

## Supreme Court Rejects Objective Standard for Scienter for False Claims Act

On June 1, 2023, the United States Supreme Court decided two consolidated cases, *United States ex rel. Schutte v. SuperValu Inc.* and *United States ex rel. Proctor v. Safeway*, 589 U.S. \_\_\_ (2023), holding that a defendant’s subjective belief about the falsity of its claims at the time the claim is presented is the basis for determining whether the plaintiff has proved scienter under the False Claims Act (“FCA”). The Court rejected the Seventh Circuit’s so-called “objective” intent standard (which had been endorsed by the Eighth and D.C. Circuits) under which a defendant does not have the requisite scienter under the FCA so long as its position was supported by an objectively reasonable interpretation of the law, regardless of its actual knowledge or intent. Writing for a unanimous court, Justice Thomas explained that scienter “refers to [a defendant’s] knowledge and subjective beliefs—not to what an objectively reasonable person may have known or believed.” Slip Op. 8.

The Court continued its recent trend of drawing on principles of common law fraud in interpreting the FCA to conclude that the critical inquiry is “what the defendant knew when presenting the claim,” not whether the defendant’s “*post hoc* interpretations” of the relevant law are reasonable. Slip Op. 11.

Although the Court ruled in favor of the relator-appellees, the decision imposes a standard that may be difficult for many FCA plaintiffs to meet, as it requires proof of a defendant’s *actual* knowledge at the time a claim was submitted rather than what a reasonable person would have believed. Indeed, the Court left the door open to arguments that a defendant’s incorrect but contemporaneous interpretation may preclude a finding of scienter—provided that the defendant is not conscious of a “substantial and unjustifiable risk” that its interpretation is wrong or deliberately ignorant to the falsity of its claim. Slip Op. 10. Nor did the Court address the other elements of an FCA claim, including falsity and materiality, all which must be satisfied to hold a defendant liable under the FCA.

As a practical matter, defendants challenging the scienter element of an FCA claim should be prepared for fact-intensive inquiries into intent that may be less amenable to resolution on a motion to dismiss or summary judgment. Even in these cases, the Court did not preclude the defendants from ultimately prevailing on their motions for summary judgment; rather, the Court simply clarified the proper legal standard for scienter under the FCA. Thus, defendants should continue to be alert for instances in which the evidence developed in discovery cannot support the complaint’s allegations.

### Background

In *Schutte* and *Proctor*, the relators alleged that supermarkets SuperValu and Safeway overcharged Medicaid and Medicare for years when seeking reimbursement for generic prescription drugs. Medicaid and Medicare regulations do not allow healthcare providers to charge more than the providers’ “usual and customary” charges for a drug to the general public. Thus, when SuperValu and Safeway submitted reimbursement claims to these entities, they were required to charge and disclose their “usual and customary” price for drugs.

The relators accused SuperValu and Safeway of knowingly and improperly reporting prices to Medicaid and Medicare that were higher than they usually and customarily charged the public.

According to the relators, SuperValu and Safeway implemented a matching discount program, under which the majority of their generic drug sales to retail customers were \$4 for a 30-day supply. The relators contended that this made the discounted price the “usual and customary” price, but that the supermarkets reported higher, non-discounted prices to Medicare and Medicaid. While the Court acknowledged that the phrase “usual and customary” may be “somewhat open to interpretation,” it noted that the relators had presented evidence that the supermarkets “were informed that their lower, discounted prices were their ‘usual and customary’ prices, believed their discounted prices were their ‘usual and customary’ prices, and tried to hide their discounted prices from regulators and contractors.” Slip Op. 5. The complaints contained some specific allegations, including that internal documents existed directing employees not to memorialize certain pricing decisions, and that executives at both companies were concerned about letting state agencies or pharmacy benefit managers know about the discounted prices.

The district court determined that the supermarkets’ discounted prices were their “usual and customary” prices, and that, by not reporting them, the supermarkets had submitted false claims. Nevertheless, the court granted summary judgment to the supermarkets on the scienter element of the FCA claims, finding that they could not have acted “knowingly.” The court found that the supermarkets did not have the requisite intent because their interpretation of “usual and customary” was reasonable.

The Seventh Circuit affirmed, applying “a two-step inquiry for ascertaining whether a defendant acted recklessly or knowingly,” relying on a Fair Credit Reporting Act (“FCRA”) case, *Safeco Ins. Co. of America v. Burr*, 551 U. S. 47 (2007). Slip Op. 6. Under the Seventh Circuit’s objective intent framework, at step one a court must ask whether a defendant’s acts were consistent with any objectively reasonable interpretation of the law that had not been precluded by definitive legal authority or guidance. According to the Seventh Circuit, a court need only consider the defendant’s actual subjective beliefs at step two if the defendant’s acts were not consistent with any objectively reasonable interpretation at step one. As the Supreme Court explained, under the Seventh Circuit’s framework, it did not matter under the first step what the defendant thought, instead “a claim would have to be objectively unreasonable, as a legal matter, before a defendant could be held liable for ‘knowingly’ submitting a false claim.” Slip Op. 7. The Seventh Circuit therefore never reached step two—to examine the supermarkets’ subjective beliefs and actual knowledge—because it concluded that the supermarkets’ interpretation of “usually and customary” was objectively reasonable. The Supreme Court granted *certiorari* to address the Seventh Circuit’s objective intent framework and to clarify whether courts can examine subjective intent even if a defendant offers an objectively reasonable *post hoc* interpretation.

### **The Court’s Analysis**

In its decision, the Court rejected the Seventh Circuit’s two-part framework, holding that “if [defendants] correctly interpreted the relevant phrase and believed their claims were false,” then they could have had the requisite scienter. Slip Op. 2. The Court explained that scienter “refers to [defendants]’ knowledge and subjective beliefs—not to what an objectively reasonable person may have known or believed.” *Id.* at 8.

In rejecting the Seventh Circuit’s framework, Justice Thomas analyzed the text of the FCA to explain that it is rooted in the common law of fraud. He noted that the FCA’s definition of “knowingly,” which requires a showing of “either actual knowledge, deliberate ignorance, or recklessness,” Slip Op. 9, corresponds to “the common-law scienter standards for fraud,” which also requires a showing of actual knowledge, deliberate ignorance of the truth, or recklessness, Slip Op. 10. In applying the common law principles of fraud to interpret the FCA’s scienter requirement, the Court thus built on its reasoning in *Universal Health Services, Inc. v. United States ex rel. Escobar*, where it relied on common-law fraud principles to examine the scope of the FCA’s materiality requirement. 579 U. S. 176, 187 (2016).

Using that framework, the Court examined the FCA’s text and its common law roots to determine that “the FCA’s standards focus primarily on what [defendants] thought and believed,” not on whether a claim is based on an objectively reasonable interpretation. Slip Op. 10. For example, the court explained that “actual knowledge” refers to a person’s perception of the truth or awareness of information, while “deliberate indifference” refers to those who “are aware of a substantial risk that their statements are false, but intentionally avoid taking steps to confirm the statement’s truth or falsity.” Slip Op. 10. The Court also explained that “reckless disregard,” the lowest bar for scienter under the FCA, refers to those “who are conscious of a substantial and unjustifiable risk that their claims are false, but submit the claims anyway.” Slip Op. 10. The Court did not provide further guidance on the reckless disregard standard, specifically declining to decide whether a defendant could be reckless under the FCA for acting in the face of an objectively “unjustifiably high risk” that its claim was false “that was so obvious that it should have been known, even if the defendant itself was not actually conscious of that risk.” Slip Op. 10 n.5. Nor did the Court explain what would constitute the type of “substantial and unjustifiable risk” that would lead to a finding of “reckless disregard.” These unanswered questions are certain to arise in future litigation.

After concluding that the scienter analysis focuses on the defendant’s actual knowledge and belief, the Court explained that the FCA’s text and common law principles “also point to what the defendant thought when submitting the false claim,” not to whether the defendant’s *post hoc* interpretation of the relevant law is reasonable. Slip Op. 11. As the Court explained, “we do not look to legal interpretations that respondents did not believe or have reason to believe at the time they submitted their claims.” Slip Op. 14.

After reviewing the record, the Court rejected the defendants’ argument that “facial ambiguity alone” can be sufficient “to preclude a finding that [defendants] knew their claims were false.” Slip Op. 8. The Court examined whether the defendants were on notice of the ambiguous term’s “correct meaning,” finding that even though “usually and customary” could be considered ambiguous, the defendants could not claim the ambiguity precluded a finding of scienter. This is because the relators in these cases had presented evidence that: (1) defendants received notices from regulators and others of the correct interpretation; and (2) defendants evidently comprehended those notices, because they tried to hide evidence that their claims were inflated. Slip Op. 12–13. The Court distinguished *Safeco*, the decision upon which the Seventh Circuit’s framework rested, by noting that different scienter standards apply to the FCA (“knowingly”) and FCRA (“willingly”). Finally, the Court rejected the defendants’ argument that misrepresentations of law are not actionable at common law and so cannot give rise to liability under the FCA. Slip Op. 14. The Court declined to decide whether that common law principle is actually incorporated in the FCA, noting only that the issue presented in this case was a mixed issue of law and fact. Slip Op. 15–16.

## Takeaways

Following the Court's decision, litigants should bear the following in mind:

- The burden of proof on establishing scienter (as well as falsity and materiality) under the FCA remains with the plaintiff, who must allege and produce evidence that the defendant actually knew the claims were false—not merely that the defendant, or a reasonable person in defendant's position, should have known the claims were false. In many contexts, this will be a higher burden than merely showing that the plaintiff's understanding was unreasonable.
- The Court's decision places greater emphasis on FCA defendants' contemporaneous understanding of ambiguous laws and regulations, so defendants should expect aggressive discovery into their knowledge and beliefs regarding such laws and regulations. This inherently factual inquiry may also make a motion to dismiss more challenging for FCA defendants in cases in which a plaintiff can plausibly allege actual knowledge or recklessness, and meet the other elements of an FCA claim. On summary judgment, however, plaintiff will have to make some evidentiary showing to support their allegations.
- The Court defined "reckless disregard," the lowest bar for scienter under the FCA, as referring to those "who are conscious of a substantial and unjustifiable risk that their claims are false, but submit the claims anyway," but declined to decide whether what constitutes a "substantial and unjustifiable risk" should be determined from an objective perspective. Thus, the Court left the door open to arguments that a defendant's incorrect but reasonable contemporaneous interpretation as to the truth of its claims precludes a finding of scienter.
- Litigants should endeavor to incorporate common law arguments into their FCA cases, given the Court's repeated focus on the common law of fraud in recent FCA opinions.

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