PAUL HASTINGS

STAY CURRENT

October 2017

Follow @Paul_Hastings

Does Your Research Compliance Need a Refresh? China's Highest Court Sends a Warning to Life Sciences Companies

By Haiyan Tang, Gary Giampetruzzi, Joy Dowdle, Bo Xie & Yan Bao

In yet another enforcement tool aimed at the life sciences sector, a legal interpretation ("Interpretation") issued by China's highest court and prosecutor's office imposes potential criminal liability on entities convicted of submitting falsified non-clinical drug study reports or clinical drug testing reports and related materials. The Interpretation, which has binding effects on lower courts, went into effect on September 1, 2017,[1] and sends yet another warning from global regulators to life sciences companies: carefully mind your clinical trials and research activities.

Criminal Liability for Clinical Trial Data Falsification under China's New Interpretation

The Interpretation clarifies and expands Article 229 of China's Criminal Law ("Article 229"). Prior to the Interpretation, criminal liability for data falsification applied only to entities in charge of asset assessment and examination, certificate examination, accounting, auditing, legal services and other duties under Article 229.[2] Under the Interpretation, Article 229 now applies to non-clinical drug research institutions, clinical drug trial institutions and contractual research organizations ("CROs") involved in submitting falsified data.[3] Medical researchers, doctors, scientists, and applicants for drug registration may also be covered under the Interpretation.[4] Such applicants who intentionally use falsified clinical non-drug reports, clinical drug study reports and relevant documents to fraudulently obtain drug manufacturing licenses and use such licenses to manufacture and sell drugs, can be held liable for the crime of "manufacturing or sale of fake drugs" under Article 141 of China's Criminal Law.[5]

The Interpretation specifies the "serious circumstances" criminal threshold, which includes (1) "deliberately using falsified study-related drugs, (2) concealing severe adverse events, (3) deliberately destroying original study data, (4) falsifying information of animal or human testing subjects, or (5) submitting falsified information while having a prior record of criminal/administrative penalties for submitting falsified documents in connection with the registration of drugs or medical devices within two years of the current act, etc."[6] A maximum sentence of five years of imprisonment or detention, plus fines, will be assessed for any one of the above circumstances.[7] The punishment becomes more severe in the case of corruption—those who meet one of the above circumstances while also illegally taking or receiving money or property from others are subject to imprisonment between five to ten years, plus fines, under Section 2 of Article 229.[8]

China's Increasing Scrutiny of Drug and Medical Device Registration

This new Interpretation comes as just another wave in China's continued ramp up of the review and approval process for drugs and medical devices. China has passed legislation and guidelines and made several important pronouncements[9] on regulating and curtailing data falsification by both pharmaceutical and medical device companies, and has implemented regulatory measures through the China Food and Drug Administration ("CFDA"). The CFDA has ordered pharmaceutical companies to conduct internal reviews of potentially fraudulent data. In addition, the CFDA has conducted on-site verification regarding the clinical trial data of drug registration applicants and selective examinations of medical device registration applicants.

With respect to pharmaceutical companies, the CFDA ordered pharmaceutical companies behind 1,622 drugs in line for regulatory approval to conduct internal reviews of potentially fraudulent data in studies and trials in 2015.[10] Between July 2015 and June 2017, the CFDA has reviewed 2,033 drug applications. 1,316 of the 2,033 applicants, representing 64.7% of all applications, voluntarily retracted their applications due to the CFDA's increasing efforts focusing on clinical data verification. In that same time period, the CFDA issued 27 notices which either denied drug applications or announced drug application withdrawals.[11] Since June 2017, the CFDA has sent 185 inspection teams and 1,635 inspectors to conduct on-site verifications regarding the clinical trial data of 313 drug applications that submitted self-inspection information. Among them, 94 are applications for new drugs, 37 are applications for generic drugs, and 182 are applications for imported drugs (representing 58.1% of all applications).[12]

Along similar lines, with respect to medical device companies, the CFDA conducted two selective examinations on 20 registration applications from 20 medical device companies involving 40 clinical trial organizations in 2016.[13] The CFDA questioned the authenticity of the eight registration applications; in addition to declining to process the eight applications, the CFDA prohibited re-application of these devices within one year.[14] Altogether, 122 medical device companies withdrew a total of 263 medical device applications in 2016.[15] The CFDA denied the applications from several large domestic and international medical device companies.[16]

Increasing Global Scrutiny of Clinical Trials and Research Activities

In the context of clinical trials and associated consultancy arrangements, one of the most prominent risks associated with the falsification of data would be that the relevant payments are being made in order to secure favorable clinical trial results and to gain a foothold for subsequent sales (i.e., to "seed" the commercial market). In China, for example, most clinical research institutions are public hospitals. As a result, medical workers who fabricate subject data are also likely to be functionaries of state organs. Therefore, to "seed the market," the conduct of providing falsified data is often associated with bribery of publicly employed researchers or public institutions,[17] thereby constituting potential violations under the Foreign Corrupt Practices Act ("FCPA"), U.K. Bribery Act ("Bribery Act"), and other applicable anti-corruption laws.

From the standpoint of the FCPA, the Bribery Act, and most other anti-corruption laws, including relevant Chinese laws on anti-bribery, the provision of an improper benefit, whatever the form, to a foreign government official in order to obtain or retain business is prohibited. Thus, companies that find themselves confronting falsified clinical trial data must also understand the root cause of those issues, including whether any improper payments lie behind the falsification, thereby turning what would have been an already challenging clinical trial issue into a global anti-corruption one as well.

In recent years, multiple international life sciences companies were found by various government authorities worldwide to have influenced HCPs with improper payments through schemes, including those involving conducting clinical trials, and were assessed with heavy penalties. In

2014, the Japanese Health Ministry alleged that Novartis's Diovan was improperly marketed as an aid for the treatment of stroke and angina. Novartis allegedly advertised based on manipulated or fabricated data and clinical studies that were eventually revoked. Novartis admitted to failing to report to regulators at least 2,579 cases in which patients had suffered serious potential side effects from its drugs, while other Japanese sources claim the figure could be as high as 6,000, including incidents resulting in death. Japanese health officials ordered Novartis to suspend its operations in the country for 15 days and indicted a former Novartis employee for manipulating the data in clinical studies that were later used in the marketing of the drug Valsartan. Events in Japan reportedly led to investigations by the Korean authorities on Novartis in 2016 for giving cash "rebates" to Korean doctors to incentivize prescriptions, which shows how one investigation may lead to other, even unrelated, investigations.[18] Please see a detailed report by Paul Hastings on the Novartis Korean action here.

In another case, an international medical device company agreed to pay a $21.4 million criminal penalty as part of a deferred prosecution agreement ("DPA") with the U.S. Department of Justice ("DOJ") to resolve improper payments by the company's subsidiaries to government officials in various countries in violation of the FCPA.[19] The DOJ and the U.S. Securities and Exchange Commission ("SEC") found that, from 2000 to 2006, the company's overseas subsidiaries had entered into $3.65 million worth of professional services contracts with publicly employed HCPs, known as "civil contracts," purportedly for lecturing, leading workshops, and conducting clinical trials. It was also found that the company failed to provide proof that all of the work was actually performed under the civil contracts, and that the contracts were in fact designed to corruptly influence the HCPs in their capacities as members of tender committees.[20]

In yet a third case, another international medical device company entered into a DPA with the DOJ and the SEC, in part, for making $1.5 million of corrupt payments over eight years to HCPs in China, including "commissions" or "10-15% consulting fees," to those conducting clinical trials. The payments made to the HCPs in connection with clinical trials were coded as "entertainment." The company also agreed to pay a monetary penalty of $17.3 million to resolve the charges brought by the DOJ.[21]

Practical Considerations for Life Sciences Companies in View of Increasing Regulatory Scrutiny of Clinical Trials and Research Activities

In view of China's recent Interpretation and the increasing scrutiny by global regulators, life sciences companies should revisit their current anti-corruption compliance efforts relating to research and clinical trials. While these efforts must be tailored to the company's specific activities, the following are a few steps to consider:

- First, companies should take steps to ensure their CROs have a comprehensive anti-corruption compliance program, are verified via due diligence, and have a code of conduct, appropriate policies, procedures, and controls, and include a due diligence process for vetting and monitoring investigators and other third parties utilized by the CRO.[22]

- Second, companies should undertake appropriate proactive reviews to confirm that the related compliance program is indeed working. Companies should consider both internal reviews—looking at their own employees and transactions relating to research—and also the CROs and other research entities engaged to work on the company's behalf. Are the engagements shams or providing legitimate services? Are the expenses proper and properly documented? Is data being appropriately collected and managed? Are fees and payment structures consistent with fair market value and paid via transparent

mechanisms? Are researchers and investigators being thoroughly diligenced prior to retention?

- Third, where issues and concerns are identified, companies should undertake both remedial actions specific to the concerns, as well as enhancements to the policies, procedures, and controls to mitigate the chances that these concerns will be replicated in other relationships. These remedial and enhancement efforts should be properly documented and shared with the right members of management to ensure appropriate resources and implementation.

- Finally, agreements with relevant entities and third parties should be examined to ensure appropriate protection to the company. All too often such agreements contain anti-corruption representations and warranties, but do not mandate the maintenance of a compliance program, or provide the contractual specifics necessary for companies to conduct appropriate review, mandate transparency, or carry out remedial efforts when concerns are surfaced. Companies should take care to develop their strategy for these entities and then ensure their contracts provide the support needed for effective execution.

✧ ✧ ✧

If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

Shanghai

Haiyan Tang
86.21.6103.2722
haiyantang@paulhastings.com

New York

Gary F. Giampetruzzi
1.212.318.6417
garygiampetruzzi@paulhastings.com

Houston

S. Joy Dowdle
1.713.860.7349
joydowdle@paulhastings.com

---

[1] *Interpretation on Several Issues Concerning the Application of Law in Handling Criminal Cases involving Drugs and Medical Devices Clinical Trial Data Falsification*, issued by the Supreme People's Court and the Supreme People's Procuratorate on April 10, 2017.

[2] Article 229 of China's Criminal Law.

[3] Article 1 of the Interpretation.

[4] *The Supreme People's Court and the Supreme People's Procuratorate Regulate the Pharmaceutical and Medical Device Industry, Impose Criminal Liability on Clinical Trial Data Falsification*, August 15, 2017, http://m.china.caixin.com/m/2017-08-15/101130594.html.

[5] Article 3 of the Interpretation.

[6] Article 1 of the Interpretation.

[7] *Id.*

[8] Article 2 of the Interpretation.

[9] *Opinions Concerning the Reform of the Review and Approval System for Drugs and Medical Devices*, China's State Council, August 18, 2015, http://www.gov.cn/zhengce/content/2015-08/18/content_10101.htm; *Standard for Quality Management of Medical Device Clinical Trials*, CFDA, March 1, 2016, http://www.sda.gov.cn/WS01/CL0053/148101.html; *Circular on the Supervision and Examination of Medical Device Clinical Trials*, CFDA, July 10, 2017, http://www.sda.gov.cn/WS01/CL0051/167628.html.

[10] *Top Court Makes It Illegal to Falsify Data in Drug Studies*, August 17, 2017, http://www.caixinglobal.com/2017-08-17/101131403.html.

[11] *Notice on Denial of 11 Drug Applications from 8 Pharmaceutical Companies* (2015, No. 229), November 11, 2015, http://www.sda.gov.cn/WS01/CL0087/134600.html; *Notice on Denial of 13 Drug Applications from 14 Pharmaceutical Companies* (2015, No. 260), December 7, 2015, http://www.sda.gov.cn/WS01/CL0050/137100.html; *Notice on Denial of 6 Drug Applications from 7 Pharmaceutical Companies* (2016, No. 92), April 29, 2016, http://www.sda.gov.cn/WS01/CL0087/151712.html.

[12] *Periodical Review Report of Drug Clinical Trial Data*, CFDA, July 23, 2017, http://www.sohu.com/a/159405648_464400.

[13] *2016 Reports on Medical Device Registration Applications*, CFDA, March 27, 2017, http://www.sda.gov.cn/WS01/CL0051/171161.html.

[14] *Id.*

[15] *Id.*

[16] *Investigations on Authenticity of Clinical Trial Data from 3 Medical Device Registration Applications*, CFDA, December 16, 2016, further stating that a company is prohibited from re-applying for registration within one year from the declination date and that the provincial FDA should investigate and sanction related clinical research institutions and responsible persons. http://www.sda.gov.cn/WS01/CL0051/167628.html.

[17] *The Supreme People's Court and the Supreme People's Procuratorate Regulate the Pharmaceutical and Medical Device Industry, Impose Criminal Liability on Clinical Trial Data Falsification*, August 15, 2017, http://m.china.caixin.com/m/2017-08-15/101130594.html.

[18] *Novartis Japan admits concealing drug side effects*, September 1, 2014, https://medicalxpress.com/news/2014-09-novartis-japan-concealing-drug-side.html.

[19] *Ratting Out The Competition: New DOJ Strategies,* March 28, 2012, https://www.law360.com/articles/323359/ratting-out-the-competition-new-doj-strategies.

[20] *Updates on CRO Compliance: The Latest Best Practices for Minimizing Pre- and Post-Market Corruption Risks*, American Conference Institute's 10th Advanced Forum on FCPA & Anti-Corruption for the Life Sciences Industry, April 27-18, 2016.

[21] *Third Medical Device Company Resolves Foreign Corrupt Practices Act Investigation*, March 26, 2012, https://www.justice.gov/opa/pr/third-medical-device-company-resolves-foreign-corrupt-practices-act-investigation.

[22] *Updates on CRO Compliance: The Latest Best Practices for Minimizing Pre- and Post-Market Corruption Risks*, American Conference Institute's 10th Advanced Forum on FCPA & Anti-Corruption for the Life Sciences Industry, April 27-18, 2016.