KATZ, MARSHALL & BANKS, LLP

Post-Escobar Ruling Further Defines Materiality in False Claims Act

By Matthew LaGarde
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In a May 2019 decision in the case of *United States v. Aerojet Rocketdyne Holdings, Inc.*, a California court permitted whistleblower Brian Markus's claims against Aerojet Rocketdyne Holdings, Inc. ("Aerojet") to proceed under the False Claims Act ("FCA"), providing further guidance on the meaning of materiality in cases alleging false statements or fraudulent conduct by government contractors. However, the court granted the company's motion to compel arbitration of Mr. Markus's claims that he was fired in retaliation for objecting to his employer's fraud.

Background on the Whistleblower Case

Aerojet develops and manufactures products for the aerospace and defense industry, primarily working with government clients like the Department of Defense and the National Aeronautics & Space Administration. Pursuant to Federal Acquisition Regulations ("FARs"), contractors to these agencies are required to adhere to specific cybersecurity requirements to ensure their information systems sufficiently safeguard "unclassified controlled technical information" against security threats.

Mr. Markus worked for Aerojet as the company's Senior Director of Cyber Security, Compliance, and Controls, and in this role was responsible for, among other things, overseeing the company's compliance with the cybersecurity FARs. Shortly after Mr. Markus started to work for Aerojet, he discovered that the company was knowingly failing to comply with federal cybersecurity guidelines, but nevertheless entering into contracts with the federal government and implicitly asserting its compliance with the FARs. Mr. Markus eventually refused to sign a document stating that the company was compliant with the cybersecurity requirements and filed an internal report expressing his concerns. Less than two months later, Aerojet terminated his employment.

Following his termination, Mr. Markus filed a qui tam lawsuit under the FCA alleging that Aerojet was defrauding the government. Whistleblowers who bring qui tam suits sue on behalf of the government and, if they prevail, are entitled to receive between 15 and 30 per cent of the total amount the government recovers. The government may intervene in a qui tam suit but is not required to do so and private individuals can proceed on their own. Mr. Markus amended his qui tam suit to allege that Aerojet had terminated his employment because of his efforts to stop the company from defrauding the government. Aerojet moved to dismiss his qui tam claims and to compel arbitration of his employment claims.

Theories of Liability under the FCA

The court denied Aerojet's motion to dismiss Mr. Markus's qui tam claims. Applying the Supreme Court's decision in *Universal Health Services, Inc. v. United States ex rel. Escobar*, the court determined that Mr. Markus had sufficiently alleged both "implied false certification" and "promissory fraud" theories of liability under the FCA. As the Supreme Court explained in *Escobar*, the implied false certification theory requires that a defendant make specific representations about the goods or

services it is providing and that its failure to disclose noncompliance with material statutory, regulatory, or contractual requirements makes those representations "misleading half-truths." Promissory fraud is a broader theory of liability which holds a company liable for each claim submitted to the government under a contract originally obtained through false statements or fraudulent conduct. Both liability theories require that the fraud be material, and that was the only element of Mr. Markus's claims that was in dispute in this motion to dismiss. Fraud is material if it influences the government's payment to a contractor.

Materiality Argument

Aerojet argued on several different grounds that regardless of whether it was technically in compliance with the relevant FARs, its alleged violations were not material. Defendant based this argument on four different sub-arguments. Its first and second arguments were related: Aerojet first argued that it had self-disclosed its noncompliance with the FARs and the government continued to contract with it, and further argued that the government continued to contract with the company even after it learned of the DOJ's investigation into Aerojet. The court rejected these arguments, finding that the government was only partially aware of the fraud prior to the DOJ's investigation, and that the government's decision to continue to contract with Aerojet after learning of the DOJ's investigation was not dispositive as to materiality. Aerojet next argued that the government's decision not to intervene in the qui tam indicated that the alleged fraud was not material. The court rejected this argument entirely, holding that the DOJ's decision not to intervene in the case is not a factor in the materiality analysis.

Third, Aerojet argued that its alleged noncompliance did not go to the "central purpose" of any of the contracts. The court also rejected this argument, finding that that the specific misrepresentations identified by Mr. Markus *could* have influenced the central purpose of the company's work under the contract, which was sufficient for his claim to survive at the motion to dismiss stage of the case. Finally, the company argued that the government has generally been tolerant of noncompliance of the kind alleged here in the defense industry, contending that "the DoD never expected full technical compliance because it constantly amended its acquisition regulations." The court also rejected this argument, finding that Aerojet had failed to put forth "any judicially noticeable evidence that the government paid a company it knew was noncompliant to the same extent as AR was." Accordingly, the court found that Mr. Markus had adequately pleaded a qui tam under the implied false certification and promissory fraud theories of FCA liability and denied the company's motion to dismiss.

Arbitration Ordered in FCA Retaliation Claim

Aerojet also moved to compel arbitration of Mr. Markus's claims of FCA retaliation. Like many employees, Mr. Markus was subject to an employment agreement in which he agreed to mandatory and binding arbitration of any dispute arising from his employment. Such mandatory arbitration agreements are becoming increasingly unpopular among the public, but companies still favor them because they generally result in far more favorable results for corporations than traditional litigation. In 2010, the Dodd-Frank Act amended another anti-retaliation provision – this one under the Sarbanes-Oxley Act – to prohibit the enforcement of pre-dispute arbitration agreements for claims brought under that statute. Unfortunately, the Dodd-Frank Act did not similarly amend the FCA anti-retaliation provision, and retaliation claims brought under the FCA are still subject to arbitration where the employer has imposed such an agreement on its employees. Thus, Mr. Markus did not oppose Aerojet's motion to compel arbitration of his employment claims and the court granted the motion. Significantly, the court refused to stay the qui tam suit pending the arbitration proceedings, so the fraud case will go forward.

The *Aerojet* decision is important in that it serves as another test-case for the courts' continued efforts to define materiality under the implied false certification theory following the Supreme Court's decision in *Escobar*. Here, the court rejected evidence the company identified, including that the company had self-reported to its government customers and that the defense agencies continued to contract with Aerojet after learning of DOJ's investigation, as sufficient to disprove materiality. This is a positive development for whistleblowers, as other courts in the wake of *Escobar* have relied on similar evidence to dismiss qui tam lawsuits.