AMERICAN HEALTH LAW ASSOCIATION

HEALTH LAW WEEKLY
January 27, 2023

Whistleblowers and Justice Department Continue to Ramp Up False Claims Act Enforcement Against Private Equity Firms

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It has been nearly a year since President Biden used his greatest stage, the State of the Union Address, to announce that he was increasing scrutiny of private equity firms that invest in health care providers. Since then, the Justice Department has done little on that front in terms of publicized settlement agreements and False Claims Act complaints. But does that mean private equity firms are off the hook? No. Far from it.

Like a giant cargo ship already in motion, it takes time for the Justice Department to make big moves. But those big moves are likely to arrive as federal investigations ready to launch en masse against private equity firms in the coming months and years (not to mention the legion of whistleblower lawyers who clearly noted the increase in federal resources going toward deep pockets). How can the government hold private equity firms liable for the actions of their portfolio companies? This article answers that question and discusses what private equity firms can do to prepare now.

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How can private equity firms cause false claims to the government?

The False Claims Act sprung out of massive defense contractor fraud targeted at the United States during the Civil War. Congress determined that suing for the United States to just get its money back was an inadequate deterrent, and therefore created a statute that awarded the United States double damages plus a penalty for each knowing false claim. Over time, double damages has grown to treble (or triple) damages, and the penalty has grown to over ten thousand dollars per claim. But most critically, as the federal government took on an increasingly larger role in financing health care, the False Claims Act became a tool to ferret out health care fraud. And the next big frontier in health care enforcement under the False Claims Act is to loop in companies and individuals who turn a blind eye to others' wrongdoing.

This next frontier isn't exactly like the series finale of *Seinfeld*, where the main characters are imprisoned for seeing a crime but not stopping it, but it's close. There are two big concepts in the False Claims Act that are problematic for private equity firms and other owners of health care entities that do business with the federal government.

"Presents, or Causes to Be Presented"

The prototypical false claim is where a company or individual "presents" a false claim to the government. Think of a Civil War-era defense contractor sending the Army an invoice claiming provision of 50 two-year-old horses when in fact the contractor provided near-dead mules. Or think of a physician group submitting a claim to Medicare through a Form 1500 for a patient who wasn't actually treated. In both scenarios, the wrongdoer is sending the invoice, submitting the claim, or otherwise "presenting" the false claim to the government for payment.

But the False Claims Act expands beyond that to companies and individuals that "cause" a false claim "to be presented." It's this undefined "causes to be presented" concept that gets many in False Claims Act trouble, and courts have interpreted this phrase broadly. Here, courts have green-lighted False Claims Act complaints against anyone involved in another's business, so long as there is some allegation that the non-wrongdoer had a bare requisite level of awareness of the false claims. Executives, directors, and parent companies have all been subjected to False Claims Act complaints that survived dismissal on the theory that they could have caused a false claim to be presented to the government. And now, courts have begun to allow complaints to move forward against private equity firms that are alleged to have exercised control over a portfolio company that submitted false claims.

The root of the problem for private equity firms is that they are not passive investors. Firms research the company before investing and then are active participants in the

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company as owners because they want the company to succeed. It's hard to research and maintain some level of control over a company without crossing a line into False Claims Act liability. For example, one recent California federal court denied a private equity firm's motion to dismiss a whistleblower's qui tam complaint under the False Claims Act because it found that the private equity firm exercised enough control of the portfolio health care company for the firm to have "caused" false claims (at least, as alleged in the complaint).[1]

Under this standard, it's nearly impossible for active investors to eschew False Claims Act liability at the dismissal stage, so long as the complaint's allegations are adequate and satisfy particularity requirements under Fed. R. Civ. P. 9(b). And, moving into discovery, summary judgment motions, and eventual trial, there is another problem within the statutory text of the False Claims Act for private equity firms.

"Reckless Disregard of the Truth"

The knowledge prong under the False Claims Act is far-reaching. It includes not only actual knowledge and deliberate ignorance (also called the "ostrich" defense), but also reckless disregard. This means that if a factfinder (like a jury) concludes that a reasonable person would have sought answers and it was reckless to disregard the question, a False Claims Act defendant can still be found liable under the False Claims Act. In other words, juries can second-guess a companies' decisions.

This presents an extraordinary problem for private equity firms, and others. Inviting jurors to second-guess whether a private equity firm should have known its portfolio company was submitting false or fraudulent claims is a big risk, and a unique risk in the current legal landscape. And it's a risk that will only become more apparent as the Justice Department and whistleblower attorneys focus more resources towards private equity firms that invest in health care providers.

What then are private equity firms to do?

There are things private equity firms with health care portfolios can do now to put themselves in better situations.

1. Respect corporate formalities and avoid emails showing direct control of portfolio companies.

A key tool in fixing the problem of ever-expanding liability is the veil of separate corporate entities. But veils tear when we don't take proper care. And courts appear to be quick to discard the separateness of corporate interests when key figures demonstrate control across corporate entities.

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For example, in one recent declined qui tam action against a private equity firm (and others), a federal judge allowed the suit to go forward against the private equity firm because (among other reasons), the managing partner of the firm sent emails that showed control of the portfolio company.[2] The judge put stock in emails (which were obtained by the whistleblower and included in the whistleblower's complaint) that used the pronoun "we," when referring to the portfolio company. Those emails also showed that the private equity firm's managing partner was personally negotiating contracts on behalf of the portfolio company. The federal judge found that those allegations were enough to allow the whistleblower to get past a motion to dismiss and into discovery. Since then, the private equity firm appears from court filings to be settling the case.

2. If attending a portfolio company board meeting, be diligent about following up on anything discussed that might involve non-compliant practices.

Private equity firms commonly attend board meetings of the portfolio company for regular business purposes. But it's common for whistleblowers to use the minutes from those board meetings to support a *qui tam* complaint. For example, in one declined qui tam action that was unsealed last year, the complaint had scarce allegations about private equity's involvement in the portfolio company that was alleged to have committed fraud, except for the firm's attendance at board meetings.[3] The whistleblower, who was also at the board meetings, used documented attendance and PowerPoint slides presented at the meetings to allege knowledge and tacit participation in the portfolio company's fraud schemes. The whistleblower's complaint notes that the private equity firms had sufficient notice of the fraud because the meeting minutes showed the attendees discussed "referral source relationships," which the whistleblower alleged to have been illegal kickbacks.

In other words, private equity representatives invite knowledge by involving themselves in portfolio companies in ways that can be documented by whistleblowers and witnesses. It's necessary to get involved, but once involved, diligence also is required. Attending board meetings and being put on notice of compliance problems—even if not labeled at the meeting as a problem—can be characterized by enterprising whistleblowers and Justice Department attorneys as constituting knowledge. Therefore, private equity representatives attending portfolio company board meetings, or otherwise involving themselves in the operations of the portfolio company, must understand the facets of the portfolio company's actions and follow up if there is any question as to compliance.

3. If you find a compliance problem, don't just ignore it.

An increasingly used provision of the False Claims Act imposes liability on those who discover a false claim after it's been made but conceal or fail to report it. The "reverse" false claims theory, as it is commonly called, is unclear as applied to those besides the entity who made the claim in the first place, but the statutory language could be vague

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enough to loop in private equity firms that discover non-compliant claims by portfolio companies and decide to do nothing.

On the other hand, instructing portfolio companies to promptly return overpayments may end up as a mere overpayment-only, non-False-Claims-Act-multiplier settlement, in addition to cutting off private equity liability on a reverse false claims theory. How firms respond to new knowledge sometimes matters just as much as how the false claims came about in the first place.

Final Takeaway

The action items discussed above are far from a guarantee that the Justice Department and whistleblower attorneys will give private equity firms a pass. As always, when these obstacles present themselves, it is critical for firms to hire experienced counsel who have extensive False Claims Act experience and are familiar with the minutiae of the law that has evolved in applying the False Claims Act to companies with varying degrees of control over the alleged wrongdoer.

About the Author

Jonathan A. Porter is a Partner at Husch Blackwell, LLP in Savannah, Georgia. Jonathan's focus is representing health care entities in criminal and civil federal investigations, and defending *qui tams* in all phases. Jonathan also counsels health care clients on a range of regulatory and compliance issues, with the aim of keeping clients off of the Justice Department's radar. Jonathan is a former Assistant United States Attorney for the Southern District of Georgia, where Jonathan was the criminal and civil health care fraud coordinator, and worked extensively on False Claims Act investigations involving all types of health care entities. Jonathan also teaches White Collar Crime as an adjunct professor at Mercer University School of Law in Georgia.

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[1] *See United States ex rel. Ebu-Isaac, et al. v. INSYS Therapeutics, Inc., et al.*, No. 2:16-cv-07937-JLS-AJW, Doc. 185 (C.D. Cal. June 9, 2021) (order denying motion to dismiss by private equity firm).

[2] *See Ebu-Isaac,* Doc. 185 at 12 (citing to specific emails in order denying motion to dismiss by private equity firm).

[3] *See United States ex rel. Webster et al. v. BioMatrix Holdings, LLC et al.*, 2:19-cv-09333, Doc. 41 (May 5, 2022) (redacted complaint).

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