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DEAL OR NO DEAL? WHY STATES ARE AND SHOULD CONTINUE REJECTING THE FEDERAL MANDATE ON STATE FALSE CLAIMS ACTS

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States have been debating the merits of enacting new state False Claims Acts (FCAs), or broadening existing ones, largely in response to a federal mandate included in the 2005 federal Deficit Reduction Act. The 2005 mandate dictates that to have a federally qualified FCA, the state must have a whistleblower provision targeted at Medicaid-related fraud that is at least as generous to whistleblowers as the federal civil FCA, which gives the whistleblowers up to 30% of recoveries. If a state enacts such a false claims act, the federal government will give states 10% more of the awards in cases brought under those laws.

A few states quickly passed laws to meet these standards, but most have taken a more careful and cautious look. These states want to know if the federal "deal" is worth it, both financially and in their ability to fight and deter fraud. To date, most states have not adopted these changes. This paper explains why this decision is sound from the perspectives of both economics and public policy.

FCA Enforcement and Compliance

Federal and state FCAs have a specific purpose: to place harsh economic punishments on those who defraud governments or submit broadly defined "false claims." Their penal measures can triple damages, impose up to $11,000 in fines per violation and require defendants to pay legal fees. Further, a defendant found to have violated the FCA can be foreclosed from doing business with the government. FCA enforcement has been economically successful, recovering $27.2 billion for federal and state governments from 1986 through 2010.

Integral to this success has been fostering a private enforcement network. Businesses, non-profits and others who receive government funds often have state-of-the-art compliance programs designed to stop, identify, and expose fraud within their ranks. Governments rely on these public-private partnerships because they enhance the effectiveness of government anti-fraud resources and stop more potential fraud than governments could on their own. In recognition of this fact, if an entity identifies fraud, self-reports, and rights the wrong committed, it will receive reduced penalties. Compliance programs can reduce penalties up to 95%, so there is a strong financial incentive for companies to "do the right thing."[1]

Further, the federal government has actively encouraged and supported thorough compliance programs for Medicare and Medicaid expenses. The Department of Health and Human Services Office of the Inspector General publishes Compliance Guidance Programs for establishing successful compliance programs for hospitals, pharmaceutical manufacturers, nursing facilities, and small physician offices.[2] Strong FCA compliance programs in the health care arena are now the norm.

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[1] *See* James F. Gunn, Evan R. Goldfarb & J. Stuart Showalter, *Creating a Corporate Compliance Program: Steps to a Program that Reinforces Mission and Protects the Organization*, Health Progress May-June 1998, at 61.

[2] *See, e.g.,* OIG Compliance Program Guidance for Hospitals, 63 Fed. Reg. 8987, 8993 (Feb. 23, 1998); OIG Compliance Program Guidance for Pharmaceutical Manufacturers, 68 Fed. Reg. 23,731 (May 5, 2003); OIG Compliance Program Guidance for Nursing Facilities, 65 Fed. Reg. 14,289, 14,289 (Mar. 16, 2000).

Private individuals also help with FCA enforcement. Employees, for example, are supposed to report a perceived fraud internally. If a business or other such entity fails to stop the alleged fraud, however, the FCA provides the person with a private right of action to "blow the whistle" on the alleged fraud. These are called "qui tam" suits. There are requirements for who can file such a claim, including that the whistleblower must be the "original source" of the information that gave rise to the FCA claim. The whistleblower first files the claim under seal so that governments can evaluate the allegations and, if merited, join the lawsuit. Should the whistleblower's suit result in an award, the federal FCA authorizes awarding the whistleblower up to 30% of the federal government's recovery. This monetary incentive can reach tens of millions of dollars.[3]

The 2005 federal mandate becomes relevant when the award covers both federal and state funds, as with FCA cases over Medicaid fraud. If a state does not have an FCA or has an FCA without a whistleblower provision, the state keeps the entire award that corresponds to its share of the recovery and the whistleblower is paid entirely out of the federal government's share. But, if a state has a whistleblower incentive akin to the 2005 federal mandate, the state pays the whistleblower out of its share in addition to what the whistleblower receives from the federal government.

The Scope and Cost of False Claims Act Abuse

Some contingency fee lawyers whose practices involve recruiting and filing FCA claims have abused this private right of action. Their goal is to maximize their own fees, even at the expense of fighting fraud. The abuse is made possible by the fact that even when governments decline to intervene in their cases, the contingency fee lawyers can still pursue the FCA claims on behalf of the private plaintiffs. They, therefore, can use the threat of harsh FCA penalties to pressure defendants to settle even meritless claims. This type of abuse, which has increased in recent years, goes to the core of the controversy over the federal mandate to give whistleblowers more money.

The Scope of False Claims Act Abuse

The Department of Justice statistics demonstrate the extent of this abuse. Of all the privately generated FCA claims since 1986, the Department has intervened in only 20% of them. These 20% of cases, though, account for nearly all – $17.6 billion of the $18.1 billion – of the funds recovered through private FCA actions.[4]

The other 80% of privately generated FCA claims are generally considered meritless. There often is no hint of any actual fraud or wrongdoing. The government has not been cheated. Rather, these suits tend to focus on minor issues.[5] For example, in *United States ex rel. Dallas-Fort Worth Internat'l Airport Board*, 2007 WL 4561140 (5th Cir. 2007) (unpublished), a former employee filed an FCA claim against the airport over federal aviation grants. The employee was not alleging that the airport misappropriated the grant money, but that it signed a certification stating that is was in full compliance with environmental regulations when it might not have been. The government investigated and did not intervene, the jury sided with the airport, and the Fifth Circuit affirmed. Yet, the Airport reportedly paid $5 million to defend this baseless claim.

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[3] For example, two "whistleblowers" received a $95 million payment in once recent case and another received $48.75 million in another. See *TAP Pharmaceuticals and Others Charged with Health Care Crimes: Agrees to Pay $875 Million to Settle Charges*, DOJ Press Release #513 (Oct. 31, 2001); *Northrop Grumman Corp. Settles False Claims Act Case for Defective Satellite Parts*, DOJ Press Release #09-305 (April 2, 2009).

[4] *See* Department of Justice False Claims Act Statistics, The False Claims Act Legal Center, Taxpayers Against Fraud Education Fund, at http://www.taf.org/statistics.htm.

[5] *See, e.g.*, United States ex rel. Harrison v. Westinghouse Savannah River Co., 352 F.3d 908 (4th Cir. 2003) (no damages as government had no loss); Ab-Tech Construction, Inc., v. United States, 31 Fed. Cl. 429 (1994) (same).

Similarly, a person preparing a Medicare contract must certify that he or she is "familiar with the laws and regulations regarding the provisions of health care services and that the services identified in [the] cost report were provided in compliance with such laws and regulations."[6] There are 130,000 pages of government health care rules, over 100,000 applying to Medicare.[7] The FCA's harsh penalties should not penalize a preparer found to be unfamiliar with every single rule or, as with the airport, a defendant that may have been out of compliance with a rule not material to the contract. Nevertheless, such cases are filed and give rise to the same bet-the-company litigation as if the contractor had fraudulently overcharged Medicare.

When there is an earnest regulatory or business dispute, governments and contractors should be able to work out honest differences. As the Association of American Universities has reported, the amounts of disputed funds are usually "reduced after the government acquires an understanding of the complexity of the charge" and accounting methods companies use when contracting with the government. Private "qui tam" lawsuit seekers should not be able to interfere with the ability of the actual parties to resolve their business disputes with threats of harsh FCA penalties.

If there were such a private action for traffic enforcement, America's highways would be lined with contingency fee lawyers with radar guns, charging every car with speeding regardless of how fast it was actually going. Occasionally, they may have a good case, but mostly they would be suing people for minor violations or who were not speeding at all. Even many drivers going under the speed limit would settle charges for a few dollars and admit to no wrongdoing rather than hire a lawyer and spend endless time in a lawsuit.

The Cost of False Claims Act Abuse

The "80 percenters" cost governments, their contractors and local communities by wasting money and fraud-fighting resources. They also can adversely affect job creation. As demonstrated above, defendants must "lawyer up" because any verdict against them, fair or otherwise, can be an economic "death sentence." The average FCA claim, even for small businesses and nonprofits, takes at least $1 million and several years to litigate, even when the claims are meritless and end in "nuisance" settlements. In addition, these costs are not always insurable, as insurance companies often exclude FCA cases from their coverage.

This "lost" money has high costs. For small and nonprofit entities defending meritless litigation consumes funds that are needed to create local jobs and grow their business. This is particularly true for state FCAs, which would likely be used predominantly against local entities. An additional hidden cost is that governments will have to pay more for products and services as contractors incorporate in their prices the unavoidable costs of defending abusive FCA claims.

Further, these claims undermine, not supplement, the public-private compliance efforts governments rely on to fight fraud. Instead of utilizing the self reporting systems at their places of employment, the lure of a large award prompts these "whistleblowers" to not report the fraud immediately, allow it to get worse, and then hire a lawyer for a cut of whatever damages they can allege. When whistleblowers are employees, it is part of their job to report the suspected fraud internally in order to give their employers the opportunity to investigate and take appropriate

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[6] *See* United States ex rel. Thompson v. Columbia/HCA, 20 F. Supp. 2d 1017, 1041 (S.D. Tex. 1998).

[7] *Rx for the Health Care System*, Wall St. J. at A18 (Oct. 8, 1998).

actions.[8] When they go right to litigation, whistleblowers can interfere with compliance programs and, ultimately, take resources away from fighting fraud.

All of us know that when we have a dispute within our own families, it is usually best to try to work out matters at home, before going off to court. The same is true at work. Most employers want the opportunity to do right and will reward employees who alert them to fraud occurring within their business, nonprofit or other such entity. In the rare instance where this is not true, there are strong whistleblower laws preventing an employer from retaliating against someone who in good faith reports an alleged fraud and tries to resolve the issue "in house" first. In such situations, the whistleblower can then also bring a private FCA claim.

Is the Federal Mandate Worth It At All?

Many states have decided "No" to adopting the federal mandate. This is why. In an effort to offset some of the costs of investigating new claims and paying whistleblowers, the federal government will add 10 percentage points to the state's portion of the recovery in certain shared awards. As some states have found, however, this amount does not cover a state's new expenses from having such whistleblower provisions.

The primary concern is that the 10 percentage point gain may be more than offset by the money the state will now have to pay the whistleblower. For example, assume a company settles an FCA claim for Medicaid fraud for $100 million and a state without its own FCA receives 40% or $40 million of that award. For a state with a qualifying FCA, the federal "incentive" raises the state's share to 50% or $50 million. In the first instance, the state keeps the $40 million. But with the latter, the state has to pay the whistleblower. If the court sets the whistleblower percentage at 20%, the whistleblower gets $10 million and the state's share is back to $40 million. If the whistleblower's share is 30%, the federal "incentive" ends up <u>reducing</u> the state's share to $35 million.

Another concern states have raised is the cost of hiring staff and investigating every single FCA claim private individuals file, regardless of a claim's merits. After adding in these costs, the Minnesota Attorney's General office found that the cost of adopting the 2005 federal mandate would be about $2 million. Washington State's analysis showed a net cost of more than $6 million per year. These additional state costs may be worthwhile if they were needed to fight fraud, but here they are not. States already receive a portion of settlements under the federal FCA when state funds are involved and use common law fraud, contract, statutory remedies, Medicaid Fraud Control actions, criminal charges, and other legal avenues to stop fraud at the state level.

Should States Support State FCA Reform?

The issues relating to state FCA reforms do not stop there. Some contingency fee lawyers and their allies, including Taxpayers Against Fraud, are using the federal mandate to try to enact state FCAs that go beyond federal law. In many circumstances, the provisions they offer to expand private actions under state FCAs have already been offered and rejected at the federal level. Here are three examples of the expansions they have sought in state FCA legislation:

- **Increase the Number of Whistleblowers**: They are seeking to weaken the qualifications for being a whistleblower. Namely, they want to quash the bedrock requirement that a whistleblower must be the original source of information so they can have more clients.

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[8] Private FCA actions allow governments to "purchase" information the private citizens have about fraud. *See* United States ex rel. Russell v. Epic Healthcare Mgmt. Group, 193 F.3d 304, 309 (5th Cir. 1999). Governments need not "purchase" such information when the contractor would have provided it for free under a compliance program.

Without this bar, anyone who reads a newspaper or does Internet research can run to the courthouse door and file a claim to be a whistleblower.

- **Water Down Standards for When the FCA Can Be Used:** These provisions allow more issues or disputes to be fodder for private FCA causes of actions. For example, they want to file their FCA claims against those who supposedly benefitted from an "inadvertent" false claim, regardless of existing practices for how such mistakes are typically reconciled. But, the purpose of the FCA is to combat fraud, not mistakes. Any such deviations from when private FCA actions are permitted under federal law would make it problematic to coordinate and resolve joint enforcement actions.

- **Go Directly to Litigation. Do Not Allow Self Policing:** These provisions would assure that whistleblowers could always call contingency fee lawyers first and deny businesses and others the opportunity to self report and right the wrong. If someone identifies a potential fraud, they should be encouraged to report the problem internally first and go outside the system only if the entity fails to take the right actions.

Again, none of these changes help fight fraud. They only expand the "80 percenters."

Conclusion

The issue that state governments face in deciding whether to adopt the federal mandate to enhance whistleblower recoveries is not whether states oppose fraud against their governments. Of course they do. States must decide how best to minimize fraud, not maximize lawsuits. As courts have recognized, FCAs must "walk a fine line between encouraging whistle-blowing and discouraging opportunistic behavior."[9]

Currently, whistleblowers are well-compensated when they expose fraud and false claims under the federal FCA. Giving whistleblowers a significant portion of a state's recovery on top of what a whistleblower already receives from the federal government does not help fight fraud. However, it can give private individuals more power to abuse the FCA's harsh penalties for their own gain, even when the state does not see the need to join the case and pursue the defendant. Understanding the potential of such abuse is the same reason states do not pay contingency fee lawyers to prosecute criminal charges.

If a state decides to enact its own FCA, though, it should scrupulously stick to the exact language in the federal FCA. Otherwise, states may find that they and their contractors will have even fewer resources to fight true fraud.

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[9] United States ex rel. Springfield Terminal Railway CO. v. Quinn, 14 F.3d 645, 651 (D.C. Cir. 1994).