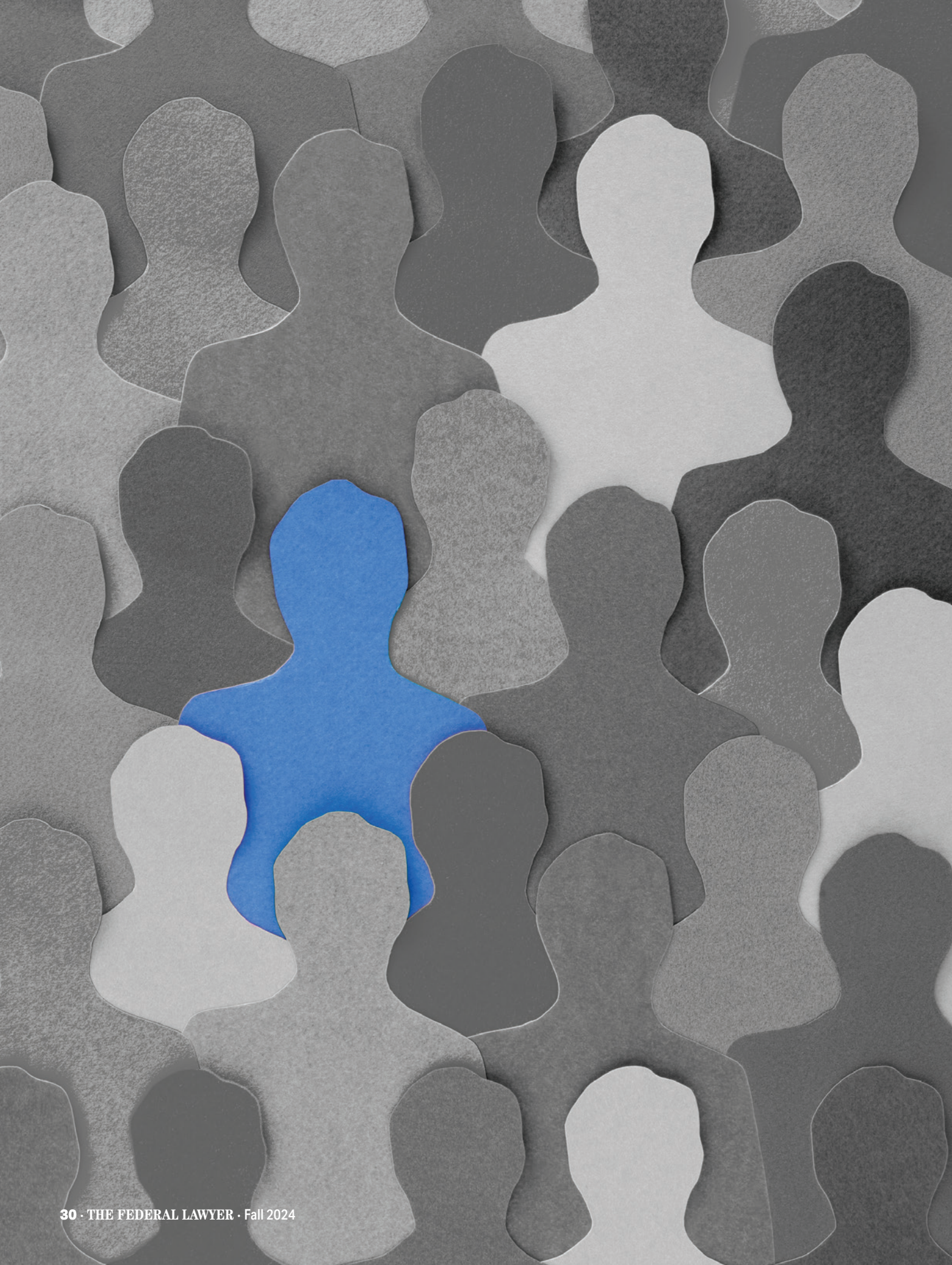

One Year Later: Scienter Under the False Claims Act in the Wake of *United States ex rel. Schutte v. SuperValu Inc.*

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In June 2023, the Supreme Court issued a unanimous opinion in *United States ex rel. Schutte v. SuperValu Inc.*,[1] *(Schutte)*, holding that the scienter (i.e., mens rea) requirement of the False Claims Act, 31 U.S.C. § 3729 et seq., refers to a defendant's particular knowledge and subjective beliefs—not to what an objectively reasonable person may have known or believed. In the wake of Schutte, legal commentators raised many practical questions about what effect, if any, this holding would have on the False Claims Act landscape.

Now, approximately one year later, as the dust settles and the principles from *Schutte* trickle through the lower courts, several takeaways are starting to become clear:

- Although scienter was already as an issue typically left for jury resolution, defendants are now even less likely to secure a pretrial dismissal of a False Claims Act claim on scienter grounds.
- Courts have rebuffed some litigants' efforts to recast *Schutte* as a defense-friendly decision.
- The good-faith defense—i.e., the defense that a party failed to comply with applicable law but operated in good faith in the face of ambiguous statutes—survives but is a matter to be decided at trial rather than at summary judgment.
- Substantial uncertainty still exists over to what extent recklessness under the False Claims Act, which is an independent means of establishing a party's scienter, incorporates the concept of objective reasonableness.

Although these principles collectively show a slight trend of the False Claims Act landscape in plaintiffs' favor, the shift has been minimal, and there has not been the seismic shift that several commentators predicted. Nearly all prior defenses survive in some form. Claims that a party legally complied with a statute are still relevant to the falsity element. Claims that a statute was ambiguous are still relevant to whether a party was acting in good faith, even if not dispositive. And scienter remains a matter for the jury. The principal result of *Schutte* appears to concern a relatively uncommon set of circumstances—where a party possesses actual knowledge of or deliberate indifference to a claim's falsity but nonetheless seeks to escape liability through an objectively reasonable (though still incorrect) interpretation of the applicable legal standard.

Case Background: The Focus on Subjective Knowledge under *Schutte*

In seeking prescription drug reimbursement under the Medicare and Medicaid federal benefit programs, applicable regulations provide that pharmacies must charge their "usual and customary" prices. Qui tam plaintiffs brought a lawsuit under the False Claims Act contending that two operators of drug pharmacies—defendants SuperValu and SafeWay—offered discounted prices to the

general public that represented their "usual and customary" pricing, but rather than submitting those lower prices for government reimbursement, they instead reported their higher, non-discounted prices. Regardless of any ambiguity in the phrase "usual and customary," plaintiffs further contended that defendants learned, believed, and ultimately tried to conceal from regulators that their lower, discounted prices were their "usual and customary" prices, such that they thought their reimbursement claims were inaccurate—yet submitted them anyway.

The issue before the Supreme Court was limited to whether the defendants acted with scienter under the False Claims Act—specifically, whether they acted "knowingly" in submitting inflated claims for reimbursement. The False Claims Act establishes a three-part definition of the term "knowingly:" either actual knowledge, deliberate ignorance, or recklessness will suffice.[2] Relying heavily on precedent involving *mens rea* under the Fair Credit Reporting Act, defendants sought summary judgment contending that, regardless of any subjective (i.e., actual) beliefs about the accuracy of their claims, they could not have acted knowingly. That's because, according to defendants, their acts were consistent with an objectively reasonable interpretation of the relevant law that had not been ruled out by definitive legal authority or guidance. In response, plaintiffs contended to have established scienter because defendants actually thought that their claims were false—because they believed that their reported prices were not actually their "usual and customary" prices.

Relying on the plain statutory text and the common-law roots of fraud claims, the Supreme Court ruled in favor of plaintiffs. Writing for the unanimous Court, Justice Clarence Thomas explained 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."[3] This means a party can "knowingly" submit false claims notwithstanding differing reasonable interpretations of ambiguous legal standards or regulatory regimes, such as the phrase "usual and customary" pricing. According to Justice Thomas, the common law understanding of the scienter requirement for fraud claims focused on what the alleged fraudster actually thought and believed rather than post hoc interpretations or what other people believed.[4]

Now, pursuant to *Schutte*, a defendant cannot defeat scienter by establishing the existence of some other, objectively reasonable interpretation of the applicable legal standard. Instead, the test for scienter is the defendants' actual knowledge of or deliberate indifference to the accuracy of their claims.

Post-*Schutte* Fallout

There was a variety of reactions from commentators in the wake of *Schutte*. Some predicted the decision would have limited applicability due to a perceived narrow scope. Indeed, *Schutte* concerned a relatively uncommon situation where a party's actual beliefs about falsity were inconsistent with an objectively reasonable interpretation of the law. *Schutte* also did not address situations where defendants erroneously believed their claims were false but were, in reality, permitted by the regulations. In this situation, there could be no False Claims Act liability due to an absence of the falsity element.

Other commentators sounded alarm bells for False Claims Act defendants, particular corporate defendants operating in highly regulated industries, noting the challenges of establishing an actual good-faith belief without also waiving privilege over compliance information provided by counsel. They also noted the removal of a means to resolve False Claims Act cases at the pleadings or summary judgment stages given the fact-intensive nature of a defendant's actual beliefs, which may be alleged generally under Rule 9(b).

Given these divergent viewpoints, *Schutte* left much to litigate, including the following questions:

- Will defendants be less likely to secure pretrial dismissals given the need to analyze a party's subjective intent, which is often a question for jury resolution?
- To what extent, if at all, is a statute's ambiguity still relevant to establish a party's good-faith belief that it was submitting accurate claims?
- To what extent will defendants be able to recast a statute's ambiguity in terms of falsity rather than scienter?
- Does recklessness under the False Claims Act still incorporate the concept of objective reasonableness? If so, what qualifies as authoritative guidance likely to establish a party's recklessness—and thus "knowledge" under the False Claims Act—that its claims were false?

Although the answers to many of these questions are still unfolding, case law in the lower courts interpreting *Schutte* has established several trends in the False Claims Act's scienter landscape, discussed next.

There Will Be Fewer Pretrial Dismissals on Scienter Grounds

Now that an objectively reasonable interpretation of a legal framework is no longer sufficient to defeat scienter, conventional wisdom was that there would likely be fewer pretrial dismissals of False Claims Act cases. Based on a review of the case law over the past year, this view has been borne out.

The clearest illustration of this shift with respect to Rule 12(b)(6) dismissals is *United States ex rel. Ocean State Transit, LLC v. Infante-Green*.[5] That case arose from allegations that the commissioner of the Rhode Island Department of Elementary and Secondary Education (RIDE) had falsely certified compliance with COVID-19 relief statutes requiring the state department of education "to the greatest extent practicable, continue to pay its employees and contractors during the period of any disruptions or closures related to the coronavirus." *Id.* at *1. Prior to *Schutte*, the court had dismissed the case because the commissioner's certification, which included the decision not to pay workers during school closures, was an objectively reasonable interpretation of applicable contractual requirements.

In light of *Schutte*, however, the court granted plaintiff's Rule 59(e) motion to alter the judgment and re-opened the case. The court held that allegations that the commissioner certified compliance with the CARES Act requirement knowing that it would not comply was sufficient to state the scienter element of a claim under the False Claims Act. The new obstacle to securing Rule 12(b)(6) dismissal on scienter grounds is best shown through the following reasoning from the court:

> *Schutte* instructs that the Court must consider what the Commissioner herself knew and believed, not how an objectively reasonable person may have interpreted the relevant obligations. Unlike *Schutte*, which was an appeal of the granting of the defendants' motions for summary judgment, this

> case is at the motion to dismiss stage. At this early pleading stage, the Court must accept as true the well-pleaded facts. [Plaintiff] has asserted that the Commissioner knowingly and falsely certified that RIDE would comply with the CARES Act requirement knowing that RIDE would not comply. The plaintiffs therefore appropriately state the scienter element of their FCA claim.[6]

The court further rejected the argument that the statute's ambiguity could not give rise to scienter as a matter of law, stating that "a dearth of clarity to the phrase 'to the greatest extent practicable' is not—at the pleadings stage—itself a reason that an FCA action must fail."[7]

Schutte has had similar effects at the summary judgment stage. Consistent with common law fraud, scienter under the False Claims Act was typically a fact issue left for jury resolution. For that reason, even before *Schutte*, False Claims Act defendants faced an uphill battle in securing summary judgment on the grounds of scienter. That hill has only become steeper in the past year. For example, one court denied a motion for summary judgment on scienter grounds, noting a lack of contemporaneous emails or other written documents in support of defendant's executives' position and, referencing *Schutte*, noted that "the jury could reasonably deem the claim a *post hoc* justification that does not reflect the executives' actual mental states at the time."[8] Indeed, *Schutte* itself vacated a grant of summary judgment.

Schutte Did Not Establish a New Scienter-Based Defense

Some defendants have attempted to recast *Schutte* in their favor in an effort to secure dismissal on scienter grounds. Focusing on the need for subjective knowledge to establish scienter under the False Claims Act, such defendants have been typically pointed to a supposed lack of evidence of their actual views and beliefs. These efforts have been unsuccessful, however.[9]

In a related vein, some defendants have attempted to use *Schutte* offensively in an effort to show that government communications blessing the conduct at issue established their subjective belief that statements were accurate. These efforts too have been unsuccessful because, as explained above, scienter may be pleaded generally and is typically a matter reserved for the jury. For example, in *Scollick ex rel. United States v. Narula*,[10] defendants argued that a government communication authorized the alleged false statements—or, at least, established as a matter of law that defendants thought it did.[11] The court expressed skepticism about defendants' intentions, notwithstanding the letter, but nonetheless held that, in light of all the evidence, "there was a triable issue fact regarding whether defendants' had actual knowledge of the fraud they were allegedly committing, and accordingly held that the issue would need to proceed trial."[12] Such government communications were relevant but not dispositive on the issue of scienter.

The Good Faith Defense Continues

Although *Schutte* may generally be viewed as a plaintiff-friendly decision for the reasons described above—namely, it forecloses pretrial dismissals based on an objectively reasonable interpretation of an ambiguous statute—the decision also has reinforced the longstanding good faith defense. Most notably, *Schutte* reinforced that scienter is based on a party's subjective views—even views that may be perceived as illogical or a stretch. That is, *Schutte* reinforced the longstanding defense to fraud claims, albeit one typically reserved for trial, that a party cannot be held liable if it believed it was operating in good faith compliance with the law.

For example, in *United States ex rel. Edalati v. Sabharwal,*[13] plaintiffs alleged that defendants knowingly presented false claims by using improper place-of-service codes to seek higher reimbursement rates from Medicare. According to the plaintiffs, defendants knowingly submitted claims to Medicare for payment for professional services, along with claims for facility fees, as though the services were provided in the outpatient hospital setting rather than in an office setting. Plaintiffs successfully obtained summary judgment on the question of whether the claims at issue were "false." But the court refused to find the existence of scienter as a matter of law notwithstanding abundant evidence in plaintiff's favor, instead leaving the issue for the jury. According to the court, "[i]t was sufficient to defeat summary judgment for the defendant to contend that he subjectively believed that the standards for provider-based status were met and that the claims were properly submitted."[14] The court found this defense sufficient notwithstanding the following commentary: "Why he thought this is not entirely clear from the current record, and this issue will likely be tested at trial. But because the focus of the scienter inquiry is 'primarily on what [those submitting the claims] thought and believed,' on this current record, scienter cannot be decided on summary judgment."[15]

The defendant in *United States v. McComber*,[16] made a similar argument with less success. There, defendant was criminally charged for submitting false claims to the government for work that he did not actually perform. Following conviction at trial, the defendant invoked *Schutte,* contending that "there was ***no*** evidence that [she] subjectively believed she was billing her time falsely."[17] In this procedural context, post-trial on a Rule 29 motion, the court found that "the evidence in the government's case-in-chief was also sufficient to establish that defendant was well aware that she was not entitled to bill the government for work she did not perform."[18]

Consistent with the authorities described above, the upshot of the post-*Schutte* decisions is that a defendant's good faith continues as a viable defense, but one left for resolution by a jury.

Recklessness May Incorporate the Concept of Objective Reasonableness

Notwithstanding the emphasis on subjective beliefs, post-*Schutte* decisions have been forced to grapple with the extent to which recklessness still incorporates a defendant's failure to act in an objectively reasonable manner. In addition to actual knowledge of or deliberate indifference to a claim's falsity, another way to establish "knowledge" under the False Claims Act is to show that a party "acts in reckless disregard of the truth or falsity of the information."[19] Whereas theories of direct knowledge or deliberate indifference require evidence of subjective knowledge, *Schutte* raised questions over how, if at all, subjective knowledge relates to the concept of recklessness.

Language from the opinion indicates that recklessness too focuses on a defendant's subjective intent, such as Justice Thomas's statement that "the term 'reckless disregard' similarly captures defendants who are conscious of a substantial and unjustifiable risk that their claims are false, but submit the claims anyway."[20] But Justice Thomas expressly left open the question of whether an objective theory of knowledge (i.e., allowing the jury to consider what a defendant

should have known) may be applied to a theory of reckless disregard under the False Claims Act. That is, in analyzing recklessness, the Supreme Court left open the question of whether recklessness could be judged from a purely objective standard in certain cases, such as where a defendant acts contrary to unambiguous legal frameworks:

> In some civil contexts, a defendant may be called "reckless" for acting in the face of an unjustifiably high risk of illegality that was so obvious that it should have been known, even if the defendant was not actually conscious of that risk. We need not consider how (or whether) that objective form of "recklessness" relates to the FCA today ... .[21]

In light of this footnote, some courts have continued to focus on what defendants should have known with respect to the accuracy of their claims under an objective framework. As one court emphasized, *Schutte* "explicitly declined [to] foreclose the application of an objective form of recklessness to [False Claims Act' liability," and that "[r]ead faithfully, nothing in [*Schutte*] suggests that a defendant can bury its head in the sand and avoid FCA liability in the face of overwhelming evidence that its submissions to the Government contained false statements."[22]

The court similarly relied on the notion of objective reasonableness in *United States ex rel. Brooks v. Stevens-Henager Coll., Inc.*[23] There, plaintiff alleged that defendants, in this case a college, submitted false claims to receive federal financial aid arising from its compensation program for admissions consultants.[24] Both parties cross-moved for summary judgment on scienter grounds. Relying on *Schutte*, the court denied the government's motion under a theory of deliberate indifference, holding that "awareness of the *general* legal risks of noncompliance" with the rules pertaining to compensation "rather than the *particular* noncompliance of" the college's policy itself was insufficient to withhold scienter "from the wisdom of the jury." But the court also denied defendants' cross-motion on scienter grounds, holding that, at minimum, a jury could find recklessness with respect to the compensation plan. The court referenced binding Tenth Circuit precedent, which, in turn, relied on D.C. Circuit precedent that embraced a concept of objective reasonableness:

> Because the court understands the Tenth Circuit as having adopted a test for reckless disregard that would allow weighing of inferences derived from objective analysis, and because the Supreme Court expressly declined to address the question, the jury is entitled to consider what [Defendants] should have known or considered as it considers the culpability of [Defendants'] mental state.[25]

Whether defendants' views were reasonable, according to the court, was ultimately a jury question.[26]

In light of *Schutte*, other courts have also been reluctant to infer the existence of reckless conduct solely based on objectively reasonable conduct—i.e., without reference to a defendant's actual mental state. The *Edalati* decision, described above, focused on actual conduct in analyzing recklessness. It refused to find the existence of scienter based solely on an objective standard and the fact that the defendant had violated a relatively unambiguous regulation.[27] In the wake of *Schutte* and the focus on subjective intent and actual knowledge, the Seventh Circuit similarly has analyzed recklessness with respect to a defendant's particular conduct, holding that defendant's "own conduct at least raises a genuine question as to whether it acted in reckless disregard of the truth or falsity of the claims submitted."[28] In reaching that result, the Seventh Circuit cataloged the circumstantial evidence on which a court could rely to find recklessness with respect to price charging practices, including a lack of compliance methods or processes and a lack of systems for complying with the applicable rules.[29]

Ultimately, it remains undecided how, if at all, *Schutte* affected what it means for a defendant to act recklessly under the False Claims Act. Further case law will develop whether a plaintiff merely needs to show a defendant's failure to take objectively reasonable steps to ensure compliance or whether some additional evidence of a defendant's particular mental state is required.

The Relationship Between Scienter and Falsity

Finally, it bears noting that lower courts have heeded language from *Schutte* that the decision is confined to the question of scienter. *Schutte* emphasized that "[i]t is equally important to recognize what we did *not* grant certiorari to review: We are not reviewing ... whether any of respondents' claims were, in fact, inaccurate or otherwise false."[30] Thus, the question whether an interpretation of an ambiguous legal standard was accurate pertains to the falsity element, not scienter.

To that end, in *United States ex rel. Miller v. Reckitt Benckiser Grp. PLC*,[31] the court rebuffed efforts to collapse falsity and scienter. There, plaintiff alleged that defendants fraudulently reported to the government the lowest price (i.e., "best price") that they sell a Medicaid-covered prescription drug. Defendants sought to dismiss the complaint on scienter grounds, among others, because the Medicaid best price statute, regulations, and guidance were unambiguous that defendants' conduct was not prohibited.[32] Referencing *Schutte*, the court held that the defendant's argument improperly collapsed falsity and scienter. Whether a reasonable person could have read the guidance as permitting defendants' conduct cannot defeat the scienter allegations here that defendants believed their claims were inaccurate.[33]

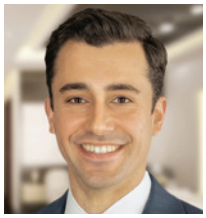
Conclusion

Overall, the effect of *Schutte* on the False Claims Act terrain so far has been relatively minor. Defendants still argue that their claims were submitted in good faith. And they still seek pretrial dismissal on numerous other grounds created by ambiguous regulatory frameworks, such as an absence of falsity or materiality.

That said, a review of the case law interpreting *Schutte* reveals that the decision has marginally benefited plaintiffs. This is not surprising as the decision foreclosed a potential scienter defense based on objectively reasonable interpretations of ambiguous legal standards. As the Seventh Circuit stated plainly, "[t]he Court [in *Schutte*] simply held that a defendant who harbors such a subjective belief [that a claim is false] cannot avoid liability by arguing that reasonable minds might disagree. That holding does not help [defendant]. Indeed, it makes it harder—not easier—for him to avoid FCA liability."[34] Indeed, case law has shown an increasing reluctance to dismiss claims on scienter grounds pretrial or the creation of a new scienter defense altogether.

Finally, questions still linger over the effect on recklessness—specifically, whether it still incorporates the concept of objectively un-

reasonable behavior or requires some subjective knowledge. Given the constant allegations of recklessness in False Claims Act cases, the law should further develop on this issue in due course. ⊙



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Endnotes

[1]598 U.S. 739 (2023)
[2]*See* 18 U.S.C. § 3729(b)(1)(A).
[3]*Schutte*, 598 U.S. at 749.
[4]*Id.* at 752.
[5]*United States ex rel. Ocean State Transit, LLC v. Infante-Green*, No. 121CV00391MSMPAS, 2023 WL 6199183 (D.R.I. Sept. 22, 2023)
[6]*Id.* at *2.
[7]*Id.*
[8]*Id.* at *17.
[9]*See, e.g., United States of Am. Ex rel. Randy Jacobs v. Pac. Dermatology Inst., Inc.*, No. EDCV 20-1906 JGB (SHKX), 2024 WL 3086586, at *7 (C.D. Cal. May 16, 2024) (rejecting defendants' contention that *Schutte* "requires a different outcome" with respect to scienter and holding instead that, "[h]aving considered the import of [*Schutte*], the Court reaffirms its earlier ruling and finds that the [complaint] likewise alleges scienter" under the False Claims Act).
[10]*Scollick ex rel. United States v. Narula*, No. 1:14-CV-01339-RCL, 2024 WL 2017132 (D.D.C. May 7, 2024),
[11]*Id.* at *4.
[12]*Id.* at *4.
[13]*United States ex rel. Edalati v. Sabharwal*, No. 2:17-CV-02395-HLT, 2023 WL 5334621 (D. Kan. Aug. 18, 2023),
[14]*Id.* at *11.
[15]*Id.* (quoting *Schutte*, 143 S. Ct. at 1400).
[16]*United States v. McComber*, No. CR ELH-21-036, 2024 WL 1243851 (D. Md. Mar. 22, 2024)
[17]*Id.* at *32.
[18]*Id.* at *34.
[19]31 U.S.C. § 3729(b)(1)(A)(iii).
[20]*Schutte*, 598 U.S. at 751.
[21]*Id.* at 751 n.5 (emphasis added).
[22]*United States v. Peripheral Vascular Assocs., P.A.*, No. SA-17-CV-00317-XR, 2024 WL 390091, at *7 (W.D. Tex. Jan. 30, 2024); *accord United States ex rel. Souza v. Embrace Home Loans, Inc.*, No. 122CV00453JJMPAS, 2023 WL 4234967, at *4 (D.R.I. June 28, 2023) ("[I]f Defendants claim to have known and have complied with HUD regulations while failing to catch dozens of alleged underwriting deficiencies, they at least ignored a 'substantial risk' that their quality control processes were inadequate.").
[23]*United States ex rel. Brooks v. Stevens-Henager Coll., Inc.*, No. 2:15-CV-00119-JNP-DAO, 2024 WL 2857885, (D. Utah Mar. 29, 2024).
[24]*Id.* at *1.
[25]*Id.* at *8.
[26]*Id.*; *see also United States ex rel. Kraemer v. United Dairies, L.L.P.*, 82 F.4th 595, 606 (8th Cir. 2023), reh'g denied, No. 22-3306, 2023 WL 7015733 (8th Cir. Oct. 25, 2023) (discussing *Schutte* and affirming a lack of recklessness where, among other grounds, "Defendants' interpretation of the ambiguous insurance policy was objectively reasonable").
[27]*See United States ex rel. Edalati v. Sabharwal*, No. 2:17-CV-02395-HLT, 2023 WL 5334621, at *12 (D. Kan. Aug. 18, 2023).
[28]*See United States ex rel. Heath v. Wisconsin Bell, Inc.*, 92 F.4th 654, 662–63 (7th Cir. 2024), cert. granted sub nom. *Wisconsin Bell, Inc. v. U.S. ex rel. Heath*, No. 23-1127, 2024 WL 3014477 (U.S. June 17, 2024).
[29]*Id.*
[30]598 U.S. at 749.
[31]*United States ex rel. Miller v. Reckitt Benckiser Grp. PLC*, No. 1:15CV00017, 2023 WL 6849436, (W.D. Va. Oct. 17, 2023)
[32]*Id.* at *16.
[33]*Id.* at *16 ("[I]t is [defendant's] subjective knowledge at the time of its submission, not its post hoc rationalizations or an interpretation that is objectively reasonable, that matters." (citing *Schutte*, 598 U.S. at 752).
[34]*Stop Illinois Health Care Fraud, LLC v. Sayeed*, 100 F.4th 899, 905 (7th Cir. 2024), *reh'g denied*, No. 22-3295, 2024 WL 2785312 (7th Cir. May 30, 2024) (citing *Schutte*, 143 S. Ct. at 1395).