Reprinted from The Government Contractor, with permission of Thomson Reuters. Copyright © 2016. Further use without the permission of West is prohibited. For further information about this publication, please visit *http://legalsolutions.thomsonreuters.com*, or call 800.328.9352.

The Government Contractor®

THOMSON REUTERS

Information and Analysis on Legal Aspects of Procurement

Vol. 58, No. 23 **June 15, 2016**

Focus

¶ 208

FEATURE COMMENT: Keeping The False Claims Act Civil: Why FCA Damages Should Be Based On The Government's Actual Losses

There can be no question that the False Claims Act (FCA) carries with it severe penalties. It provides for a penalty from $5,500 to $11,000 per offense, and further provides that the defendant must pay "three times the amount of damages which the Government sustains because of the act of that person." 31 USCA § 3729(a); 28 CFR § 85.3(9). The per-offense penalty will soon increase pursuant to the Bipartisan Budget Act of 2015, in an amount to be determined through "interim final rulemaking" basing the increase on the consumer price index. See H.R. 1314, 114th Cong. § 701 (as passed by the House and Senate, Oct. 30, 2015) (amending the Federal Civil Penalties Inflation Adjustment Act of 1990). The Bipartisan Budget Act itself does not permit more than a 150-percent increase in the per-offense fine, though some commentators have speculated that the upward adjustment will be toward the high end of that cap. See, e.g., *www.whitehouse.gov/sites/default/files/omb/memoranda/2016/m-16-06.pdf*.

Those already stiff penalties can be made even stiffer if, as the Department of Justice and FCA relators at times successfully argue, they are in addition to damages calculated at treble the entire amount the Government paid on a claim, without any deduction for the value of services or goods actually provided. But such damages are akin to grafting the criminal Alternative Fines Act onto the FCA's damages scheme. See 18 USCA § 3571(d) (when defendant is convicted of a crime,"[i]f any person [the convicted party] derives pecuniary gain from the offense, or if the offense results in pecuniary loss to a [another] person other than the defendant, ... the defendant may be fined not more than the greater of twice the gross gain or twice the gross loss" attributable to the offense).

Courts have most frequently agreed with such expanded damages theories in the context of FCA claims based on Medicare and Medicaid billing violations, which are typically based on potentially criminal violations of statutes such as the Anti-Kickback Statute or the Food, Drug, and Cosmetics Act. See, e.g., *U.S. v. Rogan,* 517 F.3d 449 (7th Cir. 2008) (violation of Anti-Kickback Statute and Stark Law); *Hopper v. Solvay Pharms. Inc*., 588 F.3d 1318 (11th Cir. 2009) (alleged criminal misbranding violation). In such cases, a court may deem quasi-criminal sanctions a fair punishment for what it sees as a criminal enterprise. See, e.g., *Rogan*, 517 F.3d at 453 (damages for claims tainted by the Stark Law and Anti-Kickback Statute equal to the total amount paid, as had the Government known of the prohibited financial relationships and kickbacks, it would have paid nothing for the claims); *U.S. ex rel. Drakeford v. Tuomey,* 792 F.3d 364, 386 (4th Cir. 2015) (same). Courts have applied similar logic in more traditional breach of contract cases, ruling that a defendant's entire gain can constitute single damages under the FCA. See, e.g., *U.S. ex rel. Longhi v. Lithium Power Techs., Inc.*, 575 F.3d 458, 473 (5th Cir. 2009) (basing damages on the full value of Small Business Innovation Research grants where contractor falsely certified as a small business); *U.S. v. TDC Mgmt. Corp.*, 288 F.3d 421 (D.C. Cir. 2002) (assessing damages based on the full contract value where contractor falsely certified progress and concealed deviation from program terms to obtain payment).

Awarding damages for the full value of services charged, whether or not the Government received a corresponding benefit, is fundamentally incompatible with a civil cause of action like the FCA, not to mention the Act's text and legislative history. Indeed, if courts insist on awarding FCA damages based on an analog in criminal law, that

analog should be restitution damages. But as the Supreme Court has reaffirmed, even criminal restitution sanctions should only be awarded for harm actually caused to the victim. See *Paroline v. U.S.*, 134 S. Ct. 1710 (2014); see also *U.S. v. Pikus*, 2015 WL 3794456 (E.D.N.Y. June 16, 2015) (rejecting Government's argument that restitution should be for full amount of services charged because of statutory mandate to limit restitution to losses "directly caused by" the offense). As recently as late April, the Fifth Circuit rightly noted that a criminal "who uses fraud to procure a contract but intends to provide the contracted-for services" should not be sentenced under a loss calculation in the same manner as one who "intends to totally cheat the victim, giving nothing in return." *U.S. v. Harris,* ---F.3d---, 2016 WL 1720046 at *16 (5th Cir. Apr. 28, 2016). Accordingly, the court ruled that a procurement fraud defendant's Sentencing Guidelines range should be calculated under a loss calculation that deducts the fair market value of the services the defendant had rendered under the allegedly fraudulently procured contract. Id. If "full value" damages would not be permitted as restitution or as a basis for sentencing in a *criminal* claim, it is time for courts to seriously reconsider whether they are truly "damages" in the civil context. It is simply inappropriate to award what are essentially criminal *fines* as *single damages* in a civil FCA claim. Courts should force the Government to prove criminal conduct beyond a reasonable doubt if it seeks criminal fines from a defendant. See 18 USCA § 3571(d).

The FCA Is a Civil Fraud Statute, and Traditional Civil Fraud Damages Should Apply—The FCA is a civil fraud statute designed to protect the public fisc; it is not an independent enforcement mechanism for all federal laws. *U.S. ex rel. Clausen v. Lab. Corp. of Am., Inc.*, 290 F.3d 1301, 1311 (11th Cir. 2002) ("The False Claims Act does not create liability merely for a health care provider's disregard of Government regulations or improper internal policies unless, as a result of such acts, the provider knowingly asks the Government to pay amounts it does not owe."); *U.S. ex rel. Steury v. Cardinal Health, Inc*., 625 F.3d 262, 272 (5th Cir. 2010) ("The [federal] FCA is not a general 'enforcement device' for federal statutes, regulations, and contracts. Not every breach of a federal contract is an FCA problem."); *In re Baycol Prods. Litig*., 732 F.3d 869, 874 (8th Cir. 2013) ("The FCA is not concerned with regulatory noncompliance, but with false or fraudulent claims that cause the Government to pay money." (quotation omitted)). Yet, the boundary between civil and criminal sometimes becomes muddled, particularly where FCA claims rest on a theory that a party contracting with the Government has committed a criminal violation in the course of fulfilling the contract, and the Government would have refused to pay under the contract had it known of the underlying violation. See, e.g*., U.S. ex rel. Barrett v. Columbia/HCA Health Care Corp*., 251 F. Supp. 2d 28, 33 (D.D.C. 2003) ("compliance with the [Anti-Kickback Statute] and Stark Laws would affect the Government's decision to pay" claims). However, at bottom, FCA claims are not criminal claims; they are civil claims more akin to a breach of contract. See, e.g., *Clausen,* 290 F.3d at 1311.

It is well established that breach of contract plaintiffs—even those pressing a fraud-based claim—must prove an actual loss suffered as a result of the breach or fraud in order to establish damages. See, e.g., *Godley v. U.S.*, 5 F.3d 1473, 1476 (Fed. Cir. 1993) ("Illegal acts by a Government contracting agent do not alone taint a contract ... Rather, the record must demonstrate some causal link between the illegality and the contract provisions [being enforced]."); *Winant v. Bostic,* 5 F.3d 767, 776 (4th Cir. 1993) (damages under North Carolina unfair and deceptive practices statute were, consistent with common law fraud damages, "the difference between what was received and what was promised"); Restatement of Contracts (Second) § 347, comment (e); Am. Jur. 2d § III(c)(1)(50). This, then, is the measure of damages that should be used in FCA claims. That interpretation is not only bolstered but necessitated by the language of the FCA itself, which provides that the Government may receive "three times *the amount of damages which the Government sustains because of the act of*" the defendant. 31 USCA § 3729(a)(1) (emphasis added); see also *U.S. v. Bornstein*, 423 U.S. 303, 317, n. 13, (1976) (the Government is entitled to receive damages under the FCA "equal to the difference between the market value [of the item] it received and retained, and the market value it would have received if they had been of the specified quality.").

Courts seem to more readily recognize this principle when reviewing claims more akin to traditional breach of contract claims. For example, in *U.S. v. Anchor Mortgage Corp.*, the Seventh Circuit had little problem interpreting the FCA to require trebling of only net damages—in other words, the difference between the value the Government contracted to receive and the value the Government actually received. 711

© 2016 Thomson Reuters

F.3d 745 (7th Cir. 2013). The Seventh Circuit's *Anchor Mortgage* opinion is difficult to square with the same Court's holding in *Rogan*, 517 F.3d at 453, where the Court did not reduce damages for medical care actually provided to beneficiaries of Government health care programs. While in theory the *Anchor Mortgage* decision concerns the amount of damages that are trebled while the *Rogan* decision looks to entitlement to damages generally, it is also possible that the difference is best explained by the fact that the *Anchor Mortgage* case presents more traditional claims that did not involve underlying criminal conduct, while the *Rogan* case did involve criminal conduct.

Similarly, in *U.S. ex rel. Davis v. District of Columbia* the D.C. Circuit rejected a claim that the D.C. Public Schools (DCPS) should pay FCA damages relating to Medicaid reimbursements of transportation services it provided to special education students. 679 F.3d 832 (D.C. Cir. 2012). In that case, there was no dispute that DCPS had, in fact, provided the transportation services, nor that those services were properly covered by Medicaid. However, the relator alleged that DCPS had submitted false claims because it failed to keep appropriate records, and the recordkeeping requirements were a precondition to payment. Id. at 834-35. Expressly because the case "in no way call[ed] into question the value of the medical care provided by DCPS," the D.C. Circuit found it irrelevant that the Government would not have paid the claim if it had known of the lack of documentation. Id. at 840. The court instead reasoned that the maintenance of documents "has no independent monetary value" and that the Government did not receive "less than what it believed it had purchased," and accordingly there were no damages. Id.; see also *U.S. v. Sci. Applications Int'l Corp.*, 626 F.3d 1257 (D.C. Cir. 2010). Other courts have reached similar conclusions. See, e g., *U.S. ex rel. Compton v. Midwest Specialties, Inc.*, 142 F.3d 296, 304 (6th Cir. 1998) (FCA damages are the difference between "the value received by the Government" and the value that the Government contracted to receive).

More recently, the Sixth Circuit strongly endorsed a requirement for "actual damages" in *U.S. v. United Techs. Corp.*, 782 F.3d 718 (6th Cir. 2015). In that case, a military contractor allegedly made false statements to the Air Force as it competed with a rival company to win a contract to supply the Air Force with engines for a particular fighter jet. Id. at 720. The defendant did not gain much, if any, business as a result of the alleged fraud, which was eventually discovered. Id. And, in the end, the effects on competition likely meant that the Air Force actually paid market price for the engines it did purchase from the defendant. Id. at 730-31. The Sixth Circuit noted that where "the government gets what it paid for despite a contractor's misstatements, it has suffered no 'actual damages.'" Id. at 731. Thus, the court concluded that damages should be measured with reference to the "fair market value" of the services provided. Id. Accordingly, the Sixth Circuit reversed a large damages award and remanded the case to the trial court to consider whether the Government had proven that it was actually damaged by the defendant's misstatement, in light of the fact that the Air Force only purchased engines from the defendant after it had successfully competed for the business (and lowered its prices accordingly). Id. at 734; see also *U.S. ex rel Harrison v. Westinghouse Savannah River Co.*, 352 F.3d 908, 922-23 (4th Cir. 2003) (requiring plaintiff to prove "how much more the government paid ... to perform the subcontract than it would have paid another firm absent the false … certification.").

Courts' intuitive reactions in these cases might stem from their sense that ruling otherwise would divorce the FCA action from general principles of breach of contract and civil fraud claims. See *United Techs*., 782 F.3d at 731 (stating that its damages analysis was consistent with "the black letter law of fraud and restitution"); *U.S. ex rel Wilson v. Kellogg Brown & Root, Inc.*, 525 F.3d 370 (4th Cir. 2008) (finding that FCA relator could not base a claim on "nothing more than his own interpretation of an imprecise contractual provision" and that "[t]o hold otherwise would render meaningless the fundamental distinction between actions for fraud and breach of contract"); *Steury,* 625 F.3d at 268; *Mikes v. Strauss*, 274 F.3d 687, 699 (2d Cir. 2001) (FCA relators must prove that a contractor's compliance with a contractual provision was a "condition" or "prerequisite" for payment under a contract in order to claim the entire payment under the contract as damages); see also *Ebeid ex rel. U.S. v. Lungwitz*, 616 F.3d 993, 998 (9th Cir. 2010) (requiring the contractor to have expressly certified compliance with a law, rule, or regulation prior to violating it and submitting invoices for FCA liability to attach). In this way, courts can ensure not only that the Government is only collecting on damages it actually suffered, but also that breaches of contract with the Government have no greater consequences than breaches of contract with any private party.

© 2016 Thomson Reuters

Alternate Damages Theories Should Be Rejected—However, this seemingly intuitive principle of contract law often goes by the wayside in FCA cases premised on the defendant's alleged violations of criminal statutes. In such cases, the Government often claims that it has been monetarily "damaged" by the entire amount it paid for a good or service, regardless of whether those goods or services were actually administered or necessary. This is because, the Government frequently argues, the entire claim is "tainted" by an underlying criminal violation, and had the Government known of that "taint," it would never had paid the claim. See, e.g., *Pogue v. Am. Healthcorp, Inc.*, 914 F. Supp. 1507 (M.D. Tenn. 1996); *Rogan*, 517 F.3d at 453. Indeed, the *Rogan* court took this analysis a step further by implying that it is inherently impossible for the Government to receive value for a Medicare or Medicaid payment made for purposes of providing a beneficiary's health care. Id. at 454 ("The Government offers a subsidy ... with conditions. When the conditions are not satisfied, nothing is due. Thus the entire amount ... received on these claims ... must be paid back.").

Damages figures under this theory can be astronomical and extremely attenuated. For example, many complex services are billed under what is known as a Severity Diagnosis Related Group (DRG) basis. Under that billing system, the Centers for Medicare and Medicaid Services classifies hospital inpatient cases into 500 payment categories based on anticipated resource utilization and other factors. The DRG codes "bundle" services that are needed to treat a patient with a particular disease or diagnosis, and CMS creates a rate of payment based on the average cost to deliver the care associated with a particular DRG code. In other words, inpatient hospital claims, by the time they are paid by CMS, are generally calculated on the basis of a patient's diagnosis, not by the specific goods and services consumed by the patient during her hospital stay. Under the "taint" theory, the Government could go so far as to claim that if one small portion of the services provided as part of the DRG bundle (for example, the anesthesia used to operate on an appendicitis patient) is tainted by a kickback, the *entire* DRG payment for that diagnosis can be considered single damages.

The flaws with the "taint" theory can further be illustrated in the medical context. Suppose a defendant's Medicaid claim was "tainted" by an underlying kickback, but that the defendant actually rendered medically necessary services to the patient before submitting the claim. The Medicaid beneficiary would have every right to (and presumably would) get medically necessary services from another provider even in the absence of any illegal activity on the provider's part, and the Government would be required to pay for that service. Accordingly, the public fisc is not "damaged" by the entire amount the Government paid to the provider who submitted a false or "tainted" claim; it is "damaged" by the amount above and beyond what it would have paid *some* provider to render medically necessary services to a beneficiary. The Government has undoubtedly received some value by eliminating the need to pay for a service that it would otherwise be required to pay a different provider. Indeed, if *Rogan*'s "subsidy theory" were taken to its logical conclusion, there would be no consideration for the Government behind any Medicaid or Medicare provider contract, and it would be impossible for a provider to breach a contract by providing sub-par medical services to beneficiaries. After all, if the contract has no value for the Government, it would be impossible for the sub-par services to have had a value of less than zero.

The other problem with the "taint" theory is that it is directly contrary to the legislative history of the statute. On Sept. 12, 2007, Sen. Chuck Grassley (R-Iowa) introduced S. 2041, The False Claims Correction Act of 2008. In comments to the draft bill, the Government urged the Senate to amend the language of the FCA to provide for a penalty "plus 3 times the amount of money or property paid or approved because of the act of that person." DOJ comment letter on S. 2041, Feb. 21, 2008. The Senate asked the Chamber of Commerce for its views on the proposed change. The Chamber argued that the proposed change was "bad policy" for a number of reasons. Letter of John T. Boese on behalf of the Chamber of Commerce and the U.S. Chamber Institute for Legal Reform Regarding S. 2041, March 19, 2008 (Chamber comment). Among other objections, the Chamber noted that the proposed change would not serve the FCA's goal of protecting the public fisc, and instead would result in "enormous windfalls" to the Government. In the end, no action was taken on S. 2041 and the bill did not become law. The following year, Senator Patrick Leahy (D-Vt.) introduced S. 386, the Fraud Enforcement and Recovery Act of 2009 (FERA), which proposed amendments to the FCA that did *not* include any changes to the damages calculation. That bill passed and was signed into law in May 2009.

If "taint-based" damages are contrary to the text of the FCA, its legislative history, and precedent

© 2016 Thomson Reuters

interpreting the Act, why are they so appealing to certain courts? Likely because, as the *Rogan* court put it, some courts feel that a defendant who violates a criminal law should not be able "to keep money obtained from the treasury by false pretenses, or avoid the penalty for deceit." *Rogan*, 517 F.3d at 454. In other words, when faced with an FCA violation based on a criminal statute, it seems intuitive to courts that criminal sanctions similar to those imposed under the Alternative Fines Act are appropriate to deter the conduct in the future. See 18 USCA § 3571(d) (providing for fine of twice the defendant's gain or victim's loss).

That logic has significant holes. For one thing, the FCA's own penalties provision provides more than enough deterrence against submitting a false claim. Those penalties could be so exorbitant that they could run afoul of the Eighth Amendment's prohibition against excessive fines, which is obviously an amount well in excess of disgorgement of ill-gotten gains. See, e.g., *U.S. ex rel. Smith v. Gilbert Realty*, 840 F. Supp. 71 (E.D. Mich. 1993); *U.S. ex rel. Lamberts v. Stokes*, 640 F. Supp. 2d 927 (W. D. Mich. 2009). For another thing, Congress is perfectly capable of expressly providing for complete disgorgement of any amounts collected if that is what it intended to do. See 42 USCA § 1395nn(g)(1)-(2) (Stark Law provision forbidding the Government from paying claims submitted in violation of its terms and requiring disgorgement of any amounts collected for services performed in violation of the act). It did not do so in the FCA, which requires proof of actual "damages" to the public fisc. As the Fifth Circuit recently reiterated, "[t]reating the loss amount as the difference between the contract price and the fair market value of services rendered" is a "realistic, economic approach" that "is consistent with the idea that fraud is not always the same as theft[.]" *Harris*, 2016 WL 1720046 at *16 (calculating loss for Sentencing Guidelines purposes by subtracting fair market value of services rendered). Only this approach "properly focuses the loss inquiry on the pecuniary impact on victims." Id. at *15.

Even setting the per-violation penalties aside, the Government is not without recourse if it wants to seek disgorgement. The *criminal* laws provide the disincentive required to deter criminal violations, including but not limited to the Government's ability to seek disgorgement and criminal fines of twice the amount gained. See 18 USCA § 3571(d); 42 USCA § 1395nn(g)(1)-(2). Thus, should the Government believe that complete disgorgement is necessary to deter future misconduct, it can require disgorgement by levying a criminal action against the defendant and proving its case under a criminal standard of proof. 18 USCA § 3571(d); 42 USCA § 1395nn(g)(1)-(2). It should not, however, be allowed to skirt criminal standards of proof by collecting "damages" that the Government did not actually suffer under the guise of a civil action.

Proper Damages Calculations—Thus, instead of imposing what amounts to a criminal fine for a civil FCA violation, see 18 USCA § 3571(d), courts should only treble and award "net damages"—the amount the Government can show that it paid above and beyond what it would have paid absent the fraud. For example, if there was an alternative product available at a lower price that a provider did not use because of a kickback scheme, the price differential between the two products might be a compensable single damage. Or, if an illegal scheme resulted in the Government being billed for services that were not in fact medically necessary and would never have been provided independent of the scheme, a relator might argue that the service was of no value to the Government and the entire amount should therefore be characterized as "damages." Similarly, if a company marketed snake oil under the brand name and label of an FDA-approved drug, a relator might argue that the drug did not effectively treat the condition that it was prescribed to treat, and therefore its purchase price should be compensable in its entirety.

However, if an FCA claim concerns payment for necessary and compensable services and products—those the Government would have needed to pay to *some* provider even in the absence of an FCA violation yet now does not need to pay—the amount paid under that claim is not truly a "damage" to the public fisc. That is so even if the claim was "tainted" by underlying criminal or quasi-criminal activity. Trebling the entire amount of the claim as FCA damages conflicts with not only the language of the FCA itself, but also the defendant's Constitutional right not to be assessed criminal penalties unless each element of the criminal claim has been proven beyond all reasonable doubt.

***This Feature Comment was written for The Government Contractor by* Nicole Henning, J. Andrew Jackson, Stephen Sozio, *and* Tina Tabac-**

© 2016 Thomson Reuters

chi. ***The authors are partners in the Chicago, Cleveland, and Washington D.C. offices of Jones Day, where they defend FCA cases. Disclaimer: The views set forth herein are the personal views of the authors and do not necessarily reflect those of Jones Day. Any publication by a Jones Day lawyer or employee should not be considered or construed as legal advice on any individual matter or circumstance. The contents of this document are intended for general information purposes only. The distribution of this publication or its content is not intended to create, and receipt of it does not constitute, an attorney-client relationship.***

© 2016 Thomson Reuters