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The Government's Take on Materiality After Escobar

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Following the Supreme Court's decision in *Universal Health Services, Inc. v. United States ex rel. Escobar*, 136 S. Ct. 1989 (2016), we expected significant False Claims Act litigation over the Act's materiality standard. Such litigation is a direct consequence of *Escobar*'s holding, which does not limit the implied certification theory to violations of conditions of payment[1] and emphasizes the Act's "demanding" materiality standard.

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Escobar

In *Escobar*, the Court explained that whether a misrepresentation of compliance with a statutory, regulatory, or contractual requirement is material to the Government's payment decision may depend on several factors. These factors include the following:

- Importance (An Objective Test) – Whether a "reasonable man [acting on the Government's behalf] would attach importance to [the representation] in determining his choice of action in the transaction." at 2003. It follows that a reasonable person would not attach importance to a violation that is "minor or insubstantial." *Id.* at 2003.
- Government Knowledge/Government Treatment of Violations (A Subjective Test) – Whether the Government knew of a claim's falsity and nevertheless paid the claim, which would tend to negate a finding of materiality. at 2003. This argument is also known as the so-called "government knowledge" defense. Conversely, "evidence that the defendant knows that the Government consistently refuses to pay claims in the mine run of cases based on noncompliance" supports a finding of materiality. *Id.*
- Labels Used – Whether the Government has "expressly identif[ied] a provision as a condition of payment," although such identification is "relevant but not automatically dispositive." at 2002.
- Essence of the Bargain – Whether the regulatory, statutory, or contractual violation goes to the "essence of the bargain." at 2003 n.5.

Government's Positions on Materiality

In the three months since *Escobar*, the Government has filed briefs in several cases, arguing for its particular interpretation of materiality.[2] The Government's arguments in these cases are based primarily on the above language from *Escobar*, in which the Court defined some of the factors relevant to a materiality analysis. These arguments, a sample of which are set forth below, show the Government is determined to use language from *Escobar* to expand the Act's reach.

First, in late July, the Government filed a statement of interest in a non-intervened *qui tam* in a Ninth Circuit district court, brought against a company that allegedly violated the Act by submitting claims for payment to the Department of Education when it knew it was not complying with a statutory ban on incentive compensation to student recruiters. The ban, also known as the ICB, is meant to curb the risk that student recruiters will sign up poorly qualified students, who will likely be unable or unwilling to repay federally guaranteed student loans. The Court in this case had denied summary judgement to the defendant; however, the defendant requested

reconsideration of that decision in light of *Escobar*.

In its statement of interest, which was filed in connection with the defendant's reconsideration request, the Government emphasized that *Escobar* had "reaffirmed" prior case law finding that "material" means "having a natural tendency to influence, or be capable of influencing, the payment or receipt of money or property." In discussing the factors from *Escobar*, discussed above, the Government carefully avoided the Court's characterization of the materiality standard as "demanding", instead concluding that "materiality is a flexible standard that can be met in a variety of circumstances." The Government then argued that the *Escobar* factors weighed in favor of materiality in the case at hand because:

- The violations of the ICB are "significant" since they would likely result in five-figure commissions that "by any measure" would be a "significant" amount of remuneration with the potential to influence recruiters in their decisions about how and who to recruit. This argument appears to respond to *Escobar*'s demand that actionable violations not be "minor or insubstantial." Read in context, however, this demand requires that violations be significant to the Government; the Government's focus, therefore, on the significance of remuneration to recruiters is odd.

- The Department of Education considers ICB compliance important, based on two Federal Register entries discussing the negative effects of incentive compensation. Notably, these entries demonstrate only that (unsurprisingly) the Department takes the law itself to be important, not that it places importance on the particular violations at issue.

- The Department of Education's actions demonstrate materiality. Particularly, the Department has terminated a school's participation in Title IV funding based on its violation of the ICB. Traditionally, the fact that a violation has a remedy other than denial of payment – like administrative termination of participation – would weigh against treating the violation as actionable under the FCA. The Government argued, however, that because termination of participation also terminates eligibility to receive Title IV funds, this termination was evidence of the materiality of ICB violations. Additionally, the Government cited instances in which the Department attempted to recover Title IV funds based on ICB violations, as well as instances in which ICB violations have been pursued through FCA actions.

- The Ninth Circuit had previously held that the ICB is an express condition of payment, which after *Escobar* is still "relevant" to the materiality inquiry, but not determinative.

- Compliance with the ICB goes to "the essence of the bargain" between the academic institution and the Government for Title IV funds, since the purpose of the ban was to ensure that funds went to students "enrolled in institutions likely to meet their educational needs and who could repay their loans."

Defendants' motion to reconsider the Court's denial of summary judgement is still under consideration by the Court.

Second, in early August, the Government filed a statement of interest in a *qui tam* filed against a major pharmaceutical company in a Second Circuit district court. The Government's statement of interest was prompted by the defendant-company's motion to dismiss, which is still pending as of this writing. The Government's statement did not take a position on whether the action should be dismissed. Instead, it disagreed with the defendant-company's legal arguments relating to materiality and advanced its own interpretation of the materiality standard. Particularly:

- The Government argued that materiality does not depend on whether the Government would have *actually* refused to pay the claim. Such an outcome-dependent materiality standard, the Government argued, was stricter than the natural tendency standard "reaffirmed" in the *Escobar*

- The Government sought to minimize the company's Government knowledge defense. The Government conceded that Government knowledge of a violation is *relevant* to materiality, but emphasized that it is not dispositive. In support of its argument, the Government suggested that the Government's inaction, despite actual knowledge of violative conduct, should not undermine a materiality finding because other important considerations, such as public health or safety, may dictate that the Government continue to accept and pay for services.

Third, in mid-August, the Government filed a supplemental brief in the well-publicized case of *United States ex rel. Badr v. Triple Canopy, Inc.*, No. 13-2190 (4th Cir.), following its remand from the Supreme Court to the Fourth Circuit. The Government raised three arguments relating to materiality and based on the language from *Escobar*:

- The Government argued that the marksmanship requirement went to the "essence of the bargain" the Army struck with Triple Canopy for security personnel to protect its military bases.

- Second, the Government contended that Triple Canopy's violations were not "minor or insubstantial," noting that none of the guards Triple Canopy supplied to the Army passed the required marksmanship test at any time during the year they served as guards.

- Third and finally, the Government noted the Army's treatment of its future dealings with Triple Canopy, observing that the Army did not renew its contracts with Triple Canopy and the United States intervened in the *Triple Canopy qui tam*.

The Fourth Circuit has not yet issued a decision on remand.

Relevance of Government Positions

The Government's arguments in the cases above reflect some notable developments in the Government's litigation positions, none of which are good for False Claims Act defendants. First, the authors of this article are aware of no case in which the Government has attached any importance to its decision to intervene. In fact, the Department of Justice has been explicit that "[t]he decision…to intervene in a case does not necessarily mean that it will endorse, adopt or agree with every factual allegation or legal conclusion in the relator's complaint." DOJ, False Claims Act Cases: Government Intervention in Qui Tam (Whistleblower) Suits. Nevertheless, the Department of Justice has applauded itself for being "highly successful in intervening in those cases that have merit." Testimony of Michael F. Hertz, Deputy Assistant Attorney General, Civil Division, Department of Justice before the Senate Committee on the Judiciary (Feb. 27, 2008). The Government's reliance in *Triple Canopy* on its own intervention decision as evidence of materiality may indicate an emphasis on linking intervention decisions to the merits of the underlying complaint.

Second, the Government's opposition to the government knowledge defense has not been abated by passages in the *Escobar* opinion emphasizing the importance of government knowledge to the materiality inquiry. *See Escobar*, 136 S. Ct. at 2003–04. For example, in the pharmaceutical case described above, the Government sought to diminish the defendant's government knowledge defense on the grounds that other factors, such as public health or a pressing need to acquire materials, might cause the Government to pay for false claims even when it knows such claims are false. But when public health or a pressing need to acquire materials is so significant that the Government *knowingly decides to pay* false claims, then the falsity of those claims was clearly not material to – and did not, in fact, tend to influence – the Government's *decision to pay*. Indeed, *Escobar* is explicit on this point: "if the Government pays a particular claim in full despite its actual knowledge that certain requirements were violated, that is very strong evidence that those requirements are not material." *Id.* at 2003. The Government's attempt to diminish the relevance of government knowledge in these cases is concerning, to say the least.

Third, in the Government's view, the distinction between conditions of payment and conditions of participation can now serve only to help the Government, but will never help the defendant. In other words, following *Escobar*, the characterization of a regulatory, statutory, or contractual provision as a condition of participation does not help the defendant. But the characterization of such a provision as a condition of payment can help the Government show materiality, because such a label "is relevant, but not automatically dispositive." *Escobar*, 136 S. Ct. at 2003.

Fourth, the Government has not focused on *Escobar*'s mandate that courts treat the materiality standard as "demanding." Rather, the Government has clung to the idea that the court merely "reaffirmed" the standard that was already in place. This is particularly concerning because *Escobar* left open the possibility that "all claims for payment implicitly represent that the billing party is legally entitled to payment." *Id.* at 2000. If future decisions transform this possibility into an actual holding, then the falsity element will be significantly eroded in implied certification cases

None of these cases has yet been decided; therefore, it is not yet clear whether courts will be receptive. In fact, there are some early indications that at least some courts may not accept the Government's aggressive stance on materiality — we will summarize these decisions in a forthcoming post. In the meantime, the Government's positions offer little comfort to defendants and potential defendants who may be required to defend False Claims Act cases against the Department of Justice.

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[1] A forthcoming post will address the Department of Justice's position on *Escobar*'s holding on falsity.

[2] In cases in which it has not intervened and has filed a statement of interest, the government usually does not advocate for a particular result. Rather, the government typically argues for a particular legal interpretation in the hopes of shaping future enforcement of the Act.