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OPINION

Private equity faces heightened FCA and antitrust scrutiny

A storm is brewing, and PE firms should be proactive in building their shelters before it is too late.

Over the last five years, private equity (PE) firms have invested in excess of \$450 billion in the healthcare industry – more than \$250 billion of which can be accounted for in the past two years alone. This influx of capital also happens to coincide with a precarious time for the Medicare program, as the Medicare Part A trust fund will become insolvent by 2028 according to the most recent 2022 Medicare Trustees Report. Due to this confluence of events, some experts believe that politicians and regulators have every reason to focus on PE as a fresh source of liquidity to help protect the trust fund and promote their individual agendas by using two powerful weapons: the federal False Claims Act (FCA) and federal antitrust laws.

While the government has had longstanding concerns about healthcare providers and others who do business with the federal government engaging in fraudulent conduct, the Department of Justice (DOJ) is enhancing its focus by scrutinizing the role of PE investors when investigating potential misconduct under the FCA. The DOJ is also engaged in joint efforts with the Federal Trade Commission (FTC) to investigate potential anti-competitive conduct by PE firms under federal antitrust laws. Last year, the Biden administration joined a growing number of critics alleging that PE firms drive down quality and drive up prices, stating that “the private equity model has



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put profits before people – a particularly dangerous model.” It is no longer just the portfolio companies that are at risk. With plenty of “dry powder” – almost \$2 trillion, globally, according to one estimate – PE is a particularly inviting target. A storm is brewing, and PE firms should be proactive in building their shelters before it is too late.

The False Claims Act

As the government’s leading weapon to combat healthcare fraud and abuse, the FCA imposes liability on any person or entity that “knowingly” submits false claims to the government, or knowingly retains overpayments. Through an expansive definition of the word “knowingly” – which includes not just actual knowledge, but also “reckless disregard” or “deliberate ignorance” of the truth or falsity of information – the government has recovered more than \$5.6 billion from FCA actions in 2021 alone, with more than \$5 billion attributable to the health care industry.

The United States Principal Deputy Assistant Attorney General, Ethan P Davis, has highlighted the DOJ’s intent to hold PE investors accountable for the conduct of their portfolio companies in certain circumstances, stating:

“When a private equity firm invests in a highly-regulated space like health care or the life sciences, the firm should be aware of laws and regulations designed to prevent

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fraud. Where a private equity firm takes an active role in illegal conduct by the acquired company, it can expose itself to False Claims Act liability.”

The DOJ has reached a number of multi-million-dollar settlements with PE funds in recent years, which only encourages the department to further investigate PE funds and their portfolio companies for potential FCA violations. However, it is not only the DOJ that has a right to sue under the FCA; the statute includes qui tam provisions that also allow whistleblowers and their attorneys to file lawsuits and receive a percentage of any financial recovery obtained under the FCA. With maximum FCA penalties currently exceeding \$25,000 per claim, plus treble damages, whistleblowers and their attorneys have a powerful incentive motivating them to file FCA lawsuits against perceived “deep pockets” – which includes well-capitalized PE firms – in search of large recoveries.

The DOJ and private whistleblowers have pursued a number of legal theories in their lawsuits against PE firms, and some early patterns have emerged. For example, FCA exposure is likely to increase in cases where PE firms become aware of regulatory violations by a portfolio company and fail to take corrective action; take an active role in the portfolio company’s operational or strategic decision-making; sit on the board of a portfolio company that is engaged in fraudulent conduct; or otherwise fail to implement appropriate internal controls to curb fraudulent conduct. We expect that legal theories of liability will continue to evolve as stakeholders seek to hold investors accountable at the highest level of



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the enterprise.

Antitrust Laws

The DOJ and FTC are also scrutinizing PE activity under federal civil and criminal antitrust laws. For example, given that consolidation is often a key driver of PE activity, certain transactions – particularly roll-ups – may be viewed as anti-competitive. According to the FTC’s director of the Bureau of Competition, the risks of enforcement action have increased as PE firms “increasingly engage in roll-up strategies that allow them to accrue market power off the Commission’s radar.”

The DOJ has also increased scrutiny of PE purchasers of divested assets. According to Assistant Attorney General Jonathan Kanter: “Too often partial divestitures ship assets to buyers like private equity firms who are incapable or uninterested in using them to their full potential.” He also stated: “Very often settlement divestitures [involve] private

equity firms [often] motivated by either reducing costs at a company, which will make it less competitive, or squeezing out value by concentrating [the] industry in a roll-up.”

There have also been indications that DOJ is willing to use the Clayton Act to break up “interlocking directorships,” when an individual simultaneously serves as a director or officer of competing corporations. Antitrust risk, then, increases when PE investors sit on the Boards of multiple portfolio companies and there is competitive overlap among those companies.

On February 3, 2023, the DOJ’s Antitrust Division announced its withdrawal of three significant healthcare antitrust policy statements, eliminating certain antitrust “safety zones” that had previously protected certain types of transactions. This withdrawal suggests that previously protected transactions may no longer be safe from prosecution.

Looking Ahead

Government enforcement activities and whistleblower lawsuits will continue to play an important role in the PE marketplace. As investors search for creative solutions to counter increased risks, firms should have a clear sense of urgency to be proactive with mitigation efforts. Being reactive is no longer a viable option. ■

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