



A Robinson+Cole Legal Update

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Department of Justice and State Attorneys General Pursue Private Equity Firms Under the False Claims Act

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On October 14, 2021, the Massachusetts Attorney General (MA AG) announced a \$25 million settlement with South Bay Mental Health Center, Inc.'s (SBMHC) private equity owner and two former executives for allegedly causing false claims to be submitted to the Massachusetts Medicaid Program. According to the MA AG's press release, the case was handled with "substantial assistance" from the U.S. Attorney's Office for the District of Massachusetts and the Office of the Inspector General (OIG).[1] The SBMHC settlement demonstrates a continuing trend on the part of the Department of Justice (DOJ) and OIG to include private equity firms as part of their investigations of whistleblower False Claims Act (FCA) allegations, as well as state attorneys general to enforce state laws regarding false claims against private equity firms and their executives.

False Claims Act

The federal FCA is a statute that permits individuals (relators) to file so-called *qui tam* lawsuits on behalf of the federal government for alleged violations. The federal government may choose to intervene in these cases and assume responsibility for their prosecution or decline to intervene and allow the relator to prosecute.[2]

Under the FCA, it is unlawful for an individual or entity to knowingly present, or cause to be presented, a false or fraudulent claim for payment, or knowingly make, use, or cause to be made or used, a false record or statement material to a false or fraudulent claim.[3]

Whistleblowers and other relators often use *qui tam* lawsuits under the FCA, as do the DOJ and OIG through intervention in such cases, to seek damages for allegedly false or fraudulent claims knowingly submitted to federal health care programs by health care providers and health care entities. Recently, this scrutiny has extended to private equity firms that invest in health care entities. Some states, such as Massachusetts, Connecticut, and New York, also have similar statutes for false claims submitted to state payment programs.[4]

Recent Enforcement Involving Private Equity

Recent interest in FCA enforcement against private equity firms started in the 2018 case of *United States ex rel. Medrano and Lopez v. Diabetic Care Rx, LLC dba Patient Care America, et al.* case (PCA). In that case, the DOJ released a statement describing how the complaint was made against a pharmacy and several of its executives as well as the private equity firm that manages the pharmacy and the private equity fund that owns the pharmacy. The United States Attorney's Office for the Southern District of Florida stated in the release that "We will hold pharmacies, and those companies that *manage* them, responsible for using kickbacks to line their pockets at the expense of taxpayers and federal health care beneficiaries." [5]

According to the complaint, the private equity defendant managed a private equity fund, which owned the controlling stake in the pharmacy since 2012, and the private equity firm “managed and controlled” the pharmacy “on behalf of the private equity fund through two [private equity firm] partners...who served as officers and/or directors of [the pharmacy] and of a holding company with an ownership interest in [the pharmacy].” The FCA lawsuit alleged involvement in a kickback scheme designed to generate unnecessary referrals for prescription pain creams, scar creams, and vitamins reimbursed by TRICARE, the federal health care program for military members and their families. Ultimately, in 2019, PCA, its Chief Executive, and its former Vice President of Operations, along with the private equity firm that managed PCA, settled with the DOJ for \$21.36 million.[6]

In 2020, the DOJ announced an \$11.5 million FCA settlement with Therakos, Inc., for the promotion of a drug-device system for unapproved use in pediatric patients and related claims for payment. Notably, \$1.5 million of the settlement was paid by the private equity firm that acquired Therakos to resolve allegations that the alleged improper sales and promotion practices continued after the private equity firm acquired it in 2012 (the remaining \$10 million was paid by the prior owner of Therakos).[7]

In July 2021, the DOJ announced a \$15.3 million settlement with a national electroencephalography testing company, Alliance Family of Companies LLC (Alliance), and the private equity firm that managed it, for false claims related to an alleged kickback scheme. The private equity firm was responsible for \$1.8 million of the settlement due to allegations of causing false billings resulting from its management agreement. The DOJ “alleged that [the private equity firm] learned of the kickbacks based on due diligence it performed prior to investing in Alliance and then caused false claims by allowing that conduct to continue once it entered into an agreement to manage Alliance.”[8]

The South Bay Mental Health Center Case

Most recently, in the SBMCH case, a whistleblower filed an FCA *qui tam* lawsuit alleging violations related to mental health services provided by SBMCH. The MA AG intervened, alleging violations of the Massachusetts False Claims Act. According to the MA AG, “the clinics named in the complaint suffered significant gaps in licensing and supervision of therapists during the relevant time period ... [and] SBMCH had a widespread pattern of employing unlicensed, unqualified, and unsupervised staff at its mental health facilities in violation of MassHealth regulations.” Accordingly, the complaint alleged that “by submitting fraudulent claims to MassHealth for mental health services provided by unlicensed, unqualified, and unsupervised personnel, SBMCH violated the Massachusetts False Claims Act.” SBMCH settled for \$4 million in 2018, and the MA AG continued to pursue SBMCH’s prior CEO, current CEO, and the private equity firm that owned SBMCH, alleging they “knew that SBMCH was providing unlicensed, unqualified, and unsupervised services in violation of regulatory requirements and caused fraudulent claims to continue to be submitted to MassHealth by failing to adopt recommendations to bring SBMCH into compliance.” The three settled for \$25 million, \$19.95 million of which is to be paid by the private equity firm.[9]

Key Takeaways

- Private equity firms remain under scrutiny from the DOJ and OIG for FCA violations and the recent SBMCH case exemplifies that state attorneys general also have private equity firms on their radar.
- The \$19.95 million paid by the private equity firm in the SBMCH settlement is notably larger than the amounts in the prior Alliance and Therakos settlements.
- The PCA and SBMCH settlements both involve allegations that the private equity firms had knowledge of the FCA violations as a result of their roles in managing the respective portfolio companies.

The government’s continued interest in this area highlights the need for private equity firms to be cognizant of their level of involvement in the operations of their portfolio companies, and thorough in their diligence review of new acquisitions, especially in the health care space and when such involvement might create potential exposure.

FOR MORE INFORMATION

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ENDNOTES

[1] Office of Attorney General Maura Healey. *Private Equity Firm and Former Mental Health Center Executives Pay \$25 Million Over Alleged False Claims Submitted for Unlicensed and Unsupervised Patient Care*, October 14, 2021. Available [here](#).

[2] 31 U.S.C. §§ 3279 et seq.

[3] 31 U.S.C. § 3729 (a)(1).

[4] The OIG reviews state false claims acts enacted under state law to determine if they qualify for an increased share in recoveries under section 1909 of the Social Security Act. The OIG has approved 22 such acts as qualifying. Seven states have false claims acts that do not qualify for an increased share in recoveries. Together, 29 states have their own false claims acts. See [here](#).

[5] Department of Justice, *United States Files False Claims Act Complaint Against Compounding Pharmacy, Private Equity Firm, and Two Pharmacy Executives Alleging Payment of Kickbacks*, February 23, 2018. Available [here](#).

[6] Department of Justice, *Compounding Pharmacy, Two of Its Executives, and Private Equity Firm Agree to Pay \$21.36 Million to Resolve False Claims Act Allegations*. September 18, 2019. Available [here](#).

[7] Department of Justice, *Former Owners of Therakos, Inc. Pay \$11.5 Million to Resolve False Claims Act Allegations of Promotion of Drug-Device System for Unapproved Uses to Pediatric Patients*, November 19, 2020. Available [here](#).

[8] Department of Justice, *EEG Testing and Private Investment Companies Pay \$15.3 Million to Resolve Kickback and False Billing Allegations*, July 21, 2021. Available [here](#).

[9] *Id.*

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