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False Claims Act Will Continue to Grow in Influence

BENJAMIN SOUEDE AND NOAH ELLENBERG

In view of the large (and apparently growing) role of the False Claims Act ("FCA") in helping the federal government combat fraud and recover the proceeds of fraud, a brief history of the FCA is a useful exercise. Such a review reveals not only that the FCA is poised to continue to grow in influence as a national revenue source (or at least a revenue recovery source), but that reducing whistleblowers' pleading requirements would make the FCA an even more effective tool to combat fraud against the federal government.

As 2012 drew to a close (and as 2013 dawned), the financial and popular presses ran innumerable (and perhaps, interminable) stories regarding the Congressional battle over the "fiscal cliff," the similarly sited battle over the national debt ceiling, and the almost voracious hunt for new revenue among tax hawks and doves alike.

Amidst this general clamor, there was a small but significant bit of good news on the revenue front: the United States Department of Justice announced that it had secured a record $4.9 billion in "settlements and judgments in civil cases involving fraud against the [federal] government in the fiscal year ending September 30, 2012."[1] While this sum falls significantly below what are generally agreed to be the nation's new revenue needs, $5 billion is undeniably a welcome addition (or perhaps more accurately, given the fraud involved, a welcome restoration) of funds to the federal coffers. Moreover, and significant with respect to the trends for such recoveries, the FY

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2012 recovery was a $1.7 billion leap past the previous single-year recovery record.

THE FALSE CLAIMS ACT

The Justice Department recovered these funds primarily through litigation brought under the False Claims Act ("FCA"), which serves as the government's main civil remedy to recover federal money that has been acquired by means of fraud. Some of the most common types of fraud that form the basis of FCA cases include: Medicare and Medicaid fraud by providers, device manufacturers, and pharmaceutical companies; mortgage and housing fraud by mortgage servicers; and procurement fraud by defense contractors. The largest recoveries for FY 2012 included:

- $1.5 billion from pharmaceutical company GlaxoSmithKline for promoting its drugs for off-label uses and paying kickbacks to physicians;
- $441 million from pharmaceutical company Merck for promoting off-label use and making misleading statements about its drugs' safety;
- $900 million from mortgage servicers for servicing and foreclosure abuses; and
- $200 million from software manufacturer Oracle for overcharging the government for software.

The most effective recovery tool provided by the False Claims Act is found in its *qui tam* provisions. These provisions allow ordinary citizens to serve as whistleblowers, and to file suit (as so-called "relators") in federal court against purported fraudsters. The whistleblower (and his attorney, who is often working on a contingent fee basis) is incentivized and rewarded for filing these suits: a relator may recover up to 30 percent of the total damages and penalties awarded. Demonstrating the importance of these *qui tam* provisions: in 2012, whistleblowers filed 647 FCA lawsuits, which accounted for $3.3 billion of the total $4.9 billion recovered.

In view of the large[2] (and apparently growing) role of the FCA in helping the federal government combat fraud and recover the proceeds of fraud, a

brief history of the FCA is a useful exercise. Such a review reveals not only that the FCA is poised to continue to grow in influence as a national revenue source (or at least a revenue recovery source), but that there are several (solvable) obstacles to the FCA being an even more effective tool to combat fraud against the federal government.

HISTORY OF THE FALSE CLAIMS ACT

Fraud by military contractors during the Civil War was the impetus for passage of the earliest version of the FCA, known informally at the time as "Lincoln Law" and the "Informer's Law." The FCA was passed in 1863 as a means to recover damages from contractors who, among other abuses, sold the army decrepit horses and mules, faulty rifles and ammunition, and rancid rations and provisions. President Abraham Lincoln, in decrying the fraud that led to the FCA's passage, stated: "Worse than traitors in arms are the men who pretend loyalty to the flag, feast and fatten on the misfortunes of the nation while patriotic blood is crimsoning the plains of the south and their countrymen are moldering in the dust."[3]

In 1943 (with the nation again at war), Congress took actions that almost certainly curtailed the FCA's effectiveness. Among other actions, Congress amended the FCA to cut the percentage of damages recovered by the whistleblower from 50 percent to 10 percent (in cases in which the federal government itself intervened as a party in the whistleblower-initiated lawsuit) and 25 percent (when the government did not intervene). Congress also prohibited whistleblower suits if the government already possessed the underlying evidence or information of fraud, even if the federal government had not shown any interest in pursuing recovery. In supporting these restrictive amendments, United States Attorney General Francis Biddle described *qui tam* suits as parasitical actions, explaining that plaintiffs frequently were not providing the government with any new information, instead basing their actions on prior governmental investigations or indictments.[4]

Unsurprisingly, these amendments caused the FCA to fall into general disuse until 1986, when the Reagan Administration (with the support of Congress) gave it new teeth. The Administration was inspired to so act by extensive media reports of widespread fraud being committed against the

federal government, especially by defense contractors taking advantage of increased defense spending generated by the Cold War.[5] In 1985, 9 of the largest 10 defense contractors, and 45 of the top 100, were under investigation for fraud offenses,[6] and voters read newspaper stories of the government paying $900 for toilet seats and $500 for hammers.[7] The government estimated that it was losing between $10 billion and $100 billion per year due to fraud.[8]

The resulting 1986 amendments to the FCA increased the potential recovery from double damages to treble damages (that is, three times the amount of the fraud), increased civil penalties from $2,000 per violation to between $5,000 and $10,000, extended the period of limitations during which a suit may be filed, and reduced the level of willfulness for fraud from actual knowledge to reckless disregard. The amendments also increased the incentives for *qui tam* suits by increasing the whistleblower's recovery to between 15 percent and 30 percent of total damages, by allowing the whistleblower to recover attorney fees from the defendant, and by creating a cause of action for retaliation to protect the whistleblower from a vengeful employer.

Since these amendments were enacted into law, the government has recovered more than $35 billion,[9] with $24.2 billion of that recovery coming from *qui tam* suits.[10] The quantity of FCA litigation increased significantly after the arrival of the 2008 financial crisis: 25 percent of the *qui tam* suits since the FCA's 1986 relaunch have been filed since 2009 (with $10.5 billion recovered from *qui tam* suits since that time). In fact, the FCA has been so effective that the Internal Revenue Service established a similar whistleblower program in 2006;[11] the Dodd-Frank Act, the financial-reform law passed in 2010, did the same for the Securities and Exchange Commission, extending the whistleblower concept from the realm of government contracts to fraud against private parties.[12]

As the recovery figures and the number of filed *qui tam* suits continue to increase, Congress has taken recent measures to further strengthen the FCA. In 2009, as part of the Fraud Enforcement and Recovery Act ("FERA"), Congress strengthened the FCA's provisions for reverse claims (that is, claims where the defendant fraudulently holds onto money it should be paying to the government, as opposed to the typical FCA claim in which the defendant fraudulently receives money from the government). The FERA also expanded conspiracy liability for those who scheme to defraud the government

(but do not necessarily themselves commit the fraud), provided yet more retaliation protection for whistleblowers from employers, and again eased the statute of limitation requirements. In 2010, as part of the Patient Protection and Affordable Care Act, Congress weakened the FCA's restrictions on *qui tam* suits in which the relator is not the original source of the underlying information.[13] Finally, in 2012, Congress once again broadened protections for whistleblowers against their employers.[14]

Despite Congress's demonstrated willingness to strengthen the incentives that encourage whistleblowers, and despite the tangible results those incentives have won, at least one significant barrier to a fully functional FCA remains. This obstacle is both within Congress's powers to fix, and requires only a very small technical addition to the current statute.

FEDERAL RULE OF CIVIL PROCEDURE 9(B)

Federal Rule of Civil Procedure 9(b) requires plaintiffs in fraud actions to plead "with particularity the circumstances constituting fraud." This means that a plaintiff must, in the words of one federal court of appeals, identify "the who, what, when, where, and how" of the events at issue.[15]

While the intent of the drafters of Rule 9(b) is somewhat oblique, post hoc justifications of the Rule often hinge on the importance of protecting defendants' reputations against fraud, deterring nuisance suits, and providing defendants with sufficient notice. Although these justifications certainly carry a certain weight, the problem with respect to FCA cases is that Rule 9(b) implicitly presumes that the plaintiff is the victim of the fraud. That is, the burden of Rule 9(b) on the actual victim of the fraud is not terribly heavy, because a fraud victim will tend to have sufficient information with which to plead the details of the fraud with particularity. However, a whistleblower often will only have partial access to the particulars of a fraudulent scheme, especially if the whistleblower is a lower-level employee.

Despite this distinction, several federal appellate courts have held that FRCP 9(b)'s enhanced pleading requirement applies to claims brought under the FCA. For example, in *Clausen v. Laboratory Corp. of America, Inc.*,[16] the Eleventh Circuit affirmed the dismissal of the whistleblower's complaint under Rule 9(b), even though the complaint contained detailed allegations of a medical testing corporation's scheme to overcharge the government for

unnecessary lab tests. Indeed, the complaint went so far as to identify the specific patients who received tests, describe which tests were improper, and set forth the dates on which the procedures were performed. But the complaint failed to provide any information linking the tests to the submission of actual false claims, except for a conclusory allegation (that is, the bare assertion without any specific supporting factual details). The court held that this failure alone warranted dismissal. Thus, even though the relator was aware of this overcharging scheme, the relator's lack of access to the corporation's billing records was fatal to the claim.

The court ruled similarly in *Atkins v. McInteer*.[17] There, the relator, a psychiatrist, learned of two other psychiatrists who were allegedly committing Medicare and Medicaid fraud by billing the government for services that had not been performed, were not medically necessary, or were the result of upcoding. The relator's complaint was based on medical records he had gained access to, but of course, just like the relator in *Clausen*, he had no access to billing records. The court noted the similarity of the *Clausen* and *Atkins* relators: both cited particular patients, dates, and corresponding medical records, but both failed to show that the defendants actually submitted reimbursement claims for the described fraudulent services.

Several other circuits have agreed with the Eleventh Circuit's approach.[18] These courts typically require that the relator establishes the who, what, when, where and how of the alleged fraud in order to satisfy Rule 9(b); in other words, the time, place, and contents of the false representation.[19] The First Circuit has expounded on that requirement by describing the type of information it looks for in an FCA complaint: "details concerning the dates of the claims, the content of the forms or bills submitted, their identification numbers, the amount of money charged to the government, the particular goods or services for which the government was billed, the individuals involved in the billing, and the length of time between the alleged fraudulent practices and the submission of claims based on those practices."[20] This is clearly a high bar, and it is unclear how any employee who is neither in the billing department nor an executive with widespread access to records would be able to access this information. A low-level employee who becomes aware of a fraud, but does not have access to billing records, is almost *per se* excluded from bringing a *qui tam* lawsuit in these circuits.

Not all circuits have so strictly applied Rule 9(b) to FCA cases. In *Grubbs v. Kanneganti*,[21] the Fifth Circuit was presented with facts very similar to the Tenth Circuit cases discussed above: a psychiatrist learned of a fraudulent billing scheme by several other psychiatrists, and was able to plead with particularity with respect to the scheme, but did not possess such detail on the actual billings sent to the government. But the court in *Grubbs* reversed the district court's dismissal of the claim. It explained that the "time, place, contents, and identity standard is not a straitjacket for Rule 9(b). Rather, the rule is context specific and flexible and must remain so to achieve the remedial purpose of the False Claims Act."[22] The court held that a relator's complaint satisfies Rule 9(b) by "alleging particular details of a scheme to submit false claims paired with reliable indicia that lead to a strong inference that claims were actually submitted."[23] Thus, the relator in *Grubbs* was able to survive the motion to dismiss because the court could infer from the doctors' fraudulent scheme that the goal was to submit false bills to the government.[24] So far only the Seventh Circuit has agreed with the Fifth Circuit's reasoning.[25]

CONCLUSION

While the $4.9 billion recovered by the Justice Department in 2012 was a record figure, plenty of fraudulent schemes remain undetected. The cost of fraud against the federal government is astronomical: some estimates put annual Medicare and Medicaid fraud alone at $100 billion.[26] Given that Congress has acted several times over the past few years to strengthen the FCA, and that the current political climate would favor those who increase government revenue without increasing taxes, Congress might prove receptive to the idea of explicitly weakening Rule 9(b) as it applies to the FCA. Such a move would seem to require little political courage (who is in favor of fraud?), and would permit more whistleblowers to bring *qui tam* lawsuits, when those whistleblowers are aware of fraud but do not yet have all of the details of that fraud. Should Congress enact this change, the FY 2012 recovery of $4.9 billion might be quickly dwarfed.

NOTES

[1] Justice Department Recovers Nearly $5 Billion in False Clims Act Cases in Fiscal Year 2012, *available at* http://www.justice.gov/opa/pr/2012/December/12-ag-1439.html (accessed January 15, 2013).

[2] According to statistics compiled by the nonprofit Taxpayers Against Education Fund, FCA recoveries for fiscal years 1987 through 2008 totaled $21.6 billion. Fraud Statistics—Overview October 1, 1986-September 30, 2008, Civil Division, U.S. Department of Justice, http://www.taf.org/FCA-stats-DoJ-2008.pdf (accessed January 15, 2013).

[3] Larry D. Lahman, *Bad Mules: A Primer on the Federal False Claims Act*, 76 Oklahoma Bar Journal 901 (Apr. 9, 2005), *available at* http://www.okbar.org/obj/articles_05/040905lahman.htm. Senator Jacob Howard explained that the whistleblower provisions were based "upon the old-fashion idea of hold[ing] out a temptation, and setting a rogue to catch a rogue, which is the safest and most expeditious way…ever discovered of bringing rogues to justice." Claire M. Sylvia, *The False Claims Act: Fraud Against the Government* § 2:6, at 43 (West 2004).

[4] Biddle also disapproved of whistleblower suits because of their very nature of rewarding "informers." Biddle quoted a contemporaneous Third Circuit opinion (later reversed by the Supreme Court) that stated that "[i]t is wrong for a free county to allow an informer to seek redress for his own pecuniary advantage in respect of a public wrong in which he has no direct personal interest or concern." Charles Doyle, *Qui Tam: The False Claims Act and Related Federal Statutes* 6 n.39, Congressional Research Service Report for Congress (Aug. 6, 2009), *available at* http://www.fas.org/sgp/crs/misc/R40785.pdf. The case was *Marcus v. Hess*, 127 F.2d 233 (3d Cir. 1942).

[5] *See, e.g.*, Senator William Proxmire, *Cleaning Up Procurement; Why Military Contracting Is Corrupt*, N.Y. Times, Dec. 15, 1985.

[6] Doyle, *supra* note 4, at 7 n.48.

[7] Lahman, *supra* note 3.

[8] Doyle, *supra* note 4, at 7 n.48.

[9] $21.6 billion through 2008, *see supra* note 2, and $13.3 billion since 2008, *see supra* note 1.

[10] *See supra* note 1.

[11] *Whistleblower Office At-A-Glance*, *available at* http://www.irs.gov/uac/Whistleblower-Office-At-a-Glance (accessed January 16, 2013).

[12] *Dodd-Frank Act Rulemaking: Whistleblower Program*, *available at* http://www.sec.gov/spotlight/dodd-frank/whistleblower.shtml (accessed January 16, 2013).
[13] Brian G. Santo, *The False Claims Act: Analysis of the Recently Expanded Legislation on Qui Tam Actions and Related Impact on Whistleblowers*, ABA Health eSource, https://www.americanbar.org/newsletter/publications/aba_health_esource_home/Volume6_SE2_Santo.html.
[14] Editorial, *New Protections for Whistle-Blowers*, N.Y. Times, Nov. 29, 2012.
[15] *Dorsey v. Portfolio Equities, Inc.*, 540 F.3d 333, 339 (5th Cir. 2008) (quoting *ABC Arbitrage Plaintiffs Group v. Tchuruk,* 291 F.3d 336, 350 (5th Cir. 2002)) (internal quotations omitted).
[16] 290 F.3d 1301 (11th Cir. 2002).
[17] 470 F.3d 1350 (11th Cir. 2006).
[18] *See, e.g.*, *Vigil v. Nelnet, Inc.*, 639 F.3d 791, 798-99 (8th Cir. 2011); *Sanderson v. HCA*, 447 F.3d 873, 877-78 (6th Cir. 2006); *Sikkenga v. Regence Bluecross Blueshield of Utah*, 472 F.3d 702, 726-28 (10th Cir. 2006).
[19] *See, e.g.*, *Sikkenga*, 472 F.3d at 727.
[20] *Karvelas v. Melrose-Wakefield Hosp.*, 360 F.3d 220, 233 (1st Cir. 2004).
[21] 565 F.3d 180 (5th Cir. 2009)
[22] *Id.* at 190.
[23] *Id.*
[24] *Id.* at 192.
[25] *See Lusby v. Rolls-Royce Corp.*, 570 F.3d 849, 853-54 (7th Cir. 2009).
[26] George Lemieux, *Lots of Talk, Little Action on Medicare Fraud*, Wall Street Journal A15, Nov. 28, 2012; *see also* Cynthia McFadden, *Medicare Fraud Costs Taxpayers More than $60 billion Each Year*, ABC Nightline, Mar. 17, 2010, http://abcnews.go.com/Nightline/medicare-fraud-costs-taxpayers-60-billion-year/story?id=10126555.