Alert

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COZEN O'CONNOR

Trending Enforcement Targeting Private Equity Healthcare Portfolios Provides Important Compliance Reminder

Over the last decade, private equity firms have acquired healthcare companies, hospitals, and clinics at an increasing rate. In fact, in those ten years, private equity firms have spent roughly $1 trillion on an estimated 8,000 healthcare deals. This trend is only expected to increase through 2024. However, with the growing presence of private equity in healthcare, investors should expect increased scrutiny by the Department of Justice (DOJ) and other agencies.

2023 was a record year for False Claims Act enforcement, with over $1.8 billion recovered by the government from the healthcare industry alone. Earlier this year, Principal Deputy Assistant Attorney General Brian Boynton announced that healthcare fraud would continue to be a focus for FCA enforcement and that the Department would focus on private equity acquisitions, in particular. Boynton warned that investors who “knowingly engage[] in conduct that causes the submission of false claims . . . [will] subject themselves to liability.” Indeed, FCA enforcement pursuing private equity has grown in recent years, demonstrating the challenges of investing in such a highly regulated space.

The growing focus on investigating private equity healthcare acquisitions emphasizes the importance of due diligence to avoid inheriting or creating FCA liability. If a provider is acquired with existing or ongoing violations, investors can be found to cause false claims to be presented to the government by failing to identify and correct misconduct that began prior to acquisition. Along with assets, private equity firms can acquire the liability of their portfolio companies by failing to exercise proper due diligence. For example, in a record-setting qui tam recovery, private equity firm H.I.G. settled an FCA case in 2021 for an enormous $19.95 million, with two of its former executives paying an additional $5.05 million. South Bay Medical Center in Massachusetts, H.I.G.’s portfolio company, purportedly used unlicensed personnel to provide mental health care to its patients. The DOJ declined to intervene in the case, but after the Commonwealth of Massachusetts intervened, the District Court for the District of Massachusetts held that there was sufficient evidence that H.I.G. knew of the fraudulent behavior to move past the summary judgment phase and proceed to trial, prompting the enormous settlement.

Additionally, private equity firms must avoid prohibited relationships between the healthcare companies in their portfolios. Federal healthcare regulations tightly restrict the circumstances in which providers may refer patients for to one another. The Physician Self-Referral (STARK) Law prohibits physicians from referring patients to providers in which he or she has a financial interest. The Anti-Kickback Statute prohibits providing anything of value in exchange for making, arranging for, or recommending a referral for services. The Eliminating Kickbacks in Recovery Act prohibits certain payment arrangements where marketing or arranging for the provision of laboratory services. Each of these laws, and potentially others, may be implicated where providers share corporate ownership and patients. Accordingly, before any private equity firm makes a new acquisition, it is critical to review any relationships that the new acquisition may have with other providers in the firm’s portfolio.

Government scrutiny of private equity healthcare acquisitions is only expected to increase, at least as long as the pace of acquisitions continues. Accordingly, firms should expect government review and prepare to defend their due diligence processes. Both firms and investors can take critical steps prior to acquisitions to eliminate or reduce potential liability and the cost of responding to government inquiries.

If questionable conduct is discovered during due diligence, investors should discuss with their attorneys the merits of self-disclosure or including indemnification terms in their investment agreements. The DOJ’s Mergers and Acquisitions Safe Harbor Policy, which was instituted in

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October 2023, allows investing companies who discover criminal conduct during a merger or acquisition to receive a presumptive declination of charges by disclosing the conduct within six months of closing, cooperating with the DOJ's resulting investigation, and participating in prompt remedial efforts. However, it is important to note that the safe harbor provision only applies to *criminal* conduct, not civil liability under the FCA. For further coverage of the Safe Harbor Policy, click here.

With the high risks and potential stakes for FCA liability, investors interested in acquiring healthcare companies should work with counsel to adopt a comprehensive approach to due diligence. Planning ahead for inevitable government inquiries will pay enormous dividends when those inquiries arrive or a compliance issue is identified.