



Health Care Compliance Precautions in Private Equity: An Ounce of Prevention...

Dec 23, 2022

Categories:

[Blogs](#)

[Health Law Matters](#)

[Private Equity Industry](#)

[Blog](#)

Authors:

[Darren S. Skyles](#)

[J. Patrick LaRue](#)

[Chad N. Eckhardt](#)

This was originally [published](#) in Reuters Legal News (Dec. 22, 2022).

Private equity's investment in health care has rapidly increased over the last few years, particularly in the acquisition of physician practices, senior living facilities, and dental practices. By way of example, in the first three quarters of 2022, Pitchbook estimates there were 725 sponsor-led deals in health care services, which exceeds 2020's entire deal number of 721.

Why is health care so attractive to private equity? Private equity firms can receive high returns on investments in health care in a short period of time. However, to do so effectively, potential investors must be aware of the heightened responsibilities that accompany the entrance into the health care sector, specifically, the adherence to health care regulations and compliance pertaining to billing and collecting for health care services.

Recent trends have shown that U.S. enforcement agencies, such as the U.S. Department of Justice, have put a heightened scrutiny on private equity firms directly involved in or owning portfolio companies in the health care industry. Owners of health care businesses (including private equity firms with a controlling interest) must be aware of all the risks and responsibilities of purchasing and managing a health care practice to ensure a strong health care compliance program and avoid unwanted legal repercussions.

Here we provide key compliance considerations for private equity investors.

Pre-closing due diligence

Private equity firms may be tempted to skim over the representations and warranties of the selling health care practice when they are under tremendous pressure to close a deal, but

conducting thorough due diligence prior to investing in the health care space is crucial to the future success of the business.

A purchaser of a health care practice will want to ensure there are not any non-compliant billing practices that could lead to problems under Medicare reimbursement, which could include serious claims of fraud and abuse in prior billing practices. Close adherence to compliance in the billing for services is critical to minimize risk and potential liability associated with operating a health care practice.

Compliance with federal and state laws

There are numerous cases where private equity firms have been held liable for violation of health care regulations. Some of the main regulations to consider include the Stark Law, the False Claims Act, the Anti-Kickback Statute, and other health care laws that specifically address fraud and abuse in billing and collecting for care reimbursed through federal programs, such as Medicare.

To generally summarize the regulations of main concern in terms of illegal referrals and billing compliance:

- The Stark Law (specific to financial relationships with physicians) and the Anti-Kickback Statute are intended to prevent health care providers from gaining profits from illegal inducement for referrals payable under a federal reimbursement program. More interestingly, the “kickbacks” do not have to be in the form of cash to be illegal under these laws, but can be anything of value, such as business courtesies or even favorable treatment under a contract.
- The False Claims Act imposes penalties for making false claims related to billing for services reimbursed through federal government reimbursement and includes illegal inducement in violation of the Stark Law and Anti-Kickback Statute, claims for services that were not provided, and other fraudulent claims.

In several recent cases, private equity firms with a majority interest in health care practices settled actions brought by the Department of Justice for millions of dollars due to their failure to act on knowledge of fraudulent actions taken by the health care providers

within those health care practices.

For example, in 2021, a private equity firm and its subsidiary were found liable in a “whistleblower” case when they failed to act on knowledge they acquired during the due diligence phase, specifically that the mental health service they purchased was using improperly supervised and unqualified staff to provide mental health services.

Under the False Claims Act, “whistleblowers,” or persons with insider knowledge, are financially incentivized to come forward and inform federal officials, as they may be entitled to a significant portion of the recovered amount. In this case, a whistleblower lawsuit was filed by a former employee. Because the private equity firm did not act on the improper supervision issue, despite having the knowledge and power to do so, it was forced into a \$25 million settlement. U.S. ex. rel Martino–Fleming v. South Bay Mental Health Centers (U.S. Dist. Ct., D. Mass.).

In another case in 2019, the U.S. Department of Justice alleged that a group of defendants, associated with a compounding pharmacy and its controlling interest private equity firm, paid illegal kickbacks to induce prescriptions for compounded drugs reimbursed by TRICARE. This lawsuit was also filed by whistleblowers under the False Claims Act, and the group of defendants settled for \$21 million. U.S. ex. rel Medrano v. Diabetic Care RX, LLC d/b/a Patient Care America (U.S. Dist. Ct., S.D. Fla.).

As these examples illustrate, health care fraud and abuse laws receive intense enforcement from the Department of Justice, but scrutiny also comes from the Department of Health & Human Services Office of Inspector General (OIG) and the Center for Medicare & Medicaid Services (CMS). Thus, it is essential that compliance with these laws are included in the checklist when private equity firms are conducting due diligence.

Purchasers should also consider negotiating robust indemnity provisions addressing health care regulatory violations or obtaining insurance that is tailored to health care regulations.

Recently, representation and warranty insurance (R&W) has been receiving increased attention, as the financial penalties for violating

the health care fraud and abuse laws can be extremely high.

Finally, aside from federal regulatory compliance, investors must consider state health care compliance requirements prior to and during their purchase. Many states such as Texas, New York, and New Jersey prevent anyone other than a licensed medical professional from owning/controlling profits from a health care practice, through such laws otherwise known as the “corporate practice of medicine.” Consequently, it is essential to organize private equity’s ownership of health care services in compliance with these laws.

Conclusion

It is the responsibility of private equity firms in the health care sector to perform thorough audits prior to acquiring a health care business and to construct effective compliance programs to continuously monitor for potential violations of health care laws. Lack of knowledge due to failure to conduct due diligence is not a viable excuse accepted by the U.S. enforcement agencies that regulate and enforce this area.

To ensure the implementation of a compliance program that will protect private equity firms from legal liability, private equity firms should consider the following elements for an effective compliance program:

- Establishing policies and procedures, which are clearly written and communicated to employees through training programs,
- Designating appropriate leadership to oversee compliance,
- Conducting frequent audits,
- Proactively responding to issues, including reporting issues to the government according to regulatory requirements,
- Incentivizing compliant behavior, such as making anonymous reports; and,
- Deterring noncompliance by promptly reprimanding employees when offenses are discovered.

Health care can be a tricky industry to invest in as a result of the strict regulations that do not necessarily exist in other industries.

Despite this, health care can also be a reasonably lucrative investment area when these regulations are adhered to and a compliance plan has been put in place, which begins at the due diligence phase in acquiring a health care practice.

For more information, contact any attorney with Frost Brown Todd's [Health Care Innovation](#) industry team.

**Legal interns Anushka Gupta and Halie Kang*

© 2026 FBT Gibbons LLP. May be considered attorney advertising in some jurisdictions.