



## CRS Report for Congress

# 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 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 the proposed False Claims Correction Acts (S. 2041 and H.R. 4854), which, if enacted, could limit the application of the *Allison Engine* decision.

### 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.<sup>1</sup> The FCA, as amended, is considered

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<sup>1</sup> 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 (continued...)

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.<sup>2</sup>

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 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.

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<sup>1</sup> (...continued)

1986, available at [[http://www.usdoj.gov/opa/pr/2007/November/07\\_civ\\_873.html](http://www.usdoj.gov/opa/pr/2007/November/07_civ_873.html)].

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

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.<sup>3</sup>

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.<sup>4</sup> 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.<sup>5</sup>

On appeal, the Sixth Circuit reversed the district court in relevant part and found the subcontractors liable under the FCA.<sup>6</sup> 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.<sup>7</sup> 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).

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

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

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

<sup>5</sup> *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.

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

<sup>7</sup> 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.C.A.N. 5266).

the case for further proceedings.<sup>8</sup> 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.”<sup>9</sup> 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).”<sup>10</sup> 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.”

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.<sup>11</sup> However, it remains to be seen how courts will interpret the *Allison*

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

<sup>9</sup> *Id.* at 2126.

<sup>10</sup> *Id.* at 2128.

<sup>11</sup> See generally Katherine M. Keefe and Susan L. Fields, Health Care Providers Face Unprecedented New Regulatory, Compliance and Enforcement Challenges, *New Jersey Law Journal*, Vol. 193, Issue 11 (September 15, 2008) (*Allison Engine* case a “potential victory for (continued...)”).

*Engine* decision and 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.<sup>12</sup> 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; or that the falsehoods were not material to the government's decision to pay the claim.<sup>13</sup> 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.<sup>14</sup>

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.<sup>15</sup> 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 claim federal reimbursement for Medicaid expenditures, and there is a reconciliation of the expenditures with the federal advance.<sup>16</sup> 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

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<sup>11</sup> (...continued)

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").

<sup>12</sup> *See e.g.*, 42 U.S.C. § 1395kk-1 (addressing the authority and functions of a Medicare administrative contractor).

<sup>13</sup> *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).

<sup>14</sup> Ian Hennessey and Diana Gustin, *U.S. Supreme Court Decision Limits False Claims Act*, East Tennessee Medical News (August 2008).

<sup>15</sup> 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.

<sup>16</sup> *Id.*

when the claim was submitted to a state Medicaid program.<sup>17</sup> 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).

## Proposed Legislation in the 110<sup>th</sup> Congress

The False Claims Correction Acts (S. 2041, as reported in the Senate, and H.R. 4854, as introduced in the House) aim 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.<sup>18</sup> The bills, which would make several changes to the FCA, could make it easier for plaintiffs, under certain circumstances, to bring an FCA claim.

Proposed amendments to the FCA included in S. 2041 and H.R. 4854 could also potentially limit the application of *Allison Engine*. Section 2 of S. 2041 would amend § 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.<sup>19</sup> Both bills remove the phrase “by the government” from § 3729(a)(2) 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 the bills would 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, the removal of the phrase “by the government” could allow a plaintiff to have a successful FCA claim in circumstances where the plaintiff cannot prove that the defendant intended to defraud the government, but can prove that a defendant did intend to defraud a private party of government funds.

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<sup>17</sup> 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](http://www.pattonboggs.com/files/News/41ac72e6-e74a-4023-9f17-19b6cffb82e5/Presentation/NewsAttachment/3bc9457f-5ea0-446f-b3c6-1c66c19d1b67/Allison_Memo_HarrySilver.pdf)].

<sup>18</sup> See, e.g., S.Rept. 110-507 (2008).

<sup>19</sup> Section 2 of H.R. 4854 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.