

# Government Contract

COMMENTARY

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## The Real Good News From *GEICO*: Reasonable Interpretations Negate *Scienter* Under the False Claims Act

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During the last term the U.S. Supreme Court handed down an important ruling that will affect False Claims Act litigation. Deciding jointly *GEICO General Insurance Co. v. Edo* and *Safeco Insurance Co. v. Burr*, 127 S. Ct. 2201 (2007), the court, with the support of the Justice Department as *amicus*, unanimously held that in the civil context, a defendant's reliance on an objectively reasonable interpretation of a legal obligation precludes a finding of "willfulness," regardless of evidence of the defendant's subjective intent.

While *GEICO* involved the interpretation of a provision of the Fair Credit Reporting Act, the court's discussion of what constitutes a willful violation, which the court found to include "reckless disregard," sweeps considerably broader. Indeed, the court characterized its holding as the "common law" understanding of recklessness. *Id.* at 2215.

Thus, this decision may have significant consequences outside the FCRA context. Many civil statutes condition liability upon a finding of willfulness or recklessness, so if reliance on an objectively reasonable interpretation of an ambiguous statute defeats this level of *scienter*, courts may dispose of the issue of intent at the pleading stage if the alleged conduct comports with such an interpretation. *GEICO* thus appears to create an effective "safe harbor" that could significantly streamline litigation.

*GEICO* should have a particularly dramatic effect in actions brought under the False Claims Act, 31 U.S.C. § 3729(a)(1), which prohibits any person from knowingly presenting a false or fraudulent claim for payment or approval to the federal government.

*GEICO* should prove especially significant in FCA litigation involving complex legal and regulatory issues, which often turn on whether the challenged conduct is consistent with a reasonable interpretation of legal duties.

To date, courts have been split on whether a reasonable interpretation precludes liability in the FCA context, but *GEICO* answers this question conclusively. Going forward, courts in many instances will be able to analyze at the pleading stage whether an FCA action can be pursued. If the conduct challenged by the government or a relator is consistent with a reasonable interpretation of the applicable law or regulations, under *GEICO*, the action must be dismissed without the need to evaluate the fact-intensive issue of subjective intent.

### The *GEICO* Decision

The Fair Credit Reporting Act requires "users of consumer reports" to provide notice to consumers if they take "any adverse action with respect to any consumer that is based in whole or in part on any information contained in a consumer report." 15 U.S.C. § 1681m(a).

The FCRA defines "adverse action" differently depending on the purpose for which the consumer report is used. With regard to insurance, the statute says an "adverse action" is "a denial or cancellation of, an increase in any charge for, or a reduction or other adverse or unfavorable change in the terms of coverage or amount of any insurance, existing or applied for, in connection with the underwriting of insurance." 15 U.S.C. § 1681a(k)(1)(B)(i). Any "person" (as defined by the FCRA) "who willfully fails to comply" with the law is subject to statutory and punitive damages. 15 U.S.C. § 1681n(a).

GEICO and Safeco are two insurance companies that relied on credit reports to set initial rate premiums. GEICO's policy was to provide adverse-action notice only where the customer received an insurance rate worse than he or she would have received had the company not considered the customer's credit score. Safeco's policy was less nuanced; it did not provide notice to any first-time applicants, reasoning that an "increase" in premiums could not occur where there was no initial baseline.

The insurers were sued in separate class actions in the U.S. District Court for the District of Oregon for willful violations of the FCRA. The court granted summary judgment for the companies, but the U.S. Court of Appeals for the 9th Circuit reversed, holding that neither insurer's policy complied with the statute, which, in the court's view, required an insurer to provide notice of an adverse action any time the customer would have received a better insurance premium had his or her credit report been more favorable.

The 9th Circuit also held that the companies may have "willfully" violated the FCRA if they acted with "reckless disregard" for its legal requirements. The court said this determination depended on a fact-sensitive subjective inquiry into each defendant's good faith in failing to provide notice.

On appeal to the Supreme Court, GEICO and Safeco argued first that their notice policies reflected the proper interpretation of the FCRA's adverse-action provision and that even if their interpretations were incorrect, they were objectively reasonable and thus their failure to give notice was not willful as a matter of law.

On the definitional question, the plaintiffs disputed the companies' interpretation of "adverse action"; on the willfulness question, the plaintiffs countered that even assuming the reasonableness of the insurers' interpretations, evidence in the record indicated *subjective* bad faith, that is, that the companies were aware that their policies violated the FCRA.

The government, filing a brief as *amicus*, took an intermediate position, agreeing with the plaintiffs as to the meaning of "adverse action" and the fact that willfulness reached acts taken with reckless disregard. But it agreed with GEICO and Safeco that their interpretations of the law, though wrong, were reasonable and that such reasonableness precluded a finding that they had "willfully fail[ed] to comply" with the FCRA.

Notably, the government wrote: "[The] purely legal inquiry into the objective recklessness of the defendant's failure to comply with the FCRA can, and generally

should, be undertaken at an early stage in the case. Only if the defendant's failure to comply with the law was objectively reckless would it become necessary for a court to probe ... the defendant's subjective good faith." Brief for the United States, at 23.

The Supreme Court held that GEICO's policy complied with the statute while Safeco's likely did not. 127 S. Ct. at 2210-14. The court further agreed with plaintiffs and the government that willfulness covered reckless conduct. In applying this standard, however, the court adopted the view espoused by defendants and the government, holding that Safeco had not willfully violated the FCRA because its interpretation of the statute was reasonable, which precluded a finding of willfulness as a matter of law. "Here, there is no need to pinpoint the negligence/recklessness line, for Safeco's reading of the statute, albeit erroneous, was not objectively unreasonable." *Id.* at 2215.

In coming to this conclusion, the court noted that the common law conceives of civil recklessness "as conduct violating an *objective* standard: action entailing 'an unjustifiably high risk of harm that is either known or so obvious that it should be known.'" *Id.* (citations omitted) (emphasis added). By definition, a reasonable reading of the FCRA cannot be reckless, and whether a defendant's interpretation of the law is reasonable is an objective consideration that a court may decide as a matter of law.

In so finding, the court explicitly dismissed the plaintiffs' allegations of subjective bad faith:

Respondent-plaintiffs argue that evidence of subjective bad faith must be taken into account in determining whether a company acted knowingly or recklessly for purposes of Section 1681n(a). To the extent that they argue that evidence of subjective bad faith can support a willfulness finding even when the company's reading of the statute is objectively reasonable, their argument is unsound.

Where, as here, 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. Congress could not have intended such a result for those who followed an interpretation that could reasonably have found support in the courts, whatever their subjective intent may have been.

*Id.* at 2216 n.20.

Having clarified the relevant standard, the court had no trouble finding that Safeco's interpretation, though erroneous, was objectively reasonable in light of its "foundation in the statutory text," its adoption by the District Court, and the "dearth of guidance and the less-than-pellucid statutory text." *Id.* at 2216.

### The False Claims Act

As noted above, this holding will have a significant impact on litigation under civil penalty statutes that contain a willfulness or recklessness *scienter* standard. The False Claims Act is one such statute, and *GEICO*'s effect on this area of the law could be profound.

The FCA prohibits any person from knowingly presenting a false or fraudulent claim for payment or approval by the federal government. 31 U.S.C. § 3729(a)(1). A *prima facie* case under the law therefore requires proof that the defendant made a claim against the United States, the claim was false or fraudulent, and the defendant knew the claim was false or fraudulent. The FCA defines "knowledge" as meaning "that a person, with respect to information: (1) has actual knowledge of the information; (2) acts in deliberate ignorance of the truth or falsity of the information; or (3) acts in reckless disregard of the truth or falsity of the information, and no proof of specific intent to defraud is required." 31 U.S.C. § 3729(b) (emphasis added).

Thus the broadest definition of "knowingly" in the FCA context is the same as the definition used by the Supreme Court to define "willfully" in the civil context in general and in the FCRA context in particular: A defendant who recklessly disregards a legal obligation acts both "knowingly" within the meaning of the FCA and, under *GEICO*, "willfully" within the meaning of the FCRA.<sup>1</sup>

To this point, courts have split on whether a defendant can "knowingly" submit a false claim where it takes a reasonable, but ultimately incorrect, position as to its entitlement to payment from the government. Defendants have argued for years that a claim consistent with a reasonable interpretation of the governing laws and regulations cannot be "false"; at most it can be wrong. Some courts have treated the question as a predominantly objective one, reasoning that one cannot "knowingly present what is known to be false" under the FCA if a term is unclear and the defendant has interpreted its legal duties in an objectively reasonable way.

The leading opinion espousing this view is Judge Edith Jones' concurrence in *United States v. Southland Management*, 326 F.3d 669 (5th Cir. 2003) (*en banc*). Judge Jones concluded that "[w]here disputed legal issues arise from vague provisions or regulations, a contractor's deci-

sion to take advantage of a position cannot result in his filing a 'knowingly' false claim." *Id.* at 682. Even this view, however, stops short of *GEICO* in banishing subjective intent from the analysis altogether.

On the other side of the spectrum, some courts have approached this as a purely subjective inquiry, reasoning that *scienter* may be shown even in the presence of an objectively reasonable interpretation. In *United States ex rel. Oliver v. Parsons Co.*, 195 F.3d 457 (9th Cir. 1999), the 9th Circuit held that a defendant's reasonable interpretation is merely evidence of a lack of intent to present a false claim. Under *Oliver*, the court determines the correct interpretation under the relevant statutory or regulatory scheme.

If the court does not agree with the defendant's interpretation, the "knowledge" element turns on an evaluation of the defendant's subjective intent. Such a heavily fact-dependent issue would often have to be decided by a jury, which could still find that a defendant subjectively knew (or acted with reckless disregard as to whether) its interpretation was incorrect, and thus its claim false, even though that interpretation was objectively reasonable.

Because subjective intent is a quintessential jury question, *Oliver* and its progeny make it all but impossible for a defendant to obtain summary judgment based on a reasonable interpretation of the False Claims Act. Perhaps more importantly, the Department of Justice has embraced *Oliver* in the negotiation context as a rationale for rejecting arguments based purely on the demonstration by defense counsel that the conduct at issue was consistent with a reasonable interpretation of law, insisting that inquiry into subjective intent is crucial. This factual inquiry has escalated the cost of defending against an FCA case dramatically, giving the government and relators' counsel significant leverage in settlement negotiations and increasing the likelihood of strike suits.

### After *GEICO*

The Supreme Court's approach to *scienter* in *GEICO* rejects the subjective approach of *Oliver* in favor of an objective approach that goes beyond even *Southland*. In *GEICO* the court applied an objective test for recklessness at the threshold, emphasizing the reasonableness of the defendants' interpretation of the FCRA and rejecting the relevance of evidence of subjective intent. The lack of clarity in the law and the paucity of available judicial and regulatory guidance, combined with Safeco's plausible reading of the statute, persuaded the court that Safeco's interpretation of the law, though erroneous, was nonetheless reasonable, which foreclosed a finding of willfulness/recklessness as a matter of law.

Perhaps just as significant as this holding was the government's advocacy in its favor. Since it was decided, *Oliver* has been one of the government's favorite tools in FCA cases. However, the U.S. solicitor general's assertion in *GEICO* that an objectively reasonable interpretation of a legal obligation precludes recklessness as a matter of law marks a dramatic and welcome change in policy by the Justice Department. Under long-standing department policies regarding filings by the solicitor general, this change would have to have been approved at the highest levels within the agency.

The words of the solicitor general with respect to why an objective standard is appropriate are well-reasoned and powerful:

That purely legal inquiry into the objective recklessness of the defendant's failure to comply with the FCRA can, and generally should, be undertaken at an early stage in the case. Only if the defendant's failure to comply with the law was objectively reckless would it become necessary for a court to probe, as the court of appeals invited here, the defendant's subjective good faith. Resolving the objective recklessness of the defendant's noncompliance with the law at the outset will (i) help to develop the contours of FCRA law, thereby providing prospective guidance concerning the law's requirements and reducing violations; (ii) "permit the resolution of many insubstantial claims on summary judgment," *Harlow v. Fitzgerald*, 457 U.S. 800, 818 (1982); and (iii) minimize the significant intrusions on attorney-client privilege that often attend inquiries into subjective good-faith compliance with the law.

Brief for the United States, at 23 (citations omitted).

Given that there is no principled distinction between the legal standards applicable and policy issues presented in the FCRA and FCA contexts, one would expect that the Justice Department would now conform its approach in FCA negotiations to reflect the objective paradigm adopted by the Supreme Court — at the department's urging — in the FCRA context. And one would certainly expect that this would be the position adopted by the courts.

Even if the Justice Department seeks to somehow back away from this well-reasoned position, the courts do not have that luxury. Motion practice after *GEICO* presumably will be a far more attractive means for FCA defendants to test the sometimes extreme positions taken by relators or the government as to when particular conduct in highly regulated industries should give rise to FCA liability. Given the requirement that the government or a relator conform

to Federal Rule of Civil Procedure 9(b) in pleading with specificity the facts giving rise to the alleged false claim, defendants may craft motions to dismiss that hold those facts up to the applicable legal standard and allow a court to evaluate the (now) purely legal issue of reasonableness. If the court determines that the defendant's conduct is consistent with a reasonable interpretation, the case will be dismissed, regardless of whatever allegations of pernicious intent are pleaded.

After *GEICO*, defendants in many cases will not have to endure the expense and disruption of discovery in order to test whether there is a colorable legal theory that could give rise to liability. If the case is not dismissed, the parties can make a reasoned determination as to whether further litigation or settlement is appropriate. In that sense, it is easy to see the policy rationale that would support the Justice Department's embrace of *GEICO* in the FCA context. Allowing a relatively quick and independent adjudication of whether the conduct at issue meets the FCA standard will allow all parties to reach appropriate resolutions quickly and with minimal litigation expense.

Of course, a cynic might believe that the department will be reluctant to give up the negotiating leverage that it had under the prior regime. No one in good faith would question the usefulness of allowing qualified neutral parties — federal judges — to consider the merits of what the department has now argued in *GEICO* is a purely objective legal issue. (Nor would it be appropriate as a policy matter for the government to take the position that the decision to seek such a determination reflects badly on a government contractor or health care provider who in good faith disagrees with the legal position espoused by government counsel.)

The False Claims Act has proven to be an important weapon in the government's arsenal to combat fraud, not only generating large recoveries, but also incentivizing entities that deal with the federal government to enhance their compliance programs. But Congress has recognized that the determination of the "right" application among varying possible interpretations of complex regulatory structures such as Medicare reimbursement or government contract cost principles is best committed in the first instance to an expert administrative forum, such as the Provider Reimbursement Review Board and the Board of Contract Appeals. Federal courts are capable of making the threshold determination that a particular legal interpretation is reasonable, but they are not the proper forum, nor is FCA litigation, with its punitive sanctions, the proper context to determine the "right" answer and impose potentially massive damages on a defendant whose approach is later determined to be reasonable but not correct.

In the wake of *GEICO* the bulk of the inquiry in many FCA cases hopefully will shift to a determination of whether a particular interpretation was, in fact, reasonable. This is a purely legal question, one that judges, rather than juries, are aptly situated to answer. Persuaded by the able advocacy of the solicitor general, the Supreme Court apparently has buried *Oliver* and replaced it with a far more workable and well-reasoned approach.

Subjective intent now will be relevant only if the conduct is not consistent with a reasonable interpretation of the underlying statutory or regulatory scheme. No longer will claims based on a wrong but reasonable interpretation of law be actionable under the FCA; it will once again be the False Claims Act and not the Wrong Claims Act. So while the *GEICO* decision may not save you a bundle on your car insurance, it could in fact prove far more useful.

## Notes

<sup>1</sup> The statutes' *scienter* requirements might appear theoretically different in that the FCRA is concerned with willful noncompliance with a legal duty (such as recklessness with respect to the law), while the FCA is concerned with reckless behavior (such as reckless submission of false claims). However, in the FCA context what renders the claim "false" in fact is the failure to comply with a legal duty associated with the submission of that claim. Thus the critical inquiry— and the *scienter* standard — are identical.

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