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Insights

WHAT PE FIRMS NEED TO KNOW ABOUT THEIR FALSE CLAIMS ACT RISK

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Private equity firms have recently become targets of False Claims Act (FCA) liability. This new risk exposure comes from portfolio companies that do business with the government, which necessarily exposes those portfolio companies to FCA litigation. The companies and their executives have faced FCA risk for decades. Now, in their constant quest to add additional sources of funds to pay settlements or judgments, the Department of Justice (DOJ) and whistleblowers, who are the typical genesis of FCA cases, are sinking their hooks into PE firms as another liable party that must pay handsomely and be held responsible.

At a very high level, the FCA is what the government uses each year to recover *billions* of dollars from individuals and companies that defraud the government. Not only are the fraudulently received funds recovered, but the damages can be up to triple the amount the government paid, and there are also very high monetary penalties for *each* false claim that is submitted. The typical exposure of a FCA case is *10s to 100s of millions of dollars of* ***potential liability***.

Alarming Statistics:

For the past 10 years:	DOJ has recovered between **$2.9 and $5 billion** in settlements and judgments from FCA cases;
	The lion's share of the amount recovered is from law suits brought by whistleblowers under the *qui tam* provisions of the FCA;
	Whistleblowers collectively received between **$271 and $714 million** as their share of the recovery; and
	Over half of the amount recovered came from the health care industry.
States, which have their own False Claim Act statutes, recover **additional millions of dollars** from FCA cases.	

Other highly targeted areas include housing and mortgage fraud, procurement fraud, fraud associated with federal education funds, and customs fraud.

Specific Risk to PE Firms

This area of the law is still developing. It is unknown whether pursuing PE firms in an FCA context is a new trend that will be short-lived or is a harbinger of things to come. The most recent end to an FCA case involving a PE firm resulted in a settlement of $21.05 million – with the PE firm contributing an undisclosed amount toward the settlement. Notably, in its press release announcing the settlement, the DOJ highlighted that both the prosecution and end result were a sign of the government's "continuing commitment to hold all responsible parties to account" for submitting false claims to the government.

The current, limited information shows that PE firms face FCA risk when they are more than just a passive investor in the portfolio company and exert a certain level of control. This is typically demonstrated through active participation on the portfolio company's board of directors or involvement in the day-to-day operations of the portfolio company.

How to Protect Yourself and Mitigate Risk

It is imperative PE firms are aware of their portfolio companies that face FCA risk and take action to limit their potential exposure. FCA risk should also be a significant focus of due diligence going forward.

If the portfolio company becomes the subject of a FCA inquiry by the DOJ or other government agency, or is alerted by a whistleblower of potential liability, the initial response is critical and has long-lasting consequences to the entire life of the investigation or lawsuit. PE firms should retain experienced counsel as soon as they become aware of a potential issue to ensure they respond appropriately and effectively. Retention of counsel also sends a clear message to the government that the company is taking the matter very seriously.

Suggested best practices:

- Ensure your portfolio companies that do business with the government have robust and proactive compliance programs that address their industry's specific risk areas. PE firms should promote enforcement of the compliance programs and on-going training.
- Be mindful of how you provide oversight to your portfolio companies, with the understanding that by participating in decision-making you are assuming certain responsibilities.
- If you are concerned about risk from your current portfolio companies, retain experienced counsel to assess those that are a potential threat and then apprise you of any potential or

actual issues and guide you through how to proactively address them and mitigate your risk. For new acquisitions, ensure FCA risk is evaluated during the due diligence phase.

- If you become aware of an issue, either through a whistleblower or through a government investigation, immediately retain experienced counsel to conduct an independent, internal investigation and represent the company through the life of the matter.

RELATED PRACTICE AREAS

- White Collar
- False Claims Act
- Investigations

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