



FDA and DEA Litigation Briefing

2017

Introduction

Hyman, Phelps & McNamara, P.C. is pleased to present this report summarizing leading cases and settlements from 2017 affecting the FDA-regulated industry. Our goal is to provide a concise summary of issues that most impact our clients, many of whom are drug and medical device manufacturers, compounding facilities, and officers of those companies.

For each case or settlement, we summarize the facts and the key takeaways. And we include at the end of the report the hot-button issues that we are monitoring in 2018.

We hope this report proves useful and interesting to you. If you have any questions, please contact J.P. Ellison (zellison@hpm.com), John Gilbert (jjgilbert@hpm.com), or Anne Walsh (awalsh@hpm.com).

About Hyman, Phelps and McNamara, P.C.

Hyman, Phelps & McNamara has its finger on the pulse of the FDA and extensive experience with the universe of issues faced by companies regulated by FDA. As the largest dedicated FDA law firm in the United States, our technical expertise and industry knowledge are exceptionally wide and deep.

We represent clients in arbitration and administrative, civil, and criminal litigation. We regularly defend our clients against allegations of violations of law by state and federal regulators and prosecutors. Examples of our defensive litigation include:

- Litigating DEA immediate suspension orders and orders to show cause, and Controlled Substances Act cases seeking criminal sanctions and/or civil monetary penalties
- Defending Federal False Claims Act cases
- Defending federal criminal charges
- Litigating seizure and injunction actions
- Representing witnesses in investigations, depositions, hearings, and trials
- Defending State Attorney General actions

We also sue the government when it violates our clients' rights. Our affirmative government litigation includes suits against agencies for:

- Unlawful FDA decisions regarding market exclusivity under the FDC Act
- Unreasonable delay in agency action
- Unlawful product classification
- Arbitrary and capricious or otherwise unlawful agency action, such as
 - Actionable FDA Warning Letters
 - Unlawful FDA approval of competitors' products
 - Failure to approve our clients' products
 - Improper imposition of import detentions

Please see our website at www.hpm.com or the FDA Law Blog (www.fdalawblog.net) for more information.

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**Sandoz Inc. v. Amgen, Inc.
137 S. Ct. 1664 (2017)**

Amgen affirms that the patent-exchange (aka “patent dance”) provisions of the Biologic Price Competition and Innovation Act of 2009 (BPCIA) are not mandatory for approval and that 180-day premarket notice of a biosimilar market entry may be given prior to licensure.

The BPCIA serves as the abbreviated pathway for obtaining FDA approval of a biosimilar, a biological product similar to an already licensed reference product. This scheme includes an exchange of patent information in which biosimilar applicants must provide application and manufacturing information to the reference product sponsor within 20 days of FDA acceptance of the biosimilar application for review. This notification triggers an exchange of information between the applicant and sponsor in preparation for patent litigation. In addition, the applicant must give the sponsor at least 180 days notice before commercially marketing the biosimilar to allow for any necessary further patent litigation. Failure to comply with these procedural requirements allows the sponsor to seek a declaratory judgment on any patent claiming the product.

The BPCIA’s patent dance is not mandatory, and biosimilar applicants may provide 180-day premarket notice prior to obtaining a biosimilar license.

In a unanimous decision, the Supreme Court determined that the statutory exchange of information is not mandatory under the BPCIA. Amgen sued Sandoz for failure to partake in the exchange process and for providing inadequate notice of commercial marketing under the 180-day notice requirement for Sandoz’s biosimilar version of Amgen’s product. Amgen sought to enjoin Sandoz to provide this information while Sandoz counterclaimed for declaratory judgment on the basis that Amgen’s patent was invalid and that Sandoz had not violated the BPCIA.

The Court held that Sandoz did not violate the BPCIA by failing to disclose its application information to Amgen, as the BPCIA explicitly provides consequences for failure to do so. Failure to participate was expressly contemplated by the BPCIA, and it permits the sponsor to bring an immediate declaratory judgment action for artificial infringement. Therefore, the Court held that injunctive relief mandating disclosure of this information was not available to Amgen.

Further, while Amgen argued Sandoz’s notice prior to licensure was premature because the 180-day notice of intent to market can be provided only after FDA licenses the biosimilar, the Court determined that the language of the 180-day notice requirement permits notice any time prior to marketing. The biosimilar must be licensed prior to marketing, but need not be licensed prior to providing notice. Accordingly, the applicant may provide notice either before or after approval.

Amgen addresses the first set of many questions surrounding enforcement of the BPCIA. The Court implicitly determined that reference product sponsors are not entitled to an additional six months of exclusivity after a biosimilar is approved. Theoretically, this should expedite bringing biosimilar products to market. However, at the same time, the Court held that participation in the statutory exchange of patent information is voluntary. This determination gives some control of the process to biosimilar applicants, but may also complicate and delay the patent infringement litigation process under this pathway. While the Court gave plenty of leeway to biosimilar applicants, the decision may produce mixed results.

(Disclosure: Hyman, Phelps & McNamara, P.C., represented amicus curiae in this case)



Otsuka Pharmaceutical Co. v. Price
869 F. 3d 987 (D.C. Cir. 2017)

In *Otsuka*, the D.C. Circuit addressed whether FDA approval of a subsequent drug application for the same “conditions of approval” with a slightly different active moiety should be blocked by the three-year new clinical investigation exclusivity of the relevant reference listed drug.

The Drug Price Competition and Patent Term Restoration Act, commonly known as the Hatch-Waxman Amendments, and its implementing regulations provide a period of three-year exclusivity for an application involving a previously approved drug under the Federal Food, Drug, and Cosmetic Act (FDC Act). To qualify, the application must contain “reports of new clinical investigations (other than bioavailability studies)” that were “essential to approval” of the application and were “conducted or sponsored by” the applicant. 21 C.F.R. § 314.108(b). All three criteria, as defined in FDA regulations, must be satisfied in order to obtain three-year exclusivity.

The D.C. Circuit affirmed that three-year exclusivity only precludes approval of subsequent applications for drugs that share the same active moiety.

Otsuka sued FDA, alleging that FDA violated the three-year exclusivity granted for its Abilify (aripiprazole) product when the Agency approved Alkermes PLC’s 505(b)(2) New Drug Application for Aristada (aripiprazole lauroxil). Both drug products are primarily used to treat schizophrenia and bipolar disorder. The products metabolize in the body into the same molecule, but are not the same upon administration. Alkermes further relied in part on Otsuka’s studies for a predecessor to Abilify for approval of Aristada. Otsuka claimed that, because Aristada has a sufficiently close relationship to Abilify, relied on Abilify studies, and was approved for the same conditions of use as Abilify, the

products were “legal equivalents,” and Aristada’s approval infringed Abilify’s three-year exclusivity period. FDA disagreed and argued that because the products have two different active moieties (including a different covalent bond), Aristada was not blocked by Abilify’s exclusivity.

In a unanimous decision, the D.C. Circuit concluded that FDA’s interpretation of the three-year exclusivity provision was consistent with the relevant statutory terms. Affording *Chevron* deference to the Agency, the D.C. Circuit determined that FDA’s “active moiety” distinction was a reasonable reading of the statute and that the FDC Act does not contemplate treating different active moieties as “legally equivalent.”

The D.C. Circuit’s decision makes clear that both drug products must share the same conditions of approval and share an active moiety in order for three-year exclusivity to have an effect against a competitor’s product. Though this case makes clear the limitations of three-year exclusivity, the decision leaves room for competitors to evade exclusivity by creating and obtaining approval for highly similar or “legally equivalent” follow-on versions of a competitor product’s active moiety, which, in turn, could dissuade brand companies from innovating.



United States ex rel. Campie v. Gilead Sciences, Inc.
862 F.3d 890 (9th Cir. 2017)
and
United States ex rel. D’Agostino v. ev3, Inc.
802 F.3d 188 (1st Cir. 2016)

These cases exemplify two key Circuit Courts’ application of the materiality requirement imposed by the U.S. Supreme Court’s decision in *Escobar*. These courts addressed whether to impose liability on drug and device manufacturers for allegations that they deceived FDA and caused the submission of false claims to the government even though FDA or CMS declined to take action.

The False Claims Act (FCA) permits the recouping of damages and civil penalties for false claims submitted to the federal government. An implied false certification theory of FCA liability exists where private parties seek government reimbursement for a good or service when it is implied that compliance with a statutory, regulatory, or contractual provision is contingent on payment but such compliance is not met. In 2016, the Supreme Court explained in *Universal Health Services, Inc. v. United States ex rel. Escobar* that the non-compliance must be “material” to the government’s decision to pay the claim, and the Court posited that the government’s decision to continue to pay for a good or service despite knowledge of non-compliance can be evidence of a lack of materiality. In 2017, the First and Ninth Circuits disagreed over how to apply this materiality standard.

In the post-*Escobar* world, FDA or CMS inaction may or may not be sufficient to dismiss an FCA claim.

In *D’Agostino*, a relator alleged that a device manufacturer marketed product for off-label uses, despite disclaiming marketing for such uses and omitting important safety information when seeking approval from FDA. The First Circuit held that the complaint was

inadequately pled because CMS continued to reimburse procedures using the device long after the complaint was filed and because there was no evidence that FDA had taken any form of post-approval enforcement or action, such as demanding a recall or relabeling of the product, temporarily suspending approval, or withdrawing approval. The court viewed these facts as a crippling blow to the relator’s ability to plead materiality.

The Ninth Circuit reached the opposite conclusion in *Campie*, in which relators alleged that a drug manufacturer made false statements to FDA by concealing the use of unapproved ingredients and failing to report manufacturing problems. Despite awareness of these issues, FDA allowed the manufacturer to continue marketing the drugs, and the manufacturer argued that the complaint should be dismissed for failing to adequately plead materiality. The court rejected this argument, holding that it would read little into FDA’s continued approval of the drugs, and concluding that the issue was a matter of proof for a jury, not legal grounds for dismissal. At the end of December, after its request for an en banc rehearing was denied, Gilead Sciences filed a petition for a writ of certiorari for a review by the U.S. Supreme Court.

These decisions represent how different courts have applied *Escobar*’s materiality standard, and they demonstrate a split on whether inaction by FDA or continued reimbursement by CMS, despite knowledge of regulatory violations, can foreclose an FCA complaint at the motion-to-dismiss stage. Drug and device manufacturers facing FCA allegations based on regulatory violations could challenge the materiality of the alleged false compliance “certification” if FDA or CMS declines to respond to earlier knowledge of the alleged non-compliance. Depending on the circuit, however, the issue may be deferred to the jury.



**United States ex rel. Wall v. Baxter International, Inc.
No. 1:13-CV-42 (W.D.N.C. 2017)**

The *Baxter* settlement signifies the government’s intent to expand its use of the False Claims Act (FCA) to cover activities that Congress specifically delegated to other regulatory authorities.

A basic cornerstone of FDA’s authority is to ensure that the drugs it regulates are manufactured in accordance with current good manufacturing practices (cGMP). Under the Federal Food, Drug, and Cosmetic Act (FDC Act), a drug is adulterated if “the methods used in, or the facilities or controls used for, its manufacture, processing, packing, or holding do not conform to or are not operated or administered in conformity with current good manufacturing practice to assure that such drug meets the requirements of this chapter as to safety and has the identity and strength, and meets the quality and purity characteristics, which it purports or is represented to possess.” 21 U.S.C. § 351(a)(1)(B). In contrast, the FCA is intended to impose liability on companies who defraud governmental programs, not to provide additional avenue for regulating manufacturing activities by companies.

The *Baxter* settlement agreement was based on an allegation that Baxter manufactured products in violation of cGMP. Because Baxter sold these products to the government (specifically the Department of Veterans Affairs) under contracts that required compliance with the FDC Act, the government alleged that Baxter submitted false claims to the government and violated the FCA.

The products at issue were large-volume sterile intravenous (IV) solutions. Baxter manufactured these IV solutions in clean rooms that were installed with high-efficiency particulate absorption (HEPA) filters. Baxter regularly scheduled inspection and testing of the HEPA filters, and was required by company procedure to replace any that failed testing. An employee complained that 5 of 120 of these filters needed replacement; the employee ultimately became the whistleblower and recovered over \$400,000 as part of the FCA settlement. The company conducted testing throughout the time period on how much mold was present in the air and on surfaces in the clean room. There were no “out of limits” results.

Nor did testing of the products themselves identify any “out of limits” mold in the IV solutions before sterilization. There was no mold contained in products distributed from the company. Indeed, other court documents reveal: “There was no evidence of impact on the IV solutions manufactured at North Cove from the mold found on the HEPA filters above the Line 11 clean room.” Nevertheless, Baxter agreed to pay \$2.158 million to resolve the FCA matter.

There have been only two other major FCA settlements based on cGMP violations, and both involved product that was negatively impacted by the company’s failure to follow cGMP. The settlement by GlaxoSmithKline in 2010 involved product that had no active ingredient or no controlled release mechanism, higher or lower amounts of the active ingredient, non-sterile product, or product that contained microorganisms. Similarly, the FCA settlement with Ranbaxy involved the manufacture of drugs “the strength of which materially differed from, or the purity or quality of which materially fell below, the strength, purity, or quality which they purported or were represented to possess.” In contrast, in the *Baxter* settlement, there was “no evidence of impact” on the products and no harm to patients.

The government sought monetary damages for drug manufacturing issues using a False Claims Act theory even though the field falls squarely within the purview of FDA authority.

FCA cases based on cGMP compliance remain a rarity. The *Baxter* settlement, however, should give a company pause that, at any given time, it can be cited for not satisfying the requirements of cGMP, which, by their very nature as “current” practices, are constantly evolving.



United States ex rel. Nargol v. DePuy Orthopaedics, Inc.
865 F.3d 29 (1st Cir. 2017)
and
United States ex rel. Higgins v. Boston Scientific Corp.
No. 0:11-CV-2453 (D. Minn. 2017)

Decisions by federal courts in 2017 run the gambit in applying Federal Rule of Civil Procedure (FRCP) 9(b)'s pleading standard to False Claims Act (FCA) allegations regarding false claims submitted to federal healthcare programs.

FRCP 9(b) creates a heightened pleading standard for claims involving fraud, mandating that allegations in a complaint must "state with particularity the circumstances constituting fraud." Because FCA claims are based on allegations of false or misleading statements, courts apply FRCP 9(b)'s pleading standard in considering motions to dismiss. The courts, however, have struggled to determine the level of particularity required when reviewing allegations of false claims submitted to federal healthcare programs, particularly when they involve allegations of fraud on FDA to obtain product approval.

In contrast, the *Higgins* court appeared to impose a more strenuous burden under FRCP 9(b), requiring that – among other things – the relator plead with particularity not only the existence of false claims, but also that any alleged false statements were material. Specifically, the court required the relator to plead (1) the specific misstatements or omissions made in a submission to FDA, and (2) whether the government had actually *denied* claims for payment after FDA implemented a recall of product upon discovery of serious health concerns that were allegedly covered up by the manufacturer when seeking approval.

These cases highlight the connection between the FCA's "materiality" requirement and FRCP 9(b) in courts' consideration of motions to dismiss FCA claims. Depending on its application, FRCP 9(b) may serve as an additional hurdle to relators' claims brought contrary to the FCA's vigorous materiality requirement.

The level of particularity required to meet FRCP 9(b)'s pleading standard in FCA cases alleging fraud on FDA varies by court.

In *Nargol* and *Higgins*, the two courts significantly diverged with respect to the specificity required to meet FRCP 9(b)'s particularly standard. In *Nargol*, the First Circuit resurrected the relators' claims related to the sale of defective devices, and determined that just two allegations were sufficient to keep the case against DePuy alive under FRCP 9(b): (1) a "single exemplar false claim," and (2) statistical evidence that showed a likelihood that federal healthcare programs covered many of the procedures in question. On the basis of these allegations, the First Circuit concluded that it is "virtually certain that the insurance provider in many cases was Medicare, Medicaid, or another government program."



United States v. Medistat Rx, LLC No. 1:17-CV-236 (S.D. Ala. 2017)

Medistat highlights FDA's focus on enforcement efforts related to compounders and Title I of the Drug Quality and Security Act (Compounding Quality Act).

In 2013, the Compounding Quality Act amended the Federal Food, Drug, and Cosmetic Act with respect to the regulation of compounded drugs and created the outsourcing facility as a new type of FDA-registered facility that can produce compounded drugs on a large scale. Since that time, FDA has inspected hundreds of compounding pharmacies and outsourcing facilities, resulting in numerous 483s and warning letters, voluntary recalls, and cessation of non-sterile and sterile operations at those facilities.

Compounding pharmacies converting to outsourcing facilities must be wary of pitfalls and FDA enforcement activity.

Based on information that a *Staphylococcus aureus* infection outbreak was potentially linked to product manufactured by Medistat, FDA conducted an inspection of the Alabama outsourcing facility in 2015. After a review of Medistat's documents, FDA found that the facility had previously identified several types of microorganisms in the air and on surfaces used for sterile compounding. FDA observed similarly poor conditions and practices for sterile drug production during an inspection in 2014 that, despite assurances that Medistat would correct the violations, had not been corrected adequately. Ultimately, the inspection revealed a lack of sterility assurance for Medistat's purportedly sterile drug products. As part of its response to the inspectional findings, Medistat agreed to voluntarily recall all lots of unexpired drug products produced for sterile use and to cease sterile and non-sterile drug operations.

Nevertheless, in 2017, the government filed a federal complaint for a permanent injunction. The complaint, filed in the U.S. District Court for the Southern District of Alabama, alleged that, upon identifying the microbial contamination, the company failed to "adequately investigate or take sufficient corrective action to alleviate the insanitary conditions that resulted in the contamination in the sterile areas of the facility."

In July 2017, the government announced that it entered into a consent decree of permanent injunction with the now-closed facility, its owners, production manager, and pharmacist-in-charge. The consent decree prohibited all named defendants for a period of at least five years from "manufacturing, holding or distributing drugs until they comply with the Federal Food, Drug and Cosmetic Act . . . and its regulations, in addition to other requirements."

Consent decrees involving compounding, like the one in this case, present a common enforcement theme: Each consent decree involves allegations of illness or visible contamination derived from compounded products prepared by the pharmacies. This case also presents a cautionary tale for pharmacies and outsourcing facilities. Medistat obtained a pharmacy license in 2007 and then obtained an outsourcing facility registration in November 2014, a year after enactment of the Compounding Quality Act. The conversion from a traditional compounding pharmacy to an outsourcing facility (with significantly greater quality and manufacturing requirements) remains fraught with significant legal and regulatory hurdles, and both FDA and states are paying close attention.



United States v. Cadden No. 1:14-CR-10363 (D. Mass. 2017)

Unsanitary conditions in a compounding pharmacy that resulted in a nationwide public health crisis gave rise to the *Cadden* prosecution and sweeping regulation of the compounding industry.

The defendant in this case, Barry J. Cadden, was the co-owner and head pharmacist at the New England Compounding Center (NECC), the Massachusetts compounding pharmacy that shipped contaminated compounded epidural methylprednisolone (MPA) nationwide. The contaminated product resulted in a massive fungal meningitis outbreak in 2012, with 64 deaths and over 750 non-fatal injuries. The outbreak is the nation's largest public health crisis caused by a pharmaceutical product. It resulted in widespread scrutiny of the compounding industry and increased regulation of compounding activities, and it served as the impetus for passage of the Drug Quality and Security Act (DQSA), Title I (the Compounding Quality Act), in November 2013. Specifically, the DQSA amended the Federal Food, Drug, and Cosmetic Act (FDC Act) to give FDA more authority to regulate large scale manufacturing of compounded drugs and to seek to ensure safe and effective compounded drugs are available to the public.

The New England Compounding Center prosecution set the stage for heightened regulation of drug compounding activities and targeted FDA enforcement of the industry.

The government brought various charges against fourteen individuals (six of which were pharmacists) associated with NECC, including charges of second-degree murder in seven states, racketeering, mail fraud, conspiracy, contempt, structuring, and violations of the FDC Act. Mr. Cadden was the first of the 14 former officers and employees of NECC to be prosecuted. Prosecutors alleged that NECC employees shipped drugs before test results were returned confirming sterility, failed to inform customers of nonsterile results, and produced compounded drugs with expired ingredients.

After lengthy criminal proceedings, the case eventually went to trial in the U.S. District Court for the District of Massachusetts. In March 2017, a jury found Mr. Cadden guilty of racketeering, conspiracy, mail fraud, and introduction of misbranded drugs into interstate commerce with the intent to defraud and mislead. The jury acquitted Mr. Cadden, however, of other charges, including second-degree murder. In June 2017, the court sentenced Mr. Cadden to 108 months in prison, three years of supervised release, forfeiture, and restitution.

As a direct result of the NECC incident, passage of the DQSA, FDA and states' increased enforcement concerning compounding activities, and the *Cadden* and related prosecutions, compounding pharmacies and outsourcing facilities should expect more scrutiny and enforcement activity on both the federal and state levels.



Consent Decree: Shut Down Authority

United States v. Philips North America LLC No. 1:17-CV-11955 (D. Mass. 2017)

The *Philips* consent decree is another example of FDA's exercise of its shut down authority when faced with current good manufacturing practice (cGMP) violations.

The Federal Food, Drug, and Cosmetic Act (FDCA) authorizes FDA to regulate the manufacture of devices in order to ensure that devices are produced pursuant to cGMP. FDA's Quality System Regulation (QSR), 21 C.F.R. Part 820, sets forth the cGMP requirements for devices, and a failure to comply with the QSR renders a device adulterated. Introduction of an adulterated device is a prohibited act under the FDCA, and may result in administrative, civil, or criminal liability.

cGMP violations result in FDA shutting down a device manufacturer's product line, with potential impact on product lines outside the scope of the consent decree.

In 2017, Philips North America LLC (Philips) entered into a consent decree with the government whereby Philips agreed to suspend the manufacture and distribution of certain medical devices—external defibrillators—made at two of its facilities until FDA certified its compliance with the QSR. The government alleged that Philips failed to establish and maintain adequate processes regarding its corrective and preventative actions (CAPA), design verification and validation controls, and product specifications. Both the complaint and consent decree outline a long history of QSR violations at both facilities over the last few years, including several inspections resulting in observations of document violations of the QSR and warning letters to both facilities, as recently as during two inspections in 2015.

Although Philips acknowledged its deficiencies, FDA found that the corrective actions were too little too late. After six years of repeated violations, the government required Philips to stop manufacturing a number of its products. The consent decree also named specific executives at the company, and it contained a staggered shutdown provision by which FDA could shut down other product lines upon discovery of other violations without the need to seek a new injunction.

The *Philips* consent decree is an important reminder to device manufacturers—and their executives—of FDA's enforcement to ensure compliance with the QSR. Device manufacturers cannot afford to allow cGMP violations to continue after systemic violations and a failure to make appropriate corrections can result in shutting down production of those devices or other devices that the company manufactures.



Masters Pharmaceutical, Inc. v. Drug Enforcement Administration 861 F.3d 206 (D.C. Cir. 2017)

Masters addresses the requirements for distributors of controlled substances under DEA's suspicious order regulation and DEA's authority to impose additional requirements.

The Controlled Substances Act requires registered distributors to maintain effective controls against diversion of controlled substances. As part of this duty, DEA's regulations require distributors to design and operate a system to identify "suspicious orders" of controlled substances and to report those orders to DEA. 21 C.F.R. § 1301.74(b). Over the years, DEA began to impose additional requirements on distributors. These duties included an obligation to refuse to ship suspicious orders to customers (instead of just reporting them to DEA) and to conduct fairly extensive due diligence of customers that ordered controlled substances.

The D.C. Circuit affirmed DEA's enforcement authority against distributors for shipping suspicious orders and failing to conduct due diligence of customers, even though these specific requirements are not contained in DEA's regulations.

In this case, DEA brought an administrative enforcement action against *Masters*, alleging that the distributor had failed to report suspicious orders and had shipped suspicious orders without conducting appropriate due diligence of its customers. While an administrative law judge (ALJ) found that DEA did not meet its burden of proof at the evidentiary hearing, the DEA Acting Administrator rejected the ALJ's findings and ordered that *Masters*' DEA registration be revoked as not in the public interest.

In denying *Masters*' petition for review of the Acting Administrator's final order, the D.C. Circuit explained that distributors face two requirements: a reporting requirement and a shipping requirement. The reporting requirement follows the suspicious order regulation, mandating that distributors report all suspicious orders to DEA. The shipping requirement necessitates that a distributor, upon reporting a suspicious order, either choose to (1) decline to ship the order or (2) conduct

due diligence and—upon a determination that the order is not likely to be diverted—ship the order. Unlike the reporting requirement that was set forth in a regulation, the court cited a prior DEA administrative adjudication as support for the shipping requirement.

The court declined to review the argument raised by *Masters* and amici curiae that the requirements to stop shipping suspicious orders and to conduct additional due diligence violated the Administrative Procedure Act because DEA imposed them without following required notice-and-comment rulemaking procedures. The court also rejected *Masters*' argument that DEA had created additional requirements for distributors, explaining that the due diligence activities only applied if a distributor seeks to "dispel the suspicion surrounding" an order.

Masters is a setback to the DEA-regulated industry that had long sought clarity from DEA related to the handling of suspicious orders and that had asserted that such clarity should come through notice-and-comment rulemaking. The D.C. Circuit's explanation of the refusal-to-ship and due diligence requirements is inconsistent with how DEA has articulated and enforced those same duties in the past. The holding in *Masters* permits a distributor, upon reporting a suspicious order, to simply choose not to fill that order and forego any additional due diligence. The decision, however, provides inconsistent descriptions of whether this due diligence should take place before or after reporting an order as suspicious. This inconsistency, coupled with the fact that many distributors will choose only to report, rather than also to investigate, suspicious orders, likely will cause DEA to announce a long-promised new suspicious order proposed regulation in the near future.

(Disclosure: Hyman, Phelps & McNamara, P.C., represented Masters Pharmaceutical, Inc. in this case)



Mallinckrodt LLC Settlement (E.D. Mich. and N.D.N.Y. 2017)

The Mallinckrodt civil penalty settlement involving allegations of failure to identify and report suspicious orders of controlled substances is the first of its kind to involve a drug manufacturer, and it announces “groundbreaking” guidance that drug manufacturers must utilize chargeback data to report suspicious orders.

The Controlled Substances Act requires registrants to maintain effective controls against diversion of controlled substances. As part of this duty, DEA’s regulations require non-practitioner registrants to design and operate a system to identify “suspicious orders” of controlled substances and to report those orders to DEA. 21 C.F.R. § 1301.74(b). DEA has historically focused its enforcement against distributors who sell to pharmacies and clinics. The agency has provided ambiguous guidance on how to comply, particularly for manufacturers.

In July 2017, DOJ and DEA announced a \$35 million settlement with Mallinckrodt LLC regarding its manufacture and sale of oxycodone. The government alleged that the manufacturer failed to detect and notify DEA of suspicious orders of controlled substances, along with violating certain recordkeeping requirements. Mallinckrodt and DEA entered into a parallel memorandum of agreement (MOA) that set forth a number of compliance obligations.

The most significant part of the MOA was the government’s discussion of chargebacks. In general, a chargeback is a payment made by a manufacturer to a distributor to make the distributor whole when it sells the manufacturer’s product at a price below a specified rate. After a distributor sells a manufacturer’s product to a customer at the lower price, it requests a chargeback from the manufacturer, and, to support its request for payment, the distributor identifies the product, volume, and the customer to which it sold the product.

In the settlement press release, the government announced that “[t]he groundbreaking nature of the settlement involves requiring a manufacturer to utilize chargeback and similar data to monitor and report to DEA suspicious sales of its oxycodone at the next level in the supply chain, typically sales from distributors to independent and small chain pharmacy and pain clinic customers.”

This announcement and position is noteworthy for several reasons. First, it contradicts the language in the MOA that only requires the manufacturer to alert DEA of pharmacies (not orders) based on its review of chargeback data. Second, requiring manufacturers to review orders between two downstream third parties and to report “suspicious” orders between those two parties is not a requirement in the plain language of DEA’s regulations. This duty does not comport with prior DEA guidance, and it likely warrants implementation only through notice-and-comment rulemaking.

Manufacturers of controlled substances must analyze orders and other available data between two downstream third parties and report any resulting suspicious orders.

The government’s public statements on this settlement indicate that DEA believes manufacturers must use available company data to “know your customer’s customer.” In DEA’s view, manufacturers suspicious order reporting duties of their products extends further down the distribution chain, and can be held liable for failing to report suspicious orders by distributors to the distributors’ customers. The settlement also highlights the continuing ambiguity surrounding the regulated community regarding the detection, investigation, and reporting of suspicious orders of controlled substances.

(Disclosure: Hyman, Phelps & McNamara, P.C., advised Mallinckrodt, LLC in this case)



Cases to Watch in 2018

Looking into the new year, there are a number of important food and drug cases that will impact the regulation of marijuana, menu labeling, orphan drug exclusivity, and the materiality standard applied in False Claims Act cases.

In the Ninth Circuit, the hemp industry has filed a petition for review, *Hemp Industries Association v. Drug Enforcement Administration*, of DEA's final rule designating non-psychoactive cannabinoids, including cannabidiol, as "marihuana extract" and adding all cannabinoids to schedule I of the federal Controlled Substances Act (CSA). The hemp industry claims that DEA failed to follow required CSA procedures and that the final rule "dictates that the mere presence of 'cannabinoids,' which are not controlled substances, is the determinative factor of whether a compound is a 'marihuana extract.'" Oral argument is likely to take place in early 2018.

The Affordable Care Act requires chain restaurants and certain retail food establishments to post calorie information and other labeling information on menus. FDA has delayed enforcement of these federal menu labeling requirements for years and announced in 2017 a further extension of the compliance deadline to May 2018. Consumer advocacy groups sued FDA to force a more immediate compliance date, while the City of New York announced that it would begin enforcing its own menu labeling requirements that mirrored the federal requirements. Food industry trade groups sued the city, arguing that the city was preempted from enforcement of its requirements prior to FDA's national compliance date. All parties reached a shaky détente when FDA agreed to issue additional guidance before the end of the year and not to extend the compliance deadline again. Meanwhile, the City of New York agreed not to take enforcement action against members of the plaintiff trade groups until the federal compliance date if the trade groups agreed to educate and encourage their members to come into compliance as soon as practicable. Expect more developments when FDA announces its new guidance.

In two separate cases in the U.S. District Court for the District of Columbia, *Eagle Pharmaceuticals, Inc. v. Burwell* and *United Therapeutics Corp. v. Department of Health & Human Services*, drug manufacturers are alleging that FDA violated the Administrative Procedure Act by refusing to grant exclusivity to their orphan drug products. (Note: Hyman, Phelps & McNamara, P.C. is representing United Therapeutics in this litigation.) The Orphan Drug Act provides a seven year period of exclusivity to drugs that are (1) designated by FDA as "orphan drugs" (i.e., for treatment of rare diseases or conditions) and (2) approved by FDA for use in that disease or condition. In these two cases, however, FDA denied exclusivity to approved orphan drugs on the ground that they are not clinically superior to a previously approved orphan drug. FDA took this stance—and lost—in a similar lawsuit brought by Depomed in the same court in 2012 on the grounds that the plain language of the Orphan Drug Act (*Chevron* Step 1) required FDA to grant the exclusivity if FDA approves a designated orphan drug, regardless of clinical superiority. Both cases are pending on motions for summary judgment.

Finally, look for courts to continue to interpret the *Escobar* materiality standard in False Claims Act (FCA) cases brought against drug and device manufacturers. A split between the circuits may force the Supreme Court to grant a petition for certiorari in the near future. Indeed, Gilead Sciences filed a petition for a writ of certiorari in *United States ex rel. Campie v. Gilead Sciences, Inc.*, reported earlier in this briefing. We may be reporting on the U.S. Supreme Court's decision in the next briefing.



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