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Client Alert Commentary

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Supreme Court Holds FCA Liability Hinges on Defendants' Subjective Beliefs as to Falsity

The Court unanimously held that a defendant's subjective belief is relevant to scienter under the False Claims Act, even when a defendant's conduct is consistent with an objectively reasonable interpretation of the law.

On June 1, 2023, the US Supreme Court issued a decision in *U.S. ex. rel. Schutte v. SuperValu Inc.*, holding that the scienter requirement of the False Claims Act (FCA)[1] must account for defendants' subjective beliefs as to the falsity of their claims regardless of what an objectively reasonable person may have believed.[2] In a unanimous opinion authored by Justice Clarence Thomas,[3] the Court overturned two Seventh Circuit decisions[4] holding that the respondent-pharmacies' subjective beliefs as to the falsity of claims submitted to government healthcare programs were irrelevant if their understanding was consistent with an objectively reasonable interpretation of the relevant law.[5]

While narrow in scope, the Court's ruling that "reckless disregard" includes awareness of "an unjustifiable risk of falsity"[6] introduces further uncertainty for government contractors trying to comply with an ambiguous law or regulation.

FCA Requires "Knowing" Submission of False Claims

The FCA is the US government's primary tool to address fraud related to the performance of government contracts and the submissions of claims to the government for payment. The FCA deputizes private parties to act as whistleblowers who pursue claims on behalf of the government (and collect a share of the recovery) in what are known as "*qui tam* actions."[7]

The FCA imposes liability where a defendant "knowingly" submits a false or fraudulent claim for payment to the government.[8] There is no requirement to prove a specific intent to defraud — "knowingly" can be "actual knowledge," "deliberate ignorance," or mere "reckless disregard" of the truth or falsity of the information.[9]

Supreme Court Reverses Seventh Circuit

The Supreme Court consolidated two cases, *United States ex rel. Schutte v. SuperValu Inc.*[10] and *United States. ex rel. Proctor v. Safeway Inc.*,[11] and granted certiorari to decide the narrow issue of whether the pharmacies "knowingly" submitted false claims under the FCA, where their claims were false and they believed their claims were false when submitted, though the claims comported with an

"objectively reasonable" interpretation of an ambiguous law. The *qui tam* actions alleged that Safeway and SuperValu pharmacies submitted to Medicare[12] and Medicaid[13] inflated claims for reimbursement of covered prescription drugs that were higher than the "usual and customary" prices charged to the public. The whistleblowers presented evidence that Safeway and SuperValu believed their discounted prices were their "usual and customary" prices, yet reported higher retail prices to Medicare and Medicaid and attempted to hide the discounted drug prices from the government.

In *SuperValu*, the district court found that the pharmacy's discounted prices were its true "usual and customary" prices and that its claims for reimbursement to Medicare and Medicaid of the higher retail drug prices were therefore false.[14] Despite this finding of falsity, the district court granted summary judgment in favor of SuperValu, holding that the pharmacy could not have acted "knowingly" under the FCA because the phrase "usual and customary" was facially ambiguous and SuperValu had applied an objectively reasonable interpretation of the law.[15] The district court granted Safeway summary judgment on the same basis.[16]

The Seventh Circuit affirmed in both cases, adopting from a 2007 case, *Safeco Ins. Co. of America v. Burr*,[17] the Supreme Court's interpretation of the Fair Credit Reporting Act's requisite scienter, "willfully," and holding that where the relevant law is ambiguous or "allow[s] for more than one reasonable interpretation," a defendant could not have *knowingly* submitted false claims under the FCA.[18]

The Supreme Court reversed both holdings, declining to read *Safeco* as broadly as the Seventh Circuit did and holding that "facial ambiguity alone is not sufficient to preclude a finding that respondents knew their claims were false."[19] Referencing the FCA's statutory text and the scienter requirement for common law fraud, the Court held that "[t]he FCA's scienter element refers to respondents' knowledge and subjective beliefs—not to what an objectively reasonable person may have known or believed."[20] Even if the respondents' actions comported with an "objectively reasonable" interpretation of an ambiguous law, for FCA scienter, "it is enough if respondents believed that their claims were not accurate," and ambiguity does not preclude respondents from learning or becoming aware of the terms' correct meaning.[21]

The Court emphasized the importance of contemporaneous evidence of the respondents' beliefs as to the falsity of their claims, stating that the scienter inquiry focuses "on what the defendant knew when presenting the claim" and "not … on *post hoc* interpretations that might have rendered their claims accurate."[22]

The Court also stated that "reckless disregard" includes awareness of "a substantial and unjustifiable risk" of falsity, but did not provide further guidance as to what type of evidence would constitute such risk.[23] That said, the Court emphasized the particular facts at issue — noting that the respondents had received notice that the phrase "usual and customary" referred to their discounted prices, including notice from the same entities to which they reported their prices, and then ignored it.[24] The Court concluded that "[i]f that is true, then perhaps respondents actually knew what the phrase meant or perhaps respondents were aware of an unjustifiably high risk that the phrase referred to their discounted prices" and, "if that is true, then respondents may have known that their claims were false."[25]

Notably, because the district court had found falsity, the Court did not consider the respondents' ambiguity argument in the context of the FCA's falsity element.

Nor did the Court rule on the respondents' argument that even if false, the claims constituted only a misrepresentation of law — which is not actionable at common law. The Court recognized the support

for the principle, as misrepresentations of law are not actionable at common law.[26] However, the Court did not reach respondents' argument because it found that the respondents' actions "plainly implied *facts* about their prices" — specifically that the claims reflected the pharmacies' "usual and customary" prices — which could support a theory of fraud.[27]

Takeaways

The Supreme Court's decision leaves a number of questions unanswered, and it remains to be seen how the decision will play out in the lower courts. For example, the Court did not provide guidance regarding when a government contractor meets the threshold for "substantial and unjustifiable risk" that its claims were false. Such open questions about the practical implications of the Court's holding will likely lead to numerous (and possibly conflicting) interpretative decisions from lower courts.

In the meantime, government contractors and FCA defendants should be prepared to litigate the element of scienter as a fact issue for the jury, rather than an issue of law at the motion to dismiss stage. Courts also may still be amenable to arguments that scienter cannot be proven where the claims would be knowingly false only because of their view of the law and not because of any misrepresentations of fact, given that the Court did not address that scenario.

Where a case turns on a vague or ambiguous law or complex regulatory regime, defendants should consider pressing ambiguity arguments as a falsity defense. Significantly, the *SuperValu* opinion is narrowly confined to scienter and the falsity of the claims was not in dispute.

In terms of compliance takeaways, companies operating in complex regulatory schemes should exercise care in taking efforts to understand ambiguous laws and requirements, and consider documenting that contemporaneous analysis and understanding. In doing so, companies should consider to what extent such analyses can be undertaken by business personnel or non-attorneys. Companies that exclusively rely on legal assessments by internal or external legal counsel may limit their ability to refute scienter without waiving privilege. Alternatively, companies that want to rely on an "advice of counsel" defense and waive privilege by asserting this defense should consider contemporaneously documenting the legality of the conduct, including the lack of "substantial and unjustifiable risk" of non-compliance.

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Endnotes

1 31 U.S.C. § 3729 *et seq*.

2 *See United States ex rel. Schutte v. SuperValu Inc.*, No. 21-111, 2023 WL 3742577, at *2 (U.S. June 1, 2023).

3 Justice Thomas has a long-running history of authoring FCA opinions for the Court. Since the 1990s, Justice Thomas has authored more FCA opinions than any of his colleagues — seven opinions compared to one to two authored by other Justices — and he authored one of the Court's most significant FCA opinions, *Universal Health Services v. Escobar*, in 2016. *See* Jeff Overley & Daniel Wilson, *Thomas Burnishes False Claims Act Crown With 9-0 Decree*, Law360 (June 1, 2023, 11:35 PM EDT),

https://www.law360.com/lifesciences/articles/1683660?nl_pk=574b80ed-8b52-4210-8da8-56ac534225cf&utm_source=newsletter&utm_medium=email&utm_campaign=lifesciences&utm_content=2023-06-02&read_more=1&nlsidx=0&nlaidx=0.

[4] *See, e.g., United States ex rel. Schutte v. SuperValu Inc.*, 9 F.4th 455 (7th Cir. 2021) and *United States ex rel. Proctor v. Safeway Inc.,* 30 F.4th 649 (7th Cir. 2022).

[5] 2023 WL 3742577, at *2.

[6] *Id.* at *1.

[7] 31 U.S.C. § 3730(b).

[8] 31 U.S.C. § 3729(a)(1)(B).

[9] 31 U.S.C. § 3729(a)(1)(B), (b)(1)(A).

[10] 9 F.4th 455 (7th Cir. 2021).

[11] 30 F.4th 649 (7th Cir. 2022).

[12] Medicare provides federally funded health insurance coverage to individuals 65 or older or those individuals with certain health conditions. *See* 42 U.S.C. § 1395 *et seq*.

[13] Medicaid establishes a federal-state program that provides medical assistance to certain low-income individuals. *See* 42 U.S.C. § 1396 *et seq*.

[14] 2023 WL 3742577, at *10.

[15] *Id.* at *8–10.

[16] *Id.; see also United States v. Safeway Inc.*, 466 F. Supp. 3d 912, 941 (C.D. Ill. June 12, 2020), *aff'd sub nom. United States ex rel. Proctor v. Safeway, Inc.*, 30 F.4th 649 (7th Cir. 2022), *vacated and remanded sub nom. United States ex rel. Schutte v. SuperValu Inc.*, No. 21-111, 2023 WL 3742577 (U.S. June 1, 2023).

[17] *Safeco Ins. Co. of America v. Burr,* 551 U.S. 47 (2007).

[18] *Id.* at 70 n.20.

[19] 2023 WL 3742577, at *2.

[20] *Id.* at *6.

[21] *Id*. at *10.

[22] *Id.* at *7.

[23] *Id.* at *10.

[24] *Id.* at *8.

[25] *Id.*

[26] *Id*. at *9.

[27] *Id.* at *10.