Private Equity Firms Risk Increasing Exposure to False Claims Act

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Client Alert

Background

Private equity (PE) transactions in the healthcare industry have surged in recent years. Home health and hospice is a sub-sector that has continued to grow, especially due to pandemic-driven interest. As PE firms invest more in the healthcare industry, they risk exposure to various laws and regulations, including the False Claims Act (FCA).

Recent enforcement actions by the U.S. Department of Justice (DOJ) have shown that FCA violations remain a top priority for the agency. In 2021, the DOJ obtained more than $5.6 billion in settlements and judgments from civil cases involving fraud and false claims made against the government. This is the second-largest annual total in FCA history and the largest since 2014. As PE firms expand their footprint into the healthcare sector, firms must conduct careful due diligence of their portfolio companies that do business with the government.

Recent Developments

The False Claims Act is a civil statute that imposes liability for knowingly or recklessly submitting, or causing or conspiring in the submission of, materially false claims for payment, or making false statements material to a false claim. False Claims Act suits can be brought by the government or by private persons (also known as "whistleblowers") in *qui tam* lawsuits.

A recent settlement for $15.3 million was reached with Alliance Family of Companies LLC (Alliance), a national electroencephalography (EEG) testing company, and its private investment company Ancor Holdings LP (Ancor), which will pay $1.8 million. This settlement resolves allegations that Alliance ran an illegal scheme involving kickbacks and fraudulent billings and that Ancor had discovered Alliance's wrongdoing during due diligence at the time of the investment but failed to take action to stop the conduct.

Private equity firms H.I.G. Growth Partners and H.I.G. Capital (collectively, H.I.G.) and former executives of South Bay Mental Health Center, Inc. (South Bay) agreed to pay $25 million for allegedly causing fraudulent claims to be submitted to federal and Massachusetts health care programs and for failure to stop pre-investment misconduct after investing. The whistleblower alleged that, during the pre-investment due diligence process, H.I.G. learned of South Bay's misconduct and knew or should have known that the conduct continued after the acquisition.

Qui tam judgments have, at times, triggered Chapter 11 bankruptcies and made it challenging to collect on those judgments. For example, the United States Court of Appeals for the Eleventh Circuit affirmed a jury verdict that six entities owned by Consulate Health Care, a provider of home health and hospice services, engaged in a multi-year scheme to defraud Medicare by misrepresenting the level of services they provided. The judgment of more than $255 million represents one of the largest FCA jury verdicts upheld on appeal. However, the six entities filed for Chapter 11 bankruptcy in response to the judgment against them. Recently, a U.S. Bankruptcy judge formally approved a settlement in which Consulate Health Care will pay $4.5 million of the judgment to the Department of Justice and the whistleblower.

Key Takeaways

The recent settlements and verdicts demonstrate that PE firms must consider potential FCA risks when investing in companies that receive federal funding. PE firms should consider:

- Conducting robust due diligence prior to and after purchasing or investing in a company, and engage outside counsel to investigate any claims;
- Ensuring compliance functions are in place for portfolio companies, such as strong internal reporting systems and robust audit practices;
- Continuing to improve compliance processes and follow best practices;
- Examining existing portfolio companies' compliance policies and procedures for possible failures; and
- Confirming whether portfolio companies document investigations and comply with applicable mandatory reporting obligations.

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