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White Collar Crime and Government Investigations Alert

Life Sciences Investors Beware

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Private Equity Firm Settles Federal False Claims Act Suit Regarding Compounding Pharmacy It Managed

On September 18, 2019, the Department of Justice announced a $21.36 million settlement to resolve a False Claims Act ("FCA") lawsuit alleging a fraudulent kickback scheme through which a pharmaceutical company (Patient Care America, or "PCA") induced doctors to write expensive and unnecessary prescriptions to military veterans. A False Claims Act settlement of this magnitude is not unusual, particularly in the healthcare industry (which accounted for $2.5 billion of the DOJ's $2.8 billion in FCA settlements and judgments in 2018). What is unusual is who is writing part of the settlement check — a private equity firm that acquired PCA in 2012. While it is too early to identify a meaningful trend from this one settlement, it is clear that private equity firms that take active roles in company management must take steps to guard against False Claims Act liability.

In *United States ex rel. Medrano and Lopez v. Diabetic Care Rx LLC, d/b/a Patient Care America, et al*., No. 15-CV-62617 (S.D. Fla.), two former PCA employees alleged that PCA paid $40 million to a number of marketing agencies, which then located military veterans with government-funded healthcare. The marketing agencies pushed the veterans to purchase PCA's compound pain and scar creams, which had higher rates of reimbursement than other products. These agencies encouraged the veterans to speak with particular physicians with whom the agencies had relationships; the doctors would then prescribe the expensive creams via "telemedicine," without actually seeing the patients (and sometimes without even speaking to them). PCA received an estimated $87.75 million in government reimbursement for these prescriptions.

The complaint alleges the involvement of PCA's highest executives, as well as a private equity firm, Riordan, Lewis & Haden, Inc. ("RLH") that acquired a controlling share of PCA in 2012. PCA was losing money on its legacy products for diabetic patients, and so, the complaint alleges, decided to fraudulently pump up revenues from compound creams. Notably, the complaint alleges RLH was not only aware of the fraudulent scheme, but "bankrolled it" and was a "principal orchestrator." RLH principals allegedly met "every two months" with PCA's executive team to plan and evaluate the scheme's progress, and loaned $10 million to PCA to alleviate cash flow problems resulting from the massive kickback payments. These allegations of direct involvement in the scheme likely led to RLH being named as a defendant. After the United States government intervened in the *qui tam* suit, the parties settled the claims (without admitting liability), and RLH and PCA collectively agreed to pay more than $21 million of the settlement.

It remains to be seen if this settlement represents the start of a new trend or is isolated to its facts. Clearly, RLH was not merely a passive investor, and it was allegedly involved in driving the conduct from day one. This settlement appears to be the first of its kind involving a private equity firm, but it may not be the last. For example, a federal court in Massachusetts denied a motion to dismiss and permitted an FCA claim to proceed against multiple defendants, including a private equity firm. See *Commonwealth ex rel. Martino-Fleming v. South Bay Mental Health Center, Inc*., CV 15-13065-PBS (D. Mass.).

These cases send a message that private equity firms that take an active role in managing their portfolio companies must bear some responsibility for their investments' legal compliance. Going forward, private equity firms, particularly those that take active management roles, should review their compliance policies to ensure not only that they can adequately detect internal fraudulent conduct, but also fraudulent or other improper conduct within companies in which they invest.

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