

# Shark Attack: Pharmaceutical Industry's Feeding Frenzy

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Prepared by the Institute for Health and Socio-Economic Policy

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## SUMMARY

### → Stock Buybacks

- Pharmaceutical companies are spending profits on buying back their own stock instead of investing in research and development (R&D) or growing the company
- Pfizer, Merck, and Sanofi spent more on dividends and buybacks than the total amount of profit they made over the last three years.
- Pfizer spent \$139 billion on buybacks and dividends in the past decade, compared to just \$82 billion on R&D

### → Tax Credits

- Pharmaceutical companies are getting enormous tax breaks and still attempt to find more
- Pfizer's effective tax rate averaged just 6.4% from 2010 to 2014
- Pharmaceutical companies are holding enormous amounts of profit off shore in order to avoid paying taxes
- In 2015, Pfizer had \$193 billion of offshore income, Merck had \$59 billion, and Johnson & Johnson had \$58 billion

### → Inversions

- Pharmaceutical companies are buying other companies and switching headquarter locations in order to avoid even more taxes
- Valeant moved to Canada, Mylan to the Netherlands, and Activis to Ireland
- Pfizer attempted to move to Ireland, prompting Federal Regulators to write new rules preventing the tax benefits of the move.

### → The Human Cost of Profit First

- Johnson & Johnson's use of illegal marketing a drug caused an autistic boy to grow breasts
- Novartis marketed a skin cream to infants that causes cancer
- Since 1991, drug makers have entered into 373 settlements totaling \$35.7 billion in criminal and civil penalties



## **Shark Attack: Pharmaceutical Industry's Feeding Frenzy**

Throughout the series of briefs we have seen how pharmaceutical companies charge high drug prices<sup>1</sup>, enabling these companies to realize enormous profits.<sup>2</sup> Through patents<sup>3</sup> as well as mergers and acquisitions<sup>4</sup> they have created a market structure that allows them to charge these high prices. Seeking to enhance profit at all costs comes with many consequences, such as underinvestment in research and development.<sup>5</sup> Through lobbying efforts,<sup>6</sup> pharmaceutical companies have managed to rewrite the laws and gain influence over regulatory agencies. This brief discusses the consequences that of this system that the pharmaceutical industry has created, which places short-term greed above long-term health of Americans and people around the world.

### **Spending Away the Future to Pay for the Present**

Our earlier brief on profits showed that companies spend much of the profits on dividends.<sup>7</sup> Another form of profit spending is stock buybacks. Stock buybacks occur when companies use profit to buy back company stock. There are several reasons that a company may do this, but the most important is to increase shareholder value.<sup>8</sup> When a company buys back its own stock, it increases the earnings per share value simply by making less stock available. This will generally raise the value of existing shares. The executive compensation brief<sup>9</sup> discussed that the majority of executive compensation is through stock options. Tying executive compensation to the share price of a company's stock incentivizes those executives to make decisions that

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<sup>1</sup> Institute for Health and Socio-Economic Policy (IHSP), *Tough Pill to Swallow – the High Prices of Prescription Drugs in the US*, Sept 16, 2016

<sup>2</sup> Institute for Health and Socio-Economic Policy (IHSP), *Global Pill-Age: Pharmaceuticals Making a Killing*, Sept 26, 2016

<sup>3</sup> Institute for Health and Socio-Economic Policy (IHSP), *Game of Patents - How the US Government and Big Pharma Protect Pharmaceutical Profits* September 30, 2016

<sup>4</sup> Institute for Health and Socio-Economic Policy (IHSP), *Marching Toward Monopoly – Mergers and Acquisitions in the Pharmaceutical Industry*, October 17, 2016

<sup>5</sup> Institute for Health and Socio-Economic Policy (IHSP), *The R&D Smokescreen*, October 20,, 2016

<sup>6</sup> Institute for Health and Socio-Economic Policy (IHSP), *A Profitable Stranglehold – The Pharmaceutical Industry's Investment In Lobbying and Politics*, October 3, 2016

<sup>7</sup> Institute for Health and Socio-Economic Policy (IHSP), *Global Pill-Age: Pharmaceuticals Making a Killing*, Sept 26, 2016

<sup>8</sup> William Lazonick, *Buybacks: From Basics to Politics*, August 19, 2015

<sup>9</sup> Institute for Health and Socio-Economic Policy (IHSP), *Outrageous Fortunes: Pharma Executives Cash-In On High Drug Prices*, , October 7, 2016

increase the share price rather than what is best for the long term health of the company.<sup>10</sup> For example, between 2011 through 2015, Pfizer paid out \$44.7 billion in buybacks and \$32.9 billion in dividends.<sup>11</sup> In the same time period, Ian Read, Pfizer’s CEO made \$76.8 million in total compensation, 63% of which came from stock-based pay.<sup>12</sup>

Pfizer isn’t alone in its pursuit to spend profit on stock dividends and buybacks. Below are the top 10 most profitable pharmaceutical companies and the amount they spent to enrich shareholders.<sup>13</sup>

COMPANY	2013-2015 Sales	2013-2015 PROFIT	2013-2015 Dividends Paid	2013-2015 Stock Buybacks	Percent of Profit Spent on Dividends and Buybacks
JOHNSON & JOHNSON	\$215,717,000,000	\$45,563,000,000	\$23,227,000,000	\$10,226,000,000	73%
NOVARTIS AG	\$159,191,720,000	\$36,096,120,000	\$19,800,000,000	\$10,242,000,000	83%
ROCHE HOLDING AKTIENGESELLSCHAFT	\$148,461,030,000	\$30,798,490,000	\$20,862,000,000	\$2,264,000,000	75%
PFIZER INC.	\$150,040,000,000	\$27,693,000,000	\$20,129,000,000	\$23,435,000,000	157%
GLAXOSMITHKLINE PLC	\$115,031,130,000	\$25,713,860,000	\$18,860,000,000	\$3,927,000,000	89%
MERCK & CO. , INC.	\$125,768,000,000	\$20,766,000,000	\$15,444,000,000	\$15,347,000,000	148%
SANOFI S.A.	\$125,040,300,000	\$15,091,310,000	\$13,516,000,000	\$3,606,000,000	113%
NOVO NORDISK AS	\$45,577,530,000	\$14,029,160,000	\$5,601,000,000	\$7,458,000,000	93%
BAYER AG	\$156,771,420,000	\$13,004,940,000	\$2,978,021,700	-\$3,113,708,400	-1%
ELI LILLY AND COMPANY	\$62,687,400,000	\$9,483,700,000	\$6,349,200,000	\$3,247,600,000	101%
<b>Total</b>	<b>\$1,304,285,530,000</b>	<b>\$238,239,580,000</b>	<b>\$146,766,221,700</b>	<b>\$76,638,891,600</b>	<b>94%</b>

<sup>10</sup> William Lazonick, *Buybacks: From Basics to Politics*, August 19, 2015

<sup>11</sup> Inequality.org, *Let’s End the Pfizer Stock Buybacks*, May 14, 2016, <http://inequality.org/lets-pfizer-buybacks/>

<sup>12</sup> Ibid

<sup>13</sup> IHSP calculations using Thomson Financials and Yahoo Financials.

So, what's wrong with increasing shareholder value? The methods being used by pharmaceutical companies are rewarding short-term gain rather than reinvesting back into the company to ensure long-term health. There are many other ways to spend the enormous profits pharmaceutical companies make that would benefit society as a whole, such as lowering the cost of drugs in the U.S. that are already the highest in the world<sup>14</sup>, or increasing the research and development (R&D) budget in order to find cures for diseases<sup>15</sup>. Instead, Pharmaceutical companies are making a conscious decision, through the distribution of dividends and the use of stock buy-backs that shareholders and company executives are more deserving of the enormous profits than society is deserving of affordable medications. Pfizer, for example, spent \$139 billion on buybacks and dividends in the past decade, compared to just \$82 billion on R&D.<sup>16</sup> The chart above shows that companies like Pfizer, Merck, and Sanofi spent more on dividends and buybacks than their total profit amount. That means not only is the profit not being reinvested back into the company, often forcing these companies to make cuts somewhere else, raise the price on drugs to increase revenue, or do both. Stock buybacks are not slowing down either. Already in 2016, the following companies have either completed buybacks or have gained authorization to do so:

Company	Amount	
<b>Johnson &amp; Johnson<sup>17</sup></b>	<b>\$10 Billion</b>	<b>Authorized</b>
<b>Allergan<sup>18</sup></b>	<b>\$10 Billion</b>	<b>Authorized</b>
<b>Pfizer<sup>19</sup></b>	<b>\$5 Billion</b>	<b>Purchased</b>
<b>AbbVie<sup>20</sup></b>	<b>\$3.4 Billion</b>	<b>Purchased</b>
<b>Gilead Sciences<sup>21</sup></b>	<b>\$8 Billion</b>	<b>Purchased</b>

<sup>14</sup> Institute for Health and Socio-Economic Policy (IHSP), *Tough Pill to Swallow – the High Prices of Prescription Drugs in the US*, Sept 16, 2016

<sup>15</sup> Institute for Health and Socio-Economic Policy (IHSP), *The R&D Smokescreen*, October 20,, 2016

<sup>16</sup> Reuters, *The Cannibalized Company*, November 16, 2015, <http://www.reuters.com/investigates/special-report/usa-buybacks-cannibalized/>

<sup>17</sup> Johnson& Johnson press release October 13, 2015, <http://www.investor.jnj.com/releaseDetail.cfm?ReleaseID=936279>

<sup>18</sup> Bloomberg News, *Allergan to Buy Back Up to \$10 Billion in Shares*, May 10, 2016, <http://www.bloomberg.com/news/articles/2016-05-10/allergan-plans-to-buy-back-up-to-10-billion-in-stock>

<sup>19</sup> Real Money, The Street, *What Pfizer's Share Buyback Means for Allergan*, March 9, 2016, <http://realmoney.thestreet.com/articles/03/09/2016/what-pfizers-share-buyback-means-allergan>

<sup>20</sup> Fact set, September 20, 2016, [www.factset.com/websitefiles/PDFs/buyback/buyback\\_9.20.16](http://www.factset.com/websitefiles/PDFs/buyback/buyback_9.20.16)

<sup>21</sup> 24/7 Wall Street, *20 Companies Buying Back the Most Stock in 2016*, June 23, 2016, <http://247wallst.com/investing/2016/06/23/20-companies-buying-back-the-most-stock-in-2016/>

## Rewarding Bad Behavior

One of the benefits of lobbying<sup>22</sup> is the ability to change the laws on taxes or be in a position to create and exploit loopholes. Pfizer, for example, claimed a 25.5% tax rate in its SEC filings for 2014.<sup>23</sup> In reality, Pfizer paid an estimated 7.5% effective tax rate for that year. From 2010 to 2014, they claimed an average of 24% on worldwide income, when in reality that rate averaged 6.4%.<sup>24</sup> The reason for the discrepancy is that Pfizer reports as part of the tax rate very large provisions for U.S. taxes that will never be paid unless Pfizer decides to bring that money back into the U.S. Pfizer has as much as \$148 billion in profits<sup>25</sup> parked off shore that it has never paid U.S. taxes on, and has no intention of doing so. Yet they are allowed to claim money set aside for future taxes on these profits as part of their tax rate. In 2004, the U.S. government gave companies a tax holiday, allowing them to repatriate profits to the U.S. at a rate of 5.25%. Pfizer brought back \$37 billion, the most of any company.<sup>26</sup>

Below is list of pharmaceutical companies and the amount of money held offshore that isn't being taxed by the U.S.<sup>27</sup>

Company	2015 Offshore Income	2014 Offshore Income	2013 Offshore Income
<b>Pfizer</b>	\$193 billion	\$175 billion	\$162 billion
<b>Merck</b>	\$59 billion	\$60 billion	\$57 billion
<b>Johnson &amp; Johnson</b>	\$58 billion	\$53 billion	\$50 billion
<b>Amgen</b>	\$32 billion	\$29 billion	\$25 billion
<b>Gilead Sciences</b>	\$28 billion	\$15 billion	\$8 billion
<b>Eli Lilly</b>	\$26 billion	\$25 billion	\$23 billion
<b>Abbvie</b>	\$25 billion	\$23 billion	\$21 billion
<b>Bristol-Meyers Squibb</b>	\$25 billion	\$24 billion	\$24 billion
<b>Abbott Laboratories</b>	\$22 billion	\$23 billion	\$24 billion
<b>Celgene</b>	\$9 billion	\$7 billion	\$6 billion

<sup>22</sup> Institute for Health and Socio-Economic Policy (IHSP), *A Profitable Stranglehold – The Pharmaceutical Industry's Investment In Lobbying and Politics*, October 3, 2016

<sup>23</sup> Americans For Tax Fairness, *Pfizer Tax Dodging Rx: Stash Profits Off Shore*, November 2015, [www.americansfortaxfairness.org/files/Pfizers-Tax-Dodging-Rx-Stash-Profits-Offshore-Final1.pdf](http://www.americansfortaxfairness.org/files/Pfizers-Tax-Dodging-Rx-Stash-Profits-Offshore-Final1.pdf)

<sup>24</sup> Ibid

<sup>25</sup> Ibid

<sup>26</sup> Ibid

<sup>27</sup> Citizens for Tax Justice, *Fortune 500 Companies Hold a Record \$2.4 Trillion Offshore*, March 3, 2016, [ctj.org/pdf/pre0316.pdf](http://ctj.org/pdf/pre0316.pdf)

In addition to being able to store profits offshore in order to avoid taxes, many pharmaceutical companies are able to write off expenses to lower their taxes. In fact, just about every single business expense can be written off. The entire R&D budget, money spent on marketing and sales, even fines levied by the government for bad behavior, are all written off as expenses and not taxed. Pharmaceutical companies are always complaining about the U.S. having the highest tax rate, but there is a difference between the nominal rate and what is actually paid. What a company actually pays is known as the effective tax rate. Merck, for example, paid an effective tax rate of 18% in 2013. In 2014, Merck paid an effective tax rate of 0%. In fact, in the second quarter, the effective rate was a negative 7.5%, essentially a tax credit, despite a 52% increase in pre-tax income.<sup>28</sup> Merck received a tax benefit in that quarter from an option exercise connected with rival AstraZeneca buying Merck's interest in a partnership. Financial moves connected to the deal resulted in Merck getting a one-time tax benefit.<sup>29</sup>

### **Home is Where the Heart is, or At Least Where the Lower Taxes Are**

When companies can't, or find it too difficult politically or financially, to get tax breaks, they use another method to lower the tax bill, a merger or acquisition (M&A).<sup>30</sup> One of the reasons for pharmaceutical companies to attempt to pull off an M&A is to perform what is called an inversion. An inversion is when a company moves their headquarters to another country to avoid taxes. By merging with, or acquiring another company, with the stroke of a pen, the drug company can now avoid taxes, despite the fact that nothing at all with their business has changed.

In 2010, Valeant, no stranger to acquisitions<sup>31</sup>, acquired a little known company named Biovail and moved their headquarters to Canada. In 2015, Mylan, the well-known seller of Epipen, purchased from Abbott Laboratories assets in their generic division, allowing Mylan to "relocate" to the Netherlands.<sup>32</sup> Pfizer, the largest player in the M&A world, attempted to pull off an inversion with Allergan and move its base to Ireland. The deal was thwarted by new Treasury regulations, forcing Pfizer to pay \$150 million to Allergan.<sup>33</sup> The interesting thing about the Allergan attempt by Pfizer is that Allergan was previously purchased by a company

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<sup>28</sup> USA Today, *20 big profitable U.S. companies paid no taxes*, August 12, 2014, <http://americasmarkets.usatoday.com/2014/08/12/20-big-profitable-u-s-companies-paid-0-taxes/>

<sup>29</sup> Ibid

<sup>30</sup> Institute for Health and Socio-Economic Policy (IHSP), *Marching Toward Monopoly – Mergers and Acquisitions in the Pharmaceutical Industry*, October 17, 2016

<sup>31</sup> Ibid

<sup>32</sup> The Wall Street Journal, *Why Pharma Is Flocking to Inversions*, July 14, 2014.

<sup>33</sup> The Wall Street Journal, *Pfizer Walks Away From Allergan Deal*, April 6, 2016, <http://www.wsj.com/articles/pfizer-walks-away-from-allergan-deal-1459939739>

named Activist, which kept the name Allergan after the merger. Activist had purchased the Ireland based Warner Chilcott in 2013 and pulled off an inversion of its own.

The following chart is a list of pharmaceutical company inversions over the past decade<sup>34</sup>

Year	U.S. Company	Foreign acquisition target	New Incorporation
2015	Mylan	Abbott's generic unit	Netherlands
2014	Horizon Pharma	Vidara Therapeutics	Ireland
2014	Theravance	NA	Cayman Islands
2014	Endo International	Paladin Labs	Ireland
2013	Perrigo	Elan	Ireland
2013	Actavis	Warner Chilcott	Ireland
2012	Jazz Pharmaceuticals	Azur Pharma	Ireland
2011	Alkermes	Elan	Ireland
2010	Valeant	Biovail	Canada

### Do No Harm? It's Just the Cost of Doing Business

When Pharmaceuticals put profit above everything else, it's doesn't just affect research and development spending or increase drug prices. Take the case of Austin Pledger, a teenage boy with autism. Johnson & Johnson, the household name we all know, manufactures a drug called Risperdal. Risperdal is used to treat people with schizophrenia, bipolar disorder, and at times autism. Despite the fact that the Food and Drug Administration had prohibited salespeople from promoting the drug to doctors to treat children due to side effects such as hormonal imbalance, a Johnson & Johnson salesperson gave thousands of samples to Austin Pledger's doctor promoting the drug. Austin's doctor did prescribe the drug to him and as a result this poor boy developed 46 DD breasts. This incident isn't a case of one bad sales representative. Johnson & Johnson has settled thousands of cases involving illicit promotion of Risperdal, to the tune of nearly \$3 billion, and is still dealing with an additional 4200 cases.<sup>35</sup>

If you were expecting a scandal such as this to put a damper on Johnson & Johnson stock prices, you would be wrong. As one analyst said, "Oh, they've already reserved for that stuff," and "It's their cost of doing business."<sup>36</sup> And, if you were expecting some sort of punishment handed down to those in charge of these types of aggressive and harmful sales tactics, you would be even more wrong. Alex Gorsky, who was then head of Risperdal sales and then head of the

<sup>34</sup> Bloomberg, *Tax Inversion: How US Companies Buy Tax Breaks*, April 6, 2016, <https://www.bloomberg.com/quicktake/tax-inversion>

<sup>35</sup> The Huffington Post, *Americas Most Admired Lawbreaker*, Steven Brill, <http://highline.huffingtonpost.com/miracleindustry/americas-most-admired-lawbreaker/>

<sup>36</sup> Ibid

Johnson & Johnson subsidiary that marketed Risperdal, is now the current CEO of Johnson & Johnson. And they say no good deed goes unpunished.

Johnson & Johnson is certainly not the only company improperly marketing to children. Novartis recently agreed to pay \$35 million to U.S. authorities for marketing Elidel, a skin cream, to infants under 24 months despite the warnings that the cream may cause cancer. Donald Galmines, 44, a former Novartis Sales representative, stated “We were instructed that Elidel was so safe it could be put on up to 80 percent of a baby’s body. And we were never told that it might cause cancer.”<sup>37</sup> This comes on the heels of the company being fined \$390 million last year for to settle charges of paying kickbacks to boost sales of two other drugs, and \$422.5 million in 2010 for allegedly marketing six drugs off-label and paying kickbacks to health care professionals.<sup>38</sup> Another drug company, GlaxoSmithKline, was found guilty of bribery by a Chinese court and fined \$500 million dollars, and may still face charges in both the UK and the U.S.<sup>39</sup>

Most recently, Mylan reached a \$465 million settlement with the U.S. Justice Department and other government agencies to resolve questions over rebates required by the Medicaid program. The case stems from Mylan misclassifying the EpiPen as a generic rather than a brand name drug. Centers for Medicare and Medicaid Services requires companies to pay rebates to the Medicaid program of 23.1% for brand-name drugs and 13% for generics. Mylan paid only the 13 percent for \$1 billion worth of EpiPens that Medicaid bought between 2011 and 2015. That cost state and federal taxpayers \$163 million.<sup>40</sup> So on the one hand, Mylan was treating the EpiPen as some remarkable new drug to justify increased rates of over 500% to the population at large, but, on the other hand, they classified the drug as generic when selling it to the government in an effort to make even more money.

Contrary to what the pharmaceutical industry would have us believe, these aren’t isolated cases of a few bad apples. Since 1991, drug makers have entered into 373 settlements totaling \$35.7 billion in criminal and civil penalties.<sup>41</sup> These violations run the ambit of types of fines and are certainly not limited to a few players. The type of violations we are seeing are pervasive throughout the entire industry, and have seen a dramatic increase over the last decade.<sup>42</sup>

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<sup>37</sup> Stat News, *Novartis to pay \$35 million to settle charges of illegally promoting a drug for infants*, October 5, 2016, <https://www.statnews.com/pharmalot/2016/10/05/novartis-35-million-improper-marketing/>

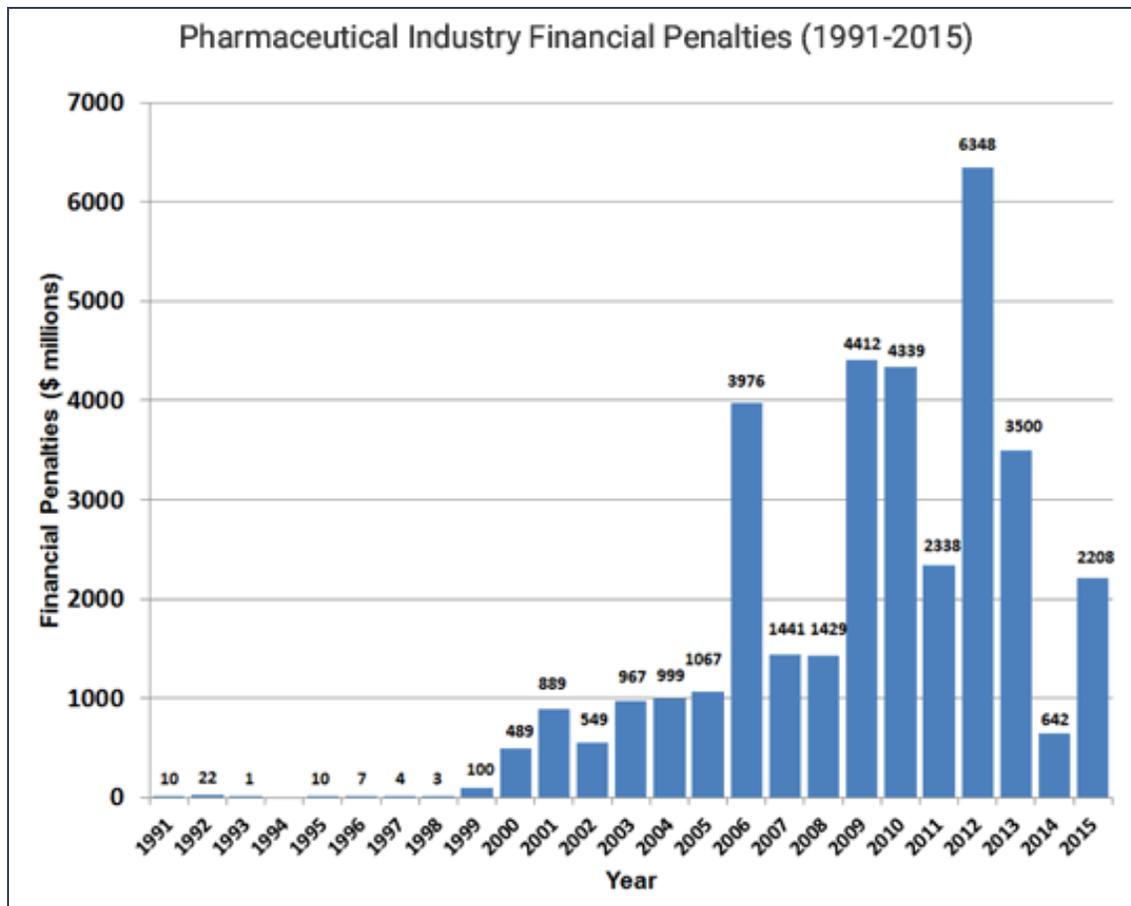
<sup>38</sup> Ibid

<sup>39</sup> The Wall Street Journal, *GlaxoSmithKline Found Guilty of Bribery in China*, September 19, 2014, <http://www.wsj.com/articles/glaxosmithkline-found-guilty-of-bribery-in-china-1411114817>

<sup>40</sup> NPR, *EpiPen-Maker Mylan Settles For \$465 Million In Medicaid Dispute*, October 7, 2016, <http://www.npr.org/sections/health-shots/2016/10/07/497092356/epipen-maker-mylan-settles-for-485-million-in-medicaid-dispute>

<sup>41</sup> <http://www.citizen.org/Page.aspx?pid=4734> (Accessed on 10/10/16)

<sup>42</sup> Ibid



Type of Violation	Financial Penalties	Number of Violations
Unlawful Promotion	\$11 billion	105
Overcharging Government Health Programs	\$5 billion	201
Financial Violations	\$3.5 billion	4
Monopoly Practices	\$2 billion	25
Poor Manufacturing Practices	\$1.7 billion	10
Kickbacks	\$743 million	47
Concealing Data	\$267 million	16
Environmental Violations	\$232 million	10
Illegal Distribution	\$67 million	4
Multiple Violations	\$10 billion	

Company	Total Financial Penalties	Number of Settlements
GlaxoSmithKline	\$7.8 billion	31
Pfizer	\$3.9 billion	31
Johnson & Johnson	\$2.8 billion	19
Merck	\$1.9 billion	30
Abbott	\$1.8 billion	16
Eli Lilly	\$1.7 billion	15
Teva	\$1.4 billion	13
Schering-Plough	\$1.3 billion	6
Novartis	\$1.2 billion	20
AstraZeneca	\$1 billion	11
Amgen	\$900 million	12
TAP	\$875 million	1
Bristol-Myers Squibb	\$795 million	13
Mylan	\$715 million	21
Serono	\$704 million	1
Purdue	\$646 million	5
Allergan	\$601 million	2
Daiichi Sankyo	\$586 million	8
Boehringer Ingelheim	\$427 million	15
Cephalon	\$425 million	1
Other	\$3 billion	162

## Conclusion

The theme throughout this brief has been the great lengths pharmaceutical companies go to increase their profit. Whether it's to find dodgy tax loopholes, acquire or merge with a company from another country, or to the disgusting use of marketing harmful drugs to children, the reach for higher profits is always the goal. To know that these higher profits are merely spent to increase dividend and stock buybacks that only enrich the wealthy shareholders and drug company CEO's, makes the matter all the more revolting. California's Proposition 61 is designed to lower drug prices, and in effect, help us fight back against the drug companies' greed that is harming our society.