Critical Thinking
A Monthly Guest Column

Damages Under the False Claims Act: Is the Sky the Limit?

By
David Z. Bodenheimer

"Hospital Chain to Settle Case; Medicare Fraud Charges Cost Columbia/HCA $745 Million"
The Washington Post, May 19, 2000

"9 Oil Concerns to Pay $223 Million Claim"
The New York Times, December 14, 1999

"Treasury Bond Lawsuit Settled; Brokers to Pay $140 Mil for Overcharging"
The Arizona Republic, April 7, 2000

By any measure, damages under the False Claims Act have blasted into stratospheric levels. In a press release of February 2000 that predated some of the headlines above, the Department of Justice highlighted the skyrocketing recoveries obtained under the *qui tam*[1] provisions of the False Claims Act:

> More than $3 billion has been recovered in civil fraud cases brought under the whistleblower provisions of the False Claims Act, since the law was amended in 1986, the Justice Department announced today. Almost half of the recoveries have come in the last two and a half years.[2]

As recoveries like the Columbia/HCA settlement continue to set new records and *qui tam* actions spread to new fields like the energy and financial industries, the False Claims Act promises to boost damages into the ionosphere.

No contractor wants to begin a discussion of the False Claims Act by focusing on damages, because the preferred answer is always that no liability exists in the first place. However, in the hands of an experienced Justice Department attorney or aggressive *qui tam* counsel, the risk of liability under the False Claims Act is rarely zero. For this reason, the prudent course in defending against these lawsuits is to attack the action from both ends – no liability *and* no damages. This article focuses upon some of the ways in which the courts have limited, or even denied, recovery of damages under the False Claims Act.

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In few areas of the law are general principles and bright-line rules harder to find than in decisions regarding the False Claims Act, especially in the murky world of damages. Nonetheless, the courts have often measured requests for damages against the following basic tests:

- Did the plaintiff prove *causation*, meaning that a nexus existed between the alleged false claim and the requested damages?
- Did the Government *rely* upon the claim at issue?
- Did the Government suffer any *actual* loss, as opposed to speculative or potential losses?
- Did the plaintiff prove the *extent* of the alleged losses?

Statutory Provisions Governing Damages

The False Claims Act establishes two basic types of damages: (1) actual damages that are generally subject to trebling; and (2) statutory penalties applicable to each false claim submitted. 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 . . .[3]

The entire burden of proving each and every element of a false claim rests upon the plaintiff. In particular, the Act states:

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GAO Reports and Activities

GAO Report on Recovery Auditing

NSIAD-00-134, 6/5/00

The General Accounting Office (GAO) released a report on June 5 examining the Department of Defense's (DOD) use of recovery auditing. The report assesses DOD's progress in recovering overpayments, reasons for delays, and ways to expand the use of recovery auditing.

Recovery auditing is the practice of auditing accounting and procurement records to find overpayments made to vendors. If an overpayment is found, the contracting officer (CO) first tries to resolve the claim by negotiating. If that fails, the CO issues a letter of final decision demanding payment of the claim. DOD vendors have the right to appeal the CO's decision to the Armed Services Board of Contract Appeals (ASBCA) or to a federal court.

In 1996, the Defense Supply Center (DSC) began a demonstration program involving recovery auditing by awarding a contract to a private firm for profit recovery services. This program was the result of a Congressional mandate to evaluate using private firms to identify overpayments to vendors. The demonstration program ended in 1999, and collection efforts by DSC continue.

According to the report, DOD has achieved limited progress in recovering overpayments. Collections of claims have been slow, due in large part to disagreements between vendors and the DSC and the time and effort required to review disputed claims. Thirty-four of the 59 vendors who have received letters demanding payments have appealed to the ASBCA.

GAO also found that DOD is expanding its use of recovery auditing. Since June 1999, six defense agencies have contracted for recovery audit services, and a seventh is planning to do so soon. The House Report (H.R. Rep. 105-532) accompanying the fiscal year 1999 DOD authorization bill directed DOD to expand the recovery audit demonstration to at least two commercial functions within its working capital fund agencies.

GAO recommended that DOD examine the need to clarify price warranty provisions in its contracts, after the ASBCA rules on the appeals, in order to minimize disagreements between DOD and vendors in the future. DOD agreed with this recommendation.

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> In any action brought under section 3730 [Civil Actions for False Claims], the United States shall be required to prove all essential elements of the cause of action, *including damages*, by a preponderance of the evidence.[4]

As discussed below, this burden requires the plaintiff to establish two well-recognized elements of damages: (1) *causation* – a causal connection or nexus must exist between the false claim and the specific loss; and (2) *amount* – the actual amount of the loss must be proved.

Proof Of Causation Or Nexus

To recover damages under the False Claims Act, the plaintiff must prove that it sustained such damages "because of the act" of the defendant.[5] Based upon this language in the statute, the courts have consistently found proof of causation to be an essential element in the proof of damages under the Act.[6]

In trying to clear this hurdle, plaintiffs have fallen short of proving causation under a variety of circumstances. Two of the more common failures of proof occur when: (1) no logical or direct connection exists between the loss and the false claim; or (2) the Government does not rely upon, or otherwise change its position as a result of, the false claim.

Losses Unaffected by False Claim

It is not enough that the loss and the false claim or statement coincidentally involve the same subject matter. Instead, the loss must be *caused by or related to* the false claim or statement. In one case where the plaintiff claimed that the defendant overstated the value of some residential property, the court rejected the plaintiff's claimed damages for the value of this property because the loss stemmed from the defaults by the mortgagors and the diminished property value caused by an injunction against lead paint in residences, *not* the defendant's representations regarding the condition of the property.[7]

In another case involving alleged bid rigging of a state highway project, the court found no connection between the false claims submitted to the State of Illinois and the amount actually paid by the Federal Government. Under this program, the Federal Highway Administration paid a fixed sum to the State for qualifying highway projects, regardless of how much the State ultimately paid. Accordingly, the court stated:

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> Assuming, without deciding, that the Government here still possessed a proprietary interest in the funds so that the allegedly false claims were filed "upon or against" the United States, the Government must still show that the claims injured the United States. Under the Federal-Aid Highway Act, the Government contributed a fixed sum to Illinois to assist in the construction of the two highways at issue here. The ceiling on the federal contribution imposed by the Highway Act, however, operated to insulate the United States from any overcharge. Although the overcharge may have increased the contribution of the United States toward the two particular projects, it did not affect the Government's overall contribution to Illinois.[8]

As a result, the court found that the United States suffered no injury because it would have paid the same fixed amount, regardless of whether a fraud occurred.

Lack of Reliance by the Government

To prove damages, the plaintiff must generally show reliance, or in other words, demonstrate that the Government actually changed its position as a result of the false claim.[9] One court summed up the rule as follows: "Proof of reliance or that false statements induced action is indispensable to the recovery of damages."[10]

The classic lack of reliance occurs where the Government knew of the alleged fraud, but did nothing. For example, the plaintiff failed to show reliance where the agency knew of the misrepresentation, but entered into a further agreement with the defendant anyway.[11] Under similar circumstances, recovery has been denied where the Government knew of the defects in the product, but proceeded apace with the project:

> In any event, the Army was aware of the deficiencies of the Subsystems and was present during all testing of the Subsystems, and nevertheless elected to proceed with production and acceptance of the Apache, and the Army decided to enter Phase III and execute the first production contracts independently of, and prior to, submission of the Phase II Test Report. Accordingly, the Court finds as a matter of law that there is no legally sufficient basis for a reasonable jury to have found that there was any causal connection between the allegedly false or incorrect statements made by [defendant] and the government's decision to purchase the Apache aircraft. The government knew what it was getting with respect to the Subsystems, and it got what it paid for.[12]

Proof Of Amount Of Loss

Under the False Claims Act, the plaintiff "has the burden to prove *what amount it lost as a result* of the [defendant's] fraudulent acts."[13] Thus, the plaintiff must demonstrate both an *actual loss* and the *extent* of that loss.

Proof of Actual Loss

Actual financial harm, rather than potential loss or increased risk, represents an essential element of damages. As one court explained, "[t]he False Claims Act allows the United States to recover only damages for *harm actually sustained* due to defendant's fraudulent acts."[14] Plaintiffs have encountered difficulty in proving actual economic injury in a variety of circumstances, such as missed steps in an inspection process, actions resulting in increased risk to the Government, and failure to adhere to certain procedural requirements.

Inspection Process. A variety of cases have recognized certain types of damages resulting from a contractor's failure to perform specified inspections or tests.[15] However, the fact that a contractor misses a step in the inspection process does not, *per se*, translate into a loss to the Government. In one case involving elaborate inspection requirements for high-rate production with tight delivery schedules, the Government complained of defective ammunition "due to failure to inspect visually 100,000 to 125,000 rounds of ammunition."[16] However, the court concluded that skipping this step in the inspection process did not necessarily mean that the ammunition would be defective:

> There is no evidence from which it could be concluded that this ammunition in the course of production had not received all other inspections under defendant's system, and some of it may have received a visual inspection on some other day. Neither is there any evidence from which it could be concluded that any of the ammunition in this entire bank was defective *beyond the amount that was to be expected and allowed in the usual operation* of the plant.[17]

Increased Risk. The fact that the Government experienced more financial risk than planned does not prove that an economic loss has been incurred. In one case, the defendant diverted some of the Government's funds to "temporary private use" and the Government bore greater financial risk due to the defendant's failure to disclose all outstanding liens in the application for the loan proceeds. However, the court upheld the finding of no actual damages:

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> The work was ultimately done and the court has found that the funds obtained were used to pay for it. . . . Ultimately, however, the project was completed, and so far as appears [the agency] obtained the security that it bargained for when it agreed to make the loan.[18]

In essence, the Government suffered no financial injury because it eventually got what it paid for.

Procedural Compliance. The fact that a contractor fails to comply with some procedural rule does not necessarily show actual financial damage to the Government. For example, an employee alleged that a contractor violated the Davis-Bacon Act by not filing payroll documentation in a timely manner. The court concluded that this procedural violation did not suffice for proof of damages:

> Moreover, a contractor's failure to submit payroll reports, in and of itself, causes *no economic loss* to the government and is not a "claim" within the meaning of the FCA [False Claims Act]. . . . There is simply no logical nexus between the failure to submit reports, by itself, and economic injury to the government.[19]

As a result, the plaintiff could not establish any actual damages flowing from the contractor's procedural non-compliance.

Proof of the Extent of Loss

Under the False Claims Act, the courts generally apply a market-value test: actual damages represent the difference between the value of the goods or services actually received by the government versus the value as falsely claimed or represented.[20]

The failure to itemize damages represents one of the more common pitfalls in proving the extent of the loss. In one case, the court refused to base the computation of damages upon the full amount of funds furnished by the Government to the defendant because some work had been accomplished with those funds. The court explained:

> The government has not shown that it received zero benefit from the entire sum of illegally procured funds.
>
> ***
>
> All of the above are inadequate because of plaintiff's failure to prove, or even allege, what was done with this money. Throughout the entire time these false claims were being presented, work on the projects was being done. Perhaps very little work was in fact accomplished, *but if absolutely zero benefit was received by the government, it must be proved*.[21]

In another case, the plaintiff claimed that the contractor delivered 1,301 substandard hand tools, but only introduced evidence regarding the defects or diminished value of a few of the tools. The court declined to award actual damages, despite the difficulty of obtaining and presenting evidence on each of the tools:

> Unfortunately, Plaintiff failed to present sufficient evidence at trial concerning the fair market value of the tools delivered to GSA so as to allow the Court to determine the extent of the Plaintiff's actual damages. . . . Plaintiff failed to set forth specific evidence as to whether any of the 1301 tools were ever used, are still in use, or if any of the tools had any utility whatsoever.[22]

Thus, despite finding false claims by the contractor, the court limited the plaintiff's recovery to the statutory civil penalties, due to the failure to prove actual damages with particularity.

Conclusion

As news of False Claims Act recoveries exceeding $100 million spreads, potential whistleblowers will increasingly view *qui tam* actions as a viable alternative to hitting the lottery, resulting in more litigation and even more exotic theories of damages. In this free-for-all environment, the fundamental rules governing proof of damages will take on heightened importance in False Claims Act cases.

Endnotes

1. Under 31 U.S.C. § 3730, a private individual may initiate a False Claims Act action, generally known as a *qui tam* suit, in the name, and on behalf, of the United States.
2. "Justice Department Recovers Over $3 Billion in Whistleblowers False Claims Act Awards and Settlements," Department of Justice News Release, WWW.USDOJ.GOV (Feb. 24, 2000).
3. 31 U.S.C. §□3729(a).
4. 31 U.S.C. §□3731(c) (emphasis added).
5. *See* 31 U.S.C. §□3729(a). The 1982 amendments changed the Act's language from "by reason of" to "because of," but did not alter the substance or meaning of the Act. *See United States v. First National Bank of Cicero*, 957 F.2d 1362, 1373 n. 11 (7th Cir. 1992); *United States v. Hill*, 676 Supp. 1158, 1180 (N.D. Fla. 1987).

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6. *See United States v. Miller*, 645 F.2d 473, 476 (5th Cir. 1981) (plaintiff "must demonstrate the element of causation between the false statements and the loss"); *United States v. Hibbs*, 568 F.2d 347, 351 (3rd Cir. 1977) (statute "compels consideration of the element of causation"); *United States v. Rapoport*, 514 F. Supp. 519, 525 (S.D.N.Y. 1981) (material issue remained as to "whether the Government has established causation").

7. *United States v. Hibbs*, 568 F.2d at 351.

8. *United States v. Azzarelli Constr. Co.*, 647 F.2d 757, 760-61 (7th Cir. 1981).

9. *See United States v. Planning Research Corp.*, 59 F3d 196, 200 (D.C. Cir. 1995) (plaintiff may recover damages if he "is able to prove that he relied on" the reports at issue); *United States v. Hill*, 676 F. Supp. at 1177 (Government failed to carry its burden regarding agency's reliance on false statements); *United States v. Rapoport*, 514 F. Supp. at 519 (proof of damages required a showing of reliance). *But see, United States v. Board of Education of Union City*, 697 F. Supp. 167, 179 (D. N.J. 1988) ("Actual reliance is not essential to the recovery of damages under the False Claims Act").

10. *United States v. Consolidated Indus., Inc.*, 720 F. Supp. 919, 923 (N.D. Ala. 1989).

11. *United States v. Hill*, 676 F. Supp. at 1177.

12. *United States v. Hughes Helicopter Co.*, 1993 U.S. Dist. LEXIS 17844 (C.D. Cal. 1993).

13. *Brown v. United States*, 207 Ct. Cl. 768, 790 (1975).

14. *United States v. Board of Education of Union City*, 697 F. Supp. at 173 (emphasis added).

15. *United States ex rel. Compton v. Midwest Specialties, Inc.*, 142 F.3d 296, 299, 304 (damages measured by full value of contract where contractor failed to perform required tests, Army found substantial percentage of Jeep brake shoes were defective, and court concluded that the brake shoes were essentially "valueless" to the Government); *BMY-Combat Systems v. United States*, 44 Fed. Cl. 141, 148-50 (1998) (damages for failure to perform specified tests included costs of inspection and repair, costs of replacing items, and interest on premature contract payments).

16. *United States v. United States Cartridge Co.*, 95 F. Supp. 384, 398 (E.D. Mo. 1950), *aff'd*, 198 F.2d 456 (8th Cir. 1952), *cert. denied*, 345 U.S. 910 (1953).

17. *Id.* (emphasis added).

18. *United States v. Woodbury*, 359 F.2d 370, 379 (9th Cir. 1966).

19. *United States v. DynCorp., Inc.*, 895 F. Supp. 844, 850 (E.D. Va. 1995).

20. *See, e.g., United States v. Bornstein*, 423 U.S. 303, 316 n.13 (1976); *United States v. Hibbs*, 568 F.2d at 351.

21. *United States v. Board of Education of Union City*, 697 F. Supp. at 172-4 (emphasis added).

22. *United States v. Advance Tool Co.*, 902 F. Supp. 1001, 1017 (W.D. Mo. 1995).

Upcoming Events

Sep. 12 **Accounting, Cost & Pricing Committee Meeting.** American Bar Association, Public Contract Law Section. Members Only. Washington, D.C. Registration/Information: (202) 626-5993.

Sep. 15 **National Defense Industrial Association, Finance Subcommittee Meeting.** Members Only. Embassy Suites Hotel, Alexandria, VA. Registration/Information: (703) 522-1820.

Sep. 19 **Institute of Management Accountants, Potomac Area Chapter Government Contractor Breakfast.** Speaker: Dave Capitano. Topic: CAS Updates Initiatives. Stratford/ATI Culinary Institute, Falls Church, VA. Registration/Information: (202) 462-6227.

Sep. 21-22 **AICPA National Conference on Fraud.** Caesars Palace, Las Vegas, NV. Registration/Information: (202) 737-6600.

Oct. 3-4 **The A-76 Institute: The Road to Economy and Efficiency.** The Women's Memorial (Arlington Cemetery), Washington, D.C. Registration/Information: (202) 776-7776.

Oct. 10 **Accounting, Cost & Pricing Committee Meeting.** American Bar Association, Public Contract Law Section. Members Only. Washington, D.C. Registration/Information: (202) 626-5993.

Nov. 6 **National Defense Industrial Association, Finance Subcommittee Meeting.** Members Only. Holiday Inn Rosslyn-Westpark, Arlington, VA. Registration/Information: (703) 522-1820.

Dec. 5-6 **The A-76 Institute: The Road to Economy and Efficiency.** Catamaran Resort Hotel, San Diego, CA. Registration/Information: (202) 776-7776.

Fax your Upcoming Event information to (202) 833-1959, Attn: Jay Leffingwell. The publication of any events will be at the sole discretion of the editor and as space permits.