

Congress of the United States
Washington, DC 20515

October 6, 2020

The Honorable Jay Clayton
Chairman
Securities & Exchange Commission
100 F Street, N.E.
Washington, DC 20549

Dear Chairman Clayton,

We write to express our dismay with the continued lack of any final rules regarding clawbacks of executive compensation more than 10 years after they were first required, and to ask that you prioritize completing them.

The logic behind clawbacks is simple: incentive-based compensation due to performance that was not actually justified by correct financial statements should be returned to the company. As part of Section 954 of the Dodd-Frank Act, the SEC was directed to undertake rulemaking requiring public companies to have a policy for clawbacks. The SEC's failure to finalize this rule and meet its statutory obligation is of particular concern given the recent settlements with Bausch Health, formerly known as Valeant Pharmaceuticals, and three executives there, which included returning a portion of their incentive-based compensation.

As you know, Valeant Pharmaceuticals grew rapidly from the time J. Michael Pearson took over as Chief Executive Officer (CEO) in 2008 until 2015. This required first merging with the Canadian company Biovail in a tax inversion, reducing their corporate tax rate to less than 10% and allowing them to more easily shift intellectual property (and thus profits) to tax havens like Barbados and Bermuda.

Valeant then continued to grow with a strategy based largely on acquiring existing drugs or pharmaceutical corporations, rather than developing new ones of their own. The company typically followed acquisitions with a price gouging strategy – aggressively raising prices on existing drugs while also aggressively cutting investment in research and development (R&D). Their actions included raising the prices of two drugs which have been approved for the treatment of a rare disease known as Wilson disease for more than 30 years, Cuprimine and Syprine, from less than \$700 to more than \$20,000 per month, an increase of more than 3,000%.¹ These are far from the only drugs Valeant did this with – Nitropress and Isuprel saw price increases of 525% and 212%

¹ <https://www.aging.senate.gov/imo/media/doc/Drug%20Pricing%20Report.pdf>

the day after Valeant purchased them. From 2011 to June 2014,² Valeant increased list prices for drugs by more than 20% 122 times.

In 2013, Valeant helped establish a mail order pharmacy named Philidor, which distributed primarily Valeant products and grew to become a significant part of Valeant's sales in 2014 and 2015. However, Valeant failed to properly disclose the relationship and its impact on Valeant's business, where it represented 14% of the entire company's U.S. organic growth. Valeant also likely used Philidor to shift sales into earlier quarters in order to meet revenue and earnings targets. Only when press attention began to focus on Philidor did Valeant disclose the relationship, followed days later by terminating the relationship with Philidor.³

Valeant's track record of growth and beating both company and analyst estimates for earnings and revenues over this time period was a major factor in it becoming a favorite stock of hedge funds and other investors, causing major increases in the stock price. From the date Michael Pearson became CEO in February 2008 through the end of July 2015, Valeant stock returned more than 2400%.

After information about Valeant's price gouging and information about their relationship with Philidor came to light in late 2015, Valeant's stock dropped more than 90%. On March 21, 2016, Valeant announced Mr. Pearson would resign, and on April 29, 2016, Valeant restated its financial statements for the full year of 2014 and the first three quarters of 2015. This restatement reduced revenue and income for 2014, which would also have likely reduced Valeant's stock price had it been public at the time.

As a result of Valeant and its executives' misconduct, the SEC recently announced a settlement with the company and its executives, which included a total settlement of \$700,000 from Mr. Pearson, of which \$450,000 was reimbursement for incentive-based compensation.

This settlement pales in comparison to the nearly \$100 million of stock that Mr. Pearson sold in mid-2016⁴ after his resignation, in addition to more than \$70 million of stock he still held at the time. Further, he received cash compensation of \$10 million in 2014 and a severance package worth almost \$12 million in 2016,⁵ despite the enormous damage he'd done to the company during this time.

While the SEC did not approve the excessive pay package Valeant provided to Mr. Pearson while he was CEO or the golden parachute he received, the enormous disparity between this settlement for serious misconduct while running Valeant and his pay there remains. For a man who left Valeant after 8 years with more than \$150 million in compensation, losing \$700,000 creates virtually no incentive against wrongdoing. This settlement draws our attention to the lack of any

² <https://www.wsj.com/articles/pharmaceutical-companies-buy-rivals-drugs-then-jack-up-the-prices-1430096431>

³ <https://www.sec.gov/litigation/admin/2020/33-10809.pdf>

⁴ <https://www.wsj.com/articles/valeants-ex-ceo-michael-pearson-sells-nearly-100-million-in-company-stock-1468446524>

⁵ <http://api40.10kwizard.com/cgi/convert/pdf/ValeantPharmaceuticalsInternationalInc-20160531-8K-20160527.pdf?ipage=10969400&xml=1&quest=1&rid=23§ion=1&sequence=-1&pdf=1&dn=1>

movement on SEC rules to require that companies have policies for recovery of incentive-based compensation, or clawbacks.

Unfortunately, despite being called for under Section 954 of the Dodd-Frank Act more than 10 years ago, and despite a proposed rule being issued more than five years ago, these rules have not only not been finalized, this required rulemaking was removed from the SEC's priority rulemaking agenda at the beginning of this administration. During this time, the Commission has also not issued any new proposed rule. That lack of action and attention at the SEC is extremely disappointing.

The SEC proposed a rule to address this problem in June of 2015, which would have required all listed companies to have a policy requiring clawbacks from executive officers.⁶ While a number of stakeholder comments recommended improvements to the rule, especially with regard to increased disclosures, the proposed clawback requirement would have included both cash and equity compensation, as well as compensation from incentives based on shareholder return. While Valeant did (and Bausch does) have a clawback policy, that policy is significantly narrower than this proposal, and a stronger policy would have likely made it easier to achieve a significant settlement. Perhaps even more importantly, a better clawback policy creates a stronger disincentive against this kind of misconduct in the first place.

Had even just the SEC's proposed rule been in place, Valeant's shareholders would have been better protected from the malpractices of the CEO. This type of common-sense policy should never have been delayed this long, and a strong rule to protect investors should be finalized quickly. We urge your swift attention to this matter, and we ask for a written response no later than October 22, 2020.

Sincerely,



Cynthia Axne
Member of Congress



Brad Sherman
Chairman
Subcommittee on Investor Protection,
Entrepreneurship, and Capital Markets

Wm. Lacy Clay
Chairman
Subcommittee on Housing, Community
Development, and Insurance

Bill Foster
Chairman
Task Force on Artificial Intelligence

⁶ <https://www.sec.gov/news/pressrelease/2015-136.html>

Stephen Lynch
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