NOTES

Make Hay While the Sun Shines: Private Equity and the False Claims Act

For years, the federal government has used the False Claims Act to police fraud in the healthcare industry. Every year, the Department of Justice recovers billions of dollars from healthcare companies for their False Claims Act violations, both penalizing wrongdoers and providing incentives for whistleblowers to come forward. Over the past decade, however, private equity activity within the healthcare industry has increased significantly, presenting questions as to how the False Claims Act applies when a private equity firm's portfolio company is accused of wrongdoing. This Note analyzes the ambiguity in how different courts have previously applied the False Claims Act to different corporate forms—focusing on the level of involvement required of a parent organization—to determine how the Act should apply to private equity firms going forward, concluding that any direct involvement by a private equity firm in fraud committed by its portfolio company should trigger False Claims Act liability for the private equity firm.

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INTRODUCTION

On September 18, 2019, the Department of Justice announced a settlement had been reached in a False Claims Act lawsuit that shocked and captivated legal, healthcare, and financial insiders.[1] The case—*United States ex rel. Medrano v. Diabetic Care RX, LLC*—marked the first time that a private equity ("PE") firm was held liable for the alleged crimes of its investment portfolio company.[2] The fraudulent scheme was alleged to "constitute the largest volume of cash kickbacks over a period of one year or less in the history of U.S. government health programs."[3] The private equity firm, Riordan, Lewis & Haden ("RLH"), along with its portfolio company, Patient Care America ("PCA"), agreed to pay

1. Press Release, U.S. Dep't of Just., Compounding Pharmacy, Two of Its Executives, and Private Equity Firm Agree to Pay $21.36 Million to Resolve False Claims Act Allegations (Sept. 18, 2019), https://www.justice.gov/opa/pr/compounding-pharmacy-two-its-executives-and-private-equity-firm-agree-pay-2136-million [https://perma.cc/V73X-KQEX]; *see, e.g.*, Christopher Hewitt & Jayne Juvan, *Diabetic Care RX Case Is a Warning Sign for Private Equity*, LAW360 (May 7, 2018, 1:44 PM), https://www.law360.com/articles/1041067/diabetic-care-rx-case-is-a-warning-sign-for-private-equity [https://perma.cc/9PCC-Z7ZG] ("The United States government recently sent shock waves through the private equity industry by charging a private equity firm for its portfolio company's alleged health care fraud.").

2. No. 15-cv-62617-BLOOM/Valle, 2019 WL 1054125 (S.D. Fla. dismissed Oct. 1, 2019); *see* Brian Bewley & Kaitlyn Dunn, *Government Files Amended FCA Complaint Against Private Equity Firm and Its Portfolio Company*, JD SUPRA (Apr. 1, 2019), https://www.jdsupra.com/legalnews/government-files-amended-fca-complaint-69787/ [https://perma.cc/6VY9-8SBY] ("This case . . . represents the first time DOJ has intervened in an FCA suit against a private equity firm alongside a healthcare portfolio company accused of submitting false claims.").

3. First Amended Federal Civ. False Claims Act Complaint & Request for Jury Trial at 2, *Medrano*, 2019 WL 1054125 (No. 15-cv-62617-BLOOM/Valle) [hereinafter First Amended Complaint]. Note, however, that this allegation is absent from the Complaint in Intervention later filed by the United States. The United States' Complaint in Intervention, *Medrano*, 2019 WL 1054125 (No. 15-cv-62617-BLOOM/Valle) [hereinafter Complaint in Intervention].

$21,050,000 to settle claims that they had used illegal kickbacks to induce referrals for costly, and medically unnecessary, pain creams in violation of the Anti-Kickback Statute and False Claims Act.[4]

The False Claims Act—the federal government's biggest tool to police fraud in the healthcare industry—has routinely been invoked against parent corporations.[5] Though naming a private equity firm as a defendant in a False Claims case was unprecedented, it was not entirely absurd: the notion of imposing False Claims Act liability on a semi-external third party that is able to exercise some degree of control or management over the subsidiary is nothing new. The unique structure of private equity ownership and oversight of investment companies, however, is not completely compatible with existing doctrines of corporate liability.

Indeed, one can argue that imposing liability on this new class of defendants is squarely within the purpose of the False Claims Act, and extending the doctrine is simply effectuating congressional intent as applied to a landscape of evolving corporate and investment structures. Unfortunately for the legal analysts carefully tracking the *Medrano* case, however, a settlement was reached before the district judge had the opportunity to issue a final ruling.[6] How well the government's theories of liability against RLH would hold up under judicial scrutiny remains open to speculation—the Department of Justice's decision to name RLH as a defendant, however, sends a clear signal that it now sees private equity firms as fair game in False Claims Act lawsuits.[7]

In a healthcare space increasingly dominated by private equity actors, how these firms are regulated could have a profound impact on healthcare in America. Private equity activity in the healthcare industry has exploded within the past decade: in 2009, private equity

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4. Press Release, U.S. Dep't of Just., *supra* note 1.

5. Scott Stein & Brenna Jenny, *Court Rules Corporate Parent Not Liable for Subsidiary's Alleged FCA Violations*, SIDLEY: ORIGINAL SOURCE (Dec. 22, 2014), https://fcablog.sidley.com/court-rules-corporate-parent-not-liable-for-subsidiarys-alleged-fca-violations/ [https://perma.cc/W5W2-C2FE].

6. *Id.*; *see* Lori Smith & Dana Petrillo, *The Long Arm of the Law Lengthens: What the* U.S. ex rel. Medrano v. Diabetic Care RX, LLC *Settlement Means for Private Equity Investors*, WHITE & WILLIAMS LLP (Oct. 7, 2019), https://www.whiteandwilliams.com/resources-alerts-What-the-US-ex-rel-Medrano-Diabetic-Care-RX-LLC-Settlement-Means-for-Private-Equity-Investors.html [https://perma.cc/R7VP-8UGH] ("Because the claims were settled with no determination of liability, the precedential value of this case is limited.").

7. *See* Nathan J. Andrisani, Eric W. Sitarchuk & Matthew D. Klayman, *DOJ Targeting Private Equity Firms in False Claims Act Litigation*, TEMP. 10-Q, https://www2.law.temple.edu/10q/doj-targeting-private-equity-firms-in-false-claims-act-litigation/ (last visited Dec. 22, 2020) [https://perma.cc/4UZN-SCZJ] ("Based on its recent complaint in intervention . . . , DOJ may be setting its sights on a new class of potential defendants in FCA cases: private equity firms.").

buyers and sellers were involved in 229 healthcare deals.[8] That number hit 380 in 2020, despite a raging global pandemic.[9] There has been considerable debate as to whether the influx of private equity activity in healthcare benefits or harms consumers. But *Medrano* provides one concrete manifestation of fears that have been simmering beneath the surface since the blowup of private equity activity in the healthcare sector—namely, fear that a hunger for profits would take precedence over medical necessity at the ultimate expense of quality of care under the rigidly defined short-term timeline PE firms prefer. The COVID-19 pandemic has further thrust PE practices into the spotlight, as many speculate that substandard conditions in PE-owned nursing homes contributed to the spread of the coronavirus.[10]

As others have noted, "[PE acquisitions of healthcare companies] are a significant phenomenon with unknown consequences for physicians and patients, although they have received little attention from researchers and policymakers."[11] Many are quick to jump to conclusions on either side of the issue—approaching the topic would first require careful consideration of what little empirical research does in fact exist. If *Medrano* and other recent studies suggesting a higher prevalence of fraudulent billing and coding practices within private equity-owned groups are any indication,[12] such concerns may be well founded. While private equity is at the center of a recent national hot-button political debate threatening comprehensive regulatory overhaul, it is possible that a less drastic and less costly measure could police private equity firms' fraud within the healthcare industry. Although some call for banning private equity acquisitions of healthcare practices altogether, extending False Claims Act liability to private equity firms

8. Health Rsch. Inst., *Top Health Industry Issues of 2019: The New Health Economy Comes of Age*, PWC 30 (2019), https://www.pwc.com/us/en/industries/health-services/pdf/pwc-us-health care-top-health-industry-issues-2019.pdf [https://perma.cc/4T66-FMRG].

9. Alia Paavola, *Private Equity Healthcare Deals in 2020: 5 Key Report Findings,* BECKERS HOSPITAL REV. (Mar. 17, 2021), https://www.beckershospitalreview.com/hospital-transactions-and-valuation/private-equity-healthcare-deals-in-2020-5-key-report-findings.html [https://perma.cc/HNA5-NWSV].

10. Alex Spanko, *Private Equity-Owned Nursing Home Had Higher COVID-19 Infection, Fatality Rates: Report*, SKILLED NURSING NEWS (Aug. 10, 2020), https://skillednursingnews.com/2020/08/private-equity-owned-nursing-homes-had-higher-covid-19-infection-fatality-rates-report/ [https://perma.cc/M5CC-QHJK].

11. Lawrence P. Casalino, Rayhan Saiani, Sami Bhidya, Dhruv Khullar & Eloise O'Donnell, *Private Equity Acquisition of Physician Practices*, 170 ANNALS INTERNAL MED. 114, 114 (2019).

12. *See* Sailesh Konda, Joseph Francis, Kiran Motaparthi & Jane M. Grant-Kels, *Future Considerations for Clinical Dermatology in the Setting of 21st Century American Policy Reform: Corporatization and the Rise of Private Equity in Dermatology*, 81 J. AM. ACAD. DERMATOLOGY 287, 290–91 (2019) ("The fact that 5 of the 30 currently PE-backed practices are represented in the top 25 suggests that PE firms may overlook billing practices and focus more on profitability than on due diligence when consolidating practices.").

that encourage or orchestrate fraudulent schemes would allow the existing regulatory framework to police the more flagrant behavior with the threat of the crippling monetary penalties False Claims Act violations carry.

Part I of this Note sets the background framework for the discussion that follows, diving deeper into the growing trend of private equity in healthcare while also exploring the laws most relevant to regulating misconduct specific to the healthcare industry—particularly the False Claims Act. Part II seeks to answer the question of whether mounting concerns over the increased private equity presence in healthcare are well founded through several empirical studies and two cases, including *Medrano*. Concluding that there may be good reason for these concerns, Part II then analyzes the ambiguity in how different courts apply the False Claims Act to parent corporations as a proxy for application to private equity firms, focusing on the question of whether the False Claims Act requires a parent company to directly submit false claims to the government or rather participate in a fraudulent scheme with its portfolio company who then submits false claims to the government.

Finally, Part III proposes that extending False Claims Act liability to private equity firms, though unprecedented pre-*Medrano*, provides an immediate and effective way of checking potential abuses of private equity firms within healthcare, including increased violations of regulations and laws that may lead to a decline in patient care. This solution is only feasible, however, if the False Claims Act is interpreted in such a way that assigns liability when a private equity firm directly participates in fraud the portfolio company commits. This method of enforcement is analyzed through the lens of two private equity cases wherein a rule that may serve as a test of False Claims Act liability for private equity firms going forward may be extracted from the facts of the cases.

I. BACKGROUND

A. Private Equity and the Allure of the Healthcare Industry

One of the most noteworthy shifts characterizing the healthcare industry over the past decade has been the dramatic rise in private equity acquisitions of healthcare providers.[13] The relatively recession-proof healthcare industry, which continues to outpace the Gross Domestic Product in terms of growth rate, offers investors the promise

13. *Id.* at 288–89.

of consistent market demand and the hope of guaranteed profits.[14] This Part provides an overview of how private equity firms typically function and explores the mutual attraction between PE firms and healthcare ventures.

Using capital invested by pension funds, university endowments, high net-worth individuals, and sovereign wealth funds, private equity firms typically invest in large and well-managed practices with the goal of generating at least twenty percent in annual returns.[15] By acquiring sixty to eighty percent ownership stakes in a target company, the firms take a controlling hold of the business and frequently install partners or members of the PE firms on the target company's board, giving the PE firms a voice in strategic decisions and business operations moving forward.[16] In addition to generating significant annual returns, investors seek to grow the value of the practice with the end goal of cashing out three to seven years down the road by selling to a larger healthcare company, a larger private equity firm, an insurance company, or to the public through an initial public offering.[17] This exit strategy provides the firm with a handsome payout as investors with longer-term timeframes take over.

Private equity activity in the healthcare space has increased significantly in the past few years, and industry trends show no signs of slowing down. In 2017, the value of disclosed private equity healthcare deals rose seventeen percent from 2016, totaling a record $42.6 billion.[18] The number of deals also rose in 2017, up to 265 from 206 in 2016.[19] 2018 again brought record levels of private equity activity in healthcare: the value of disclosed deals in 2018 grew nearly fifty percent to $63.1 billion, with the number of transactions growing to 316.[20] By all accounts, private equity firms will continue their push into

14. Patrick D. Souter & Andrew N. Meyercord, *Private Equity Investment in the Physician Practice: Has Its Time Finally Come or Will the Mistakes of the Past Be Repeated?*, 13 J. HEALTH & LIFE SCIS. L. 84, 88 (2020).

15. Casalino et al., *supra* note 11.

16. *See* Joanne Finnegan, *Private Equity Companies' Acquisition of Physician Practices Likely to Accelerate*, FIERCE HEALTHCARE (Jan. 10, 2019, 3:07 PM), https://www.fiercehealthcare.com/practices/private-equity-companies-acquisition-physician-practices-likely-to-accelerate [https://perma.cc/3K7T-WY86].

17. *Id.*

18. BAIN & CO., GLOBAL HEALTHCARE PRIVATE EQUITY AND CORPORATE M&A REPORT 2018, at 3 (2018), https://www.bain.com/contentassets/c69b2e6d50314251b83982c206a93361/bain_report_global_healthcare_private_equity_and_corporate_manda_report-2018.pdf [https://perma.cc/5SLW-XEG6].

19. *Id.*

20. *See* BAIN & CO., GLOBAL HEALTHCARE PRIVATE EQUITY AND CORPORATE M&A REPORT 2019, at 4 (2019), https://www.bain.com/globalassets/editorial-disruptors/2019/healthcare-pe-report/bain_report_global_healthcare_private_equity_and_corporate_m_and_a_report_2019.pdf [https://perma.cc/6H43-GHSS].

healthcare markets, especially as growing fields, such as telemedicine, present enticing new investment opportunities.

In order to achieve the desired dramatic annual returns, private equity firms frequently consolidate their portfolio companies into larger groups, using economies of scale to centralize costly services such as marketing, billing, scheduling, call centers, information technology, health records, and regional management, thereby reducing overhead cost.[21] Though specialty healthcare industries, such as dermatology, urology, and ophthalmology, exhibit the most dramatic rise in private equity acquisitions, recent years have shown that the trend is spreading to all areas of healthcare, including nursing homes, pharmacies, and staffing organizations.[22]

As appealing as healthcare practices are to PE firms, buyouts also appeal to healthcare ventures and providers. For example, for a physician who is looking to give up ownership of her practice, a buyout provides a potentially lucrative payout: practice owners typically pocket one to two million dollars per physician.[23] Partnering with a private equity firm may also provide entities with greater access to capital to expand the business or cover operating costs, alleviating the burden on providers themselves, who may be ill-equipped to handle the administrative and managerial demands of overseeing a company.[24]

Indeed, healthcare professionals often lack the business acumen and legal sophistication to effectively manage a growing entity: "[U]nlike any other occupation where management skills are important, physicians are neither taught how to lead nor are they typically rewarded for good leadership."[25] These considerations weigh heavily when an eager PE firm comes knocking on the door with the promise of shouldering the administrative tasks and allowing the

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21. *Id.* at 11–12; Konda et al., *supra* note 12, at 291.

22. *See* Halee Fischer-Wright, *Commentary: What Primary-Care Doctors Should Know Before a Private Equity Deal*, MOD. HEALTHCARE (May 4, 2019, 1:00 AM), https://www.modernhealthcare.com/opinion-editorial/commentary-what-primary-care-doctors-should-know-private-equity-deal [https://perma.cc/CE66-ZNPC] ("Since 2016, . . . private equity has begun spreading its net to target primary-care physician groups."); Margot Sanger-Katz, Julie Creswell & Reed Abelson, *Mystery Solved: Private-Equity-Backed Firms Are Behind Ad Blitz on 'Surprise Billing'*, N.Y. TIMES: THEUPSHOT, https://www.nytimes.com/2019/09/13/upshot/surprise-billing-laws-ad-spending-doctor-patient-unity.html (last updated Sept. 16, 2019) [https://perma.cc/E7CV-3QBF] (discussing two of the largest private equity-owned physician staffing companies).

23. COUNCIL ON MED. SERV., AM. MED. ASS'N, CORPORATE INVESTORS 1–2 (2019), https://www.ama-assn.org/system/files/2019-12/issue-brief-corporate-investors.pdf [https://perma.cc/R79G-9PHM]; Finnegan, *supra* note 16.

24. COUNCIL ON MED. SERV., *supra* note 23, at 2.

25. *See* Lisa S. Rotenstein, Raffaella Sadun & Anupam B. Jena, *Why Doctors Need Leadership Training*, HARV. BUS. REV. (Oct. 17, 2018), https://hbr.org/2018/10/why-doctors-need-leadership-training [https://perma.cc/G6XF-64KC].

medical professionals to devote more time and energy to what they actually care about—the practice of medicine.[26]

B. False Claims Act

To succeed in the healthcare industry, an entrant into the field must navigate a complex and oftentimes perplexing web of laws and regulations governing public and private conduct of businesses and individuals. Various agencies, including the Department of Justice, the Department of Health and Human Services Office of Inspector General, and the Centers for Medicare and Medicaid Services, can bring enforcement actions against an embattled defendant. Rather than producing a treatise of all healthcare law that may implicate PE firms, this Note narrows its review to the law most salient to the potential frauds that flow from the unchecked activity of healthcare practices controlled by PE firms.[27]

The federal government's point of entry in prosecution and detection of healthcare fraud is through the federal healthcare insurance programs, including Medicare and Medicaid, which come with thousands of regulatory strings attached.[28] With the very narrow exception of specialty practices that operate on a retail or "concierge" model, for most healthcare providers, the federal insurance programs—and Medicare in particular—account for huge revenue streams.[29] Together, Medicare and Medicaid account for forty-three percent of

26. Paul A. Gomez & Alex S. Kajan, *Looking Under the Skin of the Dermatology Acquisition Trend*, AM. HEALTH L. ASS'N SEMINAR PAPERS, May 10, 2018, Westlaw 20180510 AHLA-SEM 23.

27. One important doctrine undergirding any discussion of investor involvement in healthcare is the ancient corporate practice of medicine doctrine. The doctrine exists in a majority of states, either through statutes, regulations, or common law jurisprudence, and "prohibits corporations from engaging in the practice of medicine by directly employing or otherwise controlling a physician's practice of medicine." Mary Anne Bobinski, *Law and Power in Health Care: Challenges to Physician Control*, 67 BUFF. L. REV. 595, 606 (2019). The most important justification for the doctrine highlights the importance of a physician-patient relationship that is untainted by external pressures and organizational controls. *Id.* at 606–07. While the doctrine is "somewhat archaic" and has varying levels of enforcement throughout the states, it is a critical consideration whenever considering an arrangement between a physician and a nonphysician. THOMAS C. FOX, CAROL COLBORN LOEPERE & JOSEPH W. METRO, HEALTH CARE FINANCIAL TRANSACTIONS MANUAL § 10:22 (2019), Westlaw HTHCFTM; *see also* Melesa Freerks, Colleen McKnight, Jay Munisteri & Torrey Young, *Corporate Practice of Medicine—"A Bad Penny Always Turns Up*,*"* 20 J. HEALTH CARE COMPLIANCE 17, 19 (2018) ("Situations in which a non-licensed entity (*i.e.*, a private equity firm) attempts to control the medical decisionmaking of a licensed provider . . . are more likely to encounter compliance scrutiny . . . .").

28. Bailey Wendzel, Ian Deitz, Nicholas Engle, David Favre, Andrea Fenster, Nikolas Foran & Allen Gehring, *Health Care Fraud*, 56 AM. CRIM. L. REV. 1035, 1036 (2019).

29. Drew Altman & William H. Frist, *Medicare and Medicaid at 50 Years: Perspectives of Beneficiaries, Health Care Professionals and Institutions, and Policy Makers*, 314 J. AM. MED. ASS'N 384, 388 (2015).

hospital revenues.[30] Profitability depends, however, on federal reimbursements. By accepting federal reimbursements, a physician, hospital, or healthcare company agrees to accept the conditions attached to the funds; failure to take heed can and does lead to crippling liability under laws such as the False Claims Act.

A relic from the Civil War brought back from near statutory extinction, the False Claims Act ("FCA" or "the Act") functions as the primary tool for the Department of Justice ("DOJ") to recover judgments and settlements in civil healthcare fraud cases against the government.[31] The Act was "originally passed in response to rampant fraud perpetrated against the United States military . . . by selling it sick mules, lame horses, sawdust instead of gunpowder, and rotted ships with fresh paint."[32] It allows a private party relator to bring a *qui tam* action on the government's behalf and be rewarded with fifty percent of the recovery.[33] The whistleblower is usually an employee (often recently fired) who uncovered damaging information about the employer.

Under its original formulation, anyone who "knowingly submitted false claims to the government" could be held liable for "double the government's damages plus a penalty of $2,000 for each false claim."[34] The Act, however, largely faded into oblivion for the latter half of the twentieth century after a 1943 congressional amendment severely gutted jurisdiction—but by 1986, Congress had grown frustrated with the ballooning problem of fraud on the government that law enforcement was not properly addressing.[35]

In response, Congress passed amendments that resuscitated the Act's bite by restoring jurisdiction when the relator—the private party whistleblower who initiates the claim—was the original source of the

30. *Id.* at 384.

31. *See* Thomas Reilly, Comment, *The Extrapolation Conundrum: Finding a Unified Theory for the Use of Statistical Sampling in Medicare Fraud Cases Brought Under the False Claims Act*, 47 SETON HALL L. REV. 1103, 1104 ("For many years, the federal government has considered the False Claims Act . . . to be its primary instrument in preventing fraud against the government.").

32. Press Release, U.S. Dep't of Just., Justice Department Recovers $2.8 Billion from False Claims Act Cases in Fiscal Year 2018 (Dec. 21, 2018), https://www.justice.gov/opa/pr/justice-department-recovers-over-28-billion-false-claims-act-cases-fiscal-year-2018 [https://perma.cc/7ZEJ-KDGJ].

33. *See also* Patricia Meador & Elizabeth S. Warren, *The False Claims Act: A Civil War Relic Evolves into a Modern Weapon*, 65 TENN. L. REV. 455, 459–60 (1998) (explaining that a congressional amendment to the Act in 1943 resulted in fewer qui tam actions, though use of the Act to fight government fraud increased).

34. U.S. DEP'T OF JUST., THE FALSE CLAIMS ACT: A PRIMER 1 (2011), https://www.justice.gov/sites/default/files/civil/legacy/2011/04/22/C-FRAUDS_FCA_Primer.pdf [https://perma.cc/9ALG-6JV2].

35. Meador & Warren, *supra* note 33, at 460.

inculpatory information.[36] This led to an explosion of FCA suits, many in healthcare. Since the 1986 amendments, settlements and judgments awarded through the FCA top thirty billion dollars.[37] In 2018 alone, the Department of Justice recovered over $2.8 billion in FCA cases, $2.5 billion of which involved healthcare.[38] Indeed, the FCA penalties for violations can be crippling: as of 2016, the penalty *per claim* ranges between $10,781.40 and $21,562.80, on top of treble damages the federal government incurs as a result of the false claims.[39] For providers submitting dozens of claims per day, the penalties can quickly skyrocket into the millions. Important to note, however, is that the high damages serve dual purposes: not only do they penalize wrongdoers, but they also provide a much higher incentive for whistleblowers, who pocket a percentage of the reward, to come forward.[40]

Under its current formulation, liability under the FCA attaches when a party "knowingly submits a false claim to the government or causes another to submit a false claim to the government or knowingly makes a false record or statement to get a false claim paid by the government."[41] Though there is no developed case law examining how the FCA applies to PE firms, several cases have ruled on how parent companies can be held liable when involved in fraud perpetrated by their subsidiaries. Much of the legal discourse in these cases involves interpretation of the causation element: *how* and *when* does a parent cause a subsidiary to submit a false claim to the government?

In 2016, the Supreme Court "rocked the world of False Claims Act litigation"[42] by handing down its ruling in *Universal Health Services v. United States* ex rel *Escobar*.[43] *Escobar* confirmed the validity of the "implied false certification" theory of False Claims Act liability.[44] Under the implied false certification theory, by submitting a claim for

36. *Id.*

37. DEP'T OF JUST., FRAUD STATISTICS – HEALTH AND HUMAN SERVICES: OCTOBER 1, 1986–SEPTEMBER 30, 2017, at 1–2 (2017), https://www.justice.gov/opa/press-release/file/1020116/download [https://perma.cc/2KSL-FAH9].

38. Press Release, U.S. Dep't of Just., *supra* note 32.

39. 28 C.F.R. § 85.5 (2020). *See* Wendy K. Arends, Sean O'D. Bosack & Thomas N. Shorter, *False Claims Act Penalties Double as of August 1, 2016*, NAT'L L. REV. (July 19, 2016), https://www.natlawreview.com/article/false-claims-act-penalties-double-august-1-2016 [https://perma.cc/NA87-GKPE] ("As of August 1, 2016, False Claims Act civil penalties increase to between $10,781.40 and $21,562.80 per claim, plus three times the amount of damages that the federal government sustains because of the false claim.").

40. Arends et al., *supra* note 39.

41. U.S. DEP'T OF JUST., *supra* note 34. *See also* 31 U.S.C. § 3729(a)(1)(A)-(B).

42. Jeff Overley, *One Year Later,* Escobar *Is Roiling FCA Landscape*, LAW360 (June 16, 2017, 4:06 PM), https://www.law360.com/articles/933393 [https://perma.cc/E6E4-6CGY].

43. 136 S. Ct. 1989 (2016).

44. *Id.* at 1995.

reimbursement, a provider "impliedly certifies compliance with all conditions of payment. But if that claim fails to disclose the defendant's violation of a material statutory . . . requirement, . . . the defendant has made a misrepresentation that renders the claim 'false or fraudulent' . . . ."[45] The Court developed a two-part test for liability under the implied certification theory: (1) the claim for payment "makes specific representations about the goods or services provided"; and (2) "failure to disclose noncompliance with material statutory . . . requirements makes those representations misleading half-truths."[46]

II. ANALYSIS

A. A Cause for Concern

The staggering and rapid growth of PE activity does not come without some risk, and the recent recharacterization of ownership has led to growing concerns from medical professionals: "At the current pace, by the time more is understood about the takeover . . . by private equity firms, it will likely be too late to change course. Efforts to protect the field . . . and the American public from the potential adverse consequences should begin now."[47] This Section begins with an analysis of the possible risks and benefits posed by private equity takeovers within healthcare.

1. Potential Risks and Benefits

Unlike acquisitions made by healthcare systems or hospitals, which tend to envision the target acquisitions as part of long-term strategic growth, PE firms are laser focused on making short-term financial gains before washing their hands of the target. Chief among the worries commentators espouse are parallel concerns regarding a

45. *Id.*

46. *Id.* at 2001. Lower courts have had difficulty applying *Escobar*, resulting in circuit splits over several of the issues decided in the case, including whether satisfying this two-part test is a necessary precondition to liability under the implied certification theory. *See* Conor Duffy, *Ninth Circuit Issues Long-Awaited Interpretation of Escobar Two-Part Test*, HEALTH L. DIAGNOSIS (Sept. 20, 2018), https://www.healthlawdiagnosis.com/2018/09/ninth-circuit-issues-long-awaited-interpretation-of-escobar-two-part-test/ [https://perma.cc/9TGG-UAG9] ("The Ninth Circuit was asked to determine whether that language in *Escobar* makes satisfying those two requirements a necessary precondition to proving falsity under the implied false certification theory, or whether . . . while satisfying that test is sufficient to establish falsity, it is not mandatory.").

47. Joshua M. Sharfstein & Jamar Slocum, *Private Equity and Dermatology—First, Do No Harm*, 155 JAMA DERMATOLOGY 1007, 1008 (2019).

decline in patient care and a pressure to violate regulations and laws,[48] a classic corporatization-of-medicine dilemma pitting profit optimization in one corner and patient care in the other.[49] The drive to generate short-term gains pressures providers to "increase volumes of patients seen per day, to overprescribe diagnostic tests or perform unnecessary procedures, or to save on costs by using shoddier but less costly supplies and devices."[50] As one scholar noted: "[I]t is difficult to imagine investors from most [private equity] firms weighing patient care and physician values over profits when making strategic decisions over time."[51]

This may be particularly acute in the case of PE firms that invest in many different sectors of the economy: customary techniques used to add value to a target company in, say, the retail or manufacturing sector—by generating lower costs and increased revenues—often translate to "lower quality and worse patient outcomes" when conducted within the healthcare space.[52] Fundamentally, private equity firms are working under the pressure of a fiduciary duty to return capital to their investors, so they might invest in healthcare without understanding the regulations—like the FCA or the Anti-Kickback Statute—surrounding government reimbursements, which prohibit conduct that is typical to investment strategies outside of healthcare.[53] Strategic efforts, such as wooing potential clients with courtside tickets or engaging in a mutually beneficial quid pro quo with a supplier, commonplace in other sectors, are strictly *verboten* in healthcare due to concerns that such tactics could taint medical judgment. Violating laws

48. *See, e.g.*, Suhas Gondi & Zirui Song, *Potential Implications of Private Equity Investments in Health Care Delivery*, 321 J. AM. MED. ASS'N 1047, 1047 (2019) ("[T]he need for generating returns may create pressure to increase utilization, direct referrals internally to capture revenue from additional services, and rely on care delivered by unsupervised allied clinicians.").

49. *See* Shriji N. Patel, Sylvia Groth & Paul Sternberg Jr., *The Emergence of Private Equity in Ophthalmology*, 137 JAMA OPHTHALMOLOGY 601, 602 (2019) ("[T]he corporatization of medicine opens the door for optimizing profits at the expense of patient care.").

50. Eileen Appelbaum & Rosemary Batt, *Private Equity Buyouts in Healthcare: Who Wins, Who Loses?* 5 (Ctr. for Econ. Pol'y & Rsch., Working Paper No. 118, 2020).

51. Jack S. Resneck, Jr., *Dermatology Practice Consolidation Fueled by Private Equity Investment: Potential Consequences for the Specialty and Patients*, 154 JAMA DERMATOLOGY 13, 13–14 (2018).

52. Sean Shenghsiu Huang & John R. Bowblis, *Private Equity Ownership and Nursing Home Quality: An Instrumental Variables Approach*, 19 INT'L J. HEALTH ECON. & MGMT. 273, 274 (2019).

53. *See* Evan M. Chen, Jacob T. Cox, Tedi Begaj, Grayson W. Armstrong, Rahul N. Khurana & Ravi Parikh, *Private Equity in Ophthalmology and Optometry: Analysis of Acquisitions from 2012 to 2019 in the United States*, 127 OPHTHALMOLOGY 445, 452 (2020) (noting that "[t]he added pressure of a fiduciary commitment to return investor capital in the short term may decrease PE firms' incentive to enforce clinical practice guidelines").

prohibiting such conduct, like the Anti-Kickback Statute and the Physician Self-Referral Law ("Stark"), carries hefty liability.[54]

In addition to the potential threats that are acute to the healthcare industry, several broader PE-related concerns may also ultimately contribute to a decline in the value of care. As one scholar described it, the "low-risk/high-reward nature of the PE business model for the PE firm is a classic case of moral hazard . . . [resulting] in excessive risk-taking by the PE firm, using other people's money . . . ."[55] In the context of a leveraged buyout, the high debt load could render the portfolio company unable to make payments on the debt, threatening bankruptcy,[56] which does not affect the PE firm once the exit strategy has been employed.

How, exactly, might these concerns manifest in the day-to-day operations of a PE-backed practice? Consider this simple scenario: a PE firm acquires a practice in a leveraged buyout—using high levels of debt to gain its controlling share—and plans to sell the practice for profit in four years, expecting to generate annual returns of twenty percent for its investors. Furthermore, in an acquisition effectuated through debt financing, as is typical in a PE acquisition, management must also devote a significant amount of revenue to interest payments and debt reduction.[57] The firm implements some above-board cost-cutting measures, such as staff consolidation, but fails to see the expected returns. In this scenario, the firm may seek additional margins by "promoting out-of-pocket procedures, increased surgical volumes, and unnecessary testing."[58] These seemingly benign benchmarks translate to a higher cost and lower quality of care when applied to healthcare. To be sure, these cost-cutting and profit-generating avenues are in no way unique to PE ownership, but in a practice largely controlled by PE interests, medical professionals will have less of an opportunity to meaningfully express any concerns or opposition.[59]

That is not to say, however, that academics are in unanimous agreement that all PE activity leads to undesirable results. Advocates of PE in healthcare note that the PE capital can "curb costs, improve efficiencies, and infuse capital . . . to finance new technologies, upgrade

54. 42 U.S.C. §§ 1320a-7b(b), 1395nn.

55. Appelbaum & Batt, *supra* note 50, at 8.

56. *See id.*

57. *See* Huang & Bowblis, *supra* note 52, at 276–77 ("The use of debt can have negative consequences by increasing the amount of revenue that must be devoted to interest payments and paying down debt instead of reinvesting in quality improvement efforts.").

58. Patel et al., *supra* note 49, at 602.

59. *See id.* ("However, when physicians have already surrendered control, they are unable to combat these changes whether or not they agree with management.").

facilities, and consolidate fragmented markets."[60] A study by Nicholas Bloom et al. noted that, at least in other industries, PE-owned companies have notably better management practices "than almost all other ownership groups such as family-run, founder owned, or government owned firms."[61] Particular benefits associated with PE ownership include improved operational practices, greater delegation of authority, and stronger incentive practices.[62] Other studies have found that PE ownership limits opportunism among management, generates stronger incentives for management, provides better incentives for promotion and continued employment, and improves oversight.[63]

2. Empirical Risk

To provide stronger justification for actions taken to curb the excesses of private equity within healthcare, it should be established that some of the risks that inspired concern among those in the industry have actually come to pass in a systemic way, as opposed to in only a couple of case studies. Unfortunately, another hallmark of PE firms—the stark lack of transparency in their business operations facilitated by few reporting requirements and many nondisclosure agreements—has made drawing conclusions difficult for healthcare researchers.[64] In recent years, however, several studies have emerged that examine discrete sectors of the healthcare industry—namely, dermatology practices and nursing homes. Taken together, it may be possible to extract a conclusion about the effect of PE ownership on healthcare ventures in general.

Several pre-COVID-19 studies of PE nursing home acquisitions revealed lower qualities of care in those PE-owned facilities, reporting "lower staffing levels, an increase in lower skilled providers, and worse performance in a variety of nursing measures."[65] Atul Gupta et al.

60. Appelbaum & Batt, *supra* note 50, at 4.

61. Nicholas Bloom, Raffaella Sadum & John Van Reenen, *Do Private Equity Owned Firms Have Better Management Practices?*, 105 AM. ECON. REV. 442, 442 (2015); *see also* Mark Brandon Lainoff, *Leveraging the Future of Healthcare: Private Equity's Changing Role in Healthcare Delivery, Performance, and Quality*, J. HEALTH CARE FIN., Winter 2020, at 1, 5 (discussing the Bloom study).

62. Bloom et al., *supra* note 61, at 442.

63. *See* Lainoff, *supra* note 61, at 5.

64. *See* Barry Ritholtz, *Hedge Funds and Private Equity Need Full Disclosure*, BLOOMBERG: OP. (Nov. 19, 2019, 5:30 AM), https://www.bloomberg.com/opinion/articles/2019-11-19/hedge-funds-private-equity-venture-capital-need-full-disclosure [https://perma.cc/DP67-V2K9] ("Unlike mutual funds or exchange-traded funds, [private equity funds] don't have to provide much in the way of transparency. . . . They don't even have to disclose the identity of their senior managers.").

65. Chen et al., *supra* note 53, at 452. *But cf.* Huang & Bowblis, *supra* note 52, at 295 ("These results . . . provide evidence that PE ownership does not deteriorate [nursing home] quality. . . .

conducted a comprehensive study of PE-acquired nursing homes using data from 2000 to 2017 and found significant evidence of declines in both patient health and compliance with care standards.[66] The authors of the study reasoned the declines were due to the "particular incentives" PE managers have, as distinct from the incentives of non-PE corporations or chains, where no such evidence of declines was found post-acquisition.[67] These "particular incentives," of course, come down to the difference between a PE firm's need for short-term gains versus a corporation's typically longer-term investment strategy where gradual returns are acceptable. Notably, and perhaps unsurprisingly, the decline in patient health was accompanied by a decline in compliance with federal guidelines.[68]

Importantly, studies suggesting lower quality of care do not necessarily implicate fraudulent conduct (though regulatory violations can form the basis of an FCA claim). A recent study of dermatology practices, however, found through an analysis of billing records that PE-backed dermatology groups were statistically overrepresented as extreme outliers in billing the highest reimbursement rates—billing more frequently for the most expensive procedures than their non-PE backed counterparts.[69] The study used information from the 2015 Medicare Part B physician payment data set, focusing on reimbursement code 88305, representing the highest reimbursement rate paid by the federal reimbursement programs.[70] The study compiled a list of the top twenty-five billers of code 88305; of the top twenty-five, five private equity-backed practices were represented, amounting to seventeen percent (five out of thirty) of the private equity-backed dermatology practices in operation.[71]

These findings suggest that "PE firms may overlook billing practices and focus more on profitability than on due diligence when [considering] practices."[72] Put another way, the firms may choose medical procedures based on the lucrative reimbursement rate rather than on sound medical judgment and medical necessity, which will

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Despite a growing and significant role in healthcare markets, our knowledge of PE ownership in healthcare firms is still very limited and many questions remain unanswered.").

66. Atul Gupta, Sabrina T. Howell, Constantine Yannelis & Abhinav Gupta, Does Private Equity Investment in Healthcare Benefit Patients? Evidence from Nursing Homes 1–2, 11, 30–31 (Nov. 12, 2020) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3537612 [perma.cc/KXW6-Z34E].

67. *See id.*

68. *Id.*

69. Konda et al., *supra* note 12, at 290–91.

70. *Id.*

71. *Id.*

72. *Id.* at 291.

ultimately have a negative impact on value of care. Though the facts of any individual scenario will dictate the outcome, this type of situation runs dangerously close to conduct prohibited by the FCA.

3. COVID-19

Early in the COVID-19 pandemic, nursing homes were recognized as infection hot spots, bringing the quality-of-care issue into the national spotlight, particularly as it related to PE-owned nursing homes. In the face of the nursing home death toll, critics waged attacks against PE's cost-cutting methods, like reduced staffing: "Decades of ownership by private equity . . . left many nursing homes with staggering bills and razor-thin margins . . . . Even so, many of their owners still found creative ways to wring profits out of them . . . ."[73]

One report looked into the pandemic's toll on nursing homes in New Jersey. In the state, about seventy-five percent of nursing homes are for-profit; of those, nearly twenty-five percent are either owned, operated, or financially supported by PE firms.[74] Using data from the New Jersey Department of Health, the study found that the infection rate among nursing home residents was 24.5 percent higher in PE nursing homes than the average of nursing homes in the state.[75] The fatality rate in PE nursing homes was 10.2 percent higher than the statewide average.[76] The study went on to find similar disparities in nursing home staff infection and fatality rates.[77]

The report's authors attribute the infection and fatality rates to "lower quality, lower staffing, and higher numbers of deficiencies for failing to meet federal standards" in PE nursing homes.[78] They note that patients in PE-owned and backed nursing homes received significantly fewer hours of nursing care per patient per day—twenty percent less than at nursing homes with other ownership types, leading to higher instances of deficiency violations.[79]

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73. Matthew Goldstein, Jessica Silver-Greenberg & Robert Gebeloff, *Push for Profits Left Nursing Homes Struggling to Provide Care*, N.Y. TIMES (May 7, 2020), https://www.nytimes.com/2020/05/07/business/coronavirus-nursing-homes.html [https://perma.cc/7F5J-M459].

74. AMS. FOR FIN. REFORM EDUC. FUND, THE DEADLY COMBINATION OF PRIVATE EQUITY AND NURSING HOMES DURING A PANDEMIC: NEW JERSEY CASE STUDY OF CORONAVIRUS AT PRIVATE EQUITY NURSING HOMES 2 (2020), https://ourfinancialsecurity.org/wp-content/uploads/2020/08/AFREF-NJ-Private-Equity-Nursing-Homes-Covid.pdf [https://perma.cc/M965-WEN3].

75. *Id.* at 2, 14.

76. *Id.* at 2.

77. *Id.* at 3.

78. *Id.* at 5.

79. *Id.* at 3.

Though the predominant media narrative has been that PE-owned nursing homes are faring worse than their non-PE peers, some evidence might suggest otherwise: one study found that nursing homes currently owned or backed by PE firms were actually *less likely* to have outbreaks and had greater personal protective equipment ("PPE") availability.[80] *Prior* PE ownership, however, correlated to a greater likelihood of outbreaks and resident deaths and decreased PPE availability than the average.[81] This could implicate the concerns expressed earlier over how PE firms extract value from the portfolio and leave it with an unmanageable debt load after exiting the investment.

The available data is slim, but these studies suggest that the concerns about PE healthcare ownership are well founded, presenting evidence of a decrease in quality of care and increased regulatory and compliance violations. These violations, when accompanied by federal reimbursements, often lay the groundwork for False Claims actions.

B. Fraud in Action

Two recent cases—one settled and one ongoing as of April 2021—provide a glimpse into how PE firms prioritize profits over patients and lay the groundwork for examining the FCA as applied to PE firms. The first, *United States ex rel. Medrano v. Diabetic Care RX, LLC*, marks the first time the DOJ pursued an FCA case against a PE firm for its involvement in its portfolio's conduct, signaling a new class of defendants. [82]

1. *Medrano*

Patient Care America ("PCA") was founded in 2006 as Diabetic Care Rx LLC (before a subsequent name change) as a sterile compounding pharmacy that provided end-stage renal disease patients with intravenous nutritional therapy.[83] In 2012, Riordan, Lewis &

80. Ashvin Gandhi, YoungJun Song & Prabhava Upadrashta, Have Private Equity Owned Nursing Homes Fared Worse Under COVID-19? 8 (Oct. 20, 2020) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3682892 [https://perma.cc/3XKE-5CZH].

81. *Id.*

82. No. 15-cv-62617-BLOOM/Valle, 2019 WL 1054125 (S.D. Fla. Mar. 6, 2019).

83. United States *ex rel.* Medrano v. Diabetic Care RX, LLC, No. 15-CV-62617-BLOOM/VALLE, 2018 WL 6978633, at *1 (S.D. Fla. Nov. 30, 2018). For purposes of clarity, I will use "PCA" when referring to the company, regardless of whether the name had been officially changed from DCRX. A compounding pharmacy is a pharmacy that mixes or combines ingredients to create a prescription unique to a patient's individual needs. *Compounding and the FDA: Questions and Answers*, U.S. FOOD & DRUG ADMIN., https://www.fda.gov/drugs/human-drug-compounding/compounding-and-fda-questions-and-answers (last updated June 21, 2018) [https://perma.cc/KCT9-M92W].

Haden ("RLH"), a Los Angeles-based private equity firm, acquired a controlling investment in the company. RLH hoped to turn around and sell PCA for profit within five years of its initial investment.[84] RLH was no stranger to healthcare: it held several healthcare companies, including a compounding pharmacy similar to PCA.[85] To ensure the profitability of PCA, RLH appointed partners Kenneth Hubbs and Michel Glouchevitch as officers of PCA.[86]

Unfortunately for RLH, one year after it secured ownership of PCA, the Centers for Medicare and Medicaid Services ("CMS") issued a Notice of Proposed Rulemaking seeking to cut dialysis treatment reimbursement rates by twelve percent.[87] The Final Rule solidifying these changes was published in December 2013.[88] The prospects were chilling for providers in the field: estimates suggested that 55.6 percent of facilities would suffer negative Medicare margins as a result of the cuts.[89] RLH, already one year into its five-year plan, became desperate for a new profitmaking strategy.[90]

Glouchevitch and Hubbs set their sights on a potentially lucrative area of reimbursement: nonsterile compounding of topical creams.[91] The creams carried a federal reimbursement rate ranging from $1,000 to $8,000 per prescription—and a ninety percent profit margin.[92] RLH quickly put the wheels in motion and hired a CEO and other industry veterans to implement the plan.[93]

Topical compounding promised to give RLH exactly what it needed: a quick payoff for a short-term investment. Correctly predicting that CMS would soon lower the staggeringly high profit margins for the creams,[94] RLH knew that it had to act quickly to extract as much value

84. *Medrano*, 2018 WL 6978633, at *1.

85. Complaint in Intervention, *supra* note 3, at 10. RLH still appears to have a robust healthcare portfolio. *See Selections from Our Portfolio*, RLH EQUITY PARTNERS, http://www.rlhequity.com/portfolio/ (last visited Jan. 28, 2020) [https://perma.cc/4YX8-NJA4] (discussing RLH's various healthcare investments).

86. Complaint in Intervention, *supra* note 3, at 9–10.

87. Diane Wish, Doug Johnson & Jay Wish, *Rebasing the Medicare Payment for Dialysis: Rationale, Challenges, and Opportunities*, 9 CLINICAL J. AM. SOC'Y NEPHROLOGY 2195–96 (2014).

88. *Id.*

89. *Id.* at 2196.

90. Complaint in Intervention, *supra* note 3, at 10 ("Restoring DCRX's profitability became RLH's primary objective.").

91. United States *ex rel.* Medrano v. Diabetic Care RX, LLC, No. 15-CV-62617-BLOOM/VALLE, 2018 WL 6978633, at *1 (S.D. Fla. Nov. 30, 2018); Complaint in Intervention, *supra* note 3, at 10.

92. *Medrano*, 2018 WL 6978633, at *1.

93. *Id.*

94. Complaint in Intervention, *supra* note 3, at 11. Interestingly, it appears that RLH's predictions regarding the short-lived nature of the high profit margins were correct. A 625 percent increase in Medicare spending on compounded drugs from 2006 to 2015 caused the OIG to

as possible in a short amount of time. The only way to achieve this was, in the words of Glouchevitch, to "make hay while the sun shines."[95]

PCA outsourced the task of drumming up patient referrals to three external marketing companies, whose sole obligation was to target and refer patients for PCA prescriptions.[96] RLH approved of this plan, despite the Anti-Kickback Statute's prohibition on providing referrals in exchange for compensation.[97] The scheme functioned as follows: the marketers targeted TRICARE beneficiaries and secured the patient's consent to accept the free compounded creams.[98] PCA then sent the patient's information to an out-of-state telemedicine physician, who, with no physical examinations and often no consultations at all, wrote the prescriptions and sent them to PCA.[99] PCA billed TRICARE for the reimbursement.[100] In exchange for providing referrals, the marketers shared in fifty percent of the profits generated.[101] RLH fronted $2 million dollars to pay the marketers' commissions,[102] despite warning from counsel that "paying commissions to marketers could violate the AKS and that compliance with the AKS was a material requirement for reimbursement from TRICARE."[103]

Within months, the scheme soared past projections: PCA's 2015 annual budget projected the year's net compounding revenues to be $51.2 million; by April 2015, PCA had already accumulated $69 million in net revenue from the compounding creams.[104] But as alleged, the marketing scheme violated the Anti-Kickback Statute's prohibition on providing referrals in exchange for compensation.

The case first came before a U.S. Magistrate Judge for the Southern District of Florida, who filed a Report and Recommendation to the District Judge on November 30, 2018.[105] With regards to the marketing scheme, the magistrate judge found causation satisfied: RLH

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recommend CMS change its coverage policies. *See* U.S. DEP'T OF HEALTH & HUM. SERVS. OFF. OF INSPECTOR GEN., QUESTIONABLE BILLING FOR COMPOUNDED TOPICAL DRUGS IN MEDICARE PART D 1, 17–18 (2018).

95. Complaint in Intervention, *supra* note 3, at 11.

96. *Medrano*, 2018 WL 6978633, at *3.

97. *Id.* at *11.

98. Complaint in Intervention, *supra* note 3, at 20.

99. *Id.* The conduct of the telemedicine doctors was clearly illegal and has resulted in several criminal convictions against the prescribing doctors for health care fraud. *Id.*

100. *Id.*

101. *Id.*

102. *Medrano*, 2018 WL 6978633, at *11.

103. *Id.*

104. The United States of America's First Amended Complaint in Intervention at 19–20, United States *ex rel.* Medrano v. Diabetic Care RX, LLC, No. 15-cv-62617-BLOOM/Valle (S.D. Fla. Mar. 6, 2019), 2019 WL 1054125, at *16 [hereinafter First Amended Complaint in Intervention].

105. *Medrano*, 2018 WL 6978633, at *1.

caused PCA to submit false claims.[106] RLH squarely opposed this conclusion, advancing a theory of causation that would require RLH's involvement with PCA on a granular level—involvement in the day-to-day operations of the marketers, managing the conduct of PCA employees, and approving the actual marketing contracts, rather than directing the contracts be executed.[107] The judge rejected RLH's proposition, pointing to RLH's approval of the marketing agreements, knowledge of the AKS prohibition on kickbacks, and fronting of the $2 million to pay the marketers.[108]

On March 6, 2019, the district judge issued an Order Adopting in Part Report and Recommendations, dismissing the claims against RLH without prejudice.[109] The district court judge, in agreement with the magistrate judge, dismissed the claim for a different reason: she found that the complaint failed to properly state a presentment claim.[110] The district court judge did not issue an opinion on whether RLH caused the false claims to be submitted.[111] Twelve days after its complaint was dismissed without prejudice for failure to plead a claim under either an express or implied certification theory, the United States filed its amended complaint.[112] Despite RLH's insistence that a PE firm should not be held liable for conduct involving its portfolio company, a historic settlement was reached six months later.[113]

2. *Martino-Fleming*

Although *Medrano* was the first instance where the DOJ brought FCA charges against a PE firm for conduct related to its portfolio company, another FCA relator filed a complaint seeking to hold a PE firm liable for the conduct of its portfolio company just three months before the *Medrano* complaint. This case, *United States ex rel. Martino-Fleming*,[114] was still ongoing as of spring 2021.[115] Interestingly, of the two complaints filed just months apart, the DOJ

106. *Id.* at *12–13.

107. Riordan, Lewis & Haden, Inc.'s Motion to Dismiss the Government's Complaint in Intervention at 9–11, United States *ex rel.* Medrano v. Diabetic Care RX, LLC, No. 15-62617-CIV-BLOOM (S.D. Fla. Mar. 6, 2019), 2018 WL 1980692.

108. *Medrano*, 2018 WL 6978633, at *12.

109. United States *ex rel.* Medrano v. Diabetic Care RX, LLC, No. 15-cv-62617-BLOOM/Valle, 2019 WL 1054125, at *1, *7 (S.D. Fla. Mar. 6, 2019).

110. *Id.* at *7.

111. *Id.*

112. First Amended Complaint in Intervention, *supra* note 104, at *16.

113. Press Release, U.S. Dep't of Just., *supra* note 1.

114. United States *ex rel.* Martino-Fleming v. S. Bay Mental Health Ctr., Inc., No. 15-13065-PBS, 2018 BL 342655 (D. Mass. Sept. 21, 2018).

115. *See id.* (displaying multiple filings in January 2021).

elected to intervene only in *Medrano*. Undeterred by the federal government's failure to intervene, however, Martino-Fleming continues to pursue her claim.

The case involves South Bay, a mental health center in Massachusetts.[116] H.I.G. Capital, a private equity firm, and H.I.G. Growth, the capital-investment affiliate of H.I.G. Capital, purchased South Bay in April 2012 following due diligence.[117] South Bay received reimbursements from MassHealth, the Massachusetts Medicare program, which both the federal and Massachusetts state governments finance, thus opening the door to federal FCA liability.[118] As a condition of reimbursement, MassHealth has certain licensing and supervision requirements for staff therapists.[119] The relator, Christine Martino-Fleming, a South Bay employee, alleged that a substantial majority of the South Bay-employed therapists and other professionals were not properly licensed or supervised.[120] An internal investigation discovered that "over 60 percent of regional directors, over 80 percent of clinical directors, and over 75 percent of supervisors across all South Bay facilities were not properly licensed according to MassHealth regulations."[121]

Martino-Fleming further alleged that she informed the South Bay board—composed of five directors, three of whom were directors or principals at PE firm H.I.G.—that these licensing and supervisory problems violated state regulations and needed to be addressed by hiring more licensed supervisors.[122] The PE-controlled board rejected her recommendation, and South Bay continued operating as it had done in the past.[123]

Ruling on a motion to dismiss, the United States District Court for the District of Massachusetts held that the PE firm could be held liable "where the submission of false claims by another entity was the foreseeable result of a business practice."[124] The court held the board's conduct in rejecting the recommendation that would "bring South Bay into regulatory compliance" constituted "sufficient participation in the claims process to trigger FCA liability."[125] The court reasoned that a

116. *Id.* at *2.
117. *Id.* at *2–3.
118. *Id.* at *2.
119. *Id.*
120. *Id.* at *3.
121. *Id.* (emphasis omitted).
122. *Id.* at *3–4.
123. *Id.* at *6.
124. *Id.*
125. *Id.*

parent could be held liable for a subsidiary's false claims submissions if the parent was directly involved in the claims process.[126] By virtue of the fact that H.I.G. members comprised a majority of the South Bay board and had direct involvement in South Bay's operations, the court found H.I.G. could be held liable and denied H.I.G.'s motion to dismiss.[127]

C. Parent Liability Under the False Claims Act

"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."[128] During the height of the COVID-19 pandemic in June 2020, Principal Deputy Assistant Attorney General Ethan P. Davis delivered a speech addressing how the DOJ would police violations of the terms and conditions attached to the billions of dollars distributed to healthcare providers through the Coronavirus Aid, Relief, and Economic Security Act.[129] In the speech, he flaunted the enforcement actions taken against Riordan, Lewis, and Haden—the PE firm in *Medrano*—as a cautionary tale to PE firms, illustrating they are now fair game for the DOJ under the FCA.[130]

In *Medrano* and *Martino-Fleming*, the PE firms exercised varying degrees of direction and control over the fraudulent schemes the portfolio companies were operating to generate revenue. The conduct alleged is indicative of the concerns voiced above: as profits took priority over patient outcomes, regulations designed to protect quality and value-of-care were disregarded. Despite the PE firms' involvement in these schemes, the law is less than clear on *how* FCA liability should apply in the context of PE ownership.

The existing doctrines in this area have established frameworks to handle corporation-employee relationships and parent company-subsidiary relationships within the FCA context;[131] however, trying to fit the PE relationship into either of these boxes has its challenges. On a basic level, a PE fund typically has limited partners who are each individual owners in the fund, which is in turn managed by an

126. *Id.*

127. *Id.*

128. Ethan P. Davis, Principal Deputy Assistant Att'y Gen., Dep't of Just., Speech to the Institute for Legal Reform, U.S. Chamber of Commerce (June 26, 2020).

129. *Id.*

130. *Id.*

131. *See, e.g.*, United States *ex rel.* Hockett v. Columbia/HCA Healthcare Corp., 498 F. Supp. 2d 25, 59–63 (D.D.C. 2007) (explaining when a parent corporation may be held liable for fraudulent conduct).

investment management company on behalf of the fund's investors.[132] The management company makes the investment decisions for the fund.[133] At its core, the PE fund is the equivalent of a collective group of individual investors, which does not function the same way as a corporate body, so parent-subsidiary comparisons may seem attenuated.

Whatever the structural dissimilarities may be, it is difficult to see them as anything other than technicalities when the essence and function of the relationships are the same. At the very least, there is room for argument to reject a formalist approach to the rules and to functionally extend their reach to PE firms. The few courts that have touched on this issue looked past the structural barriers to the essence of the relationship between PE and portfolio and were satisfied with the parent-subsidiary view, despite protests from PE attorneys.[134]

Within the parent-subsidiary context, courts have developed doctrines to determine a parent corporation's FCA liability.[135] These judge-made doctrines stem from statutory interpretations of one key element of FCA liability: that the defendant *cause* a false claim to be submitted for reimbursement (from Medicare, Medicaid, etc.).[136] The general rule of parent liability is that parent corporations are not liable for a subsidiary's FCA violations simply by virtue of being a parent corporation.[137] Similarly, general control over a subsidiary is insufficient for liability.[138] To trigger liability against the parent, the plaintiff must present evidence that the parent played a role in

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132. *See* James Garrett Baldwin, *What Is the Structure of a Private Equity Fund?*, INVESTOPEDIA, https://www.investopedia.com/articles/investing/093015/understanding-private-equity-funds-structure.asp (last updated July 9, 2019) [https://perma.cc/7EJW-R4GJ] (discussing how limited partnerships are used in structuring private equity funds); Souter & Meyercord, *supra* note 14, at 89–90 ("[P]rivate equity firms primarily utilize management companies as the vehicle for their investment.").

133. *See* Souter & Meyercord, *supra* note 14, at 89–90 (discussing the role of management companies).

134. *See, e.g.*, United States *ex rel.* Martino-Fleming v. S. Bay Mental Health Ctr., Inc., No. 15-13065-PBS, 2018 BL 342655, at *6 (D. Mass. Sept. 21, 2018) (applying traditional parent-subsidiary doctrine to the private equity-portfolio relationship).

135. *See, e.g.*, *Hockett*, 498 F. Supp. 2d at 59–63 (explaining when a parent corporation is triggered by its subsidiary's fraudulent conduct).

136. 31 U.S.C. § 3729(a)(1)(A) (imposing liability on "any person who . . . knowingly . . . causes to be presented, a false or fraudulent claim for payment").

137. *See* ROBERT S. SALCIDO, PORTFOLIO 2650-1ST: THE FALSE CLAIMS ACT: HEALTH CARE APPLICATIONS AND DEFENSES § 2E, Bloomberg Law, https://www.bloomberglaw.com/product/health/document/26274445864 (last visited Mar. 23, 2021) [https://perma.cc/W978-AGLV] ("[C]ourts have held that simply being a parent corporation of a subsidiary that commits an FCA violation, without some degree of participation by the parent in the claims process, is not enough to support a claim against the parent for the subsidiary's FCA violation.").

138. *Id.*

submitting claims for reimbursement.[139] In one oft-cited case, conduct supporting parent liability included the parent reviewing and giving input to the subsidiary's cost reports submitted for reimbursement and corresponding with fiscal intermediaries.[140] Additionally, if a parent or other third party establishes a policy as to *how* the subsidiary submits its claims, liability may also be triggered.[141]

Comparing corporate liability cases, however, reveals ambiguities and inconsistencies in how these principles are applied. The ambiguity stems from the parent's involvement in the claim submission process. One line of cases requires direct involvement and oversight of the claims and cost reports being submitted. Another line of cases, more frequently involving third parties as opposed to parent corporations, applies a looser standard that is satisfied by a parent's involvement in the *fraudulent scheme*, without granular focus on the physical process of submitting claims or overseeing cost reports. The differing applications have immense implications for how PE firms will be held liable under the FCA. Several representative cases below illustrate the difference.

1. Direct Involvement in Claims

One case that illustrates the more demanding approach is *United States ex rel. Schaengold v. Memorial Health, Inc.*—an Eleventh Circuit 2014 case.[142] In *Schaengold*, defendants were parent company Memorial Health, Inc. and subsidiaries Memorial Health University Medical Center ("Memorial Hospital"), Provident Health Services ("Provident"), and Memorial Health University Physicians ("MHUP").[143] The government alleged a complicated scheme by the defendants that resulted in Memorial System, the health system owned and operated by Memorial Health, compensating physicians in excess of fair market value.[144] The physicians in turn referred Medicare patients to Memorial Hospital, which billed Medicare for reimbursement; this compensation arrangement violated the Stark Statute and effectively rendered the claims false under the FCA.[145]

The court dismissed the claims against every party except Memorial Hospital—the subsidiary directly involved in submitting the

139. *Id.*
140. *Hockett*, 498 F. Supp. 2d at 59–63.
141. *Id.*
142. No. 4:11-cv-58, 2014 WL 6908856 (S.D. Ga. Dec. 8, 2014).
143. *Id.* at *1, *5.
144. *Id.* at *9.
145. *Id.*

falsely certified cost reports to the government.[146] The court reasoned that direct involvement in claims submission was the sine qua non—an absolutely essential condition—to FCA liability: "[M]ere participation in a scheme that results in an eventual submission of a false claim is not sufficient for FCA liability."[147] Without that essential element, any other fraudulent conduct by the parent was irrelevant. Allegations that the parent, Memorial Health, organized and set up the fraudulent compensation arrangements that led directly to the subsidiary, Memorial Hospital, submitting those false claims constituted insufficient involvement in the submission process.[148]

The Central District of Illinois reached a similar result in *United States v. Safeway, Inc.*[149] Defendant Safeway operated multiple pharmacies including its subsidiary, Dominick's.[150] The complaint alleged that Safeway "directed and supervised the transition of Dominick's pharmacy" to a fraudulent billing program, resulting in Dominick's submitting false claims for Medicaid reimbursement.[151] Notably, however, the complaint did not allege Safeway's direct participation in the billings.[152] In addressing a venue issue Safeway raised, the court determined that the complaint "[did] not allege that Safeway committed any act proscribed [in] the False Claims Act," despite allegations that Safeway directed its subsidiary to commit fraud.[153]

2. Direct Involvement in Fraud

Contrasted with the strict direct involvement approach of *Schaengold* and *Safeway* is the broader approach suggested in *United States ex rel. Lisitza v. Par Pharmaceutical Cos., Inc.*[154] *Lisitza* involved three drug companies owned in whole or in part by Merck KGaA.[155] Alphapharm and Genpharm, generic drug manufacturers, developed a generic equivalent to Prozac in anticipation of Prozac's expiring patent.[156] The two manufacturers approached a third company, Par

146. *Id.* at *14.
147. *Id.*
148. *Id.* at *14.
149. United States *ex rel.* Proctor v. Safeway, Inc., No 11-cv-3406, 2016 WL 3906571 (C.D. Ill. July 14, 2016).
150. *Id.* at *1–2.
151. *Id.* at *2.
152. *Id.*
153. *Id.*
154. No. 06 C 06131, 2013 WL 870623 (N.D. Ill. Mar. 7, 2013).
155. *Id.* at *1.
156. *Id.*

Pharmaceutical, to market the generic drug.[157] Genpharm became Par's "de facto 'owner' " by installing Genpharm executives in various roles at Par, including roles on the Board of Directors and the Office of the President.[158] Under Genpharm and Alphapharm's "direction and under their control," Par employed a marketing campaign that promoted an illegal drug-switching scheme and illegal financial incentives for pharmacies.[159]

The court granted Genpharm and Alphapharm's motion to dismiss due to the complaint's failure to suggest that the entities caused the submission of false claims—the same result reached in *Schaengold* and *Safeway*.[160] The specific behavior that the court found lacking, however, was different from the behavior required by the strict direct involvement approach. Rather than specifying there were no allegations that the drug manufacturers directly submitted claims to the government, the court instead highlighted the absence of allegations of direct involvement *in the fraud itself*. The court gave several examples of allegations that might have saved the pleading: "[T]hat any individual employed by Genpharm did anything to . . . bring about the sale or marketing . . . *through fraud*"[;][161] that Genpharm "actually 'directed' Par to make false statements about the [generic drug], or to pay pharmacies to swap drug forms"[;][162] that anyone "encouraged Par to market the tablets based on improper prescription-switching."[163] Nothing that the court found lacking alluded to direct involvement in claims submission but rather in directing the fraud.[164]

Lisitza relied in part on a case from the Third Circuit Court of Appeals: *United States ex rel. Schmidt v. Zimmer, Inc.*[165] Unlike the three previously mentioned cases, *Schmidt* did not involve anything resembling a parent-subsidiary relationship but rather two unrelated parties to a contract involving illegal kickbacks and referrals.[166] Only

157. *Id.* at *2.

158. *Id.*

159. *Id.*

160. *Id.* at *7; *see also* United States *ex rel.* Proctor v. Safeway, No. 11-cv-3406, 2016 WL 3906571, at *3 (C.D. Ill. July 14, 2016) (suggesting that venue is improper because the parent entity did not directly participate in the subsidiary's fraudulent billing); United States *ex rel.* Schaengold v. Mem'l Health, Inc., No. 4:11-cv-58, 2014 WL 6908856, at *14 (S.D. Ga. Dec. 8, 2014) (dismissing claim against the parent because the complaint did not allege that the parent was directly involved in the claim submission process).

161. *Lisitza*, 2013 WL 870623, at *5.

162. *Id.*

163. *Id.*

164. *See id.* (discussing allegations sufficient to state a claim for relief).

165. *Id.* at *4 (citing United States *ex rel.* Schmidt v. Zimmer, Inc., 386 F.3d 235 (3d Cir. 2004)).

166. 386 F.3d at 237–39.

one of the parties—Mercy Health Systems—submitted the false claims.[167] The lower district court applied the strict direct involvement standard and dismissed the claims against the nonsubmitting party—Zimmer, Inc.—because it never submitted a cost report and therefore could not have *caused* the other party to submit.[168] The Court of Appeals reversed, holding that Zimmer's creation and pursuit of the kickback and referral schemes provided sufficient evidence for a jury to conclude that Zimmer "knowingly caused Mercy's false claims to be filed," despite not being directly involved in submitting the claims.[169]

III. SOLUTION

Multiple studies and anecdotal case illustrations have begun documenting the ongoing concerns about the adverse effects of private equity's presence in the healthcare industry—increased regulatory violations, a decline in patient care, higher prices, and less meaningful choice. And though the available evidence of the long-term impact of PE in healthcare is scant, it demonstrates a need for effective enforcement against potential fraud that could have adverse health consequences for patients nationwide.

The best way to monitor private equity abuses within healthcare is to follow the lead of *Medrano* and *Martino-Fleming* and permit the DOJ to bring False Claims Act charges against PE firms for the fraudulent conduct of their portfolio companies when the private equity firm played an active role in the fraud. This is a practical method of enforcement that could build on existing case law. But this approach can function as an effective deterrent only if a PE firm can be held liable for its participation in its portfolio company's fraud without further requiring it participated in submitting the actual reimbursement claims.

Acknowledging that expanding FCA enforcement as done under *Medrano* would be the most prudent and practical approach also demands an answer as to how exactly the FCA should be applied to PE firms in this context and whether that application holds up to judicial scrutiny.

167. *Id.* at 238–39.
168. *Id.* at 240.
169. *Id.* at 244.

A. Extended Enforcement Under the False Claims Act

Medrano sparked speculation that a new DOJ enforcement trend lurks around the corner.[170] The DOJ's case against RLH and PCA ended in a landmark $20 million settlement, marking the first time a PE firm accepted liability under the FCA for the alleged fraud of its portfolio company.[171] The message of the *Medrano* settlement, and certainly the message delivered by AAG Davis, has put PE firms "on notice that their liability may not be limited to just their financial exposure in the portfolio company. A private equity firm may itself face direct liability."[172]

Section I.B above discusses in detail the mechanics of the FCA and touches on the penalties that attach for violations. Expanding enforcement of the FCA to PE firms *does* come after PE firms where it hurts the most: their bottom line. The looming threat of the massive FCA imposed treble damages could bleed dry a PE's investment in the portfolio. This threat translates to lower returns for investors—a death knell for PE firms. Fewer FCA violations translate directly to increased quality of care, as healthcare companies operate in compliance with regulatory guidelines and avoid behaviors that may jeopardize patient health. Given the novelty of this approach as applied to PE firms, however, there is still a question of how PE firms actually *can* be held liable for FCA violations of portfolio companies.

B. Adopting a Direct Involvement in Fraud Causation Standard

To effectively disincentivize PE firms from encouraging their portfolio companies to engage in fraudulent, money-grabbing schemes while the firms themselves hide behind the direct involvement theory of claim submission, courts should interpret a PE firm's direct involvement in the *fraud* as sufficient causation in submitting

170. *See* Gomez & Kajan, *supra* note 26 (discussing the ramifications of *Medrano*).

171. Press Release, U.S. Dep't of Just., *supra* note 1.

172. Alexander M. Owens, *First of Its Kind? Private Equity Firm and Its Portfolio Company Settle FCA Lawsuit*, LAW.COM: LEGAL INTELLIGENCER (Sept. 27, 2019, 1:59 PM), https://www.law.com/thelegalintelligencer/2019/09/27/first-of-its-kind-private-equity-firm-and-its-portfolio-company-settle-fca-lawsuit/ [https://perma.cc/TM7C-W8E7].

fraudulent claims. This interpretation is supported by legislative history, Supreme Court precedent, and policy.

1. Legislative History

The legislative history of the 1986 FCA amendments provides strong justification for extending the parent-subsidiary doctrines to the PE-portfolio relationship and for the "indirect involvement" theory. Congress "designated complex corporate structures as a principal threat to the integrity of federal procurement programs" and "intended duties imposed by the law to strengthen as the size and sophistication of the party submitting claims increased."[173] Indeed, there are few corporate structures more sophisticated or complex than PE firms. One chief evil to be remedied by the amendments was corporate compartmentalization: corporate officers maintaining just enough distance from the fraud committed by lower-level employees to prevent the FCA elements from being satisfied.[174] In what has become a favorite passage for courts to cite, the Senate Committee Report accompanying the 1986 amendments takes aim at "[t]his 'ostrich-like' conduct which can occur in large corporations [which] poses insurmountable difficulties for civil false claims recoveries."[175]

Congress might not have anticipated the role PE would play in healthcare when the amendments were passed in 1986, but this reasoning lends itself to bringing PE firms under the umbrella of FCA defendants when they are directly involved in the fraud. Far from the "ostrich-like conduct" targeted in the Senate Committee Report, PE firms have actively participated in their portfolio's fraud under a presumption of immunity to these suits by virtue of the relationship's structure—they might have risked losing an investment but were not exposing themselves to any liability—so it is not difficult to see how an aggressive and reckless takeover approach festered.[176]

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173. Sam F. Halabi, *Collective Corporate Knowledge and the Federal False Claims Act*, 68 BAYLOR L. REV. 265, 292, 297 (2016).

174. *See id.* at 305 (discussing the Senate Committee Reports from the 1986 amendments to the False Claims Act, which took aim at corporate compartmentalization).

175. *Id.* at 295 (quoting S. REP. NO. 99-345, at 7 (1986)).

176. *See* Riordan, Lewis & Haden, Inc.'s Motion to Dismiss the Government's Complaint in Intervention, *supra* note 107, at 1 ("The Government takes the unprecedented step of attempting to impose [FCA] liability on a private equity firm for the alleged wrongdoing of one of its portfolio investment companies . . . .").

2. Supreme Court Precedent

Adopting an indirect involvement causation interpretation also aligns more closely with Supreme Court precedent, at least in third-party liability cases. Admittedly, these are not parent-subsidiary cases, but there can be no justification for exempting a parent company from liability for conduct that would render an unrelated third party liable. To the extent that a parent company is even better situated to direct a subsidiary into a fraudulent scheme by virtue of board seats, common management, and general influence, all the more justification exists for following the precedent established in the third-party liability cases.

The Supreme Court cases that touch on third-party liability focus on involvement in the fraud, not involvement in the actual billing. For example, *United States ex rel. Marcus v. Hess*,[177] like *Schmidt*, does not involve a parent-subsidiary relationship but rather relationships between two parties to a contract. The facts of *Marcus* involved electrical contractors who were contracted through local municipalities and thus never submitted claims to the federal government.[178] In holding an FCA claim could be brought against the electrical contractors, the Court stated that the FCA's purpose was "to reach any person who knowingly assisted in causing the government to pay claims which were grounded in fraud, without regard to whether that person had direct contractual relations with the government."[179]

Based on the Supreme Court's logic in *Marcus*, FCA should reach a PE firm that assisted in causing its portfolio company to pay fraudulent claims, regardless of whether the PE firm had a direct contractual relationship with CMS for reimbursements.

3. Practical Application

The aforementioned PE cases—*Medrano* and *Martino-Fleming*—can be used to illustrate how this interpretation will work in practice. *Medrano* ended in a settlement and *Martino-Fleming* is still ongoing in April 2021, though each produced district court opinions helpful to this analysis.

The district court in *Medrano* did not consider the question of causation,[180] though the magistrate judge found causation satisfied in her report based on PE conduct that could have only satisfied a direct

177. 317 U.S. 537 (1943).

178. *Id.* at 539.

179. *Id.* at 544–45.

180. United States *ex rel.* Medrano v. Diabetic Care RX, LLC, No. 15-cv-62617-BLOOM/Valle, 2019 WL 1054125, at *7 (S.D. Fla. Mar. 6, 2019).

involvement in fraud causation theory: approving a fraudulent scheme and funding commissions to further the fraudulent scheme.[181] There were no allegations that the PE firm actually partook in submitting the reimbursement claims.[182] The PE firm's decision to settle with the DOJ, the first settlement of its kind,[183] suggests that the PE firm found this meritorious. The general allegations in *Medrano* are similar to those in *Schaengold*: the parent company helped to operate a system of fraudulent compensation that led to its subsidiary submitting false claims.[184] Under *Schaengold*, the claims against the PE firm would be dismissed. This is not an optimal result, nor is it supported by Supreme Court precedent or legislative history.

Martino-Fleming gives a similar result, though there the district court actually ruled on a motion to dismiss that the PE firm had sufficient involvement in causing the submission of false claims based on its rejection of recommendations to bring its staff into regulatory compliance, thus ratifying the policy of submitting false claims.[185] Again, under *Schaengold* or *Safeway*, the facts *of Martino-Fleming* would have warranted dismissal. It is important to extend FCA to PE firms because of the risk that they represent. Providing effective deterrence would require both enhanced due diligence on the front end to ensure the portfolio company is not already engaged in fraud and increased due diligence on the back end as the PE firm strategizes with its portfolio company.

CONCLUSION

Since the *Medrano* charges were announced and the settlement was reached, headlines warning private equity firms to tread carefully in how they mine for profits in the healthcare industry have splashed across the internet.[186] *Medrano* and *Martino-Fleming* are at once

181. United States *ex rel.* Medrano v. Diabetic Care RX, LLC, No. 15-CV-62617-BLOOM/VALLE, 2018 WL 6978633, at *13 (S.D. Fla. Nov. 30, 2018).

182. *Id.*

183. Bewley & Dunn, *supra* note 2.

184. *Compare Medrano*, 2018 WL 6978633, at *13 (alleging that PE firm oversaw system of commission payments to marketers), *with* United States *ex rel.* Schaengold v. Mem'l Health, Inc., No. 4:11-cv-58, 2014 WL 6908856, at *9 (S.D. Ga. Dec. 8, 2014) (alleging that the parent oversaw system of fraudulent compensation).

185. United States *ex rel.* Martino-Fleming v. S. Bay Mental Health Ctr., Inc., No. 15-13065-PBS, 2018 WL 4539684, at *4–5 (D. Mass. Sept. 21, 2018).

186. *See, e.g.*, Jason P. Mehta & A. Lee Bentley III, *Investor, Beware: New Prosecutorial Scrutiny of Private Equity Investment in Healthcare Companies*, BRADLEY (Mar. 29, 2018), https://www.bradley.com/insights/publications/2018/03/investor-beware-new-prosecutorial-scrutiny-of-private-equity-investment-in-healthcare-companies [https://perma.cc/B6HN-9HD5] (providing a bulleted list of guidance that PE firms should consider post-*Medrano*); Lori Smith &

simultaneously unprecedented and precedented: unprecedented in their extension of FCA liability to PE firms yet precedented in holding a controlling entity accountable for its involvement in the fraudulent conduct of its subsidiary. Drawing from existing FCA cases, a court may require a PE firm be directly involved in *claims* or directly involved in *fraud*. To hold such a controlling entity accountable effectively demands an interpretation of the FCA that imposes liability in a way that recognizes the practical realities and supplants the direct involvement in claim submission requirement with a "direct involvement in a fraudulent scheme that leads to claim submission" requirement.

Time will tell whether the next case of PE liability will be upheld in court, but if the purpose of the FCA is to be effectuated, the existing legal framework can justifiably be extended to the PE firms that are so entrenched in the operations of their portfolio companies as to be directly involved in knowingly causing the submission of false claims. By allowing the Department of Justice to bring FCA charges against private equity firms operating in healthcare, the most serious abuses—those violations of regulations that work to ensure that patients receive medical care informed by medical necessity rather than potential profit—can be curtailed.

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Kate Woods, *Recent Healthcare Fraud Suit Puts Private Equity Industry on Notice as to Potential Liability for Portfolio Company Conduct*, WHITE & WILLIAMS LLP (Mar. 15, 2018), https://www.whiteandwilliams.com/resources-alerts-Recent-Healthcare-Fraud-Suit-Puts-Private-Equity-Industry-on-Notice-as-to-Potential-Liability-for-Portfolio-Company-Conduct.html [https://perma.cc/FNJ4-PZND] ("[P]rivate equity firms should make sure that their portfolio companies are engaged in ongoing monitoring of legal or regulatory guidance developments . . . .").

* J.D. Candidate, 2021, Vanderbilt University Law School; B.A., 2011, Belmont University. Thank you to all of the members of the *Vanderbilt Law Review* who were instrumental in the publishing process. And thank you to my partner and family for always keeping a stocked refrigerator when deadlines were approaching.