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U.S. Supreme Court Applies a Subjective Standard for Scienter Under the False Claims Act

Stuart Silverman

On June 1, 2023, the Supreme Court ruled, in a unanimous decision, in *United States ex rel. Schutte v. SuperValu, Inc.* and *United States ex rel. Proctor v. Safeway, Inc.*,ⁱ that a subjective standard applies for the scienter element under the False Claims Act (“FCA” or “the Act”).ⁱⁱ

In this much anticipated decision, the Court rejected an “objectively reasonable” standard. The Court explained that for FCA scienter purposes, culpability arises from the defendant’s subjective state of mind at the time a false claim is filed for reimbursement.

The matter before the Supreme Court derived from two Seventh Circuit decisionsⁱⁱⁱ where it was concluded that the FCA scienter element should be construed in accordance with the Supreme Court’s 2007 decision in *Safeco Insurance Company of America v. Burr*.^{iv} There, the Court interpreted the scienter provision under the Fair Credit Reporting Act, and concluded that the scienter element imposes liability if the defendant acts with reckless disregard for the law. Liability does not arise, though, where the defendant has an objectively reasonable reading of the law at issue.

The Seventh Circuit concluded that, as a matter of law, an objectively reasonable standard applies for the FCA scienter requirement. The Seventh Circuit joined some other courts of appeals. Other courts of appeals, though, have declined to follow *Safeco*, and have embraced a subjective standard for FCA scienter. The Supreme Court granted review to resolve the split among the circuit courts.

Background

Under the FCA, civil monetary liability arises where a person “knowingly presents, or causes to be presented, a false or fraudulent claim for payment or approval” by the government.^v Congress provided a three-prong definition of “knowingly” in the Act. Scienter is met where a person who submits a false or fraudulent claim (i) knows that the claim is false, (ii) is in deliberate ignorance of the falsity of the claim or (iii) acts in reckless disregard for the truth or falsity of the claim.^{vi} The matter before the Supreme Court focused on this scienter element of the FCA.

For those courts of appeals that have adhered to an objectively reasonable standard for FCA purposes,^{vii} a person who presents a false claim for payment by the government is not liable where that person articulates in FCA litigation a “post hoc legal rationale,” a reasonable, but incorrect, reading of an ambiguous statute or rule. A person’s state of mind at the time the false claim is filed is not relevant, even though that person acted in bad faith. The objectively reasonable standard does not apply where there is authoritative guidance from an agency or court of appeals warning against an interpretation of the relevant law that a defendant seeks to advance.

Other courts of appeals have favored a reading of the scienter requirement that is tethered to the text of the FCA. As mentioned, the Act imposes liability when a person acts “knowingly,” as defined under the statute, and the inquiry is the state of mind of the person at the time the false claim is filed. Here, a subjective standard applies. The proof focuses on whether that person has no honest belief in the truth of the claim filed.^{viii}

In *Schutte* and *Proctor*, whistleblower lawsuits filed by “relators,” two pharmacies provided drugs to beneficiaries under Medicare Part D and Medicaid. To seek government reimbursement, those pharmacies were required to report their “usual and customary” prices for drugs dispensed. It was alleged that the pharmacies defrauded the government by submitting false claims that did not reflect drug discounts and thus the pharmacies inflated their usual and customary prices. The Seventh Circuit held that each pharmacy’s reading of the term “usual and customary” was incorrect, but that the pharmacy’s reading of that ambiguous term was objectively reasonable. Thus, no liability arose under the FCA, even though the pharmacies acted in bad faith.

The Supreme Court granted review of these two Seventh Circuit decisions as consolidated cases. Those cases presented identical questions of law.

The Supreme Court’s Decision

The Supreme Court’s ruling is grounded in the three-prong definition of “knowingly” under the FCA, and common law fraud. It interpreted scienter under the Act as one that, as a matter of law, imposes a subjective standard. The Court emphasized that scienter, as defined under the Act, focuses on the state of mind of the defendant, “what was thought and believed” at the time the false claim was filed. This conforms with common law fraud which looks to a defendant’s absence of honest belief in a statement’s truth.

The Supreme Court wrote that, notwithstanding a facial ambiguity in the term “usual and customary,” evidence suggested that the pharmacies had knowledge that their usual and customary prices were inflated, but “tried to hide” this from government representatives.

The Court has definitively rejected the objectively reasonable standard for scienter. It vacated and remanded the Seventh Circuit’s decisions for further development.

Observations

The Supreme Court’s decision in *Schutte* and *Proctor* has wide ramifications. While those cases involved the health care sector, the Court’s decision has impact for a wide swath of industries that receive payment under government programs. The Court’s construction of the scienter element under the FCA is consequential. Federal prosecutors and whistleblowers are no longer shackled by a narrow interpretation of the FCA’s scienter element. This is of particular import in view of the potential for crippling financial penalties and damages provisions under the FCA.

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- i No. 21-1326, slip op (2023), https://www.supremecourt.gov/opinions/22pdf/21-1326_6jfl.pdf.
 - ii 31 U.S.C. § 3729, *et seq.*
 - iii *United States ex rel. Schutte, et al. v. SuperValu Inc. et al.*, 9 F. 4th 455 (7th Cir. 2021); *United States ex rel. v. Safeway, Inc.*, 30 F. 4th 649 (7th Cir. 2022).
 - iv 551 U.S. 47 (2007).
 - v 31 U.S.C. § 3729(a)(1)(A).
 - vi *Id.* at § 3729(b)(1).
 - vii *See United States ex rel. Streck v. Allergan*, 746 F. App’x 101, 106 (3rd Cir. 2018); *United States ex rel. McGrath v. Microsemi Corp.*, 690 F. App’x 551, 552 (9th Cir. 2017); *United States ex rel. Donegan v. Anesthesia Assocs. of Kan. City, PC*, 833 F.3d 874, 879-80 (8th Cir. 2016); *United States ex rel. Purcell v. MWI Corp.*, 807 F. 3d 281, 284 (D.C. Cir. 2015).
 - viii *See United States ex rel. Prather v. Brookdale Senior Living Communities, Inc.*, 892 F.3d 822 (6th Cir. 2018); *United States ex rel. Phalp v. Lincare Holdings, Inc.*, 857 F. 3d 1148, 1155-1156 (11th Cir. 2017); *United States v. Chen*, 402 Fed. Appx. 185 (9th Cir. 2010).