FALSE CLAIMS ACT REMEDIES

Taxpayers Against Fraud Education Fund Conference
September 10-13, 2006

Paul D. Scott, Esq.
Law Offices of Paul D. Scott, P.C.
San Francisco, CA

The False Claims Act ("FCA" or "Act") provides that a person who violates the Act "is liable to the United States Government for a civil penalty of not less than $5,000 and not more than $10,000, plus 3 times the amount of damages which the Government sustains because of the act of that person . . . ." 31 U.S.C. § 3729(a).[1]

While this language is unambiguous, its application is anything but straightforward, for the sheer variety of government programs and related financial transactions to which the FCA has been applied have required courts to fashion numerous and distinct formulas for calculating damages in individual proceedings. Nonetheless, there are several overarching considerations that are potentially relevant in all manner of cases. These include 1) the remedial purposes of the Act, 2) determining actual damages, 3) calculating the ultimate damage award, 4) determining penalties under the Act, and 5) constitutional limitations on damages and penalties. Each of these topics is examined, in turn, below.

I. REMEDIAL PURPOSES OF THE ACT

In formulating a remedy for fraud against the Government, Courts occasionally look to the equitable doctrines of restitution and unjust enrichment, in addition to legal principles of damages. *See e.g. United States v. American Heart Research Foundation, Inc.*, 996 F.2d 7 (1st Cir. 1993). By its plain language, however, the False Claims Act provides only for the award of damages and penalties. A threshold issue in a False Claims Act case is thus whether the remedy being sought qualifies as damages as defined under the Act. In *U.S. ex rel. Taylor v. Gabelli, et al.*, No. 03 Civ. 8762 (PAC), 2005 WL 2978921 (S.D.N.Y Nov. 4, 2005), a case of first impression, the question of available remedies under the Act was examined in detail.

---

1 Violations of the FCA occurring after September 29, 1999 are subject to increased penalties of between $5,500 and $11,000. *See* 28 U.S.C.A. § 2461 (note); 28 C.F.R. § 85.3(a)(9) (2005).

The principal allegation in *Gabelli* was that defendants had misrepresented themselves as small businesses in order to obtain discounted spectrum licenses in auctions by the Federal Communications Commission. Relator argued that the available remedies under the Act should include the disgorgement of profits earned by the defendants in reselling the licenses. The district court, however, held that "the law of remedies . . . strikes a clear distinction between damages – a compensatory form of relief – and restitution – a form of relief that prevents unjust enrichment." *Id.* at *3 (S.D.N.Y. Nov. 4, 2005). "Damages typically focus on the plaintiff and provide 'make-whole,' compensatory, monetary relief; restitution, by contrast, concentrates on the defendant - preventing unjust enrichment, disgorging wrongfully held gains, and restoring them to the plaintiff." *Id.* at *4. "[U]nder current FCA jurisprudence, courts narrowly construe "damages" to mean some form of "actual damages" and, thus, exclude various other types of damages (such as prejudgment interest and consequential damages)--let alone restitutionary remedies such as contribution, indemnification, or disgorgement of unjust gains." *Id.* at *11. Disgorgement of profits, as a form of restitution, was, in the court's view, therefore not an available remedy under the Act. *Id.*

The court also rejected the relator's contention that disgorgement was the equivalent of "rescissory damages" and thus covered by the explicit terms of the Act, holding that "rescissory damages" are normally available as a form of restitution in rescission cases, and rescission is not an available remedy under the False Claims Act. *Id.* at *5.

Lastly, the court did not accept the relator's argument that the Government was actually harmed by the fraud. The Government had argued that, if it had discovered the fraud, it could have re-auctioned the licenses and collected the same proceeds earned by defendants from reselling the licenses, but the court viewed this as simply an attempt to "disguise . . . disgorgement of allegedly unjust riches." *Id.*

Putting aside the soundness of the court's reasoning, the impact of its decision should be extremely limited, for it is a highly unusual circumstance where the illicit profit a defendant gains from defrauding the government does not involve an outlay of federal funds or otherwise cause the Government monetary damage. Had the fraudulent bids not been submitted, the government would presumably have received lower amounts from other legitimate bidders, and those bidders, not the Government, would likely have enjoyed most of the profits unjustly earned by the defendants on any resale of the licenses.[2] In the vast majority of cases, however, a defendant's unjust profit comes at the expense of the Government and is thus typically included within a standard damage calculation. *Compare United States v. Bound Brook Hosp.*, 251 F.2d 12, 13-14 (3d Cir. 1958) (in case brought under Surplus Property Act, resale proceeds treated as a "pecuniary loss" to the Government).

II. DETERMINING ACTUAL DAMAGES

"No single rule can be, or should be, stated for the determination of damages under the Act . . . ."[3] By necessity, courts have employed different rules to determine damages in line with the myriad different cases that have been brought under the Act.[4] Nevertheless, some general rules relevant to broad categories of cases can still be stated, which this article reviews below.

A. Common Schemes and Corresponding Damage Theories

1. Overbilling

A common type of False Claims Act case involves overbilling by a contractor for goods or services provided. In such cases, the measure of damages is relatively simple. Courts look at the additional amount paid beyond what should have been paid for the products or services provided to determine the Government's

---

2 As the court observed, the resale of the licenses was not forbidden, "[n]or was it contemplated that the Government would share in the resale proceeds." *Id*. at *6.

3 S. Rep. No. 615, 96th Cong., 2d Sess. at 4. "Fraudulent interference with the government's activities damages the government in numerous ways that vary from case to case. Accordingly, the committee believes that the courts should remain free to fashion measures of damages on a case by case basis. The Committee intends that the courts should be guided only by the principles that the United States' damages should be liberally measured to effectuate the remedial purposes of the Act, and that the United States should be afforded a full and complete recovery of all its damages." *Id.*

4 Notably, proof of financial damages is not required for liability under the Act. *U.S. ex rel. Romano v. New York Presbyterian Hospital*, 2006 WL 897208 (S.D.N.Y. April 6, 2006); *Young-Montenay, Inc. v. United States*, 15 F.3d 1040 (Fed. Cir. 1994); *United States ex rel. Harrison v. Westinghouse Savannah River Co.*, 176 F.3d 776, 785 n.7 (4th Cir. 1999); *United States v. Advance Tool Co.*, 902 F. Supp. 1011, 1018 (W.D. Mo 1995). Penalties can still be awarded in such circumstances. *U.S. ex rel. Hagood v. Sonoma County Water Agency*, 929 F.2d 1416, 1421 (9th Cir. 1991).

damages. *See e.g. United States v. Halper*, 490 U.S. 435 (1989) (in case where doctor upcoded charges for office visits by patients, measure of damages the additional amount billed beyond the amount properly due for the services provided); *United States v. Grannis*, 172 F.2d 507, 509 (4th Cir. 1949) (combination of improperly charged profits and rebates not passed on to government the measure of damages).

2. Substandard Products

In *United States v. Bornstein*, 423 U.S. 303 (1976), the Court endorsed a benefit-of-the-bargain approach to calculating damages in the context of substandard products sold to the Government. The defendant in the case supplied substandard radio tubes, pursuant to a subcontract, which were then included in radios sold to the Government by the prime contractor. The Supreme Court subsequently held that "[t]he Government's actual damages are equal to the difference between the market value of the tubes it received and retained and the market value that the tubes would have had if they had been of the specified quality." *Id. at 317 n. 13.*

Cases interpreting *Bornstein's* benefit-of-the-bargain rule have held the difference in value can amount to as much as the full contract value or even the replacement cost of the product in question.

In *United States v. Aerodex*, 469 F.2d 1003 (5th Cir. 1973), the measure of damages was the full amount of the contract. The defendant in *Aerodex* had delivered falsely denominated aircraft engine bearings to the Navy. Upon discovering the problem, the Government removed and replaced the bearings with the correct bearings. The Fifth Circuit thus awarded the total contract price of $27,000 as damages, holding that "[t]he Government paid $27,000 for bearings it did not receive." *Id.* at 1011. The market value of the falsely labeled bearings was implicitly assumed to be zero. *See also Faulk v. United States*, 198 F.2d 169 (5th Cir. 1952) (in case where defendant substituted reconstituted milk for fresh milk, jury not instructed to consider market value of reconstituted milk in measuring damages) (cited in *Bornstein*).

In *United States ex rel. Roby v. Boeing Co.*, 302 F.3d 637 (6th Cir. 2002), the benefit-of-the-bargain rule was effectively interpreted to permit recovery of replacement costs. In *Roby*, a subcontractor

delivered a defective gear to defendant Boeing, which included the part in a helicopter delivered to the Army. The helicopter subsequently crashed, due to the defective gear. Boeing argued that it should only be liable for the value of the defective gear. Alternatively, it argued that it should only be liable at most for the $4.1 million it was paid by the Government for the helicopter. *Id.* at 646. The Sixth Circuit disagreed, noting that the part was "flight critical." *Id.* at 647. In this context, the Government's damages equaled "the difference between the market value of [the helicopter] as received (zero) and as promised." *Id.* at 648. While the Government was not entitled to damages based on the value of a new helicopter, it was entitled to the value of a remanufactured helicopter that met contract specifications.[5]

A similar conclusion was reached in *Commercial Contractors, Inc. v. United States*, 154 F.3d 1357 (Fed. Cir. 1998). In *Commercial*, the defendant constructed a flood canal that was substantially defective, but it was not possible to determine the actual loss in value of the product supplied. The Court, relying on principles articulated in the Restatement (Second) of Contracts, therefore held that the Government could recover the replacement cost of the channel, as long as it could establish the defective work undermined the channel's structural integrity or the cost of repair was "not clearly disproportionate to the probable loss in value caused by the defects in question." *Id.* at 1373. *See also Advance Tool Co.*, 902 F. Supp. 1011, 1017 (W.D. Mo. 1995) (no award of damages where government did not present evidence concerning fair market value of goods provided by defendant); *Ab-Tech Constr., Inc. v. United States*, 31 Fed. Cl. 429, 434 (1994) (damages not awarded to government due to its failure to prove a difference in value between what it paid for and what it received), *aff'd*, 57 F.3d 1084 (Fed. Cir. 1995).[6]

---

5 The court noted that the crash of the helicopter and its contents caused a loss of "at least $10 million." *Id.* at 640. For additional discussion of *Roby* and consequential damages, see Section II(C) *infra.*

6 The benefit-of-the-bargain rule should not be confused with the out-of-pocket rule of damages. The out-of-pocket rule "is stated as the difference between the price paid by the person defrauded and the value of the property he has received in fact from the fraud doer." *United States v. Ben Grunstein & Sons Co.*, 137 F. Supp. 197, 204-05 (D.N.J. 1956); *see also United States ex rel. Marcus v. Hess*, 317 U.S. 537 (1943). While both rules consider the value of what was delivered, the benefit-of-the-bargain rule considers the market value of what the government should have received, as opposed to simply what it paid. The benefit-of-the-bargain approach thus includes as damages any increases in price of the product in question between the date of the initial transaction and the day of trial.

3. Failure to Deliver Products or Services

In failure to deliver cases, courts frequently assess damages based on the amount paid for that which was not provided. *See e.g., United States v. Krizek*, 909 F. Supp.. 32 (D.D.C. 1995) (claims submitted to Medicare and Medicaid for psychiatric services not actually provided). But this reasoning makes sense only when the false representation involves a product or service that does not need to be replaced (e.g., a medically unnecessary service for a Medicare patient). When a product or service is not delivered as originally promised, and the Government still needs to obtain the product or service, it is more appropriate to apply the benefit-of-the-bargain rule, as doing so protects the Government against an increase in price of the product or service. *See United States v. Bornstein*, 423 U.S. 303 (1976).

4. Failure to Test

When the fraud at issue involves a failure to test, the reasoning applied by courts generally echoes the "benefit of the bargain" test, but miscellaneous factors (including, but not limited to, the type of product, the government's use of the product, and the costs of inspection and repair) can lead to awards ranging from nominal damages to replacement cost and more.

In *United States ex rel. Compton v. Midwest Specialties, Inc.*, 142 F.3d 296 (6th Cir. 1998), the defendants failed to perform tests of brake shoe kits delivered to the Army. Subsequent testing by the Government indicated that more than 60% of the kits did not meet contract specifications. *Id.* at 302. In light of these facts, combined with the Government's decision not to use the brake shoes after discovering the lack of testing, the court deemed the brake shoe kits valueless and awarded the full contract amount as single damages. *Id.* at 304-305.

The Court of Claims reached a similar result in *BMY-Combat Systems v. United States*, 44 Fed. Cl. 141 (1998). In *BMY-Combat*, the defendant failed to perform adequate tests on mounting brackets for howitzers delivered to the Army. The damages awarded by the court included costs of inspection and repair, costs of having

replacement brackets manufactured for precautionary purposes, and interest on progress payments. *Id.* at 148-150.

In *United States v. Collyer Insulated Wire Co.*, 94 F. Supp. 493, 496 (D.R.I. 1950), the defendant delivered wire to the United States that had not been tested to the proper specifications, and 51% did not, in fact, meet specifications. *Id.* at *498.* The government used the wire, however, and "there were no complaints relative to the cable." *Id.* at 498. In this context, the court awarded only nominal damages.[7]

5. False Certification of Entitlement to Payment

When false statements are made to qualify for program payments (e.g., loan guarantees), "[o]rdinarily, the measure of the government's damages would be the amount that it paid out by reason of the false statements over and above what it would have paid if the claims had been truthful." *United States v. Woodbury*, 359 F.2d 370, 379 (9th Cir. 1966). Cases applying this "but-for" standard have varied in result, depending primarily on whether the government suffered an actual loss.

In *United States v. Ekelman & Associates, Inc.*, 532 F.2d 545, 550 (6th Cir. 1976), the defendants made false statements regarding creditworthiness on a loan application to obtain loan guarantees. The measure of damages applied by the Court included the guarantee amount along with the costs of maintaining and repairing the defaulted property until resold. *Id.* at 551. The court reasoned that, as a result of the fraud, "the property securing the guaranteed and insured loans and the necessary burden of preserving the property were thrust on the government." *Id*. Accordingly, the court concluded "that the government is entitled to the *reasonable* expenses incurred in preserving the property." *Id.* All of the funds included as damages would not have been expended by the Government "but for" the defendants false representations.

Similarly, in *United States v. TDC Mgmt. Corp., Inc.*, 288 F.3d 421, 428 (D.C. Cir. 2002), the government paid for certain ombudsman services by the defendant that ultimately did not have value due to the defendant's failure to avoid conflicts of interest and its attempts to profit from its ombudsman role. In this context, the

---

7 Notably, $210,000 in penalties were also awarded. *Id.*

Court of Appeal upheld the district court's use of a "but for" measure of damages, by including all tainted progress payments to the defendant in damages. *Id.*

The Fourth Circuit, in *United States ex rel. Harrison v. Westinghouse Savannah River Co.*, 352 F.3d 908, 922-923 (4th Cir. 2003), cited *Ekelman's* "but-for" reasoning with approval, but did not award damages in the case, because the government had suffered no actual loss. While the defendant engaged in misconduct in connection with the retention of a subcontractor, there was no evidence the government paid more for the subcontractor than it would have paid for any other firm, and no evidence indicated the subcontractor failed to perform the work for which it was paid. *Id. But see United States v. Brothers Const. Co. of Ohio*, 219 F.3d 300, 317-18 (4th Cir.) (in criminal case where disadvantaged Section 8(a) contractor improperly diverted work to other contractor, full amount paid to contractor deemed government's loss under criminal sentencing guidelines, despite fact that work was completed to contract terms), *cert denied*, 531 U.S. 1037 (2000). *See also Toepleman v. United States, 263 F.2d 697, 700-01* (4th Cir. 1959) (holding that the United States is entitled to recover double the loss it suffered "but for the fraud").

In *United States v. Cooperative Grain and Supply Co.*, 476 F.2d 47 (8th Cir. 1973), the defendant falsely represented that it had produced certain grain, when it had, in fact, only produced 86% of the grain. The government, which had paid certain warehousing charges for the grain pursuant to a price support program, argued that all of the warehousing charges should be included in damages. The court, however, concluded that the damage amount should be limited to 14% of the warehousing charges, as 86% of the grain qualified for the price support. *Id.* at 53. Accordingly, while the Court did not award the Government everything it sought, the court effectively awarded as damages that amount the government would not have paid "but for" defendant's misconduct.

The only decision notably out of line with the foregoing authority is the divided opinion in *United States v. Hibbs*, 568 F.2d 347, 351 (3d Cir. 1977). But the decision, which rejected the "but for" standard employed by the lower court, appears to be wrongly decided. In *Hibbs*, a real estate broker falsely represented to the Government that real property serving as collateral for a guaranteed loan met certain Federal Housing Administration standards. The loan later went into default due to the financial condition of the mortgagor.

The Court of Appeal calculated the damages caused by the broker as the difference between the true value of the collateral and the value of the collateral as represented on the loan application. The court did not award the full guarantee payment as damages. The explanation given by the court was that "the same loss would have been suffered by the government had the certifications been accurate and truthful." *Id.*

In *United States v. First National Bank of Cicero*, 957 F.2d 1362 (7th cir. 1992), however, the Seventh Circuit Court of Appeals specifically rejected the Third Circuit's reasoning in *Hibbs.* The Seventh Circuit pointed out that the Third Circuit was mistaken in its assumption that "the same loss would have been suffered" if the representations had been truthful. *Id.* at 1374 n. 12 (quoting *United States v. Hill*, 676 F. Supp. 1158, 1162 (N.D. Fla. 1987)). The Seventh Circuit noted that the district court in *Hibbs* had, in fact, held the Government would *not* have insured the mortgage had it not been for the false certifications. *Id.* Accordingly, if the representations had been accurate, the Government, in reality, "would not have lost any money." *Id.*[8]

6. Premature Progress Payment Requests

Defendants frequently contend that the only damage to the United States in premature progress payment cases is the time value of money. At least one circuit, however, disagrees. In *Young-Montenay, Inc. v. United States*, 15 F.3d 1040 (Fed. Cir. 1994), the defendant made false statements in order to accelerate payments before they would otherwise have been due under the contract. The Federal Circuit held that the measure of single damages was the amount paid prematurely, since "the government was denied the use of the overpaid money" and since, because of the overpayment, "the contractor had less incentive to complete the project in a timely or satisfactory manner." *Id.* at 1043 n.3. *But see United States v. American Precision Products Corp.*, 115 F. Supp. 823, 828 (D.N.J. 1953) (holding government does not suffer damage if it ultimately receives the item for which it has paid; time value of money not considered).

8 The dissent in *Hibbs* pointed out that the mistaken result reached by the court was likely driven by the fact that applying the correct rule would have resulted in a harsh remedy against the defendant broker. The damages in the case would have been greater than a typical loan guarantee fraud case, since the real estate serving as collateral turned out to be valueless due to a lead paint condition. *Hibbs*, 568 F.2d at 352.

7. Bid-rigging

The "measure of damages under the False Claims Act in cases involving collusive bidding is the difference between what the Government actually paid out to the contractor and what it would have paid for the same work in the competitive market." *United States v. Cripps*, 460 F. Supp. 969, 976 (E.D. Mich. 1978) (competitive price based on actual cost and not including defendant's profit margin); *Brown v. United States*, 524 F.2d 693, 706 (Ct. Cl. 1975) (competitive price determined by taking contractor's actual cost and adding a profit margin). *See also United States ex rel. Marcus v. Hess*, 41 F. Supp. 197, 216 (W.D. Pa. 1941), rev's 127 F.2d 233 (3d Cir. 1942), *reinstated and* aff'd, 317 U.S. 537 (1943) (in bid-rigging case, evidence admitted regarding the difference in price between fraudulent bids and fair competitive bids; contractor's actual costs deemed irrelevant).

8. Defective Pricing

Many government contracts are sole-source contracts that require the government to determine the price of the contract based on the contractor's own cost and pricing information. The Truth in Negotiations Act ("TINA"), 10 U.S.C. 2306a, governs such contracts. Some of TINA's features have been applied to False Claims Act cases, including, most notably, TINA's "rebuttable presumption that the Government is damaged dollar for dollar by the non-disclosed amount once non-disclosure is shown." *See United States ex rel. Taxpayers Against Fraud v. Singer Co*., 889 F.2d 1327, 1333 (4th Cir. 1989) (undisclosed volume discount assumed to have full impact, i.e., had dollar-for-dollar impact on price). The burden is then on the contractor to show "nonreliance on behalf of the Government in order to rebut the natural and probable consequences of the existence of the nondisclosed or inaccurate data." *Sylvania Elec. Products, Inc. v. United States*, 479 F.2d 1342, 1349 (Ct. Cl. 1973).

Multiple Award Schedule contracts awarded by the General Services Administration (for purchases by government agencies of commercially available products) similarly require the submission of pricing information by contractors, for the purpose of insuring that the Government is being given the best available price by the contractor. The measure of damages in such cases is generally the difference between the amount paid by the Government and the amount it would have paid had it been charged the supplier's lowest commercial

price. ***See generally, United States v. Data Translation, Inc.*****, 984 F.2d 1256, 1266 (1st Cir. 1992).**

9. Kickbacks

In *United States v. Killough*, 848 F.2d 1523 (11th Cir. 1988), the defendant paid kickbacks to state officials in charge of administering federal funds. The kickbacks paid totaled $577,000, and the jury awarded $633,000 in the case. "The government introduced the inflated invoices into evidence, as well as testimony from other contractors who were willing to do the work for less money and expert testimony on the fair market value . . ." *Id.* at 1531. The court determined that "[a]lthough [the amount of the kickback] was neither a floor nor a conclusive presumption of the measure of damages, it was relevant as circumstantial evidence." *Id.* at 1532. "Taken together, this was more than sufficient evidence from which the jury could have determined damages attributable to the defendants." *Id.* at 1531. The court rejected the argument that the Government had suffered no damages simply because honest contractors had submitted higher bids than the collusive contractors. *Id.* at 1532. *See also United States ex rel. Thompson v. Columbia/HCA Healthcare Corp.*, 20 F. Supp. 1017, 1047-1049 (S.D. Tex. 1998) (in case involving payment of kickbacks by one medical provider to another, where financial impact on government unclear, conduct may still be actionable; "pecuniary damage to the public fisc is no longer required for an actionable claim under the FCA").

B. Statistical Extrapolation

In some FCA cases (often involving the Medicare program), the amount of damages is difficult or impossible to ascertain simply as a consequence of the number of false claims submitted by the defendants in connection with a particular scheme. Courts have permitted proof of damages in such cases through the use of statistical sampling. *See e.g.*, *United States v. Cabrera Diaz*, 106 F. Supp.2d 234 (D.P.R. 2000); *United States v. Krizek*, 192 F.3d 1024 (D.C. Cir. 1999) (psychiatric services). *See also Brooks v. Department of Agriculture*, 841 F. Supp. 833 (N.D. Ill. 1994) (damages over 10 months extrapolated from several month sample of reliable data).

In the related area of Medicare overpayment cases, courts have similarly permitted proof of damages through statistical extrapolation.

See Ratanasen v. State of California, 11 F.3d 1467 (9th Cir. 1993) (rejecting due process challenges to the use of statistical extrapolation); _Yorktown Medical Laboratory, Inc. v. Perales,_ 948 F.2d 84, 89-90 (2d Cir. 1991) (same); _Illinois Physicians Union v. Miller,_ 675 F.2d 151, 155 (7th Cir. 1982) ("the use of statistical samples has been recognized as a valid basis for findings of fact in the context of Medicaid reimbursement"); _Chaves County Home Health Service v. Sullivan,_ 931 F.2d 914 (D.C.Cir. 1991), _cert. denied,_ 502 U.S. 1091, 112 S.Ct. 1160, 117 L.Ed.2d 408 (1992) (holding that HHS could disallow claims by extrapolating from audits of sample Medicare claims, but disallowance subject to appeal by provider).

In employing statistical proof to establish damages, courts have recognized a few basic rules, which should apply equally in FCA cases.

First, there is no rule of law stating how large a sample size must be. _Ratansan v. Cal Dept of Health Services,_ 11 F.3d 1467, 1469 (9th Cir. 1993) ("whether the use of sampling and extrapolation is proper is a question of law, while whether the sample size, etc., were appropriate is a question of fact").

Second, there is no rule of law stating that samples must be stratified. _Id_. at 1471-72.

Third, there is no legal requirement that a 90% confidence interval be used. The Center for Medicare and Medicaid Services ("CMS") uses the lower bound of a 90% confidence interval in Medicare overpayment cases. HCFA Program Manual Memo, Transmittal B-01-01 (January 8, 2001). But this approach, which "works to the financial advantage of the physician," _id._ at 6, while perhaps necessary in a criminal case, should not be required in a FCA case. _See Brown v. Bowen,_ 847 F.2d 342, 345 _(7th_ Cir. 1988) ("All burdens of persuasion deal with probabilities. The preponderance standard is a more likely than not rule, under which the trier of fact rules for the plaintiff if it thinks the chance greater than .5 that the plaintiff is right. The reasonable doubt standard is much higher, perhaps .9 or better. The clear and convincing standard is somewhere in between"); see also _U.S. v. Shonubi,_ 895 F. Supp. 460, 521 (E.D.N.Y. 1995) (describing approximate confidence level required under different burdens of proof as "95% plus" to prove allegations beyond a reasonable doubt, "70% plus" to meet the standard of clear and convincing evidence, and "50% plus" to meet a preponderance of the evidence standard).

FCA cases are not scientific experiments. Simply because statisticians normally use 90% or 95% confidence intervals when conducting scientific research should not determine the standard appropriate in a civil case. *See e.g. Bazemore v. Friday,* 478 US 385, 400 (1986) ("a plaintiff in a title VII suit need not prove discrimination with scientific certainty; rather his or her burden is to prove discrimination by a preponderance of the evidence."); *Pitre v. Western Electric Co.,* 843 F.2d 1262, 1269 (10th Cir. 1988) ("statistics that are irrelevant to the social scientist may well be relevant to a court . . . [W]hile social scientists search for certainty, the trier of fact in a Title VII case need only find that discrimination is more likely than not").[9]

C. Consequential Damages

Courts have generally held that consequential damages are not recoverable under the False Claims Act. *United States v. Aerodex,* 469 F.2d 1003 (5th Cir. 1972); *BMY-Combat Systems v. United States*, 44 Fed. Cl. 141, 147 (1998). When it amended the Act in 1986, Congress considered the possibility of explicitly including consequential damages but ultimately elected not to do so. *Cook County v. United States ex rel. Chandler,* 538 U.S. 119, 131 n. 9 (2003). There is still, however, some debate over the definition of consequential damages, and there are exceptions to the general rule in cases where it is not possible for the Government to prove the exact amount of its damages.

As the district court aptly stated in *United States ex rel. Roby v. Boeing Co.*, 79 F. Supp. 2d 877, 894 (S.D. Ohio 1999), the issue "boils down to one of causation, specifically, proximate causation."[10] The court noted that Black's Law Dictionary defines consequential damages as: "such damage, loss or injury as does not flow directly and immediately from the act of the party ... damages which arise from the intervention of special circumstances not ordinarily

---

9 ***See also Bigelow v. RKO Radio,* 327 U.S. 251, 264 ("The jury may make a just and reasonable estimate of the damage based on relevant data . . . In such circumstances, juries are allowed to act on probable and inferential as well as upon direct and positive proof"); *United States v. Halper,* 490 U.S. 435, 446 (1989) ("the Government is entitled to rough remedial justice, that is, it may demand compensation according to somewhat imprecise formulas such as reasonable liquidated damages or a fixed sum plus double damages").**

10 For additional discussion of *Roby*, see Section II(A)(2) *supra.*

predictable." *Id.* at 891, n. 41 (internal quotes omitted). In contrast, direct damages are those "which arise naturally or ordinarily from a breach of contract; they are damages which in the ordinary course of human experience can be expected to result from a breach." *Id.* at 890, n. 39 (internal quotes omitted). Thus, while acknowledging that consequential damages are not recoverable under the Act, the court held that "if the Government and relator present sufficient evidence that the damages sought are of a direct, proximate, and foreseeable nature, then those damages may be available to the Government and Relator under a FCA theory of recovery." *Id.* at 895. The court also noted the availability of damages for "incidental or maintenance" costs resulting from a fraud, as distinguished from "consequential damages." *Id.* All these issues were held to be questions of fact. *Id.*

On appeal, the Sixth Circuit upheld the district court decision, initially noting that the amount "wrongfully paid" was the amount paid in response to Boeing's entire claim for payment, not just the amount paid for the defective gear. *United States ex rel Roby v. Boeing,* 302 F.3d 637, 646-647 (6th Cir. 2002). But the contract amount was not the measure of damages.[11] Consistent with the benefit-of-the bargain rule, the court held the Government's damages equaled "the difference between the market value of [the helicopter] as received (zero) and as promised." *Id.* at 648. While the Government was not entitled to damages based on the value of a new helicopter, it was entitled to the value of a remanufactured helicopter that met contract specifications. *Id. See also United States v. Woodbury, 359 F.2d 370,* 379 9th Cir. 1966) (government's damages included "money spent by its employees in straightening out the mess [caused by the false claims] and in protecting its interest thereafter"); *United States v. Ekelman & Assocs., Inc., 532 F.2d 545, 550-51 (6th Cir. 1976) (*in loan fraud case, Government permitted to recover not only the guarantee amount but also the reasonable expenses incurred in preserving the properties that served as collateral for the loans); *Daff v. United States,* 31 Fed. Cl. 682, 695 (1994) (damages included government's inspection and repair costs resulting from failure of contractor to reveal fact that product had failed to pass required tests).

11 The court distinguished *United States ex rel. Compton v. Midwest Specialties, Inc.*, 142 F.3d 296, 305 (6th Cir. 1998), which awarded the contract amount as damages, based on the fact that the Government "apparently did not claim that its full or actual damages were more than the contract price in *Compton* . . . ."

In those cases where it is not possible for the Government to quantify its damages, damages akin to consequentials may be permissible. In such cases, the "replacement costs" or the "cost of remedying defects" may be used as measures of damages if those costs are "not clearly disproportionate to the probable loss in value caused by the defects in question." *Commercial Contractors, Inc. v. United States*, 154 F.3d 1357, 1372-1373 (Fed. Cir. 1998). "The cost of remedying defects is not regarded as disproportionate if the defects significantly affect the integrity of a structure being built. In that setting, the injured party is entitled to recover the cost of remedying the defects despite the fact that the cost may be very high." *Id*. at 1372. *See also Daff v. United States*, 78 F.3d 1566 (Fed. Cir. 1996) (costs incurred in testing and repairing included in single damage calculation); *BMY-Combat Systems v. United States*, 44 Fed. Cl. 141 (1998) (damages included costs of replacement parts, costs of inspection and replacement of parts, and interest).

D. Reverse False Claims

The False Claims Act provides for the award of damages against defendants who use a "false record or statement to conceal, avoid, or decrease an obligation to pay or transmit money or property to the Government." 31 U.S.C. 3729(a)(7). Determining what has been underpaid to the government often raises issues similar to those in cases involving affirmative claims for payment. If a defendant understates their obligation to pay a specific amount, calculating damages involves simply determining the difference between the amount paid and the amount due - effectively the converse of the approach used in overbilling cases. The primary tasks are to determine whether an obligation exists and the amount of that obligation. Once the existence and dollar value of the obligation is determined, the damage calculus generally proceeds the same way. *See e.g. United States ex rel. Dunleavy v. County of Delaware*, 1998 WL 151030 (E.D. Pa. 1998).

E. Mitigation

In *Toepleman v. United States*, 263 F.2d 697, (4th Cir.), *cert. denied sub nom. Cato Bros., Inc. v. United States*, 359 U.S. 989 (1959), the defendant made false representations concerning cotton held by the government as collateral on a loan. The defendant offered to redeem the cotton shortly after the fraud was discovered, when it could have been sold at a profit, but the government declined

the offer and sold the cotton several years later at a loss. Under these circumstances, the defendant argued it should not be liable for the loss suffered by the government on the transaction. The Court of Appeals, however, held as follows: "Having by his fraud thrust this burden on the United States, the appellant cannot be exonerated by the failure of the Government to cast it off at the most propitious time. The fraud was the effecting cause of the loss, the drop in the market a foreseeable incident." *See also United States v. Ekelman & Associates, Inc.*, 532 F.2d 545 (6th Cir. 1976) (citing *Toepleman*).

F. Government Discovery of Fraud and the Damage Amount

The argument is sometimes made by defendants that the government's damages under the False Claims Act should stop accruing once the government discovers the defendant's fraud, but this argument is without merit. In *United States v. Ehrlich*, 643 F.2d 634, 639 (9th Cir.), *cert.* denied, 454 U.S. 940 (1981), the Ninth Circuit held that defendants were liable for payments made after the government's discovery of fraud, noting that, if the government had ceased making payments, it would have been potentially liable to a third party. Practical concerns like this frequently motivate the government to continue making payments when it becomes aware of fraud, making it appropriate to leave the burden on defendants, rather than the government, to discontinue the conduct. *Compare U.S. ex rel. Hagood v. Sonoma County Water Agency*, 929 F.2d 1416 (9th Cir. 1991) (government knowledge not a defense as to falsity of claim).

G. Interest

It is generally accepted that prejudgment interest is not available under the FCA, as relief for this harm is contemplated by the Act's treble damage provisions. *Cook County v. United States ex rel. Chandler,* 538 U.S. 119, 131 n. 9 (2003) (in explaining compensatory component of treble damages, Court noted that "[t]he FCA has no separate provision for prejudgment interest, which is usually thought essential to compensation."); *but see United States v. Cooperative Grain and Supply Co.*, 476 F.2d 47 (8th Cir. 1973) (awarding prejudgment interest).

III. CALCULATING THE ULTIMATE DAMAGE AWARD

The Act provides for the award of treble the single damage amount. The trebling calculation is based on the amount of the

United States damages at the time it pays the false claim. *See United States v. Ekelman Associates, Inc.*, 532 F.2d 545, 550 (6th Cir. 1976). After a payment has been made on a false claim, defendants will sometimes reimburse the falsely claimed amount or the government will otherwise mitigate its damages. In such cases, treble damages are still calculated in the same fashion (i.e., based on the damage resulting from the initial false claim) and the amount recovered by the Government is simply credited against the trebled amount. *<u>Id.</u>* *See also United States v. Bornstein,* 432 U.S. 303, 306-07 (1976) ("make-whole purpose of the Act is best served by doubling the Government's damages before any compensatory payments are deducted"); *Young-Montenay, Inc. v. United States*, 15 F.3d 1040 (Fed. Cir. 1994) (in case where defendant fraudulently collected $49,000 in progress payments before they were due, court awarded treble that amount - $147,000, despite the government's request for only the net amount of $98,000).[12]

IV. DETERMINING PENALTIES UNDER THE ACT

The statutory language on penalties under the FCA is mandatory. It states that any person who violates the False Claims Act "is liable to the United States Government for a civil penalty . . . ." 31 U.S.C. § 3729(a). Courts have historically read this language as making the

---

12 **A defendant's exposure for damages under the Act may be limited to double damages plus costs if they disclose the fraud in accordance the Act's voluntary disclosure provision:**

> **(A) the person committing the violation of this subsection furnished officials of the United States responsible for investigating false claims violations with all information known to such person about the violation within 30 days after the date on which the defendant first obtained the information;**
>
> **(B) such person fully cooperated with any Government investigation of such violation; and**
>
> **(C) at the time such person furnished the United States with the information about the violation, no criminal prosecution, civil action, or administrative action had commenced under this title with respect to such violation, and the person did not have actual knowledge of the existence of an investigation into such violation;**

31 U.S.C. § 3729(a). *See United States ex rel. Falsetti v. Southern Bell Tel. and Tel. Co.*, 915 F. Supp. 308, 312 (N.D. Fla. 1996) (noting the omission of penalties in the Act's voluntary disclosure provision).

imposition of penalties automatic under the terms of the Act. *United States v. Killough*, 848 F.2d 1523, 1533 (11th Cir. 1988) (penalties "mandatory for each claim found to be false"); but see *Peterson v. Weinberger*, 508 F.2d 45, 55 (5th Cir. 1975) (holding district court had discretion to award penalties in proportion to the damages sustained by the Government); *United States ex rel. Garibaldi v. Orleans Parish School Board*, 46 F. Supp. 2d 546 (E.D. La. 1999) (follows *Peterson*).

A. Determining the Amount of Each Penalty

The False Claims Act originally specified a $2,000 penalty per violation. 31 U.S.C. § 231. The 1986 Amendments to the FCA raised the penalty amount to "not less than $5,000 and not more than $10,000 . . . ." 31 U.S.C. 3729(a). As noted supra, to account for inflation, violations of the FCA occurring after September 29, 1999 are subject to increased penalties of between $5,500 and $11,000. *See* 28 U.S.C.A. § 2461 (note); 28 C.F.R. § 85.3(a)(9) (2005).

The Act gives Courts broad discretion in determining the amount of each penalty within the statutory range. In exercising this discretion, Courts have cited one or more of a wide variety of factors, including the culpability of the defendant, criminal prosecution of the defendant, the defendant's financial condition, and the government's costs of investigation and prosecution. The number of penalties has also appeared to play a role. *See Hays v. Hoffman*, 325 F.3d 982, 993-94 (8th Cir. 2003) (defendant's conduct a factor in awarding maximum penalty but number of penalties also reduced by decision); *UMC Electronics Co. v. United States*, 43 Fed. Cl. 776 (1999), *aff'd*, 249 F.3d 1337 (Fed. Cir. 2001) (defendant's conduct a factor in awarding maximum penalty but only one penalty awarded); *U.S. ex rel. Virgin Islands Housing Authority v. Coastal General Construction Services Corporation*, 299 F. Supp. 2d 483 (D.V. I. 2004) (defendant's conduct, government's costs, public policy concerns, criminal prosecution of defendant, and defendant's ability to pay considered in awarding 10 penalties of $5,000); *U.S. v. Bottini*, 19 F. Supp. 2d 632 (W.D. La. 1997), *aff'd*, 159 F.3d 1357 (5th Cir. 1998) (defendant's conduct and ability to pay both factors); *United States v. Stocker*, 798 F. Supp. 531 (E.D. Wis. 1992) (government's costs considered in awarding 28 penalties of $5,000).

B. Determining the Number of Penalties

The number of penalties under the Act is typically based on the

number of demands for payment by the Government. *See U.S. v. Krizek*, 111 F.3d 938-40 (D.C. Cir. 1997); *United State v. Woodbury*, 359 F.2d 370 (9th Cir. 1966); *United States v. Aerodex*, Inc. 469 F.2d 1003, 1011 (5th Cir. 1973); *U.S. v. Rohleder*, 157 F.2d 126, 130-131 (3d Cir. 1946); *U.S. v. Grannis*, 172 F.2d 507, 515-516 (4th Cir. 1949); *Miller v. United States*, 550 F.2d 17, 23-24 (Ct. Cl. 1977).

But some courts, consistent with the Supreme Court's holding in *United States v. Bornstein*, 423 U.S. 303, 313 (1976), have focused on the defendant's wrongful acts and thus properly considered false statement and conspiracy violations in assessing penalties as well. *See U.S. ex. rel. Koch v. Koch Industries*, *57* F. Supp.2d 1122 (N.D. Okla. 1999) (penalties based on number of leases where royalties underreported; not based on single payment demand into which false information was consolidated); *United States v. Zan Machine*, 803 F. Supp. 620, 624 (E.D.N.Y. 1992) (penalties assessed based on the number of false records, rather than payment demand); *United States v. Greenberg,* 237 F. Supp..439, 443 (S.D.N.Y. 1965) (false payroll reports used rather than payment demand); *United States v. Board of Education of the City of Union City*, 697 F. Supp. 167, 175-177 (D.N.J. 1988) (penalties assessed based on number of false claims, false records or statements, and conspiracy); *see also United States v. Peters*, 927 F. Supp. 363 (D. Neb. 1996), *aff'd*, 110 F.3d 616 (8th Cir. 1997) (penalties assessed based on false claims and conspiracy).

In cases where defendants are conducting business indirectly with the Government, the number of penalties may be determined by the number of fraudulent acts by the defendant, which may or may not necessarily coincide with the number of resultant payment demands on the Government by the company conducting business directly with the Government. *See Bornstein*, 423 U.S. at 313 (penalties assessed against subcontractor based on number of deliveries by subcontractor; not based on number of claims made against the Government by the prime contractor). *See also United States v. Ehrlich*, 643 F.2d 634 (9th Cir. 1981) (where defendant submitted false information to mortgagee and aware the false information would lead to false claims, defendant assessed penalty for each false claim submitted to govoucher).

V. CONSTITUTIONAL LIMITATIONS ON PENALTIES AND DAMAGES

A. Penalties

In cases involving large numbers of claims, constitutional limits have sometimes been placed on the number of available penalties.

1. Double Jeopardy Clause

Historically, the only constitutional limit on penalties was derived from the Double Jeopardy Clause. In *United States v. Halper*, 490 U.S. 435 (1989), the Supreme Court reasoned that, in cases where the defendant had a prior criminal conviction, a large penalty award under the FCA could effectively amount to punishment and thus violate the Double Jeopardy Clause.

In *Hudson v. United States*, 522 U.S. 93 (1997), however, the Supreme Court reconsidered *Halper* and rejected its "punitive versus non-punitive" framework for evaluating penalties. The issue, in the Court's view, was whether the penalties were criminal or civil. The Court concluded that civil penalties could only be considered criminal in effect if Congress intended them to be so, or the "clearest proof" demonstrated they were "so punitive in form and effect as to render them criminal despite Congress' intent to the contrary." *Id. (internal citation omitted).* Civil False Claims Act penalties would plainly never meet the foregoing standard and thus could not present a basis for a Double Jeopardy violation. Notably, however, the Court also observed that "the Due Process and Equal Protection Clauses already protect individuals from sanctions which are downright irrational . . . [and] [t]he Eighth Amendment protects against excessive civil fines, including forfeitures." *Id.* at 103. This observation presaged the Court's subsequent analysis of these same issues.

2. Excessive Fines Clause

The Eighth Amendment provides: "Excessive bail shall not be required, nor excessive fines imposed, nor cruel and unusual punishments inflicted." *U.S. Const., Amdt. 8*.

In *United States v. Bajakajian*, 524 U.S. 321 (1998), the Supreme Court applied the Excessive Fines clause for the first time, in a case involving a forfeiture for failure to report currency. The Court examined two issues in determining whether the sanction violated the

Excessive Fines Clause: First, the Court examined whether the forfeiture was punitive; then, upon concluding that it was, the court evaluated whether the forfeiture was excessive. On the latter issue, the Court held "a punitive forfeiture violates the Excessive Fines Clause if it is grossly disproportional to the gravity of the defense it is designed to punish." ***Id.*** **at 322.**

Four main factors were relevant to the Court in evaluating the gravity of the defendant's offense: (1) the severity of the violation; (2) whether the crime was related to any other illegal activities, (3) the maximum criminal penalty the defendant might have faced, and (4) the harm caused by the violation. ***Bajakajian*****, 524 U.S. at 337-40.**

Subsequent to ***Bajakajian*****, the Ninth Circuit held in** ***United States v. Mackby*****, 339 F.3d 1013 (9th Cir. 2003) that an award of $174,454.92 in treble damages and $550,000 in penalties was not excessive under the Eighth Amendment. While the court did not consider the** ***Bajakajian*** **factors a "rigid set of factors," it did reference them in its decision.** ***Id.*** **at 1017.**

The Court of Appeal first pointed to the fact that, unlike the defendant in ***Bajakajian*****, Mackby was "among the class of people targeted by the Act." Also, while Mackby was assessed $550,000 in penalties, he had committed a total of 8499 violations of the Act.** ***Id.*** **at 1018.**

In comparing the penalties and damages awarded against Mackby to the potential criminal sanction for the conduct, the court observed that the criminal sanction could conceivably have been worse - several years of jail time and restitution for the full amount of the fraud. ***Id.*** **Also relevant was the fact that the defendant's conduct – falsely representing himself as a licensed medical provider - harmed the Government, both in the form of monetary damages and harm to the administration and integrity of Medicare.** ***Id.*** **at 1018-1019.**

Lastly, the Court noted that "some part of the judgment against Mackby [was] remedial." ***Id.*** **Relying on** ***United States v. Bornstein, 423 U.S. 303, 314 (1976),*** **the Ninth Circuit observed that the pre-amendment version of the Act – which called for double damages and $2,000 in penalties per false claim – had been deemed "largely remedial" by the Supreme Court.** ***Id.*** **at 1019. Accordingly, it held that "at least some portion of the award that was over and above the**

amount of money actually paid out by the government was similarly remedial." ***Id.***

In the end, the Court of Appeals upheld the award of penalties equal to 9.5 times the amount of single damages. ***See also*** **TXO Production Corp v. Alliance, 509 US 443 (1993) (in upholding case with $19,000 in actual damages and $10,000,000 in punitive damages, Court observed it has "consistently rejected the notion that the Constitutional line is marked by a simple mathematical formula");** ***United States v. Byrd*****, 100 F. Supp. 2d 342 (E.D. N.C. 2000) (in case with $85,012 in damages, court awarded $1.3 million in penalties -- more than 15 times single damages);** ***U.S. v. Advance Tool Co.*****, 902 F. Supp. 1011, 1018 (W.D. Mo 1995) (court awarded $365,000 in penalties in case with zero damages and $3,430,000 in possible penalties available);** ***Hays v. Hoffman*****, 325 F.3d 982, 993-994 (8th Cir. 2003) ($1.68 million in penalties reduced to $80,000 in case involving $6,000 overcharge; while Excessive Fines Clause not the basis relied upon for the reduction, court noted district court's decision was "laced with Excessive Fines Clause implications").[13]**

B. Treble Damages

No case has ever held that treble damages under the FCA violate the U.S. Constitution. In ***Vermont Agency of Natural Resources v. United States ex. rel. Stevens*****, 529 U.S. 765, 784 (2000), the Supreme Court described treble damages under the False Claims Act as "essentially punitive in nature." In** ***Cook County v. United States ex rel. Chandler*****, 538 U.S. 119, 130 (2003), however, the Court clarified its statement in** ***Stevens*****, observing that "treble damages have a compensatory side, serving remedial purposes in addition to punitive objectives."** ***Id.*** **The Court thus held that the FCA's treble damages provision "certainly does not equate with classic punitive damages," and the Court did not otherwise challenge the provision.** ***Id.*** **at 132. It is thus highly unlikely the Act's treble damage provision, by itself, will ever be subject to serious Constitutional challenge. Future cases in this area will undoubtedly be limited to an analysis of the combined impact of damages and penalties in assessing the potential constitutional infirmities of judgments rendered under the Act.** ***See United States v. Mackby*****, 261**

---

13 As of this date, no court has applied the Due Process clause to limit the award of penalties under the False Claims Act. ***But see State Farm Mutual Automobile Insurance Co. v. Campbell*****, 538 U.S. 408, 410 (2003) ("in practice, few awards exceeding a single digit ratio between punitive and compensatory damages will satisfy due process").**

F.3d 821 (9th Cir. 2001) ("treble damages provision, at least in combination with the Act's statutory penalty provision, is not solely remedial and therefore is subject to an Excessive Fines Clause analysis under the Eighth Amendment").

Law Offices of Paul D. Scott, Esq.
San Francisco, California
www.fraudhotline.com