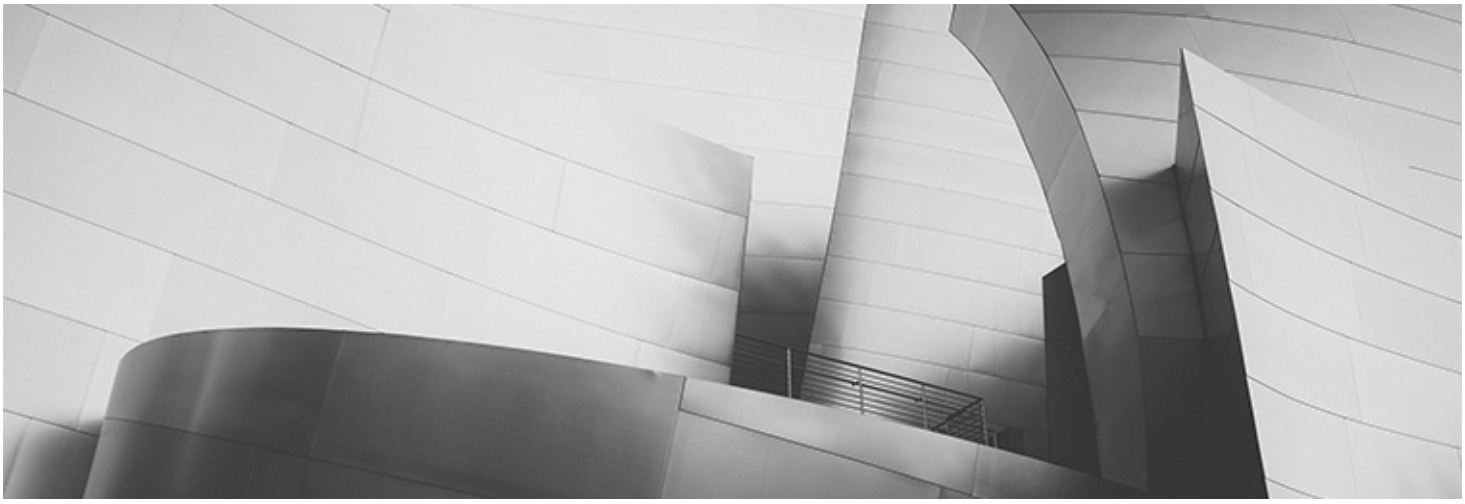

Split Seventh Circuit lowers the bar for pleading a False Claims Act violation

White Collar Alert

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In *United States ex rel. Prose v. Molina Healthcare of Illinois, Inc.*, decided August 19, 2021, a divided Seventh Circuit panel applied an arguably lower standard for pleading "falsity" against "sophisticated players in the healthcare market." Under this ruling, defendants may again be at risk for False Claims Act (FCA) liability, including treble damages and attorneys' fees, for what appear to be mere breaches of contract or technical regulatory violations.

Molina contracted with Illinois Medicaid to provide services on a "capitation," or fixed per-patient per-month basis, at specific tiers. The highest tier covered nursing home residents. That tier included skilled nursing facility services, among dozens of other services, which were provided by a contractor founded by the relator. After the vendor canceled the subcontract, Molina did not contract with a replacement provider and did not inform Illinois Medicaid but continued to seek reimbursement at the same rate.

After the district court twice dismissed the complaint, a divided Seventh Circuit panel reversed. Molina has filed a petition for rehearing *en banc*, which remains pending at this time. According to a forceful dissent from Chief Judge Diane Sykes, the majority's decision "conflicts" with the Supreme Court's decision in *Universal Health Services, Inc. v. U.S. ex rel. Escobar*, 136 S. Ct. 1989 (2016) and other decisions in key ways.

Factual falsity by omission alone

First, the majority seemingly expanded the notion of factual falsity – that is, "a claim for payment that is itself literally false or fraudulent" – to include misleading omissions, separate and apart from the higher standard of an implied certification theory. The majority held that enrollment forms were expressly factually false because the defendant requested a capitation payment without disclosing that it could not provide one of the many services required under the contract. But, as Judge Sykes put it, a "direct falsehood is an affirmative misrepresentation, not an omission." Under the majority's ruling, however, any failure to disclose noncompliance with a contractual or regulatory requirement may now give rise to factually false claims in the Seventh Circuit, even if the relator cannot satisfy the other requirements for an implied false certification claim under *Escobar*.

Relaxing the "specific representations" requirement for impliedly false claims

Under *Escobar*, FCA relators may state a claim for implied false certification by pleading two elements: "first, [that] the claim does not merely request payment, but also makes specific representations about the goods or services provided; and second, [that] the defendant's failure to disclose noncompliance with material statutory, regulatory, or contractual requirements makes those representations misleading half-truths." *Escobar*, 136 S. Ct. at 2001.

But the Seventh Circuit majority in *Prose* focused solely on *Escobar's* second prong – materiality – when evaluating the relator's implied certification claim without considering whether there were any "specific representations" to the government in the first place. As the majority put it: "Material omissions can suffice."

Judge Sykes criticized this approach, stating in dissent that "a general request for payment coupled with some degree of contractual or regulatory noncompliance is not enough to support a claim for implied false certification." She also pointed out that the majority's ruling was out of step with *United States v. Sanford-Brown, Ltd.* ("*Sanford-Brown II*"), 840 F.3d 445, 447 (7th Cir. 2016), in which the Seventh Circuit previously rejected an implied false certification claim based on a general request for payment absent any specific representations tantamount to a "misleading half-truth."

Higher expectations of "sophisticated players"

The majority also held that the relator adequately pleaded the knowledge element of an FCA violation because "sophisticated players in the healthcare market" are "familiar" with the contractual and regulatory requirements that apply in the industry, and these sophisticated defendants can be expected to know which requirements are material to government payment decisions. The majority held that the district court "failed to give proper weight to the complaint's description of [the defendant] as a highly sophisticated member of the medical-services industry" that was familiar with the reimbursement scheme at issue.

Fraud in the inducement without 9(b) particularity

Finally, the majority held that fraud in the inducement can be pleaded generally – without meeting the heightened requirements of Rule 9(b) – if the plaintiff was not privy to the underlying contractual negotiations between defendant and government. The relator in *Prose* alleged that the defendant fraudulently induced the government to renew its contract by representing that it would provide services while never intending to do so. The majority excused the complaint's failure to plead the details about the contracts or contract renewal negotiations with particularity under Rule 9(b) because the relator "would not have had access to those documents or conversations." The majority also held that allegations of promissory fraud "on information and belief" were sufficient. Judge Sykes again disagreed, stating "we are not at liberty to loosen pleading standards under circumstances where a specific false statement is hard to identify."

Takeaways

The Seventh Circuit's decision in *Prose* is a shot across the bow of all sophisticated players in the healthcare market – as well as other highly regulated industries. The industry knowledge and compliance experience of these companies may be held against them in a future *qui tam* suit. As the dissent put it, for such sophisticated players, "*any* claim for payment while in material noncompliance with a contract or governing law is an actionable violation of the FCA." This rule seems to conflict with both *Escobar* and past Seventh Circuit case law. It remains to be seen if this new standard will be applied to other cases and industries, but all such sophisticated players are now on notice.

As with most recent developments in this space, this latest decision serves as a further reminder to companies in highly regulated industries that they must police not just the express representations in contracts and invoices, but also legal and regulatory compliance more generally. Prudent companies will work with experienced FCA and regulatory counsel to ensure they are doing so.

Read the decision here. For more information about any of these topics, please contact the authors.

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