

HEALTH CARE FRAUD

Expert Analysis

2010 Year-End False Claims Act Update: Part 2

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LEGISLATIVE ACTION IN 2010

As Assistant Attorney General Tony West remarked halfway through 2010, recent legislation “has greatly increased the [False Claims] Act’s power and effectiveness.”¹ In the first half of 2010, Congress, in passing the Patient Protection and Affordable Care Act, made sweeping changes to the FCA, including:

- A change to the public disclosure bar for *qui tam* suits that made it easier for putative relators to bring suit.
- An expansion of the definition of a “false claim” that increased the scope of conduct giving rise to an FCA violation.²

Legislative activity in the second half of 2010 continued the trend of strengthening the FCA.

Dodd-Frank expands whistle-blower protections

The Dodd-Frank Wall Street Reform and Consumer Protection Act, signed into law July 21, 2010, includes an amendment to the FCA that expands protected whistle-blower conduct.³ Specifically, Section 1079A expands coverage to preclude retaliation for “lawful acts done by the employee, contractor, or agent or associated others in furtherance of an action under this section or other efforts to stop 1 or more violations of [the FCA].”

Thus, the statute protects anyone “asso-ciated” with the whistle-blower and a broad range of activities related to bringing an FCA suit or stopping potential FCA violations. Arguably, this legislative expansion could extend liability to relationships outside the employment context, although “discrim-ination” is limited to that affecting “the terms and conditions of employment” as a result of taking protected action.

Section 1079A of the Dodd-Frank Act also amends the FCA to clarify the statute of limitations for FCA-related whistle-blower retaliation actions, allowing a civil action to be brought within three years from the date of the discriminatory or retaliatory conduct.

The Dodd-Frank Act includes considerable expansion of whistle-blower protections.

Dodd-Frank includes considerable expansion of whistle-blower protections in other contexts as well, including securities laws and the Sarbanes-Oxley Act of 2002, providing incentives and protection for those who provide tips.

Considering the success whistle-blowers have had in bringing *qui tam* suits under the FCA in recent years, the Dodd-Frank Act's expansions are likely to increase whistle-blower activity in all contexts, including the False Claims Act. In fact, Dodd-Frank requires the Securities and Exchange Commission to set up a "whistle-blower office" to attend to this increased activity, although in light of the current budget freeze, the SEC recently announced that it is delaying those plans.⁴

State legislative action

More than 30 states and the District of Columbia have some version of a false-claims act, as do several cities. Indeed, the financial incentive provided in Section 1909 of the Social Security Act, as enacted by Section 6031 of the Deficit Reduction Act of 2005, encourages states to enact qualifying false-claims acts.

Specifically, states whose law meets the federal standards may receive 10 percent of any recoveries of federal Medicaid funds recovered through a state action.⁵ States continue to enact false-claims acts in response to the Deficit Reduction Act's incentive and continue to strengthen existing laws.

During the second half of 2010, New York amended its false-claims law to increase the protections and incentives available to whistle-blowers and the availability of *qui tam* suits, exceeding the federal False Claims Act in many respects.⁶

As of Aug. 27, *qui tam* plaintiffs in New York may bring actions for tax fraud where the defendant's net income or sales exceed \$1 million (thereby including most small businesses) and where damage to the state York exceeds \$350,000. The federal FCA, by contrast, expressly prohibits suits based on the Internal Revenue Code.⁷

Although other states, including Florida,⁸ do not expressly prohibit false-claims suits based on tax violations, New York is the first state to expressly authorize such actions.⁹ In addition, the level of *scienter* (intent to defraud) required for tax fraud *qui tam* suits under the New York law is lower than the federal standard; "reckless disregard" of the state's tax laws is sufficient. And *qui tam* relators may move to compel the disclosure of a defendant's tax records, provided the attorney general approves the request.

As amended, the New York False Claims Act further encourages *qui tam* suits by expanding whistle-blower protections to "any current or former employee, contractor, or agent" and protecting them from, among other things, retaliation for taking materials from their employer in support of a false-claims action. The latter protection — for stealing confidential or otherwise sensitive documents from the workplace — exists even where taking those materials would violate a contract, employment term or duty owed to the employer or contractor.

New York also allows a relator to bring suit within 10 years of a violation; the federal FCA's limitations period generally is only six years (absent the application of a tolling provision available in limited circumstances). New York's law, creating significant exposure for those doing business with the state while at the same time affording significant protection to whistle-blowers, may signal a new standard for state false-claims laws.

Illinois also amended its false-claims act in the second half of 2010, improving both its investigatory abilities and its ability to recover the costs of investigating and litigating false-claims cases.¹⁰ The Illinois law also includes whistle-blower protections for those who report fraud and rewards for those who assist the state in recovering money.

Other states that have joined in passing false-claims acts in 2010 with *qui tam* enforcement provisions and other protections include Colorado and Maryland.¹¹

As state false-claims laws increase in number and coverage, the complexity and cost of FCA litigation are likely to increase. The American Bar Association notes that enforcement actions and recoveries under state versions of the FCA are “skyrocketing.”¹² Businesses face more eligible *qui tam* plaintiffs, additional acts that can give rise to potential liability, and an increased pool of potential government interveners from both federal and state governments.

CASE LAW DEVELOPMENTS AND JUDICIAL TRENDS

In the second half of 2010, federal courts continued to be active in deciding FCA-related cases, with more than 200 decisions citing the statute during that time. And the U.S. Supreme Court has agreed to hear yet another FCA case this term. According to Justice Department statistics, 709 “new matters” (including referrals, investigations and *qui tam* actions) were opened during fiscal year 2010, including 573 *qui tam* actions.¹³ Moreover, thousands of FCA cases remain under seal. Thus, FCA cases will continue to fill federal court dockets.

Interpreting the public disclosure bar

Supreme Court developments

In September the Supreme Court granted review in a False Claims Act case to resolve a circuit split over the issue of whether a federal agency’s response to a Freedom of Information Act request is a “report ... or investigation” within the meaning of the FCA public disclosure bar, 31 U.S.C. § 3730(e)(4). *Schindler Elevator Co. v. United States ex rel. Kirk*, No. 10-188, cert. granted (Sept. 28, 2010).

The 1st, 3rd, 5th and 10th Circuits have all held that FOIA responses constitute “administrative reports” or “investigations” within the meaning of the FCA’s jurisdictional bar because the FOIA response itself is a “report” or “investigation.” *United States ex rel. Kirk v. Schindler Elevator Co.*, 601 F.3d 94, 104-05 (2d Cir. 2010) (discussing cases).

In this case, however, the 2nd Circuit followed the 9th Circuit in holding that whether an FOIA response constitutes a public disclosure “depends on the nature of the document[s]” disclosed. *Id.* at 98, 105-07. This will be the sixth FCA case before the Supreme Court in as many years. The court held oral argument March 1.

Do disclosures to government officials qualify as ‘public disclosures’?

A federal judge in Tennessee followed the 1st, 9th, 10th and 11th Circuits in holding that a company’s voluntary disclosure to certain government entities does not constitute a public disclosure or otherwise bar the plaintiff’s *qui tam* suit. *United States ex rel. Cox v. Smith & Nephew Inc.*, 2010 WL 4365467 at *8 (W.D. Tenn. Nov. 4, 2010).

The court held that allowing disclosure to government officials to substitute for disclosure to the public would “conflate the statute’s use of ‘government’ and ‘public’

without any textual basis indicating that Congress intended the two terms to be used interchangeably." *Id.*

Although this issue had been litigated in other jurisdictions, it was an issue of first impression for courts in the 6th Circuit. The judge rejected the 7th Circuit's ruling that disclosure to officials with "managerial responsibility for the very claims being made" qualified as a public disclosure. *Id.* at *6 (quoting *United States ex rel. Mathews v. Farmington*, 166 F.3d 853, 861 (7th Cir. 1999)).

Notably, the judge did not rely on the 2010 amendments to the public disclosure bar contained in the Affordable Care Act. The judge did note, however, that the outcome of the case would not have been any different under the amendments. *Id.* at *5.

Public disclosure through a publicly searchable database

In a matter of first impression, the U.S. District Court for the Southern District of New York held that the FCA's public disclosure bar prohibited a relator from pursuing an FCA claim based upon information obtained from a publicly searchable database. *United States ex rel. Rosner v. Glenn Gardens Assocs*, 2010 WL 2670829, at *7 (S.D.N.Y. July 2, 2010).

The court concluded that a tenant's FCA claim against a housing complex, alleging fraudulent reports to the U.S. Department of Housing and Urban Development to obtain federal housing assistance payments, failed because the searchable database, available on a state government website, qualified as an administrative report within the meaning of Section 3730(e)(4)(A). *Id.* at *6-7.

A new circuit split over the failure to comply with filing requirements

The FCA specifies that a *qui tam* relator must file a complaint under seal and that the seal must remain in place for at least 60 days. But what happens when a *qui tam* plaintiff fails to abide by those requirements? The 6th Circuit recently weighed in on this issue and set itself apart from the 2nd and 9th circuits.

In a case involving a *qui tam* plaintiff who failed to file the complaint under seal, the 6th Circuit affirmed dismissal of the case with prejudice, adopting a per se rule that "violations of the procedural requirements imposed on *qui tam* plaintiffs under the False Claims Act preclude such plaintiffs from asserting *qui tam* status." *United States ex rel. Summers v. LHC Group*, 623 F.3d 287, 296 (6th Cir. 2010).

The 2nd and 9th circuits had adopted more of a case-by-case analysis, but the 6th Circuit expressly declined to adopt the 9th Circuit's three-part balancing test, dismissing the test as "a form of judicial overreach." *Id.*; see also *United States ex rel. Lujan v. Hughes Aircraft Co.*, 67 F.3d 242, 245-46 (9th Cir. 1995); *United States ex rel. Pilon v. Martin Marietta Corp.*, 60 F.3d 995, 997-1000 (2d Cir. 1995).

Courts continue to grapple with 'false certification' theories

The "implied certification" theory of liability under the FCA "is based on the notion that the act of submitting a claim for reimbursement itself implies compliance with governing federal rules that are a precondition to payment." *Mikes v. Straus*, 274 F.3d 687, 699 (2d Cir. 2001). In the second half of 2010, two more circuits endorsed some variety of this theory of liability.

Notably, however, the FCA claims in both cases ultimately failed. In *Ebeid ex rel. United States v. Lungwitz*, 616 F.3d 993 (9th Cir. 2010), the 9th Circuit joined the 2nd, 6th, 10th and 11th circuits in "recognizing a theory of implied certification under

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the FCA,” but nevertheless affirmed the lower court’s order dismissing the second amended complaint with prejudice because the relator failed to sufficiently plead an implied-certification claim with the particularity required under Federal Rule of Civil Procedure 9(b). *Id.* at 996-99 (9th Cir. 2010) (“Implied false certification occurs when an entity has previously undertaken to expressly comply with a law, rule, or regulation, and that obligation is implicated by submitting a claim for payment even though a certification of compliance is not required in the process of submitting the claim.”).

In *United States v. Science Applications International Corp.*, 2010 WL 4909467 (D.C. Cir. Dec. 3, 2010), the court recognized an implied-certification theory, holding “to establish FCA liability under an implied certification theory, the plaintiff must prove by a preponderance of the evidence that compliance with the legal requirement in question is material to the government’s decision to pay.” *Id.* at *10. Nevertheless, the court vacated the FCA liability judgment and remanded the case for a new trial based on an erroneous jury instruction with respect the FCA’s *scienter* element.

Noting that “[n]ot every breach of a federal contract is an FCA problem,” the 5th Circuit recently held that a false-certification FCA claim requires that the certification be a prerequisite to receipt of payment. *United States ex rel. Steury v. Cardinal Health*, 625 F.3d 262, 268-69 (5th Cir. 2010).

Without reaching the general viability of an “implied false certification” theory — still unresolved in the 5th Circuit — the court in *Steury* found that the relator had failed to provide an adequate factual basis in support of an implied-false-certification under the FCA. *Id.* at 268.

“[E]ven if a contractor falsely certifies compliance (implicitly or explicitly) with some statute, regulation or contract provision, the underlying claim for payment is not ‘false’ within the meaning of the FCA if the contractor is not required to certify compliance in order to receive payment.” *Id.* at 269.

In so holding, the court cited with approval to *Mikes v. Straus*, 274 F.3d 687, 700 (2d Cir. 2001), which similarly held a false certification must be a prerequisite for payment in order to support an FCA violation. The relator in *Steury*, who premised her FCA claim on the sale of allegedly defective IV fluid pumps to the Department of Veteran Affairs, could not show that government conditioned payment on compliance with the warranty of merchantability. *Steury*, 625 F.3d at 270.

The *Steury* decision also is noteworthy insofar as it addresses (albeit briefly) retroactivity issues. The overwhelming majority of courts addressing the issue have held that the FCA amendments enacted as part of the Fraud Enforcement and Recovery Act of 2009 apply retroactively only to actions in which *claims for government payment* were pending June 7, 2008. However, without much discussion, the 5th Circuit in *Steury* appears to have taken the contrary view that the FERA amendments apply to *cases* pending June 7, 2008. *Id.* at 267 n.1 (As *Steury*’s complaint was pending June 7, 2008, it was assessed under the current version of Section 3729(a)(1)(B).).

The day before Justice Department announced a \$313 million settlement with Forest Laboratories to resolve alleged “off-label promotion” claims, a federal judge in Massachusetts rejected similar claims against Pfizer Inc. and Pharmacia Corp. In *United States ex rel. Rost v. Pfizer Inc.*, 2010 WL 3554719, at *1 (D. Mass. Sept. 14, 2010), the relator alleged that Pfizer and Pharmacia induced pharmacies to submit false Medicaid claims by providing illegal kickbacks to physicians who prescribed a certain medication off-label.

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The court held that the pharmacies' claims were not false or fraudulent under a theory of implied certification because there are no statutes, regulations or express certifications supporting that contention. *Id.* at *10. The court reasoned that certification is specific to the party seeking reimbursement and does not apply to the entire transaction.

"Neither the government nor the parties have cited any cases that have stretched an implied-certification theory to reach back to impose FCA liability on a payer of kickbacks where the person who submitted the claim was innocent of wrongdoing and where (a) the claim itself was not factually false, (b) the claim was not legally false due to an express certification of compliance with the [Anti-Kickback Statute] or (c) compliance with the federal statute was not an expressly stated precondition of payment," the court said. *Id.*

Notably, this case likely would have been decided differently under the recent Affordable Care Act amendments to the FCA, which did not apply in *Rost*. Indeed, the court noted that the federal Anti-Kickback Statute, 42 U.S.C. § 1320a-7b, "was recently amended to include language stating that 'a claim that includes items or services resulting from a violation of this section constitutes a false or fraudulent claim for the purposes of the [False Claims Act].'" *Id.*

D.C. Circuit rejects government's 'collective knowledge' and damages theories

In December, the D.C. Circuit vacated an FCA judgment that had been premised on a broad theory of *scienter* and a sweeping theory of damages that barred the jury from considering the value of the services actually provided. *United States v. Science Applications Int'l Corp.*, 2010 WL 4909467, at *1 (D.C. Cir. Dec. 3, 2010).

The court agreed with Science Applications International Corp. (represented by the authors' firm, Gibson, Dunn & Crutcher) in holding that the lower court's "collective knowledge" instruction, which permitted the jury to find that SAIC acted with *scienter* even if no particular employee knew the company's claims were false, was legally deficient. *Id.* at *13.

The appeals court also found that the jury instruction with respect to damages was "flawed" in that it barred the jury from considering the value of the services that the defendant company actually provided. *Id.* at *17-18. The court concluded that the "proper measure of damages" was a "benefit-of-the-bargain framework" requiring the government to prove "that the performance [it] received was worth less than what it believed it had purchased." *Id.* at *18.

Earlier in 2010, an Alabama federal judge concluded that the 2009 FERA amendments to the FCA did not provide a clear statement of congressional intent to waive sovereign immunity. *Bell v. Dean*, 2010 WL 1856086, at *3-4 (M.D. Ala. May 4, 2010). Although certain claims for relief were dismissed under this holding, the court ordered additional briefing on claims for official-capacity injunctive relief and individual-capacity relief.

In a second decision, the court found that state officials are not entitled to qualified immunity for retaliation suits initiated under the FCA. "Such retaliation, if sufficient to actually violate the statute, has no conceivably legitimate purpose, and applying the judicially created doctrine of qualified immunity to bar [retaliation suits] would seem at odds with the purpose of the FCA, and specifically with the

purpose of the retaliation provision, as recently expanded by Congress." *Bell v. Dean*, 2010 WL 2976752, at *2 (M.D. Ala. July 27, 2010).

A *qui tam* relator must file his or her complaint under seal, and the complaint shall remain under seal for at least 60 days. 31 U.S.C. § 3730(b)(2). The 60-day period is designed to allow the government time to investigate and decide whether to intervene and conduct the action or decline to intervene and allow the relator to conduct the action on the government's behalf. The government may move to extend the seal period for "good cause." 31 U.S.C. § 3730(b)(3). By most accounts, more than 1,000 *qui tam* actions presently remain under seal.

In January 2009 the American Civil Liberties Union, OMB Watch and the Government Accountability Project challenged the constitutionality of the FCA's seal provisions. See *ACLU v. Holder*, 652 F. Supp. 2d 654, 671 (E.D. Va. 2009). After the trial court rejected the constitutional challenges and dismissed the action, the plaintiffs appealed to the 4th Circuit (No. 09-2086). The appeals court heard oral argument in the case Sept. 21, and a decision is pending.

The seal provision is yet another fascinating aspect of the FCA. Although the federal government does not release statistics on the average length of time a *qui tam* action remains under seal, the statutorily mandated 60-day period now seems the exception rather than the norm.

Navigant Consulting reported on five *qui tam* actions unsealed during the third quarter of 2010, ranging from 105 days to 486 days under seal.¹⁴ The authors sampled *qui tam* cases unsealed or first served on defendants in 2010 and noted that several remained under seal for more than two years, as opposed to two months. (See box below for some examples.)

Case unsealed	Complaint filed	Complaint
<i>United States ex rel. King v. Solvay S.A.</i> , 2010 WL 2851725 (S.D. Tex.).	June 10, 2003	December 2009
<i>United States ex rel. Denenea v. Allstate Insurance Co.</i> , No. 2:07-cv-02795 (E.D. La.).	May 4, 2007	Sept. 21, 2010
<i>United States ex rel. Frascella v. Oracle Corp.</i> , 2010 WL 4623793 (E.D. Va.).	May 29, 2007	April 2, 2010
<i>United States ex rel. Davis v. Blackwater Lodge & Training Center</i> , No. 1:08-cv-01244 (E.D. Va.).	Dec. 1, 2008	Feb. 2, 2010
<i>United States ex rel. Resnick v. Omnicare Inc.</i> , No. 1:07-cv-5777 (N.D. Ill.).	Oct. 11, 2007	Jan. 8, 2010
<i>United States ex rel. Hauger v. Health Alliance of Greater Cincinnati</i> , No. 1:07-cv-00631 (S.D. Ohio).	Aug. 3, 2007	June 4, 2010

As these examples suggest, often, a defendant named in a *qui tam* action may be unaware of the action for a lengthy period of time, during which time whistle-blowers may be surreptitiously collecting evidence of wrongdoing, all the while allowing potentially fraudulent practices to continue and potential damages to mount (when, for example, a corporate defendant is unaware of improper conduct secretly carried out by an agent or employee).

After some initial seal period, the government frequently will obtain a partial lifting of the seal to inform the defendant of the pendency of the action and nature of the claims, which presents an opportunity for the government and a defendant to investigate and negotiate without fear of negative publicity.

But this partial lifting of the seal may create additional dilemmas. For example, publicly traded companies may have disclosure obligations under securities laws, but they risk violating the seal provision (and contempt of court) if they reveal the existence of the *qui tam* action. As of today, this "Catch-22" remains unresolved.

RISK MITIGATION: TAKE EMPLOYEE COMPLAINTS SERIOUSLY

Two studies published last year concluded that most FCA whistle-blowers are corporate insiders who first raised their concerns internally.¹⁵ First, in a Dec. 17 formal sub-mission to the SEC, titled "Impact of *Qui Tam* Laws on Internal Compliance," the National Whistleblowers Center reported that based on its review of FCA *qui tam* cases filed between 2007 and 2010, "89.7 percent of employees who would eventually file a *qui tam* case initially reported their concerns internally, either to supervisors or compliance departments."

Second, a study published in the *New England Journal of Medicine* May 13, 2010, similarly concluded that nearly all the whistle-blowing insiders "first tried to fix matters internally." The study also noted that many whistle-blowers wore personal recording devices, taped phone calls and copied relevant documents, often working closely with government investigators to collect evidence of wrongdoing.

The lesson to be learned from these studies: Take employee complaints seriously. Any company that does business directly or indirectly with the government should consider educating its workforce about the FCA and establishing standard procedures for raising complaints and responding to them.

CONCLUSION

By all accounts, 2010 was a busy year for legislators, courts, prosecutors and FCA practitioners. With the Justice Department's increased resources and recent legislative and judicial expansion of whistle-blower protections and application of the False Claims Act, expect to see an even greater increase in FCA activity in 2011.

NOTES

- ¹ Tony West, Assistant Attorney Gen. for the Civil Div., Dep't of Justice, Remarks at the American Bar Association National Institute on the Civil False Claims Act and *Qui Tam* Enforcement, at 1 (June 3, 2010).
- ² Patient Protection and Affordable Care Act, Pub. L. No. 111-148, 124 Stat. 119 (2010).
- ³ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 1079A (2010).
- ⁴ *Id.* at § 924(d); see also Jessica Holzer, *SEC Delays Plans for Whistle-blower Office*, WALL ST. J., Dec. 3, 2010.
- ⁵ Deficit Reduction Act of 2005, Pub. L. No. 109-171, § 6031, 120 Stat. 4, 72 (2006); see 42 U.S.C. § 1396h(a) (2010) ("[I]f a state has in effect a law relating to false or fraudulent claims that

meets the requirements of subsection (b), the federal medical assistance percentage with respect to any amounts recovered under a state action brought under such law, shall be decreased by 10 percentage points.”).

- ⁶ See N.Y. State Fin. Law §§ 187-194 (2010).
- ⁷ 31 U.S.C. § 3729(d).
- ⁸ See Florida False Claims Act, Fla. Stat. §§ 68.081-68.09 (2007).
- ⁹ Press Release, N.Y. Senate, Senator Eric T. Schneiderman Shepherds Historic Anti-Fraud Taxpayer Protection Measure Through Legislature (July 1, 2010).
- ¹⁰ See Whistle-blower Reward and Protection Act, 740 Ill. Comp. Stat. § 175 (2010); Press Release, Ill. Attorney Gen., Madigan Heralds Newly Strengthened False Claims Act (July 28, 2010).
- ¹¹ See Colo. Medicaid False Claims Act, Colo. Rev. Stat. §§ 25.5-4-305–25.5-4-310 (2010); Md. False Health Claims Act of 2010, Md. Code Ann. §§ 2-601–2-611 (2010).
- ¹² Am. Bar Ass’n, CLE Program Guide, The Eighth Annual National Institute on the Civil False Claims Act and *Qui Tam* Enforcement (June 2-4, 2010), available at http://new.abanet.org/calendar/civil-false-claims-act-and-qui-tam-enforcement-2010/Documents/cen0cfc_Website_Brochure_5-7-10.pdf.
- ¹³ Dep’t of Justice, Civil Division, Fraud Statistics, at 2 (Nov. 23, 2010), available at <http://www.justice.gov/civil/frauds/fcastats.pdf>.
- ¹⁴ Navigant Consulting Inc., Health Care Disputes, Compliance and Investigations Practice, *False Claims Act Case Tracker*, at 2 (2010) (reporting on trends in the third quarter of 2010).
- ¹⁵ Nat’l Whistleblowers Center, *Impact of Qui Tam Laws on Internal Compliance: A Report to the SEC*, at 4 (Dec. 17, 2010) (submitted in response to the SEC’s Proposed Rules for Implementing the Whistle-blower Provision of Section 21F of the Securities and Exchange Act of 1934); Aaron S. Kesselheim, David M. Studdert & Michelle M. Mello, *Special Report, Whistle-Blowers’ Experiences in Fraud Litigation against Pharmaceutical Companies*, 362 N. ENG. J. MED. 1832 (2010).



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