

# Clients & Friends Memo

## Health Care Investors Beware: U.S. Attorney Sues Private Equity Firm For Portfolio Company's Alleged Billing Fraud

March 20, 2018

The U.S. Attorney for the Southern District of Florida has recently decided to intervene in a lawsuit brought under the Federal False Claims Act and initiated by a whistleblower. The U.S. Attorney has filed his own complaint-in-intervention. ([U.S. ex rel. Medrano v. Diabetic Care Rx, LLC](#), No. 15-cv-62617, S.D. Fla.) What is significant about this case is that the federal government has also named a private equity ("PE") firm (Reardon, Lewis & Haden, Inc., or RLH) as a defendant.

The U.S. Attorney alleges that a pharmacy company billed over \$68 million for allegedly false claims to the Federal TRICARE program for compounded drugs prescribed to active or retired military personnel or their dependents from September 1, 2014 to April 29, 2015. In that time frame, TRICARE reimbursed for compounded drugs for ESRD (end stage renal disease) patients on a fee-for-service basis based on the "average wholesale price" for each ingredient of the drug minus a negotiated discount. Effective May 1, 2015, TRICARE imposed a screening process for medical necessity that resulted in far fewer claims for compounded drugs thereafter.

According to the U.S. Attorney, the PE firm invested in the pharmacy company in 2012 with the goal of increasing the company's value and then selling it for a profit in 5 years. The PE firm allegedly "managed and controlled" the pharmacy company through two of its partners who served as "officers and/or directors" of the company. During its investment, the PE firm was allegedly actively involved in developing and implementing the company's business strategy around maximizing TRICARE reimbursement -- allegedly through kickbacks and beneficiary inducements in violation of the anti-kickback statute and other fraud and abuse laws -- so as to enhance the value of the company prior to selling its interest.

The complaint describes statements in e-mails sent by the PE firm principals, about opportunities to "capitalize on 'the extraordinarily high profitability of this therapy' which RLH anticipated could result in a 'quick and dramatic payback' on its investment in DCRX." According to the U.S. Attorney, the PE firm acknowledged that "'overcharging the product' in its 'pain management business' risked 'cross[ing] the line from an ethics standpoint.'" The complaint points to key hiring decisions as well

as improper marketing activities allegedly undertaken with the knowledge and approval of the PE firm.

In the [press release](#) accompanying the filing of its complaint, the U.S. Attorney declared that “[w]e 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.”

### **Key Takeaways**

This attempted extension of False Claims Act liability to the PE firm should serve as a cautionary tale about the risks to private equity invested in the health care space, for a portfolio company’s management decisions and business operations implicating the fraud and abuse statutes that are applicable to the Medicare, Medicaid, and TRICARE programs. It is akin to “piercing the corporate veil,” except in the context of the potentially broader reach of the False Claims Act and the Act’s higher stakes -- treble damages and per-claim penalties of up to \$22,363.

Given the federal government’s extensive reliance on RLH’s own damning words, this case also underscores the importance of being careful and circumspect when communicating about investment opportunities and management decision-making. It is possible that the selected e-mail excerpts do not tell the full story. Even so, a poor choice of words or quotes taken out of context can create the misimpression that a PE firm is both “calling the shots” and countenancing or encouraging improper marketing strategies that “cross the line” of legality under the fraud and abuse statutes.

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