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Novartis Agrees to Settle Bribery Charges Against Chinese Subsidiaries for \$25 Million

On March 23, 2015, Swiss-based pharmaceutical company Novartis AG (“Novartis”) reached a civil settlement with the United States Securities and Exchange Commission (“SEC”) for violating the internal controls and books and records provisions of the Foreign Corrupt Practices Act (“FCPA”), the terms of which included Novartis agreeing to pay \$21.5 million in disgorgement of profits, \$1.5 million in prejudgment interest, and a \$2 million civil penalty. Novartis neither admitted nor denied the SEC’s allegations, which claimed that two of Novartis’ Chinese subsidiaries engaged in various schemes from 2009 to 2013 to bribe health care professionals (“HCPs”) in order to increase sales. According to the SEC administrative order, these Chinese-based business units obscured corrupt payments by instead identifying them as legitimate expenses for conferences, lecture fees, marketing events, education seminars, and medical studies. These false records ultimately were incorporated into the books and records of the Novartis corporate parent.

The SEC provided details in its administrative order about some of the overseas conduct that it believed caused Novartis’ inaccurate financial accounting. For example, in 2011, two sales representatives of Sandoz China (an indirect subsidiary of Novartis based in Shanghai) submitted approximately \$8,100 in falsified receipts for “holiday gift” purchases in connection with employee expense reimbursement requests, which requests were approved by a regional sales manager. The reimbursed funds then were used to provide illegitimate entertainment to HCPs, such as spa and sauna sessions. Certain Sandoz China employees also allegedly maintained projections in spreadsheets directly linking cash value “investments” to be provided to HCPs in exchange for guaranteed monthly prescription volumes, with the top tier of HCPs identified in the spreadsheet as “money worshippers.” Other HCPs were paid for participation in what the SEC described as sham medical studies designed by Sandoz China in 2009 and 2010, in which doctors effectively received financial rewards for each prescription of a particular Novartis drug without having to submit any legitimate clinical data.

Other improper benefits purportedly were extended by both Sandoz China and Novartis China (another indirect Novartis subsidiary based in Beijing) by utilizing Chinese travel agencies to arrange transportation, accommodation, and meals for HCPs in connection with company-sponsored educational events. Many of those events, however, allegedly did not include any educational purpose, or were accompanied by disproportionate paid entertainment and other recreational activities. The SEC offered an example from 2009, when Sandoz China allegedly sponsored 20 Chinese HCPs to attend a third-party medical congress in Chicago, and provided travel packages that included an excursion to Niagara Falls, \$150 in “pocket” or “walking around” money, and payment of cover charges at an adult entertainment club. In other cases, Chinese travel agencies supposedly were reimbursed for HCP lecture fees and other expenses relating to Sandoz-sponsored events, but where there was no evidence that the events actually took place. The administrative order specifically alleges critical deficiencies in the China subsidiaries’ internal controls relating to these vendors, including failure to conduct appropriate due diligence on third parties, failure to prevent and detect inappropriate payments by travel and event planning agencies, and failure to ensure adequate documentary support for claimed sales and marketing expenses.

The SEC noted, however, that Novartis had undertaken an “expansive” internal review of its travel and event planning relationships upon being notified of the Commission’s investigation, after which Novartis “promptly took remedial steps to improve its internal controls” in China, including overhauling its anti-corruption policies and

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procedures, terminating or otherwise disciplining culpable employees, eliminating the use of vendors for external meetings, and instituting increased training and other oversight procedures. Under the terms of the settlement, Novartis is required to submit periodic reports to the SEC for a two-year period regarding the ongoing status of its compliance program enhancements, along with an obligation to promptly report any additional credible evidence of questionable or corrupt payments, or related books and records failures.

This settlement reflects a number of current trends in FCPA enforcement: 1) it follows a number of other FCPA resolutions this year involving conduct based in China (e.g. Qualcomm, [PTC](#), and [SciClone Pharmaceuticals](#)); 2) the resolution was reached with the SEC alone, without the participation of the Department of Justice; 3) it was based on violations of the FCPA's books and records provisions, rather than the statute's anti-bribery provisions; and 4) it was predicated not only on alleged misconduct by Novartis subsidiaries, but on the third parties utilized by those companies. All of these factors underscore the need for multinationals to ensure they have robust internal accounting and other controls at their overseas operations, including anti-corruption due diligence, training, and monitoring. The Novartis resolution also sends a reminder that even in the absence of criminal liability, companies may nonetheless be exposed to substantial civil fines and penalties for FCPA noncompliance.