

Scienter solved: The Supreme Court decides subjective intent matters under the False Claims Act

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On June 1, the Supreme Court unanimously settled a circuit split, ruling that the scienter element of the False Claims Act (FCA) refers to a defendant's subjective belief of wrongdoing. The question before the Court was whether a defendant acts "knowingly" under the FCA when the defendant believed that a claim was false or whether a claim must be objectively unreasonable, as a matter of law, before a defendant can be found to have acted "knowingly," regardless of what the defendant believed.

The Supreme Court resoundingly rejected the objective reasonableness standard adopted by the majority of the circuits.

Background and procedural history

In *United States ex rel. Schutte v. SuperValu Inc.*¹ and *United States ex rel. Proctor v. Safeway Inc.*,² the Seventh Circuit granted summary judgment for the defendants, which were supermarket chains with pharmacies, and addressed whether the defendants knowingly violated the FCA by failing to accurately report their "usual and customary" drug prices.

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SuperValu had introduced a discount drug program, matching competitors' lower prescription drug prices. However, it allegedly failed to report these discounted prices as its usual and customary prices, potentially leading to greater reimbursement from Medicare and Medicaid.

Similarly, Safeway had introduced several prescription drug discount programs, which lowered the cost of covered prescriptions. Like SuperValu, Safeway did not report these lower prices as its "usual and customary" pricing, which allegedly inflated its reimbursement from Medicare and Medicaid.

In *Schutte*, the Seventh Circuit held that defendant SuperValu had not acted "knowingly" when it failed to report its discounted prices based on its reasonable interpretation of the regulatory definition of "usual and customary" price and because there was no authoritative guidance to place it on notice of its error.

In *Proctor*, the Seventh Circuit determined that a footnote in a Centers for Medicare and Medicaid Services Manual did not constitute "authoritative guidance," and therefore there was nothing to put the defendant on notice of its error.

In so holding, and contrary to the circuits that adopted a subjective intent standard, the Seventh Circuit adopted the objective standard that a defendant's reasonable interpretation of the law does not satisfy the scienter element of the FCA, even if the reasonable interpretation is incorrect.

Companies that operate under a complex regulatory scheme face increased exposure to liability under the FCA even where they incorrectly, but reasonably, interpret the rules.

Both *Schutte* and *Proctor* relied heavily on *Safeco Insurance Co. of America v. Burr*,³ which interpreted "willfully" in a Fair Credit Reporting Act case, and held that a defendant does not act with "reckless disregard" if it acts under an objectively reasonable interpretation of a law.

Supreme Court rules that subjective belief matters

Justice Thomas, writing for the Court, resolved the circuit split by concluding that the FCA's scienter standard refers to the defendant's knowledge and subjective belief. The Court explained that the statutory text of the FCA, and its common-law roots, made the question before it "straightforward." The Court anchored the foundational underpinning of the FCA to common-law fraud, which the Court explained "ordinarily depends on a subjective test and the defendant's culpable state of mind."

Further, the Court also found that while the phrase "usual and customary" may be facially ambiguous, that ambiguity does not prevent a finding that the defendants knew the claims were false.

Finally, the Court found that any reliance on *Safeco* was misplaced because *Safeco* involved a completely "different statute with a

different mens rea” and does not suggest a court should look to facts that a defendant did not know or never had reason to know at the time he or she acted.

Implications

The Supreme Court’s decision has important consequences for defendants sued under the FCA. Specifically, companies that operate under a complex regulatory scheme, such as under the rules of Medicare and Medicaid, face increased exposure to liability under the FCA even where they incorrectly, but reasonably, interpret the rules.

Going forward, defendants will no longer be able to assert the *Safeco* defense to avoid liability and must be ready for emboldened relators to potentially put forward alternative interpretations of regulations and robust evidence demonstrating that a defendant thought or believed that the claims submitted were false.

Notes

¹ 9 F.4th 455 (7th Cir. 2021).

² 30 F.4th 649 (7th Cir. 2022).

³ 551 U.S. 47 (2007).

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