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Supreme Court Holds That False Claims Act's Scienter Element Refers to Defendant's Subjective Knowledge

On June 1, 2023, the Supreme Court issued a decision in two consolidated cases, *United States ex rel. Schutte* v. *SuperValu* and *United States ex rel. Proctor* v. *Safeway*, holding that the False Claims Act's scienter element "refers to [defendants'] knowledge and subjective beliefs—not to what an objectively reasonable person may have known or believed." It may be prudent for companies that contract with the government (including federal contractors) to assess their interpretations of ambiguous regulations.

Background

The False Claims Act imposes civil liability on anyone who "knowingly" submits a "false" claim to the government. 31 U.S.C. § 3729(a). These cases are about the scienter element: specifically, the legal standard for determining whether a company "knowingly" made false claims.

The FCA allows private parties to bring *qui tam* lawsuits in the name of the United States. Petitioners brought such actions against two companies that operate retail drug pharmacies nationwide: SuperValu and Safeway. According to petitioners, those companies overcharged the government by submitting false claims for reimbursement from Medicaid and Medicare programs.

Medicare and Medicaid programs reimburse pharmacies for certain prescription drugs. Under the relevant regulations, the amount of reimbursement is based in part on the "usual and customary charges [for the drug] to the general public." 42 C.F.R. § 447.512(b)(2) (2021). To receive a reimbursement, a pharmacy must submit a claim reporting its "usual and customary" price for the drug.

Petitioners claimed that SuperValu and Safeway submitted "false" claims in violation of the FCA when they reported higher prices than what they usually and customarily charged the public. Petitioners alleged that, while SuperValu and Safeway charged customers lower prices by running various "price-match" and discount prescription drug programs in order to better compete with Walmart, the companies reported undiscounted retail prices in their submitted claims to the government so as to get a higher reimbursement. According to petitioners, executives at SuperValu and Safeway understood that "usual and customary" refers to the discounted prices because, for example, they allegedly received notices from pharmacy benefit managers and state Medicaid agencies informing them so, but they attempted to hide the companies' discounted prices.

The district court granted summary judgment to SuperValu and Safeway on petitioners' FCA claims. The court ruled against SuperValu on the falsity element, concluding that "usual and customary" refers to the discounted prices and that Supervalu submitted "false" claims by failing to report those prices. But the district court dismissed the claims based on the scienter element, holding that SuperValu could not have submitted false claims "knowingly." The district court granted summary judgment to Safeway on the same basis.

The Seventh Circuit affirmed. In so doing, it relied on the Supreme Court's decision in *Safeco Insurance Company of America* v. *Burr*, 551 U.S. 47 (2007), to hold that the FCA's scienter element has an "objective" safe harbor. The court explained that the "usual and customary" standard is ambiguous and could be reasonably interpreted as referring to higher retail prices, even if that interpretation is incorrect and the submitted claims were "false." Because the interpretation is objectively reasonable, the court concluded, it is irrelevant whether the respondent companies subjectively believed that their claims were false when they submitted them. Therefore, the companies could not have acted "knowingly" in submitting false claims that reported the higher prices.

Supreme Court Decision

In a unanimous decision by Justice Clarence Thomas, the Supreme Court held that under the FCA, the "scienter element refers to respondents' knowledge and subjective beliefs—not to what an objectively reasonable person may have known or believed." If the companies "correctly interpreted the relevant phrase"—"usual and customary charges"—and "believed their claims were false, then they could have known their claims were false." The Court thus concluded that the Seventh Circuit's objective scienter standard was erroneous and vacated the judgments below.

The Court explained that both the "FCA's statutory text and its common-law roots" support that its scienter element refers to a defendant's subjective knowledge at the time of submitting the claim. The FCA provides three definitions of "knowingly": (1) the person "has actual knowledge of the information"; (2) the person "acts in deliberate ignorance of the truth or falsity of the information"; or (3) the person "acts in reckless disregard of the truth or falsity of the information." 31 U.S.C. § 3729(b). Those definitions on their face "focus primarily on what respondents thought and believed," including whether they were " 'aware of' information" or "aware of a substantial risk" that their statements were false.

The FCA's common-law roots, the Court continued, confirm that scienter refers to subjective knowledge. The Court noted that the text of the FCA "tracks the traditional common-law scienter requirements for claims of fraud" and thus "incorporate[s] the well-settled meaning" of common-law terms. Common-law fraud "ordinarily 'depends on a subjective test' and the defendant's 'culpable state of mind.' "

The Court then addressed respondents' arguments. *First*, the Court acknowledged that the terms "usual and customary" are "less than perfectly clear," but concluded that ambiguity does not rule out a finding of scienter. The terms' ambiguity "does not preclude respondents from having learned their correct meaning—or, at least, becoming aware of a substantial likelihood of the terms' correct meaning." *Second*, the Court explained that respondents erroneously relied on the scienter standard in *Safeco*. *Safeco* interpreted a different *mens rea* requirement from a different statute: "willfully" under the Federal Credit Reporting Act. Besides, "*Safeco* did not purport to set forth the purely objective safe harbor that respondents invoke." *Third*, the Court rejected respondents' argument that false statements of law—as opposed to false statements of fact—are not "actionable." Even assuming that the "FCA incorporates some version of this" common-law rule, the statements here "implied facts about [respondents'] prices" that were not known to the government agencies that received their claims.

The Court emphasized that its holding is limited to the legal standard for scienter under the FCA. It did not interpret the meaning of "usual and customary," conclude whether respondents subjectively believed that "usual and customary" referred to discounted drug prices, or decide any other factual disputes. Those questions are to be decided on remand, and in any trial, the evaluation of the facts will not be constrained by the summary-judgment standard.

Implications

Before the Court's decision, federal courts of appeals were divided on the standard for scienter under the FCA. Under *Schutte*, a company's subjective knowledge of falsity is relevant to FCA liability, and its reliance on an objectively reasonable interpretation of an ambiguous regulation is not necessarily a defense against FCA claims.

In light of *Schutte*, companies that contract with the government should assess their interpretations of confusing or ambiguous regulations, as well as the compliance of any programs that are governed by such regulations. Companies should also consider

taking a proactive approach in engaging with government agencies on the meaning of certain regulations. Because subjective knowledge is relevant to FCA liability, companies should also evaluate the ways in which they can demonstrate their contemporaneous interpretation of regulations through documentation and records.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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