



California's False Claims Act: What it Means for Companies Doing Business with California Governmental Entities

May 31, 2011

California Attorney General Kamala Harris announced on May 23, 2011 that she is creating a team of seventeen lawyers and eight special agents to pursue sellers of mortgage backed securities and alleged perpetrators of mortgage-related fraud using California's False Claims Act. She explained that the False Claims Act is "one of the very powerful tools that California uniquely has." Indeed, just days prior to the Attorney General's announcement, on May 19, 2011, California formally approved a \$241 million settlement with Quest Diagnostics, Inc. to resolve a False Claims Act case alleging that Quest overcharged California's Medi-Cal program. This bulletin discusses the California False Claims Act, its distinctive provisions, and what they mean for companies doing business with the State at a time when the economic climate gives members of the *qui tam* bar compelling incentives to find new ways to help the State generate revenue through litigation.

CALIFORNIA'S FALSE CLAIMS ACT

In 1987, California became the first state to adopt a False Claims Act, California Government Code § 12650, *et seq.* (the "CFCA"). The CFCA is modeled after the federal False Claims Act.¹ In general, the CFCA prohibits any person or entity from knowingly presenting or causing to be presented, "a false or fraudulent claim for payment or approval,"² or knowingly making, using, or causing "to be made or used, a false record or statement material to a false or fraudulent claim."³ To violate the CFCA, the conduct at issue must usually be done "knowingly" but a specific intent to defraud—a higher standard—is not required.⁴ Actions undertaken with deliberate ignorance of the truth or in reckless disregard of the truth of a claim are sufficient to satisfy the required state of mind.⁵ Nevertheless, innocent mistakes or good faith errors do not equate to acting "knowingly" and the information submitted to the government must be objectively false for liability to arise.⁶

¹ The federal False Claims Act, 31 U.S.C. § 3729, *et seq.*, was enacted in 1863 to redress Civil War defense contractor fraud against the government.

² *Wells v. One2One Learning Found.*, 39 Cal. 4th 1167, 1187 (2006).

³ Cal. Gov't Code § 12651(a)(1) and (2).

⁴ Cal. Gov't Code § 12650(b)(3) ("Proof of specific intent to defraud is not required.").

⁵ *Thompson Pacific Const., Inc. v. City of Sunnyvale*, 155 Cal. App. 4th 525, 549-50 (2007).

⁶ *San Francisco Unified Sch. Dist. v. Laidlaw Transit*, 182 Cal. App. 4th 438, 453 (2010); Cal. Gov't Code § 12651(a)(1)-(8).

The CFCA allows the government, through the Attorney General or local prosecutors, or individual citizens, to bring civil actions to recover damages, penalties and costs when government contractors, vendors or others defraud the government. For purposes of the CFCA, “government” includes both state and local governmental entities. “The ultimate purpose of the [CFCA] is to protect the public fisc” by, among other things, authorizing private citizens who discover fraudulent claims to file a *qui tam* action on behalf of the government.⁷ While the State of California may file a CFCA suit itself,⁸ a private party also may file suit. Individuals who bring these actions are interchangeably known as “whistleblowers,” “*qui tam* plaintiffs” or “relators,” and are permitted to file suit in the name of the government. Initially, the suit must be filed under seal and the defendant is not served with the complaint. A *qui tam* plaintiff must serve the Attorney General with a copy of the suit and the Attorney General has 60 days to decide whether to intervene, *i.e.*, join the suit. In the event the Attorney General intervenes, the State of California will primarily conduct and prosecute the action. The Attorney General may also decline to intervene and, in that event, the *qui tam* plaintiff will proceed to prosecute the case.⁹

Qui tam plaintiffs file hundreds of cases each year and since 1986, federal and state false claims act recoveries have regularly been in the billions each year.¹⁰ To incentivize *qui tam* plaintiffs to root out corruption and fraud against the government, lucrative rewards are provided if the case resolves in favor of the plaintiff – whether by settlement or otherwise. In the event a false claim is found to have been made, the CFCA provides for automatic punitive-like treble damages plus statutory penalties between \$5,000 and \$10,000 for each false claim.¹¹

SIGNIFICANT ASPECTS OF CALIFORNIA’S FALSE CLAIMS ACT

Essentially, any knowing submission of a false claim to a public state agency may constitute a violation under the CFCA. There are eight specific types of false claims enumerated in the CFCA. Any person who commits any of the following acts will be liable under the CFCA: (1) presenting a false claim to the government for payment;¹² (2) making or using a false record;¹³ (3) conspiring to commit any violation of the CFCA;¹⁴ (4) delivering of less property

⁷ *Wells*, 39 Cal. 4th at 1187, 1196.

⁸ Cities and counties in the State of California may also file suit. Cal. Gov’t Code § 12650(b)(5)–(7).

⁹ Cal. Gov’t Code § 12652(c).

¹⁰ In Fiscal Year 2010, the United States Department of Justice recovered \$3 billion in false claims act settlements and judgments. See Press Release, Dep’t of Justice (Nov. 22, 2010) (available at <http://www.justice.gov/opa/pr/2010/November/10-civ-1335.html>) (last visited May 24, 2010)). “Recoveries since 1986, when Congress substantially strengthened the civil False Claims Act, now total more than \$27 billion.” *Id.*

¹¹ Cal. Gov’t Code § 12651(a).

¹² Cal. Gov’t Code § 12651(a)(1) (“Knowingly presents or causes to be presented a false or fraudulent claim for payment or approval.”).

¹³ Cal. Gov’t Code § 12651(a)(2) (“Knowingly makes, uses, or causes to be made or used a false record or statement material to a false or fraudulent claim.”).

than bargained for;¹⁵ (5) making or delivering a false receipt;¹⁶ (6) making a false purchase;¹⁷ (7) making a reverse false claim—*i.e.*, using a false claim or record to decrease what is owed to the government;¹⁸ and (8) inadvertently being a beneficiary of a false claim.¹⁹ Federal case law, which California may consider in interpreting the CFCA, has stated that the government need not prove it suffered damage or actually paid the claim for liability to attach under the statute.²⁰ Discussed below are three significant features of the CFCA that render it a powerful tool in pursuing claims against those doing business with the State.

Inadvertent False Claim

A unique aspect of the CFCA, and one that distinguishes it from the federal False Claim Act, is the inadvertent false claim provision. This section arguably imposes a responsibility to report a false claim if you have received the benefit from an *inadvertent* submission of a false claim and you subsequently discover the falsity of the claim.²¹ In the event you do not report this false claim, you could be liable under the CFCA. Under the existing case law, it is unclear whether this statute applies only to the party that submits the false claim or to third party beneficiaries of a false claim submitted by another. In the single case analyzing the provision head on, the majority and dissent reach diametrically opposite conclusions as to the scope of this section.²²

¹⁴ Cal. Gov't Code § 12651(a)(3).

¹⁵ Cal. Gov't Code § 12651(a)(4) ("Has possession, custody, or control of public property or money used or to be used by the state or by any political subdivision and knowingly delivers or causes to be delivered less than all of that property.").

¹⁶ Cal. Gov't Code § 12651(a)(5) ("Is authorized to make or deliver a document certifying receipt of property used or to be used by the state or by any political subdivision and knowingly makes or delivers a receipt that falsely represents the property used or to be used.").

¹⁷ Cal. Gov't Code § 12651(a)(6) ("Knowingly buys, or receives as a pledge of an obligation or debt, public property from any person who lawfully may not sell or pledge the property.").

¹⁸ Cal. Gov't Code § 12651(a)(7) ("Knowingly makes, uses, or causes to be made or used a false record or statement material to an obligation to pay or transmit money or property to the state or to any political subdivision, or knowingly conceals or knowingly and improperly avoids, or decreases an obligation to pay or transmit money or property to the state or to any political subdivision.").

¹⁹ Cal. Gov't Code § 12651(a)(8) ("Is a beneficiary of an inadvertent submission of a false claim, subsequently discovers the falsity of the claim, and fails to disclose the false claim to the state or the political subdivision within a reasonable time after discovery of the false claim.").

²⁰ See, e.g., *United States ex rel. Hagood v. Sonoma County Water Agency*, 929 F.2d 1416, 1421 (9th Cir. 1991) (interpreting federal False Claims Act statute); *Fleming v. United States*, 336 F.2d 475, 480 (10th Cir. 1964); *United States v. Kensington Hosp.*, 760 F. Supp. 1120, 1127 (E.D. Pa. 1991). See also *California v. Altus Finance*, 36 Cal. 4th 1284, 1299 (2005).

²¹ Cal. Gov't Code § 12651(a)(8).

²² See *Armenta ex rel. City of Burbank v. Mueller Co.*, 142 Cal. App. 4th 636 (2006). See also *In re Pharm. Indus. Average Wholesale Price Litig.*, 478 F. Supp. 2d 164, 176 (D. Mass. 2007) (holding that

Monetary Incentives for Qui Tam Plaintiffs

A defendant found to have violated the CFCA can be liable for *three times* the amount of damages the State suffers from the acts of that violator, civil penalties ranging from \$5,000 to \$10,000 per claim, and the plaintiff's costs and attorneys' fees for bringing the action. Thus, the potential damages and statutory penalties can quickly multiply.

In addition to these hefty damages, the CFCA provides significant financial incentives for *qui tam* plaintiffs. A relator who brings an action in which the government intervenes will receive between 15% and 33% of any recovery.²³ If a relator brings an action in which the government does not intervene, the relator is statutorily entitled to receive between 25% and 50% of the overall recovery.²⁴ In addition, a successful relator receives attorneys' fees and costs. California also permits successful relators to recover "reasonable expenses that the court finds to have been necessarily incurred."²⁵ This is a significant addition to the recovery scheme as plaintiffs' pre-litigation expert expenses could be awarded.

Overall, the statutory incentives provide *qui tam* plaintiffs—and their attorneys—significant reason to uncover and allege potential frauds pursuant to the CFCA.

A Generous Statute of Limitations

California provides a generous statute of limitations for prosecuting alleged false claims. An action under the CFCA may be brought no more than three years after the date of discovery or no more than ten years after the date on which the violation was committed.²⁶ Accordingly, given California's inadvertent beneficiary provisions, any entity that has done business with a California state agency within the past decade is theoretically subject to a CFCA claim.

RECENT CALIFORNIA FALSE CLAIMS ACT INVESTIGATIONS, ACTIONS & SETTLEMENTS

Lawsuits brought pursuant to the CFCA rarely proceed to verdict. In fact, from 1987 when the law was enacted until late 1995, not one case under the CFCA had gone to trial in California.²⁷ Instead, defendants in these suits chose to pay million dollar settlements rather than face the prospect of trebled damages, statutory penalties and attorneys' fees and costs.²⁸ The recent cases discussed below exemplify the huge risks, and difficult choices, defendants face when confronted with allegations under the CFCA.

obtaining an increase in market share, rather than money, does not constitute being labeled a "beneficiar[y] of an inadvertent submission of a false claim" under Cal. Gov't Code § 12651(a)(8)).

²³ Cal. Gov't Code § 12652(g)(2).

²⁴ Cal. Gov't Code § 12652(g)(3).

²⁵ Cal. Gov't Code § 12652(g)(8).

²⁶ Cal. Gov't Code § 12654(a).

²⁷ See James W. Taylor, *The California False Claims Act*, 25 Pub. Cont. L.J. 315, 328 (1995-1996).

²⁸ *Id.* at 328-29.

Securitized Mortgage Investigation

California's most recent investigation of possible claims under the CFCA involves the so-called "Mortgage Fraud Strike Force," which has said it will target financial institutions that allegedly bundled poor-quality mortgage loans into securities and sold them to state pension funds, among other state investors. The State will seek to recover, through the CFCA, billions of dollars that state investors lost when the nationwide recession began, borrowers defaulted, and the housing market declined. While California's Attorney General has not set forth the allegations the State will make, a complaint under the CFCA might allege, for example, that the mortgage loans were insufficiently underwritten, contained false statements or that the entity selling the security knew the mortgage was backed by insufficient collateral. In any event, California's Attorney General will bypass having to prove criminal fraud by taking advantage of the CFCA's lower civil standard of proof.

The Quest Action and Settlement

Earlier this month Quest Diagnostics, Inc. ("Quest") agreed to a settlement totaling \$241 million to resolve a CFCA action that was initially brought by a Quest competitor in 2005. It is reported that the Quest settlement is the largest recovery by a single state under a false claims act statute.²⁹ Hunter Laboratories, LLC—a Quest competitor—filed the *qui tam* action as a whistleblower in 2005. Hunter alleged that Quest engaged in an illegal kickback scheme that overcharged California's Medi-Cal program for lab tests so that Quest could undercharge private customers and obtain referrals of Medi-Cal-eligible clients. The complaint alleged that Quest charged Medi-Cal up to six times the amount it charged others for the same test. In 2009, after a three-year investigation spurred by the *qui tam* complaint, the California Attorney General intervened in the action. In conjunction with the settlement approved on May 19, 2011, Quest stated that it agreed to certain reporting obligations relating to its pricing and would provide Medi-Cal a discount through July 2012.³⁰ Hunter Laboratories, as the original *qui tam* plaintiff, will receive between 15-33% of the settlement.

The Los Angeles Subway Settlement

In late 2010, after fifteen years of what a court described as "extraordinarily acrimonious, bare-knuckles"³¹ litigation, the Los Angeles Metropolitan Transit Authority ("MTA") and construction contractor Tutor-Saliba-Perini ("TSP") settled a suit relating to TSP's work on Los Angeles's Red Line subway. The suit initially began with TSP filing suit for \$16 million against the MTA for unpaid change orders related to unforeseen cost overruns during the construction of the subway.³² The MTA filed a counter-claim against TSP in 1999 claiming that TSP had committed over a thousand violations of the CFCA. In 2001, a jury awarded \$60 million to the

²⁹ Nate Raymond, *American Lawyer*, "Quest Diagnostics Agrees to \$241 Million Settlement in California False Claims Act Suit Over Lab Pricing" (May 10, 2011).

³⁰ *Id.*

³¹ *See Tutor-Saliba-Perini, J.V. v. Los Angeles Metro. Transit Auth.*, Case No. B143430, 2005 WL 240685, at *1 (Jan. 15, 2005) (unpublished).

³² *See id.*

MTA, over half of which included attorneys' fees and costs. TSP appealed and the court of appeal remanded the action four years later. In late 2010, days before a second trial began, the parties announced a settlement in which the MTA would drop its CFCA claims and pay TSP \$1.1 million. Despite the reversal of fortune for the MTA, TSP was forced to litigate the CFCA claims for well over a decade.

The State Street Action

Highlighting the far reach of the CFCA's statute of limitations, California intervened in a suit in 2009 against State Street Bank and Trust alleging it had been overcharging two state pension funds, CalPERS and CalSTRS, since 2001.³³ The Attorney General alleged that State Street had improperly used the highest exchange rate of the day rather than charging the interbank rate at the time the actual trade took place resulting in over \$56 million in overcharges. Contending that each overcharge constituted a separate "claim" under the CFCA, the State sought a statutory penalty of \$10,000 for each of the tens of thousands of alleged overcharges. Because the investigation into State Street began through claims by whistleblowers, they will be entitled to a portion of the possible recovery California receives as a result of the suit.

* * *

Given California's current—and longstanding—budget deficit as well as the public's increasing scrutiny of Wall Street and government spending, companies would be well served to revisit their compliance programs with False Claims Act issues, including California's inadvertent beneficiary provision, in mind. Ongoing monitoring and handling of employee concerns regarding alleged violations of regulations or government contractual requirements also should be adopted.

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³³ *The People of the State of California ex rel. Brown v. State Street Corp.*, Case No. 34-2008-00008457-CU-MC-GDS (Cal. Super. Ct., Sacramento).

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