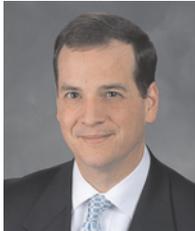


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Blowing the Whistle on Bankrupt Relators



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Most False Claims Act practitioners have a checklist of potential defenses to evaluate when first learning of a *qui tam* lawsuit. Is the relator the first to file? Have her allegations been publicly disclosed? If so, is she really an original source? Though not FCA-specific, it is important to include an additional question on the list: Has the relator filed for bankruptcy?

If a relator has filed for bankruptcy, it may serve as a basis to dismiss her from the case before getting to the merits. Specifically, a growing body of case law holds that a relator who previously filed for bankruptcy but failed to disclose her potential or pending *qui tam* claims to the bankruptcy court must be dismissed on the basis of standing, judicial estoppel or both.

These decisions are based on well-established bankruptcy law. The moment a debtor files for bankruptcy, all of her assets, including any pending lawsuits and

any potential claims that accrued before she filed for bankruptcy, become part of the bankruptcy estate.

The debtor has a duty to disclose these assets to the bankruptcy court under oath on her "Schedule B," and she has a continuing duty to disclose any additional assets she obtains while the bankruptcy case is pending, such as a potential claim that accrues before her assets are distributed to creditors and her case is closed.

Failure to disclose an asset does not prevent it from becoming part of the bankruptcy estate. Because undisclosed assets are neither distributed nor abandoned by the bankruptcy trustee, they remain part of the bankruptcy estate after the case closes.

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Every circuit court to consider the issue has held that the bankruptcy trustee has exclusive standing to pursue claims that are part of the bankruptcy estate. This exclusive standing survives the closure of the bankruptcy case. So, if a debtor fails to disclose a potential claim and then tries to bring it later, she lacks standing. Even though the bankruptcy case is closed, the claim is still part of the bankruptcy estate, and only the trustee has standing to bring it.

For the case to continue (assuming the trial court does not dismiss it outright), she must convince the bankruptcy court to reopen the case, and the trustee must take some action regarding the claim—either substituting herself as plaintiff to pursue it or formally abandoning it.

Even if a relator is allowed to reopen bankruptcy and regain standing, her claims may still be barred by the doctrine of judicial estoppel. This doctrine prevents a party from benefitting from opposing positions in different actions.

The U.S. Supreme Court has articulated three elements for judicial estoppel to apply in federal actions: (1) the asserted positions in the two actions are clearly inconsistent, (2) the party to be estopped successfully persuaded the court to accept its position in the first action, and (3) the party would obtain an unfair advantage or impose an unfair detriment on the other party if not estopped.

In the context of claims undisclosed in bankruptcy but asserted later, (1) a debtor takes the sworn position that she does not have a potential claim by failing to disclose it to the bankruptcy court and later takes the inconsistent position that a claim exists by asserting it herself, (2) the bankruptcy court relies on the debtor's first position by granting a discharge that does not dispose of the claims, and (3) the debtor obtains an unfair advantage from this misrepresentation by receiving a discharge that does not fully satisfy her creditors.

Every circuit court to consider this issue has held that judicial estoppel applies in this context, and the majority rule prevents the plaintiff from reopening bankruptcy in an attempt to save her claim.

Relators' Arguments. Until recently, there has been scant case law on whether these bankruptcy-related arguments have the same force in the *qui tam* context. Relators have argued that two factors unique to *qui tam* claims should prevent courts from dismissing FCA claims that the relators failed to disclose in their personal bankruptcies.

First, relators—and, in at least one case, the Department of Justice—have argued that a relator's standing ultimately derives from the United States' injury-in-fact and should prevent the relator from losing standing based on her personal conduct in bankruptcy.

Second, relators have argued that the requirement to file *qui tam* claims under seal to give the government an opportunity to evaluate the case means that they cannot be disclosed in bankruptcy, excusing any failure to disclose the claims.

These arguments have been uniformly rejected. The first published case that addressed the issue—the Eighth Circuit Court of Appeals decision in *U.S. ex rel. Gebert v. Transportation Administrative Services*—held that a relator's interest in a *qui tam* case should be treated just like any other asset in bankruptcy.¹

On standing, the court held that, under Supreme Court precedent, a relator's Article III standing derives from the United States' assignment of an interest in the government's claim to the relator. It is this personal stake in the action that gives a relator standing, and the relator loses that personal stake by failing to disclose the claim in bankruptcy.

On the mandatory seal argument, the court held that a debtor with a potential *qui tam* claim must take advantage of the tools available in bankruptcy for making confidential disclosures to the trustee in order to disclose the unfiled *qui tam* claim as an asset.

Consequently, failure to disclose a *qui tam* claim means that the relator must be dismissed for lack of

standing and may, in the court's discretion, be dismissed on the basis of judicial estoppel.

Although the *Gebert* court held that the relators in that case could not pursue the *qui tam* claims they failed to disclose, the court also noted that its order would not bar the United States from pursuing the claim.

Recently, the Fifth Circuit Court of Appeals followed *Gebert's* holding on standing in *U.S. ex rel. Spicer v. Westbrook*.² *Spicer* involved a bankruptcy trustee's motion to be substituted as the relator in a *qui tam* case that was under seal when the relator filed for bankruptcy.

Like the *Gebert* court, the court in *Spicer* held that only the trustee had standing to pursue the claim and granted the trustee's motion to be substituted as relator. The court reached this conclusion even though the debtor had disclosed the existence of his *qui tam* claim to the trustee orally because the disclosure did not reflect the value of the claim the relator later asserted. The court did not reach the judicial estoppel issue.

Two Recent Decisions. No other circuits have considered a relator's failure disclose a *qui tam* claim in bankruptcy. But two recent decisions involving *qui tam* cases filed by relator Antonio Saidiani in different circuits show the willingness of other courts to follow *Gebert* and *Spicer*.

These cases also illustrate different approaches courts can take with respect to the United States' interest in the FCA claims after deciding that a relator must be dismissed due to his failure to disclose his *qui tam* claims in bankruptcy.

Saidiani filed his first case ("*Saidiani I*") under seal in the Western District of North Carolina in March 2011.³ This case was based on a period of employment that ended in April 2010. In September 2011, while the case was still under seal, Saidiani filed for Chapter 7 bankruptcy. He did not disclose the pending action when he filed for bankruptcy or attempt to reopen bankruptcy when *Saidiani I* was unsealed in June 2012. In June 2013, Saidiani filed a second FCA case under seal ("*Saidiani II*") in the District of Arizona alleging different claims arising out of the same period of employment.⁴

Tracking the analysis in *Gebert* and *Spicer* but applying Fourth and Ninth Circuit law, the courts in both cases dismissed Saidiani's claims on standing and judicial estoppel grounds. The courts differed, however, in the terms of dismissal.

Although the United States had already declined to intervene in both cases, the court in *Saidiani I* held the case open for 60 days at the government's request to give the government a chance to reconsider its decision. The court reasoned that the government, as the real party in interest, should have an opportunity to decide whether to pursue its claims before they were dismissed due to Saidiani's personal misconduct.⁵ In contrast, the

² 751 F.3d 354 (5th Cir. 2014).

³ *U.S. ex rel. Saidiani v. NextCare, Inc.*, 3:11-cv-00141-GCM (W.D.N.C. Mar. 24, 2011)

⁴ *U.S. ex rel. Saidiani v. NextCare, Inc.*, 2:13-cv-01162-PXH-MHB (D. Ariz. June 7, 2013). The authors were involved in the defense of the Saidiani cases.

⁵ The United States ultimately decided not to pursue the claims, and the case has been dismissed.

¹ 260 F.3d 909 (8th Cir. 2001)

court in *SaidianiII* dismissed the case with prejudice outright.

Because no court has yet declined to follow *Gebert* or *Spicer*,⁶ there appears to be a growing consensus across circuits that a relator, just like any other plaintiff, must suffer the consequences of a bankruptcy.

⁶ Two other cases have followed or approved of *Gebert* or *Spicer*. See *Malhotra v. Steinberg*, C09-1618JLR, 2012 WL 5497978, at *3, (W.D. Wash. Nov. 13, 2012); *United States ex rel. Long v. GSD&M Idea City LLC*, Civil Action No. 3:11-cv-1154-O (N.D. Tex. June 10, 2014). One other case applied ordinary bankruptcy standing and judicial estoppel principles but declined to dismiss a relator's case where the relator moved to reopen bankruptcy and disclose the claim as soon as it was unsealed. See *United States ex rel. Bibby v. Wells Fargo Bank, National Association*, 1:06-cv-547-AT (N.D. Ga. Dec. 6, 2011). As far as the authors are aware, no other case has addressed the intersection of bankruptcy and *qui tam* law.

Review Relator's Bankruptcy History. Consequently, defense counsel, plaintiff's counsel and the government should incorporate a review of a relator's bankruptcy history into their normal case evaluation process. Doing so will help eliminate the unnecessary expenditure of time and money litigating claims that the relator is not entitled to bring.

As a practical matter, checking for prior bankruptcy filings is a quick and easy process. Bankruptcy filings are public records available online through the federal PACER system. A simple search for the relator on PACER will show the dates of any prior bankruptcies.

If it appears from the factual allegations in the *qui tam* lawsuit that the claims may have accrued before the bankruptcy closed and further investigation is warranted, all of the filings, including Schedule B, can be found under the History/Documents tab for the case. From there, the debtor's Schedule B will show whether the debtor disclosed the claim.