

Making the Business Case for Supplier Quality

Attorney Discusses the Need To Ensure Compliance — and the Costly Consequences of Failing To Do So

Corporations do not look at compliance decisions in isolation, according to Cathy L. Burgess, a partner in the Health Care Group of Washington, D.C.-based Alston & Bird L.L.P. Rather, the decisions are “part of a broader package”: How much will a particular compliance decision cost? Will additional staff be needed? Will a new compliance initiative mean that there is less funding for other matters within the company? What will shareholders think? Quite often, she said, a compliance-related question will turn on the company’s notion of what makes sense from a business perspective.

There is a good business case to make in favor of assuring good drug product supplier quality, Burgess suggested. She spoke on the need for sound supplier quality management at the recent Enforcement, Litigation and Compliance Conference presented by the Food and Drug Law Institute.

Pressure has grown for prescription drug manufacturers to cut costs, she said. The growth in the prescription drug market has flattened in recent years; patients and third-party payors have brought increased pressure to have the cost of drugs reduced; recently there have been only “insignificant” gains in labor productivity; and the government is moving toward an increased role in managing the costs of drugs.

The Possibility of Significant Savings

The pressures to reduce costs and increase productivity have driven manufacturers to seek out lower-cost suppliers, according to Burgess — and many of those suppliers are outside the United States. The savings can be significant. For example, the costs of active pharmaceutical ingredient (API) formulations are 15 to 40 percent lower in India than in the United States. In part because of such savings, approximately 80 percent of APIs now come from foreign suppliers, whose revenues increased from \$2.8 billion in 2000 to almost \$4.6 billion in 2007.

In this light, China is “a very attractive market right now,” Burgess said. China has benefited particularly from the shift to overseas suppliers. As of June 2011, there were approximately 1,400 drug companies there capable of producing more than 60 dosage forms and more than 5,000 types of drug products. The current market value of drug products supplied by China is approximately \$50 billion — about 5.7 percent of the world market. There has been a 19.3 percent compound

annual growth rate in Chinese drug product sales over the past five years, with the compound annual growth rate expected to rise to 25 percent in the next five years. The market value for Chinese drug products is expected to reach \$150 billion by 2015.

In addition, the contract manufacturing market has grown to approximately \$46 billion in 2010, which is more than twice the size of the market at the beginning of the last decade. It is now difficult to find a drug manufacturer that is not outsourcing some aspect of its manufacturing operations, Burgess said. And, as the FDA has recently recognized, the result of the trend is a vastly increased fragmentation of regulated drug producers (see “FDA Report Tackles Problem of Surge in Imports,” August 2011, p. 5).

Increased Costs of Compliance

The risk, Burgess said, is that companies are cutting quality at the same time they are trying to cut costs. The consequences of outsourcing — particularly outsourcing to non-U.S. suppliers — can be profound, Burgess reported:

- The price of the due diligence needed to identify qualified contract manufacturers and other suppliers can rise, with manufacturers wondering exactly how much due diligence is necessary. “Can [companies] just go on word of mouth?” Burgess said. “What do they need to know?”
- The costs of contract manufacturer audits rise substantially over time if the manufacturers are outside the United States.
- The management of upstream suppliers becomes more difficult. Who controls those suppliers? What standards are appropriate? What are the consequences for an effective supplier management program?
- Product quality agreements establishing the manufacturer’s expectations for the supplier also become more complex. Who drafts the agreements? How are they enforced? How often should they be reviewed? Often, Burgess said, companies are tempted to completely forgo drafting such agreements.

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- Language barriers can create additional problems. It can become more difficult to review suppliers' standard operating procedures and batch records, among other things. If these documents are in Chinese, for example, Burgess asked, "are you going to look at them? Are you going to pay someone else to look at them?"

A supplier compliance management program needs to be well constructed and resourced appropriately, Burgess said. Is your compliance staff qualified and adequately funded for this work? If a small staff is busy keeping up with onsite compliance, how will it be able to pay enough attention to suppliers' compliance? If you rely on a third party for compliance management, how can you ensure that your consultant's work is adequate?

What Can Go Wrong

If a manufacturer relies on a contract manufacturing organization (CMO) as a supplier as part of an effort to save money, it may be tempted to "cut costs to the bone" — with product quality suffering as a result. This can be the case particularly if the cost-cutting means there are no supplier audits, there is no product quality agreement, the CMO is left to manage its own upstream suppliers, or the manufacturer neglects to review the supplier's batch records.

If a supplier receives complaints about product quality or reports of adverse events, Burgess suggested, it may not be wise merely to forward the complaints or reports to the CMO without any involvement in a subsequent investigation. Nor may it be wise for the manufacturer merely to rely on or accept the CMO's assurances that the problems are "isolated incidents" or that they have no assignable cause.

In such a case — where adverse events or product quality issues are involved — the FDA first may conduct a "for cause" inspection of the CMO. However, an inspection of the end-product manufacturer may follow — with the agency issuing a Form FDA 483 that includes "multiple observations" citing alleged deficiencies in supplier management or complaint handling, inadequate investigations and/or a failure to file field alerts as appropriate. Moreover, a failure by the manufacturer or the CMO to address the FDA's concerns adequately can eventually lead to Warning Letters, import alerts, seizures and widespread recalls.

This is by no means "a wild-and-crazy scenario that couldn't possibly happen," Burgess said. The number of Warning Letters citing poor supplier quality has increased, she added. One recent Warning Letter contained the observation on the part of the FDA that a supplier whose

product came to the end-product manufacturer through a distributor could not even be identified — prompting the FDA to recommend "an extensive evaluation" of the drug company's overall quality and manufacturing controls, and predicting that the company's "broad-based compliance issues will require significant remediation and substantial investment of time and resources."

The Costs of Noncompliance

Burgess identified a number of costs — beyond the huge cost of coming into compliance — that can flow from supplier problems. These costs, she said, should figure into any decision to engage a supplier without providing adequate supplier management:

- the expenses involved in drafting a response to a 483 and a Warning Letter — not only the legal and consulting fees directly associated, but also the costs of diverting company staff from other activities to help prepare the response;
- the expenses associated with a recall;
- lost business due to an import alert;
- the loss of government contracts, with the contracts either not being renewed or being terminated for default;
- the consequences of not having export certificates granted;
- the costs of lawsuits brought by injured patients, customers and possibly shareholders;
- lost business resulting from adverse publicity; and
- the threat of additional FDA enforcement action.

Manufacturers also should be aware of possible new statutory enforcement authority that the agency may be given to address supply chain issues, Burgess said. "FDA doesn't feel like they are getting anyone's attention" on these problems, she observed. She pointed to testimony presented before a Senate committee in September 2011 by Deputy Commissioner for Global Regulatory Operations and Policy Deborah M. Autor, in which Autor identified new recommended enforcement authorities that could help the FDA address the challenges posed by global supply chains (see "FDA Wants New Powers To Secure Drug Supply Chain; GAO Calls for Quick Action on Reforms," October 2011, p. 8). The suggested new authorities included:

- refusing to admit a product offered for import when a manufacturer delays, limits or denies a facility inspection;
- requiring certificates of compliance for imports;

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- requiring beefed-up quality management programs;
- mandatory recall authority for drugs;
- administrative destruction of products at the border, bypassing the hearing that is currently required;
- administrative detention of drugs;
- enhanced criminal and civil penalties;
- increased information requirements for non-U.S. APIs (registration/listing, threat notification, unique facility identifiers, more sharing of nonpublic information with other agencies and governments); and
- new track-and-trace requirements for drug products throughout the supply chain.

If Congress acts to grant these recommended authorities, Burgess said, “this could increase costs at the end of the process.”

The Value of Compliance

The better business decision at the front end is to ensure compliance, Burgess suggested. “Compliance is good for business,” she said — not only because compliance costs less than responding to enforcement actions, but also because compliance reduces the likelihood of further litigation. Moreover, the risk of personal liability among senior executives for noncompliance is sizable, she stressed. Individuals can be the target of strict liability misdemeanor charges under the Park doctrine, with personal liability resulting from a failure to detect and correct violations or a failure to take steps to prevent violations from occurring in the first place.

To Find Out More

Cathy L. Burgess will present a ThompsonInteractive webinar Feb. 23 on “Global Supplier Management: Strategies for 2012 and Beyond.” The webinar will discuss the selection and qualification of suppliers on a global scale, conducting global supplier audits, and other best practices in supplier risk management and evaluation. Information on the webinar is available online at <http://www.thompsoninteractive.com>. 