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Growing Scrutiny of Private Equity in Health Care

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The presence of private equity (PE) investment has exploded in recent years in all areas of the health care sector. PE in health care is a good thing when done right: It can pave the way for much needed innovation, efficiency, and nontraditional care delivery models. However, government regulators, media journalists, some health care practitioners, and private parties are watching PE investment with growing suspicion that profit-driven goals may conflict with the quality of care for patients. Indeed, PE firms often do not have the luxury of long time horizons for their investments and often have investors that expect relatively quick financial returns. News outlets have added fuel to concerns by publishing reports alleging decreases in quality care when PE firms acquire health care businesses. Additionally, PE firms do not always appreciate the complex regulatory environment in which health care operates — an environment where a regulatory misstep can become a major fraud and abuse issue. That is drawing the focus of government enforcers. Meanwhile, PE investment is capturing the attention of antitrust regulators concerned about industry roll-ups and the lessening of competition.

The Biden Administration has made several pronouncements of its stance against what it calls Wall Street's "takeover" of health care. In accordance with this policy, anti-fraud and abuse government enforcers are becoming increasingly hostile to PE. Enforcers are looking beyond target companies to include the companies that invest in and manage them. In the last three years, PE firms have paid millions of dollars to settle government allegations that they knew of the allegedly improper practices of companies they backed, including a PE firm that allegedly knew of a scheme to pay purported kickbacks to marketers; a PE firm that allegedly learned of a purported unlawful scheme to submit false claims during due diligence of a company it invested in but did not put an end to the practice after investing; and a PE firm that held the majority of seats on the board of directors of a company that allegedly submitted claims for Medicaid reimbursement for unlicensed, unqualified, and inappropriately supervised patient care.

PE companies are also facing increased scrutiny by antitrust regulators. The Department of Justice's (DOJ) Antitrust Division has identified as among its enforcement priorities the cumulative competitive impact of PE-backed roll-ups, particularly smaller transactions that do not require Hart-Scott-Rodino Act (HSR) reporting which may over time reduce competition; market distortions stemming from PE

prioritizing short-term financial gains and cost cutting over innovation and quality; and interlocking directorates which violate Section 8 of the Clayton Act (Section 8 prohibits directors and officers from serving simultaneously on the boards of competing corporations subject to limited exceptions because of the potential for anti-competitive effects such as facilitating collusion – e.g. pricing fixing and market allocation). This prioritized targeting of PE by DOJ, coupled with escalating rhetoric from antitrust enforcement leadership at DOJ and the Federal Trade Commission (FTC), suggests increased investigations and enforcement actions are forthcoming. One area where we see these priorities in action is that DOJ appears poised to proactively scrutinize interlocks as part of standalone investigations and enforcement actions (rather than only during merger or transaction reviews). DOJ can rely largely on publicly available information and filings to do so. In October 2022, DOJ announced the resignation of seven directors from the corporate boards of five companies after DOJ sent letters to multiple companies, including PE firms, expressing concerns that their board composition constituted unlawful interlocks in violation of Section 8 and warning that enforcement actions might be coming. While historically PE companies have not been the target of aggressive antitrust enforcement, they should be prepared for a different experience moving forward.

Private plaintiffs have gotten in on the action against PE firms as well, bringing lawsuits against PE-backed companies and their investors for violations of state corporate practice of medicine laws. Corporate practice of medicine laws prohibit corporations from practicing medicine or otherwise exercising undue influence on physicians and their medical care choices.

Despite their laudable contributions to innovation, efficiency, and influx of cash investment into the health care sector, PE firms do not always get a good rap, and we anticipate the unflattering buzz surrounding PE in health care continuing in 2023. Well-intentioned investors may not always be aware of the regulatory hurdles facing health care companies; downstream consequences to patient care of certain practices; or the evolving priorities and concerns of enforcers. Investors should seek to appreciate the complex regulatory scheme, including fraud and abuse, antitrust, and corporate practice of medicine risks, and the priorities and philosophies of enforcers, so that they can take proactive steps to manage risk.

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