

Private Equity Regulatory Update

March 30, 2018

Industry Update

- SEC Announces National Compliance Outreach Seminar for Investment Companies and Investment Advisers

Litigation

- United States Pursues False Claims Act Suit Against Private Equity Firm for Portfolio Company's Alleged Prescription Kickback Scheme

Industry Update

SEC Announces National Compliance Outreach Seminar for Investment Companies and Investment Advisers

The SEC will hold its compliance outreach program's national seminar for investment companies and investment advisers on April 12, 2018 in Washington, D.C. The seminar is jointly sponsored by the SEC's Office of Compliance Inspections and Examinations, Division of Investment Management and the Asset Management Unit of the Division of Enforcement and aims to assist Chief Compliance Officers ("CCOs") and other senior personnel at investment companies and investment advisory firms in strengthening their compliance programs. The seminar is also a forum where professionals can share their own ideas and concerns with other industry peers and colleagues.

The seminar will address a range of topics, including issues related to fees and expenses, portfolio management trends, current regulatory issues, cybersecurity, compliance and rulemaking. In addition, the agenda will include a number of panel discussions among SEC staff, CCOs and other industry professionals.

Litigation

United States Pursues False Claims Act Suit Against Private Equity Firm for Portfolio Company's Alleged Prescription Kickback Scheme

On February 16, 2018, the United States filed a complaint in intervention in a False Claims Act qui tam action against Diabetic Care Rx, LLC, d/b/a Patient Care America, a Florida-based pharmacy, Patrick Smith and Matthew Smith, two of its executives, and, notably, Riordan, Lewis & Haden, Inc. ("RLH"), a California-based private equity firm that manages a fund with a controlling stake in Patient Care America.

The United States complaint alleges that the defendants participated in a scheme to present false or fraudulent claims for compounded drugs to TRICARE, the federal health care program for active duty military personnel, retirees, and their families. According to the complaint, defendants allegedly paid kickbacks to independent marketing companies to target military members and their families for prescriptions for compounded pain creams, scar creams, and vitamins. The defendants and marketers then allegedly manipulated formulations of prescriptions in order to ensure the highest possible reimbursement from TRICARE, paid telemedicine doctors to prescribe creams and vitamins to patients whom they would never physically examine, and colluded with marketers to cover the cost of patient

copayments in order to induce patients to accept prescriptions for the compounded drugs. In sum, the government seeks to recover approximately \$85 million under the False Claims Act ("**FCA**") or common law claims for mistaken payment and unjust enrichment.

The federal government routinely pursues claims for false or illegal reimbursements under federal benefits programs using the FCA, which holds liable any individual or entity that "knowingly presents, or causes to be presented, a false or fraudulent claim for payment or approval" or "knowingly makes, uses, or causes to be made or used, a false record or statement material to a false or fraudulent claim." 31 U.S.C. § 3729(a)(1)(A)-(B).

What makes the *Patient Care America* case notable is that the United States has chosen to name the private equity firm that allegedly holds, through one of its managed funds, a controlling interest in Patient Care America. This decision may signal that the Department of Justice will seek to pursue a private equity sponsor that it believes participated in, or bears responsibility for, the violations of one of its portfolio companies.

Indeed, Executive Assistant Randy Hummel of the United States Attorney's Office for the Southern District of Florida stated in a press release, "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."

The *Patient Care America* case also underscores the importance of ensuring that proper corporate governance procedures are in place, and that the separate corporate identity of a portfolio company is respected. The complaint of the United States alleges a number of instances in which the private equity sponsor directly participated in management and operations of the subsidiary, and exceeded the control typical of a controlling shareholder:

- Two of the private equity firm's partners served as officers of Patient Care America (in addition to serving as directors of Patient Care America and a holding company).
- The private equity sponsor partners allegedly directed that Patient Care America enter into the business in which it allegedly submitted false claims.
- The private equity sponsor allegedly imposed close control and reporting requirements on Patient Care America, including that it apprise the sponsor "as early as possible about significant developments or concerns" and obtain sponsor approval for any contract requiring "annual payments over \$50,000 or total payments over \$150,000."

The private equity sponsor allegedly provided funding for commissions to marketers, including one instance in which the sponsor allegedly provided \$2 million to Patient Care America in response to its CEO's specific request for funds to pay commissions.

Because the *Patient Care America* case is in an early stage, the defendants have not yet had an opportunity to tell their side of the story. That said, the allegations highlight the importance of robust due diligence before an acquisition, robust internal compliance and control procedures within the portfolio company, and respect for the distinct corporate identity of the portfolio company and observing proper corporate formalities.

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