

E-ALERT | Anti-Corruption

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ELI LILLY & Co. PAYS \$29.4 MILLION TO SETTLE FCPA ALLEGATIONS ALLEGED IMPROPER PAYMENTS BY SUBSIDIARIES IN CHINA, RUSSIA, POLAND, AND BRAZIL

On December 20, 2012, Eli Lilly & Co. (“Lilly”) [agreed to pay \\$29.4 million](#) to settle allegations that it violated the Foreign Corrupt Practices Act (“FCPA”) in connection with improper payments made by its Chinese, Russian, Polish and Brazilian subsidiaries to, or for the benefit of, foreign officials in those countries. According to a complaint filed by the SEC (“the SEC Complaint”), Lilly subsidiaries made payments over a 15-year period either directly or through third-parties to government officials in the four countries, including government-employed doctors in China. The SEC Complaint also alleged that Lilly failed to accurately record the transactions in its books and records, and failed to maintain an effective system of internal controls to prevent such payments.

The US government has been engaged in a broad anti-corruption investigation of the pharmaceutical industry since the mid-2000s, and Lilly is the latest major pharmaceutical company to be the subject of an FCPA enforcement action. To settle the allegations contained in the SEC Complaint, Lilly agreed to pay nearly \$14 million in disgorged profits, \$6.7 million in prejudgment interest, and a civil penalty of \$8.7 million. The US Department of Justice has not brought any charges against Lilly in connection with the alleged improper payments.

ALLEGED MISCONDUCT

Lilly is a global pharmaceutical company that is headquartered in Indianapolis, Indiana, and is listed on the New York Stock Exchange. It operates and markets its products all over the world through subsidiaries and distributors, including in China, Russia, Poland and Brazil. According to the SEC Complaint, between 1994 and 2009, Lilly’s subsidiaries in each of these four countries separately made improper payments to, or for the benefit of, government officials in order to directly obtain business or other advantages.

Sales representatives employed by Lilly’s subsidiary in China (“Lilly China”) and their supervisors allegedly falsified expense reports submitted to Lilly China. Reimbursements generated by the artificially inflated expense reports were then allegedly used to purchase gifts and provide entertainment for Chinese government officials and doctors employed by the government. According to the SEC Complaint, Lilly China’s sales representatives made such payments with the goal of encouraging the government-employed doctors to prescribe Lilly’s products and incentivizing the other Chinese government officials to include Lilly’s products on lists of pharmaceutical products eligible for government reimbursement. Notably, none of the alleged improper gifts to the government officials or government-employed doctors were particularly high in value. For example, the improper gifts allegedly included wine, meals, jewelry, spa treatments, and visits to bath houses and karaoke bars. However, the SEC Complaint also alleged that the practice of giving such modest but improper gifts was widespread throughout Lilly-China.

Lilly’s subsidiary in Russia (“Lilly-Vostok”) sells pharmaceutical products to Russian government entities directly and through a network of distributors. The SEC Complaint alleged that, in connection

with such sales, Lilly-Vostok entered into dozens of sham “marketing” or “service” agreements between 1994 and 2005 worth millions of dollars with third parties located outside of Russia that were connected with various Russian government officials and distributors. Through these marketing agreements, Lilly-Vostok allegedly made payments to the third parties, which the SEC charges were often selected by Russian government officials or government-chosen distributors, and were often connected to such officials or distributors. The SEC Complaint further alleged that Lilly-Vostok employees “viewed the payments as necessary to obtain the business from the distributor or government entity, and not as payment for legitimate services.” Notably, the SEC Complaint also charges that Lilly itself identified concerns with these agreements as early as 1997 and 1999, but did not take action to prevent its subsidiary from entering into such agreements until 2004.

The alleged misconduct of Lilly’s Polish subsidiary (“Lilly-Poland”) was more limited. According to the SEC Complaint, between 2000 and 2003, Lilly-Poland made nearly \$40,000 in payments to a charitable foundation that was founded and run by a Polish regional government official responsible for developing the list of pharmaceutical products for which the Silesian regional government would reimburse hospitals and health care providers. Specifically, the SEC Complaint alleged that Lilly-Poland made these payments “with the intent of inducing the [government official] to allocate public monies to hospitals and other healthcare providers” to reimburse them for the purchase of a Lilly product, Gemzar.

In Brazil, Lilly’s subsidiary (“Lilly-Brazil”) regularly provides discounts to its distributors for selling Lilly products, which allows the distributors to earn a profit by re-selling the Lilly products at higher prices to both the Brazilian government and private purchasers. However, according to the SEC Complaint, in 2007, Lilly-Brazil, “without adequate verification and analysis of the surrounding circumstances,” gave one of its distributors an exceptionally large discount on two of its purchases. The distributor allegedly then used a portion of the inflated discount to provide payments to Brazilian government officials in exchange for their purchase of the Lilly product.

CONSEQUENCES

To settle the SEC’s claims that it violated the FCPA’s anti-bribery, books and records, and internal control provisions as a result of its subsidiaries’ actions, Lilly agreed to the entry of a final judgment under which it:

- must pay a combined \$29.4 million in disgorgement of profits (\$14 million), prejudgment interest (\$6.7 million), and a civil penalty (\$8.7 million);
- must obtain an independent consultant for 60 days to conduct a review and provide recommendations regarding Lilly’s anti-corruption policies; and
- is permanently enjoined from violating the anti-bribery, books and records, and internal control provisions of the FCPA.

IMPLICATIONS

The geographic diversity of the alleged improper payments, and the different schemes employed to make them, underscore that companies must be alert to much more than the risk of quid pro quo arrangements in seeking to comply with the FCPA.

The Lilly settlement also capped an active year for China-related FCPA enforcement actions. Indeed, this was the seventh China-related FCPA enforcement action of 2012, following the [Biomet](#),

(former CCI executives), [Garth Peterson](#) (former Morgan Stanley executive), [NORDAM](#), [Pfizer](#), and [Tyco](#) enforcement actions. Lilly's experience offers a series of valuable lessons for companies subject to the FCPA and their subsidiaries, including the need to:

- provide adequate anti-corruption training to employees of foreign subsidiaries;
- conduct careful oversight of both company employees and third-party service providers, including distributors;
- properly document the services provided by third parties;
- scrutinize from an anti-corruption perspective and exercise careful control of payments made to distributors, such as sales commissions, discounts, and reimbursements;
- proactively address the challenges of working with state-run health care systems, such as in China, where most doctors will be deemed by US regulators to be "foreign officials"; and
- understand that even relatively small gifts can constitute things of value under the FCPA.

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If you have any questions concerning the material discussed in this client alert, please contact the following China-focused members of our [Global Anti-Corruption Practice Group](#):

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