

**States, Statutes, and Fraud:
An Empirical Study of Emerging State False Claims Acts**

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States, Statutes, and Fraud: An Empirical Study of Emerging State False Claims Acts*

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Since Congress revitalized the federal False Claims Act (FCA) in 1986, the qui tam action—which allows recovery by a private party who alleges and proves fraud against the government—has become an increasingly important and successful regulatory tool. Not surprisingly, the success of the federal FCA has motivated a growing minority of state legislators to pass similar statutes. Academic study of these provisions, however, has been limited.

This Article presents the first comprehensive survey of the structure and implications of state FCAs and qui tam provisions. The results are based on interviews with state officials charged with their enforcement. Interviewees were questioned regarding investigative resources allocated to false claims cases, the practical application of each individual state qui tam provision, the effectiveness of each provision, the impact of federal cases upon state cases, and coordination efforts between federal and state offices.

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I. INTRODUCTION

As Zachary Bentley sat in his Key West, Florida, office reviewing the financial books of his pharmacy, he could hardly have imagined he would discover a pricing discrepancy that would lead to lawsuits yielding over half a billion dollars in recoveries.¹ Bentley's modest company, Ven-A-Care, Inc., provided in-home intravenous drug treatments to AIDS patients in his Key West community.² Bentley never intended to be a whistleblowing crusader, but could not ignore the pricing discrepancy he discovered in 1990.³ At that time, high drug costs were exhausting many of his clients' insurance benefits.⁴ Bentley saw firsthand the anguish the high costs created for his clients who could no longer afford the medicine they needed.⁵ Again and again, Bentley and his two partners opted to continue treating AIDS patients whose insurance benefits were depleted.⁶ As he sat in his office reviewing the pricing discrepancies, Bentley realized that many of his clients had been cheated by the false "spreads" pharmaceutical companies were using to market their products to drug suppliers.⁷ The pharmaceutical companies were reporting higher than actual prices for their drugs, thereby guaranteeing themselves windfall profits through inflated Medicare reimbursements.⁸

1. David Batstone, *Shaking Up the Drug Industry*, 32 SOJOURNERS MAG., Jan./Feb. 2003, at 19; *Medicare Drug Reimbursements: A Broken System for Patients and Taxpayers: Joint Hearing Before the Subcomm. on Health and the Subcomm. on Oversight and Investigations of the H. Comm. on Energy and Commerce*, 107th Cong. 47 (2001) [hereinafter *Bentley Statement*] (prepared statement of Mr. Zachary Bentley), available at <http://energycommerce.house.gov/107/hearings/09212001Hearings371/Bentley616print.htm> (last visited Oct. 26, 2005).

2. Batstone, *supra* note 1, at 19.

3. *Id.*

4. *See id.*

5. *Id.*

6. *Id.*

7. *Id.* See generally Seventh Amended Petition, *Texas v. Warrick Pharm. Corp.*, No. GV002327, 1000 WL 45998, at *3-4, *6-7 (Tex. Dist., Apr. 20, 2004) [hereinafter *Warrick Petition*] (describing fraudulent methods used by pharmaceutical companies).

8. See Batstone, *supra* note 1, at 19; *Warrick Petition*, *supra* note 7, at *3-4, *6-7.

Bentley was stunned when a Medicare reimbursement check passed across his desk for the infusion cancer drug, Leucovorin.⁹ The Medicare reimbursement was 1000% more than his company paid for the drug.¹⁰ According to Bentley, “[t]he ten-fold profit on this drug, being paid for by Medicare (80%) and the beneficiary (20%), was so excessive that the beneficiary’s co-payment actually exceeded the cost of the drug to Ven-A-Care.”¹¹

Angered, Bentley and his partners refused to participate in the scheme when first approached.¹² A year later, when another drug company pitched a similar arrangement to them, they decided to blow the whistle on the fraudulent practice.¹³ But before doing so, they wanted to be sure they were right.¹⁴ They dug deeper, and discovered that the pricing scheme was a widespread and systemic problem.¹⁵ According to Bentley, “[i]t became apparent to us that many drug manufacturers reported truthful prices, while others falsely inflated their price reports so that their targeted customers—oncologists, urologists, home care companies, [dialysis] providers, [durable medical equipment] companies, and others—would be induced by the resulting windfall profits to order their drugs.”¹⁶

Bentley and his partners reported the scheme to federal officials and eventually presented their findings to a U.S. congressional subcommittee.¹⁷ In Ven-A-Care’s name, they also brought suit as a “*qui tam* relator”¹⁸ under the federal civil False Claims Act (federal FCA).¹⁹ Ultimately, the United States Department of Justice (DOJ) joined Ven-A-Care’s FCA lawsuit.²⁰ Together, they obtained a judgment netting the federal treasury close to \$500 million and shared in \$44.8 million for their role in bringing and assisting in the lawsuit.²¹

9. Bentley Statement, *supra* note 1, at 46-47.

10. *Id.*

11. *Id.*

12. Batstone, *supra* note 1, at 19.

13. Bentley Statement, *supra* note 1, at 46.

14. *Id.*

15. *Id.*

16. *Id.* at 48.

17. See *id.* at 47-48; see also *Medicaid Prescription Drug Reimbursement: Why the Government Pays Too Much: Hearing Before the Subcomm. on Oversight and Investigations of the H. Comm. on Energy and Commerce*, 108th Cong. 75-94 (2004) (testimony of Mr. T. Mark Jones and Dr. John Lockwood).

18. See *infra* notes 33-38 and accompanying text.

19. 31 U.S.C. §§ 3729-3733 (2000); Bentley Statement, *supra* note 1, at 48.

20. Bentley Statement, *supra* note 1, at 48.

21. *The Top 100 False Claims Act Settlements*, CORP. CRIME REP., Dec. 30, 2003, at 11-12, available at <http://www.corporatecrimereporter.com/fraudrep.pdf> (last visited Oct. 26,

The Ven-A-Care story is one of tremendous success for the federal government, but one of failure for all but a handful of state governments. Because drug companies also utilized their pricing discrepancy scheme to defraud the states through their Medicaid programs, the states, like the federal government, were potential plaintiffs. Most states, however, had no meaningful statutory power with which to proceed against the putative defendants. Those states which did not possess a potent statute similar to the federal FCA could not commence lawsuits against the pharmaceutical companies themselves.²² Only a handful of states with *qui tam* provisions similar to the one found in the federal FCA were poised to reap large rewards.²³

2005). The suit brought against Fresenius Medical Care of North America ranks as the fifth-largest settlement ever under the federal FCA. *Id.*

22. See Press Release, Office of Attorney General of Texas, Attorney General Reaps \$27 Million Medicaid Fraud Settlement with Major Drug Maker (May 3, 2004) [hereinafter Texas Press Release], available at <http://www.oag.state.tx.us/oagnews/release.php?id=453> (last visited Dec. 28, 2005).

23. Texas was one of the fortunate few to be able to sue the pharmaceutical companies for the losses it suffered because of their pricing scheme. See Robert Bryce, *Texas Goes After Big Pharma*, TEX. OBSERVER, Mar. 4, 2005, at 6. Using Texas' Medicaid Fraud Prevention Act, TEX. HUM. RES. CODE ANN. § 36.001-36.117 (2001), which mimics the federal FCA's *qui tam* provision, 31 U.S.C. § 3730 (2000), the Texas Attorney General adopted Ven-A-Care's claims and partnered with the whistleblowers and their legal counsel in a lawsuit against three drug companies: Schering-Plough Corporation's Warrick Pharmaceuticals, Boehringer Ingelheim's Roxane drug division, and Dey Laboratories. See *Warrick Petition*, *supra* note 7, at *1; *Bentley Statement*, *supra* note 1, at 47. Like the federal suit, the Texas lawsuit targeted the pharmaceutical companies' alleged practice of overstating the price of prescription brand-name and generic-brand albuterols. See *Warrick Petition*, *supra* note 7, at *3. The lawsuit trudged through three years of laborious litigation and seemingly endless deposition testimony, eventually extending into the term of Attorney General Cornyn's successor, Gregg Abbott, before concluding with a settlement. See Texas Press Release, *supra* note 22; Bryce, *supra*, at 3-4; *infra* App. B. "It was a hard-fought settlement," said Susan Miller, an attorney in Abbot's office. "We had at least a hearing a month regarding discovery and well over one hundred depositions." Telephone Interview with Susan Miller, Office of Attorney Gen. of Tex., in Austin, Tex. (Mar. 15, 2005). But the struggle proved worth the effort. On May 3, 2004, Texas Attorney General Gregg Abbott announced that his office "scored a major victory" in the Ven-A-Care litigation under his state's Medicaid Fraud Prevention Act. Texas Press Release, *supra* note 22.

Through its suit, Texas recovered \$45.5 million. *Id.* Currently, Texas is among only thirteen states and the District of Columbia that have a statute modeled after the federal FCA. See *infra* Apps. A-B; see also Taxpayers Against Fraud, State False Claims Acts, at <http://www.taf.org/statefca.htm> (last visited Dec. 28, 2005). Other states with *qui tam* statutes and the District of Columbia have filed similar suits. See, e.g., *United States v. Merck-Medco Managed Care, L.L.C.*, 336 F. Supp. 2d 430, 433-35 (E.D. Pa. 2004) (describing a healthcare fraud case brought by three relators in partnership with the United States and several states under the federal FCA and by the States of Florida, Illinois, Tennessee, Nevada, Virginia, and the District of Columbia under their own false claims statutes). The *Merck-Medco Managed Care* case settled for \$22.7 million in an agreement between the defendant

There is no question that the federal FCA, with its *qui tam* provisions, is a powerful regulatory tool. Only recently have states begun passing statutes that to some degree or another are modeled after it.²⁴ As they do so, questions arise: Is the FCA model effective, or overreaching? What impact will passage of multiple state false claims statutes have on an already complex regulatory world? What can we learn about detecting and deterring fraud from these experiences?

This Article reviews the experience of those states that have passed civil false claims acts. As part of this review, we have conducted what is to date the only comprehensive survey of states that have false claims acts with *qui tam* provisions.²⁵ Part II of this Article provides an overview of the federal FCA that serves as a prototype for the various state statutes. Part III discusses the results of the survey. Part IV concludes with observations about the states' current experiences in a rapidly changing environment.

and the various plaintiffs. See Press Release, Pennsylvania Office of Attorney General, AG Pappert Announces \$22.7 Million Settlement with Medco Health Solutions Resolving Allegations It Violated Consumer Protection Laws, Apr. 26, 2004, available at <http://www.attorneygeneral.gov/press/release.cfm?p=275B8BE9-CF8B-D3DC-6493FF599F20B11D> (last visited Dec. 28, 2005). For a sample of other successful state *qui tam* cases, see Taxpayers Against Fraud, State False Claims Acts, <http://www.taf.org/statefca.htm> (last visited Oct. 26, 2005). For example, California Attorney General Bill Lockyer and his staff are currently pursuing a related case with Ven-A-Care against Abbott Laboratories, Inc. and Wyeth Pharmaceuticals, Inc. See Press Release, Office of the Attorney General of the State of California, Attorney General Lockyer Accuses Two Major Drug Companies of Inflating Prices, Cheating California Taxpayers, Jan. 7, 2003 [hereinafter California Press Release], available at <http://caag.state.ca.us/newsalerts/2003/03-004.htm> (last visited Oct. 26, 2005). Originally filed on July 28, 1998, the California lawsuit remained under seal for almost five years before Lockyer announced his accusations against the drug companies in early 2003. *Id.*

The Texas Attorney General readily admits that neither the lawsuit nor the large settlement would have been possible if the state had not amended its statute to include a *qui tam* or whistleblower provision. Texas Press Release, *supra* note 22; see Bryce, *supra* note 23, at *3-4. Shortly after announcing the settlement with Schering-Plough, Attorney General Abbott announced that Texas would be pursuing a similar suit against Abbott Laboratories and Baxter International. Juliann Walsh, *Texas Suit Alleges Abbott, Baxter Inflated Prices for Medicaid Patients*, CHI. SUN-TIMES, May 27, 2004, at 62. That suit is currently being litigated. *Id.*; Bryce, *supra*, at *1. Illinois announced an almost identical price inflation suit against Abbott Laboratories and forty-seven other defendants (the largest single drug-pricing suit to date) under its state statute in early February 2005. Michael D. Sorkin, *Drug-Pricing Practices Cost Consumers Millions, Illinois Says in Lawsuit*, ST. LOUIS POST-DISPATCH, Feb. 9, 2005, at A01.

24. See *infra* App. A.

25. The survey is limited to states with false claims statutes containing *qui tam* provisions in effect before January, 2005. See discussion *infra* Part III.A.

II. THE FEDERAL CIVIL FALSE CLAIMS ACT

Diseased mules, defective muskets,²⁶ and an iconic President's frustration²⁷ led to passage of the federal FCA in 1863.²⁸ The statute gave the federal government a way to combat fraud suffered by the Union Army when it received deliveries of defective supplies.²⁹ Today the federal FCA is used against fraud perpetrated by all sorts of government contractors including health care providers,³⁰ defense contractors,³¹ and oil and gas companies.³²

Since its passage in 1863, the federal FCA has included a *qui tam* provision.³³ *Qui tam* comes from the Latin phrase, "*qui tam pro domino rege quam pro se ipso in hac parte sequitur*," which means, he "who pursues this action on our Lord the King's behalf as well as his own."³⁴ Private parties who allege and prove fraud against the federal

26. 132 CONG. REC. 22339 (1986) (statement of Rep. Berman). According to the 1863 investigation, one thousand mules delivered to the Union army were "unfit for the service, and almost worthless, for being too old or too young, blind, weak-eyed, damaged, worn out, or diseased." *False Claims Act Amendments: Hearings Before the Subcomm. on Admin. Law & Gov't Relations of the H. Comm. on the Judiciary*, 99th Cong. 295 (1986); see Note, *The History and Development of Qui Tam*, 1972 WASH. U. L.Q. 81, 91-101 [hereinafter *History of Qui Tam*] (describing the history of *qui tam* in American jurisprudence); J. Randy Beck, *The False Claims Act and the English Eradication of Qui Tam Legislation*, 78 N.C. L. REV. 539, 555-56 (2000) (describing passage of 1863 federal FCA).

27. See Beck, *supra* note 26, at 555.

28. Act of March 2, 1863, ch. 67, 12 Stat. 696.

29. S. REP. NO. 99-345, at 8 (1986), reprinted in 1986 U.S.C.C.A.N. 5266, 5273.

30. "Approximately one of every three dollars recovered through false claims cases relate to healthcare fraud." The False Claims Act Res. Ctr., Examples of Qui Tam Cases, <http://www.falseclaimsact.com/healthcare.html> (last visited Oct. 26, 2005); see ANDY SCHNEIDER, TAXPAYERS AGAINST FRAUD EDUCATION FUND, THE ROLE OF THE FALSE CLAIMS ACT IN REDUCING MEDICARE AND MEDICAID FRAUD BY DRUG MANUFACTURERS: AN UPDATE 5 (2004), at <http://www.taf.org/publications/TAFSingle.pdf> (last visited Oct. 26, 2005) (noting that in the fall of 2004, according to the Assistant United States Attorney General in charge of the Civil Division, there were "under seal in the neighborhood of 100 whistleblower cases involving allegations against over 200 drug manufacturers with respect to 500 different products").

31. S. REP. NO. 99-345, at 2-3, reprinted in 1986 U.S.C.C.A.N. 5266, 5267-68.

32. In fiscal year 2000, the second largest category of fraud recoveries (\$230 million) came from "companies alleged to have underpaid royalties on [production of oil and other minerals from public lands], including \$95 million from Chevron, \$56 million from Shell, \$32 million from BP Amoco, \$26 million from Conoco and \$11.9 million from Devon Energy." Press Release, U.S. Dep't of Justice, Justice Recovers Record \$1.5 Billion in Fraud Payments, Highest Ever for One Year Period (Nov. 2, 2000), available at <http://www.USDOJ.Gov/opa/pr/2000/November/641civ.htm> (last visited Nov. 4, 2005).

33. Act of March 2, 1863, ch. 67, 12 Stat. 696, 698.

34. *Vt. Agency of Nat'l Res. v. United States ex rel. Stevens*, 529 U.S. 765, 768 n.1 (2000); see *History of Qui Tam*, *supra* note 26, at 83 & n.9 (citing 3 WILLIAM BLACKSTONE, COMMENTARIES ON THE LAWS OF ENGLAND 160 (1768)).

government bring *qui tam* lawsuits.³⁵ If successful, these *qui tam* plaintiffs (known as “relators”)³⁶ collect a percentage of the recovery.³⁷ The relator need not be personally injured or affected by the defendant’s conduct, but is deemed to have standing on the theory that the federal government, as the real injured party, may assign its right to sue to a private plaintiff.³⁸

Prior to 1986, the federal FCA was amended several times³⁹ in ways that weakened all *qui tam* actions,⁴⁰ so that they were rarely and ineffectively used.⁴¹ In 1986, Congress substantially amended the FCA, invigorating *qui tam* actions.⁴² The 1986 amendments increased

35. 31 U.S.C. § 3730 (2000). There are seven types of conduct covered by the FCA, all involving the submission of false claims to the federal government, including: the conspiracy to do so; the submission of a false statement in support of a claim; or the making, using, or causing to be made or used a “false record or statement to conceal, avoid, or decrease an obligation to pay or transmit money or property to the Government.” *Id.* § 3729(a); *see, e.g.*, *Pickens v. Kanawha River Towing*, 916 F. Supp. 702, 705 (S.D. Ohio 1996) (discussing “reverse false claims”).

36. JOHN T. BOESE, *CIVIL FALSE CLAIMS AND QUI TAM ACTIONS* §§ 1-5 (2005). Boese’s treatise is an excellent resource on the FCA.

37. Relators may collect up to 30% of the total recovery, and barring a few limited situations set forth in the FCA, are guaranteed at least 15%. 31 U.S.C. § 3730(d). The recoveries are statutorily set treble damages (with double damages in instances of sufficient cooperation) and civil penalties at amounts of \$5500 to \$11,000. *Id.* § 3729(a). The statute specifies penalties of \$5000 to \$10,000, but Congress increased the penalty amount for all claims specified after September 29, 1999, pursuant to the Debt Collection Improvement Act of 1996, Pub. L. No. 104-134, 110 Stat. 1321-358 (1996).

38. In *Vermont Agency of Natural Resources v. United States ex rel. Stevens*, 529 U.S. 765, 773 (2000), the United States Supreme Court held “that adequate basis for the relator’s suit . . . is to be found in the doctrine that the assignee of a claim has standing to assert the injury in fact suffered by the assignor. The FCA can reasonably be regarded as effecting a partial assignment of the Government’s damages claim.”

39. Act of March 2, 1863, ch. 67, 12 Stat. 696 (1863), *amended by* Rev. Stats. 3490-94, 5438 (1875), *amended by* Act of Dec. 23, 1943, ch. 377, 57 Stat. 608 (1944), *codified at* 31 U.S.C. §§ 232-235 (1976), *recodified at* 31 U.S.C. §§ 3729-3731, Pub. L. No. 97-258, 96 Stat. 978 (1982), *amended by* False Claims Amendments Act of 1986, Pub. L. No. 99-562, 100 Stat. 3153 (1986), *amended by* Pub. L. No. 103-272, 108 Stat. 1362 (1994) (*codified at* 31 U.S.C. §§ 3729-3731).

40. For example, the 1943 amendments made it difficult for would-be relators to overcome the jurisdictional bar provision, by prohibiting FCA *qui tam* lawsuits when federal government personnel are already aware of the false claims even if the putative relator was the one who had informed the federal government about the fraud. Act of December 23, 1943, ch. 377, 57 Stat. 608, 609 (1944). A number of courts also limited use of the FCA in general through their interpretations of the *mens rea* requirement in the FCA. By 1986, a number of courts had interpreted the FCA’s requirement of “knowledge” as necessitating proof of “specific intent to defraud.” *See United States v. Mead*, 426 F.2d 118, 122 (9th Cir. 1970); *United States v. Priola*, 272 F.2d 589, 593-94 (5th Cir. 1959).

41. *See* BOESE, *supra* note 36, § 1.03.

42. *See id.* § 1.04[H].