New York's Highest Court Addresses State False Claims Act for First Time; Holds that Federal Law Preempts its Application to DHL Delivery Fees

2012-05-08

On April 26, 2012, the New York State Court of Appeals issued its first decision addressing the five-year-old New York State False Claims Act, N.Y. State Fin. Law § 187 et seq. ("NYS FCA"). In *State of New York ex rel. Grupp v. DHL Express (USA), Inc.*, No. 71, 2012 WL 1429252 (N.Y. April 26, 2012), the Court held that an NYS FCA *qui tam* case, which alleged that DHL falsely charged the State for air shipments when it was actually transporting the packages by ground, was preempted by federal air and carrier laws.[1] In reaching this conclusion, the Court acknowledged the punitive nature of the NYS FCA, a finding that may be useful to defendants seeking to challenge retroactive application of the statute.

Background

The NYS FCA was enacted in 2007, based on the federal False Claims Act as it then stood. Both FCAs allow private whistleblowers, as well as the government itself, to file suit to redress fraud against the government (with the NYS FCA covering both fraud against the State and fraud against local governments within the State); both provide for treble damages plus per-claim penalties; and both award whistleblowers a share of any money recovered as a result of their action. However, the NYS FCA is in some respects broader and in some respects narrower than its current federal counterpart.[2]

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, concluding that the market-participant exception to federal preemption applied.[3]907 N.Y.S.2d 772 (Sup. Ct., Erie County 2010). The Appellate Division reversed and dismissed the complaint, rejecting applicability of the market-participant doctrine. 83 A.D.3d 1450 (NY App Div. 4th Dep't 2011).

The Court of Appeals' Decision

The Court of Appeals affirmed. First, relying on the broad preemption provisions of the ADA and FAAAA,[4] 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. *See Grupp*, 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, Inc. v. Wolens*, 513 U.S. 219 (1995); *Morales v. Trans World Airlines, Inc.*, 504 U.S. 374, 383 (1992)).

Then the court turned to the relators' invocation of the market-participant exception to the preemption doctrine. Noting that this exception "recognizes the important distinction between the actions of a state in its dual regulatory and proprietary capacities," *Grupp*, 2012 WL 1429252, 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," *id.* (quoting *Cardinal Towing & Auto Repair, Inc. v. City of Bedford, Tex.*, 180 F.3d 686, 691 (5th Cir. 1999)). 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,'" *Grupp*, 2012 WL 1429252 (quoting *Council of City of New York v. Bloomberg*, 6 N.Y.3d 380, 442 (2006)). 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." *Grupp*, 2012 WL 1429252.[5]

In 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 . . . .

Id. This observation by New York's highest court may provide good ammunition for defendants challenging retroactive application of the NYS FCA as unconstitutional on ex post facto grounds, an

argument we explained in another recent client alert.[6]

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[1] This appears to be the first time any state's highest court has considered whether a federal statute preempted claims under the state's civil 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), Inc. v. State of Florida ex rel. Grupp*, 60 So.3d 426 (Fla. App. 2011) (claims preempted and market-participant exception not applicable).

[2]WilmerHale False Claims Act Alert, "New York Attorney General Files First-of-its-Kind Lawsuit, Casting Spotlight on Recent Developments in State and Local False Claims Acts" (Apr. 23, 2012) (comparing NYS and federal FCAs).

[3] 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 Inc. v. City of Bedford, Texas*, 180 F.3d 686, 691 (5th Cir. 1999).

[4] 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").

[5] Two of the court's seven members dissented on the ground that they would apply the market-participant exception.

[6] WilmerHale False Claims Act Alert, *supra* n.2.

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