

State AGs Are Realizing Power of False Claims Statutes

WRITTEN BY

Stephen C. Piepgrass | Ashley L. Taylor, Jr. | Amy Pritchard Williams

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When it comes to false claims cases, the federal False Claims Act tends to be the first law that comes to mind. That may be because the federal statute tends to get a lot of publicity — with good reason.

According to the U.S. Department of Justice,^[1] it secured more than \$5.6 billion in False Claims Act settlements and judgments in the fiscal year that ended Sept. 30, 2021.

Since 1986, when Congress strengthened the federal False Claims Act by providing more attractive incentives to whistleblowers, the DOJ has secured more than \$70 billion in settlements and judgments.

While the federal False Claims Act has long enjoyed the spotlight, it might need to get used to sharing it more often: We expect state attorneys general to increasingly take advantage of their states' false claims statutes, which provide them great power as sovereigns to hold individuals and corporate entities accountable for allegedly defrauding their states' governments.

Although state attorneys general have in the past often used their states' false claims statutes to piggyback on federal False Claims Act cases involving Medicare fraud brought by the DOJ, they are coming to realize those statutes give them power to pursue a broad array of fraudulent claims beyond those covered by the federal False Claims Act or arising within the health care industry.

As state attorneys general grasp how powerful of a weapon their states' false claims statutes can be, we expect an uptick in the number of prosecutions involving such statutes — statutes whose broad application was seemingly ignored, or at least underappreciated, for years by state attorneys general.

A Brief History of the Federal and State False Claims Acts

The origins of the federal False Claims Act date back to the Civil War. The Union Army found itself entering into transactions for sorely needed supplies with crooked suppliers. These suppliers were taking advantage of the high wartime demand for their products and the low odds of being held accountable for wrongdoing. Many suppliers sold shoddy products at high prices, and frequently shipped fewer items than were purchased.

In 1862, while the Civil War was raging, Congress investigated this fraud. Its investigation led to passage of the False Claims Act, which was signed into law by President Abraham Lincoln on March 2, 1863.

The statute was amended in 1943 to limit the financial gains attorneys and whistleblowers could receive after what some politicians perceived to be a common practice of attorneys taking advantage of successful criminal prosecutions of fraud by quickly filing civil suits for the same conduct.

Congress again amended the statute in 1986, after a wave of highly publicized defense contractor fraud, to provide whistleblowers with more incentives to expose fraud against the government.

In 2009 and 2010, the False Claims Act was amended again to conform to the newly passed Dodd-Frank Wall Street Reform and Consumer Protection Act and the Affordable Care Act.

For more than a century, the federal False Claims Act was the only false claims statute on the books in the U.S. But starting in the late 20th century, states began enacting their own false claims statutes.

Today, more than 40 states, territories and municipalities — including California in 1987, Florida in 1994, Georgia in 2007, Illinois in 1991, Michigan in 2006, Nevada in 1999, New Jersey in 2008, New York in 2007, Texas in 1995, the District of Columbia in 2011, and Puerto Rico in 2018 — have enacted their own false claims statutes.

However, some states' statutes only cover Medicaid fraud, leaving these state attorneys general unable to pursue the wide array of fraudulent activity the DOJ can pursue under the federal False Claims Act. The states with Medicaid-only false claims laws include Colorado, Connecticut, Louisiana, Michigan, New Hampshire, Texas and Washington.

When discussing state false claims statutes, we would be remiss if we did not mention that municipalities and counties are also enacting their own false claims ordinances. Miami-Dade County, Florida, enacted its False Claims Ordinance in 1999. Chicago enacted its False Claims Act in 2004. Philadelphia did the same in 2010. Allegheny County, Pennsylvania, enacted its False Claims Act in 2011.

These acts add to the mix more prosecutors who will likely take the opportunity to bring false claims cases against entities allegedly defrauding their sovereigns.

State AGs Have Not Aggressively Wielded Their States' False Claims Statutes, but This Could Be Changing

Historically, state attorneys general have not aggressively wielded their states' false claims statutes despite some having had them at their disposal for decades. When they did wield these laws, it was often to tag along on federal False Claims Act cases targeting Medicaid fraud.

State attorneys general historically overlooked this tool because they tended to focus on criminal and civil prosecutions, such as organized crime and consumer fraud.

This focus can be attributed in large part to the people who, in our observations, historically had run for the state

attorney general office: career prosecutors and government attorneys who viewed the office as the culmination of their careers. They tended to prosecute traditional wrongdoing before they came into office, so it naturally followed that they would guide their colleagues and line prosecutors to do the same once they held the office.

Today, we're seeing several trends that lead us to expect increased state false claims investigations. First, the office of state attorney general has become much higher profile. Attorneys general have their eyes and ears out for cases high-impact cases that raise the profiles of their office and help them build a record.

Claims against individuals and entities allegedly defrauding a state and its taxpayers are appealing to state attorneys general who operate at the intersection of politics, policy and the law. They're naturally drawn to potential prosecutions that can be politically advantageous because they can change defendants' policies and industry policies — or the law — through media coverage of the prosecutions and public outcry over the alleged misconduct.

Second, state attorneys general can see the settlements and judgments federal prosecutors are securing through the federal False Claims Act as examples of how they can use their states' false claims acts to secure similarly large settlements and judgments.

It is only natural for government entities to look for ways to bring additional money into their treasuries while penalizing alleged wrongdoing. Large false claims recoveries fit that bill, and do so with minimal risk and large potential rewards.

Third, we have seen increased collaboration between state attorneys general, plaintiffs attorneys and plaintiffs attorneys' clients. As plaintiffs attorneys and their clients become more sophisticated and organized in their false claims case selection and litigation strategy, we expect them to increase the amount of information they share with state attorneys general with the hopes of securing their intervention in false claim suits.

If recent cases are any indication, the uptick we expect to see in state false claims prosecutions is just the beginning.

For example, in August, District of Columbia Attorney General Karl Racine announced that his office was bringing a tax fraud lawsuit under the district's False Claims Act^[2] against billionaire technology executive Michael Saylor, co-founder of publicly traded data tracking company MicroStrategy.

The lawsuit alleges Saylor illegally avoided more than \$25 million in District of Columbia taxes by falsely claiming to be a resident of other jurisdictions with personal income taxes lower than the district's, even though he has allegedly been a District of Columbia resident since 2005.

In July, the New York Attorney General's Office settled a New York False Claims Act case against Egon Zehnder International Inc., a headhunting firm that allegedly bilked the state out of \$13.3 million in taxes. The attorney general intervened in the case in 2022.

And in February, the New Jersey Attorney General's Office settled a New Jersey False Claims Act case^[3] against several private bus companies, including Academy Bus LLC, and related parties for \$20.5 million.

The case, in which the attorney general's office intervened in late 2020, alleged the defendants overcharged New Jersey Transit by billing the agency for miles and hours not driven, as well as underreporting missed bus trips on routes the companies operated for the agency. The settlement was New Jersey's largest-ever False Claims Act settlement outside the health care sector.

Expect More State AGs to Get in the False Claims Game

Based on these and other public prosecutions, observations from the defense bar, and our own recent experience, we expect state attorneys general to bring more false claims prosecutions in the coming years. Early indications are that these prosecutions could focus on three areas.

First, we expect state attorneys general to pursue false claims cases in the cybersecurity arena given the importance of cybersecurity today and in the future, and the lucrative nature of cybersecurity consulting contracts.

The prototypical case of this type is one the DOJ settled in July. In that case, the DOJ announced a settlement against defense contractor Aerojet Rocketdyne Inc.[4] in a False Claims Act case where a whistleblower alleged the company misrepresented its compliance with the federal government's cybersecurity requirements.

The case arose when Aerojet's senior director for cybersecurity alleged the company fraudulently induced the federal government to contract with it by not fully disclosing its noncompliance with the U.S. Department of Defense's cybersecurity requirements.

Second, we expect state attorneys general to pursue claims against private equity firms when those firms are so involved in a portfolio company's business operations, or exert so much control over those operations, that they can be arguably deemed to have caused their portfolio company to submit a false claim or to have wrongfully underpaid a state government entity.

Pursuit of these investors will be viewed as consistent with state attorneys general charge to pursue all possible defendants when investigating false claims cases. When such cases involve private equity-backed companies, private equity firms could be named as defendants.

Finally, we expect state attorneys general to bring more false claims actions tied to securities fraud claims. An example would be where a publicly held company allegedly made false or misleading statements that artificially inflated its stock price and caused a state entity, such as a state employees' pension system, to lose money when those false or misleading statements came to light.

These cases are relatively straightforward and can draw from plaintiffs attorneys' or the U.S. Securities and Exchange Commission's efforts in alleging or proving the elements of securities fraud.

High Tide for State False Claims Act Cases Could Be Coming

Over the past few decades, few state attorneys general seemed to view their states' false claims acts as key tools in their toolbox for prosecuting wrongdoing that defrauded their sovereigns. We expect that to change.

These once effectively dead-letter statutes appear poised to start driving more investigations, prosecutions and interventions by state attorneys general.

Whether concerning cybersecurity misrepresentations, private equity firms' alleged misconduct, securities fraud or other forms of misconduct, we expect a new wave of state and local false claims cases to surface over the next few years.

The scope and types of claims at issue in state and local false claims cases can differ markedly from those under the federal False Claims Act. Entities at risk for investigation by state attorneys general or local prosecutors for alleged violations of state or local false claims statutes or ordinances should ensure they are well-versed in the nuances of the various state and local false claims statutes and ordinances on the books.

[1] Press Release, U.S. Department of Justice, Justice Department's False Claims Act Settlements and Judgments Exceed \$5.6 Billion in Fiscal Year 2021 (Feb. 1, 2022), <https://www.justice.gov/opa/pr/justice-department-s-false-claims-act-settlements-and-judgments-exceed-56-billion-fiscal-year>.

[2] Press Release, Office of the Attorney General for the District of Columbia, AG Racine Sues DC-Based Billionaire Michael Saylor & Software Company Microstrategy for Evading More Than \$25 Million in District Taxes (Aug. 31, 2022), <https://oag.dc.gov/release/ag-racine-sues-dc-based-billionaire-michael-saylor>.

[3] Press Release, New Jersey Office of the Attorney General, Acting AG Bruck Announces \$20.5 Million Settlement over Allegations Academy Bus Fraudulently Billed NJ Transit (Feb. 11, 2022), <https://www.njoag.gov/acting-ag-bruck-announces-20-5-million-settlement-over-allegations-academy-bus-fraudulently-billed-nj-transit>.

[4] Press Release, U.S. Department of Justice, Aerojet Rocketdyne Agrees to Pay \$9 Million to Resolve False Claims Act Allegations of Cybersecurity Violations in Federal Government Contracts (July 8, 2022), <https://www.justice.gov/usao-edca/pr/aerojet-rocketdyne-agrees-pay-9-million-resolve-false-claims-act-allegations>.

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