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Expert Analysis

It's the End of the False Claims Act As We Know It

Where It Began, Where It's Been and Where It May Be Going

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What do dishonest health care providers and the loss of more than $1 billion in 2008 have in common? The False Claims Act. Easily the federal government's favorite weapon in its anti-fraud arsenal, the FCA has returned more than $21 billion to the national treasury in the past 20 years.

> *Seven score and five years ago, President Abraham Lincoln urged Congress to bring forth, upon this country, a new law, conceived in honesty, and dedicated to the proposition that no one should defraud the government.*

Of that amount, the government reclaimed $14.2 billion — 67 percent of FCA settlements and judgments — from health care providers. Just in the fiscal year ending Sept. 30, health care providers have surrendered more than $1 billion to the government.

The two largest recoveries in this fiscal year came from pharmaceutical companies: $361.5 million from Merck & Co. and $258 million from Cephalon Inc. In addition to these recoveries, Merck and Cephalon returned $276 million and $116 million, respectively, to state Medicaid programs.

Needless to say, the potential damages to a health care provider under the FCA are enormous. With such colossal recoveries at stake, entities undoubtedly will continue to find themselves embroiled in FCA litigation. In addition, with Medicare and Medicaid expenditures consistently rising, health care providers can fairly assume that they will continue to be the federal government's favorite FCA target.

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The Nuts and Bolts of Today's FCA

Although the False Claims Act casts a wide net over fraudulent conduct, it most often is asserted against entities that allegedly submit false claims to the government for payment, make false records or statements to support a false claim, or conspire to defraud the government by getting a false claim paid.

Unlike most civil statutes, the FCA provides both the government and private citizens — typically company employees or former employees — standing to assert such claims against entities accused of defrauding the government. The incentive for a motivated citizen, referred to as a relator, is a percentage of any settlement or judgment resulting from the lawsuit.

If a relator files suit, designated a *qui tam* action, the government can investigate the claims and determine if it will intervene in the action. A decision in the affirmative increases the defendant's burden while decreasing the relator's portion of any recovery. Each violation of the FCA carries a maximum penalty of $11,000 plus treble damages, and a relator may recover up to 30 percent of the damages awarded if the government declines to intervene.

Since 1995 the lion's share of FCA lawsuits have been asserted by relators. In fact, the number of lawsuits filed by relators in fiscal 2008 was more than double the amount filed by the government. Not surprisingly, this is due in large part to the limited resources the government can expend on such cases.

Incredibly, however, the damages in cases where the government intervened in fiscal 2008 eclipsed $1 billion while those recovered by relators without government intervention fell below $6 million. This unbalanced result illustrates the defendant's uphill battle when the government intervenes and the death knell to a relator's action that by the government's decision to abstain often signals. This dichotomy may be explained by the FCA's storied history.

The 'Lincoln Law'

Seven score and five years ago, President Abraham Lincoln urged Congress to bring forth, upon this country, a new law, conceived in honesty, and dedicated to the proposition that no one should defraud the government. That law, the False Claims Act, was enacted in 1863 to impede the sale of faulty weapons and equipment to the Union army.

Even at its inception the FCA contained a *qui tam* provision that permitted private citizens to assert fraud claims on behalf of the government. The assertion of such a claim excluded the government from intervening in the lawsuit.

The U.S. Supreme Court significantly narrowed the scope of liability under the FCA through its decision in Allison Engine Co.

The original FCA assessed double damages and a $2,000 fine for each false claim submitted. As an incentive for asserting an FCA claim, a successful relator was provided half the damages awarded to the government.

To Intervene or Not to Intervene, That Is the Question

For 80 years the original FCA was left intact. In response to relators' widespread abuse of the law, however, Congress finally amended it in 1943. As amended, the FCA included a provision under which the government had the authority to intervene in a relator's *qui tam* action.

In addition a relator's potential award was reduced to a maximum of 10 percent of the damages when the government intervened and 25 percent when it did not.

Further, Congress enacted a "government knowledge" bar that prevented a relator from filing an FCA action based on information to which the government was already privy. These amendments often proved to be an insurmountable obstacle for otherwise motivated relators. In fact, over the next 43 years relators only filed about six cases per year.

Congress Wins One for the Gipper

In the 1980s President Ronald Reagan's increased defense budget in response to the Cold War provoked particular scrutiny of defense contractors' practices. Reports of widespread fraud against the government forced Congress to revise the FCA in 1986 to reinvigorate potential relators.

First, Congress eliminated the government-knowledge bar. Second, the burden on relators was reduced by merely requiring evidence that a defendant conducted itself with deliberate ignorance or reckless disregard for the truth.

Third, Congress increased the potential damages to treble damages plus fines of $5,000 to $10,000 for each false claim. As further incentive, rewards were increased to 15 percent to 30 percent of any damages recovered. To ensure the revitalization of the FCA, Congress added a provision under which a successful relator could recoup his expenses and attorney fees.

Finally, the FCA now protected a relator from retaliation by his employer via a provision that permitted reinstatement, double back pay and special damages.

The 1986 amendments renewed interest in the FCA. In fact, since then more than 10,000 FCA cases have been filed, leading to more than $22 billion in recoveries by the government.

The Engine *for Change*

The U.S. Supreme Court significantly narrowed the scope of liability under the FCA through its decision in *Allison Engine Co. v. United States ex rel. Sanders*, 128 S. Ct. 2123 (U.S. June 9, 2008).

The case involved multibillion-dollar contracts between the U.S. Navy and two shipbuilders to construct a new fleet of guided missile destroyers. The shipbuilders, in turn, entered into a subcontract for the production of generator sets to supply the electrical power for the ships.

Two former employees of a subcontractor asserted *qui tam* claims under the FCA against several subcontractors, alleging that they fraudulently sought payment for work that had not been completed in accordance with contract specifications.

At trial, the U.S. District Court for the Southern District of Ohio granted the subcontractors' motion for judgment as a matter of law because the former employees had failed to introduce any evidence that a false or fraudulent claim had ever been presented to the Navy.

On appeal the 6th U.S. Circuit Court of Appeals disagreed, finding that the relevant provisions of the FCA did not require proof that a false claim was presented to the government. Rather, the court determined that a false claim to a private entity that then paid the claim with "government funds" was sufficient.

The Supreme Court Ups the Ante

In a unanimous decision the Supreme Court vacated the 6th Circuit's decision. In doing so, the high court made several key findings that narrowed the scope of liability under the FCA.

First, the Supreme Court said a relator did not need to provide evidence that a defendant actually presented a false record or statement to the government. Rather, a relator must prove the defendant intended that the false record or statement be material to the government's decision to pay or approve the false claim.

As such, a subcontractor is liable for causing a false record or statement to be presented to the government only if it submits a false statement to the prime contractor intending that contractor to use the statement to get the government to pay its claim. A subcontractor that does not intend such reliance by the government is not liable under the FCA.

Second, the Supreme Court found that a relator asserting a conspiracy claim under the FCA must prove that the conspirators intended to defraud the government. Again, a relator must provide evidence that the conspirators agreed that the false record or statement would have a material effect on the government's decision to pay the false claim.

Although the elimination of the presentment element favors a relator, the inclusion of both intent and materiality requirements represents a significant shift in FCA jurisprudence in favor of defendants.

Such a modification of FCA liability benefits all potential defendants, including those in the health care industry. For example, a zealous health care provider may seek to escape liability for submitting false records to Medicaid by claiming that it did not intend that Medicaid use the records to get the government to pay its claim.

The Supreme Court Wakes the Sleeping Giant

In response to *Allison Engine* and other recent Supreme Court and appellate decisions setting reasonable limits on the scope of FCA liability, both houses of Congress have proposed new amendments to the FCA to broaden its reach. Both versions of these amendments, dubbed the FCA Correction Act of 2007, include revisions that would drastically increase the scope and potential damages under the FCA.

The Proposed Senate Amendments

Iowa Republican Charles Grassley, the advocate behind the 1986 amendments to the FCA, proposed Senate Bill 2041 in September 2007. The bill includes

numerous provisions to strengthen the grip on FCA defendants.

First, the Senate bill would adopt the 6th Circuit's holding in *Allison Engine*. Thus, not only would a relator not need to prove that a defendant submitted a false claim to the government to establish liability, but every claim to a private entity for government money or property would potentially subject an entity to the FCA. This would constitute an enormous expansion of the statute's scope of liability.

As one illustration of the scope of these proposals, the federal government currently is determining the proper allocation of its $700 billion bailout plan. Under S. 2041 every entity that conducts business with the recipients of such funds will be subject to the FCA. The government's decision to distribute a portion of these funds to a private hospital, for example, would haul into the FCA's zone of liability a dishonest supplier of medical equipment.

Such an extension of the scope of liability ensures the FCA's nearly limitless reach. Coupled with health care providers' surrender of the 20 largest FCA settlements and judgments in history, this amendment would have a profound effect on the entire health care industry.

Second, the bill would effectively eliminate the "public disclosure" defense, a mechanism that generally bars relators from asserting FCA lawsuits based on information that already is available to the public. Under the Senate bill, a defendant would be prohibited from asserting this defense. Instead, the government would be the only entity endowed with such authority. Of course, the government has little incentive to assert such a defense against a relator that is attempting to recover funds to be added to the government's coffers.

Further narrowing the scope of the public disclosure defense, Senate Bill 2041 would require that any prior public disclosure be broadly disseminated and reveal all essential elements of liability. In addition, a relator would be barred from asserting an action only if the allegations are based exclusively on a public disclosure. This emasculation of the public disclosure defense carries with it the inherent danger of reviving the kind of abuse of the FCA by relators that existed before the 1943 amendments.

Third, S.B. 2041 would provide additional protection for relators, including a provision that permits them to assert retaliation claims as a result of their involvement in revealing any employer fraud. As such, relators would be protected from retaliation regardless of whether their conduct was in furtherance of an FCA action.

Fourth, the bill would extend the limitations period for all FCA claims, including retaliation claims, to 10 years. This would virtually ensure that vital witnesses and documents will not be available by the time an FCA case reaches trial.

Together with the elimination of the public disclosure defense, this extension lets a relator intentionally avoid asserting a claim for years while the potential damages continue to mount. The danger of such a permissible delay is exacerbated by the potentially indefinite period of time the government is allotted to investigate a relator's claims and determine whether to intervene.

Regardless of the iteration of the FCA, however, relators intend to continue to provide health care providers with the same prognosis — a seat at the defense table.

This provision of the Senate bill has particular significance to any entity that adheres to short-term document retention policies, including health care providers that may only maintain records for the duration required by law.

Fifth, the Senate bill would prohibit the waiver or release of FCA claims except by court-approved settlement. This would stifle the bargaining process between private citizens and entities, resulting in yet another drain of the courts' already scarce resources.

Finally, the bill would even permit relators and their attorneys access to documents and other information obtained during a U.S. Justice Department civil investigative demand. In so doing, S. 2041 would permit access to information that may lend credence to otherwise meritless claims.

The Senate Judiciary Committee filed a written report supporting the pending bill Sept. 25.

The Proposed House Amendments

Proposed by Democrat Howard Berman of California in December 2007, House Bill 4854 includes all the Senate bill's provisions along with several unique revisions.

First, the House bill would remove Federal Rule of Civil Procedure 9(b) pleading requirements for FCA cases. As such, a relator no longer would be required to include particular allegations of fraud in his complaint. Rather, he would be permitted to assert a lawsuit against a defendant that merely will have a vague notion of the claims against it.

Aside from stripping an FCA defendant of a significant defense, this would deprive both defendants and the courts of a viable opportunity to dispose of a case summarily. The bill, of course, would have no effect on common-law fraud cases, creating a disparate treatment of cases rooted in the same type of conduct.

Second, H.B. 4854 would eliminate materiality as an element of FCA liability. As a result, a defendant may be culpable under the FCA even if his allegedly false record or statement had no impact on the government's decision to pay or approve a claim. This elimination of the materiality requirement further eviscerates *Allison Engine* and reduces a relator's burden under the FCA.

Finally, the bill would apply all its amendments to the FCA retroactively to all pending cases.

As a result, potential lawsuits that were barred will be revived. Deficient complaints otherwise subject to motions to dismiss now will be deemed acceptable. Potentially meritorious defenses will be eliminated. Previously waived FCA claims will be restored. In addition, due process will be compromised.

H.B. 4854 was subjected to a markup session July 16 and ordered to be reported by voice vote. Further, the Subcommittee on Courts, the Internet and Intellectual Property and the Subcommittee on Commercial and Administrative Law have discharged the bill, and it is pending in the House.

The End?

Since its inception, the FCA has survived two amendments that respectively weakened then strengthened it, as well as numerous court decisions that produced similar results. If Congress' proposed amendments are any indication, the already broad scope of FCA liability is set to expand exponentially.

Regardless of the iteration of the FCA, however, relators intend to continue to provide health care providers with the same prognosis — a seat at the defense table. In addition, with fewer procedural barriers at their disposal, health care providers will be forced to choose between two unenviable positions: settle early or prepare for trial.

Glenn V. Whitaker, **Victor A. Walton**, and **Michael J. Bronson** are members of the *qui tam* team at **Vorys, Sater, Seymour & Pease** in Cincinnati. They successfully represented Allison Engine Co. at trial and before the U.S. Supreme Court. Whitaker, a partner at the firm, represents defendants in complex civil litigation, white-collar crime cases and a wide variety of *qui tam* False Claims Act actions. Walton, also a partner at the firm, has experience in complex civil litigation and corporate defense work over alleged violations of the FCA. Bronson, an associate in general litigation, specializes in defending corporations in *qui tam* and FCA cases.