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Seventh Circuit Reins in Justice Department's Overreaching False Claims Act Damages Theory

For several years, the Justice Department has been advocating for and employing a harsh and aggressive False Claims Act ("FCA") damages methodology that distorts the government's actual damages and leads to unwarranted FCA recoveries. In particular, the Justice Department's preferred methodology calculates FCA damages by *first* trebling the (false) claim amount and *only then* deducting the value of the goods or services provided. This "gross trebling" approach leads to phantom damages since it severely diminishes the value of any benefit obtained by the government. The proper approach – one that takes into account the actual damages sustained due to the FCA violation – is a "net trebling" methodology, which accounts for the benefit *prior to* trebling.

On March 21, 2013, the Seventh Circuit decisively rejected the Justice Department's methodology, making clear that FCA damages are calculated based on the government's trebled *net* loss, not its trebled *gross* loss. *See United States v. Anchor Mortgage Corp.*, No. 10-3122, 2013 WL 1150213 (7th Cir. 2013). The Seventh Circuit ruled that the Justice Department's position is not supported by statutory language or policy and is based on a misreading of *United States v. Bornstein*, 423 U.S. 303 (1976), setting up a clearer circuit split on this issue, given the Ninth Circuit's decision in *United States v. Eghbal*, 548 F.3d 1281 (9th Cir. 2008).

The Seventh Circuit's outright rejection of the Justice Department's gross trebling approach, and its careful reading and well-reasoned reaffirmation of *Bornstein*, are sound. The net trebling approach adopted by the Seventh Circuit should be applied in FCA cases where the government has received some benefit from the defendant, whether that benefit comes from the inherent value of property transferred to the government, goods or services provided, or other offset, recovery, and/or mitigation.

The Seventh Circuit's Careful and Correct Reading of Bornstein

The scenario in *Anchor Mortgage* is straightforward. Having found Anchor Mortgage Corporation and its CEO liable under the FCA for making false statements to HUD/FHA relating to federally guaranteed mortgage loans, the district court had to assess FCA damages. The FCA provides for both a statutory penalty "plus 3 times the amount of damages which the Government sustains because of" the violation. 31 U.S.C. § 3729(a)(1). The district court calculated damages by trebling the amounts paid by the government on the defaulted loans and then deducting the proceeds recovered from the sale of the mortgaged properties. On appeal, the defendants argued that the district court should have credited the proceeds from the sales of mortgaged properties before, rather than after, trebling. The Seventh Circuit agreed with defendants on this aspect of the appeal, rejecting the district court's gross trebling approach.

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The Seventh Circuit's analysis began with a confirmation that no FCA language or policy supported departure from the norm in civil litigation, where damages are based on net loss. Next, the Seventh Circuit analyzed *Bornstein* and rejected the Justice Department's reading of it. The appellate court found that the Supreme Court had held that *third party settlement payments* should be subtracted after applying the FCA multiplier, but that the government's actual damages vis-à-vis an FCA *defendant* are appropriately measured by the difference between the market value received and the market value promised, supporting the net trebling approach. *Anchor Mortgage Corp*., 2013 WL 1150213, at *3 (citing *Bornstein*, 423 U.S. 303, 317 n. 13). The Seventh Circuit refused to follow the Ninth Circuit's *Eghbal* decision, noting that the Ninth Circuit had failed to mention note 13 in *Bornstein*, and chose instead to find support in several post-*Bornstein* appellate decisions – including the Second Circuit's recent decision in *United States ex rel. Feldman v. Van Gorp*, 697 F.3d 78 (2d Cir. 2012) – that generally use a net trebling approach. 2013 WL 1150213, at *4.

The Seventh Circuit remanded the case to the district court, instructing it to recalculate the award using the net trebling approach.

The Drastic Reduction in Trebled Damages under the Net Trebling Approach

The damages differential between the gross and net trebling approaches is dramatic, as shown by one of the loans at issue in *Anchor Mortgage*. In the particular example examined by the Seventh Circuit, the government paid $131,643.05 on the guaranty of a particular loan, and recovered $68,200 on the subsequent sale of the mortgaged property.

Under the **gross trebling approach**, FCA trebled damages would be **$326,729.15**:

- Treble the government's guaranty payment ($131,643.05 x 3 = $394,929.15).
- Subtract the credit received ($394,929.15 - $68,200 = $326,729.15).
- FCA trebled damages are $326,729.15.

Under the **net trebling approach**, FCA trebled damages would be **$190,329.15**:

- Subtract the credit received from the government's guaranty payment ($131,643.05 - $68,200 = $63,443.05).
- Treble the remaining balance ($63,443.05 x 3 = $190,329.15).
- FCA trebled damages are $190,329.15.

Using the gross trebling approach rejected by the Seventh Circuit, the FCA damages in this single example are $136,400 greater than they would be using the net trebling approach. The district court originally and erroneously assessed FCA treble damages as approximately $2.7 million. Applying the proper net trebling methodology to the remainder of the loans at issue in *Anchor Mortgage* will result in a substantial reduction in the judgment amount.

This is clearly the right result in FCA cases where the government received some benefit from the defendant notwithstanding the FCA violation. FCA single damages should reflect the actual loss sustained by the government, which must take into account any benefit the government received. By ensuring that the value of the benefit is applied prior to trebling, actual damages are not distorted (beyond the statutory trebling).

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