FEATURE COMMENT: Ex Rel. Wall—Another Piece Of The Puzzle: The Sixth Circuit Applies Benefit-Of-The-Bargain Analysis To Calculate FCA Damages

In a refreshingly witty and succinct opinion issued in February, the U.S. Court of Appeals for the Sixth Circuit rebuked yet another attempt by the Government in a False Claims Act case to dub the contractor's performance worthless and recover three times the total amount paid under the contract. In the first paragraph of the three page opinion, the majority rejected the Government's position that FCA damages automatically equal the full value paid for performance, and limited damages to the difference between the market value of the performance the contractor promised and the value actually provided:

Samuel Johnson would have had little patience for this case. Johnson once responded to the metaphysics of George Berkeley—a contemporary English philosopher who argued that matter has no existence—by kicking a large stone and declaring, “I refute it thus.” One can do rather the same thing with the Government’s theory here. The defendant, Circle C, is a contractor that built several dozen warehouses at an Army base. In doing so, over the course of seven years, the contractor (actually a subcontractor) paid a handful of electricians about $9,900 less than the Davis-Bacon wages specified in its contract with the Army. As a remedy for that underpayment, the government sought and obtained a damages award of $763,000. 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. We reject the government’s theory, reverse the damage award, and remand for entry of an award of $14,748.


By engaging in this benefit-of-the-bargain analysis, the Sixth Circuit adhered to the U.S. Supreme Court’s precedent set forth in U.S. v. Bornstein, 423 U.S. 303 (1976), and reiterated by the District of Columbia Circuit in U.S. v. Science Applications Int’l Corp., 626 F.3d 1257 (D.C. Cir. 2010); 53 GC ¶ 25.

This outcome is a step in the right direction toward reining in the Government’s and qui tam relators’ efforts to obtain treble damages based on the entire value of a contract, grant or benefit program. Nonetheless, Wall does not invalidate the viability of future arguments that damages are equal to the entire value of performance, and, unfortunately, the majority does not provide a clear rule to determine which damages theory will apply in any given case.

This Feature Comment provides context for the competing damages theories at issue in Wall and analyzes the majority and concurring opinions in that case for indications of how Wall may affect future FCA litigation. Given the much-anticipated Supreme Court decision in Universal Health Servs., Inc. v. U.S. ex rel. Escobar, 136 S.Ct. 582 (Dec. 4, 2015), which could trigger more FCA cases brought under the implied certification theory, it is particularly important for contractors and grantees to understand how courts may calculate damages under the FCA. Wall is not a definite answer to that question, but it is another piece of the puzzle.

FCA Damages: Benefit-of-the-Bargain v. Fraudulent Inducement—In Bornstein, the Supreme Court established a benefit-of-the-bargain analysis for determining damages in FCA cases, under which the Government’s damages are equal to the difference in market value between what the Government contracted for and what it ultimately
received. That calculation was relatively simple in Bornstein because that case involved the delivery of radio kits containing electron tubes that were worth less than the electron tubes required by the contract. 423 U.S. at 307, 313-14. In many FCA cases, it is not as easy to calculate the difference in value between what the contract required and what the Government received.

In cases following Bornstein, many courts accepted arguments by the Government and relators that their actual damages were equal to the full amount that the Government paid under the contract. Such an argument rests on a theory of fraudulent inducement—i.e., but for the fraud, the Government would not have paid anything for the goods and services provided. Stated another way, the Government argues that the false claim taints the entire value of performance. This makes calculating damages very simple: Treble the entire amount the Government paid under the contract. Of course, this approach often results in a recovery that is exponentially greater than the value of the contractor’s or grantee’s failure to perform.

Several circuits have applied the fraudulent inducement theory, particularly in cases in which the Government did not bargain for any direct, tangible benefit, but instead provided federal funds for the benefit of a third party. For example, an oft-cited case to support the fraudulent inducement theory involved the defendants’ misrepresentations about eligibility to receive federal grants under the Small Business Innovation Research (SBIR) program. U.S. ex rel. Longhi v. Lithium Power Techs., 575 F.3d 458 (5th Cir. 2009); 51 GC ¶ 277.

In Longhi, the Fifth Circuit agreed with the Government that even though the defendants completed the research they were required to perform, their false claims caused $1.6 million in SBIR funding to be “siphoned off by a company with ‘dubious qualifications’ and ... the funding should have gone to a better-qualified candidate.” Id. at 472. The court reasoned that the “government’s benefit of the bargain was to award money to eligible deserving small businesses,” and “where there is no tangible benefit to the government and the intangible benefit is impossible to calculate, it is appropriate to value damages in the amount the government actually paid to the Defendants.” Id. at 473.

Other circuits have applied the reasoning from Longhi in analogous cases in which the Government did not contract for any direct, tangible benefit—particularly in the Medicaid and Medicare contexts. See, e.g., U.S. v. Rogan, 517 F.3d 449, 453 (7th Cir. 2008) (affirming damages equal to entire amount of Medicaid and Medicare reimbursements because patient referrals violated the Stark Amendment to the Medicare Act and the Anti-Kickback Act, reasoning that the “government offers a subsidy ... with conditions. When the conditions are not satisfied, nothing is due.”); U.S. v. Mackby, 339 F.3d 1013, 1018–19 (9th Cir. 2003) (finding actual damages equal to full amount of Medicare reimbursements because the clinic falsely certified that it was supervised by a physician, applying the rule that “the measure of the government's damages [under the FCA] 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”) (internal quotations and citations omitted); 45 GC ¶ 355.

The fraudulent inducement theory has also been applied in more traditional Government contract cases in which the Government did contract for a tangible benefit. In U.S. ex rel. Compton v. Midwest Specialties, Inc., 142 F.3d 296 (6th Cir. 1998), the contractor delivered defective brake-shoe kits to the Army. The Sixth Circuit accepted the Government’s argument that the brake-shoe kits were worthless because none of them came with the needed quality assurance, and held that “the value of the goods promised (about $1.3 million) less the value received by the government (zero) equals the contract price.” Id. at 304, 305. Justifying this result, the Court explained that calculating damages using a setoff based on the value the Government purportedly received under the contract would create a perverse incentive system in which government contractors could endanger the lives of American soldiers by providing substandard materiel, and the Army would be deterred from correcting the danger because it would be forced to bear the cost of any use it received from the substandard goods before their defects were discovered.

Id. at 305 n.8.

Five years after ex rel. Compton, in U.S. ex rel. Roby v. Boeing Co., 302 F.3d 637 (6th Cir. 2002), 44 GC ¶ 382, the Sixth Circuit again found that the contractor’s defective performance resulted in damages equal to the entire value of the contract. Boeing delivered a remanufactured helicopter with a defective transmission gear that flew only for 56 of the minimum required 200 flight hours, and the Sixth Circuit upheld the trial court’s determination that the value the Government received was zero: “The fact that every component but one conformed to contract requirements is not legally
significant when the defective gear was ‘flight critical’ and thus necessary for flight.” Id. at 647.

In 2010, the D.C. Circuit declined to follow this reasoning and reaffirmed the benefit-of-the-bargain analysis that the Supreme Court expressed in Bornstein. In SAIC, the Government alleged that the defendant made implied false certifications that it did not have any organizational conflicts of interest (OCIs). 626 F.3d at 1261. The trial court imposed damages equal to three times the entire amount of the contract, after instructing the jury that “calculation of damages should not attempt to account for the value of services, if any, that SAIC conferred upon the [Government].” Id. at 1278.

On appeal, SAIC argued that the Government suffered no damages because it received the full value of the services covered by the contract. The D.C. Circuit reversed, stating that “this automatic equation of the government’s payments with its damages is mistaken,” and reaffirmed the need to apply the benefit-of-the-bargain analysis set forth in Bornstein: “To establish damages, the government must show not only that the defendant’s false claims caused the government to make payments that it would have otherwise withheld, but also that the performance the government received was worth less than what it believed it had purchased.” Id. at 1278–79.

In 2015, the Sixth Circuit set the stage for Wall by embracing the D.C. Circuit’s analysis in U.S. v. United Techs., Inc., 782 F.3d 718 (6th Cir. 2015), 57 GC ¶ 115. There, the D.C. Circuit vacated and set aside the trial court’s damages award after determining that the district court did not account for the fair market value of the goods and services the Government received and the role of competition in setting a fair market value.

**Ex rel. Wall**—Circle C, the defendant in Wall, built 42 warehouses at an Army base pursuant to a contract that required it and its subcontractors to pay employees wages in accordance with the Davis-Bacon Act. *Ex rel. Wall*, 2016 WL 423750 at *1. The contract also required weekly compliance statements certifying, among other things, that employees were being paid as required. Id. One of Circle C’s subcontractors for electrical work underpaid some of its electricians by three dollars an hour, resulting in a total underpayment of $9,916. Id. at *1–2. The parties did not dispute that the underpayments rendered false a number of Circle C’s compliance statements and thus created liability under the FCA. Id. at *1.

To establish its damages, the Government argued that Circle C’s fraudulent claims “tainted” the entire value of the electrical work that the subcontractor improperly paid, and thus rendered all of the electrical work worthless. Id. at *1. The district court agreed and held that the Government’s actual damages were equal to the total amount the Government paid Circle C for electric work attributable to the subcontractor that violated the Davis-Bacon Act: $259,298.18. Id. When trebled and adjusted for partial settlement payments, the total judgment equaled $762,894.54. Id.

The Sixth Circuit reversed, finding that the trial court abused its discretion when calculating damages. The Court explained that the FCA allows for recovery of three times “actual damages,” and that “actual damages” are “the difference in value between what the government bargained for and what the government received.” Id. The majority then reasoned, the government bargained for two things: the buildings, and payment of Davis-Bacon wages. It got the buildings but not quite all of the wages. The shortfall was $9,916. That amount is the government’s actual damages. Id. In doing so, the majority rejected the Government’s assertions that the false certifications rendered the entire electrical work valueless, and concluded that the Government’s claim was “belied by the government’s own conduct in using the buildings.” Id. at *2.

The majority also dismissed the idea that the Government would have suspended its payments had it known about the underpayments. Id. The Court explained that when determining actual damages, “the relevant question is not whether in some hypothetical scenario the government would have withheld payment, but rather, more prosaically, whether the government in fact got less value than it bargained for.” Id.

The concurrence took exception to the majority’s focus on the fact that the Government was using the electricity in the warehouses. It proffered instead that the “reason that such damages [full contract performance] are not proper in the case before us is not that the goods are still being used, but instead that it is easy to place a market value on Davis-Bacon Act damages in particular.” Id. at *3.

**Analysis of Wall**—The majority’s reasoning in Wall is in line with the D.C. Circuit’s opinion in SAIC, but it does not overrule previous Sixth Circuit opinions like *ex rel. Compton* and *ex rel. Roby*, discussed above, which do calculate damages using the fraudulent inducement theory. Instead, the majority and concurring opinions focus on the facts to distinguish Wall from circumstances in which a false claim
arguably may result in actual damages equal to the full amount paid. To make this distinction, the Court explained that, in Wall, the Government received the goods and services that it asked for, as opposed to goods and services either rendered technically defective and thus useless, or provided in a morally repugnant manner:

This case is not like {ex rel. Compton}, where the contractor delivered defective brake-shoe kits for jeeps, or {ex rel. Roby}, where the contractor delivered a helicopter with a defective transmission that caused it to crash. In those cases the goods were worthless because they were dangerous to use. Nor is this case one where some unalterable moral taint makes the goods worthless to the government. Suppose that, contrary to the contract’s terms, a contractor delivers uniforms manufactured by child laborers in Indonesia or silicon chips shipped from Iran. In those cases no award of money damages could remedy the contractors’ breach. But here they can: the contract required Circle C to pay electricians $19 per hour, [the subcontractor] paid them only $16—and simply writing a check can make up the difference. Money damages provide a remedy for this sort of breach every day.

Ex rel. Wall, 2016 WL 423750 at *3. The majority seems to have created a test for calculating damages that turns on whether “some unalterable moral taint makes the goods worthless to the government”—compelling rhetoric, perhaps, but not an easily workable rule. Id. Possibly seeking to limit the scope of the majority’s holding, the concurrence focused on the ability to calculate the market value of the Government’s injury, and suggested that the rest of the majority’s reasoning is dicta:

[T]he market value of the public harm can be precisely ascertained: it is the amount of additional wages that should have been paid. There is no need to hypothesize prior nonacceptance of the goods or services in order to compensate the government for the public harm.

This contrasts with cases like the majority’s example of computer chips from Iran. It may not be possible as a practical matter to remove and return the chips, and the government may still be using the chips every day. The chips are not defective like the jeep or helicopter parts in the cases distinguished by the majority. Another example would be the provision of a service, such as driving a truck without a required license (it is hard to undrive a truck). In such cases, the measure of damages may well be the amount that the government would have refused to pay if it had known in time, because there is no easily ascertainable alternative like the amount of extra pay owed under the Davis-Bacon Act.

The difference here is not so much that trade with Iran is immoral, any more than driving without a proper license is immoral. Instead, the difference has to do with the extent to which the value of the injury to the public is calculable in terms of market value. My concern is that the majority opinion might be read to suggest more generally that the price of irreversibly provided goods or services—because still in use—cannot be the measure of False Claims Act damages. Such a suggestion would not be necessary to our holding.

Id. The concurrence would limit the effect of the majority’s holding, only limiting the Government’s actual damages to the difference between the value it received and the value it bargained for in those cases in which the market value of that difference is readily calculable. Id. While not binding, the concurrence provides future plaintiffs and courts with the blueprint for an argument to limit the majority’s reasoning.

Conclusion—Although the Sixth Circuit’s willingness to point out the Government’s overreaching in Wall is a step in the right direction, we are at best cautiously optimistic that the Wall opinion will meaningfully limit the Government’s ability to assert damages equal to the full amount paid for performance. Without a clear rule from the majority, the Government will be able to make arguments that distinguish future cases from Wall based on the facts.

The concurring opinion provides a blueprint to do just that: The underpayments in Wall made it extremely easy to calculate the market value of the difference between what the Government bargained for and what it received. That may not be true in some FCA cases. As such, contractors and grantees operating with federal funds should think twice before reading Wall to substantially reduce the cost of FCA liability.

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