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# The Supreme Court's Ruling Narrows Available FCA Scienter Defenses

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In a unanimous opinion, the United States Supreme Court ("Court") recently held that the False Claims Act's ("FCA") *scienter* requirement refers to a defendant's knowledge and subjective beliefs, rather than what a hypothetical reasonable person could have known or believed. As supported by the text of the FCA itself and by its common-law roots, the Court explained that the "focus is what a defendant thought when submitting a claim—not what a defendant may have thought *after* submitting it." Consequently, the Court vacated the holding of the Seventh Circuit and remanded the matter for further proceedings consistent with the Court's opinion. Because the Seventh Circuit had affirmed a Federal district court's grant of the defendants' motions for summary judgment, the Court's opinion effectively revives the FCA claim against the defendants.

**The District and the Seventh Circuit Endorsed a Pure Objective Reasonableness Standard for FCA Scienter**

In this case, the relator alleged that certain pharmacies, among other things, misreported their pricing of certain drugs covered by Medicare and Medicaid. Specifically, the pharmacies allegedly reported to CMS their retail prices as their "usual and customary" prices for such drugs—instead of their discounted prices. Consequently, the pharmacies were allegedly overpaid by the Medicare and Medicaid programs pursuant to their claims to CMS.

Although the District Court ruled against the defendants on the first element of the FCA (*falsity of the claims*), finding that their misreporting of their retail prices as their "usual and customary" prices represented false claims, the District Court granted the defendants' motions for summary judgment on the second element of the FCA (their *knowledge of the claim's falsity*). The District Court specifically found that, regardless of what the defendants actually believed, they could not have acted "knowingly" because the District Court advanced an objectively reasonable interpretation of "usual and customary" in litigation.

The Seventh Circuit affirmed the District Court's ruling as to this second element of the FCA based on the Court's interpretation of the term "willingly" in the Fair Credit Reporting Act. See *Safeco Ins. Co. of America v. Burr*, 551 U.S. 47 (2007). Agreeing with the District Court that the defendants could not have acted "knowingly" if their actions were consistent with an objectively reasonable interpretation of the phrase "usual and customary," the Seventh Circuit concluded that the pharmacies were entitled to summary judgment even if they actually thought that their discounted prices were their "usual and customary" prices (and therefore, thought that their claims to CMS were false).

**The Supreme Court Held that Subjective Belief Must Also Be Considered**

Embedded within the Seventh Circuit's holding is the reasoning that "because *other* people might make an honest mistake [when interpreting the phrase "usual and customary"], defendants' subjective beliefs become irrelevant to their scienter" for FCA liability purposes. In support of the Seventh Circuit's holding and rationale, the pharmacies posited three arguments—each of which the Court rejected.

First, the defendants argued that they could not have "known" that their claims were inaccurate because they could not have "known" what the phrase "usual and customary" actually meant. The Court rejected the defendants' arguments because the relator alleged that the defendants received notice from various sources (including a pharmacy benefit manager and State Medicaid agencies) that the phrase "usual and customary" referred to their discounted prices and that the defendants understood the notices but then tried to hide their discounted prices.

Second, the defendants argued that, based on the Court's interpretation of the common-law definitions of "knowing" and "reckless" in *Safeco*, the FCA should be read with the same interpretation—i.e., using an objective reasonableness test. The Court rejected this argument because the Court in *Safeco* interpreted a different statute than the FCA and because *Safeco* did not purport to provide an objective reasonableness test that the defendants invoked before the Court. On this latter point, the Court specifically explained that *Safeco* stated that a person is reckless if he acts "*knowing* or having reason to know of facts which would lead a reasonable man to realize" that his actions were substantially risky. Accordingly, as the Court previously noted, *Safeco* did not suggest that the Court should look to facts that the defendants neither knew nor had reason to know at the time they acted.

Lastly, the defendants argued that, at common law, their claims would not be actionable as fraudulent even if their reported prices were not accurate under the correct meaning of "usual and customary." The Court explained that, essentially, the defendants' argument was as follows:

At common law, misrepresentations of law are not actionable; only misrepresentations of fact are. Because the FCA incorporates the common law of fraud, it embodies that same limitation. And the claims here would have been knowingly false only because [the defendants] correctly understood what "usual and customary" meant. Therefore, [the defendants] conclude, their reports were not false because of any misrepresentation of fact; to the contrary, their claims would have been false only because of their view of the law.

To this argument, the Court held that the "premises do not support that conclusion," reasoning that an interpretation of a law may be viewed as a mere opinion "that no one could justifiably rely on." By making statements about what their "usual and customary" prices are to CMS, they implied facts that were not known to CMS, who received the defendants' claims. Given that such statements included false facts, there was a potentially valid fraud theory, even under the defendants' common-law rule.

**Future Implications**

The impact of the Court's holding is likely to reduce the ability of defendants of FCA claims to secure a dismissal prior to trial based on the absence of *scienter* based on a standalone reasonable interpretation of a regulation. Defendants who seek to dismiss FCA claims based on their objectively reasonable interpretation of the law have the added requirement of establishing that their subject belief at the time the claim was submitted was one and the same as the reasonable interpretation of the same law. Consequently, this will likely invite probing discovery from relators (and even DOJ) into the subjective motivations of FCA defendants. Moreover, under the subjective standard, the existence of *scienter* (or lack thereof) is oftentimes a fact-intensive inquiry that is difficult to resolve short of trial.

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