FIGHTING MEDICAID FRAUD: THE DEFICIT REDUCTION ACT, FEDERAL INCENTIVES TO ENACT STATE QUI TAM LAWS AND THE NEW YORK STATE FALSE CLAIMS ACT.

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Introduction

On April 1, 2007, New York State passed a False Claims Act ("NY FCA").[1] This landmark law allows the state and any local government to bring a civil action to recover three times its financial losses from fraud. It also allows a private citizen with inside knowledge of such fraud to bring a qui tam whistleblower action on behalf of the government and to receive up to 30% of the proceeds.

As the highest-spending state in the nation, the absence of a New York State FCA had been a conspicuous void since states started passing laws similar to the federal False Claims Act[2] ("federal FCA") 20 years ago. Still, New York is amongst the first twenty states to do so, along with California,[3] Delaware,[4] Florida,[5] Georgia,[6] Hawaii,[7] Indiana,[8] Illinois,[9] Louisiana,[10] Massachusetts,[11] Michigan,[12] Montana,[13] Nevada,[14] New Jersey,[15] New Hampshire,[16] New Mexico,[17] Oklahoma,[18] Rhode Island,[19] Tennessee,[20] Texas,[21] Virginia[22] and the District of Columbia.[23] New York also was the very first state to pass an FCA since the 2005 enactment of Section 6032 of the federal Deficit Reduction Act ("DRA"), which took effect on January 1, 2007.[24] Since the enactment of the DRA, there has been a flurry of state FCA activity, with six state FCAs passed,[25] seven amended[26] and fourteen introduced.[27]

The DRA: a New Era in Medicaid Fraud Enforcement

"The passage of the DRA ushered in a new era for the FCA."[28] So said the draftsman of the DRA provision, Senator Chuck Grassley of Iowa, Chairman of the Committee on Finance. The purpose of the new provision, he wrote, was to create "a new partnership between the states and the federal government in fighting Medicaid fraud"[29] by giving state governments a financial incentive to pass their own FCAs.[30] Under Section 6032, a state with a qualifying FCA is entitled to an additional 10% share of the state's recoveries in Medicaid fraud cases. In order to qualify for the additional funds, the state FCA must contain provisions that are "at least as effective in rewarding and facilitating qui tam actions" as the federal FCA.

How does this work? Medicaid is funded by federal and state governments in proportions that vary between states, from 50-50 (e.g., New York, California, New Jersey) to approximately 75 (federal)–25 (state) (Mississippi).[31] When there is a national FCA Medicaid fraud recovery, both the federal and the state governments get money back. For example, in late 2007 the drug company Bristol Myers Squibb settled an alleged drug pricing fraud with the government for $515 million, $328 million of which went to the federal government and $187 million of which was shared amongst the states. An individual state's share is based, amongst other things, on the amount of funding the state provides for the Medicaid program. The DRA incentive tacks an extra 10% on to the state share. So, for example, the federal-state share of a Medicaid fraud recovery in New York, prior to the enactment of the NY FCA, was based on a 50-50 split. It is now based on a 40-60 split, a 20% increase in fact. As the state's share decreases, the percentage increase under the DRA increases. So in Georgia, which passed an FCA in 2007,[32] the state's share will increase from 38% to 48%, a 26.3% increase in fact.

So what prompted Congress to give away federal funds in order to prod states down the FCA road? The reported size and scope of Medicaid fraud, for a start. The Medicaid program, which serves some 50 million needy and disabled people, costs the nation about $300 billion a year.[33] While the precise amount lost to Medicare and Medicaid fraud is not known, estimates typically run at around 10%.[34] According to a 2003 study, Medicaid fraud recoveries have been dwarfed by Medicare fraud recoveries by a factor of 24 to 1.[35] While settlements in national pharmaceutical fraud cases have since narrowed this gap, recoveries for Medicaid frauds that are <u>not</u> national in scope remain small compared to Medicare fraud recoveries. Add to this the indisputable success of the post-1986 False Claims Act in recovering federal funds: from $86 million in 1987 (no qui tam cases) to $3.1 billion (qui tam and non-qui tam cases) in 2006.[36] In short, Congress wanted the states to partner with the federal government in containing the escalation of fraud in the Medicaid program.

What is a "qualifying" state FCA?

It is clear that not just any old state FCA will qualify for the additional federal funding. The DRA outlines four requirements for determining if a state FCA is DRA-compliant: (1) the law must create liability for false or fraudulent claims on the Medicaid program; (2) it must be "at least as effective in rewarding and facilitating qui tam actions" as those in the federal FCA; (3) it must provide for filing an action under seal for 60 days with review by the state Attorney General; and (4) it must contain a civil penalty that is not less than that in the federal FCA.[37]

The DRA requires the Inspector General of the Department of Health and Human Services ("HHS IG"), in consultation with the Attorney General, to determine whether these requirements are met.[38] In a letter to the HHS IG and the Attorney General in March 2006, Senator Grassley noted that some states were drafting FCAs "with various modifications and deviations" from the requirements of the DRA that may "undermine the ability of whistleblowers to file qui tam complaints." He asked the recipients to ensure that the Congressional purpose to encourage qui tam actions is fulfilled.[39]

The HHS IG indeed has taken a hard line. On August 18, 2006, the HHS IG released Guidelines for Evaluating State False Claims Acts ("Guidelines"),[40] and thereafter rejected 7 of the first 10 state DRA compliance applications.[41] For example, the California FCA was initially rejected because it set a maximum, but not a minimum, for civil penalties. The Florida FCA was rejected because the limitations period was five years rather than six, and because it imposed liability only for "false" claims, rather than "false or fraudulent" claims. These and other states whose FCAs were initially rejected, including Texas, Louisiana and Nevada, have since passed amendments to their statutes to bring them into DRA compliance.

While the Guidelines avowedly are not "model statutory provisions,"[42] they are quite specific as to the elements of a state FCA that will be considered DRA-compliant. The Guidelines track those aspects of the federal FCA that the HHS IG presumably considered most crucial to fulfilling the Congressional purpose behind the DRA, in particular that state FCAs must be "at least as effective in rewarding and facilitating qui tam actions." In addition to the DRA mandates regarding the sealing of the qui tam action and the inclusion of civil penalties, the Guidelines set forth the following factors that it will consider when evaluating whether a state law is DRA-complaint:

- The state FCA should create liability for knowingly filing false or fraudulent claims, making or using false statements to get false claims paid, conspiracy to get false claims paid, and so-called "reverse false claims," i.e., making a false statement to conceal, avoid or decrease a financial obligation to the state. (For example, the Medicaid Rebate paid by pharmaceutical companies to the government is such an obligation. FCA cases alleging that drug makers misreported their "Best Price" to the government in order to decrease Medicaid Rebate payments have been brought under the "reverse false claims" section of the federal FCA.[43] Settlements in Best Price cases total least $1.3 billion to date.[44])

- The "knowledge" element of the state FCA should mean actual knowledge, deliberate ignorance or reckless disregard.

- The state FCA should include a qui tam provision requiring a copy of the complaint and disclosure of material evidence to be served on the state Attorney General.

- The state FCA should include a "first in time, first in right" provision, barring the filing of a case based on the facts underlying a pending qui tam action.

- The state FCA should permit the qui tam plaintiff to continue as a party to the action if the government intervenes in the action, thus assuming primary responsibility for the action.

- The state FCA should permit the qui tam plaintiff to proceed with the action if the state declines to intervene. The Texas statute, which predates the DRA, was initially declared DRA non-compliant by the HHS OIG because it provided for the action to be dismissed if the state declined to intervene. The Texas statute has since been amended to permit declined cases to go forward.[45]

- The state FCA should provide for the qui tam plaintiff to receive at least 15% of the recovery in a case in which the state intervenes, and at least 25% in a case that the state declines. In both cases, the statute should provide for the qui tam plaintiff to receive a higher percentage depending upon the person's contribution to the prosecution of the action. The Guidelines do not make any reference to a ceiling on the qui tam plaintiff's share. Thus, while the federal FCA provides for a maximum share of 30%, a state FCA could well go beyond that. The California FCA provides for a share of up to 50% in declined cases.[46]

- The state FCA should authorize an award to the qui tam plaintiff of reasonable attorneys' fees and costs, paid by the defendant.

- The state FCA should specify a statute of limitations period of no less than 6 years from the date of the violation, or three years when the material facts were known or should have been known to the state, whichever occurs last.

- The state FCA should state that the burden of proof for liability and damages is a preponderance of the evidence.

- The state FCA should include a cause of action for whistleblowers who suffer retaliation from employers for activities related to an FCA case.

In addition, the Guidelines state that if a state law includes "procedural rights, reductions in [qui tam plaintiff] awards, jurisdictional bars and other qui tam provisions" that are "more restrictive" than those in the federal FCA, the IG "may determine that a State law is not as effective in rewarding or facilitating qui tam actions." This means, for example, that state laws containing monetary caps on the qui tam plaintiff share, or criteria for awarding the qui tam share going beyond the "substantial contribution" standard set forth in the Guidelines, would likely render the state law DRA non-compliant -- unless, of course, the state law made qui tam actions easier or more attractive.

In other words, under the new qui tam era ushered in by the DRA, the only way to go is up. Any state law provisions that might result in a qui tam award that is less than the plaintiff would get under the federal FCA, or that might operate to discourage people from bringing qui tam actions, would likely result in a state law that will not qualify under the DRA.[47]

The NY FCA: a Creature of the DRA

In August 2007, the newly-inked NY FCA was judged by the HHS IG to be DRA-compliant. While it closely tracks the federal FCA, it is not identical. Its central features are the following:

- <u>The scope is broad</u>: The FCA covers almost any false or fraudulent claim or statement that involves a demand for payment from the state or a local government or which deprives it of revenues in some way, including "reverse false claims."[48] The knowledge element includes actual knowledge, deliberate ignorance or reckless disregard.[49]

- Procedure**:** A qui tam complaint is initially filed in court under seal to allow the government to investigate the allegations in confidence. A copy of the complaint, together with a statement of materials facts, are served on the state, which has 60 days (plus extensions of time) to conduct an investigation.[50] Based on federal practices, seal extensions may extend over several years. At the end of this period, the Attorney General decides whether to join the action or to allow the qui tam plaintiff to pursue the action alone. The procedural steps at this point differ slightly from the federal FCA. Under the NY FCA, the Attorney General may:

    - "convert" the action into an Attorney General civil action;

    - "intervene in" the action "so as to aid and assist the plaintiff in the action;"

    - decline to participate in the action, in which case the qui tam plaintiff may pursue the action.[51] If the qui tam plaintiff elects to go forward, the state has the right to intervene at a later date upon a showing to the court of good cause.[52]

- The NY FCA is a "first-in-time, first-in-right" statute: In order to encourage the prompt reporting of fraud, the FCA bars any qui tam case that is based on the "facts underlying" a pre-existing qui tam action.[53] Qui tam plaintiffs with knowledge of the same fraud essentially are in a "race to the courthouse," even if the second-filer has more detailed knowledge and/or provides the government with more assistance. Similarly, the NY FCA provides that if a qui tam plaintiff files the same case as a pre-existing civil case filed by government, the qui tam action is barred.[54]

- NY FCA cases cannot be derived from information that is in the public domain: The qui tam law is designed to encourage individuals with inside knowledge of fraud on the government to come forward and report it. Therefore, the FCA prohibits qui tam cases in which the plaintiff seeks to rely on information that is acquired from public sources, unless the qui tam plaintiff is an "original source" of the information.[55] An "original source" is defined as someone who has direct and independent knowledge of the information and who has reported it to the government before filing the case.[56]

  Under the federal FCA, a case is barred if it is "based on" the public disclosure. The NY FCA uses the language "derived from." This should permit the NY FCA to escape some of the complexity that has characterized rulings on the public disclosure bar in the federal courts. The use of "derived from" effectively adopts Fourth and Seventh Circuit rulings that a qui tam case is not barred if the qui tam plaintiff did not know of the public disclosure and did not rely on it.[57]

- Factors governing the qui tam plaintiff's share**:** The NY FCA provides for a qui tam reward of 15-25% if the Attorney General converts or intervenes in the case, and 25-30% if the government declines to intervene and the plaintiff pursues the action alone.[58] If the relator relied on "specific information" in certain public or government sources, the share is limited to 10%. Like its federal counterpart, the NY FCA provides that the size of the qui tam reward is determined by the extent to which the qui tam plaintiff "substantially contributed" to the prosecution of the case.[59]

- Plaintiffs who were involved in the fraud may have their reward substantially reduced or eliminated**:** The court is authorized to reduce the reward of a qui tam plaintiff who "planned and initiated" the wrongdoing. If the person is criminally convicted for conduct arising from his or her role in the fraud, the person must be dismissed from the case and will not receive any share of the proceeds.[60]

- Employment retaliation**:** Employees whose employers retaliate against them because of their acts in furtherance of a qui tam action can receive double the amount of back pay plus interest, reinstatement and compensation for "special damages."[61]

- Attorneys fees and costs: In a successful suit, both the government's and the relator's attorney fees and costs are recoverable from the defendant.[62]

- Statute of Limitations and Retroactivity: The New York State FCA is expressly retroactive and thus any claims within the statutory limitations period can be immediately filed. A case must be brought within six years of the violation or within three years of the date the government learns, or should have learned, of the facts material to the violation, but in no event more than ten years after the violation.[63]

Conclusion

Critics of the DRA argue that state FCAs will strain the resources of already overtaxed state Medicaid fraud enforcement agencies by requiring them to investigate an avalanche of frivolous state qui tam lawsuits. They argue that the primary beneficiaries of the new regime will be qui tam plaintiffs, who will now receive a "windfall," i.e., a qui tam share of recoveries in states with qualifying FCAs.[64]

As to the first point, state Medicaid fraud enforcers have long complained that they are under-resourced. Meanwhile, the reported incidence of Medicaid fraud has continued to grow. If experience with the federal FCA is any guide, fraud recoveries in states with FCAs will increase as more people, empowered by the qui tam law, come forward with reports of fraud. This will provide additional funds for the state to invest in fraud control. Indeed, the DRA was designed to shine a light on the fact that state agencies do need more money and more staff to fight Medicaid fraud. By exposing more Medicaid fraud and thereby recouping some of the funds that Medicaid fraudsters have looted from state treasuries, states can fund their ongoing enforcement efforts. However dire the predictions of overworked state investigators swamped by mountains of marginal qui tam lawsuits, the federal example cannot be ignored: since the 1986 amendments to the federal FCA, more than $20 billion has been recovered.[65] And for every dollar the federal government invested in health care fraud investigation and prosecution between 2000 and 2004, it got fifteen dollars back.[66]

As to the second point - that only the whistleblowers will benefit from a proliferation of state qui tam laws - it all depends on whether or not you think the qui tam law is a good thing. The whole purpose of the qui tam law is to bring fraud to the government's attention by rewarding people financially for reporting it. The Lincoln Administration saw that as a worthwhile measure in 1863, as did the Reagan Administration in 1986. The thinking behind the DRA is the same. If a qui tam recovery is a "windfall," then the qui tam law must be working. Never let it be forgotten that big qui tam awards do not occur in the absence of big frauds.

There is no doubt that the DRA era presents new challenges for federal and state enforcement agencies, courts and qui tam attorneys on both sides. Federal and state agencies will need to fine-tune their existing coordination infrastructure. Courts will need to deal with the existence of parallel federal-state lawsuits. Litigation of FCA cases will become more complex, and protecting the rights of both plaintiffs and defendants more exacting. From the taxpayers' point of view, all of this will have been worthwhile if state FCAs achieve even a fraction of the recoveries achieved under their federal counterpart.

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[1] NY State. Fin. Law, ch. 13 §§ 187-194.

[2] 31 U.S.C. §§ 3729-3733.

[3] Cal. Govt. Code §§ 12650-12656 (1987).

[4] Del. Code Ann. Title 6 §§ 1201-1209 (2000).

[5] Fla. State. Ann. §§68.081-68.092 (1996).

[6] Ga. Code Ann. §§ 49-4-168 to 49-4-168.6 (2006).

[7] Haw. Rev. Stat. §§ 661.21-26 (2000).

[8] Ind. Code § 5-11-5.5 (2005).

[9] 740 Ill. Comp. Stat. §§ 175/1-8 (1992).

[10] La. Rev. Stat. 46:437.1-14 (1997).

[11] Mass. Gen. L. Ch. 12, §§ 5B *et seq.* (2000).

[12] MCL §§ 400.601 et seq. (2006).

[13] 2005 Montana Code, ch. 465 (2005).

[14] Nev. Rev. Stat. §§ 357.010 *et seq.* (1999).

[15] N.J.S.A.2A; 32C-1 (2008). This statute takes effect in March 2008.

[16] Rev. Stat. Ann. §§ 167.58 *et seq.* (2004).

[17] N.M. Stat. Ann. §§ 27-12-1 *et seq.* (2004).

[18] Okla. Stat. title 63, § 5503.1 *et seq.* (2007).

[19] R.I. Gen. Laws § 9-1.1-1 – 9-1.1.8 (2007).

[20] Tenn. Code Ann. §§ 71-5-182 – 71-5-185 (health care) (1993); Tenn. Code Ann. §§ 41-18-101 – 41-18-108 (general) (2001).

[21] Tex. Hum. Res. Code Ann. §§ 36.001 *et seq.* (1997).

[22] Va. Code Ann. §§ 8.01-216.3 *et seq.* (2002).

[23] D.C. Code Ann. §§ 2-308.13-21 (1996).

[24] § 6032 of the DRA adds § 1909 to the Social Security Act, 42 U.S.C. § 1396 *et seq*. It reads as follows:

> `SEC. 1909. (a) IN GENERAL- Notwithstanding section 1905(b), if a State has in effect a law relating to false or fraudulent claims that meets the requirements of subsection (b), the Federal medical assistance percentage with respect to any amounts recovered under a State action brought under such law, shall be decreased by 10 percentage points.
> `(b) REQUIREMENTS- For purposes of subsection (a), the requirements of this subsection are that the Inspector General of the Department of Health and Human Services, in consultation with the Attorney General, determines that the State has in effect a law that meets the following requirements:
>
> > `(1) The law establishes liability to the State for false or fraudulent claims described in section 3729 of title 31, United States Code, with respect to any expenditure described in section 1903(a).

`(2) The law contains provisions that are at least as effective in rewarding and facilitating qui tam actions for false or fraudulent claims as those described in sections 3730 through 3732 of title 31, United States Code.

`(3) The law contains a requirement for filing an action under seal for 60 days with review by the State Attorney General.

`(4) The law contains a civil penalty that is not less than the amount of the civil penalty authorized under section 3729 of title 31, United States Code.

`(c) DEEMED COMPLIANCE- A State that, as of January 1, 2007, has a law in effect that meets the requirements of subsection (b) shall be deemed to be in compliance with such requirements for so long as the law continues to meet such requirements.

`(d) NO PRECLUSION OF BROADER LAWS- Nothing in this section shall be construed as prohibiting a State that has in effect a law that establishes liability to the State for false or fraudulent claims described in section 3729 of title 31, United States Code, with respect to programs in addition to the State program under this title, or with respect to expenditures in addition to expenditures described in section 1903(a), from being considered to be in compliance with the requirements of subsection (a) so long as the law meets such requirements.'.

(b) EFFECTIVE DATE- Except as provided in section 6035(e), the amendments made by this section take effect on January 1, 2007.

[25] New York, New Jersey, Georgia, Rhode Island, Oklahoma, and New Mexico (general FCA supplementing pre-existing health care FCA) have passed FCAs since 2005.

[26] California, Florida, Nevada, Texas, Illinois, Louisiana, and Virginia have amended their FCAs since 2006.

[27] Arkansas, Colorado, Connecticut, Iowa, Kansas, Maine, Michigan, Mississippi, Missouri, North Carolina, North Dakota, Pennsylvania, South Carolina, and Wisconsin introduced FCA bills in 2006 or 2007.

[28] Senator Chuck Grassley of Iowa, U.S. Senate Committee on Finance, Grassley Works to Implement New Incentives for States to Fight Medicaid Fraud, March 21, 2006. **http://finance.senate.gov/sitepages/grassley2006.htm** (last visited January 21, 2008).

[29] *Id*.

[30] While the DRA was inspired by concerns about fraud in the Medicaid program, most state statutes, with some exceptions (Georgia, Louisiana, Michigan, New Hampshire, Oklahoma, and Texas) are not limited to health care fraud and cover all kinds of fraud on the state. Some state FCAs, e.g., New York, California and Illinois, also cover fraud on local governments. Thus in state areas of spending like public construction, education, roads, bridges and transportation, the environment, criminal justice, and public housing can be the subject of state FCA cases.

[31] See **http://www.taf.org/cashbackstatefca.htm** for a state-by-state listing of federal and state shares of Medicaid funding for FY 2007 (last visited January 21, 2008).

[32] Ga. Code Ann. §§ 49-4-168 to 49-4-168.6.

[33] See **http://www.cms.hhs.gov/MDFraudAbuseGenInfo/** (last visited January 21, 2008).

[34] E.g., Clifford J. Levy and Michael Luo, *New York Medicaid Fraud May Reach Into Billions*, NEW YORK TIMES, July 18, 2005.

[35] Andy Schneider, Taxpayers Against Fraud Education Fund, REDUCING MEDICAID FRAUD: THE POTENTIAL OF THE FALSE CLAIMS ACT (June 2003) available at **http://www.taf.org/publications.htm** (last visited January 21, 2008).

[36] A one-page presentation of official Department of Justice False Claims Statistics for FY 1987-2007 can be found at **http://www.taf.org/statistics.htm** (last visited January 21, 2008). This table does not include recoveries to the states in Medicaid cases.

[37] 42 U.S.C. § 1909(b).

[38] *Id.*

[39] *Supra*, note 24, at 8.

[40] Publication of OIG's Guidelines for Evaluating State False Claims Acts, 77 Fed. Reg 48552 (August 21, 2006).

[41] See **http://oig.hhs.gov/fraud/falseclaimsact.html** (last visited January 21, 2008). The HHS IG's letters to the states stating whether the state's FCA has been judged DRA compliant are posted on this site.

[42] 71 Fed. Reg. 48553 at 48553, *supra*, note 40, at 10.

[43] 31 U.S.C. Section 3729(a)((7).

[44] See Andy Schneider, Taxpayers Against Fraud Education Fund, THE ROLE OF THE FALSE CLAIMS ACT IN COMBATTING MEDICARE AND MEDICAID FRAUD BY DRUG MANUFACTURERS: AN UPDATE (February 2007) Table 1. Available at **http://www.taf.org/publications.htm** (last visited January 21, 2008).

[45] 2007 Texas S.B. 362.

[46] Cal. Govt. Code §12652(f)(3).

[47] Joseph E.B. White, Executive Director of The Taxpayers Against Fraud Education Fund, has drafted a Model State FCA that is specifically tailored towards compliance with the DRA. See **http://www.taf.org/home.htm**. (last visited January 21, 2008).

[48] N.Y. St. Fin. § 189(1).

[49] N.Y. St. Fin. § 188(3).

[50] N.Y. St. Fin. § 190(2)(b).

[51] N.Y. St. Fin. § 190(2)(c).

[52] N.Y. St. Fin. § 190(5)(a).

[53] N.Y. St. Fin. § 190(4).

[54] N.Y. St. Fin. § 190(9)(a).

[55] N.Y. St. Fin. § 190(9)(b).

[56] N.Y. St. Fin. § 188(5).

[57] *U.S. ex rel. Siller v. Becton Dickinson*, 21 F3d 1339 (4th Cir 1994); *U.S. v. Bank of Farmington*, 166 F3d. 853 (7th Cir. 1999).

[58] N.Y. St. Fin. § 190(6) (a) and (b).

[59] N.Y. St. Fin. § 190(6) (a)

[60] N.Y. St. Fin. § 190(8).

[61] N.Y. St. Fin. § 191.

[62] N.Y. St. Fin. § 190(7).

[63] N.Y. St. Fin. § 192.

[64] E.g., Jonathon Diesenhaus, *The Proliferation of State Qui Tam Statutes and the Increasing Complexity of Multi-State Program Fraud Investigations*, Course Materials, American Bar Association Health Care Fraud National Institute (2006).

[65] *Supra*, note 32, at 10.

[66] Jack A Meyer, Taxpayers Against Fraud Education Fund, FIGHTING MEDICARE FRAUD: MORE BANG FOR THE FEDERAL BUCK (July 2006), available at **http://www.taf.org/publications.htm** (last visited January 21, 2008).