5

Information Item

Joint CSAC and EdFund Audit Committee

General Discussion on Chronicle of Higher Education Article: The Growing Threat of False-Claims Lawsuits

At the request of Commission Chair Fousekis, legal counsel of the Commission and EdFund will have a general discussion with the Committee regarding the recent Chronicle of Higher Education Article: *The Growing Threat of False-Claims Lawsuits* and discuss any possible steps that may be taken to protect against such potential claims.

Recommended Action:

No action is required.

Responsible Staff: Catherine Brown
David Reid

THE CHRONICLE OF HIGHER EDUCATION

The Chronicle Review

http://chronicle.com/weekly/v52/i45/45b01601.htm

From the issue dated July 14, 2006

POINT OF VIEW

The Growing Threat of False-Claims Lawsuits

By TIMOTHY J. HATCH and BRYAN ARNOLD

Since Congress strengthened the False Claims Act in 1986, it has become a powerful tool to combat fraud against the federal government. Over the last 20 years, the government has recovered more than $15-billion under the act, primarily from defense and health-care companies. Increasingly, however, plaintiffs and their lawyers are turning their attention to colleges — and the millions of dollars in financial aid that students receive to attend them.

Armed with new legal theories, creative plaintiff's lawyers have sought to expand traditional notions of what constitutes a false claim and to make colleges liable for alleged violations of any one of the hundreds of statutory and regulatory requirements with which institutions must comply to participate in federal student-aid programs. To date, most courts have dismissed such claims as not actionable as fraud under the False Claims Act. But a recent decision by the Seventh Circuit Court of Appeals in the case of *United States ex rel. Jeffrey E. Main v. Oakland City University* — in which a plaintiff accused a university of unlawfully receiving federal funds because of how it compensated student recruiters — could open doors for more lawsuits against colleges for any number of purported regulatory violations.

Not only the Department of Justice but also individuals — often disgruntled current or former employees who have been discharged, given poor reviews, or passed over for promotion — can bring actions under the False Claims Act. Whether or not the government intervenes, such individuals (referred to as "*qui tam* plaintiffs" or "relators") can receive up to 33 percent of any recovery, either as a result of a court judgment or a settlement — plus legal fees, in some cases.

For defendants, the consequences of a False Claims Act lawsuit can be significant. Anyone who knowingly submits a false claim to the government is liable for three times the actual damages the government incurs, plus a penalty of up to $11,000 for each false claim submitted. Beyond that, an entity accused of fraud faces the possibility of administrative fines and penalties, bad publicity, years of contentious and costly investigation and litigation, and — perhaps most important — the loss of eligibility to receive federal funds or participate in federal programs. Such lawsuits can also spawn related investigations by state-licensing authorities and accrediting organizations or, in the case of public companies, securities class-action lawsuits. Thus, defendants are under tremendous pressure to settle such actions, meritorious or not.

Over the past decade or so, courts have fairly consistently held that breaches of contract, statutory or regulatory violations, and simple mistakes are not actionable under the False Claims Act. Courts have explained that the act is a means of compensating the government for fraud perpetuated against it, not a tool to enforce regulatory or statutory compliance. The *Main* decision, however, largely ignores that critical distinction.

In *Main* the plaintiff did not claim that Oakland City University, a Baptist institution in Indiana, overcharged the government or that there was anything explicitly false about student applications for financial aid — the type of circumstances that would give rise to a typical claim under the False Claims Act. Instead, the plaintiff argued that the university violated the act because it accepted federal student aid at a time in which it was allegedly not in compliance with a requirement set forth in the agreement that all colleges must sign to participate in such financial-aid programs. A college must comply with a multitude of requirements laid out in the agreement, as well as with all other statutes and regulations applicable to Title IV programs.

The plaintiff in *Main* alleged that Oakland City University paid its student recruiters commissions, bonuses, and incentives based on their enrollment success, an action that the participation agreement prohibits. The university, like all other institutions, was not required to certify that it was in compliance with that requirement as an immediate condition of receiving financial-aid funds. Rather, the plaintiff argued that the university "impliedly certified" that it was in compliance with that requirement when it accepted the funds.

The Seventh Circuit ultimately adopted a related theory of liability called "promissory fraud," by which a party commits fraud if it enters into an agreement but never intends, from the outset, to honor its obligations. In recent cases, plaintiffs have argued that colleges never planned to comply with the limits on incentive compensation when they entered their participation agreements and would not have been eligible to administer federal financial-aid programs had they been upfront about it. Although the focus of most cases thus far has related to incentive compensation, those theories could apply to virtually any statutory or regulatory condition of program participation. Plaintiffs asserting them have sought the return of all federal financial aid an institution has received.

Most courts have rejected the broad application of the implied-certification and promissory-fraud theories precisely because they can be used to turn every statutory, regulatory, or contractual violation into a false claim. The courts have limited legal action to situations in which compliance with a particular regulation or contract term directly relates to the government's decision to make a payment.

But the Seventh Circuit did not require the plaintiff in *Main* to demonstrate any direct connection between the government's decision to provide financial-aid funds to students and the institution's compliance with the incentive-compensation restriction. Rather, it ruled that a False Claim Act lawsuit will withstand a motion to dismiss if it alleges that a university is violating a provision of the program agreement and did not intend to comply with that provision at the time it entered into that agreement. Moreover, for the case to proceed, the Seventh Circuit did not require the plaintiff to identify any facts that would show the university never expected to honor its obligations. Simply alleging in conclusive fashion that a defendant never intended to do so was enough to allow the plaintiff's complaint to survive a motion to dismiss, proceed to discovery, and, in turn, gain greater odds of a favorable settlement. In April the Supreme Court declined to hear the case, letting the Seventh Circuit ruling stand.

The *Main* decision potentially opens the door to False Claims Act litigation based on the alleged violation of any number of statutory and regulatory provisions, no matter how far removed the particular provision is from the government's decision to pay a claim. In fact, the impact of *Main* is already being felt. In May, Judge James V. Selna of the Central District Court of California relied on the *Main* decision to find that a False Claims Act case could be based on violations of requirements imposed not by the government but by a regional accrediting organization.

In that case, *United States v. Chapman University et al.*, the plaintiffs alleged that, as part of the accreditation process, Chapman University falsely represented to the Western Association of Schools and Colleges that one of its programs met the association's standards for classroom hours and clinical supervision. Although the federal government does not impose any such requirements, the judge rejected a motion to dismiss. He ruled that allegedly false statements made to an accreditation organization could support a false claim because colleges must be accredited to meet the standards for participating in federal financial-aid programs.

As Judge Selna's decision illustrates, the *Main* decision could be applied to virtually any requirement imposed on the administration of financial-aid programs, or even as part of the accreditation process a college must go through to be eligible to participate in such programs. In fact, if courts continued to apply the *Main* decision in the fashion of Judge Selna, a college could face liability for allegedly violating any provision of its own policies because government regulators and private accreditors often require, as a condition of licensing or accreditation, that institutions comply with their own policies. In the end, *Main* accomplishes what so many prior courts have attempted to avoid: It turns the False Claims Act into a means for private individuals, as well as the government, to enforce statutory or regulatory compliance.

Main is also troubling because, by setting the bar so low, it makes it virtually impossible for a court to dismiss a False Claims Act case without full discovery and the prospect of trial. All that a smart plaintiffs' counsel must do to salvage a case with a shaky factual or legal foundation is to allege that the defendant never intended to comply with a term of the agreement or, potentially — as the recent Chapman University decision indicates — any requirement imposed by the government or any organization as a condition of accreditation or participation in federal financial-aid programs.

The *Main* case also undermines the authority of government agencies to handle and resolve contractual, regulatory, and statutory issues on a case-by-case basis. In 2002, for instance, the deputy secretary of education had established as a matter of department policy that a violation of the provision at issue in *Main* did not cause monetary damage to the government and should not generally make a college ineligible to participate in Title IV programs. The *Main* decision allows a plaintiff to collect treble damages in situations that an agency might believe warrants only a fine, corrective action, or no action at all. It effectively lets self-interested plaintiffs substitute their judgment for that of the agencies responsible for administering federal programs.

Unfortunately, colleges have no easy solutions available to eliminate the risks of being subjected to a False Claims Act lawsuit. Institutions should closely monitor developments in this area and take any necessary steps to review and revamp their compliance efforts and programs. Only time will tell if the recent suits challenging recruiter-compensation practices are anomalies or the beginning of the next wave of litigation.

Timothy J. Hatch is a partner in the Los Angeles office of Gibson, Dunn & Crutcher, and Bryan Arnold is a partner at Gordee, Nowicki & Arnold in Irvine, Calif.

http://chronicle.com
Section: The Chronicle Review
Volume 52, Issue 45, Page B16
