

# False Claims Act Spotlight (3 of 3): Changing Landscape of the FCA in the Courts

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On August 12, 2021, a panel of the Seventh Circuit voting 2-1 endorsed the existence of an “objective reasonableness” defense under the FCA. *United States ex rel. Schutte v. SuperValu, Inc.*, No. 11-cv-3290, 2021 WL 3560894 (7th Cir. Aug. 12, 2021). In *Schutte*, the defendants allegedly knowingly filed false claims to the government by seeking reimbursements for drugs based on their customary prices, without reporting to the government discounted prices offered to certain customers under a discount program. The Seventh Circuit held that, although the defendants should have reported the discounted prices, the defendants were not liable under the FCA; the court held that although the defendants’ interpretation of the regulations governing drug price reporting was incorrect, the defendants had not applied an objectively unreasonable interpretation of the regulations. Therefore, they did not meet the requirement under the FCA that the defendants “knowingly” submitted false claims to the government. This is because, as the court explained, if defendants in an FCA action followed an objectively reasonable interpretation of a law in making claims to the government, there would be no way for defendants “to actually know that they submitted a false claim.” If the requirements for the claim are “unknown” or uncertain, then a claim that was made on reliance of an objectively reasonable interpretation of those requirements could not have been “knowingly” false. The Court reiterated that there is no subjective intent requirement under the FCA, so this defense is not defeated even by FCA defendants’ subjective suspicion or belief that a claim may be a false claim because some other interpretation of the underlying law may rule.

This objective reasonableness standard was originally introduced in the context of the Fair Credit Reporting Act (“FCRA”) in *Safeco Insurance Company of America v. Burr*, 551 U.S. 47 (2007). In *Safeco*, the Supreme Court had held that the defendant’s interpretation of the FCRA was “albeit erroneous, not objectively unreasonable,” and thus did not meet the scienter standard required to enforce a violation of the FCRA. With its decision to extend this defense to FCA actions in *Schutte*, the Seventh Circuit Court of Appeals joins several other circuit courts, including the D.C., Third, Eighth, and Ninth Circuits, that had already extended the *Safeco* objective reasonableness standard to the FCA.

In addition to endorsing the application of *Safeco*’s objective reasonableness test to the FCA, the court in *Schutte* considered whether there was any “authoritative guidance” that could have made clear to the defendants that their interpretation, despite being objectively reasonable, was false. By evaluating the existence of such authoritative guidance, the Seventh Circuit panel explained, application of the objective reasonableness “test does not shield bad faith defendants that turn a blind eye to guidance indicating that their practices are likely wrong.” Here too, the Seventh Circuit adopted *Safeco*’s reasoning, stating that in order to be authoritative, the guidance must originate from “either circuit court precedent or guidance from the relevant agency” and must apply to the issue at hand with “a high level of specificity.”

With this decision, the Seventh Circuit introduced a defendant-favorable defense to FCA violations. This defendant favorable-trend follows another defendant-favorable decision reached by the D.C. Circuit earlier this year. In *United States ex rel. Cimino v. International Business Machines Corp.*, No. 19-7139, 2021 WL 2799946 (D.C. Cir. July 6, 2021), the D.C. Circuit took a closer look at the theory of “fraudulent inducement” as a source of FCA liability, which states that an initial fraud in the inducement of a contract with the government can taint all claims for reimbursement made to the government under that contract and transform them all to false claims under the FCA. The court in *Cimino* did ultimately hold that the relator in that case had met the necessary burden of pleading but-for causation (i.e., that the fraudulent actions of the defendants actually caused the government to enter into the contract). However, by characterizing the causation requirement of the FCA in such strong terms, the D.C. Circuit’s decision places a critical restriction on FCA relators’ use of the fraudulent inducement theory as an avenue through which to bring FCA enforcement actions.

We will keep an eye on how courts continue to clarify the contours of FCA enforcement actions and report back on this blog with further updates as they become available.

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