

Did the WAR DOGS Get What They Deserved? Materiality and Escobar One Year Later

By

War Dogs was a popular 2016 movie starring Jonah Hill and Miles Teller as young hustlers who win a \$300 Million contract from the Defense Department to provide 100 million rounds of ammunition to the Afghan army. It was loosely based on the true story of David Packouz and Efraim Diveroli.

SPOILER ALERT: At the end of the movie, both men are found guilty of defrauding the federal government, mostly because they provided bullets from China, a country whose products were banned from use by government contractors. But U.S. officials had enthusiastically welcomed the low bid and the shipments of ammunition, apparently looking the other way when it came to any violations. (Indeed, an Army captain in Iraq had earlier congratulated the War Dogs on a different contract, paying with wads of commandeered cash and praising the contractors' bravery for personally driving a delivery of pistols through the "triangle of death.")

As we mark the one-year anniversary of the U.S. Supreme Court's decision in *Universal Health Servs., Inc. v. United States ex rel. Escobar*, 136 S. Ct. 1989, 195 L. Ed. 2d 348 (2016), it raises an interesting question: was the fact that the bullets had actually come from China "material" to the performance of the War Dogs' contract?

Escobar instructs that even when a contractor commits a technical violation of a regulatory prohibition incorporated into its contract, this cannot rise to the level of liability for an "implied certification" under the False Claims Act (FCA) unless the violation was truly "material" to the contract – in other words, only if the government can show it would not have continued purchasing the products despite knowing of the technical violation will a contractor's violation be "material" and therefore actionable under the "implied certification" theory.

Now, we don't know all the facts and details surrounding the War Dogs' contract. This is just a fun hypothetical based on embellished or invented facts for a Hollywood movie plot, and for purposes of this blog we are assuming that the use of Chinese bullets was the only violation (despite the fact that the contractors switched the packaging of the product to hide the Chinese lettering, and also fabricated many documents regarding their financials, indicating intentional fraud), but it begs an important question about the impact of *Escobar*. If the Pentagon or the officers on the ground in Afghanistan who were managing this contract were so relieved and desperate to get this ammunition (which was apparently hard to find because it included 100 million bullets for nonstandard Soviet-made AK-47 rifles, which Afghan soldiers used), and if they really just would have looked the other way even if they had known it was originally from China, would the contractors' violation have been considered "material" in light of *Escobar*? In the year since *Escobar* was issued, a number of lower courts have reaffirmed its rejection of an "extraordinarily expansive view" that the materiality element would be satisfied whenever the government could withhold payment due to some minor regulatory infraction, asking instead whether the government would withhold payment despite knowing of the noncompliance. Recently, the Third Circuit in *United States ex rel. Petratos v. Genentech Inc.*, 855 F.3d 481 (3d Cir. 2017), relied heavily on this "heightened materiality standard," dismissing a claim for lack of evidence that the government consistently refuses to pay in similar cases of noncompliance.

Not all regulations are created equal. Bans on the sale of foreign arms may be considered so significant for public policy reasons as to not be mere minor regulatory prohibitions. But these regulations are often bunched together with dozens, or even hundreds, of other regulatory requirements that are incorporated by reference into federal contracts. So another issue is whether any certification by the War Dogs that they were not using Chinese products would have been considered "implied" or explicit. *Escobar* really only addressed materiality in the context of "implied certification," but a generic certification of compliance with a long list of regulations might not necessarily be considered an explicit certification, as the Supreme Court seemed to suggest that a contractor is unlikely to be able to meaningfully review every single regulation that is incorporated by reference or otherwise applicable to a federal contract.

Regardless, it's probably not a good idea to push the limits just to test the bounds of Escobar's materiality standard, nor is it a good idea to drive a truck through the "triangle of death," for that matter. But *War Dogs* offers an interesting way to think about the importance of the materiality element of the Supreme Court's test for implied certification under the FCA, underscoring that implied certification may not be the black hole of exposure that some had feared. Time will tell, as more lower courts interpret *Escobar* and generate more "ammunition" for these arguments.