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As the federal government does business in new ways, the False Claims Act increasingly is being used outside the traditional procurement context. These contexts present issues that ultimately could influence the framing and resolution of actions against contractors.

In a recent decision involving allegations of falsified small business status in connection with an auction of Federal Communications Commission spectrum licenses, a federal district court rejected the qui tam relator's claim for disgorgement of profits as an element of damages under the act. This analysis discusses that decision, and its possible implications for other cases involving the purchase of property from the government.

DISGORGEMENT OF PROFITS IS NOT AVAILABLE AS DAMAGES UNDER THE FALSE CLAIMS ACT

BY LANNY A. BREUER, SARAH L. WILSON, AND BENJAMIN J. RAZI *

A novel application of the False Claims Act (''FCA'') to Federal Communications Commission (''FCC'') spectrum licensing has yielded one of the most significant damages decisions under the statute in recent years. In *United States ex rel. Taylor v. Gabelli,*[1] a *qui tam* relator alleged that defendants fraudulently certified their small business status in order to bid on discounted spectrum licenses. After winning spectrum licenses at FCC auctions, the defendants sold several of the licenses at a substantial profit to other telecommunications companies. The trebled value of the sales profits accounted for more than half of the relator's purportedly highest-ever $1.2 billion dollar damages claim.

In a landmark decision, Judge Paul A. Crotty of the U.S. District Court for the Southern District of New York held that the FCA does not grant *qui tam* relators the remedy of disgorgement of sales profits. Judge Crotty relied on the express language of the statute, which limits single damage awards to ''damages which the Government sustains,'' and on the clear distinction in the law of remedies between restitution or unjust enrichment and damages.

[1] *United States ex rel. Taylor v. Gabelli, et al.*, No. 03 Civ. 8762 (S.D.N.Y., Nov. 4, 2005) .

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The decision suggests that courts' flexibility in fashioning remedies under the FCA is not unlimited, but rather is limited by the text of the statute and first principles of remedies law. The decision has important implications for FCA cases involving the resale or transfer of government-awarded property, leases, contracts, and benefits.

As the reach of the FCA is extended to regulatory decisions beyond the fields of procurement and health care, legal challenges to the scope of recoverable damages in FCA cases will likely proliferate. For example, litigants may challenge government disgorgement requests in light of the punitive and restorative purposes of the False Claims Act's trebling provision and statutory penalties.

I. Overview of the Case

United States ex. rel. Taylor v. Gabelli is unique in several respects. The case is one of a handful of FCA cases arising from allegedly false small business certifications for the purpose of obtaining preferential treatment from federal government agencies. It constitutes the first extension of the FCA to FCC licensing decisions. And, in fulfillment of the statute's commitment to ''setting a rogue to catch a rogue,'' the *qui tam* ''whistleblower'' in the case is not an insider but rather an outside communications lawyer-turned-graduate student who unsuccessfully bid on licenses in FCC auctions on behalf of other small businesses. Defendants include top money manager and telecommunications investor Mario Gabelli, investment companies owned by Mr. Gabelli, and several dozen individual and corporate entrepreneurs backed by Mr. Gabelli in order to participate in spectrum auctions.

A. FCC Wireless Spectrum Auctions

Since the mid-1990s, the FCC has auctioned wireless spectrum licenses—including licenses for PCS cell phone service—to the highest eligible bidder. The auction program was instituted in response to legislation authorizing the FCC to award spectrum licenses ''through a system of competitive bidding.''[2] Congress also directed the FCC to ''promot[e] economic opportunity and competition . . . by avoiding excessive concentration of licenses and by disseminating licenses among a wide variety of applicants, including small businesses.''[3] The FCC's small business program provides various incentives for small business participation in spectrum auctions, including the reservation of spectrum blocks for ''small businesses and other designated entities with total assets and revenues below certain levels,''[4] and provision of bidding credits and other favorable financing terms to eligible entities.

Recognizing that small businesses lack adequate capital to compete effectively for licenses in the free market, the FCC allows small businesses to partner with financial investors who serve as ''deep pockets'' and ''minority owners.'' Minority investors may substantially fund the cost of the licenses and own 49.9 percent of the small business bidders, as long as the 50.1 percent majority owners maintain *de facto* control of the companies winning licenses. The FCC auctions have been enormously lucrative for the U.S. Treasury, in no small part because most major telecommunications carriers and other institutional investors have partnered with small businesses and bid up prices in highly competitive auctions.

B. The Relator's Allegations and Requests for Relief

According to the relator, the minority investor defendants in fact controlled the businesses but falsely certified that they were eligible for small business preferences. The relator alleged that defendants should have paid full freight rather than discounted rates for the licenses and been excluded from auctions reserved for small businesses. Instead of protesting the FCC's award of the licenses at the time of the relevant auctions (1995-2001), the relator sought three categories of monetary relief in an FCA suit filed years later. First, the relator sought the trebled value of the bidding credits, or discounts on the price of the licenses. Second, he sought the trebled value of government installment financing available to small businesses and extended to two of the defendants.

The relator's third request for monetary relief—disgorgement of profits—was the focus of the court's summary judgment ruling on damages. Subsequent to the auctions in which they won licenses, three of the defendants resold their licenses to other private companies for a combined total of over $200 million. FCC regulations allow secondary-market sales upon certain conditions, including agency approval. The relator claimed that he was entitled to recover three times the amount by which defendants profited as a result of their license sales.

II. Disgorgement Ruling

A. The Defendants' Contentions

In July 2005, defendants moved for summary judgment on the relator's claim for disgorgement of profits as a category of FCA damages. Defendants argued that the plain text of the statute, its legislative history, and governing precedent precluded such relief. The FCA entitles the government to recover ''3 times the amount of damages which the Government sustains because of the [illegal] act.''[5] The statute defines damages in terms of injury to the government rather than gain to a defendant. In defendants' view, the relator's disgorgement claim focused incorrectly on defendants' gains instead of the government's loss.

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Defendants also argued that the FCA's treble damages and penalty provisions compensated the government for any harm it may have suffered from losing out on resale profits. One of the central purposes of treble damages under the FCA is to compensate the govern-

[2] 47 U.S.C. § 309(j)(l).
[3] *Id.* § 309(j)(3)(B).
[4] *FCC v. Nextwave Pers. Communications, Inc.*, 537 U.S. 293, 296 (2003).
[5] 31 U.S.C. § 3729(a).

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ment for the harms it suffers as a result of fraud *in addition to* its actual damages.[6]

Indeed, the statute's trebling provision goes beyond compensatory recovery to ''impose[] damages that are essentially punitive in nature.''[7] The FCA's mandatory statutory penalties also ''address the broad range of ancillary harms—harms apart from the fraud itself—that the Government may have suffered'' and ''compensate the Government for the costs of corruption.''[8] Defendants' position was that any harm the government theoretically could have suffered from defendants' license sales would be more than adequately compensated by the statute's mandatory trebling provision and statutory penalties.

Finally, defendants argued that Congress's explicit rejection of consequential damages in FCA cases in 1986 underscored its intent to limit single damages to the government's actual economic loss. As the Supreme Court has noted, ''[t]he Senate version of the [1986 Amendments] proposed consequential damages on top of treble damages, while the House version proposed consequential damages plus double damages. . . . Ultimately, the Senate's treble figure was adopted and the consequential damages provision dropped.''[9] In an FCA case, ''consequential damages'' are those damages ''that do not flow directly from the submission of the false claim, but rather from some consequence or result, which itself arises from the submission of the false claim.''[10]

B. The Relator's Contentions

The relator asserted two arguments in support of his request for trebled sales profits. *First*, he argued that defendants' sale proceeds are a standard measure of damages in non-FCA cases involving fraud by a buyer (as opposed to a seller). Relying on a series of securities law cases, the relator argued that courts have repeatedly looked to the amount of the buyer's resale profit in calculating the damage to the defrauded party. Because the FCA is designed to make the government whole and lacks a ''set formula for determining the Government's actual damages,''[11] the relator contended that the statute permitted a court to award disgorgement damages under the FCA.

Second, the relator alleged that defendants' requests for agency approval of the sales constituted a second set of false claims, and that the sales profits constituted the proper measure of the value of the ''right to resell'' provided by the government in response to these secondary false claims. In other words, the relator assumed that the government would have recouped the resale gains captured by the defendants had the false claims not been made.

C. The Court's Decision

The court's comprehensive opinion relied first and foremost on the difference between compensatory damages and restitutionary disgorgement. ''The law of remedies,'' the court noted, ''strikes a clear distinction between damages—a compensatory form of relief—and restitution—a form of relief that prevents unjust enrichment.''[12] Restitution, unlike damages, is generally considered a form of equitable rather than legal relief, and trial courts may exercise considerable discretion in fashioning equitable relief. Money damages, on the other hand, represent ''the classic form of legal relief,'' and serve to compensate a plaintiff for recognized losses.[13]

Echoing the distinction drawn by defendants, the court observed that ''[d]amages typically focus on the plaintiff and provide 'make-whole,' compensatory, monetary relief; restitution, by contrast, concentrates on the defendant—preventing unjust enrichment, disgorging wrongfully held gains, and restoring them to the plaintiff.''[14]

The court rejected the relator's attempts to characterize the disgorgement of profits as damages, reasoning that the government, ''while perhaps harmed by defendants' unjust enrichment, sustained no actual damages or monetary losses by virtue of the defendants' purportedly wrongful gains.'' [15] The court also rejected the relator's attempt to cast his claim for resale profits as a claim for ''rescissory'' *damages* and thus bring the claim within the plain language of the FCA. Judge Crotty explained that even though the word ''damages'' is part of the term ''rescissory damages,'' such damages ''are inextricably tied to restitution.''[16] In other words, in order for rescissory damages to be available, the remedy of rescission (*i.e.*, the undoing or cancellation of a contract) must be available. Because rescission is an equitable remedy not provided for under the FCA, the court was unpersuaded by the relator's ''rescissory damages'' argument.

Judge Crotty also disagreed with the relator's suggestion that defendants' profits represented a financial loss to the government because the government could have revoked defendants' licenses at the time of resale and reauctioned the licenses. In the court's view, the relator's ''articulation trie[d] to disguise the simple fact that the remedy [he sought] is disgorgement of unjust riches — a 'classic' restitutionary remedy inherently distinct from compensable damages.''[17]

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[6] *See, e.g.*, *United States ex rel. Marcus v. Hess*, 317 U.S. 537, 551-52 (1943) (''[T]he device of double damages [pre-1986 Amendments] plus a specific sum was chosen to make sure the Government would be made completely whole.''); *Cook County v. United States ex rel. Chandler*, 538 U.S. 119, 131 (2003) (''The treble feature thus leaves the remaining double damages to provide elements of make-whole recovery beyond mere recoupment of the fraud.'').

[7] *Vermont Agency of Natural Res. v. United States ex rel. Stevens*, 529 U.S. 765, 784 (2000) (73 FCR 586, 05/23/00).

[8] *Ab-Tech Constr., Inc. v. United States*, 31 Fed. Cl. 429, 435 (Fed. Cl. 1994) (internal citation and quotations omitted).

[9] *Chandler*, 538 U.S. at 131 n.9 (internal citations omitted).

[10] John T. Boese, *Civil False Claims and Qui Tam Actions* § 3.03[A][1], at 3-55 (2d ed. 2003).

[11] *United States v. Killough*, 848 F.2d 1523, 1532 (11th Cir. 1998).

[12] *United States ex rel. Taylor v. Gabelli*, No. 03 Civ. 8762 (PAC), 2005 WL 2978921, at *3 (S.D.N.Y. Nov. 4, 2005).

[13] *Id.* (internal citation omitted).

[14] *Id.* at *4.

[15] *Id.* at *5.

[16] *Id.*

[17] *Id.*

The FCA's comprehensive enforcement scheme supports a strong presumption that non-damages remedies are excluded.

Turning next to the task of statutory interpretation, the court emphasized that the plain language of the FCA provides for ''3 times the amount of *damages which the Government sustains* because of the [fraudulent] act'' and that the term damages is not ambiguous.[18] Following Supreme Court decisions directing lower courts to construe damages provisions narrowly,[19] the court noted that the FCA's comprehensive enforcement scheme supports a strong presumption that non-damages remedies are excluded. The government's ability to pursue administrative remedies or common law unjust enrichment claims rendered it unnecessary, according to the court, ''to resort to an extraordinary and unprecedented interpretation of the Act in order to protect the Government's interests.''[20]

Consistent with the practice of many courts these days, Judge Crotty disavowed the need to rely on legislative history, while, in fact, covering it comprehensively. The court noted that the legislative history is ''replete with references to the remedial purpose of the Act and in particular to recoupment of monetary losses.''[21] Saying that Congress's major amendments to the FCA in 1986 ''did not change the scope of the remedial purpose of the Act: only compensatory damages may be recovered,'' the court found the legislative record ''barren of any suggestion or consideration of disgorgement as an anticipated or expected remedy under the Act.''[22]

The court summed up its reasoning and decision as follows:

> [D]isgorgement of . . . resale profits differs—fundamentally, functionally, and definitionally—from actual damages. The Court must give effect to the clear and unambiguous text of the Act. This Act expressly provides for civil penalties and damages alone—and not for restitution. Moreover, governing precedents have typically construed [the] FCA narrowly—permitting recovery when litigants sought actual damages, denying prejudgment interest, and ultimately looking with disfavor on consequential damages. No court has ever granted restitution—whether as disgorgement of profits or as contribution or indemnification—as a remedy under the Act and this Court declines to do so in this case.[23]

Possible Government Remedy

The issue addressed by the court in *Taylor v. Gabelli* is likely to present itself in other contexts and in other cases involving transfers of government property. Examples of the types of transactions that could give rise to FCA cases with disgorgement issues are military equipment purchases, oil and gas leases, timber purchases, or any transaction in which a buyer purchases property from the government.

The court's ruling substantially reduced the relator's recovery in the *Gabelli* case, yet left open the possibility of government pursuit of unjust enrichment through a separate but consolidated equitable claim. Following the court's ruling, the government moved to intervene a few months before trial on the ground of protecting its interests in disgorgement profits. There has not yet been a ruling on this motion.

[18] *Id.* at *7.
[19] *See id.* at *8.
[20] *Id.*
[21] *Id.* at *12.
[22] *Id.* at *13.
[23] *Id.*