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FCA Cases: Protect Claims by Relying on NY's Favorable Pleading Standard

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Fraud-related claims usually must be pled with particularity. But in a little-noticed provision at the end of New York's False Claims Act, §192(1-a), the New York legislature provided for a lower pleading hurdle when asserting violations of New York's FCA in state court. In federal court, in contrast, FCA cases are evaluated under the heightened pleading standard embodied in Federal Rule of Civil Procedure 9(b). As a consequence, when qui tam relators (whistleblowers) file cases in federal court alleging violations of both the federal and state FCAs, their New York FCA causes of action are subject to the heightened federal pleading standard. Accordingly, relators should strongly consider filing separate federal and state qui tam actions (or seeking to remand improperly removed cases) in order to benefit from the New York FCA pleading standard at the dismissal stage.

NY's FCA Pleading Standard

The federal False Claims Act dates back to Civil War times and is one of the federal government's most important enforcement tools to battle against misconduct that harms the federal fisc. Importantly, it empowers whistleblowers to bring such actions and incentivizes them with a share of the recovery. New York and many other states enacted state false claims acts after Congress, in 2005, gave states the financial incentive of an increased share of Medicaid recoveries to enact their own such acts. But to receive the sizable incentive, the state false claims acts had to be "at least as effective in rewarding and facilitating qui tam actions" as the federal FCA. Deficit Reduction Act of 2005, codified in relevant part at 42 U.S.C. §1396h(b)(2). One of the ways that New York met that challenge was to lower the pleading bar for whistleblowers asserting False Claims Act violations.

Specifically, §192(1-a) of New York's False Claims Act removes, for whistleblower cases, the usual requirement that fraud causes of action be pled with particularity. It says that for purposes of applying New York's particularity rule, CPLR §3016, the "qui tam plaintiff shall not be required to identify specific claims that result from an alleged course of misconduct, or any specific records or statements used … ." Instead, it continues, the allegations are sufficient if the facts, if ultimately proven true, "would provide a reasonable indication" that there were FCA violations and the allegations "provide adequate notice of the specific nature of the alleged misconduct to permit" the government to investigate and the defendants to defend against them. N.Y. State Fin. Law §192(1-a). In other words, it requires notice pleading of the schemes at issue.

Under this New York FCA pleading standard, a plaintiff must only make allegations about false claims "which taken together manifest any cause of action cognizable at law." *511 W. 232nd Owners v. Jennifer Realty Co.*, 98 N.Y.2d 144, 152 (2002) (emphasis added). Courts must "liberally construe the complaint," "accept as true the facts alleged in the complaint," and "accord plaintiffs the benefit of every possible favorable inference." Id. Defendants may still argue that particularity is required in pleading the knowledge element of an FCA violation, but no court has yet decided that issue.

This pleading standard provision keeps a low profile, for it falls nearly at the end of an already-lengthy statute. It refers to the particularity rule only by referencing CPLR §3016, and even employs a non-traditional sub-paragraph number (1-a). Thus it risks being overlooked. Most recently, in the case of *New York ex rel. Lerman v. Siemens AG*, in moving to dismiss, the defendant sought dismissal by arguing that the alleged false claims had not been pled with particularity under CPLR § 3016(b).1 It clearly missed §192(1-a). As a result, the state, which had declined to intervene in the case, submitted a statement of interest in order to advise the court of the correct pleading standard.[2]

Heightened Federal Standard

In federal court, in contrast, Rule 9(b) requires that a party pleading fraud "must state with particularity the circumstances constituting fraud or mistake." FCA causes of action in federal court are subject to this heightened pleading standard.[3] Because Rule 9 is considered to be *procedural*, not substantive, federal courts exercising diversity or supplemental jurisdiction over state law claims apply the federal pleading standard.[4]

As a consequence, federal courts evaluating New York state FCA causes of action apply the heightened Rule 9 pleading standard. For example, one federal court recently dismissed New YorkFCA causes of action because the complaint's "description of a fraudulent scheme paired with information about a defendant's standard billing practice is not enough 'particular' information to fulfill the purposes of Rule 9(b)." *U.S. ex rel. Kester v. Novartis Pharm.*, 23 F. Supp. 3d 242, 255 (S.D.N.Y. 2014). Instead, the court held, "a plaintiff must plead the particular details of a fraudulent scheme and 'details that identify particular false claims for payment that were submitted to the government.'" Id. (quoting *United States ex rel. Karvelas v. Melrose-Wakefield Hosp.*, 360 F.3d 220(1st Cir. 2004)).

So while the federal courts sometimes differ as to how to apply the heightened pleading standard, defendants are consistently relying on Rule 9(b) in seeking to dismiss FCA claims pending in federal court. For example, a federal court dismissed certain New York FCA causes of action in a qui tam case arising from New York City's infamous CityTime project, even though it found that, "liberally construed," certain allegations were plausible. In the court's view, the complaint failed to meet the "who, what, when, where and how" required under Rule 9(b). *N.Y. ex rel Khurana v. Spherion*, No. 15 Civ. 6605, 2016 WL 6652735, at *15-16 (S.D.N.Y. Nov. 10, 2016). And in a case against the Moody's rating service, even though the relator had "provided enormously helpful information to various congressional committees and government investigators," and despite the court's statement that it was "particularly sympathetic to [relator's] position in light of the serious and far-reaching effects that Moody's conduct had on the American economy," the court dismissed the FCA causes of action. The court found that the relator had failed to allege which *specific* ratings (and, thus, claims) were false. *United States ex rel. Kolchinsky v. Moody's*, No. 12 Civ. 1399, --- F. Supp. 3d ----, 2017 WL 825478, at *6-8 (S.D.N.Y. March 2, 2017). Most recently, in a case against the Visiting Nurse Service of New York, the defendants moved to dismiss federal and state claims that the defendant had fraudulently billed for no-show nurse visits, arguing that allegations of a fraudulent scheme were insufficient, and that relator must instead allege the particular false visits and false claims.[5]

Overall, all of these are examples where the arguments, and probably the results, may have been different under the New York standard in §192(1-a).

Keeping NY FCA Cases in NY Courts

Given the case law, relators can help New York state recover taxpayer monies lost to false or fraudulent conduct by seeking to keep their qui tam cases in New York state courts and subject to the more favorable pleading standard set by the New York's legislature. They can do so by filing their New York FCA causes of action in state court and fighting removal to federal court where appropriate. They can also consider avoiding the usual practice of combining both federal and state FCA causes of action into a single federal court complaint when alleging that both federal and state governments have been victimized. Instead, though it is a bit cumbersome, where the pleading standard is likely to be a key issue, they can file separate qui tams —one under the federal FCA in federal court and one under the New York FCA in state court.

While the federal FCA explicitly permits federal courts to exercise supplemental jurisdiction over state FCA claims,[6] a defendant cannot remove to federal court a separate state court lawsuit on the same basis.[7] The weight of the law further holds that a federal court cannot exercise diversity over state FCA causes of action where the state government is the real party in interest because Congress has not provided federal diversity jurisdiction to cases between a state and a citizen of another state.[8]

As a consequence, relators can file state FCA claims in state courts and keep them there, even if the same relator filed a parallel federal FCA case. Such a strategy cannot be dismissed as "forum shopping." On the contrary, making full use of the means that the New York legislature provided for the overall benefit of New York's taxpayers, embodies and fulfills New York's legislative goals.

Endnotes:

1. See Memorandum of Law in Support of Motion to Dismiss, in *New York ex rel. Lerman v. Siemens AG*, No. 100303/2013, Sup. Ct., New York Cty. (March. 22, 2017), at 5.
2. See The State of New York's Statement of Interest, in *New York ex rel. Lerman v. Siemens AG*, No. 100303/2013, Sup. Ct., New York Cty. (April 26, 2017).
3. See *United States ex rel. Ortiz v. Mount Sinai Hosp.*, No. 13 Civ. 4735, 2015 WL 7076092, at *4 (S.D.N.Y. Nov. 9, 2015).
4. See, e.g., *Minger v. Green*, 239 F.3d 793, 800 (6th Cir. 2001) ("While state law governs the burden of proving fraud at trial in a diversity action in federal court, the procedure for pleading fraud in all diversity suits in federal court is governed by the special pleading requirements of Fed. R. Civ. P. 9(b)."); *Gravatt v. City of N.Y.* , 54 F. Supp. 2d 233, 233-34 (S.D.N.Y. 1999) ("Pursuant to Erie and its progeny, federal courts sitting in diversity and/or pendent jurisdiction apply state substantive law and federal procedural law.").
5. See Memorandum of Law in Support of Defendant Visiting Nurse Service of New York's Motion to Dismiss the Amended Complaint Pursuant to Rules 12(b)(6) and 9(b), in *United States ex rel. Lacey v. Visiting Nurse Service of New York*, No. 14 Civ. 5739, S.D.N.Y., Nov. 21, 2016. The court has not yet ruled on the motion.
6. See 31 U.S.C. §3732(b) ("The district courts shall have jurisdiction over any action brought under the laws of any State for the recovery of funds paid by a State or local government if the action arises from the same transaction or occurrence as an action brought under section 3730.").
7. See, e.g., *Cardillo v. Cardillo*, 360 F. Supp. 2d 402, 415 (D.R.I. 2005) ("notwithstanding the fact that both cases might share the same parties, facts, and witnesses were they to proceed to trial, … [defendants] 'don't get to come to federal court just because [they] think it would be nice to try them together.'"); *McClelland v. Longhitano,* 140 F. Supp. 2d 201, 203 (N.D.N.Y. 2001) ("According to Defendants, because the state court action is so related to the existing federal court action, removal was proper and this Court may consolidate them. Although Defendants' approach does have the benefit of efficiency and avoids the possibility of inconsistent adjudications of similar, if not identical, issues, their argument incorrectly attempts to turn 28 U.S.C. §1367(a) into an independent source of removal jurisdiction"); *In re Estate of Tabas*, 879 F. Supp. 464, 467 (E.D. Pa. 1995) ("the supplemental jurisdiction statute does not allow a party to remove an otherwise unremovable action to federal court for consolidation with a related federal action. Although such an approach would have the benefits of efficiency, it runs aground on a close reading of the [supplemental jurisdiction] statute").
8. See, e.g., *State of California, ex rel. Servs. Disabled Veterans Telecomms. v. MCI Telecomms.,* 185 F.3d 868, 1999 WL 387034 (9th Cir. 1999) (unpublished) (state in declined qui tam action "cannot be considered a party in name only. Because California is not a citizen of a state, diversity is defeated and the district court lacked jurisdiction"); *Indiana ex rel. Harmeyer v. Kroger Co.*, No. 17 Civ. 00538, 2017 WL 2544111, at *3-4 (S.D. Ind. June 13, 2017) ("The Court finds that the State of Indiana is a real party in interest to this litigation, despite the fact that it has declined to intervene … . the Court also finds that the State of Indiana is not considered a citizen of any State and, therefore, its presence in the litigation destroys diversity jurisdiction."). Cf. *Nevada ex rel. Bates v. Mortg. Elec. Registration Sys.*, 493 F. App'x 872, 874 (9th Cir. 2012) (unpublished) (where relator "did not assert any plausible claims against Defendants on behalf of the State," the state was only "a nominal party," and the district court thus possessed diversity jurisdiction to dismiss (instead of remand) the removed qui tam complaint).

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