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FEATURE COMMENT: Tainted Love—Plaintiffs' Increasing Reliance On The 'Tainted Claim' Theory Of Damages

In recent years, plaintiffs in False Claims Act (FCA) cases have taken an increasingly aggressive position on how damages should be calculated—i.e., that the Government is entitled to three times the amount of the total contract value, regardless of any value actually received, because the claim for payment was "tainted" by an underlying legal violation. Accordingly, the U.S. Court of Appeals for the Sixth Circuit's rebuke of this theory in *U.S. ex rel. Wall v. Circle C Constr.*, 813 F.3d 616 (6th Cir. 2016) is a welcome development. The majority opinion's reference to "fairyland" damages—will surely be cited in defendants' briefs in FCA cases for years to come.

But the concurrence serves as an important reminder that the facts of *Wall* made it an easy case in which to determine the proper measure of damages because the market value of the Government's injury was readily ascertainable. As such, the *Wall* decision may be helpful in circumstances of clear overreach by FCA plaintiffs, but the case law is far from settled in tainted claim cases in which the market value of the Government's injury cannot be easily calculated.

Benefit-of-the-Bargain Framework—In addition to civil penalties, the FCA provides for three times the amount of damages that the Government sustains. 31 USCA § 3729(a). The measure of damages is generally the amount of additional money the Government had to pay as a result of the alleged false statement or claim. *U.S. ex rel. Marcus v. Hess*, 317 U.S. 537 (1943).

In the seminal case of *U.S.* v. *Bornstein,* 423 U.S. 303 (1976), the U.S. Supreme Court established the benefit-of-the-bargain rule as a method of calculating damages in cases in which the Government receives services or products that fail to meet specifications or are of a lower quality—i.e., FCA damages are limited to the difference between the market value of the products the Government actually received from the defendant and the market value of what the Government should have received from the defendant, but for the alleged fraud. In *Wall*, the Sixth Circuit rejected the Government's use of the tainted claim theory and applied the damages standard articulated by *Bornstein*.

Taint Theory Hits a Wall—In *Wall*, the Army contracted with Circle C Construction to build 42 warehouses at a fort on the border between Kentucky and Tennessee. The contract required Circle C and its subcontractors to pay their employees above market wages in accordance with the Davis-Bacon Act (DBA), and to submit weekly compliance statements that the required wages were being paid. However, one of Circle C's electrical subcontractors underpaid its electricians by $9,916 in total. Because of the underpayment, several Circle C compliance statements were false, rendering Circle C liable to the Government under the FCA. Even though the Government received and was using the electrical work in the warehouses, it claimed that Circle C fraudulently induced it into paying for the full value of the services because, had the Government known about the fraud, it would not have paid anything or it would have suspended payments altogether. The U.S. District Court for the Middle District of Tennessee found that Circle C's underpayment tainted all of the work under the contract and rendered the performance worthless. *U.S. ex rel. Wall v. Circle C Constr.*, 43 F. Supp. 3d 853, 873 (M.D. Tenn. 2014). Thus, according to the district court, the Government was entitled to treble damages on the full value of all services rendered, or $777,894.

On appeal, the Sixth Circuit rejected the Government's argument that it would have withheld all payments to Circle C had it known about the

underpayments, noting that the applicable DBA regulations required only that the Government withhold "an amount equal to the estimated wage underpayment and estimated liquidated damages." *Wall*, 813 F.3d at 618. The court quickly dispatched with the Government's tainted goods theory, writing that:

> The government's theory in support of that award is that all of the electrical work, in all of these warehouses, is "tainted" by the $9,900 underpayment—and therefore worthless. The problem with that theory is that, in all of these warehouses, the government turns on the lights every day.

Id. at 617. The Sixth Circuit highlighted the importance of evaluating the actual value of the goods received rather than the "fairyland" damages that the Government sought to recover. Id. at 618. The court said that the relevant question is not whether the Government would have suspended payment in a hypothetical scenario, but rather whether the Government actually got less value than what it bargained for. Id. Here, the Government bargained for two things: (1) the electrical work in the buildings, and (2) payment of DBA wages. Id. at 617. The Government received the electrical work, but not all of the wages. Id. As a result, the difference between what the Government bargained for and what it actually received was $9,916, or the value of the underpayment. Id. at 618.

Application of the Taint Theory—The benefit-of-the-bargain principle is easy to apply in cases like *Wall* in which the market value of the goods and services is easy to calculate, but what about cases in which the claim for payment is tainted because the Government has been fraudulently induced into entering into a contract or has been denied an intangible societal goal such as increasing small business participation? Both the concurrence and majority opinions in *Wall* tee up this question—without providing an answer—by posing a hypothetical: What standard should a court use to determine damages if a contractor delivers computer chips, which the Government installs and uses, but the Government later discovers that the chips were illegally imported from Iran?

Building on the hypothetical posed by the Sixth Circuit, let us assume that the Government has paid $10 million for the computer chips, the contractor issues a single invoice and delivers the chips which—other than the Iran sourcing violation—perform according to specifications. In this hypothetical, plaintiffs argue that the claim for payment is tainted because the contractor violated an essential condition for payment, and so the full value of the contract should be used as the basis of determining damages ($10 million x 3 = $30 million). Under plaintiff's theory, the value of what was actually delivered ($10 million worth of computer chips) can be deducted *after* the trebling occurs ($30 million - $10 million = $20 million).

Therefore, under the Government's theory, defendant should be liable for $20 million in damages plus penalties of $5,500–$11,000 per false claim. In contrast, defendant argues that the Government received tangible, valuable goods under the contract, and so the Government's actual damages are zero. Presumably, the contractor would still be on the hook for penalties, but in the hypothetical there has been only one invoice and so, at most, the contractor would be liable for only $11,000. No doubt, the Government would argue that such a paltry penalty is insufficient to dissuade the hypothetical contractor from sourcing less-expensive computer chips from Iran. But is holding the contractor liable for $20 million the right outcome when the computer chips have been delivered? Grappling with such questions is where the rubber meets the road and courts have reached different conclusions.

Given the $20 million variance between the two approaches described above, it comes as no surprise that plaintiffs are increasingly seeking treble damages based on the full value of the contract under the tainted claim theory. Consistent with the act's goal of ferreting out fraud and returning federal monies to taxpayer-funded programs, Government attorneys pursue their mandate by seeking the largest recovery supportable by law. Similarly, whistleblowers (referred to as relators under the FCA) have strong financial incentives to push for extensive damages because their bounty is tied to the amount of the Government's recovery. To the defense bar and industry, such recoveries—in cases where goods and services were delivered—seem like a windfall. The following sections discuss four areas in which the Government and relators have argued for the full contract value under a tainted claim theory—and where courts have reached different results: (1) small business fraud, (2) fraudulent inducement, (3) Trade Agreements Act, and (4) organizational conflicts of interest (OCIs).

Small Business Fraud—In *U.S. ex rel. Longhi v. Lithium Power Techs.*, 575 F.3d 458 (5th Cir. 2009); 51

GC ¶ 277, the Fifth Circuit found that defendants misrepresented their eligibility to receive federal grants under the Small Business Innovation Research program. Lithium Power Technologies' grant itself provided no direct benefit to the Government, but there was clear harm to the Government's public policy objectives—i.e., defendant had frustrated a societal goal of increasing small business participation because it was not qualified for the set-aside. As the court noted, it is impossible to quantify the intangible societal goal of awarding money to deserving small businesses. The court reasoned that "[t]he Government's benefit of the bargain was to award money to eligible small businesses," and that is what the defendant denied to the Government. Id. at 473. Thus, the court concluded that because the Government received no benefit from the bargain, the damages consisted of all payments made under the grant.

Notably, the Fifth Circuit distinguished the research grant cases from "standard procurement contract" cases in which there is a tangible benefit to the Government. Id. Despite this recognized distinction, *Longhi* has become a favorite case for relators and the Government, even outside of the small business context, when arguing that courts should use the full value of the contract when determining damages. It is also worth noting that a year after *Longhi* was decided, the Government's negotiating position in small business contracting fraud cases was strengthened in light of the Small Business Jobs Act of 2010, which created a presumption of loss to the Government equal to the amount expended on the contract. 15 USCA § 632 (w).

Fraudulent Inducement—In *U.S. ex rel. Magee v. Knesel,* et al., the Government alleged that defendants, including Science Applications International Corp. (SAIC), were awarded a task order after obtaining advance access to non-public procurement information that was not provided to other potential bidders. First Amended Complaint, No. 1:09-cv-324, 2009 WL 2029783 (S.D. Miss. July 6, 2009).

When the FCA case was litigated, defendants had been performing under the $116 million contract for four years, but the Government argued that the benefit-of-the-bargain rule should not apply because the Government would never have agreed to the contract *but for* the defendant's fraud. Because all of the work was tainted by the underlying fraud, the proper measure of damages was to use the entire amount the Government paid—$116 million. In a motion for partial summary judgment as to damages, SAIC argued that the Government had to prove that the amount the Government paid to defendant exceeded the value of the goods and services provided. See Defendant SAIC's Memorandum of Points and Authorities in Support of its Motion for Partial Summary Judgment as to Damages, *U.S. ex. rel. Magee v. Lockheed Martin Corp.*, 2010 WL 4626043 (S.D. Miss. Nov. 15, 2010). The court denied defendant's motion and concluded that it was not appropriate to deduct any benefit received before trebling the damages. Dkt. No. 559. Facing staggering damages if it lost at trial, SAIC opted to settle the case for $20.4 million.

Trade Agreements Act—In *U.S. ex rel. Liotine v. CDW Gov't, Inc.,* 2012 WL 2807040 (S.D. Ill. July 10, 2012), a relator alleged that the defendant GSA schedule-holder had violated the Trade Agreements Act (TAA) by misrepresenting the country of origin of products. In a motion for partial summary judgment, the defendant argued that the Government suffered "no damages" as a result of the noncompliant sales because the proper measure of damages was the monetary difference between what the Government contracted for and what it received.

In response, the Government—which had not intervened—filed a statement of interest in which it argued that when a contractor violates a core precondition for payment that relates directly to the contractor's eligibility to supply a particular good or service, nothing is due to the contractor, regardless of whether goods or services were provided. Accordingly, the Government argued that the appropriate measure of damages to the Government would be the full value of any amount paid under the contract. After the court denied defendant's motion for partial summary judgment, the defendant settled the case for $5.6 million.

OCIs—In *U.S. v. Sci. Applications Int'l Corp*., 626 F.3d 1257 (D.C. Cir. 2010), the Government alleged that SAIC failed to make disclosures of OCIs as required under two contracts that SAIC entered into with the Nuclear Regulatory Commission. The district court instructed the jury that when assessing damages, the jury should not attempt to account for the value of the services that SAIC provided. On appeal, the D.C. Circuit reversed, holding that "the proper measure of damages is the difference between the value of the goods or services actually provided by the contractor and the value the goods and services would have had to the Government had they been delivered as promised." Id. at 1278. In other words, the value of the services received and used must be included in the calculation.

Conclusion—The full impact of the Sixth Circuit's decision in *Wall* remains to be seen. Defendants will rely on the case if plaintiffs claim damages based on the full value of the contact even though the market value of the actual injury is ascertainable. In such cases, it is clear that plaintiffs should not be allowed to recover a windfall.

But in cases of fraudulent inducement or cases in which the value of the injury to the public is nebulous, plaintiffs will continue to use the tainted claim theory to argue for the full value of the contract. Such a posture is most likely to be effective in settlement talks because, as seen in the *Liotine* and *Magee* cases, contractors face enormous exposure in cases when they could be on the hook for three times the contract value. Contractors will sometimes settle these cases before trial because there is simply too much litigation risk to let the case proceed to a decision on the merits.

Although the Government may aggressively push this position in settlement talks, it likely also has concerns about having the "tainted claim" damages theory tested in the courts. Certainly, the Department of Justice will want to avoid creating more precedent like the Sixth Circuit's unfettered criticism of the Government's "fairyland" damages theory in *Wall*. Moreover, proving harm to the Government will present practical challenges for plaintiffs and defendants alike if courts adopt the D.C. Circuit's proposition from *SAIC* that delivered goods or services still have some value to the Government even if there is some "taint" associated with an undisclosed OCI or TAA violation. Such a standard puts the Government in the difficult position of trying to put on evidence and expert testimony to determine the market value of tainted goods.

Returning to the hypothetical posed in *Wall*, how does one determine the market value of computer chips illegally purchased from Iran? Given how much is at stake for both the Government and defendants in these tainted claim cases—and the incentives for both sides to settle—it may be some time before that question gets answered.

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