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Legal Sidebar

Private Equity Investments in Health Care: Selected Enforcement Issues

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A 2021 report from the Medicare Payment Advisory Commission (MedPAC) found that private equity investments in health care substantially expanded in the preceding 20 years, particularly with respect to acquisitions of health care providers, including hospitals, physician groups, and nursing homes. While the overall significance of these investments to the health care sector is disputed, they have attracted regulatory, legislative, and academic interest, particularly in the midst of ongoing conversations about health care quality and costs.

Scrutiny often focuses on the structure and incentives of private equity investment in health care. Private equity funds typically aim to acquire portfolio companies, increase their value, and exit from these investments, generally in a defined time frame. The structure of private equity can involve an array of corporate entities, which may generally shield fund managers and investors from liability. Regulators have expressed concern that these institutional features may give private equity firms an "undue focus on short-term profits and aggressive cost-cutting" that creates unique risks relative to other market participants, with impacts on patient care and competition. For example, MedPAC's report details ongoing debates regarding the effects of private equity efforts to increase profitability in health care investments by increasing revenue while reducing costs. On the other hand, private equity representatives and other stakeholders argue that such efforts can improve both efficiency and patient care, and that private equity has been scapegoated for broader issues in the health care system.

In December 2023, the Biden Administration announced that federal agencies, including the Department of Justice (DOJ), the Department of Health and Human Services (HHS), and the Federal Trade Commission (FTC), would take increased actions to lower health care costs, increase quality, and protect consumers. As part of this effort, the agencies released a Request for Information (RFI) soliciting public comments on the effects of private equity investments on patients and health care workers. The agencies argued that "[a]cademic research and agency experience in enforcement actions" have demonstrated that "patients, health care workers, and others may suffer negative consequences" as a result of these investments in the health care sector.

Although there is limited federal law that directly addresses private equity ownership in health care, private equity firms and funds have recently faced claims alongside their portfolio companies in the health care sector under federal laws concerning both fraudulent and anticompetitive behavior. Legal

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commentators have noted the increased legal risk such trends create for private equity investors, whose involvement in managing portfolio businesses may support alleged knowledge of wrongdoing. This Legal Sidebar explores recent regulatory and enforcement activities involving private equity investments in health care under federal antitrust law and the False Claims Act, including efforts to hold private equity firms and funds directly liable alongside portfolio companies.

Private Equity and Limited Liability

The term *private equity* is often used to refer to a variety of investments that typically pool private funds from specific, qualified investors for a set period of time and use them to purchase controlling interests in operating businesses, known as portfolio companies. Private equity funds are generally structured as limited partnerships; the general partners manage the fund's investments, and limited partners are those that invest in the fund but are not directly involved in its operation. A private equity firm may serve as the general partner for multiple funds, each with their own limited partners and portfolio companies. The qualified investors who invest as limited partners include pension plans, other private funds, foreign institutional investors, insurance companies, and high-net-worth individuals. Investments in portfolio companies could take the form of leveraged buyouts. For more information on the private equity industry generally, including its structure, size, and common terminology, *see* CRS Report R47053, *Private Equity and Capital Markets Policy*, by Eva Su.

The typical structure of a private equity fund will thus involve several separate entities, all of which are distinct from the portfolio companies controlled by the fund. Portfolio companies may themselves consist of a collection of separate legal entities, including corporations and limited liability companies (LLCs). Under general principles of corporate law, the shareholders of a corporation and the members of an LLC are ordinarily not liable for the entity's obligations. Instead, they risk only the amount they have invested in the business.

These principles do not always shield owners from liability. In some rare circumstances, the corporate entity may be disregarded and liability imposed upon the company's owners for corporate conduct, a process called *piercing the corporate veil*. Owners of a company may also be held directly liable for their own conduct, separate from the company's conduct or liability.

Federal Antitrust Law

The federal antitrust laws aim to protect economic competition. Key provisions include Sections 1 and 2 of the Sherman Act, prohibiting restraints of trade and monopolization, and Section 7 of the Clayton Act, which prohibits mergers and acquisitions that threaten "substantially to lessen competition, or to tend to create a monopoly." While state attorneys general and private parties may bring suits to enforce these laws, the primary federal enforcement agencies are the FTC and the Antitrust Division of the DOJ. The agencies share enforcement authority under the Clayton Act, and mergers that meet certain size thresholds are subject to a premerger notification process under the Hart-Scott-Rodino Antitrust Improvements Act (HSR Act). While DOJ enforces the Sherman Act, the FTC can address restraints of trade, monopolization, and other anticompetitive behavior via Section 5 of the FTC Act, which prohibits unfair methods of competition.

In recent years, federal antitrust enforcers have voiced concerns regarding the competitive effects of private equity investment in health care, particularly the use of "roll-ups." A firm pursuing a roll-up strategy aims to combine several smaller entities in a particular sector into a larger company through a series of mergers and acquisitions. While such acquisitions may create efficiencies by reducing duplicative costs and taking advantage of economies of scale, regulators have highlighted the risk that such combinations can increase market power and reduce competition. This concern is exacerbated

because the piecemeal transactions used in a roll-up strategy may not separately meet the notification thresholds of the HSR Act or may fall within other HSR exceptions, rendering review somewhat more difficult and potentially permitting what FTC Commissioners have called "stealth consolidation."

DOJ and FTC officials have expressed concern about private equity roll-up transactions in health care in various public remarks, and the Biden Administration's December 2023 announcement raised similar issues. In the 2023 Merger Guidelines, the DOJ and FTC indicated that they will consider the potentially anticompetitive effects of a series of transactions as a whole, rather than focusing on individual transactions. To that end, the agencies' proposed revisions to the filing requirements for HSR premerger notification include increased disclosures regarding past acquisitions by the filing parties. Media reports present some disputed evidence that this scrutiny may be discouraging new transactions.

One prominent enforcement action that arose out of the agencies' enhanced scrutiny of roll-up strategies is the FTC's suit against U.S. Anesthesia Partners (USAP) and Welsh Carson, filed pursuant to Section 13(b) of the FTC Act in the U.S. District Court for the Southern District of Texas in September 2023. The FTC alleges that private equity firm Welsh Carson used a roll-up strategy to gradually and systematically create a single dominant provider for hospital-based anesthesia services in Texas. The firm allegedly created USAP in 2012 as the vehicle to begin this series of acquisitions, beginning with practices in Houston, and later expanding to Dallas and elsewhere in Texas and beyond. (In February 2024, USAP entered into an agreement to resolve an antitrust investigation brought by the Colorado Attorney General regarding conduct in that state.) The FTC alleges that Welsh Carson controlled and directed USAP's conduct, and has pursued similar roll-up strategies in emergency medicine and radiology.

USAP allegedly further enhanced its power in Texas by striking price-setting arrangements with certain of the remaining independent anesthesia providers and by entering into a market allocation agreement to avoid direct competition from another large anesthesia provider. USAP allegedly grew from handling 8% of hospital anesthesia cases in Texas in 2013 to 43% of cases in 2021. USAP allegedly increased its market share of revenue generated from such cases from 13% to 57% over the same period.

The FTC alleges that USAP has monopoly power within the Houston and Dallas markets for commercially insured hospital-only anesthesia services, as well as a dominant position for the same services in the Austin market. USAP has allegedly leveraged its control in these markets against commercial insurers in contract negotiations, purportedly raising the overall prices of anesthesia services in Texas by tens of millions of dollars, without any offsetting procompetitive benefits. The FTC's complaint includes claims for monopolization, conspiracy to monopolize, prohibited merger, restraint of trade, and unfair methods of competition. The FTC asked the court to declare USAP and Welsh Carson's conduct illegal, enjoin them from similar and related conduct, and grant equitable relief, including potential structural relief, which could include requiring USAP to divest assets.

USAP and Welsh Carson each moved to dismiss the FTC's complaint. In addition to questioning the plausibility of the allegations, they challenged the FTC's statutory authority to seek injunctive relief under Section 13(b) absent related FTC administrative proceedings and, separately, to seek such relief for purely past conduct that is not continuing. They also raised constitutional challenges to the structure of the FTC. Welsh Carson argued that the FTC's allegations attempted to evade bedrock corporate law by holding Welsh Carson liable for USAP's conduct, and failed to differentiate between the seven different Welsh Carson entities named in the complaint.

The district court granted Welsh Carson's motion and denied USAP's motion. The court held that Section 13(b) permits the FTC to bring suit to enjoin continuing or imminent violations of law, but not to address entirely past conduct. Past violations, the court held, must be addressed by FTC administrative actions pursuant to Section 5(b) of the act. The court determined that the FTC failed to adequately allege that Welsh Carson was actively violating or about to violate antitrust law through its relationship with USAP, which by this stage consisted of a minority, noncontrolling interest. The court indicated that the FTC

could file a new lawsuit if evidence emerged that Welsh Carson was poised to violate antitrust law via USAP or another portfolio company. The court explicitly did not reach any assessment of Welsh Carson's past conduct and thus did not evaluate the FTC's arguments regarding Welsh Carson's alleged direct or indirect liability.

As to USAP, the court held that the FTC need not first bring an administrative action in order to seek injunctive relief under Section 13(b) and that the FTC adequately alleged ongoing antitrust violations by USAP. The court also concisely rejected USAP's constitutional arguments. USAP has filed an interlocutory appeal on the 13(b) issue and certain constitutional arguments. The FTC has moved to dismiss the appeal as procedurally inappropriate.

The False Claims Act

The federal government looks to a number of antifraud statutes to address fraud and abuse in federal health care programs, including the False Claims Act (FCA). Penalties for violating these statutes may include civil or criminal penalties and exclusion from participation in federal health care programs, such as Medicare and Medicaid. Like publicly traded businesses, health care companies controlled by private equity firms must comply with these laws. In recent years, DOJ has used antifraud statutes to recover millions of dollars from both public and private companies that reportedly engaged in practices like inflated billing or "upcoding," unlawful referrals, or other fraudulent claims for reimbursement. Data from DOJ indicates that in FY2020 alone, DOJ recovered more than $2.2 billion in FCA judgements and settlements related to false or fraudulent claims against the government, more than 80% of which ($1.8 billion) was from the health care industry. This section explores how private equity firms and their investors could face liability under the FCA for their actions and those of their portfolio companies.

The FCA is a statute of general applicability that creates civil liability for "any person" who "knowingly presents … a false or fraudulent claim for payment" by the U.S. government, or who "knowingly makes [or] uses … a false record or statement material to a false or fraudulent claim." The statute does not define "person," but the term is defined broadly elsewhere in the *U.S. Code* and has historically been understood to include corporations and limited liability companies. The FCA may be enforced directly by the federal government or by a private individual (known as a relator) bringing a *qui tam* action on the government's behalf. Where the government succeeds in a *qui tam* action, the relator bringing the suit receives a portion of the award. Liability under the FCA generally requires the government to prove several elements, including the falsity of the claim, knowledge (or scienter), causation, and materiality. In the health care industry, private equity firms have faced lawsuits alleging that they are liable under the FCA for allegedly fraudulent activities, including in instances where the firm was allegedly directly involved in the business operations of its portfolio company and it appeared likely that the firm had actual knowledge of wrongdoing.

For example, in *U.S. and Commonwealth of Massachusetts ex rel. Martino-Fleming v. South Bay Mental Health Centers*, a private equity firm was sued for the allegedly fraudulent business dealings of its portfolio company. South Bay Mental Health Centers was a for-profit mental health clinic that was purchased by private equity firm H.I.G. Capital in 2012. After the acquisition, H.I.G. filled the majority of seats on South Bay's Board of Directors. In 2015, a former employee of South Bay, Christine Martino-Fleming, filed a *qui tam* action in which she alleged that South Bay, its owners, and investors violated the FCA by submitting Medicaid claims for services of "unlicensed, unqualified, and unsupervised" social workers and counselors at the center. Massachusetts intervened in the suit in 2017.

To hold the private equity firm liable under the FCA, the plaintiffs had to show that South Bay's investors "knowingly presented, or caused to be presented, a false claim … for payment" to Medicaid. The plaintiffs asserted a theory of "implied false certification," as recognized by the U.S. Supreme Court in 2016, arguing that South Bay and its owners submitted false claims for Medicaid reimbursement because

some of its clinicians were not qualified to provide clinical care and were improperly supervised by unlicensed clinicians, in violation of several Massachusetts Medicaid requirements. The consolidated complaint alleged that the private equity firm had direct knowledge of or should have known that the claims being submitted were false and thus should be held liable for South Bay's actions. In response to the complaint, the firm filed a motion to dismiss in which it argued that the company and its Board of Directors were shielded by the corporate veil. The motion urged that "[c]orporations are almost never liable for the acts and omissions of their subsidiaries," and contended that the plaintiffs failed to show that the private equity firm was directly involved in causing the false claims to be submitted. The court denied the motion to dismiss, because the plaintiffs alleged that the private equity firm made up a majority of South Bay's Board of Directors and was "directly involved" in the clinic's business operations.

After extensive discovery in the case, but before the parties settled in 2022, they filed cross motions for summary judgment. In its decision, the court found that summary judgment in favor of the private equity firm was improper because the plaintiffs "pointed to sufficient evidence to raise a genuine dispute of material fact" about whether the firm had actual knowledge of South Bay's noncompliance with Medicaid regulations. The court pointed to specific evidence in the record cited by the plaintiffs, including that the firm knew that South Bay relied upon the submission of Medicaid claims for revenue, that the program had certain terms of participation related to licensure and qualification of staff, and that South Bay had certain staff inadequacies. The court also found that "undisputed facts in the record support Plaintiffs' argument that H.I.G. should have known that misrepresentations concerning compliance with the supervision and licensing requirements were material to payment." Also, while the private equity firm argued that it was "not involved in the decision-making process" for the submission of claims, the court found sufficient evidence that "by virtue of its … participation" on the board, the firm "had the power to fix the regulatory violations which caused the presentation of false claims but failed to do so."

In the *Martino-Fleming* case, the court found that there was enough evidence to at least demonstrate a viable claim against the corporate defendants for their alleged involvement in "knowingly" violating the law. It demonstrates that even though these firms structure their investments in a way that shields them from liability stemming from the actions of their portfolio companies, such legal structures are not ironclad. Other examples of *qui tam* lawsuits that resulted in settlement agreements involving private equity firms invested in the health care industry include *U.S. ex rel. Johnson v. Therakos* (FCA) and *U.S. ex rel. Mandalapu v. Alliance Family of Companies* (FCA and anti-kickback statute).

Considerations for Congress

Some stakeholders have criticized private equity investments in the health care industry, arguing that they can drive up patient care costs and adversely affect the health workforce. These concerns were amplified after researchers published a paper in the *Journal of the American Medical Association* in December 2023 reporting that quality of care and certain measured patient outcomes were worse in hospitals acquired by private equity investors compared to hospitals that were not acquired by private equity. In contrast, others say private equity's involvement in health care has the potential to save otherwise failing businesses as well as to reduce patient care costs.

Some Members in the 118th Congress have also indicated interest in private equity firms' investments in the health care industry. For example, some Members have requested information from private equity firms with health care investments and considered the potential for increased federal oversight of mergers and acquisitions involving health care providers. As Congress continues to assess the need for such additional measures, it could consider a variety of legislative changes. For example, Congress could update federal health care laws, such as the Social Security Act, that require certain hospitals and other providers to disclose information regarding their ownership; in one example, MedPAC has observed that the complexity of the corporate structures involved can complicate data gathering and/or enforcement.

Congress could also amend the False Claims Act or consider other legislation to target certain business practices or broaden liability for corporate investors under certain circumstances.

As some private equity acquisitions are small enough to avoid federal antitrust reporting requirements, Congress could consider lowering the statutory thresholds required for HSR Act premerger notification in specific circumstances—for example, some set of health-care-related transactions more generally. The increased review could provide additional information to the DOJ and FTC and may also require additional agency resources. In addition, Congress could also choose to regulate private equity firms more directly, or consider broader reforms to antitrust law.

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