

Examining the Risk of False Claims Act Enforcement on Private Equity Investment in Health Care



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In recent years, partnerships between healthcare providers and private equity firms have grown considerably. For the provider, private equity provides capital to expand business, improve efficiency and reduce costs. For the firm, investing in healthcare portfolio companies can yield solid, if not high, returns. Our aging population means considerable growth in years to come. At the very least, the projected health spending share of the U.S.'s Gross Domestic Product remains constant for the next decade. We can expect these relationships to continue for at least that period. But private equity—a sector familiar with risk—will need to assess potential False Claims Act (FCA) exposure with these deals.

As these private investments have grown, so too has the government's scrutiny of private equity's ownership in healthcare and use of the FCA to recoup allegedly fraudulent billing to federal healthcare programs based on their portfolio companies' conduct. Government officials have expressed skepticism in no uncertain terms: In both his 2023 and 2022 State of the Union addresses, President Biden voiced concerns with private equity. In 2022, he stated, "... as Wall Street firms take over more nursing homes, quality ... has gone down and costs have gone up." In 2023, he announced increased accountability of private equity relationships through disclosure requirements for long-term care facilities. Other government officials have similar concerns. In March, Senator Grassley called for accountability of private equity investors of a healthcare center, writing that "[t]he constant selling and reselling of hospital assets by private equity, private capital, real estate investment trusts (REITs), and other related entities raises questions with respect to whether these financial maneuvers have negatively impacted

the resources and thereby the care our nation's rural hospitals provide to their patients." In 2022, FTC Chair Lina Khan warned that, "A focus on short term profits in the health care context can incentivize practices that may reduce quality of care, increase costs for patients and payors, and generate appalling patient outcomes." In 2021, Pauline Lapin, Director of the Center for Medicaid and Medicaid Innovation's Seamless Care Models Group, asked, "Are they in it for the right reason . . . Are they in it to provide better care and focus on underserved populations? Or have they found a way to use federal dollars . . . to make some money without actually improving care and driving value?" In 2020, Principal Deputy Assistant Attorney General Ethan Davis remarked, "When a private equity firm invests in a company in a highly regulated space like health care or the life sciences, the firm should be aware of laws and regulations designed to prevent fraud. Where a private equity firm takes an active role in illegal conduct by the acquired company, it can expose itself to False Claims Act liability."

Given this apprehension, it is safe to expect continued attention to private equity deals in the healthcare sector. And if the Biden administration's February 15, 2023, proposed rule for additional disclosure and transparency requirements for ownership of nursing facilities (88 Fed. Reg. 9820 (Feb. 15, 2023)) is finalized, the extent of private equity investment over nursing home providers will become publicly known. The plaintiffs' bar and whistleblowers could use that information to name private equity firms in FCA cases. With that landscape in mind, this article examines past FCA actions against private equity firms and finds that the government's interest in these cases will depend on the strength of the evidence of misconduct; the investor's involvement in day-to-day operations and decision-making on how the care is provided; and the investor's knowledge of billing and regulations.

ALLEGATIONS OF FCA LIABILITY INVOLVING PRIVATE EQUITY FUNDS

With no public FCA settlements against private equity companies announced in 2022, some may be led to believe private equity is no longer a government focus. As long as private equity stays active in health care, however, it will remain a subject of interest in investigations. Prior settlements with private equity firms may be illustrative of cases we could see this year. Whistleblowers have made allegations regarding the knowledge of the firms and how their conduct could be construed as causing the alleged false claims.

In *U.S. and Commonwealth of Mass. ex rel. Martino Fleming v. South Bay Mental Health Centers, et al. al.*, (No. 15 cv 13065, D. Mass.), a chain of mental health centers allegedly billed for services of unlicensed, unqualified social workers to provide mental health services to Medicaid patients without the supervision of properly licensed supervisors or licensed clinic directors. The Relator claimed that the private equity investor was involved in the centers' operations; that its principles were on the Board; and they had knowledge that the conduct violated Medicaid regulations. The case was litigated through cross motions for summary judgment and in October 2021, the private equity firm settled for nearly \$20 million.

In *U.S. ex rel. Mandalapu et al. v. Alliance Family of Companies* (No. 4:17 cv 00740, S.D. Tex.), two companies agreed to pay a combined \$15.3 million settlement for allegations that an EEG testing company paid kickbacks to refer physicians, among other things. In July 2021, the private equity firm paid \$1.8 million "for causing false billings resulting from the kickback scheme through its management agreement" with the testing company.

In *U.S. ex rel. Johnson et al. v. Therakos, Inc. et al.* (No. 12-cv-1454, E.D. Pa.), a private equity firm paid \$1.5 million (of a total settlement of \$11.5 million), in November 2020, to resolve allegations

that defendants marketed and promoted extracorporeal photopheresis systems for unapproved use in pediatric patients after the firm acquired the company. The Relators and government contended that the private equity group knew or should have known about the improper sales and promotion practices that went on for six years prior to the acquisition and continued after the acquisition.

In *U.S. ex rel. Medrano v. Diabetic Care Rx LLC, et al., Riordan, Lewis & Haden Inc.* (No. 15 CV 62617, S.D. Fla.), the United States alleged that Patient Care America (PCA)'s controlling stakeholder, a private equity firm, managed and controlled PCA and participated in the charged misconduct, which involved kickbacks to outside "marketers" to target military members and their families for prescriptions for compounded creams and vitamins, which were formulated to ensure the highest possible reimbursement from TRICARE. The case settled for \$21.36 million in 2019.

In contrast to these settlements, in *U.S. et al. ex rel. Wendy Welch v. CleanSlate Centers, Inc., et al.*, (No. 17-CV-30038-MGM, D. Mass.), the Relator named as defendants in the Complaint a nationwide chain of opioid treatment centers and a venture capital firm. The Relator alleged that the centers exploited the national opioid epidemic in a scheme to build and operate a chain of for-profit addiction-treatment centers that operated as "pill mills." Relator's complaint alleged that Defendants' fraudulent lab testing scheme was a profit driver and part of an aggressive growth strategy that began when the venture firm became its major investor and financial backer. Other than alleging that the firm and lab company identified "the national opioid addiction epidemic" as an "opportunity" to expand services nationwide, there were no allegations in either the government's or the Relator's complaints that the firm had knowledge of or caused the submission of claims for unnecessary

medical procedures and laboratory tests. It is likely for this reason that the firm was not named as a defendant in the government's Complaint-in-Intervention.

CONTROL AND CAUSATION & SCIENTER AND KNOWLEDGE

When attempting to hold private equity firms liable under the FCA, the government will need to prove that the firm was aware of the allegedly unlawful conduct. In *ex rel. Martino Fleming*, discussed above, the key issues for theories of liability were whether the firm caused the company to submit false claims and whether the firm knew the company was noncompliant with state regulations on licensure and supervision. To support causation, the government used evidence that the firm knew that recommendations to come into compliance were not implemented. In addition, the government alleged that the firm, through its members' participation on the company board, could have fixed, but did not fix, regulatory violations that caused the submission of false claims. Scienter could have been established by reckless disregard evidenced by facts that the firm's leadership understood the company's revenue was tied to Medicaid money, which comes with terms and conditions of payment; the firm was aware Medicaid has specific licensure and qualifications requirements; and the firm knew that clinicians had inadequate supervision and licensed supervisors should have been hired. Generally, the government can fulfill these elements by showing that reports of misconduct were brought to the attention of the firm during due diligence preceding the firm's acquisition of the target company or during the oversight of the portfolio company. Investigators will home in on the private equity firm's involvement in managing the portfolio company's operations; the firm's awareness (or involvement) in misconduct; and its' knowledge of applicable health care law and regulations.

We have yet to see *en masse* government investigations of private equity-owned companies. DOJ has not targeted (and likely will not target) mere passive investors for FCA violations. But where facts lead to findings of the firm's control of the investor-backed company and support an allegation that the firm caused the submission of false claims, active investors may have FCA exposure. FCA investigations into private equity firms' knowledge of fraudulent conduct are almost certainly

in progress. Given these risks and government's scrutiny on private equity firms, some firms are opting instead to acquire companies that do not receive federal funds, such as healthcare technology, DSOs, funeral homes, or cannabis, to eliminate FCA liability risk. Any private equity considering investment into companies that receive government funds must be cautious, not only when conducting diligence, but ultimately when managing and overseeing their investments.

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