

Two Are Charged In Fraud And Kickback Scheme Against Valeant Pharmaceuticals



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Gary Tanner and Andrew Davenport, the former CEO of Philidor Rx Services, have been arrested and charged with fraud. Preet Bharara, United States Attorney for the Southern District of New York, is accusing Tanner and Davenport of engaging in a "multi-million dollar fraud and kickback scheme" against Valeant Pharmaceuticals.

Bharara's charges accuse Tanner, a former Valeant executive, and Davenport of fraudulently building Philidor, a Pennsylvania-based specialty pharmacy, through its near-exclusive access to Valeant. The complaint alleges Tanner and Davenport colluded to make Philidor the de facto sales channel for Valeant, while conspiring to evade oversight from Valeant's upper ranks and side-step the company's broader corporate policies.

It further states Tanner, who was fired by Valeant in 2015, concealed his interest in Philidor from the company and Davenport controlled the business through an entity called End Game LLC, which connected to his bank account, End Game LP. Ultimately, the conspiracy would yield Davenport \$40 million and Tanner \$10 million.

"Today, we charge corporate fraud at Valeant Pharmaceuticals. Gary Tanner, a former Valeant executive, and Andrew Davenport, the CEO of Philidor, allegedly concocted a fraudulent scheme to illegally use Philidor as a vehicle for personal profit and self-dealing," U.S. Attorney Bharara said in a statement. "Their alleged kickback scheme illegally converted Valeant shareholder money into their own personal nest eggs. As alleged, while purporting to be arms-length business counterparts, the two men were, in fact, partners in crime," he added.

"Valeant Pharmaceuticals International today learned that a criminal complaint was filed in relation to Philidor. Gary Tanner and Andrew Davenport were charged in the matter. The company, former CEO, former CFO and current executives have not been charged at this time," Valeant said in a statement Thursday. "The counts issued today include allegations that the charged parties engaged in actions to defraud Valeant as a company. Valeant continues to cooperate with all relevant authorities in this matter," it added.

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Valeant Pharmaceuticals International Inc. Photographer: Ron Antonelli/Bloomberg [-]

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Philidor was part of Valeant's alternate fulfillment program, which sought to have doctors prescribe Valeant's branded products like Jublia and Solodyn instead of cheaper generics by finding price rebates or ways of expanding customers' insurance coverage on scripts. The pharmacy, mostly done via mail order, was consolidated by Valeant nearly two-years ago in a \$100 million option purchase agreement. It now sits at the heart of one of the biggest stock collapses since the days of Enron and WorldCom.

Valeant became one of the hottest stocks on Wall Street under former CEO J. Michael Pearson, who with the backing of activist investors ValueAct Capital and Pershing Square sought to upend the pharmaceutical industry through a series of cost-cutting and tax-dodging acquisitions. For a brief time Valeant's epic rise made Pearson a billionaire, and its stalking of pharmaceutical takeovers helped turn ValueAct and Pershing Square into two of the hedge fund industry's hottest funds.

But the strategy ultimately failed.

Valeant shares have fallen nearly 90% in 14-months and the company narrowly averted a default on the \$30 billion debt load it picked up during multi-year acquisition spree. Former CEO Pearson and his long-serving CFO Howard Schiller are now gone, and in their wake lies a laundry list of regulatory and criminal probes. Many of Valeant's problems tie to Philidor, where the first criminal charges have been now been leveled. Other issues facing the company include scrutiny on its drug price gouging, its financial

disclosures, its billing practices and investor lawsuits.

But instead of further plunging Valeant into disarray, Thursday's charges may be a surprising relief after months of scrutiny and sharp losses.

The complaint alleges that as a Valeant employee, Tanner, and his co-conspirator Davenport systemically misled the company about Philidor in an effort to keep the drug distribution relationship exclusive, generating millions in performance-based payments. At times, Valeant senior executives directed Tanner to diversify the company's fulfillment programs, mainly Philidor, but the complaint states Tanner resisted those efforts and devised a scheme with Davenport to advance their personal interests.

"Gary Tanner, the defendant, used his position of trust at Valeant to not only promote Philidor, but to resist efforts by Valeant to diversify its [fulfillment] program so that it not become overly dependent on Philidor," said Ryan F. Redel, a special agent with the Federal Bureau of Investigations, in a complaint unsealed Thursday.

Furthermore, it was Tanner, secretly a beneficial Philidor owner, who Valeant's upper ranks and board relied on to manage the Philidor program. "Ultimately, we have to trust the management team and the people that we have providing oversight (i.e. Gary [Tanner], compliance person, etc) to do their jobs and make sure this [i.e. Philidor] is running correctly," a Valeant executive wrote to Pearson just before they struck the \$100 million Philidor purchase option in late 2014. Ahead of the deal, Valeant's board toured Philidor.

Emails uncovered by the FBI, however, indicate Valeant's faith in Tanner and Davenport was misguided. Specifically, the suit alleges Philidor pushed Valeant products in an uneconomic manner to reach sales milestones, netting Tanner and Davenport millions that they spent on homes, investments and even a \$50,000 custom wine cellar. As Philidor collected heavy performance milestones through 2015, it appears Davenport and Tanner were aware of a spiraling scheme to defraud Valeant, which would eventually be uncovered as the company took a greater hold over the business.

"They are too deep in our sh*t," Davenport said in an email to Tanner, according to the complaint. "Can picture our butch and sundance ride into the sunset (or off the cliff as in the flick) as our wiggle room/ability to operate independently gets whittled down to nothing," the email added.

That's exactly what seems to have eventually happened. In August and September of 2015, when trying to collect a \$25 million performance payment, 80% of which would have accrued to Davenport, Valeant CEO Pearson severed communication with Tanner and never transferred the funds. Within weeks, Philidor would be revealed in media reports, creating a 14-month tailspin for Valeant.

"I have learned that neither the nature of Valeant's relationship to Philidor, nor Valeant's increasing dependence on Philidor to achieve its sales and profitability goals, was disclosed to the public by Valeant until investor websites and news organizations revealed suspect aspects of Philidor's operations and Valeant's connection to Philidor in about October 2015," states FBI special agent Redel. Following these revelations, Valeant suffered the "payor risk that senior executives at Valeant had sought to avoid by diversifying away from Philidor, and Valeant's stock price declined dramatically," his complaint concludes.

Philidor is accused of pushing Valeant's costly pharma products through dubious distribution and billing practices with insurers and pharmacy benefit managers. Valeant, which claims it never owned Philidor, shuttered the business a year ago after PBMs including CVS Health and Express Scripts cut ties with it due to what they deemed were improper charges. Separately, media reports alleged that Philidor employees doctored scripts in order to push Valeant products.

"It was Gary Tanner's job at Valeant to grow and promote Philidor. He performed that job exceptionally well, greatly benefiting Valeant's shareholders, and regularly communicated to his superiors what he was doing," said Howard Shapiro, a lawyer for Tanner at WilmerHale. "We will demonstrate his innocence at trial," he added.

"Philidor also benefited Valeant, which is why its highly sophisticated and active management team sought to buy it," said Jonathan Rosen, a lawyer for Davenport. "Mr. Davenport earned his success with integrity and hard work and will vigorously defend himself and his good name," he added.

"I commend the U.S. Attorney's office for aggressively pursuing an investigation to hold these executives accountable for their corrupt business practices," said Rep. Elijah E. Cummings, Ranking Member of the House Committee on Oversight and Government Reform. "I have repeatedly requested interviews with Mr. Tanner and several other Valeant employees to determine how deep their involvement was with Philidor, but Valeant refused to cooperate with Congress and prevented information about their relationship from coming to light sooner," he added.

Since Philidor's closure, [Valeant's sales and profits have plunged](#). A review of the unit also caused Valeant to restate its earnings after finding \$58 million in incorrectly booked sales related to Philidor. And now, the business may prompt a series of criminal charges. Tanner and Philidor CEO Andrew Davenport have been arrested, meanwhile Bloomberg reported earlier in November U.S. Attorney Preet Bharara may bring charges against Pearson and Schiller.

After initially falling over 5%, Valeant shares were rising slightly in early afternoon trading at \$17.88. The company hit a high of \$262 a share in mid-2015, before the Southern Investigative Reporting Foundation uncovered Philidor that October. James Chanos, head

of hedge fund Kynikos Associates and a Valeant short-seller, said earlier this week the company's collapse may create \$40 billion in hedge fund losses, the most in history.

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