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Supreme Court Rules FCA Liability Turns on Subjective Belief, Not Objective Reasonableness

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In a much-anticipated opinion released on June 1, 2023, the US Supreme Court held that the scienter element of the False Claims Act (FCA) turns on the defendant's "knowledge and subjective beliefs" – not on "what an objectively reasonable person may have known or believed."

The **unanimous decision** in the consolidated cases, *United States ex rel. Schutte v. Supervalu Inc.* and *United States ex rel. Proctor v. Safeway Inc.*, held that "what matters for an FCA case is whether the defendant knew the claim was false." The Supreme Court's application of this subjective standard appears to preclude scienter defenses based in objective reasonableness – a key argument FCA defendants had frequently relied on to seek early dismissal of cases. Going forward, defendants may expect to face discovery probing their knowledge and state of mind before a court may deem dismissal is warranted.

Background

FCA liability arises where a person "**knowingly presents … a false or fraudulent claim for payment or approval**." To establish an FCA violation, a plaintiff – the government or qui tam relator – must prove both that the claim was false and that the defendant knew it was false (scienter).

Here, the petitioners claimed that the two supermarket chains defrauded Medicaid and Medicare when seeking reimbursements that were limited by regulation or contract to the pharmacies' "usual and customary" prices. According to the petitioners, the pharmacies offered discounted prices to their customers but reported higher retail prices when submitting reimbursement claims to the federal benefits programs. The petitioners presented evidence that ostensibly demonstrated the pharmacies believed their claims to be inaccurate, but still submitted them.

At summary judgment, the district court ruled that the pharmacies' discounted prices were their "usual and customary" prices, and so their claims reporting the retail prices were false. However, the district court held that the pharmacies could not have acted "knowingly," because their position was objectively reasonable at the time. As a result, the district court granted summary judgment in favor of the pharmacies.

The US Court of Appeals for the Seventh Circuit affirmed, relying in large part on a prior Supreme Court case interpreting the term "willfully" in the context of a different federal statute. The Seventh Circuit reasoned that the defendants' actual knowledge was irrelevant if their actions were consistent with "any objectively reasonable interpretation of the relevant law," and that the defendants' subjective belief should only be considered if their acts were objectively unreasonable. The Seventh Circuit affirmed the grant of summary judgment for the pharmacies on the grounds that their acts were consistent with an objectively reasonable interpretation of "usual and customary," which **could** have referred to the retail price, rather than the discounted price.

The Supreme Court's decision

The Supreme Court granted certiorari to address the question of whether the pharmacies could have the scienter required by the

FCA if they correctly understood the relevant standard and believed their claims were inaccurate – regardless of what an "objectively reasonable" person would believe. Relying on the text of the FCA and its "common-law roots," the Supreme Court answered that question in the affirmative. The Supreme Court held that "[w]hat matters for an FCA case is whether the **defendant** knew the claim was false" – not "what an objectively reasonable person may have known or believed" (emphasis added). The opinion also made clear that FCA defendants cannot rely on after-the-fact interpretations that "might have rendered their claims accurate" – the crucial question is what the defendant knew **when submitting the claim**.

Of course, discerning what a defendant **knew** at a moment in time is not necessarily straightforward. Justice Clarence Thomas, writing for the Supreme Court, stated that scienter under the FCA captures defendants who were "**conscious of a substantial and unjustifiable risk** that their claims are false, but submit the claims anyway." Yet the Supreme Court declined to provide guidance on what constitutes a "substantial and unjustifiable risk," or how a defendant would identify that type of risk when confronted with an ambiguous regulation.

Relatedly, though the Supreme Court acknowledged that the phrase "usual and customary" is not clear on its face, it rejected all of the pharmacies' arguments urging it to adopt the Seventh Circuit's reasoning that "because other people might make an honest mistake, defendants' subjective beliefs become irrelevant." Instead, the Supreme Court concluded that, "it does not matter whether some other, objectively reasonable interpretation of 'usual and customary' would point to [the pharmacies'] higher prices. For scienter, it is enough if [they] believed that their claims were not accurate."

Significance

In practice, the Supreme Court's command to focus on subjective belief may stymie early dismissal of FCA cases, which had often been based on scienter arguments related to objective reasonableness. FCA defendants may instead be exposed to expansive and costly discovery exploring the defendant's state of mind at the time claims were submitted. Litigants may also see protracted disputes as lower courts begin to address questions left unanswered – including whether a defendant faced with an ambiguous regulation was aware of a "substantial and unjustifiable risk" that the claims submitted were false.

As this new landscape unfolds, companies will have to consider whether and how to create contemporaneous records documenting their interpretations of ambiguous regulations at the time claims are submitted. Defendants who can demonstrate good faith in their decision-making process may still be able to have success at summary judgment.

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