CLIENT ALERT

Supreme Court Grants Certiorari in False Claims Act Scienter Cases

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On Friday, January 13, 2023, the Supreme Court granted writs of certiorari in *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, consolidating the cases and agreeing to address the questions of 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 False Claims Act (the "FCA").[1] The Supreme Court's decision will clarify whether a defendant can knowingly submit a false claim so long as the conduct is consistent with an objectively reasonable interpretation of the statute.

FCA Background

The FCA, 31 U.S.C. § 3729 *et seq.*, prohibits persons from "knowingly" submitting false claims or making material false statements to the government in support of claims. 31 U.S.C. § 3729(a). The statute fleshes out the scienter requirement, specifying three mental states for which defendants can be held liable for "knowing" acts: (1) actual knowledge; (2) deliberate ignorance; or (3) reckless disregard of the falsity of information. *Id.* § 3729(b)(1)(A). Proof of specific intent to defraud is not required. *Id.* § 3729(b)(1)(B).

Those who violate the FCA may be liable for treble the U.S. government's damages plus a penalty. In addition to allowing the United States to address the fraud on its own, the FCA allows private citizens, known as "relators," to file *qui tam* suits

[1] Counsel for Petitioners and Respondents are the same in each case, and the question presented in the later-filed *Safeway* explicitly states that "the Court may wish to consider the two petitions together."

on behalf of the government against those who have defrauded the government. Citizens who successfully bring *qui tam* actions may receive a portion, typically 15–30%, of the Government's recovery.[2] The FCA is one of the U.S. Department of Justice's primary tools for redressing false claims and fraud involving government resources. In fiscal year 2021, the Department of Justice's FCA settlements and judgments totaled $5.6 billion, the second largest in history after 2014, in part due to substantial settlements relating to opioid cases.

Circuit Split: the FCA Scienter Requirement

The emerging circuit split finds roots in *Safeco Insurance Co. of America v. Burr*, 551 U.S. 47 (2007), in which the Supreme Court evaluated the scienter requirement of the Fair Credit Reporting Act. The Court held that scienter cannot be shown as a matter of law if the defendant's conduct was consistent with an objectively reasonable interpretation of an ambiguous legal statutory or regulatory requirement, unless authoritative guidance existed against the defendants' interpretation. *Id.* at 70 & n.20.[3]

In determining whether a false claim was perpetrated "knowingly" despite a reasonable, erroneous interpretation of an ambiguous legal requirement, the Sixth, Ninth, Tenth, and Eleventh Circuits have been willing to evaluate subjective intent including with reference to defendants' reactions to warnings and red flags, as well as holistic evidence including government documents and company guidance. *See, e.g.*, *United States v. Chen*, 402 F. App'x 185, 187–88 (9th Cir. 2010) (determining that Medicare "pamphlets and newsletters that collectively explained the requirements" for a regulation were indicia that the defendant's interpretation "was neither correct nor in good faith" (citing *United States ex rel. Oliver v. Parsons Co.,* 195 F.3d 457, 464 (9th Cir. 1999))); *United States v. Boeing Co.*, 825 F.3d 1138, 1145–50 (10th Cir. 2016) (evaluating what defendant knew or intended at the time with reference to record evidence of whether defendant subjectively knew of compliance issues or was reckless to them, regarding reasonableness of a defendant's interpretation as relevant but not dispositive, and noting that ambiguity is only one factor in holistic scienter inquiry); *United States ex rel. Phalp v. Lincare Holdings, Inc.*, 857 F.3d 1148, 1155 (11th Cir. 2017) (stating that "ambiguity … does not foreclose a finding of scienter," and that the inquiry is "whether the defendant actually knew or should have known that its conduct violated a regulation in light of any ambiguity at the time of the alleged violation"); *United States ex rel. Prather v. Brookdale Senior Living Communities*, 892 F.3d 822, 838 (6th Cir. 2018) (focusing on subjective understanding at the time of the alleged misconduct, holding that "defendants deliberately ignored multiple employees' concerns about their compliance with relevant regulations," indicating "that they acted with 'reckless disregard.'"). The Eleventh Circuit's decision in particular embraces inquiry into the contemporaneous and subjective intent of the defendant, stating that defendants may not rely on a

[2] The U.S. government does not always intervene in the case, however. Under the statute, the Government has 60 days to determine whether to intervene or request an extension. Extensions are routine, and the Government's intervention investigation can stretch on for years.

[3] In granting certiorari, the Supreme Court apparently rejects the respondents' efforts to evaporate the circuit split by arguing that "no circuit has ever held that *Safeco*'s standard is inapplicable to the FCA in cases where falsity turns on an ambiguous legal obligation. There is no circuit split." Resp. Br. 2.

"'reasonable' interpretation of an ambiguous regulation manufactured post hoc." *See United States ex rel. Phalp*, 857 F.3d at 1155.

On the other side of the ledger, the Fourth Circuit, the Seventh Circuit (addressed below), the Eighth Circuit, and the D.C. Circuit have held that, as stated in *Safeco*, a defendant's "reasonable" interpretation FCA scienter, even where that interpretation is wrong, does not establish FCA scienter unless authoritative guidance warned the defendant to the contrary. *See, e.g.*, *United States ex rel. Hixson v. Health Mgmt. Sys., Inc.*, 613 F.3d 1186, 1190 (8th Cir. 2010) ("[A] reasonable interpretation of a statute cannot support a claim under the FCA if there is no authoritative contrary interpretation of that statute."); *United States ex rel. Donegan v. Anesthesia Associates of Kansas City, PC*, 833 F.3d 874, 878–80 (8th Cir. 2016) (affirming summary judgment for defendant because Medicare requirement was ambiguous, the requirement had not "been defined by a controlling source," and defendant's interpretation was "objectively reasonable"); *United States ex rel. Purcell v. MWI Corp.*, 807 F.3d 281, 289 (D.C. Cir. 2015) (defendant not liable because interpretation of ambiguous term was "reasonable" and no "authoritative guidance" existed from court of appeals or relevant agency against defendant's interpretation (citing *United States ex rel. K&R Ltd. P'ship v. Mass. Hous. Fin. Agency*, 530 F.3d 980, 983 (D.C. Cir. 2008))); *United States ex rel. Sheldon v. Allergan Sales, LLC*, 24 F.4th 340, 343–44, 351 (4th Cir. 2022) (defendant's interpretation of relevant law "was at the very least objectively reasonable and because it was not warned away from that reading by authoritative guidance, it did not act 'knowingly' under the False Claims Act"), *vacated en banc by* 49 F.4th 873 (4th Cir. Sept. 23, 2022) (mem.) (equally divided court affirming lower court's decision).[4]

In contrast to the Eighth and D.C. Circuits, which leave open the possibility that a defendant must have believed its interpretation at the time in order to lack scienter, the Fourth Circuit flatly circumscribes liability for defendants by determining that a defendant's subjective intent is irrelevant to the scienter inquiry. *Compare United States ex rel. Miller v. Weston Educ., Inc.*, 840 F.3d 494, 502–03 (8th Cir. 2016) (reversing summary judgment because evidence of defendant's understanding "both before and after" the challenged conduct showed a "dispute of material fact whether, when signing the [agreement, defendant] intended to manipulate its records"), and *United States v. Sci. Applications Int'l Corp.*, 626 F.3d 1257, 1272 (D.C. Cir. 2010) (holding that defendant's "alleged[ly] false statements [that] were the result of its belief" precluded judgment as a matter of law since it could have led to "reasonable jury inferences [about what defendant] knew"), *with United States ex rel. Sheldon v. Allergan Sales, LLC*, 24 F.4th at 348 ("This objective standard precludes inquiry into a defendant's subjective intent.").

The Seventh Circuit's Decisions in *Schutte* and *Proctor*

U.S. ex rel. Schutte v. SuperValu Inc., et al., 9 F.4th 455 (7th Cir. 2021) and *U.S. ex rel. Proctor v. Safeway, Inc.*, 30 F.4th 649 (7th Cir. 2022) are *qui tam* actions brought by relators against grocery and pharmacy chains for charging the United States more than the "usual and customary" prices charged to cash-paying customers. In both cases, relators alleged that in

[4] The Fourth Circuit's *Sheldon* opinion is not operative in light of the *en banc* court's vacatur. But its careful analysis is still useful for purposes of describing and considering the different approaches applied by the courts of appeals.

submitting claims for reimbursement, the stores knowingly overstated the "usual and customary" prices for prescription drugs by disregarding that the majority of drugs were substantially discounted under price-match programs, causing government healthcare programs including Medicare Part D and Medicaid to pay more for the drugs than they should have.

Schutte was first to be decided. In a split decision, the Seventh Circuit applied *Safeco* and concluded that there is no scienter as a matter of law if the defendant's conduct falls within an "objectively reasonable" interpretation of the law, and "no authoritative guidance cautioned defendants against it." *Id.* at 464. The majority rejected the argument "that for an erroneous interpretation to be objectively reasonable, the defendant must have held that view at the time that it submitted its false claim," stating, "it is not enough that a defendant suspect or believe that its claim was false"—and "a defendant's subjective intent does not matter for [the] scienter analysis" because "the inquiry is an objective one." *Id.* at 470. The majority further stated that only "circuit court precedent or guidance from the relevant agency" can qualify as "authoritative guidance," which "must come from a source with authority to interpret the relevant text" and "must have a high level of specificity to control an issue." *Id.* at 471. Thus, the Seventh Circuit majority held that "SuperValu has offered an objectively reasonable interpretation of [usual and customary] price." *Id.* at 470.

In dissent, Judge David Hamilton stated that the majority's holding contradicts the FCA's text and history, noting in particular that using *Safeco*'s scienter rule "effectively nullifies two-thirds of the statutory definition of 'knowing,'" *id.* at 481 (Hamilton, *J.*, dissenting), by reducing the requirement to recklessness, and that eliminating consideration of subjective intent could allow additional fraudulent conduct where lawyers "can concoct a post hoc legal rationale that can pass a laugh test." *Id.* at 473 (Hamilton, *J.*, dissenting).

In relevant part, *Proctor* presented a case of *déjà vu*, with the Court applying *Schutte* to a similar fact pattern. The panels were nearly identical, and Judge Amy St. Eve wrote for the majority in both. As he did in *Schutte*, Judge Hamilton dissented in *Proctor*, this time explicitly calling for *Schutte* to be overruled. *Proctor*, 30 F.4th at 663. In reaching its conclusion, the Seventh Circuit joins the Fourth Circuit in a more defendant-friendly, narrow statutory interpretation, determining not only that ambiguity defeats a finding of scienter absent authoritative guidance, but also that a defendant's subjective intent is "irrelevant" to the scienter inquiry. *Schutte*, 9 F.4th at 466, 471.

Closing Thoughts

The Supreme Court may have been persuaded to grant certiorari in the case given the pipeline of similar cases, as well as by the amicus participation at the certiorari stage—most significantly the United States—arguing that the petition for a writ of certiorari should be granted. The brief by the United States, which argues that the Seventh Circuit erred, United States Br. 8–18, and that the Supreme Court's consideration "is important to efforts to fight fraud involving the public fisc," *id.* 18–19, was precipitated by the Court's order inviting the Solicitor General to express the views of the United States.

Together, these cases are the latest in a recent stream of requests, with mixed results, that the Supreme Court clarify the contours of the powerful statute. On October 17, 2022, the Supreme Court declined the opportunity to clarify the heightened pleading standard governing fraud allegations under the FCA in *Johnson v. Bethany Hospice & Palliative Care LLC*, No. 21-462, *United States ex rel. Owsley v. Fazzi Associates, Inc.*, No. 21-936, and *Molina Healthcare of Illinois, Inc. v. Prose*, No. 20-2243, allowing a more lenient standard—where relators either may identify specific false claims or plead other sufficiently reliable indicia supporting a strong inference that false claims were submitted—to continue in certain circuits. On December 6, 2022, the Supreme Court heard argument in *United States ex rel. Polansky v. Executive Health Resources, Inc.*, No. 21-1052, a case that considers whether the government has authority to dismiss an FCA suit brought by an individual after initially declining to proceed with the action, and if so, what standard would apply—affecting cost and lifespan of certain FCA cases.

The case should be closely watched by defendants who regularly interface with the U.S. government in this space. The decision will clarify the subjective/objective divide of the scienter requirement currently roiling the courts, it will address what constitutes "authoritative guidance" and the relevance of ambiguity of such guidance, and it may also offer insight into the distinct but related requirement of "falsity" that, like "knowingly," bears on liability under the statute. It remains to be seen where on the spectrum from the Fourth and Seventh Circuits (liability least likely) to the Eleventh Circuit (liability most likely) the Supreme Court will land on its clarification of the contours of scienter under the FCA.

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