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Supreme Court Holds That FCA Requires Subjective Intent

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Is subjective intent relevant to FCA claims? The Court answered yes, holding that FCA liability turns on what the defendant actually believed, not on what an objectively reasonable person may have believed.

On June 1, 2023, in a highly anticipated decision, the United States Supreme Court held that the False Claims Act (FCA) requires that defendants subjectively believe that their claims are false in order to violate the FCA. The cases are *United States ex rel. Proctor v. Safeway Inc.*, Case No. 22-111 and *United States ex rel. Schutte, et al. v. SuperValu Inc. et al.*, Case No. 21-1326, and the Supreme Court's opinion can be found **here**. Writing for a unanimous court, Justice Clarence Thomas summarized the question presented as "whether [defendants] could have the scienter required by the FCA if they correctly understood [the relevant legal] standard and thought that their claims were inaccurate."

In claiming victory, the relators' bar has argued that this is a seismic shift that will free whistleblowers to file dramatically more suits against companies that do business with the government. As discussed in this Client Alert, a closer look at the potential impact of this decision is likely more muted than the relator's bar is claiming.

I. Background

The whistleblowers sued two retail pharmacies, SuperValu and Safeway, alleging that they misreported their "usual and customary" price in submitting claims for reimbursement from Medicare and Medicaid. In the decisions below, split panels of the Seventh Circuit Court of Appeals affirmed summary judgment for each defendant based on the ambiguity of the phrase "usual and customary" and the objective reasonableness of the defendant's interpretation during the litigation, rejecting the need for a separate inquiry into the defendant's beliefs at the time the claims were submitted.

In response, the companies argued that the Medicare and Medicaid billing requirements were unclear, and their conduct was supported by an "objectively reasonable" reading of the law. The Seventh Circuit agreed and found that there was no need to look at subjective intent evidence, because the pharmacies made an "objectively reasonable" interpretation of an ambiguous policy, adopting the standard from *Safeco Insurance Co. of America v. Burr*, 551 U.S. 47 (2007) (holding that companies can be liable for violating the Fair Credit Reporting Act (FCRA) if they show "reckless disregard" for the law).

With the argument framed as whether courts should examine evidence of subjective intent, the Supreme Court, predictably, held that the Seventh Circuit erred in applying the *Safeco* standard to the FCA. The Court explained that an assessment of a defendant's subjective beliefs at the time a claim is filed – not what an objectively reasonable person may have known or believed or what could be contemplated after the fact – about potential wrongdoing is required based on the text of the FCA's *scienter* standard, as well as its common law underpinnings.

II. Key Takeaways From the Supreme Court's Decision: A Win for Relators and Defendants

Despite the relators' bar early – and noisy – victory lap, the Court's decision is a win for both whistleblowers and sophisticated companies with established compliance programs. To be clear, plaintiffs succeeded in

winning the case and establishing a standard that will likely expand discovery requests to obtain evidence of a defendant's subjective intent. However, a standard that embraces "subjective intent" is more of a victory for defendants than it is for relators. Furthermore, investigations have always focused on subjective intent – the argument raised by the defendants in these cases was more of an exception to an already typical practice in government investigations.

The relators' bar points to the opinion's language that "reckless disregard . . . captures defendants who are *conscious of a substantial and unjustifiable risk* that their claims are false, but submit them anyway." Slip op. 10 (emphasis added). This language, they argue, enables the government, or a *qui tam* relator, to rely on a deliberate ignorance or recklessness *mens rea* standard, rather than needing to prove actual knowledge. As such, they predict that future cases will likely delve into extensive discovery disputes about who said what, when, and where to establish the scienter element.

However, such a reading ignores that the focus of the Court's opinion was that the defendant's subjective intent is the crucial inquiry. Even the Court's "*substantial and unjustifiable risk*" test requires evidence that a defendant was "*conscious*" and aware of those risks. Such evidence may be easy to allege, but difficult to establish. Indeed, at the pleading stage, requiring FCA plaintiffs to plead *conscious* disregard of a risk that is both "substantial and unjustified" is likely to be a substantial blockade to the vast majority of relators who lack inside knowledge of a corporate defendant's internal risk assessment and decision-making. These barriers increase for relators attempting to file FCA claims against sophisticated corporate defendants that have sophisticated compliance programs and are unwilling to "*consciously*" engage in activities that present substantial compliance risks that are not justifiable. Furthermore, the "reckless disregard" standard has been a well-established part of the False Claims Act – this opinion merely solidifies its definition and, importantly, establishes that there must be subjective belief.

III. The Path Forward – a *Mens Rea* Standard by Any Other Name

Unfortunately, the Court's decision leaves many open questions. Although the Court clearly required defendants' subjective belief that their claims are false to be liable under the FCA, the Court did not provide guidance for litigants and lesser courts for what these terms mean or how they should be presented. *Id.* at 10 & n.5 ("We need not decide how (or whether) that objective form of 'recklessness' relates to the FCA today[.]"). While distinguishing *Safeco* and the FCRA's "willfulness" standard, the Court adopted a standard that appears to require litigants to engage in a "willfulness" analysis but summarily calls it a "knowingly" standard. *Id*. at 13-14. The Court indicates that defendants can violate the FCA if they act with "reckless disregard" of "substantial and unjustifiable risks" but does not define what those "substantial and unjustifiable risks" would be. The Court's lack of guidance is particularly frustrating for companies that make bet-the-company business decisions based on interpretations of ambiguous regulations.

Courts handling FCA litigation over the next few years will answer many of these questions, but companies doing business with the government should take measures to protect themselves. Because FCA liability requires subjective intent at the time a claim is submitted, companies should consider working with legal counsel to reasonably interpret the meaning of ambiguous regulations and keep an evidentiary record of those interpretations to prove that it attempted to contract with the government in good faith. Much like the Department of Justice's (DOJ) recent guidance on Compliance Programs, companies with existing, well-established compliance programs will be able to minimize the risk of being subject to FCA lawsuits based on their ability to develop risk-management procedures, while companies that do nothing are at risk of being accused of recklessly disregarding "substantial and unjustifiable risks."

With extensive Government Enforcement and Investigations and Corporate Governance experience, Baker Donelson has the tools to help clients navigate potential challenges posed by False Claims Act litigation and other aspects of the DOJ's Corporate Enforcement Policies.

If you have any questions about this topic, please contact Sean B. O'Connell, Thomas H. Barnard, Kseniya "Nicole" Kuprovska, or other members of Baker Donelson's Government Enforcement and Investigations Group.