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Supreme Court Hears Arguments on False Claims Act Scienter Standard

Article By:

David T. Fischer

Sheela Ranganathan

Companies regularly are required to interpret ambiguous and vague regulatory provisions. Today, the United States Supreme Court heard oral arguments in a pair of consolidated cases to determine whether a defendant's subjective interpretation of an ambiguous regulation is relevant to determining the knowledge (or scienter) element of the False Claims Act or, as the Seventh Circuit held in the case below, that once a defendant can articulate an objectively reasonable interpretation its contemporaneously held subjective belief is irrelevant to the knowledge inquiry. The issue is a significant one for both the government and relators on one side, and potential defendants on the other, as False Claims Act (FCA) liability imposes treble damages and penalties exceeding $20,000 per claim as well as relators' attorneys' fees and costs.

The Seventh Circuit case below turned on the FCA's knowledge element, which reaches claims that are "knowingly" false which includes (1) actual knowledge, (2) deliberate ignorance of the truth or falsity of the information, or (3) reckless disregard of the truth or falsity of the information.

The Court's questioning did not signal the likely decision. All of the Justice asked questions, allowing both Relators and the government (collectively, Petitioners) and Defendants (Respondents) to exceed the established time limits. Three lines of arguments and questioning stood out, however. *First*, both sides were candid that they were seeking a ruling that would provide broad guidance to future litigants, although each side readily acknowledged they would certainly be content with a narrow holding favorable to their position. Seeking a broad ruling, however, invited extensive colloquy concerning hypotheticals and appeared, to us, to muddy the analysis.

Petitioners pressed the Court to hold that a defendant's subjective belief as to its statements concerning factual or legal matters is relevant to the inquiry whether a defendant's admittedly false statement was made with actual knowledge. Defense counsel, unsurprisingly, warned the Court that to permit inquiry into a defendant's subjective intent where there is an objectively reasonable, lawful interpretation would lead to costly discovery, require defendants to waive the attorney-client privilege, and preclude resolving cases by dispositive motion, although the Court did not appear to be particularly concerned about this risk. Justices Kagan, Sotomayor, and Jackson appeared receptive to Petitioners' argument that precluding inquiry into a defendant's subjective intent could allow an

after the fact objectively reasonable interpretation to shield a defendant from FCA liability for a statement it believed to be false at the time it was made. Their questions suggest that they believe the Court should simply reverse the Seventh Circuit's holding that, as they described it, a defendant's subjective belief that its statements were false is relevant to the scienter determination. Justice Kagan reasoned that the Court in *Escobar* noted the FCA is grounded in common law fraud principles under which a defendant's subjective knowledge of the truth or falsity of its statement is relevant to the knowledge inquiry.

Justices Thomas, who initiated the questioning for the Court, displayed some sympathy to the difficulty of requiring a company to defend its interpretation of ambiguous regulations. Justices Kavanaugh, Alito, and Gorsuch echoed this concern. They presented hypotheticals asking whether a defendant's decision to adopt an interpretation that it believed would likely be rejected by a court could satisfy the knowledge element. For example, Chief Justice Roberts and Justice Alito inquired whether a defendant who adopted an interpretation that it subjectively believed had a 49% likelihood of being correct could be found to have made a knowing false statement.

Second, Petitioners also argued that the text of the FCA and congressional intent encourage transparency. They argued a defendant can avoid liability if it discloses with the claim (or statement) its understanding of the ambiguous term(s). Government counsel argued, for example, that if defendants in the cases here "had shown their work" and provided proof of why they thought their interpretation was reasonable, there would not have been anything deceitful regarding their disclosure and thus there would not be liability under the FCA. Defense counsel countered that Petitioners' approach would be unworkable as a practical matter in many contexts and would unduly burden every company that does business, directly or indirectly, with the government. Moreover, as defense counsel noted, the government is able to address ambiguous terms through rulemaking followed by authoritative guidance. "[I]f the federal government wants to take [a] position, there's a way to do it. It adopts a rule. It tells everybody what the standard is, and then you're on notice, and there's no question." Justice Kavanaugh was receptive to this argument, saying that if a company's understanding is "based on a legal understanding, it's a little hard for me to say your legal view is false." Further, in our view, requiring a company to set forth its legal view of an ambiguous regulation to an agency and then having the agency decide upon the merits of the legal view puts the government agency in the role of judge, and jury.

Third, Respondent's counsel repeatedly emphasized that requiring evidence of subjective intent relating to ambiguous regulations would necessarily require waiver of the attorney-client privilege. FCA defendants would be required to do this in order to prove what advice was given and what the client knew. This issue was briefly addressed in just two paragraphs of Respondent's brief. It is possible that this issue was repeatedly emphasized during oral argument as it may appeal to all of the Justices and provide an issue that could unify the bench, although the Justices did not appear receptive to it based on their lack of questions on this issue.

Predicting outcomes based on oral argument is challenging. Nonetheless, it appears to us unlikely that a majority of the Justices will adopt the broad interpretation advocated by the Government and Relator. First, Petitioners' reliance on policy arguments beyond the text of the statute is inconsistent with the Court's history of taking a textual approach to interpreting the FCA. Second, Petitioners' argument would require the Court to distinguish its prior holding in *Safeco Insurance Co. of America v. Burr*, in which the Court held, in ruling upon a similar scienter spectrum in the Fair Credit Reporting Act, that a regulated entity cannot be a "knowing or reckless violator" when it conducts itself consistent with an objectively reasonable interpretation of ambiguous legal obligations. 551 U.S. 47, 70 n.20 (2007). And, based on that decision, the D.C. Circuit, in a decision joined by then D.C. Circuit

Judge Kavanaugh, applied the *Safeco* reasoning to reach substantially the same result in *United States ex rel. Purcell v. MWI Corp.*, 807 F.3d 281, 290–91 (D.C. Cir. 2015). It seems unlikely that Justice Kavanaugh experienced a change of heart since the *Purcell* decision. Nevertheless, the bench as a whole was clearly troubled by the potential and unknowable consequences of holding that a defendant's subjective interpretation can never be relevant to determining its state of mind if it can generate an objectively reasonable interpretation, including a *post hoc* interpretation.

The Justices suggested possible bases for a narrow ruling, such as holding that a false statement of fact can be considered in determining scienter and leaving the question of the falsity of a regulatory interpretation for another day. Or, taking into account prior precedent, the Court could decide that a subjectively held objectively reasonable interpretation of an ambiguous regulatory provision defeats scienter, even if the interpretation was arguably wrong, unless authoritative guidance warned the defendant away from its interpretation.

Regardless of the outcome, the decision will likely be consequential for healthcare companies and other regulated industries. We will report the Court's decision and offer guidance companies can use to strengthen their compliance and risk-management programs as appropriate.

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