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Measuring Damages In FCA Fraudulent Inducement Cases

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Victor Walton and Joseph Harper, attorneys in the Vorys Cincinnati office, authored this column about theories that have been used for calculating damages in False Claims Act (FCA) fraudulent inducement cases. The authors conclude that the way that damages can have profound consequences for FCA defendants due to the FCA's treble damages provisions. The column was originally posted in the August 23, 2012 edition of the *Government Contracts Law* 360.

Measuring Damages In FCA Fraudulent Inducement Cases

In recent years, the government has pursued aggressive theories for calculating damages in False Claims Act fraudulent inducement cases. One of the core questions in these types of cases is whether single FCA damages should be measured by (1) the actual net loss suffered by the government, taking into account the value of goods or services provided by the contractor, or (2) the total amount paid by the government without regard to such value — even if the government is completely satisfied with the product or service.

Unsurprisingly, the U.S. Department of Justice has argued that the latter rule applies. And even when courts require that the value of the goods or services retained by the government be accounted for in a damages calculation, FCA plaintiffs often argue that the value received by the government should not be considered until after the total amount paid by the government has been trebled.

The way that damages are defined in this context can have profound consequences for FCA defendants due to the FCA's treble damages provisions. Assume, for example, that the government paid a contractor \$60 million for services, but, due to the alleged fraud, the value of the services received was only \$59 million. If no accounting is made for the value of the services provided, the damages are \$180 million (\$60 million trebled). If the value provided is considered, but the \$60 million contract price is trebled before the \$59 million in value is accounted for, the resulting damages are \$121 million (\$60 million trebled, less the \$59 million in services received). If, however, the true “damages” — the difference between the value of what the government paid and what it

received — are trebled, the government's damages are only \$3 million (\$60 million less \$59 million, trebled).

The Method of Calculating Damages Frequently Endorsed by DOJ Applies Only When the Government Receives No Value At All

The DOJ has argued that the damages in a fraudulent inducement case are the total amount of the payments under the fraudulently induced contract, but this damages formulation is rarely appropriate. The total amount of the payments made under a fraudulently induced contract should equal the government's single damages only when the government receives no value at all from the products or services provided.

For instance, in *United States ex rel. Longhi v. Lithium Power Techs Inc.*, the Fifth Circuit held that the government's damages equaled the total amounts paid to the defendants under fraudulently awarded research grants without any offset for the value of the work performed. The court distinguished the research grants awarded to the defendants in this case from "standard procurement contracts where the government ordered a specific product or good." Because the grants provided a benefit only to the grant recipients and the government obtained no tangible benefit, the appropriate measure of damages in this case was the amount the government actually paid to the defendant.

But in cases where the government has received value for the goods or services provided by a defendant, that value should be deducted from the total amount of the payments made by the government to determine single damages.

This approach was adopted by the D.C. Circuit in the seminal *United States v. Sci. Applications Int'l Corp.* (SAIC) decision. In SAIC, the government argued that noncompliance with material contract terms was sufficient to establish damages in the full amount of the "tainted" contracts, and the trial judge instructed the jury to disregard entirely the value provided by SAIC under those contracts. The jury concluded that the government suffered FCA damages in the full amount of the payments made by the government for the claims, which totaled almost \$2 million. Trebling that amount and adding \$577,500 in penalties, the district court awarded a total of \$6.5 million under the FCA.

The D.C. Circuit vacated the damages award because the court's instructions to the jury prevented the jury from accounting for the value of the services SAIC conferred on the government. Stating that the aim of the FCA's damages provisions is to "put[] the government in the same position as it would have been if the defendant's claims had not been false," the D.C. Circuit rejected the government's expansive damages theory, ruling that the proper measure of damages was instead "the amount the government actually paid minus the value of the goods or services the government received or used."

The court held that the full amount of payments to a defendant can be awarded as single damages "only where the government proves that it received no value from the product delivered." Although it was not a fraudulent inducement case, the SAIC rationale should apply in all cases where the government has retained something of value from the defendant.

The Proper Measure of Damages in a Fraudulent Inducement Case is the Difference Between the Amount Paid by the Government and the Value Received by the Government, Trebled

Relying on the U.S. Supreme Court's decision *United States v. Bornstein*, the DOJ often argues that the value of the goods and services received by the government should not be deducted from the "damages" until after the amount of payments made by the government to the contractor are trebled. This argument is based on language in the *Bornstein* decision stating that "in computing the double damages authorized by the [FCA], the government's actual damages are to be doubled before any subtractions are made for compensatory payments previously received by the government from any source."

There is a significant difference, however, between compensatory payments (which, in this context, refers to restitution that reimburses the government for losses) and the value of goods and services provided to the government in exchange for payment. The U.S. Supreme Court recognized this distinction, stating that "[t]he Government's actual damages are equal to the difference between the market value of the [products or services] it received and retained and the market value that the [products or services] would have had if they had been of the specified quality."

Despite the Supreme Court's direction that the value of goods or services received by the government should be used to calculate the government's actual damages, some courts have nonetheless held that the value received by the government should not be deducted from the "damages" until after the sum of the payments by the government are trebled.

For example, in *Longhi*, although the Fifth Circuit ultimately concluded that the government received no value from the defendants, the court explicitly rejected the argument that "the court should subtract the value of the benefit that the Defendants conferred on the government from the amount the government paid to the Defendants and then treble this 'actual-damages' figure." Equating compensatory payments with the "benefit" the government receives under a contract, the Fifth Circuit found that, under *Bornstein*, "when deducting the 'bargain' received from a defendant, a court must begin with the already [trebled] amount."

Fortunately, the majority of courts have held that the proper method of calculating damages is to deduct the value of goods and services retained by the government from the total payments made by the government prior to trebling. The court in *SAIC* properly articulated the rule of *Bornstein*, holding that damages are calculated by subtracting the value of the goods or services retained by the government from the amount the government actually paid. The Sixth Circuit has also properly applied the rule from *Bornstein*. In *United States v. United Techs. Corp.*, a fraudulent inducement case, the Sixth Circuit held that "the district court should have calculated damages as the difference between what the government paid and what it should have paid for what it received."

Contrary to what the DOJ and relators have traditionally argued, *SAIC* and other decisions — including *Bornstein*, on which the DOJ frequently relies — hold that the "damages" are the difference between what the government paid for and what it received. Only then are these "actual damages" trebled. These rulings are the correct rulings, and should help protect government contractors by reining in FCA damage theories that impose awards that are disproportionate to any actual economic harm caused by the alleged conduct. Determining the value of goods or services actually provided may be difficult in some circumstances, but is a necessary step to properly calculate FCA damages and avoid creating a windfall for

FCA plaintiffs.

