The Expanding Risk Of State False Claims Act Actions

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Recent expansion of state false claims acts represents a new front in the battle against procurement fraud, one that government contractors must be aware of in order to fully analyze and mitigate risks when contracting with state entities. In addition to examining what is driving this development, this article offers suggestions for ways in which contractors can mitigate the growing risk of state fraud actions.

Why State False Claims Act Risk Is Expanding

Following the federal government's example, states are increasingly looking to their own false claims act statutes to combat procurement and health care fraud. This trend is being driven by two main factors: (1) the huge recoveries by the Department of Justice under the federal FCA — $5.7 billion in fiscal year 2014 alone; and (2) a federal statute that provided a financial incentive for states to mirror their own FCAs on the federal FCA with regard to health care fraud.

Currently, 33 states and the District of Columbia have a false claims statute. Of these, 11 states have FCAs that are limited to health care fraud; the remaining statutes penalize a broad range of false claims. Many — but not all — of these state FCAs have provisions allowing for whistleblowers to file qui tam actions on behalf of the state government and to share in any recovery.

Given the enormous recoveries under the federal FCA, states see an opportunity to recover funds by expanding their own FCAs. While health care sector and, more recently, financial sector recoveries account for the majority of funds recovered under the federal FCA, significant liability risks exist in the government contracts space, with approximately $300 million of the DOJ's recoveries in FY 2014 flowing from procurement and grant cases. Of the $5.7 billion recovered in FY 2014, cases filed by whistleblowers accounted for nearly $3 billion, with the whistleblowers receiving $435 million.

In addition, under the Deficit Reduction Act of 2005, the federal government incentivized states to implement or expand their FCAs. Under the DRA, if a state's FCA is as robust as the federal FCA, particularly with respect to the whistleblower incentives and protections, then the state is authorized to keep a portion of the federal government's share of recovered Medicaid funds in addition to the state's own recoveries. Since the DRA was passed, a number of states have revised their FCAs and sought to become eligible for this incentive. The U.S. Department of Health and Human Services publishes its state FCA reviews on its website.[1]

Amendments to State FCA Statutes

In the past decade, dozens of states have amended their FCA statutes. The majority of these amendments have been in two key areas: (1) expanded whistleblower provisions, and (2) expanded scope of liability from health care fraud to all types of fraud, including procurement.

For example, North Carolina amended its FCA statute in 2009 (effective Jan. 1, 2010) to expand the scope of the statute beyond claims for Medicaid reimbursement to include all claims for payment submitted to

the state. The amendments also added whistleblower provisions similar to the federal FCA, allowing private citizens to file suit on behalf of the state and receive 15 to 30 percent of the recoveries, depending on whether the state chooses to intervene.

And last month, Maryland, New Jersey and Vermont became the latest states to take action to either establish or expand the scope of existing FCA legislation:

- Vermont — On Feb. 4, legislation was proposed in Vermont that would establish a state false claims act. The proposed law in many ways mirrors the federal FCA.[2]

- New Jersey — A bill was voted out of the New Jersey Assembly's Health and Senior Services Committee on Feb. 5.[3] If passed, the law would allow New Jersey's FCA to apply retroactively to certain civil actions for false claims made prior to March 13, 2008, the date the original statute took effect.[4] The bill was introduced in response to an October 2011 appellate ruling that held the New Jersey FCA applies only prospectively.

- Maryland — On Feb. 6, a bill was introduced in Maryland that proposed to expand the scope of the state's existing false claims statute to cases beyond Medicaid and health care-related fraud.[5] The current statute, enacted in 2010, is limited to health care.[6]

Revised State False Claims Acts Have Resulted in Large Recoveries

State FCA actions based on alleged procurement fraud have already resulted in large settlements. For example, on Jan. 14, 2014, a California judge approved a $68.5 million settlement to resolve allegations that Office Depot allegedly overcharged California government agencies for office supplies in violation of the state's FCA. Office Depot settled similar overcharging allegations with Florida in 2010 for $4.5 million. Investigations of Office Depot are also underway in Texas, Arizona, Missouri and New York.

In addition, Compass Group USA agreed to an $18 million settlement with the state of New York for claims brought under New York's FCA statute. The settlement resolved allegations that Compass Group overbilled New York schools and school districts from 2003 to 2010, by failing to disclose or pass through to the schools cost-saving rebates paid to the company by vendors and suppliers.

Mitigating the Growing State FCA Risk

The first step in mitigating false claim act risk, whether at the federal or state level, is to ensure your company has an operational ethics and compliance program. Over the past decade, federal contractors have become increasingly aware of the importance of having a robust ethics and compliance program, but the expansion of the state authorities discussed above highlights the importance of including state contracts within the scope of those programs. In other words, contractors active in the federal and state markets should have public procurement compliance programs, not simply federal compliance programs.

For companies with existing compliance programs, integration of state requirements will not pose a significant challenge. State contracting obligations should be integrated into training, included in periodic monitoring and auditing, and addressed in compliance policies and procedures. For those contractors lacking public procurement compliance programs, the increased risk of state false claims act liability provides an additional incentive to put such a program in place.

In addition to assessing whether existing ethics and compliance programs sufficiently address state contracting obligations, companies can mitigate the risk of false claims act suits being filed by whistleblowers by ensuring open lines of communication exist that permit employees, subcontractors and agents to raise concerns. Hotlines that provide for anonymity, policies against retaliation, and a culture of

openness fostered by frequent communications from leadership about commitment to ethical practices will serve to identify potential compliance problems and reduce the risk of disgruntled employees taking legal action.

Because of the incentives provided by the DRA and the size of the recoveries under the federal FCA, we expect state legislatures to continue to expand state FCA statutes. As state prosecutors and whistleblowers become more familiar with these authorities, companies contracting with state entities will face increased risk of state FCA action. It is important that contractors understand this new legal landscape and have policies and procedures in place to adequately mitigate this risk.

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[1] https://oig.hhs.gov/fraud/state-false-claims-act-reviews/

[2] http://legislature.vermont.gov/assets/Documents/2016/Docs/BILLS/H-0120/H-0120%20As%20Introduced.pdf

[3] https://legiscan.com/NJ/text/S2645/id/1055211

[4] http://www.falseclaimsact.com/wp-content/uploads/2013/02/New_Jersey.pdf

[5] https://legiscan.com/MD/text/SB374/id/1112139

[6] http://www.falseclaimsact.com/wp-content/uploads/2013/02/Maryland.pdf

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