Private Equity Throws FCA Enforcement Off-Kilter

By Alexander M. Owens

Private Equity's Expanding Role in Healthcare

Over the last 15 years, private equity ("PE") firms have invested hundreds of billions of dollars in the healthcare sector, infiltrating every corner of the industry from emergency rooms and labs to billing providers and dental practices. Relators and the Department of Justice ("DOJ") have taken close notice. PE firms are increasingly being named in False Claims Act ("FCA") lawsuits. A growing number of settlements with PE firms and mounting caselaw finding that PE firms can, in the right cases, be held liable under the FCA[1] will ensure that the trend continues.

Yet PE liability under the FCA remains the exception, not the rule. In most cases where a PE firm's portfolio company has violated the FCA, the PE firm will not be held liable. That reflects a couple of basic realities. Relators typically work at the portfolio company, which offers limited visibility into the conduct of the PE firm. Further, the PE firm may have no relevant connection to the fraud anyway, and mere ownership of a fraudulent enterprise is not enough for FCA liability.

Overleveraged Corporate Defendants

PE firms use leveraged buyouts ("LBOs") to purchase companies. In an LBO, a PE firm borrows large sums of money to finance the acquisition of a company on behalf of one of its funds. A $200 million buyout might be financed with $50 million in equity and $150 million in debt. Significantly, service of that debt falls, not on the PE firm or fund, but on the portfolio company. With interest rates having spiked in recent years, these debt obligations have risen further still.

A growing roster of overleveraged defendants is not good for FCA recoveries and enforcement. The FCA's treble damages and civil monetary penalty ("CMP") provisions allow the government to not just make itself whole but penalize fraudsters. That serves critical public policy aims, chief among them, deterrence. Yet with healthcare companies increasingly owned by PE, FCA cases are often being settled (e.g., on an ability-to-pay basis) for well below the double damages figures that have become the gold standard for FCA resolutions. The government may not even be made whole through a single damages settlement – and, in such cases, *fraud pays* given that the wrongdoer makes more from the fraud than it pays via settlement.

This dynamic is even more concerning because PE firms can financially benefit from fraud. Fraud-driven revenue at a portfolio company services that company's debt. As debt falls, the value of the PE fund's equity stake in the portfolio company grows. When the portfolio company is sold, the PE fund and firm (e.g., through carried interest) then gets a bigger slice of the sale proceeds. Meanwhile, fraud-driven revenue can help to pay for dividend recapitalizations where the portfolio company takes on debt to finance generous dividend payments.

If, in a given case, a PE firm can profit from fraud but cannot be held liable, while the portfolio company is too debt-laden to pay a fair settlement, what options does DOJ have to obtain an adequate resolution? There are two key avenues.

Fraudulent Transfers

The Federal Debt Collection Procedures Act ("FDCPA")[2] allows the government to obtain relief, including prejudgment remedies, premised on fraudulent transfers made by one owing a debt to the federal government.

Fraudulent transfers can occur where, inter alia, an FCA defendant which is insolvent (or will become insolvent due to an asset transfer) transfers assets without receiving reasonably equivalent value in return. FCA liabilities (including treble damages and CMPs) are "debts" under the FDCPA which arise at the time of overpayment.[3]

As a result of the FCA's treble damages and CMP provisions, a PE-owned company engaged in significant fraud can easily find itself *legally* insolvent under the FDCPA. FDCPA liability can then arise if the portfolio company makes a payment to a related entity. For example, portfolio companies often pay dividends to PE funds or so-called monitoring fees to PE firms. This creates fraudulent transfer risk if the payments occur after significant FCA debts arise.

A recent settlement involving healthcare investors is instructive. In January 2024, DOJ settled FCA claims against Silver Lake Hospital for $18.6 million. DOJ did not bring FCA claims against the hospital's investors but obtained a $12 million FDCPA settlement with those parties. DOJ alleged that the investors received fraudulent transfer distributions from the hospital.

The FDCPA, however, is not a cure all for the complicating financial dynamics that PE introduces to the FCA arena. Much of the revenue from a portfolio company will not be distributed to PE firms or funds but instead will be used to pay down pre-existing loan debts. Such payments would typically not be fraudulent transfers as they would be made for legitimate, antecedent debts. And even when DOJ pursues an FDCPA case, unless the relator can establish that the relief is an alternative remedy under the FCA, the relator will not share in the recovery.

Individual Liability

Despite longstanding DOJ policy calling for FCA enforcement against individuals, most FCA cases still do not result in any meaningful individual accountability. This is due to practical difficulties, most pertinently, the fact that individuals tend to lack deep pockets – or at least their pockets are not nearly as deep as those of their employers.

When FCA violations occur before a buyout, that dynamic can reverse. Attendant to a buyout, the prior owners' illiquid equity stakes turn into large cash payments. If

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Endnotes

[1]See Office of Public Affairs | False Claims Act Settlements and Judgments Exceed $2.68 Billion in Fiscal Year 2023 | United States Department of Justice
[2]Office of Public Affairs | False Claims Act Settlements and Judgments Exceed $2.68 Billion in Fiscal Year 2023 | United States Department of Justice

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ance, transactions, government administrative actions, and litigation involving healthcare, cybersecurity, corporate and securities law, as well as False Claims Act and Dodd-Frank whistleblower cases. She also teaches bioethics at Baylor College of Medicine in Houston. Rachel holds a variety of leadership positions within the FBA, including serving on its National Board of Directors and can be reached through her website, www.rvrose.com.

Endnotes

[1]5 U.S.C.A. § 551 et seq. ("enact[ing] the APA as a check upon administrators whose zeal might otherwise have carried them to excesses not contemplated in legislation creating their offices, and as the culmination of a comprehensive rethinking of the place of administrative agencies in a regime of separate and divided powers.)".
[2]Pub. L. 104-191 (Aug. 21, 1996).
[3]Congress enacted the Safe Drinking Water Act (SDWA), 42 U.S.C. § 300f et seq., to protect the quality of drinking water. To further that goal, the statute authorizes EPA's Administrator to take various actions against contaminants in waters. Id. § 300g-1.

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the prior owners were engaged in the fraud, DOJ now has individuals who can be held liable and have the ability to pay a sizable resolution. In fact, those individuals, compared to the heavily indebted corporate defendant, may have the deepest pockets of all.

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Endnotes

[1]*E.g., U.S. ex rel. Martino-Fleming v. S. Bay Mental Health Centers*, No. 15-CV-13065, 2021 WL 2003016, at *17-18 (D. Mass. May 19, 2021) (denying PE firm's motion for summary judgment).
[2]28 U.S.C. § 3001, *et seq.*
[3]*U.S. ex rel Doe v. DeGregorio*, 510 F. Supp. 2d 877, 883-84 (M.D. Fla. 2007).