

# Clients & Friends Memo

## Important Court Decision For No-Fault Insurers: Federal Court Rejects Limitation on *State Farm v. Mallela*

January 9, 2013

We are pleased to inform you that our firm has obtained a very favorable and significant decision for no-fault insurers on an important issue of first impression. Specifically, on January 7, 2013, in the case of [Allstate Ins. Co. v. Elzanaty](#), the United States District Court for the Eastern District of New York (Honorable Arthur D. Spatt) rejected the defendants' attempt to limit the ability of insurers to seek affirmative recovery for fraud and the verification of compliance with licensing requirements from health care providers licensed pursuant to Article 28 of the New York Public Health Law ("Article 28 Facilities"). The decision is significant because it is the first time a court has extended the reach of *State Farm v. Mallela* to health care providers other than professional medical corporations.

As you may recall, in *Mallela*, the New York Court of Appeals ruled that, as of April 5, 2002, fraudulently-incorporated providers, or providers that were violating core licensing requirements, were not entitled to reimbursement under New York's no-fault system. Since that time, many providers have sought, in the context of litigating actions against insurers or defending against affirmative recovery actions brought by insurers, to limit the scope and effect of *Mallela*. In *Elzanaty*, Allstate's Complaint alleged claims of fraud and violations under the Racketeer Influenced and Corrupt Organizations ("RICO") Act, asserting that the defendants, certain Article 28 Facilities, were improperly licensed and formed as conduits for the defendants' fraudulent no-fault billing. In particular, the Complaint asserted that the defendants were not entitled to no-fault benefits because they had actively participated in fraudulent practices and were established and/or operated in violation of New York's Public Health Law and the rules and regulations promulgated thereunder.

The defendants sought to dismiss the Complaint on various grounds, essentially arguing that certain anti-fraud regulations and *Mallela* were not applicable to Article 28 Facilities because their formation and structure had already been approved by the State through the Article 28 establishment approval process and subsequent State overview of such facilities. Specifically, they argued that (i) the Court should abstain from exercising jurisdiction under the "*Burford* abstention" doctrine because a determination of the issue of whether the defendants were properly licensed would reverse the decision of the Department of Health to license those facilities, subvert the

Department of Health's jurisdiction over licensing matters and undermine the comprehensive state regulatory process and (ii) the defendants were properly licensed through the Department of Health's establishment process and regulatory overview, and thus eligible to receive no-fault reimbursement.

*Burford Abstention:* The Court concluded that *Burford* abstention was not warranted because Allstate was not challenging the "Article 28 regulatory framework" or challenging the "State's authority with regard to licensing determinations." Rather, Allstate's challenge was to the defendants' fraudulent conduct and their ability to receive no-fault reimbursement. The Court explained that a determination with respect to the providers' fraudulent conduct would not disrupt the State's purpose in establishing a coherent public policy with respect to licensing and would not disrupt New York's regulatory scheme.

*Licensure:* The Court concluded that Allstate properly pleaded its fraud and RICO claims. The Court framed the issue as whether Allstate could "claim that a medical facility did not comply with N.Y. DOH's Article 28 licensing requirements under the auspices of fraud, when the N.Y. DOH has previously confirmed its compliance." The Court answered this question in the affirmative, relying largely on the *Mallela* decision. The Court explained that *Mallela* stands for the proposition that an insurer may bring an action for fraud or unjust enrichment, based on fraudulent incorporation, to recover no-fault payments made to fraudulently incorporated providers. Although the defendants in *Mallela* were licensed as medical corporations and not Article 28 Facilities, the Court found this difference to be "irrelevant." Relying on the operative regulation, 11 N.Y.C.R.R. § 65-3.16(a)(12), the Court concluded that any provider of health services -- a medical corporation, Article 28 Facilities, or otherwise -- was not eligible for reimbursement under the Insurance Law if it failed to meet any New York State or local licensing requirements. In emphasizing this point, the Court expounded that any attempt to limit *Mallela* only to fraudulent activity of medical corporations, as opposed to other types of health service providers, would "be in direct conflict with the New York Court of Appeals advice that insurers may 'look behind the face of licensing documents to identify willful and material failure to abide by state and local law.'"

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This decision constitutes the first judicial ruling addressing the scope of available relief under *Mallela* against health service providers other than professional medical corporations. The decision is critical to no-fault insurers because entities that have attempted to shield their fraudulent activity through professional corporations will have no incentive to shift such fraudulent conduct to an Article 28 structure. This decision helps provide insurers with another tool to fight the proliferation of no-fault fraud.

If you have any questions concerning the decision, or require assistance in no-fault or other health care/insurance issues generally, please do not hesitate to contact an attorney from the Health Care and Not-for-Profit Group at Cadwalader.

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