

Truth or Consequences: California's False Claims Act

On Oct. 11, 2009, Governor Arnold Schwarzenegger signed AB 1196, amending the California False Claims Act. These amendments strengthen an already potent anti-fraud statute, increase the scope of liability, and legislatively "overrule" a number of cases favorable to defendants. Given the vast amount of public money being pumped into the economy, businesses and their lawyers should be aware of the expanded reach of the California False Claims Act.

In 1987, California became the first state to enact its own False Claims Act to protect the public fisc and provide state and local government a new weapon against fraud. The statute imposes triple damages and civil penalties of up to \$10,000 per false claim. It also identifies eight categories of violations for various types of fraud or overbilling that results in a person obtaining more public funds than warranted. Unlike common law fraud, no specific intent to defraud is required and it is enough that a defendant act with reckless disregard for the truth. Depending on whether state or local funds are involved, the State Attorney General or a local prosecuting authority can institute a False Claims Act action. The statute also authorizes *qui tam* actions by private persons who may share in any recovery.



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The False Claims Act has become an important tool for the state and local governments. The state alone reportedly recovered more than \$1 billion under the False Claims Act since 1999. Actions have been brought in a wide array of contexts, including against contractors on public works projects, health care providers, and those who contract to supply public entities with goods and services.

The California False Claims Act is based upon the federal version of this statute, which Congress originally enacted in 1863 to combat fraud by private contractors during the Civil War. On May 20, 2009, President Obama signed the Fraud Enforcement and Recovery Act, which contained significant amendments to the federal False Claims Act, many of which are incorporated into the amendments to California's False Claims Act. Both the federal and state amendments reflect an intent to overrule recent cases imposing judicial limitations on the scope and reach of these statutes.



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The amendments to the California False Claims Act change the language regarding the imposition of civil penalties from "may" to "shall" making clear that penalties are not discretionary. As amended, the statute specifies that a person who commits any of the "enumerated acts...shall have violated this article" and "shall" be liable for a civil penalty of "not less than" \$5,000 and "not more than" \$10,000 "for each violation."

Also, the California False Claims Act has been changed so that civil penalties are now assessed "for each violation" rather than "for each false claim." This seemingly minor change in language has potentially far-reaching consequences and is directed at the decision in *Fassberg Construction Co. v. Housing Authority of the City of Los Angeles*, 152 Cal.

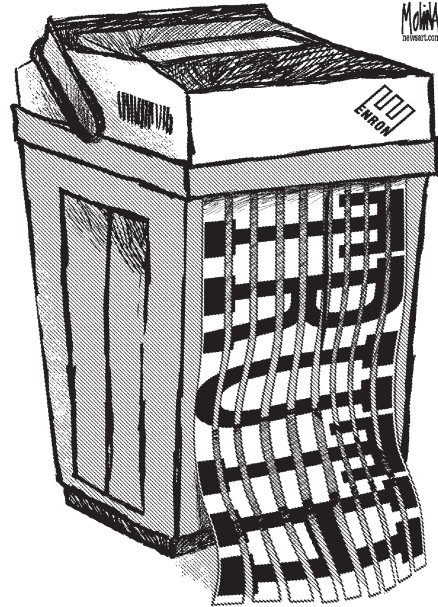
App. 4th 720 (2007). This case took what some considered to be an extremely narrow view of a "false claim" and when civil penalties could be imposed. The legislative history suggests that the change may have been intended to influence how courts count the number of violations and the proper number of penalties. For example, if 100 false records are created to support one false claim, some might argue based on the legislative history that 100 civil penalties of not less than \$5,000 per false record should be imposed (i.e., \$500,000 in penalties). If the amendment is so interpreted, defendants could face exposure to civil penalties out of proportion to the amount of the damages. This may lead to constitutional challenges in a particular case.

A number of changes were made to both the federal and California False Claims Act to legislatively "reverse" the United States Supreme Court's decision in *Allison Engine Co. v. United States ex. rel. Sanders*, 128 S. Ct. 2123 (2008). The *Allison* case held that subcontractors ordinarily could not be liable for using a false record "to get a false or fraudulent claim paid or approved by the Government" or for conspiring "to defraud the Government by getting a false or fraudulent claim allowed or paid." In the Supreme Court's view, the quoted statutory language imposed an intent requirement even though no such express intent requirement appears on the face of the statute. The *Allison* decision provided subcontractors on government contracts with a potentially significant defense to False Claims Act liability and raised doubts as to liability of intermediaries (e.g., recipients of federal grant money administered through state entities).

Congress and the state Legislature made a number of detailed changes to definitions in the False Claims Act and to several of the enumerated violations to broaden the scope of liability and prevent the interpretations reflected in *Allison* from being resurrected. First, the definition of "claim" in Section 12650(b)(1) of the California False Claims Act was revised to generally conform with the expanded definition of "claim" in the federal False Claims Act. Under this definition, the False Claims Act expressly extends to a claim by a subcontractor to a general contractor or other intermediary who receives the public money even where the subcontractor making the request for payment may not intend for the claim to be paid by the government itself. Second, the language relied upon in *Allison* was removed from the violations listed in Sections 12651(a)(2) (false record) and (a)(3) (conspiracy). As revised, the conspiracy subsection makes clear that liability exists for conspiring to violate any of the enumerated violations. The violation of Section 12651(a)(2) now only requires that a false record be "material" to a false claim and not that it be made or used "to get a false claim paid or approved by the state or by any political subdivision." The same revisions were made to the federal False Claims Act.

Section 12651(a)(7) has been revised to enhance potential recovery for so-called reverse false claims, which may now include attempts to knowingly and improperly conceal, avoid or decrease an obligation to pay or transmit money or property to the state or local government, regardless of whether a false record or statement was used. However, the amendments to the federal False Claims Act added a very broad definition of "obligation" that, for some reason, was not added to the amendment of the California False Claims Act.

Under prior law, *qui tam* actions could be dismissed with approval of the court. Section 12652 has been amended to also require written consent from the Attorney General and/or the prosecuting authority for a political subdivision (depending upon the funds in dispute). The amendment to Section 12652 also adds that no claim for any of the enumerated violations in Section 12651 "may be waived or released by any private person, except if the action is part of a court approved settlement of a false claim civil action brought under this section."



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As amended, a False Claims Act action must be filed within three years "after the date of discovery by the Attorney General or prosecuting authority with jurisdiction to act under this article" subject to a ten year statute of repose. This amendment may raise challenging issues concerning the scope of discovery and privileges as the statute now specifies that the knowledge of government lawyers commences the running of the three year discovery rule.

In one of the few bright spots for potential defendants, Section 12653 now permits a court to award reasonable attorney's fees and costs if the defendant prevails in an action under the False Claims Act and the court finds that the claim was brought "primarily" rather than "solely" for purposes of harassment.

The California amendments confirm that the Legislature views the False Claims Act as a powerful tool for state and local government, particularly in light of the billions of dollars in new spending under the federal stimulus plan. Like the federal government, California has strengthened the False Claims Act and attempted to nullify judicially imposed limitations. As a result, more claims under the California False Claims Act are likely to be filed and potential defendants may face greater exposure to liability.

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