Portfolio Media. Inc. | 860 Broadway, 6th Floor | New York, NY 10003 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

FCA Allows Treble Damages — 'But Treble What?'

Law360, New York (March 26, 2013, 11:22 AM ET) -- The False Claims Act authorizes the United States — and whistleblowers suing on its behalf — to seek civil penalties plus "treble damages" for a violation of the FCA. The ability to seek treble damages is a key feature of the law, and one that makes the statute particularly attractive to the Justice Department and to whistleblowers, who stand to gain up to 30 percent of the government's recovery.

And yet few courts have asked the simple question that one court posed recently: "But treble what?" In United States v. Anchor Mortgage Corporation[1], the Court of Appeals for the Seventh Circuit answered that key question, and resoundingly rejected the Justice Department's longstanding approach to calculating damages in FCA cases. The implications of this decision for financial institutions and others facing False Claims Act liability are significant.

In Anchor Mortgage, the Justice Department sued a mortgage lender and its CEO for making false statements to the U.S. Department of Housing and Urban Development (HUD) in connection with residential mortgage loans originated and insured under the Federal Housing Administration's (FHA's) direct endorsement program. After trial, the court found that the defendants provided false information and/or violated HUD guidelines for 11 defaulted mortgage loans, and awarded civil penalties plus treble damages to the government.

To calculate the government's damages, the court totaled the amounts that HUD had paid the lender under the government's guarantees, multiplied that figure times three, and then subtracted the amounts (where applicable) that HUD had realized by the date of trial from selling the properties that secured the loans. In other words, the court trebled the government's loss before subtracting any recoveries — a "gross trebling" approach to damages.

An example from one of the loans in the case illustrates the court's approach. After a property on King Henry Drive in Popular Grove, Ill., defaulted, the government paid $131,643 on its guarantee, and later sold the property for $68,200. HUD's original (gross) loss was $131,643, but its net loss — taking into account its $68,200 recovery from its sale of the insured property — was only $63,443. At the government's urging, the trial court trebled the gross amount (i.e., $131,643 x 3 = $394,929), and only then subtracted the $68,200 recovery, resulting in a treble damages award of $326,729, to which it then added civil penalties. The trial court applied that method to the other 10 loans in the case, subtracting recoveries from the sale of properties only after trebling the amount of the guarantee payments. For those properties that HUD has not sold, the court subtracted nothing from the gross amount.

This “gross trebling” method accords with the Justice Department and HUD’s long-standing approach to damages in False Claims Act cases, and has been the prevailing method for calculating treble damage awards in FCA cases. According to the Justice Department, the “gross trebling” method was adopted by the Supreme Court a generation ago in United States v. Bornstein[2], in which the court reasoned that FCA “damages should be [multiplied] before any compensatory payments are deducted, because that method of computation most faithfully conforms to the language and purpose of the Act.”

In fact, the Supreme Court observed in Bornstein that the False Claims Act “speaks in terms of [multiplying] ‘damages’ not [multiplying] ‘net damages’ or ‘uncompensated damages.’” The Justice Department and the courts have applied Bornstein and its “gross trebling” approach in a variety of contexts, including not only mortgage lending but also alleged fraud in government contracting and procurement, health care, subsidies and small business loans. On the strength of this language, the government has viewed the issue as settled. And until now, many defendants had, too.

The court in Anchor Mortgage, however, bucked the conventional wisdom last week, boldly disagreeing with the Justice Department and perhaps taking on the Supreme Court itself. In an opinion by Chief Judge Frank Easterbrook, the court in Anchor Mortgage flatly rejected the government’s “gross trebling” method of calculating damages, adopting instead a “net trebling” approach as the proper method in False Claims Act cases.

The court was not persuaded by the language quoted above from Bornstein. According to Judge Easterbrook, damages in civil cases (such as breach of contract) are traditionally calculated based on the net loss to the plaintiff, and Bornstein and the majority of courts calculating damages in False Claims Act cases apply a contract measure of damages.

The court also rejected the trial judge’s decision to assign no value to the properties that had not been sold, noting that courts routinely determine the value of “off the market” real property. Accordingly, the court sent the case back to the trial court with instructions to apply the “net trebling” method, with the government’s single damages (before trebling) equal to “the amount paid on the guarantee less the value of the collateral, whether or not the agency has chosen to retain the collateral.”

The difference between “net trebling” and “gross trebling” is significant. In the Anchor Mortgage case, the damages under a “net trebling” approach for the same property equate to a difference of more than $136,000 — nearly 40 percent less than that afforded by the trial court’s approach. Consider the outcome of the gross trebling methodology compared to that produced by a net trebling methodology side-by-side:

Trial Court’s Gross Trebling
Calculation: (131,643 x 3) - 68,200

Total: 326,729

Appellate Court’s Net Trebling

Calculation: (131,643 - 68,200) x 3
Total: 190,329

Also, when the trial court recalculates damages for all 11 loans at issue, it must now assign a value to four of those 11 properties that HUD still owns, and then subtract those amounts before trebling.

The implications of the Anchor Mortgage decision are even greater when you consider that the Justice Department has recently sued financial institutions not over a dozen loans, but thousands of loans. In 2011, the Justice Department sued one mortgage lender under the False Claims Act alleging false certifications of insurance eligibility in connection with 3,200 defaulted mortgage loans that led to $368 million in claims paid by HUD.[3]

Treble damages under a "gross trebling" approach in that case would have led to a number exceeding $1.1 billion before reducing for recoveries. That case settled for $202 million. Since then, the government has filed similar False Claims Act cases against mortgage lenders, also alleging false certifications in connection with thousands of defaulted loans and seeking hundreds of millions of dollars in damages.[4]

If the courts in cases like these follow the Seventh Circuit's approach in Anchor Mortgage, the potential damages in these cases may be reduced substantially. Likewise, the government will need to assign market values to the thousands of properties that have not been sold at the time of trial — a substantial undertaking in its own right.

It remains to be seen, however, whether the Seventh Circuit's approach to damages in Anchor Mortgage will turn out to be an outlier or a trend-setter. The Justice Department may well decide that the issue is important enough to take to the Supreme Court. As it stands, the Ninth Circuit is on record in favor of "gross trebling," relying unquestioningly on the Supreme Court's decision in Bornstein.[5]

Anchor Mortgage therefore creates a split in the circuits on an issue of significant importance to the Justice Department. Notably, the Ninth Circuit barely paused over the issue when it was presented to that court, citing Bornstein for the proposition that gross trebling applied — a proposition even the defendants in that case did not seriously dispute. And, in Anchor Mortgage, the government's brief to the trial court spent barely a sentence on the proper calculation of treble damages, resting comfortably on what had appeared to be the settled strength of Bornstein.

The government may rest comfortably no longer. With the question of "treble what?" now squarely framed by the Seventh Circuit, other courts — and defense counsel — are likely to hesitate before acceding to the government's "gross trebling" approach so quickly. In the meantime, expect whistleblowers and the government to file their FCA cases as far outside of the Seventh Circuit as possible.

--By Andrew W. Schilling, Ross E. Morrison and Michelle L. Rogers, BuckleySandler LLP

Andrew Schilling is a partner with BuckleySandler and leads the New York office's government enforcement practice. Prior to joining BuckleySandler, Schilling served as chief of the Civil Division at the U.S. Attorney's Office for the Southern District of New York. Ross Morrison is a counsel in the firm's New York office and Michelle Rogers is a counsel in the firm's Washington, D.C., office.

The authors represent entities and individuals facing government enforcement actions and in complex civil litigation, including matters involving the False Claims Act.

The opinions expressed are those of the authors and do not necessarily reflect the views of the firm, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.

[1] Case Nos. 10-3122, 3342 and 3423, 2013 WL 1150213 (7th Cir. Mar. 21, 2013).

[2] 423 U.S. 303, 314 (1976)

[3] United States v. Deutsche Bank, Case No. 11-2976 (S.D.N.Y).

[4] See, e.g., United States v. Citigroup, Inc., Case No. 11-5473 (S.D.N.Y.); United States v. Flagstar Bank, Case No. 12-1392 (S.D.N.Y.); United States v. Allied Home Mortgage Corp., Case No. 11-5443 (S.D.N.Y.); United States v. Wells Fargo Bank, N.A., Case No. 12-7527 (S.D.N.Y.); U.S. ex rel. O'Donnell v.Bank of America Corp et al., Case No. 12-01422 (S.D.N.Y.).

[5] United States v. Eghbal, 548 F.3d 1281 (9thCir. 2008).
