Recent Developments in the New York False Claims Act

On January 26, 2011, Attorney General Eric Schneiderman unveiled his first major initiative, a plan to increase enforcement of the recently amended New York False Claims Act ("NY FCA") to target fraud against the state.[1] In addition to increasing prosecution of Medicare and Medicaid fraud, the Attorney General announced his intention to create a Taxpayer Protection Unit to focus on other areas of contractor fraud. The announcement was not unexpected. As a state senator, General Schneiderman shepherded the 2010 New York Fraud Enforcement and Recovery Act ("NY FERA"), which consisted of amendments to the NY FCA, through the New York legislature, and promised throughout his 2010 campaign for Attorney General that enforcement of the invigorated statute would be his office's top priority in 2011. The move has serious implications for any entity doing business with or within the state of New York.

The NY FCA imposes treble damages and steep civil fines on anyone who recklessly submits false claims to the government and encourages private whistleblowers to report false claims by granting them a share of any recovery. The 2010 amendments further expand liability in three important ways: First, the statute now explicitly authorizes actions for tax fraud, which no other state's statute does and which the federal FCA expressly prohibits. Second, the NY FERA amendments expand the types of protected whistleblower activities and grants employees immunity as to potential violations of contractual provisions governing the use of confidential company information. Finally, the amendments limit certain common legal defenses against such suits by extending the statute of limitations and relaxing the public-disclosure and heightened-pleading requirements. Below is an overview of the NY FCA, an explanation of how these amendments expand fraud liability against individuals and companies doing business with the state, and points on what to expect in NY FCA enforcement this year.

I. Overview of the New York FCA

The NY FCA imposes liability on persons or entities who knowingly or recklessly present false claims for payment to the state or local governments.[2] Specific intent to defraud is not a required element; a party's "reckless disregard for the truth or falsity" of information submitted is sufficient to establish liability.[3] To facilitate enforcement, the law allows a private party, known as a "*qui tam* plaintiff" (or "relator") to bring claims on behalf of the state, and incentivizes such conduct by offering relators between 15% and 30% of any recovery by the government plus attorneys' fees.[4] The statute sets forth the procedures by which whistleblowers may file FCA claims on behalf of the state and protects whistleblowers by offering a cause of action against employers who retaliate against an individual as a result of attempts to prevent or expose violations of the NY FCA.[5]

In the past, the statute has been used almost exclusively against doctors or hospitals in connection with Medicaid fraud. However, just as whistleblowers and the federal government have expanded the bases and theories of liability in recent years under the federal act—the model for the state statute—so the Attorney General is committed to an expansion of liability in New York.[6]

II. NY FCA Liability for Tax Fraud

Under the 2010 NY FERA amendments, *qui tam* plaintiffs may now bring actions under the NY FCA for tax fraud where the defendant's net income or sales exceed $1 million for the applicable year and damages to the state exceed $350,000.[7] The federal law, in contrast, expressly prohibits qui tam claims for tax fraud and, while many other states do not prohibit these claims, New York is the first state to expressly authorize them.[8] In addition, under the NY FCA, the state's potential recovery for such suits includes not only civil fines but also three times the amount of underpaid taxes. Together, these changes increase the likelihood that companies and high-net-worth individuals will face legal scrutiny regarding their tax submissions, and the potential exposure if they do.

The expansion of NY FCA liability to tax evasion has some important implications for corporations and high-net-worth individuals doing business in New York. For example, persons who reside in New York part-time but consider themselves residents of other states are likely to face greater scrutiny now that an unintentional but potentially reckless failure to comply with residency requirements could provide the state with a significant recovery of tax revenue. Corporations doing business in New York must also be extremely vigilant in complying with the requirements of complex tax shelters or exemptions. Because an employee's recklessness may be imputed to his employer, educating employees of the severe consequences of noncompliance with exemptions claimed by the corporation is now more important than ever. Expect to see the Department of Taxation and Finance work with the Attorney General's office to pursue corporations or wealthy individuals for tax evasion under the FCA.

III. Expanded Whistleblower Protection Against Retaliation

The NY FERA amendments expand the coverage of the statute's anti-retaliation provisions in order to encourage private individuals to expose alleged fraud and file suit under the statute. Whereas the statute previously protected "any employee of any private or public employer" who engaged in certain specified conduct, the amendments expand the coverage to "any current or former employee, contractor, or agent of any private or public employer."[9] The Act dictates that anyone who is "discharged, demoted, suspended, threatened, harassed or in any other manner discriminated against . . . because of lawful acts done . . . in furtherance of an [FCA] action" is entitled to relief, including reinstatement, two-times backpay, compensation for any special damages, and attorneys' fees.[10]

As amended, therefore, the statute extends a cause of action not only to employees, but also former employees and agents, including independent contractors, accountants, or consultants. In addition, rather than requiring employees or agents to report potential fraud within the corporation before bringing an FCA claim, the amendments encourage suit by immunizing employees, contractors, or agents who steal or transmit confidential or sensitive company documents from their workplace to support an FCA claim. Under the amended statute, a "lawful act" for purposes of the anti-retaliation provision includes "obtaining or transmitting to the state, a local government, a *qui tam* plaintiff, or private counsel solely employed to investigate, potentially file, or file a cause of action under [the FCA], documents, data, correspondence, electronic mail, or any other information . . ." even if the removal or transmission "may violate a contract, employment term, or duty owed to the employer or contractor."[11] As a result, agents who are tasked with ensuring regulatory compliance and have access to confidential information to do so, such as accountants or consultants, may file an FCA action rather than report noncompliance to the company. To avoid a deluge of *qui tam* actions, companies should take additional steps to monitor their

government sales practices as well as to create an environment in which employees will choose to raise problems internally first.

IV. Elimination of Common Defenses

The 2010 NY FERA amendments have eliminated a number of potent legal defenses relied upon by companies to dismiss FCA claims at the early stages of litigation. As a result of these changes, FCA plaintiffs will increasingly reach discovery and defendants will be required to address the merits of their claims.

1. Statute of Limitations

Prior to the 2010 amendments, the statute of limitations for claims under the NY FCA was identical to the federal statute: six years from the date the violation occurred or three years after the date when facts material to the action were "known or reasonably should have been known by the [appropriate government entity or individual]. . . but in no event more than ten years after the date on which the violation is committed, whichever occurs last."[12] The revised law extends the statute of limitations from six years from the date of the violation to ten years and removes the alternative three-year limitations period tied to the government's actual or constructive knowledge.[13] As amended, the statute of limitations for FCA suits is now substantially longer than the limitations period for almost every other civil action under New York law, including common-law fraud between private parties (six years). Corporations and high-net-worth individuals doing business in New York should reevaluate their record retention policies to ensure they are not defenseless to a claim of fraud under the FCA that may arise up to ten years in the future.

2. Public Disclosure Requirement / Original Source Exemption

Mirroring the federal FCA Amendments in 2009-2010, the NY amendments narrow the class of sources that may create a "public disclosure" under the law; give the state or local governments an opportunity to oppose dismissal of an action even if based on a public disclosure; and expand the definition of "original source," which presents an exception to the public-disclosure requirement. After the amendment, the definition of "original source" now includes individuals who (i) provide the information on which the FCA complaint was based to the government prior to the public disclosure, or (ii) have knowledge that is independent of and materially adds to the public disclosures, and who voluntarily provides such information to the government before or concurrent with the filing of the action.[14] All of these revisions will have the effect of allowing more *qui tam* actions to proceed, even where the plaintiff is arguably not a true whistleblower to the alleged claims.

3. CPLR 3016: Pleading Fraud with Particularity

Similar to Federal Rule of Civil Procedure 9(b), the CPLR requires that allegations of fraud be "stated in detail."[15] However, the 2010 FERA amendments relax this pleading burden by stating that actions brought under the NY FCA statute "shall not be required to identify specific claims that result from an alleged course of misconduct, or any specific records or statements used, if the facts alleged in the complaint, if ultimately proven true, would provide a reasonable indication of one or more violations . . . , and if the allegations in the pleading provide adequate notice of the specific nature of the alleged misconduct . . ."[16] As a result, plaintiffs may now be able to proceed to discovery without identifying specific false claims or statements used, so long as the allegations reasonably allege a violation of the statute.

Conclusion

With New York facing one of its biggest budget shortfalls in recent history, and the Attorney General expressing his willingness to use, and encourage relators to use, the newly amended NY FCA to recoup state funds, it is likely that NY FCA litigation will increase in 2011. Corporations and individuals alike in New York need to remain cognizant of these risks, and may need to revise their policies to protect themselves from potential FCA liability. Patterson Belknap will continue to monitor developments in this area. ◆

Endnotes

1 *NY Attorney General to target contractor fraud*, Wall Street Journal, Jan. 27, 2011.
2 N.Y. State Fin. Law §§ 188-89 (2010).
3 *Id.* § 188(3)(a)(iii).
4 *Id.* § 190(6).
5 *Id.* § 191.
6 *See Eric Schneiderman's Agenda for the Office of New York State Attorney General*, at 17 (2010), *available at* http://www.ericschneiderman.com/admin/miscimages/files/Eric-Schneiderman-Policy.pdf.
7 N.Y. State Fin. Law § 189(4) (2010).
8 *See* 31 U.S.C. § 3729(d).
9 N.Y. State Fin. Law § 191(1) (2010).
10 *Id.*
11 *Id.* § 191(2).
12 *Compare* 31 U.S.C. § 3731(b) *with* N.Y. State Fin. Law § 192(1) (repealed 2010).
13 N.Y. State Fin. Law § 192(1) (2010).
14 N.Y. State Fin. Law § 188(7) (2010). Prior to the 2010 Amendments, "original source" was defined as a "person who has direct and independent knowledge of the information on which allegations are based, and has voluntarily provided the information to the state or a local government before filing an action under this article which is based on the information."
15 N.Y. CPLR § 3016.
16 N.Y. State Fin. Law § 192(2) (2010).

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