LAW360

Portfolio Media. Inc. | 860 Broadway, 6th Floor | New York, NY 10003 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

The Empire State Strikes Back

Law360, New York (March 2, 2011) -- In launching his first major initiative as New York's attorney general, Eric Schneiderman, signaled increased enforcement focus on New York's recently amended False Claims Act (NYFCA) in an effort to enhance New York's ability to recover funds stolen from the taxpayers' pockets and the government's purse.

On Jan. 27, 2011, Schneiderman announced the creation of the Taxpayer Protection Unit (TPU) to target government pension fund fraud, contractors who over-bill taxpayers, public officials who use fraudulent claims to obtain state money, and major tax evaders.[1] Schneiderman also unveiled a plan to re-invigorate his office's Medical Fraud Control Unit, adding dozens of prosecutors, auditors and investigators to the ranks.

The attorney general expects that by using federal funds, along with the increased recapture of state funds through the new initiative, this redesign will not cost state taxpayers additional money, but rather will be self-funding. With this announcement, the attorney general has sent a strong message that his office will aggressively pursue violators. Companies and individuals that do business with, or in, New York State should be aware of these developments.

The New York False Claims Act

This initiative is a further development of Schneiderman's focus on the area that he began during his tenure as a state senator, during which time he authored and ushered through the New York legislature the 2010 New York Fraud Enforcement and Recovery Act (NYFERA), amending the NYFCA in novel ways.[2]

The New York False Claims Act, first enacted in 2007 and modeled after its federal counterpart,[3] authorizes the attorney general, local governments and whistleblowers to bring actions on behalf of the state against those who defraud the government; recoveries include treble damages and the highest civil penalties of any New York statute.

The NYFCA holds liable entities and individuals who knowingly or recklessly present fraudulent claims for payment to New York state or local governments, or who withhold funds due said governments. It is notable that for the purposes of the NYFCA, specific intent to defraud is not necessary when pursuing such an action.[4]

In keeping with the law's remedial purpose of ensuring that the state is compensated in full for the defendant's fraud, and the federal model, the NYFCA provides that private parties — qui tam plaintiffs — are encouraged to take up the mantle of the state by raising false claims through litigation on behalf of the government.

Under the NYFCA, qui tam plaintiffs are entitled to between 15 and 30 percent of any recovery, depending on the circumstances, plus attorneys' fees.[5] The NYFERA amendments also encourage whistleblowers by providing enhanced anti-retaliation protection to those who attempt to halt, or bring light to, NYFCA violations.

A New Cause of Action for Tax Fraud

Historically, the NYFCA has been employed against health care providers to combat Medicaid fraud. New York has now taken the unprecedented step of being the first state to expressly authorize qui tam actions for tax fraud, an area of liability into which even the federal civil False Claims Act has not ventured and, in fact, has specifically prohibited.[6]

Even the Internal Revenue Service whistleblower provision under 26 U.S.C. § 7623 falls shy of the empowerment of private individuals that the amended NYFCA provides; the federal rule provides for rewards only for information supplied to the government, but does not grant private citizens the right to pursue qui tam litigation on the government's behalf.

By expanding the bases for liability, the NYFCA arguably has become the strongest anti-fraud statute in the country.[7] Under the amended statute, a private citizen may bring a lawsuit for tax fraud against a person or business that earns more than $1 million in annual net income for the relevant taxable year and defrauds the state of more than $350,000.[8]

This extension of the NYFCA could cover a vast array of misconduct, such as improperly secreting money in an offshore account, making false representations regarding New York residency to avoid paying state or municipal taxes, hiring workers off the books, or taking improper tax credits. It is likely that potential qui tam plaintiffs will include accountants, bookkeepers, bank employees, and those of other tax-related businesses.

With the statute imposing treble damages and steep penalties of up to $12,000 per false claim, record or statement, it is even more crucial to scrutinize one's own tax submissions and those on which called upon to give advice. Not only can a person or entity be subject to liability and significant damages for directly submitting a false claim to the government, but one can be liable for causing another person or entity to submit a false claim. This suggests that persons may be liable for knowingly or recklessly providing improper tax advice, or certifying as accurate false statements or records material to a claim.

New York Makes Bringing and Pursuing FCA Claims More Attractive

Anti-Retaliation Protection Enhanced for Whistleblowers

In addition to empowering qui tam plaintiffs to file actions for tax fraud, the NYFCA amendments amplify the state's anti-retaliation protections for whistleblowers in order to encourage qui tam actions. The recent amendments expanded the law to cover former employees, contractors and agents in addition to current employees, thereby exponentially expanding the pool of eligible private plaintiffs.[9]

Protected individuals who are discriminated against in any manner, including termination, demotion and harassment for their lawful conduct in furtherance of an NYFCA action are entitled to relief under the statute; such relief may include reinstatement, two times back pay, reinstatement of benefits, compensation for special damages and attorneys' fees.[10]

The provision further immunizes whistleblowers from retaliation related to any acts that may "violate a contract, employment term, or duty owed to the employer or contractor," as long as they are for the sole purpose of putting a stop to violations of the NYFCA.[11]

This provision in particular has been the focus of criticism because it arguably empowers qui tam plaintiffs to steal confidential and proprietary information in order to bring an action under the NYFCA. In addition, it encourages whistleblowers to ignore corporate compliance systems set up to handle fraud allegations, thereby potentially undermining a company's attempts to address fraud allegations themselves.

Pleading Requirements Relaxed

Not only are more private parties incentivized to bring action, but the statute's redesign has lowered the bar for maintaining an action in court. Unlike the federal and New York civil procedure codes, the recent NYFCA amendments ease the pleading burden; a putative plaintiff no longer must satisfy heightened, particularized pleading requirements applicable to fraud actions.[12]

Enumeration of specific false claims and statements are not needed in order to proceed with potentially costly and burdensome discovery, provided that the complaint reasonably indicates violation of the NYFCA likely occurred and provides "adequate notice of the specific nature of the alleged misconduct."[13]

The new statute additionally narrows the definition for publicly disclosed information in connection with the NYFCA's public disclosure bar,[14] and expands the definition of who qualifies as an "original source" under the public disclosure bar.[15] These changes likely will have the effect of granting courts jurisdiction over suits brought by qui tam plaintiffs that might otherwise have been dismissed under the previously more expansive concept of public disclosure.

Statute of Limitations Extended and Simplified

In keeping with the trend of minimizing the existing laws curtailing the prosecution of an NYFCA claim, the amendments lengthened the statute of limitations from six years to 10 years from the date of the violation. It also dispensed with the alternate three-year limitations period dependent on the government's actual or constructive knowledge.[16]

Beyond the longer period for potential liability, this change has important ramifications for the efficacy of record retention policies now in place for many of the entities and high net worth individuals doing business in New York. These policies should be re-examined and revised to better meet the challenges of the newly extended limitations period.

Implications

Given the $10 billion deficit in next year's $136 billion New York state budget, and the projected shortfalls of $14 billion and $17 billion in the following two years, respectively, expect New York to use these new tools zealously to start bridging that gap.[17] With high civil penalties and treble damages at stake, it may become increasingly attractive to root out offenders, making it even more important for New York-based institutions to strengthen their compliance programs to minimize their risk of exposure.

Compliance with residency requirements and the use of exemptions and tax shelters should receive particular attention and cautious treatment because they may be among the most fruitful targets of government and whistleblower investigation. Under respondeat superior, employers may be responsible for their employees' business-related misconduct; companies should therefore make their employees aware of these changes and reinforce fraud-related and compliance training.

Moreover, because whistleblowers may no longer be bound by confidentiality to their companies when pursuing NYFCA claims, companies should monitor their dealings closely and encourage employees to raise concerns internally in order to head off the initiation of qui tam actions. Any entity that does become the target of an NYFCA investigation, of course, should be cautious about taking any action that could be seen as retaliatory.

Finally, many government programs are jointly funded or administered by the federal and state governments (e.g., Medicaid and many infrastructure projects), and, therefore, qui tam plaintiffs frequently argue that a defendant's conduct gives rise to liability under both the federal and state False Claims Act statutes. Some of the NYFCA amendments discussed above may have little practical effect in qui tam actions filed in federal court.

For example, qui tam plaintiffs who file FCA actions in federal district court in New York must meet the heightened pleading standards of Federal Rule of Civil Procedure 9(b), and may not benefit from the relaxed pleading requirements of the NYFCA.[18] Time will tell if we will see a shift towards more New York state-only False Claims Act actions so that qui tam plaintiffs may avail themselves of the relaxed standards.

Conclusion

The federal government secured more than $3 billion in FCA settlements and judgments for its fiscal year ending September 30, 2010 — a 25 percent increase over the previous year and the second-largest yearly recovery amount ever.[19]

New York is shoring up its investigation and enforcement efforts in the hopes of obtaining similarly staggering recoveries; Schneiderman has made it a major initiative to invigorate enforcement of New York's False Claims Act. Entities, individuals, and other governments will be watching this effort, and individuals and entities that could become subject to the statute's new and expansive grasp are well-advised to be vigilant.

--By Alexander H. Southwell, Jessica Sanderson and Sharon Grysman, Gibson Dunn & Crutcher LLP

Alexander Southwell is a partner in Gibson Dunn's New York office and a former assistant U.S. attorney in the Southern District of New York. Jessica Sanderson is of counsel in the firm's Denver office. Sharon Grysman is an associate in the firm's New York office.

The opinions expressed are those of the authors and do not necessarily reflect the views of the firm, its clients, or Portfolio Media, publisher of Law360. This article is for general information purposes and is not intended to be and should not be taken as legal advice.

[1] A.G. Schneiderman Launches New Initiative to Bolster Recovery of Taxpayers' Dollars & Fight Government Fraud, Attorney General Press Release, Jan. 27, 2011, available at http://www.ag.ny.gov/media_center/2011/jan/jan27a_11.html.

[2] Senator Schneiderman Shepherds Historic Anti-Fraud Taxpayer Protection Measure Through Legislature, New York State Senate Press Release, July 1, 2010, available at http://www.nysenate.gov/press-release/senator-eric-t-schneiderman-shepherds-historic-anti-fraud-taxpayer-protection-measure-.

[3] 31 U.S.C. §§ 3729¬–33.

[4] N.Y. State Fin. Law §§ 188, 189 (2010).

[5] Id. § 190(6).

[6] 31 U.S.C. § 3729(d) ("This section does not apply to claims, records, or statements made under the Internal Revenue Code of 1986.").

[7] New York to Pursue Corporate Tax Fraud With New Unit, Bloomberg Businessweek, Jan. 27, 2011, available at http://www.businessweek.com/news/2011-01-27/new-york-to-pursue-corporate-tax-fraud-with-new-unit.html.

[8] N.Y. State Fin. Law § 189(4) (2010).

[9] Id. § 191(1).

[10] Id.

[11] Id. § 191(2).

[12] Id. § 192(1).

[13] Id.

[14] Id. § 190(9)(b).

[15] Id. § 188(7).

[16] Id. § 192(1).

[17] A.G. Schneiderman Launches New Initiative to Bolster Recovery of Taxpayers' Dollars & Fight Government Fraud, Attorney General Press Release, Jan. 27, 2011, available at http://www.ag.ny.gov/media_center/2011/jan/jan27a_11.html.

[18] See, e.g., United States ex rel. Blundell v. Dialysis Clinic, Inc., No. 5:09-CV-00710, 2011 WL 167246, *12 (N.D.N.Y. Jan. 19, 2011) (dismissing all of plaintiff's claims against the defendant, including Medicaid fraud against the federal, state, and county governments; Medicare fraud; and fraud against the Veterans Administration under the federal FCA and NYFCA for lack of particularity under Fed. R. Civ. P. Rule 9(b)).

[19] See Press Release, Office of Pub. Affairs, U.S. Dep't of Justice, Department of Justice Recovers $3 Billion in False Claims Cases in Fiscal Year 2010 (Nov. 22, 2010), available at http://www.justice.gov/opa/pr/2010/November/10-civ-1335.html.

All Content © 2003-2011, Portfolio Media, Inc.