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Whistleblower Claims Under New York False Claims Act Found Barred By Federal Law

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New York State's highest court, the Court of Appeals, recently ruled that whistleblower claims filed under the New York False Claims Act were federally preempted — and that the "market participant" doctrine was inapplicable.

More and more states are passing false claims act in an effort to limit fraud and provide incentives to whistleblowers. In certain instances, however, a whistleblower's claims under a state's false claims act may be preempted by federal law. Recently, New York State's highest court, the Court of Appeals, considered whether certain whistleblower claims were within the scope of the statutory preemptions of the federal Airline Deregulation Act of 1978 ("ADA")[1] and the Federal Aviation Administration Authorization Act ("FAAAA"),[2] and, in any event, whether the "market participant" doctrine permitted the claims to go forward.[3]

BACKGROUND

Pursuant to a contract with the State of New York, DHL Express (USA), Inc., agreed to provide various courier services via air and ground transportation, including "Overnight Air Express," "Next Afternoon Ser-

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vice," "Second Day Service," and "Ground Delivery Service." Kevin Grupp and Robert Moll (the "plaintiffs") own a trucking company and served as an independent contractor to DHL, providing ground shipping services to defendant within the state.

The plaintiffs, as whistleblowers, commenced an action on behalf of New York State pursuant to the New York False Claims Act ("FCA")[4] alleging violations of New York State Finance Law §§189 (1)(a), (1)(b) and (1)(c),[5] and seeking treble damages, penalties and costs. They asserted that from 2003 through 2008 DHL engaged in a persistent practice of misrepresentation, claiming that packages were delivered by air, when in fact, they were shipped via ground transportation. By doing so, the complaint alleged, DHL would impose a jet fuel surcharge even though "[a] substantial percentage of DHL Next Day and 2nd Day deliveries paid for by the State did not travel by air at all."[6] The complaint further alleged that DHL billed the State a diesel fuel surcharge even when independent contractors, such as the plaintiffs, "incurred the majority of fuel costs associated with DHL's ground transportation service."

DHL moved to dismiss the complaint, arguing, in relevant part, that the plaintiffs' action was preempted by the ADA and the FAAAA. The trial court denied the motion, concluding that the market participant exception to federal preemption applied. Relying primarily on *Cardinal Towing & Auto Repair, Inc. v. City of Bedford, Tex*.,[7] the court reasoned that the plaintiffs' suit pertained to the state's proprietary, and not regulatory, capacity. It remarked that:

> The overcharging of the State for goods and services provided by private companies is the prime ill that the [FCA] seeks to address — which is, for the State, a specific proprietary problem. But because the State is such a major consumer of goods and services, the [FCA] permits relators such as plaintiffs to bring to its attention and, taking the risk of nonrecovery, prosecute the State's claims against providers of false statements.

An intermediate appellate court unanimously reversed, granting the motion and dismissing the complaint. The appellate court rejected the market participant doctrine, concluding that "the broad scope of the FCA demon-

strates that its primary goal is to regulate the actions of those who engage in business with the State, and thus the statute enforces a general policy."

The dispute reached the New York Court of Appeals.

ON APPEAL

The plaintiffs contended on appeal that the U.S. Congress, by encouraging states to pass fraudulent claim statutes such as the New York State Finance Law, could not have intended for those statutes to be preempted. Further, they asserted that the FCA was neither regulatory in nature nor related to the "price[s], route[s], or service[s]" of DHL. In the alternative, they argued that if preemption were found, then the market participant exception applied because their claims pertained to the State's proprietary capacity, as a private actor, in procuring courier services from DHL.

The Court of Appeals found these arguments unavailing.

The Court of Appeals explained that, under the Supremacy Clause of the United States Constitution, federal laws "shall be the supreme Law of the Land"[8] and Congress is vested with the authority to supersede State statutory or regulatory law.[9] Thus, the Court continued, the primary concern of courts engaged in preemption analysis was "ascertain[ing] the intent of Congress."

It then pointed out that the ADA provided, in relevant part:

> Except as provided in this subsection, a State, political subdivision of a State, or political authority of at least 2 States may not enact or enforce a law, regulation, or other provision having the force and effect of law related to a price, route, or service, of an air carrier that may provide air transportation under this subpart.[10]

The Court of Appeals added that the FAAAA had a nearly identical provision that preempted the enforcement of state laws that related to "any motor private carrier, broker, or freight forwarder with respect to the transportation of property."[11]

The U.S. Supreme Court has had previous occasion to consider the scope of these provisions, the New York Court of Appeals noted, ascrib-

ing them "a broad pre-emptive purpose."[12] In one case, the Supreme Court observed that Congress had enacted the ADA with the goal of deregulating the airline industry based on the rationale that maximum reliance on competitive market forces would best further efficiency, innovation, and low prices as well as variety and quality of air transportation services. In conjunction with this purpose, the New York Court of Appeals pointed out, the "relating to" language was construed to have expansive import, preempting any form of state enforcement actions having a "connection with or reference to" airline rates, routes, or services.

The Court of Appeals then declared that, in light of "the breadth of the ADA and FAAAA's preemptive language," it rejected the plaintiffs' contentions that their FCA claims only sought to enforce the State's proprietary interests against the fraud perpetrated by DHL's alleged pricing scheme and were based on general laws that did not prescribe the rates, routes, and services of airlines and carriers. On these points, it stated, the Supreme Court's decisions in *Morales* and *Wolens*, where similar state fraud claims were federally preempted, were particularly instructive.

The Court of Appeals explained that in *Morales*, the National Association of Attorneys General ("NAAG"), an organization composed of the attorneys general of all 50 states, adopted extensive guidelines establishing "standards governing the content and format of airline advertising," among other things. Pursuant to these guidelines, the attorneys general of seven states issued an advisory memorandum to major airlines, notifying them that the continued failure to disclose surcharges was "a violation of our respective state laws on deceptive advertising and trade practices" and could result in the commencement of "immediate enforcement actions." Although the states' intended goal was "preventing the market distortion caused by false advertising" through the enforcement of state fraud and consumer protection statutes, the claims were federally preempted because the state guidelines "related to" or bore a "reference to" airfares and rates, the Court of Appeals continued. It added that the Supreme Court also rejected the argument that general state fraud laws that did not prescribe rates, routes, and services avoided preemption, concluding that such a construction ignored the "sweep" of the preemptive language and read the words "relating to" out of the statute.

Similarly, the Court of Appeals continued, in *Wolens*, the plaintiffs asserted claims under the Illinois Consumer Fraud and Deceptive Business Practices Act ("Consumer Fraud Act"), seeking monetary relief for the allegedly fraudulent devaluation of their earned rewards caused by the defendant airline's unilateral modification to its "frequent flyer" program. Although the plaintiffs' breach of contract claims were allowed to proceed, the Supreme Court found the Consumer Fraud Act to be federally preempted because it had similar effect as the NAAG guidelines in *Morales*; that is, it controlled the primary conduct of those falling within its governance and served as a means to guide and police the marketing practices of the airlines, thereby infringing on the airline's ability to set its rates, routes, or services.

Accordingly, the Court of Appeals ruled, the plaintiffs' claims were preempted by the ADA and FAAAA as they had a connection with, or reference to, the rates, routes, and services of DHL. Although the essence of the plaintiffs' complaint pertained to allegedly fraudulent misrepresentations, it added, the State Finance Law claims were premised on alleged practices that were directly related to the imposition of fuel surcharges for the offered shipment options and thus, referenced, at a minimum, the rates billed by the courier.

THE MARKET DOCTRINE EXCEPTION

The Court of Appeals next turned to the plaintiffs' contention that the "market doctrine" exception was applicable in this case. Generally, the market participant doctrine recognizes the important distinction between the actions of a state in its dual regulatory and proprietary capacities. "[W]hen a state or municipality acts as a participant in the market and does so in a narrow and focused manner consistent with the behavior of other market participants, such action does not constitute regulation subject to preemption."[13] However, a governmental entity does not escape federal preemption, even when assuming the role of private actor, if it "us[es] its power in the marketplace to implement governmental policies."[14] Indeed, "a state acts as a regulator, not a proprietor, when it uses its bargaining leverage as a means of attaining policy ends."[15] Put another way, "courts

have found preemption when government entities seek to advance general societal goals rather than narrow proprietary interests through the use of their contracting power."[16]

The Court of Appeals explained that it was evident that the State procured services from DHL in its proprietary capacity. However, it continued, the plaintiffs' reliance on the FCA, which established public policy goals and thus was regulatory in nature, rendered the market participant exception "inapplicable to this case." As the Court of Appeals pointed out, State Finance Law §189(g) provided, in relevant part, that a finding of liability under the statute may result in "a civil penalty of not less than six thousand dollars and not more than twelve thousand dollars, plus three times the amount of all damages, including consequential damages." Thus, it noted, rather than redressing the harm actually suffered, the statute's imposition of civil penalties and treble damages evinced a broader punitive goal of deterring fraudulent conduct against the State. Put differently, instead of compensating the State for damages caused by DHL's purported scheme and addressing its narrow proprietary interests, the FCA would punish and consequently deter such future conduct, thereby promoting a general policy.

Accordingly, the Court of Appeals concluded that in light of the FCA's regulatory effect, the market participant exception was rendered inapposite.

CONCLUSION

It should be noted that the First District Court of Appeal of Florida recently dismissed, and the Supreme Court of Florida declined review,[17] of an identical action commenced by these plaintiffs against DHL under the false claims act of that state.[18] In its decision, the Florida Court of Appeal also rejected the market participant doctrine, concluding that the state "acts as a regulator in authorizing suits under the False Claims Act which, as noted above, serve to deter future behaviors on the part of the defendants."

Nonetheless, it also should be noted that the broad preemptive effect of the ADA and FAAAA should not be strained to encompass every asserted claim pertaining to the rates, routes, or services of an airline or car-

rier. As the U.S. Supreme Court has observed, there are certain actions that are sufficiently remote or tenuously related to rates, routes, and services as to avoid preemption,[19] identifying routine breach of contract claims, as such, a peripheral cause of action as they enforce privately bargained-for obligations rather than further policy matters.

NOTES

[1] 49 U.S.C. §41713(b)(1).
[2] 49 U.S.C. §14501(c)(1).
[3] *State of New York ex rel. Kevin Grupp and Robert Moll v. DHL Express (USA), Inc*., No.71 (N.Y. Apr. 26, 2012).
[4] New York State Finance Law §§187 *et seq*.
[5] State Finance Law §§189 (1)(a) and (1)(b) state that a person will be held liable under the FCA if he or she "knowingly presents, or causes to be presented a false or fraudulent claim for payment or approval; knowingly makes, uses, or causes to be made or used, a false record or statement material to a false or fraudulent claim."
[6] Plaintiffs also alleged that in 2004, DHL had expanded its network of truck hubs, increasing the efficacy of ground transportation and obviating the need for air transportation of packages.
[7] 180 F.3d 686 (5th Cir. 1999).
[8] U.S. Const, art. VI, cl (2).
[9] *See People ex rel. Cuomo v. First American Corp*., 18 N.Y.3d 173 (2011).
[10] 49 USC §41713(b)(1).
[11] *See* 49 USC §14501(c)(1).
[12] *Morales v. Trans World Airlines, Inc*., 504 U.S. 374 (1992); *see also American Airlines, Inc. v. Wolens*, 513 U.S. 219 (1995); *Rowe v. New Hampshire Motor Transport Association*, 552 U.S. 364 (2008).
[13] *Cardinal Towing*, 180 F.3d at 691.
[14] Council of City of New York v. Bloomberg, 6 N.Y.3d 380 (2006).
[15] Council of City of New York, 6 N.Y.3d at 442 citing Building & Constr. Trades Council v. Associated Builders & Contractors of Mass./R.I., Inc., 507 U.S. 218 (1993).
[16] Cardinal Towing, 180 F.3d at 692.
[17] *DHL Express (USA), Inc., et al. v. State, ex rel. Kevin Grupp and Robert Moll*, 60 So.3d 426 (Fla.App. 1 Dist. 2011) *review denied* _ So3d _; 2012 WL

299620 (2012).

[18] See §§68.081(2), 68.082(2), Fla. Stat.

[19] *Morales* at 390.