



August 15, 2013

VIA FIRST CLASS MAIL

The Honorable Pat McCrory
North Carolina Governor
Office of the Governor
20301 Mail Service Center
Raleigh, NC 27699

RE: Potential Liability for Misuse of Federal Grant Funds

Dear Governor McCrory:

We write on behalf of Cause of Action, a non-profit, nonpartisan government accountability organization that uses investigative, legal and communications tools to educate the public on how government transparency and accountability protect economic opportunity for American taxpayers. We seek to notify the State of North Carolina, as well as entities, contractors, subgrantees, subrecipients and subcontractors who are utilized in furtherance of federally-facilitated exchanges,¹ of potential liabilities that might apply if any of these entities or their agents misuses the taxpayer funds it receives.

As you are aware, on February 12, 2013, you informed federal officials that North Carolina would default to a federally-facilitated health insurance exchange, despite exploratory efforts by former Governor Perdue to establish a state-federal partnership health insurance exchange.² Nevertheless, North Carolina received \$87,357,315 in federal grant funds through the Center for Consumer Information and Insurance Oversight (CCIIO), a subdivision of the Department of Health and Human Services (HHS).³ These funds were issued through Planning and Level I Establishment Grants (Grant Funds) to further develop information technology (IT) infrastructure for North Carolina.⁴ Additionally, HHS has projected that North Carolina will

¹ This would include any future federal grants for Navigators, in-person assisters, certified application counselors, and any federal funding relating to the UX2014 program and any application programming interface with the federal data services hub.

² The Henry J. Kaiser Family Foundation, *State Exchange Profile: North Carolina* (as of Feb. 12, 2013), available at <http://kff.org/health-reform/state-profile/state-exchange-profiles-north-carolina/>.

³ U.S. Dep't of Health & Human Servs., Ctrs. for Medicare & Medicaid Servs., Ctr. for Consumer Info. & Ins. Oversight, *North Carolina Affordable Insurance Exchange Grants Awards List*, available at <http://www.cms.gov/ccio/Resources/Marketplace-Grants/nc.html> (last visited Aug. 13, 2013).

⁴ *Id.*

receive \$2,245,281 in federal funding for the Navigator program⁵ in furtherance of the anticipated start date of October 1, 2013 for the federally-facilitated exchange.⁶

Compliance Risks Associated with the Terms of the Funding Opportunity Announcement

Any entity receiving Grant Funds through CCIIO is restricted in how it may use the funds. As CCIIO's Funding Opportunity Announcement for Exchange Establishment Grants states, Grant Funds may not be used for meeting matching requirements of any other federal program, covering excessive executive compensation, or contracting with organizations that have a conflict of interest, such as individuals or companies that sell insurance or insurance-like products, including discount plans.⁷ States receiving CCIIO Grant Funds are also prohibited from using these funds to improve systems or processes solely related to Medicaid or the Children's Health Insurance Program, or any other state or federal program's eligibility, particularly as such systems relate to IT.⁸

As a recipient of an Establishment Grant, North Carolina is restricted in how it uses this funding. If North Carolina receives future Navigator grants these grant funds will also be subject to federal restrictions. Neither the Navigator grant funds nor the Establishment grant funds may be used to cover any pre-award costs, to match any other federal funds, to provide services, equipment, or support that are the legal responsibility of another party under federal or state law, to carry out services that are the responsibility of the Exchange, to expend funds related to any activity designed to influence the enactment of legislation, appropriations, regulation, administrative action, or Executive order proposed or pending before Congress or any state government, state legislature or local legislature or legislative body.⁹ The varied and numerous restrictions placed by HHS and the CCIIO on the use of Grant Funds may subject North Carolina's contractors, subcontractors, subgrantees, and subrecipients to a significant risk of liability under the False Claims Act, as well as the state itself to sanctions imposed by Centers for Medicare and Medicaid Services and/or CCIIO, such as restrictions on the use of funds

⁵ Under 45 C.F.R. § 155.210, each exchange must establish a Navigator program to assist people with healthcare enrollment. Grants are available to state agencies to serve as Navigators. 45 C.F.R. § 155.210(c).

⁶ See U.S. Dep't of Health & Human Servs., Ctrs. for Medicare & Medicaid Servs., Ctr. for Consumer Info. & Ins. Oversight, *Cooperative Agreement to Support Navigators in Federally-facilitated and State Partnership Exchanges*, 1, 9 (Apr. 9, 2013), available at <http://www.cms.gov/CCIIO/Resources/Funding-Opportunities/Downloads/2013-navigator-foa-4-9-2013.pdf>. Navigator grants are being administered by HHS's Center for Medicare and Medicaid Services. Those awards are set to be announced by HHS on or about August 15, 2013.

⁷ U.S. Dep't of Health & Human Servs., Ctrs. for Medicare & Medicaid Servs., Ctr. for Consumer Info. & Ins. Oversight, *Cooperative Agreement to Support the Establishment of the Affordable Care Act's Health Insurance Exchanges*, 1, 36-37, available at <http://www.cms.gov/CCIIO/Resources/Funding-Opportunities/Downloads/amended-spring-2012-establishment-foa.pdf>.

⁸ *Id.*; see also 2 C.F.R. pt. 225 regarding cost allocations.

⁹ This list is not exhaustive. See also U.S. Dep't of Health & Human Servs., *supra* note 3, at 27; U.S. Dep't of Health & Human Servs., *supra* note 6, at 36-37.

and/or termination of the award.¹⁰ To the extent material misrepresentations are made, criminal charges and fines may also result under 18 U.S.C. § 1001.

Compliance with the Byrd Anti-Lobbying Amendment

Section 1352 of Title 31 of the United States Code, the Byrd Anti-Lobbying Amendment, expressly prohibits a recipient “of a Federal contract, grant, loan, or cooperative agreement” from using appropriated funds to “influenc[e] or attempt[] to influence an officer or employee of any agency, a Member of Congress, an officer or employee of Congress, or an employee of a Member of Congress” in connection with specified “Federal action[s].”¹¹ In response to a Senate inquiry concerning HHS grant funding under the Centers for Disease Control and Prevention’s Communities Putting Prevention to Work program, the U.S. Department of Justice, stated “[t]he Department is committed to investigating all credible allegations of illegal lobbying activity, which strikes at the heart of the democratic process.”¹² To ensure that contractors, subcontractors, subgrantees, and subrecipients comply with federal law, North Carolina must prevent any appropriated federal funds from being used for any form of lobbying—direct or grassroots—for or against any pending legislation.¹³ Finally, it is also true regarding future recipients of Navigator grants in North Carolina that “[g]rant recipients may lobby at their own expense if they can segregate federal funds from other financial resources used for that purpose.”¹⁴

Compliance with Audit Requirements of OMB Circular A-133

Any recipient or subrecipient of \$500,000 or more in federal awards during a single fiscal year must comply with the audit requirements of the Office of Management and Budget’s (OMB) Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*.¹⁵ The federal award recipient must identify all federal awards it receives and expends, must establish and maintain internal controls to ensure it is managing the federal award programs in compliance with all laws, must prepare regular financial statements, must ensure audits are conducted at the required intervals, and must take corrective action on any audit findings.¹⁶ Any federal award recipient who contracts with a for-profit subrecipient is responsible for the for-

¹⁰ U.S. GOV’T ACCOUNTABILITY OFFICE, GAO-13-543, PATIENT PROTECTION AND AFFORDABLE CARE ACT—HHS’S PROCESS FOR AWARDED AND OVERSEEING EXCHANGE AND RATE REVIEW GRANTS TO STATES (May 31, 2013), *available at* <http://www.gao.gov/assets/660/654994.pdf>.

¹¹ 31 U.S.C. § 1352 (2012).

¹² Letter from Peter J. Kadzik, Principal Deputy Assistant Att’y General, U.S. Dep’t of Justice, to Hon. Patrick Leahy, Chairman, Senate Judiciary Comm. (May 7, 2013), 1, 57, *available at* <http://www.judiciary.senate.gov/resources/transcripts/upload/061212QFRs-Holder.pdf>.

¹³ 18 U.S.C. § 1913.

¹⁴ U.S. Dep’t of Health & Human Servs., *supra* note 3, at 27.

¹⁵ The Single Audit Act, as amended, applies to non-federal governmental units, including subrecipients, which receive federal awards of \$500,000 or more. *See* 31 U.S.C. § 7502; OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, OMB CIRCULAR No. A-133, AUDITS OF STATES, LOCAL GOVERNMENTS, AND NON-PROFIT ORGANIZATIONS at Subpart B, §§ 200(a), 210(a) (June 26, 2007), *available at* http://www.whitehouse.gov/sites/default/files/omb/assets/a133/a133_revised_2007.pdf. (“OMB Circular A-133”).

¹⁶ OMB Circular A-133 § 300.

profit subrecipient's compliance.¹⁷ The contract must describe the applicable compliance requirements and the for-profit subrecipient's compliance obligations.¹⁸

The federal award recipient must select an auditor to conduct the audit.¹⁹ Upon assessing the federal award recipient's financial statements, internal controls, and compliance, the auditor will issue a report describing its findings.²⁰ The federal award recipient is then responsible "for follow-up and corrective action on all audit findings," and must prepare a corrective action plan to address the problems identified by the audit.²¹ Finally, the federal award recipient must submit to the OMB's federal clearinghouse a reporting package that includes its financial statements, schedule of expenditures of federal awards, corrective action plan, and the auditor's reports.²² As a recipient of \$87,357,315 in federal Grant Funds, North Carolina must adhere to these requirements. Failure to comply with OMB Circular A-133 may result in suspension of federal funding and may affect eligibility for future funding.²³

Compliance with Cost Principles of OMB Circular A-87

State and local entities that receive federal funding must allocate their expenditures in accordance with OMB Circular A-87, *Costs Principles for State, Local, and Indian Tribal Governments*.²⁴ These recipients must adequately document their costs, the costs must be reasonable and in conformance with this OMB Circular as well as federal and state laws, and similar costs must be treated consistently.²⁵ Recipients must submit a Certificate of Cost Allocation Plan²⁶ and a Certificate of Indirect Costs,²⁷ certifying they are in conformance with this OMB Circular.²⁸ If the recipient submits a false certification, it may be subject to treble damages under the False Claims Act, which is further explained in the next section. Relatedly, any federal award recipient that contracts with a commercial organization is subject to the cost principles and procedures of 48 C.F.R. part 31.2. Like OMB Circular A-87, these regulations dictate how a federal award recipient is allowed to expend funds when contracting with a commercial organization. Any state that has received Grant Funds to establish an exchange—even if it is currently a federally-facilitated-exchange state—may be subject to this regulation if it has contracted with commercial organizations.

Because it is operated exclusively by the federal government, North Carolina's federally-facilitated exchange is not subject to this OMB Circular. However, if North Carolina elects to

¹⁷ *Id.* § 210(e).

¹⁸ *Id.*

¹⁹ *Id.* §§ 105, 200, 500.

²⁰ *Id.* §§ 500, 505, 510.

²¹ *Id.* § 315.

²² 31 U.S.C. § 7502(h); OMB Circular A-133 § 320(d).

²³ 31 U.S.C. §§ 7501 *et seq.*

²⁴ OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, OMB CIRCULAR at 5 (Attachment A, ¶ A(3) (Application)), available at http://www.whitehouse.gov/omb/circulars_a087_2004 ("OMB Circular A-87").

²⁵ *Id.* at 9 (Attachment A, ¶ C(1) (Basic Guidelines)).

²⁶ *Id.* at 45 (Attachment C).

²⁷ *Id.* at 56 (Attachment E).

²⁸ *Id.* at 12 (Attachment A).

transition to a state-run or a partnership exchange and receives federal funding for the project, it would be subject to the cost allocation requirements of this OMB Circular.²⁹ Furthermore, because North Carolina received federal Grant Funds to establish IT infrastructure for a state-run exchange and North Carolina has not returned these funds, the state may be subject to the cost allocation principles and procedures of 48 C.F.R. part 31.2. Violation of these requirements may subject the state to penalties under 48 C.F.R. § 52.242-3.

False Claims Act, Corporate Governance, and Internal Best Practices

Providing false information to the Government is strictly illegal under the False Claims Act.³⁰ All persons are forbidden from knowingly or willfully falsifying or concealing a material fact, making materially false or fraudulent representations, or using any false writings or documents known to be materially fictitious.³¹ Federal law similarly bars anyone from knowingly presenting false claims to any person or officer of the United States government or to any corresponding department or agency.³² A state employee may face liability under the False Claims Act if he misuses federal funds and falsely certifies that he properly used the funds. Further, if two or more parties enter into an unlawful agreement to submit a false claim to the federal government and they commit an overt act in furtherance of that agreement, they may be found liable of conspiracy under the False Claims Act.³³ Additionally, a state's subcontractors may face relator claims under the False Claims Act if the subcontractor misuses federal funds. Liability for violations under the False Claims Act is at least \$5,000, plus treble damages.³⁴

States must institute procedures to promote compliance with the financial integrity provisions of section 1313 of the Patient Protection and Affordable Care Act (PPACA), including requirements related to accounting, reporting, auditing, cooperation with investigators, and application of the False Claims Act.³⁵ A comprehensive strategy to combat fraud will hedge against False Claims Act liabilities and ensure maximal compliance with other laws and regulations.

Absent a comprehensive strategy to combat fraud as required by PPACA § 1313, North Carolina may face liability of its own and is at significant risk of reimbursing subcontractors for unlawful activity who may also face relator claims under the False Claims Act if federal funds are misused.³⁶ Given the wide-ranging functions and responsibilities of North Carolina as a federally-facilitated-exchange state and the significant taxpayer funds involved, it is increasingly plausible that health insurers and subcontractors may misrepresent their credentials and that there will be ample opportunity for vigilant whistleblowers to file False Claims Act *qui tam* suits in response.

²⁹ OMB Circular A-87 at 5 (Attachment A. ¶ A(3) (Application)).

³⁰ 31 U.S.C. §§ 3729- 33.

³¹ 18 U.S.C. § 1001.

³² 18 U.S.C. § 287.

³³ 31 U.S.C. § 3729(a)(1)(C).

³⁴ 31 U.S.C. § 3729(a).

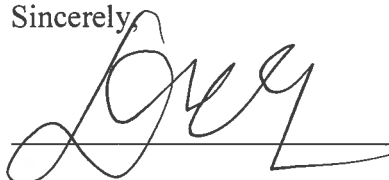
³⁵ U.S. Dep't of Health & Human Servs., *supra* note 6, at 52-53.

³⁶ 31 U.S.C. §§ 3729-3733.

Please consider whether North Carolina, its contractors, subcontractors, subgrantees and subrecipients have the oversight capability to ensure federal funds are used in a transparent, accountable, and legally compliant manner. You must promptly refer to HHS Office of Inspector General any credible evidence that a principal, employee, agent, contractor, subrecipient, subcontractor or other person or entity has submitted a false claim under the False Claims Act or has committed a criminal or civil violation of laws pertaining to fraud, conflict of interest, bribery, gratuity, or similar misconduct involving those funds. The HHS Office of Inspector General can be reached at <http://www.oig.hhs.gov/fraud/hotline/>.

If you have any questions regarding this letter, please contact me at 202-499-4232.³⁷

Sincerely,



DANIEL Z. EPSTEIN
EXECUTIVE DIRECTOR

cc: Hon. Patrick Leahy, Chairman, Senate Committee on the Judiciary
Hon. Charles Grassley, Ranking Member, Senate Committee on the Judiciary
Hon. Orrin Hatch, Ranking Member, Senate Committee on Finance
Hon. Tom Harkin, Chairman, Senate Committee on Health, Education, Labor and Pensions
Hon. Lamar Alexander, Ranking Member, Senate Committee on Health, Education, Labor, and Pensions
Hon. Richard Burr, Ranking Member, Senate Committee on Veterans Affairs
Hon. Johnny Isakson, Vice Chairman, Senate Select Committee on Ethics
Hon. Darrell Issa, Chairman, House Committee on Oversight and Government Reform
Hon. Fred Upton, Chairman, House Committee on Energy and Commerce
Hon. Elijah Cummings, Ranking Member, House Committee on Oversight and Government Reform
Hon. Roy Blunt, Ranking Member, Senate Subcommittee on Agriculture, Rural Development, Food & Drug Administration, Senate Committee on Appropriations
Hon. Michael Enzi, Ranking Member, Senate Subcommittee on Children and Families, Senate Committee on Health, Education, Labor and Pensions
Hon. Kay Hagan, Chairman, Senate Subcommittee on Children & Families, Senate

³⁷ This letter is not intended to create, and does not create, an attorney-client relationship between you or the North Carolina Office of the Governor and Cause of Action. Cause of Action is providing this letter and the information contained herein only as a convenience to the Office of the Governor, the Office of the Attorney General, and the Office of the Secretary of State of the State of North Carolina. It does not constitute legal advice and **MUST NOT** be used as a substitute for the advice of a qualified and independent attorney. Please consult proper counsel in your jurisdiction.

Committee on Health Education, Labor & Pensions
Hon. Patrick McHenry, Chairman, House Subcommittee on Oversight and Investigations,
House Committee on Financial Services
Hon. Kelly Ayotte, Senate Committee on Homeland Security & Governmental Affairs
Hon. George Butterfield, Jr., House Subcommittee on Health, House Committee on
Energy and Commerce
Hon. Renee Ellmers, House Subcommittee on Health, House Committee on Energy and
Commerce
Hon. Robert Pittenger, House Committee on Financial Services
Hon. Kathleen Sebelius, Secretary, U.S. Department of Health & Human Services
Daniel Levinson, Inspector General, U.S. Department of Health & Human Services
Peter Kadzik, Principal Deputy Assistant Attorney General, Office of Legislative Affairs,
U.S. Department of Justice
Hon. Roy Cooper, Attorney General, State of North Carolina
Hon. Elaine Marshall, Secretary of State, State of North Carolina
Wayne Goodwin, Insurance Commissioner, State of North Carolina