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L.A. pharmacy's legal battle could have huge consequences for Valeant

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Russell Reitz had owned his suburban Los Angeles pharmacy for barely three years before he found himself in a frantic struggle to protect the business and its reputation this past July.

What he couldn't know then was that the ensuing legal battle would have far-reaching consequences for one of the drug industry's biggest players: Valeant Pharmaceuticals International Inc.

Mr. Reitz, founder and pharmacist-in-charge of R&O Pharmacy LLC in Camarillo, Calif., had struck a deal to sell his mail-order pharmacy eight months earlier to a company called Isolani for initial consideration of \$350,000 (U.S.). Under the agreement, Isolani would take 10-per-cent ownership of R&O right away and the rest when the transaction closed.

Then the whole thing soured.

What happened next is the subject of differing accounts that are being contested in a Los Angeles court. It's also at the centre of growing concern about the tangled web of channels used by Valeant in the United States in its effort to sell drugs. Company executives shed more light on those operations in a conference call Monday to refute a short seller's allegations of fraud. But their answers raised new questions, not about any fictitious revenue booked by Valeant but rather about whether the methods used to sell its brand-name drugs are improper or even illegal.

Mr. Reitz's pharmacy, by all appearances a modest operation processing a modest number of prescriptions, suddenly found itself dealing with hundreds of new orders coming in from its new relationship with Isolani. And he balked.

"He got scared," said **Dimitry Khmelnitsky**, an accountant with **Veritas Investment Research** who has viewed the relevant court documents in a Sept. 8 lawsuit filed by Isolani against Mr. Reitz. "Suddenly he's hit with millions and millions of reimbursements coming to his account. And filling drugs that in some cases [he says] he didn't fill."

Relations between Mr. Reitz and his new owners, who kept him on, quickly deteriorated. In an e-mail filed in court and dated July 14 from Mr. Reitz to Eric Rice of Isolani, a company created by Valeant-affiliated drug distributor Philidor Rx Services to buy R&O, Mr. Reitz raises several issues that he says concern him including "Philidor's improper and perhaps illegal" use of his National Council for Prescription Drug Programs identification number without his knowledge or consent.

He claims the ID was used to bill for prescriptions that were "filled by some other pharmacy (in some cases for drugs that R&O did not even stock)" or "filled and billed" before the R&O purchase agreement was finalized.

In the same e-mail, Mr. Reitz says he has been asked several times to sign off on audits by insurers and other drug payers on those types of transactions. “I am not aware of any authority that would permit these types of practices,” he said.

By July 22, Mr. Reitz appears to have had enough. His lawyer sent a letter that day to Mr. Rice stating Mr. Reitz failed to obtain answers to his questions and concerns and adding: “You [Isolani and Mr. Rice] appear to be engaging in a widespread fraud perpetrated against numerous individuals and entities, including but not limited to Mr. Reitz, R&O, the California State Board of Pharmacy and the various payer networks. We believe that your actions constitute fraud, breach of contract, and potential [Racketeer Influenced and Corrupt Organizations Act] violations, among other acts of malfeasance.”

A week later, Mr. Reitz’s lawyer said his client considered the R&O takeover agreements void. Mr. Reitz began withholding money received from insurers and other payers. Isolani then sued to free up the funds, alleging for its part that Mr. Reitz breached a management agreement with his actions.

None of the allegations have been proven in court.

Philidor targeted Mr. Reitz and R&O back in the fall of 2014 because it needed access to R&O’s valuable multistate pharmacy licences and payer contracts, Mr. Reitz’s lawyer states in one letter filed in the Superior Court of California. Philidor used R&O to sell in jurisdictions it didn’t have access to itself, the lawyer alleges. The bulk of the medicines Philidor distributed at the time, including toenail fungus fighter Jublia, are believed to have been made by Valeant.

Valeant uses Philidor as part of its so-called alternate fulfilment program. As **Mr. Khmelnitsky** explains it, the strategy improves the profitability for Valeant’s brand-name drugs by running certain prescriptions through specialty pharmacies instead of through other traditional channels that also sell generics. He says Valeant makes money on the spread between the amount covered by the insurer and the subsidies that the company provides to patients to induce sales of Valeant’s brand-name drugs versus cheaper alternatives.

“This dispute should not be written off as a simple disagreement over contractual obligations and procedures,” **Mr. Khmelnitsky** said. “It raises serious questions” that could force Valeant to find another sales channel even if no wrongdoing is discovered, he said.

On Monday’s call, Valeant executives outlined the history of Valeant’s relationship with Philidor, saying a strategic relationship with the specialty pharmacy would allow it to “provide high service levels to physicians and affordable access to drugs for patients.”

Despite the potential conflict of interest, it’s not illegal for a drug manufacturer to own a specialty pharmacy.

But some analysts remain perplexed as to why Valeant has paid \$100-million for an option to own Philidor without actually owning it formally or controlling it.

Valeant said it believes it does not have legal liability for Philidor. Valeant said it can access Philidor’s books and records but has no power to tell anyone there what to do. It has mandated an ad-hoc committee to review Philidor, after which it might buy the company formally or walk away.

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