Valeant Pharmaceuticals Intl Inc.: Why the SEC Investigation Is a Very Big Deal

Description

On Monday **Valeant Pharmaceuticals Intl Inc.** (TSX:VRX)(NYSE:VRX) acknowledged that it was under investigation from the Securities and Exchange Commission (SEC), sending its shares plunging that afternoon. All in all, the stock was down more than 18% on the day.

So how exactly did this investigation come about, and what does it mean for Valeant going forward?

Shooting itself in the foot

Valeant's biggest problems started when Andrew Left of Citron Research published a scathing report on the company. In this report, Mr. Left suggested that Valeant was using a specialty pharmacy called Philidor to inflate revenue. He made some very important revelations in this report, although his suspicion of revenue inflating was probably false.

In response to the report, Valeant asked the SEC to investigate Mr. Left. It's a common defence tactic against short sellers. For example, hedge fund manager David Einhorn found himself under SEC investigation after presenting his short thesis on Allied Capital (Mr. Einhorn was eventually vindicated).

But this time, after Mr. Left shared his information, the SEC pivoted towards Valeant. So in a sense, Valeant triggered an investigation against itself.

Philidor's misdeeds

Although nothing has been proven in a court of law, numerous articles have shed some light on Philidor's practices.

One of these practices involved using other pharmacies and their National Provider Identifier numbers, to mislead insurance companies about where prescriptions were being filled. Such a practice could easily constitute mail fraud, as pointed out by Bronte Capital's John Hempton. And that could carry massive fines.

Another allegation against Philidor is that it altered prescriptions in an attempt to get reimbursement.

This could have involved adding “dispense as written” instructions to certain prescriptions, which would impede generic substitution. Again, this kind of practice could easily come with big penalties.

Will Valeant be held liable?

It’s important to remember that Valeant never owned Philidor. Instead, Valeant purchased an option for US$100 million to buy Philidor out for $0. Of course, this raised some very big suspicions. After all, why would Valeant purchase such an option when it could simply buy out Philidor instead?

One reason (the only logical reason I can think of) is that Valeant wanted to avoid any legal liabilities from Philidor’s actions. But here’s the problem: according to various sources, most notably *The Wall Street Journal*, Valeant was heavily involved in Philidor’s operations.

The Southern Investigative Reporting Foundation chimed in as well: “It’s a safe bet that Valeant heavily underwrote or otherwise subsidized the company given the long lead times of insurance reimbursement, coupled with the stress on working capital of starting a business with rapid expansion plans.”

So the SEC certainly has its work cut out for it. And as we can see above, the implications for Valeant know no bounds.

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