Bloomberg Law®

BNA's
Health Care Fraud Report™

VOL. 22, NO. 12 JUNE 6, 2018

Fraud and Abuse

Are Private Equity Firms the New Health-Care Fraud Target?

BY MATT PHIFER

Private equity firms were placed on notice recently they may fall into an expanding False Claims Act liability net after the DOJ revealed it will try to nail one such firm for fraud by a pharmaceutical company for which it was the majority owner.

This liability risk was exposed in an FCA intervenor complaint in which the Department of Justice alleged that Riordan, Lewis & Haden (RLH), a private equity firm based in Los Angeles, participated in a scheme with Diabetic Care Rx to defraud the TRICARE program, which provides health insurance for active duty members of the military, veterans, and their families. RLH bought a controlling stake in Diabetic Care Rx, a compounding pharmacy in Coral Springs, Fla., now known as Patient Care America (PCA), in July 2012.

Private equity firms are always looking for new investments and health-care companies offer the opportunity for them to see high turns. But as RLH learned, private equity firms must be diligent to ensure both they and the company they've invested in are complying with all applicable laws and regulations. The stakes are high because health-care offers some of the roughest regulatory terrain and because a failure to thoroughly investigate the compliance status of the target company could land them a seat at an FCA lawsuit's defendants' table.

''In the current climate of aggressive False Claims Act investigations, private equity firms cannot assume or presume that they will be immune from Justice Department activity,'' Michael Koenig, a former criminal fraud prosecutor and the co-chair of Hinckley Allen's Government Enforcement and White Collar Defense Practice based in Albany, N.Y., told Bloomberg Law June 1.

New Trend or Outlier Case? A question facing attorneys in the relator lawsuit brought by Marisela Medrano and Ada Lopez is whether the case naming RLH is the start of a trend that could ensnare more private equity firms.

''The government is extremely aggressive in pursuing False Claims Act cases,'' Koenig told Bloomberg Law. ''This one case, *Medrano*, can certainly be viewed as potentially an expansive approach by the DOJ. However, it is yet to be seen whether *Medrano* will be limited to the very specific circumstances of that case.''

The initial case against Patient Care America was filed in March 2016 by Medrano and Lopez, two former full-time employees, who alleged the pharmacy defrauded the U.S. by paying $40 million in kickbacks to marketing agencies. In return, those marketing agencies would try to ensure patients would be prescribed certain topical pain creams, scar creams, wound care creams, and metabolic supplements.

The U.S. intervened in the case Feb. 16, alleging that RLH directed PCA's entry into the topical cream market because it is highly profitable. According to the intervenor complaint, two RLH partners were board members of the pharmacy, led the pain management program, and were involved in the decisions to charge the federal government for the creams, even directing further research into Medicare coverage of pain creams.

The government also alleged, among other things, that RLH sometimes paid marketers before PCA had been reimbursed, even after it knew the marketers were earning commissions only based on prescriptions reimbursed by TRICARE.

Justin Linder, a health-care attorney who does extensive regulatory and compliance work for Dughi, Hewit & Domalewski in Cranford, N.J., said it may be too soon to view the government's filing as the start of a trend. ''I've heard it likened to piercing the corporate veil, in that the private equity firm was very much involved in the day-to-day operations of the pharmacy,'' Linder said. ''One needs to step back and look at the actual FCA statute.''

A person can be held liable under the FCA if he or she knowingly presents, or ''causes to be presented, a false or fraudulent claim for payment or approval'' to the government. Linder told Bloomberg Law that this is a fairly broad standard that could be extended to a number of individuals. Linder also pointed out the allegations against RLH outlined fairly egregious acts by a private equity firm.

Naming Names One way the case against PCA could lead to more private equity firms being named as defendants is by emboldening whistleblowers to name private equity firms in their initial complaints.

Brian McGovern, a senior counsel at Cadwalader, Wickersham & Taft in New York, whose focus includes health care compliance, health-care fraud, and corporate litigation, told Bloomberg Law there could be an increase in cases in which whistleblowers name private equity firms in initial complaints. ''Whistleblowers track developments, case law, and decisions. And whistleblower organizations will certainly explore opportunities for possible False Claims Act qui tam actions in the private equity space in health care,'' McGovern said. He said that adding another deep

 ISSN 1092-1079

pocket could provide whistleblowers and the government with more leverage in these cases.

''Merely by the government deciding to pursue a case against a private equity firm would give the relators' bar more confidence to pursue action against the private equity investors,'' Elizabeth Scott, an attorney at Akin Gump in Dallas whose emphasis is defense of false claims actions, told Bloomberg Law.

Do Your Due Diligence The attorneys who spoke to Bloomberg Law all echoed the same critical takeaway: Private equity firms need to do their due diligence when investing in a company.

''You need a robust compliance program. You need vigilant oversight of your company's portfolio. You want to make sure the leadership at the top of the private equity firm sets the right tone to set compliance with all laws and regulations and it permeates through the organization,'' Koenig said. Koenig added that it's important for an investor to make sure the company it is investing in also sets the right tone at the top and has robust compliance policies and procedures, especially if the private equity firm is going to be as hands-on as RLH appears to have been.

McGovern said that private equity firms need to revisit their business objectives, such as enhancing referrals and increasing revenue, to make sure they are not crossing a legal line. ''If they're going to be more hands-on, they must ensure the company has robust compliance policies and if incentives are offered, they need to be in line with anti-kickback and false claims laws, '' McGovern told Bloomberg Law.

Scott said that private equity firms need to be careful about the companies in which they choose to invest. ''The more involved the private equity firm is, the more cautious and focused on compliance they need to be,'' Scott told Bloomberg Law.

Linder suggested that private equity firms need to make sure there's a clear separation between their operations and the operations of the company in their portfolio. ''That's really the lesson of this complaint,'' Linder said. ''In managing these portfolio companies, these private equity firms need to be diligent in separating the private equity firm from the actual health-care entity.'' When an employee of the private equity firm is operating the health-care entity, there should be a clear demarcation of responsibilities, he added.

Investors in health-care companies need to be aware of the regulations and seek counsel where necessary when making an initial investment and throughout their ownership. ''It's really important that these investors go in with their eyes wide open as to the complexity of the regulatory scheme with these health-care entities,'' Linder told Bloomberg Law, noting that health care has a ''very dense, complex regulatory scheme.''

Koenig cautioned against private equity firms taking a hands off approach with a health-care company they've invested in, saying that could be just as perilous. ''No private equity firm can take a hear no evil, see no evil, do no evil approach,'' Koenig said.

''*Medrano* could be an outlier and limited to the unique facts of that case,'' Koenig told Bloomberg Law. ''However, I feel private equity firms ignore the potential impact of *Medrano* at their peril.''

This case is *United States ex rel. Medrano v. Diabetic Care Rx, LLC*, S.D. Fla., No. 15-62617.

To contact the reporter on this story: Matt Phifer in Washington at mphifer@bloomberglaw.com

To contact the editor responsible for this story: Brian Broderick at bbroderick@bloomberglaw.com

  HFRA ISSN 1092-1079