Preventing Loss Miscalculation In Gov't Contract Fraud Cases

By **Jade Chong-Smith** (November 15, 2022)


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Federal prosecutors are increasingly prosecuting government contracting fraud cases. In September, the U.S. Department of Justice announced the establishment of three new strike force teams to enhance its ability to prosecute fraud connected to pandemic relief programs. It has already charged more than 1,500 people for such offenses since the pandemic began.[1]

As prosecutors intensify their focus on contracting fraud, defense attorneys need to be wary of attempts to use inappropriate sentencing guidelines in cases with no actual or intended loss. Prosecutors may seek to invoke the government benefits rule to estimate total gain as an alternative measure of actual loss in these cases.

Invoking the government benefits rule to estimate total gain can result in much higher recommended sentences — but the prosecution's position may rest on an outdated version of the U.S. sentencing guidelines.[2]

The sentencing guidelines provide a base offense level for someone convicted of an economic offense such as larceny, embezzlement or fraud.[3] That base offense level can be increased by the amount of economic loss, resulting in a significantly higher offense level.[4] Ordinarily, such sentencing enhancement is based on actual or intended loss, whichever is greater.[5]

Actual loss is pecuniary harm that results from an offense.[6] It does not include noneconomic harm such as emotional distress or reputational injury. Intended loss is economic harm that someone purposefully tried to inflict.[7] Only when a court cannot reasonably determine loss can it use a defendant's gain as an alternative measure.[8]

To calculate loss in government contracting cases, courts have looked to three interpretive provisions of the guidelines.

The government benefits rule is intended for cases involving government benefits, which include grants, loans and entitlement program payments, where loss is the value of benefits used by unintended recipients or diverted from government programs.[9]

The credits-against-loss rule reduces loss by the fair market value of property returned or services performed by the defendant, before the offense was uncovered.[10]

The rule for procurement fraud cases includes in loss the reasonably foreseeable administrative costs of repeating or correcting a government contract.[11] If the contract is fully performed, there may be no actual or intended loss if there are no costs to repeat or correct it.

Many government contract fraud cases involve no actual or intended loss, such as where the payor would have paid the same amount and received the same benefit without knowing about the false statements,[12] where the defendant took property that was ordered destroyed,[13] or where an initial contract was obtained fraudulently by someone who was not eligible for such a contract, but the contract was fully performed.

Other examples are cases brought under a right-to-control theory of wire fraud where any deprivation of potentially valuable information relevant to discretionary economic decisions is fraud — as in the U.S. Court of Appeals for the Second Circuit's 2021 decision in Ciminelli v. U.S., an appeal that the U.S. Supreme Court will hear Nov. 28.[14]

In these cases, either the rule for procurement fraud cases[15] or the credits-against-loss rule[16] should be used to calculate loss, and either rule will produce a loss of zero.

The prosecution may argue in favor of applying the government benefits rule to use a defendant's gain as an alternative measure.[17] The government may claim there was a loss, but that cannot be easily calculated, such as reduced public confidence in the government contracting process or the opportunity cost for others who did not get to participate in a transaction.

But where there was no actual or intended pecuniary harm, loss can be readily calculated — at zero — and thus, the government benefits rule should not apply.

A prosecutor's attempt to use the government benefits rule in such instances will likely rely on case law based on an outdated provision of the sentencing guidelines, Section 2F1.1, which was deleted in 2001.[18]

At first blush, there may appear to be a circuit split which rule applies in government contracting cases, but that is not so.

Both the U.S. Court of Appeals for the Fourth Circuit in the 2000 U.S. v. Brothers Construction Co. decision,[19] and the U.S. Court of Appeals for the Seventh Circuit in the 2006 U.S. v. Leahy decision,[20] concluded that government contracts constitute government benefits, relying on Section 2F1.1, when it was in effect and even after it was deleted.

The U.S. Court of Appeals for the Eleventh Circuit reached the same conclusion in its 2009 U.S. v. Maxwell decision by relying on the Fourth and Seventh Circuit rulings — not the guidelines themselves.[21]

On the other hand, the U.S. Court of Appeals for the Third Circuit declined to apply the government benefits rule in a 2015 government contract case.

The court reasoned in U.S. v. Nagle that deleted Section 2F1.1 had an application note similar to the government benefits rule, which both the Fourth and Seventh Circuits relied on in reaching their holdings, but that no similar application note was included with the since-added credits-against-loss rule.[22]

Rulings in other cases, which are not based on deleted Section 2F1.1 and also consider the language added to the guidelines, counsel in favor of the credits-against-loss rule.

These include the U.S. Court of Appeals for the District of Columbia's 2017 decision in U.S. v. Crummy,[23] the U.S Court of Appeals for the Fifth Circuit's 2016 decision in U.S. v. Harris,[24] the U.S. Court of Appeals for the Sixth Circuit's 2020 decision in U.S. v. Kozerski,[25] and the U.S. Court of Appeals for Ninth Circuit's 2015 decision in U.S. v. Martin.[26]

The Fifth Circuit, in Harris, reasoned that even though government contracts may further public policy goals, they are not entitlement programs.[27] The Sixth Circuit, in Kozerski, noted:

> The government does not typically issue grants or make loans because it wants a concrete deliverable in return, while it typically enters construction contracts because it wants something built.[28]

Government contracts are primarily meant to serve the government's own needs.[29]

Employing the approach to statutory interpretation used in the Supreme Court's 2003 Barnhart v. Peabody Coal Co. decision, we can conclude that the sentencing commission considered including government contracting in the government benefits rule, "and meant to say no" when it declined to include such an example.[30]

The guidelines offer examples of the types of benefits to which the government benefits rule applies, but these do not reference government contracts. Elsewhere, the guidelines do mention procurement fraud.[31]

If the sentencing commission intended to include government contracts in the government benefits rule, it presumably would have done so.[32]

Even if it is unclear whether the commission intended to exclude government contracts from the government benefits rule, because doing so would impact a defendant's due process rights, the rule of lenity should be used to invoke the interpretation that leads to the shortest sentence.[33]

Doing so requires not applying the government benefits rule to a government contracting fraud case where there was no pecuniary harm.

In sum, in government contracting fraud cases, where the actual or intended loss is zero, the government benefits rule should not be applied, and total gain should not be used as a substitute for loss.

Prosecutors may rely on an outdated provision of the sentencing guidelines, which could significantly affect sentencing liability. Therefore, it is essential that defense attorneys understand how to calculate loss under different circumstances, and be able to prevent the prosecution from using no longer applicable measures of loss to achieve higher sentences.

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[1] https://www.oig.dhs.gov/sites/default/files/assets/pr/2022/dojpr-091422-justice-department-announces-covid-19-fraud-strike-force-teams.pdf.

[2] https://www.justice.gov/opa/pr/justice-department-announces-new-charges-convictions-and-sentencings-ongoing-initiative.

[3] U.S.S.G. § 2B1.1.

[4] The U.S.S.G. § 2B1.1(b)(1) Loss Table provides graduated increases in offense levels from 2 points for a loss of more than $6,500 to 30 points for a loss of more than $550 million.

[5] U.S.S.G. § 2B1.1 cmt. N.3(A).

[6] U.S.S.G. § 2B1.1 cmt. N.3(A)(i).

[7] U.S.S.G. § 2B1.1 cmt. N.3(A)(ii).

[8] U.S.S.G. § 2B1.1 cmt. N.3(B).

[9] U.S.S.G. § 2B1.1 cmt. N.3(F)(ii).

[10] U.S.S.G. § 2B1.1 cmt. N.3(E)(i).

[11] U.S.S.G. § 2B1.1 cmt. N.3(A)(v)(II).

[12] See, e.g., U.S. v. Bazantes, 978 F.3d 1227, 1250 (11th Cir. 2020) (finding no pecuniary harm to government agency where prosecution claimed that falsified payroll records "compromised the integrity of the federal contract bidding process" but agency nonetheless received the benefit it paid for, reasoning that "'compromised integrity' does not a pecuniary loss make.").

[13] See, e.g., U.S. v. Robie, 166 F.3d 444, 455 (2d Cir. 1999) (finding no pecuniary harm to federal government in case where defendant worked for a company that printed stamps for the federal government, stamps were misprinted and government ordered them destroyed, and instead of destroying stamps, defendant took them and traded them for valuable stamps).

[14] Ciminelli v.U.S., No. 22-1287 (U.S.).

[15] U.S.S.G. § 2B1.1 cmt. N.3(A)(v)(II).

[16] U.S.S.G. § 2B1.1 cmt. N.3(E)(i).

[17] U.S.S.G. § 2B1.1 cmt. N.3(F)(ii).

[18] https://guidelines.ussc.gov/gl/%C2%A72F1.1.

[19] U.S. v. Bros. Const. Co. of Ohio, 219 F.3d 300, 31/1-/28 (4th Cir. 2000).

[20] U.S. v. Leahy, 464 F.3d 773, 78/1-/20 (7th Cir. 2006).

[21] U.S. States v. Maxwell, 579 F.3d 1282, 130/1-/27 (11th Cir. 2009).

[22] Nagle, 803 F.3d at 182. See, e.g., Bros. Const. Co. of Ohio, 219 F.3d at 318 (relying on the old § 2F1.1 in using government benefits rule to calculate loss in government contracting fraud case where nondisadvantaged business received funds intended for disadvantaged business), Leahy, 464 F.3d at 790 (7th Cir. 2006).

[23] U.S. v. Crummy, 249 F. Supp. 3d 475, 482 (D.D.C. 2017) (considering the impact of current Note 3(E)(i) to hold that the government benefits rule does not apply to procurement frauds involving contracts awarded under government set-aside programs, and that loss in such cases must be reduced by the fair market value of services rendered).

[24] U.S. v. Harris, 821 F.3d 589, 604 (5th Cir. 2016).

[25] U.S. v. Kozerski, 969 F.3d 310, 31/1-/26 (6th Cir. 2020).

[26] U.S. v. Martin, 796 F.3d 1101, 110/1-/20 (9th Cir. 2015).

[27] Harris, 821 F.3d at 604.

[28] Kozerski, 969 F.3d at 313.

[29] Harris, 821 F.3d at 603.

[30] Barnhart v. Peabody Coal Co., 537 U.S. at 168; Kozerski, 969 F.3d at 314 ("The guidelines already convey an appreciation of when to vary from normal economic loss rules and when not to ... Some crimes ... receive an enhancement regardless of the economic harm they cause. Crimes involving damage to property in a national cemetery or veterans' memorial ... receive a two-level bump regardless of loss... . The Sentencing Commission knew how to ignore economic harm when it wished. The Commission simply did not make that choice here.").

[31] U.S.S.G. § 2B1.1 cmt. N.3(A)(v)(II).

[32] See, e.g., Russello v. U.S., 464 U.S. 16, 23 (1983) ("[W]here Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion.") (quotation marks and citation omitted); see also U.S. v. Nagle, 803 F.3d at 182 ("Had the Sentencing Commission intended to preclude crediting services rendered against loss for Note 3(F)(ii) [(the government benefits rule)], it would have used similar language as it used in Note 3(F)(v).").

[33] See U.S. v. R.L.C., 503 U.S. 291, 293 (1992) ("No ambiguity about the statute's intended scope survives the foregoing analysis, but if any did, the construction yielding the shorter sentence would be chosen under the rule of lenity."); Chapman v. U.S., 500 U.S. 453, 463 (1991) (A statute must be ambiguous for the rule of lenity to apply.); Bifulco v. U.S., 447 U.S. 381, 387 (1980) (The rule of lenity "means that the Court will not interpret a federal criminal statute so as to increase the penalty that it places on an individual when such an interpretation can be based on no more than a guess as to what Congress intended.").