State False Claims: Congress Uses Budget Bill to Persuade States to Enact State Qui Tam Laws

Last October we alerted FraudMail readers that a bill pending in Congress contained provisions specifically intended to increase qui tam litigation at both the state and federal level. See FraudMail Alert® No. 05-10-28. The legislation, passed on February 1st, provides incentives for states to enact qui tam false claims laws modeled on the Federal False Claims Act. Additionally, it requires certain health care entities to educate employees on false claims issues, including the methods available for filing qui tam cases.

As expected, these provisions were signed into law today (with only slight modifications) in the Deficit Reduction Act of 2005. Although the legislation amends the Social Security Act and targets the state portion of Medicaid spending, its impact is likely to be felt in industries well beyond health care.

Incentives for the Enactment of State False Claims Laws

State Medicaid programs receive a significant portion of their funding from the federal government. The exact percentage varies from state to state and is based, in part, on per capita income levels. When federal fraud cases have involved Medicaid funds (common in many health care fraud cases involving hospitals, pharmaceutical firms, etc.), recoveries typically have included substantial sums to compensate state governments for their share of damages allegedly incurred by the state Medicaid program, even in the absence of a state qui tam law specifically modeled on the Federal FCA. For example, in 2001 a DOJ press release announced that TAP Pharmaceuticals agreed to pay $25 million to resolve its Medicaid liability to all 50 states and the District of Columbia in the global settlement of a qui tam Federal FCA case. See http://www.usdoj.gov/opa/pr/2001/October/513civ.htm. Nevertheless, whistleblower representatives lobbied Congress, arguing that the absence of state false claims laws was a "loophole" that protected FCA defendants, and encouraging Congress to require all states to enact a state qui tam law.

continued on page 2
The Current Situation in the States

Twelve states currently have broad false claims laws that are modeled on the Federal False Claims Act and contain a *qui tam* enforcement mechanism: California, Florida, Illinois, the District of Columbia, Nevada, Hawaii, Delaware, Massachusetts, Tennessee, Virginia, Montana, and Indiana.

Another five states have more narrow false claims laws with whistleblower enforcement mechanisms, but these laws apply only to health care fraud: Louisiana, Texas, New Mexico, New Hampshire, and Michigan.

State false claims bills are already pending or have been recently introduced in a number of other states, including New York, New Jersey, Kansas, Mississippi, Nebraska, Pennsylvania, Alabama, Oklahoma, Connecticut, Alaska and Minnesota.

The Provisions in the Deficit Reduction Act of 2005

1. A Ten Percent Bonus for the States

Under the new federal legislation, the federal government agrees to pay an additional ten percent of the federal share of any False Claims Act recovery to the state when an action to recover Medicaid funds is litigated under a qualifying state *qui tam* law. That is, if the state provides 40 percent of the funding to its Medicaid program, it would actually be able to retain 50 percent of the recovery. To qualify for the bonus, the state false claims law must contain the following provisions:

- Liability provisions modeled on those found in the Federal FCA;
- Provisions that “are at least as effective in rewarding and facilitating qui tam actions”;
- A requirement that the complaint be filed under seal for 60 days with review by the state Attorney General; and
- A civil penalty that is not less than that authorized in the Federal FCA.

The Federal FCA imposes a civil penalty of not less than $5,500 to $11,000 for violations occurring after September 29, 1999. That provision of the FCA is commonly subjected to constitutional challenges based on the Excessive Fines Clause of the Eighth Amendment and the Due Process Clause. *See, e.g.*, Hudson v. United States, 522 U.S. 93, 103 (1997) (noting that the Due Process and Equal Protection Clauses protect against “downright irrational” sanctions); Hays v. Hoffman, 325 F.3d 982, 992 (8th Cir. 2003) (holding that “FCA penalties are punitive in nature and therefore fall within the reach of the Excessive Fines Clause”). Some states, in part to avoid such constitutional challenges, have given courts greater discretion in awarding penalties than arguably exists under the Federal FCA. For example, the California FCA provides that violations may be subject to “a civil penalty of up to ten thousand dollars ($10,000) for each false claim.” It is not clear whether a Medicaid false claims action filed under such statutes will qualify for the federal 10 percent bonus. Also notable is the fact this new legislation requires only that the state law contain a civil penalty provision that is at least equal to that authorized under the FCA. The new law therefore does not require states to enact legislation that adopts the FCA’s treble damages provision.

The Inspector General of the Department of Health and Human Services is to determine, in consultation with the Attorney General, whether a state false claims law satisfies the criteria for receiving the federal ten percent...

2. Mandatory Employee Education
A second significant FCA-related provision in the Deficit Reduction Act, which also takes effect January 1, 2007, requires certain entities to educate their employees about federal and state false claims laws. It requires any entity that receives or makes annual payments of $5 million or more under a state Medicaid plan to implement written policies for all employees, management, contractors or agents of the entity.

The policies must include “detailed information” regarding:

- the Federal False Claims Act;
- the administrative remedies found in the Program Fraud Civil Remedies Act;
- any state laws imposing civil or criminal penalties for false claims or statements;
- the whistleblower protections provided under such federal and state laws;
- the role of such laws in preventing and detecting fraud, waste, and abuse in federal health care programs; and
- the entity’s existing policies and procedures for detecting and preventing fraud.

Entities covered by this provision must also include in their employee handbooks a specific discussion of the topics listed above. Because this requirement is characterized as a “condition of payment,” plaintiffs can be expected to argue that non-compliance gives rise to potential FCA liability.

The threshold for annual Medicaid payments triggering obligations under this provision was raised from $1 million to $5 million in the conference agreement that was reached by Congress in late December. Additionally, the conference agreement dropped a provision in the original Senate version that would also have required these entities to provide training and protocols to the individuals listed above. Compare S.B. 1932 ES § 6024 with S.B 1932 ENR § 6032.

What Entities Doing State and Federal Business Can Expect

1. A Rush to the State House
A whistleblower advocacy group, Taxpayers Against Fraud (“TAF”), is already circulating a document that it describes as a “model” false claims act for states to enact. Naturally, this document heavily favors qui tam whistleblowers and their lawyers. Its provisions are much more pro-plaintiff than those in the Federal FCA, from both a procedural and substantive standpoint, and they far exceed the requirements for obtaining the federal 10 percent bonus in Medicaid cases. For example, the “model” legislation promoted by TAF contains an extra liability provision not found in the Federal FCA, and would impose FCA liability for the inadvertent receipt of payments that were the result of a false claim, if the recipient discovers the falsity of the claim and fails to report it. The whistleblowers’ bar is likely to aggressively pursue the enactment of state false claims laws that are based on this very pro-plaintiff template.
2. Legislation Targeting All State Expenditures, Not Just Health Care

Although the recently enacted law provides a ten percent federal bonus only for Medicaid recoveries, pro-whistleblower lobbyists are likely to push for, and many legislatures are likely to consider and enact, broad false claims statutes that cover any alleged fraud on the state government. Experience in states that already have such laws demonstrates that a broad range of industries will be affected. BankAmerica paid $187 million and Toshiba paid $30 million to settle suits filed under the California FCA, and large public works projects have generated hotly disputed false claims litigation in Massachusetts and California. Entities that do business with county governments, penal institutions, state universities, public school districts, and state employee pension funds can all be vulnerable to false claims liability. This will significantly affect companies in the oil and gas, highway construction, computer hardware, software, and service industries.

As a result, organizations that do business with state governmental entities should monitor the bills that are being promoted by the whistleblowers’ bar to allegedly implement the new Deficit Reduction Act. By providing legislative analysis that points out the excesses in the pro-plaintiff legislation, companies can reduce the risk that they will be subjected to laws that go well beyond the requirements established by Congress in this recently enacted federal legislation.
If you have questions regarding this area or would like a copy of the decisions or testimony discussed above, please contact us at fraudmail@ffhsj.com or (202) 639-7220.

Washington, DC
John T. Boese
Beth C. McClain