



December 1, 2021

## Episode 1: The Legal Implications of Board-Driven Decision Making

### Episode Summary

A recent whistleblower case in Massachusetts has rocked the widely accepted notion that private equity investors are insulated from risk beyond the scope of their financial investment.

In the case, the Massachusetts Attorney General pursued claims for purportedly improper and fraudulent billing against the underlying healthcare provider but also pursued the private equity fund that invested in the entity and had board members involved at the management level.

While the case ended in a settlement for the private equity fund, it's important to remember that the fund neither accepted nor denied guilt in the situation.

However, regardless of guilt, the fund was viewed as a potential area of pursuit in litigation. This fact alone is noteworthy and warrants further discussion.

David Pivnick, Partner at McGuireWoods and expert in complex corporate healthcare litigation, weighs in on the scenario and draws an important distinction between the role of investor as owner and the role of investor as decision-maker.

On the premier episode of The Professor's Corner, David tells McGuireWoods' Geoff Cockrell how funds can limit risk and lead with a compliance-driven mindset. Seeking counsel, documenting deliberations and providing regular compliance training sessions for board members are worthwhile investments.

### Top takeaways from this episode

- ★ **Having the best intentions makes a difference.** According to David, there's an important distinction to be made between a board that seeks counsel and makes an educated (but ultimately bad) decision and a board that is directly informed of misconduct and looks the other way or proceeds despite the warnings.
- ★ **In difficult situations, document deliberations to clarify the rationale.** Boards should not be afraid of documentation. Often, legal issues arise months to years after a decision is made. When a minimal paper trail exists, it is hard to demonstrate the debate and reasoning behind past choices.
- ★ **Ensuring best practices in compliance should extend to the board level.** For example, forming a compliance committee or identifying a compliance officer who can speak candidly with private equity investors allows the board to minimize risk.

## Transcript

This is The Professor's Corner, a McGuire Woods series exploring business and legal issues prevalent in today's private equity industry. Tune in with McGuire Woods' partner, Geoff Cockrell, as he and specialists share real world insight to help enhance your knowledge.

Geoff Cockrell (00:18):

Thank you everyone. For our initial installment of The Professor's Corner, I'm joined by my partner, David Pivnick, in our litigation group. I work with David on a lot of litigation related matters for private equity funds that have invested in healthcare companies. A lot of issues come up and David helps us navigate them.

Geoff Cockrell (00:38):

There's a recent case that has come up that we're going to be talking about today, that tests the boundaries of some of the insulation that private equity funds feel and being insulated from liabilities of their healthcare platform companies. And we're going to kick around some of the ideas and some best practices related to that.

Geoff Cockrell (00:55):

So, David, I'll turn over to you to set the table for this discussion.

David Pivnick (01:00):

Absolutely. Thank you very much for having me Geoff, happy to join and to discuss this topic. In short, what took place is there was a whistleblower case that had been brought and was investigated both by the Department of Justice at the federal level, as well as by the Massachusetts State AG's office.

David Pivnick (01:18):

And ultimately the state decided to intervene and looked at the case, not just from the lens of pursuing claims for purportedly improper and fraudulent billing against the underlying healthcare provider, but also a connection with the private equity fund that had invested in the entity and had board seats and involvement from a management level in light of that board participation of the entity.

David Pivnick (01:45):

And what ultimately has recently developed is the private equity fund also settled claims against it in connection with the alleged fraud. So not that they necessarily did anything wrong or admitted wrongdoing, but the fact of the settlement, and the nature of it arising out of a private equity fund's investment in the healthcare space is certainly noteworthy. And I think leads to some questions, and room for discussions as to why that came to be and how people can navigate that in the future.

Geoff Cockrell (02:17):

Yeah, I mean, normally a private equity fund, the background thinking is that while their equity investment is at risk, that's usually the boundaries of the risk that they face. And that if there are problems at the portfolio company, those taint their equity investment, but those are about it. And this has been a little jarring and a little different from what private equity funds usually think.

Geoff Cockrell (02:40):

So, they maybe get into some of the nuances that gave rise to the state, looking beyond the platform company and looking at the private equity fund as a source of recovery.

David Pivnick (02:51):

Yeah, absolutely. And there's a couple things about it. First of all, I will say, I don't think this was perceived from the government standpoint that... I can't speak for the government on this, and obviously I am positionally always opposed to the government on these cases, because I'm always representing clients from the defense side, but I think their perspective here was that it was more than just an ownership.

David Pivnick (03:12):

I don't think the government viewed this as an investigation into a private equity owner for ownership's sake. And it was more focused on the board control, board involvement, and the issues that were at play, the allegations, and the alleged misconduct has been, at least as I... As is alleged, was brought to the board's attention, the board of directors had opportunities to intervene and to try and tamp down the improper conduct, and to try and rein things in and ensure that compliance governed.

David Pivnick (03:45):

But rather than doing that, the allegation was that the board allowed the conduct to continue and that it in turn allowed the company, and therefore the private equity investor, to benefit from that wrongdoing. And so the concern that was alleged here was not as much you're potentially liable here by virtue of your ownership, but potentially liable by virtue of participating on the board, controlling the board, and not taking appropriate steps to address misconduct when it was directly brought to your attention.

Geoff Cockrell (04:17):

Yeah. So most buyout funds or going to have, if not outright board control, substantial board presence, but usually outright board control, so most buyout funds that meet that first part of that analysis. And I counsel funds and folks that are on the board. One of the things that gives them anxiety is the difference between doing something outright bad, and making close calls in gray areas and having that be second guessed later.

Geoff Cockrell (04:52):

How would you describe, we don't get too far into the specifics of this case, but how would you describe how you think the government would view that distinction as relates to a private equity member's participation on the board or the fund's control of the board?

David Pivnick (05:08):

I think it is a fair distinction that you're drawing. I don't think an investor is fully insulated by being on the board, and saying we don't have full control, but I think there is a significant difference. And I think the government very much perceives a significant difference between being on the board and making rational business judgements, particularly where those business judgements are informed and educated by going to counsel on sticky issues and trying to work through things in a meaningful way.

David Pivnick (05:39):

I think that is perceived differently than instances where a board might be informed directly. This conduct is problematic. This billing is fraudulent. We've got... we just conducted a billing and coding audit, and a hundred percent of the claims came back with issues, and nothing is done, or what's done is simply refunding those claims and not looking beyond that at extrapolation or fixing the bigger problem.

David Pivnick (06:06):

So I think there is a material difference between being on the board and making sometimes difficult decisions where, as you put it, there are shades of gray that need to be navigated, but doing that with a compliance mindset, doing that with appropriate advice, being sought and obtained where necessary, and not just focusing on making a buck or looking past those difficult issues.

David Pivnick (06:30):

I think that's very different, those circumstances, versus having an understanding or being directly told "This conduct is riskier", "This conduct is problematic", then either turning a blind eye to it, or worse, continuing down the road of that conduct because there's money to be obtained by doing so.

Geoff Cockrell (06:48):

This brings us to one of the practice pointers surrounding this, having been through lots of discussions of the type that you're referring to, it's always... And then if something arises in the future, looking back at what happened, it's always a little jarring to me in an environment where you know there was all of this communication around a subject, but three months, six months, a year removed when you look back at it, as if the only thing that happened were a handful of emails around a topic.

Geoff Cockrell (07:20):

And so, as you're thinking about with private equity funds, sitting on a board, making business determinations in areas where they have shades of gray, how would you advise them to think about making a record that if something is looked at later, the fullness of your deliberation comes out? I'm not suggesting there's a full legal memo from McGuire Woods on every topic that they're thinking about, but how do you make a better record of the deliberation that occurred?

David Pivnick (07:48):

Sure. I think there's two things, and I'm going to answer that directly, but the first thing is, I think it's important for boards to be keeping in mind their role and the compliance function, and how those things intersect as a more general matter. So one thing is, engaging in some board-level best practices can be helpful. Having the board receive and participate in compliance training, doing that on an annual basis, refreshing it, working through how the organization's compliance function works and making sure that the board is aware of that.

David Pivnick (08:22):

Setting up a compliance committee, depending on the size of the organization is often very appropriate, and making sure that the board is getting direct reporting from the compliance officer, and that it's clear that compliance has a direct line, pipeline to the board.

David Pivnick (08:37):

Taking those steps and making sure that some of that compliance function is both being addressed at the board level and actively monitored and discussed, but also is separated from some of the business concerns. I think is all helpful, both in preventing issues from arising, but also frankly, helping to position with a positive look, positive spotlight, the board's role if things arise later.

David Pivnick (09:00):

And then in terms of your specifics, so now we've had the authority issue arise. I think a lot of it will depend on the nature of what the issue is and what the resolution is. If we know, something is in the gray, and we're not going to be able to get fully comfortable with it, I think you need to take steps to A) document the processes that went through, and that, again, I don't think that means a full-blown legal memo, but if we had analysis and legal advice was obtained, I think reflecting that does make sense.

David Pivnick (09:34):

If it's one that that is not subject to legal advice, but ultimately there's a cut that's made to either discontinue conduct, well, that should be documented that it was discontinued, and if refunds were issued, but if you're proceeding, presumably there is a rationale. And I think that should be reflected in the minutes as to what the nuances were that ultimately made the company comfortable.

David Pivnick (09:56):

If there's a concern, for example, about the structure of a payment relationship, and ultimately the comfort level is there because it's not tied to referrals, there's not an intent to generate referrals. It applies to non-referral sources and the compensation is fair market value, documenting all of those things, even if there may be other aspects of the relationship, that authority can be helpful.

David Pivnick (10:19):

Because one of the things that I see afterwards is, is the DOJ may often say, well, it's easy for you to raise those arguments after the fact to try and justify this when you're already in the mud but helping to outline that in advance can be very helpful in documenting what the actual thinking was at the time. And I think that all needs to be balanced with, I think people have a general reticence to put things in writing and to document too heavily.

David Pivnick (10:44):

And obviously counsel can advise on what's necessary and appropriate there, but I think if there are going to be difficult decisions, there ought to be a rationale, both behind the decision that justifies why it was made, but if there is, there ought to be a willingness to expand upon that as well, so that if you need to justify later, people understand what the thinking was.

Geoff Cockrell (11:07):

Yeah. And that is, as you mentioned, sometimes counterintuitive to folks in their board capacities or the folks running the meetings, concerned that if I'm more specific, this will look... In hindsight, it'll look like we did this on purpose, and that it was immediately in front of us we made the wrong call.

Geoff Cockrell (11:24):

Whereas I think your point is the effect that you're really trying to convey from someone looking after the fact is that you were careful and thought about these things and did your best to honor both your business commitments and your compliance commitments, and that you'll get more grace in that process if it's clear that you were careful and attentive to these things, than if you were cavalier.

David Pivnick (11:47):

Yeah. I think that's exactly right. And one of the parallels that you could draw is frankly, there is an "advice of counsel" defense in terms of the intentionality, so you fight back on intent of a fraud case or a kickback case. For example, if you've got advice of counsel, the general thinking of that is if you went to get a legal opinion and your legal opinion, even if it steered you wrong, existed, that demonstrates you weren't intending to violate the law, you went and got a legal opinion. You tried to do it right.

David Pivnick (12:17):

Conversely, if the legal opinion says, if you ask someone... A client asks the two of us for an opinion, our opinion is we think this is likely a high risk of fraud or a high risk of violating the Anti-Kickback Statute, and someone does it, needless to say they've taken that risk and they wouldn't engage in using the "advice of counsel" defense. And I think that same logic, even though you don't have the formal "advice of counsel" defense, applies on the board level.

David Pivnick (12:41):

If you're not comfortable putting in writing how you landed as a decision and how factors were ultimately weighed, to me the bigger sign there is not, don't put this in writing at the board level. It's, don't make that decision, and go in a different pathway. And that's not to say that every decision is perfect, I mean we all have to live in the real world and navigate tricky issues.

David Pivnick (13:03):

But again, if it's something that ultimately everyone is very squirrely of documenting, to me, that's probably a very bright red flag indicating that this course of conduct has some risk.

Geoff Cockrell (13:15):

Maybe another kind of practice pointer to spend a little time on is the nature and tone and flavor of internal communication. Most communications on a topic are not with outside counsel or inside counsel seeking advice, but are internal business people having conversations on things. And again, while there might be a hundred conversations on it, there might be 10 that are an email.

Geoff Cockrell (13:45):

And one of the things that we often see is the tone of those can get lost over time. And that whether it's adding a little levity with somebody that you have a personal relationship in the office, that is not indicating a loose concern for the legality. Sometimes the tone in those communications when looked at separately and in isolation can convey a different vibe, that's not even the vibe that the person's sending it intended, but it just smells different.

Geoff Cockrell (14:17):

What advice would you give as people are thinking about authority issues internally at a company, how should they think about the nature and mode of communication?

David Pivnick (14:26):

Yeah, I think the first thing is, it's worth remembering that ultimately, emails are forever, documents, anything you put in writing and anything online, text messages, et cetera, those aren't going anywhere. And I think people should proceed with that in mind, and then take that a step back and also realize, well, shoot, if I'm concerned, because this email might be discovered later.

David Pivnick (14:46):

To me, the takeaway is not, well, then just pick up the phone and have the discussion face to face, because you could still be asked to testify about that later. The discussion should be, what is it about this that gives me a concern and how can we recalibrate the decision, or how can we take a different approach that doesn't create that same concern.

David Pivnick (15:05):

And I think often people get lost a little bit in the weeds of, well, we won't put this in writing and that makes it okay, and to me, I think sometimes that this is... I'm not saying that's imprudent either because again, things are writing live forever, but I think sometimes that this is the part of taking the step back and thinking about why is it that this gives me some reservations to begin with, and how can we potentially adjust the approach in a way that helps to solve that concern, rather than just trying to document.

David Pivnick (15:33):

And the other thing I would think about is if you get a culture of compliance instilled with the organization, and I do think this is where having a compliance committee or a compliance officer, who's got the ability to speak candidly to the board, who's going to be able to give legitimate advice. Having counsel that is trusted and a legitimate dialogue can be helpful, because you need to be able to run these issues to ground.

David Pivnick (15:58):

It can't be a matter of, we're not going to talk about X, Y, and Z, because we don't want to say something foolish, but you also need to keep in mind that every bit, every instinct in every [inaudible 00:16:09] now for a decision could come into play later on, as you're justifying that decision.

David Pivnick (16:15):

Which means I think there is a premium on thinking about not just how we're doing things from a business and operational standpoint to be profitable, but how those things tie into the bigger picture operations and how they tie in to the compliance plan, and the legal parallel would be into the Anti-Kickback Statute courts generally recognize sort of what's called the quote unquote "one purpose" rule, which is to say, any one purpose of the relationship is to induce referrals and is improper.

David Pivnick (16:43):

Even if there are 100 other great justifications for it that are completely proper, you're still violating the AKS. And I think that kind of guidepost is instructive generally in making business decisions. If one of those reasons is going to be tainted, if we know underlying this there's one problem, then there's a risk with that problem, and this issue is going to see the light of day, and we're going to have to account for it.

David Pivnick (17:07):

So trying to structure things again, not impractically, but thinking about things with that compliance viewpoint in mind, and involving counsel or the compliance team, where we get to sorting issues so that things are structured appropriately, and we make sure there is a comfortable landing spot, I think is paramount. And then messaging it and communicating it afterwards should hopefully flow from that dialogue.

Geoff Cockrell (17:30):

Thank you everybody for joining us. And we'll see you on the next segment of The Professor's Corner.

Outro (17:36):

Thank you for joining us on this installment of The Professor's Corner. To learn more about today's discussion, please email host Jeff Cockrell, at [gcockrell@mcguirewoods.com](mailto:gcockrell@mcguirewoods.com). We look forward to hearing from you.

Outro (17:51):

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Outro (18:09):

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