Anderson Kill & Olick, P.C.
COMMERCIAL LITIGATION ADVISOR
Preparing You for Success www.andersonkill.com Winter 2009

A New 'All Purpose Anti-Fraud' Act? Are You in Compliance?

By John M. O'Connor


John M. O'Connor

Are you running afoul of what might be called the new federal "All Purpose Anti-Fraud Act"? Recent amendments to the federal False Claims Act have very significantly expanded its reach, and the activities of many more entities may now be covered. Since very heavy damages and penalties may be imposed without a specific intent to defraud, it makes sense to determine whether you have exposure and to take prophylactic measures to reduce that risk and exposure.

Prior Supreme Court Law

In 2008, the United States Supreme Court held that a request for payment submitted to a private entity that received federal funds was not subject to the federal False Claims Act, unless the request was made with the specific intent of getting the government to pay (as opposed to simply getting the private entity to pay). Since government funds are received by so many private entities under so many programs, the Supreme Court unanimously decided that to hold otherwise would turn the False Claims Act into "a general all-purpose anti-fraud statute." *Allison Engine Co. v. United States ex rel. Sanders*, 128 S. Ct. 2123, 2126 (2008).

Congress "Overrules" Supreme Court

But Congress disagreed. To set the Supreme Court straight, it passed the Fraud Enforcement and Recovery Act of 2009 ("FERA"), which provided "clarifications to the False Claims Act to reflect the original intent of the law." In passing FERA, Congress amended the provisions of the False Claims Act to effectively overrule the Supreme Court's prior holding: FERA now includes within the reach of the False Claims Act requests for payment that are made to private entities if the Government provides "any portion of the money or property" requested, and if that money or property was "to be spent or used on the Government's behalf or to advance a Government program or interest." 31 U.S.C. § 3729(a) (2009). In short, the False Claims Act now appears to be what the Supreme Court described as a "general all-purpose anti-fraud statute."

> **If private entities are paying you with federal funds, you're subject to the False Claims Act.**

Perhaps your reaction is: "That's (mildly) interesting, but so what? How does that affect me?" Well, here's how. First, since Government programs and money are so far-reaching, you need to check whether any of the private entities to which you are making requests for payment (say requests for contract payments), are going to be making payment to you from funds that are supplied by, or will be reimbursed by, the federal Government. Second, if your requests for payment fall within the reach of the False Claims Act, you need to perform an internal audit to see whether you are perhaps unwittingly, yet "knowingly," submitting a false claim.

No Intent to Defraud Required

Many people will intuitively think of the False Claims Act as requiring an intent to defraud. Since they have no such intent, they believe they have nothing to worry about. *Wrong!* For starters, a claim can be viewed as "false" if it is not accurate — it does have to contain deliberate lies. The

"A New 'All Purpose Anti-Fraud' Act?" continued p2

"A New 'All Purpose Anti-Fraud' Act?" continued from p1

question then becomes what state of mind did the person submitting the "false" claim have: was it submitted "knowingly." The definitional sleeper here is that "no specific intent to defraud" is required in order to act "knowingly" under the False Claims Act. For example, if a person or entity acts "in reckless disregard" of the truth or falsity of information," then they act "knowingly" within the meaning of the False Claims Act. Or if they act in "deliberate ignorance of the truth or falsity," then they also act "knowingly."

In short, putting just these two factors together, it is very possible that activities that an entity may view as routine and as "the way we have always done it," are now subject to liability pursuant to the False Claims Act as amended by FERA — the new federal "all purpose anti-fraud statute."

Payment By Private Entity Included If Federally Funded

For example, suppose a construction subcontractor submits periodic requests for payment on a construction job and each payment to be made is dependent upon the percentage of the work that has been completed thus far. Say the subcontractor submits a claim for payment based upon fifty percent of the work being completed but, in fact, it is only 40 percent completed. The subcontractor does not have a very sophisticated method of determining the percent completed. If the construction project is being funded *in part* by funds of the Federal Government, then the requisition will be covered by the False Claims Act even if submitted to a private entity. The question then arises as to whether the subcontractor acted "recklessly" with respect to its requisition for payment based upon the inaccurate statement that fifty percent of the work is completed. Perhaps the subcontractor has used its flawed method for years but there are facts that would indicate that it was reckless not to review that method and update it.

Government programs and funding involve not only defense contractors, but hospitals and other health providers, universities and not-for-profits, and businesses in many, many different fields. The federal government has recently distributed millions of dollars through the American Recovery and Reinvestment Act and the Troubled Assets Relief Program. Since government funds are used in these situations to "advance a government program or interest," requests for payment made to private entities receiving these funds will be subject to the False Claims Act.

Enormous Exposure

An allegation that the False Claims Act has been violated can lead to very serious practical difficulties and, if proven or settled, to extensive remedies. The statute provides for treble damages — i.e., three times the amount of damages that the government sustains. In addition, there is liability for a civil penalty of $5,000 to $10,000 (to be adjusted by inflation) for each violation. It frequently happens that there are multiple requests for payments, and courts have imposed multiple penalties even where the claims are all made on the same project or contract. If the practice involved has been implemented over many years, the penalties alone can be very significant.

Because of the extensive exposure, entities faced with an allegation of liability under the False Claims Act can be placed in a very difficult practical position. Even if they believe they are innocent of any violation and did not act "recklessly" or with "indifference," there is always the risk that a judge or jury

will come to a different conclusion. Mounting a defense can also entail a significant investment of time and money. Insurers may decline coverage for payments resulting from False Claims Act allegations. As a practical matter, these risks can place considerable pressure upon an entity to settle.

Then there are the whistleblower provisions. The False Claims Act encourages the reporting of violations by offering private parties the ability to bring an action on the government's behalf and to obtain a percentage of the government's recovery if the suit is successful. The whistleblower may obtain from 15 to 30 percent of the government's recovery (including the treble damages) and can also obtain attorneys' fees and expenses from the defendant.

What To Do

The single most important step that entities can take is to have in place an effective compliance program, one which will identify situations in which the False Claims Act applies and employ effective mechanisms to ensure that requests for payment are in accordance with all contractual and regulatory provisions. Since nothing works perfectly, and there is always the possibility of human error (or worse), the program should include a method by which employees and other persons with information can alert management to existing or potential problems.

John M. O'Connor, a shareholder in the New York office of Anderson Kill, is a member of the firm's commercial litigation department. Mr. O'Connor, a former Assistant United States Attorney, has litigated False Claims Act issues. He is an experienced trial and appellate litigator and often writes on topics concerning the False Claims Act.
(212) 278-1014 joconnor@andersonkill.com

Supreme Court Serves Notice on 'Notice' Pleading

By Jerry S. Goldman and Peter Halprin*

Recent Supreme Court decisions have dramatically revamped the pleading standards that have applied for decades to complaints filed in federal courts.

Since the adoption of the Federal Rules of Civil Procedure in 1938, attorneys in federal courts have drafted complaints under a pleading standard known as notice pleading. Notice pleading simply required that complaints put opposing parties on notice. Only in certain circumstances, such as with allegations of fraud, did the Rules mandate any sort of detail.

In 1957, the Supreme Court highlighted this minimal standard of pleading in *Conley v. Gibson*, holding that "a complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief."

In the generations of practice since *Conley*, plaintiffs' lawyers drafted these short and concise notice complaints, and defendants rarely succeeded in dismissing a complaint based upon the sufficiency of the pleadings. Matters rapidly proceeded to discovery.

Two recent Supreme Court decisions, *Iqbal* and *Twombly*, have turned this pleading standard on its head.

In 2007, in *Bell Atlantic v. Twombly*, an anti-trust conspiracy case, the Supreme Court set forth a higher standard of pleading. *Bell Atlantic Corp. v. Twombly,* 550 U.S. 544 (2007). Specifically, the Supreme Court called upon plaintiffs to offer "more than labels and conclusions." In fact, the Supreme Court required plaintiffs to make allegations "plausible to support a reasonable belief that the expectations of discovery will lead to evidence of illegality."

Then, in its last term, in *Ashcroft v. Iqbal*, the Supreme Court declared that the heightened pleading standard articulated in *Twombly* applied in all federal cases, not just complex, anti-trust conspiracy cases. *Ashcroft v. Iqbal*, 129 S.Ct. 1937 (2009). According to *Iqbal*, pleadings must be more than naked assertions devoid of facts and more than threadbare recitals or mere conclusory statements.

"Supreme Court Serves Notice" continued p4

"Supreme Court Serves Notice" continued from p3

For plaintiffs' counsel, the changed landscape mandates more in-depth investigation of a claim prior to filing a complaint as well as more precise drafting. Due to the limitations of pre-suit discovery in federal court, this may be a difficult challenge to meet in many cases and will frequently require the use of creative investigation strategies, such as the use of private investigators; or, where prior government actions were involved, extensive FOIA requests. Longer lead-times than in the past will be required for the institution of suit.

Counsel defending a federal lawsuit should also look to utilize the heightened pleading requirements to their advantage since they provide a higher hurdle for plaintiffs.

Specifically, defense counsel should seriously consider a motion to dismiss complaints that have been drafted based on the old "notice only" concept. At best, the heightened pleading standards may knock out a claim, saving the defendant the substantial expenses of discovery. At worst, the motion may force plaintiffs to disclose strategic information or to make strategic decisions before they are ready to do so. If nothing else, the possibility of knocking out a claim may accelerate the litigation process and may make plaintiffs more amenable to settlement.

These heightened pleading requirements will also reverberate throughout state courts because many state courts give strong consideration to changes in federal court practice.

Legislation to overturn these new Supreme Court decisions has already been introduced in both the House and the Senate. More hearings are planned for the Spring. Monitoring the legislation is important; but for now, counsel should be prepared to litigate in the current environment.

Jerry S. Goldman is a shareholder in the New York and Philadelphia offices of Anderson Kill. Mr. Goldman practices in the areas of complex litigation, general business law, white collar criminal defense, employment law, federal and international taxation, estate planning, and estate and trust administration.
(212) 278-1000 (New York); (267) 216-2795 (Pennsylvania)
jgoldman@andersonkill.com

***Peter A. Halprin** is a law clerk in the New York office of Anderson Kill.

AKO Commercial Litigation Advisor

The ***Anderson Kill Commercial Litigation Advisor*** is published by Anderson Kill & Olick, P.C. The newsletter informs clients, friends and fellow professionals of developments in commercial litigation matters. The articles appearing in the ***Anderson Kill Commercial Litigation Advisor*** do not constitute legal advice or opinion. Such advice and opinion are provided by the firm only upon engagement with respect to specific factual situations. If you require more information, legal advice or an opinion with respect to a specific situation, please contact:

John M. O'Connor, Editor-in-Chief
(212) 278-1014 or joconnor@andersonkill.com

Michael Lane, Chair
(212) 278-1568 or mlane@andersonkill.com

The firm has offices in New York, NY, Greenwich, CT, Newark, NJ, Philadelphia, PA, Ventura, CA, and Washington, D.C.

To subscribe to Anderson Kill Newsletters and Alerts:
www.andersonkill.com/publication_subscribe.asp
To unsubscribe, please email: unsubscribe@andersonkill.com