RECENT DEVELOPMENTS IN CALCULATING DAMAGES AND PENALTIES UNDER THE FALSE CLAIMS ACT

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The most interesting decisions in the False Claims Act damages arena over the past few years have addressed the question of how to calculate damages where government funds have been used in violation of contractual or programmatic requirements designed to further intangible, public policy goals. In these cases – for example, where a defendant poses as a minority contractor to secure a government contract, or where a contractor fails to disclose organizational conflicts of interest but actually produces a good or service – the question arises whether the government has sustained damages, and how those damages should be measured. The case law in this area has evolved rapidly within the past five years, although there are still questions that remain to be answered in the most difficult factual scenarios.

A recent significant case addressing the damages issue in this context is *United States v. Science Applications*

International Corporation, 626 F.3d 1257 (D.C. Cir. 2010) ("*SAIC*"). In that case, the defendant contracted with the Nuclear Regulatory Commission ("NRC") to help the agency develop regulations to govern the conditions under which radioactively contaminated materials may be released into interstate commerce. *Id*. at 1261. The contract required SAIC to certify that it had no organizational conflicts of interest, *e.g.*, that it did not have consulting or contractual relationships with commercial customers who might have an interest in the outcome of the NRC rulemaking. *Id*. at 1262. The United States sued SAIC under the FCA alleging that SAIC had falsely certified its compliance with these conflict of interest provisions. *Id*. at 1263, 1265.

After a four week trial in the United States District Court for the District of Columbia, the jury found SAIC liable under the FCA for falsely certifying to the NRC that it had no conflicts of interest when, in fact, it had commercial contracts both with recyclers and with an industry trade association. *Id*. at 1264. The District Court affirmatively instructed the jury that its "calculation of damages should not attempt to account for the value of services, if any, that SAIC conferred upon the Nuclear Regulatory Commission." *Id*. at 1278n.20. In the face of this instruction, the jury understandably assessed damages of $1,973,839.61, reflecting the entire amount the government had paid SAIC under the contract. *Id*.

The defendant challenged this judgment on appeal, arguing that the government failed to prove that it had suffered any damages from SAIC's false claims. *Id*. at 1278. Despite the fact that it had undisclosed conflicts of interest which violated the terms of the contract, the defendant argued that the government had received consulting advice and technical assistance that had value, and the company was entitled to payment for those services. *Id*. In its brief on appeal, SAIC noted that "it not only "delivered . . . . all the work product[1] that it promised to deliver under its NRC contract," but that NRC officials had "uniformly praised" its performance. *Id*.

The government argued that it had not, in fact, received what it bargained for under the contract. *Id*. The defendant was obligated not only to provide advice that was technically correct, but also "free from potential bias" that might have occurred when SAIC was asked to provide guidance to the NRC that might conflict with its commercial interests. *Id*.

The D.C. Circuit reversed the jury verdict, finding the trial court's instruction to the jury on the issue of damages erroneous. *Id.* at 1279-80. The decision relies upon the Supreme Court's analysis in *United States v. Bornstein*, 423 U.S. 303

[1] The "work product" in question was "several reports, including both a literature review and a regulatory options paper that the NRC published in 1999 . . . [which] calculated radiological dose assessment estimates for materials recycled and released from nuclear facilities. 626 F.3d at 1261-62.

(1976). *Id*. at 1278-79. There, the Supreme Court concluded that if a contractor knowingly submits nonconforming goods but those goods have an ascertainable market value, the government's actual damages are equal to the difference between the market value of the product received and the market value the product would have had if it had been of the quality required by the contract. *Id*. Under the *Bornstein* "benefit of the bargain" analysis, if it is impossible to determine the value of the product received (or presumably, if the goods have no value at all), the fact finder may base damages on the amount the government actually paid minus the value of the goods or services the government received or used (which in the case of a service or good that has no value, is zero). *Id*.

Under the *Bornstein* analysis "the government will sometimes be able to recover the full value of payments made to the defendant, but only where the government *proves* that it received no value from the product delivered." *Id*. (emphasis added). Significantly, the D.C. Circuit specifically noted, however, that "[i]n some cases, such as where the defendant fraudulently sought payments for participating in programs designed to benefit third-parties rather than the government itself, the government can easily establish that it received nothing of value from the defendant and that all payments are therefore recoverable as damages." *Id*. at 1279.

According to the D.C. Circuit, the District Court should have instructed the jury "to calculate the government's damages by determining the amount of money the government paid due to SAIC's false claims over and above what the services the company actually delivered were worth to the government." *Id*. at 1279-80. The "government remains free to argue that the value of SAIC's advice and assistance was completely compromised by the existence of undisclosed conflicts, making the full amount paid to SAIC the proper measure of damages." *Id*. But the Court of Appeals refused to adopt "an irrebuttable presumption – essentially what the government seeks – that treats services involving expert advice and analysis affected by potential organization conflicts as categorically worthless." *Id*. at 1280.

Two New York district courts addressed damages calculations in similar circumstances. *See United States ex rel. Anti-Discrimination Ctr of Metro New York, Inc. v. Westchester County, New York*, 2009 WL 1108517 (S.D.N.Y. April 24, 2009)("*Westchester County*") and *United States v. Incorporated Village of Island Park*, 2008 WL 4790724 (E.D.N.Y. Nov. 3, 2008)("*Island Park*"). Although both of the New York courts begin their analysis by invoking *Bornstein*, once they determine that the contractor did not produce a tangible asset, they quickly conclude that, because the contractors' performance was at odds with the social goals that were to be furthered by the contract in question, the

government had, as a matter of law, received nothing of value. In contrast, the D.C. Circuit, in *SAIC*, placed the burden of proving this fact on the government.

In *Westchester County*, the plaintiff alleged that the defendant violated the FCA by falsely certifying that it would implement a program to promote fair housing choice and desegregation in Westchester County under a HUD grant. Slip op. at 1. The District Court found that the County had, in fact, completely failed to take race into account when conducting an analysis of impediments to fair housing choice in the County. *Id*. Since the government's purpose in making the grant was to promote desegregation and fairness in housing, the failure to take race — one of the most visible and persistent barriers to fair housing – into account completely undermined the government's goal.

The plaintiff argued that the damages to the government under the FCA equaled the entire amount of funds paid to the County under the grant. *Id*. The Defendant contended that the court should apply the *Bornstein* "benefit of the bargain" analysis. The damages would be the total amount paid to the County under the contract, minus the value of what the government had received from the County under the grant. *Id*.

The Court rejected the defendant's damages analysis concluding, after surveying the case law, that the *Bornstein*

"benefit of the bargain" analysis was inappropriate because the defendant "identified no tangible asset or structure it provided to the United States such that this theory would be applicable; it did not have a contract with the government to build any sort of facility for the government or to provide it with goods." Slip op. at 3. Interestingly, the opinion does not directly address whether there was a tangible "work product" that was produced under the contract, such as a consultant's report or data analysis that might have had some residual value to the government despite the failure to take race into account, something the Court seems willing to consider in SAIC. Nor does the County specifically articulate what the value to the government of its performance under the grant might be.

This fine distinction does not concern the Southern District of New York which held in *Westchester County* that the defendant could not seek to reduce the government's damages by calculating the value of any benefit provided by the County to HUD. *Id*. The Court relied heavily on two other decisions, *United States v. Rogan*, 517 F.3d 449 (7th Cir. 2008) and *United States v. TDC Mgmt. Corp., Inc*, 288 F.3d 421 (D.C. Cir. 2002). Slip op. at 2-3. In *Rogan*, the Seventh Circuit held that the measure of damages in a FCA kickback case was the entire amount of the claims that were infected by the kickbacks, rejecting the defendant's argument that the damages should be reduced by the

value of the medical care the patients had actually received. The Seventh Circuit held that when "[t]he government offers a subsidy [to patients] . . . with conditions . . . [if] the conditions are not satisfied, nothing is due." 517 F.3d at 453.

TDC, the other case upon which the Southern District relies, was decided by the D.C. Circuit shortly before *SAIC.* That case involved a government contract to assist minority enterprises to secure bonding from sureties when bidding on large transportation construction projects. 288 F.3d at 422-23. The inability to obtain bonds is, presumably, a substantial barrier to entry for minority firms. The contract made it clear that TDC was to act as a facilitator to match minority enterprises with private investors who would provide collateral and management assistance. *Id*.

TDC was contractually barred from having any financial interest in the program. *Id*. Despite this bar, TDC did try to obtain a financial interest in the program by, among other things, charging minority investors for its efforts in finding sureties. *Id*. at 426. TDC had also planned to participate as an investor with some of the minority firms it was charged with assisting under the contract. TDC argued that the government had not been damaged by its self-seeking behavior, because it had gotten what it paid for – TDC's best efforts to obtain sureties for minority enterprises. *Id*.

The D.C. Circuit affirmed the District Court's grant of summary judgment, noting that because the "Program at issue, did not call for TDC to produce a tangible structure or asset of ascertainable value . . . . the evidence allowed the district court to find that the value of . . . [the contract] was vitiated by TDC's fraudulent concealment of its rent-seeking behavior." *Id*. at 428. The Court held that "[o]nce TDC deviated from its contracted role as impartial ombudsman by seeking a financial stake in joint ventures with private investors and by charging fees for the provision of material assistance to entrepreneurs, the district court then could properly find that the Program no longer had any value to the government." *Id*. In TDC, again, the Court does not find it important to directly address the question whether the defendant had provided at least some services of value to the government, for example, by assisting at least some minority businesses without a disqualifying conflict.

In *Island Park*, the government alleged that the defendant had misused a community development and housing assistance grant from HUD that was designed to foster diversity. Slip op. at 1. Instead, the defendant funneled funds to existing Village residents in order to prevent an influx of new, minority residents. Slip op. at 3-4. The District Court held that the defendant's performance under the contract had no value to the government, because the defendant's conduct resulted in the

contract funds being used to "attain goals in contravention of HUD's affirmative obligation to administer its programs to further the purposes of the Fair Housing Act . . . the funds that were diverted by the defendants' fraudulent course of conduct would otherwise have been available to HUD to further its goals." Slip op. at 6. The appropriate measure of the damages sustained by the government was the entire amount of the payments that had been made to the defendant under the grant. *Id*.

Another important case to any analysis of damages in these factual circumstances is, of course, *United States ex rel. Longhi v. Lithium Power*, 575 F.3d 458 (5th Cir. 2009). There, the relator alleged that the defendant had defrauded the government by misrepresenting its capabilities to perform under a Small Business Innovation Research Program grant ("SBIR"). *Id*. at 461-63. The government was granted summary judgement on the issue of liability and then moved for summary judgment on damages. *Id*. at 462.

The District Court awarded the government damages in the full amount of the invoices the defendant had submitted under the contract. *Id*. at 464. The Fifth Circuit affirmed that award, but initially characterized the case as a "fraudulently induced research grant." *Id*. at 472. Cases involving fraud in the inducement of a contract may, in fact, support the award of the entire contract price as the measure of damages. *United States*

ex rel. Marcus v. Hess, 317 U.S. 537, 543-44 (1943). However, despite initially characterizing the case as one involving "fraud in the inducement," the Fifth Circuit proceeded to analyze the damage award under the *Bornstein* "benefit of the bargain" paradigm. *Id*. at 473.

Under *Bornstein*, the Fifth Circuit concluded that the "Defendants did not produce a tangible benefit to the BMDO or the Air Force . . . The end product [under the contract] did not belong to . . . [the government]. . . [i]nstead, the purpose of the SBIR grant program was to enable small businesses to reach Phase II where they could commercially market their products." *Id*. Under these factual circumstances, the Fifth Circuit noted,"[t]he Government's benefit of the bargain was to award money to eligible deserving small business. . . . [the] intangible benefit of providing an "eligible deserving" business with the grants was lost as a result of the Defendant's fraud." *Id*. The Fifth Circuit went on to hold that "where there is no tangible benefit to the government and the intangible benefit is impossible to calculate, it is appropriate to value damages in the amount the government actually paid to the Defendants." *Id*. *See also United States ex rel. Feldman v. Van Gorp*, 2010 WL 1948592 (S.D.N.Y. May 3, 2010).

The question is how this analysis will play out in cases that present more challenging facts. Consider the following

hypothetical: A federal agency contracts with a minority business to build a federal office building, only to find after the project is fully completed and placed into service that the contractor did not, in fact, qualify for the minority business set aside program. If the government is satisfied with the building, accepts delivery, and places the building into service, what are the measure of damages under the contract in light of the case law discussed above?

It appears, at first glance, that the *SAIC, Westchester County, and Island Park* courts all would require that any damage award to the government be offset by the value of the building. Under the *Bornstein* analysis these courts employ, the initial question is whether or not the contractor has delivered a tangible good. Even the *Longhi* decision would appear to support this outcome, since the contractor delivered a tangible asset to the government. But is this the correct result? And, is this the decision these courts would actually reach when confronted by these facts?

That is, however, not a very likely outcome. Despite their superficial embrace of *Bornstein*, these courts, and others, are likely to pose quite a different question at the beginning of their analysis, one that owes less to *Bornstein*, and more to *Rogan*. In the hypothetical, the government's desire to foster the development of minority businesses has been completely

thwarted. Although the government has the building, it has lost, irrevocably, the opportunity to assist minority contractors to gain experience and grow their business with the money it paid under those contracts.

The question, therefore, is not whether or not the contractor has produced a tangible asset, but whether the money spent under the contract is designed to benefit the government or, instead, to benefit a third party. Viewed in this light, the hypothetical facts seem to fit most comfortably within the Seventh Circuit's holding in *Rogan*, that where the government sets conditions on obtaining payments or benefits, if those conditions are not honored, nothing is owed. The condition of participation in the minority business set-aside program is that you have to be a *be* a minority business.

The *SAIC*, *Westchester County* and *Island Park* courts' stated reliance on the *Bornstein* analysis is thus somewhat misleading, obscuring what is apparently truly driving these decisions. The courts appear to embrace, indirectly, the reasoning that has found its best expression in cases like *Rogan.* The most critical inquiry is not whether the contract produces a tangible product, but who is the true beneficiary of the contract.

In *SAIC*, the intended beneficiary of the contract was the NRC: The agency needed help formulating rules that would apply to the uranium recycling industry. But in *Westchester County*,

Island Park, *Rogan*, *Longhi* and *Van Gorp*, the intended beneficiaries were third parties. Since the government intended the contracts in these cases to benefit third parties and not the government – in *Westchester County* and *Island Park* by fostering diversity and fairness in housing, in *Longhi* and *Van Gorp* by supporting the commercial viability of innovative products produced by minority firms, and in *Rogan* by guaranteeing health insurance for the elderly and poor – the government itself, in fact, gets no tangible benefit from these contracts.

Recall that the SAIC court says, in persuasive dicta that where "the defendant fraudulently sought payments for participating in programs designed to benefit third-parties . . . the government can easily establish that it received nothing of value . . . [and] all payments are therefore recoverable." And, in *Westchester County*, the court noted that the defendant "was more akin to the defendants in *Rogan* and *Mackby* who made false claims in order to receive what was essentially a "subsidy" from the federal government . . ."

This reasoning directly addresses the facts of the hypothetical. The government has received a building, but the attempt to support and grow a minority company with the money paid under that contract has been irrevocably lost. The court should decide, on that set of facts, that the government's damages are the full contract price. Defendants will undoubtedly

argue that this measure of damages is unnecessarily harsh and seek to ameliorate those effects by asking the courts to treat the value of the building as a type of "compensatory payment" that should be deducted prior to trebling damages. The more appropriate approach would be to follow the Supreme Court's holding in *Bornstein*, that "the make-whole purpose of the [FCA} is best served by doubling the government's damages before any compensatory payments are deducted." *See Westchester County*, slip op. at 19-20; *Island Park*, slip op. at 7.