COSMOS
Navigate the Compliance Universe

Compliance Today - September 2022
False Claims Act cases: A cautionary tale in transactional diligence

By William J. Spratt Jr. and Noam Fischman

- linkedin.com/in/william-j-spratt-jr-a1a3961b/
- linkedin.com/in/noam-fischman/

An increase in healthcare deal activity and intense diligence have resulted in False Claims Act (FCA) settlements in which the government has focused not only on the seller but the buyer as well. Third-party buyers may be exposed to liability post-sale related to their diligence findings, the seller's pre-sale operations, and the post-sale response of both parties.

This article will explore the genesis of this relatively new development and the government's approach to the liability of third-party buyers. We will suggest some preventive measures to mitigate the risk exposure of sellers and buyers. The structure of transactions will vary widely, and the structural options to mitigate or isolate liability between and among the parties, the parent entities, and affiliated organizations are beyond the scope of this article.

Our premise is simple. Buyers and sellers participating in a transaction will gain knowledge of sensitive information that may result in a whistleblower, i.e., a qui tam relator, filing an FCA suit. Similarly, a qui tam relator may already have sensitive information, and an FCA suit could be in process or could already have been filed under seal. And the conduct of the respective parties pre-sale and post-sale with respect, particularly, to the issues that surfaced in diligence may heavily influence the outcome of the case.

Case in point

The cases of the Alliance Family of Companies LLC (Alliance) illustrate an example of the focus by the Department of Justice (DOJ) on the conduct of the seller pre-sale and the conduct of both the seller and the buyer post-sale as presented in several qui tam cases.[1] Between March 6, 2017, and May 2, 2019, qui tam relators filed six different FCA cases against Alliance (or a subsidiary or affiliate thereof).[2] At their core, according to the settlement agreement,[3] these cases all involved allegations that Alliance paid independent-contractor neurologists to interpret EEG tests. Alliance allegedly would, in turn, provide these reports free of charge to nonneurologist referring physicians to enable them to bill federal payer programs for the professional interpretations that they did not perform, which the government believed to be an inducement to refer patients to Alliance. Because Alliance received referrals from these physicians, the opportunity to bill and receive payment for the professional interpretations was deemed an inducement to refer. In these cases, the relators also alleged that Alliance filed false claims for services not actually performed as required to bill for the services, and filed claims that relators contended were upcoded.

From an FCA standpoint, the *Alliance* cases are not particularly remarkable. From a transactional standpoint, they serve as a valuable "time out" moment for would-be investors and/or purchasers in businesses that derive income from federal payer programs. Ancor Holdings LP (Ancor), a Texas private investment fund, purchased a minority interest in Alliance following due diligence during which Ancor learned of the alleged conduct.

Following the sale transaction, Ancor entered into a management services agreement to manage Alliance, was paid monthly fees by Alliance, and held two seats on Alliance's Board of Directors. DOJ contended that Ancor "caused false claims when it allowed the alleged conduct . . . to continue during the period July 1, 2017 through January 1, 2020."[4] Ancor closed the sale transaction and became a minority shareholder in Alliance on July 1, 2017. Notably, the settlement agreement contains a provision that states that the parties dispute the government's rendition of the facts. Even if the parties continue to dispute the relevant facts of the underlying six FCA cases, this matter remains a cautionary tale for deal work involving targets that do business with the federal government.

The settlement agreement required Alliance to pay $13,500,000 to resolve allegations that it submitted or caused to be submitted false claims that resulted from kickbacks to referring physicians, or that it sought payment for work not performed, or it sought payment at a higher rate than was justified. In addition, Ancor agreed to pay in excess of $1,800,000 for allegedly causing false billing resulting from the continuation of the alleged misconduct of Alliance through its management services agreement with Alliance.

This case is presented to illustrate that transactional diligence may serve as a basis for liability for buyers. DOJ's allegations in settlement were essentially the following: (1) Alliance was engaged in violations of the federal Anti-Kickback Statute and FCA, (2) Ancor learned of the conduct in diligence and proceeded to purchase an interest in Alliance, (3) Ancor served on the Board of Directors of Alliance post-closing, and (4) Ancor caused the conduct to continue post-closing pursuant to a management services agreement with Alliance.

Due diligence in transactions: Lessons learned

Diligence in the life cycle of the typical transaction is fairly standard and fraught with potential FCA exposure. Diligence, when conducted and analyzed thoroughly, exposes to the buyer the warts and vulnerabilities of the seller. It will expose sensitive issues to the participants on the deal teams of both the buyer and seller. The buyer's counsel will often prepare a diligence memorandum highlighting issues surfaced by counsel and consultants engaged by the buyer to conduct diligence of the seller. The diligence memo may serve as a guide to the buyer about whether to proceed with the transaction, reprice the transaction based on additional risk, alter escrow or indemnity provisions, or abandon the transaction altogether. Issues may surface of which the seller's executives, the board of directors, and compliance officer are unaware. If the seller has conducted internal pre-sale diligence, there should be fewer surprises. Once a transaction is underway, how the parties respond to the diligence items that surface will be crucial in mitigating FCA exposure. Indeed, if not addressed, compliance concerns raised by a diligence memorandum could also serve as a road map for would-be whistleblowers and/or the government should an investigation ensue.

False Claims Act: "Knowingly" in transactional diligence

Virtually all FCA cases fall into one of three buckets. The first two buckets all derive from billing the government for services or products delivered to it or its beneficiaries. The FCA creates civil (and, in some cases, criminal) liability for knowingly presenting a false claim or knowingly presenting a false statement in support of a claim for payment. The same is true for the third FCA bucket, that is, an entity that owes the government money but knowingly makes a false claim or statement or otherwise takes actions to retain the money that it otherwise owes to the government (e.g., failure to repay overpayments 60 days after discovery, the "60 Day Rule").[5] The common denominator for all FCA cases is that the conduct must be made "knowingly."

FCA liability of the parties will turn on whether the parties "knowingly" submitted false claims. The FCA defines "knowing" or "knowingly" as: (i) the party having actual knowledge of the falsity of the information, (ii) the party acting in deliberate ignorance of the truth or falsity of the information, or (iii) the party acting in reckless

disregard of the truth or falsity of the information. Proof of specific intent to defraud the government is not required to establish that there has been a violation of the FCA.[6]

Information, facts, or conduct discovered in diligence and perhaps memorialized in diligence memoranda in the course of a transaction will be fully discoverable during an FCA investigation or proceeding. While the determination of the significance of the information, facts, or conduct, and the application of law to the facts by the respective counsel to each of the parties may differ, the facts will be known to the parties and their deal teams and advisers. It would be prudent to assume that the government's investigators will discover the facts, and the government investigators' and prosecutors' determination of the significance of the facts and application of the law may differ from that of the parties. Therefore, it would be prudent for buyers and sellers to take steps to mitigate risk of FCA exposure in advance of commencing a healthcare transaction.

Prepare for the sale transaction

The seller would be well-advised to prepare for the sale. The cliché "an ounce of prevention is worth a pound of cure" is instructional. Prophylaxis can be an effective deterrent to FCA and other types of financial liability in connection with transactional diligence. Conduct a compliance audit of the most critical areas of the company. If the selling company has a robust and effective compliance program, the diligence and sale process should be more straightforward. In companies without a robust and effective compliance program, issues will surface for the first time in preparation for a sale process. But, in all cases, assume that compliance issues will surface in diligence, or that the buyer's counsel will have a different view of an issue. Counsel for the buyer and the seller may disagree on the application of the facts to the law. It is, therefore, to the seller's advantage to conduct a compliance audit or gap analysis and a thorough review of the diligence documents and seek advice of counsel to prepare for the sale transaction.

A fresh review of operations, reports, and analyses by the compliance officer and counsel for the company may lead to the discovery of issues that either have not surfaced or were unresolved previously. Develop an action plan for addressing issues in order of priority before the sale process and, if permissible, post-sale. Limit access to sensitive information to only those members of the team who "need to know."

As the parties commence the transaction with a confidentiality and nondisclosure agreement, followed by a diligence request memorandum, followed by a flurry of uploading documents into a virtual data room (VDR), a hasty diligence process may result in the inadvertent disclosure of highly sensitive information to a potential whistleblower. Of course, the records of the compliance program should not be posted to a VDR as they often contain highly sensitive information, including self-audits, audits by third-party consultants, reports by employees of perceived compliance issues, and reports of the compliance officer to the board of directors. The compliance officer will play an important role in the diligence process, and that role will include the opportunity to review materials to avoid posting sensitive documents in the VDR. Advance scrutiny by the compliance officer and counsel of the material before it is uploaded into the VDR should reduce the potential for sensitive issues reaching a broader audience.

Staging or creating an internal VDR prior to the sale process will enable the seller's deal team to review the documents in advance of being uploaded into a buyer's VDR. The seller's deal team will have an opportunity to identify issues and be prepared to address them in management calls throughout the sale process. Restricting the size and scope of the seller's deal team and maintaining strict confidentiality should reduce the opportunity for a qui tam relator to obtain information that will form the basis of an FCA complaint.

Intermediaries representing both sides of a transaction will often be privy to the more sensitive information, and confidentiality is critical. The seller's use of investment bankers to guide the sale process can be instrumental in

identifying and vetting qualified buyers. And interested buyers will often engage consultants to audit, among other areas, billing, coding, clinical documentation, patient accounts, and collection policies. Transaction counsel should control the scope and manner of disclosure of sensitive information. Ensuring that the consultants are bound by appropriate confidentiality agreements and that the process complies with HIPAA will be important in limiting the scope of access and potential liability. The administrator of the VDR will control the number of individuals with access to the VDR and will assist in protecting sensitive information from misuse by a qui tam relator.

Lessons learned in diligence

Diligence will reveal issues that must be addressed immediately, issues that may be addressed pre-closing, and issues to be addressed post-closing. For example, the 60 Day Rule of the Affordable Care Act, referenced above, requires that repayment of overpayments must be made within 60 days of discovery.[7] But, if the billing practices that gave rise to the overpayment are ongoing, they must be corrected immediately.

Upon closing, the parties may be focused on transition and integration issues. Implementation of actions to remediate compliance issues noted in diligence may be delayed or overlooked. When an issue surfaces in diligence, the failure to address it properly and timely provides an opportunity for an FCA claim by a relator or the expansion of culpable parties by the DOJ in settlement discussions or at trial.

Relators are often employees of the organization who have inside information about the company, compliance issues previously detected, and perhaps access to the transactional diligence. Frequently, the decision to become a relator as a corporate whistleblower stems from a lack of responsiveness by the entity in addressing compliance complaints. A company with a robust compliance program is more likely to have logged compliance issues for resolution. And the dispositions may have been noted by the company in the compliance program files. The documentation of the dispositions may be helpful or harmful to the company, depending on the content.

During due diligence, buyers will inquire about such issues or complaints and review the status or disposition; sellers should be prepared to address with the buyers a summary of the nature of open and closed cases. The absence of any compliance issues or initiatives being recorded by the compliance program may suggest to the buyer that the seller's program is ineffective. With regard to closed or open cases, remedial measures taken or to be taken may mitigate the impact of an FCA case and could save the company substantial defense costs (and personnel time), and perhaps the assessment of penalties as well. In larger organizations, timely mitigation efforts may limit liability to one entity and prevent the spread to other related companies, the parent, executives, board members, and investors.

As the parties proceed to close the transaction, it would be prudent to develop a to-do list gleaned from issues that surfaced in pre-sale internal diligence and management calls, diligence memoranda of the buyer's counsel, and audit reports prepared by consultants. The parties responsible for following up on each of the action items should be identified and a time frame established for completion. Issues noted may be logged by the compliance officer for follow-up and included in status reports to the board of directors. Critically, robust remedial action plans can be used (and have been successfully used) to show the absence of scienter (i.e., guilty knowledge or intent) to win FCA cases.

Role of the board of directors in transactions

The responsibility of the board in overseeing compliance is especially important in the transactional context. While senior management often run the transactions, and senior management are usually represented on the board, the Office of Inspector General states that "a Board must act in good faith in the exercise of its oversight responsibility for its organization, including making inquiries to ensure: (1) a corporate information and

reporting system exists and (2) the reporting system is adequate to assure the Board that appropriate information relating to compliance with applicable laws will come to its attention timely and as a matter of course."[8] It is especially important to fulfill this role of the board in connection with transactions in the diligence process.

The Office of Inspector General acknowledges that healthcare companies have developed various organizational structures to enable the board to oversee the compliance functions, depending on the nature and scope of the organization. Regular board involvement in the compliance and internal audit functions and, by extension, in the transactional process will enable the board to fulfill its oversight responsibilities and mitigate risk to the company throughout the transaction process.

In closing, in the memorandum entitled "Individual Accountability for Corporate Wrongdoing," dated September 9, 2015, Deputy Attorney General Sally Q. Yates indicated that one of the most effective ways to combat corporate misconduct is by seeking accountability from the individuals who perpetrated the wrongdoing. Since that date, the DOJ has diligently investigated not only the companies alleged to be culpable, but the individuals alleged to be involved in corporate misconduct as well. The settlements of FCA cases increasingly include settlements with allegedly culpable individuals in the organizations.

Takeaways

- The Department of Justice (DOJ) is focusing on transactions, especially those involving private equity.
- Sellers should prepare for a sale transaction by conducting an internal compliance audit as a prophylactic measure.
- The buyer's post-transaction conduct may expose it to False Claims Act (FCA) liability.
- Assume that there are no secrets. All things are known or will be known.
- Individuals are being held personally accountable by the DOJ for corporate wrongdoing in FCA cases and settlements.

1 United States ex rel. Vicki Fuller v. Respiratory Sleep Solutions, et al., No. 4:17-cv-01197 (S.D. Tex.); United States ex rel. Joshua Calcanis v. Alliance Family of Companies, Inc., et al., No. 4:19-cv-1497 (S.D. Tex.); United States, et al. ex rel. Jane Doe v. Alliance Family of Companies, LLC, et al., No. 4:19-cv-1213 (S.D. Tex.); United States, et al. ex rel. Amy McKay v. Alliance Family of Companies, LLC, et al., No. 4:18-cv-1949 (S.D. Tex.); United States, et al. ex rel. Joann Krasnov v. Alliance Family of Companies, LLC, et al., No. 4:19-cv-4886 (S.D. Tex.).
2 U.S. Department of Justice, "EEG Testing and Private Investment Companies Pay $15.3 Million to Resolve Kickback and False Billing Allegations," news release, July 21, 2021, https://www.justice.gov/opa/pr/eeg-testing-and-private-investment-companies-pay-153-million-resolve-kickback-and-false.
3 Settlement Agreement, United States ex rel. Bhuvana Mandalapu, M.D., and Ramakrishna Chava, M.D., et al. v. Alliance Family of Companies, Inc., et al., No. 4:17-cv-00740 (S.D. Tex.).
4 United States, et al. ex rel. Jane Doe v. Alliance Family of Companies, LLC, et al., No. 4:19-cv-1213 (S.D. Tex.).
5 This is referred to as a reverse FCA scenario; 31 U.S.C. § 3729 (a)(1)(G) .
6 31 U.S.C. § 3729(b) .
7 42 U.S.C. § 1320a-7k .
8 U.S. Department of Health & Human Services, Association of Healthcare Internal Auditors, American Health Lawyers Association, and Health Care Compliance Association, *Practical Guidance for Health Care Governing Boards on Compliance Oversight*, April 20, 2015, 2, https://oig.hhs.gov/documents/root/162/Practical-Guidance-for-

Health-Care-Boards-on-Compliance-Oversight.pdf..