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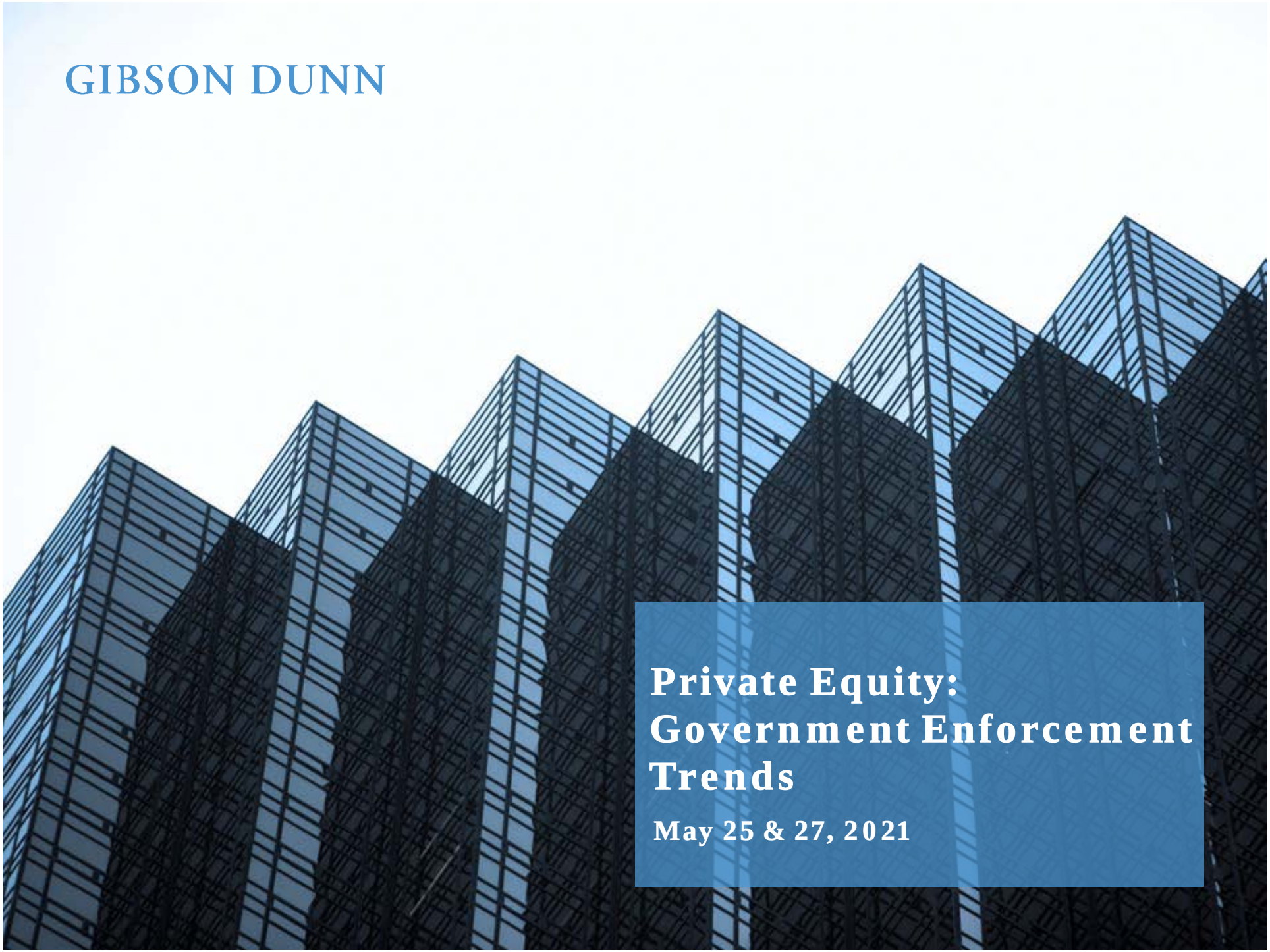

# Private Equity: Government Enforcement Trends

May 25 & 27, 2021

# Moderator & Panelists

## Moderator

**Nick Hanna**, who most recently served as United States Attorney for the Central District of California, is a litigation partner in Gibson Dunn's Los Angeles office and co-chairs the firm's global White Collar Defense and Investigations Practice Group. Mr. Hanna's practice focuses on representing corporations in high-stakes civil litigation, white collar crime, and regulatory and securities enforcement – including internal investigations, False Claims Act cases, special committee representations, compliance counseling and class actions.

## Panelists

**Michael Celio** is the partner-in-charge of Gibson Dunn & Crutcher's Palo Alto office and a sought-after trial lawyer with more than two decades of experience trying cases in Silicon Valley and beyond. He maintains a wide-ranging trial practice and has tried more than two dozen cases to verdict in state and federal court. He is a recognized expert in the field of securities litigation and is particularly experienced in defending venture capital and private equity firms and their partners as well as their portfolio companies.

**Michael M. Farhang** is a former federal prosecutor and a partner in the Los Angeles office of Gibson, Dunn & Crutcher. He is a Chambers-ranked attorney and practices in the White Collar Defense and Investigations and Securities Litigation Practice Groups. Mr. Farhang is an experienced litigator and trial attorney who has earned more than $40 million in recoveries for corporate clients pursuing fraud, contract, and M&A-related claims.

# Panelists

**Diana M. Feinstein** is a partner in the Los Angeles office of Gibson, Dunn & Crutcher. She is a member of the firm's Securities Litigation and White Collar Defense and Investigations Practice Groups. Ms. Feinstein's practice focuses on complex litigation, including securities litigation and high-value commercial litigation. She also focuses on white collar defense and investigations.

**John Partridge**, a Co-Chair of Gibson Dunn's FDA and Health Care Practice Group and Chambers-ranked white collar defense and government investigations lawyer, focuses on government and internal investigations, white collar defense, and complex litigation for clients in the life science and health care industries, among others. Mr. Partridge has particular experience with the Anti-Kickback Statute, the False Claims Act, the Foreign Corrupt Practices Act, and the Federal Food, Drug, and Cosmetic Act, including defending major corporations in investigations pursued by the U.S. Department of Justice and the U.S. Securities and Exchange Commission.

**Eric D. Vandevelde** is a litigation partner in Gibson Dunn's Los Angeles office. He is a former federal prosecutor and an experienced trial and appellate attorney. Mr. Vandevelde has been selected by Chambers USA in the area of White-Collar Crime & Government Investigations, has been repeatedly recognized as a "Super Lawyer" by Super Lawyers Magazine, and was named one of the Top 20 Cyber/Artificial Intelligence Lawyers in California by The Daily Journal.

# Panelists

**Debra Wong Yang** is a partner in Gibson, Dunn & Crutcher's Los Angeles office. Reflective of her broad practice and comprehensive abilities, Ms. Yang is Chair of the Crisis Management Practice Group, former Chair of the White Collar Defense and Investigations Practice Group, and former Chair of the Information Technology and Data Privacy Practice Group. She leads critical representations involving a wide variety of industries, economic sectors, regulatory bodies, law enforcement agencies, global jurisdictions and all types of proceedings.

**James L. Zelenay** is a partner in the Los Angeles office of Gibson, Dunn & Crutcher where he practices in the firm's Litigation Department. Mr. Zelenay has extensive experience in defending clients involved in white collar investigations, assisting clients in responding to government subpoenas, and in government civil fraud litigation. Mr. Zelenay also has substantial experience with the federal and state False Claims Acts and whistleblower litigation.

**Tyler H. Amass** is Of Counsel in the Denver office of Gibson, Dunn & Crutcher. Mr. Amass practices in the firm's Litigation Department, with a primary focus on commercial and business litigation, including M&A litigation, breach of fiduciary duty and securities law claims against companies and directors, corporate control contests, activist-investor litigation, and breach of contract claims.

# MCLE Certificate Information

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- Most participants should anticipate receiving their certificate of attendance in four weeks following the webcast
- Virginia Bar Association members should anticipate receiving their certificate of attendance six weeks following the webcast
- Please direct all questions regarding MCLE to CLE@gibsondunn.com

# Agenda

- Introduction
- Part 1 - Tuesday, May 25th
  - Data Security and Privacy Laws (Eric Vandevelde)
  - False Claims Act (James Zelenay)
  - COVID Relief (Debra Wong Yang)
  - SEC Enforcement Priorities (Michael Celio)
- Part 2 - Thursday, May 27th
  - AML Issues (Diana Feinstein)
  - FCPA (Michael Farhang)
  - Healthcare (John Partridge)
  - Post M&A Indemnification and Fraud Claims (Michael Farhang/Ty Amass)

# Introduction

# Increased Government Focus on Private Equity

- Rep. Bill Pascrell, chairman of the House Ways and Means Committee (3/25/2021):
  - "It's past time for a **bright light** to be shined on **how private equity in our health system affects patient safety, costs and jobs** . . . . Private equity's expansion to health care is troubling because private equity's main focus on profits is often at odds with what is best for patient care."

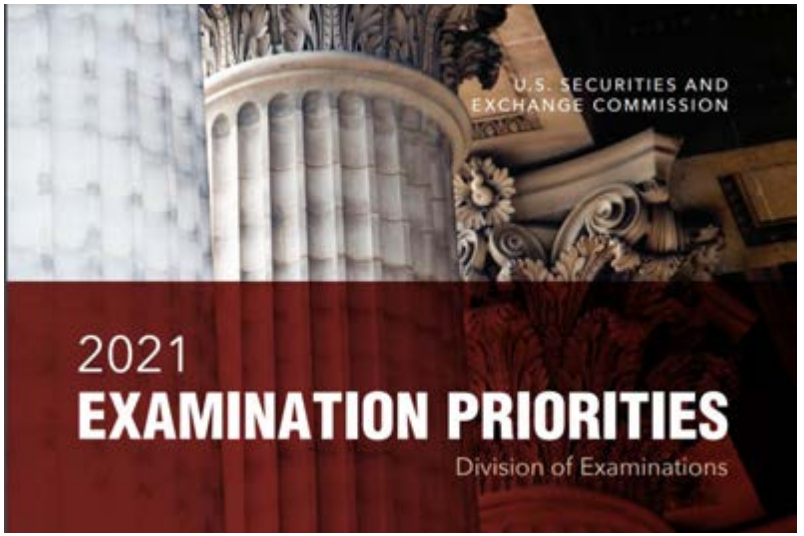
# Increased Government Focus on Private Equity

- Former Principal Deputy Assistant Attorney General, DOJ Civil Division (6/26/2020):
  - "**Our enforcement efforts may also include**, in appropriate cases, **private equity firms that sometimes invest in companies receiving CARES Act funds.** When a private equity firm invests in a company in a highly-regulated space like health care or the life sciences, the firm should be aware of laws and regulations designed to prevent fraud . . . . Where a private equity firm knowingly engages in fraud related to the CARES Act, **we will hold it accountable**."

# Increased Government Focus on Private Equity

SEC 2021 Examination Priorities:

> "... the Division will review for, among other things: **preferential treatment of certain investors by advisers to private funds** that have experienced issues with liquidity, including imposing gates or suspensions on fund withdrawals; **portfolio valuations and the resulting impact on management fees**; adequacy of disclosure and compliance with any regulatory requirements of cross trades, principal investments, or distressed sales; and **conflicts around liquidity**, such as adviser led fund restructurings, including stapled secondary transactions where new investors purchase the interests of existing investors while also agreeing to invest in a new fund."



# Sources of Inquiry

**DOJ**

**SEC**

**OFAC**

**FinCEN**

**CFTC**

**WHISTLEBLOWERS**

# Data Security and Privacy Laws

# How Did We Get Here?

| | |
|---|---|
| **June 2018** | CCPA signed in new form by legislature |
| **October 2019** | CCPA amendments; draft of AG's CCPA regulations |
| **January 2020** | CCPA takes effect |
| **August 2020** | CCPA AG regulations take effect |
| **November 2020** | CPRA approved by California voters |
| **January 2022** | CPRA look-back period begins |
| **July 2022** | CPRA regulation deadline |
| **January 2023** | CPRA takes effect |
| **July 2023** | CPRA becomes enforceable |

# Who Must Comply with the CCPA?

For-profit entities doing business in California that satisfy ***one*** or more of the following thresholds:

**(A)** Annual gross revenues in excess of $25M

**(B)** Deals with personal information of 50,000 or more consumers, households, or devices

**(C)** Derives 50 percent or more of its annual revenues from selling personal information

Cal. Civ. Code § 1798.140(c)(1)

***Despite not having typical "consumers," many businesses are covered if they have over $25M in annual gross revenue and do business in California***

# CCPA: "Personal Information"

**"Information that identifies, relates to, describes, is reasonably capable of being associated with, or could reasonably be linked, directly or indirectly, with a particular consumer or household"**

| | | | |
|---|---|---|---|
| IP addresses | ***Purchasing or consuming histories or tendencies*** | Browsing history, search history, and information regarding a consumer's interaction with an Internet Web site, application, or advertisement | Biometric information |

| | | |
|---|---|---|
| Geolocation data | Audio, electronic, visual, thermal, olfactory or similar information | ***Inferences drawn from any of this information*** |

*Cal. Civ. Code § 1798.140(o)*

# CCPA: Rights of Californians

**Understand** what personal information is collected and why

**Delete** personal information, subject to exceptions

**Access** what personal information is **sold or shared**, and to/with whom

**Opt out of the sale of their information** (if consumer is under 16 years of age, must opt in)

**Not be discriminated against** for exercising any of these rights

**Private Right of Action** (data breach context)

# Potential Liability

- **Data breach provision – private right of action**
  - Statutory damages available ($100 - $750 *per* consumer, *per* incident)
  - Actual damages too, whichever is greater

- **All other violations – AG enforcement action**
  - Civil penalties up to $2,500 per violation, or $7,500 if intentional

# CPRA: What's New?

- **Core Concepts**
  - Slight **narrowing of covered "businesses";** broadened "**publicly available**" definition
  - New concept of "**sensitive personal information**"
  - Expansion on concept of "**sharing**"

- **New Rights for Consumers**
  - **Limit use** of "sensitive personal information"
  - **Right to correct**
  - Expanded rights
    - Expanded **right to opt of "sharing"**
    - **Right of non-discrimination** expanded to employers

- **Obligations for Businesses**
  - Additional responsibilities as to new rights (correction, sensitive personal information, etc.)
  - Data hygiene/minimization (including secondary use)
  - New notice and opt-out rules
  - Additional request to know obligations
  - Contract requirements for third parties (and other service provider obligations)
- **Regulator**
  - **California Privacy Protection Agency**
  - No more notice-and-cure procedure for administrative actions
  - No expansion of private right of action

# California Privacy Protection Agency


- **New agency created**
  - $10M annual budget for enforcement
  - Anticipated 20 person team
  - **Will take on rulemaking and enforcement with the AG**
- **Administrative Fines**
  - Similar to CCPA / AG but violations relating to minors will yield higher fine
  - $2,500 fines per violation. § 1798.199.55(a)(2)
  - $7,500 for intentional violations/minors. *Id.*
- **Administrative Enforcement**
  - **Notice-and-cure procedure eliminated for administrative actions** and made discretionary. § 1798.155(a)
  - Agency may **consider lack of intent to violate the law or voluntary efforts to cure**, when deciding whether to investigate a complaint or provide a business with time to cure
    § 1798.199.45

# Private Equity Risks – Know Before You Go

- **Foundational questions PE Firms need to be asking:**
  - What data does the portfolio company collect and maintain? What third-party data processing occurs? Does the company itself even know?
    - Even if B2B and not "consumer-focused", consider employee info, business partner info, marketing info
    - Data mapping?

  - How does the portfolio company use data? What does the company tell the world about its use? Are disclosures consistent with actual practice?
    - Consider advertising practices, use of AI
  - How has the portfolio company addressed data privacy risks? Who's in charge?
  - How has the portfolio company addressed cybersecurity/data breach risks? Regular security audits? Incident response plan? Table-tops?
  - What did the portfolio company do to comply with CCPA? Is it sufficient?

# Private Equity Risks – CPRA Preparation?

- Notices must disclose new consumer rights and business responsibilities (i.e., right to opt-out of sale or sharing of PI; right to limit use/disclosure of sensitive PI)
- Requests to Know broadened (i.e., time period expanded; specific pieces of PI)
- Data Minimization & Retention


- Secondary Use Restrictions
- Third Party Requirements (e.g., relay deletion requests)
- Affirmative Security Obligations
- Profiling (artificial intelligence) restrictions
- High Risk Assessments

# False Claims Act

# What is the False Claims Act?

- Federal statute – 31 U.S.C. §§ 3729-3733 – that prohibits fraud on the government
- Often called "Lincoln's Law" – was enacted during Civil War to stop war profiteers from defrauding the Union Army
- Prohibits "false claims" for payment
- Last year more than $2.2 billion recovered
- Imposes massive penalties – virtually automatic **treble damages**, as well as automatic **civil penalties** of up to appx. $23,331 for each false claim submitted to the government
- The scope is broad:
  - Not limited to traditional false claims any longer
  - False certification theories
  - Fraudulent inducement theories
  - Reverse false claims theories
  - Conspiracy theories


For sugar [the government] often got sand; for coffee, rye; for leather, something no better than brown paper; for sound horses and mules, spavined beasts and dying donkeys; and for serviceable muskets and pistols the experimental failures of sanguine inventors, or the refuse of shops and foreign armories.

# What industries are affected?

- Healthcare
- Life sciences
- Defense contractors
- Infrastructure / transportation
- Government contracts
- Financial sector
- Education

- Basically, wherever government dollars go...

    . . . Federal, state, or local . . .

# Why is the FCA so dangerous?

- Damages and collateral consequences are catastrophic
- Broad definition of "knowledge"
- Can be filed by gov't or *qui tam* whistleblowers
    - Whistleblowers get up to 30% of what they recover on government's behalf
- DOJ is dedicated to pursuing FCA claims
    - Senator Grassley's "loyalty pledge"
    - Over 200 Main Justice attorneys devoted to FCA matters
    - Local US Attorney's Offices
    - AGs and local prosecutors

# How False Claims Act Applies to Private Equity

- Traditionally portfolio companies were targets
  - Healthcare and life sciences companies
  - Educational companies
  - Government contractors
  - Defense contractors
  - Etc.
- But that has begun to change

# False Claims Act and Private Equity

- *United States ex rel. Medrano v. Diabetic Care Rx, LLC* (S.D. Fla., 2018)
  - Qui tam suit against Diabetic Care Rx, LLC, d/b/a Patient Care America ("PCA")
  - Also sued Riordan, Lewis & Haden, Inc.
    - Private Equity firm in Los Angeles
    - Manager of PE fund, RLH Investors III, LP, which owned controlling stake in PCA
  - Alleged PCA presented false / fraudulent claims for compounded drugs to TRICARE, federal health program for military and families
  - Alleged that claims were false (tainted) because PCA allegedly paid commissions ("kickbacks") to "marketers" to target military members and families, and marketers allegedly paid kickbacks to doctors to prescribe drugs regardless of patient need.
  - Other alleged misconduct (improperly paying co-pays, selecting highest reimbursed compounds, etc.)

# *Medrano* Case

- Government filed complaint in intervention February 2018
- Also sued PE Firm
  - Alleged that "[a]t all relevant times, RLH managed and controlled PCA on behalf of the private equity fund through two RLH partners, . . . who served as officers and/or directors of PCA and of a holding company with an ownership interest in PCA"

# Gov't Allegations as to RLH in *Medrano* Case

- **RLH acquired PCA and intended to sell it for a profit in 5 years**
- **RLH board members pushed PCA into compounding because of the "extraordinarily high profitability," which could result in "quick and dramatic payback"**
- **RLH board members pushed to hire new CEO that would drive profits**, but that recruitment agency warned would "require more careful management than [RLH] may wish to provide"
- **CEO's written agreement was incentive-based and stated he would keep RLH informed and seek its involvement in important decisions**
- CEO recommended to board to hire pharmacist in part based on his "networks" in the area of compounding which would "generate referrals as soon as we are operational"

# Gov't Allegations as to RLH in *Medrano* Case (Cont'd)

- RLH approved CEO's plan to use independent contractors to generate prescriptions
- RLH knew most of prescriptions were coming through contractors and being billed to TRICARE
- RLH periodically funded commission payments to marketers before PCA received reimbursement
- **"As an investor in health care companies, RLH knew or should have known when it acquired PCA in July 2012, that health care providers that bill federal health care programs are subject to laws and regulations designed to prevent fraud, including the AKS"**
- RLH board member sent emails regarding the expectation that new laws would result in "serious changes in TRICARE reimbursement to occur"

# *Medrano*: The Story of the Case

- April 2018 – PE firm moved to dismiss, arguing no basis for suit against PE firm and that PE firm had no role or knowledge of any alleged fraud
- Dec. 2018 – Magistrate recommended dismissal of one of three claims, with leave to amend
- March 2019 – District court judge agreed with Magistrate recommendation
- March/April 2019 – Government files amended complaint; PE firm files motion to dismiss
- July 2019 – Parties announce they are on the verge of settlement
- September 2019 – Parties announce settlement of **$21.4 million**
- Government press release: "We will hold pharmacies, and **those companies that manage them**, responsible for using kickbacks to line their pockets at the expense of taxpayers and federal health care beneficiaries."

# Since *Medrano*

- *U.S. ex rel. Johnson v. Therakos, Inc.* (E.D. Pa. No. 12-1454)
  - November 19, 2020 – DOJ announces settlement with J&J and the Gores Group, a PE firm (for $1.5MM), based on claims portfolio company (Therakos) engaged in off-label marketing
- *U.S. ex rel. Martino-Fleming v. South Bay Mental Health Center, Inc.* (D. Mass.)
  - PE firm, H.I.G. Capital, sued by relator in connection with ownership of portfolio mental health care provider allegedly providing services by unqualified employees
  - Court: PE firm may be liable for causing false claims "where the submission of false claims by another entity was the foreseeable result of a business practice" and "a defendant may be liable if it operates under a policy that causes others to present false claims."
- Department of Education reportedly seeks PE firms to sign PPAs
- DOJ explicitly indicates PE firms are targets of CARES Act compliance
- PPP events

# Lessons for PE Firms

- Be aware of FCA / regulatory consequences of investment that implicates government funding
- Diligence on government certifications / promises
- Consider level of involvement with portfolio company
- If potential qui tam under foot, respond immediately
    - Warning signs – CID, unanticipated audits/reviews, statements in exit interviews, websites
    - Defenses
- Strong HR program in place / strong compliance systems in place
- Documentation / transparency

# COVID Relief

# Background

- **Coronavirus Aid, Relief and Economic Security Act (“CARES” Act)**
  - $2.2 trillion economic stimulus bill, largest in U.S. history
  - Signed into law on March 27, 2020
  - Flagship offering was the **Paycheck Protection Program (“PPP”)**
    - Loans to provide a **direct incentive for small business to keep their workers on payroll**
    - Borrowers eligible for PPP loan forgiveness
    - Deadline to apply through SBA has been extended to May 31, 2021

# PPP and Private Equity


- General eligibility: Any business –with its affiliates –that has 500 or less employees, or meets the SBA's industry size standard if more than 500, is eligible to apply.

- SBA's April 24, 2020 Interim Final Rule ("IFR") and Answers to FAQs:
  - **Explicitly prohibited private equity firms** from receiving a PPP loan
  - Clarified that **private equity-backed portfolio companies can qualify** for PPP loans **provided they meet specific requirements.**
  - Provided a "**safe harbor**" for any borrower that repaid its loan by May 18, 2020, if the borrower determined that it was not eligible based on the new rule



Source: *Interim Final Rule*, SBA & Dept. of Treasury, (Apr. 28, 2021); *PPP Loans FAQs*, Department of Treasury, (Apr. 6, 2021).

# Relevant Timeline

**March 27, 2020:** **CARES Act** is signed into law.

**May 18, 2020:** Any borrower that applied for a PPP loan before April 24 **could return its loan before May 18** and will be deemed by the SBA to have made its required certification on the loan application in good faith.

**April 24, 2020:** The PPP and Health Care Enhancement Act is signed into law, and **PPP first draw loans are issued.**

On the same day, SBA posts an **interim final rule clarifying that private equity companies are not eligible for PPP loans** and **providing a limited safe harbor** for borrowers to return loans.

**July 6, 2020:** The SBA and Treasury announces that it has **released detailed loan-level data** regarding the 4.9 million PPP loans that had been made.

# Eligibility for Receiving PPP Loan

- Private equity-backed portfolio companies can qualify for PPP loans provided they:

    1. **Certify in good faith** that their PPP loan is necessary;
    2. Abide by **affiliation rules** for size eligibility; and
    3. Use the loan appropriately.

# PPP Eligibility – Certification Requirement

- As part of the initial application, all borrowers must also certify in good faith that their PPP loan is necessary.
  - Must take into account current business activity and **ability to access other sources of liquidity** sufficient to support ongoing operations.
  - If lack adequate basis for certification, the **SBA will seek immediate repayment.**
  - Borrowers that fail to make their certifications in good faith **may be subject to civil and criminal penalties.**
    - Recklessness can give rise to liability under the False Claims Act.

# PPP Eligibility – Affiliation Rules

- Borrowers must apply the affiliation rules in 13 CFR 121.301(f).
- Entities are affiliates of each other **when one controls or has the power to control the other**, or a third party controls or has the power to control both.
- Bases of affiliation include:
  1. Ownership
  2. Potential control
  3. Management
  4. Identity of interest

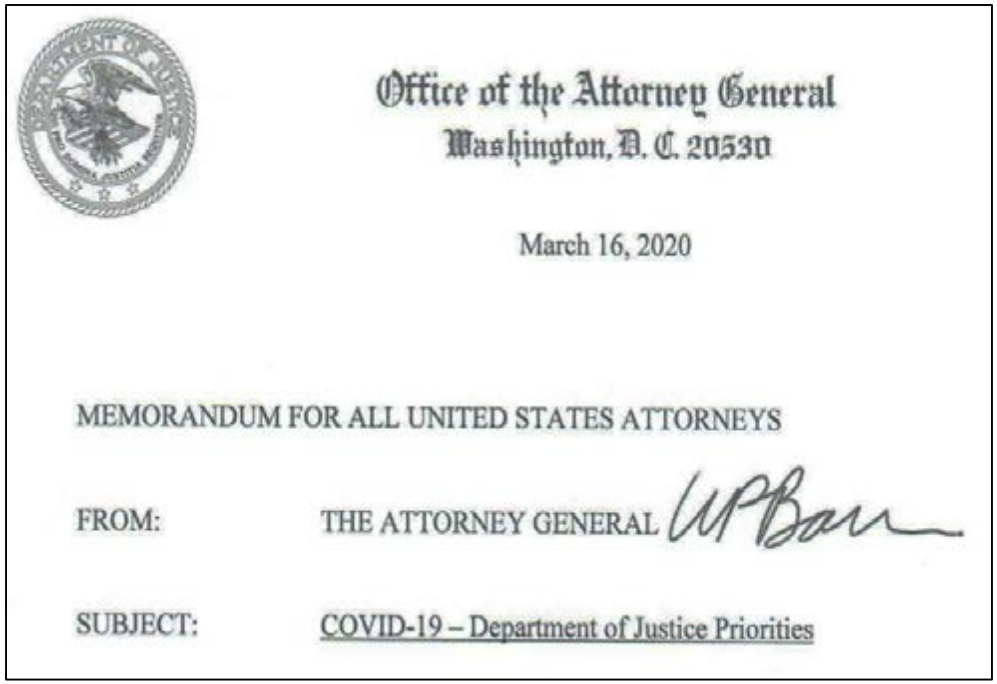
- While fact-specific, a private equity firm is likely considered an affiliate of its portfolio company for purposes of the affiliation rules.
- Indeed, portfolio companies controlled by the same private equity firm can be deemed affiliates of one another under the affiliation rules.

# PPP Loans – Permissible Uses and Additional Considerations

- The CARES Act enumerates permissible uses for PPP loans.
  - At least **60% must be used for payroll costs** (e.g., salary or similar compensation, vacation, medical benefits, retirement).
- Other permissible uses of PPP loans, other than payroll costs, include, for example:
  - Mortgage interest payments
  - Rent and/or utilities
  - Covered operations expenditures (e.g., computer software, HR)
  - Interest payments on other debt obligations incurred before February 15, 2020
- **Certification**
  - Loan forgiveness application certification
  - Loan Necessity Questionnaire if received $2M or more in first draw PPP loans

# DOJ Enforcement Priorities Generally

Even before the CARES Act was passed, DOJ pledged to **aggressively pursue COVID relief-related fraud**.



Office of the Attorney General
Washington, D. C. 20530

March 16, 2020

MEMORANDUM FOR ALL UNITED STATES ATTORNEYS

FROM: THE ATTORNEY GENERAL

SUBJECT: COVID-19 – Department of Justice Priorities

**Former Attorney General William Barr** (March 16, 2020):

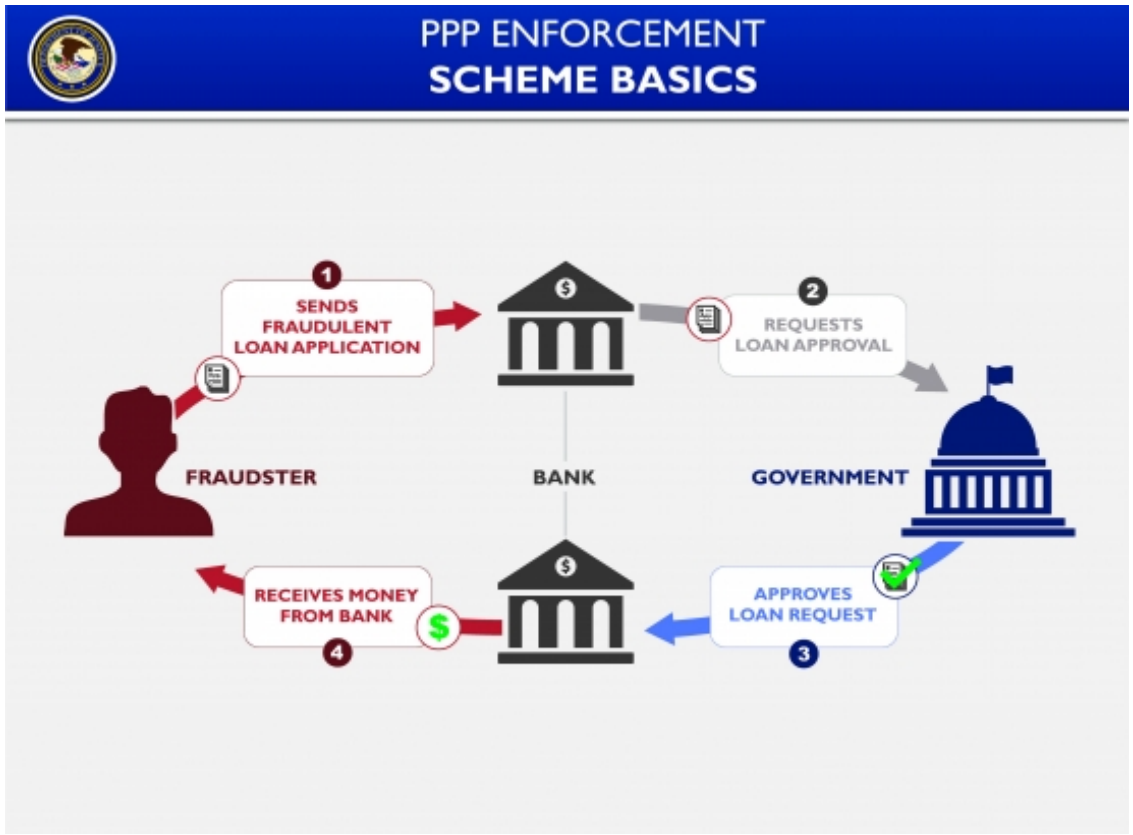
> "The pandemic is dangerous enough without wrongdoers seeking to profit from public panic and this sort of conduct cannot be tolerated. **Every U.S. Attorney's Office is thus hereby directed to prioritize the detection, investigation, and prosecution of all criminal conduct related to the current pandemic.**"



Source: *COVID-19 – Department of Justice Priorities*, Memorandum for All United States Attorneys (Mar. 16, 2020).

# DOJ Enforcement Actions

- DOJ's **Fraud Section** leads investigations and prosecutions of fraud, false statements, and money laundering related to the CARES Act.




- There is reason to believe that **enforcement action is in the early stages** because there has been more focus on brazen acts of fraud than on sophisticated corporate fraud.



Source: *Justice Department Takes Action Against COVID-19 Fraud: Historic level of enforcement action during national health emergency continues,* Press Release (Mar. 26, 2021).

# Government Focus on Private Equity & COVID Relief

**Former Principal Deputy Assistant Attorney General, DOJ Civil Division** (June 26, 2020):

- "Our enforcement efforts may also include, in appropriate cases, private equity firms that sometimes invest in companies receiving CARES Act funds. When a private equity firm invests in a company in a highly-regulated space like health care or the life sciences, the firm should be aware of laws and regulations designed to prevent fraud. Where a private equity firm takes an active role in illegal conduct by the acquired company, it can expose itself to False Claims Act liability. . . . . **Where a private equity firm knowingly engages in fraud related to the CARES Act, we will hold it accountable.**"



Source: *Speech to the Institute for Legal Reform*, U.S. Chamber of Commerce (June 26,2020).

# DOJ Enforcement

**Attorney General Merrick B. Garland** (March 26, 2021):

- "DOJ has led an historic **enforcement initiative to detect and disrupt COVID-19 related fraud schemes**. The impact of the department's work to date sends a clear and unmistakable message to those who would exploit a national emergency to steal taxpayer-funded resources from vulnerable individuals and small businesses."

**Acting Assistant Attorney General Brian M. Boynton** (March 26, 2021):

- "We will not allow American citizens or the critical benefits programs that have been created to assist them to be **preyed upon by those seeking to take advantage of this national emergency**."



Source: *Justice Department Takes Action Against COVID-19 Fraud: Historic level of enforcement action during national health emergency continues,* Press Release (Mar. 26, 2021).

# DOJ Enforcement Actions

- **Criminal:**
  - The Fraud Section has charged at least **120 defendants with PPP fraud** for a wide range of conduct.
  - USAOs across the country are increasingly charging cases on their own.
- **Civil:**
  - DOJ has obtained the **first civil settlement for fraud involving the PPP**, resolving civil claims under the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA) and the False Claims Act (FCA).
    - Arising from **false statements** submitted to a federally-insured bank.




Sources: *Justice Department Takes Action Against COVID-19 Fraud: Historic level of enforcement action during national health emergency continues,* Press Release (Mar. 26, 2021).

# Other Oversight

**Office of the Special Inspector General for Pandemic Recovery ("SIGPR"), Treasury Department**

- DOJ issued an opinion on April 29, 2021, finding that the **SIGPR's jurisdiction is limited** and does not include oversight of the PPP. The SIGPR has asked Congress to clarify SIGPR's mandate.

**Pandemic Response Accountability Committee ("PRAC")**

- An interagency commission of inspectors general created to **oversee all CARES Act spending**.

**Congressional Oversight**

- Congressional Oversight Committee –tasked with overseeing how Treasury and the Federal Reserve implement the CARES Act.
- House and Senate Subcommittees –**monitor waste, fraud, and abuse** related to COVID relief.

# Takeaways

- Carefully consider certification of necessity on the initial PPP loan application and on the Loan Necessity Questionnaire (for loans of $2M or more)
- Carefully consider certification of permissible uses on the loan forgiveness application
- Carefully evaluate eligibility criteria
- Carefully record how any funds received are spent

# SEC Enforcement Priorities

# SEC Enforcement Priorities

- **Two ways to understand the SEC: by what it says and by what it does**

- The Division of Examinations announces its priorities every year
- Its 2021 priorities include:
  - "RIAs to Private Funds Over 36 percent of RIAs manage private funds, which frequently have significant investments from pensions, charities, endowments, and families"
  - "EXAMS will continue to focus on advisers to private funds, and will assess compliance risks, including a focus on liquidity and disclosures of investment risks and conflicts of interest"

Source: https://www.sec.gov/files/2021-exam-priorities.pdf

# SEC Enforcement Priorities: What the SEC is Saying

***The SEC comes from a place of inherent skepticism.***

***What should I know?***

> ***Illiquidity***: Because of their long-term investment horizon, an investment in a private equity fund is often illiquid and it may be necessary to hold an investment in a private equity fund for several years before any return is realized. Private equity funds typically impose limitations on investors' ability to withdraw their investment.

***https://www.investor.gov/introduction-investing/investing-basics/investment-products/private-investment-funds/private-equity***

# SEC Enforcement Priorities: What the SEC is Saying

***The SEC comes from a place of inherent skepticism.***

***What should I know?***

***Fees and expenses***: The SEC has brought enforcement actions, for example here, involving fees and expenses that were incurred by funds and their investors without being adequately consented to or disclosed. Investors should be vigilant about the fees and expenses incurred in connection with their investment. The adviser has a legal obligation to act in the best interests of each of the funds it manages and must allocate expenses among itself, its funds and the funds' portfolio companies in accordance with this fiduciary duty. The SEC has brought several enforcement actions, for example here, related to shifting and allocation of expenses.

***https://www.investor.gov/introduction-investing/investing-basics/investment-products/private-investment-funds/private-equity***

# SEC Enforcement Priorities: What the SEC is Saying

***The SEC comes from a place of inherent skepticism.***

***What should I know?***

> ***Conflicts of interest***: Private equity firms often have interests that are in conflict with the funds they manage and, by extension, the limited partners invested in the funds. . . .The funds typically pay the private equity firm for advisory services. The SEC has brought several enforcement actions, for example here, related to an adviser's alleged failure to disclose certain conflicts of interest to the funds it manages. Through its various relationships, including with affiliates and portfolio companies, there exists opportunity for advisers to benefit themselves at the expense of the funds they manage and their investors. It is important for an investor to be aware and alert about the conflicts that exist, or that may arise, in the course of an investment in a private equity fund

***https://www.investor.gov/introduction-investing/investing-basics/investment-products/private-investment-funds/private-equity***

# SEC Enforcement Priorities: What the SEC is Saying

***This is not entirely new. The skepticism is long-standing – but increasing.***

## Securities Enforcement Forum West 2016 Keynote Address: Private Equity Enforcement

**Andrew Ceresney, Director, Division of Enforcement**

**Securities Enforcement Forum West <br>San Francisco, California**

**May 12, 2016**

### III. Enforcement Actions

Our actions against private equity fund advisers fall into three interrelated categories, which I will discuss in turn:

1. Advisers that receive undisclosed fees and expenses;
2. Advisers that impermissibly shift and misallocate expenses; and
3. Advisers that fail to adequately disclose conflicts of interests, including conflicts arising from fee and expense issues.

# SEC Enforcement Priorities: What the SEC is Doing

- **Method - read every IAA release over the past 4 years.**
  - **These are helpfully available on-line**
    - **Note that this is a trailing methodology; cases can take years**
    - **These are thus mostly early Trump era cases**

- **Majority are grotesque frauds.**
  - **The "tide went out" with COVID and it revealed ugly things**
    - In the Matter of Don Warner Reinhard, April 8, 2021 Release No. 5715 (Cambridge Capital raised funds former professional football players who were plaintiffs in concussion-related litigation. The complaint alleged that Reinhard mispresented the funds' investment focus.)
    - In the Matter of E*HEDGE SECURITIES INC. Release No. 5713, April 5, 2021 (E*Hedge attempted to capitalize on potential investor interest in products and treatments for COVID-19)

# SEC Enforcement Priorities

**The more complex cases can be hard to summarize, but on a general level the complaints are always the same**

**1. Fees**

## SEC Charges Private Fund Adviser for Failing to Reduce Management Fees as a Result of Write Downs

ADMINISTRATIVE PROCEEDING
File No. 3-20133

**October 22, 2020** - The Securities and Exchange Commission today announced settled charges against EDG Management Company, LLC, a Virginia-based investment adviser, concerning management fees EDG charged to a private equity fund it advises.

According to the SEC's order, the Limited Partnership Agreement (LPA) for the private fund EDG advises allows EDG to charge the fund, on a quarterly basis, a management fee based on total invested capital contributions. As described in the order, the LPA provides that the fee is calculated using an amount that should be reduced if certain triggering events occur, including write downs of portfolio securities. The order finds that, during the period from January 1, 2016 through October 1, 2019, certain portfolio securities were subject to write downs under the terms of the fund's LPA. However, as stated in the order, EDG did not adjust thirteen quarterly management fee calculations to account for these write downs, causing the fund and, ultimately, its limited partners to pay approximately $900,000 more in management fees than they should have paid.

# SEC Enforcement Priorities

**The more complex cases can be hard to summarize, but on a general level the complaints are always the same**

## 2. Expenses

**INVESTMENT ADVISERS ACT OF 1940**
**Release No. 5079/ December 17, 2018**

**ADMINISTRATIVE PROCEEDING**
**File No. 3-18935**

**In the Matter of**

**NB ALTERNATIVES ADVISERS LLC,**

**Respondent.**

2. From 2011 through 2016, NBAA and its affiliates ("Neuberger") sponsored and managed three private equity funds, known as the "Dyal Funds." The investment objective of each Dyal Fund was to acquire minority stakes in alternative investment management companies, sometimes referred to as "Partner Managers."

3. Neuberger created a group of employees, referred to as the "Business Services Platform" or "BSP," to provide client development, talent management, operational advisory and other services, support and advice to Partner Managers. Under the Dyal Funds' organizational documents, the funds were responsible for paying the expenses relating to the utilization of the BSP up to a cap per fund of 50 basis points of committed capital. Neuberger was responsible for all "compensation costs of [their] investment professionals" other than those related to the BSP.

4. Despite the fact that some BSP employees spent a percentage of their time on tasks not related to the BSP, NBAA, acting negligently, did not adjust the amount of compensation-related expense for those employees that was charged to the Dyal Funds from 2012 through 2016. By doing so, NBAA breached its fiduciary duty to the funds.

C. Respondents shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of $375,000 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Section 21F(g)(3) of the Securities Exchange Act of 1934. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717. Payment must be made in one of the following ways:

# SEC Enforcement Priorities

**The more complex cases can be hard to summarize, but on a general level the complaints are always the same**

## 3. Conflicts

**INVESTMENT ADVISERS ACT OF 1940**
**Release No. 5453 / February 27, 2020**

**ADMINISTRATIVE PROCEEDING File No. 3-19716**

**In the Matter of**

**SICA WEALTH MANAGEMENT, LLC and JEFFREY C. SICA**

**Respondents.**

These proceedings involve conflicts of interest that were not adequately disclosed to advisory clients by registered investment adviser Sica Wealth Management, LLC ("SWM") and its principal Jeffrey C. Sica ("Sica"). From October 2013 to March 2015, on Sica's recommendation, approximately 45 SWM advisory clients invested a total of more than $30 million in securities issued by Aequitas Commercial Finance, LLC ("ACF"), one of numerous entities affiliated with the Aequitas enterprise, the ultimate parent of which is Aequitas Management, LLC (collectively referred to herein as "Aequitas").[2]

From October 2013 to November 2015 (the "relevant period"), SWM and Sica failed to disclose to these clients material facts regarding compensation that Aequitas provided to SWM and another firm owned and controlled by Sica, (the "Affiliated Adviser"), which created conflicts of interest relating to SWM's and Sica's recommendations that clients invest in Aequitas securities. Specifically, Aequitas paid SWM and the Affiliated Adviser a total of approximately $2 million during the relevant period pursuant to consulting agreements and a loan agreement (collectively referred to as the "Aequitas agreements"). The Aequitas agreements and the resulting compensation should have been disclosed to clients so that they could fairly evaluate the conflicts in deciding whether to invest in Aequitas securities. By failing to disclose these facts to advisory clients, SWM and Sica violated Section 206(2) of the Advisers Act.

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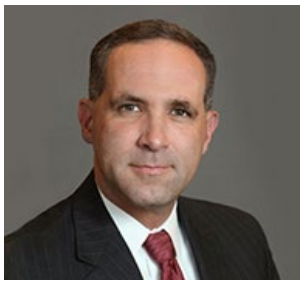


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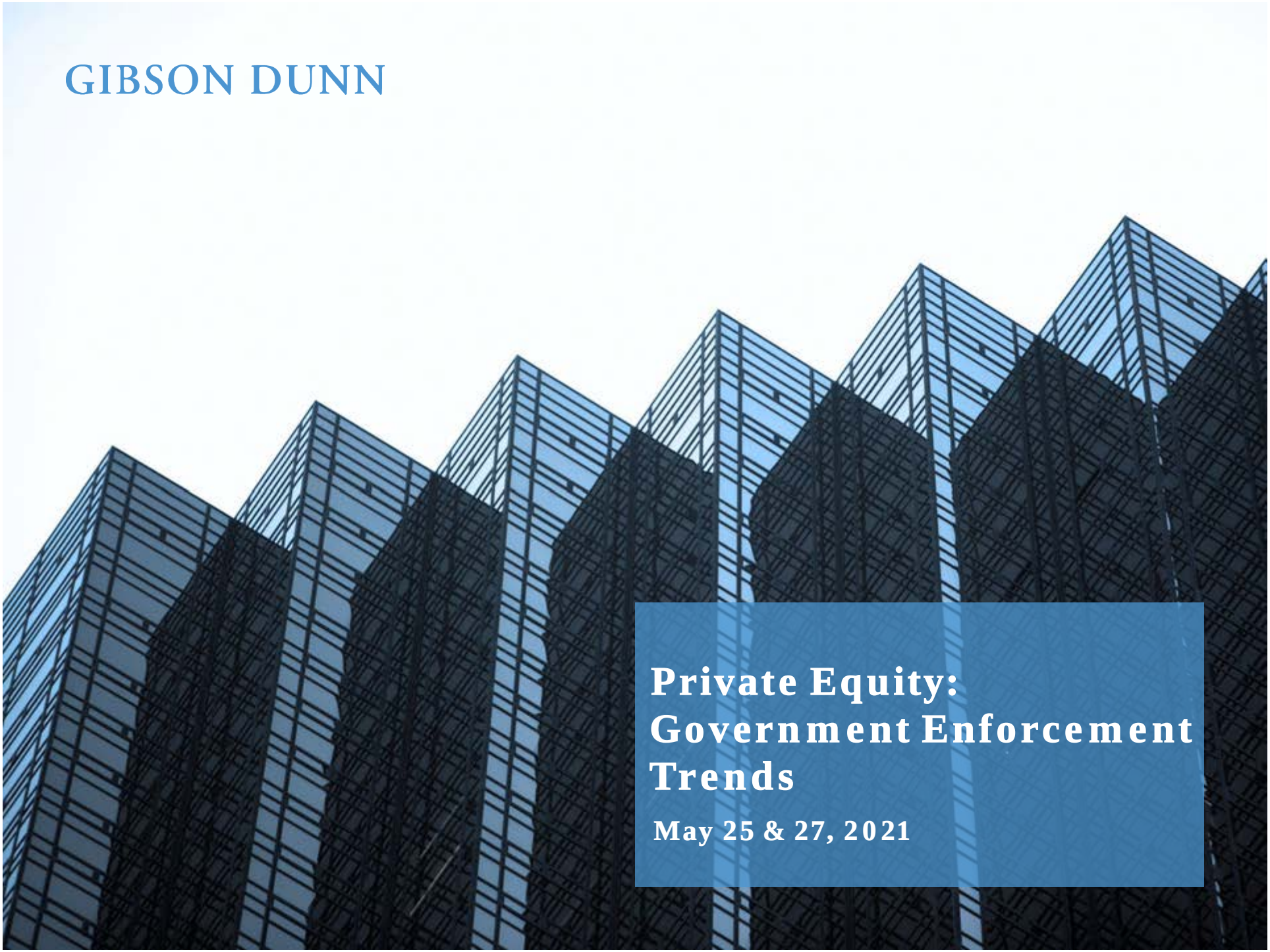
GIBSON DUNN



# Private Equity: Government Enforcement Trends

May 25 & 27, 2021

# Moderator & Panelists

## Moderator

**Nick Hanna**, who most recently served as United States Attorney for the Central District of California, is a litigation partner in Gibson Dunn's Los Angeles office and co-chairs the firm's global White Collar Defense and Investigations Practice Group. Mr. Hanna's practice focuses on representing corporations in high-stakes civil litigation, white collar crime, and regulatory and securities enforcement – including internal investigations, False Claims Act cases, special committee representations, compliance counseling and class actions.

## Panelists

**Michael Celio** is the partner-in-charge of Gibson Dunn & Crutcher's Palo Alto office and a sought-after trial lawyer with more than two decades of experience trying cases in Silicon Valley and beyond. He maintains a wide-ranging trial practice and has tried more than two dozen cases to verdict in state and federal court. He is a recognized expert in the field of securities litigation and is particularly experienced in defending venture capital and private equity firms and their partners as well as their portfolio companies.

**Michael M. Farhang** is a former federal prosecutor and a partner in the Los Angeles office of Gibson, Dunn & Crutcher. He is a Chambers-ranked attorney and practices in the White Collar Defense and Investigations and Securities Litigation Practice Groups. Mr. Farhang is an experienced litigator and trial attorney who has earned more than $40 million in recoveries for corporate clients pursuing fraud, contract, and M&A-related claims.

# Panelists

**Diana M. Feinstein** is a partner in the Los Angeles office of Gibson, Dunn & Crutcher. She is a member of the firm's Securities Litigation and White Collar Defense and Investigations Practice Groups. Ms. Feinstein's practice focuses on complex litigation, including securities litigation and high-value commercial litigation. She also focuses on white collar defense and investigations.

**John Partridge**, a Co-Chair of Gibson Dunn's FDA and Health Care Practice Group and Chambers-ranked white collar defense and government investigations lawyer, focuses on government and internal investigations, white collar defense, and complex litigation for clients in the life science and health care industries, among others. Mr. Partridge has particular experience with the Anti-Kickback Statute, the False Claims Act, the Foreign Corrupt Practices Act, and the Federal Food, Drug, and Cosmetic Act, including defending major corporations in investigations pursued by the U.S. Department of Justice and the U.S. Securities and Exchange Commission.

**Eric D. Vandevelde** is a litigation partner in Gibson Dunn's Los Angeles office. He is a former federal prosecutor and an experienced trial and appellate attorney. Mr. Vandevelde has been selected by Chambers USA in the area of White-Collar Crime & Government Investigations, has been repeatedly recognized as a "Super Lawyer" by Super Lawyers Magazine, and was named one of the Top 20 Cyber/Artificial Intelligence Lawyers in California by The Daily Journal.

# Panelists

**Debra Wong Yang** is a partner in Gibson, Dunn & Crutcher's Los Angeles office. Reflective of her broad practice and comprehensive abilities, Ms. Yang is Chair of the Crisis Management Practice Group, former Chair of the White Collar Defense and Investigations Practice Group, and former Chair of the Information Technology and Data Privacy Practice Group. She leads critical representations involving a wide variety of industries, economic sectors, regulatory bodies, law enforcement agencies, global jurisdictions and all types of proceedings.

**James L. Zelenay** is a partner in the Los Angeles office of Gibson, Dunn & Crutcher where he practices in the firm's Litigation Department. Mr. Zelenay has extensive experience in defending clients involved in white collar investigations, assisting clients in responding to government subpoenas, and in government civil fraud litigation. Mr. Zelenay also has substantial experience with the federal and state False Claims Acts and whistleblower litigation.

**Tyler H. Amass** is Of Counsel in the Denver office of Gibson, Dunn & Crutcher. Mr. Amass practices in the firm's Litigation Department, with a primary focus on commercial and business litigation, including M&A litigation, breach of fiduciary duty and securities law claims against companies and directors, corporate control contests, activist-investor litigation, and breach of contract claims.

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- Participants should complete the MCLE form and email it to the CLE address listed on the form.
- Most participants should anticipate receiving their certificate of attendance in four weeks following the webcast
- Virginia Bar Association members should anticipate receiving their certificate of attendance six weeks following the webcast
- Please direct all questions regarding MCLE to CLE@gibsondunn.com

# Agenda

- Introduction
- Part 1 - Tuesday, May 25th
  - Data Security and Privacy Laws (Eric Vandevelde)
  - False Claims Act (James Zelenay)
  - COVID Relief (Debra Wong Yang)
  - SEC Enforcement Priorities (Michael Celio)
- Part 2 - Thursday, May 27th
  - AML Issues (Diana Feinstein)
  - FCPA (Michael Farhang)
  - Healthcare (John Partridge)
  - Post M&A Indemnification and Fraud Claims (Michael Farhang/Ty Amass)

# Introduction

# Increased Government Focus on Private Equity

- Rep. Bill Pascrell, chairman of the House Ways and Means Committee (3/25/2021):
  - "It's past time for a **bright light** to be shined on **how private equity in our health system affects patient safety, costs and jobs** . . . . Private equity's expansion to health care is troubling because private equity's main focus on profits is often at odds with what is best for patient care."

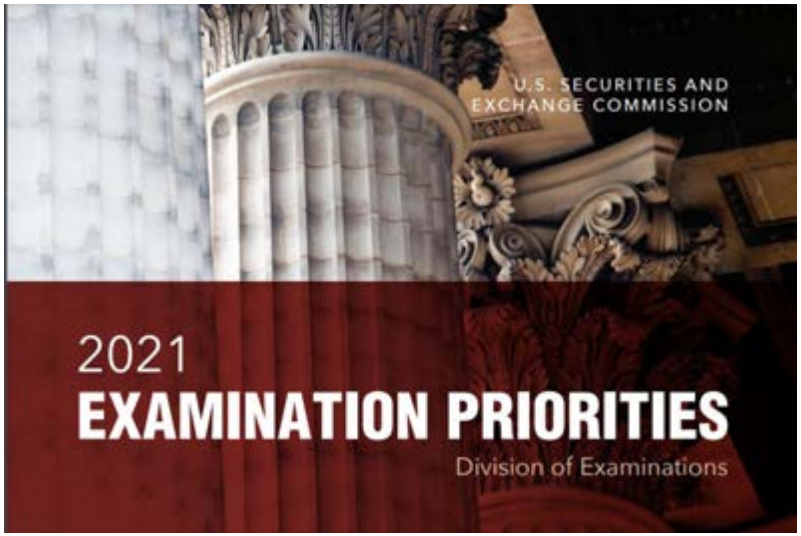
# Increased Government Focus on Private Equity

- Former Principal Deputy Assistant Attorney General, DOJ Civil Division (6/26/2020):
  - "**Our enforcement efforts may also include**, in appropriate cases, **private equity firms that sometimes invest in companies receiving CARES Act funds.** When a private equity firm invests in a company in a highly-regulated space like health care or the life sciences, the firm should be aware of laws and regulations designed to prevent fraud . . . . Where a private equity firm knowingly engages in fraud related to the CARES Act, **we will hold it accountable**."

# Increased Government Focus on Private Equity

SEC 2021 Examination Priorities:

> "... the Division will review for, among other things: **preferential treatment of certain investors by advisers to private funds** that have experienced issues with liquidity, including imposing gates or suspensions on fund withdrawals; **portfolio valuations and the resulting impact on management fees**; adequacy of disclosure and compliance with any regulatory requirements of cross trades, principal investments, or distressed sales; and **conflicts around liquidity**, such as adviser led fund restructurings, including stapled secondary transactions where new investors purchase the interests of existing investors while also agreeing to invest in a new fund."



# Sources of Inquiry

**DOJ**

**SEC**

**OFAC**

**FinCEN**

**CFTC**

**WHISTLEBLOWERS**

# AML Issues

# AML Framework

## *Criminal Provisions: 18 U.S.C. §§ 1956 & 1957*

Under the money laundering statutes, **it is a crime to engage in a financial transaction with knowledge that the proceeds involved are the proceeds of unlawful activity if the government can prove that the proceeds were derived from a specified unlawful activity.**

- **Unlawful Activity** – Generally any violation of criminal law – federal, state, local or foreign.
- **Specified Unlawful Activities** – There are over 200 specified unlawful activities – U.S. and certain foreign crimes.
  - Foreign crimes: Bribery of a public official; misappropriation, theft, or embezzlement of foreign public funds; fraud, or any scheme or attempt to defraud, by or against a foreign bank; smuggling or export control violations; controlled substance violations; and specified violent crime offenses.
- **Knowledge includes "willful blindness"** – turning a blind eye or deliberately avoiding gaining positive knowledge when faced with a high likelihood of criminal activity, i.e., ignoring red flags.

# AML Framework
## *The Bank Secrecy Act*

**The main source for AML reporting, recordkeeping, and compliance program requirements for "financial institutions" is the Bank Secrecy Act (BSA).**

- The BSA requires financial institutions to have an anti-money laundering compliance program and comply with a number of reporting and recordkeeping requirements.
  - Internal policies, procedures and controls
  - Designation of an AML officer
  - Employee training
  - Independent testing
  - Customer due diligence (CDD)

- Federal agencies can impose civil and criminal penalties for violations of the BSA. State banking agencies can impose similar penalties.

# U.S. Enforcement Agencies and Regulators

## Enforcement Responsibilities

DOJ (Civil, Criminal, and Forfeiture)

SEC (Civil)

FinCEN (Civil)

CFTC (Civil)

OFAC (Civil)

FINRA (SRO)

## Banking Regulators and Enforcers

OCC

Fed

FDIC

NCUA

DFS

# AML Laws and Private Equity

## *FinCEN Proposed Rules*

FinCEN has periodically proposed rules which would bring private equity companies within the scope of the BSA.

- In September 2002, FinCEN published a proposed rule that would have added unregistered investment companies, including private equity funds, to the BSA's definition of financial institution.
- In May 2003, FinCEN published a notice of proposed rulemaking which would have included investment advisors within the BSA's definition of financial institution.
- FinCEN withdrew its 2002 and 2003 proposals in November 2008.

In August 2015, FinCEN proposed a rule expanding the definition of financial institution to include "hedge funds, private equity funds, and other private funds."

- This rule would require these funds to establish AML programs, report suspicious activity to FinCEN, and file Currency Transaction Reports (CTRs) and maintain records of fund transfers.

UNITED STATES DEPARTMENT OF THE TREASURY

FinCEN

FINANCIAL CRIMES ENFORCEMENT NETWORK

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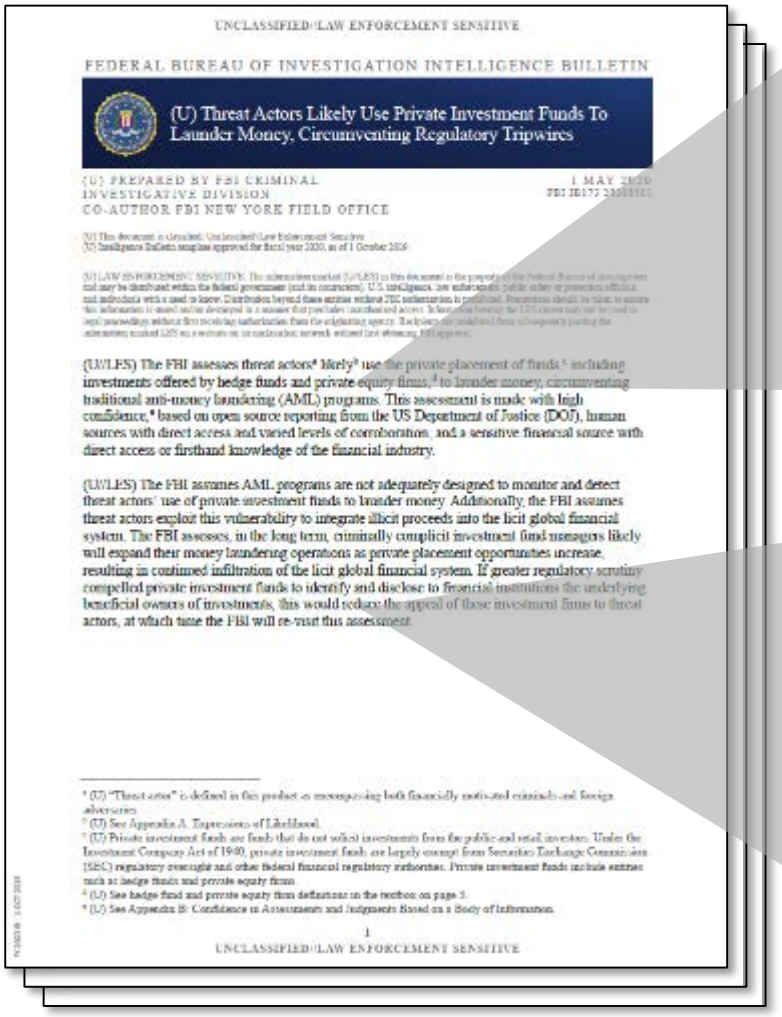
For more information, please contact FinCEN's Office of Public Affairs at (703) 905-3770

**FOR IMMEDIATE RELEASE** **CONTACT:** Steve Hudak

August 25, 2015 703-905-3770

# AML Laws and Private Equity

## *2020 FBI Intelligence Bulletin*



UNCLASSIFIED//LAW ENFORCEMENT SENSITIVE

FEDERAL BUREAU OF INVESTIGATION INTELLIGENCE BULLETIN

(U) Threat Actors Likely Use Private Investment Funds To Launder Money, Circumventing Regulatory Tripwires

(U) PREPARED BY FBI CRIMINAL INVESTIGATIVE DIVISION
CO-AUTHOR FBI NEW YORK FIELD OFFICE

1 MAY 2020

(U) This document is classified: Unclassified//Law Enforcement Sensitive
(U) Intelligence Bulletins remain approved for their year 2020, as of 1 October 2020

(U//LES) The FBI assesses threat actors[a] likely[b] use the private placement of funds[c] including investments offered by hedge funds and private equity firms,[d] to launder money, circumventing traditional anti-money laundering (AML) programs. This assessment is made with high confidence,[e] based on open source reporting from the US Department of Justice (DOJ), human sources with direct access and varied levels of corroboration, and a sensitive financial source with direct access or firsthand knowledge of the financial industry.

(U//LES) The FBI assumes AML programs are not adequately designed to monitor and detect threat actors' use of private investment funds to launder money. Additionally, the FBI assumes threat actors exploit this vulnerability to integrate illicit proceeds into the licit global financial system. The FBI assesses, in the long term, criminally complicit investment fund managers likely will expand their money laundering operations as private placement opportunities increase, resulting in continued infiltration of the licit global financial system. If greater regulatory scrutiny compelled private investment funds to identify and disclose to financial institutions the underlying beneficial owners of investments, this would reduce the appeal of these investment firms to threat actors, at which time the FBI will re-visit this assessment.

[a] (U) "Threat actor" is defined in this product as encompassing both financially motivated criminals and foreign adversaries.
[b] (U) See Appendix A: Expressions of Likelihood.
[c] (U) Private investment funds are funds that do not solicit investments from the public and retail investors. Under the Investment Company Act of 1940, private investment funds are largely exempt from Securities Exchange Commission (SEC) regulatory oversight and other federal financial regulatory authorities. Private investment funds include entities such as hedge funds and private equity firms.
[d] (U) See hedge fund and private equity firm definitions in the textbox on page 3.
[e] (U) See Appendix B: Confidence in Assessments and Judgments Based on a Body of Information.

1

UNCLASSIFIED//LAW ENFORCEMENT SENSITIVE

"The FBI assesses threat actors likely use the private placement of funds, **including investments offered by hedge funds and private equity firms**, to launder money, circumventing traditional anti-money laundering (AML) programs. This assessment is made with high confidence . . . ."

"If **greater regulatory scrutiny** compelled private investment funds **to identify and disclose** to financial institutions **the underlying beneficial owners of investments**, this would reduce the appeal of these investment firms to threat actors, at which time the FBI will re-visit this assessment."

# AML Laws and Private Equity

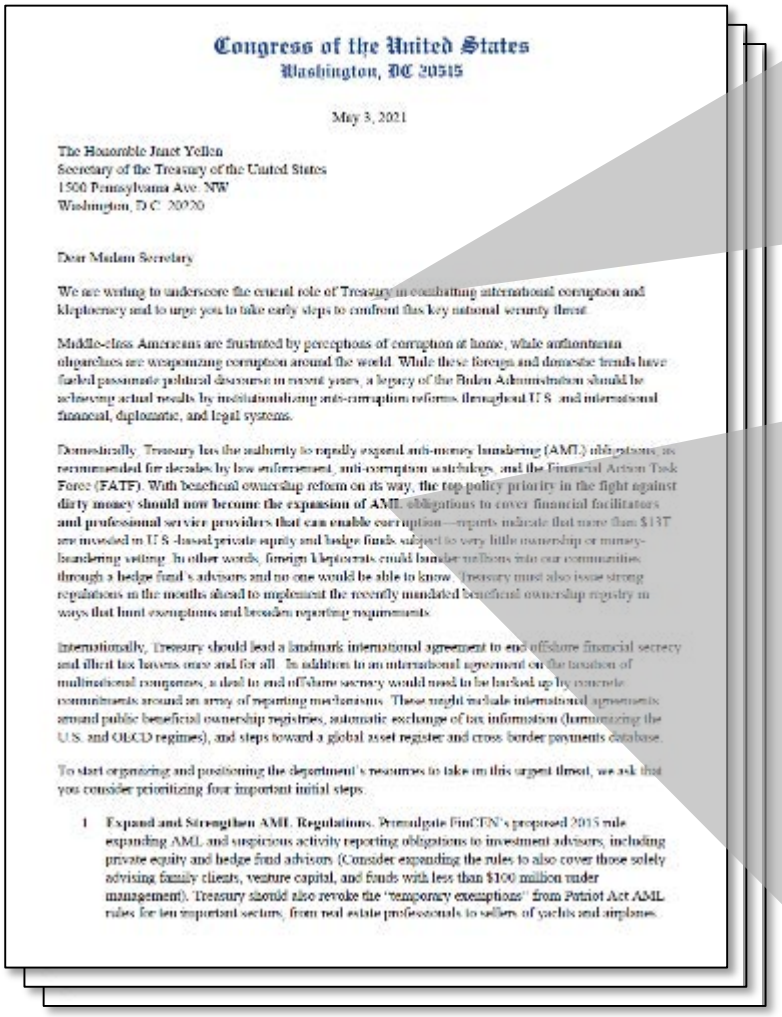
## *2021 Passage of the AML Act*

**On January 1, 2021, Congress overrode President Trump's veto of the National Defense Authorization Act, which included the AML Act of 2020.**

- The AML Act includes sweeping changes to the BSA and AML laws, including:
  - The creation of a national, nonpublic beneficial ownership database
  - Expanding the BSA's definition of "financial institution" to include businesses engaged in the exchange or transmission of "value that substitutes for currency" (*i.e.*, cryptocurrency), antiquities dealers and advisors, and, potentially, high-value art dealers
  - Increased penalties for AML violations
  - A significantly expanded whistleblower award program, which awards 30 percent of sanctions over $1 million to whistleblowers who "voluntarily provided original information" that led to a successful enforcement action.

# AML Laws and Private Equity

## *2021 Malinowski-Whitehouse Letter to Secretary Yellen*



Congress of the United States
Washington, DC 20515

May 3, 2021

The Honorable Janet Yellen
Secretary of the Treasury of the United States
1500 Pennsylvania Ave. NW
Washington, D.C. 20220

Dear Madam Secretary

We are writing to underscore the crucial role of Treasury in combatting international corruption and kleptocracy and to urge you to take early steps to confront this key national security threat.

Middle-class Americans are frustrated by perceptions of corruption at home, while authoritarian oligarchies are weaponizing corruption around the world. While these foreign and domestic trends have fueled passionate political discourse in recent years, a legacy of the Biden Administration should be achieving actual results by institutionalizing anti-corruption reforms throughout U.S. and international financial, diplomatic, and legal systems.

Domestically, Treasury has the authority to rapidly expand anti-money laundering (AML) obligations as recommended for decades by law enforcement, anti-corruption watchdogs, and the Financial Action Task Force (FATF). With beneficial ownership reform on its way, the top policy priority in the fight against dirty money should now become the expansion of AML obligations to cover financial facilitators and professional service providers that can enable corruption—reports indicate that more than $13T are invested in U.S.-based private equity and hedge funds subject to very little ownership or money-laundering vetting. In other words, foreign kleptocrats could launder millions into our communities through a hedge fund's advisors and no one would be able to know. Treasury must also issue strong regulations in the months ahead to implement the recently mandated beneficial ownership registry in ways that limit exemptions and broaden reporting requirements.

Internationally, Treasury should lead a landmark international agreement to end offshore financial secrecy and illicit tax havens once and for all. In addition to an international agreement on the taxation of multinational companies, a deal to end offshore secrecy would need to be backed up by concrete commitments around an array of reporting mechanisms. These might include international agreements around public beneficial ownership registries, automatic exchange of tax information (harmonizing the U.S. and OECD regimes), and steps toward a global asset register and cross-border payments database.

To start organizing and positioning the department's resources to take on this urgent threat, we ask that you consider prioritizing four important initial steps:

1. **Expand and Strengthen AML Regulations.** Promulgate FinCEN's proposed 2015 rule expanding AML and suspicious activity reporting obligations to investment advisers, including private equity and hedge fund advisers. (Consider expanding the rules to also cover those solely advising family clients, venture capital, and funds with less than $100 million under management). Treasury should also revoke the "temporary exemptions" from Patriot Act AML rules for ten important sectors, from real estate professionals to sellers of yachts and airplanes.

"We are writing to underscore the crucial role of Treasury in combatting international corruption and kleptocracy and to urge you to take early steps to confront this key national security threat."

"With beneficial ownership reform on its way, **the top policy priority in the fight against dirty money should now become the expansion of AML obligations to cover financial facilitators and professional service providers that can enable corruption**—reports indicate that more than $13T are invested in U.S.-based private equity and hedge funds subject to very little ownership or money laundering vetting."

-- Rep. Malinowski (D-NJ), Sen. Whitehouse (D-RI)

# AML Laws and Private Equity

*What Will This Mean for Private Equity Firms?*

**Adoption of FinCEN's proposed 2015 rule – or a similar rule – would result in new requirements for hedge funds and private equity firms.**

- Develop and implement written AML compliance programs
- Suspicious activity reporting and CTR filing requirements
- Maintain records of fund transfers
- Allow the SEC to examine hedge funds and private equity firms for AML compliance


**Though not discussed in FinCEN's proposed 2015 rule, the 2020 FBI Bulletin and the 2021 Malinowski-Whitehouse letter suggest there will be a push for private equity firms to adopt Know Your Customer ("KYC") requirements.**

- Customer due diligence, including a Customer Identification Program ("CIP")
- Enhanced due diligence for high-risk customers, such as politically exposed persons
- Identify and report beneficial ownership information

# FCPA

# Overview of the FCPA

- The *Foreign Corrupt Practices Act* ("FCPA") has two principal provisions:
  - Anti-bribery: prohibits giving or offering anything of value to a foreign government official, political party, or party official with the intent to influence that official in his or her official capacity or to secure an improper advantage in order to obtain or retain business
  - Accounting: requires that companies that are listed on stock exchanges in the U.S. and certain other companies keep accurate "books and records" accurately, and implement adequate internal financial controls
- In accordance with principles of successor liability under U.S. law, a buyer may acquire responsibility for the pre-acquisition unlawful conduct of a Target

# International Expectations

- U.S. authorities have explained that when evaluating a compliance program for the purpose of resolving accusations of corruption, they consider:


U.S. Department of Justice, Criminal Division, Fraud Section "Evaluation of Corporate Compliance Programs"

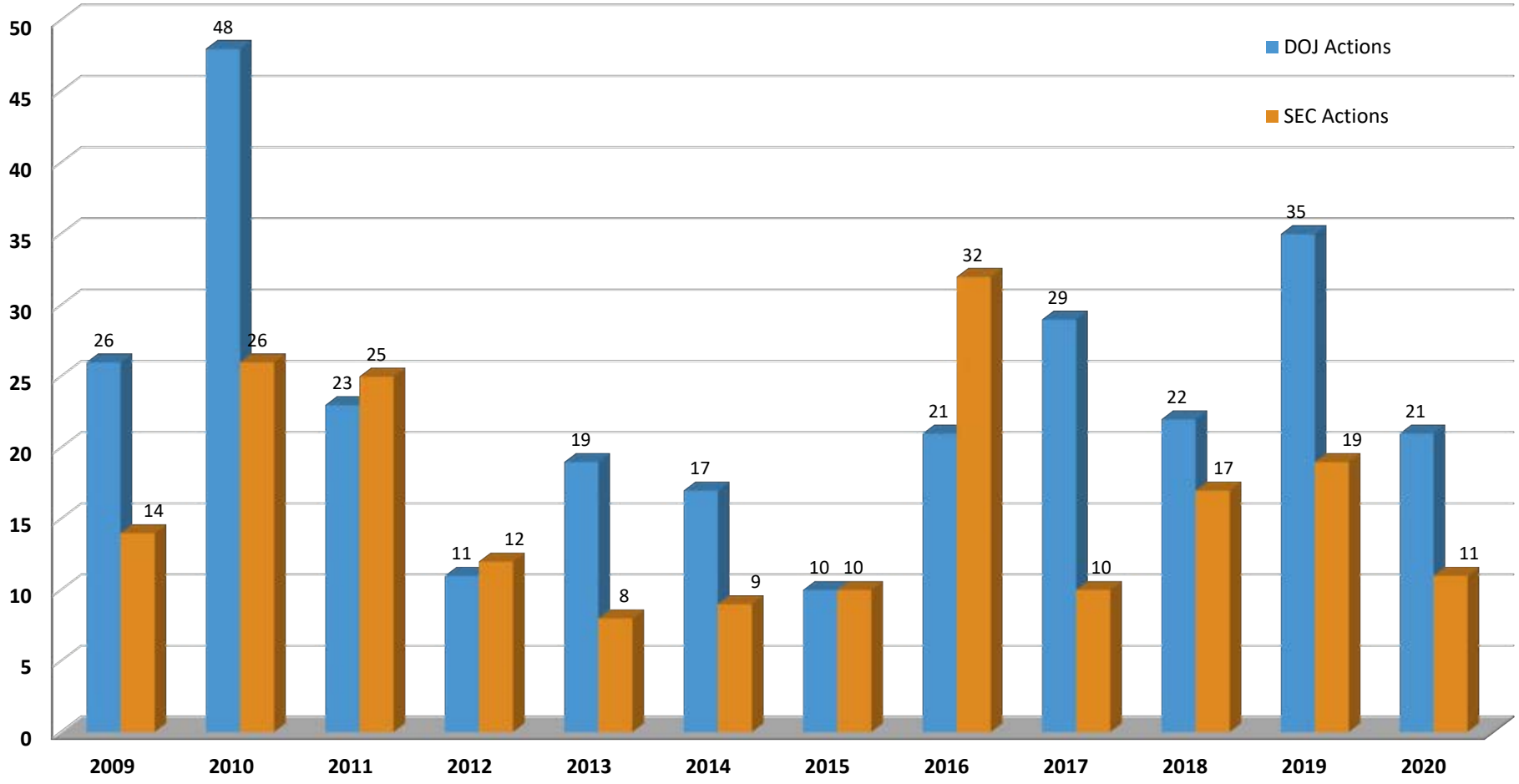
**[Section] 11. Mergers and Acquisitions ('M&A')**

**Due Diligence Process** – Was the misconduct or the risk of misconduct identified during due diligence? Who conducted the risk review for the acquired/merged entities and how was it done? What has been the M&A due diligence process generally?

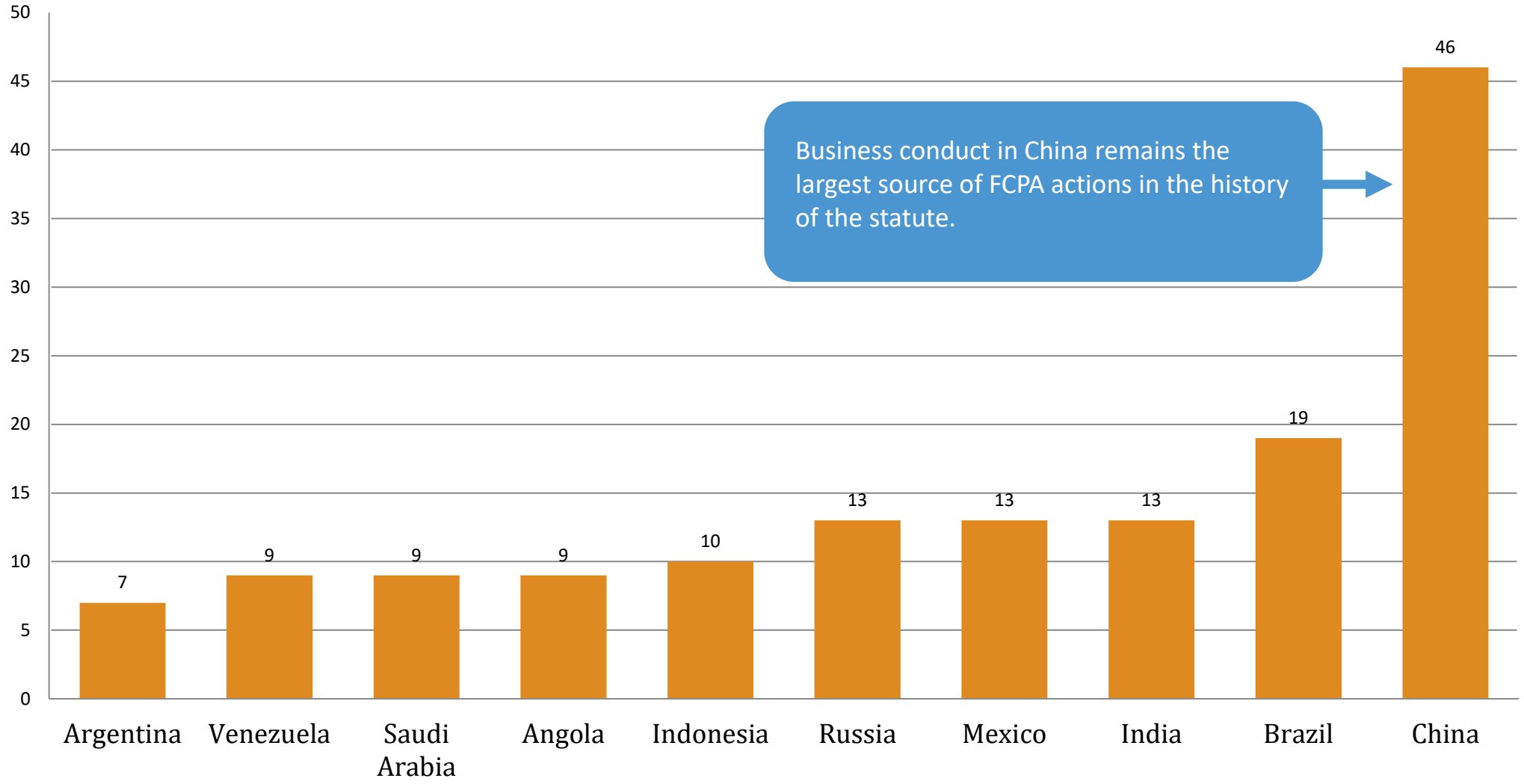
**Integration in the M&A Process** – How has the compliance function been integrated into the merger, acquisition, and integration process?

**Process Connecting Due Diligence to Implementation** – What has been the company's process for tracking and remediating misconduct or misconduct risks identified during the due diligence process? What has been the company's process for implementing compliance policies and procedures at new entities?

# FCPA Enforcement Actions Per Year (2009 – 2020)



# FCPA – Location of Improper Payments (2012 – 2021*)



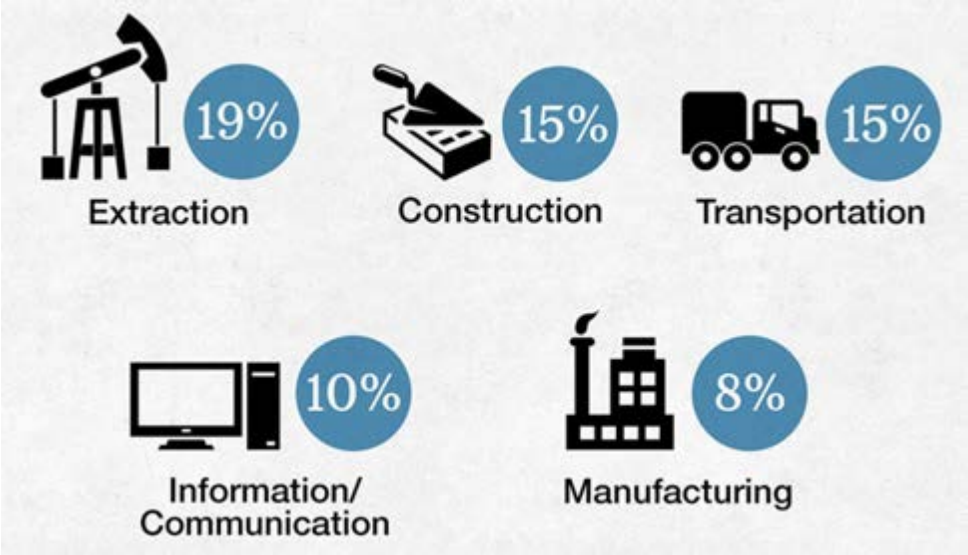

* Data is current through March 31, 2021; source: Stanford Law School

# Why Perform Due Diligence?

- Legal risk of successor liability
- Understand the risk and opportunities of the new business. Some risks include:
  - Financial penalties could surpass the expected income from the acquisition
  - It may be necessary to terminate key personnel, severely impacting the business
  - As part of the remediation, the Target may need to cancel key contracts with clients and/or suppliers.
- Determine the viability and cost of implementing appropriate compliance measures post-acquisition
- Opportunity to cancel the transaction or adjust the sales price in accordance with the risk.

# Industry Risk

- What goods or services does the Target provide/sell?
- Some industries (e.g., oil and gas) carry significantly higher risks.
- The risk is greater in those industries which depend mostly on government tenders, concessions or permits




Source: CNN, "World's Most Corrupt Industries", I. Kottasova (2014)

# Market Risk

- Where does the Target operate?
- Regulators expect diligence to be more detailed in higher risk markets in which Targets operate (e.g., China, Nigeria, Philippines, Mexico)
- A helpful reference point is Transparency International's "Corruption Perceptions Index"

Source: Transparency International, Corruption Perceptions Index (2017)

# Business Model Risk


Source: E&Y, "Knowing Your Third Party: Asia-Pacific Fraud Survey 2013"

*90% + of FCPA enforcement actions involve improper conduct by third parties*

- How does the Target bring its goods and services to market?
- Does the Target use agents, business partners, joint ventures, participation in consortiums, or other third parties to conduct its business?
- The use of third parties is a source of substantial risk

# Client Risk

- Who are the Target's principal clients?
- Does the Target sell to public-sector clients (government)?
- Public-sector clients tend to generate greater corruption risk under the FCPA, but don't forget *private or commercial bribery* pursuant to the U.K. Bribery Act 2010

# Government Interactions Risk

- Does the Target's line of business require frequent interactions with government officials?
- Examples:
  - Approval of environmental permits
  - Selection through bids or tenders
  - Approval of customs shipments/paperwork
  - Inspections of Target's facilities

# Corruption History Risk


- Has the Target ever been involved in an investigation or been accused of participating in a scheme of corruption, fraud, embezzlement, money laundering, or other improper conduct?

# Compliance Program Risk

- What anti-corruption policies and procedures does the Target have in place?
- Examples:
  - Policies on gifts and hospitality, charitable contributions, travel and entertainment
  - Processes such as audits, hotlines, trainings, etc.

# Diligence Steps

- Diligence queries
- Background checks
- Dataroom review – policies, third party contracts, audits, risk assessments, etc.
- Diligence calls with target management
- Evaluate risk profile to include other relevant areas (e.g., sanctions, export controls, AML)
- Transaction testing for higher-risk targets
- Reps and warranties, indemnities, etc.

# Post-Acquisition Integration

- Develop a post-acquisition compliance integration plan:
  - Incorporate the Target into the Buyer's compliance program (e.g., adopt Buyer's anti-corruption compliance policies and procedures, including third-party due diligence processes)
  - Offer compliance training to the new team
  - Risk assessments
  - Discipline and/or termination if significant issues identified
  - Voluntary disclosures in serious cases

# Healthcare

# Key Healthcare Fraud and Abuse Enforcement Statutes

1

**False Claims Act**

- The federal government's primary weapon to redress fraud against healthcare programs
- Since the Affordable Care Act, a "claim that includes items or services resulting from" an AKS violation is false under the FCA

2

**Anti-Kickback Statute**

- Criminalizes knowing and willful payment, offer, solicitation, or receipt of remuneration to induce patient referrals, reward a referral source, or generate business involving any item or service payable by federal health care programs

3

**Civil Monetary Penalties Law**

- Authorizes HHS to impose civil penalties and/or exclude from participation in federal healthcare programs (e.g., Medicare and Medicaid)
- Includes false claims, beneficiary inducement, kickbacks, overpayment retention, patient dumping

4

**Stark Law / EKRA**

- Stark is a civil statute barring the referral of federal beneficiaries for designated health services to an entity with which the referring physician (or a family member) has a financial relationship
- EKRA criminalizes kickbacks to induce referrals to recovery home, treatment facility, or lab

# Other Relevant Healthcare Regulatory Risk Areas

1

**Antitrust / Consumer Protection**

- Sec. Becerra stood up an aggressive California AG division focused on anti-competitive conduct, fraud, and consumer harm in the healthcare and life sciences industries
- Billing surprises are a key area of Congressional focus (particularly as to PE entities)

2

**HIPAA / Privacy / EHR**

- HHS OCR has secured a significant number of resolutions for data breaches and for failures to provide timely access to health records
- DOJ (and relators) have prioritized FCA actions against electronic health records companies

3

**Telehealth / Telemedicine**

- The pandemic period saw loosening in billing requirements relating to telehealth services
- Increased federal willingness to pay for / incentize virtual health visits will come with additional scrutiny on providers and other entities in the space

4

**COVID-Related Stimulus Fraud**

- DOJ plans aggressive enforcement (e.g., as to Provider Relief Fund recipients)
- SIPR stocked with federal healthcare fraud and abuse enforcement attorneys

# U.S. Enforcement Agencies and Regulators

## Enforcement Responsibilities

State AGs

## Regulators and Enforcers

# Life Sciences Companies – Key Legal Theories

1

**AKS**

- Payment of remuneration to providers in a position to prescribe the company's drug violates the AKS and, in turn, the FCA
- Speaker programs, specialty pharmacy relationships, patient assistance programs, and product support services are currently areas of significant scrutiny

2

**Off-Label Promotion**

- Allegations that by promoting a drug for an off-label use, the company (a) causes the target HCP to submit "false" claims for reimbursement of a noncompensable use of the drug, and/or (b) engages in a fraudulent course of conduct that may render reimbursement claims for scripts "false"

3

**Other FD&C Act Violations**

- Allegations that misbranding, adulteration, or pre- or post-approval regulatory violations make claims for reimbursement of associated drugs "false"

4

**Medical Necessity / Billing Issues**

- Diagnostic firms that submit direct claims are subject to scrutiny

# Life Sciences Companies – Areas of Enforcement

**1** **Pre-pandemic areas of focus will draw continued scrutiny**

## Pre-Pandemic Focus Areas:

- Drug Pricing
- Opioids
- Speaker Programs

The Hill

Medicare beneficiaries can't wait for lower drug prices | TheHill

Moving forward, patients must be at the center of any drug pricing legislation. We must ensure lower medication costs for beneficiaries while not ...

2 weeks ago


FDA U.S. FOOD & DRUG ADMINISTRATION

FDA Insight: The Opioid Epidemic and COVID-19 Pandemic

Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

Special Fraud Alert: Speaker Programs

November 12, 2020

I. Introduction

This Special Fraud Alert highlights the fraud and abuse risks associated with the offer, payment, solicitation, or receipt of remuneration relating to speaker programs by pharmaceutical and medical device companies. For purposes of this Special Fraud Alert, speaker programs are generally defined as company-sponsored events at which a physician or other health care professional (collectively, "HCP") makes a speech or presentation to other HCPs about a drug or device product or a disease state on behalf of the company. The company generally pays the speaker HCP an honorarium, and often pays remuneration (for example, free meals) to the attendees. In the last three years, drug and device companies have reported paying nearly $2 billion to HCPs for speaker related services.[1]

The Office of Inspector General (OIG) and Department of Justice (DOJ) have investigated and resolved numerous fraud cases involving allegations that remuneration offered and paid in connection with speaker programs violated the anti-kickback statute. The Federal government has pursued civil and criminal cases against companies and individual HCPs involving speaker programs. These cases alleged, for example, that drug and device companies:

- selected high-prescribing HCPs to be speakers and rewarded them with lucrative speaker deals (e.g., some HCPs received hundreds of thousands of dollars for speaking);[2]

# Healthcare Providers – Key Legal Theories

**1** **Medically Unnecessary Care**

- Billing federal healthcare programs for medical care that was medically unnecessary for the patient

**2** **No Services / Ineligible Services**

- Billing for services the provider did not, in fact, provide to the patient; in some instances, billing for procedures performed by a provider who was not qualified to perform the procedure
- Billing for services for which the patient was ineligible (e.g., hospice care)

**3** **Upcoding**

- Providing the billing code of a more expensive procedure instead of the appropriate code for the services actually rendered

**4** **AKS / Stark**

- Payment of remuneration to other providers in a position to refer patients to the provider
- Violation of the prohibition of physician self-referral (i.e., referral of a patient to another provider with whom the physician has a financial relationship)

# Healthcare Providers – Areas of Enforcement

**1** **Pre-pandemic areas of focus will draw continued scrutiny**

## Pre-Pandemic Focus Areas:

- "Quality of care"
- Nursing homes and elder care facilities
- Opioids
- Telemedicine
- EHR

LAW.COM | New York Law Journal

**Next for America's Nursing Homes: A Legal Pandemic**

Bloomberg Law

**Fraud Suits, DOJ Probes Await Nursing Homes After Virus Abates**

THE UNITED STATES DEPARTMENT of JUSTICE

Department of Justice Launches a National Nursing Home Initiative

THE NATIONAL LAW REVIEW

DOJ Creates National Rapid Response Strike Force As Focus on Health Care Fraud Continues to Grow

# DOJ Healthcare False Claims Act Enforcement in 2020

**>$2 billion**
FCA civil recoveries from *settlements* with healthcare providers and life sciences companies in 2020

**>$1.3 billion**
from civil settlements involving alleged Anti-Kickback Statute violations in 2020

**2nd**
FY 2020 was *very close* but slightly behind the pace set by DOJ in FY 2019 for FCA civil recoveries with healthcare entities, despite COVID-related obstacles to enforcement

# PE-Focused FCA Actions in the Healthcare Industry

**DOJ Warnings [Principal Deputy AG E. Davis, June 2020]**

1

- "When a [PE] firm invests in a company in a **highly-regulated space like health care or the life sciences**, the firm should be aware of laws and regulations designed to prevent fraud.
- Where a [PE] firm takes an **active role in illegal conduct by the acquired company**, it can expose itself to [FCA] liability."

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**U.S. ex rel. Medrano v. Diabetic Care Rx, LLC (S.D. Fla., 2018)**

2

- Compounding pharmacy, two execs, and a PE firm agreed to pay $21M+ to resolve FCA allegations
- **AKS-premised FCA case** focused on purported kickbacks to telemedicine doctors; allegations also related to **scripts generated without patient consent**

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**U.S. ex rel. Johnson v. Therakos, Inc. (E.D. Pa. No. 12-1454)**

3

- **Off-label marketing-premised FCA case**, which led to resolution by former parent company (~$10M) and PE firm (~$1.5M) that purchased the pharma company
- Sparse (if any) allegations of involvement by the PE company in the purported misconduct

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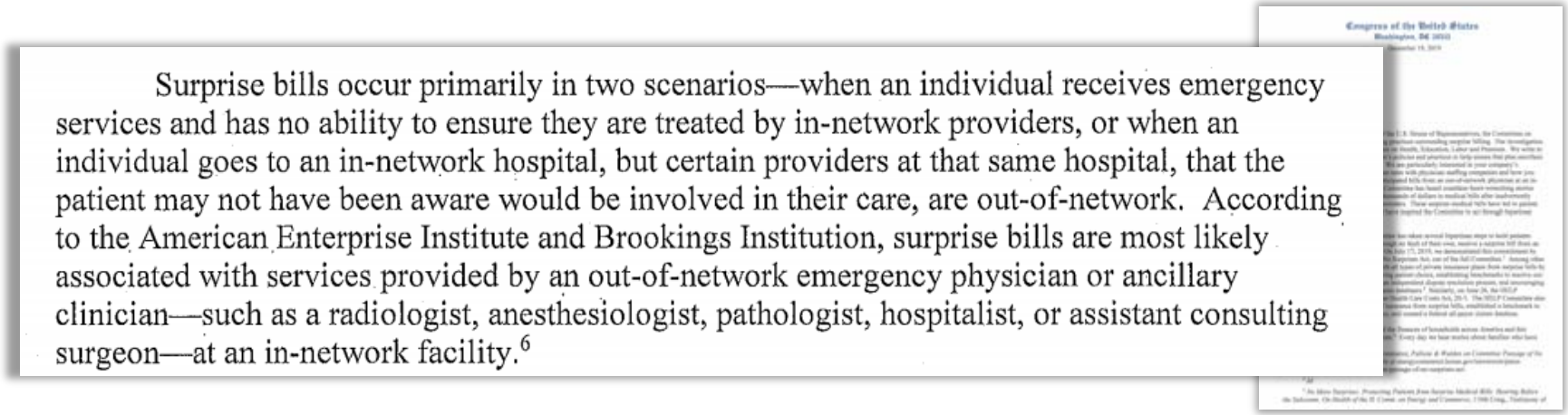
**U.S. ex rel. Cho v. Surgery Partners (M.D. Fla. No. 17-983)**

4

- FCA focused on allegations of **medically unnecessary** urine drug testing by diagnostic firm
- Relators originally named two PE companies; DOJ opted not to intervene as to either (but relators pursued (unsuccessfully) the first PE owner of the diagnostic company)

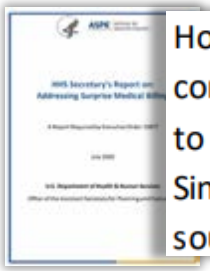
# Scrutiny on PE-Sponsored Providers and Surprise Billing

**1** **September 2019 | The House's Energy and Commerce Committee began investigating the driving forces behind surprise medical billing**



Surprise bills occur primarily in two scenarios—when an individual receives emergency services and has no ability to ensure they are treated by in-network providers, or when an individual goes to an in-network hospital, but certain providers at that same hospital, that the patient may not have been aware would be involved in their care, are out-of-network. According to the American Enterprise Institute and Brookings Institution, surprise bills are most likely associated with services provided by an out-of-network emergency physician or ancillary clinician—such as a radiologist, anesthesiologist, pathologist, hospitalist, or assistant consulting surgeon—at an in-network facility.[6]

**2** **July 2020 | HHS issued a report on surprise billing, finding that out-of-network billing increases as staffing firms proliferate and that the two largest staffing firms are owned by PE entities**



Hospitals are increasingly relying on third party staffing firms to meet their needs for personnel, which is contributing to surprise billing. These private staffing firms are often used to staff emergency rooms and to provide specialty care in areas such as anesthesiology, gastroenterology, urology and orthopedics. Since the contracts hospitals have with providers are not generally available, this paper cites public sources of information.

# Post-M&A Indemnification and Fraud Claims

# Where is Fraud Typically Found?

- Financial Statements – GAAP violations
- Inflated Projections
- Vendor Contracts
- Inflated Revenues
- Concealment of Customer Departures or Other Problems


- MAC events
- Working Capital
- FCPA, Export Compliance, etc.
- Other areas?

# Post-Acquisition Fraud Claims

## Contractual Issues

- Reps and Warranties and Disclaimers
  - *Abry Partners, Prairie Capital*
- Indemnification – Deductibles, caps, survivals
- Arbitration vs. Court
  - Confidentiality, third party discovery, appealability
  - Selecting an arbitrator
- Due Diligence
- Choice of Law and Venue Clauses

## Claims

- Contractual "Fraud" vs. Common Law "Fraud"
  - Rescission vs. Fraud Damages
  - Delaware's "Bootstrap" rule
- Securities Fraud Claims – State and Federal
- Damages and Valuation – EBITDA multiple vs. DCF Approach
  - Choosing the right experts

# Disclaimers and Reliance

- Acquisition agreements routinely attempt to limit the purchaser's remedies to those contained in the agreement's indemnity provision. Anti-reliance disclaimers are used to attempt to limit fraud claims to specific representations in the four corners of the agreement
  - Litigation often occurs over claims based on extra-contractual representations, such as fraudulent information provided during diligence (data room documents, management presentations, etc.)
- While buyers routinely agree to anti-reliance disclaimers in M&A agreements, they have increasingly demanded and obtained fraud carve-outs, which generally provide that various provisions of the contract apply "except in cases of fraud"
- Anti-reliance disclaimers seek to narrow the scope of later common law fraud claims while fraud carve-outs seek to preserve the viability of indemnification claims based on contractually-defined fraud and common law fraud claims

# Recent Delaware Post-Acquisition Fraud Decisions

- *The Anschutz Corporation et. al. v. Brown Robin Capital, LLC*, 2020 WL 3096744 (Del. Ch. June 11, 2020)
- *Agspring Holdco, LLC v. NGP X US Holdings, L.P.*, 2020 WL 4355555 (Del. Ch. July 30, 2020)
- *Infomedia Group, Inc. v. Orange Health Solutions Inc.*, 2020 WL 4384087 (Del. Super. Ct. July 31, 2020)
- *Swipe Acquisition Corp. v. Krauss*, 2020 WL 5015863 (Del. Ch. Aug. 25, 2020)

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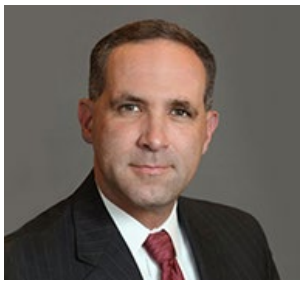


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