JONES DAY

COMMENTARY

FEBRUARY 2018

IN SHORT

The Situation: In what may indicate a sea change in terms of who the Department of Justice ("DOJ") is willing to pursue in False Claims Act cases, a private equity firm has been named as a co-defendant in a False Claims Act complaint, along with one of its portfolio companies.

The Development: The DOJ's complaint alleges that the portfolio company paid illegal kickbacks related to compound drug prescriptions reimbursed by TRICARE in an effort to generate significant returns on the PE firm's investment.

Looking Ahead: The inclusion of a PE firm as a defendant in this complaint could signal the DOJ's willingness to seek to pierce the corporate veil and hold private equity sponsors accountable for the noncompliance of their portfolio companies in the health care industry

The United States intervened in a False Claims Act case against Diabetic Care Rx LLC, d/b/a Patient Care America ("PCA"), its private equity sponsor, Riordan, Lewis & Harden, Inc. ("PE Firm"), and two of PCA's executives alleging that the defendants engaged in an illegal kickback scheme to induce prescriptions for compounded drugs that were reimbursed by TRICARE, a federally funded health care program for military personnel ("Complaint").

The allegations in the Complaint speak to a purported scheme to quickly increase short-term revenues by driving new referrals to the compound pharmacy through the use of kickbacks paid to "marketers," to target military members and their families for prescriptions for compounded creams and vitamins. The formulations of the creams allegedly were also manipulated, not based on patient need but to ensure the highest possible reimbursement from TRICARE. The government further alleges a scheme whereby independent contractors, working as marketers, would forward the patient's information to telemedicine doctors who prescribed creams and vitamins for a per-consultation fee, without physically examining or, in some instances, even talking with the patients. Additionally, the Complaint alleges that the defendants engaged in a practice of paying the copayments of a number of patients as an inducement to accept the compounded prescriptions.

"Recognizing that the Complaint amounts to only allegations at this stage, it is nonetheless significant that the DOJ has taken the position that the PE Firm's level of involvement in the portfolio company, PCA, is sufficient, in the government's view, to make the PE Firm complicit in the alleged misconduct of its portfolio company."

With respect to the PE Firm's involvement, the Complaint describes a level of involvement in the operations of a portfolio company that can be quite typical for private equity firms. The PE Firm made a controlling investment in PCA, and two partners from the PE Firm became officers of PCA. Further, PCA was managed by another company controlled by the PE Firm. The allegations suggest that the two PE Firm partners guided the strategic direction of PCA and "knew and approved of" the marketing arrangements at the heart of the Complaint. Moreover, the Complaint states that, as an investor in other health care companies, the PE Firm "knew or should have known … that health care providers that bill federal health care programs are subject to laws and regulations designed to prevent fraud, including the federal anti-kickback statute."

Recognizing that the Complaint amounts to only allegations at this stage, it is nonetheless significant that the DOJ has taken the position that the PE Firm's level of involvement in the portfolio company, PCA, is sufficient, in the government's view, to make the PE Firm complicit in the alleged misconduct of its portfolio company.

For that reason, the inclusion of the PE Firm as a defendant in the Complaint may be viewed as a "shot across the bow" for private equity sponsors whose portfolio companies are alleged to have engaged in violations of health care laws. This serves as an important reminder that private equity firms investing in the health care industry must understand the complex regulatory requirements governing the industry and ensure that appropriate attention and resources are focused on regulatory compliance, not just at the time of acquisition but throughout the life cycle of their investments.

THREE KEY TAKEAWAYS

1. The government has intervened in a False Claims Act complaint naming a private equity firm as a co-defendant relating to the alleged violations of law of one of its portfolio companies. This Complaint could signal a shift in DOJ's focus by also targeting financial sponsors in the health care industry.
2. Private equity firms should ensure that they fully understand the complex regulatory requirements to which their portfolio companies are subject.
3. Private equity firms should ensure that compliance remains a core focus, not just during due diligence at the time of acquisition but throughout the entire life cycle of their investments, through the creation of robust compliance and monitoring programs at their portfolio companies.

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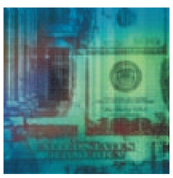

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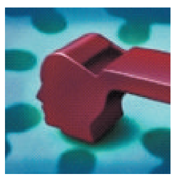

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