In Blow to False Claims Act Defendants, Supreme Court Fails to Adopt Lesser Knowledge Standard

Client Alert
6.30.2023

Earlier this month, the U.S. Supreme Court issued its decision *in U.S. ex rel. Schutte v. SuperValu Inc.* In the eagerly anticipated False Claims Act (FCA) decision, a unanimous Supreme Court declined to adopt an "objectively reasonable" scienter standard. The False Claims Act, 31 U.S.C. §§ 3729–33, which allows for the Government, and whistleblowers in qui tam actions, to sue federal contractors and other actors alleged to have defrauded the federal government, imposes liability for "any person who … knowingly presents, or causes to be presented, a false or fraudulent claim for payment or approval; or knowingly makes, uses, or causes to be made or used, a false record or statement material to a false or fraudulent claim." 31 U.S.C. § 3729(a)(1)(A)–(B).

The two critical elements in proving an FCA violation are: (1) falsity of a claim; and (2) the defendant's knowledge of the claim's falsity, i.e., scienter. The latter was at issue here. In *SuperValu*, which reviewed two companion cases from the Seventh Circuit, the petitioners alleged that respondent retail pharmacies defrauded Medicaid and Medicare—which Federal programs cap reimbursement for prescription drugs at a pharmacy's "usual and customary price"—by submitting false claims through their failure to disclose various discount programs, instead reporting their higher retail prices. The Seventh Circuit granted summary judgment for the respondents on the grounds that, in accordance with *Safeco Ins. Co. of America v. Burr*, 551 U.S. 47 (2007), a decision examining scienter in the context of another Federal statute, "respondents … actions were consistent with an objectionably reasonable interpretation of the phrase "usual and customary," a phrase that the even the Supreme Court conceded is, on its face, "less than perfectly clear."

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It is this point that has been the focus for federal contractors. As contractors know well, agencies and the FAR Council frequently promulgate vague rules, offering little in the way of guidance to contractors on how to meaningfully comply. This uncertainty, in turn, raises the specter of FCA liability (and treble damages for each actionable claim) for potentially unwitting violators. Indeed, amicus briefs were filed on behalf of industry groups urging the Court to uphold the Seventh Circuit's decisions.

However, a unanimous Court swiftly refuted the reasoning underpinning those decisions. First, the Court held that, based on the FCA's text and common-law history, the Act's scienter element referred not to what an objectively reasonable person may have known or believed, but rather to their own knowledge and subjective beliefs. Thus, the Court dispensed with the suggestion that a regulation's facial ambiguity, standing alone, is sufficient to preclude a finding of scienter. The Court then noted that the statute's ambiguity here did not deprive the respondents of the ability to learn the correct meaning of the term "usual and customary price." For instance, the Court highlighted contemporaneous evidence that the respondents received notices indicating that the phrase "usual and customary," in fact, referred to their discounted prices, such that the respondents either knew what the phrase meant or ran an unjustifiable risk that the interpretation underlying their submission of "claims" was incorrect.

The Court also rejected the respondents' arguments that, in accordance with the common law rule of fraud, which the respondents claimed is incorporated by the FCA, misrepresentations of law are not actionable. According to the Court, that common law rule, to the extent encompassed in FCA jurisprudence, was inapplicable because the respondents' purported legal representations were, in fact, implied factual statements regarding what their actual and customary prices were.

While the case does not completely foreclose FCA defendants from ever putting forward their objectively reasonable interpretation of a regulatory requirement as a defense, such interpretation, standing alone, now cannot be used as a tool to win early dismissal of an FCA case for failure to demonstrate scienter. Rather, in making such arguments, FCA defendants will have to ensure that they present factual evidence regarding their subjective belief, contemporaneous to the submission of the claims at issue (or, better, demonstrate that their interpretation is, in fact, correct). This is likely to hamper efforts at earlier stages of litigation, or at least make FCA defendants work harder, notwithstanding the very real prospect of facing FCA liability for failure to comply with certain regulatory regimes that even experienced practitioners find complex. It will be interesting to see how such arguments, frequently used by contractors to defend against FCA lawsuits, fare in the future.

Butzel continues to monitor this topic. Please feel free to contact the author of this client alert or your Butzel attorney for more information.

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