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9th Circ. Appeal Highlights FCA Safeco Defense Controversy

By **Mark Strauss** (January 5, 2023, 6:03 PM EST)

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False Claims Act lawyers are monitoring the appeal in U.S. v. Sigma Corp., which is scheduled for oral argument before a U.S. Court of Appeals for the Ninth Circuit panel on Jan. 10.[1]

A qui tam lawsuit involving an importer's alleged knowing failure to pay anti-dumping duties on pipe fittings imported from China, the case raises hugely controversial questions relating to the False Claims Act's knowledge requirement.

Applicability of Safeco Under the FCA

Under the FCA, a defendant may only be held liable for knowingly submitting false claims to the government or, under the FCA's so-called reverse false claims provisions, knowingly making false statements to avoid or decrease payments owed to the government.

The term "knowingly" is defined to include actual knowledge, deliberate ignorance, or reckless disregard.[2]

At issue in the Sigma appeal is whether and, if so, to what extent, the "objectively reasonable interpretation" defense articulated by the U.S. Supreme Court in its 2007 Safeco Insurance Company of America v. Burr decision is available to defendants under the FCA.[3]

In Safeco, the Supreme Court held that a Fair Credit Reporting Act defendant did not act "willfully" because its interpretation of an ambiguous statutory requirement was objectively reasonable and there was no authoritative guidance warning it away from its erroneous interpretation.[4]

The question is vexing courts.

In U.S. v. Allergan Sales,[5] a U.S. Court of Appeals for the Fourth Circuit panel determined in 2022 that the Safeco objectively reasonable interpretation defense was available under the FCA, warranting dismissal. The full Fourth Circuit, however, subsequently granted rehearing en banc and vacated that opinion, while nevertheless affirming dismissal by an equally divided, 7-7 vote.[6]

Meanwhile, in U.S. v. SuperValu Inc.,[7] a U.S. Court of Appeals for the Seventh Circuit panel — over a vigorous dissent — not only adopted Safeco's objectively reasonable interpretation defense under the FCA, but took the arguably extreme position that, in applying it, a defendant's contemporaneous

"subjective intent" is irrelevant.[8]

Specifically, according to the court's 2021 SuperValu decision, inasmuch as the Safeco standard is "objective," it is irrelevant whether the defendant actually held the claimed objectively reasonable interpretation at the time that it submitted its false claim, or had instead submitted those claims in bad faith and then later, with the help of defense counsel after being sued under the FCA, "concocted" an objectively reasonable interpretation of the relevant statute or regulation after the fact.[9]

The SuperValu decision is currently subject to a pending petition for certiorari. The U.S. solicitor general recently filed an amicus brief with the Supreme Court arguing that the Seventh Circuit erred in SuperValu and that certiorari should be granted.[10]

Another petition for certiorari was recently filed from the U.S. Court of Appeals for the Eleventh Circuit's decision in Olhausen v. Arriva Medical LLC, which applied Safeco under the FCA.[11]

The Scope of the Anti-Dumping Order in Sigma

In the case currently before the Ninth Circuit, the whistleblower Island Industries Inc., a domestic manufacturer of parts for fire-protection sprinkler systems, filed an FCA lawsuit against Sigma, a seller of competing products imported from China.

Island alleged that Sigma falsely claimed on its customs entry documents that the parts it was importing were not subject to any anti-dumping duties when in fact they were subject to duties of 182.9% under a 1992 U.S. Department of Commerce anti-dumping order.

Anti-dumping duties are extra import duties imposed on imports sold in the U.S. at prices less than fair value — i.e., dumped — or which benefit from foreign government subsidies. They are intended to level the playing field for domestic industries.

In addition to the anti-dumping order, Island relied on a 1992 scope ruling issued by the Commerce Department in connection with pipe fittings imported by another importer, Sprink Inc.

The so-called Sprink scope ruling determined that Sprink's fittings — which were materially identical to those imported by Sigma — were within scope of an identically worded Commerce Department anti-dumping order covering the same category of imports from Taiwan.

After receiving a subpoena from the U.S. Department of Justice and thereby learning that it was under investigation for evading anti-dumping duties, Sigma applied to the Commerce Department for its own scope ruling. The Commerce Department issued a ruling that Sigma's pipe fittings were within scope of the anti-dumping order, while noting that the agency was not bound by its prior Sprink scope ruling.[12]

Sigma then appealed to the U.S. Court of International Trade. The CIT held that the Commerce Department scope decision was unreasonable because "it was not plainly apparent from the language" of the anti-dumping order that Sigma's pipe fittings were covered.[13]

The Commerce Department's prior Sprink scope ruling "would seem to be dispositive," the CIT observed, but in its decision the agency "for some reason, chose to dismiss [that ruling] as nonbinding.[14] The CIT thus remanded the matter back to the Commerce Department for a full scope inquiry.[15]

On remand, the Commerce Department again concluded that Sigma's imported pipe fittings were within scope of the anti-dumping order. In addition, the Commerce Department clarified that the Sprink scope ruling was "informative" because it involved a "nearly identical" product.[16]

Armed with this administrative record, Sigma turned to the U.S. District Court for the Central District of California — where the FCA case was pending and by then unsealed under the caption U.S. v. Vandewater International Inc. — and argued that it was entitled to dismissal of the lawsuit as a matter of law under Safeco.

Specifically, according to Sigma, the false statements that it made in its customs entry documents denying that it owed anti-dumping duties could not have been made knowingly, given the ambiguity that the CIT identified in the anti-dumping order. As the CIT had determined, it was not plainly apparent from the language of that order that Sigma's pipe fittings were covered, warranting a full scope inquiry.

Sigma thus argued that its false statements were consistent with an objectively reasonable interpretation of the anti-dumping order.[17]

The district court rejected Sigma's Safeco argument, the case was tried, and the jury returned a $24 million verdict against Sigma.[18]

The Issues Before the Ninth Circuit

On appeal, Sigma now contends that the district court erred in denying it relief as a matter of law under Safeco. The government, which declined to intervene in the district court, has submitted an amicus brief in support of Island and affirmance of the jury verdict.

Island and the government advance a series of arguments on the appeal.

First, they maintain that the objectively reasonable interpretation defense is simply unavailable under the FCA because Safeco involved the Fair Credit Reporting Act, a different statute with a different scienter requirement.[19] Unlike the FCRA, the FCA's scienter requirement has three prongs focusing on the defendant's contemporaneous state of mind.

Additionally, courts have long held that the FCA requirement's deliberate-ignorance and reckless-disregard prongs reach the ostrich-type situation, where a defendant failed to make simple inquiries or pursue available avenues of clarification that would have revealed the falsity of its claims.[20]

Moreover, unlike the FCRA, the FCA — an anti-fraud statute designed to protect the public fisc — imposes on those who transact with the government a duty to make "limited inquiry" to ensure that the claims they submit and the statements they make are accurate.[21]

Island and the government also argue that Safeco is distinguishable because in Safeco the defendant relied on an objectively reasonable interpretation that it held contemporaneously — i.e., at the time it committed the alleged violations.

Thus, as the government argues in its brief:

> Safeco does not stand for the extraordinary proposition that any post hoc interpretation developed in subsequent litigation can preclude liability, regardless of whether the defendant actually held that interpretation at the time of the conduct at issue.

This is contrary to the position taken by the Seventh Circuit in SuperValu.[22]

Island and the government cite the Supreme Court's 2016 Halo Electronics Inc. v. Pulse Electronics decision.[23] There, the court stated that "culpability is generally measured against the knowledge of the actor at the time of the challenged conduct" and explained that nothing "in Safeco suggests that we should look to facts that the defendant neither knew nor had reason to know at the time he acted."[24]

Island and the government contend that, given the limitations on Safeco delineated in Halo, Sigma cannot rely on the objectively reasonable interpretation defense because there was no evidence that Sigma was even aware of the anti-dumping order — much less construed it as not covering its imports — when it submitted its false customs entry documents.

Instead, they say, by Sigma's own admissions at trial, it behaved ostrich-like, failing to conduct any inquiry or search with respect to potentially applicable anti-dumping orders or scope rulings, and purportedly did not become aware of the anti-dumping order until after receiving the Justice Department subpoena.[25]

Island and the government additionally argue that the Sprink scope ruling constituted authoritative guidance which warned Sigma away from its erroneous interpretation of the anti-dumping order.

Sigma disputes this on the ground that the Commerce Department stated that the Sprink Scope Ruling was nonbinding. The government, however, urges that agency guidance documents and final determinations like Commerce Department scope rulings are inherently nonbinding on third parties yet still can place them on notice that a practice is illegal.[26]

Possible Outcomes

It is difficult to predict how the Ninth Circuit will rule. Courts seem inclined to apply Safeco in the FCA context. The Ninth Circuit, however, may well reject the extreme approach adopted by the Seventh Circuit in SuperValu — i.e., that a defendant's contemporaneous "subject intent" is irrelevant, and that interpretations devised post hoc suffice.

This would accord with the Ninth Circuit's 2010 unpublished decision in U.S. v. Chen,[27] where the court stated — without mentioning Safeco — that an FCA defendant's "good faith interpretation of a regulation" could preclude FCA liability "not because his or her interpretation was correct or 'reasonable' but because the good faith nature of his or her action forecloses the possibility that the scienter requirement is met."[28]

It would also be consistent with Halo. In SuperValu, the Seventh Circuit purported to distinguish Halo as inapplicable to Safeco analysis under the FCA,[29] a point urged by Sigma in its brief. The Seventh Circuit's logic distinguishing Halo, however, is impenetrable, at least to this practitioner.

Should the Ninth Circuit adopt the Seventh Circuit's approach, Sigma will have outdone the defendants in SuperValu. Sigma not only devised a post hoc interpretation. It also pursued parallel administrative

proceedings resulting in a record it has been able to parlay into support for the reasonableness of that interpretation.

Either way, however, the Sprink scope ruling may well prove Sigma's stumbling block. The law is not well developed as to what constitutes so-called authoritative guidance — Safeco did not precisely define it. Yet the government's logic that the agency document need not be binding as Sigma urges is persuasive.

As the Taxpayers Against Fraud Education Fund aptly argued in its amicus brief to the Seventh Circuit in SuperValu, it is "logically inconsistent to speak of 'binding guidance' that would 'warn' defendants. If an interpretation is binding, then it provides the governing rule, not guidance, and does not warn defendants. It sets the rules."[30]

Furthermore, according to Island and the government, the evidence at trial in Sigma established that the Sprink scope ruling was sufficiently specific to alert any reasonable importer that the anti-dumping order covered Sigma's imports. Sigma's own executives admitted at trial that they understood their imports were covered immediately upon reading the order, and concluded based thereon that they should stop importing the parts in question from China.[31]

Determining that the Sprink scope ruling sufficiently warned Sigma away from its erroneous interpretation of the anti-dumping order potentially could obviate the need for the Ninth Circuit to resolve the more difficult question whether reliance on post hoc interpretations is permissible under Safeco.

Whatever the outcome of the Sigma appeal, there is possibility it deepens the disagreement about whether and how to apply Safeco under the FCA, increasing the likelihood that the Supreme Court will grant certiorari in SuperValu.

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[1] U.S. ex rel. Island Industries Inc. vs. Sigma Corp. Case No. 22-55063 (9th Cir).

[2] 31 U.S.C. § 3729(b)(1)(A).

[3] Safeco Insurance Company of America v. Burr, 551 U.S. 47 (2007).

[4] Safeco, 551 U.S. at 70.

[5] U, S. ex rel. Sheldon v. Allergan Sales LLC, 24 F.4th 340 (2022).

[6] See U.S. ex rel. Sheldon v. Allergan Sales, LLC, 49 F.4th 873 (4th Cir. 2022) (per curiam).

[7] U.S. ex rel. Schutte v. SuperValu Inc., 9 F.4th 455 (7th Cir. 2021).

[8] 9 F.4th at 470.

[9] Id.

[10] See Brief for the United States as Amicus Curiae on Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit (Dec. 6, 2022), U.S. ex rel. Schutte v. SuperValu Inc., No. 21-1326 (S. Ct).

[11] See Olhausen v. Arriva Med., LLC, 21-10366, 2022 WL 1203023 (11th Cir. Apr. 22, 2022) (per curiam), cert. pending, No. 22-374.

[12] See Vandewater Intl., Inc. v. U.S., 476 F. Supp. 3d 1357, 1360 (Ct. Intl. Trade 2020).

[13] Vandewater, 476 F. Supp. 3d at 1360.

[14] Id.

[15] Id.

[16] See U.S. Department of Commerce, Final Results of Redetermination Pursuant to Court Remand, A-570-814 Remand Slip Op. 20-146, at 104 (June 22, 2021), https://access.trade.gov/Resources/remands/20-146.pdf.

[17] See Brief of Appellant Sigma Corporation, at 23, 42, (Jun. 2, 2022), U.S. ex rel. Island Industries, Inc. vs. Sigma Corp., Case No. 22-55063 (9th Cir.).

[18] U.S. ex rel. Island Indus. v. Vandewater Int'l Inc., 2:17-CV-04393, 2021 WL 6104402, at **3-4 (C.D. Cal. Dec. 10, 2021).

[19] See Brief of Plaintiff-Appellee Island Industries, Inc., at 43 (Sept. 1, 2022), U.S. ex rel. Island Industries, Inc. vs. Sigma Corp., Case No. 22-55063 (9th Cir.) (hereinafter "Plaintiff-Appellee Br.").

[20] See Brief for the United States of America as Amicus Curiae Supporting Appellee and Affirmance, at 19 (Sept. 8, 2022), U.S. ex rel. Island Industries, Inc. vs. Sigma Corp., Case No. 22-55063 (9th Cir.) (hereinafter "U.S. Amicus Br.")

[21] U.S. v. Bourseau, 531 F.3d 1159, 1168 (9th Cir. 2008) (quoting S.Rep. No. 99–345, at 21 (1986), as reprinted in 1986 U.S.C.C.A.N. 5266, 5286).

[22] See U.S. Amicus Br., at 22.

[23] 579 U.S. 93 (2016).

[24] Id. at 105-06.

[25] See U.S. Amicus Br., at 19-20.

[26] See U.S. Amicus Br. at 25.

[27] 402 F. App'x 185, 188 (9th Cir. 2010).

[28] Id., citing U.S. ex rel. Oliver v. Parsons Co., 195 F.3d 457, 464 (9th Cir. 1999).

[29] U.S. v. SuperValu Inc., 9 F.4th at 466.

[30] See Brief of Amicus Curiae Taxpayers Against Fraud Education Fund in Support of the Plaintiffs-Appellants and Reversal, U.S., et al., ex rel. Tracy Schutte and Michael Yarberry, Plaintiffs-Appellants, v. SuperValu Inc., et al, Defendants-Appellees., 2020 WL 6150729, at *15 (C.A.7).

[31] See U.S. Amicus Br., at 24; Plaintiff-Appellee Br. at 71.