

Private Equity FCA Suit More Likely Outlier Than Omen

By **Daniel Wilson**

Law360 (March 16, 2018, 11:48 PM EDT) -- The U.S. Department of Justice's unusual decision to name a private equity firm as a defendant in a False Claims Act suit against one of the firm's portfolio companies is an issue all private equity firms should be aware of, although the alleged circumstances of the case may mean similar complaints will be few and far between, attorneys say.

It is rare, although **not unheard of**, for qui tam relators to bring FCA cases against not only a company they accuse of making false claims, but also its private equity owner. Similarly, parent companies are also sometimes targeted as an additional defendant when their subsidiaries are accused of violating the FCA.

But a **recent complaint in intervention** filed by the DOJ, specifically naming private equity fund Riordan Lewis & Haden Inc. as a defendant in an FCA case alleging Tricare fraud alongside its portfolio company — compounding pharmacy Patient Care America — may be the first government-led FCA complaint to specifically target a private equity owner for the alleged false claims of a portfolio company, attorneys say.

"It's not the first [FCA] case that I'm aware of [involving a private equity firm], but it's the first case I'm aware of where the government has intervened in which a private equity firm is a party," Mintz Levin Cohn Ferris Glovsky and Popeo PC health law practice leader Karen Lovitch said. "That doesn't mean there aren't others — there may be — but I'm not aware of any."

According to the DOJ's complaint, Patient Care America used "marketers," who were paid kickbacks, to help recruit Tricare beneficiaries in order to solicit medically unnecessary prescriptions for expensive compounded drugs that would be fulfilled by the pharmacy and charged to Tricare, the military's health care program.

As a result of the alleged scheme, the pharmacy billed Tricare about \$68 million for compounded drugs over the course of eight months in 2014 and 2015, ending when Tricare overhauled its process for reimbursing compounded drugs, according to the DOJ. These billings accounted for the vast majority of the company's revenue at the time, the DOJ said.

RLH, which was trying to build up Patient Care America to sell at a profit after several years of ownership, had a key hand in the scheme, with a significant level of control over the pharmacy, the government alleged.

Two of the firm's partners were officers and board members for Patient Care America, directing the pharmacy toward the lucrative compounding of topical pain management creams when it faced cuts in Medicare reimbursements for its previous main line of business, nutritional therapy for end-stage renal disease patients, according to the government's complaint.

Those RLH partners, Michel Glouchevitch and Kenneth Hubbs, also hired Patient Care America CEO Patrick Smith and pharmacist Matthew Smith with the explicit aim of growing the business, despite a talent consultant's warning that Patrick Smith would "require more careful management than [RLH] may wish to provide," the DOJ said. The CEO and pharmacist were named as defendants in the suit, while the two RLH partners were not.

RLH was aware of the marketing scheme, its extent and its possible consequences, with all defendants having been advised by multiple attorneys that the related payments could, and likely did, violate the Anti-Kickback Statute, the DOJ alleged. RLH periodically funded "commission" payments to marketers when the pharmacy had to wait for relevant reimbursements to come in, according to the complaint.

Given those specific allegations, the decision to name RLH may be noteworthy but unique, leaving

attorneys waiting to see if this case is an outlier or a sign of things to come.

"It's a sensational set of allegations, so we have no way of knowing if this is going to be something the government is seeking to do more of in the future," Lovitch said.

Given RLH's alleged level of active control over the pharmacy's operations, the government's decision to file suit against the private equity firm as well as the pharmacy is understandable, said Venable LLP partner Kan Nawaday, a former federal fraud prosecutor.

"DOJ made a point of noting that the private equity company hired the portfolio company CEO, who's also a defendant, against the advice of an outside consultant," he said. "Also, it seems that — at least as alleged in the complaint — the private equity board members knew about the illegal kickback payments ... so because of that, on the facts, it makes sense why DOJ charged the private equity company."

But many, if not most, private equity shops are more hands-off with their investments than the government alleges RLH was with Patient Care America, attorneys said.

Firms help select executives they believe will meet performance benchmarks and keep tabs on their investment, but as long as those goals are being hit, they often will leave day-to-day operations to the officers of their portfolio companies, attorneys said.

Even where a private equity firm has a more active role in the operations of a portfolio company, the relevant standard for FCA liability is knowing or intentional fraud, not mere negligence, Nawaday noted — likely tough for the government to prove when a firm doesn't exercise direct control of a company.

Nonetheless, private equity firms with portfolio companies in fields that involve government contracts or reimbursements, such as health care, aerospace and defense, and energy, should be on guard against potential FCA liability as they consider their level of control, attorneys said.

"PE firms have a responsibility to monitor their investment and make sure that they understand what's going on with the investment, for the fund and their investors," Fried Frank Harris Shriver & Jacobson LLP FCA practice leader Douglas Baruch said. "[But] one of the lessons here is that there needs to be clear separation between the operations of the portfolio company and the PE firm if the firm wants to completely insulate itself from False Claims Act liability."

--Editing by Philip Shea.