



The False Claims Act, the *Allison Engine* Decision, and Possible Effects on Health Care Fraud Enforcement

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Summary

The False Claims Act (FCA), an important tool for combating fraud against the U.S. government, generally provides that a person who knowingly submits, or causes to be submitted, a false or fraudulent claim for payment to the U.S. government may be subject to civil penalties and damages. Recently, the Supreme Court examined the scope of the FCA in *Allison Engine v. United States ex rel. Sanders*, in which a former employee of a subcontractor brought an action against other subcontractors who had allegedly submitted a false claim to the prime contractor on a U.S. defense contract. The Court struck down the FCA claim against the subcontractors, holding that a demonstration that a false claim was paid for with government funds, without more, does not establish liability under 31 U.S.C. §§ 3729(a)(2) and (a)(3). Under these sections, the Court found that a plaintiff must prove that the defendant intended to defraud the government (and not just a recipient of government funds) when it submitted or agreed to make use of the false claim. Given that the FCA is frequently invoked in the health care context, it has been questioned how this decision could affect these cases. This report provides an overview of the FCA and the *Allison Engine* decision, analyzes how this decision could affect certain FCA health care claims, and discusses proposed legislation that would amend the False Claims Act (*i.e.*, the False Claims Act Clarification Act of 2009 (S. 458), the False Claims Act Correction Act of 2009 (H.R. 1788), and the Fraud Enforcement and Recovery Act of 2009 (S. 386)), which could limit the application of the *Allison Engine* decision.

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False Claims Act

The federal False Claims Act (FCA), codified at 31 U.S.C. §§ 3729-3733, provides for judicial imposition of civil monetary penalties and damages for the knowing submission of false claims to the U.S. government.¹ The FCA, as amended, is considered a vital tool used by the U.S. government to recover losses due to fraud, and, in particular, it has been utilized with respect to false claims made to defraud government health care programs such as Medicare and Medicaid. Reports indicate that in FY2007, the U.S. government recovered \$2 billion dollars in settlements and judgments in FCA cases, and more than 75% of these recoveries were from health care entities.²

Under three key provisions of the FCA, civil liability may be imposed on any person that

- (1) knowingly presents, or causes to be presented, to an officer or employee of the United States Government or a member of the Armed Forces of the United States a false or fraudulent claim for payment or approval [31 U.S.C. § 3729(a)(1)];
- (2) knowingly makes, uses, or causes to be made or used, a false record or statement to get a false or fraudulent claim paid or approved by the Government [31 U.S.C. § 3729(a)(2)]; or
- (3) conspires to defraud the Government by getting a false or fraudulent claim allowed or paid [31 U.S.C. 3729(a)(3)].

Penalties under the FCA include treble damages, plus an additional penalty of \$5,500 to \$11,000 for each false claim filed.

Civil actions may be brought in federal district court under the False Claims Act by the Attorney General or by a private person referred to as a relator (*i.e.*, a “whistleblower”), for the person and for the U.S. government, in what is termed a *qui tam* action. The ability to initiate a *qui tam* action has been viewed as a powerful weapon against fraud, in that it may be initiated by a private party who may have direct and independent knowledge of any misconduct. Popularity of *qui tam* actions brought under the FCA may be attributed in large part to the fact that successful relators can receive between 15% and 30% of the monetary proceeds of the action or settlement that are recovered by the government.

Overview of the *Allison Engine Decision*

In *Allison Engine Co. v. U.S. ex. rel. Sanders*, the Navy contracted with two shipyards to build destroyers. The shipyards subcontracted with Allison Engine Company to build generator sets (Gen-Sets), which would provide electrical power for the destroyers. Allison Engine

¹ Recoveries under the FCA have amounted to over \$20 billion since 1986 (when substantial changes were made to the FCA). See Department of Justice Press Release, Justice Department Recovers \$2 Billion for Fraud Against the Government in Fy 2007; More Than \$20 Billion Since 1986, *available at* http://www.usdoj.gov/opa/pr/2007/November/07_civ_873.html.

² *Id.* See also Robert Wolin and B. Scott McBride, *The Feds Pick Up a New Cudgel*, National Law Journal (August 11, 2008).

subcontracted with General Tool Company (which also used a subcontractor) to manufacture different parts needed for the Gen-Sets. The Navy's contracts with the shipyards required that all parts of the destroyers, including the Gen-Sets, be constructed in accordance with Navy specifications. This requirement was included in the contracts with the subcontractors. In addition, the contracts required that each Gen-Set come with a certificate of conformance that certified the unit met the Navy's requirements. All of the money used to pay the contractors for the work on the Gen-Sets ultimately came from the U.S. Treasury.

Former employees of General Tool Company, Roger Sanders and Roger Thacker (the relators), brought actions against Allison Engine Company and other subcontractors under §§ 3729(a)(1)-(3) of the FCA, alleging fraud with respect to the construction of the Gen-Sets. The relators contended that the subcontractors knew that there were defects in the construction of the Gen-Sets and that the Gen-Sets did not conform to Navy specifications. Still, the subcontractors submitted invoices to the shipyards for payment, which constituted "false or fraudulent claims" paid by the government in violation of the FCA.³

During the jury trial before the district court, the relators produced evidence that the subcontractors had issued certificates of conformance containing false statements that the Gen-Sets complied with Navy requirements, as well as invoices that the subcontractors presented to the shipyards. However, the relators did not provide evidence of the subcontractors or the shipyards submitting a false claim to the Navy. While the subcontractors argued that the relators' claim failed because there was no demonstration that the false claims were presented to the government, the relators asserted that their claim under the FCA was sufficient because government funds had been used to pay the invoices that were presented to the shipyards.⁴ The district court agreed with the subcontractors and granted their motion for judgment as a matter of law. The court concluded that in order to sustain a claim under §§ 3729(a)(1) and (a)(2) of the FCA, there must be a showing that a false claim was presented to the U.S. government.⁵

On appeal, the Sixth Circuit reversed the district court in relevant part and found the subcontractors liable under the FCA.⁶ The court of appeals evaluated the statutory language and found that, while liability under § 3729(a)(1) depends on whether a claim has been presented to the government, the language in §§ 3729(a)(2) and (a)(3) contains no indication that presentment is required, so as long as there is a showing that the claim was paid with government funds. The court of appeals opined that the legislative history of the FCA supported this view.⁷ Additionally, while the Sixth Circuit articulated that § 3729(a)(2) requires a "causal connection" between the defendant's false statement and the payment or approval of the claim by the government, the court focused its decision on the idea that proof of presentment is not required in order to bring a successful FCA claim under § 3729(a)(2) and (a)(3).

³ United States ex rel. Sanders v. Allison Engine Co., 471 F.3d 610, 613 (6th Cir. 2006).

⁴ United States ex rel. Sanders v. Allison Engine Co., 2005 U.S. Dist. LEXIS 5612 (S.D. Ohio 2005).

⁵ *Id.* at 31-32. The district court also found with respect to § 3729(a)(3), the relators' claim failed because they had not demonstrated that there was a false or fraudulent claim.

⁶ United States ex rel. Sanders v. Allison Engine Co., 471 F.3d 610 (6th Cir. 2006).

⁷ According to the court, the legislative history indicated, among other things, that the FCA "is intended to reach all fraudulent attempts to cause the Government to pay out sums of money." *Id.* (quoting S.Rept. 99-435 (1986), reprinted in 1986 U.S.C.A.N. 5266).

The Supreme Court granted certiorari on the issue of whether false claims for federal government money made by subcontractors are actionable under § 3729(a)(2) or § 3729(a)(3) of the FCA, if the claims were not presented to the U.S. government. In a unanimous decision, the Supreme Court vacated the Sixth Circuit decision and remanded the case for further proceedings.⁸ While the Court held that a false claim does not have to be presented to the government under §§ 3729(a)(2) and (a)(3), the Court found that under § 3729(a)(2), a plaintiff “must prove that the defendant intended that the false record or statement be material to the Government’s decision to pay or approve the false claim.”⁹ Similarly, under § 3729(a)(3), a plaintiff must demonstrate that the conspirators agreed to make use of the false record or statement in an effort to defraud the government, and that the statement would have a material effect on the government’s decision to pay the false or fraudulent claim.

The Court found that the language of § 3729(a)(2) did not support the Sixth Circuit’s finding that a plaintiff can establish liability under the FCA by showing that a false statement resulted in the use of government funds to pay a false or fraudulent claim. The Court pointed to the language of the subsection, in particular, the phrase “to get a false claim paid by the government.” As the Court articulated, “[t]o get’ denotes purpose, and thus a person must have the purpose of getting a false claim ‘paid or approved by the Government’ in order to be liable under § 3729(a)(2).”¹⁰ Without this element of intent, the Court elaborated, the reach of the FCA would expand beyond its role of “combating fraud against the government.” Further, the Court explained that “[r]ecognizing a cause of action under the FCA for fraud directed at private entities would threaten to transform the FCA into an all-purpose antifraud statute.”¹¹

Additionally, the Court agreed with the Sixth Circuit that, while a plaintiff must present a claim to the government under § 3729(a)(1), § 3729(a)(2) does not require proof that a defendant’s false record or statement was submitted to the government, but instead that the defendant submitted the claim for the purpose of getting the claim paid by the government. The Court also found that under § 3729(a)(3) it is not necessary to show that conspirators presented a false claim to the government, but instead that conspirators agreed that the false record or statement would have a material effect on the government’s decision to pay the claim.

Ramifications of *Allison Engine* Decision on Health Care Cases

As mentioned above, the FCA is often invoked due to fraud in federal health care programs such as Medicare and Medicaid. Although *Allison Engine* does not address its application to health care cases, there has been speculation over how the case could affect FCA health care litigation, especially since claims for payment from federal health care programs like Medicare and Medicaid can be paid for with federal funds, but are often paid through some type of intermediary. Some commentators have suggested that *Allison Engine* could make it more difficult for plaintiffs to bring an FCA claim against health care entities.¹² While lower courts

⁸ *Allison Engine Co. v. United States ex rel. Sanders*, 128 S. Ct. 2123 (2008).

⁹ *Id.* at 2126.

¹⁰ *Id.* at 2128.

¹¹ *Id.* at 2130.

¹² *See generally* Katherine M. Keefe and Susan L. Fields, *Health Care Providers Face Unprecedented New Regulatory*, (continued...)

have begun to evaluate cases in light of the *Allison Engine* decision, it remains to be seen whether the decision will have a significant effect on health care litigation under the FCA.

The Social Security Act gives private entities a large role in the administration of Medicare, which includes making coverage determinations, as well as processing and paying claims. For example, under Medicare Parts A and B, non-government organizations contract to serve as the fiscal agent between health care providers and the federal government.¹³ It has been proposed that on the basis of *Allison Engine*, defendants may be able to argue for dismissal of an FCA claim by alleging that the claim at issue was merely relied upon by the private entities that processed and paid the claim; that the claim was not submitted with the purpose of inducing payment by the government;¹⁴ or that the falsehoods were not material to the government's decision to pay the claim.¹⁵ On the other hand, a plaintiff may be able to argue that health care providers and others submitting a Medicare claim are fully aware that, while they are submitting a claim to a contractor, the claims are ultimately paid by Medicare. This awareness could possibly demonstrate an intent to defraud the government, as opposed to a private contractor.¹⁶

Perhaps a more difficult question is how *Allison Engine* will affect Medicaid claims. Medicaid is a state-administered program that is jointly financed by states and the federal government. When some Medicaid beneficiaries receive care from a health care provider, the provider bills the state Medicaid program for the services.¹⁷ Other Medicaid enrollees receive their care through managed care organizations (MCO), entities that are usually paid monthly, in advance for each enrollee. Typically, the state pays the provider or MCO from a combination of state funds and federal funds, which the Centers for Medicare and Medicaid Services (CMS) advances to the state each quarter. The state later files an expenditure report with CMS in which the state may

(...continued)

Compliance and Enforcement Challenges, New Jersey Law Journal, Vol. 193, Issue 11 (September 15, 2008) (*Allison Engine* case a "potential victory for health care providers"); See also, Supreme Court Narrows Scope of False Claims Act, Implications for Medicare, Medicaid, Health Care Collector (August 2008). But see Judith A. Thorn, *High Court Rules Relators Must Show Intent to Defraud Government Under FCA*, BNA Health Care Fraud Report (June 18, 2008) (comments of Fredrick M. Morgan, that *Allison Engine* decision "was mostly anticlimactic in terms of the issues raised"). See also United States ex rel. Snapp, Inc. v. Ford Motor Co., 532 F.3d 496, 509 (6th Cir. 2008) (in a qui tam action concerning whether the defendant automobile manufacturer fraudulently induced the federal government to contract with the manufacturer by inflating the extent of the manufacturer's dealings with small and minority-owned businesses, court acknowledged that "in light of the Supreme Court's recent decision in *Allison Engine Co. v. United States ex rel. Sanders*, the law in this Circuit is now less friendly to qui tam plaintiffs than it was prior to that decision.").

¹³ See e.g., 42 U.S.C. § 1395kk-1 (addressing the authority and functions of a Medicare administrative contractor).

¹⁴ See e.g., United States ex rel. Thomas v. Bailey, 2008 U.S. Dist. LEXIS 91221 (E.D. Ark. 2008) (relator claimed, among other things, that company selling spinal surgery devices and others caused hospitals to present false or fraudulent claims for payment to Medicare and other federal health care programs under §§3729(a)(2) and (a)(3); court relied on *Allison Engine* and found that amended complaint failed to state a claim under these sections because the complaint did not identify any false records or statements made or used to get a false claim paid, nor did it allege a conspiracy which was specifically intended to defraud the government).

¹⁵ See Supreme Court Narrows Scope of False Claims Act, Implications for Medicare, Medicaid, Health Care Collector (August 2008). See also Robert T. Rhoad, Supreme Court's Allison Engine Decision's Potential Impact On False Claims Act Enforcement In Healthcare Cases, ABA Health eSource, Vol. 4, Number 12 (August 2008).

¹⁶ Ian Hennessey and Diana Gustin, *U.S. Supreme Court Decision Limits False Claims Act*, East Tennessee Medical News (August 2008).

¹⁷ For a description of the Medicaid payment process, see GAO Report GAO-05-748, *Medicaid Financing, States' Use of Contingency-Fee Consultants to Maximize Federal Reimbursements Highlights Need for Improved Federal Oversight*, June 2005.

claim federal reimbursement for Medicaid expenditures, and there is a reconciliation of the expenditures with the federal advance.¹⁸ Applying the reasoning of *Allison Engine*, it has been suggested that plaintiffs will have difficulty proving that a defendant intended to defraud the federal government when the claim was submitted to a state Medicaid program.¹⁹

However, it still seems possible that plaintiffs may be able to bring successful FCA claims for Medicaid fraud under the reasoning of *Allison Engine*. For example, if a plaintiff could demonstrate that a defendant intended a state Medicaid program to rely on a false record or statement in order to receive federal reimbursement, a court may be willing to find that the plaintiff meets the requirements of § 3729(a)(2). In *United States ex. rel. Romano v. New York Presbyterian Hospital*,²⁰ one of the first court opinions to rely on the Supreme Court's decision in *Allison Engine*, the relator alleged that the defendant hospital was liable under the FCA for its complicity in submitting false bills to Medicaid.²¹ The hospital argued that it was entitled to summary judgment because, as a matter of law, it could not have violated the FCA's requirement of presentment to a federal officer "for payment or approval" because the Medicaid claims were submitted to and approved by state agencies. The court denied the hospital's motion for summary judgment and found that based on the *Allison Engine* decision, the question to be addressed was whether or not the hospital acted with the requisite intent when it submitted false claims to state Medicaid agencies, and this was a question of fact to be determined at trial.

Proposed Legislation in the 111th Congress

Members of the 111th Congress have introduced legislation which would make several changes to the FCA and could, if enacted, make it easier for certain plaintiffs to bring an FCA claim. These bills include the False Claims Act Clarification Act of 2009 (S. 458), introduced by Senator Grassley, and the False Claims Act Correction Act of 2009 (H.R. 1788), introduced by Representative Berman. According to congressional reports accompanying similar versions of these bills from the 110th Congress, the legislation aims to clarify the meaning of several provisions of the FCA due to "restrictive" judicial interpretations of the statute that are said to run contrary to congressional intent.²² In addition, the Fraud Enforcement and Recovery Act of 2009 (S. 386, as reported in the Senate), which was introduced by Senator Leahy and Senator Grassley to enhance federal enforcement capabilities to counteract mortgage fraud, securities fraud, and fraud with respect to federal financial assistance, would also amend the FCA to "clarify that the False Claims Act was intended to extend to any false or fraudulent claim for government money or property, whether or not the claim is presented to a government official or employee ... and whether or not the defendant specifically intended to defraud the U.S. government."²³

¹⁸ *Id.*

¹⁹ Memorandum from Harry Silver, Laurence Freedman and Laura Laemmle-Weidenfeld, *Allison Engine Decision* (June 13, 2008) available at http://www.pattonboggs.com/files/News/41ac72e6-e74a-4023-9f17-19b6cffb82e5/Presentation/NewsAttachment/3bc9457f-5ea0-446f-b3c6-1c66c19d1b67/Allison_Memo_HarrySilver.pdf.

²⁰ 571 F. Supp. 2d 473 (S.D.N.Y. 2008).

²¹ *Id.* at 474.

²² *See, e.g.*, S.Rept. 110-507 (2008).

²³ Press Release, Leahy, Grassley Introduce Anti-Fraud Legislation, Bill Would Give Federal Government More Resources To Combat Mortgage Fraud (Feb. 5, 2009), available at <http://leahy.senate.gov/press/200902/020509b.html>.

Proposed amendments to the FCA included in S. 458, H.R. 1788, and S. 386 (which all contain similar, but not identical, provisions) could potentially limit the application of *Allison Engine*. For example, section 2 of S. 458 would amend 31 U.S.C. § 3729(a)(2) to provide that a person who “knowingly makes or uses ... a false record or statement to get a false or fraudulent claim paid or approved” can be liable to the government for penalties.²⁴ The bills all remove the phrase “by the government” from § 3729(a)(2), presumably for the purpose of clarifying that this section of the FCA covers false claims which are paid for by private parties with government grant or contract funds. While S. 458 and H.R. 1788 retain the phrase “to get,” which the *Allison Engine* Court relied on as a basis for its determination that must be an element of intent to defraud the government in a successful § 3729(a)(2) claim, S. 386 would amend § 3729(a)(2) to provide that any person who “knowingly makes, uses, or causes to be made or used, a false record or statement *material to* a false or fraudulent claim” is liable under the FCA.²⁵ According to a Senate report, the purpose of this language is to eliminate the intent requirement articulated in *Allison Engine*.²⁶ Depending on how a court interprets what records or statements are “material to” a false claim, relators may have a considerably greater opportunity to bring an FCA claim in cases where a false claim was submitted to a recipient of government funds. However, it should be noted that while all three bills could make it easier for a relator to bring a claim under § 3729(a)(2) in situations where the false claim was not submitted directly to the government, under these bills a relator still must prove that a defendant *knowingly* made or used the false or fraudulent claim.²⁷

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²⁴ Section 2 of H.R. 1788 provides that a person who “knowingly makes or uses ... a false record or statement to get a false or fraudulent claim for *Government money or property* paid or approved” will be liable under the FCA. “Government money or property,” as defined by the bill, includes money or property belonging to the United States government, or money or property that the government has provided to a contractor, grantee, agent, or other recipient (or for which the U.S. government will reimburse these entities) that is spent on the government’s behalf or to advance a government program.

²⁵ Emphasis added. S. 386 defines the term “material” as “having a natural tendency to influence, or be capable on influencing, the payment or receipt of money or property.”

²⁶ See S.Rept. 111-10 (2009). It should be noted that while S. 386 generally applies to conduct occurring on or after the date of enactment, it would make the amendments to § 3729(a)(2) retroactive to the date of the *Allison Engine* decision (i.e., June 7, 2008). It has been suggested that giving the legislation retroactive effect would be subjected to challenge in the courts. See Richard O. Duvall, Allison V. Feierabend, Christopher A. Myers and John P. Rowley III, United States: The Expansion Of The Civil False Claims Act Under S. 386, available at <http://www.mondaq.com/article.asp?articleid=77124>. An analysis of the retroactivity of this provision is outside the scope of this report.

²⁷ “Knowingly” is defined by the current version of the FCA, as well as each of the three bills discussed above, as meaning that a person, with respect to information — (1) has actual knowledge of the information; (2) acts in deliberate ignorance of the truth or falsity of the information; or (3) acts in reckless disregard of the truth or falsity of the information, and no proof of specific intent to defraud is required. 31 U.S.C. § 3729(b).

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