The Truth about False Claims

BY DANIEL D. MCMILLAN

California's False Claims Act (FCA) penalizes any person who knowingly overcharges the government. Cal. Gov't Code §§ 12650-12656. Enacted in 1987, the law was little used for almost a decade, resulting in a "dearth of California authority." *City of Pomona v. Superior Court,* 89 Cal. App. 4th 793, 802 (2001). But today FCA actions have become quite common—and are currently much in the news.

The rising tide of FCA cases has triggered complaints that the act is now being overused by public entities and those bringing whistle-blower actions. No objection can be mustered against punishing archetypal false claims in which, for example, a doctor bills Medicaid for exams on phantom patients. But critics of the new wave of FCA actions contend that the government asserts violations to chill legitimate claims and gain unfair settlement leverage knowing that few businesses have the resources to sustain a defense—and those that do frequently cannot risk the consequences of an adverse judgment. In a state confronting enormous budget deficits, many critics charge that some local prosecuting authorities may be pressured to make up shortfalls by stretching the reach of the FCA in the hope of obtaining treble damage recoveries or substantial settlements.

The debate over the FCA has made its way to Sacramento. However, efforts to scale back its scope have met little success. A bill that would have precluded the government from asserting FCA violations as cross-claims failed during the 2001–2002 legislative session. And in the current session, Assembly Bill 972, specifying that local prosecuting authorities may not file FCA actions in retaliation for good faith disputes with contractors, has stalled.

But despite harsh criticism, the FCA remains the law. And given the expansive role of state and local government in the economy, familiarity with the FCA should no longer be the sole domain of lawyers specializing in government contracts or white-collar crimes.

HISTORY AND PURPOSE

Congress enacted the federal FCA in 1863 to combat "the massive frauds" perpetrated by private contractors during the Civil War. *United States v. Bornstein,* 423 U.S. 303, 309 (1976); 31 U.S.C. §§ 3729–333. In 1986 Congress revamped the act to make it "a more useful tool against fraud in modern times." *Cook County v. United States ex rel. Chandler,* 123 S. Ct. 1239, 1248 (2003). Recovery was increased from double to treble damages and financial incentives for whistle-blower actions were also increased.

In 1987 California became the first state to enact its own FCA and patterned it after the federal statute. *Laraway v. Sutro & Co.,* 96 Cal. App. 4th 266, 275 (2002). The California FCA was adopted in the wake of the 1986 amendments to the federal statute and in the face of mounting concerns about fraud against state and local governments. Like its federal counterpart, the purpose of California's FCA is "to protect the public fisc." *LeVine v. Weis,* 68 Cal. App. 4th 758, 765 (1998). To that end, the statute is to be "liberally construed and applied to promote the public interest," and its remedies are in addition to those provided for in any other law or under common law. Cal. Gov't Code § 12655(a) and (c).

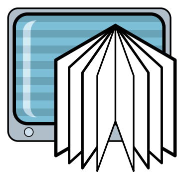
PROHIBITED CONDUCT

The California FCA (Cal. Gov't Code § 12651(A)(1)–(8)) prohibits eight types of conduct:

1. knowingly presenting or causing to be presented to the government a false claim for payment or approval

2. knowingly making, using, or causing to be made or used a false record or statement to get a false claim paid or approved by the government

3. knowingly conspiring to defraud the government by getting a false claim allowed or paid



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Daniel D. McMillan (ddmcmillan@jonesday.com) is a litigation partner at the Los Angeles office of Jones Day and serves as cochair of the firm's construction practice.

4. knowingly delivering or causing to be delivered less public property or money than reflected on a receipt or certificate
5. knowingly making or delivering a receipt by an authorized person that falsely represents the property to be used by the government
6. knowingly buying or receiving a pledge of public property from any person who lawfully may not sell or pledge it
7. knowingly making, using, or causing to be made or used a false record or statement to conceal, avoid, or decrease an obligation to pay or transmit money or property to the government—also known as a reverse false claim
8. being the beneficiary of an inadvertent false claim who discovers its falsity and fails to disclose it to the government within a reasonable time.

Despite the somewhat stilted statutory language, the essence of the various FCA violations is cheating the government from something it is owed. Though each of the first seven types of false claims has an express analogue in the federal FCA, the inadvertent beneficiary violation is unique to California. The first three types of prohibited conduct and the reverse false claim are the most frequently asserted violations.

Consistent with the remedial purpose of the FCA, the term *claim* is broadly defined to include any request or demand for money, property, or services made to any employee or representative of state or local government. In addition, claims include requests or demands made to a contractor, grantee, or other recipient when any portion of the money, property or services was provided by the government. Cal. Gov't Code § 12650(b)(1). When two or more people violate the act, joint and several liability applies. Cal. Gov't Code § 12651(c).

EXEMPTIONS AND LIMITATIONS

The FCA contains three exemptions and a minimum dollar threshold. It does not apply to workers compensation claims, claims under the Revenue and Taxation Code, or claims submitted under California's Torts Claim Act. Cal. Gov't Code § 12651(e)–(f); *Stacy & Witbeck, Inc. v. City and County of San Francisco,* 47 Cal. App. 4th 1 (1996). The FCA also does not apply to any controversy valued at less than $500; however, only the aggregate amount in controversy, not each individual false claim, must satisfy this threshold. Cal. Gov't Code § 12651(d).

ELEMENTS OF LIABILITY

With the exception of conspiracy and inadvertent beneficiary violations, the FCA expressly requires that a defendant act knowingly—with actual knowledge, in deliberate ignorance of truth or falsity, or in reckless disregard of the truth or falsity. No proof of specific intent to defraud is required. Gov't Code § 12650(b)(2). This definition of *knowingly,* which mirrors the definition in the federal FCA, enables the government not only to effectively prosecute those who have actual knowledge but also those "who play ostrich." H. Rep. No. 99-660, at 20–21 (June 26, 1986); 31 U.S.C. § 3729(b).

Even so, proving that someone acted knowingly is often problematic. First, mere errors and innocent mistakes do not establish it. As one court noted: "Proof of one's mistakes or inabilities is not evidence that one is a cheat." *Wang v. FMC Corp.,* 975 F.2d 1412, 1421 (1992). Second, the requisite mindset ordinarily cannot be established when a person proceeds in good faith based on a reasonable and nonfrivolous interpretation of an ambiguous contract or regulatory provision. *United States ex rel. Oliver v. Parsons Co.,* 195 F.3d, 457, 460 (1999); *Commercial Contractors, Inc. v. United States,* 154 F.3d 1357, 1366 (1998). Third, absent unusual circumstances such as collusion with a public employee, this requirement cannot be satisfied when the government knows of the supposedly false aspects of the claim and invites them. *People v. Duz-Mor Diagnostic Lab., Inc.,* 68 Cal. App. 4th 654, 672–73 (1998).

Depending on the violation alleged, additional elements must be established to impose liability for damages. The FCA requires that some aspect of the information submitted to the government be objectively false or inaccurate. Cal. Gov't Code § 12651(a)(1)–(8). Some courts have also required plaintiffs to establish that the false information was material, relied upon by the government, and damaged the government. *City of Pomona,* 89 Cal. App. 4th at 802. The plaintiff must prove all essential elements of the cause of action, including damages, by a preponderance of the evidence. Cal. Gov't Code § 12654(c). Finally, an action must be filed within three years after the violation was discovered or ten years after it was committed, whichever is earlier. Cal. Gov't Code § 12654(a).

REMEDIES

A person who violates the FCA is liable for three times the amount of damages sustained by the government. Cal. Gov't Code § 12651(a). The analogous treble damages provision under the federal FCA does not permit recovery of consequential damages. *United States v. Aerodex, Inc.,* 469 F.2d 1003, 1011 (1972). And violators may also be liable for civil penalties of up to $10,000 for each false claim. Cal. Gov't Code § 12651(a). Unlike the federal FCA, which specifies a minimum penalty of $5,000 and a maximum of $10,000, the California statute does not specify a minimum. Compare 31 U.S.C. § 3729(a) with Cal. Gov't Code § 12651(a).

A court may reduce the damages multiplier to not less than twice the sustained damages and may award no civil penalty when the wrongdoer has disclosed all information about the violation within 30 days of obtaining the information. Cal. Gov't Code § 12651 (b). In construing language similar to the California FCA, a number of courts have held that the government may recover statutory penalties under the federal FCA even absent actual damages. *United States v. Rule Indus., Inc.,* 878 F.2d 535, 536–38 (1989) ($604, 000 in FCA penalties imposed for 302 invoices for hacksaw blades that violated the Buy American Act but caused no actual damages).

Although a person who violates the FCA is responsible for the costs of a civil action, a successful individual plaintiff is entitled to costs plus reasonable expenses and attorneys fees. Cal. Gov't Code §§ 12651(a) and 12652(g)(8). Notably, however, the FCA does not authorize the government to recover attorneys fees. In reaction to complaints about misuse, the legislature amended the FCA in 1996 to allow courts to award a prevailing defendant reasonable attorneys fees and expenses when a party proceeds with an action that was "clearly frivolous, clearly vexatious, or brought solely for purposes of harassment." Cal. Gov't Code § 12652(g)(9).

COLLATERAL CONSEQUENCES

Violating the FCA may jeopardize a company's eligibility to contract with public entities in the future. *Stacy & Witbeck, Inc. v. City and County of San Francisco,* 36 Cal. App. 4th 1074, 1080–82 (1995). That could spell financial ruin for a business dependent on the public sector. Moreover, criminal investigation or prosecution for the same conduct alleged to violate the FCA may arise any time, and the law itself contemplates parallel criminal proceedings. Cal. Gov't Code § 12652(h); Cal. Gov't Code § 12654(d); Cal. Penal Code § 72 (false statement to public entities may constitute a felony).

DIRECT AND QUI TAM ACTIONS

FCA actions may be initiated by the attorney general when state funds are involved or by the prosecuting authority for a political subdivision when local funds are involved. Cal. Gov't Code § 12652(a)(1) and (b)(1). Although all are obligated to diligently investigate violations, they retain discretion to decide whether to commence civil actions. Cal. Gov't Code § 12652(a)(1) and (b)(1); *Southern California Rapid Transit Dist. v. Superior Court,* 30 Cal. App. 4th 713, 724 n.9 (1994).

The FCA also authorizes any private person or whistle-blower to initiate actions on behalf of the government. Cal. Gov't Code §§ 12652(c)(1) and 12650 (b)(5). Such a person is known as a qui tam plaintiff or relator. Cal. Gov't Code § 12652(c)(1). The phrase *qui tam* comes from a Latin phrase meaning "who pursues this action on our Lord the King's behalf as well as his own." *City of Pomona,* 89 Cal. App. 4th at 797 n.1. The qui tam provisions supplement government efforts to identify and prosecute fraudulent claims by creating financial incentives for whistle-blowers. *Rothschild v. Tyco Int'l, Inc.,* 83 Cal. App. 4th 488, 494–95 (2000).

A qui tam plaintiff is entitled to 25 to 50 percent of the proceeds of the action or settlement when the government declines to intervene and 15 to 33 percent when the government elects to intervene. Cal. Gov't Code § 12652(g)(2), (3), and (7). Based upon the idea of

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"setting a rogue to catch a rogue," even a person who participated in fraud may bring a qui tam action. *Mortgages, Inc. v. United States Dist. Ct.,* 934 F.2d 209, 213 (1991); Cal. Gov't Code § 12652-(g)(4)–(5) (participant in fraud not guaranteed a minimum share of the recovery). Counsel for whistle-blowers should become familiar with the special procedures that apply to qui tam actions, including the requirement that the complaint be filed under seal and served upon the attorney general. Cal. Gov't Code § 12652(c)(1)–(8).

To curb opportunistic or parasitic actions, qui tam actions are limited in several circumstances. *Rothschild,* 83 Cal. App. 4th at 495. For example, the FCA bars actions based on facts alleged in pending qui tam actions. Cal. Gov't Code § 12652(c)(10). Similarly, qui tam actions are barred when "based upon allegations or transactions that are the subject of a civil suit or an administrative civil money penalty proceeding in which the state or political subdivision is already a party." Cal. Gov't Code § 12652(d)(2). And there is no jurisdiction over actions against specified public officials based on information known to the government when the action was commenced. Cal. Gov't Code § 12652(d)(1). Public employees may not bring qui tam actions based on information discovered during their employment unless they have exhausted internal investigation procedures and the government fails to act within a reasonable time. Cal. Gov't Code § 12652 (d)(4). Finally, actions based on the public disclosure of allegations in certain judicial or other governmental investigations, reports, hearings, or audits, or by the news media are also foreclosed unless the plaintiff is an original source of the information. Cal. Gov't Code § 12652(d)(3)(A)-(B). That assures that today's headlines cannot become tomorrow's qui tam action since the whistle has already been blown.

PROTECTIONS FOR WHISTLE-BLOWERS

The FCA prohibits an employer from retaliating or discriminating against an employee in terms or conditions of employment because of lawful acts in disclosing information to the government or in furthering a false claim action. Cal. Gov't Code § 12653(b). An employer who violates this prohibition may be liable for reinstating the employee and for paying twice the amount of back pay plus interest, special damages, punitive damages, litigation costs, and reasonable attorneys fees. Cal. Gov't Code § 12653(c) and (d). Relief is available only against the employer and not against supervisors or other employees acting on the employer's behalf. *LeVine v. Weis,* 90 Cal. App. 4th 201, 214 (2001). CL

Self-Assessment Test

MCLE SELF TEST

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The California False Claims Act

1. A person who violates the California False Claims Act (FCA) may be liable for three times the amount of damages sustained by the state or political subdivision—and civil penalties of up to $10,000 for each false claim.
☐ True ☐ False

2. Only the attorney general of the state of California may initiate an action for a violation of the FCA.
☐ True ☐ False

3. The FCA imposes liability only when there has been a false "claim" in the form of a written invoice demanding that money be paid.
☐ True ☐ False

4. Liability cannot arise under the FCA when the requests for payments are made to a third-party contractor who administers a publicly funded program rather than to the state or a political subdivision.
☐ True ☐ False

5. The beneficiary of an inadvertent submission of a false claim to a public entity is liable under the FCA if he or she discovers the falsity of the claim and fails to disclose that false claim to the public entity within a reasonable time.
☐ True ☐ False

6. For violations of the FCA requiring that a person acted knowingly, the plaintiff must establish specific intent to defraud.
☐ True ☐ False

7. Presenting a public entity with a claim as required by the Torts Claim Act can itself give rise to liability under the FCA.
☐ True ☐ False

8. A person who makes false claims in connection with the California Revenue and Taxation Code faces potential liability under the FCA.
☐ True ☐ False

9. Judgments against defendants in FCA actions may result in a criminal record and imprisonment.
☐ True ☐ False

10. A court may require a person who knowingly presents a false claim for payment to pay a penalty under the FCA even if the public entity affected by the claim rejects the false claim and suffers no actual damages.
☐ True ☐ False

11. A public entity that discovers a violation of the FCA that has been concealed for more than ten years may bring an action within three years of discovering the violation.
☐ True ☐ False

12. Plaintiffs in FCA actions are required to prove all essential elements of the cause of action by a preponderance of the evidence.
☐ True ☐ False

13. The FCA is the exclusive remedy for conduct violating its provisions.
☐ True ☐ False

14. A private person who files an FCA action is known as a qui tam plaintiff.
☐ True ☐ False

15. A qui tam plaintiff may be entitled to up to 50 percent of any recovery under the FCA.
☐ True ☐ False

16. A qui tam plaintiff in an FCA action must file the complaint under seal and must also serve a copy on the attorney general.
☐ True ☐ False

17. The attorney general may commence a civil action for violation of the FCA involving state funds.
☐ True ☐ False

18. Any person who learns about transactions violating the FCA solely from viewing the television show *60 Minutes,* for example, may maintain a qui tam action as long as it is the first such action to be filed.
☐ True ☐ False

19. A person may not bring a qui tam action under the FCA when the complaint is based upon allegations or transactions that are the subject of a civil lawsuit or an administrative civil money penalty proceeding in which the state or political subdivision is already a party.
☐ True ☐ False

20. The FCA precludes a person who participated in a fraud from filing a qui tam action based on that fraud.
☐ True ☐ False

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