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Recent Controversial Decision and Insurance Law May Mitigate Exposure for Companies Subject to False Claims Act Lawsuits

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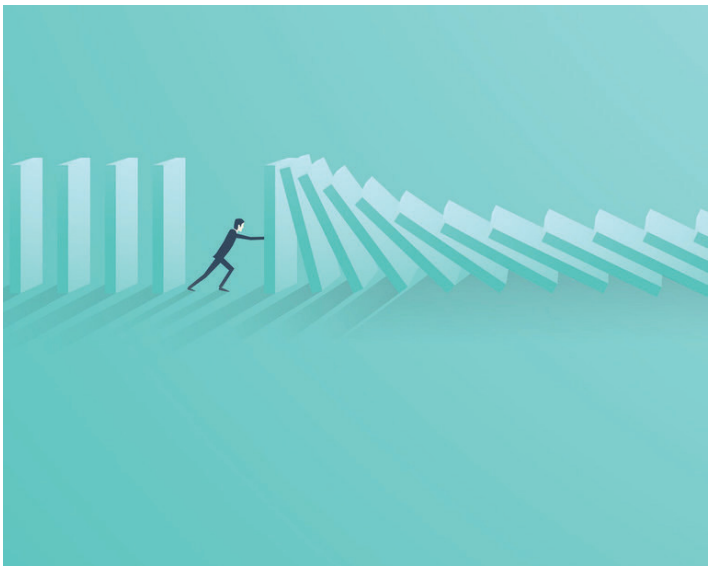
A controversial decision from 2024 and insurance law may help companies facing investigations and *qui tam* lawsuits brought by relators under the False Claims Act. This article analyzes the Act, strategic advice for policyholders seeking insurance coverage, and a shocking decision that may render all currently pending *qui tam* suits unconstitutional.



I. The False Claims Act & Civil Suits Brought by *Qui Tam* Relators

The False Claims Act was originally passed to combat contractor fraud during the Civil War. Under the Act, any person who knowingly submits false claims to the federal government may become liable for treble damages and statutory penalties. Both the attorney general and private persons, termed "relators," may bring actions to enforce violations. Relators can recover up to 30% of the proceeds of *qui tam* suits brought in the government's name.

The terms "relator" and "whistleblower" are sometimes used interchangeably, but they are different. Relators prosecute civil actions in the name of the government, take actions to final judgment and handle appeals, bind the government in future cases, and recover punitive damages for the government. In contrast, whistleblowers are merely informers who provide information. Deputized by the government in this fashion, *qui tam* relators file most civil lawsuits brought under the Act.

II. Strategic Insurance-Coverage Advice for False Claims Act Investigations & Actions

Companies subject to False Claims Act investigations and actions may mitigate their exposure using applicable insurance. Here are some best practices:

A. Provide Notice ASAP Under All Potentially Applicable Policies

Several different types of insurance can potentially cover government investigations and civil actions brought under the Act, including Directors & Officers (D&O) and Errors & Omissions (E&O) policies. These policies typically provide coverage on a claims-made-and-reported basis and require notice of a pending investigation, claim, or suit within the policy period or a certain number of days after expiration.

Insurers often use late notice as a potential ground for denying otherwise covered claims, so companies should provide notice under all potentially applicable policies as soon as possible. Insurance brokers can help.

B. Beware of Insurer Attempts to Sidestep, Pigeonhole, or Delay Coverage

In addition to late notice, insurers often assert other coverage defenses to deny coverage for False Claims Act investigations and suits. One common tactic involves an insurer trying to sidestep its coverage obligations by arguing that another type of policy should provide coverage.

1. Does a Policyholder's Submission of Allegedly False Claims to the Government Constitute Professional Services?

D&O policies have broad insuring agreements covering "Claims" alleging "Wrongful Acts," but some may also contain Professional Services exclusions that purport to bar coverage for losses "involving the rendering or failing to render professional services. "In 2016's *HotChalk, Inc. v. Scottsdale Insurance Co.* decision, the United States District Court for the Northern District of California held that a False Claims Act lawsuit arose out of the policyholder's professional services and the exclusion applied. A D&O insurer may thus argue that a Professional Services exclusion bars coverage for a suit brought under the Act. However, E&O policies specifically provide coverage for the policyholder's losses due to "Claims" alleging "Wrongful Acts" in the performance of its professional services. Furthermore, other decisions have ruled otherwise. For instance, in 2023's *ACE American Insurance Co. v. Guaranteed Rate, Inc.*, the Supreme Court of Delaware held that a False Claims Act suit and eventual settlement did not fall within a Professional Services exclusion in a D&O policy.

This variance underscores the importance of providing notice under both D&O and E&O policies. Regardless of whether a policyholder's allegedly false submissions to the government constitute professional services, either type of policy may provide coverage, depending on the applicable law and policy wording.

2. Investigative Notices May Constitute "Claims" That Trigger an Insurer's Coverage Obligations.

Many investigations begin when a government agency issues a notice. An investigative notice can take several forms, including a target letter, subpoena, or Civil Investigative Demand, among other documents. These notices often state that the government is investigating potential False Claims Act violations, believes the company may have relevant information, and seeks documents, sworn testimony, or other information. Responding to these investigative notices can cost hundreds of thousands or even millions of dollars in attorneys' fees.

D&O and E&O policies typically require a "Claim" alleging that the policyholder has committed a "Wrongful Act" to trigger the coverage. However, when a policyholder provides notice, its insurer may try to avoid paying by claiming that the investigative notice is not yet a "Claim" or does not allege "Wrongful Acts," downplaying the investigative notice as a mere request for information or taking a narrow view of the policy coverage.

Courts deciding this issue have reached varied results. Many policies define "Claim" to include "a written demand for non-monetary relief"; under this language, several courts have held that investigative notices are covered "Claims" because they demand information and can "compel compliance without judicial intervention," as a Delaware Superior Court decided in *Conduent State Healthcare, LLC v. AIG Specialty Insurance Co.* in 2019.

While other courts have reached different results, policyholders should not simply take their insurer's word for it and review their policy's definition of "Claim." Some policies also specifically cover pre-"Claim" investigations, either by endorsement or sublimit. At minimum, reporting an investigatory notice should constitute a Notice of Circumstances that could later give rise to a "Claim" and anchor an eventual suit to the policy period.

III. Controversial Decision May Render *Qui Tam* Relators Unconstitutional If the President Does Not Appoint Them Under the Appointment Clause

A controversial decision from 2024 may further aid companies facing False Claims Act suits brought by *qui tam* relators. In *United States v. Florida Medical Associates, LLC*, the United States District Court for the Middle District of Florida ruled that the Act's *qui tam* provision violates the Appointments Clause of Article II of the U.S. Constitution, as relators are "officers of the United States" and therefore must be appointed by the president to survive constitutional scrutiny. Because the president did not appoint the relator in question, the court held that she was improperly appointed and dismissed the case.

If the decision stands, it could upend False Claims Act jurisprudence. As the president did not appoint the relators in pending *qui tam* cases as officers of the United States, presumably those actions would all be unconstitutional and must be dismissed. However, note that the government has already appealed and later in 2024, the United States District Court for the Eastern District of Tennessee found the *Zafirov* decision to be "unpersuasive" in *United States v. Chattanooga Hamilton County Hospital Authority*.

IV. Conclusion

Even if *Zafirov* stands on appeal, the Attorney General and the Department of Justice will still retain investigatory and enforcement authority, so the False Claims Act will remain a source of potential exposure for companies that submit claims to the government. These businesses can follow the steps outlined above to maximize their chances at recovering for their losses under their insurance policies.

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