allegations can inflict serious, and sometime irreparable, reputational harm on qui tam defendants. That in turn can have significant financial consequences for companies or other organizations that do business with the government. For example, a government contractor subjected to qui tam allegations may not be deemed ethically responsible enough to bid on contracts. Or a health care provider subjected to qui tam allegations could be excluded from participation in Medicare or other federal health care programs. The continuing onslaught of qui tam suits only exacerbates the need to protect defendants' reputations, at least until the Department of Justice completes its investigation of a relator's allegations while a complaint remains under seal.

At the State Farm hearing Justice Sonia Sotomayor appeared to agree that "what hurts reputation ... is the nature of the allegations." Tr. at 18. Justice Stephen Breyer echoed this view. In an exchange with relators' counsel, Justice Breyer expressed concern about an innocent qui tam defendant, who as a result of a seal violation, learns about "what could be a very harmful case" against him by "read[ing] about it in the national press. Now, that's a harmful thing." Tr. at 29-30. Justice Breyer further observed that there are seals in "national security cases, privacy cases, trademark cases, all kinds of business cases ... So it's a serious thing when someone deliberately breaks a court seal and reveals the contents to the national press." Tr. at 30. "[I]t's not just the department that has an interest in this. It's the United States judicial system that has an interest in this." Ibid.

In response to a question from Justice Ruth Bader Ginsburg, the government's counsel indicated that the seal requirement is intended to prevent a qui tam defendant from "taking steps to thwart the government investigation." Tr. at 45. Although government counsel agreed with Justice Ginsburg that "reputational harm to the defendant could be relevant to determining sanction for seal violation," Tr. at 45-46, the government's amicus brief asserted that "the seal requirement was not designed to protect a defendant's reputation." U.S. Br. (merits) at 27. But when Congress enacted the seal requirement in 1986, the Senate report accompanying the bill explained that keeping the relator's complaint under seal while the Justice Department investigates and decides whether to intervene "protects both the Government's and the defendant's interests without harming those of the private relator." S. Rep. No. 345, 99th Cong., 2nd Sess. 1986. See also Am. Civil Liberties Union v. Holder, 763 F.3d 245, 249-50 (4th Cir. 1995) ("Congress adopted the [seal] period for numerous reasons [including] to protect the reputation of the defendant in that the defendant is named in a fraud action brought in the name of the United States, but the United States has not yet decided whether to intervene."). Further, even if protecting a qui tam defendant's reputation was not one of the seal provision's purposes, it "certainly has that effect." United States ex rel. Summers v. LHC Group, Inc., 623 F.3d 287, 293 n.4 (6th Cir. 2010).

Conclusion

There is ample justification for a bright-line rule that mandates dismissal where a qui tam relator and/or relator's counsel deliberately violates the seal requirement. Nonetheless, whether to require automatic dismissal for intentional qui tam seal violations or allow district courts to exercise their discretion may be a close call for the current eight-justice court. Either way, it's not only the government's investigational interests that should factor into the court's decision. The reputations of unknowing but innocent qui tam defendants, and in turn, the integrity of the qui tam scheme, also are at stake.

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DISCLOSURE: Ebner filed a Supreme Court merits-stage amicus brief on behalf of DRI-The Voice of the Defense Bar in support of State Farm.

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