Contractors Should Watch for Big Changes Coming to The California False Claims Act

By Aaron P. Silberman and Dennis J. Callahan

Contractors that work on state or local public projects in California need to prepare for changes in the California False Claims Act (FCA). Responding to federal incentives, the California Legislature is revising that statute to expand contractor liability, encourage and protect whistleblowers, and limit contractor defenses. These changes will increase government enforcement and encourage more whistleblower lawsuits.

Since its enactment during the Civil War, the federal FCA has been a primary tool for the U.S. government to recover fraudulent payments made to government contractors. In 1987, California became the first state to enact its own false claim act, and now more than 30 states have done so.

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Like the federal FCA, California's FCA includes a whistleblower provision that enables private citizens to bring false claims actions on behalf of the government. Like most states' FCAs, the California FCA applies generally to all false claims, including claims on publicly funded construction projects. (The FCAs of about 10 states only apply to health care or Medicaid fraud.)

The number of states with FCAs is growing, including many of California's neighbors. Nevada and Hawaii already have their own FCAs, both of which apply to construction and contain whistleblower provisions. Several other state legislatures, including Washington's, have introduced FCA bills in recent years that have failed. In an era of large state budget deficits, and with little downside for states, it may be only a matter time before the "holdout" states enact FCAs of their own.

False claims liability already presents a substantial risk to government contractors in California. In the construction industry, false claims take many forms, and include practices such as bid rigging, collusive

bidding, improper material or equipment substitutions, failure to pay subcontractors or suppliers, and falsely certifying compliance with licensing or disadvantaged business subcontracting requirements.

In recent years, Congress has acted to further motivate states to enact strong false claims laws against Medicaid fraud. The Deficit Reduction Act of 2005 (DRA) increased a state's share of medical assistance payments recouped in false claims actions, so long as that state's FCA meets certain criteria, including that it establishes FCA liability with respect to Medicaid spending that is as least as effective in facilitating whistleblower claims as the federal FCA, provides for filing under seal with review by the state attorney general, and contains a civil penalty at least as high as that under the federal FCA.

Since the passage of the DRA, the federal FCA has been strengthened three times, first in 2009, by the Fraud Enforcement and Recovery Act, and twice in 2010, by the Patient Protection and Affordable Care Act and the Dodd-Frank Wall Street Reform Act. Federal authorities are now reviewing state FCAs and pending bills to determine whether they still qualify for the bonus Medicaid recoupment incentive.

After previously qualifying the California FCA for the incentive, in 2011 federal authorities identified 12 provisions that no longer satisfy the requirements. These included stronger federal protections against retaliation by whistleblowers' employers, longer federal statute of limitations periods, a narrower state definition of who qualifies as an "original source" and so may maintain FCA actions based on publicly disclosed information, and the requirement for state FCA liability that the claims in question had been "presented" to a state agency.

Introduced this February, Assembly Bill 2492 is the California Legislature's answer to all 12 of these areas. In almost all cases, AB 2492 would strengthen the state FCA with respect to all whistleblower actions – not just those that relate to Medicaid payments. On July 2, 2012, the Senate Appropriations Committee passed the bill. As of this writing AB 2492 was on the Senate Floor, likely its final stop before reaching the Governor's desk.

Overall, these developments portend increased aggressive prosecution of whistleblower suits under the California FCA and increased potential exposure of contractors to false claims allegations. For example, elimination of the "presentment" requirement in state FCAs will expose to potential FCA liability grantees and subgrantees who have not presented claims directly to the government agency that funded their grants. Similarly, expanding the definition of "original source" in state FCAs may prompt companies to bring whistleblower suits against their industry competitors based on information that may be publicly available, but the importance of which may not be fully understood beyond a small circle of insiders.

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Contractors doing publicly funded work in California – as prime and subcontractors or as grantees or subgrantees – would be well advised to consider the increased exposure in all of their contracting decisions and in their continuing efforts to assure compliance through business controls and processes. ■

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