

CLIENT ALERT

Unanimous Supreme Court Clarifies False Claims Act Scienter Requirement

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On June 1, 2023, the Supreme Court issued a unanimous opinion in two consolidated False Claims Act (“FCA”) cases, *U.S. ex rel. Schutte v. SuperValu Inc., et al.*, No. 21-1326, and *U.S. ex rel. Proctor v. Safeway, Inc.*, No. 22-111. In each case, the *qui tam* whistleblower plaintiffs (“Petitioners”) alleged that retail pharmacy defendants, SuperValu Inc. and Safeway, Inc. (“Respondents”), knowingly overbilled Medicaid and Medicare programs in violation of the FCA. The Court ruled for Petitioners and held that an assessment of a defendant’s subjective understanding of the lawfulness of its conduct is the relevant inquiry for evaluating the defendant’s knowledge of falsity under the FCA.

Background

To prove an FCA violation, a party must show, among other things, that the defendant submitted a false claim to the Government and—at issue here—the defendant’s knowledge of such falsity. 31 U.S.C. § 3729(a). In January, the Supreme Court agreed to consider whether and when a defendant’s contemporaneous, subjective understanding or beliefs about the lawfulness of its conduct are relevant to whether it “knowingly” violated the FCA, granting certiorari to two cases arising from the Seventh Circuit. See *U.S. ex rel. Schutte v. SuperValu Inc., et al.*, No. 21-1326, and *U.S. ex rel. Proctor v. Safeway, Inc.*, No. 22-111. In these cases, Petitioners alleged that Respondents submitted higher prescription prices to Medicaid and Medicare for reimbursement than the “usual and customary” prices they charged to the general public, in violation of program regulations and the FCA. Petitioners specifically alleged that Respondents *knew* they were charging such programs more than their “usual and customary” prices. The Seventh Circuit had held that, as a

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matter of law, there is no scierter requisite to FCA liability if a defendant's conduct falls within an "objectively reasonable" interpretation of the law, and "no authoritative guidance cautioned defendants against it." *U.S. ex rel. Schutte v. SuperValu Inc., et al.*, 9 F.4th 455, 464 (7th Cir. 2021); *U.S. ex rel. Proctor v. Safeway, Inc.*, 30 F.4th 649, 652–53 (7th Cir. 2022). Judge David Hamilton dissented from the Seventh Circuit's opinion in both cases, stating that the majority's holding contradicted the FCA's text and history. *SuperValu Inc.*, 9 F.4th at 472–85; *Safeway, Inc.*, 30 F.4th at 663–71. The Court granted certiorari to address a circuit split on the issue.¹

Supreme Court Opinion

The Supreme Court held that the scierter requirement under the FCA is met if a plaintiff can show that a defendant "believed that their claims were not accurate." *United States ex rel. Schutte v. SuperValu Inc.*, 598 U.S. __ (2023), slip op. at 16. According to the Court, the FCA's knowledge element "refers to a defendant's knowledge and subjective beliefs" rather than "to what an objectively reasonable person may have known or believed." *Id.* at 8. Thus, the Court held that if a defendant submitted a false claim and "actually thought" that the claim was false, such defendant "knowingly" submitted a false claim in violation of the FCA. *Id.* at 7. That the Court was trending in this direction was evident from oral argument, where the Justices kept returning the advocates to the core question of what *Respondents* knew when they were submitting to federal programs for reimbursement.² With this, the Court rejected the Seventh Circuit's contrary holding that a defendant could not submit a false claim "knowingly" unless "no hypothetical, reasonable person could have thought that [the] reported prices" were "usual and customary." *Id.* at 7–8.

The Court rooted its opinion in the text of the FCA itself and its origins in the common law definition of fraud. The text of the FCA emphasizes a defendant's subjective understanding and beliefs through terms such as "actual knowledge," "deliberate ignorance," and "reckless disregard," said the Court. Further, common law fraud employs a subjective test

¹ Along with the Seventh Circuit, the Fourth, Eighth, and D.C. Circuits had held that a defendant's objectively reasonable interpretation of the law does not establish FCA scierter unless authoritative guidance warned the defendant to the contrary. *See, e.g., United States ex rel. Sheldon v. Allergan Sales, LLC*, 24 F.4th 340, 343–44, 351 (4th Cir. 2022); *United States ex rel. Hixson v. Health Mgmt. Sys., Inc.*, 613 F.3d 1186, 1190 (8th Cir. 2010); *United States ex rel. Purcell v. MWI Corp.*, 807 F.3d 281, 289 (D.C. Cir. 2015). On the other side of the ledger, the Sixth, Ninth, Tenth, and Eleventh Circuits had been willing to evaluate a defendant's subjective intent, including with reference to the defendant's reactions to warnings and red flags as well as holistic evidence such as government documents and internal company guidance. *See, e.g., United States ex rel. Prather v. Brookdale Senior LivingCommunities*, 892 F.3d 822, 838 (6th Cir. 2018); *United States v. Chen*, 402 F. App'x 185, 187–88 (9th Cir. 2010); *United States v. Boeing Co.*, 825 F.3d 1138, 1145–50 (10th Cir. 2016); *United States ex rel. Phalp v. Lincare Holdings, Inc.*, 857 F.3d 1148, 1155 (11th Cir. 2017).

² Indeed, Petitioners' allegations that Respondents actually believed their interpretation of "usual and customary" to be wrong became a sticking point for the Justices at oral argument. *Compare* Transcript of Oral Argument at 15, *United States ex rel. Schutte v. SuperValu Inc.*, 598 U.S. __ (2023), slip op. ("Justice Kagan: I thought that this case comes to us on the understanding that [Respondents] thought that this interpretation was wrong . . . Not, like, possibly permissible but possibly not the best one, that they thought that this interpretation was wrong, they knew it was wrong."); *with id.* at 43 (Justice Gorsuch: "It's an allegation yet to be proven that the company knew . . . that its representations were not its ordinary and customary price. Under its understanding of the law, it knew that, that there was no good-faith basis, and that that is potentially actionable here. I thought that's all that was before us.").

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based on a defendant's state of mind. The Court also found that the FCA's text and its common law roots suggest that the knowledge inquiry is to be undertaken at the point of a defendant's submission of a false claim rather than after the fact.

The Court additionally found that the phrase "usual and customary" was not so ambiguous as to preclude a finding of Respondents' knowledge of the falsity of their claims. The Court found that such potential ambiguity did not preclude Respondents from having "known" what "usual and customary" meant in actuality (i.e., what "usual and customary" prices the Respondents themselves charged the public). The Court found that it was possible, in light of evidence presented by Petitioners, that Respondents *knew* what "usual and customary" meant. The Court, ultimately, could not countenance the idea that the FCA would not cover submitting claims that one thought were probably false to the Federal Government—no matter how an objectively reasonable person would view the statute.

The Court similarly rejected Respondents' (and the Seventh Circuit's) arguments in reliance on *Safeco Ins. Co. of America v. Burr*, 551 U. S. 47 (2007) in support of an objective standard. The Court found such reliance on the case to be unpersuasive, as *Safeco* addressed not the FCA but the Fair Credit Reporting Act, which had a willful *mens rea* standard as opposed to the FCA's knowing standard. In addition, *Safeco's* holding was not as purely objective as Respondents had argued, according to the Court, because although its analysis of recklessness contained an objective standard (i.e., an unjustifiably high risk of harm that is so obvious that it *should be* known), it also necessarily included a subjective standard (i.e., an unjustifiably high risk of harm that *is* known). Finally, the Court rejected Respondents' argument that their reporting of higher prices as "usual and customary" was a misrepresentation of law, as opposed to a misrepresentation of fact, because it was made according to their interpretation of what "usual and customary" meant under the regulations. According to Respondents, misrepresentations of law are not actionable as fraudulent under common law, and, as the FCA is based in common law, that limitation should apply to FCA claims. The Court declined to decide whether pure misrepresentations of law are actionable under the FCA, *id.* at 15, but nonetheless found that Respondents' misrepresentations "implied facts about their prices" unknown to the agencies receiving the claims by putting forth what "[their] 'usual and customary' prices" *were* (rather than simply opining on what "usual and customary" means under the FCA) and were thus not pure misrepresentations of law. *Id.* at 16.

The Court vacated the lower court judgments and remanded both cases to the Seventh Circuit for further proceedings consistent with its understanding of the FCA's scienter provisions.

Takeaways

In rejecting a line of reasoning from previous FCA cases that provided companies with a certain amount of leeway in interpreting ambiguous regulations, the Supreme Court has made clear that lower courts should scrutinize FCA defendants' contemporaneous, subjective beliefs about what a certain regulation requires and whether the claims they submit are accurate under the regulation. It, therefore, will not work the sea change that some commentators expected

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and that the Government and relators' bar feared. The Court's opinion, however, does not preclude a defense that good-faith confusion about complicated regulatory schemes and ambiguous guidance can beat back FCA liability.

Indeed, the Court's opinion is a relatively modest opinion by its own terms. The Court declined to take positions on what constitutes authoritative guidance for purposes of interpreting a regulation, whether pure misrepresentations of law are actionable under the FCA, and whether Respondents may have in fact made honest mistakes in interpreting the regulations at issue here, as opposed to knowing misrepresentations. At the same time, this decision may further embolden *qui tam* plaintiffs and the Government to pursue more aggressive FCA claims based on what may be objectively reasonable yet subjectively questionable interpretations of regulations, knowing that they may be able to obtain fact discovery into a defendant's contemporaneous discussions about potential concerns with claims submitted to the Government. Companies that regularly contract with or submit claims to the Government should consult with counsel as they attempt to interpret ambiguous regulations and navigate the dynamic FCA litigation landscape.

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