

False Claims Act: Circuit Court Questionably Construes Scienter Requirement

IN SHORT

The Situation: The U.S. Court of Appeals for the Eleventh Circuit held that the False Claims Act's intent requirement can be met even if the underlying regulation that the defendant allegedly violated is ambiguous.

The Result: The Eleventh Circuit adopted an approach that conflicts with other courts' treatment of the FCA's intent requirement.

Looking Ahead: In our view, the ruling is inconsistent with the FCA's requirement that a defendant act "knowingly" and with case precedent.

The U.S. Court of Appeals for the Eleventh Circuit recently issued an opinion addressing the False Claims Act's intent requirement. *U.S. ex rel. Phalp v. Lincare Holdings, Inc.*, No. 16-10532, ___ F.3d ___ (11th Cir. May 26, 2017). In our view, the Eleventh Circuit adopted the wrong approach, although correctly ruling for the defendant.

Lincare supplied Medicare patients with diabetic-testing supplies. Former Lincare salespeople brought suit on behalf of the government alleging that Lincare and others submitted claims to Medicare that were "false or fraudulent" because they purportedly violated Medicare regulations requiring authorization from the beneficiary and regulations regarding unsolicited telemarketing calls. The United States did not intervene in the case, but relators proceeded. The trial court granted summary judgment for the defendants, holding that (i) relators' evidence did not show the defendants "knew or should have known that [their] policies or practices violated the applicable statutes and implementing regulations"; and (ii) that "as a matter of law," because the applicable regulations were ambiguous, "no reasonable jury could find" that defendants submitted false claims with the requisite intent. On review, while the Eleventh Circuit agreed with the first justification, it rejected the second one and thereby created a circuit split regarding the FCA's intent requirement.

Under the FCA, a plaintiff must show that a defendant acted "knowingly," which is defined as either "actual knowledge," "deliberate ignorance," or "reckless disregard." The Eleventh Circuit contrasted those mental states from "honest mistakes or incorrect claims submitted through mere negligence," and cautioned against "imposing a burdensome obligation on government contractors rather than a limited duty to inquire." The Eleventh Circuit then agreed that the relators' evidence—vague emails from after the claims for payment had been submitted—did not create an issue of fact regarding whether the defendants knew at the time the claims were submitted that the claims were false.

The court went further, however, and rejected the argument that the ambiguity in the underlying regulations prohibited a finding that defendants acted "knowingly" as a matter of law. The district court had relied upon authority from the Eighth Circuit and other district courts holding that "a defendant's reasonable interpretation of any ambiguity inherent in the regulations belies the scienter necessary to establish a claim of fraud under the FCA." See *U.S. ex rel. Hixson v. Health Mgt. Sys., Inc.*, 613 F.3d 1186, 1191 (8th Cir. 2010). The Eleventh Circuit, however, adopted the position that the United States had advocated as amicus: that a defendant can still have "knowingly" submitted false claims for payment even if the underlying regulation that the defendant allegedly violated is ambiguous. "Although ambiguity may be relevant to the scienter analysis," the Eleventh Circuit reasoned, "it does not foreclose a finding of scienter. Instead, a court must determine whether the defendant actually knew or should have known that its conduct violated a regulation in light of any ambiguity at the time of the alleged violation." The Eleventh Circuit did not explain how a defendant "should have known that its conduct violated a regulation" if the regulation itself is ambiguous.

In our view, the Eleventh Circuit's approach in *Phalp* (and the one the U.S. Department of Justice and relators have advocated) is misguided. The U.S. Supreme Court has recognized that when "the statutory text and relevant court and agency guidance allow for more than one reasonable interpretation, it would defy history and current thinking to treat a defendant who merely adopts one such interpretation as a knowing or reckless violator." *Safeco Ins. Co. of Am. v. Burr*, 551 U.S. 47, 70 n.20 (2007). Lower courts have applied *Safeco* to hold that the False Claims Act's intent requirement includes both an objective and a subjective component. The Eleventh Circuit's opinion, however, did not discuss *Safeco*.

Relators may attempt to argue that the Eleventh Circuit's approach is consistent with cases, including in the Eighth Circuit, holding that an FCA plaintiff may proceed if it provides "sufficient evidence of government guidance that warned a regulated defendant away from an otherwise reasonable interpretation of an ambiguous regulation," thus rendering the defendant's interpretation unreasonable. *U.S. ex rel. Donegan v. Anesthesia Assocs. of Kansas City*, 833 F.3d 874, 879 (8th Cir. 2016). Yet the Eleventh Circuit's approach may have taken a step further, allowing liability even where a defendant operated under one reasonable interpretation of the regulation if the defendant "should have known" its conduct violated the ambiguous regulation.

Yet, as the Supreme Court recently illustrated in its seminal FCA decision *Universal Health Services, Inc. v. U.S. ex rel Escobar*, 136 S.Ct. 1989 (2016), "strict enforcement" of the FCA's "rigorous" scienter and materiality requirements is critical in order to address "concerns about fair notice and open-ended liability" under the "punitive" FCA. As any company who does business with the government is aware, an FCA suit can bring treble damages, civil penalties, massive judgments, and even potential exclusion from participation in government programs such as Medicare and Medicaid. Instead of the necessary "strict enforcement," however, the Eleventh Circuit adopted an approach that plaintiffs will argue lessens their burden.



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THREE KEY TAKEAWAYS

1. While other federal courts have recognized that a False Claims Act plaintiff cannot bring an FCA claim alleging that the defendant "knowingly" violated a regulation that was ambiguous, the Eleventh Circuit rejected that approach in this case. Because the Eleventh Circuit ruled for the defendant on other grounds, the case is not a strong vehicle for certiorari, and defendants will need to monitor its future application.
2. Intent is a critical element of the False Claims Act that distinguishes its punitive liability from more typical regulatory violations and honest mistakes, as the Supreme Court recently reaffirmed in *Escobar*.
3. Even under the Eleventh Circuit's recent ruling, a plaintiff still must show that the defendant acted "knowingly." Without evidence that the defendant knew or should have known that its conduct violated the underlying regulation—given any ambiguity that existed at the time—the FCA claim must fail.

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