Legal Backgrounder

Washington Legal Foundation
Advocate for freedom and justice®
2009 Massachusetts Ave., NW
Washington, D.C. 20036
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Vol. 17 No. 55 December 20, 2002

STATE FALSE CLAIMS LAWS POSE NEW CHALLENGE FOR CONTRACTORS

by

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Many practitioners and corporate counsel in defense, health care, and oil and gas companies are familiar with the Federal False Claims Act, a Civil War vestige that was transformed under 1986 amendments into a powerful tool for recovering money for alleged fraud against the federal government. Since 1986, the Federal FCA's *qui tam*[1] mechanism has been used by private individuals to recover more than $5.2 billion to the Federal Treasury. The primary targets of the law have been health care and pharmaceutical companies (because of heavy funding by Medicare), defense contractors, non-military contractors, and oil and gas companies (for alleged underpayment of royalties). Whistleblowers have been paid nearly a billion dollar share of that recovery under the FCA's generous bounty provisions. These figures do not include amounts paid to resolve suits litigated by the Justice Department without the assistance of whistleblowers, nor do they include the significant sums paid for whistleblower retaliation claims and the plaintiffs' attorneys' fees and costs provided for under the Federal FCA.

However, many are not aware of a rapidly growing movement among state and local governments to enact similar laws. Earlier this year, Virginia became the twelfth state to enact a *qui tam* false claims law modeled on the Federal False Claims Act. *See* 2002 VA. ACTS 842. California, Florida, Illinois, Louisiana, Texas, Tennessee, Nevada, Hawaii, Delaware, Massachusetts, and the District of Columbia also have false claims statutes with *qui tam* provisions on the books.[2]

The trend toward enacting state false claims laws is remarkable in several ways. First, the pace at

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[1]The phrase "*qui tam*" is derived from the longer Latin phrase, "*qui tam pro domino rege quam pro se ipso in hac parte sequitur*," which means "who pursues this action on our Lord the King's behalf as well as his own." *Vermont Agency of Natural Res. v. United States ex rel. Stevens*, 529 U.S. 765, 769 n.1 (2000).

[2]For statutory citations and detailed analysis of state false claims laws, *see* BOESE, CIVIL FALSE CLAIMS AND QUI TAM ACTIONS, ch. 6.

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which local false claims laws are being placed on the books has picked up significantly. In the ten year period immediately following the 1986 amendments to the Federal FCA, only four state false claims laws were enacted. During the next six years, twice as many false claims statutes were adopted. During the 2001-2002 state legislative session alone, at least fourteen more false claims bills were proposed.

Second, many of the state and local false claims laws are being introduced and adopted quietly. In some cases, the laws have veritably flown through the legislative process with little apparent opposition. Finally, the influence of the plaintiffs' bar in enacting state false claims laws is significant, and this results in liability provisions that go far beyond the already draconian damages and penalties available under the Federal FCA. Corporations, contractors, and other entities doing business with state governments and their political subdivisions cannot afford to ignore the potentially great risk of liability under the expanding number of state false claims laws.

Sources of Liability Under State False Claims Laws. Like their federal counterparts, state false claims laws impose treble damages and high penalties on any person who, among other things, knowingly submits or conspires to submit false claims or statements to the government for payment. Many of the state false claims laws contain eight liability provisions — seven that mirror those found in the federal law, plus an eighth provision that imposes liability on the beneficiary of an "inadvertent submission of a false claim" who subsequently discovers the falsity of the claim, but fails to notify the appropriate authority of the overpayment. Most of the state *qui tam* false claims laws also impose liability for so-called "reverse false claims," which involve the use of a false record or statement to conceal, avoid, or decrease an obligation to pay money or property to the state or any of its political subdivisions. Liability can be imposed under false claims statutes for merely "reckless" conduct — for claims submitted with reckless disregard of their truth or falsity, and it is not necessary to prove that a defendant specifically intended to defraud the government.

Whistleblower Enforcement Under State False Claims Laws. Like the Federal False Claims Act, all of the state false claims statutes cited in this article contain a *qui tam* enforcement provision. This mechanism allows private citizens, who are also referred to as "relators," or *qui tam* whistleblowers, to file suit on behalf of the state and its local political subdivisions. *Qui tam* enforcement has been challenged on a variety of grounds. However, the U.S. Supreme Court held two years ago that under the Federal FCA, relators do have standing to litigate Federal FCA claims because Congress has partially assigned the government's right to litigate FCA claims to the relator. *Vermont Agency of Natural Resources*, 529 U.S. at 773. Nevertheless, a variety of other constitutional challenges to *qui tam* enforcement continue to be litigated in the federal courts. Some of those challenges, including attacks on FCA damages and penalties as unconstitutionally excessive, can also be pressed under comparable state constitutional provisions.

Qui tam suits are filed by a wide variety of individuals and organizations — some are legitimately concerned with the waste of public money. But many *qui tam* suits are filed by disappointed bidders, disgruntled employees, and advocacy groups pressing a wide range of agendas. Most often, they are motivated by the offer of a significant share of the government's recovery. Successful relators get an even more generous share of the recovery under some state laws than they do under the federal counterpart — in some states as much as fifty percent of the recovery if the government declines to exercise its prerogative to intervene in and take over the suit. Whether the state intervenes or not, prevailing relators can also usually recover reasonable attorneys' fees and costs from the defendant. Some states require losing defendants to pay the state's legal fees, as well, if the state has joined the *qui tam* action.

Whistleblower retaliation provisions in some of the state *qui tam* laws prohibit employers from taking certain discriminatory or retaliatory acts against employees who are engaged in conduct in furtherance of a false claims action. Remedies for whistleblowers typically include reinstatement, double back pay,

interest, special damages, punitive damages, litigation costs, and reasonable attorneys' fees.

Insights Gained from Past Experience with Qui Tam False Claims Laws. Experience with the Federal FCA and some of the older state false claims laws provides a number of insights into the future of litigation under the growing number of state *qui tam* false claims laws. California was the first state to enact its own law modeled on the Federal FCA, in 1987. Litigation under the California False Claims Act got off to a slow start, and then exploded. Hundreds of millions of dollars have already been paid to settle claims litigated under the California false claims law. While other state false claims laws have not yet generated a significant amount of published case law, Florida's FCA has reportedly yielded more than $28 million in Medicaid fraud recoveries as of June 2001, and media reports indicate that use of the Florida statute outside of the health care arena is increasing significantly.

State FCAs May Be Applied to Broad Range of Business. Both the Federal and California FCA are frequently applied in suits against state government contractors where the public dollars at stake are obvious. In California, for example, a number of state false claims cases have been filed in connection with the construction of the Metro Rail subway and other projects for the Los Angeles Metropolitan Transportation Authority. Tutor-Saliba Corp., which was paid approximately $945 million for its work on the Los Angeles Metro Rail subway, sued the MTA in 1995 in a dispute over $16 million in allegedly unpaid claims. The MTA responded by counter-suing under the California FCA, and ultimately prevailed on those claims at trial six years later in a high-profile, bitterly contested suit. In July 2001, the judge entered a directed verdict for the MTA, and a jury imposed a $29.5 million damages award. The judge added $2.4 million in interest to the verdict, and the MTA, which hired outside counsel to litigate the California FCA claims, requested an additional $34 million in legal fees and costs.

Although this case involved the kind of government contract that more typically comes to mind in the false claims context, state false claims laws are also frequently applied in situations where it is not immediately obvious that government funds are at stake. State false claims laws are likely to be applied by *qui tam* relators against the commercial enterprises that sell products and services to county governments, state universities and local community colleges, public school districts, publicly-funded health care institutions, penal institutions — any of the now numerous entities that rely to greater or lesser degrees on state and local tax revenues. Businesses that lease publicly-owned property or remove natural resources from state land are also at risk. The list of potential sources of liability is endless.

At least two attorney general offices have considered suing some of the companies involved in the recent spate of highly publicized bankruptcies, in an effort to recover investment losses in state employee pension funds. The Illinois Attorney General has already issued a civil investigative demand seeking documents relating to the Enron collapse in such an effort. *See* Paul Merrion, *State Joins Pursuit of Anderson*, CRAIN'S CHI. BUS., Feb. 11, 2002, at 1.

One of the largest settlements reached thus far under the California FCA involved a large banking corporation, which paid $187 million to settle allegations that the defendant improperly retained unclaimed municipal bond funds. The funds allegedly should have escheated to the state and to more than 300 California municipalities and state entities. *BankAmerica to Pay $187 Mil to Settle Municipal Bond Suit*, LEGAL INTELLIGENCER, Nov. 13, 1998, at 4. A number of title companies have also been accused of knowingly failing to turn over dormant escrow funds to the state, with one whistleblower alleging that more than $270 million has been improperly retained by the companies. One title company has already been ordered to pay a total of $53 million to resolve the allegations. The proceedings against Old Republic Title Company that are described below illustrate the aggressive way in which state false claims allegations are litigated.

State FCA Suits Can Arise from Criminal Prosecutions and May Spawn Other Civil Litigation. The California FCA suit against Old Republic Title Company began after a former employee provided information to San Francisco law enforcement authorities that ultimately led to the criminal prosecution of an Old Republic executive. Lawyers for the City then filed a civil suit against Old Republic as *qui tam* whistleblowers under the California FCA, asserting claims based on the defendant's alleged failure to escheat dormant funds to the state. A class action lawsuit was also filed as a companion action to the California FCA claims. That action was filed on behalf of consumers, and sought recovery of interest that was never paid on individual escrow accounts. Old Republic ultimately admitted liability and damages, and was ordered to pay the state more than $38 million. An additional $14.7 million was paid to resolve the class action suit. *Old Republic Told to Pay $15.1 Million*, THE RECORDER, June 12, 2001, at 6 (The headline of this article refers to only one of several payments the defendant was ordered to make.).

State False Claims Verdicts May Have Devastating Collateral Consequences. While a judgment under a state FCA may pose its own economic threat to a business, the collateral consequences of a state (or Federal) FCA verdict can be even more devastating. A contractor found liable under a state false claims law may be suspended or debarred from obtaining other government contracts, and reciprocity provisions can prevent businesses from obtaining government contracts not only with the state in which judgment was entered against the contractor, but also with other states and the Federal Government. An FCA judgment can even have negative ramifications for certain international contracts. THE PRACTITIONER'S GUIDE TO SUSPENSION & DEBARMENT (A.B.A. Sec. Cont. L., 3d. ed. 2002), at 140-41. The chief executive of the Los Angeles MTA has stated that the Tutor-Saliba verdict, if upheld on appeal, may prevent that company from bidding on other California public works projects, including three that are currently valued at more than $1.3 billion. Paul Rosta, *Trial Fallout for Tutor Pondered*, ENGINEERING NEWS-RECORD, 102001 WL 8904194, Aug. 13, 2001.

Responding to the State Qui Tam Law Movement. Members of the *qui tam* bar are often instrumental in getting state false claims bills introduced and guided through the legislature, and entities doing businesses with state and local governments cannot afford to stay on the sidelines during this process. New *qui tam* false claims laws are introduced during every legislative session. Bills that fail during one session are sometimes reintroduced repeatedly until they are ultimately passed.

State legislators are understandably reluctant to go on record opposing a bill that has been promoted as an important "fraud fighting" tool, but often respond appropriately when provided with legislative analysis identifying provisions that are over-reaching or that offer unnecessarily generous bounties to whistleblowers, provisions that inure primarily to the benefit of the plaintiffs' bar, and provisions that represent significant intrusions on the state's prosecutorial authority and discretion. Companies that are forced to defend frivolous cases and to implement unnecessarily complex compliance programs incur costs of doing business that are ultimately passed back to the state and its taxpayers. *Qui tam* litigation also is likely to reduce the number of organizations willing to do business with the state, resulting in higher costs and fewer choices in the marketplace. By aggressively monitoring and responding to proposed state false claims laws, entities doing business with state and local governments have a real opportunity to reduce the risk of suits that can literally put them out of business.

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