

Seventh Circuit revives FCA suit despite disagreeing on materiality

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In *United States ex rel. Prose v. Molina Healthcare of Illinois, Inc.*, No. 20-2243 (7th Cir. Aug. 19, 2021), a split panel of the Seventh Circuit reversed the district court's dismissal of a False Claims Act suit accusing Molina of submitting fraudulent claims to Illinois' Medicaid program for services it allegedly did not provide.

In particular, the Seventh Circuit reversed the district court's holding that Molina did not know that certain healthcare services it allegedly failed to provide played "a material role in the delivery of Medicaid benefits." This holding prompted a strong dissent from one member of the panel, making this case an interesting discussion of the strict materiality requirement described in *Universal Health Services, Inc. v. United States ex rel. Escobar*, 136 S. Ct. 1989 (2016).

The case arose from Molina's provision of Medicaid services to Illinois residents under a capitation contract, whereby Illinois paid Molina a fixed fee for each of its enrollees. Enrollees were stratified into different "rate cells" based on a variety of factors, including the setting in which the enrollees received their care.

This case concerned enrollees in the highest-cost setting, Nursing Facility, who were to receive skilled nursing facility (SNF) services delivered by Molina. But Molina itself lacked the medical providers specialized in providing SNF services — known as "SNFists" — and, as a result, subcontracted with a separate entity called GenMed, which was founded by the relator in this case.

The Seventh Circuit reversed the district court's holding that Molina did not know that certain healthcare services it allegedly failed to provide played "a material role in the delivery of Medicaid benefits."

The relator alleged that Molina knowingly submitted fraudulent claims for payment for SNF services even after its contract with GenMed was terminated and had stopped delivering SNF services completely. In its defense, Molina argued that it merely failed to

provide care from SNFists, but otherwise provided the requisite facets of SNF care.

The question for the appeals court was whether the relator's allegations met the *Escobar* materiality requirement. The district court had held that the services Molina failed to provide were material to Molina's contract with the state but dismissed the case at the pleading stage after finding that relator's complaint insufficiently alleged that Molina knew that these services were material. The Seventh Circuit reversed.

The majority found that Molina's "barebones assertion" that the government knew about the lack of SNF services was insufficient to defeat these allegations at the pleading stage.

Circuit Judge Diane Wood wrote the majority opinion (joined by Circuit Judge David Hamilton), holding that the complaint adequately pleaded allegations under three theories supporting FCA liability — (1) false certification that the party has complied with a condition of payment; (2) promissory fraud, or fraud in the inducement; and (3) implied false certification — even taking account of the heightened pleading standards imposed by Rule 9(b).

On the false-statement theory, the majority was satisfied by the allegations that Molina submitted materially fraudulent enrollment forms for new Nursing Facility enrollees and sought reimbursement for their SNF services *after* its fallout with GenMed. Likewise, on the promissory-fraud theory, the majority found that the relator plausibly alleged that Molina knew at the time of its two contract renewals with the state that it did not intend to provide the SNF services for which it was contracting.

The materiality issue arose chiefly in the majority's discussion of the final theory: implied false certification. The alleged omission at issue was that when Molina billed for enrollees in the Nursing Facility rate cell, it failed to inform the government that it was not providing

SNFist services (which were part of the overall SNF services Molina had agreed to provide to Nursing Facility enrollees).

The majority found that the significant price difference between Nursing Facility enrollees and capitation payments for lower rate cell levels was strong evidence that the government would have acted differently had it known Molina was not providing the contractually mandated services. Further, the majority found that Molina's "barebones assertion" that the government knew about the lack of SNF services was insufficient to defeat these allegations at the pleading stage.

Judge Sykes disagreed with the majority's reliance on the difference in capitation rates between Nursing Facility and non-Nursing Facility rate cells.

The majority also noted that the district court had mistakenly dismissed the complaint on the theory that because Molina was not involved in calculating the capitation rates, it did not know which service deficiencies would be material to the government.

In reversing, however, the majority agreed with relator's argument that Molina is a sophisticated player in the healthcare industry and experienced in the use of capitation rates. This was sufficient to show that Molina knew that the services it allegedly failed to provide were material, and "requiring more concrete proof of knowledge would run afoul of Rule 9(b)."

One primary sticking point between the majority and the dissent was a disagreement regarding whether the use of SNFists was "integral" to the overall provision of care for the Nursing Facility enrollees (as the majority held) or a limited "coordination and management function" (as was the dissent's view). In turn, this gave rise to different answers on the question of materiality.

In dissent, Chief Circuit Judge Diane Sykes relied on her more limited view of the SNFist function and characterized Molina as

having made "a mere request for payment from the government, coupled with material noncompliance with a contractual condition," which in her opinion, did not rise to the level of materiality required to state an FCA violation.

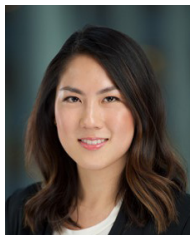
The dissent also took issue with the majority's adherence to Rule 9(b), and particularly its reliance on allegations pleaded "on information and belief" regarding what representations may or may not have made during contract negotiations. Given the lack of specificity regarding any misrepresentations, Judge Sykes would have rejected the fraud in the inducement theory and concluded that the allegations supporting the false certification theory were insufficient.

In Judge Sykes's view, relator's best argument for liability was the implied false certification theory. Yet, she argued that the allegations did not meet the threshold requirement announced by the Supreme Court in *Escobar* — that the claim makes specific misleading representations about services provided — because capitation payments cover numerous services all at once, not just SNFist services.

Judge Sykes disagreed with the majority's reliance on the difference in capitation rates between Nursing Facility and non-Nursing Facility rate cells. Reiterating that SNFist services were only one of many services provided to patients in nursing facilities (and not to patients in other rate cells), she argued that the allegations could not meet the "demanding" bar set by *Escobar* of showing that SNFist services were sufficiently important to the government that it would have acted differently had it known of the omission.

This case demonstrates the challenges that parties to FCA suits face at the pleading stage generally. On the one hand, relators face an uphill climb as a result of Rule 9(b)'s requirement of specificity. On the other hand, the concept of materiality inherently includes room for flexibility because, as this case demonstrates, there are a variety of reasons why one element of a contract may (or may not) be considered material. This gives relators an opportunity to try a variety of approaches and requires defendants to address such allegations head-on.

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