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New York State and City False Claims Acts Come to Life

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WITHIN THE LAST seven years, New York state and New York City have both enacted a False Claims Act (FCA) that, like their federal analog, allow private whistleblowers, as well as the government itself, to file suit to redress fraud against the government. Both statutes provide for treble damages plus per-claim penalties and award whistleblowers a share of any money recovered as a result of their action. The second quarter of 2012 brought several noteworthy developments highlighting these anti-fraud statutes, which are discussed in this article.

Attorney General Files Lawsuit

In a ground-breaking development on April 19, 2012, New York State Attorney General Eric T. Schneiderman filed a lawsuit relying on the New York State False Claims Act, N.Y. State Fin. Law §187 et seq. (NYS FCA), to seek over $300 million from Sprint Nextel for allegedly underpaying sales taxes.[1] This action was the culmination of over a year of increased attention by Schneiderman to the NYS FCA and particularly to a 2010 amendment—which is unique among the federal and various state FCAs and which was sponsored by Schneiderman when he was state senator—extending the NYS FCA to misrepresentations relating to taxes.[2]

In January 2011, soon after Schneiderman took office as attorney general, he committed additional resources to the Medicaid Fraud Control Unit, which enforces the NYS FCA in Medicaid matters, and created a new Taxpayer

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Protection Bureau to enforce the NYS FCA in tax and other non-Medicaid contexts, all with the stated objective of strengthening and expanding NYS FCA enforcement.[3] The April 19th filing was the Taxpayer Protection Bureau's first public invocation of the NYS FCA.

The suit against Sprint Nextel originated as a March 2011 complaint filed by a whistleblower, which prompted a Taxpayer Protection Bureau investigation. The complaint alleges that Sprint Nextel, in an attempt to gain an unfair advantage over its competitors, was and is undercollecting sales taxes on flat-rate access charges for wireless calling plans and thus passing back too small an amount to the New York state and local governments.

New York State False Claims Act

The NYS FCA was enacted in 2007, based on the federal FCA as it then stood, and it applies not only to fraud against the state but also to fraud against local governments. The current NYS FCA is in some ways broader and in some ways narrower than its current federal counterpart. The lawsuit against Sprint Nextel highlights the NYS FCA's unique provision extending it to false claims relating to taxes (above certain dollar thresholds).[4] In addition, the NYS FCA explicitly allows for consequential damages while such damages are not recoverable under the federal FCA.[5] The NYS FCA may also require less particularity in pleading fraud than the federal FCA.[6]

In other ways, though, the NYS FCA lags behind the 2009 and 2010 amendments to its federal counterpart. The U.S. Department of Health and Human Services Office of Inspector General evaluated the NYS FCA in March 2011 and determined that, unlike the federal statute, the NYS FCA:

(1) does not establish liability for knowingly concealing, or knowingly and improperly avoiding or decreasing, an obligation to pay or transmit money or property to the government;

(2) does not provide for a government complaint in intervention to relate back, for statute of limitations purposes, to the filing date of the whistleblower's complaint; and

(3) more narrowly provides for a whistleblower's recovery of expenses, attorney fees, and costs.

Unless the NYS FCA is amended by March 31, 2013, to bring it back into line with the federal FCA, New York state will lose the right it received in 2007 to retain an increased share of its Medicaid-fraud recoveries.[7]

Retroactive Application

The complaint against Sprint Nextel raises an important constitutional question: Does retroactive application of the NYS FCA violate the ex post facto

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clause? The 2010 amendment itself states that it is retroactive (as does the original statute),[8] and the complaint against Sprint seeks treble damages on the $100 million in back taxes allegedly owed since the alleged scheme began in 2005. Legislative intent notwithstanding, however, the federal constitutional ban on ex post facto laws prohibits retroactive application of statutes that are sufficiently punitive, and there is precedent that retroactive application of a false claims act, with its treble damages and penalties, crosses that threshold.[9] This ex post facto argument, which Sprint Nextel has advanced in a motion to dismiss filed on June 14, 2012,[10] got a significant boost on April 26, 2012, when the New York State Court of Appeals issued its first decision addressing the NYS FCA.

The Court of Appeals Takes on 'Grupp'

In *State of New York ex rel. Grupp v. DHL Express (USA)*, 19 N.Y.3d 278, 2012 WL 1429252 (2012), the New York State Court of Appeals held that an NYS FCA qui tam case, which alleged that DHL had falsely charged the state for air shipments when it was actually transporting the packages by ground, was preempted by federal air and carrier laws.[11] In reaching this conclusion, the court acknowledged the punitive nature of the NYS FCA, a finding that should greatly advance the cause of Sprint Nextel and other defendants seeking to challenge retroactive application of the statute.

Background of 'Grupp'

Grupp arose out of a contract under which DHL agreed to provide New York State with courier services using air and ground transportation. The relators own a trucking company that served DHL as an independent contractor, providing it with ground shipping services. In their complaint, the relators claimed that DHL submitted false claims by (1) asserting that packages were delivered by air and imposing a jet-fuel surcharge when the packages were actually delivered by truck, and (2) imposing a diesel-fuel surcharge even when independent contractors (including relators' company) incurred the fuel costs.

After the New York State Attorney General declined to intervene, DHL moved to dismiss the complaint, arguing it was preempted by the Airline Deregulation Act of 1978 (ADA), 49 U.S.C. §41713(b)(1), and the Federal Aviation Administration Authorization Act (FAAAA), 49 U.S.C. §14501(c)(1). The trial court denied the motion, applying the market-participant exception to federal preemption,[12] which provides that when a state or local government acts in the market in a narrow and focused manner consistent with other market participants' behavior, such action does not constitute regulation subject to preemption.[13] The Appellate Division, Fourth Department, reversed and dismissed the complaint, rejecting applicability of the market-participant doctrine.[14]

The Court of Appeals affirmed. First, relying on the broad preemption provisions of the ADA and FAAAA,[15] as interpreted in several U.S. Supreme Court decisions, the New York court rejected the whistleblowers' argument that their NYS FCA claims avoided preemption because they sought only to enforce the state's proprietary interests against fraud and thus were based on a general law that does not prescribe the rates, routes, and services of airlines and carriers.[16]

The complaint against Sprint Nextel raises an important **constitutional question:** Does **retroactive application** of the NYS FCA **violate the ex post facto clause?**

The court then turned to the relators' invocation of the market-participant exception to the preemption doctrine. Noting that the exception "recognizes the important distinction between the actions of a state in its dual regulatory and proprietary capacities," the court explained that "when a state or municipality acts as a participant in the market and does so in a narrow and focused manner consistent with the behavior of other market participants, such action does not constitute regulation subject to preemption."[17] But "a governmental entity does not escape federal preemption, even when assuming the role of private actor," the court reasoned, "if it 'us[es] its power in the marketplace to implement governmental policies.'"[18] The court held that while "the State procured services from DHL in its proprietary capacity," "plaintiffs' reliance on the FCA, which establishes public policy goals and is thus, regulatory in nature, renders the market participant exception inapplicable to this case."[19]

Considering the market-participant doctrine, the court recognized the punitive purpose of the NYS FCA:

> [R]ather than redressing the harm actually suffered, the statute's imposition of civil penalties and treble damages evinces a broader punitive goal of deterring fraudulent conduct against the State. That is, instead of compensating the State for damages caused by DHL's purported scheme and addressing its narrow proprietary interests, the FCA would punish and consequently deter such future conduct….[20]

This observation by New York's highest court should help carry the day for defendants, such as Sprint Nextel, challenging retroactive application of the NYS FCA as unconstitutional on ex post facto grounds. This argument may be an important means for defendants to limit treble damages and penalties in the face of Schneiderman's commitment to aggressive enforcement of the NYS FCA.[21]

City Council and Mayor Also Act

Overlapping with this FCA activity at the state level, the New York City Council (city council) and Mayor Michael Bloomberg recently saved and amended the city's FCA.

Enacted in 2005, the New York City FCA, N.Y.C. Admin. Code §7-803, et seq. (NYC FCA), expired on June 1, 2012.[22] On May 31, 2012, the city council passed, and on June 20, 2012, Bloomberg signed into law, a bill making the NYC FCA permanent and amending it to bring it more closely in line with the federal and NYS FCAs.[23]

New York City is one of only four metropolitan areas that have city FCAs (the others are Chicago, Philadelphia, and Allegheny County, Pa.). The NYC FCA is generally similar to the federal and NYS FCAs (minus the NYS FCA's tax-fraud provision), although the NYC FCA does not allow a whistleblower to sue without the permission of the city's chief lawyer.[24] Other differences between the 2005 NYC FCA and its federal and New York state counterparts are obviated by the new law.

One provision of the new law makes the NYC FCA's public-disclosure bar more similar to the public-disclosure bars in the federal and NYS FCAs. While the 2005 NYC FCA barred claims "derived from public disclosure of allegations or transactions…unless the person who submitted the proposed complaint is the primary source of the information,"[25] the bill passed by the city council allows the city's chief lawyer to waive the public-disclosure bar "in his or her absolute discretion," and exempts claims by "an original source of the information," rather than "the primary source."[26] Another provision of the new law brings the NYC FCA's whistleblower awards into conformity with the federal and NYS FCAs by increasing the minimum amount that a private individual may receive to 15 percent of recovery (up from 10 percent) if the City prosecutes the case and to 25

percent (up from 15 percent) if the City authorizes the private individual to pursue the action.[27]

By making the NYC FCA permanent and amending it, the city council and mayor have endorsed it as a fraud-fighting tool, relying on testimony by the relevant city agencies during the city council's proceedings on the bill.[28] The council and mayor also simultaneously enacted two other laws that could bolster the NYC FCA's effectiveness: The first extends whistleblower protections to officers and employees of city contractors and subcontractors, and the second requires city contractors and subcontractors to post information about whistleblower protections.[29] But it is unclear whether the resurrection of the NYC FCA will make any real difference to anyone who submits a false claim to the city of New York. First, as noted above, the NYS FCA applies to false claims submitted to local governments,[30] and the state statute has been used to recover local-government funds.[31] Second, despite the agencies' testimony, the city council's proceedings on the bill, the council's Fiscal Impact Statement regarding the NYC FCA bill concludes:

> It is assumed that there would be no impact on revenues resulting from the enactment of this legislation. The Corporation Counsel has not pursued any proposed civil complaints that have been submitted by private individuals pursuant to the City FCA since the laws inception. Most claims under the FCA cited Medicaid fraud. Pursuant to federal law, all Medicaid recoveries go to the State and not the City. For those cases in which the FCA may have played a role in recovering funds, it is without certainty whether those funds would have been recovered otherwise as the City uses multiple tools to identify false claims.[32]

Conclusion

Whether or not the NYC FCA proves valuable against those who defraud New York City, the strengthened NYS FCA is likely to remain an important weapon in the arsenal of the attorney general and whistleblowers alike at a time when state and local government finances mandate aggressive efforts to combat fraud.

1. Press Release, A.G. Schneiderman Files Groundbreaking Tax Fraud Lawsuit Against Sprint for Over $300 Million (April 19, 2012), http://www.ag.ny.gov/press-release/ag-schneiderman-files-groundbreaking-tax-fraud-lawsuit-against-sprint-over-300-million; Superseding Complaint, *State of New York ex rel. Empire State Ventures v. Sprint Nextel*, No. 103917-2011 (N.Y. Sup. Ct., N.Y. County April 19, 2012), http://www.ag.ny.gov/sites/default/files/press-releases/2012/Sprint-Complaint.pdf.

2. 2010 N.Y. Sess. Laws Ch. 379 §3 (McKinney); Press Release, Senator Eric. T. Schneiderman Shepherds Historic Anti-Fraud Taxpayer Protection Measure Through Legislature (July 1, 2010), http://www.nysenate.gov/press-release/senator-eric-t-schneiderman-shepherds-historic-anti-fraud-taxpayer-protection-measure-.

3. Press Release, A.G. Schneiderman Launches New Initiative to Bolster Recovery of Taxpayer Dollars & Fight Government Fraud (Jan. 27, 2011), http://www.ag.ny.gov/press-release/ag-schneiderman-launches-new-initiative-bolster-recovery-taxpayer-dollars-fight.

4. N.Y. State Fin. Law §189(4).

5. Compare N.Y. State Fin. Law §189(1)(g), with *United States v. Aerodex*, 469 F.2d 1003, 1011 (5th Cir. 1972).

6. Compare N.Y. State Fin. Law §192(1-a) ("in pleading an action brought under this article the qui tam plaintiff shall not be required to identify specific claims that result from an alleged course of misconduct") with *Chesbrough v. VPA*, 655 F.3d 461, 466-67 (6th Cir. 2011).

7. Letter from U.S. Dept. of Health & Human Services Inspector General to Office of Attorney General, State of New York (March 21, 2011), http://oig.hhs.gov/fraud/docs/falseclaimsact/NewYork.pdf; see 42 U.S.C. §1396h (if state FCA meets certain requirements, federal share of state Medicaid-fraud recoveries shall be decreased by 10 percent).

8. 2010 N.Y. Sess. Laws Ch. 379 §13 (McKinney) ("This act… shall apply to claims, records or statements made or used prior to, on or after April 1, 2007"); 2007 N.Y. Sess. Laws Ch. 58, S. 2108-c, §93(5) (McKinney) (NYS FCA "shall apply to claims filed or presented before, on or after April 1, 2007").

9. E.g., *Massachusetts v. Schering-Plough*, 779 F. Supp. 2d 224, 238 (D. Mass. 2011) (holding that ex post facto clause barred retroactive application of Massachusetts FCA); *Unite States ex rel. Sanders v. Allison Engine*, 667 F. Supp. 2d 747, 756 (S.D. Ohio 2009) (refusing to apply 2009 amendments to federal FCA retroactively because doing so would violate ex post facto clause); *State of New Mexico ex rel. Foy v. Vanderbilt Capital Advisors*, No. D-101-CV-2008-1895 (N.M. Dist. Ct. April 28, 2010) (finding that effect of New Mexico FCA was even more punitive than federal FCA and holding that its retroactive application would violate ex post facto clauses in both federal and state constitutions).

10. Memo. of Law in Support of Defendants' Motion to Dismiss, *State of New York ex rel. Empire State Ventures v. Sprint Nextel*, No. 103917-2011, at 21-23 (N.Y. Sup. Ct., N.Y. County June 14, 2012), https://iapps.courts.state.ny.us/fbem/DocumentDisplayServlet?documentId=YAyG/Z4jNMD3pMhpls40lQ==&system=prod.

11. This appears to be the first time any state's highest court has considered whether a federal statute preempted claims under the state's false claims act. One other state's intermediate appellate court considered this question, in another case involving Grupp and DHL, and reached the same conclusion as the New York State Court of Appeals. See *DHL Express (USA) v. State of Florida ex rel. Grupp*, 60 So.3d 426 (Fla. App. 2011) (claims preempted and market-participant exception not applicable).

12. *State of New York ex rel. Grupp v. DHL Express (USA)*, 907 N.Y.S.2d 772 (Sup. Ct. Erie County 2010).

13. When a state or local government acts participates in the market in a narrow and focused manner consistent with other market participants' behavior, such action does not constitute regulation subject to preemption. E.g., *Cardinal Towing & Auto Repair v. City of Bedford, Tex.*, 180 F.3d 686, 691 (5th Cir. 1999).

14. *State of New York ex rel. Grupp v. DHL Express (USA)*, 83 A.D.3d 1450 (N.Y. App Div. 4th Dept. 2011).

15. 49 U.S.C. §14501(c)(1) (preempting state laws that relate to "any motor private carrier, broker, or freight forwarder with respect to the transportation of property"); 49 U.S.C. §41713(b)(1) (preempting state "law, regulation, or other provision having the force and effect of law related to a price, route, or service, of an air carrier that may provide air transportation under this subpart").

16. See *Grupp*, 19 N.Y.3d 278, 2012 WL 1429252 (citing 49 U.S.C. §§14501(c)(1), 41713(b)(1); *Rowe v. New Hampshire Motor Transp. Assoc.*, 552 U.S. 364 (2008); *American Airlines v. Wolens*, 513 U.S. 219 (1995); *Morales v. Trans World Airlines*, 504 U.S. 374, 383 (1992)).

17. *Grupp*, 19 N.Y.3d 278, 2012 WL 1429252 (quoting *Cardinal Towing & Auto Repair v. City of Bedford, Tex.*, 180 F.3d 686, 691 (5th Cir. 1999)).

18. Id. (quoting *Council of City of New York v. Bloomberg*, 6 N.Y.3d 380, 442 (2006)).

19. Id.

20. Id.

21. Medicaid providers who make false claims face treble damages under a different state statute. N.Y. Soc. Serv. Law §145-b.

22. N.Y. City Local Law 53 §4 (May 19, 2005).

23. New York City Council Legislative Research Center, History of Introduction No. 828-2012 (No. 828-A), http://legistar.council.nyc.gov/LegislationDetail.aspx?ID=1105375&GUID=C503029E-5EBE-4327-AAF8-55A42D619105&Options=ID|Text|&Search=false+claims; N.Y. City Council Introduction No. 828-A (enacted June 20, 2012), available at http://legistar.council.nyc.gov/LegislationDetail.aspx?ID=1105375&GUID=C503029E-5EBE-4327-AAF8-55A42D619105&Options=ID|Text|&Search=false+claims.

24. N.Y. City Admin. Code §7-804(b)(2) (deemed repealed June 1, 2012).

25. Id. at §7-804(d)(3).

26. N.Y. City Council Introduction No. 828-A §2. Cf. 31 U.S.C. §3730(e)(4)(A) ("The Court shall dismiss an action or claim under this section, unless opposed by the Government, if substantially the same allegations or transactions alleged in the action or claim were publicly disclosed…unless the action is brought by the Attorney General or the person bringing the action is an original source of the information"); N.Y. State Fin. Law §190(9)(b) ("The court shall dismiss a qui tam action under this article, unless opposed by the state or an applicable local government, or unless the qui tam plaintiff is an original source of the information, if substantially the same allegations or transactions as alleged in the action were publicly disclosed….").

27. N.Y. City Council Introduction No. 828-A §3. Cf. 31 U.S.C. §3730(d); N.Y. State Fin. Law §190(6).

28. N.Y. City Council, Transcript of Minutes of Stated Meeting, at 39 (May 31, 2012) (Council Member Gale A. Brewer: "We heard good testimony at the hearings from the Law Department and the Department of Investigation, both indicating that even in the current state, which is a sunsetted bill, people were starting to bring cases to the attention of the DOI and the Law Department, and I feel sure that with Council Member Garodnick's legislation and more publicity about this bill, even more people will come forward, because they don't have to feel any kind of retaliation"), available at http://legistar.council.nyc.gov/LegislationDetail.aspx?ID=1105375&GUID=C503029E-5EBE-4327-AAF8-55A42D619105&Options=ID|Text|&Search=false+claims; N.Y. City Council, Report of the Governmental Affairs Division Committee on Governmental Operations, at 8-9 (May 31, 2012), available at http://legistar.council.nyc.gov/LegislationDetail.aspx?ID=1105375&GUID=C503029E-5EBE-4327-AAF8-55A42D619105&Options=ID|Text|&Search=false+claims; Press Release, Mayor Michael R. Bloomberg Signs Legislation Permanently Extending the City's False Claims Act (June 20, 2012) ("Since the law was enacted by the Council and our Administration in 2005, the Corporation Counsel's Office and the Department of Investigation have found it to be a useful tool in their efforts to curb fraud"), http://www.nyc.gov/portal/site/nycgov/menuitem.c0935b9a57bb4ef3daf2f1c701c789a0/index.jsp?pageID=mayor_press_release&catID=1194&doc_name=http%3A%2F%2Fwww.nyc.gov%2Fhtml%2Fom%2Fhtml%2F2012a%2Fpr229-12.html&cc=unused1978&rc=1194&ndi=1.

29. N.Y. City Council Introduction No. 0816-2012 (No. 816) (enacted June 20, 2012), available at http://legistar.council.nyc.gov/LegislationDetail.aspx?ID=1102945&GUID=5B432406-E65F-46E8-98C1-4D47D1FD2F97&Options=ID|Text|&Search=816; N.Y. City Council Introduction No. 0479-2011 (No. 479) (enacted June 20, 2012), available at http://legistar.council.nyc.gov/LegislationDetail.aspx?ID=842800&GUID=BF4712F4-625A-4279-9BE3-533045F74284&Options=ID|Text|&Search=479.

30. N.Y. State Fin. Law §§188(1), 189(1).

31. Press Release, New York State Attorney General Andrew M. Cuomo Announces County Waste to Pay Nearly $1 Million for Defrauding Town of Colonie and Violating Environmental Waste Permit Regulations (Feb. 22, 2010), http://www.ag.ny.gov/press-release/new-york-state-attorney-general-andrew-m-cuomo-announces-county-waste-pay-nearly-1.

32. N.Y. City Council Fiscal Impact Statement [for] Proposed Intro. No. 828-A at 2, available at http://legistar.council.nyc.gov/LegislationDetail.aspx?ID=1105375&GUID=C503029E-5EBE-4327-AAF8-55A42D619105&Options=ID|Text|&Search=false+claims.