

# FCA Knowledge Element: NY Already Got It Right

By **Randall Fox** (March 10, 2023)

On April 18, the U.S. Supreme Court will hear arguments in two cases about the knowledge element of the False Claims Act. The FCA defines "knowing" or "knowingly" to include actual knowledge, reckless disregard and deliberate indifference.

The question before the court is whether evidence of a defendant's understanding at the time that its false conduct was illegal is relevant to the knowledge element where the defendant later identifies a wrong, but reasonable, interpretation of the applicable legal rules. The appeal arises from two cases out of the U.S. Court of Appeals for the Seventh Circuit, *U.S. v. SuperValu* and *U.S. v. Safeway Inc.*, which were dismissed on this basis.[1]



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In 2015, New York's highest court conclusively resolved the same question under the state's version of the False Claims Act, which in relevant part is identical. In *New York v. Sprint Nextel Corp.*, the New York Court of Appeals held that the contemporaneous evidence of subjective understanding was relevant to the knowledge element regardless of after-the-fact alternative interpretations of the law.[2]

The U.S. Supreme Court should reach the same conclusion.

The New York case was an intervened *qui tam* case against mobile phone company Sprint, claiming it violated the New York False Claims Act by knowingly failing to collect and remit sales taxes on the full amount of the monthly access charges for its cellular calling plans.

The government, in its superseding complaint, alleged several bases for Sprint's knowledge that its sales tax returns were false when it filed them. The government alleged:

- That Sprint had complied with the law before changing its conduct, and did not seek tax refunds for the earlier years;
- That Sprint knew of on-point nonbinding guidance from the state tax agency;
- That Sprint disregarded state tax auditors' advice that its sales tax practice was illegal; and
- That Sprint knew its competitors collected and remitted the taxes that Sprint did not.[3]

Sprint argued that the knowledge element was missing because it offered the court what it

claimed was a reasonable interpretation of the law that it first raised in the litigation. Sprint did not argue that the interpretation it offered was part of Sprint's mindset when it filed its tax returns.

The New York Court of Appeals rejected Sprint's argument, holding: "This is not the stuff that a ... dismissal is made of."<sup>[4]</sup> The court went on to say that what matters for the knowledge element is whether the defendant acted on the asserted reasonable interpretation, not whether it or its attorneys could conjure up one after the fact.

In the words of the court:

Even assuming there could be such a reasonable interpretation in the face of this unambiguous statute, it cannot shield a defendant from liability if, as the complaint alleges here, the defendant did not in fact act on that interpretation. ... Otherwise, '[a] defendant could submit a claim, knowing it is false or at least with reckless disregard as to falsity ... but nevertheless avoid liability by successfully arguing that its claim reflected a "reasonable interpretation" of the requirements' ... Sprint will have to substantiate in further proceedings that it actually held such reasonable belief and actually acted upon it.<sup>[5]</sup>

Like the cases before the Supreme Court, the New York Court of Appeals considered a case at the motion to dismiss stage. The New York court recognized that the government would still have to prove the knowledge element as the case proceeded.

It stated:

There can be no doubt the AG will have to prove the allegations of fraud, that Sprint knew the AG's interpretation of the statute was proper, and that Sprint did not actually rely on a reasonable interpretation of the statute in good faith. But, given the complaint's allegations about the agency guidance and industry compliance with the AG's position, Sprint's payment of the proper amount of sales tax between 2002 and 2005, Sprint's undisclosed reversal of its practices in 2005, and the explicit warnings that Sprint received from the Tax Department, the AG has stated a cause of action for a false claim.<sup>[6]</sup>

In later proceedings, further evidence of Sprint's contemporaneous knowledge was disclosed. It became known that Sprint had lobbied for the relevant tax provision, and in the process had informed the state tax agency that Sprint understood that the provision required it to collect and remit sales taxes on all of its monthly access charges.<sup>[7]</sup> In 2018, Sprint settled the case for \$330 million.<sup>[8]</sup>

While the Supreme Court's eventual decision in its pending cases will have no effect on the interpretation of the knowledge element under the New York False Claims Act, the New York Court of Appeals' decision demonstrates for the Supreme Court the correct understanding of the element.

The New York court interpreted the same definition of "knowing" and "knowingly" as is found in the federal False Claims Act, and recognized that after-the-fact interpretations created for litigation cannot govern whether a defendant acted with knowledge at the time it submitted false claims or made false statements.

An after-the-fact interpretation, by definition, cannot have been part of a defendant's knowledge for the obvious reason that it did not yet exist. Such a later interpretation might,

in appropriate circumstances, address whether a claim or statement was in fact false, but it does not shed light on what the defendant knew, or recklessly or deliberately disregarded, when it made the claim or statement.

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***Disclosure: The author supervised work on the Sprint case while in service at the attorney general's office, but was not involved in any of the appeals.***

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[1] U.S., ex rel. Schutte v. SuperValu, Inc., 9 F.4th 455 (7th Cir. 2021), cert granted 143 S.Ct. 644 (2023); U.S., ex rel. Proctor v. Safeway, Inc., 30 F.4th 649 (7th Cir. 2022), cert granted 143 S.Ct. 643 (2023).

[2] People of the State of New York, ex rel. Empire State Ventures, LLC v. Sprint Nextel Corp., 26 N.Y.3d 98 (2015). Unlike the federal False Claims Act, the New York False Claims Act applies to tax violations. N.Y. State Fin. Law § 189(4).

[3] Id. at 108.

[4] Id. at 112.

[5] Id.

[6] Id. at 113.

[7] See Docket Entries 78-79 in People of the State of New York v. Sprint Nextel Corp., Index No. 103918/2011 (N.Y. County Supreme Court).

[8] See New York Attorney General press release, "A.G. Underwood And Acting Tax Commissioner Manion Announce Record \$330 Million Settlement With Sprint In Groundbreaking False Claims Act Litigation Involving Unpaid Sales Tax, Dec. 21, 2018.