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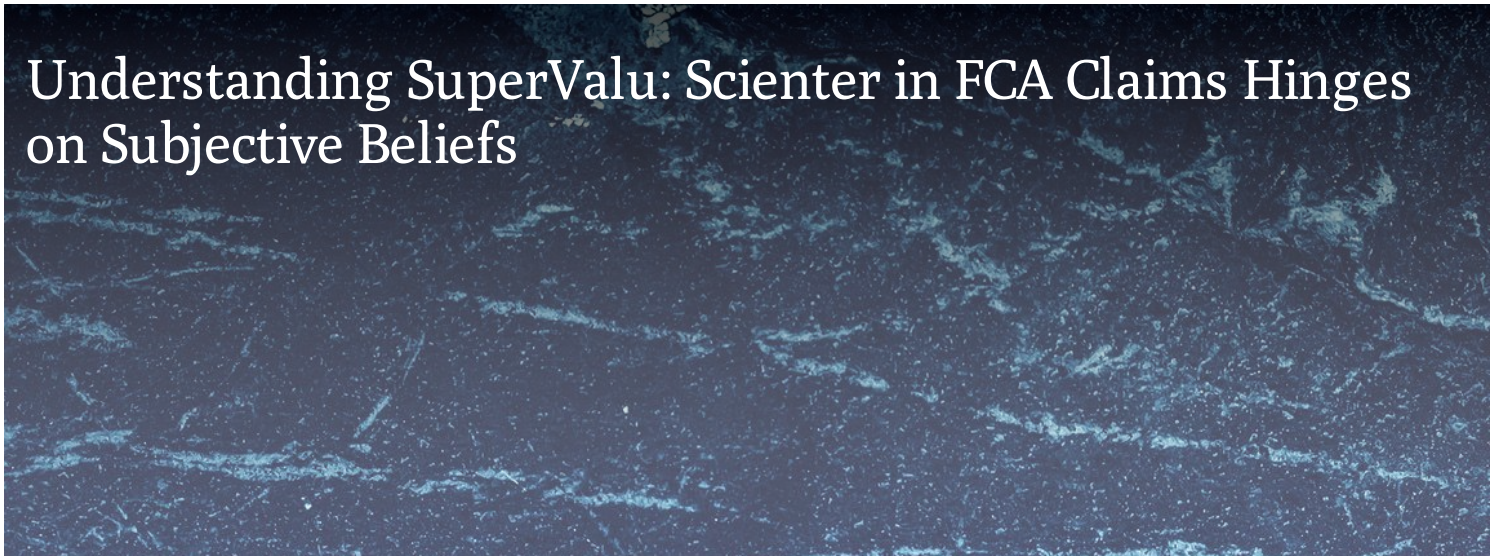
BLOG

Understanding SuperValu: Scienter in FCA Claims Hinges on Subjective Beliefs



JUNE 15, 2023

On June 1, 2023, the Supreme Court of the United States issued its decision in the most-watched False Claims Act (FCA) case of the year. In *United States ex rel. Schutte v. SuperValu Inc.* (consolidated with *United States ex rel. Proctor v. Safeway, Inc.*),[1] a unanimous Court held that the question of scienter under the FCA turns on a person's subjective beliefs, not what an objectively reasonable person may have believed—rejecting a standard that had been set by the Seventh Circuit and embraced by the Third, Eighth, Ninth and D.C. Circuits. In so doing, the Court—in an opinion drafted by Justice Thomas—made clear that a party should not submit claims to the government where it is aware that there is a "substantial and unjustifiable risk" that the claims are false, but provided little guidance as to what this standard means in practice. For now, stakeholders who do business with the federal government will need to consider how to incorporate the Court's framework into their legal and compliance operations and carefully consider the impact of the decision on the content of internal communications in all of their forms.

Background

This issue before the Court arose from two consolidated cases, *United States ex rel. Schutte v. SuperValu Inc.* (No. 21–1326) and *United States ex rel. Proctor v. Safeway, Inc.* (No. 22–111), both brought by *qui tam* whistleblowers suing under the FCA on behalf of the government. Both cases stem from a retail pharmacy's obligation to report "usual and customary" prices to the Medicare and Medicaid programs, which are then used by those programs to determine payments to the pharmacies for outpatient prescription drugs. In *SuperValu* and *Safeway*, the whistleblowers alleged that the supermarket's pharmacies overcharged the Medicare and Medicaid programs by overstating their "usual and customary" prices. Essentially, to achieve competitive pricing, the pharmacies had lowered the cost of prescriptions through certain discount programs, but then did not incorporate those discounts into the "usual and customary" prices that they reported to the Medicare and Medicaid programs, resulting in those programs paying a higher price than they would have paid if the discounts had been incorporated.

The FCA provides that any person who knowingly presents, or causes to be presented, a false or fraudulent claim to the government for payment or approval is liable for damages, including treble damages and civil penalties for each claim. 31 U.S.C. § 3729(a). The statute defines "knowingly" to mean that a person (i) has actual knowledge of the information, (ii) acts in deliberate ignorance of the truth or falsity of the information, or (iii) acts in reckless disregard of the truth or falsity of the information. 31 U.S.C. § 3729(b)(1)(A).

In *SuperValu*, the district court ruled against the pharmacy chain on the issue of falsity, concluding that the pharmacy's usual and customary prices should have reflected its discount program and thus all claims to the government for outpatient prescription drugs were false under the FCA. But the district court ultimately granted summary judgment to the pharmacy chain on the basis that it had not acted with the requisite scienter for liability under the FCA; i.e., it had not submitted false claims "knowingly." Similarly, in *Safeway*, the district court granted the retail pharmacy summary judgment on the same basis.

The Seventh Circuit affirmed the district court's decision in both cases, relying on the Supreme Court's holding in *Safeco Insurance Co. of America v. Burr*, 551 U.S. 47 (2007) to hold that the pharmacy chains did not act knowingly because they made an "objectively reasonable" interpretation of the law (i.e., the meaning of "usual and customary") that had not been ruled out by definitive legal authority or guidance. The appellate court further held that this objective-knowledge standard applies regardless of whether the pharmacies actually believed their claims were false at the time they submitted them. In other words, the Seventh Circuit's holding was that evidence of contemporaneous subjective intent is not relevant in the face of an "objectively reasonable" reading of the law (even if that interpretation of the law is subsequently determined to be incorrect and even if the pharmacies believed the interpretation to be incorrect at the time they submitted their claims). The whistleblowers subsequently appealed, and the Supreme Court granted certiorari on the limited issue of scienter and consolidated the cases for review.

The Court's Opinion

The sole question before the Court was whether *Safeco*'s objective-knowledge standard applies to FCA violations, which the Court answered with a resounding "no." In rejecting *Safeco*, the Court held that the FCA's scienter element turns on a defendant's "knowledge and subjective beliefs," not on "what an objectively reasonable person may have known or believed."

With respect to *Safeco*, the Court dismissed its relevance in the FCA context, noting that *Safeco* interpreted a different statute (the Fair Credit Reporting Act) that had a different mens rea requirement (willfully). The Court went further, however, rejecting the Seventh Circuit's formulation of the *Safeco* standard and finding that its holding in the *SuperValu* and *Safeway* cases is consistent with Supreme Court precedent. Quoting its opinion in *Halo Electronics*, where the Court held that "[n]othing in *Safeco* suggests that we should look to facts that the defendant neither knew nor had reason to know at the time he acted," the Court reasoned that, "[b]y a similar token here, we do not look to legal interpretations that [defendants] did not believe or have reason to believe at the time they submitted their claims." *SuperValu*, 2023 WL 3742577, at *9 (quoting *Halo Elecs., Inc. v. Pulse Elecs., Inc.*, 579 U.S. 93, 106 (2016)).

Like its approach in *Universal Health Services v. U.S. ex rel. Escobar*, 579 U.S. 176 (2016), which is also a unanimous opinion drafted by Justice Thomas, the Court relied on the FCA's statutory text and common-law principles in finding that the FCA's scienter standards "focus primarily on what [defendants] thought and believed" at the time "when submitting the false claim." *SuperValu*, 2023 WL 3742577, at *7.

To that end, the Court stated that to establish scienter under the FCA, a plaintiff (either the government or a *qui tam* whistleblower) must show that a party: (1) actually knew their claim was false; (2) was aware of a substantial risk that their claim was false and intentionally avoided learning whether the claim was false; or (3) was aware of such a substantial and unjustifiable risk but submitted the claims anyway. In short, "[f]or scienter, it is enough if [defendants] believed that their claims were not accurate." *Id*. at *10. Although this standard seemingly reflects an attempt by the Court to create an objective set of criteria by which to assess a party's subjective understanding when trying to establish scienter through either deliberate ignorance or reckless disregard, it raises a number of critical questions that lower courts (and individuals and companies doing business with the federal government) will have to confront, among them: What constitutes a "substantial risk" or a "substantial and unjustifiable risk"? When should a party be understood to be "aware" of such risks?

Key Takeaways

1. Significant litigation is expected to follow, clarifying the proper application of the FCA's scienter standard.

At its core, this case set out to answer a question that inevitably vexes anyone who does business with the federal government: What to do in the face of an ambiguous statutory or regulatory standard? Here, the defendants argued that they could not "know" that their claims were false for purposes of the FCA because the obligation to report "usual and customary" prices was ambiguous. The Court rejected this argument, concluding that the ambiguity of the phrase "usual and customary" did not prevent defendants from "having learned the correct meaning" of the terminology, "or, at least, becoming aware of a substantial likelihood of the terms' correct meaning." *SuperValu*, 2023 WL 3742577, at *8.

Specifically, the Court found that a party has the requisite scienter under the FCA if they are aware of a "substantial and unjustifiable risk" that their claims are incorrect and submit them anyway. The example the Court uses to illustrate the concept shifts the question from whether the requirement is ambiguous and instead focuses on whether others appear to have coalesced around a particular meaning. Specifically, the Court submitted the following scenario: A person drives down a road with a sign labeled "Drive Only Reasonable Speeds" and is informed by a police officer that speeds over 50 mph are "unreasonable." *Id.* The driver also observes that everyone else is going 48 mph. Employing its scienter framework, the Court concludes that the driver would be "hard pressed" to argue that the speed limit permits driving at 80 mph. *Id.* Indeed, according to the Court, anything over 50 mph in this context presents "an unjustifiably high risk." *Id.*

While straightforward on its face, the speed-limit example raises a number of questions. Would the risk still be unjustifiable if there had been no statement from the police officer? Does it matter if the police officer's statement was only made to one individual, rather than announced publicly? Does it matter if the police officer got approval from superiors before stating what a reasonable speed is? What if different police officers expressed different views of what constitutes a reasonable speed including the situational "reasonableness" of speeds exceeding 50 mph? What if the driver previously contacted the police to ask about the appropriate speed, in light of the sign, and either did not get an answer or got a vague, imprecise response?

2. The role of authoritative guidance remains unclear in assessing scienter.

Strikingly absent from the Court's discussion, including in its speed-limit example, is the concept of *authoritative* guidance. In rejecting the *Safeco* standard—which held that a defendant does not have the requisite scienter if (1) their interpretation of the applicable statute or regulation is objectively reasonable, and (2) there is no authoritative guidance contrary to the defendant's interpretation—the Court seemingly sidestepped the issue of what qualifies as authoritative guidance in the FCA context and the role it plays in applying the scienter standard. The Court's silence on this point is particularly notable, and arguably in tension with, the significant focus on the use of guidance documents by both courts and policymakers in FCA cases in recent years.

3. Stakeholders should evaluate the enhanced role that subjective knowledge plays when submitting a claim.

While the hypothetical driver in the Court's example faces the potential of a speeding ticket, in the real-world context of complex federal regulations, stakeholders who conduct business with the federal government face the prospect of treble damages and per-claim penalties for violating the FCA—not to mention reputational damage, legal expense, and years of uncertainty during the course of investigations and/or litigation. Deciphering the Court's opinion and trying to discern actionable guideposts thus presents a significant but essential challenge for these entities as they consider how to incorporate this framework into their legal and compliance operations.

This task becomes even more difficult when stakeholders are faced with ambiguity. Lower courts will have to consider whether the Court's holding effectively shifts the burden on private parties to clarify ambiguities prior to submitting a claim for payment or otherwise receiving funds from the government; notwithstanding the fact such avenues for clarification may or may not be available depending on the circumstances of each individual stakeholder.

Given the enhanced role that subjective knowledge is likely to play, the stakeholder's contemporaneous knowledge will be a focal point in determining the existence of scienter. Taking steps to ensure that discussions regarding potential legal ambiguities are protected by attorney-client privilege may prove strategically advantageous in the event of an FCA-focused investigation or litigation. Likewise, stakeholders should also consider developing a contemporaneous record memorializing their understanding of the requirements and representations when

submitting a claim or otherwise receiving funds from the government. If stakeholders are faced with an FCA investigation or enforcement action, this type of documentation may prove useful in negating the scienter element.

4. FCA litigation will be more costly and the number of FCA settlements may increase.

From a litigation strategy standpoint, the Court's holding will likely impact briefing at the motion-to-dismiss and summary-judgment phases. Because the Court's new scienter standard seems to contemplate a fact-intensive investigation of a party's subjective intent at the time claims were submitted, it will be more challenging for defendants to secure pre-trial dismissal based on scienter. As a result, defendants likely will focus more heavily on the falsity prong of the FCA, framing arguments derived from the ambiguity of regulatory standards in terms of falsity instead of scienter. Regardless, given the fact-specific inquiry set forth by the Court—as well as exposure to potentially punitive measures that the FCA can bring to bear (i.e., treble damages and per-claim civil penalties)—there may be increased incentives for FCA defendants to resolve cases prior to the summary-judgment stage, given the considerable risk a party faces of protracted and costly litigation and a potentially adverse judgment.

If you have additional questions or need further assistance, please reach out to the authors of this article, **Suzanne Jaffe Bloom** (Co-Chair, Government Investigations, Enforcement, and Compliance), **Cristina Calvar** (Partner, Government Investigations, Enforcement, and Compliance); **Amy Hooper Kearbey** (Partner, Government Investigations, Enforcement, and Compliance); or your Winston & Strawn relationship attorney.

A shorter version of this alert was published as an article in Bloomberg Law. Please find a link to that article here.

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[1] *United States ex rel. Schutte v. SuperValu Inc.*, 2023 WL 3742577, at *2 (U.S. June 1, 2023).

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