**INITIAL BRIEF**



**DATE FOR ORAL ARGUMENT NOT YET SCHEDULED**

**No. 04-5376**
**Consolidated with Appeal Nos. 04-5396, 05-7027, and 05-7036**

**IN THE UNITED STATES COURT OF APPEALS**
**FOR THE DISTRICT OF COLUMBIA CIRCUIT**

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**THE HAMILTON SECURITIES GROUP, INC., et al.**
Appellants,

**v.**

**UNITED STATES ex rel. ERVIN AND ASSOCIATES INC.**
Appellee

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**Appeal from the United States District Court**
**for the District of Columbia**

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# BRIEF FOR APPELLANTS, HAMILTON SECURITIES GROUP, INC. AND HAMILTON SECURITIES ADVISORY SERVICES, INC.

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**August 12, 2005**

## RULE 26.1 DISCLOSURE STATEMENT

Pursuant to Circuit Rule 26.1, Appellants The Hamilton Securities Group, Inc. and Hamilton Securities Advisory Services, Inc., hereby certify that they have no parent companies, subsidiaries, or affiliates that have issued shares or debt securities to the public.

## CERTIFICATE AS TO PARTIES, RULINGS, AND RELATED CASES

Pursuant to Circuit Rule 28(a)(1), Appellants Hamilton Securities Group, Inc. and Hamilton Securities Advisory Services, Inc., (collectively "Hamilton") hereby certify:

A. The parties appearing before the United States District Court and before this Court are Defendants/Appellants The Hamilton Securities Group, Inc. and Hamilton Securities Advisory Services, Inc., Plaintiff/Appellee U.S. Department of Housing and Urban Development, Office of Inspector General, and Relator/Appellee Ervin and Associates, Inc. ("Ervin"). No intervenors or *amici* appeared in the District Court and none have appeared in this Court at this time.

B. Rulings Under Review: Appellants appeal from the following rulings:

- Order and Judgment and Superseding Memorandum of United States District Court Judge Louis F. Oberdorfer filed on January 25, 2005;
- Order granting in part, denying in party Motion for Judgment on Partial Findings of United States District Court Judge Louis F. Oberdorfer filed on January 7, 2004;
- Order denying Motion for Summary Judgment of United States District Court Judge Louis F. Oberdorfer filed on September 22, 2003; and

- Order denying Motion to Dismiss of United States District Court Judge Louis F. Oberdorfer filed on May 1, 2003;

C. The case on review has not previously been before this or any other court, other than the District Court from which this appeal is taken, in Civil Action No. 96-01258. There are three related cases to this one: (1) The Hamilton Securities Group, Inc. et al. v. Ervin and Associates, Inc., et al., in the Superior Court of the District of Columbia (Civil Division), Civil Action No. 99-3864 (Winfield, J.), removed to U.S. District Court for the District of Columbia, Case No. 1:99-CV-1698 (Oberdorfer, J.), stayed pending the result of this appeal; and (2) Hamilton Securities Advisory Services, Inc. v. United States of America, in the United States Court of Federal Claims, Case No. 98-169 C (Braden, J.); now on appeal by the United States in No. 05-5016 in the United States Court of Appeals for the Federal Circuit; (3) Ervin and Assoc., Inc. v. United States of America, in the U.S. District Court for the District of Columbia, Case No. 1:01-cv-1052 (Oberdofer, J.), now on appeal by Ervin and Associates in No. 03-5249 in the United States Court of Appeals for the District of Columbia Circuit, stayed pending a decision in the District Court in Case No. 96-01258; held in abeyance pending further order by this Court.

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## TABLE OF AUTHORITIES

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## GLOSSARY

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|---|---|
| FCA: | False Claims Act |
| FHA: | Fair Housing Administration |
| HUD: | United States Department of Housing and Urban Development |
| LSA: | Loan Sale Agreement |
| North Central: | North and Central Sale |
| SM: | The District Court's Superseding Memorandum (issued January 25, 2005) |
| UPB: | Unpaid Principal Balance |
| WOM: | West of the Mississippi Sale |

## JURISDICTIONAL STATEMENT

The District Court exercised jurisdiction under 28 U.S.C. § 1331 and the False Claims Act ("FCA"), 31 U.S.C. § 3730 *et seq.*[1]

Following a bench trial, the District Court (Oberdorfer, J.) issued an Order and Judgment and Superseding Memorandum of United States District Court on January 25, 2005. This is a final Order from which Hamilton timely appealed on February 24, 2005.

This Court has jurisdiction over Hamilton's appeal pursuant to 28 U.S.C. § 1291.

[1] As set forth below, Hamilton contends that the District Court lacked jurisdiction under 31 U.S.C. § 3730(e)(4)(A) which creates a jurisdictional bar to FCA actions based on publicly disclosed allegations where the relator is not an original source.

## STATEMENT OF ISSUES

1. Whether the District Court erred in finding jurisdiction under 31 U.S.C. § 3730(e)(4)(A) by ruling that Ervin had proven that it was an "original source" of the North Central allegations, even though Ervin presented no original source evidence at trial and the evidence related to the investigation of the North Central sale at trial established that Ervin's claim was derivative of publicly disclosed information that had been self-reported by Hamilton to the United States.

2. Whether the District Court erred in finding Hamilton liable for a reverse false claim under 31 U.S.C. § 3729(a)(7) where there was no concealment, avoidance or decrease in any obligation by Hamilton or any other party to pay or transmit money or property to the government.

3. Whether the District Court erred in finding that Hamilton's actions in connection with the North Central sale constituted "gross negligence plus" sufficient to satisfy the False Claims Act scienter requirement.

4. Whether the District Court erred in failing to dismiss the action as a sanction for violating the FCA's seal provision, 31 U.S.C. § 3730(b)(2), where Ervin willfully and repeatedly discussed his *qui tam* allegations with

members of the press, who published articles about the allegations while the case remained under seal.

## STATUTES AND REGULATIONS

The relevant statutes and regulations appear in the Addendum to this brief.

## STATEMENT OF THE CASE

On June 6, 1996, plaintiff/appellee Ervin filed under seal a *qui tam* action against Hamilton, Goldman, Sachs & Co. ("Goldman Sachs") and BlackRock Capital Finance L.P. ("BlackRock").[2] The Complaint alleged a conspiracy surrounding auctions conducted by Hamilton as part of the United States Department of Housing and Urban Development's ("HUD") loan sales program. In general, Ervin alleged that Hamilton: 1) provided Goldman, Sachs and BlackRock with a secret opportunity to increase sealed bids during the loan sales; 2) disclosed inside information to Goldman and BlackRock; 3) used an optimization model, which allegedly favored large bidders over small bidders; and 4) misdescribed the true nature of the assets offered for sale. Compl. at pp. 40-46, ¶¶ 106-129.

On September 3, 1999, while the action remained under seal, Ervin filed a First Amended Complaint, which expanded the scope of the allegations, including for the first time those related to the West of the Mississippi ("WOM") and North Central loan sales, and added Williams, Adley & Co. ("Williams, Adley") as a defendant.[3] Hamilton was named as

[2] Goldman Sachs and BlackRock were never served with the Complaint.

[3] The First Amended Complaint also named Ocwen Financial Corporation as a defendant, but Ocwen was never served.

a defendant on each of the counts. *See* First Amend. Compl. pp. 54- 66, ¶¶ 214-295.

On April 17, 2000, the United States declined to intervene and prosecute the case. Ervin subsequently moved for leave to amend the Complaint a second time in April, 2003. Per an August 14, 2003 Order, one additional count, alleging that Hamilton made false statements in a December 20, 1996 memorandum to HUD reporting an optimization error related to the WOM and North Central sales, was added. Sec. Amend. Compl. pp. 77-78, ¶¶ 296-300.

A bench trial began on October 28, 2003. Following the completion of plaintiff's case, the District Court granted in part Hamilton's Motion for Judgment on Partial Findings on January 7, 2004, dismissing counts I, III, IV, V, VI, VII, and VIII of the Second Amended Complaint. After completion of the trial, on August 16, 2004, the Court filed an Order and Partial Judgment entering Judgment for Hamilton on counts II, XIII, XIV, XV, and XVI of the Second Amended Complaint and dismissing counts X, XI, and XII. The Court entered judgment for Ervin on Count IX of the Second Amended Complaint relating to the North Central Sale.

Following the submission of supplemental briefs regarding the proper penalty and how damages were to be divided against Ervin and the

Government, on January 25, 2005, the District Court issued its Final Order and Judgment and a Memorandum superseding the August 16, 2004 Order. This appeal followed.

## STATEMENT OF FACTS

This is a False Claims Act case like none previously reported. It concerns review of the District Court's finding of jurisdiction over the objections of both the government and the defendant that no jurisdiction exists, and in the absence of any evidence from the relator to the contrary. On the merits, this appeal involves a review of a finding of FCA liability against Hamilton for a computer error that everyone acknowledges was unintentional, self-discovered and self-reported, and did not benefit Hamilton financially, or in any other way.

More generally, this case involves the acts of a disgruntled government contractor, Ervin, who used the Courts to smear the reputation of a competitor, Hamilton, and a variety of HUD employees, simultaneously suing HUD and its officers while asserting *qui tam* claims in the name of the United States. Ervin's broadside attack on Hamilton, HUD and HUD's loan sales program, made both in this *qui tam* action and a companion *Bivens* case filed contemporaneously, alleged a tale of misrepresentation, kickbacks, bid rigging, and conspiracy, none of which were true, much less ever proven at trial. Indeed, most of Ervin's allegations, including the most sensational ones, were never presented at trial. The sole claim on which the Court found liability resulted from an innocent mistake.

## I. Hamilton And The HUD Loan Sales Program

In the early 1990s, HUD faced a huge and increasing fiscal problem in managing and servicing its single and multifamily mortgage portfolio. HUD held billions of dollars worth of single and multifamily mortgages – a significant percentage of which were for properties that were in extremely poor condition and for which HUD was not receiving regular payments. Tr. 07/20/04 at p. 117 ln. 21 – p.118 ln. 4. By June 1993, HUD's Federal Housing Administration ("FHA") had an $11.2 *billion* reserve against delinquencies in its multifamily portfolio alone. Tr. 07/20/04 at p. 117 ln. 9-20. To confront this problem, FHA established a program of selling the mortgage loans as one of a series of strategies pursued to improve the health of the FHA portfolio. *Id.* at p. 118 ln. 9-12.

In September, 1993, Hamilton was awarded a contract by HUD to serve as a financial advisor, under which Hamilton designed and developed the blue print for selling HUD-held mortgage notes through public auctions – the loan sales. Hamilton Exh. 8; Tr. 7/20/04 at p. 122 ln. 16-22. In addition, Hamilton was tasked with "all aspects of running asset sales and getting supportive services to assist in doing that such as conducting

analyses, strategizing approaches to sales, due diligence." Tr. 10/29/03 PM at p. 13 ln. 5; Tr. 7/20/04 at p. 122 ln. 16.[4]

Between March of 1995 and December 1996, HUD, with Hamilton's assistance, conducted a series of eight auctions that resulted in the sale of tens of thousands of HUD loans and generated billions of dollars in revenue to HUD. Tr. 7/20/04 at p. 130 at ln. 1-3; Ervin Exh. 77 at ¶¶ 1-2. Two of these loan sales were the West of the Mississippi ("WOM") sale, held on September 19, 1995 and covering multifamily mortgages for those properties in the western United States, and the North and Central ("North Central") sale, held on August 8, 1996 and covering mortgages for multifamily properties in the north and central regions of the country. *Id.* at ¶¶ 4-5, 19.

The rules governing the loan sale auctions were complex and the bidders were sophisticated. *See* Ervin Ex. 95. Each loan sale auction involved thousands of properties and bidders had the option of bidding on a single asset, the entire auction portfolio, or any portion of the portfolio of their choosing. Bids were submitted in secret on a specified auction date, and there was no opportunity to re-bid. *Id.*

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[4] Ervin was an unsuccessful bidder for that work (*see, e.g.*, Amended Complaint at ¶ 34) and also submitted unsuccessful bids for certain mortgage loans auctioned off as part of the loan sales program.

In addition, on both the WOM and North Central sales, bidders had the option of specifying a "bid floor." The bid floor allowed a bidder to make each of its bids contingent on being awarded a minimum amount of loans, in this case measured by the aggregate Unpaid Principal Balance ("UPB") of the mortgages. Thus, if a given bidder was not selected as the winner of loans with an aggregate UPB equal to or greater than its specified bid floor, then the bidder would not be awarded any loans at all. Tr. 10/31/03 PM at p. 147 ln 18-24; Ervin Exh. 77 at ¶ 1. A portion of the bidders on the WOM and North Central sales specified bid floors.

In order to determine which combination of bids HUD should accept, Hamilton hired Bell Labs/Lucent Technologies ("Bell Labs") as a subcontractor to develop and operate an "optimization model." The optimization model was a proprietary, computer algorithm designed to select as winners that combination of bids which represented the maximum potential revenue to HUD. Tr. 10/30/03 AM at pp. 147 ln. 17 – 148 ln. 10; Tr. 10/30/03 PM at p. 113 ln. 6-22, p. 114 ln. 10-20; Tr. 10/31/03 PM at pp. 141 ln. 25 – 142 ln. 13. Under the auction process, Hamilton received the secret bids and forwarded them to Bell Labs, who ran the optimization model and reported the results back to Hamilton. Hamilton passed the Bell Labs report on to HUD, who then decided which bids to accept.

## II. The Optimization Model Error

In determining the winning bids for the WOM sale, Bell Labs mistakenly used an optimization model that analyzed the submitted bid floors in terms of minimum revenue (the amount to be paid HUD) rather than minimum UPB (the amount outstanding on the mortgage). Tr. 10/31/03 PM at p. 149 ln. 15 – 151 ln. 3; Hamilton Exh. 44 at p.1; Ervin Exh. 77 at ¶ 6. This error was discovered by Bell Labs when the initial results were sent to Hamilton, but prior to Hamilton reporting the auction results to HUD. To correct the error, Bell Labs scientist Sol Schindler re-ran the optimization model, this time prorating the bid floors to convert them from revenue to UPB. Tr. 10/31/03 PM at pp. 153 ln. 9 – 154 ln. 11; Ervin Exh. 77 at ¶¶ 7-8; Ervin Exh. 89 at Bates No. LUC 001200. Schindler informed Robert Robinson, the Hamilton employee overseeing the WOM auction, that the prorated conversion was within one dollar of optimal. Tr. 10/31/03 PM at p. 211 ln. 2-14. Robinson did not tell anyone else at Hamilton about the error and he believed Schindler that it had been corrected to within one dollar of optimal. Tr. 7/19/04 at p. 74 ln. 6-7.

Schindler told Robinson that he would permanently correct the bid floor definition problem in the optimization model. *Id.* at p. 46 ln. 15-17; Ervin Exh. 77 ¶ 11. Hamilton was dependent on Bell Labs in this regard, as

Hamilton did not possess the capacity to fix the model itself. Tr. 10/31/03 PM at p. 204 ln 5-23. Robinson accepted Schindler's representation and understood the model would be permanently fixed. Tr. 10/31/03 PM at pp. 204 ln. 16 – 205 ln. 7. True to his word, Schindler sought fixed the problem shortly after the WOM sale by creating a separate optimization model in which bid floors were identified in terms of UPB. Ervin Exh. 77 at ¶12; Tr. 7/19/04 at p. 48 ln. 7. However, in making the correction, Schindler did not dispose of the previous revenue bid floor model, and as a result Bell Labs retained two optimization models in its computer files. *See id.*

Robinson left Hamilton shortly after the WOM sale with the understanding that Schindler had addressed the problem. Tr. 7/19/04 at p. 48 ln. 8-12. Thereafter, Schindler suffered a heart attack and. Although he later returned to another Bell Labs department, was no longer in contact with anyone involved in subsequent loan sales. Tr. 7/19/04 at p. 48 ln. 23-25; Ervin Exh. 77 at pp. 4-5 ¶¶ 11-18.

The North Central sale was the next loan sale after WOM to involve bid floors. The North Central bid floors were to be expressed in terms of UPB, just as those in the WOM. Prior to the sale, and unaware of the problem with the WOM sale, Hamilton employee Rick Wolf directed the Bell Labs scientists who replaced Schindler to run the optimization model in

the same way as in the WOM sale. Tr. 7/19/04 at p. 49, ln. 10-12; Ervin Exh. 77 at ¶17. Not realizing that Schindler had created a new model based on a UPB floor, the new Bell scientists used the revenue bid floor model, which had not been discarded. Tr. 7/19/04 at p. 49, ln. 10-12; Ervin Exh. 77 at ¶18. Bell Labs reported the results of the revenue model to Hamilton, and those results were eventually accepted by HUD.

In October 1996, while preparing for yet another loan sale, Wolf discovered a discrepancy between the bid package and the Bell Labs formula used in the WOM sale. Wolf brought this to the attention of others and Hamilton formed an investigative team to uncover the source of the discrepancy and any effect on loan sales revenues. Tr. 10/31/03 AM at p. 189 ln. 16 – 190 ln. 1, p. 189 ln. 5-15, p. 190 ln. 1-13, p. 225 ln. 17-25; Tr. 11/3/03 AM at p. 307 ln. 4-12; Tr. 7/19/04 at p. 44 ln. 11-13; Ervin Exh. 77 at ¶ 20. The investigation included a review and re-running of the optimization model on all of the previous loan sales. Ervin Exh. 77 at ¶ 21.

Hamilton's investigation of the optimization error determined that the error effected analysis of only a small percentage of the bids and had a minor impact on the optimization results. In examining the North Central sale, which generated $621,674,221 in revenue, Hamilton determined that use of the UPB optimization model would have generated a slate of winners

amounting to $623,185,465. Ervin Exh. 77 at 1. The resulting difference of $1,511,244 constituted an error of two-tenths of one percent (0.2%). In addition, Hamilton's investigation revealed that Schindler's pro-rated calculation on the WOM sale was erroneous, resulting in a difference of six-tenths of one percent (0.6%), $2,372,307. Ervin Exh. 77 at 1. Hamilton did not benefit in any way from the difference.

Hamilton's investigation further concluded that due to Robinson's departure and Schindler's heart attack, the North Central staff at Hamilton and Bell Labs were not aware that Schindler had created a separate model using UPB as the bid floor input. Tr. 7/19/04 at p. 49 ln. 6-9; Ervin Exh. 77 at ¶¶ 12, 18. Indeed, Schindler subsequently died and therefore no evidence was ever presented as to why he created a new model rather than merely modifying the original or why he retained the original model after creating the new one.

In early December, 1996, after investigating the facts of the WOM and North Central sales, Hamilton informed Kathy Rock, the FHA Comptroller and FHA Commissioner Nicolas Retsinas, the head of the loan sales program, of the optimization error and presented an initial report. Tr. 7/21/04 at p. 240 ln. 15-20; Ervin Exh. 102. At HUD's request, Hamilton submitted a more detailed December 20, 1996 memorandum to Retsinas and

Rock that contained an analysis of how the error occurred. *Id.* at p. 241, ln. 10-14; Ervin Exh. 77. This memorandum was then forwarded to HUD's Office of General Counsel. Tr. 7/21/04 at p. 241- ln. 18 - p. 242 ln. 4-22. Hamilton heard nothing further regarding the matter until October, 1997, when HUD terminated Hamilton's contract for the convenience of the government, withholding payment of certain fees owed to Hamilton for work performed under the contract.

In March, 1998, Hamilton filed suit against HUD in the United States Court of Federal Claims, seeking payment of the retained fees. In August, 1999, the United States counterclaimed alleging, *inter alia*, breach of contract based on Hamilton's report of optimization model errors n the WOM and North Central sales. On June 14, 2004, the Court of Claims granted summary judgment on behalf of Hamilton, finding no breach of contract or tort liability arising from the optimization model result in the WOM and North Central sales (Braden, J.). *See* Memorandum Opinion and Final Order, *Hamilton Securities Advisory Services, Inc. v. United States*, No. 98-169C (Fed. Cl. June 14, 2004).

## III. Ervin's Lawsuits And The Loan Sales Program

Ervin derived most of its revenue by servicing HUD loans; thus, the loan sales program – with its primary objective of privatizing those same

loans – reduced Ervin's revenue and threatened the company's existence. Ervin's animosity toward the HUD program and its participants such as HUD Deputy Assistant Secretary Helen Dunlap and Hamilton was deep and personal.[5] Ervin was determined to stop the loan sales program.

On June 5, 1996, Ervin filed a *Bivens* Complaint in the United States District Court for the District of Columbia against the United States, HUD, and several government officials, including Dunlap.[6] The *Bivens* Complaint was a broad attack on the HUD loan sale program that contained a number of allegations that were identical to claims subsequently made in the *qui tam* action, including that HUD improperly awarded contracts to Hamilton, its "favored" contractor, and improperly awarded a Due Diligence Contract to Williams Adley under the SBA's 8(a) program.[7] Original *Bivens* Compl. ¶ 240. The Complaint also repeatedly alleged that HUD discriminated against

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[5] Ervin's pleadings included scandalous allegations of overnight visits by Catherine Austin Fitts, Hamilton's President to Ms. Dunlap's house, Ms. Dunlap's alleged disdain for male employees and contractors, references to the "new girls network" and the claim that HUD had become a "white man's hell".

[6] *Ervin and Assocs. v. Helen Dunlap,* CA No. 96-CV-1253.

[7] The counts of the qui tam action which related to these allegations were dismissed by the District Court in the proceedings below. *See* Order, January 7, 2004 (granting Hamilton's Motion for Partial Judgment with respect to counts I, III, IV, V, VI, VII, and VIII of the Second Amended Complaint); Final Order, January 25, 2005 (entering judgment for Hamilton with respect to counts II, XIII, XIV, XV, and XVI of the Second Amended Complaint and dismissing counts X, XI, and XII).

white men by awarding contracts to firms owned by minorities (like Williams Adley) and women (like Hamilton). Original *Bivens* Compl. ¶ 38.

On June 6, 1996, Ervin filed the underlying *qui tam* Complaint, None of the counts in the original *qui tam* Complaint concerned the North Central loan sale, the count which is the subject of this appeal. Indeed, the North Central loan sale had not even been conducted at the time the Complaint was filed. All of the claims in the Original Complaint were eventually dismissed.

On September 3, 1999, after Hamilton had self-reported the North Central errors, after Hamilton had filed suit in the Court of Claims to recover fees from HUD, and after HUD had counterclaimed based specifically on the report of suboptimal results presented by Hamilton, Ervin filed a First Amended Complaint, which included a claim relating to the North Central sale. *See* First Amend. Compl. pp. 54- 66, ¶¶ 214-295.

Following a bench trial, the District Court (Oberdorfer, J.) entered judgment on behalf of Hamilton on all claims, save for Count IX, which alleged a "reverse false claim" resulting from Hamilton's submission of the optimization report on the North Central sale. *See United States ex rel. Ervin & Associates v. Hamilton Securities Group, Inc.*, Civ. Case No. 96-1258, Superseding Memorandum (Jan. 25, 2005) (hereinafter "SM"). In so

ruling, the District Court found that Ervin was an "original source" of the North Central allegations and that, with respect to the North Central sale, Hamilton had acted with extreme gross negligence sufficient to meet the FCA's reckless disregard standard. *Id.*

## SUMMARY OF ARGUMENT

The District Court did not have subject matter jurisdiction. Under the FCA, there is no jurisdiction where an action is based upon publicly disclosed allegations or transactions, unless the relator is an original source of the allegations. 31 U.S.C. § 3730(e)(4)(A). Prior to trial, the District Court determined as a matter of law that this action was based on public disclosures. *See* May 1, 2003 Order. At trial, Ervin utterly failed to meet its burden of proving its original source status under the standards set forth by this Court in *United States ex rel Findley v. FPC-Boron Employees Club*, 105 F.3d 675, 681 (D.C. Cir. 1997) and *United States ex rel Springfield Terminal Ry. Co. v. Quinn*, 14 F.3d 645 (D.C. Cir. 1994). Ervin presented no evidence that it had "direct and independent" knowledge of Hamilton's alleged fraud. Indeed, the only evidence presented at trial showed Ervin's allegations related to the North Central sale to be derivative of claims that had been asserted against Hamilton by the government in another matter.

The District Court also erred in finding that Ervin proved the necessary elements of the FCA's "reverse false claims" section, 31 U.S.C. § 3729(a)(7). That Section imposes liability on one who "knowingly makes, uses, or causes to be made or used, a false record or statement to conceal, avoid, or decrease an obligation to pay or transmit money or property to the

Government." No reverse false claim exists in this case because it is undisputed that Hamilton had no obligation to pay money or transmit property to the government, but instead merely conducted an auction in which third parties bid for and purchased government assets. The District Court erroneously ruled that § 3729(a)(7) applied even where the "obligation" that is decreased or avoided is a third party's, in this case the bidders in the North Central sale whose bids would have been identified as auction winners, absent an error in calculating the winners. However, there is no precedent for finding that a defendant may be held liable under 3729(a)(7) for incidentally decreasing a third party's obligation to the government. Moreover, the District Court erred because the bidders never had an obligation to pay the government. The bidders merely submitted offers that were contingent on HUD's acceptance and HUD retained the absolute discretion and ability to reject any of the bids submitted.

The District Court further erred in finding that Hamilton acted with the requisite scienter under the FCA. The FCA only imposes liability for the "knowing" presentation of false claims, which may be established by proof of a defendant's reckless disregard for the truth or falsity of a record submitted to the government. 31 U.S.C. § 3729(b). However, the error in determining the correct auction winners was an innocent mistake which was

the product of a series of unfortunate circumstances (including the heart attack of a Bell Labs scientist) and miscommunications. Hamilton fully disclosed the error to HUD as soon as it discovered and investigated it. These actions do not rise to the level of reckless disregard set forth by this Court in *United States v. Krizek*, 111 F.3d 934 (D.C. Cir. 1997).

Finally, the District Court should have dismissed the *qui tam* action because Ervin violated the FCA's seal provision. 31 U.S.C. §3730(b)(2). Ervin willfully violated the seal by contemporaneously filing a *Bivens* Complaint with allegations substantially identical to the *qui tam* action and then using the cover of the *Bivens* action to air his *qui tam* allegations through the media. Ervin openly admitted that he discussed these allegations with members of the press, who reported the allegations while the *qui tam* suit remained under seal. Several Courts have held that dismissal of a *qui tam* action is warranted where a relator violates this provision and the District Court erred by not sanctioning Ervin's misconduct. *See, e.g., United States ex rel. Pilon v. Martin Marietta Corp.*, 60 F.3d 995, 999 (2d Cir. 1995); *United States ex rel. Windsor v. Dynacorp, Inc.*, 895 F. Supp. 844, 848 (E.D. Va. 1995).

## ARGUMENT

### I. Standard of Review

This Court reviews the District Court's determination of jurisdiction under 31 U.S.C. §3730(e)(4) of the FCA *de novo*. *See United States ex rel Findley v. FPC-Boron Employees Club,* 105 F.3d 675, 681 (D.C. Cir. 1997) (an appellate court reviews *de novo* a relator's subject matter jurisdiction in a *qui tam* action); *United States ex rel Grynberg,* 389 F.3d 1038, 1048 (10th Cir. 2004) ("the interpretation and application of §3730(e)(4) is reviewed *de novo*").

A trial court's conclusions of law are reviewed de novo. *Summers v. Howard Univ.,* 374 F.3d 1188, 1195 (D.C. Cir. 2004). Thus, this Court reviews *de novo* the legal conclusions regarding whether the evidence established a reverse false claim under 31 U.S.C. § 3729(a)(7). *See Williams v. Sandman,* 187 F.3d 379, 381 (4th Cir. 1999). (after a bench trial a federal appeals court "review[s] the district court's conclusions of law de novo").

This Court also reviews the District Court's failure to dismiss Ervin's action for violation of the seal provision *de novo*. *See United States ex rel. Lujan,* 67 F.3d 242, 245 (9th Cir. 1995).

## II. The Court Lacked Subject Matter Jurisdiction Under 31 U.S.C. § 3730(e)(4) Because Ervin Was Not An Original Source Of The North Central Allegations.

The District Court did not have subject matter jurisdiction because Ervin's allegations were based on publicly disclosed information of which Ervin was *not* the original source. The FCA strictly limits a federal court's jurisdiction to hear *qui tam* claims, providing that

> No court shall have jurisdiction over an action under this section based upon the public disclosure of allegations or transactions in a criminal, civil or administrative hearing, in a congressional, administrative, or Government Accounting Office report, hearing, audit, or investigation, or from the news media, unless the action is brought by the Attorney General or the person bringing the action is an original source of the information.

31 U.S.C. § 3730(e)(4)(A).

An "original source" is defined as

> an individual who has direct and independent knowledge of the information on which the allegations are based and has voluntarily provided the information to the Government before filing an action under this section which is based on the information.

31 U.S.C. § 3730(e)(4)(B). As the District Court recognized, Ervin had the burden of establishing *at trial* all necessary elements of its claim, including that the Court had subject matter jurisdiction. Superseding Memorandum at 28, 33; *see also United States ex rel Fine v. MK-Ferguson*, 99 F.3d 1538, 1543 (10th Cir. 1996) (In an FCA case, the party asserting subject matter

jurisdiction has the burden of proving its existence); *United States ex rel. Aflatooni v. Kitsap Physicians Servs.*, 163 F.3d 516, 525 (9th Cir. 1998) (Under the FCA the relator bears the burden of proving all the elements of its case, including jurisdiction).

This Circuit applies a two-part test for determining the existence of FCA jurisdiction. *United States ex rel. Springfield Terminal Ry. Co. v. Quinn*, 14 F.3d 645 (D.C. Cir. 1994). First, the court ascertains whether the "allegations or transactions" upon which the action is based were "publicly disclosed" in one of the ways listed in Section 3730(e)(4)(A). *Id.* at 651. If, the Court determines the action was based on public disclosures, it proceeds to the "original source" inquiry. *Id.*

Prior to trial, the District Court held as a matter of law that the information supporting the allegations in Ervin's Complaint was based "upon the public disclosure of allegations or transactions." *See* May 1, 2003 Order at 8. Therefore jurisdiction was proper only if Ervin proved at trial that it fell within the "original source" exception. *See Findley*, 105 F.3d at 690 (D.C. Cir. 1997).

### A. Ervin Presented No Evidence At Trial To Meet Its Burden Of Proving That It Was An Original Source.

The District Court properly recognized that "to qualify as an original source, Ervin must have demonstrated at trial that it had 'direct' and

'independent' knowledge of the fraud and that it 'voluntarily' provided information to the United States." SM at 33; *see also Findley*, 105 F.3d at 690; *Springfield Terminal*, 14 F.3d at 656.[8] In order to be direct, the information must be first-hand knowledge. *Findley*, 105 F.3d at 690. In order to be independent, the information known by the relator cannot depend or rely on public disclosures. *Id.* Therefore, "a person who learns of fraud from a public disclosure can never be an original source." *Id* at 688.

The FCA places the burden on the relator to present evidence at trial sufficient to determine that its allegations were direct and independent. Yet, in this case, neither John Ervin, the relator's principal, nor any other Ervin representative testified at trial as to what first hand knowledge Ervin had and to what extent the information relied on public disclosures. Such evidence is required where the District Court has already found that the allegations in Ervin's Complaint were based on publicly disclosed documents. The lack of testimony from Ervin or its representative is fatal to any original source finding, as it is the only means to determine whether the allegations were direct and independent.

[8] On the opening day of trial, the District Court reiterated that it was Ervin's burden to prove jurisdiction, and specifically that it qualified as an original source under the statute. *See* Tr. 10/29/03 at p. 12 ln. 1-p.16-ln 18.

The only trial evidence cited by the District Court in support of its original source ruling, testimony of HUD OIG Inspectors that the government's 1996 investigation of the loan sales program started after Ervin's *qui tam* filing, sheds no light on whether 1) Ervin had first hand knowledge of any significant information, or 2) the information did not rely on public disclosures. SM at 25-26; 35.[9] Moreover, Ervin's North Central allegations did not surface until September, 1999. They simply could not have been the source of a 1996 government investigation.

The remainder of the District Court's analysis of whether Ervin had direct and independent knowledge is based entirely on arguments of counsel made in prior motions, not on any evidence presented at trial.[10] Indeed, there is a straightforward reason that the District Court failed to cite to a single piece of trial evidence on whether Ervin had "independent" knowledge about the North Central claims. No evidence of independent knowledge was ever presented at trial. None!

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[9] The simple fact that HUD OIG began investigating the loan sale program in response to Ervin's complaints cannot constitute proof by a preponderance of the evidence that Ervin is the "original source" of his allegations. Under the FCA, the government has no discretion. Once a *qui tam* complaint has been filed; it must investigate. 31 U.S.C. § 3730(a)-(b).

[10] In fact, large parts of the Original Source discussion in the Superseding Memorandum are merely cut and pasted from the Court's May 1, 2003 Order. However, none of the factual information cited by the Court was ever presented at trial or subject to cross-examination.

Because Ervin failed to present evidence it was an original source of any of allegations relating to the North Central sale, the District Court lacked subject matter jurisdiction.

### B. The Undisputed Evidence Shows That Ervin Was Not The Original Source Of The Allegations Related To The North Central Sale.

Not only did Ervin fail to prove that it was the original source of the allegations underlying the North Central claim, the evidence shows that the North Central allegations were merely an attempt to piggyback on claims that were already being asserted by HUD in the United States Court of Claims. The genesis of the Court of Claims matter, which predated Ervin's North Central claim by more than a year, was not anything provided by Ervin, but rather by Hamilton's own internal investigation following its discovery of the optimization error.

At the time Ervin filed its initial *qui tam* Complaint, on June 6, 1996, the North Central sale (and any false record associated with it) had not yet occurred. The North Central sale was held on August 8, 1996, two months after the Complaint was filed. Ervin Exh. 77 ¶ 19. Unsurprisingly, the North Central sale was not included in any of the information that Ervin provided to the government with the *qui tam* Complaint and there was no

evidence presented that North Central was part of any governmental investigation arising out of Ervin's *qui tam* disclosures.

To the contrary, the unrefuted testimonial and documentary evidence is that Hamilton discovered that an error in the optimization model in the North Central sale during its preparation for the December, 1996 Midwest loan sale. Tr. 10/31/03 AM at p. 189 ln. 16 – 190 ln. 1; Exh. 77 at ¶ 20. Thereafter, Hamilton thoroughly investigated the cause of the error and self-reported it to HUD within weeks, both in writing and in a meeting with the FHA Comptroller and the FHA Commissioner Retsinas, the head of the loan sales program.[11] At HUD's request, Hamilton then submitted an even more detailed memorandum that ultimately was the basis for the government's termination of Hamilton's contract.

The timeline of events preceding Ervin's assertion of a North Central claim confirms that Ervin was not the original source of those allegations. HUD contracting officer Annette Hancock testified she terminated Hamilton's contract in October 17, 1997 after receiving Hamilton's

[11] There is no evidence that Hamilton's discovery of the error was in any way related to any governmental investigation of the loan sales program. Moreover, Hamilton's investigation and disclosure occurred years before it was served with the qui tam suit in April, 2000.

memorandum, not anything form Ervin. Tr. 10/30/03; p.97 ln 4-19. On March 9, 1998, a year and a half before Ervin filed its Amended Complaint asserting the North Central claim, Hamilton filed suit against HUD in the Court of Federal Claims[12] for money owed to it that had been withheld due to the WOM and North Central optimization errors. On May 27, 1999, the government counterclaimed against Hamilton, eventually filing an amended counterclaim in August 18, 1999 specifically alleging breach of contract, negligence, or negligent misrepresentation arising from the North Central optimization error. *See* May 1, 2003 Order. It was only on September 3, 1999, three weeks after the government's amended counterclaim was filed, that Ervin finally submitted an the First Amended Complaint including the North Central count. The only permissible inference based on the evidence at trial is that the government withheld Hamilton's fees and asserted its counterclaim not because of any information from Ervin, but rather because of the December, 1996 report from Hamilton.

Despite an absence of any evidence that Ervin was the original source of the North Central allegations, the District Court nonetheless found jurisdiction on the ground that Ervin's "original complaint set the government 'on the trail' prompting investigation of possible improprieties

[12] *Hamilton Sec. Adv. Svcs. v. United States*, 98-169C.

involving auctions." SM at 37-38. However, such a sweeping ruling ignores the requirement that a *qui tam* relator plead with particularity and provide the government with specific information related to specific fraudulent actions. *See* Fed.R.Civ.P. 9(b); 31 U.S.C. § 3730(b)(2) (requiring written disclosure at the timing of filing of substantially all material evidence in the relator's possession). Ervin's 1996 *qui tam* Complaint contained detailed allegations about specific fraud alleged to have been committed on particular loan sales. The North Central sale was not one of them. Ervin cannot bootstrap his earlier allegations about other purported misdeeds into a finding that he was the original source of all FCA claims subsequently arising out of the ongoing loan sales program.[13]

The evidence at trial leads only to the conclusion that Ervin learned about the North Central optimization error after it had been publicly disclosed in the Court of Claims filings.[14] In such a case, the case law is clear that Ervin cannot be an "original source" under the statute. *See*

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[13] In any event, Ervin utterly failed to present evidence at trial that it was an original source of any of the allegations in the 1996 Complaint.

[14] That Ervin was not the source of the government's claims in the Court of Claims case is also evidenced by the nature of Ervin's North Central allegations in the First Amended Complaint. Ervin claimed that Hamilton intentionally used the wrong optimization model on the North Central auction to cover-up bid rigging of the WOM auction. No evidence was presented at trial to support this wild theory. In contrast, the government's claims of breach against Hamilton were based directly on the circumstances of the optimization error as detailed in Hamilton's December, 1996 memoranda.

*Findley*, 105 F.3d at 688. The District Court erred in finding jurisdiction over the North Central claim.

### C. The United States Has Argued That Ervin Is Not An Original Source Of The North Central Claim.

The United States has argued that Ervin's optimization claims are jurisdictionally barred. In yet another lawsuit, *Ervin & Associates, Inc. v United States of America*, CA No. 01-1052 (LFO), Ervin sought a declaration that the government's Court of Claims counterclaim was an alternate remedy under the FCA. 31 U.S.C. § 3730(c)(5). In moving to dismiss, the government argued the exact same position advocated by Hamilton here: Ervin's optimization claims were based on publicly disclosed information of which Ervin was not an original source. *See* June 11, 2002 Order at 2.[15]

While the arguments of the United States are not necessarily binding on Ervin as a relator, the North Central claim is brought against Hamilton on behalf of the United States. The government's willingness to argue against its interests and forego the potential of treble damages highlights the lack of jurisdiction under the FCA. The District Court's assertion of jurisdiction has created an anomalous situation in which Hamilton owes a $4.5 million

[15] The Court dismissed Ervin's case on other grounds, without addressing the jurisdictional argument.

judgment for a claim that the government has agreed is jurisdictionally barred by the FCA. As both Hamilton and the government have argued, Ervin was not an original source of the North Central allegations. The District Court's ruling to the contrary was in error.

## III. Ervin Failed To Prove An FCA Violation By A Preponderance Of The Evidence.

Under the FCA, Ervin bears the burden of proving all elements of its case by a preponderance of the evidence. 31 U.S.C. § 3731(c); *Aflatooni*, 163 F.3d at 525. Once jurisdiction is established, the test for FCA liability is (1) whether there was a false or fraudulent claim or statement; (2) made with the requisite scienter; (3) that was material; and (4) that caused the government to pay out money or to forfeit moneys due. *See* 31 U.S.C. §§ 3729(a)(1), (a)(2) and (a)(7); *Harrison v. Westinghouse Savannah River Co.*, 176 F.3d 776, 788 (4th Cir. 1999). In addition to the lack of original source evidence, Ervin failed to meet its burden of proof in two respects: 1) the evidence at trial regarding the North Central sale does not support finding a cognizable reverse false claim was made because no obligation to pay HUD money was concealed, avoided or decreased; and 2) the evidence did not support a finding that Hamilton acted with the scienter required for FCA liability.

### A. The District Court Erred In Finding That A Defendant May Be Liable Under Section 3729(a)(7) For Concealing, Avoiding, Or Decreasing A Third Party's Obligation To Pay The Government.

#### 1. The reverse false claims section of the FCA applies only to a Defendant's obligation to pay the government.

Section 3729(a)(7) imposes false claims liability on one who "knowingly makes, uses, or causes to be made or used, a false record or statement to conceal, avoid, or decrease an obligation to pay or transmit money or property to the Government." 31 U.S.C. § 3729(a)(7). Although a plain reading of the statute suggests that the obligation to pay must be the defendants', the District Court erroneously held that the "obligation" in this case was that owed by the bidders in the North Central sale, who would have been identified on the Bell Labs report, but for the optimization error.

Hamilton has been unable to locate any legal authority, and neither Ervin nor the District Court cited to any, that supports the proposition that a defendant may be liable under Section 3729(a)(7) for incidentally decreasing a third party's obligation to the government. To the contrary, the plain intent of the statute and several authorities strongly suggest Congress intended this provision to target a defendant's reduction of its *own* obligations to the government.

The reverse false claim section was added as part of the 1986 amendments to the FCA to close a loophole that allowed cheats to escape liability even though they had made knowingly false statements to the government to avoid paying money properly owed. In considering the statutory language that would become Section 3729(a)(7), the Senate Committee on the Judiciary addressed itself to resolving "[t]he question whether the False Claims Act covers situations where, by means of false financial statements or accounting reports, a person attempts to defeat or reduce the amount of a claim or potential claim by the United States *against him* . . . ." S. Rep. No. 99-345 (1986), *as reprinted in* 1986 U.S.C.C.A.N. 5266, 5283 (emphasis added). The Committee criticized court opinions that yielded "the result that a person's fraudulent attempt to reduce the amount payable *by him* was considered not to constitute a violation of the False Claims Act." *Id.* (emphasis added). There is no indication in the legislative history that the reverse false claim provision applies to a decrease in the obligations to the government by a third party.

Courts applying the reverse false claims provision have likewise interpreted it in terms of a defendant's own obligation. *Am. Textile Mfrs Inst., Inc. v. The Limited, Inc.*, 190 F.3d 729, 736 (6th Cir. 1999). ("[A] reverse false claim cannot proceed without proof that the defendant made a

false record or statement at a time that the *defendant owed* to the government an obligation sufficiently certain to give rise to an action of debt at common law.") (emphasis added); *See United States v. Q Int'l Courier, Inc.*, 131 F.3d 770, 773 (8th Cir. 1997) ("[I]n order to be subject to the penalties of the False Claims Act, a *defendant must have had a present duty* to pay money or property that was created by a statute, regulation, contract, judgment, or acknowledgment of debt."); *Kennard*, 363 F.3d at 1047 (10th Cir. 2004) (holding that to establish a reverse false claim relators were required to allege that Comstock [the defendant] "submitted false statements or records to conceal, avoid, or decrease that obligation." Similarly, the only reverse false claims case cited by the District Court, *United States v. Pemco Aeroplex, Inc.*, 195 F.3d 1234 (11th Cir. 1999), concerned the defendant's attempt to mislead the government about the value of excess aircraft wings so that it could cheat the government out of fair compensation for the wings to its own benefit. *See* Section III.B.2., *infra*. The reported reverse false claims cases are universal in their focus on whether the *qui tam* defendant had an obligation to the government.

Under the plain meaning of the statute, the legislative history and court precedent, it is an obligation Hamilton may have to the government, and not the bidders' potential obligations, that is relevant. However, in this

case, Hamilton was only obligated to deliver an optimization report to HUD, which it did. Hamilton was not bound to deliver money or property to HUD in the North Central sale and Hamilton's delivery of the optimization results did not decrease an obligation it owed to HUD. The fact that the report could have identified a slate of bidders that would have increased sale revenue by 0.2% does not create an obligation by Hamilton to pay.[16] Accordingly, Hamilton cannot be liable for a reverse false claim.

### 2. The FCA should not apply to cases where no one unfairly benefits from the false record.

The FCA attaches liability not to fraudulent activity, but to false claims for payment resulting from that activity. *United States ex rel. Totten v. Bombardier Corp.*, 286 F.3d 542, 551 (D.C. Cir. 2002). In the usual FCA case, therefore, the relator must produce evidence that the defendants actually submitted false demands for payment, or submitted false records or statements in order to get a false claim paid. *See United States ex rel. Ortega v. Columbia Healthcare, Inc.*, 240 F. Supp. 2d 8, 18 (D.D.C. 2003) (citing *Totten* for the proposition that submission of a false claim for payment must

[16] Indeed, the Court of Claims ruled that Hamilton did not even breach its contract with HUD by presenting an optimization report that was run with bid floors based on revenue, rather than UPB.

be pleaded as an element of an FCA claim). Implicit in the requirement that the defendant request payment is the fact that the defendant aims to profit unfairly to the detriment of the government, by receiving more than is properly owed.

In the reverse false claims context, the defendant benefits by not paying to the government an amount owed for some property or other type of benefit. *See Pemco Aeroplex, Inc.*, 195 F.3d at 1235-36. (because of false statement, defendant paid government $1,500 for aircraft wings worth approximately $2,000,000); *Kennard v. Comstock Res.*, 363 F.3d 1039 (10th Cir. 2004) (false statement allegedly made in order to underpay oil and gas royalties owed); *United States v. Raymond & Whitcomb, Co.*, 53 F. Supp. 2d 436 (S.D.N.Y. 1999) (false certification made so that defendant could use reduced postal rate). Nonetheless, the effect is the same; in each instance, the defendant's benefit is the same amount as the government's loss.

The FCA's treble damage provision is a key element in altering this balance, such that one who makes a false claim to the government is liable thrice over for any improper benefit the claimant may gain. However, where no party receives any benefit from the false record, no FCA liability should attach. *United States ex rel. Lamers v. City of Green Bay*, 168 F.3d 1013 (7th

Cir. 1999) (finding no FCA liability where there was no financial motive to violate regulations).

In this case, while the government may have suffered a "loss," in that it may have received more revenue from the North Central auction had the optimization error not occurred, no party can be fairly said to have profited from this loss. Hamilton had no financial stake in the auction results and did not benefit in any way from the optimization error. Those bidders who were not chosen because of the error at best broke even, neither gaining property they bid on, nor paying for it. And those bidders who were erroneously selected by the model cannot fairly be said to have profited, they bought the mortgages for the full price they offered and HUD accepted.

The FCA was not intended to apply to situations where the defendant does not profit (or at least attempt to profit) from the false statement. The District Court's finding of FCA liability against Hamilton extends the statute to cover situations not contemplated by Congress and unprecedented in the FCA's long history. The District Court's decision should be reversed.

### B. The District Court Erred In Finding That The North Central Bidders' Loan Sale Agreements Created An "Obligation" Under Section 3729(a)(7).

#### 1. The unaccepted bids did not create an "obligation" under Section 3729(a)(7).

Even were this Court to conclude that the FCA permitted liability to be imposed on a defendant for reducing the obligation of a third party, no "obligation" under Section 3729(a)(7) exists in this case. The District Court held that Hamilton was liable for reducing the "obligation" of the bidders who would have been selected as auction winners, but were not due to the optimization error. SM at 52-54. To reach this result, the District Court improperly characterized the contingent "offers" from those bidders as contractual obligations to pay HUD.

Courts construing the term "obligation" under the FCA have found that it requires an existing duty to pay money to the government. *See Q Int'l Courier*, 131 F.3d at 773 (considering the term obligation and holding that "in order to be subject to the penalties of the False Claim Act, a defendant must have had a present duty to pay money or property that was created by a statute, regulation, contract, judgment, or acknowledgment of indebtedness."); *see also Am. Textile*, 190 F.3d at 734. Liability for a reverse false claim cannot be based on a contingent obligation to pay. *Id.*,

190 F.3d at 736 ("a defendant's behavior regarding a contingent obligation cannot engender a reverse false claim action...").

The plaintiff bears the burden of proving that the government was owed a specific, legal obligation at the time that the alleged false record or statement was made, used, or caused to be made or used. *Q Int'l Courier, Inc.*, 131 F.3d at 773-74; *Lamers v. City of Green Bay*, 998 F. Supp. 971, 997 (E.D. Wis. 1998), *aff'd*, 168 F.3d 1013 (7th Cir. 1999). The pertinent obligation must have attached before the defendant made or used the false record or statement. *Am. Textile*, 190 F.3d at 734.

The record in this case is clear that the bidders' offers did not create a contractual obligation before the optimization records were made, and that HUD retained the discretion and ability to reject any of the bids submitted, Tr. 10/31/03 PM at p. 166 ln. 19-23; Tr. 7/20/04 at p. 133 ln. 10-13; Tr. 7/19/04 at p. 31 ln. 19-25. This comports with hornbook auction law, which provides that "where a seller reserves the right to refuse to accept any bid made, a binding sale is not consummated between the seller and the bidder until the seller accepts the bid." 7 Am. Jur 2d. Auctions and Auctioneers § 20 (2004). In this instance, no contract was ever created because HUD never accepted those bids. Accordingly, because any obligation of the bidders to pay would not have not attached until *after* any alleged false

statement made by Hamilton (and in fact never attached at all), no reverse false claim can lie.

### 2. The District Court erred in finding that the bidders had an obligation to pay HUD.

The District Court concluded that the Loan Sale Agreement ("LSA"), a form bid sheet, created an "obligation" under Section 3927(a)(7) between HUD and the highest bidder each sale. SM at 52-54. In support of this position, the District Court cited to 1) a single case, the 11th Circuit's decision in *Pemco Aeroplex* which concerned a contractor's obligation to return government property, and 2) the language in the LSA. However, neither *Pemco Aeroplex* nor the language of the LSA support a finding that the losing bidders had an "obligation" to pay money to the government.

In *Pemco Aeroplex*, a government aircraft maintenance contract required Pemco to submit an inventory schedule to the government and then account for the full value of any excess property. 195 F.3d at 1237. In accounting for certain aircraft wings, Pemco grossly understated the value of the wings so that it could subsequently offer to purchase them at a price far below actual value. As the Eleventh Circuit noted, "Pemco had government property in its possession and a *contractual obligation* to account for the full value of any excess government property by returning that property or otherwise disposing of it in accordance with the government's

instructions."). *Id.* (emphasis added). In reliance on the false inventory schedule, the government agreed to sell Pemco the wings at less than 1% of their actual value. Pemco's misrepresentation of the value of the wings reduced or avoided its obligation to transmit the wings back to the government. Accordingly, Pemco was liable for a reverse false claim under 3729(a)(7) and the Court appropriately rejected Pemco's argument that its offer to purchase the wings did not constitute an "obligation" under the FCA.

The government's relationship with Pemco is fundamentally different than its relationship with the losing bidders in the North Central auction. Pemco had a contractual obligation to return excess property to the government, which it avoided by submitting a false and deceitful inventory schedule. In contrast, the losing bidders had no contract with the government, but rather merely made offers to purchase that were never accepted. As such, the bidders' obligations were contingent, not existing, and cannot serve as the basis for a reverse false claim.

The District Court's reasoning with regard to the LSA is similarly flawed. As a threshold matter, the LSA was never admitted into evidence and is not part of the record of the proceeding. Accordingly, the Court's review and interpretation of the terms of the document is inappropriate and

should be ignored. But, in any event, as the District Court itself recognized, a bidder's obligation to pay under the LSA attached only "if its bid was accepted." Because HUD retained "sole and absolute discretion" to "accept or reject any bids," the obligation to pay could not attach when the offer was made. Indeed, because the offer was never accepted, the bidders never had an obligation to pay.

### C. Hamilton Is Not Liable Under The FCA Because It Did Not Act With The Requisite Scienter.

The False Claims Act only imposes liability for the "knowing" presentation of false claims, statements or records to the government. *See* 31 U.S.C. § 3729(a). The Act defines "knowing" and "knowingly" to mean

> that a person, with respect to information—
> (1) has actual knowledge of the information;
> (2) acts in deliberate ignorance of the truth or falsity of the information; or
> (3) acts in reckless disregard of the truth or falsity of the information,

31 U.S.C. § 3729(b).

Reckless disregard is not a "relaxed" scienter standard. This Court has stated that reckless disregard lies on a continuum between gross negligence and intentional conduct. *United States v. Krizek*, 111 F.3d 934, 941 (D.C. Cir. 1997). It is "a linear extension of gross negligence, a palpable failure to meet the appropriate standard of care." *Id.* Reckless

disregard may be thought of as "an aggravated form of gross negligence" or "gross negligence plus." *Id.* at 941-42; *accord United States ex rel. Aakus v. Dyncorp*, 136 F.3d 676, 682 (10th Cir. 1998); *UMC Elecs. Co. v. United States*, 43 Fed. Cl. 776, 792 n.15 (Fed. Cl. 1999).

The severity of conduct required to meet this standard underscores that innocent mistakes, mere negligence, or even gross negligence are not actionable under the False Claims Act. *Lamers*, 168 F.3d at 1018; *Wang ex rel. United States v. FMC Corp.*, 975 F.2d 1412, 1420-21 (9th Cir. 1992) ("Errors based simply on faulty calculations or flawed reasoning may be excused. . . . Proof of one's mistakes or inabilities is not evidence that one is a cheat. . . . Bad math is no fraud."); *UMC Elecs.*, 43 Fed. Cl. at 794-95. "The Act is concerned with ferreting out 'wrongdoing,' not scientific errors." *Wang,* 975 F.2d at 1421. A defendant's disclosure to the Government of all the facts underlying a claim or statement may show that the defendant had no intent to deceive. *Hagood v. Sonoma County Water Agency*, 81 F.3d 1465, 1478-79 (9th Cir. 1996).

**1. Hamilton's actions do not constitute gross negligence plus under the law of this Circuit.**

This Court's decision in *Krizek* provides the clearest example of the type of behavior encompassed by the "gross negligence plus" or "reckless disregard" standard. There, a physician husband and his wife were found to

have defrauded the government by "upcoding" requests for Medicare and Medicaid reimbursement; that is, reimbursement requests were submitted with treatment codes reflecting lengthier and more involved treatments than patients actually received. *Krizek* 111 F.3d at 936. Dr. Krizek's wife, who prepared and submitted the coded reimbursement requests, submitted requests on several occasions totaling more than 21 hours of patient time in a single day. In at least eleven instances, the reimbursements totaled more than 24 hours. *Id.* at 936-37. The court found Mrs. Krizek acted with "reckless disregard" by 1) completing submissions with little or no factual basis, 2) making no effort to determine how much time the doctor spent with patients, and 3) billing close to or in excess of 24 hours in a single day. *Id.* at 942. The doctor was found to meet the scienter standard because he "utterly failed" to review bills submitted on his behalf. *Id.*

With *Krizek* in mind, a review of the evidence in this case plainly shows that Hamilton did not act with reckless disregard for the falsity of the optimization report. Instead, the record reveals the report was the product of an error of miscommunication which was fully disclosed to HUD as soon as Hamilton discovered and investigated it.

As an initial matter, in contrast to the brazen conduct in *Krizek*, which was repeated on scores of occasions and could have been detected with

minimal effort, the North Central optimization error was a single event whose detection was masked by the sheer size – in excess of $620 million – of the transaction. Indeed, while the *Krizek* court found it significant that the billing requests were greatly inflated, the North Central auction results differed only 0.2% from optimal. Moreover, the highly technical nature of the optimization model, which Hamilton could not independently perform or verify, made discovery of the error difficult.

Hamilton's primary contact with Bell Labs on the WOM sale, Robert Robinson, testified that after consulting with Bell Labs on September 20, 1995, he believed the problem had been fixed and the WOM auction results presented to HUD were within $1 of the perfectly optimal solution. Tr. 10/31/03 PM at p. 211 ln 2-14. This belief was supported by his receipt of an e-mail from Bell Labs scientist and mathematician Sol Schindler representing the results to be such. *Id.* at pp. 202 ln 24 – 203 ln 2; pp. 206 ln 22 – 208 ln 2; Ervin Exh. 99 at Bates No. LUC 001200.

Schindler then represented to Robinson that Bell Labs would permanently correct the problem with the optimization model following the WOM sale. Hamilton's reliance on Bell Labs, an internationally recognized expert in the field, was reasonable. Robinson accepted Schindler's representation and believed the model would be fixed. Tr. 10/31/03 PM at

pp. 204 ln. 16 – 205 ln. 7. True to his word, Schindler created a new UPB model shortly after the WOM sale. Tr. 7/19/04 at p. 48, ln. 7. However, unbeknownst to Robinson and Hamilton, Schindler retained the original revenue model rather than dispose of it.

When the time came to optimize the North Central bids, Rick Wolf, who had no reason to believe that Bell Labs had two different optimization models, instructed Bell Labs to use the model from the WOM sale. Tr. 7/19/04 at pp. 49, ln. 10-13. Because Schindler had a heart attack and was unavailable, the new Bell Lab scientists were also unaware that Schindler had created a new model. *Id.* The Bell Labs staff ran the revenue model rather than the new UPB model. *Id.* This was an "innocent mistake" which is not actionable under the FCA. *Lamers*, 168 F.3d at 1018; *Wang*, 975 F.2d at 1420-21.

Moreover, Hamilton's response upon learning of the error sheds light on Hamilton's lack of intent to defraud the government. When Wolf discovered the bid floor instruction discrepancy in October 1996, Hamilton immediately mobilized an investigation "to get to the bottom of this . . . to report the absolute truth to . . . HUD and . . . to put procedures and protocols in so that this doesn't happen again." Tr. 10/31/03 AM at pp. 221 ln 20 – 222 ln 3. The results of that investigation were reported to FHA

Commissioner Nicolas Retsinas and FHA Controller Kathryn Rock in the December 20, 1996 memorandum. *See* Ervin Exh. 77. Evidence that Hamilton was open with the government about its mistakes "suggests that while [Hamilton] might have been groping for solutions, it was not cheating the government in the effort." *Wang*, 975 F.2d at 1421.

At bottom, had Schindler not been stricken and forced to leave Bell Labs suddenly, there is no evidence to suggest that the revenue optimization model would have been used on the North Central sale. The error was the direct result of Schindler not communicating to his successors that there were two models.

In hindsight, perhaps Hamilton and Bell Labs should have built in redundancy such that the absence of Robinson and Schindler on future loan sales did not result in a lack of communication regarding the state of the optimization model.[17] However, the failure to implement channels of communication does not rise to the level of "an aggravated form of gross

[17] The District Court reads too much into the WOM Post-Auction Review ("PAR"), Hamilton Exhibit 167, contending that Hamilton was obligated to interview Robinson and Schindler in creating the PAR. SM at 44, 45. At trial, no witness testified about the contents of the PAR, which was admitted by the District Court after the trial and over Hamilton's objection. The District Court's conclusions as to what steps should have been taken in creating the PAR is purely speculative. In any event, the WOM PAR was not done until after the North Central sale, so interviews of Robinson and Schindler would not have avoided the North Central error and any inadequacy in the report (which was never even alleged until after trial) plainly does not rise to the level of reckless disregard.

negligence" or "gross negligence plus." *United States ex rel. Ervin & Associates v. Hamilton Securities et al.*, January 7, 2004 Order at 21; *see also Krizek*, 111 F.3d at 941-42; *accord Aakus*, 136 F.3d at 682; *UMC Elecs. Co.*, 43 Fed. Cl. at 792 n.15. The District Court erred in holding otherwise.

### 2. The cases cited by the District Court do not support a finding of reckless disregard against Hamilton.

In support of its ruling that Hamilton acted with reckless disregard for the falsity of the North Central optimization report, the District Court cited to several cases, each of which involved defendants who sought to cheat the government for their own personal benefit. None of these cases support the finding that an unintentional error, like that submitted by Hamilton, can support FCA liability.[18]

In *United States ex rel. Compton v. Midwest Specialists, Inc.*, 142 F.3d 296, 304 (6th Cir. 1998), a manufacturer knowingly provided nonconforming goods under a government contract, claiming it believed that those goods were of the same quality as conforming goods. It was

[18] The District Court cites *Crane Helicopter Servs. v. United States*, 45 Fed. Cl. 410 (Ct. Cl. 1999) for the proposition that the scienter standard of the FCA is met not just where individuals set out to defraud the government, but where they "ignore the obvious warning signs." However, in *Crane*, the court also noted that under the FCA "there must be a showing by the government of more than an innocent mistake or mere negligence." Id. at 434. (quoting *Wang*, 975 F.2d at 1420-21. Indeed, in *Crane,* the court found that the scienter standard had not been met.

undisputed that Midwest Specialists knew it was contractually obligated to perform tests on the brake shoe kits of the Army Jeeps it was providing, but intentionally chose not to so that it could save the expense of the testing. This intentional conduct certainly is not comparable to and does not suggest liability for Hamilton, who had no knowledge that the North Central report was suboptimal or that the incorrect model had been used. Indeed, even the District Court admits in its opinion that Hamilton's most egregious conduct is that it "kn[ew] that it had not consulted the key players involved in the previous sale to ensure that any problems were resolved prior to the North and Central sale...." SM 42. This is a far cry intentionally choosing not to perform required tests on the safety of military equipment to save money.

*Barnes v. United States*, 45 Fed. Appx. 907 (Fed. Cir. 2002), is similarly inapposite. In that case, the United States Court of Appeals for the Federal Circuit held that a contractor showed reckless disregard of the truth where it refused to verify its claim *after* the Defense Contract Audit Agency "put [the defendant] on notice . . . that several items were unfounded." Here, far from ignoring notices from the government about the optimization error, Hamilton uncovered the miscalculation on its own and self-reported it to HUD. Moreover, Bell Labs had informed Robinson that the problem would

be permanently fixed after the WOM sale. Hamilton did not ignore warning signs and had no reason to anticipate the North Central error.

Finally, in *United States v. Cabrera-Diaz*, 106 F. Supp. 2d 234 (D.P.R. 2000) the defendants, a physician and his billing secretary, were found liable under the FCA for submitting false Medicare claims for the provision of anesthesia services. In that case, on hundreds of occasions over a two year period, the defendants inflated claims for reimbursement of anesthesia time by more than 450%. As in *Krizek*, the gross overstatement in the submission of claims resulted in the court finding that the defendants "acted with actual knowledge that the information was false, or hided behind a shield of self-imposed ignorance." Hamilton's actions in conducting the North Central sale, as well as the 0.2% error in the optimization report, are in no way analogous to the fraud committed by Cabrera-Diaz. Hamilton acted in good faith and had no actual knowledge that the North Central bid results were not optimal.

Hamilton's actions simply do not meet the FCA's stringent scienter requirement. In finding that Hamilton's actions were as culpable as the defendants' in *Krizek*, the District Court misapplied this Court's precedent. Hamilton actions did not constitute "gross negligence plus" and the District Court's decision should therefore be reversed.

## IV. The District Court Should Have Dismissed This Action Based On Ervin's Violation Of The FCA's Seal Provision.

The FCA requires that a *qui tam* "complaint shall be filed in camera, shall remain under seal for at least sixty days, and shall not be served on the defendant until the court so orders." 31 U.S.C. §3730(b)(2). After filing of the complaint, any public discussion by the relator of the existence or nature of the *qui tam* allegations while the complaint remains under seal constitutes a clear violation of the seal provision. *See United States ex rel. Lujan*, 67 F.3d 242, 244 (9th Cir. 1995).

Congress included the sealing requirement as part of its 1986 revision of the FCA. The Senate Committee Report noted that "sealing the initial private civil false claims complaint protects both the government and the defendant's interests without harming those of the private relator." S.Rep. No. 99-345 (1986), *as reprinted* in 1986 U.S.C.C.A.N. 5266, 5289. The sixty-day sealing period (and any extensions thereafter) allows the government an opportunity to determine both if the suit involves matters the Government is already investigating and whether it is in the government's interest to intervene and take over the civil action. *See e.g., United States ex rel. Pilon v. Martin Marietta Corp.*, 60 F.3d 995, 999 (2d Cir. 1995); *United States v. Fiske*, 968 F. Supp. 1347, 1350 (E.D. Ark. 1997).

As explained by the FCA's legislative history, Congress added the seal provision for multiple purposes, including the concern that a *qui tam* claim might overlap with or tip off a defendant to pending criminal investigations, and to prevent defendants from having to answer complaints without knowing whether the government or relators would pursue the litigation. *See Pilon*, 60 F.3d at 999 (citing S. Rep. No. 99-345 (1986) *as reprinted in* 1986 U.S.C.C.A.N 5266, 5288-89); *United States ex rel. Erickson v. Am. Inst. of Biological Scis.*, 716 F. Supp. 908, 912 (E.D. Va. 1989); *Fiske*, 968 F. Supp. at 1350.

Courts have recognized that another interest protected by the seal provision is the shielding a defendant from unnecessary or premature damages to its reputation from unfounded public accusations. *Erickson*, 716 F. Supp. at 912. As explained by the court in *Pilon*, "a defendant's reputation is protected when a meritless *qui tam* action is filed because the public will know that the government had an opportunity to review the claims but elected not to pursue them." 60 F.3d at 999. When a relator violates the seal provision, publication of the potentially mitigating effects of the Government's decision not to intervene are pre-empted. *See id.*

While the appropriate sanction for violating the FCA seal provision appears to be an issue of first impression for this Court, other federal courts

have ruled that where a relator's violation of the seal provision "irreversibly frustrate[s] the congressional goals," then the court should dismiss the action. *See United States ex rel. Windsor v. Dynacorp, Inc.*, 895 F. Supp. 844, 848 (E.D. Va. 1995); *Erickson*, 716 F. Supp. at 912. This serious remedy is appropriate because a party may not benefit from a statute that it does not properly invoke. *See Erickson*, 716 F. Supp. at 911. ("In general, a party pursuing a statutory remedy must comply with all the procedures the statute mandates.") (citing *United States ex rel. Texas Portland Cement Co. v. McCord*, 223 U.S. 157, 162, 58 L. Ed. 893, 34 S. Ct. 550 (1913)). The courts' strict enforcement of the 31 U.S.C. §3730(b)(2) furthers the specific purposes underlying the seal requirement. *See United States ex rel. Mikes v. Straus*, 931 F. Supp. 248, 260 (S.D.N.Y.) (quoting *Pilon*, 60 F.3d at 996).

For example, in *Pilon*, the relator failed to file the complaint under seal and then discussed its substance with a local reporter, who then published a newspaper article about the allegations. The court found these acts "incurably frustrated the statutory objectives" because the government was not notified of the action, the defendants did not know who would prosecute the claim, and both faced the consequences of the premature publication of the allegations. *Pilon*, 60 F.3d at 999.

Similarly, in *Erickson*, the court found that Congress's goals were "incurably frustrated" by the relator's failure to file his complaint under seal. 716 F. Supp. at 912. As in *Pilon*, the relator's failure to file under seal could not be cured because the government could not conduct a closed investigation into the claim, the defendant did not know who would prosecute the claims, and the defendant's reputation was jeopardized by the public disclosure of the complaint. *See id.*

In *Lujan*, the relator filed her complaint under seal, but then discussed the existence and nature of her complaint in very general terms to the Los Angeles Times. *Lujan*, 67 F.3d at 247. The District Court dismissed the action, noting that it was impossible to measure the effect of news reports on the investigation and recognizing the harm the defendant may suffer through premature disclosure of the unsealed allegations. In reviewing the dismissal and then remanding, the Ninth Circuit set forth a balancing test for determining whether violation of the seal provision merited dismissal. The Court in *Lujan* identified three factors that should be considered when a seal violation in discovered: 1) the prejudice to the government; 2) the nature of the sealing violation; and 3) the presence or absence of willfulness or bad faith by the relator.

Although the record below is silent as to prejudice to the government created by Ervin's violation of the seal provision, the nature of Ervin's violation and the bad faith in which it was made are fully documented. It is plain that Ervin engaged in a pre-meditated scheme to flout the seal requirement. On the day before filing the *qui tam* case, Ervin filed an unsealed *Bivens* lawsuit that included allegations nearly verbatim to those in the *qui tam* suit. Then, under the guise of discussing the *Bivens* case, Ervin spoke repeatedly to the press about the allegations while the *qui tam* remained under seal. These discussions led directly to newspaper and national magazine articles that further publicized Ervin's claims of bid rigging and alleged use of insider information by those involved in the loan sales while the *qui tam* action remained under seal. As set forth below, Ervin's bad faith intent is plain and the District Court erred in failing to sanction Ervin's action by dismissing the Complaint.

### A. The Filing Of The *Bivens* Complaint Incurably Frustrated The Seal Provision By Giving Ervin A Means To Disclose The Allegations In The *Qui Tam* Complaint.

Ervin attempted to circumvent the FCA seal requirement by filing the unsealed *Bivens* Complaint, *Ervin and Assocs. v. Helen Dunlap,* Case no. 1:96CV01253, just one day before filing the *qui tam* Complaint. Many of Ervin's *qui tam* allegations completely overlapped with those in the *Bivens*

Complaint. Indeed, twenty-nine substantive paragraphs in the *Bivens* Complaint are substantially identical to paragraphs in the *qui tam* Complaint. *See* Hamilton's comparison of the two Complaints, filed as Exh. 4 to Hamilton's Motion to Dismiss or, in the Alternative, Motion for Summary Judgment ("May 23, 2003 Motion"). In marked contrast to the general description of the *qui tam* allegations reported to the press in *Lujan*, Ervin published verbatim allegations in both the *qui tam* and *Bivens* Complaints.

Moreover, Ervin's intent in filing the *Bivens* Complaint was clear. Ervin sought to pressure the government to act and to smear Hamilton and the loan sales program. To this end, it used the *Bivens* Complaint as subterfuge to discuss openly the sealed allegations in the *qui tam* Complaint. The timing of the filing of the *Bivens* action, made with full knowledge that the same allegations would be filed under seal the next day, makes plain that Ervin's goal was to evade and exploit a perceived loophole in the seal provision. The willful use of a companion lawsuit to publicize allegations required to be sealed is a more serious violation than the relators' failure to file under seal in *Pilon* and *Erickson*.

Ervin used the cover of the *Bivens* action to air his *qui tam* allegations through the media. On October 28, 1996, in a telephone conversation with Ed Pound of *U.S. News & World Report*, Ervin discussed the "[IG's]

investigating two areas—whether the note sales are fixed and whether they broke procurement laws to make it possible in awarding contract to Fitts." *See* October 28, 1996 EIS Record of Conversation, filed as Exh. 3 to May 23, 2003 Motion. Ervin's internal business record of the conversation states:

> John [Ervin] said both of theses claims were made in our law suit and Helen Dunlap motion for enlargement of time states that they were investigating our wide-ranging claims. John said he cannot believe Williams & Connolly would not have put that under seal, but it helps us that they didn't.[19]

This admission that the *Bivens* suit allowed Ervin to talk openly about the *qui tam* allegations is undisputed evidence that Ervin knowingly abused the seal provision of the FCA by filing the substantially similar Complaint.

Ervin's discussion of his allegations against Hamilton and the loan sales program contributed to the *U.S. News & World Report* magazine article, "Of Contacts and Confidence: Asking questions about billion-dollar deals." Published only months after the "sealed" filing of the *qui tam* Complaint, the article echoed Ervin's allegations of bid rigging and insider information. As discussed more thoroughly in Section B, *infra*, Ervin repeatedly discussed the development of the story with authors Tim Ito and Ed Pound.

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[19] This Ervin record also demonstrates Ervin's complete understanding of the significance of filing matters under seal.

There can be no question that Ervin intentionally created the overlapping allegations in the two Complaints and used it a tactical advantage to attempt to circumvent the FCA seal provision. In a conversation with Bill Richbourg of HUD, "John [Ervin] said that hopefully with this much tighter Complaint against Hamilton and Dunlap. We will get some attention." [sic] *See* EIS Record of Conversation at 4, filed as Exh 26 filed to May 23, 2003 Motion. When asked in his deposition about this conversation, John Ervin claimed that he was referring to the *Bivens* Complaint - - even though Hamilton was not a defendant in the *Bivens* action. *See* Ervin Depo. pg. 672 ln. 20 - 673, line 17.; filed as Exh. 27 to May 23, 2003 Motion.

Because Ervin violated the FCA's seal provision with the *Bivens* Complaint, the public learned of the substance of the *qui tam* allegations years before the government's decision not to intervene. *See Pilon*, 60 F.3d at 999. Indeed, Hamilton did not have the opportunity to formally challenge Ervin's allegations until nearly four years later. The allegations in the *Bivens* action evaded and "incurably frustrated" the FCA seal provision. The District Court should have dismissed the Complaint based on Ervin's bad faith actions. *See Erickson*, 712 F. Supp. at 912.

### B. Ervin's Communications About The *Qui Tam* Allegations While The Suit Was Under Seal Warranted Dismissal.

The purpose of the FCA is to bring fraud to the attention of the government, not reporters. *See Lujan*, 67 F.3d at 245. Yet, the District Court failed to sanction Ervin despite undisputed evidence that Ervin publicized his allegations to the media within weeks of filing the *qui tam* action. Ervin's business records revealed that John Ervin discussed the allegations with Tim Ito and Ed Pound of *U.S. News and World Report* starting August 2, 1996 (within sixty days from the filing of the *qui tam* Complaint). EIS Conversation Report dated 8/21/96, filed as Exh. 29 to May 23, 2003 Motion. Between August and October, 1996, Ervin communicated with the *U.S. News & World Report* writers over twenty times before the "Of Contracts and Confidence" article was published. *See id.* Ervin's telephone conversation records provide brief descriptions of the topics discussed, including alleged loan sales bid rigging and purported fraud in contracting, both of which were bases for Ervin's original and amended *qui tam* Complaints.[20] *See id.*

On November 12, 1997, when the *qui tam* Complaint was still under seal, John Ervin provided detailed analysis of a post-closing memorandum

[20] Hamilton was not found liable in connection with any of these allegations.

on the Single Family Note Sale Number 1, a loan sale conducted by HUD with Hamilton's assistance, to Washington Times reporter, George Archibald. *See* Ervin Letter to George Archibald dated 11/12/97, filed as Exh. 30 to May 23, 2003 Motion. In the letter, Ervin wrote,

> Perhaps the most questionable item is the BCGS bid on the reoffering. Despite an announced floor of 74% (Attachment 3) to all bidders in the reoffering package, BCGS bid 73.11% which was just one one-hundredth of one percent (0.01%) over the 73.1% "value to the government" as described on page 2. This "value to the government" should not have been disclosed to any bidders prior to the bid.

This statement is nearly identical to a paragraph in the First Amended *Qui Tam* Complaint.

> On November 6, 1995, Hamilton re-offered the remaining 5,402 non-performing assets. The October 31, 1995 re-offering memorandum specifically stated that "FHA has established a floor price for the portfolio of 5,402 mortgages equal to 74% of the unpaid principal balance of the mortgages being offered." Despite this fact, BGO Team submitted a bid of 73.11% for 3,111 of the loans. This bid which was .89% lower than the published bid floor, beat the actual bid floor imposed by OMB by only one one-hundredth of a percent (0.01%). The only possible explanation for the BGO Team decision to bid 73.11% with confidence is that Hamilton informed BlackRock that the actual bid floor required was not the 74.00% it had publicly indicated, but only 73.1%.

*See* First Amended *Qui Tam* Complaint at ¶123. The letter to Archibald is perhaps the starkest evidence that Ervin intentionally and flagrantly abused the seal provision through his communication with the media.

The evidence presented to the District Court below proved that Ervin repeatedly communicated with multiple journalists about the allegations in the *qui tam* Complaint while it was under seal. Ervin's premeditated timing of the filing of the *Bivens* action and his willful efforts to evade the FCA seal provision deserved sanction. Hamilton is unaware of any case in which a *qui tam* relator has engage to such calculated steps to publicize what are legally required to be sealed allegations. Dismissal of the *qui tam* action was merited and the District Court erred in failing to do so.

## CONCLUSION

For all of the foregoing reasons, this Court should reverse the District Court's judgment for Ervin on Count IX of the Second Amended Complaint and enter judgment in Hamilton's favor.

Respectfully submitted,

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## CERTIFICATE OF SERVICE

I, Michael McManus, Counsel for Appellants The Hamilton Securities Group, Inc. and Hamilton Securities Advisory Services, Inc. hereby certify that copies of the Brief for Appellant were served via U.S. mail, postage prepaid, this 12th day of August, 2005, on the following:

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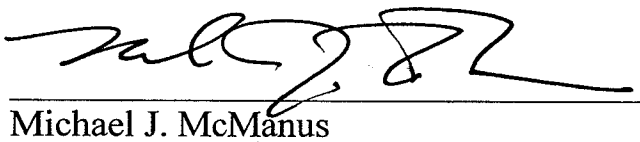
## CERTIFICATE OF COMPLIANCE WITH RULE 32(a)

Pursuant to Federal Rule of Appellate Procedure 32(a) and Circuit Rule of Appellate Procedure 32 (a)[1]-[2], the undersigned herby certifies that):

1. This brief complies with the type-volume limitations of Fed. Rule App. P. 32(a)(7)(B) because, exclusive of the exempted portions of the brief, this brief includes 13,598 words.

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using Microsoft Word 2002 in Times New Roman 14 point font.



Michael J. McManus
Attorney for Appellant
August 12, 2005

# ADDENDUM – STATUTES & REGULATIONS

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TITLE 28. JUDICIARY AND JUDICIAL PROCEDURE
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28 USCS § 1291 (2005)

§ 1291. Final decisions of district courts

The courts of appeals (other than the United States Court of Appeals for the Federal Circuit) shall have jurisdiction of appeals from all final decisions of the district courts of the United States, the United States District Court for the District of the Canal Zone, the District Court of Guam, and the District Court of the Virgin Islands, except where a direct review may be had in the Supreme Court. The jurisdiction of the United States Court of Appeals for the Federal Circuit shall be limited to the jurisdiction described in sections 1292(c) and (d) and 1295 of this title.

UNITED STATES CODE SERVICE

TITLE 28. JUDICIARY AND JUDICIAL PROCEDURE
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CHAPTER 85. DISTRICT COURTS; JURISDICTION

28 USCS § 1331 (2005)

§ 1331. Federal question

The district courts shall have original jurisdiction of all civil actions arising under the Constitution, laws, or treaties of the United States.

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TITLE 31. MONEY AND FINANCE
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CHAPTER 37. CLAIMS
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31 USCS § 3729 (2005)

§ 3729. False claims

(a) Liability for certain acts [Caution: For inflation-adjusted civil monetary penalties, see 28 CFR 85.3.]. Any person who--

(1) knowingly presents, or causes to be presented, to an officer or employee of the United States Government or a member of the Armed Forces of the United States a false or fraudulent claim for payment or approval;

(2) knowingly makes, uses, or causes to be made or used, a false record or statement to get a false or fraudulent claim paid or approved by the Government;

(3) conspires to defraud the Government by getting a false or fraudulent claim allowed or paid;

(4) has possession, custody, or control of property or money used, or to be used, by the Government and, intending to defraud the Government or willfully to conceal the property, delivers, or causes to be delivered, less property than the amount for which the person receives a certificate or receipt;

(5) authorized to make or deliver a document certifying receipt of property used, or to be used, by the Government and, intending to defraud the Government, makes or delivers the receipt without completely knowing that the information on the receipt is true;

(6) knowingly buys, or receives as a pledge of an obligation or debt, public property from an officer or employee of the Government, or a member of the Armed Forces, who lawfully may not sell or pledge the property; or

(7) knowingly makes, uses, or causes to be made or used, a false record or statement to conceal, avoid, or decrease an obligation to pay or transmit money or property to the Government, is liable to the United States Government for a civil penalty of not less than $ 5,000 and not more than $ 10,000, plus 3 times the amount of damages which the Government sustains because of the act of that person, except that if the court finds that--

(A) the person committing the violation of this subsection furnished officials of the United States responsible for investigating false claims violations with all information known to such person about the violation within 30 days after the date on which the defendant first obtained the information;

(B) such person fully cooperated with any Government investigation of such violation;

and

(C) at the time such person furnished the United States with the information about the violation, no criminal prosecution, civil action, or administrative action had commenced under this title with respect to such violation, and the person did not have actual knowledge of the existence of an investigation into such violation; the court may assess not less than 2 times the amount of damages which the Government sustains because of the act of the person. A person violating this subsection shall also be liable to the United States Government for the costs of a civil action brought to recover any such penalty or damages.

(b) Knowing and knowingly defined. For purposes of this section, the terms "knowing" and "knowingly" mean that a person, with respect to information--

(1) has actual knowledge of the information;

(2) acts in deliberate ignorance of the truth or falsity of the information; or

(3) acts in reckless disregard of the truth or falsity of the information, and no proof of specific intent to defraud is required.

(c) Claim defined. For purposes of this section, "claim" includes any request or demand, whether under a contract or otherwise, for money or property which is made to a contractor, grantee, or other recipient if the United States Government provides any portion of the money or property which is requested or demanded, or if the Government will reimburse such contractor, grantee, or other recipient for any portion of the money or property which is requested or demanded.

(d) Exemption from disclosure. Any information furnished pursuant to subparagraphs (A) through (C) of subsection (a) shall be exempt from disclosure under section 552 of title 5.

(e) Exclusion. This section does not apply to claims, records, or statements made under the Internal Revenue Code of 1986.

UNITED STATES CODE SERVICE

TITLE 31. MONEY AND FINANCE
SUBTITLE III. FINANCIAL MANAGEMENT
CHAPTER 37. CLAIMS
SUBCHAPTER III. CLAIMS AGAINST THE UNITED STATES GOVERNMENT

31 USCS § 3730 (2005)

§ 3730. Civil actions for false claims

(a) Responsibilities of the Attorney General. The Attorney General diligently shall investigate a violation under section 3729. If the Attorney General finds that a person has violated or is violating section 3729, the Attorney General may bring a civil action under this section against the person.

(b) Actions by private persons.

(1) A person may bring a civil action for a violation of section 3729 for the person and for the United States Government. The action shall be brought in the name of the Government. The action may be dismissed only if the court and the Attorney General give written consent to the dismissal and their reasons for consenting.

(2) A copy of the complaint and written disclosure of substantially all material evidence and information the person possesses shall be served on the Government pursuant to Rule 4(d)(4) of the Federal Rules of Civil Procedure. The 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. The Government may elect to intervene and proceed with the action within 60 days after it receives both the complaint and the material evidence and information.

(3) The Government may, for good cause shown, move the court for extensions of the time during which the complaint remains under seal under paragraph (2). Any such motions may be supported by affidavits or other submissions in camera. The defendant shall not be required to respond to any complaint filed under this section until 20 days after the complaint is unsealed and served upon the defendant pursuant to Rule 4 of the Federal Rules of Civil Procedure.

(4) Before the expiration of the 60-day period or any extensions obtained under paragraph (3), the Government shall--

(A) proceed with the action, in which case the action shall be conducted by the Government; or

(B) notify the court that it declines to take over the action, in which case the person bringing the action shall have the right to conduct the action.

(5) When a person brings an action under this subsection, no person other than the Government may intervene or bring a related action based on the facts underlying the

pending action.

(c) Rights of the parties to qui tam actions.

(1) If the Government proceeds with the action, it shall have the primary responsibility for prosecuting the action, and shall not be bound by an act of the person bringing the action. Such person shall have the right to continue as a party to the action, subject to the limitations set forth in paragraph (2).

(2) (A) The Government may dismiss the action notwithstanding the objections of the person initiating the action if the person has been notified by the Government of the filing of the motion and the court has provided the person with an opportunity for a hearing on the motion.

(B) The Government may settle the action with the defendant notwithstanding the objections of the person initiating the action if the court determines, after a hearing, that the proposed settlement is fair, adequate, and reasonable under all the circumstances. Upon a showing of good cause, such hearing may be held in camera.

(C) Upon a showing by the Government that unrestricted participation during the course of the litigation by the person initiating the action would interfere with or unduly delay the Government's prosecution of the case, or would be repetitious, irrelevant, or for purposes of harassment, the court may, in its discretion, impose limitations on the person's participation, such as--

(i) limiting the number of witnesses the person may call;

(ii) limiting the length of the testimony of such witnesses;

(iii) limiting the person's cross-examination of witnesses; or

(iv) otherwise limiting the participation by the person in the litigation.

(D) Upon a showing by the defendant that unrestricted participation during the course of the litigation by the person initiating the action would be for purposes of harassment or would cause the defendant undue burden or unnecessary expense, the court may limit the participation by the person in the litigation.

(3) If the Government elects not to proceed with the action, the person who initiated the action shall have the right to conduct the action. If the Government so requests, it shall be served with copies of all pleadings filed in the action and shall be supplied with copies of all deposition transcripts (at the Government's expense). When a person proceeds with the action, the court, without limiting the status and rights of the person initiating the action, may nevertheless permit the Government to intervene at a later date upon a showing of good cause.

(4) Whether or not the Government proceeds with the action, upon a showing by the Government that certain actions of discovery by the person initiating the action would interfere with the Government's investigation or prosecution of a criminal or civil matter arising out of the same facts, the court may stay such discovery for a period of not more than 60 days. Such a showing shall be conducted in camera. The court may extend the 60-day period upon a further showing in camera that the Government has pursued the criminal or civil investigation or proceedings with reasonable diligence and any proposed discovery in the civil action will interfere with the ongoing criminal or civil investigation or proceedings.

(5) Notwithstanding subsection (b), the Government may elect to pursue its claim through any alternate remedy available to the Government, including any administrative proceeding to determine a civil money penalty. If any such alternate remedy is pursued in

another proceeding, the person initiating the action shall have the same rights in such proceeding as such person would have had if the action had continued under this section. Any finding of fact or conclusion of law made in such other proceeding that has become final shall be conclusive on all parties to an action under this section. For purposes of the preceding sentence, a finding or conclusion is final if it has been finally determined on appeal to the appropriate court of the United States, if all time for filing such an appeal with respect to the finding or conclusion has expired, or if the finding or conclusion is not subject to judicial review.

(d) Award to qui tam plaintiff.

(1) If the Government proceeds with an action brought by a person under subsection (b), such person shall, subject to the second sentence of this paragraph, receive at least 15 percent but not more than 25 percent of the proceeds of the action or settlement of the claim, depending upon the extent to which the person substantially contributed to the prosecution of the action. Where the action is one which the court finds to be based primarily on disclosures of specific information (other than information provided by the person bringing the action) relating to allegations or transactions in a criminal, civil, or administrative hearing, in a congressional, administrative, or Government [General] Accounting Office report, hearing, audit, or investigation, or from the news media, the court may award such sums as it considers appropriate, but in no case more than 10 percent of the proceeds, taking into account the significance of the information and the role of the person bringing the action in advancing the case to litigation. Any payment to a person under the first or second sentence of this paragraph shall be made from the proceeds. Any such person shall also receive an amount for reasonable expenses which the court finds to have been necessarily incurred, plus reasonable attorneys' fees and costs. All such expenses, fees, and costs shall be awarded against the defendant.

(2) If the Government does not proceed with an action under this section, the person bringing the action or settling the claim shall receive an amount which the court decides is reasonable for collecting the civil penalty and damages. The amount shall be not less than 25 percent and not more than 30 percent of the proceeds of the action or settlement and shall be paid out of such proceeds. Such person shall also receive an amount for reasonable expenses which the court finds to have been necessarily incurred, plus reasonable attorneys' fees and costs. All such expenses, fees, and costs shall be awarded against the defendant.

(3) Whether or not the Government proceeds with the action, if the court finds that the action was brought by a person who planned and initiated the violation of section 3729 upon which the action was brought, then the court may, to the extent the court considers appropriate, reduce the share of the proceeds of the action which the person would otherwise receive under paragraph (1) or (2) of this subsection, taking into account the role of that person in advancing the case to litigation and any relevant circumstances pertaining to the violation. If the person bringing the action is convicted of criminal conduct arising from his or her role in the violation of section 3729, that person shall be dismissed from the civil action and shall not receive any share of the proceeds of the action. Such dismissal shall not prejudice the right of the United States to continue the action, represented by the Department of Justice.

(4) If the Government does not proceed with the action and the person bringing the action conducts the action, the court may award to the defendant its reasonable attorneys'

fees and expenses if the defendant prevails in the action and the court finds that the claim of the person bringing the action was clearly frivolous, clearly vexatious, or brought primarily for purposes of harassment.

(e) Certain actions barred.

(1) No court shall have jurisdiction over an action brought by a former or present member of the armed forces under subsection (b) of this section against a member of the armed forces arising out of such person's service in the armed forces.

(2) (A) No court shall have jurisdiction over an action brought under subsection (b) against a Member of Congress, a member of the judiciary, or a senior executive branch official if the action is based on evidence or information known to the Government when the action was brought.

(B) For purposes of this paragraph, "senior executive branch official" means any officer or employee listed in paragraphs (1) through (8) of section 101(f) of the Ethics in Government Act of 1978 (5 U.S.C. App.).

(3) In no event may a person bring an action under subsection (b) which is based upon allegations or transactions which are the subject of a civil suit or an administrative civil money penalty proceeding in which the Government is already a party.

(4) (A) No court shall have jurisdiction over an action under this section based upon the public disclosure of allegations or transactions in a criminal, civil, or administrative hearing, in a congressional, administrative, or Government [General] Accounting Office report, hearing, audit, or investigation, or from the news media, unless the action is brought by the Attorney General or the person bringing the action is an original source of the information.

(B) For purposes of this paragraph, "original source" means an individual who has direct and independent knowledge of the information on which the allegations are based and has voluntarily provided the information to the Government before filing an action under this section which is based on the information.

(f) Government not liable for certain expenses. The Government is not liable for expenses which a person incurs in bringing an action under this section.

(g) Fees and expenses to prevailing defendant. In civil actions brought under this section by the United States, the provisions of section 2412(d) of title 28 shall apply.

(h) Any employee who is discharged, demoted, suspended, threatened, harassed, or in any other manner discriminated against in the terms and conditions of employment by his or her employer because of lawful acts done by the employee on behalf of the employee or others in furtherance of an action under this section, including investigation for, initiation of, testimony for, or assistance in an action filed or to be filed under this section, shall be entitled to all relief necessary to make the employee whole. Such relief shall include reinstatement with the same seniority status such employee would have had but for the discrimination, 2 times the amount of back pay, interest on the back pay, and compensation for any special damages sustained as a result of the discrimination, including litigation costs and reasonable attorneys' fees. An employee may bring an action in the appropriate district court of the United States for the relief provided in this subsection.

UNITED STATES CODE SERVICE

TITLE 31. MONEY AND FINANCE
SUBTITLE III. FINANCIAL MANAGEMENT
CHAPTER 37. CLAIMS
SUBCHAPTER III. CLAIMS AGAINST THE UNITED STATES GOVERNMENT

§ 3731. False claims procedure

(a) A subpena [subpoena] requiring the attendance of a witness at a trial or hearing conducted under section 3730 of this title may be served at any place in the United States.

(b) A civil action under section 3730 may not be brought--
(1) more than 6 years after the date on which the violation of section 3729 is committed, or
(2) more than 3 years after the date when facts material to the right of action are known or reasonably should have been known by the official of the United States charged with responsibility to act in the circumstances, but in no event more than 10 years after the date on which the violation is committed,

whichever occurs last.

(c) In any action brought under section 3730 the United States shall be required to prove all essential elements of the cause of action, including damages, by a preponderance of the evidence.

(d) Notwithstanding any other provision of law, the Federal Rules of Criminal Procedure, or the Federal Rules of Evidence, a final judgment rendered in favor of the United States in any criminal proceeding charging fraud or false statements, whether upon a verdict after trial or upon a plea of guilty or nolo contendere, shall estop the defendant from denying the essential elements of the offense in any action which involves the same transaction as in the criminal proceeding and which is brought under subsection (a) or (b) of section 3730.