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Lack of Materiality Evidence 'Zaps' Mammoth FCA Jury Awards: 5 Lessons

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Introduction

Two courts recently upended monstrous False Claims Act (FCA) jury awards—one for $663 million and the other for $347 million—concluding that liability was not sufficiently supported by evidence of materiality, based on the Supreme Court's guidance in Universal Health Services, Inc. v. U.S. ex rel. Escobar, 136 S. Ct. 1989, 2016 BL 192168 (2016). Decisions like these illustrate how significantly Escobar narrows the scope of FCA liability. For companies susceptible to potential whistleblower lawsuits, these decisions underscore touchstones in the new materiality analysis that could end an FCA claim:

1. When the government continues paying claims despite knowledge of the claimant's noncompliance with a statutory, regulatory or contractual requirement related to the claim, the continued payments could be strong evidence against materiality (and even scienter).

2. If the defendant remains eligible for government programs while the suit is pending, the government's view of their reliability as a business partner could affect the materiality evaluation.

3. Relators must overcome an appearance of immateriality if the government has not intervened in support of their complaint.

4. A defect in goods or services that does not impact the value, or "primary purpose," of that good or service is unlikely to be material to the government's decision to pay a claim.

5. If a good or service is in limited supply, of unique value, or difficult to find, courts may consider the impact of imposing FCA liability on the government's ability to find alternative suppliers.

Materiality is required to avoid "traps, zaps, and zingers"

In Escobar, the U.S. Supreme Court said the FCA is not "an all-purpose antifraud statute, or a vehicle for punishing garden-variety breaches of contract or regulatory violations." 136 S. Ct. at 2003. Instead, it is intended to punish fraud that satisfies its "demanding" and "rigorous" materiality requirement. Escobar further clarified that any noncompliance giving rise to FCA liability must also have been known to the defendant as a misrepresentation that was material to the government. Id. at 1996.

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A federal district court recently described these requirements as necessary to prevent the government—or relators—from weaving "a system of government traps, zaps, and zingers … because of some immaterial contractual or regulatory noncompliance." United States ex rel. Ruckh v. Salus Rehabilitation LLC, No. 8:11-CV-1303-T-23TBM, 2018 BL 10554 at *5 (M.D. Fla. Jan. 11, 2018). Such a "gotcha" method of enforcing contracts, the court noted, would expand the intended reach of FCA liability and give a windfall to the government were it to recover three times the prices paid for " substantially conforming" goods or services. Id.

The Ruckh decision, along with the Fifth Circuit's decision in United States ex rel. Harman v. Trinity Industries, 872 F.3d 645 , 2017 BL 347202 (5th Cir. 2017), illustrate that courts will not only require evidence of materiality at the motion to dismiss and summary judgment stages, but also will weigh the sufficiency of the materiality evidence in the record to upend jury verdicts and judgments after trial.

The government's action or inaction as evidence of materiality

The Escobar court did not provide a bright line test for materiality under the FCA. It did, however, advise that a government agency's continued payment of claims, despite knowledge of noncompliance, "is very strong evidence that those requirements are not material." 136 S. Ct. at 2003. The Ruckh and Harman decisions both placed heavy emphasis on this guidance.

In Harman, the relator alleged that Trinity Industries changed its guardrail design, failed to disclose these changes to the Federal Highway Administration (FHWA), and falsely continued to certify that the guardrails complied with FHWA requirements. The relator presented his concerns about the undisclosed design changes to the FHWA in 2012 before filing his sealed FCA suit. The government declined to intervene. When the relator later sought to depose FHWA employees, the FHWA issued a June 17, 2014 memorandum, which explained that there was "an unbroken chain of eligibility for Federal-aid reimbursement" applicable to the challenged guard rail design, which "continues to be eligible today." Id. at 650. Despite this memorandum indicating that the defendant remained eligible for payments for the guardrails, the trial court denied Trinity Industries' motion for summary judgment. The trial court also denied a motion for judgment as a matter of law, which was filed post-verdict, and entered judgment for $663,360,750—the largest FCA judgment ever awarded by a jury.

Reversing the judgment on appeal, the Fifth Circuit explained that, "though not dispositive, continued payment by the federal government after it learns of the alleged fraud substantially increases the burden on the relator in establishing materiality." Id. at 663. After considering the sufficiency of the evidence from the trial record and finding that the relator had not rebutted the "very strong evidence" of FHWA's continued payment, the Fifth Circuit granted judgment as a matter of law in favor of the defendant. Id. at 670.

The Harman court explained that the government's payment, despite its knowledge of the contractual breach or regulatory noncompliance, is critical evidence that the government has—either explicitly or implicitly—already factored in the nonconformity. When the government has already made its assessment of the good or service, and has accepted the good or service, paid the defendant, and declined to pursue a remedy, its decision constitutes evidence that the nonconformity was immaterial.

Thus, relators must marshal evidence to show that the government was not aware of the breach or noncompliance when it remitted payment to the defendant, or that the payment and continued acceptance of the good or service were for reasons of necessity or lack of alternative. As the Fifth Circuit explained, deference is due to the government's previous or ongoing judgment to pay despite noncompliance, and that deference may even outweigh the jury's judgment as finder-of-fact:

As revered as is the jury in its resolution of historical fact, its determination of materiality cannot defy the contrary decision of the government, here said to be the victim, absent some reason to doubt the government's decision as genuine. For the demands of materiality adjust tensions between singular private interests and those of government and cabin the greed that fuels it. As the interests of the government and relator diverge, this congressionally created enlistment of private enforcement is increasingly ill served. When the government, at appropriate levels, repeatedly concludes that it has not been defrauded, it is not forgiving a found fraud—rather it is concluding that there was no fraud at all.

Harman, 872 F.3d at 669–70.

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Similarly, in Ruckh, the relator proved to a jury that the owners and operators of fifty-three specialized nursing facilities billed the government for Medicaid claims, yet failed to maintain a "comprehensive care plan" for each patient, as required by Medicaid regulation. Ruckh, 2018 BL 10554 at *1. Even though the jury found this violated the FCA, in granting the defense post-trial motions, the court noted that the "defendants delivered the services for which the governments were billed; the governments paid and continue to pay to this day despite the disputed practices, long ago known to all who cared to know." Id. at *6. As a result, the court tossed the jury's finding and granted judgment for the defense as a matter of law, concluding that "the evidence that exists gravitates contrary to materiality and scienter." Id. at *6.

As in Harman, the government did not intervene in Ruckh. Without government witnesses testifying to the contrary, the court found that the government "regard[ed] the disputed practices with leniency or tolerance or indifference or perhaps with resignation to the colossal difficulty of precise, pervasive, ponderous, and permanent record-keeping in the pertinent clinical environment." Id. at *2. In fact, the court noted that the record was "effectively barren of evidence on how the governments might have addressed the disputed practices" and "the dearth of evidence left the jurors to guess." Id. at *8. Plainly, the relator did not present sufficient evidence of materiality and scienter to overcome the conclusion inferred from the governments' payment for the services. The Ruckh court echoed the Fifth Circuit's reasoning, explaining that, by continuing to pay fully despite knowing of the alleged noncompliance, the government:

[R]elentlessly works itself into a steadily tightening bind that at some point becomes disabling because the government (or the relator, who sues in the government's stead) must prove that had the government known the facts the government would have refused to pay. In other words, at some point, this burden, growing incrementally more formidable each day, presents to the government the insurmountable burden of proving that the government would not do exactly what history demonstrates the government in fact did (and continues to do until this moment).

Id. at *13

Regulatory noncompliance that does not decrease the value or defeat the "primary purpose" of a product provided to the government is unlikely to be material

A central question emerges from Escobar and Ruckh: does the alleged breach or noncompliance wholly defeat the primary purpose of the government's acquisition of the goods or services at issue? In cases where the answer is "yes," the court likely will consider the defect to be material, as no reasonable government would pay for such performance. In that case, the defendant's scienter is presumed because "the defect is so fundamental and the consequence of the defect is so readily perceptible." Id. at *3; see also Escobar, 136 S. Ct. at 2001–02. The Ruckh court borrowed from the Escobar illustration of selling guns that do not shoot: once the defect spoils the gun's "primary purpose" and, in so doing, "entirely deprives the government of the value and utility" of having the gun, "the law imputes to the seller knowledge of the materiality of the defect" because no reasonable contractor would think otherwise. Ruckh, 2018 BL 10554 at *4-5.

But there is a difference between providing a defective good or service and failing to maintain documentation about the quality of the good or service provided. Distinguishing the facts of United States ex rel. Beauchamp v. Academi Training Center, Inc., 220 F. Supp. 3d 676, 2016 BL 399529 (E.D. Va. 2016), where the court concluded that it was "common sense" to believe the government would not have paid for security officers carrying guns that they were "actually not qualified" to shoot, the Ruckh court concluded that the purported liability was based on a formality that would not result in the government's refusal to pay—because the service providers were "fully qualified but not in possession of a certificate." Ruckh, 2018 BL 10554, at *10.

In Ruckh, the jury heard testimony about a healthcare provider who "used qualified providers who ably provided services in accord with orders issued by qualified professionals but who, for example, could not—years later—identify a 'comprehensive care plan' for each patient" as required by regulation. Id. at *10. Despite the apparent violation of a regulation, the latter facts were not likely to cause the government purchaser to, "abruptly refuse to pay those providing continuing and sustaining health care to a mass of highly vulnerable and mostly elderly and frail patients," the court posited. Id. at *10. Thus, the court found insufficient evidence of materiality.

Relaxed materiality standard could have a deterrent effect on contractors offering necessary government service in accord

Finally, the Ruckh court expressed a separate, and perhaps equally important, policy concern: punitive judgments—devoid of strong evidence of materiality—could deter businesses from providing much-needed services to the government. The court asserted that the massive judgment awarded by

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the jury was "sufficient in proportion and irrationality to deter any prudent business from providing services and products to a government armed with the untethered and hair-trigger artillery of a False Claims Act invoked by a heavily invested relator." Id. at *8. In short, prudent businesses might view the risk of incurring treble damages for lesser regulatory infractions as too high to justify doing business with the government. The Ruckh court worried that the government might litigate itself into a supply-chain predicament should FCA liability be so expansive that it can push critical vendors into financial straits:

For example, if (this is hypothetical) the only manufacturer of the only booster that can launch the United States' nuclear warheads is found to have failed to maintain metallurgical test results (the metals passed the tests) required by the Department of Defense and if the repayment times three for the price of the booster powering each American ICBM would cripple or kill the only available manufacturer, would the government demand the payment (or, more to the point, would the government allow a private party to demand the payment in exchange for a percentage of the take)?

Id. at *11-12.

Without the "demanding" and "rigorous" inquiry into materiality emphasized by Escobar, the government and qui tam relators could readily resort to pursuing FCA liability for small infractions. Such a strategy incentivizes the pursuit of FCA claims with their punitive weight of treble damages rather than "a more moderate, more proportional, more efficacious remedy, such as delivery of a notice of noncompliance, accompanied by a stern demand for, and a fair deadline for, compliance." Id. at *7-8. The use of these "traps, zaps, and zingers" inappropriately expands FCA liability to the point of abuse, resulting in a windfall for the government and an "unwarranted, unjustified, unconscionable, and probably unconstitutional forfeiture—times three"—from defendants. Id. at *8.

Hence, the court reasoned that the materiality requirement promotes the interests of the government as well as private enterprise. The Supreme Court's instruction in Escobar is consistent with vindicating the intent of the FCA, as the government's decision to consider noncompliance material and pursue an FCA suit—rather than a more moderate approach—must necessarily be determined "in the place, in the industry" and in light of the circumstances presented by the specific case. Id. at *12.

Conclusion

The Harman and Ruckh decisions signal a reluctance to let FCA awards stand when the government continued to pay claims for non-complying goods or services. These opinions rely heavily on Escobar's guidance that continued payment is "strong evidence" that the alleged noncompliance is immaterial.

In practice, this application of the materiality requirement places a premium on discovery from government agencies that would reveal how the agency has responded to similar instances of noncompliance. It also forces relators to confront the distinction between regulatory noncompliance that wholly defeats the primary purpose of the goods or services and noncompliance with a record-keeping requirement for those goods or services—when they are otherwise of sufficient quality.

Considering these dramatic upsets of jury verdicts after long trials, relators may grow more reluctant to pursue FCA claims where the government has declined to intervene. In the healthcare industry, where the U.S. Supreme Court characterized the statutes and regulations governing the federal healthcare programs as "among the most intricate ever drafted by Congress," see Schweiker v. Gray Panthers, 453 U.S. 34, 43 (1981), the impact could be greater. In the FCA context, failure to keep up with the myriad record-keeping obligations imposed by these intricate laws and regulations may ultimately be considered immaterial to receiving payment for the services that patients need, so long as the government remains willing to pay for them. While regulatory compliance should be a priority for any healthcare company, the Escobar materiality standard has proven effective in defending against the ever-expanding theories of whistleblowers.

Hogan Lovells partner Neal Katyal filed an amicus brief in United States ex rel. Harman v. Trinity Industries, discussed in this article.

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