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ALERT ▪ False Claims Act ▪ Private Equity

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DOJ Settles Claims with Private Equity Firm over Alleged False Claims Act Violations by Its Portfolio Company

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On November 19, 2020, the U.S. Department of Justice ("DOJ") announced that it had entered into settlement agreements with a Johnson & Johnson ("J&J") subsidiary and a private equity firm, the Gores Group ("TGG"). The settlement with TGG related to alleged False Claims Act ("FCA") violations by a former TGG portfolio company. This settlement is the latest indication of a continuing trend in FCA enforcement actions against private equity firms. It underscores for private equity firms the need to assess the heightened risk of FCA liability in connection with portfolio companies operating in certain industries where FCA claims are more likely, such as in the health care and life sciences space, to incorporate such assessments into their diligence process for new acquisitions, and to consider carefully their level of involvement in the operations of portfolio companies particularly in these industries.

Background: A Sea Change in FCA Enforcement

As detailed in prior alerts, until relatively recently, DOJ had rarely intervened in an FCA action against a private equity firm for conduct allegedly carried out by the firm's portfolio company. However, in 2018, DOJ filed a complaint in intervention against compounding pharmacy Patient Care America ("PCA") and its private equity owner, Riordan, Lewis & Haden, Inc. ("RLH"), in *United States ex rel. Medrano v. Diabetic Care Rx, LLC d/b/a Patient Care America et al.* (S.D. Fla. No. 15-62617).

In *Medrano*, DOJ alleged that PCA had paid kickbacks to three marketing firms to target TRICARE beneficiaries for medically unnecessary pain cream prescriptions, and that RLH played a key role in initiating the scheme. In particular, DOJ focused on two RLH partners who served as officers of PCA, enabling RLH to exert significant control and oversight in devising the alleged scheme. In 2019, RLH and PCA agreed to pay $21 million to settle the claims against them.

Relators took notice. In *United States ex rel. Cho and Baker v. Surgery Partners, Inc. et al.* (M.D. Fla. No. 17-983), for example, relators filed a *qui tam* complaint against Surgery Partners, Inc. and several related entities, including H.I.G. Capital, LLC ("H.I.G."), Surgery Partners' former private equity owner, and Bain Capital, which purchased Surgery Partners from H.I.G. in 2017. Relators alleged that Surgery Partners engaged in a scheme to promote referrals for urine drug testing that was allegedly not medically necessary.

In 2020, DOJ declined to intervene against Bain Capital and one individual, but intervened and settled claims against all remaining defendants except H.I.G. DOJ subsequently filed a notice of non-intervention as to H.I.G., leaving relators to pursue claims against H.I.G. on their own. Relators voluntarily dismissed their claims against all defendants except H.I.G., and with the settlement in *Medrano* to guide them, amended their complaint against H.I.G., adding allegations about the extent to which the firm purportedly controlled Surgery Partners and played a role in the alleged misconduct. The district court ultimately dismissed the relators' complaint against H.I.G., concluding that the complaint was barred by the "first-to-file" rule because a substantially similar complaint had previously been filed in another action against Surgery Partners and its subsidiary alleging that they had engaged in a scheme related to the same urine drug testing.[1]

[1] Relators have appealed this procedural issue to the United States Court of Appeals for the Eleventh Circuit. H.I.G. cross appealed, asking the court to also consider their argument before the district court that the relators' substantive allegations of fraud lack merit.

Recent Developments

On November 19, 2020, DOJ announced settlements with J&J and TGG related to the conduct of Therakos, Inc., resolving claims brought in *United States ex rel. Johnson et al. v. Therakos, Inc. et al.* (E.D. Pa. No. 12-1454). J&J owned Therakos from January 2006 through December 2012, while TGG owned Therakos from January 2013 through September 2015. The complaint alleged that Therakos engaged in improper off-label marketing practices, promoting its cancer treatment for use in a pediatric patient population for which it was not FDA-approved. J&J and TGG each entered into a settlement agreement with DOJ, with J&J agreeing to pay $10 million and TGG agreeing to pay $1.5 million to resolve the claims against them.

Improper off-label marketing is a well-established DOJ enforcement priority, but the *Johnson* case is notable because of DOJ's willingness to seek to hold the private equity owner responsible for the alleged misconduct, seemingly without specific allegations concerning TGG's purported involvement in the allegedly fraudulent marketing scheme. The complaint alleges a purportedly fraudulent off-label marketing scheme that allegedly began while J&J owned Therakos. It then alleges in a wholly conclusory fashion that the scheme continued after TGG acquired Therakos from J&J. The lack of specific allegations regarding TGG's role in the alleged scheme or exertion of control over Therakos may account for the relatively smaller settlement sum that TGG paid, but it should also send an alarming signal to private equity owners that they are at risk even without the same kind of detailed allegations of involvement that characterized the complaint in *Medrano*. In *Johnson*, DOJ took the unprecedented step of seeking to hold TGG accountable for the conduct of a portfolio company that began six years before TGG acquired the company and without detailed allegations about TGG's involvement in that alleged misconduct.

Key Takeaways

This continuing trend of DOJ FCA enforcement actions against private equity owners suggests some key takeaways for private equity firms:

- Enhanced Diligence: Given DOJ's seemingly increasing willingness to hold private equity firms directly responsible for the actions of their portfolio companies when it comes to FCA compliance, firms need to pay more attention to business practices during diligence. The health care industry has traditionally attracted FCA complaints. When investing in that space, private equity firms should look carefully at the business practices of the target.

  In this current COVID-19 era, there are also other issues receiving heightened FCA scrutiny from DOJ and the private relators' bar. For example, as explained in prior alerts, Paycheck Protection Program ("PPP") loans and loan forgiveness applications require applicants to make certain certifications about their business and employees. DOJ and relators' counsel will likely also scrutinize those certifications closely to ferret out any arguably false statements by fund recipients and their private equity firm affiliates. Indeed, the Attorney General has explicitly directed all U.S. Attorneys to prioritize enforcement of Coronavirus-related fraud.

- Level of Control: It also remains to be seen whether *Johnson* proves to be an outlier. Prior DOJ enforcement actions suggested that a private equity firm would be held liable under the FCA for its portfolio company's conduct only when the firm directly controlled or participated in the conduct. For example, in *Medrano*, two RLH partners allegedly actively used their roles as members of the PCA board to further the alleged kickback scheme. In *Johnson*, by contrast, all that was alleged was that TGG allowed the purported misconduct to continue after it acquired Therakos, indicating a private equity firm need not have initiated the alleged misconduct to face enforcement risk. Regardless of whether *Johnson* marks the beginning of a broadening of liability, private equity owners would be well-served to monitor and carefully consider the measure of control that the exert.

If you have any questions or would like more information about the False Claims Act, click here to go to our False Claims Act practice web page, or please contact an attorney in our False Claims Act practice.

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