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Privilege, Waiver, and Good Faith: False Claims Act Defense After *Schutte*

By Mark Kelley

You are an in-house lawyer in a highly regulated industry. You do your best to interpret the complex regulations governing your company's business with the federal government, but some of those regulations are unclear—some of them even conflict with each other. The False Claims Act (FCA) imposes liability on corporations for "knowingly" submitting false claims to the government. Is the business insulated from liability under the FCA so long as it acts pursuant to an objectively reasonable interpretation of those regulations?

Earlier this year, in *United States ex rel. Schutte v. SuperValu Inc.*, the Supreme Court answered this question in the negative. *Schutte* held that a defendant's *subjective beliefs* about whether a claim for payment is unlawful establishes scienter under the FCA even if its behavior is consistent with an objectively reasonable interpretation of the relevant statute.[1] This holding has important implications for in-house counsel, including how best to avoid and prepare to litigate FCA claims. Because *Schutte* places emphasis on a defendant's understanding of what the law requires, it also raises issues relating to the attorney-client privilege and waiver of that privilege.

A. The Supreme Court's Decision in *Schutte*

The FCA imposes liability, including treble damages, for "knowingly" presenting false or fraudulent claims for payment to the government.[2] The term "knowingly" encompasses actual knowledge, deliberate ignorance, and reckless disregard.[3] *Schutte* involved claims by retail drug pharmacies for prescription-drug reimbursement from Medicaid and Medicare. Under applicable regulations, pharmacies' reimbursement is limited to their "usual and customary" price for drugs.[4] The plaintiffs in *Schutte* alleged that the pharmacies overcharged Medicare and Medicaid by representing that their usual and customary prices were their retail prices.[5] Plaintiffs alleged those claims were false because the pharmacies' drugs were usually sold at a discount.

The district court granted summary judgment to the pharmacies,[6] and the Seventh Circuit affirmed, holding that a reasonable person could believe that the phrase "usual and customary" refers to retail, as opposed to discount, prices.[7] The Seventh Circuit concluded that the pharmacies could not have "knowingly" submitted false claims for retail prices, even if they believed their discount prices were the "usual and customary" prices, as long as their claims were lawful under a reasonable interpretation of the statute.

The Supreme Court vacated the Seventh Circuit's decision. It held that the FCA's scienter element refers to a defendant's knowledge and subjective beliefs at the time it submits a claim, not what a reasonable person may have known or believed.[8] Accordingly, a defendant that knows or believes that a claim for payment is false under the correct interpretation of a regulation is liable even if it is reasonable to interpret the regulation differently. Importantly, a defendant is also liable if

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it is aware of a *substantial risk* that its claim is unlawful under the correct interpretation and either avoids learning whether its claim was lawful or submits a claim anyways.[9]

B. *Schutte*'s Implications for Business

Schutte will make it more difficult for companies facing FCA liability to dismiss FCA suits before costly and invasive discovery commences. A defendant can no longer expect to win dismissal or summary judgment by offering a reasonable interpretation of the governing regulations that is consistent with its behavior. Rather, courts will be more likely to allow discovery into the defendant's actual beliefs about what the relevant regulations require.

Because *Schutte* places emphasis on a defendant's subjective beliefs and interpretation of governing regulations, FCA defendants may find themselves disclosing—voluntarily or involuntarily—material that would otherwise be subject to attorney-client privilege. Defendants may be faced with this dilemma when they need to rely on communications with their attorneys to prove what they understood the governing regulations to require. Companies that face potential FCA risks should therefore ensure that they have a well-prepared defense of their interpretations of relevant guidelines and regulations. That defense should include consideration of how to avoid an unwanted waiver of attorney-client privilege or to achieve the maximum benefit from an intentional waiver.

C. Responding to Ambiguous Legal Requirements

Of course, the first step to address ambiguous or undefined regulatory, contractual, and other legal requirements that may give rise to liability is to identify them. Identification will likely require involvement by legal and nonlegal personnel alike.

Once ambiguous requirements are identified, a company should establish a position as to its obligations. The company might consider agency guidance, other regulations and rules, and industry practice. A company may also request formal or informal clarification from the government, but as discussed below, reliance on such clarification may create waiver issues.

Once the company establishes an understanding of its obligations, it should implement and promulgate that understanding to the relevant functions. Personnel may need to be trained on the interpretation and/or the government reimbursement process. The company should have personnel in place to identify further issues, developments in the law and industry practice, and compliance failures in the industry.

Importantly, the company should memorialize each of the steps it took—identifying ambiguity, crafting an interpretation, and implementing the interpretation—so it has a record of its response to ambiguous legal requirements. A company may choose to create a "package" of materials to share with potential litigants to avoid or resolve a lawsuit. A company should be deliberate about whether that package contains privileged material—a decision which raises the important issue of waiver.

D. Waiver of Attorney-Client Privilege

As a company prepares its interpretation of ambiguous legal regulations, it should keep in mind concerns regarding waiver of attorney-client privilege, including whether such waiver would be beneficial or inevitable. After *Schutte*, waiver issues are likely to become more common. Indeed, *amici* in *Schutte* warned the Court that a scienter rule implicating subjective beliefs would lead to litigation of advice received from counsel.[10]

A party defending against FCA allegations should proceed carefully: Many courts will find waiver of attorney-client privilege even absent a reliance-on-counsel defense. For example, the Second Circuit's seminal *Bilzerian* decision held that introduction of evidence regarding a defendant's good-faith understanding of the law waives privilege over communications relating to that understanding.[11] The Ninth Circuit, citing *Bilzerian*, has held that where a party's claim "in fairness requires disclosure" of privileged information, the privilege may be waived.[12]

Opportunities for unintentional waiver of attorney-client privilege abound in the FCA context. For example, courts have held that reliance on statements from the government about the legality of an act may result in a waiver of attorney-client privilege.[13] In a recent FCA case, the government argued that reliance on government statements results in waiver *whether or not* the defendant also relied on advice of counsel relating to the government's statements.[14]

Intentional waiver of the privilege is not uncommon in the FCA context, either. In some circumstances, waiver is the

best means of defending a good-faith interpretation of ambiguous legal requirements. Accordingly, a company should document requests for and receipt of advice relating to ambiguous legal requirements so it may present a complete picture of its reliance on counsel. It should also be sure to provide counsel with, and document the provision of, all relevant information relating to the requested advice to avoid the allegation that counsel was not sufficiently apprised of relevant facts when it provided the advice.

E. Conclusion: Prepare and Beware

Following *Schutte*, FCA defendants' subjective beliefs and interpretations of governing legal regulations are more likely to be litigated in court. In-house counsel should adjust their internal practices accordingly. Companies should document the steps taken to identify, interpret, and promulgate their approaches to ambiguous requirements. They should also consider the possibility of intentional or unintentional waiver of attorney-client privilege, both when crafting their compliance approach and when considering a litigation strategy. By adopting and updating practices around regulatory requirements, companies can stay prepared for potential issues and the scenario every in-house lawyer wants to avoid—litigation.

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Endnotes

1. *United States ex rel. Schutte v. SuperValu Inc.*, 143 S. Ct. 1391 (2023).
2. 31 U.S.C. § 3729(a).
3. 31 U.S.C. § 3729(b)(1)(A).
4. *See* 42 C.F.R. § 447.512(b)(2).
5. *Schutte*, 143 S. Ct. at 1398.
6. *See United States v. Safeway Inc.*, 466 F. Supp. 3d 912, 935 (C.D. Ill. 2020); *United States v. SuperValu, Inc.*, No. 11-3290, 2020 WL 3577996, at *8 (C.D. Ill. July 1, 2020).
7. *See United States ex rel. Proctor v. Safeway, Inc.*, 30 F.4th 649, 659 (7th Cir. 2022); *United States v. SuperValu Inc.*, 9 F.4th 455, 468 (7th Cir. 2021).
8. *See Schutte*, 143 S. Ct. at 1401.
9. *Id.* at 1404.
10. *See, e.g.*, Brief of Chamber of Commerce of the United States of America, *et al.* as Amici Curiae at 10, 26-27, *United States ex rel. Schutte v. SuperValue Inc.*, No. 21-1326 (U.S. Mar. 28, 2023).
11. *United States v. Bilzerian*, 926 F.2d 1285, 1294 (2d Cir. 1991).
12. *Chevron Corp. v. Pennzoil Co.*, 974 F.2d 1156, 1162 (9th Cir. 1992) (citing *Bilzerian*, 926 F.2d at 1292).
13. *See, e.g., Bodega Invs., LLC ex rel. Kreisberg v. United States*, No. 08 Civ. 4065, 2009 WL 2634765, at *3 (S.D.N.Y. Aug. 21, 2009) (reliance on representations from IRS agent waived privilege over legal advice relating to those representations).
14. *See, e.g.*, Plaintiffs' Mem. Supporting Mot. to Compel at 22, Dkt. 505-1, *U.S. ex rel. Poehling v. UnitedHealth Group, Inc.*, No. 16 Civ. 08697 (C.D. Cal. June 3, 2022) (arguing that basis for waiver is parties' "assertion of good-faith reliance upon the government, not their reliance upon privileged communications"). Disclosure: MoloLamken represented defendants in this case.