No. 16-1398

In The
Supreme Court of the United States

VICTAULIC COMPANY,

*Petitioner*,

v.

UNITED STATES EX REL. CUSTOMS FRAUD INVESTIGATIONS, LLC,

*Respondent*.

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

# REPLY BRIEF FOR PETITIONER

THOMAS C. HILL
*Counsel of Record*
JEETANDER T. DULANI
STEPHEN S. ASAY
PILLSBURY WINTHROP SHAW PITTMAN LLP
1200 Seventeenth Street NW
Washington, DC 20036
(202) 663-8000
thomas.hill@pillsburylaw.com

*Counsel for Petitioner*

*August 8, 2017*

THE LEX GROUP$^{DC}$ ♦ 1825 K Street, N.W. ♦ Suite 103 ♦ Washington, D.C. 20006
(202) 955-0001 ♦ (800) 856-4419 ♦ Fax: (202) 955-0022 ♦ www.thelexgroup.com

## RULE 29.6 DISCLOSURE STATEMENT

Petitioner Victaulic Company is a private corporation organized under the laws of New Jersey. Victaulic Company does not have a parent corporation, and no publicly held corporation owns 10% or more of Victaulic Company's stock.

## TABLE OF CONTENTS

**Page**

## TABLE OF AUTHORITIES

**Page(s)**

**CASES**

**STATUTES**



**RULE**



**OTHER AUTHORITY**

Victaulic Company ("Victaulic") respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Third Circuit.

## INTRODUCTION

Contrary to the contentions of Respondent Customs Fraud Investigations, LLC ("CFI"), twelve federal courts of appeals have adopted three conflicting standards for evaluating whether a *qui tam* relator's complaint under the False Claims Act ("FCA") satisfies the particularity requirement of Rule 9(b). This Court should grant certiorari to resolve this deep divide and provide clarity on an issue affecting hundreds of cases each year.

Also at issue is the Third Circuit's holding that an alleged failure to pay contingent marking duties can serve as the basis for a "reverse false claim" under the FCA. This novel and unsupported decision creates a circuit split regarding reverse false claim liability for the alleged non-payment of contingent duties and opens the door to billions of dollars' worth of frivolous claims.

This case is an optimal vehicle for the Court to resolve these important and recurring questions of federal law.

## REASONS FOR GRANTING THE PETITION

### I. THE DEEP DIVIDE AMONG THE COURTS OF APPEALS REGARDING THE APPLICATION OF RULE 9(B) IN FCA CASES CONTINUES TO WORSEN

In seeking to oppose certiorari, CFI attempts to paint a false picture of the federal courts of appeals quickly reaching consensus regarding a single,

appropriate standard to apply when evaluating a *qui tam* relator's complaint under Rule 9(b). That is simply not the case.

The Government last provided its views on this issue in 2014, acknowledging then that two distinct standards had emerged among the lower courts: the strict "actual false claims" standard and the lenient "particular details" and "reliable indicia" standard. *See* Brief for the United States as *Amicus Curiae* at 10, *United States ex rel. Nathan v. Takeda Pharm. N. Am., Inc.*, No. 12-1349 (U.S. Feb. 2014). While the Government questioned the depth of the divide, there was, at a minimum, "at least some continuing uncertainty as to whether a *qui tam* complaint satisfies Rule 9(b) if it contains detailed allegations giving rise to a reasonable inference that false claims were submitted to the government, but does not identify specific requests for payment." *Id.* at 14. Because "[t]he proper application of Rule 9(b) in the FCA context is...a significant issue," the Government stated that, "[i]f that disagreement persists...this Court's review to clarify the applicable pleading standard may ultimately be warranted in an appropriate case." *Id.* at 10, 16.

In the past three years, three courts that had already adopted the strict standard have reaffirmed its general applicability; the Second Circuit has just recently adopted that same standard; and the Third Circuit has now created its new and even more lenient "opportunity for fraud" standard. Instead of nine courts of appeals applying two standards, as was the case when the Government stated that continued disagreement would warrant review, there are now twelve courts of appeals applying three

standards. The confusion is worse than ever and warrants this Court's review.

### A. FCA Cases Are Now Subject to Three Widely Divergent Pleading Standards

Whatever the exact nature of the divide among courts applying the strict and lenient standards, the courts themselves have observed that most courts "have applied either an across-the-board heightened standard or an across-the-board permissive one." *United States ex rel. Prather v. Brookdale Senior Living Cmtys.*, *Inc.,* 838 F.3d 750, 772 (6th Cir. 2016). CFI does not dispute that the Fourth, Sixth, Eighth, and Eleventh Circuits adopted a strict standard requiring that a relator allege representative samples of the alleged fraud with details such as the time, place, and content of the acts and the identity of the actors. (Opp. 16-18; Pet. 16-18.) Instead, CFI contends that these courts have joined a "stampede" away from the strict standard and toward the lenient standard applied by the First, Fifth, Seventh, Ninth, Tenth, and District of Columbia Circuits. (Opp. 17.) But contrary to CFI's contentions, the strict standard has been reaffirmed, and, with the Third Circuit's adoption of the "opportunity for fraud" standard below, the courts now apply three widely divergent Rule 9(b) pleading standards to FCA claims.

#### *1. Courts Have Reaffirmed the Strict Standard with Only a Narrow Modification*

Far from stampeding away from the strict standard, the decisions cited by CFI demonstrate that courts have actually *reaffirmed* the general applicability of that standard. These courts continue to hold "that when a defendant's actions, as alleged

and as reasonably inferred from the allegations *could* have led, but *need not necessarily* have led, to the submission of false claims, a relator must allege with particularity that specific false claims actually were presented to the government for payment." *Prather*, 838 F.3d at 773 (quoting *United States ex rel. Nathan v. Takeda Pharm. N. Am., Inc.*, 707 F.3d 451, 458 (4th Cir. 2013)) (emphasis in original); *United States ex rel. Thayer v. Planned Parenthood of the Heartland*, 765 F.3d 914, 918 (8th Cir. 2014) (same); *see United States ex rel. Mastej v. Health Mgmt. Assocs., Inc.*, 591 F. App'x 693, 704 (11th Cir. 2014). This strict standard is viewed as being necessary to preserve the important gatekeeping function of Rule 9(b), i.e., "protecting defendants against spurious charges of immoral and fraudulent behavior." *Prather*, 838 F.3d at 771; *Mastej*, 591 F. App'x at 703 (same); *Thayer*, 765 F.3d at 918 ("protecting defendants from baseless claims").

While these courts have reaffirmed the application of the strict "actual false claims" standard, they have also crafted a narrow modification to that standard "when a relator alleges specific personal knowledge that relates directly to billing practices." *Prather*, 838 F.3d at 769. In other words, "a relator with direct, first-hand knowledge of the defendants' submission of false claims gained through her employment with the defendants may have a sufficient basis for asserting that the defendants actually submitted false claims." *Mastej*, 591 F. App'x at 704; *Thayer*, 765 F.3d at 918 (may be sufficient to both "plead[] details about the defendant's billing practices and plead[] personal knowledge of the defendant's submission of false claims"). This applies only when a relator alleges

actual first-hand knowledge of fraudulent activity but fails to provide a representative sample of that activity. *See Prather*, 838 F.3d at 756-57 (relator hired to review backlog of Medicare claims); *Thayer*, 765 F.3d at 917 (relator oversaw billing and claims systems).

The Eleventh Circuit's *Mastej* decision perfectly illustrates the limited nature of this modification to the strict standard. There, the relator alleged direct personal knowledge of fraud based on his involvement with billings and Medicare submissions as an employee of the defendant companies. *Mastej*, 591 F. App'x at 707-08. Because the relator had not provided representative samples of fraud, the court found that only those claims *during the relator's employment* satisfied the particularity requirement of Rule 9(b); the court rejected those claims alleged to have taken place after the relator ended his employment. *Id.* at 709. Therefore, the modification adopted by courts employing the strict standard does not apply if the relator is an outsider—like CFI here—or otherwise lacks first-hand knowledge of billing practices. *Id.* at 704. In all other circumstances, these courts continue to require representative samples of false claims to satisfy Rule 9(b)'s particularity requirement.

*2. The Second Circuit Has Adopted the Same Strict Standard with Narrow Modification*

That the narrow modification to the strict standard is *not* equivalent to the lenient standard is reinforced by the Second Circuit's recent decision in *United States ex rel. Chorches v. American Medical Response, Inc.*, No. 15-3930, 2017 WL 3180616 (2d Cir. July 27, 2017) (formerly *Fabula*). In its

Supplemental Brief, CFI ignores the plain language of the *Chorches* decision and contends that the Second Circuit rejects the strict standard in favor of the lenient standard. CFI is wrong.

In fact, the Second Circuit now requires that "those who *can* identify examples of actual claims *must* do so at the pleading stage." *Id.* at *10 (emphasis in original). Far from joining an alleged stampede toward the lenient standard, the Second Circuit expressly rejected the notion that it was adopting the lenient standard. *Id.* at *15 ("Nor do we see our holding as adopting a 'lenient' pleading standard."), *15 n. 21 ("In any event, the standard we apply in this case is distinguishable from that of [*United States ex rel. Grubbs v. Kanneganti*, 565 F.3d 180 (5th Cir. 2009)]."). Nevertheless, the Second Circuit allowed for a narrow modification of the strict standard where a relator has alleged direct first-hand knowledge of fraud—unlike CFI here. Specifically, the Second Circuit allowed the relator's claims to proceed because he alleged specific instances in which he was explicitly ordered to falsify records so that those records could be submitted to Medicare for payment. *Id.* at *2-3, *8-10.

Ultimately, the narrow modification adopted by the Second Circuit—just like the Sixth, Eighth, and Eleventh Circuits—does not reflect a growing consensus around the lenient standard. Rather, it reflects the continued viability and application of the strict standard as a default rule in these courts, with a narrow modification for the limited instances in which a relator alleges first-hand knowledge of specific instances of fraud but cannot provide a representative sample of a false claim. Because the

strict standard is alive and well, the divide among the courts of appeals will continue until this Court provides clarity.

*3. The Third Circuit's "Opportunity for Fraud" Standard Reflects the Persistent Confusion Among the Courts of Appeals*

CFI's contentions notwithstanding, the Third Circuit's decision below adopted a new and even more lenient "opportunity for fraud" pleading standard for FCA claims under Rule 9(b), showing that the confusion among the courts is now greater than ever. While the panel majority paid lip service to the lenient standard previously adopted by the Third Circuit, it promptly rejected the requirements of that standard:

> [W]e accept CFI's allegations...that far more Victaulic pipe fittings on the secondary market should have country-of-origin markings, that *the way marking duties are assessed provides an opportunity for fraud*, and that only Victaulic has access to the documents that could prove or disprove CFI's well-pled allegations.
>
> We conclude that, at this pleading stage, *nothing more is required* to give Victaulic adequate notice of the claims raised against it.

(App. 30a-31a (emphasis added).) Nothing in this formulation requires "particular details" of a scheme paired with "reliable indicia" leading to a strong inference that false claims were actually submitted as previously required by the Third Circuit. (Pet. 19-

23.) Rather, the Third Circuit now merely requires *qui tam* relators to allege "an opportunity for fraud." (App. 30a.)

This new pleading standard not only deepens the divide among the courts of appeals, but also entirely abrogates the particularity requirement of Rule 9(b). Indeed, this case aptly demonstrates the serious implications for mischief when applying the "opportunity for fraud" standard. CFI is a complete outsider to Victaulic's business and has absolutely no first-hand knowledge of any alleged fraud. CFI is nevertheless allowed to proceed simply because it has undertaken a theoretical (and fundamentally flawed) third party study that alleges "an opportunity for fraud." Henceforth, the Third Circuit will become a haven for frivolous FCA claims in which relators—including complete outsider relators—need only make bare, conclusory assertions of possible wrongdoing accompanied by irrelevant paperwork.[1] This case is thus an appropriate vehicle by which this

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[1] The dissent below correctly characterized the import records provided by CFI as nothing more than "a data dump camouflaged as a set of particularized allegations." (App. 62a.) Records showing that Victaulic imported various products—even assuming the records are accurate—say nothing about whether those products required markings, whether those products were marked, whether marking duties were imposed by U.S. Customs and Border Protection ("Customs"), or whether Victaulic paid any marking duties.

Similar import data is publicly available for any company that imports products into the United States. The "opportunity for fraud" standard thus invites outsider relators without any first-hand knowledge of fraud to bring frivolous FCA claims in the Third Circuit against all of those companies.

Court can resolve the deep divide and conflicting standards among the courts of appeals and provide needed clarity.[2]

### B. There Is No Basis to Distinguish Among the Types of False Claims under the FCA for Purposes of Rule 9(b)

Faced with an undeniable circuit split, CFI for the first time advances the novel argument that reverse false claims do not actually involve false claims and thus cannot be subject to the strict "actual false claims" standard now applied in the Second, Fourth, Sixth, Eighth, and Eleventh Circuits. CFI cites no authority for this argument; CFI merely asserts that all courts have applied the lenient standard to reverse false claims. (Opp. 13-15.) That is simply incorrect. *See, e.g.*, *Olson v. Fairview Health Servs. of Minn.*, 831 F.3d 1063, 1072-74 (8th Cir. 2016) (applying strict standard to both "traditional" and reverse false claims); *United States ex rel. Matheny v. Medco Health Solutions, Inc.*, 671 F.3d 1217, 1222 (11th Cir. 2012) (same); *Prather*, 838 F.3d at 774-75 (same).

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[2] CFI disingenuously suggests that Victaulic "advocated" the lenient standard below and has now reversed course and "advocates" the strict standard. (Opp. 12, 15.) Not so. In proceedings before the Third Circuit, Victaulic was bound by that court's then-applicable precedent adopting the lenient standard and drafted its arguments accordingly.

Now that the Third Circuit has adopted a new "opportunity for fraud" standard, Victaulic "advocates" for this Court to resolve the deep divide and clarify this issue. There is no basis for CFI's passing suggestion that there has been some kind of waiver.

Moreover, although CFI (incorrectly) contends that all courts have applied the lenient standard to reverse false claims, CFI ignores the critical fact that the lenient standard—just like the strict standard—is defined with reference to false claims. Specifically, courts applying the lenient standard require that a *qui tam* relator allege "particular details of a scheme *to submit false claims* paired with reliable indicia that lead to a strong inference that *claims were actually submitted*." *Grubbs*, 565 F.3d at 190 (emphasis added). As the courts of appeals recognize, there is no reason to apply different Rule 9(b) pleading standards to a *qui tam* relator alleging the fraudulent submission of a claim to the Government and to one alleging the fraudulent avoidance of an obligation to pay the Government. Indeed, there is simply no basis in logic or law for the distinction advocated by CFI. Because the conflict regarding Rule 9(b) applies to all claims under the FCA, this Court should grant review and resolve this deep divide.

## II. THE THIRD CIRCUIT'S FUNDAMENTAL MISUNDERSTANDING OF MARKING DUTIES DRAMATICALLY EXPANDS FCA LIABILITY AND CREATES A CONFLICT AMONG THE COURTS OF APPEALS

CFI is simply wrong to suggest that liability for reverse false claims extends to an alleged failure to pay contingent obligations. (Opp. 24.) A reverse false claim occurs when a person "knowingly conceals or knowingly and improperly avoids or decreases an obligation to pay...the Government," where obligation is defined as "an established duty, whether or not fixed...." 31 U.S.C. §§ 3729(a)(1)(G), (b)(3). As

affirmed by recent case law, this definition does not encompass contingent obligations:

> [T]he overwhelming weight of authority, before ["obligation" was defined], held that contingent penalties are *not* obligations under the FCA. Given that we presume that Congress is "aware of judicial interpretations of the law, and act[s] with awareness of judicial interpretations of prior law," it necessarily follows that "whether or not fixed" resolved the active dispute over whether an obligation could be for an uncertain sum, while "established" confirmed the accepted holding that contingent penalties are not obligations under the FCA.

*United States ex rel. Simoneaux v. E.I. duPont de Nemours & Co.*, 843 F.3d 1033, 1038-39 (5th Cir. 2016) (emphasis in original) (citations omitted).

CFI contends that is irrelevant because marking duties are not actually contingent obligations. CFI's contention rests on unsupported and incorrect assertions about customs law, primarily that marking duties are absolute obligations that accrue upon importation. But the text of the marking duty statute expressly belies such assertions. The statute not only limits the imposition of marking duties to circumstances in which the importer does not mark, export, or destroy the article, but also provides that marking duties—after being levied by Customs—are "deemed to have accrued at the time of importation…." 19 U.S.C. § 1304(i). If marking duties must be "deemed" to have accrued at the time

of importation, they could not have already accrued automatically at that time, and no obligation could have existed upon importation.

Additionally, the American Association of Exporters and Importers ("AAEI")—experts in the export/import industry—have filed an *amicus curiae* brief further explaining the contingent nature of marking duties. *See generally* Brief of *Amicus Curiae* the American Association of Exporters and Importers in Support of Petitioner (June 2017). AAEI highlights the fact that: various post-importation corrective actions can remedy unmarked goods without the assessment of marking duties; the assessment of marking duties occurs, if at all, well after the date of importation; both Customs and courts have affirmed the inherently contingent nature of marking duties; an importer cannot self-determine marking duties owed on its imports; and Customs has the authority to, and does, waive marking requirements. *Id.* at 2-11. Because both the Third Circuit and CFI fundamentally misunderstand the nature of marking duties, CFI cannot—and does not—respond to AAEI's brief except to suggest that customs law is too technical for this Court's review. (Opp. 25-26.)

Technical or not, CFI cannot deny that the decision below authorizes a new theory of liability that subjects every importer in the country to the possibility of suit under the FCA. (Pet. 35-37.) Moreover, because marking duties are, in fact, contingent obligations, the decision below establishes a circuit split on the issue of whether an alleged failure to pay contingent obligations is actionable as a reverse false claim under the FCA. (Pet. 29-32.)

This issue is too important to remain un-reviewed by this Court.

## CONCLUSION

The petition for writ of certiorari should be granted.

Respectfully submitted,

THOMAS C. HILL
*Counsel of Record*
JEETANDER T. DULANI
STEPHEN S. ASAY
PILLSBURY WINTHROP
SHAW PITTMAN LLP
1200 Seventeenth Street NW
Washington, DC 20036
(202) 663-8000
thomas.hill@pillsburylaw.com

*Counsel for Petitioner*

August 2017