Private Equity Stakeholder Project (PESP) – Statement for the Record

March 25, 2021 Hearing of the House Ways and Means Committee

Examining Private Equity's Expanded Role in the U.S. Health Care System

Chairman Pascrell, Ranking Member Kelly, and Members of the Subcommittee, thank you for the opportunity to provide a statement regarding the March 25, 2021 hearing "Examining Private Equity's Expanded Role in the U.S. Health Care System" by the House Ways and Means Oversight Subcommittee.

My name is Eileen O'Grady and I work for the Private Equity Stakeholder Project. The Private Equity Stakeholder Project is a non-profit organization. Our mission is to identify, engage, and connect stakeholders affected by private equity with the goal of engaging investors and empowering communities, working families, and others impacted by private equity investments.

Private equity increasingly makes up a substantial portion of investment in U.S. health care companies, touching virtually every sector of the industry, and is expected to continue to grow. Asset managers have record levels of available capital earmarked for health care investment; as of 2019, private equity firms had $29.2 billion in capital waiting to be invested in health care.[1] These firms benefit from trillions of dollars of government health care spending.

As private equity ownership of health care companies grows and continues to benefit from taxpayer funded health care spending, it is essential for lawmakers to understand the risks associated with private equity investment in the industry and create policy that protects patients and supports health care workers.

Our testimony will highlight some of the problems associated with private equity investment in health care: dividend recapitalizations, defrauding Medicaid and Medicare, and the industry's impact on nursing homes, hospitals, and behavioral health.

Dividend Recapitalizations: Loading Health Care Companies with Debt to Reap Payouts

Dividend recapitalizations—transactions by which private equity firms add debt to their portfolio companies' balance sheets in order to collect dividends for themselves—have long been a tactic of private equity firms to generate quick returns on investments without needing to make substantive operating improvements.[2] By saddling their companies with debt to extract capital, private equity firms put those companies at risk for restructuring, bankruptcy, or cost cutting to make up the interest payments and pay off debt.[3]

Dividend recapitalizations benefit private equity owners often at the expense of the companies, their patients, their employees, and the communities they serve. It is questionable whether it is appropriate that health care companies be made to take on debt to enrich their owners, especially given the hundreds of billions of dollars of Federal spending on health care. [4]

Private equity lobby groups like the American Investment Council tout the industry's mission as "creating value" with portfolio companies by improving their performance through "changing the business strategy, injecting new managerial expertise, or improving sales and marketing, production, distribution or sourcing…." Dividend recapitalizations do little beyond enriching wealthy investors.[5]

Defenders of dividend recapitalizations offer little justification for the practice except that dividend recapitalization deals favor companies that are well-positioned to handle the added debt; theoretically, private equity firms will only undertake dividend recapitalizations at companies with strong enough financials to support the additional debt. However, there are many circumstances where that is not the case.[6] Still, the industry plows ahead in initiating debt-funded dividends—despite negative impacts on companies—with impunity.

The prevalence of dividend recapitalizations as a tactic of private equity ebbs and flows with fluctuations in interest rates, the availability of other attractive deal opportunities and the opportunities that exist to sell or otherwise exit companies they are invested in. When the COVID-19 pandemic hit the United States, dividend recapitalizations largely stopped.[7] However, in 2020 asset managers quietly returned to the practice, ushering in a flurry of new dividend recapitalizations of companies they own.[8] September 2020 saw at least $8.6 billion of dividend recapitalizations, making the month one of the largest for dividend recapitalizations since the 2008 financial crisis.[9]

Given the concerns over the impact of dividend recapitalizations on the viability of companies, it is especially troubling that private equity investors would reap debt-funded dividends from their health care portfolio companies. Siphoning cash from providers of critical health services, such as hospitals, nursing homes, dental offices, mental health clinics, and others, may negatively impact affordability, quality, staffing, and access to care.[10]

Many health care companies draw a substantial portion of their revenue from publicly funded programs such as Medicare and Medicaid. Now, billions more dollars are flowing into the industry through stimulus funding aimed to address the COVID-19 pandemic.[11]

Private equity-backed health care companies are taking full advantage of the stimulus funding. An analysis by Bloomberg found that $2.5 billion in COVID-19 aid has gone to just three private

equity-backed hospital companies—LifePoint Health (Apollo Global Management), Steward Health Care (Cerberus Capital Management), and Prospect Medical Holdings (Leonard Green & Partners).[12]

In February 2021, private equity firm Ares Management paid itself a $209 million debt-funded dividend from its physicians' practice DuPage Medical Group (DPMG).[13] DPMG collected almost $80 million in CARES Act dollars.[14]

As taxpayer-funded programs continue to provide valuable resources to the health care industry, it is essential to examine the role of private equity-backed dividend recapitalizations to ensure that that money goes where it is intended—and not primarily to benefit wealthy investors.

Case Study: The Mentor Network – Centerbridge Capital

Private equity firm Centerbridge Partners owns behavioral health company The Mentor Network (Mentor). Mentor is a national network that provides residential and other services to adults and children with intellectual and developmental disabilities and brain and spinal cord injuries, and to and to youth with emotional, behavioral and medically complex challenges. It is one of the largest for-profit foster care companies in the US.[15]

In February 2021, Centerbridge took out debt on Mentor in part to pay itself a $375 million dividend.[16] This is the second debt-funded dividend Centerbridge has extracted from Mentor. In October 2019, just six months after it acquired Mentor, Centerbridge paid itself a $100 million debt-funded dividend from the company.[17] In all, Centerbridge has collected almost half a billion dollars in debt-funded dividends from Mentor over the course of its two-year ownership.

Mentor has come under fire for allegations of widespread abuse, neglect, and deaths in its foster care and group home programs. A 2017 investigation by the US Senate Committee on Finance found that at least 86 children died in a 10-year period while in the custody of Mentor. In only 13 of those deaths did the company conduct an internal investigation.[18]

The Senate committee released its final reports on Mentor in December 2020.[19] While the majority of the investigation covered the period prior to Centerbridge's ownership,[i] the reports found that problems have persisted since its acquisition. For example, just weeks before the final report was completed, state regulators in Oregon discovered so many violations at a Mentor home that they shut the facility down for good.[20]

Given the ongoing problems with Mentor facilities and services, it is appalling that Centerbridge would add substantial debt to Mentor in order to pay itself dividends rather than investing in operations to improve patient care.

For more information, see our report: "Dividend Recapitalizations in Health Care: How Private Equity Raids Critical Health Care Infrastructure for Short Term Profit"

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[i] The 10-year period during which 86 children died occurred between 2005-2017, while Mentor was owned by private equity firm Vestar Capital Partners. Vestar remains an active investor in health care, including in Veritas Collaborative, a nationwide eating disorder treatment provider.

How Private Equity Has Defrauded Government Health Care Programs

There is substantial overlap between the risks associated with private equity ownership of health care companies and the activities targeted by the False Claims Act (FCA), a federal law that establishes liability for individuals or companies that defraud governmental programs.

The FCA is commonly used to prosecute health care companies that defraud Medicaid, Medicare, and related programs by submitting false claims for a variety of activities. Fraudulent activities may include providing substandard care, providing medically unnecessary services, receiving kick-backs for services provided, filing claims for services not provided, and providing services by unlicensed or improperly licensed providers.[21]

In an effort to achieve the high returns often expected by private equity investors, companies' aggressive profit-seeking may result in fraudulent activity.

We found that since 2013, at least 25 private equity-owned health care companies have paid a total of at least $570 million to settle false claims act suits related to alleged billing fraud that took place under private equity ownership. Altogether, the private equity firms that owned those companies currently own nearly 200 other health care companies, many of which also bill Medicare, Medicaid, and other government health programs.

The alleged fraud in these suits included providing medically unnecessary procedures and substandard care, engaging in kickback schemes, and hiring unlicensed licensed providers.

Many of the private equity firms that paid settlements are frequent health care investors, suggesting that there are substantial due diligence and operational failures that have enabled the alleged fraudulent behavior. This raises questions about what steps investors are taking to ensure that other health care portfolio companies are in compliance with applicable laws and regulations.

Case Study: Apria Healthcare - The Blackstone Group

Apria Healthcare provides home respiratory therapy, home infusion therapy and home medical equipment. Private equity firm the Blackstone Group has owned Apria since it took the company private in October 2008.[22]

In December, as the COVID-19 pandemic spiked in cities across the US, Blackstone collected a $260 million debt-funded dividend from the healthcare company.[23] Ten days later, Apria agreed to pay a $40.5 million settlement for billing fraud stemming from profit-driven business practices serving sick and elderly patients.[24] *The Washington Post* reported that the company submitted false medical claims for ventilator rentals worth millions of dollars to the government, even as it eliminated the jobs of respiratory specialists needed to ensure patients were properly using the machines.[25]

Blackstone is a repeat offender when it comes to owning healthcare companies that have paid out multimillion dollar settlements for allegedly defrauding Medicare and other government health programs. Apria is at least the third Blackstone-owned company to settle False Claims Act suits, two of which related to conduct that occurred under Blackstone's ownership. The

acquisition of all three of those companies (Apria, Vanguard Health Systems, and TeamHealth Holdings) was led by the same Blackstone executive, suggesting significant failures of monitoring or due diligence.[26]

Blackstone is one of the largest health care investors in the US, with 55 health care investments totaling $26.2 billion since 2007.[27]

For more information, see our report: "Money for Nothing: How Private Equity has Defrauded Medicare, Medicaid, and Other Government Health Programs, and How that Might Change"

Private Equity in Nursing Homes

A new academic study has found that private equity ownership of nursing homes has disquieting impacts on operations and patient care, including increasing the mortality of Medicare patients by 10%.[28]

Drawing from data reported by the Centers for Medicare and Medicaid Services, the analysis looks at US nursing homes between 2005 and 2017.

In addition to higher mortality, the report finds declines in other measures of patient wellbeing and the operational changes that help explain those effects, including declines in nursing staff and compliance with standards.

The report also asks how private equity firms make money off of nursing homes, given low profit margins in the industry cited at just 1-2%: "Using CMS cost reports, we find that there is no effect of buyouts on net income, raising the question of how PE firms create value."[29]

The authors observe a link between shifts in operating costs toward non-patient care items to three key elements of the private equity playbook: monitoring fees, selling real estate to generate cash, and taking on debt. "We find that all three types of expenditures increase after buyouts, with interest payments rising by over 300%," the authors write. "These results, along with the decline in nurse availability, suggest a systematic shift in operating costs away from patient care."[30]

> "As the strategies for returning profit to the investors are implemented, such as selling the real estate and thus requiring the operator to take on lease payments, the cash on hand turns negative. This could make the nursing home less well-equipped to manage sudden shocks such as, for example, needing to buy personal protective equipment following an infectious disease breakout."[31]

The study, "Does Private Equity Investment in Healthcare Benefit Patients? Evidence from Nursing Homes," was published in National Bureau of Economic Research (NBER) on February 13.

Key findings from the study are summarized below:

- Private equity ownership increases the short-term mortality of Medicare patients by 10%, implying 20,150 lives lost due to private equity ownership between 2005 and 2017. 20,150 Medicare lives lost implies a mortality cost of about $21 billion in 2016 dollars. This is about twice the total payments made by Medicare to private equity-owned facilities during the sample period, about $9 billion.

- Taxpayer spending over a short-term Medicare patient stay at a private equity-owned nursing home increases by 11%.

- Average staffing decreases at private equity-owned nursing homes. After a private equity buyout, the number of hours provided by frontline nursing assistants decreases on average by 3% and overall staffing declines by 1.4%. The vast majority of time spent by frontline nursing assistants is used provide mobility assistance, personal interaction, and cleaning to minimize infection risk and ensure sanitary conditions.

- After a private equity firm buyout, patient mobility declines and pain intensity increases.

- Going to a private equity-owned nursing home increases the probability of taking antipsychotic medications – discouraged in the elderly due to their association with greater mortality – by 50%. Elevated antipsychotic use could also be partly explained as a substitution response to lower nurse availability.

- After a private equity buyout: management fees increase by 7.7%, lease payments increase by 75%, and interest payments increase by about 325%. Cash on hand decreases by about 38%.

Case Study: Private Equity Investment in a Safety Net Hospital System

Private equity firm Leonard Green & Partners owns Prospect Medical Holdings, a safety net hospital company with 17 hospitals in 5 states.[32]

Since Leonard Green acquired Prospect in 2010, it has used the hospital chain as a platform to raise debt so it could siphon off hundreds of millions of dollars in dividends and fees. According to Prospect's own financial statements, the owners have collected at least $658 million from the hospitals—despite dramatic operating challenges, substantially underfunded pensions, and increasing regulatory scrutiny.[33]

The largest dividend that Prospect's owners collected in 2018 directly contradicted a commitment Prospect made to state regulators. When it bought several hospitals in Rhode Island in 2016, it told regulators It wouldn't pay out any more dividends. Just four years later, it paid the ownership an almost $460 million dividend. That same year, Prospect generated a $244 million net loss.[34]

As a result of that dividend, Prospect ran out of cash by early 2019, forcing the owners to provide emergency cash infusion.

Prospect was eventually able to pay off the existing $1.1 billion in debt it had accrued in part to fund dividends, but only by selling off the bulk of Prospect's real estate to a REIT. The transaction replaced debt with lease liabilities and left Prospect with fewer assets.[35]

- Prospect's hospitals have some of the lowest quality ratings from the Centers for Medicare and Medicaid Services.[36]
- Prospect completely shut down all of its facilities in San Antonio around this time last year—laying off nearly 1,000 workers—and sold its hospital building to a hotel developer.[37]
- Multiple lawsuits have charged Prospect's Culver City hospital with different allegations of billing fraud, including one lawsuit that claimed that the hospital needlessly admitted homeless patients to inflate Medicaid revenues at its detox centers.[38]
- Last year, the California Attorney General formally charged Prospect executives with "gross negligence" related to persistent mold contamination of a hospital pharmacy, including in equipment used to mix patient medications. The pending Attorney General proceedings could revoke or suspend the hospital's pharmacy permit.[39]

These kinds of problems are magnified in the COVID-19 era. A ProPublica investigation found that in in Rhode Island, poor infection control led to COVID-19 infection of 19 of the 21 geriatric psychiatric ward residents: six of them died. Six housekeeping staff also got COVID in part due to limited access to PPE. The head of the department died.[40]

Leonard Green currently owns at least 13 health care companies.[41]

Private Equity in Behavioral Health

Private equity investors have shown substantial interest in the behavioral health sector, and this trend is expected to continue in 2021.

In 2018, behavioral health acquisitions and mergers reached a historic high at 97 known transactions, representing a 59% year-over-year increase from 2017. Private equity-driven transactions made up a substantial portion of deal activity; between 2017 and 2018, private equity buyers went from accounting for 48% of acquisitions in behavioral health to 69% of acquisitions.[42]

Private equity interest in behavioral health has focused on a few key areas: autism, eating disorders, and addiction treatment.[43] Firms employ a familiar model in behavioral health: they typically buy or create a platform investment, such as a large treatment center, and then acquire add-on investments to expand the company. Consolidation and improvements to tech and administrative functions are expected to drive value creation.[44]

However, private equity's tendency to demand outsized returns in a sector that is already vastly underfunded, and serves vulnerable populations, raises serious concerns about its potential impact on patient care.

For example, health researchers who surveyed former owners of companies sold to private equity firms found expectations of “meeting your numbers” post-sale and, as a result, the eagerness to fill beds even without adequate staffing.[45] These kinds of behaviors may be especially harmful where having adequate staffing and training is vital both to providing safe and effective treatment as well safe working conditions for staff. Risks may include:

- Reduced staffing, or filling beds without adequate staffing ratios
- Overreliance on unlicensed staff to reduce labor costs
- Failure to provide adequate training
- Pressure on physicians to provide unnecessary and potentially costly services
- Violation of regulations required for participants in Medicare and Medicaid such as anti-kickback provisions, creating litigation risk

Case Study: Sequel Youth & Family Services – Altamont Capital

Sequel Youth and Family Services runs teen residential treatment facilities, therapeutic group homes, community-based programs, and alternative education programs for youth. The company serves 10,000 people at 50 locations in 21 states.[46] It is owned by Altamont Capital Partners, Palo Alto-based private equity firm with $2.5 billion assets under management.[47]

In the last several years, Sequel has come under immense scrutiny for the death of a teenager and numerous instances of child abuse, neglect, and poor quality of care at its facilities in multiple states.

Altamont acquired Sequel in August 2017 through a leveraged buyout from Canadian private equity firm Alaris Royalty.[48] Alaris reported generating $71 million profit, or 23% annual return on its investment in Sequel.[49]

Both Altamont and Alaris added substantial debt to Sequel over the course of their ownership; In August 2016, Alaris completed a dividend recapitalization of Sequel in part to pay itself a shareholder dividend. After Altamont acquired sequel in a leveraged buyout, it took out debt financing at least two more times, in 2017 and 2018, totaling at least $94 million.[50]

The litany of horrific conditions at Sequel facilities includes:

- Michigan: In May 2020, a Black teenager living at Sequel-operated Lakeside Academy in Michigan, died after being restrained by seven staffers. The state of Michigan had substantiated 56 violations at Lakeside Academy since 2018, including multiple instances of inappropriate physical restraints.[51]

- Alabama: In February and March 2020, Alabama Disabilities Advocacy Program (ADAP) conducted an investigation of a Sequel facility in Courtland, Alabama. In its report in the investigation, ADAP wrote that the facility had “unsafe, squalid living conditions and a disturbing cultural and programmatic environment that further traumatizes extremely vulnerable children.”[52]

- Utah: A June 2019 report had found that police were called to the Sequel-owned Red Rock Canyon School 72 times since 2017. During the same period, 23 staff members

were investigated for child abuse, nine were charged, and four more were referred for charges.[53]

- Ohio: In September 2020, children housed at Sequel Pomegranate were removed from the facility after multiple incidents of improper restraints, sexual abuse and violence. The facility's license was revoked.[54]

- Iowa: Sequel's Clarinda Academy shut down in February 2021 following numerous allegations of excessive restraint, assault, and rape.[55]

For more information, see our report: "Understaffed, Unlicensed, and Untrained: Behavioral Health Under Private Equity"

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